



ALTIGEN COMMUNICATIONS, INC.

State of Incorporation: Delaware

**679 River Oaks Parkway
San Jose, CA 95134
(408) 597-9000
www.altigen.com**

SIC Code: 3661

**QUARTERLY REPORT
For Second Quarter Ended March 31, 2018
(the "Reporting Period")**

ALTIGEN COMMUNICATIONS, INC.
QUARTERLY REPORT
FOR SECOND QUARTER ENDED MARCH 31, 2018

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FORWARD-LOOKING STATEMENTS

Certain statements made in this Quarterly Report are “forward-looking statements” regarding the plans and objectives of management for future operations and market trends and expectations. Such statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. The forward-looking statements included herein are based on current expectations that involve numerous risks and uncertainties. Our plans and objectives are based, in part, on assumptions involving the continued expansion of our business. Assumptions relating to the foregoing involve judgments with respect to, among other things, future economic, competitive and market conditions and future business decisions, all of which are difficult or impossible to predict accurately and many of which are beyond our control. Although we believe that our assumptions underlying the forward-looking statements are reasonable, any of the assumptions could prove inaccurate and, therefore, there can be no assurance that the forward-looking statements included in this report will prove to be accurate. In light of the significant uncertainties inherent in the forward-looking statements included herein, the inclusion of such information should not be regarded as a representation by us or any other person that our objectives and plans will be achieved.

These forward-looking statements rely on assumptions, estimates and predictions that could be inaccurate and that are subject to risks and uncertainties that could cause actual results to differ materially from expected results. We cannot guarantee future results, outcomes, levels of activity, performance, developments, or achievements, and there can be no assurance that our expectations, intentions, anticipations, beliefs, or projections will result or be achieved or accomplished. Forward-looking statements speak only as of the date of this report. Except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Available Information

In 2010, the Company deregistered its common stock with the U.S. Securities and Exchange Commission (“SEC”), delisted from the NASDAQ Capital Market and listed its common stock on the OTCQX marketplace. By deregistering the Common Stock with the SEC, the Company is no longer required to file annual, quarterly and current reports with the SEC. The Company’s common stock is currently quoted on the OTCQB under the trading symbol “ATGN.” As part of the OTCQB listing requirements, the Company is required to prepare and post material news, quarterly financial reports and annual audited financial reports on the OTCQB’s website. Although the Company is no longer required to file certain SEC reports, there are some references throughout this document to former filings with the SEC. These references are integral to the readers’ understanding of these financial statements and should be read in conjunction with this quarterly report. This quarterly report also summarizes various documents and other information. These summaries are qualified in their entirety by reference to the documents and information to which they relate.

Item 1. Exact Name of the Issuer and the Address of its Principal Executive Offices.

Exact name of issuer:	Altigen Communications, Inc.
Principal Executive Offices:	679 River Oaks Parkway San Jose, CA 95134 Telephone: (408) 597-9000 Facsimile: (408) 597-2020 Website: www.altigen.com
Investor Relations Officer:	Carolyn David, Vice President of Finance 679 River Oaks Parkway San Jose, CA 95134 Telephone: (408) 597-9000 Email Address: ir@altigen.com

Item 2. Shares Outstanding.

The following tables set forth the number of shares outstanding for each class of securities authorized as of the dates set forth below:

As of March 31, 2018					
Class	Number of Shares Authorized	Number of Shares Outstanding	Freely Tradable Shares (Public Float) (1)	Total Number of Beneficial Stockholders (2)	Total Number of Stockholders of Record
Common Stock	50,000,000	22,817,246	16,625,435	1,431	79
Preferred Stock	5,000,000	—	—	—	—
As of September 30, 2017					
Class	Number of Shares Authorized	Number of Shares Outstanding	Freely Tradable Shares (Public Float) (1)	Total Number of Beneficial Stockholders (2)	Total Number of Stockholders of Record
Common Stock	50,000,000	22,798,683	16,641,672	1,407	79
Preferred Stock	5,000,000	—	—	—	—
As of September 30, 2016					
Class	Number of Shares Authorized	Number of Shares Outstanding	Freely Tradable Shares (Public Float) (1)	Total Number of Beneficial Stockholders (2)	Total Number of Stockholders of Record
Common Stock	50,000,000	22,798,683	17,531,246	1,467	88
Preferred Stock	5,000,000	—	—	—	—

- (1) For purposes of this calculation only, shares of common stock held by each of Altigen's directors and officers on the given date and by each person who Altigen knows beneficially owned 5% or more of the outstanding common stock on that date have been excluded in that such persons may be deemed to be affiliates.
- (2) Estimate based on beneficial share range analysis, received from Broadridge Financial Solutions, Inc. There are greater than 100 beneficial shareholders owning at least 100 shares of the Company's common stock.

Item 3. Interim Financial Statements.

ALTIGEN COMMUNICATIONS, INC.
CONSOLIDATED BALANCE SHEETS
(amounts in thousands, except shares and per share amounts)

	March 31, 2018	September 30, 2017
	(Unaudited)	(1)
ASSETS		
Current assets:		
Cash, cash equivalents and restricted cash	\$ 4,243	\$ 3,876
Accounts receivable, less allowance for doubtful accounts of \$1 and \$2 at March 31, 2018 and September 30, 2017, respectively.....	408	255
Prepaid expenses and other current assets	179	144
Total current assets	4,830	4,275
Property and equipment, net	82	46
Capitalized software development costs, net	53	—
Long-term deposit	42	31
Total assets	\$ 5,007	\$ 4,352
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 62	\$ 45
Revolving line of credit	719	869
Accrued expenses	622	530
Deferred revenue, short-term.....	1,336	1,297
Total current liabilities.....	2,739	2,741
Deferred revenue, long-term.....	189	247
Deferred rent, long-term	3	25
Total liabilities.....	2,931	3,013
Commitments and contingencies (Note 3)		
Stockholders' equity:		
Convertible preferred stock, \$0.001 par value; Authorized—5,000,000 shares; Issued and outstanding—none at March 31, 2018 and September 30, 2017	—	—
Common stock, \$0.001 par value; Authorized—50,000,000 shares; Issued and outstanding—22,817,246 shares at March 31, 2018 and 22,798,683 September 30, 2017	25	25
Treasury stock at cost—1,918,830 shares at March 31, 2018 and September 30, 2017	(1,565)	(1,565)
Additional paid-in capital.....	71,839	71,823
Accumulated deficit	(68,223)	(68,944)
Total stockholders' equity	2,076	1,339
Total liabilities and stockholders' equity.....	\$ 5,007	\$ 4,352

(1) The information in this column was derived from the Company's audited consolidated financial statements as of and for the year ended September 30, 2017.

The accompanying notes are an integral part of the consolidated financial statements

ALTIGEN COMMUNICATIONS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited; amounts in thousands, except per share amounts)

	Three Months Ended March 31,		Six Months Ended March 31,	
	2018	2017	2018	2017
Net revenue:				
Hosted and service support.....	\$ 2,012	\$ 1,635	\$ 4,015	\$ 3,167
Software.....	398	271	673	633
Professional services and other	46	129	86	366
Total net revenue	2,456	2,035	4,774	4,166
Cost of revenue:				
Hosted and service support	368	284	753	545
Software	12	(1)	15	16
Professional services and other	7	24	14	66
Total cost of revenue	387	307	782	627
Gross profit.....	2,069	1,728	3,992	3,539
Operating expenses:				
Research and development.....	748	721	1,450	1,418
Sales and marketing	525	525	1,007	1,024
General and administrative	414	473	813	1,000
Litigation (1).....	—	23	—	23
Total operating expenses	1,687	1,742	3,270	3,465
Income (loss) from operations.....	382	(14)	722	74
Interest and other income (expense), net.....				
Interest and other income, net	5	2	9	3
Interest expense	(4)	(4)	(8)	(7)
Total interest and other income (expense), net.....	1	(2)	1	(4)
Income (loss) before income taxes	383	(16)	723	70
Provision for (benefit from) income taxes	—	—	(2)	(1)
Net income (loss)	\$ 383	\$ (16)	\$ 721	\$ 69
Net income (loss) per share:				
Basic.....	\$ 0.02	\$ (0.00)	\$ 0.03	\$ 0.00
Diluted	\$ 0.02	\$ (0.00)	\$ 0.03	\$ 0.00
Shares used to compute net income per share:				
Basic.....	22,817	22,799	22,817	22,799
Diluted	24,921	22,799	24,537	23,304

(1) Litigation expense related to a civil lawsuit filed against the Company by a former Board member. Please refer to Note 3, “Commitments and Contingencies” of the Consolidated Financial Statements and Item 5, “Legal Proceedings” of this Quarterly Report.

The accompanying notes are an integral part of the consolidated financial statements.

ALTIGEN COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(amounts in thousands, except share data)

	<u>Common Stock</u>		<u>Treasury Stock</u>	<u>Additional Paid-in Capital</u>	<u>Accumulated Deficit</u>	<u>Total Stockholders' Equity</u>
	<u>Shares</u>	<u>Amount</u>				
Balance at September 30, 2017	22,798,683	\$ 25	\$ (1,565)	\$ 71,823	\$ (68,944)	\$ 1,339
Net income.....	—	—	—	—	721	721
Common stock issued under stock plans.....	18,563	—	—	4	—	4
Stock-based compensation	—	—	—	12	—	12
Balance at March 31, 2018	<u>22,817,246</u>	<u>\$ 25</u>	<u>\$ (1,565)</u>	<u>\$ 71,839</u>	<u>\$ (68,223)</u>	<u>\$ 2,076</u>

The accompanying notes are an integral part of the consolidated financial statements.

ALTIGEN COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited, amounts in thousands)

	Six Months Ended March 31,	
	2018	2017
CASH AND CASH EQUIVALENTS, BEGINNING OF PERIOD	\$ 3,876	\$ 4,490
OPERATING ACTIVITIES:		
Net income	721	69
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization.....	20	44
Stock-based compensation	12	9
Changes in operating assets and liabilities:		
Accounts receivable.....	(153)	(3)
Inventories	—	38
Prepaid expenses and other current assets	(35)	(115)
Accounts payable.....	17	79
Accrued expenses	92	(723)
Deferred revenue	(19)	(47)
Deferred rent.....	(22)	(11)
Net cash provided by (used in) operating activities.....	633	(660)
INVESTING ACTIVITIES:		
Changes in long-term deposits	(11)	—
Purchases of property and equipment.....	(56)	—
Capitalized software development costs.....	(53)	—
Net cash used in investing activities	(120)	—
FINANCING ACTIVITIES:		
Proceeds from issuances of common stock	4	—
Proceeds from (payment to) line of credit	(150)	—
Net cash used in financing activities	(146)	—
Net change in cash and cash equivalents	367	(660)
CASH AND CASH EQUIVALENTS, END OF PERIOD	\$ 4,243	\$ 3,830

The accompanying notes are an integral part of the consolidated financial statements.

ALTIGEN COMMUNICATIONS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND BASIS OF PRESENTATION

Altigen Communications, Inc. (“Altigen,” the “Company,” “we,” “us” or “our”) was incorporated in the State of California in May 1994, and reincorporated in the State of Delaware in June 1999. We are a leading provider of premise and cloud-based IP-PBX and Contact Center solutions. We design, deliver and support Voice over Internet Protocol (VoIP) phone systems and call center solutions that combine high reliability with integrated IP communications applications. As one of the first companies to offer VoIP solutions, Altigen has been deploying systems since 1996.

The accompanying audited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”) for interim financial reporting. These principles require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, cash flow and related disclosure of contingent assets and liabilities during the reported periods. Key estimates include doubtful accounts reserve, long-term investments, long-lived assets, accounting for income taxes and the fair value of stock options granted and outstanding. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates. To the extent that there are material differences between these estimates and our actual results, our future consolidated financial statements will be affected.

These consolidated financial statements should be read in conjunction with our audited consolidated financial statements for the fiscal year ended September 30, 2017, included in the Company’s 2017 Annual Report filed through the OTC Disclosure and News Services on December 20, 2017. The Company’s results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

CASH, CASH EQUIVALENTS AND RESTRICTED CASH

Cash and cash equivalents consist of cash on hand and highly liquid investments, such as time deposits. We consider all highly liquid investments with original maturities of three months or less to be cash equivalents. Restricted cash represents cash that serves as collateral for our revolving line of credit and is restricted as to withdrawal or use. At March 31, 2018, cash, cash equivalents and restricted cash totaled approximately \$4.2 million, as compared to \$3.9 million at September 30, 2017. Restricted cash was approximately \$1.0 million as of March 31, 2018, and is presented as part of our cash and cash equivalents in our consolidated balance sheets.

ACCOUNTS RECEIVABLE

The Company extends credit to its customers and generally does not require collateral. Management performs ongoing credit evaluations of its customers and establishes an allowance for estimated losses to reduce accounts receivable to the amount management expects to collect. Historically, actual collections have been within management’s expectations. Accounts receivable are due under normal trade terms generally requiring payment within 30 days from the invoice date. Customer account balances with invoices dated 60-90 days old are considered delinquent.

The allowance for doubtful accounts reflects management’s analysis of receivables and the probability of collecting those accounts. Trade accounts receivable are charged against the allowance when the Company determines that payments will not be received. Any subsequent receipts are credited to the allowance. In the second quarter of fiscal year 2018, the Company’s allowance for doubtful accounts was \$1,000, compared to \$2,000 at September 30, 2017.

PROPERTY AND EQUIPMENT, NET

Property and equipment are stated at cost, which includes purchase cost, applicable taxes and freight costs, less accumulated depreciation and amortization. We compute depreciation and amortization using the straight-line method over the estimated useful lives of the assets, which is three years except for leasehold improvements. We depreciate leasehold improvements over the shorter of the lease term or the improvement’s estimated useful life. Depreciation and amortization expense was approximately \$20,000 for the first half of fiscal year 2018. Repairs and maintenance costs for the periods presented were immaterial and were expensed as incurred.

We periodically review our portfolio of equipment for impairment. Based on our impairment assessment, we determined there were no impairment losses for the periods referenced in the table below.

Property and equipment, net, consist of the following (in thousands):

	<u>March 31, 2018</u>	<u>September 30, 2017</u>
Furniture and equipment	\$ 526	\$ 502
Computer software	392	392
Leasehold improvements.....	132	100
Total	1,050	994
Accumulated depreciation and amortization	(968)	(948)
Property and equipment, net.....	<u>\$ 82</u>	<u>\$ 46</u>

SOFTWARE DEVELOPMENT COST

Costs incurred for the development of software to be marketed and sold are expensed as incurred until technological feasibility has been established, at which time such costs are capitalized until the product is available for general release to the public. Capitalized software development costs include purchased materials and services, and payroll and personnel-related costs attributable to programmers, software engineers and quality control. We amortize software development costs using the straight-line method over the product's estimated useful life, generally three years.

We capitalize certain costs of software developed for internal use. Capitalized costs include payroll and personnel-related costs for employees who are directly associated with and who devote time to the internal-use software projects, and purchased materials and services consumed in developing or obtaining internal-use software. The cost of internally developed software is amortized on a straight-line basis over its estimated useful life, generally three years.

The following table summarizes capitalized software costs and accumulated amortization as of October 1, 2017 and activities during the six months ended March 31, 2018 (in thousands):

	<u>Capitalized Software</u>	<u>Accumulated Amortization</u>	<u>Net</u>
Balance at October 1, 2017.....	\$ —	\$ —	\$ —
Additions	53,000	—	53,000
Balance at March 31, 2018	<u>\$ 53,000</u>	<u>\$ —</u>	<u>\$ 53,000</u>

REVENUE RECOGNITION AND COST OF REVENUE

We derive our revenue from the sales of hosted services, service support (known as software assurance programs) and sales of software licenses. Revenue from sales to end-users and resellers is recognized upon shipment or delivery of services, when risk of loss has passed to the customer, collection of the receivable is reasonably assured, persuasive evidence of an arrangement exists, and the sales price is fixed and determinable. If the Company determines that any one of the four criteria is not met, recognition of revenue is deferred until all the criteria are met. Revenue from sales to our distributors is deferred until the distributors have sold the products, as evidenced by monthly "sales-out" reports that the distributors provide to us.

HOSTED SERVICES

Hosted services consist primarily of our proprietary hosted VoIP Unified Communications system. The cloud-based model focuses on serving the needs of enterprise business that require the highest quality voice and integrated business productivity applications. The hosted offering includes hosted IP PBX service, Session Initiation Protocol (SIP) Trunk service, call center solutions, voice and video calling, conference calling, and a variety of long distance services. Our solutions are used by businesses and organizations in industries such as financial services, healthcare, retail and business services. Our hosted services are sold through reseller partners and direct arrangements with end-user customers. Our customers will typically enter into a one-year service agreement whereby they are billed for such services on a monthly basis. Revenue from our hosted services is recognized on a monthly basis as services are delivered.

Cost of hosted services consists primarily of costs associated with hosting our service and providing support, costs associated with data center capacity and certain fees paid to various third parties for the use of their technology, services and data.

SERVICE SUPPORT PROGRAMS

Our service support programs, also referred to as “software assurance” are post-contract customer support (“PCS”) services and provide our customers with the latest software updates, patches, new releases, and technical support for the applications they are licensed to use. These programs have an annual subscription and are generally structured with a one-year or three-year term. Sales from our service support programs are recorded as deferred revenue and recognized as revenue over the terms of their subscriptions. Subscriptions with expiration dates of less than one year are classified as “deferred revenue, short-term” and greater than one year are classified as “deferred revenue, long-term” in the accompanying consolidated balance sheets.

The estimated cost of providing software assurance is insignificant and the upgrades and enhancements offered at no cost during software assurance arrangements have historically been, and are expected to continue to be, minimal and infrequent. All estimated costs of providing the services, including upgrades and enhancements, are spread over the life of the software assurance contract term.

CONCENTRATIONS

Our customers are primarily end-users, resellers and distributors. We have distribution agreements with Altisys Communications, Inc. (“Altisys”) and Synnex Corporation (“Synnex”) in North America. Our agreements with Altisys and Synnex have initial terms of one year. Each of these agreements are renewed automatically for additional one-year terms, provided that each party has the right to terminate the agreement for convenience upon ninety (90) days’ written notice prior to the end of the initial term or any subsequent term of the agreement. In addition, our agreements with Altisys and Synnex also provide for termination, with or without cause and without penalty, by either party upon thirty (30) days’ written notice to the other party or upon a party’s insolvency or bankruptcy. For a period of sixty (60) days following termination of the agreement, Altisys and Synnex may distribute any products in their possession at the time of termination or, at their option, return any products to us that are in their inventories. Upon termination of the distribution agreement, all outstanding invoices for the products will become due and payable within thirty (30) days of the termination.

In North America, we also have a reseller agreement with Fiserv Solutions, Inc. (“Fiserv”). Our agreement with Fiserv has an initial term of ten years ending on August 28, 2019, and shall be renewed automatically for additional five-year terms unless either party provides the other party with ninety (90) days’ written notice of termination prior to the end of the initial term or any subsequent term of the agreement. The agreement can also be terminated for, among other things, material breach or insolvency of either party. Upon termination, Altigen would continue to have support obligations for products that Fiserv distributed subject to Fiserv’s obligation to remain current on maintenance fees.

The foregoing statements are subject to, and are qualified in their entirety by reference to, the agreements with Fiserv, Synnex and Altisys described above, which have been filed with the SEC as exhibits to the Company’s Annual Report on Form 10-K for the fiscal year ended September 30, 2009, Annual Report on Form 10-K for the fiscal year ended September 30, 2003, and Quarterly Report on Form 10-Q for the quarter ended December 31, 2001, respectively.

Altisys, Synnex and Fiserv, collectively represent approximately 29% and 27% of our total net revenue for the three and six months ended March 31, 2018, respectively, as compared to 22% and 25% for the same periods in fiscal year 2017.

SEGMENT REPORTING

The Company manages its business primarily on a geographic basis. Accordingly, the Company determined its operating segments, which are generally based on the nature and location of its customers, to be North America and Rest of World. The North America segment is comprised of the United States, Canada, Mexico, Central America and the Caribbean. The Rest of World segment is primarily comprised of Europe.

The following table shows our sales by geographic region and as percentage of total sales for the periods indicated (in thousands):

	Three Months Ended March 31, 2018		Three Months Ended March 31, 2017		Six Months Ended March 31, 2018		Six Months Ended March 31, 2017	
	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue
North	\$2,456	100%	\$2,044	100%	\$4,774	100%	\$4,141	99%
Rest of World	—	—	(9)	—	—	—	25	1
Total	<u>\$2,456</u>	<u>100%</u>	<u>\$2,035</u>	<u>100%</u>	<u>\$4,774</u>	<u>100%</u>	<u>\$4,166</u>	<u>100%</u>

2. REVOLVING LINE OF CREDIT

On September 1, 2017, we amended the credit agreement governing our Revolving Line of Credit Note (“Line of Credit”) with our primary financial lender, Wells Fargo Bank. Under the renewed terms, the Line of Credit was extended for a period of one year and expires on August 31, 2018. The total amount available for the Company to borrow was reduced from \$1.4 million to \$1.0 million. Furthermore, the terms of the Line of Credit also require us to maintain restricted cash with Wells Fargo Bank equal to the aggregate principal amount of \$1.0 million as collateral. The restricted cash is included in our cash, cash equivalents and restricted cash in our consolidated balance sheets as of March 31, 2018. Under the amended credit agreement, we are not subject to any restrictive financial covenants.

The Line of Credit is available to finance working capital and for general corporate purposes and requires monthly interest payments based on the prevailing 30-day LIBOR rate plus 0.75% (2.536% at March 31, 2018), and the interest rate is reset monthly. For the six months ended March 31, 2018 and 2017, interest expense associated with the Line of Credit was approximately \$8,000 and \$7,000, respectively.

As of March 31, 2018, the availability under the Line of Credit was approximately \$281,000 and we had outstanding borrowings of \$719,000, which was included in current liabilities on the accompanying consolidated balance sheets. The unpaid balance of the Line of Credit may increase or decrease with each payment or new advance. Any outstanding borrowings and accrued interest shall be due and payable in full on August 31, 2018.

3. COMMITMENTS AND CONTINGENCIES

Commitments

On December 31, 2013, the Company entered into an operating lease for its corporate headquarters, located in San Jose, California. The lease term commenced on May 15, 2014 and terminates in May 2019, with an option to renew for an additional five years. Under the terms of the lease agreement, we will pay rent of approximately \$1.4 million for a period of five years. The terms of the lease required a security deposit of approximately \$31,000, which is classified as long-term deposit in the Consolidated Balance Sheets. Furthermore, the terms of the lease include rent escalations and a tenant allowance of \$64,000 for certain leasehold improvements, which was recorded as part of deferred rent liability to be amortized over the term of the lease.

On November 8, 2017, the Company entered into a three-year operating lease agreement located in Taipei, Taiwan. The facility is leased through December 7, 2020 and serves as our international office for research and development functions. Under the terms of the lease agreement, total base rent payment is approximately \$137,000 for a period of three years commencing on December 8, 2017 with one rent free period at the initial term of the lease. Additionally, under the terms of the lease agreement, the Company will be obligated to pay certain customary amounts for its share of operating expenses, and the terms of the lease required a security deposit of approximately \$11,000, which is classified as long-term deposit in the Consolidated Balance Sheets.

Future non-cancellable minimum lease payments required under all existing operating leases as of March 31, 2018 are as follows:

Fiscal Year	Future Lease Payments	
	(in thousands)	
2018.....	\$	172
2019.....		221
Thereafter		53
Total.....	\$	446

Contingencies

On March 30, 2016, CTI Communications, LLC, a former reseller of the Company (“CTI”), filed a complaint against the Company, Affiliated Technology Solutions, LLC, a current reseller of the Company (“Affiliated”), James Jerome Cruz, a former CTI employee, and Thomas W. Welsh, a manager of Affiliated, in the United States District Court of Colorado, County of Larimer (the “Court”). The complaint alleged misappropriation of trade secrets, breach of contract, civil conspiracy and tortious interference. On March 17, 2017, CTI filed an amended complaint adding certain members of management and executive officers as additional defendants. The amended complaint named the Company’s CEO, Jeremiah J. Fleming, Vice President of Sales, Michael Plumer and Regional Sales Manager, Matthew Nielson. The Company responded to the amended complaint and on August 16, 2017, the Court dismissed with prejudice all CTI’s claims against Mr. Fleming. The case proceeded to a jury trial on March 19, 2018, and the jury directed a verdict in favor of CTI on March 27, 2018. The Court entered a judgment that held all defendants jointly and severally liable and awarded plaintiff approximately \$724,000 in compensatory damages, unjust enrichment, punitive damages and pre-judgment interest on compensatory damages. Furthermore, the Court ruled that plaintiff is entitled to recover certain attorneys’ fees and costs, the amount of which the Court has not yet determined. On April 30, 2018, the Court served our financial institution with a Writ of Garnishment restricting the Company’s cash in the amount of \$724,000 for the judgment and \$5,000 in post-judgment interest through April 30, 2018. On May 7, 2018, the Company filed a Motion for Stay of Execution of Judgment with the Court. Furthermore, the Company intends to appeal this verdict in the Colorado appellate court.

We continue to believe that we have meritorious defenses to CTI’s claims and intend to continue defending ourselves vigorously; however, no assurances can be made that the Company will be successful in its defense against these claims. As of the date of this report, the Company believes the amount of finally-determined damages (if any) will be allocated among the defendants. Consequently, no accruals have been recorded with respect to this litigation in the Company’s consolidated financial statements as of March 31, 2018.

On April 3, 2015, Gilbert Hu, a former member of our Board of Directors, filed a civil lawsuit against the Company in the Superior Court of California, County of Santa Clara. The lawsuit alleged (i) unpaid wages, (ii) breach of employment contract, (iii) breach of agreement, (iv) indemnity and violation of labor code section 2802, (v) conversion, (vi) fraud and (vii) intentional interference with prospective economic advantages. Mr. Hu seeks damages for unpaid wages, along with unspecified damages and attorneys’ fees as permitted by law. In July 2015, both parties formally entered into arbitration. The arbitration was conducted under the rules of Judicial Arbitration & Mediation Services, Inc. (“JAMS”). Both sides presented evidence over two hearing days ending on April 27, 2016. On August 5, 2016, after a full evidentiary hearing, the arbitrator issued an interim award granting relief to Mr. Hu for compensation claims along with court costs and attorneys’ fees. The Company disagreed with the arbitrator’s findings and conclusion and on September 14, 2016, filed an opposition with respect to this interim award. On November 28, 2016, the arbitrator issued a Final Award in favor of Mr. Hu in the amount of approximately \$725,000, consisting of compensation claims plus legal interest and attorneys’ fees and costs. Pursuant to the final award, we recorded an accrual of \$568,000 in our financial statements in the fourth quarter of fiscal year 2016 and \$157,000 in the second quarter of fiscal year 2014. The Company paid the full award in the first quarter of fiscal year 2017. On March 16, 2017, the Superior Court of California, County of Santa Clara awarded Mr. Hu post-arbitration award attorney fees in the sum of \$22,000, which the Company recorded an accrual in our financial statements in the quarter ended March 31, 2017. This award was paid in the third quarter of fiscal 2017. Furthermore, on June 2, 2017, the Company and Mr. Hu entered into a written settlement agreement to settle \$46,000 in post-arbitration fees. The Company recorded an accrual for this settlement and paid the full amount in the third quarter of fiscal 2017.

From time to time, we may become subject to other legal proceedings, claims and litigation arising in the ordinary course of business. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit or proceeding could have a material adverse effect on our results of operations, financial position or cash flows. Except as noted above, the Company is not a party to any material legal proceedings nor is the Company aware of any pending or threatened litigation that, in its opinion, would have a material adverse effect on its business or its financial position, results of operations or cash flows should such litigation be resolved unfavorably.

4. STOCKHOLDERS' EQUITY AND STOCK-BASED COMPENSATION EXPENSE

Equity Stock Incentive Plans

The Company grants incentive stock options (“ISO”), non-qualified stock options (“NSO”) and restricted stock awards to eligible employees, officers, directors and consultants under the 2009 Stock Plan (“2009 Stock Plan”), which is the successor to the 1999 Stock Plan. The 2009 Stock Plan, provides for the granting of ISO, NSO, restricted stock awards, restricted stock units, stock appreciation rights, performance units and performance shares for over a period not to exceed ten years and at exercise prices that are not less than 100% of the fair market value of the Company’s common stock on the date of grant as determined by the Board of Directors. The exercise price of options granted to a greater than 10% stockholder may not be less than 110% of the fair market value on the date of grant. Stock options issued under the 2009 Stock Plan generally vest 25% at one year from the date of grant and 1/48th monthly thereafter. Options under the 2009 Stock Plan will generally expire ten years after the date of grant. The value of common stock subject to incentive stock options that become exercisable by any one employee in any calendar year may not exceed \$100,000.

The following table summarizes the Company’s stock options as of October 1, 2017 and changes during the six months ended March 31, 2018:

	<u>Number of Shares</u>	<u>Weighted- Average Exercise Price</u>	<u>Weighted Average Remaining Contractual Life (in years)</u>	<u>Aggregate Intrinsic Value (in thousands)</u>
Outstanding at October 1, 2017	4,034,624	\$ 0.28		
Granted	91,000	0.28		
Exercised	(18,563)	0.22		
Forfeitures and cancellations	(5,937)	0.27		
Outstanding at March 31, 2018.....	<u>4,101,124</u>	<u>\$ 0.28</u>	<u>5.77</u>	<u>\$ 1,124,022</u>
Exercisable at March 31, 2018.....	<u>3,860,061</u>	<u>\$ 0.28</u>	<u>5.56</u>	<u>\$ 1,063,542</u>

Stock-Based Compensation

The Company accounts for stock-based compensation, including grants of stock options, as an operating expense in the consolidated statement of operations. The Company measures stock-based compensation cost at the grant date based on the fair value of the grant. The value of the portion of the grant that is ultimately expected to vest is recognized as expense over the requisite service periods. Stock-based compensation expense was \$7,000 and \$12,000 for the three and six months ended March 31, 2018, respectively, compared to \$4,000 and \$9,000 for the three and six months ended March 31, 2017, respectively.

5. SHAREHOLDER RIGHTS PLAN

The Company adopted a Preferred Stock Rights Agreement (the “Plan”) and declared a dividend distribution of one right for each outstanding share of its common stock. The record date for the distribution was May 7, 2009. The Company designed the plan to protect the long-term value of the Company for its shareholders during any future unsolicited acquisition attempt. The Company did not adopt the Plan in response to any specific attempt to acquire the Company or its securities, and the Company is not aware of any current efforts to do so. These rights will become exercisable only upon the occurrence of certain events specified in the Plan, including the acquisition of 15% of the Company’s outstanding shares of common stock by a person or group. Should a person or group acquire 15% or more of the outstanding shares of common stock or announce an unsolicited tender offer, the consummation of which would result in a person or group acquiring 15% or more of the outstanding shares of common stock, stockholders other than the acquiring person may exercise the rights, unless the Board of Directors has approved the transaction in advance. Each right will initially entitle stockholders to purchase one one-thousandths (0.001) of the Company’s preferred stock for \$4.00 per share. However, the rights are not immediately exercisable and will become exercisable only upon the occurrence of certain events. If a person or group acquires, or announces a tender or exchange offer that would result in the acquisition of, fifteen percent (15%) or more of our common stock while the stockholder rights plan remains in place, then, unless the rights are redeemed by us for \$0.001 per right, the rights will become exercisable by all rights holders, except the acquiring person or group,

for shares of Altigen or shares of the third party acquirer having a value of twice the right's then-current exercise price. The rights will expire on May 7, 2019 or upon earlier exchange or redemption of the rights as described above.

6. SUBSEQUENT EVENTS

As noted in Item 5, "Legal Proceedings" and Note 3, "Commitments and Contingencies," in connection with the CTI litigation, on April 30, 2018, our financial institution was served with a Writ of Garnishment issued by the Court. Although the Company believes the amount of finally-determined damages (if any) will be allocated among the defendants, the Company's cash was restricted in the amount of \$724,000 for the Court's judgment and \$5,000 in post-judgment interest through April 30, 2018. On May 7, 2018, the Company filed a Motion for Stay of Execution of Judgment in the District Court of Colorado. Furthermore, the Company intends to appeal this verdict in the Colorado appellate court.

Item 4. Management’s Discussion and Analysis of Plan of Operation.

These statements are based on current expectations and assumptions regarding future events and business performance and involve known and unknown risks, uncertainties and other factors that may cause industry trends or our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. These unaudited interim consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report for the fiscal year ended September 30, 2017, files with filed through the OTC Disclosure and News Services on December 20, 2017. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

Altigen Communications, Inc. (“Altigen,” the “Company,” “we,” “us” or “our”) was incorporated in the State of California in May 1994, and reincorporated in the State of Delaware in June 1999. We are a leading provider of premise and cloud-based IP-PBX and Contact Center solutions. We design, deliver and support Voice over Internet Protocol (VoIP) phone systems and call center solutions that combine high reliability with integrated IP communications applications. As one of the first companies to offer VoIP solutions, Altigen has been deploying systems since 1996.

Altigen’s Unified Communications (UC) solutions are designed with an open architecture, built on industry standard communication protocols, and Microsoft Windows-based applications. This adherence to widely used standards allows our solutions to both integrate with and leverage a company’s existing technology investment. Altigen’s award winning, integrated IP applications suite provides customers with a complete business communications solution. Voicemail, Contact Center, Unified Messaging, Automatic Call Distribution, Call Recording, Call Activity Reporting, and Mobility solutions take advantage of the convergence of voice and data communications to achieve superior business results.

Altigen was formed in 1994 as a California corporation and was reincorporated in the State of Delaware in 1999. Our fiscal year end is September 30 of each year. The Company’s common stock trades on the OTCQB U.S. tier under the symbol “ATGN.” Trading in the common shares of the Company commenced on March 16, 2010 and Pink OTC Markets, Inc. provides quotes and other information at www.otcmarkets.com. The Company has not been in bankruptcy, receivership, or any similar proceeding.

We focus our sales efforts on first and second tier hosted voice service providers, medium and enterprise sized businesses, multi-site businesses, corporate branch offices, and call centers. Our first products began shipping in 1996. Our UC solutions are primarily sold to small-to-medium sized businesses, multi-site businesses, corporate branch offices, call centers, credit unions and community banks.

Altigen’s software products are available from independent authorized resellers and strategic partners.

Altigen’s primary SIC code is 3661 (telephone and telegraph apparatus). Altigen has never been “shell company” as defined under the Securities Act of 1933, as amended.

Critical Accounting Policies and Estimates

Management’s discussion and analysis of the Company’s financial condition and consolidated results of operations is based upon the Company’s consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires the Company’s management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. The Company’s estimates are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for the Company’s conclusions. The Company continually evaluates the information used to make these estimates as its business and the economic environment change. The Company’s management believes that certain estimates, assumptions and judgments derived from the accounting policies have significant impact on its financial statements, so the Company considers the following be its critical accounting policies.

Revenue Recognition

Revenue from the sales of our hosted services and service support, also referred to as “software assurance” consist of direct sales to end-users and resellers, while revenue from the sales of our software licenses consist of direct sales to end-users, resellers and distributors.

Hosted service revenue is generated from the sale of subscriptions to our software applications and related services. We recognize hosted service revenue in the period when the services are performed. Our customers will typically enter into a one-year service agreement whereby they are billed for such services on a monthly basis. In accordance with generally accepted accounting principles, revenue recognition is deferred until such time the customer goes live to ensure the revenue will match the use of services. Such services include recurring fixed plan subscription fees, variable usage-based fees for usage in excess of plan limits and other recurring fees related to our subscriptions.

Revenue from our service support programs is deferred and recognized ratably over the service coverage periods, generally twelve or thirty-six months. Deferred revenue from our service support programs primarily consists of payments received in advance of revenue recognition from the service support programs described below and is recognized as the revenue recognition criteria are met. Such criteria include persuasive evidence of arrangement, billing amount is fixed or determinable, services have delivered and collection is reasonably assured. Since we receive payment for service support in advance of our recognizing the related revenue, we carry a deferred revenue balance on our consolidated balance sheet.

Revenue from sales of software licenses to end-users and resellers is recognized upon shipment, when risk of loss has passed to the customer, collection of the receivable is reasonably assured, persuasive evidence of an arrangement exists, and the sales price is fixed and determinable. We provide for estimated sales returns and allowances, and such estimates are based on historical experience. Net revenue consists of software revenue reduced by estimated sales returns and allowances. Sales to distributors are made under terms allowing certain rights of return and protection against subsequent price declines on our product held by the distributors. Upon termination of such distribution agreements, any unsold product may be returned by the distributor for a full refund. These agreements may be canceled without cause for convenience following a specified notice period. As a result of these provisions, we defer recognition of distributor revenue until such distributors resell our products to their customers, as evidenced by monthly “sales-out” reports that the distributors provide to us.

Revenue that is deferred as a result of our revenue recognition policy is classified as “deferred revenue” in the accompanying consolidated balance sheets. The related cost of such revenue is immaterial for deferral purposes.

Hosted Services

Hosted services consist primarily of our proprietary hosted VoIP Unified Communications system. The cloud-based model focuses on serving the needs of enterprise business that require the highest quality voice and integrated business productivity applications. The hosted offering includes hosted IP PBX service, Session Initiation Protocol (SIP) Trunk service, call center solutions, voice and video calling, conference calling, and a variety of long distance services. Our solutions are used by businesses and organizations in industries such as financial services, healthcare, retail and business services. Our hosted services are sold through reseller partners and direct arrangements with end-user customers. Our customers will typically enter into a one-year service agreement whereby they are billed for such services on a monthly basis. Customers are generally billed the greater of their minimum monthly fee or actual usage, and revenue is recognized monthly as services are delivered. Hosted revenue accounted for 49% of our total net revenue for the three and six months ended March 31, 2018, respectively, compared to 36% and 33% for the three and six months ended March 31, 2017, respectively. Hosted revenue is included within operating revenue as “hosted and service support” in the accompanying consolidated statement of operations.

Cost of hosted services consists primarily of costs associated with hosting our service and providing support, costs associated with data center capacity and certain fees paid to various third parties for the use of their technology, services and data.

Service Support Program

Our service support programs, also referred to as “software assurance” are post-contract customer support (“PCS”) services and provide our customers with the latest software updates, patches, new releases, and technical support for the applications they are licensed to use. These programs have an annual subscription and are generally structured with a one-year or three-year term. Sales from our service support programs are recorded as deferred revenue and recognized as revenue over the terms of their subscriptions. Subscriptions with expiration dates of less than one year are classified as “deferred revenue, short-term” and greater than one year are classified as “deferred revenue, long-term” in the accompanying consolidated balance sheets. Short-term service support deferred revenue was approximately \$1.3 million as of March 31, 2018 and September 30, 2017, respectively. Long-term service support deferred revenue was approximately \$189,000 and \$247,000 as of March 31, 2018 and September 30, 2017, respectively. Service support revenue accounted for 33% and 35% of our total net revenue for the three and six months ended March 31, 2018, respectively, compared to 44% and 43% for the three and six months ended March 31, 2017, respectively.

The estimated cost of providing software assurance is insignificant and the upgrades and enhancements offered at no cost during software assurance arrangements have historically been, and are expected to continue to be, minimal and infrequent. All estimated costs of providing the services, including upgrades and enhancements, are deferred and recognized to costs of revenue over the life

of the software assurance contract term.

Software Revenue

Software revenue consists of license revenue that is recognized upon delivery, usually a download from the Company's website with a specified one-time download key/password that the Company provides to each customer upon sale. Our software revenue consists of direct sales to end-users, resellers and distributors. The software license is sold on a standalone basis with no other services or products bundled in. The related cost of software revenue is immaterial.

Professional Services and Other Revenue

The Company also derives revenue from professional services which primarily include custom software development to extend system capabilities and enable UC integration with other enterprise applications. Our professional services are sold separately from software services and have standalone value. Revenue from professional services is recognized when the milestones are achieved and accepted by the customer for fixed price contracts. Cost of professional services consists primarily of employee-related costs, including stock-based expenses. Other revenue consists of deployments and training. Revenue from deployments and training is recognized as the services are performed.

Cash, Cash Equivalents and Restricted Cash

Cash and cash equivalents consist of cash on hand and highly liquid investments, such as time deposits. We consider all highly liquid investments with original maturities of three months or less to be cash equivalents. Restricted cash represents cash that serves as collateral for our revolving line of credit and is restricted as to withdrawal or use. At March 31, 2018, cash, cash equivalents and restricted cash totaled approximately \$4.2 million, as compared to \$3.9 million at September 30, 2017. Restricted cash was approximately \$1.0 million as of March 31, 2018, and is presented as part of our cash and cash equivalents in our consolidated balance sheets.

Stock-Based Compensation Expense

The Company has estimated the fair value of stock-based compensation for stock options at the date of the grant using the Black-Scholes option-pricing model. The Black-Scholes option-pricing model incorporates various assumptions including expected volatility, expected life and interest rate. The Company uses historical data to estimate option forfeitures. Expected volatility is based on historical volatility and the risk-free interest rate is based on U.S. Treasury yield in effect at the time of the grant for the expected life of the options. The Company does not anticipate paying any dividends in the foreseeable future and therefore used an expected dividend yield of zero in the option valuation model.

Results of Operations

The following table sets forth consolidated statements of operations data for the periods indicated as a percentage of net revenue.

	Three Months Ended March 31,		Six Months Ended March 31,	
	2018	2017	2018	2017
Net revenue:				
Hosted and service support	81.9 %	80.4 %	84.1 %	76.0 %
Software	16.2	13.3	14.1	15.2
Professional services and other	1.9	6.3	1.8	8.8
Total net revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Hosted and service support.....	14.9	14.0	15.8	13.1
Software	0.5	(0.1)	0.3	0.4
Professional services and other.....	0.3	1.2	0.3	1.6
Total cost of revenue.....	15.7	15.1	16.4	15.1
Gross profit	84.3	84.9	83.6	84.9
Operating expenses:				
Research and development	30.5	35.4	30.4	34.0
Sales and marketing.....	21.4	25.8	21.1	24.6
General and administrative.....	16.8	23.3	17.0	24.0
Litigation (1)	—	1.1	—	0.5
Total operating expenses	68.7	85.6	68.5	83.1
Income (loss) from operations	15.6	(0.7)	15.1	1.8
Interest and other income (expense), net				
Interest and other income, net.....	0.2	0.1	0.2	0.1
Interest expense	(0.2)	(0.2)	(0.2)	(0.2)
Total interest and other income (expense), net	—	(0.1)	—	(0.1)
Income (loss) before income taxes	15.6	(0.8)	15.1	1.7
Provision for (benefit from) income taxes	—	—	—	—
Net income (loss).....	15.6 %	(0.8) %	15.1 %	1.7 %

(1)Litigation expense related to a civil lawsuit filed against the Company by a former Board member. Please refer to Note 3, “Commitments and Contingencies” of the Consolidated Financial Statements and Item 5, “Legal Proceedings” of this Quarterly Report.

The accompanying notes are an integral part of the consolidated financial statements.

Results of Operations — Three and Six Months Ended March 31, 2018 Compared to Three and Six Months Ended March 31, 2017

Net Revenue

Net revenue consists of revenue from direct sales to end-users, resellers and distributors.

We categorize our operations into two operating segments - North America and Rest of World. The North America segment is comprised of the United States, Canada, Mexico, Central America and the Caribbean. The Rest of World segment is primarily comprised of Europe.

Net revenue increased 21% to \$2.5 million and 15% to \$4.8 million for the three and six months ended March 31, 2018, respectively, as compared to \$2.0 million and \$4.2 million for the same period in fiscal year 2017. The increase was primarily caused by a favorable shift in our product mix resulting in an increase of 23% in our hosted and service support revenue during the second quarter of fiscal 2018; and an increase of 27% for the six months ended March 31, 2018, compared to the respective periods of the prior year. The increase in hosted and service support revenue was partially offset by a decrease in professional services and other revenue.

Cost of Revenue

Cost of hosted services primarily consists of costs associated with hosting our services, personnel costs associated with customer care and related costs of the hosted operation, costs associated with data center capacity purchased from third-party providers and certain fees paid to various third parties for the use of their technology, services and data. Cost of revenue also includes amortization of capitalized software development costs, and other allocated overhead expenses.

Cost of hosted services is expensed as incurred. For the three months ended March 31, 2018, cost of hosted services was approximately \$368,000, or 15% of net revenue, compared to \$284,000, or 14% of net revenue for the same period a year ago. For the six months ended March 31, 2018, cost of revenue was \$753,000, or 16% of net revenue, as compared to \$545,000, or 13% of net revenue for the same period of fiscal year 2017. The increase was primarily attributable to the positive impact of the hosted revenue growth. Cost of hosted services, both in absolute dollars and as percentage of revenue, could fluctuate in the future periods depending on the growth rate of our hosted service offerings and the associated costs.

Cost of service support consists principally of upgrades, enhancements and technical support. Service support costs are deferred and recognized to costs of revenue over the life of the software assurance contract term. For the three and six months ended March 31, 2018 and 2017, the related cost of service support was immaterial.

Cost of professional services and other revenue consists primarily of employee-related costs, including stock-based expenses. Costs incurred by the Company in connection with providing such services are charged to expense as incurred. For the three months ended March 31, 2018, cost of professional services and other revenue was approximately \$7,000, or 0.3% of net revenue, compared to \$24,000, or 1% of net revenue for the same period a year ago. For the six months ended March 31, 2018, cost of professional services and other revenue was approximately \$14,000, or 0.3% of net revenue, compared to \$66,000, or 2% of net revenue for the same period of fiscal year 2017.

Research and Development (“R&D”) Expenses

R&D expenses consist primarily of salaries, benefits and overhead expenses, non-cash stock based compensation, consultant fees, prototype development expenses and other costs associated with the design, development, enhancements and testing of our products. We expense all R&D expenses as incurred and capitalize certain costs of product development when the projects under development reach technological feasibility for software to be sold, and capitalize certain costs as incurred for internal-use software developed as a service.

For the second quarter of fiscal year 2018, research and development expenses were \$748,000, 31% of net revenue, compared to \$721,000, or 35% of net revenue for the second quarter of fiscal year 2017. For the six months ended March 31, 2018, research and development expenses were \$1.5 million, or 30% of net revenue, as compared to \$1.4 million, or 34% of net revenue for the same period of fiscal year 2017.

We believe our future success relies on our ability to expand the functionality and scalability of our products and services and enhancing their ease of use, as well as our ability to development and introduce new product offerings, related software applications and services for both premise and hosted customers. Over the long term, we expect our R&D expenses to increase in absolute dollars as we continue to invest in the development of new solutions and expand our product and service offerings. Our R&D activities are conducted in San Jose, California, Shanghai, China and Taipei, Taiwan.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of salaries, benefits and overhead expenses, sales commissions, travel, non-cash stock based compensation expense and costs related to marketing, trade shows and promotional activities.

For the second quarter of fiscal year 2018, sales and marketing expenses were \$525,000, or 21% of net revenue, compared to \$525,000, or 26% of net revenue for the second quarter of fiscal year 2017. For the six months ended March 31, 2018, sales and marketing expenses were \$1.0 million, or 21% of net revenue, as compared to \$1.0 million, or 25% of net revenue for the same period of fiscal year 2017.

We plan to continue investing in our domestic marketing activities to help build brand awareness, create sales leads and to drive growth in our sales. To the extent we achieve higher sales levels, we expect sales and marketing expenses to increase in the future periods over the long-term due to increased staffing levels as well as increased commission expense. We also anticipate that sales and marketing expenses will remain relatively flat in the short-term due in part to our continued emphasis on expense control.

General and Administrative Expenses

General and administrative expenses consist of salaries, benefits and overhead expenses, non-cash stock based compensation expense and related expenses for our executive, finance and administrative personnel, facilities and allowance for doubtful accounts. In addition, general and administrative expenses include legal, accounting services and general corporate expenses.

For the second quarter of fiscal year 2018, general and administrative expenses were \$414,000, or 17% of net revenue, compared to \$473,000, or 23% of net revenue for the second quarter of fiscal year 2017. For the six months ended March 31, 2018, general and administrative expenses were \$813,000, or 17% of net revenue, as compared to \$1.0 million, or 24% of net revenue for the same period of fiscal year 2017.

The three-month decrease of \$59,000 was primarily attributable to reduced legal expenses. The six-month decrease of \$187,000 was due in part to reduced service fees of \$28,000, reduced salaries and overhead expenses of approximately \$29,000, and a reduction of \$111,000 in legal fees. The decrease in legal fees was attributable to reduced legal services related to a civil lawsuit that settled in the first quarter of fiscal year 2017. For additional information, refer to Item 5, "Legal Proceedings" of this quarterly report.

We expect general and administrative expenses will remain relatively flat in the foreseeable future due in part to our continued emphasis on expense control.

Interest and Other (Expense) Income, Net

Interest expense consists primarily of interest charged on the outstanding borrowing of our revolving line of credit. Interest income relates to amounts earned on our cash and cash equivalents. The Company recorded \$4,000 as interest expense and \$5,000 as interest income in the second quarter of fiscal year 2018, compared to \$4,000 of interest expense and \$2,000 of interest income in the second quarter of fiscal year 2017. For the six months ended March 31, 2018, the company recorded \$8,000 as interest expense and \$9,000 as interest income, compared to \$7,000 of interest expense and \$3,000 of interest income during the same periods in fiscal year 2017.

Liquidity and Capital Resources

Since inception, we have financed our operations primarily through the sale of equity securities and cash flows from operations. As of March 31, 2018, total cash and cash equivalents represents approximately 88% of total current assets.

The following table shows the major components of our consolidated statements of cash flows for the stated periods:

	Six Months Ended March 31,	
	2018	2017
	(amounts in thousand)	
Cash and cash equivalents, beginning of period.....	\$ 3,876	\$ 4,490
Cash provided by (used in) operating activities	633	(660)
Cash used in investing activities.....	(120)	—
Cash used in financing activities	(146)	—
Cash and equivalents, end of period.....	\$ 4,243	\$ 3,830

Cash Provided by (Used in) Operating Activities

During the six months ended March 31, 2018, cash provided by operating activities of \$633,000 was a result of \$721,000 of net income, adjustments for non-cash items of \$32,000 and a decrease in the net changes in operating assets and liabilities of \$120,000. Non-cash items consist of depreciation and amortization and stock-based compensation expenses. The change in operating assets and liabilities was primarily driven by the timing of cash receipts from customers, as well as a decrease in accrued expenses.

During the six months ended March 31, 2017, cash used in operating activities of \$660,000 was a result of a decrease in operating assets and liabilities of \$782,000, non-cash adjustments of \$53,000, offset by net income of \$69,000. Non-cash items consist of depreciation and amortization and stock-based compensation expenses. The decrease in assets and liabilities was primarily attributable to a civil lawsuit paid in the first quarter of fiscal year 2017. For additional information, refer to Item 5, "Legal

Proceedings” of this quarterly report.

Cash Used in Investing Activities

Cash flows from investing activities primarily relate to capitalized software costs associated with the development of new products and services and enhancements of existing products and services, as well as, capital expenditures related to technological equipment, software licenses and to a lesser degree, office equipment. Cash used in investing activities in the six months ended March 31, 2018 of \$120,000 was attributable to changes in long-term deposits and capital expenditures of \$67,000 and capitalized software development costs totaling \$53,000. We did not pursue any investing activities during the six months ended March 31, 2017.

Cash Used in Financing Activities

Our financing activities have consisted primarily of repayments under our revolving line of credits and the net proceeds from the issuance of common stock from employee option exercises. Cash used in financing activities of \$146,000 during the second quarter of fiscal year 2018 consisted primarily of cash used to pay down the principal balance on our revolving line of credit of \$150,000 and proceeds from the issuance of common stock under our employee stock purchase plan of \$4,000. We did not pursue any financing activities during the six months ended March 31, 2017.

Based on our recent performance and current expectations, we believe our existing cash and cash equivalents, as well as cash expected to be generated from operating activities will adequately meet our working capital, capital expenditure needs and other liquidity requirements associated with our existing operations over the next 12 months.

Our cash needs depend on numerous factors, including market acceptance of and demand for our products and services, our ability to develop and introduce new product offerings and enhancements to existing products, the prices at which we can sell our products, the resources we devote to developing, marketing, selling and supporting our products, as well as other factors. If we are unable to raise additional capital or if sales from our new products or enhancements are lower than expected, we will be required to make additional reductions in operating expenses and capital expenditures to ensure that we will have adequate cash reserves to fund operations.

Additional financing, if required, may not be available on favorable terms, or at all. To the extent that existing cash and cash equivalents are not sufficient to fund our future operations, we may need to raise additional funds through public or private equity offerings or through additional debt financing. If we cannot raise additional funds on acceptable terms, we may not be able to further develop or enhance our products and services, take advantage of opportunities, or respond to competitive pressures or unanticipated requirements, which could seriously harm our business. Even if additional financing is available, we may be required to obtain the consent of our stockholders, which we may or may not be able to obtain. In addition, the issuance of equity or equity-related securities will dilute the ownership interest of our stockholders and the issuance of debt securities could increase the risk or perceived risk of investing in our securities.

We did not have any material commitments for capital expenditures as of March 31, 2018. We had total outstanding commitments on non-cancelable operating leases of approximately \$446,000 as of March 31, 2018. Lease terms on our existing operating leases are generally three years.

Effects of Recently Issued Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2014-09, Revenue from Contracts with Customers (Topic 606), which is a new standard on revenue recognition. The new standard contains principles that an entity will need to apply to determine the measurement of revenue and timing of when revenue is recognized. The underlying principle is to recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The standard has a five-step approach which includes identifying the contract or contracts, identifying the performance obligations, determining the transaction price, allocating the transaction price, and recognizing revenue. The standard also significantly expands the quantitative and qualitative disclosure requirements for revenue, which are intended to help users of financial statements understand the nature, amount, timing, and uncertainty of revenue and the related cash flows. ASU 2014-09 is effective for annual periods beginning after December 15, 2019. The Company is currently evaluating this new standard and the impact it will have on its financial statements and processes.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements—Going Concern (Sub Topic 205-40) – Uncertainties about an Entity’s Ability to Continue as a Going Concern. ASU 2014-15 clarifies principles and definitions that may be used by an organization’s management for disclosures that are currently made available in financial statement footnotes. Presently U.S. GAAP does not provide an organization’s management guidance regarding its responsibility to assess whether substantial doubt exists regarding the ability to continue as a going concern or to prepare related footnote disclosures. Instead,

auditors are responsible for assessing an entity's ability to continue as a going concern under AUC 570. ASU 2014-15 will move this responsibility to management. ASU 2014-15 will require management to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as going concern from one year from the date the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016. The Company adopted this new guidance with no impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842), which requires lessees to recognize a liability associated with obligations to make payments under the terms of the arrangement in addition to a right-of-use asset representing the lessee's right to use, or control the use of the given asset assumed under the lease. The standard will be effective for nonpublic business entities for annual periods beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating this new standard and the impact it will have on its financial statements and processes.

In November 2016, the FASB issued Accounting Standards Update (ASU) No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash, which has the primary purpose of reducing the diversity in practice that exists in the classification and presentation of changes in restricted cash on the statement of cash flows. This ASU will require amounts generally described as "restricted cash" or "restricted cash equivalents" to be presented with cash and cash equivalents when reconciling the beginning and ending amounts shown on the statement of cash flows. Companies are required to disclose how the statement of cash flows reconciles to the balance sheet if restricted cash is shown separate from cash and cash equivalents on the balance sheet. Companies must also disclose information about the nature of the restrictions on cash. The standard will be effective for nonpublic business entities beginning after December 15, 2018. Early adoption is permitted, and should be applied using a retrospective transition method to each period presented. The Company is currently evaluating this new standard and the impact it will have on its consolidated financial statements.

Item 5. Legal Proceedings

On March 30, 2016, CTI Communications, LLC, a former reseller of the Company ("CTI"), filed a complaint against the Company, Affiliated Technology Solutions, LLC, a current reseller of the Company ("Affiliated"), James Jerome Cruz, a former CTI employee, and Thomas W. Welsh, a manager of Affiliated, in the United States District Court of Colorado, County of Larimer (the "Court"). The complaint alleged misappropriation of trade secrets, breach of contract, civil conspiracy and tortious interference. On March 17, 2017, CTI filed an amended complaint adding certain members of management and executive officers as additional defendants. The amended complaint named the Company's CEO, Jeremiah J. Fleming, Vice President of Sales, Michael Plumer and Regional Sales Manager, Matthew Nielson. The Company responded to the amended complaint and on August 16, 2017, the Court dismissed with prejudice all CTI's claims against Mr. Fleming. The case proceeded to a jury trial on March 19, 2018, and the jury directed a verdict in favor of CTI on March 27, 2018. The Court entered a judgment that held all defendants jointly and severally liable and awarded plaintiff approximately \$724,000 in compensatory damages, unjust enrichment, punitive damages and pre-judgment interest on compensatory damages. Furthermore, the Court ruled that plaintiff is entitled to recover certain attorneys' fees and costs, the amount of which the Court has not yet determined. On April 30, 2018, the Court served our financial institution with a Writ of Garnishment restricting the Company's cash in the amount of \$724,000 for the judgment and \$5,000 in post-judgment interest through April 30, 2018. On May 7, 2018, the Company filed a Motion for Stay of Execution of Judgment with the Court. Furthermore, the Company intends to appeal this verdict in the Colorado appellate court.

We continue to believe that we have meritorious defenses to CTI's claims and intend to continue defending ourselves vigorously; however, no assurances can be made that the Company will be successful in its defense against these claims. As of the date of this report, the Company believes the amount of finally-determined damages (if any) will be allocated among the defendants. Consequently, no accruals have been recorded with respect to this litigation in the Company's consolidated financial statements as of March 31, 2018.

On April 3, 2015, Gilbert Hu, a former member of our Board of Directors, filed a civil lawsuit against the Company in the Superior Court of California, County of Santa Clara. The lawsuit alleged (i) unpaid wages, (ii) breach of employment contract, (iii) breach of agreement, (iv) indemnity and violation of labor code section 2802, (v) conversion, (vi) fraud and (vii) intentional interference with prospective economic advantages. Mr. Hu seeks damages for unpaid wages, along with unspecified damages and attorneys' fees as permitted by law. In July 2015, both parties formally entered into arbitration. The arbitration was conducted under the rules of Judicial Arbitration & Mediation Services, Inc. ("JAMS"). Both sides presented evidence over two hearing days ending on April 27, 2016. On August 5, 2016, after a full evidentiary hearing, the arbitrator issued an interim award granting relief to Mr. Hu for compensation claims along with court costs and attorneys' fees. The Company disagreed with the arbitrator's findings and conclusion and on September 14, 2016, filed an opposition with respect to this interim award. On November 28, 2016, the arbitrator issued a Final Award in favor of Mr. Hu in the amount of approximately \$725,000, consisting of compensation claims plus legal interest and attorneys' fees and costs. Pursuant to the final award, we recorded an accrual of \$568,000 in our financial statements in the fourth quarter of fiscal year 2016 and \$157,000 in the second quarter of fiscal year 2014. The Company paid the full award in the first quarter of fiscal year 2017. On March 16, 2017, the Superior Court of California, County of Santa

Clara awarded Mr. Hu post-arbitration award attorney fees in the sum of \$22,000, which the Company recorded an accrual in our financial statements in the quarter ended March 31, 2017. This award was paid in the third quarter of fiscal 2017. Furthermore, on June 2, 2017, the Company and Mr. Hu entered into a written settlement agreement to settle \$46,000 in post-arbitration fees. The Company recorded an accrual for this settlement and paid the full amount in the third quarter of fiscal 2017.

From time to time, we may become subject to other legal proceedings, claims and litigation arising in the ordinary course of business. Litigation can be expensive, lengthy and disruptive to normal business operations. Moreover, the results of complex legal proceedings are difficult to predict. An unfavorable resolution of a particular lawsuit or proceeding could have a material adverse effect on our results of operations, financial position or cash flows. Except as noted above, the Company is not a party to any material legal proceedings nor is the Company aware of any pending or threatened litigation that, in its opinion, would have a material adverse effect on its business or its financial position, results of operations or cash flows should such litigation be resolved unfavorably.

Item 6. Defaults upon Senior Securities.

None.

Item 7. Other Information.

None.

Item 8. Exhibits.

The following is a list of all contracts which the Corporation is a party to, and which currently can reasonably be regarded as material to a security holder of the Corporation as of the date of this Quarterly Report:

- Amended Line of Credit Agreement, dated as of September 1, 2017, between Wells Fargo Bank and the Company.
- Lease Agreement for 679 River Oaks Parkway, San Jose, California, dated as of December 31, 2013, between Montague Ridge LLC and the Company.
- Amended and Restated Certificate of Incorporation of the Company.
- Second Amended and Restated Bylaws of the Company.
- Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Company.
- Preferred Stock Rights Agreement, dated as of April 21, 2009, between the Company and Computershare Trust Company, N.A., including the Certificate of Designation, the form of Rights Certificate and the Summary of Rights attached thereto as Exhibits A, B and C, respectively.
- Executive Employment Agreement by and between Jeremiah J. Fleming and the Company, dated as of December 18, 2007.
- OEM Agreement between Altisys Communications and the Company, dated as of January 18, 1999.
- Distribution Agreement between Synnex Information Technologies, Inc. and the Company, dated as of December 22, 1999.
- Reseller Agreement between Fiserv Solutions, Inc. and the Company, dated as of August 28, 2009.

Copies of these agreements will be available for inspection at the office of the Corporation located at 679 River Oaks Parkway, San Jose, California 95134, during ordinary business hours.

Item 9. Certifications.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Jeremiah J. Fleming, certify that:

1. I have reviewed this quarterly disclosure statement of Altigen Communications, Inc.;
2. Based on my knowledge, this disclosure statement 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 disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: June 28, 2018

BY: /s/ Jeremiah J. Fleming
Jeremiah J. Fleming
Chairman of the Board, President and Chief Executive Officer

CERTIFICATION OF VICE PRESIDENT OF FINANCE

I, Carolyn David, certify that:

1. I have reviewed this quarterly disclosure statement of Altigen Communications, Inc.;
2. Based on my knowledge, this disclosure statement 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 disclosure statement; and
3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: June 28, 2018

BY: /s/ Carolyn David
Carolyn David
Vice President of Finance