

# ALTIGEN COMMUNICATIONS, INC.

**State of Incorporation: Delaware**

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

**SIC Code: 3661**

**ANNUAL REPORT  
For Fiscal Year Ended September 30, 2018  
(the “Reporting Period”)**

The number of shares outstanding of our common stock, par value \$0.001 per share (“common stock”), is 22,842,246 shares as of September 30, 2018.

The number of shares outstanding of our common stock was 22,798,683 shares as of September 30, 2017.

Indicate by check mark whether the company is a shell company (as defined in Rule 405 of the Securities Act of 1933 and Rule 12b-2 of the Exchange Act of 1934):

Yes:  No:

Indicate by check mark whether the company’s shell status has changed since the previous reporting period:

Yes:  No:

Indicate by check mark whether a change in control of the company has occurred over this reporting period:

Yes:  No:

For more information:  
[www.OTCQB.com](http://www.OTCQB.com) Ticker: ATGN  
or  
[www.altigen.com](http://www.altigen.com)

## **Disclosure Regarding Forward-Looking Statements**

Any reference to “Altigen” (which also may be referred to as the “Company”, “we”, “us” or “our”) means Altigen Communications, Inc. You should read the following discussion of our financial condition and results of operations together with the audited consolidated financial statements and notes to the financial statements included elsewhere in this Annual Report.

This Annual Report contains, and certain other communications made by us contain “forward-looking statements.” Forward-looking statements include, but are not limited to, statements about our financial position, business strategy, competitive position, potential growth opportunities, future operating performance, effects of competition, the effects of future legislation or regulations and plans and objectives of our management for future operations. Any statement made herein that is not a statement of historical fact should be considered a forward-looking statement. We have based our forward-looking statements on our management’s beliefs and assumptions based on information available to our management at the time the statements are made. Use of the words “may,” “should,” “continue,” “plan,” “potential,” “anticipate,” “believe,” “estimate,” “expect,” “intend,” “could,” “project,” “predict” or variations of such words and similar expressions are intended to identify forward-looking statements but are not the exclusive means of identifying such statements. All subsequent written and oral forward-looking statements attributable to us or persons acting on our behalf are expressly qualified in their entirety by the applicable cautionary statements.

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. Forward-looking statements speak only as of the date of this Annual 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 its 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 Annual Report. This Annual 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.

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## PART A - GENERAL COMPANY INFORMATION

### Item 1. The Exact Name of the Issuer and its Predecessor (if any)

Exact name of the issuer: Altigen Communications, Inc.

Exact names of predecessor entities in the past five years and dates of name changes: N/A

### Item 2. The Address of the Issuer's Principal Executive Offices

Principal Executive Offices: 679 River Oaks Parkway  
San Jose, CA 95134  
Telephone: (408) 597-9000  
Facsimile: (408) 597-2020  
Website: [www.altigen.com](http://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](mailto:ir@altigen.com)

### Item 3. The Jurisdiction and Date of the Issuer's Incorporation or Organization

Altigen was incorporated in the state of California in May 1994, and reincorporated in the State of Delaware in June 1999. Altigen is currently active and in good standing with the State of Delaware.

## PART B – SHARE STRUCTURE

### Item 4. The Exact Title and Class of Securities Outstanding

Altigen has only one class of outstanding stock:

Title: Common Stock, par value \$0.001  
CUSIP: 021489109  
OTC Trading Symbol: ATGN

In addition, Altigen has issued options to purchase shares of its common stock. No shares of preferred stock are currently outstanding.

### Item 5. Par or Stated Value and Description of the Security

The Company's outstanding securities consist solely of shares of common stock, par value \$0.001 per share. The Company's Amended and Restated Certificate of Incorporation (the "Certificate of Incorporation") authorizes 50,000,000 shares of common stock. The holders of common stock are entitled to one vote per share on all matters submitted to a vote of the stockholders. Holders of common stock do not have cumulative voting rights. Therefore, holders of more than 50% of the shares of common stock are able to elect all of the Company's directors eligible for election in a given year. The holders of common stock are entitled to dividends if declared by the Company's board of directors (the "Board of Directors"). There are no redemption or sinking fund provisions applicable to the common stock, and holders of common stock are not entitled to any preemptive rights with respect to additional issuances of common stock by the Company.

The Certificate of Incorporation also authorizes 5,000,000 shares of preferred stock, par value \$0.001 per share. The Company may issue these shares of preferred stock without the approval of the holders of common stock. The Board of Directors has the discretion to issue the preferred stock in such series and with such preferences and rights as it may designate, including, among other things, dividend rights, voting rights, conversion rights and liquidation rights as well as redemption or sinking fund provisions.

On April 21, 2009, 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 a share of the Company's Series A Participating Preferred Stock for \$4.00 per share. 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 the Company's common stock while the 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 the Company 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 earlier pursuant to an exchange or redemption of the rights as described above. No shares of the Company's Series A Participating Preferred Stock are currently outstanding. The foregoing statements are subject to, and are qualified in their entirety by reference to, the Plan, including the certificate of designation, the form of rights certificate and the summary of rights attached thereto, which have been filed with the SEC as exhibits to the exhibit filed with the Company's Current Report on Form 8-K on April 23, 2009.

The Company's Second Amended and Restated Bylaws (the "Bylaws") require advance notice relating to certain stockholder business and Board of Director nominees to be considered at stockholder meetings. Under the Bylaws, stockholders are not permitted to call special meetings of stockholders unless they own a majority of the capital stock of the Company.



Altigen was formed in 1994 as a California corporation and was reincorporated in the State of Delaware in 1999. Our primary facility housing research and development, sales and marketing, and administrative functions is located in San Jose, California. We also have a Representative Office in Taipei, Taiwan, which serves as our international office for research and development functions. 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](http://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.

## **RESEARCH AND DEVELOPMENT**

The market for our products is characterized by rapidly changing technology, evolving industry standards and frequent product introductions. We believe that our future success depends in large part upon our ability to continue to enhance the functionality and uses of our core technology. We intend to extend the functionality of our technology and develop new products by continuing to invest in research and development.

We are currently developing enhancements to our products and services to provide greater functionality and increased capacity that we expect will enable us to enhance our position in the Internet protocol phone system market space, enter new geographical markets, and allow us to continue to penetrate the call center market.

The majority of our product development is conducted in-house. We also use a small number of independent contractors to assist with certain product development and testing activities. We intend to continue working with our strategic partners to enhance our products. As of September 30, 2018, we employed 25 employees in engineering, research and development and support.

We believe our future success relies on continued product enhancement. To accomplish this objective, we seek to improve product reliability, advance and broaden employed technologies while maintaining or reducing product cost. In addition, we actively pursue development of potential new products. Our efforts to enhance existing products and develop new products require extensive investment in research and development. We expense research and development costs relating to both present and potential future products in the period incurred. These expenses totaled approximately \$2.8 million during fiscal years 2018 and 2017, respectively. For software developed for sale purposes, we also capitalize certain costs of product development when the projects under development reach technological feasibility. For internal-use software developed as a service, we capitalized costs as incurred. Costs that qualify for capitalization include purchased materials, external services and fully-burdened salaries.

We intend to continue to focus on product innovation, quality improvement, performance enhancement and on-time delivery while striving for product cost improvements to promote added value for our products. We seek growth opportunities through the development of new applications for existing products, technological improvements for both new and existing markets and the acquisition and development of new products and competencies.

## **EMPLOYEES**

As of September 30, 2018, the Company had approximately 46 full-time equivalent employees, including 25 in research and development and support, 11 in sales and marketing, 3 in operations, and 7 in finance and administration. Furthermore, as of September 30, 2018, the Company had an additional 5 full-time equivalent contractors, of which 4 were in research and development, and 1 in sales. Our future success will depend, in part, on our ability to continue to attract, retain and motivate highly qualified technical, marketing, engineering and management personnel.

## COMPETITION

The markets for our products are intensely competitive, continually evolving and subject to changing technologies. We currently compete with Internet protocol and Internet protocol-enabled telecommunications systems, such as Avaya Inc., Mitel Networks Corporation and Cisco Systems, Inc., as well as hosted PBX service providers like 8X8, Ring Central, Inc. and Jive Software, Inc. Many of our competitors are substantially larger than us and have significantly greater name recognition, sales and marketing, financial, technical, customer support and other resources. These competitors also may have more established distribution channels and stronger relationships with local, long distance and Internet service providers. These competitors may be able to respond more rapidly to new or emerging technologies and changes in customer requirements or to devote greater resources to the development, promotion and sale of their products.

These competitors may enter our existing or future markets with products that may be less expensive, that may provide higher performance or additional features or that may be introduced more quickly than our products. Key competitive factors in each of the segments in which we currently compete and may compete in the future include: low cost of ownership, product features, price and performance. We believe that our principal competitive advantages include:

- Fully managed hosted service offering;
- Skype for Business UC Feature set powered by Microsoft;
- Rapid service delivery;
- End-to-end deployment, management and support;
- Ability to reduce communications costs;
- Full featured IP-PBX; and
- Integrated multimedia contact center.

We believe that we compete favorably with our competitors on the basis of these factors. However, if we are not able to compete successfully against our current and future competitors, it will be difficult to acquire and retain customers, and we may experience revenue declines, reduced operating margins, loss of market share and diminished value in our services.

## INTELLECTUAL PROPERTY

We generally rely upon patent, copyright, trademark and trade secret laws to protect and maintain our proprietary rights for our technology and products. As of September 30, 2018, we have been issued three registered trademarks, “Altigen™,” “AltiServ™” and “Zoomerang™.” In addition, the Altigen logo is a trademark of ours in the United States and other jurisdictions. All other trademarks and trade names used in this Annual Report are the property of their respective owners.

We have filed several U.S. patent applications relating to various aspects of our client and server software, mixed-media communications and computer telephony. As of September 30, 2018, we have been issued twenty U.S. patents. The duration of each patent is 20 years from the date of its patent application filing. Our current patents will expire between 2018 and 2025. We expect to continue to file patent applications to protect our technology and products. We cannot be sure that our patent applications will result in the issuance of patents, or that any issued patents will provide commercially significant protection for our technology. We maintain a policy requiring our employees, consultants and other third parties to enter into confidentiality and proprietary rights agreements and to control access to software, documentation and other proprietary information. Notwithstanding the steps we have taken to protect our intellectual property rights, third parties may infringe or misappropriate our proprietary rights. Competitors may also independently develop technologies that are substantially equivalent or superior to the technologies we employ in our products and services.

## LEGAL PROCEEDINGS

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 below, 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.

## *CTI Litigation*

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 (“ATS”), James Jerome Cruz, a former CTI employee, and Thomas W. Welsh, President of ATS, in the Colorado District Court, Larimer County (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, including the Company’s Chief Executive Officer, Jeremiah J. Fleming, Vice President of Sales, Michael Plumer and Regional Sales Manager, Matthew Nielson. On August 16, 2017, the Court dismissed with prejudice all of CTI’s claims against Mr. Fleming. On March 27, 2018, a jury directed a verdict in favor of CTI, and 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. On August 22, 2018, the Court served our financial institution and ordered \$729,000 for the judgment and post-judgment interest through April 30, 2018 be sent to a trust account held by plaintiff’s counsel until further order. Furthermore, after ruling on October 5, 2018, CTI was entitled to recover attorneys’ fees and costs in the amount of \$433,000. The Court served our financial institution on October 23, 2018 with a Writ of Garnishment restricting the Company’s cash in the amount of \$433,000 for the attorney’s fees and costs, and \$29,000 in post-judgment interest through October 23, 2018. The Company filed a Motion for Stay of Execution of Judgement with the Court, and on July 25, 2018, the Company and all defendants in the litigation filed a Notice of Appeal in the Colorado Court of Appeals. The appeal process is ongoing. The Company believes it has meritorious defenses to CTI’s claims and intends to continue to vigorously defend against the claims asserted. The Company, ATS, Mr. Welsh, and Mr. Cruz entered into a settlement agreement on November 29, 2018, pursuant to which the parties thereto allocated damages among themselves and \$557,000 was paid to the Company by such other co-defendants on December 3, 2018. Consequently, the Company recorded litigation expense in the sum of \$604,000, a receivable in the amount of \$557,000, and a payable in the amount of \$433,000 in our consolidated financial statements as of September 30, 2018 and for the fiscal year 2018 in connection with this matter.

## *Matter with Gilbert Hu*

On April 3, 2015, Gilbert Hu, a former member of the 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 sought 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”). On November 28, 2016, the arbitrator issued a verdict in favor of Mr. Hu in the amount of approximately \$725,000, consisting of compensation claims plus legal interest and attorneys’ fees and costs. 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 attorneys’ fees in the sum of \$22,000, such amount was paid in the third quarter of fiscal 2017. Furthermore, on June 2, 2017, the Company and Mr. Hu entered into a settlement agreement to resolve \$46,000 in post-arbitration fees. Pursuant to the terms of the settlement agreement, the Company paid the full amount of the settlement in the third quarter of fiscal 2017.

## **Item 9. The Nature of Products or Services Offered**

The information in Item 8 is incorporated herein by reference.

Altigen’s solutions portfolio is divided into two key categories: Hosted Enterprise Cloud Communications Services and Premise-Based Business Communications Solutions.

### **Hosted Enterprise Cloud Communications Services**

Altigen’s Hosted Enterprise Cloud Communications Services include: Hosted Skype for Business, MaxACD Cloud Contact Center, MaxCS Cloud and Session Initiation Protocol (SIP) Trunking Service.

#### *Hosted Skype for Business*

Hosted by Altigen and powered by Microsoft, Altigen’s Hosted Skype for Business delivers the industry’s leading unified communications service offering instant messaging, voice/video calling, web conferencing, collaboration and mobility. Our innovative Cloud UC service seamlessly incorporates our MaxACD advanced communications applications – consisting of Auto Attendant, Hunt Groups, Multimedia Contact Center, Recording and Reporting – to deliver a unique Skype for Business managed

service. Moreover, Altigen's Hosted Skype for Business reduces complexity, eliminates capital expenditure (CAPEX) and lowers the total cost of ownership versus on premises deployments of Skype for Business.

#### *MaxACD Cloud Contact Center*

MaxACD Cloud Contact Center offers business-critical multimedia routing and queuing apps including: agent/supervisor desktop clients, real-time/historical reporting, automated call recording, CRM integration, auto attendant, advanced skills-based routing and web chat queuing to Skype for Business or Office 365. This innovative solution is hosted in Altigen's Cloud and is fully managed and supported by Altigen and its certified partners. MaxACD provides a comprehensive, cost-effective and easy-to-manage solution that is ideal for Internal departmental service/help desks or external customer facing service/technical support contact centers.

#### *MaxCS Cloud*

MaxCS is an innovative new UC solution combining Altigen's MaxCS IP PBX with Microsoft's industry leading Skype for Business. This uniquely integrated UC solution enables existing Altigen customers to leverage their investment in MaxCS by seamlessly and cost-effectively adding Skype for Business for new functionalities including: instant messaging, presence, web conferencing, and collaboration.

#### *Session Initiation Protocol (SIP) Trunking*

Altigen's SIP Trunk Service is an enterprise grade Voice over Internet Protocol (VoIP) service optimized for Altigen solutions. SIP Trunking Service includes: Direct Inward Dialing (DID) phone numbers, Toll Free, DID/Toll Free porting, and local, long distance and international calling. Leveraging state-of-the-art intelligent call routing and interconnecting with global Tier 1 carriers, Altigen's SIP Trunk Service delivers high quality voice calls at highly competitive rates.

#### *Benefits of Altigen's Hosted Enterprise Cloud Communications Services*

- Enhance Productivity – New advanced UC features and functionality enable businesses to better communicate and collaborate to enhance productivity and efficiency.
- Reduce Monthly Communications Costs – Cost-effective SIP Trunking Service and new modes of communication like instant messaging allow businesses to substantially reduce their monthly communications costs.
- Lower Total Cost of Ownership – With no upfront CAPEX investment and a predictable monthly operational expense based on actual utilization, businesses will be able to realize a lower total cost of ownership.
- Simplified Management and Support – With no hardware to deploy, manage and maintain, the support burden on local IT/Telecom teams is greatly reduced.
- Future Proof Solution – As a hosted managed solution, all hardware and software is kept up to date by Altigen, providing an always up to date solution for the enterprise.

### **Premise-Based Business Communications Solutions**

#### *MaxCS IP-PBX & Contact Center*

MaxCommunications Server (MaxCS) IP-PBX, is a complete state-of-the-art, software-based phone system designed with an open architecture, leveraging today's powerful computing technologies including Intel processors, Microsoft software, and VMware and Hyper-V virtualization. The MaxCS IP-PBX provides customers with a complete business communications solution which includes: Voicemail, Unified Messaging, Mobility, Automatic Call Distribution, Call Recording, Call Activity Reporting, and Mobility solutions. In addition, it supports standard Polycom IP phones to deliver high definition voice quality. Additionally, the system provides intuitive and easy to use system administration software to allow for customer self-administration or remote administration by our authorized reseller partners.

### *MaxACD Voice Over Internet Protocol (VoIP) Contact Center*

Altigen's MaxACD is a complete, all software VoIP contact center solution that seamlessly integrates to our MaxCS business phone system. At the heart of MaxACD is a powerful, software-based automatic call distribution engine which offers sophisticated call routing and call distribution options. It includes a comprehensive call center feature set comprising of agent/supervisor clients, monitoring, management, call reporting and advanced capabilities like skills-based routing, priority queuing, call back from queue, and centralized call recording. MaxACD is ideal for businesses that require a departmental call center for customer service, technical support, telemarketing or collections.

### *MaxACD Contact Center for Microsoft Skype for Business*

MaxACD Contact Center for Microsoft Lync/Skype for Business takes advantage of Altigen's 15 years of contact center technology innovation to deliver a complete, integrated software-based contact center solution. Simple to use and manage, MaxACD is a complete and fully featured contact center solution, which includes: agent/supervisor desktop clients, real-time/historical reporting, automated call recording, CRM integration, auto attendant, advanced skills-based routing and web chat queuing. Entirely software-based, MaxACD utilizes industry standard Intel-based physical or virtual servers, allowing for cost-effective on-site or in-the-cloud deployments.

### *Benefits of Altigen's Premise-Based Business Communications Solutions*

- All Software Advantage – Altigen's Business Communications Solutions are 100% software-based, allowing businesses the flexibility to deploy on cost-effective, open industry standard Intel-based physical or virtual servers.
- Scalability – Altigen's all-software based architecture was designed to scale in both size and capability to meet the evolving needs of the small and medium-sized business and enterprise markets.
- Licensing Flexibility – Businesses have the flexibility to choose from two cost-effective licensing models: Software as a Service monthly subscription or perpetual upfront purchase.
- Reduced Administration Costs – Easy-to-use, point and click graphical user interfaces enable businesses to self-administer their own communications solution.
- Lower Total Cost of Ownership – The ability to leverage open industry standard hardware, cost-effective software licensing and the ability to self-administer enables businesses to reduce their total cost of ownership.

## PRODUCTS

The following is a list of our products that are material to our current operations from a financial standpoint:

<b>Product</b>	<b>Description</b>
MaxCS IP-PBX	MaxCS server software consists of a comprehensive suite of software applications to provide a high value, all-in-one solution. The systems include software and licensing necessary to support analog and VoIP telephones, operator software, and desktop call control software for each extension on the system. By providing a bundled approach, we maintain quality and reliability while providing for easy deployment. The platforms are scalable, and are packaged according to the size of the customer. MaxCS IP-PBX seamlessly integrates with industry standard VoIP devices like Polycom IP phones.
MaxACD VoIP Contact Center	MaxACD is available as a software upgrade to an existing Altigen phone system. This product is capable of skills-based routing, priority queuing, centralized call recording and advanced monitoring and reporting. This capability may be added on a per agent/supervisor basis as a company's needs grow. This allows a smaller business or branch office to enjoy the same capability as a larger organization with a professional call center. If a company has more than one location, calls to call centers can automatically be routed to other locations based on conditions the customer chooses.
MaxMobile	MaxMobile extends a complete set of business PBX functionality to smart phone devices, often eliminating the need for a separate desktop phone. When users log in to MaxMobile, the smart phone is registered as the "business" PBX extension. All inbound business calls are routed through the PBX (so employees don't have to publish their mobile phone numbers). Outbound calls can be routed through the PBX (in accordance with corporate policies) or directly through the cellular network. In every case, MaxMobile graphical user interface extends a multitude of business PBX features to smart phone devices.
MaxCommunicator	MaxCommunicator is a Windows-based desktop application that provides call control and visual voice mail management to the desktop. It allows users to receive and place calls, listen to voicemail messages, identify the caller phone number and manage extension configuration. MaxCommunicator is standard with all Altigen systems.
MaxAgent	MaxAgent is a Windows-based desktop application to bring call control and workgroup information to call center agents. Users can view a call queue, monitor work group status, check caller identification, measure performance, review log-on history, receive and place calls and listen to and manage voicemail messages.
MaxSupervisor	MaxSupervisor is a Windows-based desktop application for call center supervisors. The application allows a call center or workgroup supervisor to effectively manage a workgroup. MaxSupervisor provides four major real time module views for workgroup management: agent status, agent statistics, group statistics, and queue status with a quality of services capability. MaxSupervisor allows coaching, silent monitoring of agents with barge-in call participation and call recording functionality.
MaxACD for Lync	MaxACD for Lync is a robust call center solution with native integration to Microsoft Lync Servers. Similar to Alt>Contact Manager, this product is capable of advanced call distribution, skills-based routing, priority queuing, centralized call recording and advanced monitoring and reporting.

### 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, 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.

### 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 to 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 following table sets forth percentages of net revenue by product type with respect to such revenue for the periods indicated:

	Fiscal Year Ended September 30,		
	2018	2017	2016
Hosted services .....	50%	38%	21%
Service support programs .....	32%	42%	46%
Software .....	16%	14%	21%
Professional services and other .....	2%	6%	12%
Total .....	100%	100%	100%

### Customers

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.

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.

The following table summarizes customers that individually accounted for more than 10% of our total revenue for the periods presented:

	Fiscal Year Ended September 30,		
	2018	2017	2016
Synnex <sup>(1)</sup> .....	—	—	11%
Fiserv <sup>(2)</sup> .....	24%	14%	—
Total .....	24%	14%	11%

(1) During fiscal years 2018 and 2017, revenue generated from Synnex was less than 10% of our total revenue.

(2) During fiscal year 2016, revenue generated from Fiserv was less than 10% of our total revenue.

## MARKETING, SALES AND CUSTOMER SUPPORT

### Marketing

We are organized and operate as 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. Our two geographical segments both sell similar products to similar types of customers. Our marketing efforts currently focus on increasing demand for our solutions in North America and Rest of World, utilizing targeted email campaigns, telemarketing and advertising. In addition, we generate awareness by participating in industry tradeshows, issuing press releases and articulating our messaging through our website. We conduct our marketing activities both domestically and internationally to promote our products independently and in cooperation with our distributors, dealers and strategic partners. Our product information is available on our website, which contains overview presentations and technical information.

### Sales

We market and distribute our products through a worldwide network of sales representatives and we use a broad distribution channel to bring our products and solutions to our customers. Our distribution channel is comprised of distributors and resellers.

We have sales and support staff in various locations throughout the United States. Our inside sales group answers incoming calls from end users and refers new leads to a qualified dealer near each end user’s location. The inside sales group is also responsible for account management of our smaller resellers. Our outside sales force, which is primarily based in North America, includes enterprise account executives and technology solutions managers who work with direct enterprise accounts and larger resellers.

The following table summarizes net revenue and percentages of net revenue by geographic region for each of the past three fiscal years (amounts in thousands, except percentage data).

	Fiscal Year Ended September 30,					
	2018		2017		2016	
	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue
North America .....	\$ 9,959	99.6 %	\$ 8,358	99.6 %	\$ 8,314	98.6 %
Rest of World.....	\$ 43	0.4 %	\$ 30	0.4 %	\$ 117	1.4 %
Total.....	\$ 10,002	100.0 %	\$ 8,388	100.0 %	\$ 8,431	100.0 %

We also have over 130 authorized resellers who sell our products directly to a broad range of end-users. We review our resellers’ performance quarterly and discontinue distribution for those who do not meet our revenue or technical standards.

### Customer Support

We believe that consistent, high-quality service and support are key factors in attracting and retaining customers. Our customer support groups located in California, Minnesota, New Jersey, South Carolina, Texas, Utah and Virginia, coordinate service and technical support of our products and provide service during regular business hours. Outside of regular business hours, we offer after hours support through an on-call engineer. Our support personnel assist our distributors and resellers in resolving installation and support issues that arise from their sales to end users. Resellers and end-user customers can also access technical information and receive technical support through our website.

## RISK FACTORS

A description of the risks and uncertainties associated with our business is set forth below. If any of such risks and uncertainties actually occur, our business, financial condition or operating results could differ materially from the plans, projections and other forward-looking statements included in the section titled “Disclosure Regarding Forward-Looking Statements” and elsewhere in this Annual Report and in our other public filings and press releases. In addition, if any of the following risks and uncertainties, or if any other risks and uncertainties, actually occur, our business, financial condition or operating results could be harmed substantially, which could cause the market price of our stock to decline, perhaps significantly. We cannot assure you that we will successfully address these risks or that other unknown risks exist that may affect our business.

### Risks Related to Our Business

***Any disruption of service at our facilities or our third-party hosting providers could interrupt or delay our customers’ access to our solutions, which could harm our operating results.***

The ability of our customers to access our solutions is critical to our business. We currently serve our customers from third-party data center hosting facilities located in Chicago, Illinois and Phoenix, Arizona, which are setup to provide geographic data backup and redundancy. We cannot assure you that the measures we have taken to eliminate single points of failure in the primary data center and our data recovery center will be effective to prevent or minimize interruptions to our operations. Our facilities are vulnerable to interruption or damage from a number of sources, many of which are beyond our control, including, without limitation:

- extended power loss;
- telecommunications failures from multiple telecommunication providers;
- natural disaster or an act of terrorism;
- software and hardware errors, or failures in our own systems or in other systems;
- network environment disruptions such as computer viruses, hacking and similar problems in our own systems and in other systems;
- theft and vandalism of equipment; and
- actions or events caused by or related to third parties.

Any damage to, or failure of, our systems generally could result in interruptions in our services. Interruptions in our services may reduce our revenue, cause customers to terminate their subscriptions and adversely affect our attrition rates and our ability to attract new customers, all of which would reduce our revenue. Our business would also be harmed if our customers and potential customers believe our services are unreliable.

***We rely on third parties for certain financial and operational services essential to our ability to manage our business. A failure or disruption in these services could materially and adversely affect our ability to manage our business effectively.***

We rely on third parties for certain essential financial and operational services. Traditionally, the vast majority of these services have been provided by large enterprise software vendors who license their software to customers. However, we receive many of these services on a subscription basis from various software-as-a-service companies that are smaller and have shorter operating histories than traditional software vendors. Moreover, these vendors provide their services to us via a cloud-based model instead of software that is installed on our premises. As a result, we depend upon these vendors providing us with services that are always available and are free of errors or defects that could cause disruptions in our business processes, which would adversely affect our ability to operate and manage our operations.

***We May not be able to capitalize on potential emerging market opportunities and new services that we introduce may not generate the revenue and earnings we anticipated, which may adversely affect our business.***

Our business strategy involves identifying emerging market opportunities which we can capitalize on by successfully developing and introducing new services designed to address those market opportunities. We have made and expect to continue to make significant investments in research and development in an effort to capitalize on potential emerging market opportunities that we have identified. Emerging markets and opportunities often take time to fully develop, and they attract a significant number of competitors. If the emerging markets we have targeted ultimately fail to materialize as we or others have anticipated or if potential customers choose to adopt solutions offered by our competitors rather than our own solutions, we may not be able to generate the revenue and earnings we anticipated, and our business and results of operations would be adversely affected.

***We may not be able to respond to rapid technological changes in time to address the needs of our customers, which could have a material adverse effect on our sales and profitability.***

The cloud-based services market is characterized by rapid technological change, the frequent introduction of new services and evolving industry standards. Our ability to remain competitive will depend in large part on our ability to continue to enhance our existing services and develop new service offerings that keep pace with the market's rapid technological developments. Additionally, to achieve market acceptance for our services, we must effectively anticipate and offer services that meet changing customer demands in a timely manner. Customers may require features and capabilities that our current services do not have. If we fail to develop services that satisfy customer requirements in a timely and cost-effective manner, our ability to renew services with existing customers and our ability to create or increase demand for our services will be harmed, and our revenue and results of operations would be adversely affected.

***Our business depends on our customers renewing their software assurance contracts. Any decline in our customer renewals would harm our future operating results and cash flows.***

Customer retention is critical to our future success. In order for us to maintain or improve our operating results, it is important that our customers renew their software assurance contracts when such contracts are eligible for renewal. Our customers have no obligation to renew their contracts upon expiration of term, which is typically one or three years. If our customers are unable or choose not to renew their software assurance contracts, our revenue may decline, and our operating results and cash flows may be harmed.

In certain circumstances, our customers may elect not to renew their software assurance contracts upon expiration of term or may elect to cancel their contracts in order to migrate to our hosting platform. In such circumstances, we will recognize hosted services revenue over a one-year period on a monthly basis as services are delivered. Such shifts will not have a material impact on our revenue but will have a material adverse effect on our cash flows. Unlike our software assurance programs, where customer billing and collections are for the full value of the contract and revenue is recognized ratably over the coverage periods, under our hosted model, customers enter into a one-year service agreement and billing and collections for such services are processed on a monthly basis.

***Because we recognize revenue from subscriptions for our service support programs over the term of the subscription, downturns or upturns in sales may not be immediately reflected in our operating results.***

We generally recognize revenue from our customers ratably over the terms of their subscription agreements, which are typically twelve or thirty-six months. As a result, most of the service support revenue we report in each quarter is derived from subscription agreements entered into during previous quarters. Consequently, a decline in new or renewed subscriptions in any single quarter will likely have a minor impact on our revenue results for that quarter. However, such decline will negatively affect our revenue in future quarters. Accordingly, the effect of significant downturns in sales and market acceptance of our services, and potential changes in our attrition rate, may not be fully reflected in our results of operations until future periods. Our subscription model also makes it difficult for us to rapidly increase our revenue through additional sales in any period, as revenue from new customers must be recognized over the applicable subscription term.

***Our business depends substantially on customers renewing and expanding their hosted subscriptions. Any decline in our customer renewals or expansions would harm our future operating results.***

We sell our application suite pursuant to service agreements that are generally twelve months in length. Our customers have no obligation to renew their subscriptions after their subscription period expires, and they may not renew their subscriptions at the same or higher levels. Our customers' renewal rates may decline or fluctuate because of several factors, including their satisfaction or dissatisfaction with our services, the prices of our services, the prices of services offered by our competitors or reductions in our customers' spending levels due to the macroeconomic environment or other factors. If our customers do not renew their subscriptions for our services, renew on less favorable terms, or do not purchase additional functionality or subscriptions, our revenue may grow more slowly than expected or decline and our profitability and gross margin may be harmed.

***Many of our customers are small- and medium-sized businesses, which may result in increased costs as we attempt to reach, acquire and retain customers.***

We market and sell our application suite to small- and medium-sized businesses. In order for us to improve our operating results and continue to grow our business, it is important that we continually attract new customers, sell additional services to existing customers and encourage existing customers to renew their subscriptions. However, selling to and retaining small- and medium-

sized businesses can be more difficult than selling to and retaining large enterprises because small- and medium-sized business customers:

- are more price sensitive;
- are more difficult to reach with broad marketing campaigns;
- have high churn rates in part because of the nature of their businesses;
- often lack the staffing to benefit fully from our application suite's rich feature set; and
- often require higher sales, marketing and support expenditures by vendors that sell to them per revenue dollar generated for those vendors.

If we are unable to cost-effectively market and sell our service to our target customers, our ability to grow our revenue and become profitable will be harmed.

***Problems such as cyber-attacks, data breaches, or malware may disrupt our operations, harm our operating results and financial condition, and damage our reputation, and cyber-attacks or data breaches on our customers' networks, or in cloud-based services provided by or enabled by us, could result in claims of liability against us, damage our reputation or otherwise harm our business.***

Despite our implementation of network security measures, the products and services we sell to customers, and our servers, data centers and the cloud-based solutions on which our data, and data of our customers, suppliers and business partners are stored, are vulnerable to cyber-attacks, data protection breaches, malware, and similar disruptions from unauthorized tampering or human error. Any such event could compromise our networks or those of our customers, and the information stored on our networks or those of our customers could be accessed, publicly disclosed, lost or stolen, which could subject us to liability to our customers, suppliers, business partners and others, and could have a material adverse effect on our business, operating results, and financial condition and may cause damage to our reputation. Efforts to limit the ability of malicious third parties to disrupt the operations of the Internet or undermine our own security efforts may be costly to implement and meet with resistance and may not be successful. Breaches of network security in our customers' networks, or in cloud-based services provided by or enabled by us, regardless of whether the breach is attributable to a vulnerability in our products or services, could result in claims of liability against us, damage our reputation or otherwise harm our business.

***We may choose to raise additional capital. Such capital may not be available, or may be available on unfavorable terms, which would adversely affect our ability to operate our business.***

We expect that our existing cash balances will be sufficient to meet our working capital and capital expenditure needs for the next twelve months. If we choose to raise additional funds, due to unforeseen circumstances or material expenditures, we cannot be certain that we will be able to obtain additional financing on favorable terms, if at all, and any additional financings could result in additional dilution to our existing stockholders.

***Our market is subject to changing preferences; failure to keep up with these changes would result in our losing market share, thus seriously harming our business, financial condition and results of operations.***

Our customers and end users expect frequent product introductions and have changing requirements for new products and features. In order to be competitive, we need to develop and market new products and product enhancements that respond to these changing requirements on a timely and cost-effective basis. Our failure to do so promptly and cost effectively would seriously harm our business, financial condition and results of operations.

***We may not be able to achieve our strategic initiatives and grow our business as anticipated.***

Beginning in fiscal year 2015, we made a strategic decision to structurally transition from a hardware company in order to leverage our hosted cloud-based model. Our strategic initiatives have required us to devote financial and operational assets to these activities. Our success depends on our ability to appropriately manage our expenses as we invest in these initiatives, develop new solutions and successfully execute our sales strategies. If we are not able to execute on this strategy successfully or if our investments in these activities do not yield significant returns, our business may not grow as we anticipated, we could devote significant resources to developing solutions that never reach commercial success, which could adversely affect our operating results.

***We could become involved in claims or litigations that may result in adverse outcomes.***

From time to time we may be involved in a variety of claims or litigations, including those described in Note 4, “Commitments and Contingencies” of the consolidated financial statements and Part C, Item 8, “The Nature of the Issuer’s Business—Legal Proceedings” of this Annual Report. Such proceeding may initially be viewed as immaterial but could prove to be material. Litigations are inherently unpredictable, and excessive verdicts do occur. Given the inherent uncertainties in litigation, even when we are able to reasonably estimate the amount of possible loss or range of loss and therefore record an aggregate litigation accrual for probable and reasonably estimable loss contingencies, the accrual may change in the future due to new developments or changes in approach. In addition, such claims or litigations could involve significant expense and diversion of management’s attention and resources from other matters.

***Provisions in our charter documents, Delaware law, employment arrangements with certain of our executive officers and Preferred Stock Rights Agreement could discourage a takeover that stockholders may consider favorable.***

Provisions in our Certificate of Incorporation and bylaws may have the effect of delaying or preventing a change of control or changes in our management. These provisions include but are not limited to the following:

- our Board of Directors has the right to increase the size of the Board of Directors and to elect directors to fill a vacancy created by the expansion of the Board of Directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our Board of Directors;
- our Board of Directors is staggered into three (3) classes and each member is elected for a term of 3 years, which prevents stockholders from being able to assume control of the Board of Directors;
- our stockholders may not act by written consent and are limited in their ability to call special stockholders’ meetings; as a result, a holder, or holders controlling a majority of our capital stock would be limited in their ability to take certain actions other than at annual stockholders’ meetings or special stockholders’ meetings called by the Board of Directors, the Chairman of the Board or the President;
- our Certificate of Incorporation prohibits cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;
- stockholders must provide advance notice to nominate individuals for election to the Board of Directors or to propose matters that can be acted upon at a stockholders’ meeting, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer’s own slate of directors or otherwise attempting to obtain control of our company; and
- our Board of Directors may issue, without stockholder approval, shares of undesignated preferred stock; the ability to issue undesignated preferred stock makes it possible for our Board of Directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us.

As a Delaware corporation, we are also subject to certain Delaware anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the Board of Directors has approved the transaction. Our Board of Directors could rely on Delaware law to prevent or delay an acquisition of us.

Certain of our executive officers may be entitled to accelerated vesting of their options pursuant to the terms of their employment arrangements upon a change of control of Altigen. In addition to the arrangements currently in place with some of our executive officers, we may enter into similar arrangements in the future with other officers. Such arrangements could delay or discourage a potential acquisition of Altigen.

Our Board of Directors declared a dividend of one (1) right for each share of common stock under the terms and conditions of a Preferred Stock Rights Agreement by and between Altigen and Computershare Trust Company, N.A., as rights agent, dated April 21, 2009, which right is exercisable for shares of Altigen’s Series A Participating Preferred Stock after the date on which a hostile acquirer obtains, or announces a tender offer for, 15% or more of the Company’s common stock. If an acquirer obtains 15% or more of the Company’s common stock, each stockholder (except the acquirer) may purchase either our common stock or in certain circumstances, the acquirer’s common stock, at a discount, resulting in substantial dilution to the acquirer’s interest. Such rights could delay or discourage a potential acquisition of Altigen.

***We have had a history of losses and may incur future losses, which may prevent us from attaining profitability.***

We have had a history of operating losses since our inception and, as of September 30, 2018, we had an accumulated deficit of \$59.1 million as compared to \$68.9 million as of September 30, 2017. While we attained operating income for each of the fiscal

years ended September 30, 2018 and 2017, we may incur operating losses in the future, and these losses could be substantial and impact our ability to attain profitability. We do not expect to significantly increase expenditures for product development, general and administrative expenses, and sales and marketing expenses; however, if we cannot maintain current revenue or revenue growth, we will not achieve or sustain profitability or positive operating cash flows. Even if we achieve profitability and positive operating cash flows, we may not be able to sustain or increase profitability or positive operating cash flows on a quarterly or annual basis.

***Any failure by us to protect our intellectual property could harm our business and competitive position.***

Our success depends, to a certain extent, upon our proprietary technology. We currently rely on a combination of patent, trade secret, copyright and trademark law, together with non-disclosure and invention assignment agreements, to establish and protect the proprietary rights in the technology used in our products.

Although we have been issued twenty patents and expect to continue to file patent applications, we are not certain that our patent applications will result in the issuance of patents, or that any patents issued will provide commercially significant protection of our technology. In addition, other individuals or companies may independently develop substantially equivalent proprietary information not covered by the patents to which we own rights, may obtain access to our know-how or may claim to have issued patents that prevent the sale of one or more of our products. Also, it may be possible for third parties to obtain and use our proprietary information without our authorization. Our success also depends on trade secrets that cannot be patented and are difficult to protect. If we fail to protect our proprietary information effectively, or if third parties use our proprietary technology without authorization, our competitive position and business will suffer.

***We rely on resellers to promote, sell, install and support our products, and their failure to do so or our inability to recruit or retain resellers may substantially reduce our sales and thus seriously harm our business.***

We rely on resellers who can provide high quality sales and support services. As with our distributors, we compete with other telecommunications systems providers for our resellers' business as our resellers generally market competing products. If a reseller promotes a competitor's products to the detriment of our products or otherwise fails to market our products and services effectively, we could lose market share. In addition, the loss of a key reseller or the failure of resellers to provide adequate customer service could cause our business to suffer. If we do not properly train our resellers to sell, install and service our products, our business will suffer.

***We cannot predict every event and circumstance that may impact our business and, therefore, the risks discussed above may not be the only ones you should consider.***

As we continue to grow our business, we may encounter other risks of which we are not aware as of the date of this Annual Report. These additional risks may cause serious damage to our business in the future, the impact of which we cannot estimate at this time.

## **Risks Related to Our Common Stock**

***Our common stock is classed as a "penny stock." Trading of our stock may be restricted by the SEC's penny stock regulations which may limit a stockholder's ability to buy and sell our common stock.***

Our common stock is a penny stock. The SEC has adopted Rule 15g-9 which generally defines "penny stock" to be any equity security that has a market price (as defined) less than \$5.00 per share, subject to certain exceptions. Our securities are covered by the penny stock rules, which impose additional sales practice requirements on broker-dealers who sell to persons other than established customers and "accredited investors." The term "accredited investor" refers generally to institutions with assets in excess of \$5,000,000 or individuals with a net worth in excess of \$1,000,000 (excluding the value of the primary residence of such individuals) or annual income exceeding \$200,000 or \$300,000 jointly with their spouse. The penny stock rules require a broker-dealer, prior to a transaction in a penny stock not otherwise exempt from the rules, to deliver a standardized risk disclosure document in a form prepared by the SEC which provides information about penny stocks and the nature and level of risks in the penny stock market. The broker-dealer also must provide the customer with current bid and offer quotations for the penny stock, the compensation of the broker-dealer and its salesperson in the transaction and monthly account statements showing the market value of each penny stock held in the customer's account. The bid and offer quotations, and the broker-dealer and salesperson compensation information, must be given to the customer orally or in writing prior to effecting the transaction and must be given to the customer in writing before or with the customer's confirmation. In addition, the penny stock rules require that prior to a transaction in a penny stock not otherwise exempt from these rules, the broker-dealer must make a special written determination that the penny stock is a suitable investment for the purchaser and receive the purchaser's written agreement to the transaction.

These disclosure requirements may have the effect of reducing the level of trading activity in the secondary market for the stock that is subject to these penny stock rules. Consequently, these penny stock rules may affect the ability of broker-dealers to trade our securities. We believe that the penny stock rules discourage investor interest in and limit the marketability of our common stock.

*Trading of our common stock may be volatile and sporadic, which could depress the market price of our common stock and make it difficult for our stockholders to resell their shares.*

There is currently a limited market for our common stock and the volume of our common stock traded on any day may vary significantly from one period to another. Our common stock is quoted on OTC Market's OTCQB. Trading in stock quoted on OTC Market's OTCQB is often thin and characterized by wide fluctuations in trading prices, due to many factors that may have little to do with our operations or business prospects. The availability of buyers and sellers represented by this volatility could lead to a market price for our common stock that is unrelated to operating performance. Moreover, OTC Market's OTCQB is not a stock exchange, and trading of securities quoted on OTC Market's OTCQB is often more sporadic than the trading of securities listed on a stock exchange like NASDAQ. There is no assurance that a sufficient market will develop in the stock, in which case it could be difficult for our stockholders to resell their stock.

#### **Item 10. The Nature and Extent of the Issuer's Facilities**

Our headquarters is located in San Jose, California, where we lease 14,316 square feet of office space. This facility accommodates global sales and marketing, research and development and general and administration functions. The term of the lease for this facility expires in May 2019 with an option to renew for an additional five years or cancel the lease.

We also lease 2,284 square feet of office space in Taipei, Taiwan, which lease expires in December 2020. The facility serves as our international office for research and development functions.

We believe that our existing facilities are adequate and well suited to accommodate our operations. We continuously review space requirements to ensure we have adequate room for growth in the future.

### **PART D - MANAGEMENT STRUCTURE AND FINANCIAL INFORMATION**

#### **Item 11. The Name of the Chief Executive Officer, Members of the Board of Directors, as well as Control Persons**

The information concerning our directors and executive officers required by this Item 11 is incorporated by reference from the information set forth in the sections entitled "Election of Directors" and "Executive Officers" in our Proxy Statement related to the Annual Stockholders Meeting scheduled to be held in 2019 and will be filed by the Company through OTC Disclosure and News Service, available at [www.otcmarkets.com](http://www.otcmarkets.com).

#### **Item 12. Financial Information for the Issuer's Most Recent Fiscal Period**

The following documents are filed as a part of this Annual Report and incorporated herein by reference:

1. Consolidated Financial Statements – The consolidated financial statements listed on the "Index to Consolidated Financial Statements" set forth on page F-1.
2. Exhibits – Certain of the exhibits to this Annual Report are hereby incorporated by reference, as summarized in Part F below.

#### **Item 13. Similar Financial Information for Such Part of the Two Preceding Fiscal Years as the Issuer or its Predecessor Has Been in Existence**

The Company's audited consolidated financial statements for the two preceding fiscal periods are included in the Company's Annual Report for the fiscal years ended September 30, 2017 and 2016, which are separately posted on the OTCQB website and can be accessed at [www.otcmarkets.com](http://www.otcmarkets.com), are incorporated by reference in this Annual Report. The audited consolidated financial statements include the following reports: (i) consolidated balance sheet; (ii) consolidated statements of operations; (iii) consolidated statements of cash flows; (iv) consolidated statements of stockholders' equity; (v) notes to consolidated financial statements; and (vii) audit opinion.

## Item 14. Beneficial Owners

As of September 30, 2018, the following shareholders beneficially own 5% or more of our common stock:

<u>Name and Address of Shareholder</u>	<u>Position with the Company</u>	<u>Shares Beneficially Owned</u>	<u>Ownership Percentage Outstanding</u>
Jeremiah J. Fleming c/o Altigen Communications, Inc. 679 River Oaks Parkway San Jose, CA 95134	Chief Executive Officer, President and Chairman of the Board of Directors	3,433,409	15.0%

The Company is not aware of any additional beneficial shareholders owning 5% or more of its common stock. It is possible that there are additional beneficial holders of a significant percentage of the Company's common stock; however, federal securities laws do not require a beneficial shareholder of 5% or more of the Company's common stock to disclose that information publicly or to the Company. The table above is based on the best information available to the Company as of the date of this Annual Report.

## Item 15. The Name, Address, Telephone Number, and Email Address of Each of the Advisors to the Issuer on Matters Relating to Operations, Business Development and Disclosure:

Securities Counsel:

Perkins Coie LLP  
1900 Sixteenth Street Suite 1400  
Denver, CO 80202-5255  
Telephone: (303) 291-2342  
Email: [AVillier@perkinscoie.com](mailto:AVillier@perkinscoie.com)

Auditor:

Moss Adams LLP  
635 Campbell Technology Parkway  
Campbell, CA 95008  
Telephone: (408) 916-0565  
Email: [arlene.chan@mossadams.com](mailto:arlene.chan@mossadams.com)

Tax Accountant:

Moss Adams LLP  
3100 Zinfandel Drive, 5<sup>th</sup> Floor  
Rancho Cordova, CA 95670  
Telephone: (916) 503-8152  
Email: [mark.harrison@mossadams.com](mailto:mark.harrison@mossadams.com)

Preparation of Altigen's consolidated financial statements is the responsibility of the Company. Altigen's independent auditors, Moss Adams LLP, are responsible for expressing an opinion on these consolidated financial statements based on its audit.

## Item 16. Management's Discussion and Analysis or Plan of Operation

*The following discussion should be read in conjunction with the information contained in our consolidated financial statements, including the notes thereto, and the other financial information appearing elsewhere in this Annual Report. Statements regarding future financial and operating performance, management's plans and objectives, and any statements concerning assumptions related to the foregoing contained in this Management's Discussion and Analysis or Plan of Operation constitute forward-looking statements. See "Disclosure Regarding Forward-Looking Statements." Certain factors, which may cause actual results to vary materially from these forward-looking statements, accompany such statements or appear elsewhere in this Annual Report, including without limitation, the factors disclosed under "Risk Factors" in Item 9 of this Annual Report.*

## 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 ("U.S. GAAP"). 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 to be its critical accounting policies.

### ***Revenue Recognition***

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 when delivery has occurred, or services have been rendered, 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.

### ***Hosted Services***

Hosted service revenue is generated from the sale of subscriptions to our software applications and related 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. 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 U.S. GAAP, 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. For fiscal years 2018 and 2017, hosted revenue accounted for 50% and 38%, respectively, of our total revenue.

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. Short-term service support deferred revenue was approximately \$1.0 million and \$1.3 million as of September 30, 2018 and 2017, respectively. Long-term service support deferred revenue was approximately \$221,000, as compared to \$247,000 as of September 30, 2018 and 2017, respectively. Service support revenue accounted for 32% and 42% of our total revenue for fiscal years 2018 and 2017, respectively. Our service plan offering remains a key part of our business as we continue to add new service customers.

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.

### ***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 September 30, 2018, cash, cash equivalents and restricted cash totaled approximately \$3.1 million, as compared to \$3.9 million at September 30, 2017. Restricted cash was approximately \$800,000 and \$1.0 million as of September 30, 2018 and 2017, respectively, and is presented as part of our cash, cash equivalents and restricted cash in our consolidated balance sheets.

## Results of Operations

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

	Fiscal Year Ended September 30,		
	2018	2017	2016
Net revenue:			
Hosted services .....	50.0 %	38.2 %	21.4 %
Service support programs .....	31.9	42.4	45.9
Software .....	16.1	13.4	21.2
Professional services and other .....	2.0	6.0	11.5
Total net revenue.....	100.0	100.0	100.0
Cost of revenue:			
Hosted services .....	16.1	13.8	5.6
Software.....	0.5	0.3	0.2
Professional services and other .....	(0.2)	1.0	11.4
Total cost of revenue.....	16.4	15.1	17.2
Gross profit .....	83.6	84.9	82.8
Operating expenses:			
Research and development .....	28.3	34.0	34.4
Sales and marketing .....	21.5	23.7	26.2
General and administrative .....	16.3	21.7	25.3
Litigation <sup>(1)</sup> .....	6.0	0.8	6.8
Total operating expenses.....	72.1	80.2	92.7
Income (loss) from operations .....	11.5	4.7	(9.9)
Interest and other (expense) income, net .....			
Interest and other income, net .....	0.2	0.1	—
Interest expense.....	(0.2)	(0.2)	(0.1)
Total interest and other (expense) income, net .....	(0.0)	(0.1)	(0.1)
Income (loss) before income taxes.....	11.5	4.6	(10.0)
Benefit from (provision for) income taxes .....	86.9	(0.1)	0.1
Net income (loss).....	98.4 %	4.5 %	(9.9) %

(1) Refer to Note 4, “Commitments and Contingencies” of the Consolidated Financial Statements and Part C, Item 8, “The Nature of the Issuer’s Business—Legal Proceedings” of this Annual Report.

## Results of Operations—Fiscal Year 2018 Compared to Fiscal Year 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.

The following table presents net revenue, by geographic region, as a percentage of total revenue for the periods indicated (amounts in thousands, except percentage data).

	Fiscal Year Ended September 30,					
	2018			2017		
	Net Revenue	% of Net Revenue		Net Revenue	% of Net Revenue	
North America.....	\$ 9,959	99.6	%	\$ 8,358	99.6	%
Rest of World.....	\$ 43	0.4	%	\$ 30	0.4	%
Total.....	\$ 10,002	100.0	%	\$ 8,388	100.0	%

For fiscal years 2018 and 2017, one customer (Fiserv) accounted for approximately 24% and 14% of our total revenue, respectively.

### 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 hosted services is expensed as incurred. Cost of revenue also includes amortization of capitalized software development costs, and other allocated overhead expenses.

For the twelve months ended September 30, 2018, cost of hosted services was \$1.6 million, or 16% of net revenue, compared to \$1.2 million, or 14% of net revenue for 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, may 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 fiscal years 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 compensation expenses. Costs incurred by the Company in connection with providing such services are charged to expense as incurred. For fiscal years 2018 and 2017, the related cost of professional services and other revenue was immaterial.

### Research and Development (“R&D”) Expenses

R&D expenses consist primarily of salaries, benefits and overhead expenses, non-cash stock-based compensation, consultant fees, 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 both fiscal years 2018 and 2017, R&D expenses totaled \$2.8 million. R&D expense as a percentage of revenue decreased from 34% in fiscal year 2017 to 28% in fiscal year 2018. During fiscal year 2018, costs related to product development that qualify for capitalization were approximately \$333,000.

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 and as percentage of revenue as we expand our international development division, and as we continue to invest in the development of new solutions and expand our product and service offerings. While our main R&D activities for our products and services are conducted in the United States, we also have additional design and development engineering teams located in China and 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.

Sales and marketing expenses increased 8% to \$2.1 million in fiscal year 2018 from \$2.0 million in fiscal year 2017 due to higher headcount related costs and higher trade show expenses. As a percentage of net revenue, sales and marketing expenses decreased from 24% in fiscal year 2017 to 22% in fiscal year 2018.

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 commissions expense, although we will continue to maintain a prudent expense philosophy. 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.

General and administrative expenses decreased 11% to \$1.6 million in fiscal year 2018 from \$1.8 million in fiscal year 2017. As a percentage of revenue, general and administrative expenses decreased to 16% in fiscal year 2018 from 22% in fiscal year 2017. The decrease in 2018 compared to 2017 was primarily driven by reduced service fees of \$43,000 and reduced legal expenses of \$117,000, predominantly due to our continued efforts to limit the growth of our operating expenses through initiatives that are helping drive operational improvement throughout our organization.

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, cash equivalents and restricted cash. The Company recorded \$19,000 and \$16,000 as interest expense in fiscal years 2018 and 2017, respectively, as compared to interest income of \$18,000 and \$9,000, respectively.

### **Revolving Line of Credit**

On September 1, 2018, we amended the credit agreement governing our Revolving Line of Credit Note (“Line of Credit”) with our primary financial lender. Under the renewed terms, the Line of Credit was extended for a period of one year and expires on August 31, 2019. The total amount available for the Company to borrow was reduced from \$1.0 million to \$800,000. The terms of the Line of Credit also require us to maintain restricted cash with our financial institution equal to the aggregate principal amount of \$800,000 as collateral. The restricted cash is included in our cash, cash equivalents and restricted cash in our consolidated balance sheets as of September 30, 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% (2.992% at September 30, 2018), and the interest rate is reset monthly. For the twelve months ended September 30, 2018 and 2017, interest expense associated with the Line of Credit was approximately \$19,000 and \$16,000, respectively.

As of September 30, 2018, the availability under the Line of Credit was approximately \$81,000 and we had outstanding borrowings of \$719,000, which is 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, 2019.

## 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 September 30, 2018, total cash, cash equivalents and restricted cash represents approximately 59% of total current assets. We believe our cash and cash equivalents and our ability to access capital through our debt arrangements will satisfy our operations through at least the next 12 months from December 22, 2018, the date our consolidated financial statements were available to be issued.

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

	Fiscal Year Ended September 30,		
	2018	2017	2016
	(amounts in thousands)		
Cash, cash equivalents and restricted cash, beginning	\$ 3,876	\$ 4,490	\$ 4,560
Cash (used in) provided by operating activities .....	(263)	(469)	290
Cash (used in) provided by investing activities.....	(390)	5	(60)
Cash used in financing activities .....	(143)	(150)	(300)
Cash, cash equivalents and restricted cash, end of year .....	<u>\$ 3,080</u>	<u>\$ 3,876</u>	<u>\$ 4,490</u>

### *Cash (Used in) Provided by Operating Activities*

During the twelve months ended September 30, 2018, cash used in operating activities of \$263,000 was a result of \$1.5 million decrease in net change in operating assets and liabilities, non-cash adjustments to net income of \$78,000, offset by net income of \$9.8 million. Impacting the change in net income was a one-time, non-cash release of the valuation allowance for deferred tax assets of \$8.7 million. The Company's fourth quarter financial results include the reversal of a portion of the valuation allowance recorded against the deferred tax assets. Refer to Item 8 – Income Taxes for additional information. Other non-cash expense items consist of depreciation and amortization and stock-based compensation expenses.

Cash used in operating activities of \$469,000 during fiscal year 2017 was a result of \$944,000 decrease in net change in operating assets and liabilities, non-cash adjustments to net income of \$96,000, offset by net income of \$379,000. Non-cash items consist of depreciation and amortization and stock-based compensation expenses. The decrease in operating assets and liabilities was primarily attributable to a litigation expense related to a civil lawsuit paid in the first quarter of fiscal year 2017. For additional information regarding claims and litigations, please refer to Note 4, “Commitments and Contingencies” of the Consolidated Financial Statements and Part C, Item 8, “The Nature of the Issuer’s Business—Legal Proceedings” of this Annual Report.

### *Cash Provided by (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 during fiscal year 2018 primarily related to capital expenditures of property and equipment of approximately \$77,000, capitalized software totaling \$333,000 and changes in long-term deposits of \$20,000. Cash provided by investing activities during fiscal year 2017 was \$5,000.

### *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 \$143,000 during 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 \$7,000. Cash used in financing activities during fiscal year 2017 was primarily the result of cash outflow used to pay down the principal balance on our revolving line of credit of \$150,000.

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 one year from December 22, 2018, the date our consolidated financial statements were available to be issued.

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.

The current bank line of credit with our financial institution extends through August 2019 and permits borrowings up to \$800,000. We anticipate renewal of this line. In the event such a renewal does not occur, we believe we have adequate cash to address the debt services requirements.

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 September 30, 2018. We had total outstanding commitments on non-cancelable operating leases of approximately \$273,000 as of September 30, 2018. Lease terms on our existing operating leases are generally three years.

#### *Contractual Obligations*

The Company's existing operating lease for its headquarters located in San Jose, California expires in May 2019, and the Company plans to vacate this space at that time. The Company is in the process of negotiating a new lease and expects to complete the move prior to May 2019. The following table presents certain commitments that will require the use of cash in future periods under contractual obligations with minimum firm commitments as of September 30, 2018 (amounts in thousands):

<b>Contractual Obligations</b>	<b>Total</b>	<b>Payments Due in Less Than 1 Year</b>	<b>Payments Due in 1 - 3 Years</b>	<b>Payments Due in 4 - 5 Years</b>	<b>Payments Due in More Than 5 Years</b>
Operating lease obligations <sup>(1)</sup> .....	\$ 273	\$ 220	\$ 53	\$ —	\$ —

(1) Refer to discussion of "Commitments and Contingencies" Note 4 to Consolidated Financial Statements.

#### **Off-Balance Sheet Arrangements**

As of September 30, 2018, we did not have any off-balance sheet arrangements.

## PART E - ISSUANCE HISTORY

### Item 17. List of Securities Offerings and Shares Issued for Services in the Past Two Years

The following table sets forth information about options to acquire shares of Altigen common stock issued in the past two fiscal years:

<b>Date of Issuance</b>	<b>Type of Security Issued</b>	<b>Person/Entity</b>	<b>Number of Shares of Underlying Common Stock</b>	<b>Per Share Exercise Price</b>	<b>Trading Status</b>	<b>Legend Yes/No</b>
7/24/2018	Stock option	Employees	5,000	\$0.52	Restricted	Yes
4/18/2018	Stock option	Employees	7,000	\$0.50	Restricted	Yes
11/28/2017	Stock option	Employees	91,000	\$0.28	Restricted	Yes
7/25/2017	Stock option	Board of Directors	40,000	\$0.28	Restricted	Yes
7/25/2017	Stock option	Employees	50,000	\$0.28	Restricted	Yes
11/29/2016	Stock option	Employees	15,000	\$0.18	Restricted	Yes

## **PART F - EXHIBITS**

### **Item 18. Material Contracts**

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

- Amended Line of Credit Agreement, dated as of September 1, 2018, 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 Company located at 679 River Oaks Parkway, San Jose, California 95134, during ordinary business hours.

### **Item 19. Articles of Incorporation and Bylaws**

The information required by this Item 19 has been included in the Company's previous filings with the SEC, and is herein incorporated by reference. There have been no amendments to the Certificate of Incorporation or the Bylaws since those previously filed with the SEC.

### **Item 20. Purchases of Equity Securities by the Issuer and Affiliated Purchasers**

There were no purchases of equity securities by the Company or Affiliated Purchasers as defined in Item 20 of the OTC Disclosure Guidelines during fiscal year 2018.

**Item 21. Issuer's Certifications**

**CERTIFICATION OF CHIEF EXECUTIVE OFFICER**

I, Jeremiah J. Fleming, certify that:

1. I have reviewed this annual 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: December 31, 2018

/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 annual 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: December 31, 2018

/s/ Carolyn David

Carolyn David

Vice President of Finance

**ALTIGEN COMMUNICATIONS, INC.**  
**INDEX TO CONSOLIDATED FINANCIAL STATEMENTS**

The following consolidated financial statements are filed as part of this report:

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Consolidated Balance Sheets as of September 30, 2018 and 2017 .....	F-3
Consolidated Statements of Operations for the years ended September 30, 2018, 2017 and 2016 .....	F-4
Consolidated Statements of Stockholders' Equity for the years ended September 30, 2018, 2017, and 2016....	F-5
Consolidated Statements of Cash Flows for the years ended September 30, 2018, 2017, and 2016.....	F-6
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## REPORT OF INDEPENDENT AUDITORS

To the Board of Directors and Stockholders of  
Altigen Communications, Inc.

### **Report on Financial Statements**

We have audited the accompanying consolidated financial statements of Altigen Communications, Inc. (the “Company”), which comprise the consolidated balance sheets as of September 30, 2018 and 2017, and the related consolidated statements of operations, stockholders’ equity and cash flows for the years ended September 30, 2018, 2017, and 2016, and the related notes to the financial statements.

### ***Management’s Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of consolidated financial statements that are free from material misstatement, whether due to fraud or error.

### ***Auditor’s Responsibility***

Our responsibility is to express an opinion on these consolidated financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor’s judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity’s preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity’s internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Altigen Communications, Inc., as of September 30, 2018 and 2017, and the consolidated results of their operations and their cash flows for the years ended September 30, 2018, 2017, and 2016, in accordance with accounting principles generally accepted in the United States of America.

/s/ Moss Adams LLP

Campbell, California  
December 22, 2018

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

	September 30,	
	2018	2017
<b>ASSETS</b>		
Current assets:		
Cash, cash equivalents and restricted cash .....	\$ 3,080	\$ 3,876
Trade receivables, less allowance for doubtful accounts of \$0 and \$2 at September 30, 2018 and 2017, respectively .....	531	255
Other receivables .....	557	—
Prepaid expenses and other current assets .....	1,065	144
Total current assets .....	5,233	4,275
Property and equipment, net .....	78	46
Capitalized software development costs, net .....	327	—
Deferred tax assets .....	8,713	—
Long-term deposit .....	11	31
Total assets .....	\$ 14,362	\$ 4,352
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable .....	\$ 62	\$ 45
Accrued compensation and benefits .....	284	—
Revolving line of credit .....	719	869
Accrued expenses .....	822	530
Deferred revenue, short-term .....	1,041	1,297
Total current liabilities .....	2,928	2,741
Deferred revenue, long-term .....	221	247
Deferred rent, long-term .....	—	25
Total liabilities .....	3,149	3,013
Commitments and contingencies (Note 4)		
Stockholders' equity:		
Convertible preferred stock, \$0.001 par value; Authorized—5,000,000 shares; Issued and outstanding—none at September 30, 2018 and 2017 .....	—	—
Common stock, \$0.001 par value; Authorized—50,000,000 shares; Issued and outstanding—22,842,246 shares at September 30, 2018 and 22,798,683 shares at September 30, 2017 .....	25	25
Treasury stock at cost—1,918,830 shares at September 30, 2018 and September 30, 2017 .....	(1,565)	(1,565)
Additional paid-in capital .....	71,857	71,823
Accumulated deficit .....	(59,104)	(68,944)
Total stockholders' equity .....	11,213	1,339
Total liabilities and stockholders' equity .....	\$ 14,362	\$ 4,352

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

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

	<b>Fiscal Year Ended September 30,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
<b>Net revenue:</b>			
Hosted services .....	\$ 5,001	\$ 3,206	\$ 1,807
Service support programs .....	3,186	3,555	3,871
Software .....	1,611	1,126	1,786
Professional services and other .....	204	501	967
Total net revenue .....	10,002	8,388	8,431
<b>Cost of revenue:</b>			
Hosted services .....	1,613	1,160	468
Software .....	54	24	16
Professional services and other .....	(22)	86	967
Total cost of revenue .....	1,645	1,270	1,451
Gross profit .....	8,357	7,118	6,980
<b>Operating expenses:</b>			
Research and development .....	2,830	2,847	2,898
Sales and marketing .....	2,149	1,988	2,211
General and administrative .....	1,625	1,824	2,135
Litigation <sup>(1)</sup> .....	604	70	568
Total operating expenses .....	7,208	6,729	7,812
Income (loss) from operations .....	1,149	389	(832)
<b>Interest and other (expense) income, net:</b>			
Interest and other income, net .....	18	9	4
Interest expense .....	(19)	(16)	(13)
Total interest and other (expense) income, net .....	(1)	(7)	(9)
Income (loss) before income taxes .....	1,148	382	(841)
Benefit from (provision for) income taxes .....	8,692	(3)	6
Net income (loss) .....	\$ 9,840	\$ 379	\$ (835)
<b>Net income (loss) per share:</b>			
Basic .....	\$ 0.43	\$ 0.02	\$ (0.04)
Diluted .....	\$ 0.40	\$ 0.02	\$ (0.04)
<b>Shares used to compute net income (loss) per share:</b>			
Basic .....	22,820	22,799	22,799
Diluted .....	24,767	23,555	22,799

(1) Refer to Note 4, “Commitments and Contingencies” of the Consolidated Financial Statements and Part C, Item 8, “The Nature of the Issuer’s Business—Legal Proceedings” of this Annual Report.

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

**ALTIGEN COMMUNICATIONS, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**  
**YEARS ENDED SEPTEMBER 30, 2018, 2017 AND 2016**  
(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>				
<b>Balance at September 30, 2015</b>	22,798,683	\$ 25	\$ (1,565)	\$ 71,540	\$ (68,488)	\$ 1,512
Net loss .....	—	—	—	—	(835)	(835)
Stock-based compensation .....	—	—	—	266	—	266
<b>Balance at September 30, 2016</b>	22,798,683	25	(1,565)	71,806	(69,323)	943
Net income .....	—	—	—	—	379	379
Stock-based compensation .....	—	—	—	17	—	17
<b>Balance at September 30, 2017</b>	22,798,683	25	(1,565)	71,823	(68,944)	1,339
Net income .....	—	—	—	—	9,840	9,840
Common stock issued under stock plans...	43,563	—	—	7	—	7
Stock-based compensation .....	—	—	—	27	—	27
<b>Balance at September 30, 2018</b>	<u>22,842,246</u>	<u>\$ 25</u>	<u>\$ (1,565)</u>	<u>\$ 71,857</u>	<u>\$ (59,104)</u>	<u>\$ 11,213</u>

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

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

	<b>Fiscal Year Ended September 30,</b>		
	<b>2018</b>	<b>2017</b>	<b>2016</b>
CASH, CASH EQUIVALENTS AND RESTRICTED CASH, BEGINNING OF YEAR	\$ 3,876	\$ 4,490	\$ 4,560
<b>OPERATING ACTIVITIES:</b>			
Net income (loss).....	9,840	379	(835)
Adjustments to reconcile net income (loss) to net cash from activities:			
Depreciation and amortization.....	45	79	56
Deferred income tax benefit .....	(8,713)	—	—
Amortization of capitalized software.....	6	—	—
Stock-based compensation.....	27	17	266
Changes in operating assets and liabilities:			
Accounts receivable.....	(276)	51	97
Inventories .....	—	38	303
Prepaid expenses and other current assets .....	(1,478)	(49)	(41)
Accounts payable.....	17	(17)	(85)
Accrued expenses .....	576	(744)	647
Deferred revenue .....	(282)	(205)	(102)
Deferred rent.....	(25)	(18)	(16)
Net cash (used in) provided by operating activities .....	(263)	(469)	290
<b>INVESTING ACTIVITIES:</b>			
Changes in long-term deposits.....	20	5	(5)
Purchases of property and equipment .....	(77)	—	(55)
Capitalized software development costs.....	(333)	—	—
Net cash (used in) provided by investing activities .....	(390)	5	(60)
<b>FINANCING ACTIVITIES:</b>			
Proceeds from issuances of common stock .....	7	—	—
Proceeds from (payment to) line of credit .....	(150)	(150)	(300)
Net cash used in financing activities.....	(143)	(150)	(300)
Net decrease in cash, cash equivalents and restricted cash.....	(796)	(614)	(70)
CASH, CASH EQUIVALENTS AND RESTRICTED CASH, END OF YEAR	\$ 3,080	\$ 3,876	\$ 4,490

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

**ALTIGEN COMMUNICATIONS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. 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 Microsoft Cloud Solutions provider of premise and cloud-based IP-PBX and Contact Center solutions. As one of the first companies to offer VoIP 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. Altigen has been deploying systems since 1996. Our unique and feature rich Cloud PBX and Multi-channel Contact Center solutions natively integrate with Skype for Business and Office 365 to deliver business-critical functionalities required by SMBs and enterprises.

During fiscal year 2017, the Company established a Representative Office in Taipei, Taiwan, which serves as our international office for research and development functions.

**2. SIGNIFICANT ACCOUNTING POLICIES**

*Basis of Presentation*

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”). The preparation of these consolidated financial statements in conformity with U.S. GAAP requires 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 certain accruals for doubtful accounts reserve, 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.

Our fiscal year end is September 30 of each year. Unless otherwise stated, all references to fiscal years 2018, 2017, and 2016 refer to the twelve months ended September 30 of that year.

The following accounting policies involve a greater degree of judgment and complexity. Accordingly, we believe these are the most critical to fully understand and evaluate our financial condition and results of operations.

*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 September 30, 2018, cash, cash equivalents and restricted cash totaled approximately \$3.1 million, as compared to \$3.9 million at September 30, 2017. Restricted cash was approximately \$800,000 and \$1.0 million as of September 30, 2018 and 2017, respectively, and is presented as part of our cash, cash equivalents and restricted cash in our consolidated balance sheets.

*Trade 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. The Company's allowance for doubtful accounts during fiscal year 2018 and 2017 were not significant. Bad debt expense for fiscal years 2018, 2017 and 2016 were insignificant.

*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 for fiscal years 2018, 2017 and 2016, was approximately \$45,000, \$79,000 and \$56,000, respectively. Repairs and maintenance costs for all 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 fiscal years ended September 30, 2018, 2017 and 2016. During fiscal year 2017, we retired and disposed of \$489,000 of fully depreciated equipment. The disposal of such assets had no impact on our consolidated financial statements.

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

	<b>Fiscal Year Ended September 30,</b>	
	<b>2018</b>	<b>2017</b>
Furniture and equipment .....	\$ 547	\$ 502
Computer software .....	392	392
Leasehold improvements .....	132	100
Total .....	1,071	994
Accumulated depreciation and amortization .....	(993)	(948)
Property and equipment, net.....	\$ 78	\$ 46

*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 to cost of revenue for software sales. To date, we have not capitalized any cost incurred for the development of software to be marketed and sold.

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 to cost of revenue for hosted services.

The following table summarizes capitalized software costs and accumulated amortization as of September 30, 2017 and activities during the twelve months ended September 30, 2018 (in thousands):

	<b>Capitalized Software</b>	<b>Accumulated Amortization</b>	<b>Net</b>
Balance at September 30, 2017 .....	\$ —	\$ —	\$ —
Additions <sup>(1)</sup> .....	333	(6)	327
Balance at September 30, 2018 .....	\$ 333	\$ (6)	\$ 327

(1) Of the \$333,000 of software costs capitalized during the year ended September 30, 2018, approximately \$280,000 is in process and has not yet been launched as of year-end date.

## 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 when delivery has occurred, or services have been rendered, collection of the receivable is reasonably assured, persuasive evidence of an arrangement exists, and the sales price is fixed and determinable. If we determine that any one of the four criteria is not met, recognition of revenue is deferred until all the criteria are met.

**Hosted Services Revenue.** We generate recurring revenue through our cloud-based products referred to as hosted services sold through reseller partners and direct arrangements with end-user customers. Hosted services revenue is derived from providing our proprietary VoIP UC solutions in a hosted environment, in which customers pay a minimum monthly fee to use a specified number of software licenses, plus SIP services. Customers are billed the greater of their minimum monthly fee or actual usage, and revenue is recognized monthly as the services are performed. 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. 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 Revenue.** Service support, also referred to as software assurance, are post-contract customer support (“PCS”) services. We provide software assurance consisting primarily of the latest software updates, patches, new releases and technical support. Such software assurance sales are sold separately from any software licenses. Revenue from service support sales are recognized ratably over the contract term, generally over a period of one year or three years. 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 during the arrangement 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 the 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 Company will only provide such PCS on a rare and limited basis consisting primarily of technical support and bug fixes on installation if the download with the passcode key did not work. The Company does not provide any further PCS after installation in connection with the software license sale. 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.

Net revenue by customers that individually accounted for more than 10% of our revenue during fiscal years 2018, 2017 and 2016 are as follows:

	Fiscal Year Ended September 30,		
	2018	2017	2016
Synnex <sup>(1)</sup> .....	—	—	11%
Fiserv <sup>(2)</sup> .....	24%	14%	—
Total .....	24%	14%	11%

(1) During fiscal years 2018 and 2017, revenue generated from Synnex was less than 10% of our total revenue.

(2) During fiscal year 2016, revenue generated from Fiserv was less than 10% of our total revenue.

## 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 presents our revenue by geographic region and as percentage of net revenue for the periods indicated (amounts in thousands, except percentage data).

	Fiscal Year Ended September 30,					
	2018		2017		2016	
	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue
North America .....	\$ 9,959	99.6 %	\$ 8,358	99.6 %	\$ 8,314	98.6 %
Rest of World .....	\$ 43	0.4 %	\$ 30	0.4 %	\$ 117	1.4 %
Total .....	\$ 10,002	100.0 %	\$ 8,388	100.0 %	\$ 8,431	100.0 %

## Net Income (Loss) Per Share

The Company bases its basic net income (loss) per share upon the weighted average number of common shares outstanding during the period. Basic net income (loss) per common share is computed by dividing the net income (loss) by the weighted-average number of shares of common stock outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock.

The following table shows the computation of basic and diluted net income (loss) per share for the twelve months ended September 30, 2018, 2017 and 2016:

	Fiscal Year Ended September 30,		
	2018	2017	2016
	(amounts in thousands, except per share amounts)		
<b>Numerator:</b>			
Net income (loss) .....	\$ 9,840	\$ 379	\$ (835)
<b>Denominator:</b>			
Weighted-average shares outstanding .....	22,820	22,799	22,799
Effect of dilutive securities .....	1,947	756	—
Weighted average diluted share .....	24,767	23,555	22,799
Basic net income (loss) per share .....	\$ 0.43	\$ 0.02	\$ (0.04)
Diluted net income (loss) per share .....	\$ 0.40	\$ 0.02	\$ (0.04)

Options and warrants to purchase approximately 4.1 million, 4.0 million and 10.8 million shares of common stock were outstanding for the years ended September 30, 2018, 2017 and 2016, respectively, and were excluded from the computation of diluted net earnings per share for these periods because their effect would have been antidilutive.

## 3. REVOLVING LINE OF CREDIT

### Revolving Line of Credit

On September 1, 2018, we amended the credit agreement governing our Revolving Line of Credit Note (“Line of Credit”) with our primary financial lender. Under the renewed terms, the Line of Credit was extended for a period of one year and expires on August 31, 2019. The total amount available for the Company to borrow was reduced from \$1.0 million to \$800,000. The terms of the Line of Credit also require us to maintain restricted cash with our financial institution equal to the aggregate principal amount of \$800,000 as collateral. The restricted cash is included in our cash, cash equivalents and restricted cash in our

consolidated balance sheets as of September 30, 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% (2.992% at September 30, 2018), and the interest rate is reset monthly. For the twelve months ended September 30, 2018 and 2017, interest expense associated with the Line of Credit was approximately \$19,000 and \$16,000, respectively.

As of September 30, 2018, the availability under the Line of Credit was approximately \$81,000 and we had outstanding borrowings of \$719,000, which is 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, 2019.

#### 4. 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 over 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.

In December 2017, the Company entered into a three-year operating lease agreement, which expires in December 2020, for approximately 2,284 square feet of office space located in Taipei, Taiwan. The facility serves as our international office for research and development functions. Pursuant to the terms of the lease agreement, total base rent payment is approximately \$137,000 over a period of three years with one month rent free at the initial term of the lease. Additionally, under the terms of the lease agreement, the Company is 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 September 30, 2018 are as follows:

<b>Fiscal Year</b>	<b>Future Lease Payments</b>	
	<b>(in thousands)</b>	
2018.....	\$	220
2019.....		53
Thereafter .....		—
Total .....	\$	<u>273</u>

##### *Litigation*

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 below, 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.

### *CTI Litigation*

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 (“ATS”), James Jerome Cruz, a former CTI employee, and Thomas W. Welsh, President of ATS, in the Colorado District Court, Larimer County (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, including the Company’s Chief Executive Officer, Jeremiah J. Fleming, Vice President of Sales, Michael Plumer and Regional Sales Manager, Matthew Nielson. On August 16, 2017, the Court dismissed with prejudice all of CTI’s claims against Mr. Fleming. On March 27, 2018, a jury directed a verdict in favor of CTI, and 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. On August 22, 2018, the Court served our financial institution and ordered \$729,000 for the judgment and post-judgment interest through April 30, 2018 be sent to a trust account held by plaintiff’s counsel until further order. Furthermore, after ruling on October 5, 2018, CTI was entitled to recover attorneys’ fees and costs in the amount of \$433,000. The Court served our financial institution on October 23, 2018 with a Writ of Garnishment restricting the Company’s cash in the amount of \$433,000 for the attorney’s fees and costs, and \$29,000 in post-judgment interest through October 23, 2018. The Company filed a Motion for Stay of Execution of Judgement with the Court, and on July 25, 2018, the Company and all defendants in the litigation filed a Notice of Appeal in the Colorado Court of Appeals. The appeal process is ongoing. The Company believes it has meritorious defenses to CTI’s claims and intends to continue to vigorously defend against the claims asserted. The Company, ATS, Mr. Welsh, and Mr. Cruz entered into a settlement agreement on November 29, 2018, pursuant to which the parties thereto allocated damages among themselves and \$557,000 was paid to the Company by such other co-defendants on December 3, 2018. Consequently, the Company recorded litigation expense in the sum of \$604,000, a receivable in the amount of \$557,000, and a payable in the amount of \$433,000 in our consolidated financial statements as of September 30, 2018 and for the fiscal year 2018 in connection with this matter.

### *Matter with Gilbert Hu*

On April 3, 2015, Gilbert Hu, a former member of the 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 sought 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”). On November 28, 2016, the arbitrator issued a verdict in favor of Mr. Hu in the amount of approximately \$725,000, consisting of compensation claims plus legal interest and attorneys’ fees and costs. 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 attorneys’ fees in the sum of \$22,000, such amount was paid in the third quarter of fiscal 2017. Furthermore, on June 2, 2017, the Company and Mr. Hu entered into a settlement agreement to resolve \$46,000 in post-arbitration fees. Pursuant to the terms of the settlement agreement, the Company paid the full amount of the settlement in the third quarter of fiscal 2017.

## **5. STOCKHOLDERS’ EQUITY AND STOCK-BASED COMPENSATION EXPENSE**

### *Equity Offering*

In the first quarter of fiscal year 2014, the Company completed a private placement offering with certain accredited investors and management, pursuant to which the Company sold to the purchasers an aggregate of 6.7 million shares of Company common stock at a purchase price of \$0.15 per share for aggregate gross proceeds of \$1.0 million. Each purchaser also received a warrant to purchase one share of common stock for every share of common stock acquired in the offering with an exercise price of \$0.30 per share. The warrants had a term of three years. The securities offered pursuant to the private placement were not registered under the Securities Act of 1933, as amended, and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. On November 19, 2016, all warrants expired without being exercised.

### 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.

As of September 30, 2018, shares of common stock issuable pursuant to outstanding awards granted under the 2009 Stock Plan were 4.1 million shares. The Company had 2.0 million shares of common stock available for future issuance under the 2009 Stock Plan as of September 30, 2018.

The following table summarizes the Company’s stock option activities under the 2009 Stock Plan during the three fiscal years ended September 30, 2018, 2017 and 2016:

	<b>Options Outstanding</b>	<b>Weighted Average Exercise Price</b>
Outstanding at September 30, 2016 .....	4,148,820	\$ 0.30
Options granted.....	105,000	\$ 0.27
Options forfeited or expired.....	(219,196)	\$ 0.67
Outstanding at September 30, 2017 .....	4,034,624	\$ 0.28
Options granted.....	103,000	\$ 0.31
Options exercised.....	(43,563)	\$ 0.18
Options forfeited or expired.....	(5,937)	\$ 0.27
Outstanding at September 30, 2018 .....	4,088,124	\$ 0.28

Total stock options vested and expected to vest at September 30, 2018 were 4.1 million shares with a weighted average exercise price of \$0.28, aggregate intrinsic value of \$1.0 million and a weighted average remaining contractual term of 5.2 years. The total exercisable stock options at September 30, 2018 were 3.9 million shares with an aggregate intrinsic value of \$957,000, weighted average exercise price of \$0.28 and a weighted average remaining contractual term of 5.0 years.

As of September 30, 2018, the Company had unamortized share-based compensation expense relating to options outstanding of \$16,000, which is expected to be amortized to expense over a weighted average period of 1.4 years. The weighted average grant date fair value of options granted during the years ended September 30, 2018, 2017, and 2016 were \$0.28, \$0.27, and \$0.27, respectively.

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.

The table below provides the range of exercise prices of stock options outstanding and stock options exercisable at September 30, 2018:

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding	Weighted Average Remaining Contractual Term (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$0.16 – \$0.16	2,157,799	5.31	\$ 0.16	2,157,799	\$ 0.16
\$0.18 – \$0.31	317,000	8.05	\$ 0.27	124,894	\$ 0.27
\$0.35 – \$0.35	1,281,037	5.46	\$ 0.35	1,281,037	\$ 0.35
\$0.38 – \$0.50	37,000	7.33	\$ 0.40	24,792	\$ 0.38
\$0.52 – \$0.52	5,000	9.81	\$ 0.52	—	\$ —
\$0.68 – \$0.68	20,000	0.31	\$ 0.68	20,000	\$ 0.68
\$0.74 – \$0.74	35,000	0.49	\$ 0.74	35,000	\$ 0.74
\$0.86 – \$0.86	183,288	0.31	\$ 0.86	183,288	\$ 0.86
\$0.90 – \$0.90	2,000	1.13	\$ 0.90	2,000	\$ 0.90
\$1.03 – \$1.03	50,000	0.25	\$ 1.03	50,000	\$ 1.03
\$0.16 – \$1.03	4,088,124	5.24	\$ 0.28	3,878,810	\$ 0.28

#### 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.

The underlying weighted-average assumptions used in the Black-Scholes model and the resulting estimates of fair value per share were as follows for options granted during the twelve months ended September 30, 2018, 2017 and 2016:

	Fiscal Year Ended September 30,		
	2018	2017	2016
Expected life (in years) .....	7	7	7
Risk-free interest rate .....	2.1-2.8%	1.6-1.9%	1.1-1.4%
Volatility .....	124%-139%	146%-152%	154%-155%
Expected dividend .....	0.0%	0.0%	0.0%

The following table summarizes stock-based compensation expense recognized related to employee and director stock options for the years ended September 30, 2018, 2017 and 2016:

	Fiscal Year Ended September 30,		
	2018	2017	2016
	(amounts in thousands)		
Cost of goods sold .....	\$ —	\$ —	\$ 6
Research and development .....	9	12	66
Sales and marketing .....	7	3	61
General and administrative .....	11	2	133
Total .....	\$ 27	\$ 17	\$ 266

## 6. 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.

## 7. RECENT 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 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 has early adopted this new standard and complied with the disclosure requirements.

## 8. INCOME TAXES

The federal and state income tax provision (benefit) for fiscal 2018, 2017 and 2016 is summarized as follows (in thousands):

	Fiscal Years Ended September 30,		
	2018	2017	2016
<b>Current:</b>			
Federal .....	\$ 9	\$ —	\$ —
State .....	22	1	1
Total current .....	31	1	1
<b>Deferred:</b>			
Federal .....	(6,405)	—	—
State .....	(2,318)	—	—
Total deferred .....	(8,723)	—	—
Income tax provision (benefit) .....	\$ (8,692)	\$ 1	\$ 1

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with ASC 740, *Accounting for Income Taxes*, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carryforwards. Deferred tax assets and liabilities are measured using the currently enacted tax rates that apply to taxable income in effect for the years in which those tax assets are expected to be realized or settled. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed more likely than not to be realized.

The following is a summary of the significant components of the deferred tax asset (in thousands):

	Fiscal Year Ended September 30,	
	2018	2017
Net operating loss carryforwards .....	\$ 12,752	\$ 19,694
Reserve and other cumulative temporary differences .....	181	533
Research and development credit carryforward .....	1,402	1,210
Valuation allowance .....	(5,622)	(21,437)
Net deferred tax asset .....	\$ 8,713	\$ —

As of September 30, 2018, the Company had net operating loss carryforwards for federal income tax purposes of approximately \$52.6 million that expire at various dates through 2038, and federal research and development tax credits of approximately \$1.1 million that expire at various dates through 2038. The Company also had net operating loss carryforwards for state income tax purposes of approximately \$22.7 million that expire at various dates through 2038, and state research and development tax credits of approximately \$696,000, which do not have an expiration date and may be carried forward indefinitely. Utilization of the Company's net operating loss and tax credit carryforwards may be subject to substantial annual limitation due to the ownership change limitations provided by the Internal Revenue Code and similar state provisions. Such an annual limitation could result in the expiration of the net operating loss carryforwards before utilization.

A valuation allowance has been recorded for the entire deferred tax asset as of September 30, 2017, as a result of uncertainties regarding realization of the asset, lack of profitability to date and uncertainty over future operating profitability and taxable income. As of September 30, 2018, the Company reversed a portion of the valuation allowance resulting in a one-time income tax benefit of \$8.7 million. The Company performed an annual evaluation of its deferred tax asset valuation allowance and determined that it is likely that the Company will generate taxable income within the applicable net operating loss carryforward period to realize a portion of its deferred tax assets. This conclusion, and the resulting partial reversal of the deferred tax asset valuation allowance, is based on a number of factors, including the Company's completion of two consecutive years of profitability. During fiscal years 2018, 2017 and 2016, valuation allowance decreased \$15.8 million, \$1.1 million and \$372,000, respectively. As of September 30, 2018, and 2017, the Company had no significant deferred tax liabilities.

Reconciliation between the Company's effective tax rate and the U.S. statutory rate is as follows:

	Fiscal Years Ended September 30,					
	2018		2017		2016	
Tax computed at federal statutory rate.....	34.0	%	34.0	%	35.0	%
Change in valuation allowance .....	(1,377.4)		(291.0)		(44.3)	
State taxes .....	(1.2)		133.1		12.0	
Meals & entertainment.....	0.2		0.4		(0.4)	
Unbenefitted foreign loss.....	—		—		—	
Stock-based compensation.....	0.6		1.1		(8.7)	
ASC 740 liability .....	—		—		—	
Federal rate change from prior year.....	572.3		137.4		—	
Federal credits.....	(4.6)		(14.7)		—	
Expired net operating losses and credits .....	—		—		—	
Other .....	19.1		—		6.4	
Provision for income taxes .....	(757.0)	%	0.3	%	—	%

In October 2007, the Company adopted the FASB's updated guidance related to income taxes, which establishes a single model to address accounting for uncertain tax positions. This updated guidance clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company has reviewed its income tax positions and identified approximately \$274,000 of total gross unrecognized tax benefits of which none, if recognized, would impact the effective tax rate as the Company has a valuation allowance on its research credit carryforward attributes.

A reconciliation of the beginning and ending balances of the total amounts of gross unrecognized tax benefits is as follows (in thousands):

	<b>Total Gross Unrecognized Tax Benefits</b>
Balance at October 1, 2017.....	\$ 274
Additions based on tax positions related to the current year.....	—
Additions based on tax positions of prior years .....	—
Expiration of statutes .....	—
Balance at September 30, 2018.....	\$ 274

Interest and penalties related to unrecognized tax benefits within the provision for taxes on the consolidated statements of operations did not change as a result of implementing the provisions of ASC 740. Management determined that no accrual for interest and penalties was required as of September 30, 2018.

The Company filed a U.S. income tax return and tax returns in various state and local jurisdictions. In the normal course of business, we are subject to examination by taxing authorities throughout the world, including such jurisdictions as United States. With some exceptions, the Company is no longer subject to U.S. federal, state or foreign income tax examinations for fiscal years before 1998. However, to the extent allowed by law, the tax authorities may have the right to examine prior periods where net operating losses or tax credits were generated and carried forward, and make adjustments up to the amount of the net operating loss or credit carryforward amount.

In the ordinary course of the Company's business there are transactions where the ultimate tax determination is uncertain. The Company believes that it has adequately provided for income tax issues not yet resolved with federal, state, local and foreign tax authorities. In the event that actual results differ from these estimates or we adjust these estimates in future periods, an additional charge to expense would result.

## **9. SUBSEQUENT EVENTS**

We have performed an evaluation of subsequent events through December 22, 2018, the date these consolidated financial statements were available to be issued. See Part C, Item 8, “The Nature of the Issuer’s Business—Legal Proceedings” and Note 4, “Commitments and Contingencies,” in connection with the updates in the CTI litigation.