ALTIGEN COMMUNICATIONS, INC.

State of Incorporation: Delaware

670 N McCarthy Blvd, Suite 200
Milpitas, CA 95035
(408) 597-9000
www.altigen.com

SIC Code: 3661

QUARTERLY REPORT
For the quarterly period ended March 31, 2020
(the "Reporting Period")

The number of shares outstanding of our common stock, par value $0.001 per share ("common stock"), is 22,953,345 shares as of March 31, 2020.

The number of shares outstanding of our common stock was 22,914,996 shares as of September 30, 2019.

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 Ticker: ATGN
or
www.altigen.com

ALTIGEN COMMUNICATIONS, INC.
QUARTERLY REPORT
FOR SECOND QUARTER ENDED MARCH 31, 2020

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FORWARD-LOOKING STATEMENTS

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

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

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

Exact name of issuer:	Altigen Communications, Inc.
Principal Executive Offices:	670 N McCarthy Blvd, Suite 200 Milpitas, CA 95035 Telephone: (408) 597-9000 Facsimile: (408) 597-2020 Website: www.altigen.com
Investor Relations Officer:	Carolyn David, Vice President of Finance 670 N McCarthy Blvd, Suite 200 Milpitas, CA 95035 Telephone: (408) 597-9000 Email Address: ir@altigen.com

Item 2. Shares Outstanding.

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

As of March 31, 2020					
Class	Number of Shares Authorized	Number of Shares Outstanding	Freely Tradable Shares (Public Float) (1)	Number of Beneficial Shareholders Owning At Least 100 Shares (2)	Total Number of Stockholders of Record
Common Stock	50,000,000	22,953,345	16,748,446	1,606	80
Preferred Stock	5,000,000	—	—	—	—
As of September 30, 2019					
Class	Number of Shares Authorized	Number of Shares Outstanding	Freely Tradable Shares (Public Float) (1)	Number of Beneficial Shareholders Owning At Least 100 Shares (2)	Total Number of Stockholders of Record
Common Stock	50,000,000	22,914,996	16,710,097	1,572	80
Preferred Stock	5,000,000	—	—	—	—
As of September 30, 2018					
Class	Number of Shares Authorized	Number of Shares Outstanding	Freely Tradable Shares (Public Float) (1)	Number of Beneficial Shareholders Owning At Least 100 Shares (2)	Total Number of Stockholders of Record
Common Stock	50,000,000	22,842,246	16,642,035	1,426	80
Preferred Stock	5,000,000	—	—	—	—

(1) For purposes of this calculation only, shares of common stock held by each of Altigen's directors and officers on the given date and by each person who Altigen knows beneficially owned 5% or more of the outstanding common stock on that date have been excluded in that such persons may be deemed to be affiliates of Altigen. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

(2) Estimate based on beneficial share range analysis, received from Broadridge Financial Solutions, Inc.

Item 3. Interim Financial Statements.

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

	March 31, 2020 Unaudited	September 30, 2019 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 4,860	$ 4,357
Trade receivables	552	371
Prepaid expenses and other current assets	365	287
Total current assets	5,777	5,015
Property and equipment, net	64	84
Operating lease, right-of-use assets	1,001	—
Capitalized software development costs, net	1,511	1,154
Intangible assets, net	389	395
Deferred tax assets	8,453	8,453
Long-term deposit	25	36
Total assets	$ 17,220	$ 15,137
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 111	$ 83
Accrued compensation and benefits	259	227
Accrued expenses	500	478
Operating lease liabilities, current	245	—
Deferred revenue, short-term	929	890
Total current liabilities	2,044	1,678
Operating lease liabilities, long-term	818	—
Deferred rent, long-term	—	62
Deferred revenue, long-term	180	233
Total liabilities	3,042	1,973
Commitments and contingencies (Note 3)		
Stockholders' equity:		
Convertible preferred stock, $0.001 par value; Authorized—5,000,000 shares; Issued and outstanding—none at March 31, 2020 and September 30, 2019	—	—
Common stock, $0.001 par value; Authorized—50,000,000 shares; Issued and outstanding—22,953,345 shares at March 31, 2020 and 22,914,996 shares at September 30, 2019	23	23
Treasury stock at cost—1,918,830 shares at March 31, 2020 and September 30, 2019	(1,565)	(1,565)
Additional paid-in capital	71,908	71,893
Accumulated deficit	(56,188)	(57,187)
Total stockholders' equity	14,178	13,164
Total liabilities and stockholders' equity	$ 17,220	$ 15,137

(1) The information in this column was derived from the Company's audited consolidated financial statements as of and for the year ended September 30, 2019.

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

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2020	**2019**	**2020**	**2019**
Net revenue:				
Hosted services	$ 1,845	$ 1,542	$ 3,549	$ 3,004
Software assurance	663	702	1,385	1,480
Software license	250	215	454	664
Professional services and other	175	81	389	171
Total net revenue	2,933	2,540	5,777	5,319
Cost of revenue:				
Hosted services	604	458	1,202	913
Software license	50	5	82	24
Professional services and other	51	1	57	3
Total cost of revenue	705	464	1,341	940
Gross profit	2,228	2,076	4,436	4,379
Operating expenses:				
Research and development	662	646	1,318	1,260
Sales and marketing	574	520	1,138	1,040
General and administrative	499	485	993	1,045
Litigation (1)	—	12	—	12
Total operating expenses	1,735	1,663	3,449	3,357
Income from operations	493	413	987	1,022
Interest and other income (expense), net				
Interest and other income, net	8	11	16	19
Interest expense	(1)	(5)	(1)	(10)
Total interest and other income, net	7	6	15	9
Income before income taxes	500	419	1,002	1,031
Provision for income taxes	3	16	3	16
Net income	$ 497	$ 403	$ 999	$ 1,015
Net income per share:				
Basic	$ 0.02	$ 0.02	$ 0.04	$ 0.04
Diluted	$ 0.02	$ 0.02	$ 0.04	$ 0.04
Shares used to compute net income per share:				
Basic	22,948	22,866	22,933	22,854
Diluted	26,030	25,650	25,970	25,364

(1) Refer to Note 3, “Commitments and Contingencies” of the Consolidated Financial Statements and Item 5, “Legal Proceedings” of this Quarterly Report.

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

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

	Common Stock										
	Shares		Amount		Treasury Stock		Additional Paid-in Capital		Accumulated Deficit		Total Stockholders' Equity
Balance at September 30, 2019	22,914,996	$	23	$	(1,565)	$	71,893	$	(57,187)	$	13,164
Net income	—		—		—		—		999		999
Common stock issued under stock plans	38,349		—		—		7		—		7
Stock-based compensation	—		—		—		8		—		8
Balance at March 31, 2020	22,953,345	$	23	$	(1,565)	$	71,908	$	(56,188)	$	14,178

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

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

	Six Months Ended March 31, 2020	Six Months Ended March 31, 2019
Cash flows from operating activities:		
Net income	$ 999	$ 1,015
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	20	25
Amortization of intangible assets	80	—
Amortization of capitalized software	142	33
Stock-based compensation	8	13
Changes in operating assets and liabilities:		
Accounts receivable	(181)	166
Prepaid expenses and other current assets	(78)	1,381
Accounts payable	28	82
Accrued expenses	54	(440)
Deferred revenue	(14)	44
Net cash provided by operating activities	1,058	2,319
Cash flows from investing activities:		
Purchases of property and equipment	—	(22)
Changes in long-term deposits	11	—
Acquisition of intangible assets	(74)	—
Capitalized software development costs	(499)	(468)
Net cash used in investing activities	(562)	(490)
Cash flows from financing activities:		
Proceeds from issuances of common stock	7	7
Payment of revolving line of credit	—	(195)
Net cash provided by (used in) financing activities	7	(188)
Net increase in cash and cash equivalents	503	1,641
Cash and cash equivalents, beginning of year	4,357	3,080
Cash and cash equivalents, end of year	$ 4,860	$ 4,721
Supplemental disclosure of non-cash investing and financing activities:		
Right-of-use assets obtained in exchange for operating lease obligations	$ 1,185	$ —

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

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

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

ORGANIZATION AND BASIS OF PRESENTATION

Altigen Communications, Inc. ("Altigen," the "Company," "we," "us" or "our") was incorporated in the State of California in May 1994, and reincorporated in the State of Delaware in June 1999. We are a 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.

The accompanying unaudited 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.

These consolidated financial statements should be read in conjunction with our audited consolidated financial statements for the fiscal year ended September 30, 2019, included in the Company's 2019 Annual Report filed through the OTC Disclosure and News Services on January 3, 2020. The Company's results of operations for any interim period are not necessarily indicative of the results of operations for any other interim period or for a full fiscal year.

CASH AND CASH EQUIVALENTS

We consider all highly liquid investments with original maturities of three months or less to be cash equivalents. Our available cash and cash equivalents are held in time deposits, overnight sweep accounts, and money market funds. At March 31, 2020, the Company's cash and cash equivalents totaled approximately $4.9 million, as compared to $4.4 million at September 30, 2019.

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. For the second quarter of fiscal year 2020, the Company's allowance for doubtful accounts was 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 the first half of fiscal year 2020 and 2019 was approximately $20,000 and $24,000, respectively. Repairs and maintenance costs for the periods presented were immaterial and were expensed as incurred.

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

Property and equipment consist of the following as of March 31, 2020 and September 30, 2019 (in thousands):

	March 31, 2020	September 30, 2019
Furniture and equipment	$ 495	$ 495
Computer software	392	392
Leasehold improvements	53	53
Property and equipment	940	940
Less: accumulated depreciation and amortization	(876)	(856)
Property and equipment, net	$ 64	$ 84

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.

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, 2019 and activities during the six months ended March 31, 2020 (in thousands):

	Capitalized Software	Accumulated Amortization	Net
Balance at September 30, 2019	$ 1,274	$ (120)	$ 1,154
Additions	499	(142)	357
Balance at March 31, 2020	$ 1,773	$ (262)	$ 1,511

REVENUE RECOGNITION AND COST OF REVENUE

On October 1, 2018, we adopted Accounting Standards Update (ASU) No. 2014-09, *Revenue from Contracts with Customers (Topic 606)*, which supersedes the revenue recognition requirements in Accounting Standards Codification (ASC) Topic 605. The Company adopted ASU No. 2014-09 using the modified retrospective method. As a result, the Company is required to disclose the accounting policies in effect prior to October 1, 2018, as well as the policies it has applied starting October 1, 2018. The results for the reporting period beginning after October 1, 2018 are presented in accordance with the new standard, although comparative information for the prior year has not been restated and continues to be reported under the accounting standards and policies in effect for those periods. Adoption of the new standard did not have a significant impact on the current period revenues or on the prior year consolidated financial statements. No transition adjustment was required to be recorded as of October 1, 2018.

Under Topic 606, revenue is recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services.

We determine revenue recognition through the following steps:

- identification of the contract, or contracts, with a customer;
- identification of the performance obligations in the contract;
- determination of the transaction price;
- allocation of the transaction price to the performance obligations in the contract; and

- recognition of revenue when, or as, we satisfy a performance obligation.

We derive our revenue from the sales of hosted services, software assurance, software licenses and professional services. As part of its assessment of each contract, the Company evaluates certain factors including the customer's ability to pay, or credit risk. For each contract, the Company considers the promise to transfer products, each of which is distinct, to be the identified performance obligations. In determining the transaction price, the price stated on the purchase order is typically fixed and represents the net consideration to which the Company expects to be entitled, and therefore there is no variable consideration except for in the Hosted Services Revenue stream. As the Company's standard payment terms are less than one year, the Company has elected, as a practical expedient, to not assess whether a contract has a significant financing component. The Company allocates the transaction price to each distinct product based on its relative standalone selling price which is the Company's standard price list for its products and services. The product price as specified on the purchase order is considered the standalone selling price as it is an observable source that depicts the price as if sold to a similar customer in similar circumstances.

HOSTED SERVICES

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. Hosted services revenues 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. Under ASC 606 and previously under ASC 605, we recognize hosted service revenue in the period when the services are performed.

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.

SOFTWARE ASSURANCE REVENUE

Software assurance services 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. As the software assurance service is provided to the customer throughout the duration of the contractual term, revenue is recognized ratably over the contract term, generally over a period of one year or three years. Sales from our software assurance 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. The amounts of sales commissions relating to software assurance revenue contracts exceeding one year is immaterial and has not been capitalized.

SOFTWARE LICENSE REVENUE

Software license revenue consists of perpetual license revenue that is recognized upon the delivery which transfers control of the software to the customer, 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. The software 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. Our software license revenue consists of direct sales to end-users, resellers and distributors. The related cost of software license 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 services are delivered and accepted by the customer for fixed price contracts. Other revenue consists of deployments and training. Revenue from deployments and training is recognized as the services are performed. Cost of professional services consists primarily of employee-related costs, including stock-based expenses.

ASSETS RECOGNIZED FROM COSTS TO OBTAIN A CONTRACT WITH A CUSTOMER

The Company recognizes an asset for the incremental costs of obtaining a contract with a customer if it expects the benefit of those costs to be longer than one year. The Company has concluded that none of the costs it has incurred to obtain and fulfill its revenue contracts met the capitalization criteria, and as such, there are no costs deferred at March 31, 2020.

PRACTICAL EXPEDIENTS AND EXEMPTIONS

(i) Sales commissions are expensed when incurred because the amortization period would have been one year or less. These costs are recorded in sales and marketing expenses in the consolidated statements of operations.

(ii) The Company does not disclose the value of unsatisfied performance obligations for (i) contracts with original expected lengths of one year or less or (ii) contracts for which the Company recognizes revenue at the amount to which it has the right to invoice for the services performed.

Revenue Recognition Prior to the Adoption of ASC Topic No. 606 on October 1, 2018

We derive our revenue from the sales of hosted services, software assurance, software licenses and professional services. 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 five criteria are not met, recognition of revenue is deferred until all the criteria are met.

CONCENTRATIONS

Our customers are primarily end-users, resellers and distributors. We have distribution agreements with Altisys Communications, Inc. (“Altisys”) and Synnex Corporation (“Synnex”) in North America. Our agreements with Altisys and Synnex have initial terms of one year. Each of these agreements are renewed automatically for additional one-year terms, provided that each party has the right to terminate the agreement for convenience upon ninety (90) days’ written notice prior to the end of the initial term or any subsequent term of the agreement. In addition, our agreements with Altisys and Synnex also provide for termination, with or without cause and without penalty, by either party upon thirty (30) days’ written notice to the other party or upon a party’s insolvency or bankruptcy.

In North America, we also have a reseller agreement with Fiserv Solutions, Inc. (“Fiserv”). The initial term of the agreement expired on August 28, 2019, but automatically renewed for successive five-year term. 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.

Altisys, Synnex and Fiserv, collectively represent approximately 32% of our total net revenue for the three and six months ended March 31, 2020, as compared to 30% and 31%, respectively, for the same periods in fiscal year 2019.

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.

2. LEASES

The Company leases its office space and facilities under cancelable and non-cancelable operating leases, which expire at various dates through 2024. Effective October 1, 2019, the Company adopted ASC 842 using a modified retrospective transition approach which applies the standard to leases existing at the effective date with no restatement of prior periods.

The Company’s operating leases are included in operating lease right-of-use (“ROU”) assets, current portion of operating lease liabilities and long-term portion of operating lease liabilities in our condensed consolidated balance sheets. ROU assets represent the Company’s right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the leases. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. Operating lease payments are recognized as lease expense on a straight-line basis over the lease term. The Company primarily leases buildings which are classified as operating leases. ASC 842 requires a lessee to discount its unpaid lease payments using the interest rate implicit in the lease or, if that rate cannot be readily determined, its incremental borrowing rate. As an implicit interest rate is not readily determinable in our leases, we use our incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The adoption of ASC 842 resulted in the recognition of an operating ROU asset of approximately $1.1 million and operating lease liabilities of approximately $1.1 million. Adoption of the standard did not have a material impact on our Statement of Operations or Statement of Cash flows.

Our office space lease contains an option to extend the lease term for one period of five years. This extension period is not included in our ROU asset or lease liabilities. Our office lease agreement includes both lease and non-lease components, which are accounted for separately. Variable lease expense that is not dependent on an index or rate is not included in the operating lease liabilities or ROU asset and is recognized in the period in which the obligation for those payments is incurred.

The balance sheet presentation of our operating leases is as follows as of March 31, 2020 (in thousands):

		March 31, 2020
Assets:		
Operating lease right-of-use assets	$	1,001
Liabilities:		
Operating lease liabilities – current portion		245
Operating lease liabilities – non-current portion		818
Total lease liabilities	$	1,063

The weighted-average lease term and discount rate for our operating leases from continuing operations are as follows:

	March 31, 2020
Weighted Average Remaining Lease Term	4 years
Weighted Average Discount Rate	3.2%

Maturities of lease liabilities under our non-cancelable operating leases as of March 31, 2020 are as follows (in thousands):

		Operating Leases
Remainder of 2020	$	142
2021		254
2022		254
2023		261
2024		224
Total lease obligations		1,135
Less imputed interest		(72)
Present value of net minimum lease obligations		1,063
Less current portion		(245)
Long term portion	$	818

3. COMMITMENTS AND CONTINGENCIES

Legal Contingencies

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.

Altigen v. CTI

In February 2019, we filed a complaint against CTI Communications, LLC ("CTI"), a former reseller of the Company and Richard Browne, sole owner, in the United States District Court for the District of Colorado. The complaint alleges (i) copyright infringement, (ii) trademark infringement, (iii) common law trademark infringement; and (iv) violation of the Colorado consumer protection act. The complaint seeks damages, attorney fees and costs, and other relief as the court deems equitable and proper. Trial for this matter will begin on July 27, 2020.

CTI v. Altigen

In March 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, civil theft and tortious interference. In March 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. In August 2017, the court dismissed with prejudice all of CTI's claims against Mr. Fleming. In March 2018, a jury rendered a verdict in favor of CTI, and the court entered a judgment that held all defendants jointly and severally liable and awarded CTI approximately $724,000 in compensatory damages, unjust enrichment, punitive damages and pre-judgment interest on compensatory damages. Moreover, in October 2018, the court awarded CTI approximately $433,000 in attorney fees and costs, jointly and severally against all defendants. The Company and all defendants appealed this ruling to the Colorado Court of Appeals, and in October 2019, the court issued its rulings and determined that (i) the underlying judgment was affirmed and the matter was remanded to the trial court, (ii) the judgement for attorneys' fees and costs was vacated and remanded to the trial court, and (iii) civil theft claim against the Company's co-defendants was reinstated and remanded to the trial court to conduct a new trial against the Company's co-defendants.

In January 2020, the trial court rendered its final judgement and awarded CTI approximately $724,000 in damages. The court also awarded CTI post-judgment interest (based on statutory rate) of approximately $115,000 on certain categories of damages. Furthermore, on May 13, 2020, the trial court ordered a final judgment awarding CTI attorney fees and costs and post-judgement interest of approximately $447,000. The trial court also awarded CTI attorney fees of approximately $76,000 for the appellate portion of the case on June 11, 2020. The civil theft claim is currently pending before the trial court. The Company intends to continue to vigorously defend against the claims asserted.

In connection with this matter, the Company recorded litigation expenses totaling $13,00 and $604,000 during fiscal years 2019 and 2018, respectively. Furthermore, in December 2018, the Company, ATS, Mr. Welsh, and Mr. Cruz entered into a settlement agreement pursuant to which the parties thereto allocated damages among themselves and $557,000 was paid to the Company by such other co-defendants.

Intellitalk v. Altigen

In February 2019, the Company was served with a cross-complaint filed by Intellitalk, Inc. ("Intellitalk"), an active reseller of the Company. The cross-complaint was filed in the Superior Court of the State of California, County of Riverside in January 2019. The complaint alleges interference with prospective economic advantage and unfair competition. The Company is currently in the process of filing a motion to dismiss all claims in the Complaint. Although the outcome of this matter is not determinable as of the date of this report, the Company believes Intellitalk's claims are without merit and the Company intends to vigorously defend itself against these allegations. The Company has not recorded an accrual related to this matter as of March 31, 2020, as the Company does not believe a loss is probable or reasonably estimable.

With respect to all litigation, as additional information concerning the estimates used by the Company becomes known, the Company reassesses its position both with respect to accrued liabilities and other potential exposures.

4. INTANGIBLE ASSETS

Intangible assets consist primarily of customer relationships, which are recorded at fair value on the date of acquisition and amortized over their estimated economic lives on a straight-line basis. Intangible assets are reviewed periodically for impairment whenever events and circumstances indicate the carrying value of such assets may not be recoverable and exceed their fair value. If an impairment loss exists, the carrying amount of the intangible asset is adjusted to a new cost basis. The new cost basis is amortized over the remaining useful life of the asset. As of March 31, 2020, there were no indicators of impairment, and no impairment loss was recognized for intangible assets.

Customer Acquisition

In August 2019, the Company entered into an asset purchase agreement with WorkSpace Communications, LLC ("WorkSpace"), pursuant to which, on such date, the Company acquired all of WorkSpace's rights to its customer relationships for $400,000 in cash plus additional contingent cash consideration of up to $1.2 million subject to the terms on which such customers were transitioned to Altigen. In connection with the acquisition, WorkSpace agreed to provide certain transition services on a monthly basis at the Company's expense until such services were no longer needed by the Company. Furthermore, the Company hired certain WorkSpace employees. The purchase price paid in cash at closing was funded with cash from operations, and under the acquisition method of accounting, the purchase price was allocated to intangible assets and is estimated to have a three-year amortization life. For the first half of fiscal year 2020, amortization expense included in cost of goods sold was approximately $80,000.

5. REVOLVING LINE OF CREDIT

In September 2018, we amended the credit agreement governing our Revolving Line of Credit Note ("Line of Credit") with our primary financial lender. The terms of the Line of Credit required us to maintain restricted cash with our financial institution equal to the aggregate principal amount of $800,000 as collateral. The Line of Credit was extended for a period of one year, which expired in August 2019. Upon expiration, we elected not to renew the Line of Credit, and all outstanding borrowings, including interest expense were repaid in full. Our restricted cash was released in September 2019 and is included in our cash and cash equivalents in our condensed consolidated balance sheet as of March 31, 2020.

6. STOCKHOLDERS' EQUITY AND STOCK-BASED COMPENSATION EXPENSE

Equity Stock Incentive Plans

The Company's 2009 Stock Plan (the "2009 Stock Plan") expired in June 2019 and no additional awards were granted under the plan. The 2009 Plan will, however, continue to govern the securities previously granted under the plan. In July 2019, our Board of Directors approved the 2019 Equity Incentive Plan ("2019 Equity Incentive Plan"), which was approved by the Company's stockholders in October 2019 and replaced the 2009 Plan and the shares available for future grants under the plan. Shares reserved under the 2019 Stock Plan include (i) 1,000,000 new shares, plus (ii) 2,277,873 shares which have been reserved but not issued pursuant to any awards under the 2009 Plan, plus (ii) the number of shares subject to outstanding awards under the 2009 Plan that expire or otherwise terminate without having been exercised in full, or are forfeited to or repurchased by the Company, up to a maximum of 3,774,635 shares. The 2019 Stock Plan, provides for the granting of incentive stock options, nonstatutuory stock options, 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 2019 Stock Plan generally vest 25% at one year from the date of grant and 1/48th monthly thereafter. Options under the 2019 Stock Plan will 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.

No grants were made under the 2019 Stock Plan as of March 31, 2020.

The following table summarizes the Company's stock option activity under our plans during the six months ended March 31, 2020:

	Number of Shares	Weighted-Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)
Outstanding at October 1, 2019	3,729,589	$ 0.24		
Granted	—	—		
Exercised	(38,349)	0.16		
Forfeitures and cancellations	(2,000)	0.90		
Outstanding at March 31, 2020	3,689,240	$ 0.24	4.05	$ 3,915,278
Exercisable at March 31, 2020	3,613,974	$ 0.24	3.98	$ 3,839,479

Stock-Based Compensation

The Company accounts for stock-based compensation, including grants of stock options, as an operating expense in the consolidated statement of operations. The Company measures stock-based compensation cost at the grant date based on the fair value of the grant. The value of the portion of the grant that is ultimately expected to vest is recognized as expense over the requisite service periods. Stock-based compensation expense related to employee and director stock options was $2,000 and $8,000 for the three and six months ended March 31, 2020, respectively, compared to $5,000 and $13,000 for the three and six months ended March 31, 2019, respectively.

7. SHAREHOLDER RIGHTS PLAN

In May 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 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. These rights would have 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. The Plan expired on May 7, 2019 without a renewal or replacement Plan. No shares of the Company's Series A Participating Preferred Stock are currently outstanding.

8. SUBSEQUENT EVENTS

As noted in Item 5, "Legal Proceedings" and Note 3, "Commitments and Contingencies," in connection with the CTI litigation, in January 2020, the trial court rendered its final judgement and awarded CTI approximately $724,000 in damages. The court also awarded CTI post-judgment interest (based on statutory rate) of approximately $115,000 on certain categories of damages. Furthermore, on May 13, 2020, the trial court ordered a final judgment awarding CTI attorney fees and costs and post-judgement interest of approximately $447,000. The trial court also awarded CTI attorney fees of approximately $76,000 for the appellate portion of the case on June 11, 2020. The civil theft claim is currently pending before the trial court.

On May 14, 2020 (the "Loan Date"), the Company was granted a PPP Loan from Sonabank in the aggregate amount of $804,000, pursuant to the PPP administered by the SBA and established under Division A, Title I of the CARES Act.

The PPP Loan, which is evidenced by a Note dated the Loan Date issued by the Company (the "Note"), matures on May 14, 2022 and bears interest at a fixed rate of 1.0% per annum, accruing from the Loan Date and payable monthly. No payments are due on the PPP Loan for six months from the date of first disbursement, but interest will continue to accrue during the deferment period. The Note is unsecured and guaranteed by the SBA. The Note may be prepaid by the Company at any time prior to maturity with no prepayment penalties. The Note provides for customary defaults, including failure to make payment when due or to fulfill the Company's obligations under the Note or related documents, reorganizations, mergers, consolidations or other changes to the Company's business structure, and certain defaults on other indebtedness, bankruptcy events, adverse changes in financial condition or civil or criminal actions. The PPP Loan may be accelerated upon the occurrence of a default.

Under the terms of the PPP, the PPP Loan may be forgiven to the extent that funds from the PPP Loan are used for payroll costs and costs to continue group health care benefits, as well as for interest on mortgage obligations incurred before February 15, 2020, rent under lease agreements in effect before February 15, 2020, utilities for which service began before February 15, 2020, and interest on debt obligations incurred before February 15, 2020 (collectively, "qualifying expenses"), subject to conditions and limitations provided in the CARES Act. At least 75% of such forgiven amounts must be used for eligible payroll costs. The Company intends to maximize the use of PPP Loan proceeds for qualifying expenses and intends to apply for forgiveness of the PPP Loan in accordance with the terms of the CARES Act. Whether forgiveness will be granted and in what amount is subject to an application to, and approval by, the SBA and may also be subject to further requirements in any regulations and guidelines the SBA may adopt.

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

These statements are based on current expectations and assumptions regarding future events and business performance and involve known and unknown risks, uncertainties and other factors that may cause industry trends or our actual results, level of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied by these statements. These unaudited interim consolidated financial statements and notes thereto should be read in conjunction with the audited consolidated financial statements and related notes included in our Annual Report for the fiscal year ended September 30, 2019, filed through the OTC Disclosure and News Services on January 3, 2020. The Company undertakes no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Overview

Altigen Communications, Inc. ("Altigen," the "Company," "we," "us" or "our") was incorporated in the State of California in May 1994, and reincorporated in the State of Delaware in June 1999. We are a leading 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.

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

Altigen was formed in 1994 as a California corporation and was reincorporated in the State of Delaware in 1999. Our primary facility housing research and development, sales and marketing, and administrative functions is located in Milpitas, 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. Our common stock trades on the OTCQB U.S. tier under the symbol "ATGN." Trading of our common stock commenced on March 16, 2010 and Pink OTC Markets, Inc. provides quotes and other information at www.otcmarkets.com. The Company has never been in bankruptcy, receivership, or any similar proceeding.

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

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

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

Critical Accounting Policies and Estimates

Management's discussion and analysis of the Company's financial condition and consolidated results of operations is based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States ("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 be its critical accounting policies.

Revenue Recognition

On October 1, 2018, we adopted Accounting Standards Update (ASU) No. 2014-09, Revenue from Contracts with Customers (Topic 606) (ASC 606), which supersedes the revenue recognition requirements in Accounting Standards Codification (ASC) Topic 605. The Company adopted ASU No. 2014-09 using the modified retrospective method. The impact of the adoption of the new revenue standard was not material to our Consolidated Statements of Operations.

Under Topic 606, revenue is recognized when control of the promised goods or services is transferred to our customers, in an amount that reflects the consideration we expect to be entitled to in exchange for those goods or services.

We determine revenue recognition through the following steps:

- identification of the contract, or contracts, with a customer;
- identification of the performance obligations in the contract;
- determination of the transaction price;
- allocation of the transaction price to the performance obligations in the contract; and
- recognition of revenue when, or as, we satisfy a performance obligation.

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. Our customers will typically enter into a one-year service agreement whereby they are billed for such services on a monthly basis. Hosted services revenues 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. Under ASC 606 and previously under ASC 605, we recognized hosted service revenue in the period when the services are performed.

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.

Software Assurance

Software assurance services 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. Software assurance services have an annual subscription and are generally structured with a one-year or three-year term. There was no change in accounting from ASC 605 to ASC 606 relating to such software assurance revenues. Sales from software assurance 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 software assurance deferred revenue was approximately $929,000 and $890,000 as of March 31, 2020 and September 30, 2019, respectively. Long-term software assurance deferred revenue was approximately $180,000 and $233,000 as of March 31, 2020 and September 30, 2019, respectively.

The estimated cost of providing software assurance is insignificant and the upgrades and enhancements offered at no cost during software assurance arrangements have historically been, and are expected to continue to be, minimal and infrequent. All estimated costs of providing the services, including upgrades and enhancements, are recognized over the life of the software assurance contract term. The amounts of sales commission relating to software assurance revenue contracts exceeding one year is immaterial and has not been capitalized.

Software License Revenue

Software license revenue consists of perpetual license revenue that is recognized upon delivery which transfers control of the software to the customer, 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. The software is sold on a standalone basis with no other services or products bundled in. Software license revenue consists of direct sales to end-users, resellers and distributors. There was no change in accounting from ASC 605 to ASC 606 relating to such software license revenue. The related cost of software license 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 contractual milestones are achieved, services are delivered and accepted by the customer for fixed price contracts. Other revenue consists of deployments and training. Revenue from deployments and training is recognized as the services are performed. Cost of professional services consists primarily of employee-related costs, including stock-based expenses.

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

	Three Months Ended March 31,		**Six Months Ended March 31,**	
	2020	**2019**	**2020**	**2019**
Hosted services	63%	61%	61%	56%
Software assurance	23%	28%	24%	28%
Software license	8%	8%	8%	13%
Professional services and other	6%	3%	7%	3%
Total	100%	100%	100%	100%

Cash and Cash Equivalents

We consider all highly liquid investments with original maturities of three months or less to be cash equivalents. Our available cash and cash equivalents are held in time deposits, overnight sweep accounts, and money market funds.

Results of Operations

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

	Three Months Ended March 31,		Six Months Ended March 31,	
	2020	2019	2020	2019
Net revenue:				
Hosted services	62.9 %	60.7 %	61.4 %	56.5 %
Software assurance	22.6	27.6	23.9	27.8
Software license	8.5	8.5	8.0	12.5
Professional services and other	6.0	3.2	6.7	3.2
Total net revenue	100.0	100.0	100.0	100.0
Cost of revenue:				
Hosted services	20.6	18.0	20.8	17.2
Software license	1.7	0.2	1.4	0.5
Professional services and other	1.7	—	1.0	—
Total cost of revenue	24.0	18.2	23.2	17.7
Gross profit	76.0	81.8	76.8	82.3
Operating expenses:				
Research and development	22.6	25.4	22.8	23.7
Sales and marketing	19.6	20.5	19.7	19.6
General and administrative	17.0	19.1	17.2	19.6
Litigation (1)	—	0.5	—	0.2
Total operating expenses	59.2	65.5	59.7	63.1
Income from operations	16.8	16.3	17.1	19.2
Interest and other income (expense), net				
Interest and other income, net	0.3	0.4	0.2	0.4
Interest expense	—	(0.2)	—	(0.2)
Total interest and other income, net	0.3	0.2	0.2	0.2
Income before income taxes	17.1	16.5	17.3	19.4
Provision for income taxes	0.1	0.6	—	0.3
Net income	17.0 %	15.9 %	17.3 %	19.1 %

(1) Refer to Note 3, “Commitments and Contingencies” of the Consolidated Financial Statements and Item 5, “Legal Proceedings” of this Quarterly Report.

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

Results of Operations — Three and Six Months Ended March 31, 2020 Compared to Three and Six Months Ended March 31, 2019

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. Revenue from our products and services is categorized into four groups: hosted services, software assurance, software license and professional services.

For the three and six months ended March 31, 2020, net revenue was $2.9 million and $5.7 million, respectively, compared to $2.5 million and $5.3 million for the three and six months ended March 31, 2019, respectively. The increase in the second quarter was primarily attributable to a 20%, or $303,000 increase in hosted services revenue and an increase of 122%, or $96,000 in professional services revenue. The year-over-year increase was primarily caused by a favorable shift in our product mix resulting in an increase of 18%, or $545,000 in hosted services revenue, an increase of 130%, or $220,000 in professional services revenue, partially offset by a decrease in software license and software assurance revenue.

Cost of Revenue

Cost of cloud 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.

Cost of hosted services was approximately $604,000, or 21% of net revenue and $1.2 million, or 21% of net revenue for the three and six months ended March 31, 2020, respectively, compared to $458,000, or 18% of net revenue and $913,000, or 17% of net revenue for the three and six months ended March 31, 2019, respectively. The increase was primarily attributable to the positive impact of the hosted revenue growth, higher capitalized software development costs and costs related to the WorkSpace customer acquisition. 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 software assurance consists principally of upgrades, enhancements and technical support. Software assurance costs are deferred and recognized to costs of revenue over the contract term. For the three and six months ended March 31, 2020 and 2019, the related cost of software assurance 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 the three and six months ended March 31, 2020 and 2019, 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 the second quarter of fiscal year 2020, research and development expenses were $662,000, 23% of net revenue, compared to $646,000, or 25% of net revenue for the second quarter of fiscal year 2019. For the six months ended March 31, 2020, research and development expenses were $1.3 million, or 23% of net revenue, compared to $1.3 million, or 24% of net revenue for the same period of fiscal year 2019.

Capitalized development costs were $246,000 and $499,000 for the three and six months ended March 31, 2020, respectively, compared with $222,000 and $468,000 for both the three and six months ended March 31, 2019, respectively. Excluding the impact of capitalized development costs, research and development expenses were $908,000 and $1.8 million, respectively, for the three and six months ended March 31, 2020, compared to $868,000 and $1.7 million, respectively, for the comparable prior year period.

The market for our products changes rapidly and is characterized by evolving industry standards, swift changes in customer requirements, and frequent new product introductions and enhancements. We believe that strong product development capabilities are essential to our strategy of maintaining technology leadership. This includes enhancing current technology, providing excellent quality, performance, and functionality, as well as developing additional applications and services, and maintaining the competitiveness of our premise and hosted offerings. 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. Our core R&D activities are conducted in the United States with 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.

For the second quarter of fiscal year 2020, sales and marketing expenses were $574,000, or 20% of net revenue, compared to $520,000, or 21% of net revenue for the second quarter of fiscal year 2019. For the six months ended March 31, 2020, sales and marketing expenses were $1.1 million, or 20% of net revenue, compared to $1.0 million, or 20% of net revenue for the same period of fiscal year 2019.

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 absolute dollars and fluctuate as a percentage of revenue as we continue to support our growth initiatives.

General and Administrative Expenses

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

For the second quarter of fiscal year 2020, general and administrative expenses were $499,000, or 17% of net revenue, compared to $485,000, or 19% of net revenue for the second quarter of fiscal year 2019. For the six months ended March 31, 2020, general and administrative expenses were $993,000, or 17% of net revenue, compared to $1.0 million, or 20% of net revenue for the same period of fiscal year 2019.

We expect general and administrative expenses will continue at their current rate as management continues to monitor expenses and plans to keep them in line with expected revenue opportunities.

Interest and Other (Expense) Income, Net

Interest Income and Expense

Interest income consists primarily of interest earned on our cash and cash equivalents. Interest expense consists of interest charged on the outstanding borrowing of our revolving line of credit. The Company recorded $8,000 as interest income and $1,000 as interest expense in the second quarter of fiscal year 2020, compared to $11,000 of interest income and $5,000 of interest expense in the second quarter of fiscal year 2019. For the six months ended March 31, 2020, the company recorded $16,000 as interest income and $1,000 as interest expense, compared to $19,000 of interest income and $10,000 of interest expense during the same periods in fiscal year 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 March 31, 2020, total cash and cash equivalents represents approximately 84% of total current assets. We believe our cash and cash equivalents and cash generated from our ongoing operations will satisfy our operations through at least the next 12 months from June 29, 2020, the date our consolidated financial statements were available to be issued.

At March 31, 2020, we had working capital of approximately $3.7 million, compared to $2.9 million at March 31, 2019, an increase of $785,000, or 27%.

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

	Six Months Ended March 31,	
	2020	**2019**
Cash, cash equivalents and restricted cash, beginning of period	$ 4,357	$ 3,080
Cash provided by operating activities	1,058	2,319
Cash used in investing activities	(562)	(490)
Cash provided by (used in) financing activities	7	(188)
Cash, cash equivalents and restricted cash, end of period	$ 4,860	$ 4,721

Cash Provided by Operating Activities

During the six months ended March 31, 2020, cash provided by operating activities of $1.1 million was primarily comprised of net income of $999,000, a decrease of $191,000 in operating assets and liabilities coupled with non-cash adjustments of $250,000 in depreciation and amortization and stock-based compensation expenses.

During the six months ended March 31, 2019, cash provided by operating activities of $2.3 million was primarily comprised of net income of $1.0 million, an increase of $1.2 million in operating assets and liabilities coupled with non-cash adjustments of $71,000 in depreciation and amortization and stock-based compensation expenses. Changes in operating assets and liabilities was primarily due to collections of other receivables of $557,000 in connection with the CTI lawsuit. For additional information, refer to Item 5, "Legal Proceedings" of this quarterly report.

Cash Used in Investing Activities

Cash flows from investing activities primarily relate to capitalized software costs associated with the development of new products and services and enhancements of existing products and services, cash paid for acquisitions, as well as, purchase of intangible assets, capital expenditures related to technological equipment, software licenses and to a lesser degree, office equipment. Cash used in investing activities of $562,000 for the six months ended March 31, 2020 was primarily attributable to capitalized software development costs totaling $499,000, cash used in the acquisition of WorkSpace customers totaling $74,000, and changes in long-term deposits of $11,000.

Cash used in investing activities of $490,000 for the six months ended March 31, 2019 was primarily attributable to capitalized software development costs totaling $468,000 and capital expenditures totaling $22,000.

Cash Provided by (Used in) Financing Activities

Our financing activities have consisted primarily of repayments under our revolving line of credit and the net proceeds from the issuance of common stock from employee option exercises. Cash provided by financing activities was approximately $7,000 for the six months ended March 31, 2020, primarily resulting from proceeds from the issuance of common stock under our employee stock purchase plan.

Cash used in financing activities of $188,000 during the second quarter of fiscal year 2019 was primarily the result of cash outflow used to pay down the principal balance on our revolving line of credit of $195,000, offset by proceeds of $7,000 from the exercise of stock options.

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 for at least the next 12 months and foreseeable future.

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

Additional financing, if required, may not be available on favorable terms, or at all. To the extent that existing cash and cash equivalents are not sufficient to fund our future operations, we may need to raise additional funds through public or private equity offerings or through additional debt financing. If we cannot raise additional funds on acceptable terms, or at all, 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.

Contractual Obligations

The following table summarizes our contractual obligations as of March 31, 2020 (in thousands):

	Payments due by Period				
Contractual Obligations	**Total**	**Less than 1 Year**	**1 - 3 Years**	**4 - 5 Years**	**More than 5 Years**
Operating leases	$ 1,135	$ 142	$ 769	$ 224	$ —

Recent Accounting Pronouncements

Recently Adopted Accounting Guidance

ASU No. 2016-02, Leases (Topic 842)

In February 2016, the FASB issued ASU No. 2016-02, *Leases (Topic 842)*, and related ASUs, which provide supplementary guidance and clarifications on December 21, 2018. Topic 842 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 (ROU) asset representing the lessee's right to use or control the use of the given asset assumed under the lease. Under the guidance, a lessee will be required to recognize assets and liabilities for both finance, or capital, and operating leases with lease terms of more than 12 months. The standard will be effective for nonpublic business entities for annual periods beginning after December 15, 2019. The Company adopted Topic 842 using the effective date transition method on October 1, 2019. Upon adoption, the Company recognized an ROU asset of $1.1 million and offsetting lease liability for operating leases of $1.1 million. Refer to Note 1 to our consolidated financial statements for a more detailed discussion.

ASU No. 2018-07, *Improvements to Nonemployee Share-Based Payment Accounting (Topic 718)*

In June 2018, the FASB issued ASU No. 2018-07, *Improvements to Nonemployee Share-Based Payment Accounting*. Currently, share-based payments to nonemployees are accounted for under Subtopic 505-50, which significantly differs from the guidance for share-based payments to employees under Topic 718. This ASU supersedes Subtopic 505-50 by expanding the scope of Topic 718 to include nonemployee awards and generally aligning the accounting for nonemployee awards with the accounting for employee awards. The effective date for public companies is for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. The Company adopted this Accounting Standard effective October 1, 2019 and determined that the adoption of ASU No. 2018-07 had no impact on the consolidated financial statements.

ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606)

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. Topic 606 allows for either "full retrospective" adoption, meaning the standard is applied to all periods presented, or "modified retrospective" adoption, meaning the standard is applied only to the most current period presented in the financial statements. The Company adopted ASU 2014-09 and its related amendments (collectively "ASC 606") effective on October 1, 2018.

We utilized a comprehensive approach to assess the impact of the new revenue standard on our contract portfolio by reviewing our current accounting policies and practices to identify differences that would result from applying the new revenue standard to our revenue contracts. Additionally, we reviewed customer agreements representative of our business models and assessed whether changes in revenue recognition were appropriate under the new revenue standard.

The adoption of ASC 606 did not have a material impact on the Company's financial position or results of operations. The Company did not restate prior period information for the effects of the new standard, nor did the Company adjust the opening balance of retained earnings to account for the implementation of the new requirements of this standard. Refer to Note 1 to our consolidated financial statements for a more detailed discussion.

Accounting Guidance Pending Adoption

ASU No. 2018-13, *Fair Value Measurement (Topic 820)*

In August 2018 the FASB issued ASU No. 2018-13, *Fair Value Measurement (Topic 820): Disclosure Framework - Changes to the Disclosure Requirements for Fair Value Measurement*. This new standard modifies certain disclosure requirements on fair value measurements. This new standard will be effective for public companies with fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is currently evaluating the impact of our pending adoption of the new standard on the consolidated financial statements.

Item 5. 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.

Altigen v. CTI

In February 2019, we filed a complaint against CTI Communications, LLC ("CTI"), a former reseller of the Company and Richard Browne, sole owner, in the United States District Court for the District of Colorado. The complaint alleges (i) copyright infringement, (ii) trademark infringement, (iii) common law trademark infringement; and (iv) violation of the Colorado consumer protection act. The complaint seeks damages, attorney fees and costs, and other relief as the court deems equitable and proper. Trial for this matter will begin on July 27, 2020.

CTI v. Altigen

In March 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, civil theft and tortious interference. In March 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. In August 2017, the court dismissed with prejudice all of CTI's claims against Mr. Fleming. In March 2018, a jury rendered a verdict in favor of CTI, and the court entered a judgment that held all defendants jointly and severally liable and awarded CTI approximately $724,000 in compensatory damages, unjust enrichment, punitive damages and pre-judgment interest on compensatory damages. Moreover, in October 2018, the court awarded CTI approximately $433,000 in attorney fees and costs, jointly and severally against all defendants. The Company and all defendants appealed this ruling to the Colorado Court of Appeals, and in October 2019, the court issued its rulings and determined that (i) the underlying judgment was affirmed and the matter was remanded to the trial court, (ii) the judgement for attorneys' fees and costs was vacated and remanded to the trial court, and (iii) civil theft claim against the Company's co-defendants was reinstated and remanded to the trial court to conduct a new trial against the Company's co-defendants.

In January 2020, the trial court rendered its final judgement and awarded CTI approximately $724,000 in damages. The court also awarded CTI post-judgment interest (based on statutory rate) of approximately $115,000 on certain categories of damages. Furthermore, on May 13, 2020, the trial court ordered a final judgment awarding CTI attorney fees and costs and post-judgement interest of approximately $447,000. The trial court also awarded CTI attorney fees of approximately $76,000 for the appellate portion of the case on June 11, 2020. The civil theft claim is currently pending before the trial court. The Company intends to continue to vigorously defend against the claims asserted.

In connection with this matter, the Company recorded litigation expenses totaling $13,00 and $604,000 during fiscal years 2019 and 2018, respectively. Furthermore, in December 2018, the Company, ATS, Mr. Welsh, and Mr. Cruz entered into a settlement agreement pursuant to which the parties thereto allocated damages among themselves and $557,000 was paid to the Company by such other co-defendants.

Intellitalk v. Altigen

In February 2019, the Company was served with a cross-complaint filed by Intellitalk, Inc. ("Intellitalk"), an active reseller of the Company. The cross-complaint was filed in the Superior Court of the State of California, County of Riverside in January 2019. The complaint alleges interference with prospective economic advantage and unfair competition. The Company is currently in the process of filing a motion to dismiss all claims in the Complaint. Although the outcome of this matter is not determinable as of the date of this report, the Company believes Intellitalk's claims are without merit and the Company intends to vigorously defend itself against these allegations. The Company has not recorded an accrual related to this matter as of March 31, 2020, as the Company does not believe a loss is probable or reasonably estimable.

With respect to all litigation, as additional information concerning the estimates used by the Company becomes known, the Company reassesses its position both with respect to accrued liabilities and other potential exposures.

Item 6. Defaults upon Senior Securities.

None.

Item 7. Other Information.

None.

Item 8. Exhibits.

The following is a list of all contracts which the 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 Quarterly Report:

- Lease Agreement for 670 N McCarthy Blvd, Milpitas, California, dated as of April 16, 2019, between McCarthy Center Holding 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.
- 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 670 N McCarthy Blvd, Suite 200, Milpitas, California 95035, during ordinary business hours.

Item 9. Certifications.

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Jeremiah J. Fleming, certify that:

1. I have reviewed this quarterly disclosure statement of Altigen Communications, Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: June 29, 2020

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

CERTIFICATION OF VICE PRESIDENT OF FINANCE

I, Carolyn David, certify that:

1. I have reviewed this quarterly disclosure statement of Altigen Communications, Inc.;

2. Based on my knowledge, this disclosure statement does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this disclosure statement; and

3. Based on my knowledge, the financial statements, and other financial information included or incorporated by reference in this disclosure statement, fairly present in all material respects the financial condition, results of operations and cash flows of the issuer as of, and for, the periods presented in this disclosure statement.

Date: June 29, 2020

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