ALTIGEN COMMUNICATIONS, INC.

ANNUAL REPORT

For Fiscal Year Ended September 30, 2016

For more information:
www.OTCQX.com Ticker: ATGN
or
www.altigen.com

Disclosure Regarding Forward-Looking Statements

Any reference to "AltiGen" (which also may be referred to as the "Company", "we", "us" or "our") means AltiGen Communications, Inc. and its consolidated subsidiary. You should read the following discussion of our financial condition and results of operations together with the audited consolidated financial statements and notes to the financial statements included elsewhere in this annual report.

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

These forward-looking statements rely on assumptions, estimates and predictions that could be inaccurate and that are subject to risks and uncertainties that could cause actual results to differ materially from expected results. Forward-looking statements speak only as of the date of this annual report. Except as required by applicable law, we undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

Certain prior period information has been reclassified to conform to the current year presentation and to reflect the write-down of our wholly-owned subsidiary business unit as a discontinued operation. In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

Available Information

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

On December 1, 2016, the Company received a notice letter from the OTC Markets stating the Company was not in compliance with the requirements for continued qualifications under Section 3.2 of the OTCQX Rules for U.S. Companies. The Company does not meet the $5 million Market Capitalization requirement, and as such, will be downgraded to the OTCQB Marketplace effective January 1, 2017. OTCQB is the middle tier of the OTC Market. For more information regarding OTCQB requirements, please visit www.otcmarkets.com.

TABLE OF CONTENTS

PART A - GENERAL COMPANY INFORMATION

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

Exact name of the issuer: AltiGen Communications, Inc.

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

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

Principal Executive Offices:	679 River Oaks Parkway San Jose, CA 95134 Telephone: (408) 597-9000 Facsimile: (408) 597-2020 Website: www.altigen.com
Investor Relations Officer:	Philip M. McDermott, Chief Financial Officer and Director 679 River Oaks Parkway San Jose, CA 95134 Telephone: (408) 597-9000 Email Address: ir@altigen.com

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

AltiGen was incorporated in the state of California in May 1994, and reincorporated in the State of Delaware in June 1999.

PART B – SHARE STRUCTURE

Item IV. The Exact Title and Class of Securities Outstanding

AltiGen has only one class of outstanding stock:

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

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

Item V. Par or Stated Value and Description of the Security

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

The Company's Amended and Restated Certificate of Incorporation authorizes 5,000,000 shares of preferred stock, par value $0.001 per share. The Company may issue these shares of preferred stock without the approval of the holders of common stock. The Board of Directors has the discretion to issue the preferred stock in such series and with such preferences and rights as it may designate.

On April 21 2009, the Company adopted a Preferred Stock Rights Agreement (the "Plan") and declared a dividend distribution of one right for each outstanding share of the Company's common stock. The record date for the distribution was May 7, 2009. The Company designed the Plan to protect the long-term value of the Company for its shareholders during any future unsolicited acquisition attempt. The Company did not adopt the Plan in response to any specific attempt to acquire the Company or its shares and the Company is not aware of any current efforts to do so. These rights will become exercisable only upon the occurrence of certain events specified in the Plan, including the acquisition of 15% of the Company's outstanding common stock by a person or group. Should a person or group acquire 15% or more of the outstanding common stock or announce an unsolicited tender offer, the consummation of which would result in a person or group acquiring 15% or more of the outstanding common stock, shareholders other than the acquiring person may exercise the rights, unless the Board of Directors has approved the transaction in advance. Each right will initially entitle stockholders to purchase one one-thousandths (0.001) of a share of the Company's Series A Participating Preferred Stock for $4.00. If a person or group acquires, or announces a tender or exchange offer that would result in the acquisition of, fifteen percent (15%) or more of our common stock while the Plan remains in place, then, unless the rights are redeemed by us for $0.001 per right, the rights will become exercisable by all rights holders, except the acquiring person or group, for shares of AltiGen or shares of the third party acquirer having a value of twice the right's then-current exercise price. The rights will expire on May 7, 2019 or earlier pursuant to an exchange or redemption of the rights as described above. No shares of the Company's Series A Participating Preferred Stock are currently outstanding. The foregoing statements are subject to, and are qualified in their entirety by reference to, the Plan including the certificate of designation, the form of rights certificate and the summary of rights attached thereto, which have been filed with the SEC as exhibits to the exhibit filed with the Company's Registration Statement on Form 8-K on April 23, 2009.

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

Item VI. The Number of Shares or Total Amount of the Securities Outstanding for Each Class of Securities Authorized

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

As of September 30, 2016					
Class	Number of Shares Authorized	Number of Shares Outstanding	Freely Tradable Shares (Public Float) (1)	Total Number of Beneficial Stockholders (2)	Total Number of Stockholders of Record
Common Stock	50,000,000	22,798,683	17,531,246	1,467	88
Preferred Stock	5,000,000	—	—	—	—
As of September 30, 2015					
Class	Number of Shares Authorized	Number of Shares Outstanding	Freely Tradable Shares (Public Float) (1)	Total Number of Beneficial Stockholders (2)	Total Number of Stockholders of Record
Common Stock	50,000,000	22,798,683	15,819,781	1,566	89
Preferred Stock	5,000,000	—	—	—	—
As of September 30, 2014					
Class	Number of Shares Authorized	Number of Shares Outstanding	Freely Tradable Shares (Public Float) (1)	Total Number of Beneficial Stockholders (2)	Total Number of Stockholders of Record
Common Stock	50,000,000	22,798,683	15,819,781	1,717	96
Preferred Stock	5,000,000	—	—	—	—

(1) For purposes of this calculation only, shares of common stock held by each of AltiGen's directors and officers on the given date and by each person who AltiGen knows beneficially owned 5% or more of the outstanding common stock on that date have been excluded in that such persons may be deemed to be affiliates.

(2) Estimate based on beneficial share range analysis, received from Broadridge Financial Solutions, Inc. There are greater than 100 beneficial shareholders owning at least 100 shares of the Company's common stock.

Item VII. The Name and Address of the Transfer Agent

Transfer Agent: Computershare Trust Company, N.A.
8742 Lucent Boulevard, Suite 225
Highlands Ranch, CO 80129
Telephone: (303) 262-0617

Computershare is currently registered under the Securities Exchange Act of 1934, as amended, and is an authorized transfer agent subject to regulation by the SEC.

PART C – BUSINESS INFORMATION

Item VIII. The Nature of the Issuer's Business

AltiGen Communications, Inc. ("AltiGen," the "Company," "we," "us" or "our") is a leading provider of premise and cloud-based IP-PBX and Contact Center solutions. We design, deliver and support Voice over Internet Protocol (VoIP) phone systems and call center solutions that combine high reliability with integrated IP communications applications. As one of the first companies to offer VoIP solutions, AltiGen has been deploying systems since 1996.

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

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

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

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

EMPLOYEES

As of September 30, 2016, we had 38 full-time employees, including 18 in research and development and support, 12 in sales and marketing, 2 in operations, and 6 in finance and administration. Our future success will depend, in part, on our ability to continue to attract, retain and motivate highly qualified technical, marketing, engineering and management personnel.

COMPETITION

The markets for our products are intensely competitive, continually evolving and subject to changing technologies. We currently compete with Internet protocol and Internet protocol-enabled telecommunications systems, such as Avaya Inc., Mitel Networks Corporation, Shoretel Inc, and Cisco Systems, Inc., as well as hosted PBX service providers like 8X8 and Ring Central. 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. Key competitive factors in each of the segments in which we currently compete and may compete in the future include: low cost of ownership, product features, price and performance. We believe that our principal competitive advantages include:

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

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

INTELLECTUAL PROPERTY

We generally rely upon patent, copyright, trademark and trade secret laws to protect and maintain our proprietary rights for our technology and products. As of September 30, 2016, we have been issued three registered trademarks, "AltiGen™," "AltiServ™" and "Zoomerang™." In addition, the AltiGen logo is a trademark of ours in the United States and other jurisdictions. All other trademarks and trade names used in this annual report are the property of their respective owners.

We have filed several U.S. patent applications relating to various aspects of our client and server software, mixed-media communications and computer telephony. As of September 30, 2016, we have been issued twenty U.S. patents. The duration of each patent is 20 years from the date of its patent application filing. Our current patents will expire between 2017 and 2035. We expect to continue to file patent applications to protect our technology and products. We cannot be sure that our patent applications will result in the issuance of patents, or that any issued patents will provide commercially significant protection for our technology. We maintain a policy requiring our employees, consultants and other third parties to enter into confidentiality and proprietary rights agreements and to control access to software, documentation and other proprietary information. Notwithstanding the steps we have taken to protect our intellectual property rights, third parties may infringe or misappropriate our proprietary rights. Competitors may also independently develop technologies that are substantially equivalent or superior to the technologies we employ in our products and services.

LEGAL PROCEEDINGS

On March 30, 2016, CTI Communications, LLC, a former reseller of the Company ("CTI"), filed a complaint against the Company, Affiliated Technology Solutions, LLC, a current reseller of the Company ("Affiliated"), James Jerome Cruz, a former CTI employee, and Thomas W. Welsh, a manager of Affiliated, in the United States District Court of Colorado, County of Larimer. The complaint alleges misappropriation of trade secrets and breach of contract, and CTI is seeking in a currently pending motion to amend the complaint to include civil conspiracy and tortious interference claims. Although the outcome of this matter is not determinable as of the date of this report, we believe CTI's claims are without merit and we intend to vigorously defend ourselves. The Company has not recorded any liability with respect to this litigation as of September 30, 2016.

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

During the second quarter of fiscal year 2014, the Company made a strategic decision to discontinue and write-down its wholly-owned subsidiary business unit– China segment. In connection with the cessation of operations in the China subsidiary, the Company did not incur material liabilities; however, unanticipated expenses and contingent liabilities could potentially arise. Examples of such contingent liabilities include lease obligations, warranties, contracts and employment matters. We believe that the aforementioned liabilities are not probable and amounts are not estimable, therefore, we did not record any liabilities related to this matter in fiscal years 2016, 2015 and 2014.

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

Item IX. The Nature of Products or Services Offered

The information in Item XIII is incorporated herein by reference.

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

Hardware Transition

Beginning in the first quarter of fiscal 2015, the Company made a strategic decision to structurally transition from a hardware Company in order to leverage our cloud-based offering. The progress we've made over the past year has enabled us to focus on more scalable and profitable software and cloud service solutions. The Company currently relies on third-party vendors for many critical functions of our cloud-based business. The Company has entered into contracts with multiple vendors for these third party network services.

Hosted Enterprise Cloud Communications Services

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

Hosted Skype for Business

Hosted by AltiGen and powered by Microsoft, AltiGen's Hosted Skype for Business delivers the industry's leading unified communications service offering instant messaging, voice/video calling, web conferencing, collaboration and mobility. Our innovative Cloud UC service seamlessly incorporates our MaxACD advanced communications applications – consisting of Auto Attendant, Hunt Groups, Multimedia Contact Center, Recording and Reporting – to deliver a unique Skype for Business managed service. Moreover, AltiGen's Hosted Skype for Business reduces complexity, eliminates capital expenditure (CAPEX) and lowers the total cost of ownership versus on premises deployments of Skype for Business.

MaxACD Cloud Contact Center

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

MaxUC Cloud

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

Session Initiation Protocol (SIP) Trunking

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

Benefits of AltiGen's Hosted Enterprise Cloud Communications Services

- Enhance Productivity – New advanced UC features and functionality enable businesses to better communicate and collaborate to enhance productivity and efficiency.

- Reduce Monthly Communications Costs – Cost-effective SIP Trunking Service and new modes of communication like instant messaging allow businesses to substantially reduce their monthly communications costs.

- Lower Total Cost of Ownership – With no upfront CAPEX investment and a predictable monthly operational expense based on actual utilization, businesses will be able to realize a lower total cost of ownership.

- Simplified Management and Support – With no hardware to deploy, manage and maintain, the support burden on local IT/Telecom teams is greatly reduced.

- Future Proof Solution – As a hosted managed solution, all hardware and software is kept up to date by AltiGen, providing an always up to date solution for the enterprise.

Premise-Based Business Communications Solutions

MaxCS IP-PBX & Contact Center

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

MaxACD Voice Over Internet Protocol (VoIP) Contact Center

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

MaxACD Contact Center for Microsoft Skype for Business

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

Benefits of AltiGen's Premise-Based Business Communications Solutions

- All Software Advantage – AltiGen's Business Communications Solutions are 100% software-based, allowing businesses the flexibility to deploy on cost-effective, open industry standard Intel-based physical or virtual servers.

- Scalability – AltiGen's all-software based architecture was designed to scale in both size and capability to meet the evolving needs of the small and medium-sized business and enterprise markets.

- Licensing Flexibility – Businesses have the flexibility to choose from two cost-effective licensing models: Software as a Service monthly subscription or perpetual upfront purchase.

- Reduced Administration Costs – Easy-to-use, point and click graphical user interfaces enable businesses to self-administer their own communications solution.

- Lower Total Cost of Ownership – The ability to leverage open industry standard hardware, cost-effective software licensing and the ability to self-administer enables businesses to reduce their total cost of ownership.

PRODUCTS

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

Product	Description
MaxCS IP-PBX	MaxCS server software consists of a comprehensive suite of software applications to provide a high value, all-in-one solution. The systems include software and licensing necessary to support analog and VoIP telephones, operator software, and desktop call control software for each extension on the system. By providing a bundled approach, we maintain quality and reliability while providing for easy deployment. The platforms are scalable, and are packaged according to the size of the customer. MaxCS IP-PBX seamlessly integrates with industry standard VoIP devices like Polycom IP phones.
MaxACD VoIP Contact Center	MaxACD is available as a software upgrade to an existing AltiGen phone system. This product is capable of skills-based routing, priority queuing, centralized call recording and advanced monitoring and reporting. This capability may be added on a per agent/supervisor basis as a company's needs grow. This allows a smaller business or branch office to enjoy the same capability as a larger organization with a professional call center. If a company has more than one location, calls to call centers can automatically be routed to other locations based on conditions the customer chooses.
IP720 Voice over IP Telephone	The IP720 is a fully featured SIP-compatible IP telephone designed to empower the user. Bringing stylish form and functionality to the desktop, the IP720 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. The IP720 has integrated Power over Ethernet and Gigabit Ethernet support.
IP805 Voice over IP Telephone	The IP805 is a mid-level SIP-based VoIP phone designed to empower the user and has integrated Power over Ethernet. Users have convenient single button access to voicemail, call conferencing, call transferring, redial and call log lists. The IP805 has six programmable keys, speakerphone and intercom.
MaxMobile	MaxMobile extends a complete set of business PBX functionality to smart phone devices, often eliminating the need for a separate desktop phone. When users log in to MaxMobile, the smart phone is registered as the "business" PBX extension. All inbound business calls are routed through the PBX (so employees don't have to publish their mobile phone numbers). Outbound calls can be routed through the PBX (in accordance with corporate policies) or directly through the cellular network. In every case, MaxMobile graphical user interface extends a multitude of business PBX features to smart phone devices.
MaxCommunicator	MaxCommunicator is a Windows-based desktop application that provides call control and visual voice mail management to the desktop. It allows users to receive and place calls, listen to voicemail messages, identify the caller phone number and manage extension configuration. MaxCommunicator is standard with all AltiGen systems.
MaxAgent	MaxAgent is a Windows-based desktop application to bring call control and workgroup information to call center agents. Users can view a call queue, monitor work group status, check caller identification, measure performance, review log-on history, receive and place calls and listen to and manage voicemail messages.

Product	Description
MaxSupervisor	MaxSupervisor is a Windows-based desktop application for call center supervisors. The application allows a call center or workgroup supervisor to effectively manage a workgroup. MaxSupervisor provides four major real time module views for workgroup management: agent status, agent statistics, group statistics, and queue status with a quality of services capability. MaxSupervisor allows coaching, silent monitoring of agents with barge-in call participation and call recording functionality.
MaxACD for Lync	MaxACD for Lync is a robust call center solution with native integration to Microsoft Lync Servers. Similar to AltiContact Manager, this product is capable of advanced call distribution, skills-based routing, priority queuing, centralized call recording and advanced monitoring and reporting.
MAX 4x4xT1 Access Board	The MAX 4x4xT1 Access Board is a microprocessor-controlled board that allows the MAX1000 and MAX2000 phone system to connect to four (4) analog trunk lines, four (4) analog telephone extensions, and one (1) T1/E1/PRI digital central office telephone line.
MAX 4x8 Access Board	The MAX 4x8 Access Board is a microprocessor-controlled board that allows the MAX1000 and MAX2000 phone system to connect to four (4) analog trunk lines and eight (8) analog telephone extensions.
MAX 8x4 Access Board	The MAX 8x4 Access Board is a microprocessor-controlled board that allows the MAX1000 and MAX2000 phone system to connect to eight (8) analog trunk lines and four (4) analog telephone extensions.
MAX 0x12 Access Board	The MAX 0x12 Access Board is a microprocessor-controlled board that allows the MAX1000 and MAX2000 phone system to connect 12 analog telephone extensions.
MAX1000	The MAX1000 Server is an “all-in-one” PBX solution that comes preloaded with AltiGen’s MaxCS IP PBX software. It supports various MAX Access Boards for Public Switched Telephone Network (“PSTN”) access and supports up to 48 users.
MAX2000	The MAX2000 Server is an “all-in-one” PBX solution that comes preloaded with AltiGen’s MaxCS IP PBX software. It supports various MAX Access Boards for PSTN access and supports up to 100 users.

Hosted Services

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

Service Support Programs

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

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

	Fiscal Year Ended September 30,		
	2016	2015	2014 (1)
Hosted and service support	67%	50%	43%
Software	21%	28%	23%
Hardware and other	12%	22%	34%
Total	100%	100%	100%

(1) Prior year percentages have been revised to reflect the addition of hosted and service support streams.

Customers

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

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

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

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

	Fiscal Year Ended September 30,		
	2016	2015	2014
Synnex	11%	18%	22%
Fiserv	—	13%	12%
Total	11%	31%	34%

MARKETING, SALES AND CUSTOMER SUPPORT

Marketing

We focus our marketing efforts on market knowledge, product definition, new product introduction, product marketing and advertising. We may use advertising both domestically and internationally to market our products independently and in cooperation with our distributors, dealers and strategic partners. Our marketing efforts currently focus on increasing demand for our products in North America and Rest of World. We are organized and operate as two operating segments, "North America" and "Rest of World". The North America segment is comprised of the United States, Canada, Mexico, Central America and the Caribbean. The Rest of World segment is primarily comprised of Europe. Our two geographical segments both sell similar products to similar types of customers. Our product information is available on our website, which contains overview presentations and technical information.

Sales

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

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

The following table sets forth net revenue and percentages of net revenue by geographic region for each of the periods indicated (amounts in thousands, except for percentage data).

	Fiscal Year Ended September 30,					
	2016		2015		2014	
	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue
North America	$ 8,314	99 %	$ 9,588	98 %	$ 9,458	99 %
Rest of World	$ 117	1 %	$ 212	2 %	$ 118	1 %
Total	$ 8,431	100 %	$ 9,800	100 %	$ 9,576	100 %

We also have over 100 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, Utah, Minnesota, Virginia and South Carolina, coordinate service and technical support of our products and provide service during regular business hours. Outside of regular business hours, we offer after hours support through an on-call engineer. Our support personnel assist our distributors and resellers in resolving installation and support issues that arise from their sales to end users. Resellers and end-user customers can also access technical information and receive technical support through our website.

RESEARCH AND DEVELOPMENT

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

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

The majority of our product development is conducted in-house. We also use a small number of independent contractors to assist with certain product development and testing activities. We intend to continue working with our strategic partners to enhance our products. As of September 30, 2016, we employed 18 employees in engineering, research and development and support.

We believe our future success relies on continued product enhancement. To accomplish this objective, we seek to improve product reliability, advance and broaden employed technologies while maintaining or reducing product cost. In addition, we actively pursue development of potential new products. Our efforts to enhance existing products and develop new products require extensive investment in research and development. We expense research and development costs relating to both present and potential future products in the period incurred. These expenses totaled approximately $2.9 million, $3.0 million and $2.9

million during fiscal years 2016, 2015 and 2014, respectively. For software developed for sale purposes, we also capitalize certain costs of product development when the projects under development reach technological feasibility. For internal-use software developed as a service, we capitalized costs as incurred. Costs that qualify for capitalization include purchased materials, external services and fully-burdened salaries. During fiscal year 2016, costs related to product development that qualify for capitalization were not material and accordingly expensed as part of research and development expense. We did not have any capitalized costs related to product development during fiscal years 2015 and 2014.

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

RISK FACTORS

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

Risks Related to Our Business

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

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

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

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

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

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

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

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

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

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

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

Our business depends substantially on customers renewing, upgrading and expanding their subscriptions for our services. Any decline in our customer renewals, upgrades and expansions would harm our future operating results.

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

During fiscal 2015, we made a strategic decision to exit the hardware business as we leverage our cloud-based offering. Accordingly, we expect to lose additional revenue from this revenue stream, which we may not be able to replace.

In fiscal year 2015, 19% of our net revenue was generated from hardware revenue. In the first quarter of fiscal year 2015, we made a strategic decision to structurally transition from a hardware Company to a recurring-revenue, cloud-based business. As a result of this transition, hardware sales declined approximately 60% in fiscal year 2016. We expect this trend to continue into the first and second quarters of fiscal year 2017. If we are unable to replace this revenue, it could have a minor impact on our results of operations.

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

We market and sell our application suite to small- and medium-sized businesses. To grow our revenue quickly, we must add new customers, sell additional services to existing customers and encourage existing customers to renew their subscriptions. However, selling to and retaining small- and medium-sized businesses can be more difficult than selling to and retaining large enterprises because small- and medium-sized business customers:

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

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

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

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

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

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

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

From time to time we may be involved in a variety of claims or litigations, including those described in Note 5, "Commitments and Contingencies" and Part C, "Legal Proceedings" of this Annual Report. Such proceeding may initially be viewed as immaterial but could prove to be material. Litigations are inherently unpredictable, and excessive verdicts do occur. Given the inherent uncertainties in litigation, even when we are able to reasonably estimate the amount of possible loss or range of loss and therefore record an aggregate litigation accrual for probable and reasonably estimable loss contingencies, the accrual may change in the future due to new developments or changes in approach. In addition, such claims or litigations could involve significant expense and diversion of management's attention and resources from other matters.

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

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

- our board of directors has the right to increase the size of the board of directors and to elect directors to fill a vacancy created by the expansion of the board of directors or the resignation, death or removal of a director, which prevents stockholders from being able to fill vacancies on our board of directors;
- our board of directors is staggered into three (3) classes and each member is elected for a term of 3 years, which prevents stockholders from being able to assume control of the board of directors;
- our stockholders may not act by written consent and are limited in their ability to call special stockholders' meetings; as a result, a holder, or holders controlling a majority of our capital stock would be limited in their ability to take certain actions other than at annual stockholders' meetings or special stockholders' meetings called by the board of directors, the chairman of the board or the president;
- our certificate of incorporation prohibits cumulative voting in the election of directors, which limits the ability of minority stockholders to elect director candidates;
- stockholders must provide advance notice to nominate individuals for election to the board of directors or to propose matters that can be acted upon at a stockholders' meeting, which may discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer's own slate of directors or otherwise attempting to obtain control of our company; and

- our board of directors may issue, without stockholder approval, shares of undesignated preferred stock; the ability to issue undesignated preferred stock makes it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us.

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

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

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

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

We have had a history of operating losses since our inception and, as of September 30, 2016, we had an accumulated deficit of $69.3 million as compared to $68.5 million as of September 30, 2015. We may incur operating losses in the future, and these losses could be substantial and impact our ability to attain profitability. We do not expect to significantly increase expenditures for product development, general and administrative expenses, and sales and marketing expenses; however, if we cannot maintain current revenue or revenue growth, we will not achieve or sustain profitability or positive operating cash flows. Even if we achieve profitability and positive operating cash flows, we may not be able to sustain or increase profitability or positive operating cash flows on a quarterly or annual basis.

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

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

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

We sell the majority of our products through dealers and distributors, which limits our ability to control the timing of our sales, 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 resellers 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.

Risks Related to Our Common Stock

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

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

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

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

Item X. The Nature and Extent of the Issuer's Facilities

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

We believe that our existing facility is adequate and well suited to accommodate our operations. The Company continuously reviews space requirements to ensure it has adequate room for growth in the future.

PART D - MANAGEMENT STRUCTURE AND FINANCIAL INFORMATION

Certain prior period information has been reclassified to conform to the current year presentation and to reflect the write-down of our wholly-owned subsidiary business unit as a discontinued operation. In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

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

The information concerning our directors and executive officers required by this Item XI is incorporated by reference from the information set forth in the sections entitled “Election of Directors” and “Executive Officers” in our Proxy Statement related to the Annual Stockholder Meeting scheduled to be held in 2017 and will be filed by the Company through OTC Disclosure and News Service, available at www.otcqx.com.

Item XII. Financial Information for the Issuer’s Most Recent Fiscal Period

The following documents are filed as a part of this Annual Report:

1. Consolidated Financial Statements – The consolidated financial statements listed on the “Index to Consolidated Financial Statements” described at F-1.

2. Exhibits – Certain of the exhibits to this Annual Report are hereby incorporated by reference, as summarized in Part F below.

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

The Company’s audited consolidated financial statements for the two preceding fiscal periods are separately posted on the OTCQX website and can be accessed at www.otcqx.com, and are incorporated by reference in this Annual Report. The audited consolidated financial statements include the following reports: (i) balance sheet; (ii) statement of operations; (iii) statement of cash flows; (iv) statement of stockholders’ equity; (v) notes to the financial statements; and (vii) audit letter.

Item XIV. Beneficial Owners

As of September 30, 2016, the following shareholders beneficially own 5% or more of our common stock:

Name of Shareholder	Position with the Company	Shares Beneficially Owned	Ownership Percentage Outstanding
Jeremiah J. Fleming	Chief Executive Officer, President and Chairman of the Board of Directors	3,433,409	15.1%

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

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

Designated Advisor for Disclosure:	B. Riley & Co, LLC 11100 Santa Monica Blvd, Suite 800 Los Angeles, CA 90025 Telephone: (310) 966-1444 Email: corpfin@brileyco.com
Counsel:	Perkins Coie LLP 1900 Sixteenth Street Suite 1400 Denver, CO 80202-5255 Telephone: (303) 291-2442 Email: AVillier@perkinscoie.com
Auditor:	Moss Adams LLP, 101 Second Street, Suite 900 San Francisco, CA 94105 Telephone: (408) 916-0565 Email: arlene.chan@mossadams.com
Tax Accountant:	Moss Adams LLP, 3100 Zinfandel Drive, Suite 500 Rancho Cordova, CA 95670-6062 Telephone: (916) 503-8152 Email: mark.harrison@mossadams.com

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

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

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

Discontinued Operations

During the second quarter of fiscal year 2014, the Company made a strategic decision to discontinue and write-down its wholly-owned subsidiary business unit– China segment. In order to provide a more meaningful comparison of our financial results, prior year results have been reclassified to reflect the discontinued China operations. As a result of this write-down, we categorize our operations into two reportable business segments: North America and Rest of World. Additionally, in connection with the discontinued China operation, a write-down of approximately $620,000 was recorded in the second quarter of fiscal year 2014, which includes the investment in the subsidiary, accounts receivables and other assets and liabilities. The resulting write-down had no impact on our cash. There were no such write-down amounts recorded during fiscal years 2016 and 2015.

In connection with the discontinued operations in China, the Company did not incur material liabilities; however, unanticipated expenses and contingent liabilities could potentially arise. Examples of such contingent liabilities include lease obligations, warranties, contracts and employment matters. We believe that the aforementioned liabilities are not probable and amounts are not estimable at this time, therefore, we did not record any liabilities related to this matter during fiscal years 2016, 2015 and 2014.

Certain prior period information has been reclassified to conform to the current year presentation and to reflect the write-down of our wholly-owned subsidiary business unit as a discontinued operation. While the Company's operations in China were discontinued, the Chinese legal entity may still exist. In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

Potential OTC Market Change

On December 1, 2016, the Company received a notice letter from the OTC Markets stating the Company was not in compliance with the requirements for continued qualifications under Section 3.2 of the OTCQX Rules for U.S. Companies. The Company does not meet the $5 million Market Capitalization requirement, and as such, will be downgraded to the OTCQB Marketplace effective January 1, 2017. Additionally, effective January 1, 2017, as a result of certain OTC Market requirement changes, the Company will not be required to retain a Designated Advisor for Disclosure. OTCQB is the middle tier of the OTC Market. For more information regarding OTCQB requirements, please visit www.otcmarkets.com.

Critical Accounting Policies and Estimates

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

Hardware Transition

Beginning in the first quarter of fiscal 2015, we made a strategic decision to structurally transition from a hardware Company in order to leverage our cloud-based offering. The progress we've made over the past year has enabled us to focus on more scalable and profitable software and cloud service solutions. We currently rely on third-party vendors for many critical functions of our cloud-based business. We have entered into multiple contracts with such vendors for these third party network services.

Revenue Recognition

Revenue from the sales of our hardware and software licenses consist of direct sales to end-users, resellers and distributors, while revenue from the sales of our hosted services and service support, also referred to as "software assurance" consist of direct sales to end-users and resellers. Revenue from sales of hardware and software licenses to end-users and resellers is recognized upon shipment, when risk of loss has passed to the customer, collection of the receivable is reasonably assured, persuasive evidence of an arrangement exists, and the sales price is fixed and determinable. We provide for estimated sales returns and allowances and warranty costs related to such sales at the time of shipment. Such estimates are based on historical experience. 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 the distributors. Upon termination of such distribution agreements, any unsold products may be returned by the distributor for a full refund. These agreements may be canceled without cause for convenience following a specified notice period. As a result of these provisions, we defer recognition of distributor revenue until such distributors resell our products to their customers, as evidenced by monthly "sales-out" reports that the distributors provide to us.

The cloud-based business generates recurring revenue by providing services to customers, in which the customers pay a minimum monthly fee to use a specified number of software licenses, plus any overages. Customers are billed the greater of their minimum monthly fee or actual usage, and revenue is recognized monthly as the service is performed.

Revenue from our service support programs is deferred and recognized ratably over the service coverage periods, generally twelve or thirty-six months. Our service support programs provide our customers with the latest updates, new releases and technical support for the applications they are licensed to use.

Revenue that is deferred as a result of our revenue recognition policy is classified as "deferred revenue" in the accompanying consolidated balance sheets. The related cost of such revenue for hardware is also deferred and reported in the consolidated balance sheets as inventory. The related cost of software revenue is immaterial for deferral purposes. As of September 30, 2016 and 2015, the Company had approximately $1.5 million and $1.7 million, respectively, in short-term deferred revenue. Long-term deferred revenue is primarily comprised of revenue generated from our service support programs and is discussed below under the heading "Service Support Programs."

Hosted Services

Hosted services consist primarily of our proprietary hosted VoIP Unified Communications system. The cloud-based model focuses on serving the needs of enterprise business that require the highest quality voice and integrated business productivity applications. The hosted offering includes hosted IP PBX service, Session Initiation Protocol (SIP) Trunk service, call center solutions, voice and video calling, conference calling, and a variety of long distance services. Our solutions are used by businesses and organizations in industries such as financial services, healthcare, retail and business services. Our hosted services are sold through reseller partners and direct arrangements with end-user customers. Our customers will typically enter into a one-year service agreements whereby they are billed for such services on a monthly basis. Revenue from our hosted services is recognized on a monthly basis as services are delivered. Hosted revenues accounted for 21% and 9% of our total revenue for fiscal year 2016 and 2015, respectively. Hosted revenue is included within operating revenue as "hosted and service support" in the accompanying Consolidate Statement of Operations.

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

Service Support Programs

Our service support programs, also referred to as "software assurance" are post-contract customer support ("PCS") services and provide our customers with the latest software updates, patches, new releases, and technical support for the applications they are licensed to use. These programs have an annual subscription and are generally structured with a one-year or three-year term. Sales from our service support programs are recorded as deferred revenue and recognized as revenue over the terms of their subscriptions. Subscriptions with expiration dates of less than one year are classified as "deferred revenue, short-term" and greater than one year are classified as "deferred revenue, long-term" in the accompanying consolidated balance sheets. Short-term service support deferred revenue was approximately $1.5 million and $1.7 million as of September 30, 2016 and 2015, respectively. Long-term service support deferred revenue was approximately $279,000, as compared to $142,000 as of September 30, 2016 and 2015, respectively. Our service plan offering remains a key part of our business as we continue to add new service customers.

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

Cash, Cash Equivalents and Restricted Cash

Cash and cash equivalents consist of cash on hand and highly liquid investments, such as time deposits. We consider all highly liquid investments with original maturities of three months or less to be cash equivalents. Restricted cash represents cash that serves as collateral for our revolving line of credit and is restricted as to withdrawal or use. At September 30, 2016, cash, cash equivalents and restricted cash totaled approximately $4.5 million, as compared to $4.6 million at September 30, 2015. Restricted cash was approximately $1.4 million as of September 30, 2016, and is presented as part of our cash and cash equivalents in our consolidated balance sheets.

Inventories

Inventory is stated at the lower of cost (first-in, first-out method) or market. 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 or other changes, we may be required to record an additional inventory obsolescence provision which would negatively affect gross margins in the period when the write-downs are recorded. Our inventory balance was $38,000 and $341,000 as of September 30, 2016 and 2015, respectively. Provisions for excess and obsolete inventory were approximately $454,000 and $818,000 for fiscal years 2016, 2015, respectively. During fiscal years 2016 and 2015, we physically disposed of inventory of iFusion SmartStations that had been previously fully-reserved for with a carrying value of zero and an original cost of $520,000 and $801,000, respectively. The disposal of such inventory had no impact on our cash, revenue, gross margins and net profit.

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 product return rate, repair cost or replacement costs differ significantly from management's estimates, adjustments to recognize additional cost of sales may be required in future periods. The reserve is evaluated on an ongoing basis to ensure its adequacy. As of September 30, 2016 and 2015, the reserve for product warranties was $20,000 and $25,000, respectively. The amount of warranty costs expensed during fiscal years 2016 and 2015 were not significant.

Stock-Based Compensation Expense

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

Stock-based compensation expense recognized for the years ended September 30, 2016 and 2015 was $266,000 and $618,000, respectively. The decrease was primarily attributable to fully vested options that were originally granted under the exchange program in the first quarter of fiscal year 2015. See "*Option Exchange Program*" in Note 6 of Notes to Consolidated Financial Statements of this Annual Report for further information.

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,					
	2016		2015 (1)		2014 (1)	
Net revenue:						
Hosted and service support	67.3	%		%	43.3	%
Software	21.2		28.4		23.1	
Hardware and other	11.5		21.8		33.6	
Total net revenue	100.0		100.0		100.0	
Cost of revenue:						
Hosted and service support	5.6		2.8		1.0	
Software	0.2		1.0		0.8	
Hardware and other	11.4		15.9		29.2	
Total cost of revenue	17.2		19.7		31.0	
Gross profit	82.8		80.3		69.0	
Operating expenses:						
Research and development	34.4		30.1		30.0	
Sales and marketing	26.2		23.2		23.1	
General and administrative	25.3		20.3		22.1	
Litigation (2)	6.8		—		—	
Total operating expenses	92.7		73.6		75.2	
(Loss) income from continuing operations	(9.9)		6.7		(6.2)	
Interest and other (expense) income, net						
Interest and other income, net	—		—		3.6	
Interest expense	(0.1)		(0.1)		(0.2)	
Total interest and other (expense) income, net	(0.1)		(0.1)		3.4	
(Loss) income from continuing operations before income taxes	(10.0)		6.6		(2.8)	
Income taxes	0.1		—		—	
(Loss) income from continuing operations after income taxes	(9.9)		6.6		(2.8)	
Discontinued operations:						
Loss from discontinued operations	—		—		(3.8)	
Write-down of investment from discontinued operations	—		—		(2.7)	
Total loss from discontinued operations	—		—		(6.5)	
Net (loss) income	(9.9)	%	6.6	%	(9.3)	%

(1) Certain prior year amounts have been reclassified to conform to current year presentation.
(2) One-time litigation expense related to a civil lawsuit filed against the Company by a former Board member. Please refer to Note 5, "Commitments and Contingencies" and Part C, "Legal Proceedings" of this annual report.

Results of Operations—Fiscal Year 2016 Compared to Fiscal Year 2015

Net Revenue

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

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

Net revenue from continuing operations decreased 14% to $8.4 million in fiscal year 2016, as compared to $9.8 million in fiscal year 2015. This decline was primarily the result of reduced hardware sales of approximately 60%, which is largely due to our strategic decision to exit the hardware business in order to leverage our cloud-based offering. We expect this trend to continue into the first and second quarters of fiscal year 2017. Hosted revenue for the twelve months ended September 30, 2016, increased $944,000, or 109% from fiscal 2015.

The following table sets forth net revenue and percentages of net revenue by geographic region for the periods indicated (amounts in thousands, except for percentage data).

	Fiscal Year Ended September 30,			
	2016		2015	
	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue
North America	$ 8,314	99 %	$ 9,588	98 %
Rest of World	$ 117	1 %	$ 212	2 %
Total	$ 8,431	100 %	$ 9,800	100 %

Net revenue by customers that individually accounted for more than 10% of our revenue for the twelve months ended September 30, 2016 and 2015, respectively, were as follows:

	Fiscal Year Ended September 30,	
	2016	2015
Synnex	11%	18%
Fiserv	—	13%
Total	11%	31%

Cost of Revenue

Our cost of revenue consists primarily 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. The majority of these costs vary with the unit volumes of product sold. Cost of hosted services consists primarily of costs associated with hosting our service and providing support, costs associated with data center capacity and certain fees paid to various third parties for the use of their technology, services and data. Cost of service support consists principally of cost to provide maintenance and technical support, employee compensation costs and cost of providing period updates.

During fiscal year 2016, cost of revenue was $1.5 million, or 17% of net revenue, as compared to $1.9 million, or 20% of net revenue in fiscal year 2015. Cost of revenue for the twelve months ended September 30, 2016, decreased approximately 25%. This decrease was primarily associated with decreased cost of hardware of approximately $594,000, or 38% due in part to a decrease in our hardware revenue. This decrease was partially offset by an increase in cost related to our cloud-based products. This shift is the result of the aforementioned planned transition to move away from hardware products in order to leverage our cloud-based offering. As we continue to experience a favorable revenue shift in these product lines, we expect to continue to see overall improved margins.

Research and Development (“R&D”) Expenses

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

For fiscal 2016, research and development expenses were $2.9 million, or 34% of net revenue, compared to $3.0 million, or 30% of net revenue in fiscal year 2015. During fiscal year 2016, costs related to product development that qualify for capitalization were not material and accordingly expensed as part of research and development expense. We did not incur any capitalized costs related to product development during fiscal year 2015.

We have focused our research and development efforts on expanding the functionality and scalability of our products and enhancing their ease of use, as well as creating new product offerings. Over the long term, we expect our research and development expenses to increase in absolute dollars as we continue to invest in the development of new solutions and improve existing products and services; however, we expect those expenses to fluctuate as a percentage of our revenue in future periods based on fluctuations in our revenue and the timing of those expenses. In the near term, we continue to focus on expense control and we anticipate that our level of R&D expenses will be variable quarter-to-quarter as we increase headcount to further strengthen and enhance our software products.

Sales and Marketing Expenses

Sales and marketing expenses consist primarily of salaries and overhead expenses, commissions and non-cash stock based compensation expense for our employees engaged in sales, sales support, marketing, business development, and customer support functions, as well as costs related to marketing, promotional and co-operative activities.

For fiscal year 2016, sales and marketing expenses were $2.2 million, or 26% of net revenue, compared to $2.3 million, or 23% of net revenue in fiscal year 2015.

To the extent we achieve higher sales levels, we expect sales and marketing expenses to increase in the future periods over the long term due to increased staffing levels as well as increased commission expense. We also anticipate that sales and marketing expenses will remain relatively flat in the short term due in part to our continued emphasis on expense control.

General and Administrative Expenses

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

General and administrative expenses increased 7% to $2.1 million in fiscal year 2016 from $2.0 million in fiscal year 2015. As a percentage of revenue, general and administrative expenses increased to 25% in fiscal year 2016 from 20% in fiscal year 2015. The increase was due in part to increased legal expenses of $396,000, offset partially by a decrease of $78,000 in commission expenses and a decrease of $206,000 in non-cash stock based compensation expense. The reduction in commission expenses was a direct outcome of reduced net revenue, while the increase in legal fees was due to legal services obtained by the Company related to such matters disclosed in Note 5, Commitments and Contingencies and Part C, Legal Proceedings.

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

Interest and Other (Expense) Income, Net

Interest expense consists primarily of interest charged on the outstanding borrowing of our revolving line of credit. Interest income relates to amounts earned on our cash and cash equivalents. For the twelve months ended September 30, 2016 and 2015, the Company recorded $13,000 as interest expense and $4,000 as interest income.

Revolving Line of Credit

On September 1, 2016, we amended the credit agreement governing our Revolving Line of Credit Note ("Line of Credit") with our primary financial lender, Wells Fargo Bank. Under the renewed terms, the Line of Credit was extended for a period of one year and expires on August 31, 2017. The total amount available for the Company to borrow was reduced to $1.4 million. Furthermore, the terms of the Line of Credit also require us to maintain restricted cash with Wells Fargo Bank equal to the aggregated principal amount of $1.4 million as collateral. The restricted cash is included in our cash, cash equivalents and restricted cash in our consolidated balance sheets as of September 30, 2016. Under the amended credit agreement, we are not subject to any restrictive financial covenants.

The Line of Credit is available to finance working capital and for general corporate purposes and requires monthly interest payments based on the prevailing 30-day LIBOR rate plus 0.75% (1.280% at September 30, 2016), and the interest rate is reset monthly. For the twelve months ended September 30, 2016 and 2015, interest expense associated with the Line of Credit was approximately $13,000 for both periods.

As of September 30, 2016, the availability under the Line of Credit was approximately $381,000 and we had outstanding borrowings of $1.0 million, which was included in current liabilities on the accompanying consolidated balance sheet. The unpaid balance of the Line of Credit shall increase and decrease with each new advance or payment hereunder, as the case may be. Any outstanding borrowings and accrued interest shall be due and payable in full on September 1, 2017.

Liquidity and Capital Resources

Since inception, we have financed our operations primarily through the sale of equity securities and cash flows from operations. As of September 30, 2016, total cash and cash equivalents represents approximately 91% of total current assets.

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

	Fiscal Year Ended September 30,		
	2016	2015 (1)(2)	2014 (1)
	(Amounts in thousands)		
Cash and cash equivalents, beginning of period	$ 4,560	$ 3,814	$ 2,942
Cash provided by operating activities	290	1,010	272
Cash used in investing activities	(60)	(39)	(185)
Cash (used in) provided by financing activities	(300)	(225)	785
Cash and equivalents, end of period	$ 4,490	$ 4,560	$ 3,814

(1) Certain prior year amounts have been reclassified to conform to current year presentation.
(2) Amounts reflect reclassification for discontinued operations.

Cash Provided by Operating Activities

For the year ended September 30, 2016, net cash provided by operating activities was $290,000, compared to $1.0 million over the same period a year ago. The decrease was driven by a net loss of $835,000, non-cash items such as $56,000 for depreciation and amortization expense and $266,000 for stock-based compensation expense. Changes in operating assets and liabilities resulted in net cash outflow of $803,000.

Cash Used in Investing Activities

Cash used in investing activities during fiscal year 2016 and 2015, was $60,000 and $39,000, respectively, and was primarily used on capital expenditures related to technological equipment, software licenses and to a lesser degree office equipment.

Cash (Used in) Provided by Financing Activities

During the twelve months ended September 30, 2016 and 2015, cash used in financing activities was $300,000 and $225,000, respectively, and was primarily used to pay down borrowing under our Line of Credit.

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

Our cash needs depend on numerous factors, including market acceptance of and demand for our products, 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. If we cannot raise additional 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, 2016. We had total outstanding commitments on non-cancelable operating leases of approximately $755,000 as of September 30, 2016. Lease terms on our existing operating leases are generally three years.

Contractual Obligations

The Company's existing facility lease expires in May 2019. The following table presents certain commitments that will require the use of cash in future periods under contractual obligations with minimum firm commitments as of September 30, 2016 (in thousands):

Contractual Obligations	Total	Payments Due in Less Than 1 Year	Payments Due in 1 - 3 Years	Payments Due in 4 - 5 Years	Payments Due in More Than 5 Years
Operating lease obligations (1)	$ 755	$ 286	$ 469	$ —	$ —

(1) Refer to discussion of "*Commitments and Contingencies*" Note 5 to Consolidated Financial Statements.

Off-Balance Sheet Arrangements

As of September 30, 2016, we did not have any off-balance sheet arrangements.

PART E - ISSUANCE HISTORY

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

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

Date of Issuance	Type of Security Issued	Person/Entity	Number of Shares of Underlying Common Stock	Per Share Exercise Price	Trading Status	Legend Yes/No
7/19/2016	Stock option	Employees	3,000	$0.25	Restricted	Yes
4/19/2016	Stock option	Employees	70,000	$0.27	Restricted	Yes
1/22/2016	Stock option	Board of Directors	20,000	$0.28	Restricted	Yes
12/16/2015	Stock option	Employees	37,500	$0.29	Restricted	Yes
7/21/2015	Stock option	Employees	14,000	$0.38	Restricted	Yes
7/21/2015	Stock option	Consultants	20,000	$0.38	Restricted	Yes
2/19/2015	Stock option	Employees	1,432,402	$0.35	Restricted	Yes
1/20/2015	Stock option	Employees	8,000	$0.16	Restricted	Yes
12/19/2014	Stock option	Employees	2,322,799	$0.15	Restricted	Yes

PART F - EXHIBITS

Item XVIII. Material Contracts

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

- Amended Line of Credit Agreement, dated as of September 1, 2016, between Wells Fargo Bank and the Company.
- Lease Agreement for 679 River Oaks Parkway, San Jose, California, dated as of December 31, 2013, between Montague Ridge LLC and the Company.
- Amended and Restated Certificate of Incorporation of the Company.
- Second Amended and Restated Bylaws of the Company.
- Certificate of Designation of Rights, Preferences and Privileges of Series A Participating Preferred Stock of the Company.
- Preferred Stock Rights Agreement, dated as of April 21, 2009, between the Company and Computershare Trust Company, N.A., including the Certificate of Designation, the form of Rights Certificate and the Summary of Rights attached thereto as Exhibits A, B and C, respectively.
- Amended and Restated Executive Employment Agreement by and between Philip McDermott and the Company, dated as of March 6, 2009.
- Executive Employment Agreement by and between Jeremiah J. Fleming and the Company, dated as of December 18, 2007.
- OEM Agreement between AltiSys Communications and the Company, dated as of January 18, 1999.
- Distribution Agreement between Synnex Information Technologies, Inc. and the Company, dated as of December 22, 1999.
- Reseller Agreement between Fiserv Solutions, Inc. and the Company, dated as of August 28, 2009.

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

Item XIX. Articles of Incorporation and Bylaws

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

Item XX. Purchases of Equity Securities by the Issuer and Affiliated Purchasers

There were no purchases of equity securities by the Company or Affiliated Purchasers as defined in Item 20 of the Guidelines during fiscal year 2016.

Item XXI. Issuer's Certifications

CERTIFICATION OF CHIEF EXECUTIVE OFFICER

I, Jeremiah J. Fleming, certify that:

1. I have reviewed this annual disclosure statement of AltiGen Communications, Inc.;

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

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

Date: December 21, 2016

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

CERTIFICATION OF CHIEF FINANCIAL OFFICER

I, Philip McDermott, certify that:

1. I have reviewed this annual disclosure statement of AltiGen Communications, Inc.;

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

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

Date: December 21, 2016

/s/ Philip McDermott
Philip McDermott
Chief Financial Officer and Director

ALTIGEN COMMUNICATIONS, INC.
INDEX TO CONSOLIDATED FINANCIAL STATEMENTS

Certain prior period information has been reclassified to conform to the current year presentation and to reflect the write-down of our wholly-owned subsidiary business unit as a discontinued operation. In the opinion of management, all adjustments considered necessary for a fair presentation have been included.

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

REPORT OF INDEPENDENT AUDITORS

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

Report on Financial Statements

We have audited the accompanying consolidated financial statements of AltiGen Communications, Inc. and subsidiary (the “Company”) which comprise the consolidated balance sheets as of September 30, 2016 and 2015, and the related consolidated statements of operations and comprehensive loss, stockholders’ equity and cash flows for the years ended September 30, 2016, 2015, and 2014, and the related notes to the financial statements.

Management’s Responsibility for the Financial Statements

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

Auditor’s Responsibility

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

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

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

Opinion

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of AltiGen Communications, Inc., as of September 30, 2016 and 2015, and the consolidated results of their operations and their cash flows for the years ended September 30, 2016, 2015, and 2014, in accordance with accounting principles generally accepted in the United States of America.

Moss Adams LLP

San Francisco, California
December 21, 2016

ALTIGEN COMMUNICATIONS, INC.
CONSOLIDATED BALANCE SHEETS

	September 30, 2016	September 30, 2015
	(Amounts in thousands, except shares and per share amounts)	
ASSETS		
Current assets:		
Cash, cash equivalents and restricted cash	$ 4,490	$ 4,560
Accounts receivable, less allowance for doubtful accounts of $6 and $1 at September 30, 2016 and 2015, respectively	306	403
Inventories	38	341
Prepaid expenses and other current assets	95	54
Total current assets	4,929	5,358
Property and equipment, net	125	126
Long-term deposit	36	31
Total assets	$ 5,090	$ 5,515
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 62	$ 147
Accrued expenses	1,274	627
Deferred revenue, short-term	1,470	1,710
Revolving line of credit	1,019	1,319
Total current liabilities	3,825	3,803
Rent, long-term	43	58
Deferred revenue, long-term	279	142
Total liabilities	4,147	4,003
Commitments and contingencies (Note 5)		
Stockholders' equity:		
Convertible preferred stock, $0.001 par value; Authorized—5,000,000 shares; Issued and outstanding—none at September 30, 2016 and 2015	—	—
Common stock, $0.001 par value; Authorized—50,000,000 shares; Issued and outstanding—22,798,683 shares at September 30, 2016 and September 30, 2015	25	25
Treasury stock at cost—1,918,830 shares at September 30, 2016 and September 30, 2015	(1,565)	(1,565)
Additional paid-in capital	71,806	71,540
Accumulated deficit	(69,323)	(68,488)
Total stockholders' equity	943	1,512
Total liabilities and stockholders' equity	$ 5,090	$ 5,515

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

ALTIGEN COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS
AND COMPREHENSIVE INCOME (LOSS)

	Fiscal Year Ended September 30,		
	2016	**2015 (1)**	**2014 (1)**
	(Amounts in thousands, except per share amounts)		
Net revenue:			
Hosted and service support	$ 5,678	$ 4,881	$ 4,144
Software	1,786	2,784	2,216
Hardware and other	967	2,135	3,216
Total net revenue	8,431	9,800	9,576
Cost of revenue:			
Hosted and service support	468	273	92
Software	16	98	80
Hardware and other	967	1,557	2,800
Total cost of revenue	1,451	1,928	2,972
Gross profit	6,980	7,872	6,604
Operating expenses:			
Research and development	2,898	2,954	2,874
Sales and marketing	2,211	2,276	2,209
General and administrative	2,135	1,983	2,116
Litigation (2)	568	5	—
Total operating expenses	7,812	7,218	7,199
(Loss) income from continuing operations	(832)	654	(595)
Interest and other (expense) income, net			
Interest and other income, net	4	4	342
Interest expense	(13)	(13)	(16)
Total interest and other (expense) income, net	(9)	(9)	326
(Loss) income from continuing operations before income taxes	(841)	645	(269)
Income taxes	6	(1)	(1)
(Loss) income from continuing operations after income taxes	$ (835)	$ 644	$ (270)
Discontinued operations:			
Loss from discontinued operations	—	—	(361)
Write-down of investment from discontinued operations	—	—	(259)
Total loss from discontinued operations	$ —	$ —	$ (620)
Net (loss) income	$ (835)	$ 644	$ (890)
Other comprehensive (loss) income:			
Cumulative foreign currency translation	—	—	(311)
Total comprehensive (loss) income	$ (835)	$ 644	$ (1,201)
Net (loss) income per share:			
Basic	$ (0.04)	$ 0.03	$ (0.04)
Diluted	$ (0.04)	$ 0.03	$ (0.04)
Shares used to compute net (loss) income per share:			
Basic	22,799	22,799	22,799
Diluted	22,799	23,869	22,799

(1) Certain prior year amounts have been reclassified to conform to current year presentation.
(2) One-time litigation expense related to a civil lawsuit filed against the Company by a former Board member. Please refer to Note 5, “Commitments and Contingencies” and Part C, “Legal Proceedings” of this annual report.

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

ALTIGEN COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
YEARS ENDED SEPTEMBER 30, 2016, 2015 AND 2014
(Amounts in thousands, except share data)

	Common Stock		Treasury Stock	Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Total Stockholders' Equity
	Shares	Amount					
BALANCE, SEPTEMBER 30, 2013	16,732,016	18	(1,400)	69,794	311	(68,242)	481
Net loss – as restated, see Note 3	—	—	—	—	—	(890)	(890)
Cumulative foreign currency translation	—	—	—	—	(311)	—	(311)
Repurchase of treasury stock	(600,000)	—	(165)	—	—	—	(165)
Issuance of common stock in conjunction with private placement offering	6,666,667	7	—	993	—	—	1,000
Stock-based compensation	—	—	—	135	—	—	135
BALANCE, SEPTEMBER 30, 2014	22,798,683	25	(1,565)	70,922	—	(69,132)	250
Net income	—	—	—	—	—	644	644
Stock-based compensation	—	—	—	618	—	—	618
BALANCE, SEPTEMBER 30, 2015	22,798,683	25	(1,565)	71,540	—	(68,488)	1,512
Net loss	—	—	—	—	—	(835)	(835)
Stock-based compensation	—	—	—	266	—	—	266
BALANCE, SEPTEMBER 30, 2016	22,798,683	$ 25	$ (1,565)	$ 71,806	$ —	$ (69,323)	$ 943

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

ALTIGEN COMMUNICATIONS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Fiscal Year Ended September 30,		
	2016	2015 (1)	2014
	(Amounts in thousands)		
Cash flows from operating activities:			
Net (loss) income from continuing operations	$ (835)	$ 644	$ (270)
Net loss from discontinued operations	—	—	(620)
Net (loss) income	(835)	644	(890)
Adjustments to reconcile net (loss) income to net cash provided by operating activities:			
Depreciation and amortization	56	63	126
Stock-based compensation	266	618	135
Equity in net loss of investee	—	—	—
Changes in operating assets and liabilities:			
Accounts receivable	97	69	(5)
Inventories	303	135	544
Prepaid expenses and other current assets	(41)	14	96
Accounts payable	(85)	(212)	(128)
Accrued expenses	647	9	(311)
Deferred rent	(16)	(7)	65
Deferred revenue	(102)	(323)	242
Net changes in assets and liabilities of discontinued operations	—	—	398
Net cash provided by operating activities	290	1,010	272
Cash flows from investing activities:			
Changes in long-term deposits	(5)	5	(36)
Purchases of property and equipment	(55)	(44)	(149)
Net cash used in investing activities	(60)	(39)	(185)
Cash flows from financing activities:			
Proceeds from sale of common stock	—	—	1,000
Repurchase of treasury stock	—	—	(165)
Proceeds from (payment to) line of credit	(300)	(225)	(50)
Net cash (used in) provided by financing activities	(300)	(225)	785
Net change in cash and cash equivalents during year	(70)	746	872
Cash and cash equivalents, beginning of year	4,560	3,814	2,942
Cash and cash equivalents, end of year	$ 4,490	$ 4,560	$ 3,814

(1) Certain prior year amounts have been reclassified to conform to current year presentation.

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

ALTIGEN COMMUNICATIONS, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND BASIS OF PRESENTATION

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

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying audited consolidated financial statements of the Company have been prepared in accordance with accounting principles generally accepted in the United States of America (“U.S. GAAP”). The consolidated financial statements include the financial statements of AltiGen Communications, Inc. and the Company’s China subsidiary. Although the China subsidiary was shut down in April 2014 and has been inactive since that date, the legal entity may still exist.

These audited consolidated financial statements include all adjustments necessary (which are of a normal and recurring nature) for a fair presentation of the Company’s financial position, results of operations and cash flows for the periods presented. The preparation of these consolidated financial statements requires management to make estimates and assumptions that affect the amounts reported in these consolidated financial statements and accompanying notes.

Our fiscal year end is September 30. Unless otherwise stated, all references to fiscal years 2016, 2015, and 2014 refer to the twelve months ended September 30 of that year.

Use of Estimates in Preparation of Financial Statements

The preparation of the financial statements in conformity with U.S. GAAP 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, certain accruals including warranty, doubtful accounts reserve, valuation on tax assets, long-term investments and the fair value of stock options granted and outstanding. We believe that the estimates and judgments upon which we rely are reasonable based upon information available to us at the time that these estimates and judgments are made. To the extent there are material differences between these estimates and actual results, our consolidated financial statements will be affected.

Discontinued Operations

During the second quarter of fiscal year 2014, the Company made a strategic decision to discontinue and write-down its wholly-owned subsidiary business unit– China segment. Please refer to Note 3, “Discontinued Operations” of these Notes to Consolidated Financial Statements.

Reclassifications

Certain prior period information has been reclassified to conform to the current year presentation relating to the presentation of the Company’s discontinued operations. Please refer to Note 3, “Discontinued Operations” of these Notes to Consolidated Financial Statements. The reclassification had no impact on the previously reported net income (loss) or comprehensive income (loss).

Cash, Cash Equivalents and Restricted Cash

Cash and cash equivalents consist of cash on hand and highly liquid investments, such as time deposits. We consider all highly liquid investments with original maturities of three months or less to be cash equivalents. Restricted cash represents cash that serves as collateral for our revolving line of credit and is restricted as to withdrawal or use. At September 30, 2016, cash, cash equivalents and restricted cash totaled approximately $4.5 million, as compared to $4.6 million at September 30, 2015. Restricted cash was approximately $1.4 million as of September 30, 2016, and is presented as part of our cash and cash equivalents in our consolidated balance sheets.

Accounts Receivable

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

The allowance for doubtful accounts reflects management's analysis of receivables and the probability of collecting those accounts. Trade accounts receivable are charged against the allowance when the Company determines that payments will not be received. Any subsequent receipts are credited to the allowance. The Company's allowance for doubtful accounts during fiscal year 2016 and 2015 were not significant. Bad debt expense for fiscal years 2016, 2015 and 2014 were insignificant.

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 basis) 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. We record a write-down for product and component inventories that have become obsolete or are in excess of anticipated demand or net realizable value. Raw material inventory is considered obsolete and is fully reserved if it has not moved in 365 days.

Provisions for excess and obsolete inventory were approximately $454,000, $818,000 and $120,000 for fiscal years 2016, 2015 and 2014, respectively. During fiscal years 2016 and 2015, we physically disposed of inventory of iFusion SmartStations that had been previously fully-reserved for with a carrying value of zero and an original cost of $520,000 and $801,000, respectively. The disposal of such inventory had no impact on our cash, revenue, gross margins and net profit.

The components of inventories include (in thousands):

	Fiscal Year Ended September 30,	
	2016	**2015**
Raw materials	$ —	$ 89
Work-in-progress	—	3
Finished goods	38	249
Total	$ 38	$ 341

Property and Equipment, Net

Property and equipment are stated at cost, which includes purchase cost, applicable taxes and freight costs, less accumulated depreciation and amortization. We compute depreciation and amortization using the straight-line method over the estimated useful lives of the assets, which is three years except for tooling and leasehold improvements. Our tooling is depreciated using a five-year straight-line method. We depreciate leasehold improvements over the shorter of the lease term or the improvement's estimated useful life. Depreciation and amortization expense for fiscal years 2016, 2015 and 2014, was approximately $56,000, $63,000 and $126,000, respectively. Repairs and maintenance costs for all periods presented were immaterial and were expensed as incurred.

We periodically review our portfolio of equipment for impairment. Based on our impairment assessment, we determined there were no impairment losses for the periods referenced in the table below. During fiscal years 2016 and 2015, we retired and disposed of $279,000 and $1.8 million, respectively, of fully depreciated equipment. The disposal of such assets had no impact on our consolidated financial statements.

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

	Fiscal Year Ended September 30,	
	2016	2015
Machinery and equipment	$ 7	$ 7
Furniture and equipment	593	580
Tooling	—	181
Computer software	677	733
Leasehold improvements	206	206
Total	1,483	1,707
Accumulated depreciation and amortization	(1,358)	(1,581)
Property and equipment, net	$ 125	$ 126

Software Development Cost

For software to be marketed and sold, 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 for fiscal years 2016, 2015 and 2014. For internal use software used for hosted software sales, the amounts of costs eligible for capitalization relating to such software for internal use for hosting were not material for fiscal years 2016, 2015 and 2014. Accordingly, all software development costs have been charged to research and development expense in the accompanying Consolidated Statements of Operations and Comprehensive Income (Loss) for fiscal years 2016, 2015 and 2014.

Revenue Recognition and Cost of Revenue

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

Hardware Revenue. Our hardware revenue consists of direct sales to end-users, resellers and distributors. We provide for estimated sales returns and allowances and warranty costs related to such sales at the time of shipment. 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 the distributors. Upon termination of such distribution agreements, any unsold products may be returned by the distributor for a full refund. These agreements may be canceled without cause for convenience following a specified notice period. As a result of these provisions, we defer recognition of distributor revenue until such distributors resell our products to their customers, as evidenced by monthly “sales-out” reports that the distributors provide to us. 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 Revenue. Software revenue consists of license revenue that is recognized upon the delivery, usually a download from the Company’s website with a specified one-time download key/password that the Company provides to each customer upon sale. Our software revenue consists of direct sales to end-users, resellers and distributors. The software license is sold on a standalone basis with no other services or products bundled in. There is no maintenance or post-contract customer support (“PCS”) included with the software sale when it is not purchased with hardware. The Company will only provide such PCS on a rare and limited basis consisting primarily of technical support and bug fixes on installation if the download with the passcode key did not work. The Company does not provide any further PCS after installation in connection with the software license sale. The related cost of software revenue is immaterial.

Hosted Services and Service Support Revenue. We generate recurring revenue through our cloud-based business referred to as hosted services sold through reseller partners and direct arrangements with end-user customers. The cloud-based hosted business generates revenue by providing services to customers, in which the customers pay a minimum monthly fee to use a specified number of software licenses, plus any overages. Customers are billed the greater of their minimum monthly fee or actual usage, and revenue is recognized monthly as the services are performed. In accordance with generally accepted accounting principles, revenue recognition is deferred until such time the customer goes live to ensure the revenue will match the use of services. Cost of hosted services consists primarily of costs associated with hosting our service and providing support, costs associated with data center capacity and certain fees paid to various third parties for the use of their technology, services and data.

Service support, also referred to as software assurance, are PCS services. We provide software assurance consisting primarily of the latest software updates, patches, new releases and technical support. Such software assurance sales are sold separately from any software licenses. Revenue from service support sales are recognized ratably over the contract term, generally over a period of one year or three years. Sales from our service support programs are recorded as deferred revenue and recognized as revenue over the terms of their subscriptions. Subscriptions with expiration dates of less than one year are classified as “deferred revenue, short-term” and greater than one year are classified as “deferred revenue, long-term” in the accompanying consolidated balance sheets. The estimated cost of providing software assurance during the arrangement is insignificant and the upgrades and enhancements offered at no cost during software assurance arrangements have historically been, and are expected to continue to be, minimal and infrequent. All estimated costs of providing the services, including upgrades and enhancements, are deferred and recognized to costs of revenues over the life of the software assurance contract term.

Net revenue by customers that individually accounted for more than 10% of our revenue during fiscal years 2016, 2015 and 2014 are as follows:

	Fiscal Year Ended September 30,		
	2016	2015	2014
Synnex	11%	18%	22%
Fiserv	—	13%	12%
Total	11%	31%	34%

Segment Reporting

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

The following table shows our sales by geographic region for the periods indicated:

	Fiscal Year Ended September 30,					
	2016		2015		2014	
	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue	Net Revenue	% of Net Revenue
North America	$ 8,314	99 %	$ 9,588	98 %	$ 9,458	99 %
Rest of World	$ 117	1 %	$ 212	2 %	$ 118	1 %
Total	$ 8,431	100 %	$ 9,800	100 %	$ 9,576	100 %

Product Warranty

The Company provides a warranty for hardware products for a period of one year following shipment to end users. We have historically experienced minimal warranty costs. Factors that affect our reserves for warranty liability include the number of installed units, historical experience and management's judgment regarding anticipated rates of warranty claims and cost per claim. We assess the adequacy of our reserves for warranty liability every quarter and make adjustments to those reserves if necessary.

Changes in the Company's warranty liability for the fiscal years ended September 30, 2016 and 2015, respectively, are as follows (in thousands):

	Fiscal Year Ended September 30,	
	2016	2015
Accrued warranty, beginning of year	$ 25	$ 41
Provision for warranty liability	2	7
Warranty cost including labor, components and scrap	(7)	(23)
Accrued warranty, end of year	$ 20	$ 25

Net (Loss) Income Per Share

The Company bases its basic net (loss) income per share upon the weighted average number of common shares outstanding during the period. Basic net (loss) income per common share is computed by dividing the net (loss) income 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 net (loss) income per share (in thousands, except per share amounts):

	Fiscal Year Ended September 30,		
	2016	2015	2014
Numerator:			
Net (loss) income	$ (810)	$ 644	$ (890)
Denominator:			
Weighted average shares used in computing basic net (loss) income	22,799	22,799	22,799
Weighted average shares used in computing diluted net (loss) income	22,799	23,869	22,799
Basic net (loss) income per share	$ (0.04)	$ 0.03	$ (0.04)
Diluted net (loss) income per share	$ (0.04)	$ 0.03	$ (0.04)

Options and warrants to purchase approximately 10.8 million, 11.0 million and 10.2 million shares of common stock were outstanding for the years ended September 30, 2016, 2015 and 2014, respectively, and were excluded from the computation of diluted net earnings per share for these periods because their effect would have been antidilutive.

3. DISCONTINUED OPERATIONS

During the second quarter of fiscal year 2014, the Company made a strategic decision to discontinue and write-down its wholly-owned subsidiary business unit– China segment. In order to provide a more meaningful comparison of our financial results, prior year results have been reclassified to reflect the discontinued China operations. As a result of this write-down, we categorize our operations into two reportable business segments: North America and Rest of World. Additionally, in connection with the discontinued China operation, a write-down of approximately $620,000 was recorded in the second quarter of fiscal year 2014, which includes the investment in the subsidiary, accounts receivables and other assets and liabilities. The resulting write-down had no impact on our cash and cash equivalents. While the Company's operations in China was discontinued, the Chinese legal entity may still exist.

The following table summarizes the components of assets and liabilities from discontinued operations for the period indicated (in thousands):

		Discontinued Operations Balance Sheet September 30, 2013
Assets:		
Cash and cash equivalents	$	490
Accounts receivable		776
Allowance for doubtful accounts		(66)
Inventories		304
Prepaid expenses and other current assets		118
Total current assets related to discontinued operations		1,622
Property, plant and equipment, net		3
Non-current assets		88
Total assets related to discontinued operations	$	1,713
Liabilities:		
Accounts payable	$	4
Accrued expenses		302
Deferred revenue, short-term		698
Total liabilities related to discontinued operations	$	1,004

The following table summarizes certain operating data for discontinued operations (in thousands):

	Discontinued Operations Income Statements September 30,			
		2014		2013
Revenue	$	1,068	$	2,236
Cost of revenue		253		482
Gross profit		815		1,754
Operating expenses:				
Research and development		379		940
Sales and marketing		604		1,393
General and administrative		197		394
Total operating expenses		1,180		2,727
Loss from discontinued operations		(365)		(973)
Interest and other income, net		4		65
Write-down of investment in subsidiary		(259)		—
Net loss before taxes		(620)		(908)
Income taxes		—		—
Net loss from discontinued operations	$	(620)	$	(908)

In connection with the cessation of operations in the China subsidiary, the Company did not incur material liabilities; however, unanticipated expenses and contingent liabilities could potentially arise. Examples of such contingent liabilities include lease obligations, warranties, contracts and employment matters. We believe that the aforementioned liabilities are not probable and amounts are not estimable at this time, therefore, we did not record any liabilities related to this matter in fiscal year 2014. The Company did not record any amounts relating to the China subsidiary in fiscal year 2016 and 2015.

4. REVOLVING LINE OF CREDIT

On September 1, 2016, we amended the credit agreement governing our Revolving Line of Credit Note ("Line of Credit") with our primary financial lender, Wells Fargo Bank. Under the renewed terms, the Line of Credit was extended for a period of one year and expires on August 31, 2017. The total amount available for the Company to borrow was reduced to $1.4 million. Furthermore, the terms of the Line of Credit also require us to maintain restricted cash with Wells Fargo Bank equal to the aggregated principal amount of $1.4 million as collateral. The restricted cash is included in our cash, cash equivalents and restricted cash in our consolidated balance sheets as of September 30, 2016. Under the amended credit agreement, we are not subject to any restrictive financial covenants.

The Line of Credit is available to finance working capital and for general corporate purposes and requires monthly interest payments based on the prevailing 30-day LIBOR rate plus 0.75% (1.280% at September 30, 2016), and the interest rate is reset monthly. For the twelve months ended September 30, 2016 and 2015, interest expense associated with the Line of Credit was approximately $13,000 for both periods.

As of September 30, 2016, the availability under the Line of Credit was approximately $381,000 and we had outstanding borrowings of $1.0 million, which was included in current liabilities on the accompanying consolidated balance sheet. The unpaid balance of the Line of Credit shall increase and decrease with each new advance or payment hereunder, as the case may be. Any outstanding borrowings and accrued interest shall be due and payable in full on September 1, 2017.

5. COMMITMENTS AND CONTINGENCIES

Commitments

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

Future non-cancellable minimum lease payments required under all existing operating leases as of September 30, 2016 are as follows:

Fiscal Year		Future Lease Payments (in thousands)
2017	$	286
2018		294
2019		175
Thereafter		—
Total	$	755

Contingencies

On March 30, 2016, CTI Communications, LLC, a former reseller of the Company ("CTI"), filed a complaint against the Company, Affiliated Technology Solutions, LLC, a current reseller of the Company ("Affiliated"), James Jerome Cruz, a former CTI employee, and Thomas W. Welsh, a manager of Affiliated, in the United States District Court of Colorado, County of Larimer. The complaint alleges misappropriation of trade secrets and breach of contract, and CTI is seeking in a currently pending motion to amend the complaint to include civil conspiracy and tortious interference claims. Although the outcome of this matter is not determinable as of the date of this report, we believe CTI's claims are without merit and we intend to vigorously defend ourselves. The Company has not recorded any liability with respect to this litigation as of September 30, 2016.

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

During the second quarter of fiscal year 2014, the Company made a strategic decision to discontinue and write-down its wholly-owned subsidiary business unit– China segment. In connection with the cessation of operations in the China subsidiary, the Company did not incur material liabilities; however, unanticipated expenses and contingent liabilities could potentially arise. Examples of such contingent liabilities include lease obligations, warranties, contracts and employment matters. We believe that the aforementioned liabilities are not probable and amounts are not estimable, therefore, the Company did not record any liabilities related to this matter in fiscal years 2016, 2015 and 2014.

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

6. STOCKHOLDERS' EQUITY AND STOCK-BASED COMPENSATION EXPENSE

Equity Offering

In the first quarter of fiscal year 2014, the Company completed a private placement offering with certain accredited investors and management, pursuant to which the Company sold to the purchasers an aggregate of 6.7 million shares of Company common stock at a purchase price of $0.15 per share for aggregate gross proceeds of $1.0 million. Each purchaser also received a warrant to purchase one share of common stock for every share of common stock acquired in the offering with an exercise price of $0.30 per share. The warrants are immediately exercisable and have a term of three years. The securities offered pursuant to the private placement have not been registered under the Securities Act of 1933, as amended, and may not be offered or sold in the United States absent registration or an applicable exemption from registration requirements. At September 30, 2016, warrants exercisable for 6.7 million shares of common stock at an exercise price of $0.30 per common share were outstanding. No warrants were exercised as of September 30, 2016. These warrants will expire on November 19, 2016.

Stock Option Plans

On March 10, 2009, our 1999 Stock Plan (the "1999 Stock Plan") expired; however, the plan will continue to govern the securities previously granted under it. On April 21, 2009, our Board of Directors approved a 2009 Equity Incentive Plan (the "2009 Stock Plan" and together with the 1999 Stock Plan, the "2009 Stock Plan") which was approved by our stockholders on June 18, 2009. The shares available for future grants under the 1999 Stock Plan rolled into the 2009 Stock Plan. Under the 2009 Stock Plan, the Board of Directors may grant incentive stock options, non-qualified stock options, restricted stock awards, restricted stock units, stock appreciation rights, performance units and performance shares to eligible employees, directors and consultants. In accordance with the 2009 Stock Plan, the exercise price per share for stock options cannot be less than 100% of the fair market value, as determined by the Board of Directors, on the date of grant. Additionally, 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 the 2009 Stock Plan will generally expire ten years after the date of grant. Upon approval of the 2009 Stock Plan, 6.5 million shares were reserved for issuance.

The foregoing statements are subject to, and are qualified in their entirety by reference to, the 1999 Stock Plan and 2009 Stock Plan described above and the forms of agreement hereunder, which have been filed as exhibits to the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 2003, and Registration Statement on Form S-8 on June 29, 2009, respectively.

As of September 30, 2016, shares of common stock issuable pursuant to outstanding awards granted under the 2009 Stock Plan were 4.1 million shares and there were 2.0 million shares reserved for future grants.

The following table summarizes the Company's stock option activities under the 2009 tock Plan during the three fiscal years ended September 30, 2016, 2015 and 2014:

	Options Outstanding		Weighted Average Exercise Price
Outstanding at September 30, 2013	4,429,328	$	0.88
Options granted	25,000	$	0.18
Options exercised	—	$	—
Options forfeited or expired	(896,644)	$	0.93
Outstanding at September 30, 2014	3,557,684	$	0.86
Options granted	3,801,201	$	0.23
Options exercised	—	$	—
Options forfeited or expired	(3,096,381)	$	0.86
Outstanding at September 30, 2015	4,262,504	$	0.30
Options granted	130,500	$	0.28
Options exercised	—	$	—
Options forfeited or expired	(244,184)	$	0.28
Outstanding at September 30, 2016	4,148,820	$	0.30
Exercisable at September 30, 2016	3,994,153	$	0.30

Total stock options vested and expected to vest at September 30, 2016 were 4.1 million shares with a weighted average exercise price of $0.30, aggregate intrinsic value of $45,000 and a weighted average remaining contractual term of 7.6 years. The total exercisable stock options at September 30, 2016 were 4.0 million shares with an aggregate intrinsic value of $45,000, weighted average exercise price of $0.30 and a weighted average remaining contractual term of 7.6 years.

As of September 30, 2016, the Company has unamortized share-based compensation expense relating to options outstanding of $17,000, which will be amortized to expense over a weighted average period of 1.6 years. The weighted average grant date fair value of options granted during the years ended September 30, 2016, 2015, and 2014 were $0.27, $0.14, $0.17, respectively.

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

The table below provides the range of exercise prices of stock options outstanding and stock options exercisable at September 30, 2016:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding	Weighted Average Remaining Contractual Term (years)	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
$0.16 $0.16	2,225,299	8.22	$ 0.16	2,225,299	$ 0.16
0.17 – 0.31	166,125	8.60	$ 0.27	31,666	$ 0.26
0.35 – 0.35	1,286,037	8.39	$ 0.35	1,286,037	$ 0.35
0.38 – 0.38	30,000	8.81	$ 0.38	9,792	$ 0.38
0.68 – 0.68	20,000	2.31	$ 0.68	20,000	$ 0.68
0.74 – 0.74	49,781	2.49	$ 0.74	49,781	$ 0.74
0.86 – 0.86	308,078	1.87	$ 0.86	308,078	$ 0.86
0.90 – 0.90	6,000	1.07	$ 0.90	6,000	$ 0.90
1.03 – 1.03	50,000	2.25	$ 1.03	50,000	$ 1.03
1.30 – 1.30	7,500	0.25	$ 1.30	7,500	$ 1.30
$0.16 – $1.30	4,148,820	7.63	$ 0.30	3,994,153	$ 0.30

Share-Based Compensation

The Company accounts for stock-based compensation, including grants of stock options, as an operating expense in the consolidated statement of operations.

The underlying weighted-average assumptions used in the Black-Scholes model and the resulting estimates of fair value per share were as follows for options granted during the twelve months ended September 30, 2016, 2015 and 2014:

	Employee Stock Option Plans Fiscal Year Ended September 30,		
	2016	2015	2014
Expected life (in years)	7	7	7
Risk-free interest rate	1.1-1.4%	0.99-1.5%	1.5-1.7%
Volatility	154%-155%	156%-179%	146%-163%
Expected dividend	0.0%	0.0%	0.0%

The following table summarizes stock-based compensation expense recognized related to employee and director stock options for the years ended September 30, 2016, 2015 and 2014:

	Fiscal Year Ended September 30,		
	2016	2015 (1)	2014
	(Amounts in thousands)		
Cost of goods sold	$ 6	$ —	$ —
Research and development	66	179	27
Sales and marketing	61	144	9
General and administrative	133	295	99
Total	$ 266	$ 618	$ 135

(1) The increase was primarily attributable to options granted under the exchange program in the first quarter of fiscal year 2015.

Option Exchange Program

In December 2014, our Board of Directors approved a voluntary stock option exchange program (the "Option Exchange Program"). The Option Exchange Program permitted eligible employees to exchange two outstanding options for one new option. Pursuant to the terms of the exchange offer, options held by eligible employees with an exercise price equal to or greater than $0.16 per share were eligible for tender. The Option Exchange commenced on January 21, 2015 and expired on February 19, 2015. A total of 2.8 million options were tendered in the exchange program. In exchange for the eligible options that were accepted for exchange and cancellation, the Company issued new options to purchase an aggregate of 1.4 million shares of its common stock. The remaining 1.4 million options that were tendered were cancelled.

The new options were granted on February 19, 2015 and have an exercise price of $0.35 per share. The exercise price was determined using the greater of (i) the closing price of our common stock as reported on the OTCQX on February 19, 2015 (the "2015 Grant Date") or (ii) the average of the closing prices for the 30 trading days immediately preceding the 2015 Grant Date. The new options will vest quarterly over an eighteen-month period. The new options were valued on the 2015 Grant Date using the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0%, expected volatility of 179%, risk-free interest rates of 0.99% and expected lives of 2.5 years. Additionally, using the Black-Scholes repricing model, we determined that the fair value of the surrendered options was not material as of the date of the exchange, resulting in insignificant incremental stock-based compensation expense.

Issuance of Restricted Stock Options

On December 19, 2014, in connection with the option exchange program, our Board of Directors approved the grant of an aggregate of 2.3 million restricted stock options to certain directors, officers and employees in accordance with the Company's 2009 Stock Plan. The options were granted on December 19, 2014 and have an exercise price of $0.16 per share. The exercise price was determined using the greater of (i) the closing price of the Company's common stock as reported on the OTCQX on December 19, 2014 (the "2014 Grant Date") or (ii) the average of the closing prices for the 30 trading days immediately preceding the 2014 Grant Date. The options will vest quarterly over an eighteen-month period and were valued on the 2014 Grant Date using the Black-Scholes option-pricing model with the following assumptions: dividend yield of 0%, expected volatility of 179%, risk-free interest rates of 0.99% and expected lives of 2.5 years.

7. SHAREHOLDER RIGHTS PLAN

The Company adopted a Preferred Stock Rights Agreement (the "Plan") and declared a dividend distribution of one right for each outstanding share of the Company's common stock. The record date for the distribution was May 7, 2009. The Company designed the plan to protect the long-term value of the Company for its shareholders during any future unsolicited acquisition attempt. The Company did not adopt the Plan in response to any specific attempt to acquire the Company or its shares and the Company is not aware of any current efforts to do so. These rights will become exercisable only upon the occurrence of certain events specified in the Plan, including the acquisition of 15% of the Company's outstanding common stock by a person or group. Should a person or group acquire 15% or more of the outstanding common stock or announce an unsolicited tender offer, the consummation of which would result in a person or group acquiring 15% or more of the outstanding common stock, shareholders other than the acquiring person may exercise the rights, unless the Board of Directors has approved the transaction in advance. Each right will initially entitle stockholders to purchase one one-thousandths (0.001) of the Company's preferred stock for $4.00. However, the rights are not immediately exercisable and will become exercisable only upon the occurrence of certain events. If a person or group acquires, or announces a tender or exchange offer that would result in the acquisition of, fifteen percent (15%) or more of our common stock while the stockholder rights plan remains in place, then, unless the rights are redeemed by us for $0.001 per right, the rights will become exercisable by all rights holders, except the acquiring person or group, for shares of AltiGen or shares of the third party acquirer having a value of twice the right's then-current exercise price. The rights will expire on May 7, 2019 or upon earlier exchange or redemption of the rights as described above. The foregoing statements are subject to, and are qualified in their entirety by reference to, the Plan including the certificate of designation, the form of rights certificate and the summary of rights attached thereto, which have been filed as exhibits to the exhibit filed with the Company's Registration Statement on Form 8-K on April 23, 2009.

8. RECENT ACCOUNTING PRONOUNCEMENTS

In May 2014, FASB issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), which is a new standard on revenue recognition. The new standard contains principles that an entity will need to apply to determine the measurement of revenue and timing of when revenue is recognized. The underlying principle is to recognize revenue to depict the transfer of goods or services to customers at an amount that the entity expects to be entitled to in exchange for those goods or services. The standard has a five-step approach which includes identifying the contract or contracts, identifying the performance obligations, determining the transaction price, allocating the transaction price, and recognizing revenue. The standard also significantly expands the quantitative and qualitative disclosure requirements for revenue, which are intended to help users of financial statements understand the nature, amount, timing, and uncertainty of revenue and the related cash flows. In July 2015, the FASB voted to amend ASU 2014-09 by approving a one-year deferral of the effective date as well as allowing early adoption as of the original effective date, but not before the annual periods beginning after December 15, 2016. The Company is currently evaluating this new standard and the impact it will have on its consolidated financial statements, processes, and internal controls.

In June 2014, the FASB issued ASU No. 2014-12, Compensation-Stock Compensation (Topic 718), which requires an award to be treated as a performance condition when a performance target exists that affects vesting of an award and that could be achieved after the requisite service period. As such, the performance target should not be reflected in estimating the grant-date fair value of the award. Compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. If the performance target becomes probable of being achieved before the end of the requisite service period, the remaining unrecognized compensation cost should be recognized prospectively over the remaining requisite service period. The total amount of compensation cost recognized during and after the requisite service period should reflect the number of awards that are expected to vest and should be adjusted to reflect those awards that ultimately vest. The requisite service period ends when the employee can cease rendering service and still be eligible to vest in the award if the performance target is achieved. The amendments in this ASU are effective for annual periods and interim periods within those annual periods beginning after December 15, 2015. As required, the Company adopted ASU No. 2014-12 in December 2015 with no impact on our consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements—Going Concern (Sub Topic 205-40) –Uncertainties about an Entity's Ability to Continue as a Going Concern. ASU 2014-15 clarifies principles and definitions that may be used by an organization's management for disclosures that are currently made available in financial statement footnotes. Presently U.S. GAAP does not provide an organization's management guidance regarding its responsibility to assess whether substantial doubt exists regarding the ability to continue as a going concern or to prepare related footnote disclosures. Instead, auditors are responsible for assessing an entity's ability to continue as a going concern under AUC 570. ASU 2014-15 will move this responsibility to management. ASU 2014-15 will require management to evaluate whether there are conditions or events that raise substantial doubt about the entity's ability to continue as going concern from one year from the date the financial statements are issued. ASU 2014-15 is effective for annual periods ending after December 15, 2016 to allow the auditing guidance to catch up with this change. ASU 2014-15 affects all companies and non-profits and early application is allowed. The Company is currently evaluating the impact of adopting this new guidance on its consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-03, Interest – Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. ASU 2015-03 simplifies the presentation of debt issuance costs by requiring such costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. Recognizing debt issuance costs as a deferred charge is no longer permitted. This update is effective for financial statements issued for fiscal years beginning after December 15, 2015. The adoption of ASU No. 2015-03 did not have a material effect on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, Customer's Accounting for Fees Paid in a Cloud Computing Arrangement, which amended the existing accounting standards for intangible assets. The amendments provide explicit guidance to customers in determining the accounting for fees paid in a cloud computing arrangement, wherein the arrangements that do not convey a software license to the customer are accounted for as service contracts. The standard is effective for annual reporting periods beginning after December 15, 2015. The Company adopted ASU No. 2015-05 in December 2015 with no impact on our consolidated financial statements.

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

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

9. INCOME TAXES

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

	Fiscal Years Ended September 30,		
	2016	**2015**	**2014**
United States (continuing operations)	$ (841)	$ 644	$ (270)
Foreign (discontinued operations)	—	—	(620)
Net income (loss)	$ (841)	$ 644	$ (890)

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

	Fiscal Years Ended September 30,		
	2016	**2015**	**2014**
Federal	$ —	$ —	$ —
State	1	1	1
Income tax provision	$ 1	$ 1	$ 1

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

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

	Fiscal Years Ended September 30,	
	2016	**2015**
Net operating loss carryforwards	$ 20,135	$ 19,843
Reserve and other cumulative temporary differences	1,322	1,296
Research and development credit carryforward	1,090	1,036
	22,547	22,175
Valuation allowance	(22,547)	(22,175)
Net deferred tax asset	$ —	$ —

As of September 30, 2016, the Company had net operating loss carryforwards for federal income tax purposes of approximately $52.4 million that expire at various dates through 2036, and federal research and development tax credits of approximately $994,000 that expire at various dates through 2036. The Company also had net operating loss carryforwards for state income tax purposes of approximately $26.3 million that expire at various dates through 2036, and state research and development tax credits of approximately $569,000, 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, lack of profitability to date and uncertainty over future operating profitability and taxable income. During fiscal years 2016, 2015 and 2014, valuation allowance increased $372,000, decreased $356,000 and increased $1.5 million, respectively. As of September 30, 2016 and 2015, the Company had no significant deferred tax liabilities.

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

	Fiscal Years Ended September 30,		
	2016	**2015**	**2014**
Tax computed at federal statutory rate	35.0 %	35.0 %	35.0 %
Change in valuation allowance	(44.3)	(55.3)	(142.2)
State taxes	12.0	(3.0)	24.5
Meals & entertainment	(0.4)	0.3	(0.1)
Unbenefitted foreign loss	—	—	(8.2)
Stock-based compensation	(8.7)	28.6	(3.9)
ASC 740 liability	—	—	(4.1)
Expired net operating losses and credits	—	(5.4)	(113.6)
Tax loss on discontinued operations	—	—	219.3
Other	6.4	(0.2)	(6.7)
Provision for income taxes	—	—	—

In October 2007, the Company adopted the FASB's updated guidance related to income taxes, which establishes a single model to address accounting for uncertain tax positions. This updated guidance clarifies the accounting for income taxes by prescribing a minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. It also provides guidance on de-recognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure, and transition. The Company has reviewed its income tax positions and identified approximately $1.3 million of total gross unrecognized tax benefits of which none, if recognized, would impact the effective tax rate as the Company has a valuation allowance on its carryforward attributes. The Company does not expect its unrecognized tax benefits to change materially over the next 12 months.

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

	Total Gross Unrecognized Tax Benefits
Balance at October 1, 2015	$ 1,302
Additions based on tax positions related to the current year	—
Additions based on tax positions of prior years	—
Settlements of tax positions	—
Balance at September 30, 2016	$ 1,302

Interest and penalties related to unrecognized tax benefits within the provision for taxes on the consolidated statements of operations and comprehensive income (loss) did not change as a result of implementing the provisions of ASC 740. Management determined that no accrual for interest and penalties was required as of September 30, 2016.

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

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

10. SUBSEQUENT EVENTS

On December 1, 2016, the Company received a notice letter from the OTC Markets stating the Company was not in compliance with the requirements for continued qualifications under Section 3.2 of the OTCQX Rules for U.S. Companies. The Company does not meet the $5 million Market Capitalization requirement, and as such, will be downgraded to the OTCQB Marketplace effective January 1, 2017. Additionally, effective January 1, 2017, as a result of certain OTC Market requirement changes, the Company will not be required to retain a Designated Advisor for Disclosure. OTCQB is the middle tier of the OTC Market. For more information regarding OTCQB requirements, please visit www.otcmarkets.com.

On November 19, 2016, warrants to exercise 6.7 million shares in connections with a private placement offering had expired. Please refer to Note 6, "Stockholders' Equity and Stock-Based Compensation Expense" of these Notes to Consolidated Financial Statements.