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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

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Form 10-Q

☒ QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE  
ACT OF 1934

For the quarterly period ended June 30, 2001

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number 000-27115

PCTEL, Inc.  
(Exact Name of Business Issuer as Specified in Its Charter)

Delaware 77-0364943  
(State or Other Jurisdiction of (I.R.S. Employer Identification Number)  
Incorporation or Organization)

1331 California Circle, Milpitas, CA 95035  
(Address of Principal Executive Office) (Zip Code)

(408) 965-2100  
(Registrant's Telephone Number, Including Area Code)

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Indicate by checkmark whether the Registrant: (1) has filed all reports  
required to be filed by Section 13 or 15(d) of the Exchange Act during the past  
12 months (or for such shorter period that the registrant was required to file  
such reports), and (2) has been subject to such filing requirements for the past  
90 days.

Yes ☒ No ☐

As of July 31, 2001, there were 19,380,172 shares of the Registrant's Common  
Stock outstanding.

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PCTEL, Inc.  
Form 10-Q  
For the Quarter Ended June 30, 2001

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PART I. FINANCIAL INFORMATION  
ITEM 1. FINANCIAL STATEMENTS

PCTEL, Inc.

Consolidated Condensed Balance Sheets  
(in thousands, except share information)

	June 30, 2001 (unaudited)	December 31, 2000
	-----	-----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 43,269	\$ 25,397
Short-term investments	81,965	92,983
Accounts receivable, net	15,166	24,112
Inventories, net	5,475	13,837
Prepaid expenses and other assets	3,442	4,369
Deferred tax asset	3,322	3,322
	-----	-----
Total current assets	152,639	164,020
PROPERTY AND EQUIPMENT, net	4,077	4,722
GOODWILL AND OTHER INTANGIBLE ASSETS, net	18,854	21,662
DEFERRED TAX ASSET	2,333	2,333
OTHER ASSETS	227	219
	-----	-----
TOTAL ASSETS	\$ 178,130	\$ 192,956
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 4,246	\$ 9,142
Accrued royalties	11,309	11,656
Income taxes payable	5,136	3,417
Accrued liabilities	5,369	8,894
	-----	-----
Total current liabilities	26,060	33,109
	-----	-----
STOCKHOLDERS' EQUITY:		
Common stock,\$0.001 par value, 50,000,000 shares authorized, 19,329,336 and 18,817,796 shares issued and outstanding at June 30, 2001 and December 31, 2000, respectively.	19	19
Additional paid-in capital	148,150	146,461
Deferred compensation	(1,939)	(2,894)
Retained earnings	5,307	15,987
Accumulated other comprehensive income	533	274
	-----	-----
Total stockholders' equity	152,070	159,847
	-----	-----
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	\$ 178,130	\$ 192,956
	=====	=====

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

PCTEL, Inc.

CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS  
(in thousands, except per share information)  
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
REVENUES	\$ 12,255	\$ 27,523	\$ 28,706	\$ 51,644
COST OF REVENUES	8,899	14,596	20,232	27,364
GROSS PROFIT	3,356	12,927	8,474	24,280
OPERATING EXPENSES:				
Research and development	2,810	4,301	6,278	7,709
Sales and marketing	3,213	3,730	6,689	6,725
General and administrative	2,914	1,713	5,081	3,478
Acquired in-process research and development	-	-	-	1,600
Amortization of goodwill and other intangible assets	949	782	1,895	1,016
Restructuring charges (see Note 4)	1,583	-	2,107	-
Amortization of deferred compensation (See Note 6)	261	328	554	677
Total operating expenses	11,730	10,854	22,604	21,205
INCOME (LOSS) FROM OPERATIONS	(8,374)	2,073	(14,130)	3,075
OTHER INCOME, NET:				
Other income, net	1,704	1,777	3,466	3,158
INCOME (LOSS) BEFORE PROVISION FOR INCOME TAXES	(6,670)	3,850	(10,664)	6,233
PROVISION FOR INCOME TAXES	1,114	1,059	16	1,714
NET INCOME (LOSS)	\$ (7,784)	\$ 2,791	\$ (10,680)	\$ 4,519
Basic earnings (loss) per share	\$ (0.41)	\$ 0.16	\$ (0.56)	\$ 0.26
Shares used in computing basic earnings (loss) per share	19,206	17,989	19,090	17,399
Diluted earnings (loss) per share	\$ (0.41)	\$ 0.14	\$ (0.56)	\$ 0.22
Shares used in computing diluted earnings (loss) per share	19,206	20,588	19,090	20,547

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

PCTEL, Inc.

Consolidated Condensed Statements of Cash Flows  
(in thousands)

	Six Months Ended June 30,	
	2001	2000
	(unaudited)	
Cash Flows from Operating Activities:		
Net income (loss)	\$ (10,680)	\$ 4,519
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Acquired in-process research and development	-	1,600
Depreciation and amortization	3,925	2,823
Loss on disposal of property and equipment	47	-
Provision for allowance for doubtful accounts	778	552
Provision for excess and obsolete inventories	540	233
Amortization of deferred compensation	554	677
Changes in operating assets and liabilities, net of acquisitions:		
(Increase) decrease in accounts receivable	8,101	(12,607)
(Increase) decrease in inventories	7,831	(2,881)
(Increase) decrease in prepaid expenses and other assets	917	(70)
Decrease in accounts payable	(4,894)	(1,651)
Increase (decrease) in accrued royalties	(347)	1,673
Increase (decrease) in income taxes payable	1,718	(112)
Increase (decrease) in accrued liabilities	(3,540)	3,463
Net Cash Provided by (Used in) Operating Activities	4,950	(1,781)
Cash Flows from Investing Activities:		
Capital expenditures for property and equipment	(450)	(1,774)
Proceeds from disposal of property and equipment	13	-
Proceeds from sales and maturities of available-for-sale investments	62,123	36,679
Purchase of available-for-sale investments	(50,846)	(34,311)
Purchase of business, net of cash acquired	(9)	(3,648)
Net Cash Provided by (Used in) Investing Activities	10,831	(3,054)
Cash Flows from Financing Activities:		
Proceeds from issuance of common stock	2,091	31,154
Cost incurred related to issuance of common stock	-	(852)
Net Cash Provided by Financing Activities	2,091	30,302
Net increase in cash and cash equivalents	17,872	25,467
Cash and cash equivalents, beginning of period	25,397	44,705
Cash and cash equivalents, end of period	\$ 43,269	\$ 70,172

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

Notes to the Consolidated Condensed Financial Statements  
For the Three and Six Months Ended: June 30, 2001  
(Unaudited)

1. BASIS OF PRESENTATION

The condensed financial statements included herein have been prepared by PCTEL, Inc. (unless otherwise noted, "PCTEL", "we", "us" or "our" refers to PCTEL, Inc.), pursuant to the laws and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of management, the disclosures are adequate to make the information not misleading. The condensed balance sheet as of December 31, 2000 has been derived from the audited financial statements as of that date, but does not include all disclosures required by generally accepted accounting principles. These financial statements and notes should be read in conjunction with the audited financial statements and notes thereto, included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission.

The unaudited condensed financial statements reflect all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation of financial position, results of operations and cash flows for the periods indicated. The results of operations for the three and six months ended June 30, 2001 are not necessarily indicative of the results that may be expected for future quarters or the year ending December 31, 2001.

2. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization and Operations of the Company

We were originally incorporated in California in February 1994. In July 1998, we reincorporated in Delaware and this reincorporation has been reflected retroactively in the accompanying consolidated financial statements.

We are a leading provider of software-based high speed connectivity solutions to individuals and businesses worldwide. We design, develop, produce and market advanced high performance, low cost modems that are flexible and upgradable, with functionality that can include data/fax transmission at various speeds, and telephony features. Our soft modem products consist of a hardware chipset containing a proprietary host signal processing software architecture which utilizes the computational and processing resources of a host central processor, effectively replacing special-purpose hardware required in conventional hardware-based modems. Together, the combination of the chipset and software drivers are a component part within a computer which allows for telecommunications connectivity. By replacing hardware with a software solution, our host signal processing technology lowers costs while enhancing capabilities.

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles 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 revenues and expenses during the period. Actual results could differ from those estimates.

Consolidation and Foreign Currency Translation

We use the United States dollar for our financial statements, even for our subsidiaries in foreign countries. All gains and losses resulting from transactions originally in foreign currencies and then translated into US dollars are included in net income. As of June 30, 2001, we had subsidiaries in the Cayman Islands, Japan and Taiwan. These consolidated financial statements include the accounts of PCTEL and our subsidiaries after eliminating intercompany accounts and transactions.

Cash Equivalents and Short-Term Investments

We divide our financial instruments into two different classifications.

Cash equivalents: debt instruments that mature within three months after we purchase them.

Short-term investments: marketable debt instruments that generally mature between three months and two years from the date we purchase them. All of our short-term investments are classified as current assets and available-for-sale because they are marketable and we have the option to sell them before they mature.

As of June 30, 2001, short-term investments consisted of high-grade corporate securities with maturity dates of approximately five months to two years.

These investments are recorded at market price and any unrealized holding gains and losses (based on the difference between market price and book value) are reflected as other comprehensive income/loss in the stockholders' equity section of the balance sheet. We have accumulated a \$533,000 unrealized holding gain as of June 30, 2001. Realized gains and losses and declines in value of securities judged to be other than temporary are included in interest income and have not been significant to date. Interest and dividends of all securities are included in interest income.

#### Concentrations of Credit Risk

We have potential credit risk primarily in two areas, our short-term investments and trade receivables.

Our investment policy is to preserve the value of our capital and generate interest income from these investments without undue exposure to risk. Market risk is the potential loss due to the change in value of a financial instrument due to interest rates or equity prices. We try to moderate this risk in two ways. First, our investment portfolio is divided between Banc of America Securities and Salomon Smith Barney. By using two independent investment banking firms, we believe it has improved market visibility. Secondly, we independently review market pricing on a periodic basis based upon directly managing a limited amount of funds we use for operations which are not managed by our funds' managers.

For trade receivables, credit risk is the potential for a loss due to a customer not meeting its payment obligations. We have established an allowance for amounts which we may not be able to collect based on industry standards and actual payment history. We moderate this risk by establishing and reviewing credit limits, monitoring those limits and making updates as required. See below for industry segment, customer and geographic information.

#### Inventories

Inventories are stated at the lower of cost or market and include material, labor and overhead costs. Inventories as of June 30, 2001 and December 31, 2000 were composed of finished goods only. Based on our current estimated requirements, it was determined that there was excess inventory and those excess amounts were fully reserved as of June 30, 2001 and December 31, 2000. Due to competitive pressures and technological innovation, it is possible that these estimates could change in the near term.

#### Software Development Costs

We account for software development costs in accordance with Statement of Financial Accounting Standards ("SFAS") No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased or Otherwise Marketed." Our products include a software component. To date, we have expensed all software development costs because these costs were incurred prior to the products reaching technological feasibility.

#### Revenue Recognition

Revenues consist primarily of sales of products to original equipment manufacturers ("OEMs") and distributors. Revenues from sales to OEMs are recognized upon shipment. We provide for estimated sales return and price rebate allowances related to sales to OEMs at the time of shipment. As of June 30, 2001 and December 31, 2000, \$3.6 million and \$6.8 million of returns and price rebate allowances were netted against accounts receivable in the accompanying consolidated condensed balance sheets. Revenues from sales to distributors are made under agreements allowing price protection and rights of return on unsold products. We record revenue relating to sales to

distributors only when the distributors have sold the product to end-users. Customer payment terms generally range from letters of credit collectible upon shipment to open accounts payable 60 days after shipment.

We also generate revenues from engineering contracts. Revenues from engineering contracts are recognized as contract milestones and customer acceptance are achieved. Royalty revenue is recognized when confirmation of royalties due to us is received from licensees. Furthermore, revenues from technology licenses are recognized after delivery has occurred and the amount is fixed and determinable, generally based upon the contract's nonrefundable payment terms. To the extent there are extended payment terms on these contracts, revenue is recognized as the payments become due and the cancellation privilege lapses. To date, we have not offered post-contract customer support.

#### Earnings Per Share

We compute earnings per share in accordance with SFAS No. 128, "Earnings Per Share". SFAS No. 128 requires companies to compute net income per share under two different methods, basic and diluted, and present per share data for all periods in which statements of operation are presented. Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding. Diluted earnings per share is computed by dividing net income by the weighted average number of common stock and common stock equivalents outstanding. Common stock equivalents consist of preferred stock using the "if converted" method and stock options and warrants using the treasury stock method. Preferred stock, common stock options and warrants are excluded from the computation of diluted earnings per share if their effect is anti-dilutive. The weighted average common stock option grants excluded from the calculations of diluted net loss per share were 234,000 and 287,000 for the three and six months ended June 30, 2001, respectively.

The following table provides a reconciliation of the numerators and denominators used in calculating basic and diluted earning per share for the three and six months ended June 30, 2001 and 2000, respectively (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	(Unaudited)		(Unaudited)	
Net income (loss)	\$ (7,784)	\$ 2,791	\$ (10,680)	\$ 4,519
Basic earnings (loss) per share:				
Weighted average common shares outstanding	19,206	17,989	19,090	17,399
Basic earnings (loss) per share	\$ (0.41)	\$ 0.16	\$ (0.56)	\$ 0.26
Diluted earnings (loss) per share:				
Weighted average common shares outstanding	19,206	17,989	19,090	17,399
Weighted average common stock option grants and outstanding warrants	-	2,599	-	3,148
Weighted average common shares and common stock equivalents outstanding	19,206	20,588	19,090	20,547
Diluted earnings (loss) per share	\$ (0.41)	\$ 0.14	\$ (0.56)	\$ 0.22

#### Industry Segment, Customer and Geographic Information

We are organized based upon the nature of the products we offer. Under this organizational structure, we operate in one segment, that segment being software-based modems using host signal processing technology. We market our products worldwide through our sales personnel, independent sales representatives and distributors.

Our sales to customers outside of the United States, as a percent of total revenues, are as follows:



	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	----	----	----	----
	(Unaudited)		(Unaudited)	
Taiwan	23%	61%	21%	55%
China (Hong Kong)	65	30	67	37
Rest of Asia	1	6	3	5
Europe	8	-	6	-
	-----	-----	-----	-----
	97%	97%	97%	97%
	=====	=====	=====	=====

Sales to our major customers representing greater than 10% of revenues are as follows:

Customer	Three Months Ended June 30,		Six Months Ended June 30,	
- - - - -	2001	2000	2001	2000
	----	----	----	----
	(Unaudited)		(Unaudited)	
A	6%	7%	6%	12%
B	65%	28%	65%	34%
C	--%	13%	--%	9%
D	12%	21%	11%	14%
E	--%	11%	--%	7%

Our customers are concentrated in the motherboard manufacturer industry and modem board manufacturer industry segment and in certain geographic locations. We actively market and sell products in Asia. We perform ongoing evaluations of our customers' financial condition and generally require no collateral. As of June 30, 2001, approximately 72% of gross accounts receivable were concentrated with four customers. As of December 31, 2000, approximately 64% of gross accounts receivable were concentrated with four customers.

#### Comprehensive Income

The following table provides the calculation of other comprehensive income for the three and six months ended June 30, 2001 and 2000 (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
	----	----	----	----
	(Unaudited)		(Unaudited)	
Net income (loss)	\$ (7,784)	\$ 2,791	\$ (10,680)	\$ 4,519
	=====	=====	=====	=====
Other comprehensive income:				
Unrealized gains (loss) on available-for-sale securities	(132)	35	259	(110)
	=====	=====	=====	=====
Comprehensive income (loss)	\$ (7,916)	\$ 2,826	\$ (10,421)	\$ 4,409
	=====	=====	=====	=====

#### Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board issued SFAS No. 133 "Accounting for Derivative Instruments and Hedging Activities," which requires certain accounting and reporting standards for derivative financial instruments and hedging activities. It applies for the first quarter beginning January 1, 2001. We adopted SFAS No. 133 in January 2001 and this adoption did not have a material effect on our financial position or results of operations.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 101, "Revenue Recognition". In June 2000, the SEC deferred the adoption date for SAB 101 until our fourth quarter ended December 31, 2000. SAB 101 summarizes certain areas of the Staff's views in applying generally accepted accounting principles to revenue recognition in financial statements. We adopted SAB 101 in October 2000 and this adoption did not have a material effect on our financial position or results of operations.

In March 2000, the FASB issued Financial Standards Board Interpretation (FIN) No. 44, "Accounting for Certain Transactions Involving Stock Compensation--an Interpretation of APB Opinion No. 25." FIN 44 addresses the application of APB 25 to clarify, among other issues, (a) the definition of employee for purposes of applying APB 25, (b) the criteria for determining whether a plan qualifies as a noncompensatory plan, (c) the accounting consequence of various modifications to the terms of a previously fixed stock option or award, and (d) the accounting for an exchange of stock compensation awards in a business combination. FIN 44 was effective July 1, 2000, but certain conclusions cover specific events that occur after either December 15, 1998 or January 12, 2000. To the extent FIN 44 covers events occurring during the period after December 15, 1998 or January 12, 2000, but before the effective date of July 1, 2000, the effects of applying the interpretation will be recognized on a prospective basis from July 1, 2000. We adopted FIN 44 in July 2000 and this adoption did not have a material effect on our financial position or results of operations.

In July 2001, the Financial Accounting Standards Board issued SFAS No.'s 141 and 142, "Business Combinations" and "Goodwill and Other Intangibles". SFAS 141 requires all business combinations initiated after June 30, 2001 to be accounted for using the purchase method. Under SFAS 142, goodwill and intangible assets with indefinite lives are not amortized but are subject to at least an annual assessment for impairment applying a fair-value based test. Effective January 1, 2002, existing goodwill will no longer be amortized. Additionally, an acquired intangible asset should be separately recognized if the benefit of the intangible asset is obtained through contractual or other legal rights, or if the intangible asset can be sold, transferred, licensed, rented, or exchanged, regardless of the acquirer's intent to do so. Upon adoption of SFAS 142 on January 1, 2002, we will no longer amortize goodwill, thereby eliminating annual goodwill amortization of approximately \$5.5 million, based on anticipated amortization for 2002. Amortization of goodwill for the six months ended June 30, 2001 was \$2.7 million. We are currently reviewing the remaining goodwill and other intangibles to determine whether recent economic events have resulted in impairment.

#### Risks and Uncertainties

For the six months ended June 30, 2001 and the years ended December 31, 2000 and 1999, we purchased integrated circuits from a limited number of vendors. If these vendors are unable to provide integrated circuits in a timely manner and we are unable to find alternative vendors, our business, operating results and financial condition could be adversely affected.

The majority of our revenues are derived from a limited number of products utilizing host signal processing technology. The market for these products is characterized by frequent transitions in which products rapidly incorporate new features and performance standards. A failure to develop products with required feature sets or performance standards or a delay in bringing a new product to market could adversely affect our operating results.

#### Reclassifications

Certain amounts in prior periods have been reclassified to conform with the current period presentation.

### 3. ACQUISITIONS

#### BlueCom Technology Corp.

On December 14, 2000, we completed the acquisition of BlueCom Technology Corp., ("BlueCom"), one of Taiwan's industry leaders in the innovation, development and marketing of MMX Signal Processing (MSP) technology. Under the terms of the Agreement and Plan of Reorganization (the "Merger Agreement"), the former shareholders of BlueCom received 11,245 shares of our common stock and \$1,557,770 of cash in exchange for all shares of BlueCom common stock.

The acquisition was accounted for under the purchase method of accounting. Under this method, if the purchase price exceeds the net tangible assets acquired, the difference is recorded as excess purchase price. In this

circumstance, the difference was \$1.6 million which was attributed to goodwill (\$949,000) and a covenant not to compete (\$656,000). We have classified this balance of \$1.6 million as goodwill and other intangible assets, net, in the accompanying consolidated balance sheets and are amortizing it over useful lives of two to five years.

Voyager Technologies, Inc.

On February 24, 2000, we completed the acquisition of Voyager Technologies, Inc., ("Voyager"), a provider of personal connectivity and Internet access technology. Under the terms of the Agreement and Plan of Reorganization (the "Merger Agreement"), the former shareholders of Voyager received 237,272 shares of our common stock and \$2,065,331 of cash in exchange for all shares of Voyager common stock. In addition, 645,157 vested and unvested options to purchase shares of Voyager common stock were converted into 49,056 options to purchase our common stock at the exchange ratio of 0.07604. Included in the 237,272 shares are 82,419 restricted shares of common stock issued to a Voyager shareholder. These shares are not subject to forfeiture under any circumstances and, thus, were considered in the determination of the purchase price at the date of acquisition.

The acquisition was structured as a tax-free reorganization and was accounted for under the purchase method of accounting. Under this method, if the purchase price exceeds the net tangible assets acquired, the difference is recorded as excess purchase price. In this circumstance, the difference was \$17.8 million. We attributed \$1.6 million of the excess purchase price to in-process research and development, which we expensed immediately, and the balance of \$16.2 million was attributed to intellectual property (\$0.5 million), workforce (\$0.3 million) and goodwill (\$15.4 million). We have classified this balance of \$16.2 million as goodwill and other intangible assets, net, in the accompanying consolidated balance sheets and are amortizing it over a useful life of five years.

In addition to the 237,272 shares of our common stock issued to the shareholders of Voyager, 30,415 additional shares of common stock were held in an escrow account pending resolution of an outstanding claim. These shares had been treated as contingent consideration and were not initially recognized as purchase price due to the uncertainty of how the claim would be resolved. In May 2000, the outstanding claim was settled for \$1.5 million which resulted in the return of the stock held in escrow to us. No amount was initially recorded for the now-unissued stock while in escrow; however, the \$1.5 million outstanding claim settlement was recognized as additional purchase price in the quarter ended June 30, 2000.

The pro forma data has not been disclosed as the amounts are not material.

#### 4. RESTRUCTURING CHARGES

On February 8, 2001, we announced a series of actions to streamline support for our voiceband business and sharpen our focus on emerging growth sectors. These measures were part of a restructuring program to return the company to profitability and operational effectiveness and included a reduction in worldwide headcount of 7 research and development employees, 9 sales and marketing employees and 6 general and administrative employees, a hiring freeze and cost containment programs. On May 1, 2001, we announced a new business structure that will result in greater focus for our activities with a significantly reduced workforce. 13 research and development employees, 13 sales and marketing employees and 12 general and administrative employees were eliminated as a part of this reorganization. The restructuring resulted in \$1.6 million and \$2.1 million of charges for the three and six months ended June 30, 2001, consisting of severance and employment related costs and costs related to closure of excess facilities as a result of the reduction in force. The following analysis sets forth the significant components of this charge:

	Accrual Balance at March 31, 2001	Restructuring Charges	Payments	Accrual Balance at June 30, 2001
	-----	-----	-----	-----
			(unaudited)	
Severance and employment related costs	\$ 248	698	\$ 766	\$ 180
Costs for closure of excess facilities	--	885	80	805
	-----	-----	-----	-----
	\$ 248	1,583	\$ 846	\$ 985
	=====	=====	=====	=====
Amount included in accrued liabilities				\$ 985
				=====

Severance and employment related costs of \$698,000 consisted of termination compensation and related benefits. Costs for closure of excess facilities of \$885,000 consisted of future minimum lease payments and related costs on the excess and unused facilities as a result of our down sizing. We are in the process of locating a tenant to sublease the excess facilities for the remainder of the lease term. As of June 30, 2001, approximately \$766,000 of termination compensation and related benefits had been paid to terminate approximately 60 employees. The remaining accrual balance of \$180,000 will be paid on various dates extending through February 2002. As of June 30, 2001, approximately \$80,000 of lease payments and related costs had been paid to the landlord for the excess facilities. The remaining accrual balance of \$805,000 will be paid monthly through February 2003.

#### 5. CONTINGENCIES:

We record an accrual for estimated future royalty payments for relevant technology of others used in our product offerings in accordance with SFAS No. 5, "Accounting for Contingencies." The estimated royalties accrual reflects management's broader litigation and cost containment strategies, which may include alternatives such as entering into cross-licensing agreements, cash settlements and/or ongoing royalties based upon our judgment that such negotiated settlements would allow management to focus more time and financial resources on the ongoing business. We have accrued our estimate of the amount of royalties payable for royalty agreements already signed, agreements that are in negotiation and unasserted but probable claims of others using advice from third party technology advisors and historical settlements. Should the final license agreements result in royalty rates significantly different than our current estimates, our business, operating results and financial condition could be materially and adversely affected.

As of June 30, 2001 and December 31, 2000, we had accrued royalties of approximately \$11.3 million and \$11.7 million, respectively. Of these amounts, approximately \$0.2 million and \$1.2 million represent amounts accrued based upon signed royalty agreements as of June 30, 2001 and December 31, 2000, respectively. The remainder of accrued royalties represents management's estimate within a range of possible settlement losses as of each date presented. While management is unable to estimate the maximum amount of the range of possible settlement losses, it is possible that actual losses could exceed the amounts accrued as of each date presented.

ESS Technology, Inc. v. PCTEL, Inc.

On April 9, 1999, ESS Technology, Inc. ("ESS") filed a complaint against us in the U.S. District Court for the Northern District of California, alleging that we failed to grant licenses for some of our International Telecommunications Union-related patents to ESS on fair, reasonable and non-discriminatory terms. ESS's complaint includes claims based on antitrust law, patent misuse, breach of contract and unfair competition. In its complaint, ESS also seeks a declaration that some of our International Telecommunications Union-related patents are unenforceable and that we should be ordered by the court to grant a license to ESS on fair, reasonable and non-discriminatory terms.

We filed an answer to ESS's complaint by moving to dismiss on the basis that ESS had not alleged facts sufficient to state a legal claim. ESS responded by amending its complaint to include additional factual and legal allegations and filing an opposition to the motion to dismiss. On August 2, 1999, the Court denied our motion to dismiss as moot in view of ESS's amended complaint.

On August 12, 1999, we filed a motion to dismiss ESS's amended complaint. On November 4, 1999, the United States District Court in San Jose, California, granted a dismissal of the antitrust and state unfair competition claims, ruling that ESS had failed to allege injury to competition in the market for modems. The Court allowed the specific performance of contract claim to stand, ruling that the license terms granted to other market participants would provide a sufficient basis for defining contractual terms that could be applied to ESS. The Court also denied the motion with respect to dismissal of the declaratory relief claims, holding that they were sufficiently ripe for adjudication. The Court granted ESS leave to again amend its complaint, which it did on November 24, 1999, by filing a second amended complaint.

On January 14, 2000, we filed a motion to dismiss the second amended complaint. ESS filed its opposition to the motion on January 21, 2000 and we filed our reply on January 28, 2000. On February 11, 2000, the Court heard oral argument on our motion to dismiss the second amended complaint. On February 14, 2000, the Court dismissed ESS's complaint and gave ESS twenty days to amend its complaint. In particular, the Court stated that ESS must

allege the relevant geographic market and product market in the complaint. In response to the Court's February 14, 2000 order, ESS filed its third amended complaint on March 6, 2000.

On March 15, 2000, we filed a motion to dismiss ESS's third amended complaint. ESS responded on March 31, 2000 and we filed reply papers on April 6, 2000. A case management conference was held on April 21, 2000. The motion was denied on July 3, 2000. The judge ordered that discovery proceed only on the issue of whether we license our patents on a reasonable and non-discriminatory basis. This initial discovery period is currently scheduled to end on August 10, 2001. During this period of time, the parties will disclose experts and exchange expert reports on the above issue. A further case management conference is scheduled to be held on August 24, 2001.

On August 7, 2000, we filed counterclaims alleging that ESS infringes our five patents that are the subject of ESS's complaint. In addition, on October 3, 2000, the parties stipulated to permit us to amend our counterclaims to include claims that ESS infringes three of our additional patents. On April 25, 2001, the parties stipulated to permit us to amend our counterclaims to include claims that ESS infringes another patent. Six of our nine patents asserted against ESS are International Telecommunications Union-related patents. These infringement claims will be litigated, if necessary, only after the issue of whether we license our patents on a reasonable and non-discriminatory basis is resolved. The other two patents asserted against ESS are not related to International Telecommunications Related Standards.

Due to the nature of litigation generally, we cannot ascertain the outcome of the final resolution of the lawsuit, the availability of injunctive relief or other equitable remedies, or estimate the total expenses, possible damages or settlement value, if any, that we may ultimately incur in connection with ESS's lawsuit. This litigation could be time consuming and costly, and we will not necessarily prevail given the inherent uncertainties of litigation. However, we believe that we have valid defenses to this litigation, including the fact that other companies license these International Telecommunications Union-related patents from us on the same terms that are being challenged by ESS. We believe that it is unlikely this litigation will have a material adverse effect on our financial position or results of operations and, accordingly, have not accrued any amounts in the financial statements related to this claim. We are vigorously contesting, and intend to continue to vigorously contest, all of ESS's claims. We are vigorously litigating, and intend to continue to vigorously litigate our claims against ESS.

In the Matter of Certain HSP Modems, Software and Hardware Components Thereof and Products Containing Same.

On September 15, 2000, we filed a complaint under Section 337 of the Tariff Act of 1930, as amended, with the United States International Trade Commission ("ITC"). Our complaint requested that the ITC commence an investigation into whether Smart Link and ESS are engaged in unfair trade practices by selling for importation into the United States, directly or indirectly importing into the United States, or selling in the United States after importation devices which infringe our patents. Four of our patents were asserted against Smart Link and two of those four patents were asserted against ESS. A supplemental complaint was filed on October 3, 2000. On February 5, 2001, we filed a motion to reduce the number of patents asserted against Smart Link from four patents to three patents. This motion was granted February 16, 2001.

On October 11, 2000, the ITC voted to institute an investigation into our complaint. On October 18, 2000, notice of the ITC investigation was published in the Federal Register. Smart Link and ESS filed their responses to our complaint and the notice of investigation on November 13, 2000 and October 31, 2000, respectively. The judge assigned to our case has stepped down as an administrative law judge effective May 20, 2001.

Smart Link and us entered into a settlement agreement on May 17, 2001. On May 30, 2001, Smart Link and us jointly filed a motion for termination with respect to Smart Link on the basis of the settlement agreement. The judge granted the motion for termination with respect to Smart Link by an initial determination dated June 12, 2001, and the Commission has determined not to review the judge's initial determination by a notice dated June 28, 2001.

The ESS hearing took place before the judge from July 17, 2001 to July 27, 2001. By order of the administrative law judge, the ITC investigation is to be completed by January 18, 2002.

Due to the nature of litigation generally, we cannot ascertain the outcome of the final resolution of this lawsuit. This litigation could be time consuming and costly, and we will not necessarily prevail given the inherent uncertainties of litigation. We believe that it is unlikely this litigation will have a material adverse effect on our

financial position or results of operations and, accordingly, have not accrued any amounts in the financial statements related to this lawsuit. We are vigorously litigating, and intend to continue to vigorously litigate, our claims against ESS.

We are subject to various claims which arise in the normal course of business. In the opinion of management, the ultimate disposition of these claims will not have a material adverse effect on our financial position, liquidity or results of operations.

#### 6. AMORTIZATION OF DEFERRED COMPENSATION:

For the three and six months ended June 30, 2001 and 2000, amortization of deferred compensation (in thousands) relates to the following functional categories:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2001	2000	2001	2000
Research and development	\$ 18	\$ 73	\$ 65	\$ 152
Sales and marketing	\$ 68	\$ 77	\$ 138	\$ 156
General and administrative	\$ 175	\$ 178	\$ 351	\$ 369
	\$ 261	\$ 328	\$ 554	\$ 677

Item 2: Management's Discussion and Analysis of Financial Condition and results of Operations

The following information should be read in conjunction with the condensed interim financial statements and the notes thereto included in Item 1 of this Quarterly Report and with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 28, 2001. Except for historical information, the following discussion contains forward-looking statements that involve risks and uncertainties, including statements regarding our anticipated revenues, profits, costs and expenses and revenue mix. These forward-looking statements include, among others, those statements including the words "believes", "anticipates", "estimates", "expects", "may", "will", "plans", "seeks", "intends", and words of similar import. You should not place undue reliance on these forward-looking statements. Our actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the risks faced by us described below and elsewhere in this Quarterly Report, and in other documents we file with the SEC.

Overview

We provide cost-effective software-based communications solutions that address high-speed Internet connectivity requirements for existing and emerging technologies. Our communications products enable Internet access through PCs and alternative Internet access devices. Our soft modem products consist of a hardware chipset containing a proprietary host signal processing software architecture which allows for the utilization of the computational and processing resources of a host central processor, effectively replacing special-purpose hardware required in conventional hardware-based modems. Together, the combination of the chipset and software drivers are a component part within a computer which allows for telecommunications connectivity. By replacing hardware with a software solution, our host signal processing technology lowers costs while enhancing capabilities.

From our inception in February 1994 through the end of 1995, we were a development stage company primarily engaged in product development, product testing and the establishment of strategic relationships with customers and suppliers. From December 31, 1995 to December 31, 2000, our total headcount increased from 18 to 198. We first recognized revenue on product sales in the fourth quarter of 1995, and became profitable in 1996, our first full year of product shipments. Revenues increased from \$24.0 million in 1997 to \$33.0 million in 1998, \$76.3 million in 1999 and \$97.2 million in 2000. Revenues for the three and six months ended June 30, 2001 were \$12.3 million and \$28.7 million, respectively.

On February 8, 2001, we announced a series of actions to streamline support for our voiceband business and sharpen our focus on emerging growth sectors. These measures were part of a restructuring program to return the company to profitability and operational effectiveness and included a reduction in worldwide headcount of 7 research and development employees, 9 sales and marketing employees and 6 general and administrative employees, a hiring freeze and cost containment programs. The restructuring resulted in \$524,000 of charges consisting of severance and employment related costs for the three months ended March 31, 2001.

On May 1, 2001, we announced a new business structure that will result in greater focus for our activities with a significantly reduced workforce. 13 research and development employees, 13 sales and marketing employees and 12 general and administrative employees were eliminated as a part of this reorganization. The restructuring resulted in \$1.6 million of charges for the three months ended June 30, 2001, consisting of severance and employment related costs and costs related to closure of excess facilities as a result of the reduction in force.

We sell soft modems to manufacturers and distributors principally in Asia through our sales personnel, independent sales representatives and distributors. Our sales to manufacturers and distributors in Asia were 91%, 99% and 76% of our total sales for the years ended 2000, 1999 and 1998, respectively, and 89% and 97% for the three months ended June 30, 2001 and 2000, respectively. The predominance of our sales is in Asia because our customers are primarily motherboard and modem manufacturers, and the majority of these manufacturers are located in Asia. One customer represented 65% of revenue for the six months ended June 30, 2001. In many cases, our indirect original equipment manufacturer customers specify that our products be included on the modem boards or motherboards that they purchase from the board manufacturers, and we sell our products directly to the board manufacturers for resale to our indirect original equipment manufacturer customers, both in the United States and

internationally. Industry statistics indicate that approximately two-thirds of modems manufactured in Asia are sold in North America.

We recognize revenues from product sales to customers upon shipment, except sales to distributors which are recognized only when distributors have sold the product to the end-user. We provide for estimated sales returns and price rebate allowances related to sales to OEMs at the time of shipment. We recognize revenues from non-recurring engineering contracts as contract milestones and customer acceptance are achieved. Revenues from technology licenses are recognized after delivery has occurred and the amount is fixed and determinable, generally based upon the contract's nonrefundable payment terms. To the extent there are extended payment terms on these contracts, revenue is recognized as the payments become due and the cancellation privilege lapses. To date, we have not offered post-contract customer support. Customer payment terms generally range from letters of credit collectible upon shipment to open accounts payable 60 days after shipment.

#### Results of Operations

Three and six months ended June 30, 2001 and 2000

##### Revenues

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Revenues.....	\$12,255	\$27,523	\$28,706	\$51,644
% change from year ago period.....	(55.5)%	53.8%	(44.4)%	56.3%

Our revenues primarily consist of product sales of soft modems to board manufacturers and distributors in Asia. Revenues decreased \$15.3 million for the three months ended June 30, 2001 compared to the same period in 2000. Revenues for the six months ended June 30, 2001 decreased \$22.9 million compared to the same period in 2000. The revenue decrease was primarily attributable to an abnormally poor PC market due to poor economic conditions. Additionally, the decrease in sales revenues was due to downward pressure on average selling prices commonly seen in the industry.

##### Gross Profit

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Gross profit.....	\$ 3,356	\$12,927	\$ 8,474	\$24,280
Percentage of revenues.....	27.4%	47.0%	29.5%	47.0%
% change from year ago period.....	(74.0)%	46.6%	(65.1)%	51.3%

Cost of revenues consists primarily of chipsets we purchase from third party manufacturers and also includes amortization of intangibles related to the Communications Systems Division ("CSD") acquisition, accrued intellectual property royalties, cost of operations, provision for inventory obsolescence and distribution costs.

Gross profit decreased \$9.6 million for the three months ended June 30, 2001 compared to the same period last year mainly due to decreased sales revenues. Gross profit as a percentage of revenue decreased from 47.0% for the three months ended June 30, 2000 to 27.4% for the three months ended June 30, 2001 because average selling prices decreased faster than the rate of cost reduction and the fixed portion of our costs as a percentage of revenue increased due to the decrease of revenues.

Gross profit decreased \$15.8 million for the six months ended June 30, 2001 over the same period in 2000 and as a percentage of revenue from 47.0% to 29.5% for the same reasons as above.



## Research and Development

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Research and development.....	\$ 2,810	\$4,301	\$ 6,278	\$7,709
Percentage of revenues.....	22.9%	15.6%	21.9%	14.9%
% change from year ago period.....	(34.7)%	80.7%	(18.6)%	74.3%

Research and development expenses include compensation costs for software and hardware development, prototyping, certification and pre-production costs. We expense all research and development costs as incurred.

Research and development expenses decreased \$1.5 million for the three months ended June 30, 2001 compared to the same period in 2000 as a result of the completed projects and redeployment of existing personnel to new projects and reduction of headcount from the reductions in force in February and May 2001. As a percentage of revenues, research and development increased for the three months ended June 30, 2001 because of lower revenues in 2001. Research and development headcount decreased from 72 to 60 from June 30, 2000 to June 30, 2001.

Research and development expenses decreased \$1.4 million but increased as a percentage of revenues for the six months ended June 30, 2001 compared to the same period in 2000 for the same reasons as above.

## Sales and Marketing

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Sales and marketing.....	\$ 3,213	\$3,730	\$ 6,689	\$6,725
Percentage of revenues.....	26.2%	13.6%	23.3%	13.0%
% change from year ago period.....	(13.9)%	40.9%	(0.01)%	36.0%

Sales and marketing expenses consist primarily of personnel costs, sales commissions and marketing costs. Sales commissions payable to our distributors are recognized when our products are "sold through" from the distributors to end-users so that the commission expense is matched with related recognition of revenues. Marketing costs include promotional goods, public relations and trade shows.

Sales and marketing expenses decreased \$0.5 million but increased as a percentage of revenues for the three months ended June 30, 2001 compared to the same period in 2000. The decrease in spending reflects the reduction of sales and marketing personnel as a result of lower revenues and the reduction in force in February and May 2001. Sales and marketing headcount decreased from 62 to 46 from June 30, 2000 to June 30, 2001.

Sales and marketing expenses decreased slightly but increased as a percentage of revenues for the six months ended June 30, 2000 compared to the same period in 2000 because of lower revenues in 2001.

## General and Administrative

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
General and administrative.....	\$2,914	\$1,713	\$5,081	\$3,478
Percentage of revenues.....	23.8%	6.2%	17.7%	6.7%
% change from year ago period.....	70.1%	37.3%	46.1%	68.6%

General and administrative expenses include costs associated with our general management and finance functions as well as professional service charges, such as legal, tax and accounting fees. Other general and administrative expenses include rent, insurance, utilities, travel and other operating expenses to the extent not otherwise allocated to other functions.

General and administrative expenses increased \$1.2 million for the three months ended June 30, 2001 compared to the same period in 2000 and \$1.6 million for the six months ended June 30, 2001 compared to the same period in 2000. The increase was primarily due to the increased legal costs associated with the patent infringement litigation against Smart Link and ESS.

#### Acquired In-Process Research and Development

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Acquired in-process research and development.....	\$ --	\$ --	\$ --	\$1,600
Percentage of revenues.....	-- %	-- %	--%	3.1%

Upon completion of the Voyager acquisition on February 24, 2000, we immediately expensed \$1.6 million representing purchased in-process technology that had not yet reached technological feasibility and had no alternative future use. The \$1.6 million expensed as in-process research and development was approximately 9% of the purchase price and was attributed and supported by a discounted cash flow analysis that identified revenues and costs on a project by project basis. The value assigned to purchased in-process technology, based on a percentage of completion discounted cash flow method, was determined by identifying research projects in areas for which technological feasibility has not been established. The following in-process projects existed at Voyager as of the acquisition date: Bluetooth, HomeRF, Direct Sequence Cordless, Bluetooth/HomeRF Combo, Bluetooth/HomeRF/Direct Sequence, Wireless Gas Tank Sensor, Wireless GPS and Wireless Industrial Garage Door Opener projects.

The value of in-process research and development was determined by estimating the costs to develop the purchased in-process technology into commercially viable products, estimating the resulting net cash flows from such projects and discounting the net cash flows back to their present value. The discount rate includes a risk adjusted discount rate to take into account the uncertainty surrounding the successful development of the purchased in-process technology. The risk-adjusted discount rate applied to the projects' cash flows was 15% for existing technology and 20% for the in-process technology. Based upon assessment of each in-process project's development stage, including relative difficulty of remaining development milestones, it was determined that application of a 20% discount rate was appropriate for all acquired in-process projects. The valuation includes cash inflows from in-process technology through 2005 with revenues commencing in 2000 and increasing significantly in 2001 before declining in 2005. The projected total revenue of Voyager was broken down to revenue attributable to the in-process technologies, existing technologies, core technology and future technology. The revenue attributable to core technology was determined based on the extent to which the in-process technologies rely on the already developed intellectual property. The Bluetooth and HomeRF projects were approximately 25% complete at the time of the valuation and the expected timeframe for achieving these product releases was assumed to be in the second half of 2000. The Direct Sequence Cordless project was approximately 65% complete at the time of the valuation and the expected time frame for achieving this product release was assumed to be in the second half of 2000. The Bluetooth/HomeRF Combo and Bluetooth/HomeRF/Direct Sequence projects were approximately 10% complete at the time of the valuation and the expected timeframe for achieving these product releases was assumed to be in the second half of 2000 and the first half of 2000, respectively. The Wireless Gas Tank Sensor and the Wireless Industrial Garage Door Opener projects were approximately 70% complete at the time of the valuation and the expected time frame for achieving these product releases was assumed to be 2001. The Wireless GPS was approximately 50% complete at the time of the valuation and the expected time frame for achieving this product release was assumed to be in the second half of 2000. The percentage complete calculations for all projects were estimated based on research and development expenses incurred to date and management estimates of remaining development costs. Significant remaining development efforts were to be completed in the next 6 to 18 months in order for Voyager's projects to become implemented in a commercially viable timeframe. Management's cash flow and other assumptions utilized at the time of acquisition do not materially differ from historical pricing/licensing, margin, and expense levels of the Voyager group prior to acquisition.

Approximately \$0.5 million was attributed to core wireless technology and royalty revenue associated with the Wireless Water Meter Reading Device project.

## Restructuring Charges

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Restructuring charges.....	\$1,583	\$ --	\$2,107	\$ --
Percentage of revenues.....	12.9%	-- %	7.3%	--%

On February 8, 2001, we announced a series of actions to streamline support for our voiceband business and sharpen our focus on emerging growth sectors. These measures were part of a restructuring program to return the company to profitability and operational effectiveness and included a reduction in worldwide headcount of 7 research and development employees, 9 sales and marketing employees and 6 general and administrative employees, a hiring freeze and cost containment programs. On May 1, 2001, we announced a new business structure that will result in greater focus for our activities with a significantly reduced workforce. 13 research and development employees, 13 sales and marketing employees and 12 general and administrative employees were eliminated as a part of this reorganization. The restructuring resulted in \$1.6 million and \$2.1 million of charges for the three and six months ended June 30, 2001, consisting of severance and employment related costs and costs related to closure of excess facilities as a result of the reduction in force.

## Amortization of Deferred Compensation

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Amortization of deferred compensation.....	\$ 261	\$ 328	\$ 554	\$ 677
Percentage of revenues.....	2.1%	1.2% b	1.9%	1.3%
% change from year ago period.....	(20.4)%	121.6%	(18.2)%	312.8%

In connection with the grant of stock options to employees prior to our initial public offering, we have recorded deferred compensation representing the difference between the exercise price and deemed fair market value of our common stock on the date these stock options were issued.

The amortization of deferred compensation decreased \$67,000 and \$123,000 for the three and six months ended June 30, 2001 compared to the same periods in 2000 primarily due to employee turnover. We expect the amortization of deferred compensation to remain at approximately \$260,000 per quarter through the third quarter of 2003, based on option grant activity through June 30, 2001.

## Other Income, Net

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Other income, net.....	\$1,704	\$1,777	\$3,466	\$3,158
Percentage of revenues.....	13.9%	6.5%	12.1%	6.1%
% change from year ago period.....	4.1%	N/A	9.8%	N/A

Other income, net, consists of interest income, net of interest expense. Interest income is expected to fluctuate over time. Other income, net, decreased \$73,000 for the three months ended June 30, 2001 compared to the same period in 2000 primarily due to the decrease in interest rates in 2001. Other income, net, increased \$308,000 for the six months ended June 30, 2001 compared to the same period in 2000 primarily due to the higher cash balances as a result of the proceeds from the secondary public offering in April 2000.

## Provision for Income Taxes

	Three Months Ended June 30, 2001	Three Months Ended June 30, 2000	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Provision for income taxes.....	\$1,114	\$1,059	\$16	\$1,714

We have \$5.7 million in deferred tax assets as of June 30, 2001. The realization of the deferred tax assets is dependent on future profitability. If we do not generate net income in future periods, the \$5.7 million will be written off. As a result of our tax structure and revised annual projections, we recorded \$1.1 million of provision for income taxes for the three months ended June 30, 2001 to offset the \$1.1 million benefit recorded for the three months ended March 31, 2001. For the six months ended June 30, 2001, we recorded \$16,000 of provision for income taxes for minimum taxes.

#### Liquidity and Capital Resources

	Six Months Ended June 30, 2001	Six Months Ended June 30, 2000
Net cash provided by (used in) operating activities.....	\$ 4,950	\$ (1,781)
Net cash provided by (used in) investing activities.....	10,831	\$ (3,054)
Net cash provided by financing activities.....	2,091	\$ 30,302
Cash, cash equivalents and short-term investments at the end of period....	125,234	\$121,279
Working capital at the end of period.....	126,579	\$124,371

The increase in net cash provided by operating activities for the six months ended June 30, 2001 compared to the same period in 2000 was primarily due to the decrease in accounts receivable as a result of our aggressive collection efforts in the first half of 2001 as well as a decrease in inventory due to reduced purchasing activities. Net cash provided by investing activities for the six months ended June 30, 2001 consists primarily of proceeds from the sales and maturities of short-term investments. Net cash provided by financing activities for the six months ended June 30, 2001 consists of proceeds from issuance of common stock associated with stock option exercises and from share purchases through the employee stock purchase plan.

As of June 30, 2001, we had \$125.2 million in cash, cash equivalents and short-term investments and working capital of \$126.6 million.

We believe that our existing sources of liquidity will be sufficient to meet our working capital and anticipated capital expenditure requirements for at least the next 12 months. Thereafter, we may require additional funds to support our working capital requirements or for other purposes, and we may seek, even before that time, to raise additional funds through public or private equity or debt financing or from other sources. Additional financing may not be available at all, and if it is available, the financing may not be obtainable on terms acceptable to us or that are not dilutive to our stockholders.

#### Factors Affecting Operating Results

This quarterly report on Form 10-Q contains forward-looking statements which involve risks and uncertainties. Our actual results could differ materially from those anticipated by such forward-looking statements as a result of certain factors including those set forth below.

#### Risks Related to Our Business

The recent economic slowdown, particularly the rapid deterioration in PC demand, makes it difficult to forecast customer demand for our products, and will likely result in excessive operating costs and loss of product revenues.

Since the fourth quarter of 2000, our customers, primarily our PC motherboard and distribution manufacturers, were impacted by significantly lower PC demand. As a result, our revenues and earnings in the first half of 2001 were negatively affected. Because we expect PC demand to continue to be weak for the foreseeable term, we expect our revenues and earnings to continue to be negatively affected.

In addition, the current economic environment also makes it extremely difficult for us to forecast customer demand for our products. We must forecast and place purchase orders for specialized semiconductor chips several months before we receive purchase orders from our own customers. This forecasting and order lead time requirement limits our ability to react to unexpected fluctuations in demand for our products. These fluctuations can be unexpected and may cause us to have excess inventory or a shortage of a particular product. In the event that our forecasts are inaccurate, we may need to write down excess inventory. Similarly, if we fail to purchase sufficient

supplies on a timely basis, we may incur additional rush charges or we may lose product revenues if we are not able to meet a purchase order. These failures could also adversely affect our customer relations. Significant write-downs of excess inventory or declines in inventory value in the future could cause our gross margin and net income to decrease.

Our sales are concentrated among a limited number of customers and the loss of one or more of these customers could cause our revenues to decrease.

Our sales are concentrated among a limited number of customers. If we were to lose one or more of these customers, or if one or more of these customers were to delay or reduce purchases of our products, our sales revenues may decrease. For the six months ended June 30, 2001, approximately 82% of our revenues were generated by three of our customers, with one customer representing 65% of revenues. These customers may in the future decide not to purchase our products at all, purchase fewer products than they did in the past or alter their purchasing patterns, because:

- . we do not have any long-term purchase arrangements or contracts with these or any of our other customers,
- . our product sales to date have been made primarily on a purchase order basis, which permits our customers to cancel, change or delay product purchase commitments with little or no notice and without penalty, and
- . many of our customers also have pre-existing relationships with current or potential competitors which may affect our customers' purchasing decisions.

We expect that a small number of customers will continue to account for a substantial portion of our revenues for at least the next 12 to 18 months and that a significant portion of our sales will continue to be made on the basis of purchase orders.

Continuing decreases in the average selling prices of our products could result in decreased revenues.

Product sales in the connectivity industry have been characterized by continuing erosion of average selling prices. Price erosion experienced by any company can cause revenues and gross margins to decline. The average selling price of our products has decreased by approximately 73% from October 1995 to June 30, 2001 and approximately 5% from March 31, 2001 to June 30, 2001. The average selling price of our products may continue to decline in the future.

In addition, we believe that the widespread adoption of industry standards in the soft modem industry is likely to further erode average selling prices, particularly for analog modems. Adoption of industry standards is driven by the market requirement to have interoperable modems. End-users need this interoperability to ensure modems from different manufacturers communicate with each other without problems. Historically, users have deferred purchasing modems until these industry standards are adopted. However, once these standards are accepted, it lowers the barriers to entry and price erosion results. Decreasing average selling prices in our products could result in decreased revenues even if the number of units that we sell increases. Therefore, we must continue to develop and introduce next generation products with enhanced functionalities that can be sold at higher gross margins. Our failure to do this could cause our revenues and gross margin to decline.

Our gross margins may vary based on the mix of sales of our products and services, and these variations may hurt our net income.

We derive a significant portion of our sales from our software-based connectivity products. We expect margins on newly introduced products generally to be higher than our existing products. However, due in part to the competitive pricing pressures that affect our products and in part to increasing component and manufacturing costs, we expect margins from both existing and future products to decrease over time. In addition, licensing revenues from our products historically have provided higher margins than our product sales. Changes in the mix of products sold and the percentage of our sales in any quarter attributable to products as compared to licensing revenues will cause our quarterly results to vary and could result in a decrease in gross margins and net income.

We have significant sales concentrated in Asia. Continued political and economic instability in Asia and difficulty in collecting accounts receivable may make it difficult for us to maintain or increase market demand for our products.

Our sales to customers located in Asia accounted for 91% of our total revenues for the six months ended June 30, 2001. The predominance of our sales is in Asia, mostly in Taiwan and China, because our customers are primarily motherboard or modem manufacturers that are located there. In many cases, our indirect original equipment manufacturer customers specify that our products be included on the modem boards or motherboards, the main printed circuit board containing the central processing unit of a computer system, that they purchase from board manufacturers, and we sell our products directly to the board manufacturers for resale to our indirect original equipment manufacturer customers, both in the United States and internationally. Due to the industry wide concentration of modem manufacturers in Asia, we believe that a high percentage of our future sales will continue to be concentrated with Asian customers. As a result, our future operating results could be uniquely affected by a variety of factors outside of our control, including:

- . delays in collecting accounts receivable, which we have experienced from time to time,
- . fluctuations in the value of Asian currencies relative to the U.S. dollar, which may make it more costly for us to do business in Asia and which may in turn make it difficult for us to maintain or increase our revenues,
- . changes in tariffs, quotas, import restrictions and other trade barriers which may make our products more expensive compared to our competitors' products, and
- . political and economic instability.

Our future success depends on our ability to develop and successfully introduce new and enhanced products that meet the needs of our customers.

Our revenue depends on our ability to anticipate our customers' needs and develop products that address those needs. In particular, our success will depend on our ability to introduce new products for the wireless and broadband markets. Introduction of new products and product enhancements will require coordination of our efforts with those of our suppliers to rapidly achieve volume production. If we fail to coordinate these efforts, develop product enhancements or introduce new products that meet the needs of our customers as scheduled, our revenues may be reduced and our business may be harmed. We cannot assure you that product introductions will meet the anticipated release schedules.

Our revenues may fluctuate each quarter due to both domestic and international seasonal trends.

We have experienced and continue to experience seasonality in sales of our connectivity products. These seasonal trends materially affect our quarter-to-quarter operating results. Our revenues are typically higher in the third and fourth quarters due to the back-to-school and holiday seasons as well as purchasers of PCs making purchase decisions based on their calendar year-end budgeting requirements.

We are currently expanding our sales in international markets, particularly in Asia, Europe and South America. To the extent that our revenues in Asia, Europe or other parts of the world increase in future periods, we expect our period-to-period revenues to reflect seasonal buying patterns in these markets.

Any delays in our normally lengthy sales cycles could result in customers canceling purchases of our products.

Sales cycles for our products with major customers are lengthy, often lasting six months or longer. In addition, it can take an additional six months or more before a customer commences volume production of equipment that incorporates our products. Sales cycles with our major customers are lengthy for a number of reasons:

- . our original equipment manufacturer customers usually complete a lengthy technical evaluation of our products, over which we have no control, before placing a purchase order,
- . the commercial integration of our products by an original equipment manufacturer is typically limited during the initial release to evaluate product performance, and
- . the development and commercial introduction of products incorporating new technologies frequently are delayed.

A significant portion of our operating expenses is relatively fixed and is based in large part on our forecasts of volume and timing of orders. The lengthy sales cycles make forecasting the volume and timing of product orders

difficult. In addition, the delays inherent in lengthy sales cycles raise additional risks of customer decisions to cancel or change product phases. If customer cancellations or product changes were to occur, this could result in the loss of anticipated sales without sufficient time for us to reduce our operating expenses.

We expect that our operating expenses will increase in the future and these increased expenses may diminish our ability to remain profitable.

Although we have been profitable in recent years, we may not remain profitable on a quarterly or annual basis in the future. Although we intend to control expenses given the current PC market environment, in order to expand and develop our core business, we still anticipate that our expenses will increase over at least the next three years as we:

- . further develop and introduce new applications and functionality for our host signal processing technology,
- . conduct research and development and explore emerging product opportunities in digital technologies and wireless communications,
- . expand our distribution channels, both domestically and in our international markets, and
- . pursue strategic relationships and acquisitions.

We will be required to increase our revenues to meet these additional expenses. Any failure to significantly increase our revenues as we implement our product, service, distribution and strategic relationship strategies would result in a decrease in our overall profitability.

To date, we have principally relied upon our distributor sales organization for product sales to smaller accounts. Our direct sales efforts have focused principally on board manufacturers and smaller PC original equipment manufacturers. To increase penetration of our target customer base, including large, tier-one original equipment manufacturers, we must significantly increase the size of our direct sales force and organize and deploy sales teams targeted at specific domestic tier-one original equipment manufacturer accounts. If we are unable to expand our sales to additional original equipment manufacturers, our revenues may not meet analysts' expectations, which could cause our stock price to drop.

We rely heavily on our intellectual property rights which offer only limited protection against potential infringers. Unauthorized use of our technology may result in development of products that compete with our products, which could cause our market share and our revenues to be reduced.

Our success is heavily dependent upon our proprietary technology. We rely primarily on a combination of patent, copyright and trademark laws, trade secrets, confidentiality procedures and contractual provisions to protect our proprietary rights. These means of protecting our proprietary rights may not be adequate. We hold a total of 48 patents, a number of which cover technology that is considered essential for International Telecommunications Union standard communications solutions, and also have 23 additional patent applications pending or filed. These patents may never be issued. These patents, both issued and pending, may not provide sufficiently broad protection against third party infringement lawsuits or they may not prove enforceable in actions against alleged infringers.

Despite precautions that we take, it may be possible for unauthorized third parties to copy aspects of our current or future products or to obtain and use information that we regard as proprietary. We may provide our licensees with access to our proprietary information underlying our licensed applications. Additionally, our competitors may independently develop similar or superior technology. Finally, policing unauthorized use of software is difficult, and some foreign laws, including those of various countries in Asia, do not protect our proprietary rights to the same extent as United States laws. Litigation may be necessary in the future to enforce our intellectual property rights, to protect our trade secrets or to determine the validity and scope of the proprietary rights of others. Litigation could result in substantial costs and diversion of resources.

We have received communications from Lucent and Dr. Brent Townshend, and may receive communications from other third parties in the future, asserting that our products infringe on their intellectual property rights, that our patents are unenforceable or that we have inappropriately licensed our intellectual property to third parties. These claims could affect our relationships with existing customers and may prevent potential future customers from purchasing our products or licensing our technology. Because we depend upon a limited number of products, any claims of this kind, whether they are with or without merit, could be time consuming, result in costly litigation, cause product shipment delays or require us to enter into royalty or licensing agreements. In the event that we do not prevail in litigation, we could be prevented from selling our products or be required to enter into royalty or licensing

agreements on terms which may not be acceptable to us. We could also be prevented from selling our products or be required to pay substantial monetary damages. Should we cross license our intellectual property in order to obtain licenses, we may no longer be able to offer a unique product. To date, we have not obtained any licenses from Lucent or Dr. Townshend because we believe that both Lucent and Dr. Townshend have requested license fees or cross licenses of our portfolio of intellectual property on terms that are not fair, reasonable and nondiscriminatory as required by the International Telecommunications Union. Other than the ESS Technology and Smart Link lawsuits described elsewhere in the notes to financial statements, no material lawsuits relating to intellectual property are currently filed against us.

New patent applications may be currently pending or filed in the future by third parties covering technology that we use currently or may use in the future. Pending U.S. patent applications are confidential until patents are issued, and thus it is impossible to ascertain all possible patent infringement claims against us. We believe that several of our competitors, including Lucent, Motorola and Texas Instruments, may have a strategy of protecting their market share by filing intellectual property claims against their competitors and may assert claims against us in the future. The legal and other expenses and diversion of resources associated with any such litigation could result in a decrease in our revenues and profitability.

In addition, some of our customer agreements include an indemnity clause that obligates us to defend and pay all damages and costs finally awarded by a court should third parties assert patent and/or copyright claims against our customers. As a result, we may be held responsible for infringement claims asserted against our customers.

We have accrued for negotiated license fees and estimated royalty settlements related to existing and probable claims of patent infringement. If the actual settlements exceed the amounts accrued, additional losses could be significant, which would adversely affect future operating results.

We recorded an accrual for estimated future royalty payments for relevant technology of others used in our product offerings in accordance with SFAS No. 5, "Accounting for Contingencies." The estimated royalties accrual reflects management's broader litigation and cost containment strategies, which may include alternatives such as entering into cross-licensing agreements, cash settlements and/or ongoing royalties based upon our judgment that such negotiated settlements would allow management to focus more time and financial resources on the ongoing business. Accordingly, the royalties accrual reflects estimated costs of settling claims rather than continuing to defend our legal positions, and is not intended to be, nor should it be interpreted as, an admission of infringement of intellectual property, valuation of damages suffered by any third parties or any specific terms that management has predetermined to agree to in the event of a settlement offer. We have accrued our estimate of the amount of royalties payable for royalty agreements already signed, agreements that are in negotiation and unasserted but probable claims of others using advice from third party technology advisors and historical settlements. Should the final license agreements result in royalty rates significantly higher than our current estimates, our business, operating results and financial condition could be materially and adversely affected.

Competition in the connectivity market is intense, and if we are unable to compete effectively, the demand for, or the prices of, our products may be reduced.

The connectivity device market is intensely competitive. We may not be able to compete successfully against current or potential competitors. Our current competitors include Conexant, ESS Technology, Lucent Technologies, Motorola, Smart Link, Broadcom and Texas Instruments. We expect competition to increase in the future as current competitors enhance their product offerings, new suppliers enter the connectivity device market, new communication technologies are introduced and additional networks are deployed.

We may in the future also face competition from other suppliers of products based on broadband and/or wireless technologies or on emerging communication technologies, which may render our existing or future products obsolete or otherwise unmarketable. We believe that these competitors may include Aironet, Alcatel, Analog Devices, Aware, Breezecom, Centillium Communications, Efficient Networks, Globespan, Intersil, ITeX, Metalink, Proxim, Symbol Technologies and Virata.

We believe that the principal competitive factors required by users and customers in the connectivity product market include compatibility with industry standards, price, functionality, ease of use and customer service and support. Although we believe that our products currently compete favorably with respect to these factors, we may not be able to maintain our competitive position against current and potential competitors.



In order for us to operate at a profitable level and continue to introduce and develop new products for emerging markets, we must attract and retain our executive officers and qualified technical, sales, support and other administrative personnel.

Our past performance has been and our future performance is substantially dependent on the performance of our current executive officers and certain key engineering, sales, marketing, financial, technical and customer support personnel. If we lose the services of one or more of our executives or key employees, a replacement could be difficult to recruit and we may not be able to grow our business.

Competition for personnel, especially engineers and marketing and sales personnel in Silicon Valley, is intense. We are particularly dependent on our ability to identify, attract, motivate and retain qualified engineers with the requisite education, background and industry experience. As of June 30, 2001, we employed a total of 60 people in our engineering department, over half of whom have advanced degrees. In the past we have experienced difficulty in recruiting qualified engineering personnel, especially developers, on a timely basis. If we are not able to hire at the levels that we plan, our ability to continue to develop products and technologies responsive to our markets will be impaired.

Failure to manage our technological and product growth could strain our management, financial and administrative resources.

Our ability to successfully sell our products and implement our business plan in rapidly evolving markets requires an effective management planning process. Future product expansion efforts could be expensive and put a strain on our management by significantly increasing the scope of their responsibilities and resources by increasing the demands on their management abilities during periods of constrained spending. We are focusing on the broadband and wireless areas as well as placing substantial effort on sustaining our leadership position in the analog modem space. To effectively manage our growth in these new technologies, we must enhance our marketing, sales, research and development areas. With revenues either stabilizing or declining, these efforts will have to be accomplished with limited funding. This will require management to effectively manage significant technological advancement within existing budgets.

We rely on independent companies to manufacture, assemble and test our products. If these companies do not meet their commitments to us, our ability to sell products to our customers would be impaired.

We do not have our own manufacturing, assembly or testing operations. Instead, we rely on independent companies to manufacture, assemble and test the semiconductor chips, which are integral components of our products. Most of these companies are located outside of the United States. There are many risks associated with our relationships with these independent companies, including reduced control over:

- . delivery schedules,
- . quality assurance,
- . manufacturing costs,
- . capacity during periods of excess demand, and
- . access to process technologies.

In addition, the location of these independent parties outside of the United States creates additional risks resulting from the foreign regulatory, political and economic environments in which each of these companies exists. Further, some of these companies are located near earthquake fault lines. While we have not experienced any material problems to date, failures or delays by our manufacturers to provide the semiconductor chips that we require for our products, or any material change in the financial arrangements we have with these companies, could have an adverse impact on our ability to meet our customer product requirements.

We design, market and sell application specific integrated circuits and outsource the manufacturing and assembly of the integrated circuits to third party fabricators. The majority of our products and related components are manufactured by three principal companies: Taiwan Semiconductor Manufacturing Corporation, Kawasaki/LSI, ADMTek and Silicon Labs. We expect to continue to rely upon these third parties for these services. Currently, the data access arrangement chips used in our soft modem products are provided by a sole source, Silicon Labs, on a purchase order basis, and we have only a limited guaranteed supply arrangement under a contract with our supplier.

Although we believe that we would be able to qualify an alternative manufacturing source for data access arrangement chips within a relatively short period of time, this transition, if necessary, could result in loss of purchase orders or customer relationships, which could result in decreased revenues.

Undetected software errors or failures found in new products may result in loss of customers or delay in market acceptance of our products.

Our products may contain undetected software errors or failures when first introduced or as new versions are released. To date, we have not been made aware of any significant software errors or failures in our products. However, despite testing by us and by current and potential customers, errors may be found in new products after commencement of commercial shipments, resulting in loss of customers or delay in market acceptance.

Connectivity devices generally require individual government approvals throughout the world to operate on local telephone networks. These certifications collectively referred to as homologation can delay or impede the acceptance of our products on a worldwide basis.

Connectivity products require extensive testing prior to receiving certification by each government to be authorized to connect to their telephone systems. This testing can delay the introduction or, in extreme cases, prohibit the product usage in a particular country. International Telecommunications Union standards seek to provide a worldwide standard to avoid these issues, but they do not eliminate the need for testing in each country. In addition to these government certifications, individual Internet Service Providers, or "ISPs", can also have unique line conditions that must be addressed. Since most large PC manufacturers want to be able to release their products on a worldwide basis, this entire process can significantly slow the introduction of new products.

Our financial position will be adversely affected if any of our goodwill is determined to be partially or entirely impaired.

Under SFAS 142, goodwill will no longer be subject to amortization over its estimated useful life commencing January 1, 2002. Rather, goodwill will be subject to at least an annual assessment for impairment applying a fair-value based test. We are assessing and will continue to assess our goodwill for impairment. Should any of our goodwill be determined to be partially or entirely impaired, our operating results and financial condition would be adversely affected.

Our financial position will be adversely affected if any of our deferred tax assets are determined to be partially or entirely impaired.

We have \$5.7 million in deferred tax assets as of June 30, 2001. Should we fail to generate net income in future periods, the deferred tax assets will be partially or entirely impaired and our operating results and financial condition would be adversely affected.

#### Risks Related to Our Industry

If the market for applications using our host signal processing technology does not grow as we anticipate, or if our products are not accepted in these markets, our revenues may stagnate or decrease.

Our success depends on the growth of the market for applications using our host signal processing technology. Market demand for host signal processing technology depends primarily upon the cost and performance benefits relative to other competing solutions. This market has only recently begun to develop and may not develop at the growth rates that have been suggested by industry estimates. Although we have shipped a significant number of soft modems since we began commercial sales of these products in October 1995, the current level of demand for soft modems may not be sustained or may not grow. If customers do not accept soft modems or the market for soft modems does not grow, our revenues will decrease.

Further, we are in the process of developing next generation products and applications which improve and extend upon our host signal processing technology. If these products are not accepted in the markets when they are introduced, our revenues and profitability will be negatively affected. We only recently introduced our Solsis(TM) modem for the embedded market. We expect sales of this product to continue to increase and become visible in our product mix by the second half of 2001. However, if the market does not accept our product, or if PC demand remains weak, our revenues will be adversely affected.

In addition, distribution models need to change in order for some of our products to be accepted. For example, in order for our LiteSpeed(TM) product to be adopted by a mass market, the distribution model for broadband technology must change from the current complicated provisioning model (which requires a technician to visit the home to install additional equipment) to a 56K/V.90 modem distribution model (where the modem is bundled inside a personal computer or alternative access device.) We believe that the market will in fact move towards the 56K/V.90 business model towards the end of 2001. However, if it does not, then our LiteSpeed(TM) product may not be accepted by the mass market, and our revenues will be adversely affected.

Our industry is characterized by rapidly changing technologies. If we do not adapt to these technologies, our products will become obsolete.

The connectivity product market is characterized by rapidly changing technologies, limited product life cycles and frequent new product introductions. To remain competitive in this market, we have been required to introduce many products over a limited period of time. For example, we introduced a 14.4 Kbps product in 1995, a 28.8 Kbps product in 1996, a 33.6 Kbps product in late 1996, a non-International Telecommunications Union standard 56 Kbps modem in the second half of 1997 and a V.90 International Telecommunications Union standard 56 Kbps modem in early 1998. During 2001, we expect to see the introduction of additional International Telecommunications Union standards referred to as V.92 and V.44. The market for high speed data transmission is also characterized by several competing technologies that offer alternative broadband solutions which allow for higher modem speeds and faster Internet access. These competing broadband technologies include digital subscriber line and wireless. In the digital subscriber line area, various speed and technologies are currently being considered in the market such as G.Lite at 1.5Mbps, G.DMT at 8Mbps and VDSL at 52 Mbps. The wireless area includes competing standards such as Bluetooth, HomeRF 1.0 and HomeRF 2.0 as well as 802.11b and 802.11a. However, substantially all of our current product revenue is derived from sales of analog modems, which use a more conventional technology. We must continue to develop and introduce technologically advanced products that support one or more of these competing broadband technologies. These new technology developments have taken longer time than expected. If we are not successful in our response, our products will become obsolete and we will not be able to compete effectively.

Changes in laws or regulations, in particular, future FCC regulations affecting the broadband market, Internet service providers, or the communications industry, could negatively affect our ability to develop new technologies or sell new products and therefore, reduce our profitability.

The jurisdiction of the Federal Communications Commission, or FCC, extends to the entire communications industry, including our customers and their products and services that incorporate our products. Future FCC regulations affecting the broadband access services industry, our customers or our products may harm our business. For example, future FCC regulatory policies that affect the availability of data and Internet services may impede our customers' penetration into their markets or affect the prices that they are able to charge. In addition, international regulatory bodies are beginning to adopt standards for the communications industry. Although our business has not been hurt by any regulations to date, in the future, delays caused by our compliance with regulatory requirements may result in order cancellations or postponements of product purchases by our customers, which would reduce our profitability.

We rely on a continuous power supply to conduct our operations, and California's current energy crisis could disrupt our operations and increase our expenses.

Our business operations depend on our ability to maintain and protect our facilities, computer systems and personnel, which are primarily located in or near our principal headquarters in Milpitas, California. California is currently experiencing power outages due to a shortage in the supply of power within the state. In anticipation of continuing power shortages, the electric utility industry in California has warned power consumers to expect rolling blackouts throughout the state, particularly during the summer months when power usage peaks. We currently do not have backup generators or alternate sources of power in the event of a blackout, and our current insurance does not provide coverage for any damages we or our customers may suffer as a result of any interruption in our power supply. Although the blackouts we have experienced to date have not materially impacted our business, an increase in the frequency or length of the blackouts could damage our reputation, harm our ability to retain existing customers and to obtain new customers, and could result in lost revenue, any of which could substantially harm our business and results of operations. Furthermore, the deregulation of the energy industry has caused power prices to increase. If wholesale prices continue to increase, our operating expenses will likely increase, as the majority of our facilities are located in California.

## Risks Related to our Common Stock

Our stock price may be volatile based on a number of factors, some of which are not in our control.

The trading price of our common stock has been highly volatile. Our stock price could be subject to wide fluctuations in response to a variety of factors, many of which are out of our control, including:

- . actual or anticipated variations in quarterly operating results,
- . announcements of technological innovations,
- . new products or services offered by us or our competitors,
- . changes in financial estimates by securities analysts,
- . conditions or trends in our industry,
- . our announcement of significant acquisitions, strategic partnerships, joint ventures or capital commitments,
- . additions or departures of key personnel,
- . mergers and acquisitions, and
- . sales of common stock by us or our stockholders.

In addition, the Nasdaq National Market, where many publicly held telecommunications companies, including our company, are traded, often experiences extreme price and volume fluctuations. These fluctuations often have been unrelated or disproportionate to the operating performance of these companies. The trading prices of many technology companies continue to trade at multiples of earnings or revenues which are substantially above historic levels. These trading prices and multiples may not be sustainable. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our actual operating performance. In the past, following periods of volatility in the market price of an individual company's securities, securities class action litigation often has been instituted against that company. This type of litigation, if instituted, could result in substantial costs and a diversion of management's attention and resources.

Substantial future sales of our common stock in the public market may depress our stock price.

Our current stockholders hold a substantial number of shares, which they will be able to sell in the public market in the near future. Sales of a substantial number of shares of our common stock could cause our stock price to fall.

Provisions in our charter documents may inhibit a change of control or a change of management which may cause the market price for our common stock to fall and may inhibit a takeover or change in our control that a stockholder may consider favorable.

Provisions in our charter documents could discourage potential acquisition proposals and could delay or prevent a change in control transaction that our stockholders may favor. These provisions could have the effect of discouraging others from making tender offers for our shares, and as a result, these provisions may prevent the market price of our common stock from reflecting the effects of actual or rumored takeover attempts and may prevent stockholders from reselling their shares at or above the price at which they purchased their shares. These provisions may also prevent changes in our management that our stockholders may favor. Our charter documents do not permit stockholders to act by written consent, do not permit stockholders to call a stockholders meeting and provide for a classified board of directors, which means stockholders can only elect, or remove, a limited number of our directors in any given year.

Our board of directors has the authority to issue up to 5,000,000 shares of preferred stock in one or more series. The board of directors can fix the price, rights, preferences, privileges and restrictions of this preferred stock without any further vote or action by our stockholders. The rights of the holders of our common stock will be affected by, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. Further, the issuance of shares of preferred stock may delay or prevent a change in control transaction without further action by our stockholders. As a result, the market price of our common stock may drop. The board of directors has not elected to issue additional shares of preferred stock since the initial public offering on October 19, 1999.

Item 3: Quantitative and Qualitative Disclosures about Market Risk

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We are exposed to minimal market risks. We manage the sensitivity of our results of operations to these risks by maintaining a conservative investment portfolio, which is comprised solely of high-grade securities. We do not hold or issue derivative, derivative commodity instruments or other financial instruments for trading purposes. We are exposed to currency fluctuations, as we sell our products internationally. We manage the sensitivity of our international sales by denominating all transactions in U.S. dollars.

We may be exposed to interest rate risks, as we may use additional financing to fund additional acquisitions and other capital expenditures. The interest rate that we may be able to obtain on financings will depend on market conditions at that time and may differ from the rates we have secured in the past.

Part II. Other Information  
For the Three and Six Months Ended: June 30, 2001

Item 1 Legal Proceedings:

See Note 5 of Notes to the Consolidated Condensed Financial Statements.

Item 6 Exhibits and reports on Form 8-K

(a) Exhibits (numbered in accordance with Item 601 of Regulation S-K)

Exhibit Number	Description
10.22	(a) Consulting Agreement with Martin Singer, Non-Executive Chairman of the Board, signed May 6, 2001

- (a) Filed herewith.  
(b) Reports on Form 8-K: None.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PCTEL, Inc.  
A Delaware Corporation

August 13, 2001

By: /s/ Andrew Wahl

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Andrew Wahl  
Vice President, Finance and  
Chief Financial Officer  
(Principal Financial and Accounting Officer)

April 29, 2001

Mr. Martin Singer  
3927 Snowbird Lane  
Northbrook, IL 60062

Dear Marty,

The Board of Directors of PCTEL, Inc. ("PCTEL") desired to expand your consulting responsibilities in addition to your role as our Non-Executive Chairman of the Board. We believe that your skills, expertise and knowledge of the communications industry will be a great asset to PCTEL. This letter sets forth the terms and conditions of your consultancy with us.

In your expanded role, you will be responsible for providing the services set forth in Exhibit A to this letter (the "Services"). The compensation to

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which you are entitled for performing the Services is also set forth in Exhibit  
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A.  
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By accepting this offer, you agree that all materials, inventions, improvements, and trade secrets which relate in any manner to the business of PCTEL conceived or discovered by you in performing the Services hereunder, solely or in collaboration with others, are the sole property of PCTEL.

Your consultancy will commence on the date you accept this offer, as indicated below, and will continue until the earlier of (i) final completion of the Services or (ii) termination of the consultancy by you or by PCTEL. Your consultancy is completely "at-will" and, as a result, you are free to terminate the relationship at any time, for any reason, or for no reason. Similarly, PCTEL is free to terminate the relationship with you at any time, for any reason or for no reason.

The laws of the State of California shall govern this offer. This letter sets forth the entire agreement between you and PCTEL and supersedes any prior agreements, whether written or oral, with respect to your consultancy. No waiver, alteration, or modification of any of the provisions of this letter shall be binding unless in writing and signed by you and a duly authorized representative of PCTEL.

On behalf of the Board of Directors, I thank you for your continued commitment and support of PCTEL. Should you have any questions about this letter, please do not hesitate to call me or Tom Capizzi, our V.P. Human Resources & Administration, at (408) 965-2100. If the foregoing terms are agreeable, please indicate your acceptance of this offer by signing the letter in the space provided below and returning this letter to PCTEL.

ACKNOWLEDGED AND AGREED TO:

Sincerely,

/s/ Martin A. Singer

- -----  
Martin A. Singer

William F. Roach

Date: May 6, 2001

President and Chief Executive Officer



EXHIBIT A

SERVICES AND COMPENSATION  
- - - - -

1. Services. Martin A. Singer ("Consultant") will render to PCTEL the  
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following Services:

(a) Consultant will help PCTEL to obtain a favorable resolution to the outstanding litigation with Smart Link Ltd. and Smart Link Technologies, Inc. (collectively, "Smart Link") and the claims asserted by Dr. Brent Townshend regarding our intellectual property (the "Litigation Matters").

(b) Consultant will continue to train employees of PCTEL how to use Experience Curve, a statistics program that Consultant has introduced to PCTEL. Consultant will also support executive team in the use of this program throughout PCTEL.

2. Compensation.  
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(a) For his services relating to the Litigation Matters, PCTEL shall pay Consultant on a monthly basis the sum of \$13,500 and upon successful completion of this agreement the remaining portion of the agreed upon figure of \$80,000 shall be paid in a lump sum payment to the Consultant. In the event the consultancy is terminated prior to completion of the Services related to the Litigation Matters, in which event Consultant and PCTEL shall agree upon a prorated amount. In addition to the above payment, PCTEL shall make bonus payments to Consultant if Consultant contributes substantially to the achievement of the objectives set forth in the table below, as determined by a majority of the other Board of Directors of PCTEL:

Objective	Bonus Payment
=====	
1) Execution of a settlement agreement with Smart Link and avoidance of trial	\$10,000
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2) Execution of a settlement agreement with Smart Link at 2-3% of the resale prices for HSP and V90	\$10,000
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3) Execution of a settlement agreement with Dr. Townshend at less than 3% of the resale prices of PCTEL products	\$10,000
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4) Execution of a settlement agreement with Dr. Townshend at less than 2% of resale prices of PCTEL products	\$10,000
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(b) For professional services relating to Experience Curve, PCTEL shall pay Consultant \$2,500 per day for up to a maximum of 10 days. With the support of the Consultant, if PCTEL is successful in achieving cost reduction from Silicon Labs in 2001, PCTEL shall pay Consultant an additional bonus of \$10,000.

(c) PCTEL shall reimburse Consultant for all reasonable travel and living expenses incurred by Consultant in performing Services pursuant to this Agreement, provided Consultant receives written consent from an authorized agent of PCTEL prior to incurring such expenses.

(d) Consultant shall submit all statements for services and expenses in a form prescribed by PCTEL every two (2) weeks and such statements shall be approved by the Chief Executive Officer or Chief Financial Officer of PCTEL.