ALTIGEN COMMUNICATIONS INC
Form 10-K
December 27, 2007

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended September 30, 2007

OR

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

For the transition period from to
Commission File Number 000-27427

ALTIGEN COMMUNICATIONS, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE	**94-3204299**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
4555 Cushing Parkway Fremont, CA	**94538**
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: **(510) 252-9712**

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

Securities registered pursuant to Section 12(g) of the Act: **Common Stock, $0.001 par value**
(Title of Class)

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o Accelerated filer o Non-accelerated filer ý

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

The aggregate market value of the common stock held by non-affiliates of the registrant was approximately $24,716,602 as of March 31, 2007, based on the closing price of our common stock as reported on The NASDAQ Global Market on such date. Shares of common stock held by each officer and director and by each person known to own 5% or more of our outstanding common stock have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes. As of March 31, 2007, there were 15,205,613 shares of our common stock issued and outstanding.

As of December 21, 2007, there were 15,824,125 shares of our common stock issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Certain sections of AltiGen Communications, Inc.'s definitive Proxy Statement for the 2008 Annual Meeting of Stockholders to be held on February 7, 2008 are incorporated by reference in Part III of this Form 10-K to the extent stated herein.

ALTIGEN COMMUNICATIONS, INC.

Form 10-K for the Year Ended September 30, 2007

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PART I

Item 1. Business

INTRODUCTION

AltiGen Communications, Inc. (NASDAQ: ATGN) is a pioneer and market leader in Voice over Internet Protocol (VoIP) telephone systems. We design and manufacture advanced phone systems and call center products that use both the Internet and the public telephone network.

AltiGen Communications, or AltiGen, was founded by current CEO Gilbert Hu in 1994, and the first products began shipping in 1996. Our telephony products are primarily sold to small-to-medium sized businesses, multi-site businesses, corporate branch offices, call centers, credit unions and community banks.

AltiGen's products enable an array of applications like VoIP phones and servers, voicemail, call recording, call activity reporting, and mobility solutions that take advantage of the convergence of voice and data communications to achieve cost reduction. Our systems are designed with an open architecture and are built on an industry standard platform. This adherence to widely-used standards allows our products to integrate with and leverage a company's existing technology investment.

AltiGen Communications products are available from independent authorized resellers and strategic partners. AltiGen's family of telephony solutions has been recognized for excellence with more than 40 industry awards since 1996. Most recently, AltiGen's IP705 VoIP phone was awarded a 2006 Product of the Year award from TMC's Internet Telephony magazine. In addition, AltiGen's MAX1000 branch office solution was awarded a 2006 Product of the Year by Communications Solutions Magazine.

We generated net revenue of $17.9 million with a net loss of $936,000 during fiscal year 2007. As of September 30, 2007, we had an accumulated deficit of $52.1 million. Net cash used in operating activities was $712,000 for fiscal year 2007.

Our principal executive offices are located at 4555 Cushing Parkway, Fremont, California 94538. Our telephone number is (510) 252-9712. We were incorporated in California in May 1994, and we reincorporated into Delaware in June 1999.

We maintain an Internet website at *http://www.altigen.com*. Our most recent annual report on Form 10-K and certain of our other filings with the Securities and Exchange Commission (SEC) are available through the Investor Relations section of our website. Our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and other required filings and amendments to these filings are available on the SEC website at *http://www.sec.gov*, which can be reached from our Investor Relations website. In addition, you may read and copy any material we file with the SEC at the SEC's Public Reference Room at 450 Fifth Street, NW, Washington, DC 20549. You may obtain information on the operation of the Public Reference Room by calling the SEC at 1-800-SEC-0330.

INDUSTRY BACKGROUND

We focus on the small-to-medium sized businesses, multi-site businesses, corporate branch offices, and call centers.

Convergence of Voice and Data

Traditionally, businesses have supported two separate, incompatible networks to handle their communications needs. The first network has been the traditional telephone network, which relies on a technology called "circuit-switching." A circuit-switched network establishes and maintains a dedicated (i.e. not shared) line between calling parties for the duration of a call. The second type of network on which businesses have traditionally relied is a "packet-switched" network, such as an internal local area network or an external network, like the Internet, where voice, video, images or data is divided into small Internet protocol packets of information for transmission that are simultaneously combined with other unrelated packets of information and routed to a final destination where this process is reversed. Packet-switched networks are more efficient than the traditional circuit-switched telephone network, because network paths are not dedicated to a single user, but instead are available to be shared by all users. As a result, network capacity is allocated more efficiently. It is commonplace for networks installed today to be able to support both voice and data usage with Internet protocol packet-switching.

Most telecommunications systems do not address the needs of businesses that need to transmit voice communications over both traditional telephone networks and packet-switching networks. For example, businesses may wish to route internal calls over their existing voice network and route calls between offices over packet-switched networks, all using the same telecommunications system. We believe a significant opportunity exists to provide small-to-medium sized and mid-enterprise businesses with an integrated phone system that delivers the benefits of integrated, multi-function telecommunications systems using Internet protocol packet switching networks as well as traditional circuit-switched telephone networks.

THE ALTIGEN PRODUCT OFFERING

AltiGen phone systems are complete business telephone systems that are installed on custom designed and manufactured industrial server platforms. The systems include a comprehensive bundle of AltiGen software applications to provide a high value, all-in-one solution. The systems include software and licensing necessary to support analog and Voice over Internet Protocol (VoIP) telephones, operator software, and desktop call control software for each extension on the system. By providing a bundled approach, we are able to maintain quality and reliability while providing for easy deployment of our products.

The AltiGen phone systems work with digital, analog and internet protocol trunks, and internet protocol and analog telephone extensions. The systems can be configured with digital, analog or voice over internet protocol, or a combination of the three. By allowing the customer to choose what best fits their current and future requirement, we provide a practical and cost effective solution to future growth.

Each system includes a comprehensive voicemail system with over 2,500 hours of storage, 255 auto attendant menus with unlimited levels, automatic call distribution, call detail reporting, call recording on demand, meet-me conference bridges, and a standard PBX (Private Branch Exchange) functionality. A PBX is a telephone system within an enterprise that switches calls between enterprise users on local lines while allowing all users to share a certain number of external telephone lines. 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.

AltiGen phone systems can be implemented for businesses requiring as few as eight extensions and supporting up to 400 users per individual system. Individual systems can be affordably scaled to customer needs, and multiple systems may be networked together for greater expansion. These networked systems can be at a single site, a campus environment or multiple locations throughout the world using Internet protocol technology to link them. AltiGen phone systems allow affordable entry point while maintaining logical system growth.

For customers with more advanced requirements, we provide AltiContact Manager. The product is available as a software upgrade to an existing AltiServ Office 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 the customer grows. This allows a smaller business or branch office to enjoy the same capability as a large professional call center organization. If a customer has more than one location, call center calls can automatically be routed to other locations based on conditions the customer chooses.

Key features of our phone systems include:

Measurable Information to Ensure Best Business Practices. We provide a complete view into individual and group performance. The amount, type and duration of calls can be tracked an analyzed. An individual can record a call for later review, or a company can centrally record all or a percentage of calls for quality control.

Reduced Administration Costs. Our easy to use self administration software allows customers to manage their own telephone system. This reduces or eliminates ongoing operating cost of any business telephone system typically referred to as adds, moves and changes. AltiGen phone systems allow administrators to perform many of these tasks on site or remotely without assistance from third parties.

Lower Toll Costs. By routing voice over data networks, our systems reduce toll charges associated with long-distance calls between locations. Using our products, businesses can send and receive voice communications over the Internet or a private data network.

Unified Company Locations. For companies with AltiGen systems in multiple locations, we provide a seamless dialing plan. Customers calling into one location can automatically be routed to the correct group or individual. This allows a multi-site business to operate under a unified dialing plan and allows users in different sites to operate as if they were supported by a single system rather than an individual system for each location.

Survivability Options. Our systems allow practical and cost efficient options for disaster recovery planning. Redundant system hard drives allow all voicemail and configuration information to be copied to a spare hard drive. The system allows nightly backup to another network drive. If weather or other problems prevent employees from reaching the office, ExtensionAnywhere, One Number Access and VoIP telephones can be utilized to keep operations running. We provide multiple options based upon what best fits the customer environment.

Innovative Desktop Productivity Software. Our systems provide desktop software applications to increase user productivity. Call control, changes in extension configuration and the ability to view and manage voicemail messages improve an employee's ability to process calls. In addition, we provide software for group supervisors, agents, system administrators and operators. Applications are centrally upgraded from the phone system to allow for quick and efficient deployment.

Integration with Customer Relationship Management Software. The AltiView and AltiAgent desktop interface provides automatic contact record retrieval and "screen pops" of contact records to a user's desktop. Microsoft Outlook users can type in a name to automatically retrieve telephone numbers and click and dial from an integrated contact record directory. We provide built-in integration with other Microsoft software applications like Microsoft Outlook and Microsoft Exchange.

Ease of Installation, Use and Maintenance. AltiGen phone systems allow easy installation and system maintenance. Administrators can manage call routing, extension management, voice messaging, email and Internet features of our products through a single AltiWare administrator interface. By using industry standards we believe that AltiGen systems make it easier for resellers and end-user customers to implement and maintain systems.

Improved Customer Service Capabilities. The AltiGen phone systems provide integrated call center functionality. For more advanced call center or centralized call recording requirements, we offer the AltiContact Manager software application. Both contact center applications are designed to enhance our customers' communications with their customers by employing comprehensive contact center and call center routing, reporting and recording technologies.

Integrated Centralized Call Recording. Voice calls can be recorded on demand by employees, agents and supervisors or automatically centrally recorded by the phone system. Traditional phone systems require a separate system to be tied to a PBX to centrally record calls. Modular feature licensing allows businesses to add capabilities on a per-feature or per-user basis offering a reduced up-front investment.

True Employee Mobility. We provide flexible and useable mobility options while retaining accountability. We provide several powerful options. ExtensionAnywhere allows any phone with a direct telephone number to be enabled as a live extension on the system. Call handling, call transfer, conferencing and voicemail capability are retained. Our "One Number Access" feature allows the system to search and then transfer a call at up to four numbers. For remote employees, we offer a VoIP telephone to connect to an employee's high speed Internet access. Our mobility options are flexible and simple to use.

PRODUCTS

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

Product	Description
AltiWare	AltiWare 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 scaleable, and are packaged according to the size of the customer.
AltiContact Manager	AltiContact Manager 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.
AltiTouch 510 Analog Telephone	The AltiTouch 510 telephone is an executive level analog phone with a high quality speaker, a large (7.4 square inch) backlit LCD display with adjustable viewing angle, and LED voicemail waiting indicator. One-touch buttons provide access to features and call control including: volume, mute, voicemail, voice mail greeting management, do not disturb, intercom, headset answering, conference, hold, transfer, redial, call release, speed dial, call directory, extension management, line pickup, account codes and much more.
IP710 Voice over IP Telephone	The IP710 is a fully featured IP telephone designed to empower the user. Bringing stylish form and functionality to the desktop, the IP710 makes sophisticated features simple and intuitive to use. Users have single button access to voicemail, activity/presence selection, voicemail greeting selections, call recording, call conferencing, call transferring, and even placing calls to employees in other countries. Our IP710 Telephone was recognized in Internet Telephony Magazine as Product of Year for 2005.
IP705 Voice over IP Telephone	The IP705 provides a subset of the flagship IP710 VoIP telephone's features while offering the same level of voice quality at a reduced price. The IP705 was recognized as a 2006 Product of the Year by Internet Telephony Magazine.
AltiView	AltiView 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. AltiView is standard with the system.

AltiAgent	AltiAgent 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.
AltiSupervisor	AltiSupervisor is a Windows-based desktop application for call center supervisors. The application allows a call center or workgroup supervisor to effectively manage a workgroup. AltiSupervisor 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. AltiSupervisor allows coaching, silent monitoring of agents with barge-in call participation and call recording functionality.
Triton IP Board	The Triton IP Board is a microprocessor-controlled board supporting VoIP communications. This allows voice conversations to be carried over public and private data networks that support Internet protocol. The Triton IP Board is a 12-port board that can be software configured to 30 ports. The Triton IP Board can be used for Internet protocol trunks connecting multiple networked AltiServ systems or to support voice over Internet protocol telephones extensions and VoIP agent extensions.
Triton T1, E1, T1/PRI Board	The Triton T1, E1, T1/PRI Board is a microprocessor-controlled board that allows AltiServ systems to connect to T1, E1 or T1/PRI digital high-capacity central office telephone lines. This board can be configured with software to support provisioning for T1, E1 or T1/PRI communication protocols.
Triton Trunk Board	The Triton Trunk Board is an 8 or 12 port, microprocessor-controlled board that allows AltiServ systems to connect to analog central office telephone lines. This allows outbound and inbound calls to be carried over traditional analog central office telephone lines.
Triton Extension Board	The Triton Extension Board is a 12 port, microprocessor-controlled board that allows AltiServ systems to support 12 analog telephone extensions with each Triton Extension Board.
Triton Conference Board	The Triton Conference Board allows up to 30 simultaneous callers per conference and includes a scheduling application to control access and attendees.
MAX 4x4xT1	The MAX 4x4xT1 Access Board is a microprocessor-controlled board that allows the MAX1000 phone system to connect to four analog trunk lines, four analog telephone extensions, and one T1/E1/PRI digital central office telephone line.
MAX 4x8	The MAX 4x8 Access Board is a microprocessor-controlled board that allows the MAX1000 phone system to connect to four analog trunk lines and eight analog telephone extensions.

MAX 8x4	The MAX 8x4 Access Board is a microprocessor-controlled board that allows the MAX1000 phone system to connect to eight analog trunk lines and four analog telephone extension.
MAX 0x12	The MAX 0x12 Access Board is a microprocessor-controlled board that allows the MAX1000 phone system to connect twelve analog telephone extensions.

AltiGen Hardware and Firmware

We have developed a single base circuit board with high performance digital signal processing technology, which means that the circuit board has an integrated computer built on it that can run special, high-speed software programs, called firmware. Firmware can receive, send and modify digital information for communications with network services. Our Triton families of digital signal processing boards are designed to allow us to create different circuit boards to meet many communication requirements by simply adding a few hardware and/or software components to the basic board. For example, the Triton digital signal processing board can become a T1, E1 or Integrated Services Digital Network communication circuit board or a circuit board supporting VoIP with simple changes in on-board software and, in some cases, new circuits.

This modular design not only enables us to provide new capabilities, but we also believe that it enables our products to achieve a high degree of reliability and cost reduction since the underlying technology is consistent across our products.

AltiGen Modular Software

Our software products are based on modular software components similar to the concept described above for our hardware and firmware. The service provider layer of software is composed of separate software components, each of which communicates with a hardware circuit board within the AltiGen phone system. The middleware layer interacts with all the service providers in the system and manages their resources. This middleware layer communicates with the hardware and allows application programs to provide specific features. The application program layer consists of components that implement the application logic, such as voicemail and auto attendant menus. These applications do not depend on any particular hardware integration.

We believe that the layered architectural structure of our AltiServ products provides important benefits:

- New features can be developed without changing hardware.
- Development time is generally shorter.
- New hardware and software features can be added to installed systems.
- Changing one component in the system does not require other components to be changed.

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,		
	2007	2006	2005
Hardware	91%	92%	86%
Software	9%	8%	14%
Total	100%	100%	100%

MARKETING, SALES AND CUSTOMER SUPPORT

Marketing

Our marketing efforts currently focus on increasing demand for our products in the Americas, Europe and Asia Pacific. We are working to increase market awareness of our technology and demand for our products in the small-to-medium sized business and call center markets through public relations, print, email and web campaigns.

To assist our distributors, dealers and strategic partners, we provide market development funds, marketing tools and technical and sales training developed specifically for our products. We expect that these programs will allow us to leverage the expertise and contacts of the local and regional reseller channels to create strong lead generation.

Sales

Our sales organization continues to grow. In the United States, in fiscal 2007, we added additional channel sales managers, strategic accounts managers, and business development and marketing personnel. In addition, we added new resellers and a distribution partner. We believe this new partnership will position us for continued growth in fiscal 2008. In China, we continue to see increased government spending and expect revenue from the region to increase in fiscal 2008.

We are organized and operate as two operating segments, the Americas and International. The Americas segment is comprised of the United States, Canada, Mexico, Central America and the Caribbean. The International segment is comprised of China, the United Kingdom and Norway.

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

	Fiscal Year Ended September 30,		
	2007	2006	2005
Americas	90%	90%	90%
International	10%	10%	10%
Total	100%	100%	100%

We currently have sales and support staff in more than 14 locations in the United States. Our inside sales force answers incoming calls from end users and refers new leads to a qualified dealer near each end user's location. The inside sales force also is responsible for account management of our smaller resellers. Our outside sales force, which is primarily based in the Americas, includes regional sales managers and technology solutions managers who work with our larger resellers and recruit new reseller partners. In fiscal 2007, we continued our expansion to a more scalable reseller community by signing on an increasing number of resellers that currently sell traditional and Internet protocol telephone systems manufactured by companies such as Avaya Communications (Avaya), 3Com Corporation (3Com), Nortel Networks Inc., (Nortel) and NEC Corporation (NEC).

Customers

Our direct customers primarily are distributors and resellers who sell our products to end-users. We have distribution agreements with AltiSys, Graybar and Synnex in the Americas. Our agreements with AltiSys, Graybar and Synnex have initial terms of one year and are renewed automatically for additional one year term, provided that each party shall have 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, Graybar and Synnex also provide for termination, with or without cause, by either party upon 30 days' written notice to the other party without penalty, or upon insolvency or bankruptcy. For a period of 60 days' following termination of the agreement, AltiSys, Graybar and Synnex may distribute any products in their possession at the time of termination or, at their option, return any products to us that are in their inventories. Upon termination of the distribution agreement, all outstanding invoices for the products will become due and payable within 30 days' of the termination. In September 2007, we signed a new distribution agreement with Jenne Distributors, Inc., a leading North American supplier of business telephones, data and computer telephony products and solutions. Our agreement with Jenne has an initial term of two years and will renew 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. We believe this relationship will contribute to revenue growth in fiscal 2008.

The following table sets forth our net revenue by customers that individually accounted for more than 10% of our revenue for the periods indicated:

	Fiscal Year Ended September 30,		
	2007	**2006**	**2005**
AltiSys	16%	15%	16%
Synnex	50%	55%	53%
Graybar	15%	14%	11%

We also have over 200 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, Texas, Colorado, Minnesota and Shanghai, China coordinate service and technical support of our products and provide service twenty-four hours a day, seven days a week. Our support personnel assist our distributors and resellers in resolving installation and support issues that arise from their sales to end users and also provide limited support to end-users to supplement dealer support. Resellers and end-user customers also can access technical information and receive technical support through our web site.

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 and uses of our hardware and software technology and develop new products by continuing to invest in research and development.

We are currently developing enhancements to our products to provide greater functionality and increased capabilities 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 for small-to-medium sized businesses.

We currently conduct the majority of our product development 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, 2007, we employed 51 individuals in engineering, research and development and support.

During fiscal years 2007, 2006, and 2005, our research and development expense was approximately $3.4 million, $3.7 million, and $3.5 million, respectively.

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, 3Com, Shoretel, and Cisco Systems, Inc. Many of our competitors are substantially larger than us and have significantly greater name recognition, financial, sales and marketing, technical, customer support, manufacturing 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. In fiscal 2007, we believe that we continued to be both feature and price competitive. Additionally, we believe we provide a low ongoing cost of ownership. We believe that our principal competitive advantages include:

- System designed for small-to-medium sized business budgets;
- Ability to reduce communications costs;
- Ease of system manageability;
- Ease of use;
- Simple deployment in single and multi-site implementations;
- Ability to achieve rapid product development;
- Experience in service and technical support of Internet protocol telephony;
- Complete call center application now standard with all AltiServ systems;
- Decentralized voice processing support for advanced and integrated telephony application;

Innovative mobility capabilities supporting mobile telephone devices such as the telephone system extensions; and

Reliable redundant configurations supported.

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, 2007, 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 Form 10-K 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, 2007, we have been issued fourteen U.S. patents and have two U.S. patent applications pending. 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.

MANUFACTURING AND ASSEMBLY

Our manufacturing operations consist of two phases. In the first phase, we send out components of our products to a third party assembler. The third party assembler auto-inserts the components into the printed circuit boards instead of manually inserting the components and returns the assembled circuit board back to us. In the second phase, we insert the assembled circuit boards into the burn-in process for a minimum of two weeks and after that we perform the final test of the circuit boards. In fiscal year 2007, we engaged All Quality Services and Bestronics in San Jose as our third party assemblers. During fiscal 2007, four suppliers, Advantech Corporation, BCM Communications, Inc., Fanstel Corporation, and Avnet Electronics, provided us with approximately 79% of our hardware product components. We purchase fully-assembled chassis from Advantech Corporation, Analog phones from Fanstel Corporation and Internet protocol phones from BCM Communications, Inc. As of September 30, 2007, our in-house manufacturing operations occupied approximately 7,000 square feet of our corporate headquarters in Fremont, California.

We test our products after the assembly process using internally developed product assurance testing procedures, which include visual inspection, functional testing and final systems testing. Although we generally use standard components for our products and try to maintain alternative sources of supply, we purchase some key components from sole source suppliers for which alternative sources are not currently available. We incorporate the following sole-sourced components in our products:

Zarlink Corporation chips are included in all of our boards and are the means by which our boards communicate with each other to enable our products to function correctly.

Texas Instruments' digital signal processor ("DSP") chips are included in our Triton family of boards. The DSP chip is designed to perform the mathematics, data compression and other tasks required to manipulate voice communications that are routed through our products.

Xilinx, Inc provides chips for our Triton family of boards which allow our boards to work with digital communications lines.

Infineon Technologies provides chips for our Triton Analog product line which allow our board to work with analog communications lines.

PMC Sierra, Inc. provides chips for our Triton Digital product line which allow our board to work with digital communications lines.

Advantech Corporation provides the chassis for our AltiServ Office products based on our specifications.

BCM Communications, Inc. manufactures our Internet protocol phone loaded with customized firmware to work with our system.

Fanstel Corporation manufactures our analog phone loaded with customized firmware to work with our system.

Chiah Jyh Industrial Co. manufactures the chassis for our MAX products.

Loss of any key component supplier would adversely impact our business.

EMPLOYEES

As of September 30, 2007, we had 109 full-time employees, including 51 in research and development and support, 37 in marketing and sales, 8 in operations, and 13 in finance and administration. Of these full-time employees, 62 were located in the United States and 47 in China. 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.

Item 1A. Risk Factors

CERTAIN FACTORS AFFECTING BUSINESS, OPERATING RESULTS, AND FINANCIAL CONDITION

You should carefully consider the risks described below and all of the information contained in this Form 10-K. If any of the following risks occur, our business, financial condition and result of operations could be harmed, the trading price of our common stock could decline and you may lose all or part of your investment in our common stock.

Risks Related to Our Business

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

We have had a history of operating losses since our inception and, as of September 30, 2007, we had an accumulated deficit of $52.1 million. We may incur operating losses in the future, and these losses could be substantial and impact our ability to maintain profitability. We do not expect to 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.

Our operating results vary, making future operating results difficult to predict.

Our quarterly and annual operating results have varied significantly in the past and likely will vary significantly in the future. A number of factors, many of which are beyond our control, have caused and may cause our operating results to vary, including:

- our ability to respond effectively to competitive pricing pressures;
- our ability to establish or increase market acceptance of our technology, products and systems;
- our success in expanding our network of distributors, dealers and companies that buy our products in bulk, customize them for particular applications or customers, and resell them under their own names;

- market acceptance of products and systems incorporating our technology and enhancements to our product applications on a timely basis;
- our success in supporting our products and systems;
- our sales cycle, which may vary substantially from customer to customer;
- unfavorable changes in the prices and delivery of the components we purchase;
- the size and timing of orders for our products, which may vary depending on the season, and the contractual terms of the orders;
- the size and timing of our expenses, including operating expenses and expenses of developing new products and product enhancements;
- deferrals of customer orders in anticipation of new products, services or product enhancements introduced by us or by our competitors; and
- our ability to attain and maintain production volumes and quality levels for our products.

Our future projected budgets and commitments are based in part on our expectations of future sales. If our sales do not meet expectations, it will be difficult for us to reduce our expenses quickly and, consequently, our operating results may suffer.

Our dealers often require immediate shipment and installation of our products. As a result, we have historically operated with limited backlog, and our sales and operating results in any quarter primarily depend on orders booked and shipped during that quarter.

Any of the above factors could harm our business, financial condition and results of operations. We believe that period-to-period comparisons of our results of operations are not meaningful, and you should not rely upon them as indicators of our future performance.

Our market is highly competitive and we may not have the resources to adequately compete.

The market for our integrated, multifunction telecommunications systems is new, rapidly evolving and highly competitive. We expect competition to intensify in the future as existing competitors develop new products and new competitors enter the market. We believe that a critical component to success in this market is the ability to establish and maintain strong partner and customer relationships with a wide variety of domestic and international providers. If we fail to establish or maintain these relationships, we will be at a serious competitive disadvantage.

We face competition from companies providing traditional private telephone systems. Our principal competitors that produce these telephone systems are Avaya Communications, NEC and Nortel Networks. We also compete against providers of multi-function telecommunications systems, including 3Com Corporation, and Cisco Systems, Inc., as well as any number of future competitors. Many of our competitors are substantially larger than we are and have significantly greater name recognition, financial resources, sales and marketing teams, technical and customer support, manufacturing capabilities and other resources. These competitors also may have more established distribution channels and stronger relationships with 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, provide higher performance or additional features or be introduced earlier than our phone systems. We also expect that other companies may enter our market with better products and technologies. If any technology that is competing with ours is more reliable, faster, less expensive or has other advantages over our technology, then the demand for our products and services could decrease and harm our business.

We expect our competitors to continue to improve the performance of their current products and introduce new products or new technologies. If our competitors successfully introduce new products or enhance their existing products, our sales or market acceptance of our products and services could be reduced, price competition could be increased or our products could become obsolete. To remain competitive, therefore, we must continue to invest significant resources in research and development, sales and marketing and customer support. We may not have sufficient resources to make these investments or to make the technological advances necessary to be competitive, which in turn will cause our business to suffer.

We sell our products through dealers and distributors, which limits our ability to control the timing of our sales, and which makes it more difficult to predict our revenue.

We do not recognize revenue from the sale of our products to our distributors until these products are sold to either resellers or end-users. We have little control over the timing of product sales to dealers and end users. Our lack of control over the revenue that we recognize from our distributors' sales to resellers and end-users limits our ability to predict revenue for any given period. Our future projected budgets and commitments are based in part on our expectations of future sales. If our sales do not meet expectations, it will be difficult for us to reduce our expenses quickly, and consequently our operating results may 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.

Software or hardware errors may seriously harm our business and damage our reputation, causing loss of customers and revenue.

Users expect telephone systems to provide a high level of reliability. Our products are inherently complex and may have undetected software or hardware errors. We have detected and may continue to detect errors and product defects in our installed base of products, new product releases and product upgrades. End users may install, maintain and use our products improperly or for purposes for which they were not designed. These problems may degrade or terminate the operation of our products, which could cause end users to lose telephone service, cause us to incur significant warranty and repair costs, damage our reputation and cause significant customer relations problems. Any significant delay in the commercial introduction of our products due to errors or defects, any design modifications required to correct these errors or defects or any negative effect on customer satisfaction as a result of errors or defects could seriously harm our business, financial condition and results of operations.

Any claims brought because of problems with our products or services could seriously harm our business, financial condition and results of operations. We currently offer a one-year hardware guarantee to end-users. If our products fail within the first year, we face replacement costs. Our insurance policies may not provide sufficient or any coverage should a claim be asserted. In addition, our introduction of products and systems with reliability, quality or compatibility problems could result in reduced revenue, uncollectible accounts receivable, delays in collecting accounts receivable, warranties and additional costs. Our customers, end users or employees could find errors in our products and systems after we have begun to sell them, resulting in product redevelopment costs and loss of, or delay in, their acceptance by the markets in which we compete. Further, we may experience significant product returns in the future. Any of these events could have a material adverse effect on our business, financial condition and results of operations.

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, therefore, 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. Also, introducing new products could require us to write-off existing inventory as obsolete, which could harm our results of operations.

We depend on attracting and retaining qualified personnel to maintain and expand our business; our failure to promptly attract and retain qualified personnel may seriously harm our business, financial condition and results of operations.

We depend, in large part, on our ability to attract and retain highly skilled personnel, particularly engineers and sales and marketing personnel. We need highly trained technical personnel to design and support our server-based telecommunications systems. In addition, we need highly trained sales and marketing personnel to expand our marketing and sales operations in order to increase market awareness of our products and generate increased revenue. Competition for highly trained personnel is intense, especially in the San Francisco Bay Area where most of our operations are located. We cannot be certain that we will be successful in our recruitment and retention efforts. If we fail to attract or retain qualified personnel or suffer from delays in hiring required personnel, our business, financial condition and results of operations may be seriously harmed.

Changes in taxation and accounting regulations could adversely affect our operating income and results of operations.

We are subject to numerous tax and accounting requirements, and the adoption, revision or reinterpretation of these requirements may have a material impact on our operating income and results of operations.

In December 2004, the FASB issued SFAS No. 123(R), *Stock-Based Compensation*, which establishes standards for transactions in which an entity exchanges its equity instruments for goods or services. In March 2005, the SEC issued Staff Accounting Bulletin No. 107 Stock-Based Compensation, which provides interpretive guidance related to SFAS No. 123(R). SFAS No. 123(R) requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. This eliminates the exception to account for such awards using the intrinsic method previously allowable under APB Opinion No. 25. SFAS No. 123(R). This standard was adopted on October 1, 2005. The adoption of SFAS No. 123(R) resulted in a negative impact on our results of operations. From time to time, the government, courts or the FASB may issue new laws, regulations, rules or accounting standards that will affect our reported operating results. Additionally, there may be future changes in laws, interpretations, standards, rules or regulations that would affect our financial results or the way in which we present them.

Other new accounting pronouncements or taxation rules and varying interpretations of accounting pronouncements or taxation practice have occurred and may occur in the future. This change to existing rules, future changes, if any, or the questioning of current practices may adversely affect our reported financial results or the way we conduct our business.

If, as of the end of our 2008 fiscal year, we are unable to assert that our internal control over financial reporting is effective, investors could lose confidence in our reported financial information, and the trading price of our stock price and our business could be adversely affected.

We are in the process of documenting, and plan to test our internal control procedures in order to satisfy the requirements of Section 404 of the Sarbanes-Oxley Act. Commencing on September 30, 2008, the end of our 2008 fiscal year, the Sarbanes-Oxley Act requires annual management assessments of the effectiveness of our internal controls over financial reporting. During the course of our testing we may identify deficiencies which we may not be able to remediate in time to meet the deadline imposed by the Sarbanes-Oxley Act for compliance with the requirements of Section 404. In addition, if we fail to achieve and maintain the adequacy of our internal controls, as such standards are modified, supplemented, or amended from time to time, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal controls over financial reporting in accordance with Section 404 of the Sarbanes-Oxley Act. Effective internal controls are important to help produce reliable financial reports and to prevent financial fraud. If we are unable to assert that our internal control over financial reporting is effective as of the end of our 2008 fiscal year, we could lose investor confidence in the accuracy and completeness of our financial reports, investors could lose confidence in our reported financial information, and the trading price of our stock and our business could be adversely affected.

If we do not manage our growth effectively, our business will suffer.

We may not be successful in managing our future growth. We have expanded our operations rapidly since our inception. In order to manage this expansion and grow in the future, we will need to expand or enhance our management, manufacturing, research and development and sales and marketing capabilities. We may not be able to hire the management, staff or other personnel required to do so.

We may not be able to install adequate control systems in an efficient and timely manner, and our current or planned operational systems, procedures and controls may not be adequate to support our future operations. Difficulties in installing and implementing new systems, procedures and controls may significantly burden our management and our internal resources. Delays in the implementation of new systems or operational disruptions when we transition to new systems would impair our ability to accurately forecast sales demand, manage our product inventory and record and report financial and management information on a timely and accurate basis.

Lead times for materials and components used in the assembly of our products vary significantly, and depend on factors such as the supplier, contract terms and demand for a component at a given time. If orders do not match forecasts, we may have excess or inadequate inventory of certain materials and components, which may seriously harm our business, financial condition and results of operations.

Losing any of our key distributors would harm our business. We also need to establish and maintain relationships with additional distributors and original equipment manufacturers.

Sales through our three key distributors, Altisys, Graybar and Synnex, accounted for 81% of our net revenue in the fiscal year ended September 30, 2007. Our business and operating results will suffer if any one of these distributors does not continue distributing our products, fails to distribute the volume of our products that it currently distributes or fails to expand our customer base. We also need to establish and maintain relationships with additional distributors and original equipment manufacturers. We may not be able to establish, or successfully manage, relationships with additional distribution partners. In addition, our agreements with distributors typically provide for termination by either party upon written notice to the other party. For example, our agreement with Synnex provides for termination, with or without cause, by either party upon 30 days' written notice to the other party, or upon insolvency or bankruptcy. Generally, these agreements are non-exclusive and distributors sell products that compete with ours. If we fail to establish or maintain relationships with distributors and original equipment manufacturers, our ability to increase or maintain our sales and our customer base will be substantially harmed.

We rely on sole-sourced components and third party technology and products; if these components are not available, our business may suffer.

We purchase technology that is incorporated into many of our products, including virtually all of our hardware products, from a single third-party supplier. We order sole-sourced components using purchase orders and do not have supply contracts for them. One sole-sourced component, a TI DSP chip, is particularly important to our business because it is included in virtually all of our hardware products. If we were unable to purchase an adequate supply of these sole-sourced components on a timely basis, we would be required to develop alternative products, which could entail qualifying an alternative source or redesigning our products based on different components. Our inability to obtain these sole-sourced components, especially the TI DSP chip, could significantly delay shipment of our products, which could have a negative effect on our business, financial condition and results of operations.

Compliance with changing regulations of corporate governance and public disclosure may result in additional expenses.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act of 2002, new SEC regulations and NASDAQ National Market rules, are creating uncertainty for companies such as ours. These new or changed laws, regulations and standards are subject to varying interpretations in many cases due to their lack of specificity, and as a result, their application in practice may evolve over time as new guidance is provided by regulatory and governing bodies, which could result in continuing uncertainty regarding compliance matters and higher costs necessitated by ongoing revisions to disclosure and governance practices. As a result, our efforts to comply with evolving laws, regulations and standards have resulted in, and are likely to continue to result in, increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities to compliance activities. In particular, our efforts to comply with Section 404 of the Sarbanes-Oxley Act of 2002 and the related regulations regarding our required assessment of our internal controls over financial reporting and our external auditors' audit of that assessment has required the commitment of significant financial and managerial resources. We expect these efforts to require the continued commitment of significant resources. Further, our board members, chief executive officer, and chief financial officer could face an increased risk of personal liability in connection with the performance of their duties. As a result, we may have difficulty attracting and retaining qualified board members and executive officers, which could harm our business. If our efforts to comply with new or changed laws, regulations and standards differ from the activities intended by regulatory or governing bodies due to ambiguities related to practice, our reputation may be harmed.

Our facility is vulnerable to damage from earthquakes and other natural disasters and other business interruptions; any such damage could seriously or completely impair our business.

We perform final assembly, software installation and testing of our products at our facility in Fremont, California. Our facility is located on or near known earthquake fault zones and may be subject to rolling electrical blackouts and is vulnerable to damage or interruption from fire, floods, earthquakes, power loss, telecommunications failures and similar events. If such a disaster or interruption occurs, our ability to perform final assembly, software installation and testing of our products at our facility would be seriously, if not completely, impaired. If we were unable to obtain an alternative place or way to perform these functions, our business, financial condition and results of operations would suffer. The insurance we maintain may not be adequate to cover our losses against fires, floods, earthquakes and general business interruptions.

Our strategy to outsource assembly and test functions in the future could delay delivery of products, decrease quality or increase costs.

We may begin outsource a substantial amount of our product assembly and test functions. This outsourcing strategy involves certain risks, including the potential lack of adequate capacity and reduced control over delivery schedules, manufacturing yield, quality and costs. In the event that any significant subcontractors were to become unable or unwilling to continue to manufacture or test our products in the required volumes, we would have to identify and qualify acceptable replacements. Finding replacements could take time and we cannot be sure that additional sources would be available to us on a timely basis. Any delay or increase in costs in the assembly and testing of products by third-party subcontractors could seriously harm our business, financial condition and results of operations.

Our expansion in international markets has been slow and steady. However, our plan is to accelerate this growth rate and will involve new risks that our previous domestic operations have not prepared us to address; our failure to address these risks could harm our business, financial condition and results of operations.

For fiscal year 2007, approximately 10% of our net revenue came from customers outside of the Americas. We intend to expand our international sales and marketing efforts. Our efforts are subject to a variety of risks associated with conducting business internationally, any of which could seriously harm our business, financial condition and results of operations. These risks include:

- tariffs, duties, price controls or other restrictions on foreign currencies or trade barriers, such as import or export licensing imposed by foreign countries, especially on technology;

- potential adverse tax consequences, including restrictions on repatriation of earnings;

- fluctuations in foreign currency exchange rates, which could make our products relatively more expensive in foreign markets; and

- conflicting regulatory requirements in different countries that may require us to invest significant resources customizing our products for each country.

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 filed 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 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. Further, the laws of some countries, such as those in Japan, one of our target markets, may not adequately protect our intellectual property or such protection may be uncertain. 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.

If we are unable to raise additional capital when needed, we may be unable to develop or enhance our products and services.

We may seek additional funding in the future. If we cannot raise funds on acceptable terms, we may be unable to develop or enhance our products and services, take advantage of future opportunities or respond to competitive pressures or unanticipated requirements. We also may be required to reduce operating costs through lay-offs or reduce our sales and marketing or research and development efforts. If we issue equity securities, stockholders may experience additional dilution or the new equity securities may have rights, preferences or privileges senior to those of our common stock.

We may face infringement issues that could harm our business by requiring us to license technology on unfavorable terms or temporarily or permanently cease sales of key products.

We may become parties to litigation in the normal course of our business. Litigation in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of complex litigation are difficult to predict. We were previously a defendant in a patent infringement suit brought by Vertical Networks. On October 4, 2007, the parties entered into a stipulation dismissing the lawsuit in its entirety without prejudice. Consequently, Vertical Networks may reassert these or related claims in one or more separate proceedings. For additional information on this suit, see Item 3 "Legal Proceedings."

More generally, litigation related to these types of claims may require us to acquire licenses under third party patents that may not be available on acceptable terms, if at all. We believe that an increasing portion of our revenue in the future will come from sales of software applications for our hardware products. The software market traditionally has experienced widespread unauthorized reproduction of products in violation of developers' intellectual property rights. This activity is difficult to detect, and legal proceedings to enforce developers' intellectual property rights are often burdensome and involve a high degree of uncertainty and substantial costs.

Our products may not meet the legal standards required for their sale in some countries; if we cannot sell our products in these countries, our results of operations may be seriously harmed.

The United States and other countries in which we intend to sell our products have standards for safety and other certifications that must be met for our products to be legally sold in those countries. We have tried to design our products to meet the requirements of the countries where we sell or plan to sell them. We also have obtained or are trying to obtain the certifications that we believe are required to sell our products in these countries. We cannot, however, guarantee that our products meet all of these standards or that we will be able to obtain any certifications required. In addition, there is, and will likely continue to be, an increasing number of laws and regulations pertaining to the products we offer and may offer in the future. These laws or regulations may include, for example, more stringent safety standards, requirements for additional or more burdensome certifications or more stringent consumer protection laws.

If our products do not meet a country's standards or we do not receive the certifications required by a country's laws or regulations, then we may not be able to sell our products in that country. This inability to sell our products may seriously harm our results of operation by reducing our sales or requiring us to invest significant resources to conform our products to these standards.

Risks Related to the Industry

Integrated, multifunction telecommunications systems may not achieve widespread acceptance.

The market for integrated, multifunction telecommunications systems is relatively new and rapidly evolving. Businesses have invested substantial resources in the existing telecommunications infrastructure, including traditional private telephone systems, and may be unwilling to replace these systems in the near term or at all. Businesses also may be reluctant to adopt integrated, multifunction telecommunications systems because of their concern about the current limitations of data networks, including the Internet. For example, end users sometimes experience delays in receiving calls and reduced voice quality during calls when routing calls over data networks. Moreover, businesses that begin to route calls over the same networks that currently carry only their data also may experience these problems if the networks do not have sufficient capacity to carry all of these communications at the same time.

Evolving standards may delay our product introductions, increase our product development costs or cause end users to defer or cancel plans to purchase our products, any of which could adversely affect our business.

The standards in our market are still evolving. These standards are designed to ensure that integrated, multifunction telecommunications products from different manufacturers can operate together. Some of these standards are proposed by other participants in our market, including some of our competitors, and include proprietary technology. In recent years, these standards have changed, and new standards have been proposed, in response to developments in our market. Our failure to conform our products to existing or future standards may limit their acceptance by market participants. We may not anticipate which standards will achieve the broadest acceptance in our market in the future, and we may take a significant amount of time and expense to adapt our products to these standards. We also may have to pay additional royalties to developers of proprietary technologies that become standards in our market. These delays and expenses may seriously harm our results of operations. In addition, customers and users may defer or cancel plans to purchase our products due to concerns about the ability of our products to conform to existing standards or to adapt to new or changed standards, and this could seriously harm our results of operations.

Future regulation or legislation could harm our business or increase our cost of doing business.

The Federal Communications Commission (FCC) has submitted a report to Congress stating that it may regulate certain Internet services if it determines that such Internet services are functionally equivalent to conventional telecommunications services. The increasing growth of the voice over data network market and the popularity of supporting products and services, heighten the risk that national governments will seek to regulate the transmission of voice communications over networks such as the Internet. In addition, large telecommunications companies may devote substantial lobbying efforts to influence the regulation of this market so as to benefit their interests, which may be contrary to our interests. These regulations may include, for example, assessing access or settlement charges, imposing tariffs or imposing regulations based on encryption concerns or the characteristics and quality of products and services. In February 2004, the FCC found that an entirely Internet based voice over Internet protocol service was an unregulated information service. At the same time, the FCC began a broader proceeding to examine what its role should be in this new environment of increased consumer choice and what can be done to meet its role of safeguarding the public interest. Future laws, legal decisions or regulations, as well as changes in interpretations of existing laws and regulations, could require us to expend significant resources to comply with them. In addition, these future events or changes may create uncertainty in our market that could reduce demand for our products.

Item 1B. Unresolved Staff Comments

Not applicable.

Item 2. Properties

As of September 30, 2007, our headquarters for corporate administration, research and development, manufacturing and sales and marketing occupied 32,000 square feet of space in Fremont, California. The lease expires on February 21, 2009. Outside the United States, we lease approximately 9,400 square feet of a facility in Shanghai, China, where we conduct administration, research and development, sales and marketing, and another 1,600 square feet of a facility in Beijing, China to serve sales and marketing functions. We believe that our existing facilities both in the United Sates and China are adequate and will support our needs through the end of fiscal 2008.

Item 3. Legal Proceedings

On September 6, 2002, Vertical Networks, Inc. filed suit against us in the United States District Court for the Northern District of California, alleging infringement of U.S. Patents Nos. 6,266,341, 6,289,025, 6,292,482, 6,389,009, and 6,396,849. On October 28, 2002, Vertical Networks amended its complaint to add allegations of infringement of U.S. Patents Nos. 5,617,418 and 5,687,174. Vertical Networks filed a second amended complaint on November 20, 2002 to identify products and/or activities that allegedly infringe the seven patents-in-suit. Vertical Networks' Complaint seeks an injunction against future patent infringement, an award of damages, including treble damages for alleged willful infringement, and attorneys' fees and costs. On December 9, 2002, we filed an answer and counterclaims for declaratory relief, and on December 26, 2002, Vertical Networks filed its reply to those counterclaims. On October 4, 2007, the parties entered into a stipulation dismissing the lawsuit in its entirety without prejudice.

From time to time, we may become party to litigation and subject to various routine claims and legal proceedings that arise in the ordinary course of our business. To date, these actions have not had a material adverse effect on our financial position, result of operations or cash flows. Although the results of litigation and claims cannot be predicted with certainty, we believe that the final outcome of such matters would not have a material adverse effect on our business, financial position, results of operation and cash flows.

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

No matters were submitted to a vote of security holders during the fourth quarter of the Company's fiscal year ended September 30, 2007.

PART II

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

From October 4, 1999, the date of our initial public offering, to June 11, 2002, our common stock was traded on the NASDAQ National Market under the symbol "ATGN". Since June 12, 2002, our common stock has traded on the NASDAQ Capital Market under the symbol "ATGN." The following table sets forth, for the periods indicated, the high and low closing prices of our common stock on the NASDAQ Stock Market. As of September 30, 2007, we had approximately 85 stockholders of record of our common stock. We have never declared or paid any cash dividends on our capital stock. We currently expect to retain future earnings, if any, to support operations and to finance the growth and development of our business. We do not expect to pay cash dividends in the foreseeable future.

	Fiscal 2007		Fiscal 2006	
	High	Low	High	Low
1st Quarter	$ 1.70	$ 1.51	$ 2.05	$ 1.45
2nd Quarter	$ 1.98	$ 1.50	$ 1.90	$ 1.53
3rd Quarter	$ 1.97	$ 1.62	$ 1.98	$ 1.35
4th Quarter	$ 1.75	$ 1.46	$ 1.57	$ 1.37

COMPANY STOCK PERFORMANCE

COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN*
Among AltiGen Communications, Inc., The NASDAQ Composite Index
and The NASDAQ Telecommunications Index

The following graph compares the cumulative total stockholder return data for our stock for the period beginning September 30, 2002 and ending on September 30, 2007 to the cumulative return over such period of (i) The NASDAQ National Market Composite Index and (ii) the NASDAQ Telecommunications Index. The graph assumes $100 was invested on September 30, 2002 in our Common Stock and in each of the comparative indices, assuming the reinvestment of any dividends. Note that the historic stock price performance on the following graph is not necessarily indicative of future stock price performance.

*
$100 invested on 9/30/02 in stock or index-including reinvestment of dividends.
Fiscal year ending September 30.

We received aggregate net proceeds of approximately $33.3 million from the initial public offering of shares of our common stock in October 1999. As of September 30, 2007, proceeds from our initial public offering have been used for working capital and general corporate purposes, including research and development of new products, sales and marketing efforts, general and administrative expenses and international expansion. The remaining net proceeds have been invested in cash, cash equivalents and short-term investments.

Plan category	**Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)**	**Weighted-average exercise price of outstanding options, warrants and rights (b)**	**Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))[1] (c)**
Equity compensation plans approved by security holders	3,701,205	$ 3.62	2,102,575
Equity compensation plans not approved by security holders			
Total	3,701,205	$ 3.62	2,102,575

(1) The number of shares reserved for issuance under the Company's 1999 Stock Option Plan will be increased on the first day of the Company's fiscal year by an amount equal to the lesser of: (i) 1,796,783 shares; (ii) 5% of the Company's outstanding shares on that date; or (iii) such lesser amount as determined by the Board of Directors. The number of shares reserved for issuance under the Company's 1999 Employee Stock Purchase Plan will be increased on the first day of each fiscal year by an amount equal to the lesser of: (i) 598,928 shares; (ii) 2% of the outstanding shares on that date; or (iii) such lesser amount as determined by the Board of Directors.

Item 6. Selected Financial Data

This section presents selected historical financial data of AltiGen Communications, Inc. This section should be read carefully in conjunction with "Management's Discussion and Analysis of Financial Conditions and Results of Operations" and the consolidated financial statements included in this Form 10-K, including the notes to the consolidated financial statements. The selected data in this section is not intended to replace our consolidated financial statements.

	Fiscal Year Ended September 30,				
	2007	2006	2005	2004	2003
	(in thousands, except per share data)				
Consolidated Statements of Operations Data:					
Net revenue	$ 17,888	$ 17,896	$ 15,441	$ 14,842	$ 11,824
Cost of revenue	8,123	8,082	6,592	5,607	4,978
Gross profit	9,765	9,814	8,849	9,235	6,846
Operating expenses:					
Research and development	3,373	3,740	3,496	3,288	3,990
Sales and marketing	5,277	4,353	3,943	4,130	4,648
General and administrative	2,497	2,058	1,946	1,894	1,943
Amortization of deferred stock compensation					55
Total operating expenses	11,147	10,151	9,385	9,312	10,636
Loss from operations	(1,382)	(337)	(536)	(77)	(3,790)
Equity in net loss of investee	(4)	(36)	(12)		
Interest and other income, net	461	380	237	105	241
Net income (loss) before income taxes	(925)	7	(311)	28	(3,549)
Income taxes	(11)	(19)			
Net income (loss)	$ (936)	$ (12)	$ (311)	$ 28	$ (3,549)
Basic and diluted net income (loss) per share	$ (0.06)	$ (0.00)	$ (0.02)	$ 0.00	$ (0.26)
Weighted average shares used in computing basic net income (loss) per share	15,363	14,964	14,605	14,242	13,643
Weighted average shares used in computing diluted net income (loss) per share	15,363	14,964	14,605	15,725	13,643

	2007	2006	2005	2004	2003
	(in thousands)				
Consolidated Balance Sheets Data:					
Cash, cash equivalents and short-term investments	$ 9,907	$ 9,922	$ 9,422	$ 10,034	$ 10,146
Working capital	11,551	11,027	10,133	10,314	9,850
Total assets	15,250	14,644	13,335	13,516	13,210
Accumulated deficit	(52,094)	(51,158)	(51,146)	(50,835)	(50,863)
Total stockholders' equity	12,345	11,837	10,718	10,669	10,290

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

FORWARD-LOOKING INFORMATION

This report contains certain forward-looking statements (within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended) and information relating to us that are based on the beliefs of our management as well as assumptions made by and information currently available to our management. Additional forward-looking statements may be identified by the words "anticipate," "believe," "expect," "intend," "plan," or the negative of such terms, or similar expressions, as they relate to us or our management.

The forward-looking statements contained herein reflect our judgment as of the date of this report with respect to future events, the outcome of which is subject to certain risks that may have a significant impact on our business, operating results or financial condition. You are cautioned that these forward-looking statements are inherently uncertain. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual results or outcomes may vary materially from those described herein. Although we believe that the expectations reflected in these forward-looking statements are reasonable, we cannot guarantee future results, levels of activity, performance or achievements. You should carefully review the cautionary statements contained in this Form 10-K, including the "Certain Factors Affecting Business, Operating Results and Financial Condition" above.

OVERVIEW

We are a pioneer and market leader in Internet protocol telephony systems for small-to-medium sized businesses. We design, manufacture and market next generation, Internet protocol phone systems and contact centers that use both the Internet and the public telephone network to take advantage of the convergence of voice and data communications. Unlike traditional proprietary phone systems, our systems are designed with open architecture and are built on an industry standard platform. This adherence to industry standards allows our products to play an important role in the small-to-medium sized business market by delivering phone systems that can integrate with other technologies and provide integrated voice and data solutions. We believe this enables our customers to implement communication systems that have an increased return on investment versus past technology investments. We generated net revenue of $17.9 million, for a net loss of $936,000, during fiscal year 2007. As of September 30, 2007, we had an accumulated deficit of $52.1 million. Net cash used in operating activities was $712,000 for fiscal year 2007.

We derive our revenue from sales of our telephone systems. Product revenue is comprised of direct sales to end-users (including dealers) and sales to distributors. Revenue from product sales to end users and resellers are recognized upon shipment. We defer recognition of revenue for sales to distributors until they resell our products to their customers. Upon shipment, we also provide a reserve for the estimated cost that may be incurred for product warranty. Under our distribution contracts, a distributor has the right, in certain circumstances, to return products it determines are overstocked, so long as it provides an offsetting purchase order for products in an amount equal to or greater than the dollar value of the returned products. In addition, we provide distributors protection from subsequent price reductions.

Our cost of revenue consists of component and material costs, direct labor costs, provisions for excess and obsolete inventory, warranty costs and overhead related to the manufacturing of our products. Several factors that have affected and will continue to affect our revenue growth are the state of economy, the market acceptance of our products, our ability to add new resellers and our ability to design, develop, and release new products. We engage third-party assemblers, which in fiscal year 2007 were All Quality Services and Bestronics in San Jose, to insert the hardware components into the printed circuit board. We selected our manufacturing partners with the goals of ensuring a reliable supply of high-quality finished products and lowering per unit product costs as a result of manufacturing economies of scale. We cannot assure you that we will maintain the volumes required to realize these economies of scale or when or if such cost reductions will occur. The failure to obtain such cost reductions could materially adversely affect our gross margins and operating results.

We continue to focus on (i) developing enhancements to our current products to provide greater functionality and increased capabilities, based on our market research, customer feedback and our competitors' product offerings and (ii) creating new product offerings to both enhance our position in our target market segment and enter new geographical markets. Additionally, we intend to continue selling our products to small-to medium-sized businesses, enterprise business, multi-site businesses, corporate branch offices and call centers. Also, we plan to continue to recruit additional resellers and distributors that focus on selling phone systems to our target customers. We believe that the adoption rate for this Internet telephony is much faster with small-to medium-sized businesses because many of them have no significant investment on their books for traditional phone systems. Also we believe that small-to medium-sized businesses are looking for call center-type administration to increase the productivity and efficiency of their contacts with customers.

CRITICAL ACCOUNTING POLICIES

Revenue recognition. Net sales consist primarily of revenue from direct sales to end-users, including resellers, and sales to distributors. The Company recognizes revenue pursuant to SEC Staff Accounting Bulletin ("SAB") No. 104, *Revenue Recognition*, ("SAB No. 104"). Revenue from sales to end-users are recognized upon shipment, when risk of loss has passed to the customer, collection of the receivable is reasonably assured, persuasive evidence of an arrangement exists, and the sales price is fixed and determinable. We provide for estimated sales returns and allowances and warranty costs related to such sales at the time of shipment in accordance with SFAS No. 48, *Revenue Recognition when Right of Return Exists* ("SFAS No. 48"). Net revenue consists of product revenue reduced by estimated sales returns and allowances. Sales to distributors are made under terms allowing certain rights of return and protection against subsequent price declines on our products held by its distributors. Upon termination, any unsold products may be returned by the distributor for a full refund. These agreements may be canceled without cause by either party following a specified notice period. As a result of the above provisions, we defer recognition of distributor revenue until such distributors resell our products to their customers. The amounts deferred as a result of this policy are reflected as "deferred revenue" in the accompanying consolidated balance sheets. The related cost of revenue is also deferred and reported in the consolidated balance sheets as inventory. Our total deferred revenue was $565,000 and $531,000 as of September 30, 2007 and September 30, 2006, respectively.

Software components are generally not sold separately from our hardware components. Software revenue consist primarily of license revenue that are recognized upon the delivery of application products. We provide limited post-contract customer support ("PCS"), consisting primarily of technical support and "bug" fixes. In accordance with SOP 97-2, revenue earned on software arrangements involving multiple elements is allocated to each element based upon the relative fair values of the elements. Although we provide PCS, the revenue allocated to this element is recognized together with the initial licensing fee on delivery of the software because: (1) the PCS fee is included with the initial licensing fee; (2) the PCS included with the initial license fee is for one year or less; (3) the estimated cost of providing PCS during the arrangement is insignificant; and (4) unspecified upgrades/enhancements offered for minimal or no cost during PCS arrangements historically have been and are expected to continue to be minimal and infrequent. All estimated costs of providing the services, including upgrades and enhancements are accrued for at the time of delivery.

Cash and Cash Equivalents. Cash and cash equivalents include cash on hand, deposits with banks and highly liquid investments with a time to maturity of three months or less at the time of purchase.

Short-Term Investment. Short-term investments are highly liquid financial instruments with original maturities greater than three months but less than one year and are classified as "available-for-sale" investments. We classify our available-for-sale securities as current assets. We report our available-for-sale securities at their fair value. Further, we recognize unrealized gains and losses in our available-for sale securities as an increase or reduction in shareholders' equity. We evaluate our available-for-sale securities for impairment quarterly.

Inventory. Inventory is stated at the lower of cost (first-in, first-out method) or market. Our inventory balance was $1.6 million and $1.4 million as of September 30, 2007 and September 30, 2006, respectively. We perform a detailed review of inventory each fiscal quarter, with consideration given to future customer demand for our products, obsolescence from rapidly changing technology, product development plans, and other factors. If future demand or market conditions for our products are less favorable than those projected by management, or if our estimates prove to be inaccurate due to unforeseen technological changes, we may be required to record additional inventory provision which would negatively affect gross margins in the period when the write-downs were recorded. As of December 2001, we had established a reserve to write off $3.5 million of excess inventory which management believed would not be sold. During 2002 through 2006, we reversed a portion of the reserve related to inventory which was sold. The amounts of such reversals were $301,000 and $167,000 in fiscal years ending 2006 and 2005, respectively. In fiscal year 2007, we did not reverse any portions of this reserve.

Warranty Cost. We accrue for warranty costs based on estimated product return rates and the expected material and labor costs to provide warranty services. If actual products return rates, repair cost or replacement costs differ significantly from our estimates, then our gross margin could be adversely affected. The liability for product warranties was $148,000 and $263,000 as of September 30, 2007 and September 30, 2006, respectively. This liability was largely related to adjustments of warranty reserve requirements. Each quarter, we reevaluate our estimates to assess the adequacy of our recorded warranty liabilities considering the products subject to warranty protection and adjust the amounts as necessary.

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,		
	2007	**2006**	**2005**
Consolidated Statements of Operations Data:			
Net revenue:			
Hardware	90.7%	92.1%	86.5%
Software	9.3	7.9	13.5
Total net revenue	100.0	100.0	100.0
Cost of revenue:			
Hardware	44.7	44.6	41.7
Software	0.7	0.6	1.0
Total cost of revenue	45.4	45.2	42.7
Gross profit	54.6	54.8	57.3
Operating expenses:			
Research and development	18.9	20.9	22.6
Sales and marketing	29.4	24.3	25.5
General and administrative	14.0	11.5	12.6
Total operating expenses	62.3	56.7	60.7
Loss from operations	(7.7)	(1.9)	(3.4)
Equity in net loss of investee		(0.2)	(0.1)
Interest and other income, net	2.6	2.1	1.5
Net loss before income taxes	(5.1)		(2.0)
Provision for income taxes	(0.1)	(0.1)	
Net loss	(5.2)%	(0.1)%	(2.0)%

Fiscal Year Ended September 30, 2007 Compared to Fiscal Year Ended September 30, 2006

Net Revenue

Net sales consist primarily of revenue from direct sales to end-users, including resellers, and sales to distributors.

We are organized and operate as two operating segments, the Americas and International. The Americas is comprised of the United States, Canada, Mexico, Central America and the Caribbean. The International segment is comprised of China, the United Kingdom and Norway.

The following table sets forth percentages of net revenue by geographic region with respect to such revenue for the periods indicated (in thousands, except revenue percentages):

	Fiscal Year Ended September 30,	
	2007	2006
Americas	90%	90%
International	10%	10%
	100%	100%

Net revenue by customers that individually accounted for more than 10% of our revenue for the twelve months ended September 30, 2007 and 2006, respectively, were as follows (in thousands, except revenue percentages):

	Fiscal Year Ended September 30,	
	2007	2006
AltiSys	16%	15%
Synnex	50%	55%
Graybar	15%	14%

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

	Fiscal Year Ended September 30,	
	2007	2006
Hardware	91%	92%
Software	9%	8%
Total	100%	100%

Net revenue was $17.9 million in both fiscal years 2007 and 2006. Revenue generated in the Americas accounted for $16.2 million, or 90% of total net revenue, for fiscal year ending September 30, 2007 as compared to $16.1 million, or 90% of total net revenue, for fiscal year ending September 30, 2006; however, total units shipped in fiscal year 2007 increased by approximately 11% as compared to fiscal year 2006 as the average selling price per unit decrease in fiscal year 2007 by approximately 10% as compared to fiscal year 2006. Additionally, the number of smaller units increased in fiscal year 2007 by approximately 19% as compared to fiscal year 2006 while the larger units declined in fiscal year 2007 by approximately 18% as compared to fiscal year 2006. We sold more of the smaller units in the fiscal 2007 compared to the same period in the prior year. The increase in the sales of our smaller telephone systems is largely attributable to lower prices of our new MAX1000 Voice over IP phone systems compared to lower end products in the same period in the prior year.

Cost of Revenue

For the fiscal years ended September 30, 2007 and September 30, 2006, cost of revenue was approximately $8.1 million. Cost of revenue as a percentage of net revenue was 45% for both fiscal years ending September 30, 2007 and 2006, respectively.

Research and Development ("R&D")

Research and development expenses consist primarily of costs related to personnel and overhead, consultant expenses and other costs associated with design, development, prototyping and testing of our products and enhancements of our converged telephone system software. Expenditures for R&D decreased 10% or $367,000 to $3.4 million in 2007 compared to $3.7 million in fiscal year 2006. The decrease in R&D expense in absolute dollars was primarily attributable to a reduction in project related expenses of approximately $238,000 and a decrease in overhead allocations of approximately $115,000. In fiscal 2006, our project related expenditures were primarily related to our new product, MAX1000 Voice over IP phone systems which was successfully brought to market in fiscal 2007. Research and development expenses as a percentage of revenue decreased from 21% in fiscal year 2006 to 19% in fiscal year 2007. We continue to believe that focused investments in R&D are critical to the future growth and competitive position in the marketplace and are directly related to timely development of new and enhanced products that are central to our business strategy. As such, we expect to increase spending in R&D expenses in the future periods over the long term to remain competitive. In the short term, we expect research and development expenses to remain consistent as management continues to monitor expenses and plans to keep them in line with expected revenue opportunities.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries, commissions and related expenses for personnel engaged in marketing, sales and customer support functions, as well as trade shows, advertising, and promotional expenses. Sales and marketing expenses increased by approximately $924,000 or 21% from $4.4 million in fiscal year 2006 to $5.3 million in fiscal year 2007. The expense increase in fiscal 2007, as compared to fiscal 2006 in absolute dollars, was primarily related to an increase in personnel-related expenses of approximately $539,000, $155,000 increase in travel-related expenses, service-related expenses of approximately $128,000, $17,000 increase in overhead allocations and increased advertising expenses of approximately $80,000. Sales and marketing expenses as a percentage of revenue increased from 24% in fiscal year 2006 to 29% in fiscal year 2007. We anticipate sales and marketing expenses will increase in future periods over the long term due to increased staffing levels, particularly in sales and increased marketing activities and as we face increasing commission expense to the extent we achieve higher sales levels.

General and Administrative ("G&A")

General and administrative expenses consist of salaries and personnel related expenses for (i) executive, finance, human resources and administrative personnel, (ii) facilities, (iii) allowance for doubtful accounts, (iv) legal, and (v) other general corporate expenses. General and administrative expenses increased by approximately $439,000 or 21% from $2.0 million in fiscal year 2006 to $2.4 million in fiscal year 2007. The expense increase in absolute dollars was primarily attributable to an increase in personnel-related expenses of approximately $138,000, $93,000 increase in overhead allocations, $47,000 increase in travel-related expenses, increase of approximately $53,000 in legal expenses associated with corporate governance matters and an increase of approximately $100,000 in general corporate expenses. General and administrative expenses as a percentage of revenue increased from 12% in fiscal year 2006 to 14% in fiscal year 2007. We expect general and administrative expenses to increase due to the cost associated with compliance with Section 404 of Sarbanes Oxley Act during fiscal year 2008 and beyond.

Equity Investment in Common Stock of Private Company

Equity investment in common stock of private company is primarily our allocated portion of the net income or losses of a private Korean telecommunications company acquired an ownership interest in July 2004. We purchased common stock of a private Korean telecommunications company for approximately $79,000. As a result of this investment, we acquired approximately 23% of the voting power of the company. This gives us the right to nominate and elect one of the three members of the Company's current board of directors. We are accounting for this investment using the equity method.

For the fiscal years ended September 30, 2007 and September 30, 2006, we recorded product sales revenue to this Company totaling $33,000 and $14,000, respectively. Our accounts receivable from this company decreased to $16,000 in fiscal year 2007 from $30,000 in fiscal year 2006. Total equity in net loss of this company was approximately $4,000 and $36,000 for fiscal years ended 2007 and 2006, respectively.

Interest and Other Income, Net

Net interest and other income increased to $461,000 in fiscal year 2007 from $380,000 in fiscal year 2006. The increase in 2007 is attributable primarily to stronger investment yields resulting from higher average market interest rates. The weighted average interest rate earned by us on our cash, cash equivalents, and short-term investments increased to 5.27% in 2007 as compared to the 4.58% rate earned during 2006. We expect net interest and other income to remain relatively flat with little change in cash available to invest.

Fiscal Year Ended September 30, 2006 Compared to Fiscal Year Ended September 30, 2005

Net Revenue

The following table sets forth percentage of net revenue by geographic region with respect to such revenue for the periods indicated (in thousands, except revenue percentages):

	Fiscal Year Ended September 30,	
	2006	**2005**
Americas	90%	90%
International	10%	10%
	100%	100%

Net revenue by customers that individually accounted for more than 10% of our revenue for the twelve months ended September 30, 2006 and 2005, respectively, were as follows (in thousands, except revenue percentages):

	Fiscal Year Ended September 30,	
	2006	**2005**
AltiSys	15%	16%
Synnex	55%	53%
Graybar	14%	11%

For fiscal year ended September 30, 2006, we incurred a net loss of $12,000 as compared to a net loss of $311,000 for fiscal year ended September 30, 2005. During the current fiscal year ended September 30, 2006, we recognized $801,000 of non-cash stock-based compensation due to the adoption of SFAS No. 123(R). This standard was adopted on October 1, 2005.

Net revenue increased 16% from $15.4 million in fiscal year 2005 to $17.9 million in fiscal year 2006 primarily due to higher sales of telephone systems in the Americas. Revenue generated in the Americas accounted for $16.1 million or 90% of revenue in fiscal year 2006 and $13.9 million or 90% of revenue in fiscal year 2005. The number of system shipped in fiscal year 2006 grew 22% over fiscal year 2005 as a result of increased customer acceptance of our new pricing and packaging strategy of bundling the AltiView software, which offers more features than other products on the market, the penetration of our AltiContact Manager (ACM) in the call center market and the introduction of our internet protocol phones, the IP710 and IP705 to the market.

Cost of Revenue

Cost of revenue in fiscal year 2006 increased $1.5 million or 23% to $8.1 million from approximately $6.6 million in fiscal year 2005 primarily due to an increase in overall sales of products and the requisite increase in product costs. Cost of revenue as a percentage of net revenue increased from 43% in fiscal year 2005 to 45% in fiscal year 2006. This increase was primarily caused by a lower profit margin as a result of a price deduction on our smaller telephone system bundles in the second quarter of fiscal year 2005.

Research and Development ("R&D")

Research and development expenses consist principally of salaries and related personnel expenses, consultant fees and prototype expenses related to the design, development and testing of our products and enhancement of our converged telephone system software. Research and development expenses increased by approximately $244,000 or 7% from $3.5 million in fiscal year 2005 to $3.7 million in fiscal year 2006. Research and development expenses as a percentage of revenue decreased from 23% in fiscal year 2005 to 21% in fiscal year 2006. The increase in research and development expenses in absolute dollars was primarily attributable to a $279,000 increase of non-cash stock-based compensation recorded due to the adoption of SFAS No. 123(R) and a decrease of approximately $36,000 in legal expenses.

Sales and Marketing

Sales and marketing expenses consist primarily of salaries, commissions and related expenses for personnel engaged in marketing, sales and customer support functions, as well as trade shows, advertising, and promotional expenses. Sales and marketing expenses increased by approximately $410,000 or 10% from $3.9 million in fiscal year 2005 to $4.4 million in fiscal year 2006. Sales and marketing expenses as a percentage of revenue decreased from 26% in fiscal year 2005 to 24% in fiscal year 2006. This increase in absolute dollars was due to a $216,000 increase of non-cash stock-based compensation recorded due to the adoption of SFAS No. 123(R); an increase of approximately $42,000 in advertising; headcount-related costs also increased by approximately $48,000 as well as an increase in market development funds of approximately $108,000.

General and Administrative ("G&A")

General and administrative expenses consist of salaries and related expenses for (i) executive, finance, human resources and administrative personnel, (ii) facilities, (iii) allowance for doubtful accounts, (iv) legal, and (v) other general corporate expenses. General and administrative expenses increased by approximately $112,000 or 6% from $1.9 million in fiscal year 2005 to $2.0 million in fiscal year 2006. General and administrative expenses as a percentage of revenue decreased from 13% in fiscal year 2005 to 12% in fiscal year 2006. The increase in absolute dollars was mainly the result of a $270,000 non-cash stock-based compensation expense required by SFAS No. 123(R), and a reduction in insurance expenses of approximately $168,000.

Equity Investment in Common Stock of Private Company

In July 2004, we purchased common stock of a private Korean telecommunications company for $79,000. As a result of this investment, we acquired approximately 23% of the voting power of the company and have the right to nominate and have elected one of the three members of the company's current board of directors. We are accounting for this investment using the equity method. We had revenue from product sales to this company of $14,000 and $37,000 during fiscal years 2006 and 2005, respectively. Our accounts receivable from this company decreased to $30,000 in fiscal year 2006 from $40,000 in fiscal year 2005. The total equity in net losses of Korea investee was approximately $160,000 of which 23%, or $36,000 was recognized in fiscal 2006. In fiscal year 2005 equity in net losses of our

Korea investee was approximately $52,000 of which 23% or $12,000 was recognized in the fourth quarter of fiscal year 2005.

Interest and Other Income, Net

Net interest and other income increased to $380,000 in fiscal year 2006 from $237,000 in fiscal year 2005. The increase in net interest and other income was primarily a result of higher interest rates on investments. We expect net interest and other income to remain relatively flat as we have limited cash reserves to invest.

Liquidity and Capital Resources

Since inception, we have financed our operations primarily through the sale of equity securities. For both fiscal years 2007 and 2006, respectively, we held cash, cash equivalents and short-term investments totaling $9.9 million. As of September 30, 2007, $6.1 million of our total assets are classified as cash and cash equivalents compared with $5.1 million at September 30, 2006. Short-term investments were approximately $3.8 and $4.8 for fiscal year ended September 30, 2007 and 2006, respectively.

The Company believes its existing balances of cash, cash equivalents, and short-term investments, as well as cash expected to be generated from operating activities, will be sufficient to satisfy its working capital needs, capital expenditures, and other liquidity requirements associated with its existing operations over the next 12 months.

The following table presents selected financial information for each of the last three fiscal years:

	Fiscal Year Ended September 30,		
	2007	**2006**	**2005**
		(in thousands)	
Cash and cash equivalents	$ 6,111	$ 5,053	$ 3,963
Short-term investments	3,796	4,869	5,459
Total cash, cash equivalents and short-term investments	$ 9,907	$ 9,922	$ 9,422
Cash provided by (used in) operating activities	$ (712)	$ 570	$ (509)
Cash provided by investing activities	$ 931	$ 191	$ 1,215
Cash provided by financing activities	$ 839	$ 329	$ 359
Net increase in cash and cash equivalents	$ 1,058	$ 1,090	$ 1,065

Changes in Cash Flows

In fiscal year 2007, our net cash used in operating activities was $712,000 compared to net cash provided by operating activities of $570,000 during the same period in fiscal 2006. This change was primarily attributable to our net loss of $936,000 for fiscal 2007, an increase of $185,000 in net inventories, an increase of $426,000 in accounts receivable and $114,000 increase in prepaid and other current assets. The cash impact of the loss for the year was partially offset by non-cash adjustments of $247,000 in depreciation and amortization costs, and non-cash stock-based compensation expense of $602,000.

The net cash provided by operating activities of $570,000 for fiscal year 2006 was based on a lower net loss of $12,000, an increase of approximately $273,000 in accounts receivable, an increase of $417,000 in net inventories and an increase in accounts payable of approximately $184,000. The non-cash adjustments to net income were primarily comprised of depreciation and amortization costs of $219,000, $801,000 of non-cash stock-based compensation expense and a $36,000 net loss of a private Korean company.

Net accounts receivable increased to $2.7 million at September 30, 2007 from $2.2 million at September 30, 2006. We attribute the increase in accounts receivable to an increase in sales of our products during the fourth quarter of fiscal 2007 and an increase in days sales outstanding (DSO) at 46 days as of September 30, 2007 from 44 days at September 30, 2006. As we continue to focus on developing products that allow us to enhance our position in our target market segment and enter new markets, we expect to see continued revenue growth for fiscal year 2008. Generally, as sales levels rise, we expect inventories, accounts receivable and accounts payable to increase. However, there will be routine fluctuations in these accounts from period to period that may be significant in amount.

We ended the fourth quarter of fiscal year 2007 with a cash conversion cycle of 85 days as compared to 69 days for the fourth quarter of fiscal 2006. The cash conversion cycle is the duration between purchase of inventories and services and the collection of the cash from the sale of our products and services and is a metric on which we have focused as we continue to try to efficiently manage our assets. The cash conversion cycle results from the calculation of days of sales outstanding (DSO) added to days of supply in inventories (DOS), reduced by days of payable outstanding (DPO).

Inventories increased to $1.6 million at September 30, 2007 from $1.4 million at September 30, 2006 and our annualized inventory turn rate decreased to 5.7 times as of September 30, 2007 as compared to 5.9 times as of September 30, 2006. Our annualized inventory turn rate represents the number of times inventory is replenished during the year. This increase in inventories was primarily attributable to the new product introduction of our MAX1000 Voice over IP (VoIP) phone system. Inventory management will continue to be an area of focus as we balance the need to maintain strategic inventory levels to help ensure competitive lead times with the risk of inventory obsolescence due to rapidly changing technology and customer requirements.

Accounts payable decreased to $821,000 at September 30, 2007 from $837,000 at September 30, 2006. The decrease in accounts payable during this period was the result of routine period-to-period fluctuations.

Net cash provided by financing activities was approximately $839,000 and $329,000 as of September 30, 2007 and 2006, respectively. This increase was primarily attributable to the proceeds from the stock option exercises made by our president and chief operating officer, Jeremiah Fleming as described in the Form 8-K filed with the SEC on April 6, 2007. The Company sold and issued 300,000 shares of common stock to Mr. Fleming at a fair market value of $1.70.

Liquidity and Capital Resources

As of September 30, 2007, our principal sources of liquidity included cash, cash equivalents and short-term investments of approximately $9.9 million. The maturities of our short-term investments are staggered throughout the year to ensure we meet our cash requirements.

Our cash needs depend on numerous factors, including market acceptance of and demand for our products, our ability to develop and introduce new products 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, the timing and expense associated with expanding our distribution channels, increases in manufacturing costs and the prices of the components we purchase, 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 acceptable terms, or at all. We also may require additional capital to acquire or invest in complementary businesses or products, or obtain the right to use complementary technologies. If we cannot raise needed funds in the future if needed, on acceptable terms, we may not be able to further develop or enhance our products, 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, 2007. We had total outstanding commitments on noncancelable capital and operating leases of $1.2 million as of September 30, 2007. Lease terms on our existing facility operating leases generally range from three to nine years. We believe, we have sufficient cash reserves to allow us to continue operations for more than a year. Our cash and short-term investments totaled approximately $9.9 million as of September 30, 2007.

In fiscal year 2008, our Board of Directors approved the repurchase of up to $2.0 million of its common stock in the open market. The repurchases will be made from time to time through November 14, 2008 at the Company's discretion depending on factors such as our stock price, general business and market conditions, and other investment opportunities. The repurchase will be made in the open market and will be funded from available working capital.

The following table presents certain payments due by us under contractual obligations with minimum firm commitments as of September 30, 2007:

	Fiscal Year Ended September 30, 2007				
Contractual Obligations	**Total**	**Payments Due in Less Than 1 Year**	**Payments Due in 1 - 3 Years**	**Payments Due in 3 - 5 Years**	**Payments Due in More Than 5 Years**
			(in thousands)		
Operating leases obligation	$ 1,098	$ 526	$ 572	$	$
Capital leases obligation	124	47	77		
Total contractual lease obligation	$ 1,222	$ 573	$ 649	$	$

Recent Accounting Pronouncements

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 (our 2009 fiscal year). We have not yet determined the impact, if any, of SFAS No. 159 on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(revised 2007), *Business Combinations ("SFAS No. 141R").* SFAS No. 141R will significantly change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, IPR&D and restructuring costs. In addition, under SFAS No. 141R, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008 (our 2010 fiscal year). We have not yet determined the impact, if any, of SFAS No. 141R on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 ("SFAS No. 160").* SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests (NCI) and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008 (our 2010 fiscal year). We have not yet determined the impact, if any, of SFAS No. 160 on our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. ("FIN") 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, "Accounting for Income Taxes," and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 provides guidance on derecognition, classification, interest penalties and accounting in interim periods, and requires expanded disclosure with respect to the uncertainty in income taxes. FIN 48 is effective as of the beginning of our 2008 fiscal year. The cumulative effect, if any, of applying FIN 48 is to be reported as an adjustment to the opening balance of retained earnings in the year of adoption. We have not yet determined the impact, if any, of FIN 48 on our consolidated financial statements.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk.

At September 30, 2007, our investment portfolio consisted primarily of fixed income securities. These securities are subject to interest rate risk and will decline in value if market interest rates increase. Due to the short duration and conservative nature of these instruments, we do not believe that we have a material exposure to interest rate risk. For example, if market interest rates were to increase immediately and uniformly by 10% from levels as of September 30, 2007, the decline in the fair value of the portfolio would not have a material effect on our results of operations over the next fiscal year.

Interest Rate Risk

Our interest income and expense is most sensitive to fluctuations in the general level of U.S. interest rates. As such, changes in U.S. interest rates affect the interest earned on our cash, cash equivalents, and short-term investments, the value of those investments. Due to the short-term nature of our cash equivalents and investments, we have concluded that a change in interest rates does not pose a material market risk to us.

Foreign Currency Exchange Risk

We transact business in non-U.S. currencies, primarily the Chinese Yuan (Renminbi). In the short term, we do not foresee foreign exchange currency fluctuations to pose a material market risk to us. In future periods over the long term, we anticipate we will be exposed to fluctuations in foreign currency exchange rates on accounts receivable from sales in these foreign currencies and the net monetary assets and liabilities of the related foreign subsidiary.

Item 8. Financial Statements and Supplementary Data.

The financial statements required by this item are incorporated by reference from Part IV Item 15(a) 1 and 2 hereof. The selected quarterly supplementary data is included as part of Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations."

1. INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

The following Consolidated Financial Statements are filed as part of this report:

2. INDEX TO FINANCIAL STATEMENT SCHEDULE

The following financial statement schedule is submitted herewith:

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

None.

Item 9A. Controls and Procedures

Evaluation of disclosure controls and procedures

Based on an evaluation under the supervision and with the participation of our management, our Chief Executive Officer ("CEO") and Chief Financial Officer ("CFO") have concluded that our disclosure controls and procedures as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended ("Exchange Act") were effective as of September 30, 2007 to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission rules and forms and accumulated and communicated to our management, including our CEO and CFO, as appropriate, to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal controls over financial reporting during the fourth quarter of fiscal 2007 that has materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors and Executive Officers of the Registrant

The information required by this section with respect to our directors is incorporated by reference from the information in the section entitled: "Election of Directors" in the Company's definitive Proxy Statement for the Annual Meeting of Stockholders to be held on February 7, 2008 (the "Proxy Statement").

The information required by this section with respect to any known late filing or failure by an insider to file a report required by Section 16 of the Exchange Act is incorporated by reference from the information in the section titled "Section 16(a) Beneficial Ownership Reporting Compliance" in our Proxy Statement.

Our board of directors adopted a Code of Conduct for all of directors, officers and employees on July 26, 2004. Our Code of Conduct is posted on our website at *http://www.altigen.com/company investors-conduct.html*. We intend to disclose any amendment to, or waivers of, the provisions of our Code of Conduct that apply specifically to our Chief Executive Officer, Chief Financial Officer, Controller or persons performing similar functions by posting such information on our website.

A copy of our Code of Conduct is also available upon written request and without charge to any stockholder by writing to: Secretary, AltiGen Communications, Inc., 4555 Cushing Parkway, Fremont, CA 94538.

The following table sets forth certain information with regard to our executive officers and their ages as of September 30, 2007:

Name	Age	Position With the Company
Gilbert Hu	50	Chief Executive Officer, Director
Jeremiah Fleming	50	President, Chief Operating Officer, Director
Philip M. McDermott	61	Chief Financial Officer
Michael Plumer	43	Vice President of Sales
Simon Chouldjian	54	Vice President of Hardware Engineering
Tsyr-Yi (Shirley) Sun	47	Vice President of Research and Development

Gilbert Hu founded AltiGen and has served as our Chief Executive Officer and a Class III Director since May 1994. Before founding AltiGen, Mr. Hu was a founder, President and Chief Executive Officer of Centrum Communications, Inc., a networking company acquired by 3Com Corporation in early 1994. Mr. Hu has also served in technical and managerial roles at Vitalink Communication Corporation, an internet working equipment manufacturer. He received a Bachelor of Science degree in Electrical Engineering from National Chiao-Tung University in Taiwan and a Master of Science degree in Electrical Engineering from Arizona State University.

Jeremiah Fleming has served as our President and Chief Operating Officer since April 2007. Mr. Fleming has also served as a Class II Director of AltiGen since July 2007. For the past ten years, Mr. Fleming has served as a member of the executive management team of Interactive Intelligence, Inc. When Interactive Intelligence launched its Vonexus subsidiary in 2004 to focus on Microsoft-based IP communications solutions, Mr. Fleming was appointed President of Vonexus. In that role, he was responsible for corporate strategy, management, business development and overall financial performance. Mr. Fleming originally joined Interactive Intelligence, Inc. as Vice President of Sales in 1997 to drive the inaugural launch of the company's enterprise communications software. Following Interactive Intelligence's initial public offering in 1999, Mr. Fleming was promoted to

Executive Vice President of Sales for the Americas, Europe, Middle East and Africa. Previously, he spent five years at Software Artistry Inc. in various management positions, including Vice President, Domestic Sales from January 1995 to February 1997. Mr. Fleming holds a B.A degree and an M.B.A. degree from the University of Missouri.

Philip M. McDermott has served as our Chief Financial Officer since June 1999. From October 1995 to May 1999, Mr. McDermott served as Director of Finance for Americas Sales for 3Com Corporation. From October 1994 to October 1995, Mr. McDermott served as Vice President of Finance, Operations and Administration for DAVID Systems, a division of Chipcom Corporation, a public networking company. Chipcom was subsequently acquired by 3Com Corporation. Mr. McDermott received Certified Management Accountant accreditation from The Society of Management Accounting in Montreal, Canada.

Michael Plumer has served as our Vice President of Sales since July 2004. Mr. Plumer joined AltiGen in November 1996 to begin building the AltiGen sales channel. In the past eight years he has held various positions including Senior Director of Sales and National Sales Director. From January 1994 until October 1996, Mr. Plumer worked for NetManage, Inc. Mr. Plumer received a Bachelor of Arts degree in Journalism and Public Relations from Iowa State University.

Simon Chouldjian has served as our Vice President of Hardware Engineering since November 2001. He served as our Vice President of Manufacturing from June 1997 to November 2001. From July 1984 to June 1997, Mr. Chouldjian was the founder and Vice President of Engineering of Luxcom, Inc., a manufacturer of communication hub equipment. Mr. Chouldjian has held supervisory and project manager positions in engineering at the Hewlett Packard Company and TRW, Inc. He received a Bachelor of Science degree in Electrical Engineering from the University of California, Berkeley and a Master of Science degree in Electrical Engineering from Stanford University.

Tsyr-Yi (Shirley) Sun has served as our Vice President of Research and Development since October 1999. Prior to that role, she served as our Director of Internet Protocol Telephony from April 1998 to October 1999. From February 1994 to March 1998, Ms. Sun worked for 3Com Corporation as an engineering manager. From August 1991 to February 1994, Ms. Sun was a founder and an engineering manager with Centrum Communications, Inc., a networking company acquired by 3Com Corporation in early 1994. Ms. Sun received a Bachelor of Science degree in Mechanical Engineering from National Central University in Taiwan and a Master of Science degree in Computer Science from Utah State University.

Item 11. Executive Compensation

The information required by this section is incorporated by reference from the information in the section titled "Executive Compensation and Other Matters" in our Proxy Statement.

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

The information required by this section is incorporated by reference from the information in the section titled: "Security Ownership of Certain Beneficial Owners and Management" in our Proxy Statement.

Item 13. Certain Relationships and Related Transactions

The information required by this item regarding certain relationships and related transactions is incorporated by reference to the information set forth in the section titled "Certain Relationships and Related Transactions" in our Proxy Statement.

Item 14. Principal Accountant Fees and Services

The following table presents fees for professional audit services rendered by Moss Adams LLP and Deloitte & Touche LLP for the audit of our annual financial statements for the year ended September 30, 2007 and September 30, 2006 and fees billed for other services rendered by Moss Adams LLP and Deloitte & Touche LLP during those periods.

Audit and Non-Audit Fee:

	Fiscal Year Ended September 30,	
	2007	**2006**
	(in thousands)	
Moss Adams LLP		
Audit Fees(1)	$ 216	$ 160
Audit-Related Fees(2)		
Tax Fees(3)	25	30
All Other Fees(4)		
Total	$ 241	$ 190
Deloitte & Touche LLP		
Audit Fees(1)	$	$ 88
Audit-Related Fees(2)		
Tax Fees(3)	10	
All Other Fees(4)	9	20
Total	$ 19	$ 108

(1) Audit fees consist of fees relate to professional services rendered in connection with the audit of our consolidated annual financial statements, quarterly review of the interim consolidated financial statements included in our Forms 10-Q, and audit services provided in connection with other statutory and regulatory filings. For fiscal year ended September 30, 2006, Moss Adams LLP's audit fees included professional services rendered in connection with the audit of our consolidated annual financial statements and the review of our interim consolidated financial statements included in our third quarter report on Form 10-Q. During the same period, Deloitte & Touche LLP's audit fees included the review of our interim consolidated financial statements included in our first and second quarter reports on Form 10-Q.

(2) There were no audit-related fees incurred in fiscal 2007 or 2006 which would have consisted of fees billed for assurance and related services that are reasonably related to the performance of the audit or review of our consolidated financial statements and are not reported under "Audit Fees."

(3) Tax fees consist of fees related to professional services rendered for tax compliance and tax planning (domestic and international). These services include assistance regarding federal, state and international tax compliance and tax planning. Moss Adams LLP's tax fees were approximately $25,000 and $30,000 for fiscal year 2007 and 2006, respectively. During fiscal 2007, we paid Deloitte & Touche LLP approximately $10,000 for services related to the review of international filing requirements and consultation with Moss Adams LLP in connection with the transition of our tax preparation services to Moss Adams LLP.

(4) All other fees consist of fees for products and services other than the services reported above. During fiscal 2007, Deloitte & Touche LLP billed the Company approximately $9,000 for services rendered in connection with the Consent issued with the Company's filing Form 10-K for the year ended September 30, 2006. During fiscal year 2007, Moss Adams LLP did not provide any services other than as described above. During fiscal 2006, Deloitte & Touche LLP billed the Company approximately $20,000 for services rendered in connection with the filing of one of our Current Reports on Form 8-K.

The Audit Committee pre-approves all audit and permissible non-audit services provided by the independent registered public accounting firm. These services may include audit services, audit-related services, tax services and other services. The Audit Committee has adopted a policy for the pre-approval of services provided by the independent auditors. Under the policy, pre-approval generally is provided for up to one year and any pre-approval is detailed as to the particular service or category of services and is subject to a specific budget. In addition, the Audit Committee may also pre-approve particular services on a case-by-case basis. For each proposed service, the independent registered public accounting firm is required to provide detailed back-up documentation at the time of approval. The Audit Committee may delegate pre-approval authority to one or more of its members. Such member must report any decisions to the Audit Committee at the next scheduled meeting.

PART IV

Item 15. Exhibits and Financial Statement Schedules

(a)
The following documents are filed as a part of this Annual Report on Form 10-K.

1.
FINANCIAL STATEMENTS

2.
FINANCIAL STATEMENT SCHEDULES

The following financial statement schedule is submitted herewith:

(All other schedules are omitted because they are not applicable or the required information is shown in the Consolidated Financial Statements or notes thereto.)

3. EXHIBITS

The following exhibits are included in this Annual Report on Form 10-K (numbered in accordance with Item 601 of Regulation S-K):

Exhibit Number	Description
3.1*	Amended and Restated Certificate of Incorporation.
3.2*****	Second Amended and Restated Bylaws.
4.2*	Specimen common stock certificates.
4.3*	Third Amended and Restated Rights Agreement dated May 7, 1999 by and among AltiGen Communications, Inc. and the Investors and Founder named therein.
10.1*	Form of Indemnification Agreement.
10.2*	1994 Stock Option Plan, as amended, and form of stock option agreement.
10.3*	1998 Stock Purchase Plan.
10.4****	1999 Stock Plan, as amended, and form of stock option agreement.
10.5***	1999 Employee Stock Purchase Plan, as amended, and forms of subscription agreement and notice of withdrawal.
10.8****	Lease agreement: 4555 Cushing Parkway, Fremont, California between VEF III Funding, LLC and AltiGen Communications, Inc., dated October 1, 2003.
10.19*	Employment Agreement by and between the Registrant and Philip McDermott, dated June 8, 1999.
10.26**++	OEM Agreement between AltiSys Communications and AltiGen Communications, Inc., dated January 18, 1999.
10.27****++	Distribution Agreement between Synnex Information Technologies, Inc. and AltiGen Communications, Inc. dated December 22, 1999.
10.28****++	Distribution Agreement between Graybar Electric Company, Inc. and AltiGen Communications, Inc. dated June 12, 2003.
10.29+++	Distribution Agreement between Jenne Distributor, Inc., and AltiGen Communications, Inc. dated September 30, 2007.
21.1*	Subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm.
23.2	Consent of Deloitte & Touche LLP, Independent Registered Public Accounting Firm.
24.1	Power of Attorney (included on signature page).
31.1	Certification of Principal Executive Officer.
31.2	Certification of Principal Financial Officer.
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

* Incorporated by reference to exhibit filed with the Registrant's Registration Statement on Form S-1 (No. 333-80037) declared effective on October 4, 1999.

** Incorporated by reference to exhibit filed with the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2001.

***	Incorporated by reference to exhibit filed with the Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 2002.
****	Incorporated by reference to exhibit filed with the Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 2003.
*****	Incorporated by reference to exhibit filed with the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004.
++	Confidential treatment was granted for certain portions of this exhibit.
+++	Confidential treatment requested as to certain portions of this exhibit.

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
AltiGen Communications, Inc.
Fremont, CA

We have audited the accompanying consolidated balance sheets of AltiGen Communications, Inc. and subsidiaries (the "Company") as of September 30, 2007 and 2006, and the related consolidated statements of operations, stockholders' equity, and cash flows for the periods ended September 30, 2007 and 2006. Our audits also included the financial statement schedules for the years ended September 30, 2007 and 2006 listed in the Index at Item 15(a)(2). These financial statements and financial statement schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedules based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of AltiGen Communications, Inc. and subsidiaries as of September 30, 2007 and 2006, and the results of their operations and their cash flows for the periods ended September 30, 2007 and 2006, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedules, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

As described in Note 2 to the consolidated financial statements, the Company adopted a new principle of accounting for share-based payments in accordance with Financial Accounting Standards Board Statement No. 123(R), Share-Based Payment.

/s/ MOSS ADAMS LLP

San Francisco, California
December 27, 2007

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of
AltiGen Communications, Inc.
Fremont, CA

We have audited the accompanying consolidated statements of operations, stockholders' equity and comprehensive income (loss), and cash flows of AltiGen Communications, Inc. and subsidiaries (the "Company") for the year ended September 30, 2005. Our audit also included the financial statement schedule for the year ended September 30, 2005 listed in the Index at Item 15(a)(2). These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audit.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the results of operations and cash flows of AltiGen Communications, Inc. and subsidiaries for the year ended September 30, 2005, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule for the year ended September 30, 2005, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

/s/ DELOITTE & TOUCHE LLP

San Jose, California
December 27, 2005

ALTIGEN COMMUNICATIONS, INC. AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)

	September 30,	
	2007	**2006**
ASSETS		
Current assets:		
Cash and cash equivalents	$ 6,111	$ 5,053
Short-term investments	3,796	4,869
Accounts receivable, net of allowances of $33 and $38 in 2007 and 2006, respectively	2,656	2,230
Inventories, net	1,567	1,382
Prepaid expenses and other current assets	237	123
Total current assets	14,367	13,657
Property and equipment:		
Furniture and equipment	1,837	1,783
Computer software	938	920
	2,775	2,703
Less: Accumulated depreciation	(2,269)	(2,022)
Net property and equipment	506	681
Other non-current assets:		
Long-term investments	209	211
Long-term deposit	168	95
Total other non-current assets	377	306
Total assets	$ 15,250	$ 14,644
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 821	$ 837
Accrued liabilities:		
Payroll and related benefits	459	328
Warranty	148	263
Marketing	79	68
Accrued expense	322	263
Other	422	340
Deferred revenue	565	531
Total current liabilities	2,816	2,630
Long-term deferred rent and other	89	177
Stockholders' equity:		
Convertible preferred stock, $0.001 par value; Authorized 5,000,000 shares; Outstanding none at September 30, 2007 and September 30, 2006		

	September 30,	
Common stock, $0.001 par value; Authorized 50,000,000 shares; Outstanding 16,733,552 shares at September 30, 2007 and 16,157,364 shares at September 30, 2006	16	16
Treasury stock at cost 1,063,895 shares at September 30, 2007 and September 30, 2006	(1,014)	(1,014)
Additional paid-in capital	65,434	63,993
Accumulated other comprehensive loss	3	
Accumulated deficit	(52,094)	(51,158)
Total stockholders' equity	12,345	11,837
Total liabilities and stockholders' equity	$ 15,250	$ 14,644

See accompanying Notes to Consolidated Financial Statements.

ALTIGEN COMMUNICATIONS, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

	Fiscal Year Ended September 30,		
	2007	**2006**	**2005**
Net revenue:			
Hardware	$ 16,233	$ 16,486	$ 13,363
Software	1,655	1,410	2,078
Total net revenue	17,888	17,896	15,441
Cost of revenue:			
Hardware	7,993	7,979	6,442
Software	130	103	150
Total cost of revenue	8,123	8,082	6,592
Gross profit	9,765	9,814	8,849
Operating expenses:			
Research and development	3,373	3,740	3,496
Sales and marketing	5,277	4,353	3,943
General and administrative	2,497	2,058	1,946
Total operating expenses	11,147	10,151	9,385
loss from operations	(1,382)	(337)	(536)
Equity in net loss of investee	(4)	(36)	(12)
Interest and other income, net	461	380	237
Net income (loss) before taxes	(925)	7	(311)
Income taxes	(11)	(19)	
Net loss	$ (936)	$ (12)	$ (311)
Basic and diluted net loss per share	$ (0.06)	$ (0.00)	$ (0.02)
Weighted average shares used in computing basic net loss per share	15,363	14,964	14,605
Weighted average shares used in computing diluted net loss per share	15,363	14,964	14,605

See accompanying Notes to Consolidated Financial Statements.

ALTIGEN COMMUNICATIONS, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY AND COMPREHENSIVE INCOME (LOSS)

(In thousands, except share amounts)

	Common Stock						
	Shares	Amount	Treasury Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Loss	Accumulated Deficit	Total Stockholders' Equity
BALANCE, SEPTEMBER 30, 2004	15,462,506	$ 15	$ (1,014)	$ 62,505	$ (2)	$ (50,835)	$ 10,669
Exercise of stock options	210,107	1		199			200
Issuance of common stock in connection with Employee Stock Purchase Plan	109,458			159			159
Unrealized gain from investments					1		1
Net loss						(311)	(311)
Comprehensive income (loss)							(310)
BALANCE, SEPTEMBER 30, 2005	15,782,071	16	(1,014)	62,863	(1)	(51,146)	10,718
Exercise of stock options	265,895			186			186
Issuance of common stock in connection with Employee Stock Purchase Plan	109,398			143			143
Unrealized gain from investments					1		1
Stock-based compensation				801			801
Net loss						(12)	(12)
Comprehensive income (loss)							(11)
BALANCE, SEPTEMBER 30, 2006	16,157,364	16	(1,014)	63,993		(51,158)	11,837
Exercise of stock options	481,438			711			711
Issuance of common stock in connection with Employee Stock Purchase Plan	94,750			128			128
Unrealized gain from investments					3		3
Stock-based compensation				602			602
Net loss						(936)	(936)
Comprehensive income (loss)							(933)
BALANCE, SEPTEMBER 30, 2007	16,733,552	$ 16	$ (1,014)	$ 65,434	$ 3	$ (52,094)	$ 12,345

See accompanying Notes to Consolidated Financial Statements.

ALTIGEN COMMUNICATIONS, INC. AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Fiscal Year Ended September 30,		
	2007	**2006**	**2005**
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net loss	$ (936)	$ (12)	$ (311)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	247	219	109
Stock-based compensation	602	801	
Equity in net loss of investee	4	36	12
Changes in operating assets and liabilities:			
Accounts receivable	(426)	(273)	(100)
Inventories, net	(185)	(417)	93
Prepaid expenses and other current assets	(116)	25	(81)
Accounts payable	(16)	184	(145)
Accrued liabilities	168	64	(188)
Deferred revenue	34	24	(11)
Long-term deferred rent and other	(88)	(81)	113
Net cash provided by (used in) operating activities	(712)	570	(509)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of short-term investments	(28,772)	(26,031)	(8,761)
Proceeds from sale of short-term investments	29,848	26,621	10,440
Changes in long-term investments			15
Changes in long-term deposits	(73)	(21)	
Purchases of property and equipment	(72)	(378)	(479)
Net cash provided by investing activities	931	191	1,215
CASH FLOWS FROM FINANCING ACTIVITIES:			
Proceeds from issuances of common stock, net of issuance costs	839	329	359
Net cash provided by financing activities	839	329	359
NET INCREASE IN CASH AND CASH EQUIVALENTS	1,058	1,090	1,065
CASH AND CASH EQUIVALENTS, BEGINNING OF YEAR	5,053	3,963	2,898
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 6,111	$ 5,053	$ 3,963

See accompanying Notes to Consolidated Financial Statements.

ALTIGEN COMMUNICATIONS, INC. AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION OF THE COMPANY

We are a pioneer and market leader in Internet protocol telephony systems for small-to-medium sized businesses. We design, manufacture and market next generation, Internet protocol phone systems and contact centers that use both the Internet and the public telephone network to take advantage of the convergence of voice and data communications. Unlike traditional proprietary phone systems, our systems are designed with open architecture and are built on an industry standard platform. This adherence to industry standards allows our products to play an important role in the small-to-medium sized business market by delivering phone systems that can integrate with other technologies and provide integrated voice and data solutions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Presentation

Our consolidated financial statements reflect the operations of AltiGen Communications, Inc. and our wholly-owned subsidiary. The subsidiary is located in Shanghai, China and was incorporated in November 1998. As of September 30, 2007, we had approximately $41,000 in long-lived assets located in China. Our hardware tooling used to develop the IP710 and the IP705 phones as well as the tooling used to develop the face plate for the MAX1000 Voice over IP phone system are located in Taiwan. All significant intercompany transactions and balances have been eliminated. Our fiscal year end is September 30. Unless otherwise stated, all references to fiscal years 2007, 2006, and 2005 refer to the twelve months ended September 30 of that year.

In March 2005, the Company revised the presentation of its consolidated statements of operations to separate net revenue and cost of revenue by source (hardware and software).

Use of Estimates in Preparation of Financial Statements

The preparation of the financial statements in conformity with generally accepted accounting principles in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reported periods. Key estimates include provisions for excess and obsolete inventories, warranty, doubtful account reserve, valuation on tax assets and long-term investments. Actual results could differ from those estimates.

Concentration of Risk

Financial instruments that potentially subject us to significant concentrations of credit risk consist principally of cash, cash equivalents and accounts receivable. We invest our cash in demand and money market deposit accounts in banks. We limit the credit exposure to any one financial institution or instrument and is exposed to credit risk in the event of default by these institutions, to the extent of the amounts recorded on the balance sheet. To date, we have not experienced losses on these investments.

Our purchases are concentrated with four suppliers and certain key chip components of our products are sole sourced. For fiscal years 2007 and 2006 these four suppliers provided 79% and 91%, respectively, of all raw materials purchased. Loss of one of these suppliers could adversely impact our operations.

Cash and Cash Equivalents and Short-Term Investments

We consider all highly liquid investments with an original maturity of three months or less from the date of purchase to be cash equivalents. Short-term investments are in highly liquid financial instruments with original maturities greater than three-months but less than one year and are classified as "available-for-sale" investments. Investments are reported at their fair value, with unrealized gains and losses excluded from earnings and reported as a separate component of stockholders' equity. As of September 30, 2007, our cash and cash equivalents consisted of commercial paper and cash deposited in checking and money market accounts.

The following table summarizes the fair value of the Company's available-for-sale securities held in its short-term investment portfolio, recorded short-term investments:

Available for Sale Securities:

Fiscal Year Ended September 30, 2007
(in thousands)

Security Description	Amortized Cost	Net Unrealized Gain/(Losses)	Fair Market Value	Accrued Interest Income	Total Value
Corporate bonds and notes	1,875	(2)	1,873		1,873
Commercial paper	1,908	(1)	1,907	16	1,923
Total	$ 3,783	$ (3)	$ 3,780	$ 16	$ 3,796

Fiscal Year Ended September 30, 2006
(in thousands)

Security Description	Amortized Cost	Net Unrealized Gain/(Losses)	Fair Market Value	Accrued Interest Income	Total Value
U.S. government securities	$ 1,001	$ 1	$ 1,002	$ 2	$ 1,004
Commercial paper	3,835	(1)	3,834	31	3,865
Total	$ 4,836	$	$ 4,836	$ 33	$ 4,869

The U.S. government securities include bonds and discount notes with a maturity date of one to 30 years at issuance. Corporate bonds and discount notes have maturities from one day to one year at issuance. The securities are issued by such agencies as Fannie Mae (FNMA), Freddie Mac (FHLMC) and Government Sponsored Enterprises (GSEs).

Accrued interest is calculated on a 30-day month/360-day year for corporate bonds and municipal bonds, and on actual-calendar-days for Government bonds. Income bonds and bonds in default trade without accrued interest. When calculating accrued interest on a bond that is being sold, it is conventional to consider the time period from the most recent payment up to, but not including, the date on which the bond sale is settled.

The unrealized losses on the Company's investments during 2007 were caused primarily by changes in interest rates. The Company typically invests in highly-rated securities with strong liquidity. The

Company's investment policy requires investments to be rated single-A or better. Therefore, the Company considers the declines to be temporary in nature. During 2007, the Company did not record any impairment on outstanding securities.

Inventories

Inventories (which include costs associated with components assembled by third-party assembly manufacturers, as well as internal labor and allocable overhead) are stated at the lower of standard cost (which approximates actual cost on a first-in, first-out method) or market value. Provisions, when required, are made to reduce excess and obsolete inventories to their estimated net realizable values. We regularly monitor inventory quantities on hand and record a provision for excess and obsolete inventories based primarily on our estimated forecast of product demand and production requirements for the next six months. As of September 30, 2007, we recognized $96,000 of provision for excess and obsolete inventories. Inventory reserve was approximately $2.4 million and $2.3 million as of September 30, 2007 and 2006, respectively. The components of inventories include:

	Fiscal Year Ended September 30,	
	2007	**2006**
	(in thousands)	
Raw materials	$ 675	$ 497
Work-in-progress	106	75
Finished goods	786	810
Total	$ 1,567	$ 1,382

Property, Plant and Equipment Net

Property, plant, and equipment are stated at cost. Cost includes purchase cost, applicable taxes and freight costs. Depreciation is computed by use of the straight-line method over the estimated useful lives of the assets, which is three years except for tooling. Our tooling is depreciated using the greater value between the five year straight-line method or the number of phones shipped in the period. Cost includes purchase cost, applicable taxes and freight. Depreciation expense for fiscal years 2007, 2006 and 2005, was approximately $247,000, $218,000 and $109,000, respectively. All repairs and maintenance costs are expensed as incurred.

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

	Fiscal Year Ended September 30,	
	2007	2006
Machinery and equipment	$ 238	$ 214
Furniture and equipment	1,097	1,067
Tooling	502	502
Software	938	920
Total	2,775	2,703
Accumulated depreciation and amortization	(2,269)	(2,022)
Property and equipment net	$ 506	$ 681

Net book value of equipment leased under capital leases was $52,000 and $118,000 for fiscal years 2007 and 2006, respectively. Net of accumulated deprecation for such equipment was $147,000 and $81,000 for fiscal years 2007 and 2006, respectively.

Long-Term Investments

As of September 30, 2006, we held an investment of common stock of private Taiwanese telecommunication company valued at approximately $195,000 accounted for using the cost method. Our interest in the company is approximately 2%, which interest does not allow us to exercise significant influence.

In July 2004, we purchased common stock of a private Korean telecommunications company for $79,000. As a result of this investment, we acquired approximately 23% of the voting power of the company. This gives us the right to nominate and elect one of the three members of the Company's current board of directors. We are accounting for this investment using the equity method and record our minority interest of their results in our results of operations. As of September 30, 2007, our investment in the Korean company had a remaining book value of approximately $14,000 compared to $16,000 at fiscal year 2006.

We perform periodic reviews of our investments for impairment. Our investments are considered impaired when a review of the issuer's operations and other indicators of impairment indicate that the carrying value of the investment is not likely to be recoverable. Such indicators include, but are not limited to, limited capital resources, limited prospects of receiving additional financing, and limited prospects for liquidity of the related securities. No write-downs were recorded during fiscal years 2007, 2006 or 2005.

Software Development Costs

In accordance with Statement of Financial Accounting Standards ("SFAS") No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed," the Company capitalizes eligible computer software development costs upon the establishment of technological feasibility, which it has defined as completion of a working model. The amount of costs eligible for capitalization, after consideration of factors such as realizable value, were not material and, accordingly, all software development costs have been charged to research and development expense in the accompanying consolidated statements of operations.

Stock-Based Compensation

Commencing October 1, 2005, the Company adopted the provisions of Statement of Financial Accounting Standard ("SFAS") No. 123(R), "*Share Based Compensation*" ("SFAS No. 123(R)"), which requires all share-based compensation, including grants of stock options, to be recognized in the income statement as an operating expense, based on their fair market values. On October 1, 2005, first day of fiscal 2006, the Company adopted SFAS No. 123(R) using the modified prospective method. Under this transition method, stock based compensation cost recognized subsequent to October 1, 2005 included: (i) compensation cost for all share-based awards granted prior to but not yet vested as of September 30, 2005, based on the grant-date fair value estimated in accordance with SFAS No. 123(R), and (ii) compensation cost for all share-based awards granted subsequent to September 30, 2005, based on the grant-date fair value estimated in accordance with SFAS No. 123(R). In accordance with the modified prospective method of adoption, the Company has not restated the Company's results of operations and financial position for prior periods.

Prior to adopting SFAS No. 123(R), the Company accounted for stock-based employee compensation under Accounting Principles Board ("APB") Opinion No. 25, "*Accounting for Stock Issued to Employees*," as amended by SFAS No. 148, "*Accounting for Stock-Based Compensation Transition and Disclosures*." The Company applied the modified prospective method in adopting SFAS No. 123(R) and, accordingly, the Company recorded compensation costs as the requisite service was rendered for the unvested portion of previously issued awards that remain outstanding at the initial date of adoption. Periods prior to the adoption of SFAS No. 123(R) have not been restated.

The Company has provided pro forma disclosures of the effect on net (loss) and earnings (loss) per share for the year ended September 30, 2005 in the table below to reflect the impact had the Company been required to include the amortization of the Black-Scholes option value as an expense (in thousands, except for per share data):

	For the Year Ended September 30, 2005	
Net loss	$	(311)
Add: stock-based employee compensation expense included in reported net loss under APB No. 25		
Deduct: Total stock-based compensation determined under fair value based method prior to adoption of SFAS No. 123R, net of related tax effects		(1,680)
Net loss pro forma	$	(1,991)
Basic and diluted net income (loss) per share:		
As reported	$	(0.02)
Pro forma	$	(0.14)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model, and is not subject to revaluation as a result of subsequent stock price fluctuations. The following table lists the weighted-average assumptions the Company used to value stock options:

	Employee Stock Option Plans Fiscal Year Ended September 30,			Employee Stock Purchase Plan Fiscal Year Ended September 30,		
	2007	2006	2005	2007	2006	2005
Expected Life (in years)	5	5	5	0.5	0.5	0.5
Risk-free interest rate	4.6-4.9%	4.3-5.4%	3.5-4.0%	5.32%	5.15%	4.3%
Volatility	90%	95%	100%	89%	94%	99%
Expected dividend	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%

The Black-Scholes option pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option pricing models require the input of highly subjective assumptions, including the expected stock price volatility. The Company estimates expected stock price volatility based on historical volatility rates since our initial public offering, trended into future years. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of our options. The Company bases the risk-free interest rate for periods within the contractual life of the option upon the U.S. Treasury yield.

Revenue Recognition

The Company accounts for the recognition of revenue in accordance with Statement of Position ("SOP") 97-2, "*Software Revenue Recognition*." Revenue consist of sales to end-users, including resellers, and to distributors. Revenue from sales to end-users including resellers are recognized upon shipment, when risk of loss has passed to the customer, collection of the receivable is reasonably assured, persuasive evidence of an arrangement exits, and the price is fixed and determinable. Sales to distributors are made under terms allowing certain rights of return and protection against subsequent price declines on the Company's products held by its distributors. Upon termination, any unsold products may be returned by the distributor for a full refund. These agreements may be canceled by either party based on a specified notice. As a result of the above provisions, the Company defers recognition of distributor revenue until such distributors resell our products to their customers. The amounts deferred as a result of this policy are reflected as "deferred revenue" in the accompanying consolidated balance sheets. The related cost of revenue is also deferred and reported in the consolidated balance sheets as inventory.

Software components are generally not sold separately from the Company's hardware components. Software revenue consist of license revenue that are recognized upon the delivery of application products. The Company provides limited post-contract customer support ("PCS"), consisting primarily of technical support and "bug" fixes. In accordance with SOP 97-2, revenue earned on software arrangements involving multiple elements is allocated to each element based upon the relative fair values of the elements. Although the Company provides PCS, the revenue allocated to this element is recognized together with the initial licensing fee on delivery of the software because: (1) the PCS fee is included with the initial licensing fee; (2) the PCS included with the initial license fee is for one year or less; (3) the estimated cost of providing PCS during the arrangement is insignificant; and (4) unspecified upgrades/enhancements offered for minimal or no cost during PCS arrangements historically have been and are expected to continue to be minimal and infrequent. All estimated costs of providing the services, including upgrades and enhancements are accrued for at the time of delivery.

For fiscal years 2007, 2006, and 2005, percentage of net revenue generated in the Americas for the following customers was approximately 81%, 84%, and 80%, respectively:

	Fiscal Year Ended September 30,		
	2007	**2006**	**2005**
AltiSys	16%	15%	16%
Synnex	50%	55%	53%
Graybar	15%	14%	11%

International revenue derived from sales to customers outside of the Americas, primarily in China, Norway and the United Kingdom. Net revenue generated internationally was approximately 10% for fiscal years 2007, 2006 and 2005, respectively.

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 the Americas and International. The Company's two geographical segments, all sell the same products to the same types of customers. The Company's reportable operating segments are comprised of the Americas, and International operations. The Americas segment includes the United States, Canada, Mexico, Central America and the Caribbean. The International segment is comprised of China, the United Kingdom and Norway.

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

	Fiscal Year Ended September 30,		
	2007	**2006**	**2005**
Americas	90%	90%	90%
International	10%	10%	10%
Total	100%	100%	100%

Computation of Basic and Diluted Net Loss Per Share

The Company bases its basic earnings per share upon the weighted average number of common shares outstanding during the period in accordance with SFAS No. 128, *Earnings per Share* ("SFAS No. 128"). Basic earnings per common share is computed by dividing income available to common shareholders 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 sets forth the computation of basic and diluted loss per share (in thousands, except net loss and per share amounts):

	Fiscal Year Ended September 30,		
	2007	**2006**	**2005**
Net loss	$ (936)	$ (12)	$ (311)
Computation of common shares outstanding basic loss per share:			
Weighted average common stock	15,363	14,964	14,605
Basic net loss per share	$ (0.06)	$ (0.00)	$ (0.02)
Diluted loss per share	$ (0.06)	$ (0.00)	$ (0.02)

Options to purchase 3.7 million, 3.6 million and 4.1 million shares of common stock were outstanding for the years ended September 30, 2007, September 30, 2006 and September 30, 2005, respectively, and were excluded from the computation of diluted net earnings per share for these periods because their effect would have been antidilutive.

Comprehensive Loss

Comprehensive income consists of two components, net income and other comprehensive income. Other comprehensive income refers to revenue, expenses, gains, and losses that under U.S. generally accepted accounting principles are recorded as an element of shareholders' equity but are excluded from net income. The Company's other comprehensive income consists of unrealized gain and losses on marketable securities categorized as available-for-sale.

The following table summarizes comprehensive loss for fiscal years 2007, 2006 and 2005, respectively (in thousands):

	Fiscal Year Ended September 30,		
	2007	**2006**	**2005**
Net loss	$ (936)	$ (12)	$ (311)
Other comprehensive income	3	1	1
	$ (933)	$ (11)	$ (310)

Recent Accounting Pronouncements

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ("SFAS No. 159"). SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007 (our 2009 fiscal year). We have not yet determined the impact, if any, of SFAS No. 159 on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations ("SFAS No. 141R").* SFAS No. 141R will significantly change the accounting for business combinations in a number of areas including the treatment of contingent consideration, contingencies, acquisition costs, IPR&D and restructuring costs. In addition, under SFAS No. 141R, changes in deferred tax asset valuation allowances and acquired income tax uncertainties in a business combination after the measurement period will impact income tax expense. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008 (our 2010 fiscal year). We have not yet determined the impact, if any, of SFAS No. 141R on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an amendment of ARB No. 51 ("SFAS No. 160").* SFAS No. 160 will change the accounting and reporting for minority interests, which will be recharacterized as noncontrolling interests (NCI) and classified as a component of equity. This new consolidation method will significantly change the accounting for transactions with minority interest holders. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008 (our 2010 fiscal year). We have not yet determined the impact, if any, of SFAS No. 160 on our consolidated financial statements.

In July 2006, the FASB issued FASB Interpretation No. ("FIN") 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, "Accounting for Income Taxes," and it seeks to reduce the diversity in practice associated with certain aspects of measurement and recognition in accounting for income taxes. In addition, FIN 48 provides guidance on derecognition, classification, interest penalties and accounting in interim periods, and requires expanded disclosure with respect to the uncertainty in income taxes. FIN 48 is effective as of the beginning of our 2008 fiscal year. The cumulative effect, if any, of applying FIN 48 is to be reported as an adjustment to the opening balance of retained earnings in the year of adoption. We have not yet determined the impact, if any, of FIN 48 on our consolidated financial statements.

3. WARRANTY

The Company provides a one year warranty for hardware products starting upon shipment to end users. The Company has historically experienced minimal warranty costs. Factors that affect our warranty liability include the number of installed units, historical experience and management's judgment regarding anticipated rates of warranty claims and cost per claim. The Company assesses the adequacy of its recorded warranty liability every quarter and makes adjustments to the liability if necessary.

Changes in the Company's warranty liability for the fiscal years ended September 30, 2007 and 2006, respectively, are as follows (in thousands):

	Fiscal Year Ended September 30,	
	2007	**2006**
	(in thousands)	
Beginning balance	$ 263	$ 264
Provisions for warranty liability	168	146
Other adjustments	(100)	
Warranty cost including labor, components and scrap	(183)	(147)
Ending balance	$ 148	$ 263

Other adjustments were the result of a significant decline in the product return rate caused by changes in the Company's management of the return programs.

4. COMMITMENTS AND CONTINGENCIES

Commitments

We lease our facilities under various operating lease agreements expiring on various dates through February 2009. In December 2003, we leased approximately 32,000 square feet to serve as our headquarters for corporate administration, research and development, manufacturing, and sales and marketing facility in Fremont, California. The lease for its headquarters expires on February 21, 2009. Rent expense for all operating leases totaled approximately $574,000, $539,000 and $486,000, for fiscal years 2007, 2006 and 2005, respectively. In June 2007, the Company's Shanghai branch entered into a new lease agreement for a period of three years. The Company believes its current facilities are adequate to support its needs through the end of fiscal 2008. Additionally, the Company also leases certain equipment under capital lease arrangements. The minimum future lease payments under all noncancellable capital and operating leases as of September 30, 2007 are as follows (in thousands):

	Capital Leases	Operating Leases
Fiscal Year Ending September 30,		
2008	47	526
2009	44	332
2010	33	240
Total contractual lease obligation	$ 124	$ 1,098
Amount representing interest	$ 14	
Present value of minimum lease payment	110	
Total minimum future lease payment	$ 124	
Current portion	$ 39	
Long-term portion	71	
Total capital lease commitments	$ 110	

Contingencies

From time to time, the Company may become party to litigation in the normal course of our business. Litigation in general, and intellectual property and securities litigation in particular, can be expensive and disruptive to normal business operations. Moreover, the results of complex litigation are difficult to predict.

On September 6, 2002, Vertical Networks, Inc. filed suit against the Company in the United States District Court for the Northern District of California, alleging infringement of U.S. Patents Nos. 6,266,341, 6,289,025, 6,292,482, 6,389,009, and 6,396,849. On October 28, 2002, Vertical Networks amended its complaint to add allegations of infringement of U.S. Patents Nos. 5,617,418 and 5,687,174. Vertical Networks filed a second amended complaint on November 20, 2002 to identify products and/or activities that allegedly infringe the seven patents-in-suit. Vertical Networks' Complaint seeks an injunction against future patent infringement, an award of damages, including treble damages for alleged willful infringement, and attorneys' fees and costs. On December 9, 2002, the Company filed an answer and counterclaims for declaratory relief, and on December 26, 2002, Vertical Networks filed its reply to those counterclaims. On October 4, 2007, the parties entered into a stipulation dismissing the lawsuit in its entirety without prejudice.

5. CAPITAL STOCK

Common Stock

The Company is authorized to issue 50,000,000 shares of common stock. At September 30, 2007, we had reserved the following shares of common stock for future issuance:

1994 Stock Option Plan	962,189
1999 Employee Stock Purchase Plan	670,890
1999 Stock Option Plan	4,170,701
Total	5,803,780

Stock Option Plans

In October 1994, we adopted the 1994 Stock Option Plan (the "1994 Plan") and authorized the issuance of 2,096,246 shares to employees, directors, and consultants. As of September 30, 2007, there were 168,233 vested shares outstanding from the 1994 Plan. In 1996, all shares under the 1994 Plan vested and continue to remain outstanding. Additionally, no new options can be granted from this plan. During fiscal year 1999, we adopted the 1999 Stock Option Plan (the "1999 Plan" and together with the "1994 Plan", the "Plans") and authorized the issuance of 2,096,247 shares to employees, directors and consultants. The number of shares will be increased on the first day of the Company's fiscal year equal to the lesser of (i) 1,796,783 shares, (ii) 5% of the outstanding shares on that date or (iii) a lesser amount as determined by the Board of Directors. Under the Plans, the Board of Directors may grant incentive and nonqualified stock options to employees, directors and consultants of the Company. The exercise price per share for an incentive stock option cannot be less than 100% of the fair market value, as determined by the Board of Directors, on the date of grant. The exercise price per share for a nonqualified stock option cannot be less than 85% of the fair market value, as determined by the Board of Directors, on the date of grant. Also, 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. 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. Options under these Plans generally vest over a four-year period and generally expire ten years after the date of grant.

The following table summarizes the Company's stock option plans under the Plans as of September 30, 2004 and changes during the three fiscal years ended September 30, 2007:

	Options Available for Grant	Options Outstanding	Weighted Average Exercise Price
Balance as of September 30, 2004	2,937,899	3,751,814	$ 3.79
Options authorized for grant	719,931		
Options granted (weighted average of fair value of $2.99)	(831,000)	831,000	2.99
Options exercised		(210,107)	0.95
Options forfeited or expired	288,217	(288,217)	4.11
Balance as of September 30, 2005	3,115,047	4,084,490	$ 3.75
Options authorized for grant			
Options granted (weighted average of fair value of $1.76)	(58,000)	58,000	1.76
Options exercised		(265,895)	0.69
Options forfeited or expired	317,425	(317,425)	5.86
Balance as of September 30, 2006	3,374,472	3,559,170	$ 3.76
Options authorized for grant			
Options granted (weighted average of fair value of $1.76)	(778,000)	778,000	1.76
Options exercised		(481,438)	1.48
Options forfeited or expired	154,527	(154,527)	4.21
Balance as of September 30, 2007	2,750,999	3,701,205	$ 3.62
Exercisable at September 30, 2005		2,829,037	$ 4.12
Exercisable at September 30, 2006		2,992,428	$ 3.91
Exercisable at September 30, 2007		3,080,129	$ 3.91

At September 30, 2007, the aggregate intrinsic value of the ending outstanding stock options was $814,000. The total ending vested and expected to vest stock options were 3.6 million shares, the weighted average exercise price was $3.67, the aggregate intrinsic value was $814,000, and the weighted average remaining contractual term was 4.92 years. The total ending exercisable stock options were 3.1 million shares, the aggregate intrinsic value was $814,000, the weighted average exercise price was $3.91, and the weighted average remaining contractual term was 4.30 years.

The following table summarizes information concerning outstanding and exercisable options at September 30, 2007:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding as of 9/30/07	Weighted Average Remaining Contractual Term (years)	Weighted Average Exercise Price	Number Exercisable as of 9/30/07	Weighted Average Exercise Price
\$ 0.23 - \$ 0.59	14,937	3.23	\$ 0.47	14,937	\$ 0.47
0.60 - 0.60	370,516	5.12	0.60	370,516	0.60
0.72 - 0.83	405,811	3.28	0.79	405,811	0.79
0.87 - 1.88	668,544	7.78	1.56	232,504	1.09
1.93 - 2.89	395,571	3.50	2.21	378,989	2.21
2.98 - 2.98	588,500	6.88	2.98	446,023	2.98
3.82 - 3.82	521,833	6.05	3.82	500,856	3.82
3.95 - 11.38	636,736	2.29	9.43	631,736	9.47
11.69 - 11.69	78,757	1.55	11.69	78,757	11.69
12.69 - 12.69	20,000	1.20	12.69	20,000	12.69
	3,701,205	5.05	\$ 3.62	3,080,129	\$ 3.91

1999 Employee Stock Purchase Plan

Under the 1999 Employee Stock Purchase Plan (the "1999 Purchase Plan"), 670,890 shares of common stock are reserved for issuance at September 30, 2007 to eligible employees at a price of 85% of the lower of the fair market value of the common stock on the first day of the offering period or a specified exercise date (last trading day in April or October). The number of reserved shares will be increased on the first day of each fiscal year by the lesser of (i) 598,928 shares, (ii) 2% of the outstanding shares on that date or (iii) a lesser amount determined by the Board of Directors. Participants under the 1999 Purchase Plan generally may not purchase shares on any exercise date to the extent that, immediately after the grant, the participant would own stock totaling 5% or more of the total combined voting power of all stock of the Company, or greater than \$25,000 worth of stock in any calendar year. In addition, no more than 5,989 shares may be purchased by any participant during any offering period. In the event of a sale or merger of us, the Board may accelerate the exercise date of the current purchase period to a date prior to the change of control, or the acquiring company may assume or replace the outstanding purchase rights under the 1999 Purchase Plan. In fiscal year 2007, 94,750 shares were purchased by and distributed to employees at a price of \$1.35 per share.

6. DEFERRED STOCK COMPENSATION

The following table shows total stock-based compensation expense classified by Consolidated Statement of Operations reporting caption for the year ended September 30, 2007, 2006 and 2005:

	Fiscal Year Ended September 30,		
	2007	2006	2005
	(in thousands)		
Cost of goods sold	$ 20	$ 36	$
Research and development	179	279	
Selling, general and administrative	403	486	
Pre-tax stock-based compensation	602	801	
Income tax			
Net stock-based compensation	$ 602	$ 801	$

7. INCOME TAXES

Worldwide income (loss) from continuing operations before provision for income taxes consists of the following:

	Fiscal Year Ended September 30,		
	2007	2006	2005
	(in thousands)		
United States	$ (731)	$ 114	$ (131)
Foreign	(194)	(107)	(180)
Income (loss) from continuing operations	$ (925)	$ 7	$ (311)

The provision for income taxes consisted of the following and is attributable to federal and state minimum taxes:

	Fiscal Year Ended September 30,		
	2007	2006	2005
	(in thousands)		
Federal	$ 9	$ 14	$
State	2	5	
Foreign			
Income tax provision	$ 11	$ 19	$

The Company records a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with SFAS No. 109, *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):

	September 30,	
	2007	**2006**
Net operating loss carryforwards	$ 15,313	$ 15,056
Reserve and other cumulative temporary differences	1,696	1,860
Research and development credit carryforward	1,085	1,085
Net capitalized research and development expenses	282	490
	18,376	18,491
Valuation allowance	(18,376)	(18,491)
Net deferred tax asset	$	$

As of September 30, 2007, we had net operating loss carryforwards for federal income tax purposes of approximately $41.5 million that expire at various dates through 2027, and federal research and development tax credits of approximately $520,000 that expire at various dates through 2027. We also had net operating loss carryforwards for state income tax purposes of approximately $14.2 million that expire at various dates through 2017, and state research and development tax credits of approximately $565,000 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 a result of uncertainties regarding realization of the asset, including limited operating history of the Company, lack of profitability to date and uncertainty over future operating profitability and taxable income. During fiscal years 2007 and 2006, the valuation allowance decreased $115,000 and $1,213,000, respectively. In fiscal year 2005, the valuation allowance increased $47,000. As of September 30, 2007 and 2006 we had no significant deferred tax liabilities.

We did not incur any income tax expenses from our foreign subsidiaries, AltiGen Korea and AltiGen China as of September 30, 2007.

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

	Fiscal Year Ended September 30,		
	2007	**2006**	**2005**
Tax at federal statutory rate	35.0%	35.0%	35.0%
Change in valuation allowance	(10.4)	(4,098.5)	(31.0)
State taxes	2.4	543.7	
Meals & entertainment	(1.8)	179.5	
Unbenefitted foreign loss	(7.3)	535.0	
Stock-based compensation	(18.5)	3,067.8	
Other		8.3	(4.0)
Provision for income taxes	(0.6)%	270.8%	0.0%

8. EQUITY INVESTMENT IN COMMON STOCK OF PRIVATE COMPANY

Equity investment in common stock of private company is primarily the Company's allocated portion of the net income or losses of a private Korean telecommunications company acquired an ownership interest in July 2004. We purchased common stock of a private Korean telecommunications company for approximately $79,000. As a result of this investment, we acquired approximately 23% of the voting power of the company. This gives us the right to nominate and elect one of the three members of the Company's current board of directors. We are accounting for this investment using the equity method. For the fiscal years ended September 30, 2007 and September 30, 2006, we recorded product sales revenue totaling $33,000 and $14,000, respectively. Our accounts receivable from this company decreased to $16,000 in fiscal year 2007 from $30,000 in fiscal year 2006. Total equity in net loss of this company was approximately $2,000 and $36,000 for fiscal years ended 2007 and 2006, respectively.

9. RELATED PARTY TRANSACTION

As of September 30, 2006, we held an investment of common stock of private Taiwanese telecommunication company valued at approximately $195,000 accounted for using the cost method. Our interest in the company is approximately 2%, which interest does not allow us to exercise significant influence.

In July 2004, we purchased common stock of a private Korean telecommunications company for $79,000. As a result of this investment, we acquired approximately 23% of the voting power of the company. This gives us the right to nominate and elect one of the three members of the Company's current board of directors. We are accounting for this investment using the equity method and record our minority interest of their results in our results of operations. As of September 30, 2007, our investment in the Korean company had a remaining book value of approximately $14,000 compared to $16,000 at fiscal year 2006.

10. SUBSEQUENT EVENTS

In fiscal year 2008, our Board of Directors approved the repurchase of up to $2.0 million of our common stock in the open market. The repurchases will be made from time to time through

November 14, 2008 at the Company's discretion depending on factors such as our stock price, general business and market conditions, and other investment opportunities. The repurchase will be made in the open market and will be funded from available working capital.

Additionally, subsequent to our November 13, 2007 board meeting, our Board of Directors authorized and approved to issue approximately 1.0 million shares of our common stock to employees and directors.

11. SELECTED QUARTERLY FINANCIAL DATA

Following is a summary of our quarterly operating results and share data for the years ended September 30, 2007 and September 30, 2006.

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
	(in thousands, except per share data) (Un-audited)			
Consolidated Statements of Operations Data:				
Fiscal year ending September 30, 2007:				
Net revenue	$ 4,372	$ 4,145	$ 4,181	$ 5,190
Gross profit	2,361	2,241	2,233	2,930
Net loss	(94)	(172)	(526)	(144)
Basic and diluted net loss per share	(0.01)	(0.01)	(0.03)	(0.01)
Fiscal year ending September 30, 2006:				
Net revenue	$ 4,403	$ 4,174	$ 4,806	$ 4,513
Gross profit	2,385	2,239	2,711	2,479
Net income (loss)	(218)	(120)	190	136
Basic and diluted net income (loss) per share	(0.01)	(0.01)	0.01	0.01

ALTIGEN COMMUNICATIONS, INC. AND SUBSIDIARY

SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS

Classification	Balance at Beginning of Fiscal Year	Charged to Costs and Expenses(a)	Deductions(b)	Balance at End of Fiscal Year
		(in thousands)		
Allowance for doubtful accounts:				
Fiscal year ending September 30, 2007	$ 38	$ 15	$ (20)	$ 33
Fiscal year ending September 30, 2006	$ 40	$ 1	$ (3)	$ 38
Fiscal year ending September 30, 2005	$ 35	$ 34	$ (29)	$ 40

(a) Related to identified uncollectible accounts

(b) Charges for which allowances were created

	Balance at Beginning of Fiscal Year	Charged to Revenue(a)	Deductions(b)	Balance at End of Fiscal Year
Inventory reserve:				
Fiscal year ending September 30, 2007	$ 2,279	$ 96	$	$ 2,375
Fiscal year ending September 30, 2006	$ 2,458	$ 122	$ (301)	$ 2,279
Fiscal year ending September 30, 2005	$ 2,625	$	$ (167)	$ 2,458

(a) Primarily related to sales reserves

(b) Charges for which allowances were created

The deductions are a result of sales of product that were recovered and we are currently using up this reserve as we sell our product.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Date: December 27, 2007

ALTIGEN COMMUNICATIONS, INC.

By: /s/ GILBERT HU

Gilbert Hu
Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENT, that each person whose signature appears below constitutes and appoints Gilbert Hu and Philip M. McDermott, jointly and severally, his attorneys-in-fact, each with the power of substitution, for him in any and all capacities, to sign any amendments to this report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes may do or cause to be done by virtue hereof.

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

Signature	Title	Date
/s/ GILBERT HU Gilbert Hu	Chief Executive Officer (principal executive officer) and Director	December 27, 2007
/s/ JEREMIAH J. FLEMING Jeremiah J. Fleming	President, Chief Operating Officer (principal operating officer) and Director	December 27, 2007
/s/ PHILIP M. MCDERMOTT Philip M. McDermott	Chief Financial Officer (principal financial and accounting officer)	December 27, 2007
/s/ ERIC D. WANGER Eric D. Wanger	Director	December 27, 2007
/s/ TACHENG CHESTER WANG Tacheng Chester Wang	Director	December 27, 2007
/s/ MIKE MON YEN TSAI Mike Mon Yen Tsai	Director	December 27, 2007

AltiGen Communications, Inc.

Exhibit Index

Exhibit Number	Description
3.1*	Amended and Restated Certificate of Incorporation.
3.2*****	Second Amended and Restated Bylaws.
4.2*	Specimen common stock certificates.
4.3*	Third Amended and Restated Rights Agreement dated May 7, 1999 by and among AltiGen Communications, Inc. and the Investors and Founder named therein.
10.1*	Form of Indemnification Agreement.
10.2*	1994 Stock Option Plan, as amended, and form of stock option agreement.
10.3*	1998 Stock Purchase Plan.
10.4****	1999 Stock Plan, as amended, and form of stock option agreement.
10.5***	1999 Employee Stock Purchase Plan, as amended, and forms of subscription agreement and notice of withdrawal.
10.8****	Lease agreement: 4555 Cushing Parkway, Fremont, California between VEF III Funding, LLC. And AltiGen Communications, Inc. dated October 1, 2003.
10.19*	Employment Agreement by and between the Registrant and Philip McDermott, dated June 8, 1999.
10.26**++	OEM Agreement between AltiSys Communications and AltiGen Communications, Inc., dated January 18, 1999.
10.27****++	Distribution Agreement between Synnex Information Technologies, Inc. and AltiGen Communications, Inc. dated December 22, 1999.
10.28****++	Distribution Agreement between Graybar Electric Company, Inc. and AltiGen Communications, Inc. dated June 12, 2003.
10.29+++	Distribution Agreement between Jenne Distributor, Inc., and AltiGen Communications, Inc. dated September 30, 2007.
21.1*	Subsidiaries of the Registrant.
23.1	Consent of Independent Registered Public Accounting Firm.
23.2	Consent of Deloitte & Touche LLP, Independent Registered Public Accounting Firm.
24.1	Power of Attorney (included on signature page).
31.1	Certification of Principal Executive Officer.
31.2	Certification of Principal Financial Officer.
32.1	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

*	Incorporated by reference to exhibit filed with the Registrant's Registration Statement on Form S-1 (No. 333-80037) declared effective on October 4, 1999.
**	Incorporated by reference to exhibit filed with the Registrant's Quarterly Report on Form 10-Q for the quarter ended December 31, 2001.
***	Incorporated by reference to exhibit filed with the Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 2002.
****	Incorporated by reference to exhibit filed with the Registrant's Annual Report on Form 10-K for the fiscal year ended September 30, 2003.
*****	Incorporated by reference to exhibit filed with the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 2004.
++	Confidential treatment was granted for certain portions of this exhibit.
+++	Confidential treatment requested as to certain portions of this exhibit.

QuickLinks