

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(MARK ONE)

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

OR

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

FOR THE FISCAL YEAR ENDED JULY 31, 1999

Commission file number 0-20008

VTEL CORPORATION

A Delaware Corporation IRS Employer ID No. 74-2415696

108 Wild Basin Road
Austin, Texas 78746
(512) 437-2700

Securities registered pursuant to section 12 (b) of the Act:

None

Securities registered pursuant to Section 12(g) of the Act:
Common Stock

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes No .
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Indicate by check mark if disclosure of delinquent filings pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K. () .

The aggregate market value of 20,665,891 shares of the registrant's Common Stock held by nonaffiliates on October 13, 1999 was approximately \$68,466,096. For purposes of this computation all officers, directors and 5% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed an admission that such officers, directors and beneficial owners are, in fact, affiliates of the registrant.

At October 13, 1999 there were 24,456,573 shares of the registrant's Common Stock, \$.01 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the definitive Proxy Statement to be delivered to stockholders in connection with the 1999 Annual Meeting are incorporated by reference into Part III.

A list of all Exhibits to this Annual Report on Form 10-K is located at pages 50 through 54.

PART I.

ITEM 1. BUSINESS

GENERAL

VTEL Corporation (VTEL, we or our) designs, manufactures, markets and supports visual communication systems. VTEL's product line is based on the latest microprocessor technology, a unique integration of hardware and software that provides features which are far beyond traditional video and audio conferencing. The use of open PC architecture and standard Microsoft(R) operating systems allows users to bring virtually any kind of data into a meeting or training environment. These new visual communications systems allow access and sharing of any information available on the World Wide Web, data that resides on an organization's Local Area Network or Intranet, or local PC files and software applications. The majority of our systems are built upon a system platform that is based on industry-standard, PC-compatible open hardware and software architecture. The PC-architecture also provides a natural pathway to connect VTEL's visual communication systems to either Internet Protocol (IP) networks or traditional telephone networks on a call by call basis through simple software commands. Our network management software uses industry standard protocols to allow large visual communications networks to be operated in the same manner currently used in traditional data networks, thereby leveraging the rapidly expanding network infrastructures being deployed in organizations throughout the world. VTEL's streaming video software allows users to "webcast" events live over an internal network or the Internet and store any multimedia content for convenient, on-demand playback. We offer a wide range of global professional services to assist customers in designing, installing, operating and supporting organizational visual communications networks worldwide.

The cornerstone of VTEL's business strategy is to identify end-user customer markets that can most benefit from the advanced functionality of our multi-media visual communication systems and to focus a substantial portion of its sales and marketing efforts on these targeted markets. Consistent with this strategy, VTEL has targeted the manufacturing, education, government, health care, and financial institution market segments and certain portions of the general business market. VTEL primarily distributes its systems through third-party resellers which include major telecommunications providers and distributors such as Ameritech, Bell South, GTE, MCI, Norstan, PacBell, SBC, Sprint, US West and other value-added resellers. We have built an extensive marketing and sales organization to support our third-party resellers. This organization provides marketing programs; field support personnel including sales managers, system engineers, and business development managers; and personnel with industry expertise to implement our targeted market strategy. Since VTEL's inception, it has sold more than 30,000 visual communication systems.

On May 23, 1997, shareholders of VTEL and Compression Labs, Incorporated, a Delaware corporation ("CLI"), approved the merger of VTEL-Sub, Inc., a Delaware corporation and direct wholly-owned subsidiary of VTEL (the "Merger"), with and into CLI, pursuant to an Agreement and Plan of Merger and Reorganization, with CLI becoming a direct wholly-owned subsidiary of VTEL. As a result of the Merger all of the outstanding common and preferred CLI shares were exchanged for a total of 8,424,741 shares of VTEL Common Stock. The acquisition was accounted for as a pooling of interests.

On March 9, 1999, VTEL completed the acquisition of substantially all of the assets of Vosaic LLP, an Internet video software and technology company for \$3.2 million in cash, stock and warrants. The transaction was accounted for as a purchase of assets. The acquisition involved the issuance of 1,149,000 shares (equivalent to approximately 5% of the outstanding shares of VTEL's stock as of March 9, 1999). VTEL acquired the core team, originally associated with the University of Illinois, who pioneered the first multimedia Web Browser, and has refined scalable video delivery technologies to stream and store video information securely with high Quality of Service (QoS).

As part of VTEL's initiative to expand its international presence, we consummated the acquisition of certain of the assets of the videoconferencing division of one of our German resellers effective July 1, 1998. The

consideration paid by VTEL consisted of restricted stock, warrants, a note payable, and the assumption of certain payables and other liabilities for total consideration of approximately \$1,871. In September 1998, VTEL completed the acquisition of one of its French resellers through the issuance of restricted stock.

VTEL's executive offices are located at 108 Wild Basin Road, Austin,

Texas 78746, and its telephone number is (512) 437-2700.

INDUSTRY BACKGROUND

Visual communications systems enable users at remote locations to meet and share information face-to-face. A wide range of business or professional meetings, education and training classes, and technical or medical consultations make use of this innovative technology to reduce operating costs, improve customer services, reduce cycle times, and improve intra- or inter-company communications. A videoconference entails the transmission of video, audio and data signals between two or more locations over a network connection. Video, audio and data conferencing involves a large amount of digital information. In order to transmit this information over digital networks, the video, audio and data signals must be digitized and compressed without substantially reducing the information content. Improved compression algorithms reduce transmission costs by allowing more information to be sent over lower capacity digital networks. Improved quality and lower costs of videoconferencing systems and network services have made videoconferencing applications more attractive to a broader group of users worldwide. Also contributing to the wider use of videoconferencing is the increased availability of switched digital telephone service and the use of Internet Protocol networks, allowing a videoconference to be initiated with nearly the ease of a normal telephone call.

The major change occurring in the industry today involves the evolutionary migration of telecommunications networks from circuit-switched technology (like traditional telephone lines) to packet-switched technology (Internet Protocol networks). We are ideally positioned to take advantage of this change because our underlying product technology is built upon an open PC architecture. In October 1999, VTEL introduced its new product line of Galaxy(TM) visual communication systems. The enhanced software included in the Galaxy(TM) line can accommodate and support customer migration to Internet Protocol networks easily because these endpoints can operate on either type network and move from one network architecture to another on a call by call basis through simple software commands. For many customers that previously purchased VTEL products, the migration to Internet Protocol network functionally can be accomplished through software upgrades to existing products.

Videoconferencing systems are also becoming simpler to use. Current videoconferencing systems can be configured as "set-top" appliances or "roll-about" room systems that can be used without the need for trained operators or special room requirements. In general, the videoconferencing market can be grouped into four complementary categories: personal conferencing, set-top conferencing, workgroup conferencing, and group conferencing. The personal conferencing market is targeted at the individual. As such, solutions are typically priced in the \$1,000 to \$7,000 range. The set-top conferencing market is targeted at groups of two to three individuals. Systems in this market range from \$4,995 to \$9,000. The workgroup conferencing market is targeted at the project teams or executive offices that require collaborative data and software interaction. Solutions in this market range from \$9,995 to \$15,000. The group conferencing market is targeted at larger groups, typically eight or more individuals. Application uses vary greatly from boardrooms to large classrooms. These group systems are priced at \$8,500 and above.

Another factor contributing to the growth of videoconferencing is the continuing emergence of international industry standards designed to allow interoperability of videoconferencing systems manufactured by different vendors. The International Telecommunications Union ("ITU-T") sets international standards used by the industry. VTEL has been a leader in promoting standards across the industry and delivers standards-based products to its customers.

While technological advances and market receptivity have increased the use of videoconferencing, traditional audio and video videoconferencing alone lacks the functionality and effectiveness of face-to-face meetings in many applications. We believe that, for certain applications, users are seeking conferencing features, in addition to audio and video, that allow for the exchange of information and interaction through a variety of media. For example, engineers can communicate and solve problems more effectively by supplementing the videoconference with shared media, such as graphics with annotations, computer programs, document exchanges and whiteboards, which results in a better replication of the impact and effectiveness of a face-to-face meeting. VTEL has taken a leadership position in this form of high-value visual communication

technology due to its open PC platform and flexible architecture.

CORPORATE STRATEGY

VTEL's primary focus is on high-value visual communication systems which provide high functionality tailored to the needs of our targeted markets. This results in a range of offerings from desktop to boardroom applications. The following are the components of VTEL's corporate strategy:

PRODUCT DIFFERENTIATION. VTEL's strategy is to differentiate its products from the products marketed by its competitors. Key elements of this strategy are as follows:

Open Architecture. VTEL's principal visual communication systems are built upon a system platform which integrates video, audio and data compression technologies in a PC-compatible open hardware and software architecture. This open architecture allows VTEL to accelerate the development process through the use of commonly available, low-cost hardware and software components and the incorporation of third-party technological developments. VTEL's PC-based system platforms are field-upgradable and easily accommodate software upgrades, thereby extending the useful life of the customer's investment and providing us with incremental revenues through these upgrade sales. In October 1999, we began shipping our Galaxy(TM) line of visual communication systems. The new line is distinguished by a new more intuitive user interface software (Vtouch TM) that offers the additional functionality of H.323 (or Internet Protocol) networking capability. Because VTEL's systems are PC-based, existing customers of our later generation ESA(TM) line of visual communication systems will be able upgrade to the latest features of the Galaxy(TM) line.

Centralized Management and Administration. Using the industry standard Simple Network Management Protocol ("SNMP"), VTEL is able to centrally manage and administer large, distributed visual communication networks. VTEL's SmartVideoNet Manager product provides advanced functionality for management in the videoconferencing industry. It leverages the industry standard SNMP for statistics, controls, and alerts. These functions allow for centralized problem determination and resolution, thereby eliminating the requirement for on-site expert personnel to support the system. An additional benefit of SmartVideoNet Manager is the ability to establish video calls from a centralized console with no local user intervention. Using this, meeting participants simply arrive at the conference room or classroom and the video call is already in session waiting for their participation.

Consistent Operating Platform. An important characteristic of each product in the family is the consistent use of standard Microsoft operating systems (Windows 95(R), Windows 98(R), Windows NT(R)). This consistency combines the PC-microprocessor architecture with a recognized software platform and provides a familiar look and feel for the user throughout the product family architecture. Windows operating systems support a wide variety of software and hardware applications that can be integrated into a videoconference as stand-alone features or as shared applications by visual communication users through our collaboration capability.

Multi-media Functionality. VTEL's visual communication systems provide a wide range of functions that utilize a variety of media and more closely replicate the impact and effectiveness of face-to-face meetings. These functions, referred to by VTEL as visual communications technology, combine video and audio, document exchange,

shared whiteboard and computer application sharing. VTEL strives to make this functionality easily accessible to the user. Our Pen Pal Graphics and AppsView(TM) user interfaces were designed to make our group systems easier to use and are fully integrated on VTEL Team Conferencing and Leadership Conferencing systems. Galaxy's(TM) new Vtouch(TM) graphical user interface builds upon the success of these earlier efforts to provide even easier system operation. Both AppsView(TM) and Vtouch(TM) are customizable user interfaces that run on a Microsoft Windows(R) operating system. They integrate all application functions under a software defined interface which can be customized by the user to meet specific needs.

Standards Compliance. VTEL believes the continued adoption and implementation of industry standards for interoperability are critical to the continued growth of the videoconferencing market. All of our visual

communication systems and multipoint products comply with the leading ITU-T standards for videoconferencing. VTEL's platforms also comply with an extensive array of additional communications and computer industry standards, both formal and de facto (such as ISA, PCI, Intel x86, SNMP, and Microsoft Windows(R)), involving video, audio, graphics, communications, computers, peripherals, and network management. We have been an active participant on the relevant ITU-T committees and intend to continue to promote both acceptance of the standards by all vendors and formal compliance testing to assure interoperability.

Network Integration Capabilities. The PC-based open architecture design of VTEL's products provides a natural pathway to connect our visual communication systems onto local area networks (LANs) and wide area networks (WANs), thereby leveraging the rapidly expanding network infrastructures being deployed in organizations throughout the world. We believe that not only will such networks continue to expand globally, but the capability to centrally manage large internationally dispersed networks will become a requirement for the successful establishment of such networks. We believe that development of network integration and network management capabilities will be an important success factor to our strategy. The VTEL Network Assured Program was initiated with the goal of ensuring interoperability between the various networking systems in the marketplace and VTEL's videoconferencing equipment. This program offers the customer, who must interface with the different major equipment vendors, the peace-of-mind they are seeking as they integrate multivendor equipment on a network. To facilitate an easy migration into the new realm of IP communications, VTEL is collaborating with vendors of network services including Cisco, GTE Network Services, IXC Communications and Ezenia! to enable seamless integration between VTEL's H.323-based product line and their product line.

Service and Systems Integration Capabilities. VTEL's Global Services division offers installation, integration and support services to customers of its products. Most sales occur through resellers to the end users of our products. This offering of services enhances VTEL's resellers' ability to sell our visual communication systems and to generate additional revenues to VTEL from the sales of such services. During fiscal 1999 Global Services expanded the capabilities offered to our resellers by building application-specific systems that address individual users' needs. This service excelled where resellers expressed the need to deliver a system requirement that could be duplicated many times within a market or region. Projects were typically priced in the range of \$100,000 to \$300,000. The building of application-specific systems for a reseller further differentiates VTEL and its hardware/software solutions. VTEL intends to expand in this area in fiscal year 2000.

TARGETED MARKETS. The cornerstone of VTEL's business strategy is to identify end-user customer markets that can most benefit from the advanced functionality of our multi-media visual communication systems, and to focus a substantial portion of our sales and marketing efforts on these targeted markets. Consistent with this strategy, VTEL has targeted the manufacturing, education, government, health care, and certain portions of the business market. VTEL continues to focus on those markets in which it has the highest potential for increasing its market share. We currently enjoy a leadership position in the education market with installations at secondary and higher education systems throughout the world.

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DISTRIBUTION STRATEGY. VTEL believes that a well-executed distribution channel is critical to marketing success. VTEL currently relies on third party resellers to sell, install and support its visual communication systems in an effort to leverage the sales forces of the resellers that are already providing telecommunications and systems integration services to potential purchasers of visual communication systems. All major resellers maintain demonstration networks, with trained sales and support personnel.

Consistent with its focus on its targeted market segments, we work with a number of VARs that specialize in specific applications, geographic areas and markets such as education, health care, project management and government procurement. Typically, VTEL's agreements with its resellers and VARs involve non-exclusive arrangements which may be canceled by either party at will and contain no minimum purchase requirements on the part of the resellers.

VTEL also sells products directly to certain end-user customers, generally large global end user customers which have sophisticated global visual communication networks and require much more involvement to support the sale, installation and maintenance of the network. These sales are mostly completed

through VTEL's Global Service division.

PRODUCTS

We offer a complete line of interoperable multi-media visual communication systems. VTEL differentiates its systems from competitive products by a high level of advanced functionality, such as presentation graphics and access to PC-based software and hardware peripherals. Because VTEL systems are based on open PC-architecture, and most functionality is contained in software, many system upgrades are accomplished via software, enabling customers to protect their investment in our systems. VTEL systems may be configured with LAN connections so that data and presentations may be created at an individual PC workstation, stored on the LAN and retrieved by the visual communication system for presentation or transfer to the remote location during a videoconference.

Videoconferences can range from simple point-to-point connections between two locations of a single organization to connections between multiple locations of multiple organizations in several countries. VTEL's primary visual communication products are based upon one of three architectures, the SmartStation Architecture (SSA) for personal and workgroup visual communication, the Enterprise Series Architecture (ESA) for group conferencing, and the TurboCast(TM) Architecture for Internet targeted visual communications solutions.

ENTERPRISE SERIES ARCHITECTURE PLATFORM. VTEL's Enterprise Series Architecture(TM) ("ESA") is the hardware and software platform for a family of products designed to meet the needs of large and small groups. The ESA platform is a PC-based, open architecture visual communication system configured around an Intel Pentium(TM) PC chassis containing the ESA(TM) video-audio processing boardset. The ESA(TM) system contains, in addition to the standard internal disk drive and 3.5 inch floppy drive, a CD-ROM drive as well as an expansion chassis which contains all the audio and video input/output ports. The ESA(TM) platform utilizes the Microsoft Windows(R) operating system as its software platform and incorporates either the AppsView(TM) software user interface and control system or its newly released Galaxy(TM) Vtouch(TM) software user interface and control system. Through AppsView(TM) or Vtouch(TM), the user controls all conference functions with on-screen software icons which may be customized for each user or application. The ESA platform contains open PC card slots for application-specific peripherals.

The ESA(TM) platform supports industry standards for video, audio and data compression and is interoperable with any other system supporting the H.320 standard using the AppsView(TM) software, and both H.320 and H.323 using the Galaxy(TM) software. The platform operates over digital communication bandwidths transmitting at data rates from 56 Kbps to T1 or E1 rates in point-to-point and multipoint conferences. ESA connections can be made over public dial-up digital networks or private digital dedicated facilities. During fiscal 1999, ESA connectivity was expanded to include Internet Protocol networks through a hardware addition. ESA systems may also be upgraded to H.323 (Internet Protocol) with our new Galaxy(TM) software.

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Configurations of the ESA(TM) platform with AppsView(TM) include VTEL's Team Conferencing(TM) ("TC") and Leadership Conferencing(TM) ("LC") Systems. These systems are single or dual monitor systems built on the ESA platform and designed to provide mid-range products for users seeking high quality video and audio and visual communication capability in a small to mid-sized group setting. Data rates from 56 Kbps to 512 Kbps are provided on all systems and high speed data rates up to T1 or E1 for the high end LC systems. The systems provide higher performance PC-based functionality through the use of the Intel Pentium(TM) microprocessor, inclusion of a CD-ROM drive, the Microsoft Windows(TM) operating system and the AppsView(TM) user interface. Product features include LAN connectivity, Internet access, both document and computer conferencing, 30 frame per second video and capability of including software applications designed for Microsoft Windows(TM) as part of the videoconference. The TC systems have suggested list prices of \$11,700 to \$40,995 and LC5000 configurations vary in price from \$54,995 to \$59,495

Configurations of the ESA(TM) hardware platform with Galaxy(TM) include several new Products: Galaxy Model 725, Galaxy Model 755, Galaxy Model 2500 and Galaxy Model 5500. This new family of products provide the competitive price performance characteristics required by customers across the wide range of group

system applications. The products provide state of the art video and audio with high resolution slide capture and send graphics. The systems are H.323 capable for videoconferencing over Internet Protocol Networks and/or H.320 capable for videoconferencing over traditional circuit switched networks. Within this product family there are solutions that support single or dual monitor configurations, and data rates from 56kbps to 1920Kbps (T1/E1). All are supported by the new Vtouch(TM) graphical user interface.

WG500. The WG500 is a series of workgroup visual communication systems targeted at the project team or executive office where the ability to share and interactively create a work product is required. As such, it is designed to utilize industry leading collaborative multi-media tools such as Microsoft NetMeeting(TM). Based on a high performance, multi-media PC platform, the WG500 fills the price-point and functionality gap between the personal desktop conferencing market and the large group conferencing market. The WG500 has suggested list prices of \$9,995 to \$14,995

SETTOP 250. The SETTOP 250 was the first business-class, set-top videoconferencing system in the industry priced under \$5,000. Combining ease-of-use with high-quality features, the SETTOP 250 is the solution for enterprise users who require entry-level group conferencing with industry-standard voice and video. The SETTOP 250 includes an intuitive user interface, an easy, color-coded installation process, and comes in both 128 Kbps and 384 Kbps models.

SMARTSTATION. The SmartStation(TM) converts a Windows-based PC into a videoconferencing system for personal use. Incorporating the performance of the ESA(TM) products with its high-quality audio and video, the SmartStation(TM) allows users to collaborate while still leveraging the power and versatility of their desktop PC. In one easy-to-install package, SmartStation(TM) includes VTEL's AppsView(TM) graphical conference control interface for consistent operation across many of VTEL's visual communication solutions. SmartStation(TM) supports data rates up to 384 Kbps for high-quality desktop conferencing and supports the T.120 standard for data collaboration by integrating Microsoft NetMeeting 2.0(TM).

SMARTVIDEONET MANAGER(TM). SmartVideoNet Manager(TM) software is a tool designed to help customers simplify the administration of video networks and reduce the operating costs. Based on the Windows NT platform and utilizing the SNMP communications protocol, SmartVideoNet Manager(TM) leverages the PC-based architecture of our systems to allow customers to use their existing Intranet to provide continuous monitoring of their video network. SmartVideoNet Manager(TM) allows administrators to remotely control, configure, diagnose and troubleshoot VTEL systems, all from a PC console.

NETWORK EQUIPMENT. VTEL carries an extensive line of equipment to optimize connectivity in a variety of network environments. In order to maximize communication effectiveness, many customers choose to purchase multipoint control units to link multiple users into a single meeting. The SmartLink

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Multimedia Conference SERVER(TM) ("MCS") is the hub of a videoconferencing meeting, allowing interactive communications with up to 48 participants. The SmartLink MCS(TM) provides translation capabilities for a number of line rates and video and audio algorithms to ensure maximum flexibility. Additionally, the SmartLink MCS(TM) is manageable through SmartVideoNet Manager(TM). SmartLink MCS(TM) configurations range in price from \$19,480 to more than \$150,000 for advanced configurations.

TURBOCAST. The TurboCast(TM) software allows customers to capture, store, distribute, and view media streams across the Internet and to be accessed by clients using standard web browsers. The TurboCast solution consists of three principal components: Studio, Reflector, and Viewer. The Studio and Reflectors work together to capture and distribute live or stored multimedia content. The TurboCast Viewer, implemented as a lightweight Java(R) applet, allows a media stream to play directly within browsers such as Microsoft Internet Explorer(R) and Netscape Navigator(R), without downloading additional software.

Since TurboCast(TM) can be used with any Java(R)-enabled browser, broadcasts can be viewed on PC, Macintosh and Unix systems as well as some Java(R)-based hand-held consumer devices. Current TurboCast products include: TurboCast Studio which allows events to be captured for live broadcasts or time-shifted replays using a standard video camera and PC or VTEL's Enterprise

Series videoconferencing systems.

PRODUCT DEVELOPMENT

VTEL's product development strategy is to design and develop core systems capabilities and leverage the availability of hardware peripherals and application software from third parties and to efficiently integrate such third party resources into its systems. Additionally, with the acquisition of the Internet streaming technology obtained with the purchase of Vosaic, we intend to continue to introduce products that incorporate streaming technology. To the extent that market needs cannot be met by available third party resources, we may undertake the development of such resources. The following represent development efforts that have been undertaken by VTEL:

SOFTWARE SYSTEM PLATFORM. The SmartStation(TM) Architecture and ESA(TM) hardware platforms support our proprietary software architectures. The characteristics of our products are developed and implemented primarily through software, facilitating upgrades for users and the rapid incorporation of new technologies. Upgrades are modular in nature, allowing additional licensed program products to be added incrementally to the user's basic system. Our software products are developed primarily in "C", a commonly-used, high-level programming language, to provide future portability to other hardware platforms. Development resources are being applied to the creation of new system software and program products for increased functionality and flexibility of the platform.

PERSONAL VISUAL COMMUNICATION SYSTEMS. Increased performance of semiconductor processors specifically designed for video and image processing allow for the cost-effective design and packaging of small group visual communication systems and high functionality personal desktop systems that are compatible with small and large group visual communication systems. We introduced the SmartStation(TM) visual communication cardset which was developed utilizing the capability of our visual communication software ported to a suitable hardware platform. The principal hardware-related resource commitment in the development process is the effort to find and test boardset candidates for suitability for VTEL's software.

AUDIO COMPRESSION/ECHO CANCELLATION. Audio quality is an important element in any video conference. At lower transmission rates, the amount of bandwidth allocated to audio decreases, thereby requiring audio compression algorithms to maintain acceptable audio quality. VTEL produces its own proprietary, integrated echo canceller to improve audio quality. We offer audio compression capability at allocated bandwidths of 8, 12, 32 and 74 Kbps through audio subsystems.

VIDEO/IMAGE COMPRESSION. VTEL's continuing video compression development activity is focused on the refinement of both H.320 and H.323 algorithms for higher resolution video capabilities and the integration of that technology. Shortly following the merger with CLI in 1997, VTEL announced

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StandardsPlus(TM) Video which provides improved video quality using industry standards. Significant video quality improvements using industry technology standards were achieved via a collaborative development effort between VTEL engineers in Austin and Sunnyvale.

NETWORK MANAGERS. In the summer of 1997, VTEL introduced the industry's first standards-based management and administration platform for distributed visual communication networks. Using the SNMP standard, SmartVideoNet Manager(TM) allows VTEL customers to centrally control their visual communication network for functions such as problem determination, problem resolution, call setup and conference statistics. Using this management framework, conference support can be provided centrally with no requirement for local user intervention, even for networks with hundreds of visual communication system endpoints.

INTERNET TECHNOLOGIES. In 1999 VTEL launched several development initiatives aimed at harnessing the emerging power of the Internet with its associated technologies. The Internet will benefit VTEL on several fronts. First, as a widely distributed and accessible "data network", the Internet eventually will surpass in usage any data communication infrastructure based on dedicated transmission media, initial bandwidth limitations notwithstanding. By acquiring Vosaic, a University of Illinois-based Internet start-up, in 1999, VTEL has begun to aggressively address the need to adapt its core

video-conferencing expertise to this new transmission medium.

Second, as an increasingly popular e-commerce infrastructure, the Internet offers unprecedented access to new markets and customers without the need to rely on intermediaries. By expanding its video-conferencing products from hardware - software combination products into pure software solutions that can run on any personal computer, VTEL can also harness the Internet as a distribution and sales channel for its new generation of products without the need for storing and shipping physical hardware. Sales, marketing, and distribution of its products can all occur via the Internet.

VTEL's Internet products will be launched in several waves, all relying on the same bandwidth optimizing technology and no-download viewing capabilities. The first wave of products will be aimed at one-way streaming of mostly archived, but in some cases also live visual content. A video-mail type product will thus lead the way with the associated server and hosting infrastructure. This product will be closely followed by a wave of visual applications aimed at several specific OEM opportunities as well as the distance learning market in general. The subsequent wave of products will expand the interactive capabilities of the first thus broadening their market applicability.

PRODUCT SUPPORT AND EXPANSION OF SUPPORT CAPABILITIES

Currently, end-user support and installation of our products are provided by resellers and VARs, by Dictaphone in the United States, Fujitsu/Bell Atlantic and ICL Sorbus (a wholly-owned subsidiary of Fujitsu/Bell Atlantic) in most foreign markets as third-party service providers or directly by VTEL in order to provide a comprehensive service offering for its worldwide customer base. We train the service employees of Dictaphone, Fujitsu/Bell Atlantic and ICL Sorbus and VTEL's resellers on diagnostics and service of its products. Dictaphone, Fujitsu/Bell Atlantic and ICL Sorbus and the reseller service network are supported by trained technicians at VTEL's Technical Assistance Center. In order to meet all of its service commitments, we currently employ our own field service engineers as well as maintain contracts with third party Certified ISO technicians.

COMPETITION

The videoconferencing industry is highly competitive. VTEL believes that the principal competitive factors in the industry are product architecture, ease of use, video and audio quality, functionality, service and support, market visibility, and price. We face competition from a number of companies that market communications systems for videoconferencing. Currently in the United States, PictureTel Corporation, Sony Corporation, Nippon Electric Corporation,

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Polycom Corporation, and Tandberg ASA, among others, are marketing roll-about group videoconferencing systems and multipoint control units. Internationally, videoconferencing systems are available from, among others, British Telecommunications plc., PictureTel Corporation, Sony Corporation, Nippon Electric Corporation, Mitsubishi, Ltd., Fujitsu, Ltd., Panasonic Ltd., Polycom Corporation, and Tandberg ASA.

Certain of our competitors have devoted significant resources to the development and marketing of person-to-person visual communications products, such as desktop videoconferencing systems, set-top systems, and software-based internet/intranet visual communications systems, which may help to increase awareness in the value of visual communications products while also resulting in increased competition. Microsoft has introduced visual components to its NetMeeting Release 2.0(TM) product. We intend to continue to focus on large-, small-, and work-group visual communication systems, in addition to gateways and other products, where we believe we can add significant value through software, user interfaces, integrated environments, and applications designed to meet the needs of its targeted markets. Additionally, we recognize that as streaming technology proliferates over the Internet, there will be increased competition directed toward our Internet products.

Our competitors and many of our potential competitors are more established, benefit from greater market recognition, and have greater financial, technological, production, and marketing resources than we do. It is possible for these factors to have an adverse impact on our competitive position.

MANUFACTURING

VTEL's manufacturing operations consist of integration and testing of subsystems and assemblies. Our manufacturing strategy is to contract work to established vendors, with VTEL fulfilling the quality and materials management functions. Substantially all of the integrated circuits, subsystems and assemblies used in our products are made to our specifications by third parties under contract. We establish the relationship with the component vendors, qualifies the vendors and arranges for shipment to VTEL or directly to the vendor responsible for the next level of integration. Systems must pass several levels of testing, including testing with current-release software, prior to shipment. Our manufacturing quality system was initially certified in December 1994 as meeting the standards of ISO 9002 as set by the International Standards Organization. VTEL has passed subsequent audits with only minimal corrective action needed.

We rely on outside vendors for supplying substantially all of our electronic components, subsystems and assemblies. Although we use standard parts and components for our products that are generally available from multiple vendors, certain components are currently available only from sole sources and embody such parties' proprietary technology. We depend upon our suppliers to deliver products that are free from defects, competitive in functionality and price and consistent with our specifications and delivery schedules. The failure of a supplier to provide such products could delay or interrupt our manufacture and delivery of products and thereby adversely affect our business and operating results. We endeavor to mitigate the potential adverse effect of supply interruptions by carefully qualifying vendors on the basis of quality and dependability and by maintaining adequate inventories of certain components. However, there can be no assurance that such components will be readily available when needed. Similarly, excessive rework costs associated with defective components or process errors could adversely affect our business and operating results. We do not have contracts with many of our suppliers ensuring continued availability of key components.

VTEL attempts to forecast orders and to purchase certain long lead-time components in advance of receipt of purchase orders from customers to enable us to provide timely deliveries to customers when customer orders are received. In addition, from time to time we enter into development arrangements with other third parties to develop and incorporate new features and functions into our products. As such, we are dependent upon these third parties to fulfill their respective obligations under these development arrangements, and failure of these third parties to do so could have a material adverse effect on our results of operations.

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PATENTS AND TRADEMARKS

VTEL has 24 patents issued by the United States Patent and Trademark Office and 15 patent applications pending related to our technology.

There can be no assurance that the pending patents will be issued or that issued patents can be defended successfully. However, we do not consider patent protection crucial to our success. We believe that, due to the rapid pace of technological change in the videoconferencing industry, legal protection for our products are less significant than factors such as our use of an open architecture, the success of our distribution strategy, the ongoing product innovation and the knowledge, ability and experience of our employees.

VTEL has been issued two trademarks and two service marks by the United States Patent and Trademark Office covering the "VTEL" mark and our logo as well as trademarks and service marks issued by certain foreign countries and entities. Applications for other trademarks are currently pending both in the United States and abroad.

EMPLOYEES

At July 31, 1999, we employed 617 full-time employees as follows:

FUNCTION	NUMBER OF EMPLOYEES
----------	------------------------

Sales and marketing	224
Research and development	113
Service, support and systems integration	143
Manufacturing	50
Finance and administration	87
	=====
Total	617
	=====

Our continued success will depend, in large part, on our ability to attract and retain trained and qualified personnel who are in great demand throughout the industry. None of our employees are represented by a labor union. We believe that our employee relations are good.

VTEL's development, management of its growth and other activities depend on the efforts of key management and technical employees. Competition for such personnel is intense. We use incentives, including competitive compensation and stock option plans, to attract and retain well-qualified employees. There can be no assurance, however, that we will continue to attract and retain personnel with the requisite capabilities and experience. The loss of one or more of our key management or technical personnel also could have a material and adverse affect. VTEL generally does not have employment agreements with its key management personnel or technical employees. Our future success is also dependent upon our ability to effectively attract, retain, train, motivate and manage our employees. Failure to do so could have a material adverse effect on our business and operating results.

EXECUTIVE OFFICERS

Our executive officers are as follows:

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STEPHEN L. VON RUMP, age 41, was appointed President of VTEL in July 1999. He joined VTEL as Chief Marketing Officer in September 1998. Prior to joining VTEL, Mr. Von Rump spent thirteen years at MCI Corporation most recently as Vice President, Enterprise Services Marketing where he was responsible for their data and Internet services strategy. As one of MCI's top data marketing executives, he lead the transition of their enterprise business offerings from legacy data services into the new era of virtual data and internet services. Prior to MCI, Mr. Von Rump was a member of the technical staff at AT&T Bell Laboratories. He holds a master's degree in electrical engineering, has authored numerous technical and marketing publications and served as keynote speaker for numerous professional conferences in the U.S. and abroad.

RODNEY S. BOND, age 55, joined VTEL in May 1990 as Chief Financial Officer, Vice President - Finance and Assistant Secretary and Treasurer. He has served as Secretary of VTEL since February 1993 and is now Assistant Treasurer as of February 1999. From 1989 until he joined VTEL, he served as Managing Director of Sherman Partners, a Dallas-based private investment and consulting firm. From September 1985 to October 1988, Mr. Bond served as Chief Financial Officer and Executive Vice President of Advanced Business Communications, Inc., a telecommunications equipment manufacturer.

DENNIS M. EGAN, age 48, joined VTEL in November 1995 as Vice President - Service. From January 1993 to November 1995, Mr. Egan served as Senior Vice President of Peirce-Phelps, Inc. From June 1985 to January 1993, Mr. Egan was Vice President and General Manager of the Integrated Communications Systems Group of Peirce-Phelps. Mr. Egan's pre-1985 experience includes 13 years serving in various sales and management positions with Peirce-Phelps.

DIANNE B. JOHNSON, age 40, was appointed Treasurer in February 1999. She joined VTEL in July 1988 and has held a variety of management positions in finance and operations. From December 1984 to July 1988, Ms. Johnson served in the role of Accounting Manager with Capitol City Contractors.

STEVE F. KEILEN, age 40, was appointed Vice President, Chief Marketing Officer in April 1999. He joined VTEL in July 1998 as Vice President and General Manager of Enterprise Systems. Prior to joining VTEL, Mr. Keilen served as the Director for Systems Marketing - North America at Compaq Computer Corporation and was Director of Desktop Marketing and Product Management at Digital Equipment Corporation prior to the merger of these two companies. He previously held management positions at Digital Equipment Corporation and Hewlett-Packard

Company.

F.H. (DICK) MOELLER, age 54, joined VTEL in October 1989 and is currently Chairman of the Board of Directors. From 1989 to September 1998, Mr. Moeller has also served as President and/or Chief Executive Officer of VTEL. From May 1982 to October 1989, Mr. Moeller served as the founder and President of ProfitMaster Computer Systems, Inc., a computer software firm specializing in real-time financial management systems for retail point-of-sale applications. Prior to founding such firm, Mr. Moeller spent 12 years with Texas Instruments, Inc. during which he held a variety of management positions, most recently serving as Advanced Systems Manager of its Computer Systems Division. Effective in July 1998, Mr. Moeller also began serving as General Partner of SSM Ventures, a venture capital company.

LY-HUONG T. PHAM, age 41, joined VTEL in October 1997 as Chief Technology Officer and Vice President of Research and Development. From May 1992 to October 1997, Ms. Pham served in numerous senior management positions at Apple Computer, most recently serving as senior director, Operating Systems Technologies. Prior to Apple, Ms. Pham spent 12 years at Wang Laboratories where she held a variety of technical and senior management positions.

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MICHAEL J. STEIGERWALD, age 40, joined VTEL in June 1998 as Vice President and General Manager of the Professional Services strategic business unit, based in King of Prussia, Pennsylvania. Mr. Steigerwald currently holds the position Vice President Global Services. Prior to joining VTEL, Mr. Steigerwald held the position of Vice President at Newbridge Networks, where he lead the Global Service and Support organization responsible for their ViVID Internetworking Products business unit. For thirteen years prior to his experience with Newbridge Networks, Mr. Steigerwald held several services management positions at Ungermann-Bass Networks, an early pioneer in the LAN industry, with his last position being that of Vice President, Worldwide Customer Care.

BOB R. SWEM, age 62, joined VTEL in September 1992 as Vice President - Manufacturing. From June 1981 to July 1992, Mr. Swem held various positions with the Austin Division of Tandem Computers, Inc., ranging from Manager of Manufacturing to Director of Operations.

ITEM 2. PROPERTIES

VTEL's headquarters, product development, and sales and marketing facility leases approximately 139,000 square feet in Austin, Texas under a lease which expires in March 2013. During fiscal 1999, we reduced the workforce of VTEL (see Restructuring Activities in Item 7.) and as a result were able to sublet approximately 15,000 square feet during the later part of fiscal 1999 and the first quarter of fiscal 2000. We believe that the remaining facilities are adequate to meet our current requirements, and that suitable additional space will be available, as needed, to accommodate further physical expansion of corporate and development operations and for additional sales and marketing offices. VTEL occupies approximately 60,000 square feet of a facility that is situated in a light industrial area in Austin, Texas where our manufacturing, training and spare parts depot are located. VTEL's manufacturing facilities and equipment are currently utilized generally on a one-shift per day basis. Should additional manufacturing capacity be needed during the next year, we believe that it could provide the necessary manufacturing capacity through the addition of work shifts or subcontractors and additional warehouse space.

VTEL leases 52,500 square feet in Sunnyvale, California under a lease that expires in April 2008. We have a research and development group in our Sunnyvale location. As a result of its restructuring activities, VTEL has sublet approximately 5,200 square feet at its Sunnyvale location. VTEL's Professional Services group occupies a facility of approximately 41,000 square feet in the Philadelphia, Pennsylvania vicinity which is leased through June 2006.

ITEM 3. LEGAL PROCEEDINGS

VTEL is the defendant or plaintiff in various actions which arose in the normal course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse affect on our financial condition or results of operations.

Our wholly owned subsidiary, CLI, was previously involved in a legal dispute with Philips Electronics North America Corporation ("Philips"). On May 25, 1999, we announced a compromise settlement agreement between Philips and CLI. The settlement agreement, valued at less than \$900,000, stipulates payment by CLI in the form of cash and a future payment under a note, for \$250,000 (see Note 8 in the Consolidated Financial Statements), as well as warrants for VTEL common stock. These amounts had previously been accrued as part of the reserve for contingent liabilities related to the merger (see Note 1 in the Consolidated Financial Statements). In addition, the settlement mutually releases each party from all future claims, demands and causes of action.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

None

PART II.

ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Since April 7, 1992, VTEL's Common Stock has been traded in the NASDAQ-National Market System under the symbol "VTEL". The following table sets forth the range of high and low closing prices for each fiscal quarter of 1997, 1998 and 1999:

	FISCAL YEAR 1997		FISCAL YEAR 1998		FISCAL YEAR 1999	
	HIGH	LOW	HIGH	LOW	HIGH	LOW
1st Quarter	\$ 10.625	\$ 6.625	\$ 8.875	\$ 5.438	\$ 5.875	\$ 2.875
2nd Quarter	\$ 11.000	\$ 8.250	\$ 8.438	\$ 5.625	\$ 4.750	\$ 2.500
3rd Quarter	\$ 8.625	\$ 4.875	\$ 7.688	\$ 5.250	\$ 9.250	\$ 2.000
4th Quarter	\$ 7.125	\$ 5.500	\$ 7.063	\$ 4.750	\$ 6.500	\$ 4.000

VTEL has not paid cash dividends on its Common Stock and presently intends to continue a policy of retaining earnings for reinvestment in its business.

ITEM 6. SELECTED FINANCIAL DATA

The following table sets forth consolidated financial data for VTEL as of the dates and for the periods indicated. All such data reflects the Merger with CLI on May 23, 1997, which was accounted for as a pooling of interests. The consolidated operations data for the years ended July 31, 1997, 1998 and 1999 has been derived from the audited consolidated financial statements of VTEL included elsewhere herein. The consolidated operations data for the year ended December 31, 1995 and the seven months ended July 31, 1996 has been derived from the audited consolidated financial statements of VTEL not included herein.

The consolidated balance sheet data as of July 31, 1998 and 1999 has been derived from the audited consolidated financial statements of VTEL included elsewhere herein. The consolidated balance sheet data as of December 31, 1995 and July 31, 1996 and 1997 have been derived from the audited consolidated financial statements of VTEL not included herein.

The consolidated financial data as of July 31, 1995 and for the seven months then ended have been derived from the unaudited consolidated financial statements of VTEL not included herein. The unaudited consolidated financial data include all adjustments, consisting of normal recurring adjustments, which VTEL considers necessary for a fair presentation of its financial position as of such dates and the results of operations and cash flows for such periods. The selected financial data should be read in conjunction with the consolidated

financial statements of VTEL and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

The Restatement of the Consolidated Financial Information combines the financial information of VTEL and CLI giving retroactive effect to the merger as if the two companies had operated as a single company for all periods presented. However, the two companies operated independently prior to the merger that was consummated in May 1997 and the historical changes and trends in the financial condition and results of operations of these two companies resulted from independent activities.

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	FOR THE YEAR	FOR THE SEVEN MONTHS			FOR THE YEARS	
	ENDED	ENDED		ENDED	ENDED	
	DEC 31,	JULY 31,		JULY 31,	JULY 31,	
	1995	1996	1997	1998	1999	
	-----	-----	-----	-----	-----	-----
	UNAUDITED					
	In thousands, except per share amounts					
STATEMENT OF OPERATIONS DATA:						
Revenues	\$ 191,074	\$98,079	\$96,962	\$ 191,023	\$ 179,684	\$ 151,602
Gross margin	66,843	39,971	35,980	74,702	84,957	67,238
Net income (loss) from continuing operations	(17,301)	(4,335)	(18,507)	(44,271)	2,779	(15,565)
Net income (loss)	(53,843)	(3,811)	(18,507)	(52,054)	2,779	(15,565)
Net income (loss) per share from continuing operations	(0.90)	(0.24)	(0.87)	(2.10)	0.12	(0.66)
Net income (loss) per share	(2.81)	(0.21)	(0.87)	(2.45)	0.12	(0.66)
BALANCE SHEET DATA:						
Working capital	\$ 93,330	\$76,023	\$77,091	\$ 39,528	\$ 41,503	\$ 28,135
Total assets	223,061	182,082	175,092	131,135	129,289	124,091
Long-term liabilities	985	1,278	-	-	3,848	15,930
Stockholders' equity	139,512	126,739	122,238	76,765	81,258	68,019

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS OF THE COMPANY

On May 23, 1997, shareholders of VTEL and CLI approved the merger of VTEL-Sub, Inc., a Delaware corporation and direct wholly-owned subsidiary of VTEL ("Merger Sub"), with and into CLI, pursuant to an Agreement and Plan of Merger and Reorganization (the "Merger Agreement"), with CLI becoming a direct wholly-owned subsidiary of VTEL (the "Merger"). The restatement of the consolidated financial information for the year ended July 31, 1997 combines the financial information of VTEL and CLI giving retroactive effect to the Merger as if the two companies had operated as a single company for the entire year. The following discussion of the consolidated operations and financial condition of VTEL should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere herein.

The restatement of the consolidated financial information combines the financial information of VTEL and CLI giving retroactive effect to the Merger as if the two companies had operated as a single company for all periods presented. However, the two companies operated independently prior to the Merger that was consummated in May 1997 and the historical changes and trends in the financial condition and results of operations of these two companies resulted from independent activities. Nonetheless, the following Management's Discussion and Analysis of Financial Condition and Results of Operations attempts to relate the activities which resulted in the changes in financial condition and results of operations of the combined company, taking into consideration that a trend or change in the historical results of the combined entity was caused by many events related to each individual company operating independently as competitors. The financial information presented on a historical restated basis is not indicative of the financial condition and results of operations that may have been achieved in the past or will be achieved in the future had the companies operated as a single entity for the periods presented. The following discussion of the consolidated operations and financial condition of VTEL should be read in conjunction with our consolidated financial statements and related notes thereto included elsewhere herein.

RESULT OF OPERATIONS

The following table sets forth for the fiscal periods indicated the percentage of revenues represented by certain items in VTEL's consolidated statement of operations:

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	FOR THE YEARS ENDED		
	1997	JULY 31, 1998	1999
Revenues	100.0%	100.0%	100.0%
Gross margin	39.1	47.3	44.4
Selling, general and administrative	34.2	36.1	40.1
Research and development	12.8	11.1	11.8
Total operating expenses	62.9	46.8	54.7
Other income, net	0.6	1.1	0.1
Net income (loss) from continuing operations	(23.2)	1.5	(10.3)
Net income (loss)	(27.3)%	1.5%	(10.3)%

FOR THE YEARS ENDED JULY 31, 1997, 1998, AND 1999

Revenues

Consolidated revenues decreased from \$191.0 million in fiscal 1997 to \$179.7 million in fiscal 1998 and to \$151.6 million in fiscal 1999.

Revenues for the year ended July 31, 1998 decreased in comparison with revenues for the year ended July 31, 1997 due to Merger transition issues. During the year ended July 31, 1998, we combined the sales forces of VTEL and CLI, migrated to a single product platform by eliminating the former CLI platform, and combined the management and operations of the two companies into a single organization. The primary reason for the decrease in revenues during fiscal 1999 was the result of a decrease in unit sales of our large group visual communications systems. The decline in revenues is also attributed to delays or shifts in purchasing decisions of customers resulting from new product announcements by VTEL and its competitors. We have determined that trends presented by our customer base indicate shifts of capital spending. It appears that customers may be delaying their purchase decision for large group systems while they evaluate the impact of converting from videoconferencing systems which currently run on digital (ISDN) type phone lines to systems which run on Internet Protocol (IP) packet based networks. We anticipate that this trend will reverse itself as we release products in fiscal 2000 that provide an IP network solution.

We differentiate our operations between product and service. We feel that our service capabilities set us apart from our competitors. Service revenues have continued to increase over the last three fiscal years, and for the years ended July 31, 1997, 1998, and 1999, services have represented 21%, 25% and 30%, respectively, of total revenues. Margins associated with our service operations have continued to increase, for the years ended July 31, 1997, 1998 and 1999, gross margins for services increased to 28%, 36% and 37%, respectively.

International sales as a percentage of total consolidated product revenues were, 26%, 24% and 22% for the years ended July 31, 1997, 1998, and 1999. These revenue percentages represent export sales from our domestic operations, as well as sales from our foreign subsidiaries. The general decline in international sales over the three year period can be attributed to many factors including the economic decline in the Far East and competition from foreign producers of competing videoconferencing systems in Europe as well as the Far East.

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VTEL primarily sells its products through resellers. For the years ended July 31, 1997, 1998 and 1999 reseller sales were 75%, 77% and 80% of product sales, respectively.

One of VTEL's initiatives is to grow revenues from non-U.S. markets. Non-U.S. operations are subject to certain risks inherent in conducting business

abroad including price and currency exchange fluctuations and restrictive government actions. We believe our foreign currency exposure to be relatively low as foreign sales are predominantly in U.S. dollars. We use currency hedging programs that utilize foreign currency forward contracts on a limited basis and review the credit worthiness of our customers to mitigate foreign currency exchange and credit risk. There can be no assurance that our foreign currency hedging program will effectively hedge foreign currency exchange risk (see also "Market Risk" below).

While we strive for consistent revenue growth, there can be no assurance that consistent revenue growth or profitability can be achieved. Consistent with many companies in the technology industry, our business model is characterized by a very high degree of operating leverage. Our expense levels are based, in part, on our expectations as to future revenue levels, which are difficult to predict partly due to VTEL's strategy of distributing its products primarily through resellers. Because expense levels are based on our expectations as to future revenues, our expense base is relatively fixed in the short term. If revenue levels are below expectations, operating results may be materially and adversely affected and net income is likely to be disproportionately adversely affected. In addition, our quarterly and annual results may fluctuate as a result of many factors, including price reductions, delays in the introduction of new products, delays in purchase decisions due to new product announcements by VTEL or its competitors, cancellations or delays of orders, interruptions or delays in supplies of key components, changes in reseller base, customer base, business or product mix and seasonal patterns and other shifts of capital spending by customers. There can be no assurance that we will be able to increase or even maintain our current level of revenues on a quarterly or annual basis in the future.

Gross margin

Gross margins were 39%, 47% and 44% for the years ended July 31, 1997, 1998, and 1999 respectively.

During the year ended July 31, 1997 VTEL's restated combined revenues consisted of a higher proportion of revenues from CLI, which resulted in a lower gross margin on a combined basis. The higher proportion of product revenues from the large group visual communications systems using the ESA platform resulted in a higher blended gross margin for the year ended July 31, 1998 as compared to the year ended July 31, 1997. The lower gross margin percentage for the year ended July 31, 1999 was the result of the shift by our customers to the purchase of lower margin product segments as well as lower average sales prices brought on by competitive price pressure. Gross product margins were also adversely affected by excess manufacturing capacity as unit sales were lower than initially anticipated. As we continue to grow our Global Services division, the associated service and systems integration revenues which generally carry a lower gross margin than our product revenues, may contribute to overall downward gross margin pressure.

While many customers continue to delay the purchase of higher cost large group systems, some are shifting to the purchase of lower cost small group systems in order to maintain their visual communications networks with only a moderate continued investment during the perceived industry transition. We believe this transition will be driven by the shift to visual communications systems which function within an IP network environment. As such, we anticipate that lower gross margins will be offset by stronger unit sales as IP networks proliferate.

We expect gross margin pressures due to price competitiveness in the industry, shifts in the product sales mix and anticipated offerings of new products, which may carry a lower gross margin. We expect that overall price competitiveness in the industry will continue to become more intense as users of visual communication systems attempt to balance performance, functionality and cost. Our gross margin is subject to fluctuation based on pricing, production costs and sales mix.

Selling, general and administrative

Selling, general and administrative expenses of \$60.9 million in fiscal 1999 decreased by 6% from \$64.8 million in fiscal 1998, which decreased by 1% from \$65.4 million in fiscal 1997. Selling, general and administrative expenses were 34%, 36% and 40% of revenues for the years ended July 31, 1997, 1998 and

1999.

Selling, general and administrative expenses as a percentage of revenue increased from the year ended July 31, 1997 to the year ended July 31, 1998. The proportionate increase was due to investments made during the year ended July 31, 1998 related to marketing and branding campaigns which were designed to provide brand awareness for VTEL's products and to establish VTEL as an industry leader in visual communications. Additionally, Merger transition issues related to the combination of the sales forces of VTEL and CLI contributed to an increase in selling, general and administrative expenses without a proportionate increase in revenues.

Selling, general and administrative expenses as a percentage of revenue increased from the year ended July 31, 1998 to the year ended July 31, 1999 despite a decline in total expenses. VTEL's expense levels were based, in part, on expectations as to revenue levels. Because expense levels were based on our expectations of future revenues, our expense base is relatively fixed in the short term. For this reason, the selling, general and administrative expenses were higher, as a percentage of revenues, for fiscal 1999 as compared to prior periods.

Research and development expense

Research and development expenses of \$18.0 million in fiscal 1999 decreased by 9.5% from \$19.9 million in fiscal 1998, which decreased by 18.7% from \$24.5 million in 1997. Research and development expenses were 12.8%, 11.1% and 11.8% of revenues for the years ended July 31, 1997, 1998, and 1999. Merger-related expenses recorded during the year ended July 31, 1997 included a \$3.2 million charge for the write-off of capitalized research and development cost incurred by CLI for products that were discontinued subsequent to the Merger. Efficiencies were realized by combining the research and development efforts of VTEL and CLI subsequent to the Merger and the Company migrated to a single product platform by eliminating CLI's product platform. The research and development capabilities of both companies were then focused on a single platform such that Company could make a larger investment in its ESA(TM) platform while reducing the overall research and development expenses of the combined companies. Additionally, during the year ended July 31, 1998, we capitalized \$0.98 million of software development costs related to new product developments resulting in a reduction in research and development expenses recorded during the year.

The decrease in research and development expense from the year ended July 31, 1998 to the year ended July 31, 1999 reflects the capitalization of software development costs totaling \$6.4 million. Research and development projects being capitalized are related to the new user interface software included with our next generation of video conferencing systems and software for video conferencing solutions over IP networks. In October 1999, the user interface software was released with our new Galaxy(TM) line of visual communication systems. Software development costs are capitalized after a product is determined to be technologically feasible and is in the process of being developed for market. At the time of release, the capitalized software will be amortized over the estimated economic life of the related projects. During the year ended July 31, 1999, research and development expenses included a charge for in-process research and development related to the acquired assets of Vosaic (see "Acquisition" below). As part of the valuation associated with Vosaic, we recorded a charge to research and development expense of \$474,000. The charge is based on our estimate of purchase price associated with research and development on projects that were in-process at the time of acquisition. The charge for research and development that was in-process relates to the next generation video streaming product that was approximately 20% complete at the date of acquisition.

The market for VTEL's products is characterized by rapidly changing technology, evolving industry standards and frequent product introductions. New products are generally characterized by increased functionality and better picture quality at lower bandwidths and at reduced prices. The introduction of

products, by either VTEL or its competitors, embodying new technology and the emergence of new industry standards may render existing products obsolete and unmarketable. Our ability to successfully develop and introduce on a timely basis new and enhanced products that embody new technology, anticipate and

incorporate evolving industry standards and achieve levels of functionality and prices acceptable to the market will be a significant factor in VTEL's ability to grow and to remain competitive. Although the percentage of revenues invested in research and development may vary from period to period, VTEL is committed to investing in its research and development programs.

Merger and other expense

Merger and other expense decreased from \$29.4 million in fiscal 1997 to a \$1.5 million credit to income in fiscal 1998 and a \$0.2 million credit to income in fiscal 1999. Merger and other expenses of \$29.4 million recorded during fiscal 1997 consisted of transaction expenses of \$5.7 million and restructuring and other expenses of \$23.7 million. See Note 1 to the Consolidated Financial Statements.

In connection with the Merger, we made the decision to discontinue the CLI product-line and made the transition to a single product platform, VTEL's Enterprise Series Architecture (ESA) platform. We also made the decision to reduce duplicate operating functions, which resulted in a reduction in the workforce of CLI. The merger transition plan also resulted in a charge in fiscal 1997 for the obsolescence of all the remaining CLI inventory related to the discontinued products (\$3.5 million) and the impairment of excess and unproductive assets (\$9.0 million). Asset impairment was determined by estimating the lower of the asset's carrying amount or fair value less cost to sell.

Management determined that, based on unanticipated favorable events that occurred during fiscal 1998, including resolution of certain litigation and other matters, a reversal of certain accruals totaling \$2.6 million should be recorded in fiscal 1998. Separately, a charge of \$1.0 million was recorded to reflect the final write-off and disposal costs of remaining discontinued CLI inventory, which had previously been held for sale.

During the year ended July 31, 1999, the final significant contingent liabilities, involving litigation in which CLI was a defendant, were either settled or dismissed in court. Final Merger related payments totaling \$1.3 million were paid during 1999. In addition, we recorded a note payable to Philips Electronics North America Corporation for \$0.3 million as part of terms of that settlement agreement. Since no determinable contingent liabilities remained in relation to the Merger, the final balance of accrued liabilities totaling \$0.2 million were returned as a credit to the Consolidated Statement of Operations.

Restructuring Activities

In November 1998, management adopted a restructuring plan that is intended to match the size and complexity of the organization with our planned path. The plan included the involuntary reduction of 138 employees in 1999. Terminations were generally made in all departments, including manufacturing, sales, management and accounting, and were effective immediately for most employees upon announcement. We also made the decision to reduce operating costs by exiting other activities and reducing related overhead costs. These activities included the closure of certain field sales offices and our Sunnyvale, California spare parts depot.

As a result of the restructuring, we recorded a charge of \$3.1 million during the year ended July 31, 1999. As of July 31, 1999, substantially all of the termination and severance benefits had been paid. The transition of the spare parts depot in Sunnyvale was completed during 1999.

The following schedule summarizes the components and activities of the restructuring plan:

	RESTRUCTURING CHARGE	EXPENDITURES INCURRED	BALANCE ACCRUED AT JULY 31, 1999
Termination and severance benefits	\$ 2,311	\$ 2,293	\$ 18
Facility closure and other (primarily non-cancelable lease obligations)	769	769	-
	-----	-----	----
	\$ 3,080	\$ 3,062	\$ 18
	=====	=====	=====

Interest income and expense

Interest income was \$2.7 million, \$1.2 million and \$.8 million for the years ended July 31, 1997, 1998, and 1999, respectively. Changes in interest income are based on interest rates earned on invested cash and cash balances available for investment. The decrease in interest income during fiscal 1998 is the result of the reduced cash balances due to Merger related expenditures incurred and primarily is the result of reduced cash balances due to operating losses during fiscal 1999.

Interest expense was \$1.6 million, \$0 and \$0.9 million for the years July 31, 1997, 1998 and 1999 respectively. Interest expense for the year ending July 31, 1997 relates almost entirely to VTEL's wholly-owned subsidiary, CLI, which relied on lines of credit to fund working capital and capital investment requirements. No interest expense was incurred during fiscal 1998 as we repaid all outstanding debt prior to July 31, 1997. Interest expense during fiscal 1999 relates to borrowings under our line of credit as well as interest paid on notes payable.

Income taxes

We have experienced substantial changes in ownership as defined by the Internal Revenue Code. These changes result in annual limitations of the amount of net operating loss carryforward generated prior to each change which can be utilized to offset future taxable income. As a result of the ownership change at CLI at the date of the Merger, a portion of CLI's net operating loss carryforward generated prior to the Merger will never be available to offset future taxable income due to the effect of the annual limitation and the expiration of the related net operating losses. Therefore, the unavailable portion of the net operating loss carryforward is not considered in determining the deferred tax asset at July 31, 1999.

At July 31, 1999, VTEL had total domestic net operating loss carryforwards of \$113,948 (\$40,530 and \$73,418 for VTEL and CLI, respectively). The portions of these carryforwards available for utilization during fiscal 2000 (in consideration of the annual limitations) are \$83,048. Additional net operating losses created prior to the changes in control of \$2,574 become available in each subsequent year and accumulate if not used until such net operating losses expire.

Due to the uncertainty surrounding the timing of realizing the benefits of our favorable tax attributes in future tax returns, we have placed a full valuation allowance against our net deferred tax asset. Accordingly, no deferred tax benefit has been recorded for the years ended July 31, 1997, 1998 and 1999.

Discontinued operation

In November 1995, VTEL's wholly-owned subsidiary, CLI, adopted a plan to discontinue operation of its broadcast products division and focus its efforts and resources in developing and marketing videoconferencing products. In June 1996, CLI completed the sale of certain assets of its broadcast products division. During the year ended July 31, 1997, CLI revised the amount of loss associated with disposing of the broadcast products division and recorded an additional charge of \$7.8 million, primarily due to additional at-risk receivables that were subsequently identified (see Note 7 to the Consolidated Financial Statements). No activity related to discontinued operation was recorded in either fiscal 1998 or 1999.

Net income (loss)

VTEL generated a net loss from continuing operations of \$44.3 million for the year ended July 31, 1997. In fiscal 1998, we recorded net income from continuing operations of \$2.8 million. For the year ended July 31, 1999 we generated a net loss of \$15.6 million. The large net loss incurred for the year ended July 31, 1997 was due substantially to charges of \$29.4 million taken related to the Merger (see Note 1 to the Consolidated Financial Statements). We generated net income during fiscal 1998 as a result of a reduction of operating expenses which was greater than the decline in revenues and several nonrecurring

events. Additionally, we generated income of approximately \$1.3 million (net of expenses) from a planned non-recurring real estate transaction which eliminated duplicate corporate headquarter facilities. Due to the favorable resolution of certain Merger-related issues during the year ended July 31, 1998, we were able to record a net credit to income of approximately \$1.5 million due to the reversal of certain Merger and other accruals that were recorded as of July 31, 1997.

The loss generated during fiscal 1999 was the result of lower revenues due to a decline in the demand for large group video conferencing systems. Since expense levels are based to a large extent on revenue expectations we experienced significant losses during the first and second quarters of the year after which we were able to complete its restructuring (see "Restructuring Activities") and align more closely its expense levels with projected revenue.

Other factors affecting results of operations

VTEL's future results of operations and financial condition could be impacted by the following factors, among others: trends in the videoconferencing market segment, introduction of new products by competitors, increased competition due to the entrance of other companies into the videoconferencing market segment especially more established companies with greater resources than ours, delay in the introduction of higher performance products, market acceptance of new products introduced by VTEL, price competition, interruption of the supply of low-cost products from third-party manufacturers, changes in general economic conditions in any of the countries in which we do business, adverse legal disputes and delays in purchases relating to federal government procurement.

Due to the factors noted above and elsewhere in Management's Discussion and Analysis of Financial Condition and Results of Operations, our past earnings and stock price have been, and future earnings and stock price potentially may be, subject to significant volatility, particularly on a quarterly basis. Past financial performance should not be considered a reliable indicator of future performance and investors are cautioned in using historical trends to anticipate results or trends in future periods. Any shortfall in revenue or earnings from the levels anticipated by securities analysts could have an immediate and significant effect on the trading price of VTEL's Common Stock in any given period. Also, we participate in a highly dynamic industry which often contributes to the volatility of VTEL's Common Stock price.

On October 1, 1999, VTEL filed Form 8-K in which we restated our Consolidated Statement of Operations for the quarters ended October 31, 1998, January 31, 1999 and April 30, 1999. The restatements are attributed to non-cash adjustments made to certain depreciation and amortization accounts, inventory accounts, and to the reversal of final acceptance revenues for certain Chinese orders in which final cash payment has not yet been received. The unaudited quarterly financial results are included in Note 15 of the accompanying Consolidated Financial Statements.

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Further, this Annual Report on Form 10-K contains forward-looking statements, within the meaning of the Private Securities Litigation Reform Act of 1995, that relate to future results or events and are based on our current expectations. There are many factors that affect our business and results of operations, all of which involve risks and uncertainties that could cause actual results to differ materially from those reflected in those forward-looking statements, including the risks discussed above and elsewhere herein.

Liquidity and capital resources

At July 31, 1999, we had working capital of \$28.1 million, including \$12.1 million in cash, cash equivalents and short-term investments. Cash used by operating activities was \$15.2 million for the year ended July 31, 1997. Cash provided by operating activities was \$19.8 million for the year ended July 31, 1998. Cash used by operating activities was \$10.7 million for the year ended July 31, 1999. Changes in cash from operating activities are primarily the result of the net losses or income generated and changes in working capital, primarily increases and decreases in accounts receivable, inventories and accounts payable.

Cash provided by investing activities was \$23.3 million for the year

ended July 31, 1997 as compared to cash used in investing activities of \$10.6 million for the year ended July 31, 1998. During fiscal 1997, cash provided by investing activities was primarily due to the net sale of investments to finance our operations during the period, which included large cash requirements associated with the Merger. During fiscal 1998 cash used in investing activities was primarily the result of expenditures related to leasehold improvements in Austin and Sunnyvale, the implementation of its Enterprise Resource Planning System, our transaction processing and financial accounting system, and purchases of equipment. During fiscal 1999, we used \$4.6 million in investing activities that were spent primarily to complete the acquisition of property and equipment and capitalize the costs associated with the research and development of our next generation of visual communication products. These were partially offset by the net sale and maturity of short-term investments.

Cash used by financing activities was \$5.1 million for the year ended July, 31 1997 as compared to cash provided by financing activities of \$1.5 million for the year ended July 31, 1998 and cash provided by financing activities of \$8.0 million for the year ended July 31, 1999. Cash used in financing activities during fiscal 1997 was primarily the result of the purchase of treasury stock by VTEL and the repayment of debt by our wholly-owned subsidiary, CLI, offset by the sale of preferred stock by CLI during the year ended July 31, 1997. Cash provided by financing activities for the year ended July 31, 1998 relates to the issuance of stock under VTEL's stock option and stock purchase plans (see Note 10 to our Consolidated Financial Statements). Cash provided by financing activities for the year ended July 31, 1999 relate to borrowing under our line of credit and is offset by the purchase of treasury stock and payments on notes payable.

During fiscal 1997, we purchased 455,200 shares of our Common Stock for approximately \$3.7 million. All of the repurchased shares were reissued during fiscal 1997 to fulfill requirements for VTEL's Common Stock. In February 1997, we terminated the stock repurchase program. During fiscal 1999 we initiated a new stock repurchase program and repurchased 526,000 shares of our Common Stock for \$2.3 million. The repurchased shares have been used to fulfill requirements for VTEL's stock including stock option exercises or stock issuances under business combination transactions. No additional share repurchases are currently planned, although we are authorized to repurchase up to 1,474,000 additional shares.

VTEL has a \$20.0 million revolving line of credit with a banking syndicate. We have issued a letter of credit totaling \$1.2 million under our revolving line of credit as a lease deposit on one of our facilities. At July 31, 1999 we have drawn \$11.2 million under the syndicated line of credit. The line of credit is subject to loan covenants that require the maintenance of certain financial ratios. In the event we are unable to maintain these ratios in the future; additional advances under the line of credit may not be available.

VTEL's principal sources of liquidity at July 31, 1999 consist of \$12.1 million of cash, cash equivalents and short-term investments, amounts available under our revolving line of credit and the ability to generate cash from operations.

Legal Matters

VTEL is the defendant or plaintiff in various actions which arose in the normal course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse affect on our financial condition or results of operations.

Our wholly owned subsidiary, CLI, was previously involved in a legal dispute with Philips Electronics North America Corporation ("Philips"). On May 25, 1999, we announced a compromise settlement agreement between Philips and CLI. The settlement agreement, valued at less than \$900,000 stipulates payment by CLI in the form of cash and a future payment under a note for \$250,000 (see Note 8 in the Consolidated Financial Statements), as well as warrants for VTEL common stock. These amounts had previously been accrued as part of the reserve for contingent liabilities related to the merger (See Note 1 in the Consolidated Financial Statements). In addition, the settlement mutually releases each party from all future claims, demands and causes of action.

Many computer systems may experience problems handling dates beyond the year 1999. Therefore, some computer hardware and software will need to be modified prior to the Year 2000 in order to remain functional. Prior to April 1999, we believed that our products were Year 2000 compliant with minor exceptions due to the incorporation of third party software such as Microsoft Windows(TM) which is Year 2000 compliant with minor exceptions. In April 1999, Microsoft announced that upgrades would be made available that will make Microsoft Windows(TM) Year 2000 compliant. The ability to make Windows(TM) compliant favorably affects VTEL customers who are using older video conferencing systems that run on Windows 95, 98 and NT(TM) software. We believe that all our products being shipped are Year 2000 compliant. Additionally, previous shipments of our current products can be made Year 2000 compliant through software patches or upgrades. While we are not currently aware of any other Year 2000 compliance issues with our products, no assurances can be made that problems will not arise such as customer problems with other software programs, operating systems or hardware that disrupt their use of their products. There can be no assurances that such disruption would not negatively impact costs and revenues in future years.

The Enterprise Resource Planning System was acquired in 1998. We have been assured by the vendor of our Enterprise Resource Planning System that the system is Year 2000 compliant. On August 1, 1999, the system began processing transactions in our fiscal year 2000. We began assessing Year 2000 issues and Year 2000 testing of other management information systems during fiscal 1998.

We presently believe that with modifications to existing software and conversions to new software, the Year 2000 issue can be mitigated. It is not anticipated that there will be a significant increase in costs as much of the Year 2000 activities will be a continuation of the on-going process to improve all of our systems. We have estimated the total costs of Year 2000 compliance and related contingency planning to be \$200,000. We have not accrued any amounts related to the expected costs as we intend to expense Year 2000 costs as they are incurred. We have plans to complete our internal risk assessment of Year 2000 issues and expect to complete our review of significant vendors and key business partners by November 15, 1999. Through the implementation of our Year 2000 compliant Enterprise Resource Planning Software and review of all computer hardware on our premises we are optimistic about our ability to continue to be able to conduct business on January 1, 2000. However, other factors that are beyond our control could potentially have a material effect on future financial results. Specific factors that might cause a material impact include, but are not limited to, electrical power outages that would disrupt operations, failure by third parties to timely convert their systems, and similar uncertainties. In addition, Year 2000 issues may impact our customer's ability to purchase products and therefore materially impact our future revenue stream. To the extent these potential revenue reductions cannot be anticipated and/or we cannot reduce operating expenses correspondingly, then we may experience severe unfavorable financial impact to our net income. We have asked our employees to be available during the transition period into 2000 as an additional measure to address any unexpected Year 2000 issues.

Recent Accounting Pronouncements

In June 1998, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. SFAS No. 133 requires the recognition of all derivatives as either assets or liabilities in the statement of financial position and the measurement of those instruments at fair value. We are required to adopt this standard in the first quarter of fiscal 2001. We expect that the adoption of SFAS No. 133 will not have a material impact on our financial position or our results of operations.

In April 1998, the American Institute of Certified Public Accountants issued Statement of Position (SoP) No. 98-5, "Reporting on the Costs of Start-up Activities", which provides guidance on the financial reporting of start-up costs and organization costs. It requires costs of start-up activities and organization costs to be expensed as incurred. The SoP is effective for VTEL on August 1, 1999. We estimate that the effect of adopting the SoP to be approximately \$0.1 million which will be recorded as a cumulative change in accounting principle as reported in the results of operations during the first

quarter of fiscal 2000.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We identify our principal market risks as foreign currency exchange rate fluctuations and interest rate risk related to long-term debt obligations. Foreign currency exchange rate fluctuations are mostly related to the settlement of net intercompany receivables due from our foreign subsidiaries. The amount of risk is mitigated by the practice of requiring where possible the repayment of such receivables in U.S. currency. In the normal course of business, we employ established policies and procedures to manage these risks. We use proceeds from debt obligations to support general corporate purposes including capital expenditures and working capital needs. Interest rate exposure is related to borrowings under the \$20 million revolving line of credit facility. Interest rate exposure with regard to our investments is minor due to the short term nature of our maturities.

Foreign Exchange Risk

Our objective in managing our exposure to foreign currency exchange rate fluctuations is to reduce the impact of adverse fluctuations in earnings and cash flows associated with foreign currency exchange rate changes. Accordingly, we utilize forward contracts to hedge our foreign currency exposure on firm commitments. The principal currencies hedged during fiscal year 1999 were the German mark, the Euro and Australian dollar. We monitor our foreign currency exchange exposures to ensure the overall effectiveness of our foreign currency hedge positions. However, there can be no assurance our foreign currency hedging activities will offset the impact of substantial fluctuations in currency exchange rates on our results of operations and financial position.

The following are summarized market risks of forward contracts at July 31, 1999 by foreign currencies in which we do business:

(Thousands except contract rates)	Notional Settlement Amount	Average Contract Rate	Unrealized Gain (Loss)
Functional Currency			
Euros	\$ 2,261	1.07	\$ (19)
Australian Dollars	452	0.65	1
	----- \$ 2,713 =====	-----	----- \$ (18) =====

* * *

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Financial Statement Schedules:

Schedule II - Valuation and Qualifying Accounts

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Schedules other than those listed above have been omitted since they are either not required, not applicable or the information is otherwise included

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and
Stockholders of VTEL Corporation

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of VTEL Corporation and its subsidiaries at July 31, 1998 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended July 31, 1999 in conformity with generally accepted accounting principles. In addition, in our opinion, the financial statement schedule listed in the accompanying index, presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and the financial statement schedule are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements and the financial statement schedule based on our audits. We conducted our audits of these consolidated financial statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Austin, Texas
September 24, 1999

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VTEL CORPORATION

CONSOLIDATED BALANCE SHEET
(Amounts in thousands, except share and per share data)

	1998	1999
ASSETS		
Current assets:		
Cash and equivalents	\$ 15,191	\$ 7,805
Short-term investments	14,484	4,308
Accounts receivable, net of allowance for doubtful accounts of \$9,447 and \$1,223 at July 31, 1998 and July 31, 1999	40,527	38,291
Inventories	12,951	15,553
Prepaid expenses and other current assets	2,533	2,320

Total current assets	85,686	68,277
Property and equipment, net	28,106	29,704
Intangible assets, net	11,812	15,841
Capitalized software	984	7,351
Other assets	2,701	2,918
	\$129,289	\$124,091
	=====	=====
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 22,600	\$ 18,375
Accrued merger and other expenses	1,741	-
Accrued compensation and benefits	5,258	4,916
Other accrued liabilities	2,791	3,555
Notes payable, current portion		2,234
Deferred revenue	11,793	11,062
Total current liabilities	44,183	40,142
Long-term liabilities:		
Borrowings under line of credit	-	11,200
Notes payable	-	554
Other long-term obligations	3,848	4,176
Total long-term liabilities	3,848	15,930

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VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share and per share data unless otherwise noted)

Commitments and contingencies (Note 13)	-	-
Stockholders' equity:		
Preferred stock, \$.01 par value; 10,000,000 authorized; none issued or outstanding	-	-
Common stock, \$.01 par value; 40,000,000 authorized; 23,227,000 and 24,423,000 issued at July 31, 1998 and July 31, 1999	232	244
Additional paid-in capital	256,594	260,057
Accumulated deficit	(175,455)	(191,665)
Unearned compensation	(76)	(385)
Stock subscriptions receivable	-	(150)
Accumulated other comprehensive loss	(37)	(82)
Total stockholders' equity	81,258	68,019
	\$129,289	\$124,091
	=====	=====

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

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VTEL CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS
(Amounts in thousands, except per share data)

	FOR THE YEARS ENDED JULY 31,		
	1997	1998	1999
REVENUES:			
Products	\$ 150,791	\$ 134,775	\$ 105,520
Services and other	40,232	44,909	46,082
Total revenues	191,023	179,684	151,602
COST OF SALES:			
Products	87,231	65,811	55,167
Services and other	29,090	28,916	29,197
Total cost of sales	116,321	94,727	84,364
Gross margin	74,702	84,957	67,238
OPERATING EXPENSES:			
Selling, general and administrative	65,399	64,802	60,855
Research and development	24,460	19,892	17,951
Merger and other	29,397	(1,536)	(235)
Amortization of intangible assets	960	960	1,271
Restructuring expense	-	-	3,080
Total operating expenses	120,216	84,118	82,922
Income (loss) from operations	(45,514)	839	(15,684)
OTHER INCOME (EXPENSE):			
Interest income	2,736	1,242	792
Interest expense and other	(1,505)	735	(723)
	1,231	1,977	69
Net income (loss) before provision for income taxes	(44,283)	2,816	(15,615)
Benefit (provision) for income taxes	12	(37)	50
Net income (loss) from continuing operations	(44,271)	2,779	(15,565)
DISCONTINUED OPERATION:			
Net loss from discontinued operation	(7,783)	-	-
Net income (loss)	\$ (52,054)	\$ 2,779	\$ (15,565)
COMPUTATION OF NET INCOME (LOSS) PER SHARE:			
Net income (loss) from continuing operations	\$ (44,271)	\$ 2,779	\$ (15,565)
Deemed preferred stock dividend related to conversion discount	(2,527)	-	-
Adjusted net income (loss) from continuing operations	(46,798)	2,779	(15,565)
Net income (loss) from discontinued operation	(7,783)	-	-
Net income (loss) applicable to common stock	\$ (54,581)	\$ 2,779	\$ (15,565)
Basic and diluted income (loss) per common share:			
Income (loss) from continuing operations	\$ (2.10)	\$ 0.12	\$ (0.66)
Income (loss) from discontinued operation	(0.35)	-	-
Net income (loss) per share	\$ (2.45)	\$ 0.12	\$ (0.66)
Weighted average shares outstanding:			
Basic	22,255	23,057	23,509
Diluted	22,255	23,458	23,509

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

VTEL CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(Amounts in thousands)

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	OTHER	ACCUMULATED OTHER COMPREHENSIVE INCOME (LOSS)	TOTAL STOCKHOLDERS' EQUITY
	NUMBER OF	AMOUNT					
	SHARES						
BALANCE AT JULY 31, 1996	21,498	\$ 215	\$ 245,585	\$ (123,713)	\$ -	\$ 151	\$ 122,238
Proceeds from sale of stock	1,258	13	7,703	-	-	-	7,716
Proceeds from stock issued under employee plans	572	1	2,503	-	-	-	2,504
Purchase and issuance of treasury stock	(455)	-	(1,275)	(2,467)	-	-	(3,742)
Unearned compensation	-	-	364	-	(364)	-	-
Amortization of unearned compensation	-	-	-	-	249	-	249
Net loss	-	-	-	(52,054)	-	-	-
Foreign currency translation adjustment	-	-	-	-	-	(146)	(146)
Comprehensive loss	-	-	-	-	-	-	(52,200)
BALANCE AT JULY 31, 1997	22,873	229	254,880	(178,234)	(115)	5	76,765
Proceeds from stock issued under employee plans	344	3	1,473	-	-	-	1,476
Common stock issued for acquisition	10	-	153	-	-	-	153
Unearned compensation	-	-	88	-	(88)	-	-
Amortization of unearned compensation	-	-	-	-	127	-	127
Net income	-	-	-	2,779	-	-	2,779
Foreign currency translation adjustment	-	-	-	-	-	(42)	(42)
Comprehensive income	-	-	-	-	-	-	2,737
BALANCE AT JULY 31, 1998	23,227	232	256,594	(175,455)	(76)	(37)	81,258
Proceeds from stock issued under employee plans	47	1	103	-	-	-	104
Purchase of treasury stock	(526)	-	(2,265)	-	-	-	(2,265)
Issuance of treasury stock under employee plans	357	-	1,438	(645)	-	-	793
Treasury stock issued for acquisition	169	-	826	-	-	-	826
Common stock issued for acquisitions	1,149	11	2,596	-	-	-	2,607
Warrants issued in legal settlement [Note 13]	-	-	52	-	-	-	52
Stock subscriptions receivable	-	-	150	-	(150)	-	-
Unearned compensation	-	-	563	-	(563)	-	-
Amortization of unearned compensation	-	-	-	-	254	-	254
Net loss	-	-	-	(15,565)	-	-	(15,565)
Foreign currency translation adjustment	-	-	-	-	-	(45)	(45)
Comprehensive loss	-	-	-	-	-	-	(15,610)
BALANCE AT JULY 31, 1999	24,423	\$ 244	\$ 260,057	\$ (191,665)	\$ (535)	\$ (82)	\$ 68,019

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

VTEL CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS
(Amounts in thousands)

FOR THE YEARS ENDED JULY 31,
1997 1998 1999

CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income (loss)	\$ (52,054)	\$ 2,779	\$ (15,565)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operations:			
Depreciation and amortization	12,667	8,870	11,797
Provision for doubtful accounts and returns	4,145	(119)	436
Amortization of unearned compensation	249	127	254
Gain on sale of fixed assets	-	-	(132)
Foreign currency translation gain (loss)	(3)	112	88
Decrease in accounts receivable	106	3,299	2,206
(Increase) decrease in inventories	7,064	10,758	(1,294)
(Increase) decrease in prepaid expenses and other current assets	(492)	358	220
Increase (decrease) in accounts payable	5,005	(3,099)	(5,539)
Increase (decrease) in accrued expenses	6,535	(5,505)	(2,967)
(Decrease) in research and development advance	(5)	-	-
Increase (decrease) in deferred revenues	2,195	2,172	(178)
Decrease in accrued expenses, discontinued operation	(657)	-	-
Net cash provided by (used in) operating activities	(15,245)	19,752	(10,674)
CASH FLOWS FROM INVESTING ACTIVITIES:			
Purchases of short-term investments	(391,628)	(247,223)	(150,828)
Sales and maturities of short-term investments	419,636	253,038	161,004
Purchases of property and equipment	(18,781)	(15,835)	(8,778)
Sales of property and equipment	11,208	260	1,441
Cash paid for acquired assets (Note 3)	-	-	(231)
Issuance of notes receivable	-	-	(750)
(Increase) decrease in capitalized software	3,561	(984)	(6,367)
(Increase) decrease in other assets	(745)	104	(67)
Net cash provided by (used in) investing activities	23,251	(10,640)	(4,576)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Net proceeds from issuance of stock	8,044	1,476	104
Purchase of treasury stock	(3,742)	-	(2,265)
Proceeds from the sale of treasury stock	1,275	-	793
Borrowings under line of credit agreements	-	-	11,200
Payments on notes payable	-	-	(1,835)
Repayment of short-term debt	(10,656)	-	-
Net cash provided by (used in) financing activities	(5,079)	1,476	7,997
Effect of translation exchange rates on cash	(143)	(154)	(133)
Net increase (decrease) in cash and equivalents	2,784	10,434	(7,386)
Cash and equivalents at beginning of period	1,973	4,757	15,191
Cash and equivalents at end of period	\$ 4,757	\$ 15,191	\$ 7,805
SUPPLEMENTAL CASH FLOW INFORMATION:			
Interest paid	\$ 1,582	\$ -	\$ 775
Non-cash transactions			
Stock issued for acquired assets (Note 3)	-	153	3,433
Notes payable issued for acquired asset	-	837	4,373
Issuance of stock warrants and note in legal settlement (Note 13)	-	-	302
Issuance of restricted stock to employees (Note 10)	-	-	563
Stock issued in lieu of repayment of research and development advance	901	-	-

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

VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share and per share data unless otherwise noted)

1. THE COMPANY

VTEL Corporation ("VTEL" or the "Company") designs, manufactures, markets, services and supports integrated, multi-media visual communication systems which operate over private and switched digital communication networks. VTEL distributes its systems to a domestic and international marketplace through a reseller network and directly to end-user customers.

On May 23, 1997, shareholders of VTEL and Compression Labs, Incorporated, a Delaware corporation ("CLI"), approved the merger (the "Merger") of VTEL-Sub, Inc., a Delaware corporation and direct wholly-owned subsidiary of VTEL ("Merger Sub"), with and into CLI, pursuant to an Agreement and Plan of Merger and Reorganization (the "Merger Agreement"), with CLI becoming a direct

wholly-owned subsidiary of VTEL.

The acquisition was accounted for as a pooling of interests and accordingly, the consolidated financial statements have been restated for the period ended July 31, 1997 to include the accounts of CLI. Revenues, net income (loss) from continuing operations and net income (loss) of the separate companies for the 1997 period were as follows:

	VTEL	CLI	TOTAL
	-----	-----	-----
YEAR ENDED JULY 31, 1997 *			
Revenues	\$124,438	\$ 66,585	\$191,023
Net loss from continuing operations **	556	(44,827)	(44,271)
Net loss	(508)	(51,546)	(52,054)

<FN>

* Information for CLI is through the date of the Merger, May 23, 1997.

** Includes loss of \$29,397 related to the merger.

</FN>

In connection with the Merger, the Company recorded merger and other expenses of \$29,397 during the year ended July 31, 1997 as follows:

TRANSACTION EXPENSES:

Investment banking fees	\$ 2,391
Legal and accounting fees	1,600
Other	1,663

	5,654

RESTRUCTURING AND OTHER:

Asset impairments	12,469
Reserve for contingent liabilities	5,271
Severance and termination benefits	3,457
Other	2,546

	23,743

Total	\$ 29,397
	=====

In connection with the Merger in 1997, the Company made the decision to discontinue the CLI product-line and made the transition to a single product platform, VTEL's Enterprise Series Architecture (ESA) platform. The Company also made the decision to reduce duplicate operating functions, which resulted in a reduction in the workforce of CLI. These activities resulted in the obsolescence of all of the remaining CLI inventory related to the discontinued products and the impairment of excess and unproductive assets resulting from the merger transition plan. Asset impairment was determined by estimating the lower of the asset's carrying amount or fair value less cost to sell.

VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share and per share data unless otherwise noted)

The restructuring activities related to the Merger involved the involuntary termination of approximately 150 employees over the period from May 23, 1997 (the date of the Merger) to November 30, 1997.

The major components of the asset impairment recorded at July 31, 1997 are as follows:

Write-down of recorded value of discontinued CLI inventory due to discontinuance of the CLI product line	\$ 3,500
Write-off of capitalized software development costs due to discontinuance of the CLI product line	3,200

Write-off of purchased software deemed redundant as a result of the Merger	1,300
Write-off of unproductive CLI assets (primarily furniture, fixtures, equipment and leasehold improvements) due to workforce reduction subsequent to the Merger	2,800
Reserve for uncollectible receivables related to sales of products which were subsequently discontinued and no longer supported	1,669
Total	----- \$ 12,469 =====

Contingent liabilities of \$5.2 million accrued at July 31, 1997 reflect amounts accrued for the discharge of pending and threatened litigation against the Company's wholly-owned subsidiary, CLI, and amounts accrued to discharge known and probable vendor disputes related to CLI. These amounts include management's estimate of the probably costs expected to be incurred to settle, discharge or litigate the matters.

Other restructuring charges of \$2.5 million include \$1.6 million related to the cancellation of purchase commitments that had no future economic benefit to the discontinued CLI product-line and costs associated with the closure of redundant facilities.

Changes to accrued merger and other and the reserve for asset impairments during the year ended July 31, 1999 were as follows:

	BALANCE AT JULY 31, 1998	PAID IN FISCAL 1999	DISPOSALS IN FISCAL 1999	REVERSED IN FISCAL 1999	BALANCE AT JULY 31, 1999
ASSET IMPAIRMENTS	\$ 382	\$ -	\$ 382	\$ -	\$ -
ACCRUED MERGER AND OTHER EXPENSES:					
Reserve for contingent liabilities	\$ 1,484	\$ 1,249	\$ -	\$ 235*	\$ -
Severance and termination benefits	257	257	-	-	-
	\$ 1,741	\$ 1,506	\$ -	\$ 235	\$ -

<FN>

* During the fiscal year ended July 31, 1999, the remaining litigation claims involving CLI were either dismissed in court or settled with the plaintiff. The remaining reserves for contingent liabilities were credited to income.

</FN>

VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share and per share data unless otherwise noted)

2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and include the accounts of VTEL's wholly owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. Preparation of the consolidated 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 reporting period. The more significant estimates made by management include the provision for doubtful accounts

receivable, inventory write-downs for potentially excess or obsolete inventory, warranty reserves, the valuation allowance for the gross deferred tax asset, contingency reserves, lives of fixed assets and the amortization period for intangible assets. Actual amounts could differ from the estimates made. Management periodically evaluates estimates used in the preparation of the financial statements for continued reasonableness. Appropriate adjustments, if any, to the estimates used are made prospectively based upon such periodic evaluation.

Revenue Recognition

Product revenues, recorded net of discounts, are recognized at the time a product is shipped or services are performed and the Company has no significant further obligations to the customer. Customer prepayments are deferred until product shipment has occurred or services have been rendered and there are no significant further obligations to the customer. Service revenues are recognized at the time the services are rendered and the Company has no significant further obligations to the customer. Revenues for extended warranty contracts are recorded over the contract period. The Company records an allowance to reduce sales revenue by an amount which reflects management's estimate of potential future sales returns, exchanges, customer stock rotations or price protection discounts.

Warranty Costs

The Company generally warrants its products against hardware defects for one year from the date of installation but not to exceed fifteen months from date of shipment. A warranty is provided for software defects for ninety days from the date of installation. The Company provides currently for the estimated costs which may be incurred in the future under the warranty program.

Software Development Costs

Costs incurred in connection with the development of software products are accounted for 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." Costs incurred prior to the establishment of technological feasibility are charged to research and development expense. Amortization of capitalized software begins upon initial product shipment.

VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Software development costs are amortized (a) over the estimated life of the related product (generally thirty months), using the straight-line method or (b) based on the ratio of current revenues from the related products to total estimated revenues for such products, whichever is greater.

The Company capitalized internal software development costs of \$1,622, \$984 and \$6,367 for the years ended July 31, 1997, 1998 and 1999, respectively. Amortization of such costs was \$1,827, \$50 and zero for the years ended July 31, 1997, 1998 and 1999, respectively. In connection with the Merger, the Company recorded an impairment charge of \$3,218 related to capitalized software development costs during the year ended July 31, 1997 due to the elimination of the product line to which the capitalized software development costs related.

Cash and Equivalentents

Cash and equivalentents include cash and investments in liquid money market accounts.

Short-term Investments

Short-term investments are carried at market value, which approximates cost, at the balance sheet date. Short-term investments consist of funds primarily invested in mortgage-backed securities guaranteed by the U.S. government, government securities and commercial paper. Investment securities

generally have maturities of less than one year.

The Company accounts for investment securities under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." SFAS No. 115 requires investment securities to be classified as held-to-maturity, trading or available-for-sale based on the characteristics of the securities and the activity in the investment portfolio. At July 31, 1998 and 1999, all investment securities are classified as available-for-sale. No unrealized gains or losses have been recorded as a separate component of equity for the current period or prior year as market values approximate cost due to the short-term nature of the investments.

Inventories

Inventories are stated at the lower of cost (weighted average cost which approximates the first-in, first-out method) or market. Cost includes the acquisition of purchased components, parts and sub-assemblies, labor and overhead.

Property and Equipment

Property and equipment is recorded at cost. Internal support equipment is video teleconferencing equipment used internally for purposes such as sales and marketing demonstrations, Company meetings, testing, troubleshooting customer problems, and engineering, and is recorded at manufactured cost. Depreciation and amortization are provided using the straight-line method over the estimated economic lives of the assets, ranging from two to ten years, or over the lease term or life of the improvement of the respective assets, as applicable. Repair and maintenance costs are expensed as incurred. The Company periodically reviews the estimated economic lives of property and equipment and will make adjustments according to the latest information available.

In accordance with Statement of Position ("SoP") 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for internal Use," the Company capitalized \$0.8 million of internal costs associated with the implementation of the Oracle Enterprise Resource Planning Software System, the Company's management resource planning, transaction processing and financial accounting system, during the year ended July 31, 1998.

VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

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Intangible Assets

Intangible assets include the goodwill that results from various acquisitions of the Company (see Note 3) as well as other intangibles, including acquired technology. Goodwill is associated with the acquisition of the Company's Global Services unit, Vosaic and its subsidiaries in France and Germany. Amortization periods for the intangibles associated with these acquisitions range from 3 to 15 years. In accordance with Accounting Principles Board Opinion ("APB") No. 17, "Intangible Assets," the Company periodically evaluates the amortization period associated with the acquired intangible assets based upon anticipated periods of future benefit. The Company evaluates factors such as loss of employees with key or unique skills, the Company's ability to continue to successfully utilize the specialized knowledge acquired and other relevant factors which could require revision of the estimate of the amortization period. Appropriate adjustments, if any, to the amortization period will be made prospectively based upon such periodic evaluation. Accumulated amortization of intangibles was \$2,554 and \$3,817 at July 31, 1998 and 1999.

Foreign Currency Translation

The financial statements of the Company's foreign subsidiaries are measured using the local currency as the functional currency. Accordingly, assets and liabilities of the subsidiaries are translated at current rates of exchange at the balance sheet date. The resultant gains or losses from translation are included in a separate component of stockholders' equity. Income

and expense from the subsidiaries are translated using monthly average exchange rates.

Income Taxes

The Company accounts for income taxes under SFAS No. 109, "Accounting for Income Taxes," which requires the liability method of accounting for income taxes. Under the liability method, deferred taxes are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect in the years in which the differences are expected to reverse.

Net Income (Loss) Per Share

The Company reports earnings per share under SFAS No. 128, "Earnings Per Share." Under SFAS No. 128, basic earnings per share is based on the weighted effect of all common shares issued and outstanding, and is calculated by dividing net income available to common stockholders by the weighted average shares of common stock outstanding during the period. Diluted earnings per share is calculated by dividing net income available to common stockholders by the weighted average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming conversion of all potentially dilutive shares outstanding. All historical earnings per share data have been restated to conform to the current year presentation.

The calculation of the number of weighted average shares outstanding for basic and dilutive earnings (loss) per share for each of the periods presented is as follows:

	FOR THE YEARS ENDED		
	1997	JULY 31, 1998	1999
Weighted average shares			
Outstanding - basic	22,255	23,057	23,509
	-----	-----	-----
Effect of Dilutive Securities:			
Stock options	-	400	-
Warrants to purchase common stock	-	1	-
	-----	-----	-----
Dilutive potential common shares	-	401	-
	-----	-----	-----
Weighted average shares			
outstanding - diluted	22,255	23,458	23,509
	=====	=====	=====
Antidilutive securities	3,648	1,764	4,457
	=====	=====	=====

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Net loss applicable to common stock for the year ended July 31, 1997 is computed by increasing the net loss from continuing operations by \$2,527 which represents a deemed dividend related to the 20% conversion discount on Series C Preferred Stock measured at the date of original issuance.

Concentration of Credit Risk

The Company sells its products to various companies across several industries, including third-party resellers. The Company performs ongoing credit evaluations of its customers and maintains reserves for potential credit losses. The Company requires advanced payments or secured transactions when deemed necessary.

Fair Value of Financial Instruments

The carrying amount of the Company's financial instruments, including cash and equivalents, short-term investments and short-term trade receivables, payables, and debt, approximates fair value. The fair value of the Company's foreign currency forward contracts is determined at July 31, 1998 and 1999 based on quoted market rates. The carrying amount of short-term investments approximates fair value because of the short maturity and nature of these instruments. The Company places its cash in investment quality financial instruments and limits the amount invested in any one institution or in any type

of instrument. The Company has not experienced any significant losses on its investments.

Long-lived Assets

The Company evaluates its long-lived assets and intangibles based on guidance provided by SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of." SFAS No. 121 established accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used for long-lived assets and certain identifiable intangibles to be disposed of. The Company believes no impairment exists at July 31, 1999.

Employee Stock Plans

The Company determines the fair value of grants of stock, stock options and other equity instruments issued to employees in accordance with SFAS No. 123, "Accounting and Disclosure of Stock-Based Compensation." SFAS No. 123 encourages, but does not require, companies to recognize compensation expense for grants of stock, stock options, and other equity instruments to employees based on their estimated fair market value on the date of grant. The Company has opted to continue to apply the existing accounting rules contained in APB No. 25, "Accounting for Stock Issued to Employees." As such, SFAS No. 123 has had no effect on the Company's financial position or results of operations.

The Company records unearned compensation related to stock options that are issued at exercise prices which are below the fair market value of the underlying stock on the measurement date. Such unearned compensation is amortized ratably over the vesting period of the related stock options.

Treasury Stock

The Company accounts for its treasury stock purchases and issuances using the cost method.

VTEL CORPORATION

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Comprehensive Income

During fiscal 1999, the Company adopted SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 establishes standards for reporting comprehensive income and its components. The Company's comprehensive income (loss) is shown on the Company's Statement of Changes in Stockholders' Equity and is comprised of net income (loss) and foreign currency translation adjustments.

Segment Information

The Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," in the fiscal year ended July 31, 1999. SFAS No. 131 supersedes SFAS No. 14, "Financial Reporting for Segments of a Business Enterprise," replacing the "industry segment" approach with the "management" approach. The management approach designates the internal organization that is used by management for making operating decisions and assessing performance as the source of the Company's reportable segments. SFAS No. 131 also requires disclosures about products and services, geographic areas and major customers. The adoption of SFAS No. 131 did not affect the Company's results of operations or financial position, but did affect the disclosure of segment information as and has been used for all years presented in these financial statements (Note 14).

Recent Accounting Pronouncements

In June 1998, Financial Accounting Standards Board (FASB) issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative

instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. SFAS No. 133 requires the recognition of all derivatives as either assets or liabilities in the statement of financial position and the measurement of those instruments at fair value. The Company is required to adopt this standard in the first quarter of fiscal 2001. The Company expects that the adoption of SFAS No. 133 will not have a material impact on its financial position or its results of operations.

In April 1998, American Institute of Certified Public Accountants issued SoP No. 98-5, "Reporting on the Costs of Start-up Activities", which provides guidance on the financial reporting of start-up costs and organization costs. It requires costs of start-up activities and organization costs to be expensed as incurred. The SoP is effective for the Company on August 1, 1999. The Company estimates that the effect of adopting the SoP to be approximately \$100 which will be recorded as a cumulative change in accounting principle in the results of operations during the first quarter of fiscal 2000.

3. ACQUISITIONS

The Company consummated the acquisition of certain of the assets of the videoconferencing division of one of its German resellers effective July 1, 1998. The consideration paid by the Company consisted of restricted stock, warrants, a note payable, and the assumption of certain payables and other liabilities totaling approximately \$1,871. During fiscal 1999, the Company completed the acquisition of one of its French resellers primarily through the issuance of restricted stock for approximately \$826.

On March 9, 1999, the Company completed the acquisition of substantially all of the assets of Vosaic LLP, an Internet video software and technology company for \$3.2 million in cash, stock and warrants. The transaction has been accounted for as a purchase of assets. The acquisition involved the issuance of 1,149,000 shares (equivalent to approximately 5% of the outstanding

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 shares of the Company's stock as of March 9, 1999). The common shares have been registered with the Securities Exchange Commission as of May 14, 1999. Of these shares, 200,000 are to be held in escrow and an additional, 350,000 warrants remain unearned pending the completion of certain obligations by Vosaic LLP.

4. INVENTORIES

Inventories consist of the following:

	JULY 31,	
	1998	1999
Raw materials	\$ 5,938	\$ 8,595
Work-in-process	517	1,504
Finished goods	5,833	4,637
Finished goods held for evaluation and rental agreements	663	817
	-----	-----
	\$12,951	\$15,553
	=====	=====

Finished goods held for evaluation and under rental agreements consists of completed visual communication systems used for demonstration and evaluation purposes, which are generally sold during the next year.

5. PROPERTY AND EQUIPMENT

Property and equipment and related depreciable life is composed of the following:

	JULY 31,	
	1998	1999
Furniture, machinery and equipment, 2-10 years	\$ 30,045	\$ 24,241
Internal support equipment, 2-4 years	12,513	9,043
Customer service assets, 4-8 years	15,263	15,520
Leasehold improvements, lease term or life of the improvement	6,686	8,893
	-----	-----
	64,507	57,697
Less accumulated depreciation	(36,401)	(27,993)
	-----	-----
	\$ 28,106	\$ 29,704
	=====	=====

Depreciation and amortization expense relating to property and equipment was approximately \$12,991, \$7,910 and \$9,964 for the years ended July 31, 1997, 1998 and 1999, respectively.

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VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share and per share data unless otherwise noted)

6. RESTRUCTURING ACTIVITIES

In November 1998, management adopted a restructuring plan that was intended to match the size and complexity of the organization with the planned path of the Company. The plan included the involuntary reduction of 138 employees in fiscal 1999. Terminations were generally made in all departments, including manufacturing, sales, management and accounting, and were effective immediately for most employees upon announcement. The Company also made the decision to reduce operating costs by exiting other activities and reducing related overhead costs. These activities included the closure of certain field sales offices and its Sunnyvale, California spare parts depot.

As a result of the restructuring, the Company recorded a charge of \$3.1 million during the year ended July 31, 1999. As of July 31, 1999, substantially all of the termination and severance benefits had been paid. The transition of the spare parts depot in Sunnyvale was completed during 1999.

The following schedule summarizes the components and activities of the restructuring plan:

	RESTRUCTURING EXPENSE	EXPENDITURES INCURRED	BALANCE ACCRUED AT JULY 31, 1999
Termination and severance benefits	\$ 2,311	\$ 2,293	\$ 18
Facility closure and other (primarily non-cancelable lease obligations)	769	769	-
	-----	-----	-----
	\$ 3,080	\$ 3,062	\$ 18
	=====	=====	=====

7. DISCONTINUED OPERATION

On June 27, 1996, CLI completed the sale of certain assets of its broadcast products division to another company in exchange for \$12,500 in cash and the assumption of \$2,000 in liabilities. The purchaser assumed past warranty obligations associated with the product family covered by the sale. With the exception of the accounts receivable, CLI disposed of the remaining assets of the division to a separate buyer. During the year ended July 31, 1997, the Company recorded a provision for probable losses to fully reserve the remaining accounts receivable of the discontinued operation that were considered to be uncollectible. Such provision is reflected in the accompanying consolidated

statement of operations in the net loss from discontinued operations. No revenues from discontinued operation were recorded during the years ended July 31, 1997, 1998 or 1999.

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(Amounts in thousands, except share and per share data unless otherwise noted)

8. NOTES PAYABLE

Notes payable at July 31, 1999 consist of the following:

Notes payable to the vendor of the Company's Enterprise Resource Planning System in quarterly and annual installments through May 2001, bearing interest at rates ranging from 7.22% to 8.50%	\$ 2,538
Other	250

	2,788
Less:	
Current maturities	(2,234)

Long-term notes payable	\$ 554
	=====

The aggregate annual maturities of notes payable at July 31, 1999 are as follows:

FISCAL YEAR ENDING:	
2000	\$ 2,234
2001	554

	\$ 2,788
	=====

9. LINE OF CREDIT

On May 5, 1999, the Company executed a credit agreement with a banking syndicate which established a \$20,000 revolving line of credit. Under the line of credit, the Company may borrow up to 80% of eligible accounts receivable. The credit agreement also provides that the Company may request the issuance of letters of credit up to a maximum of \$10,000 and foreign exchange contracts up to a maximum of \$10,000. Each of the aforementioned provisions are subject to certain limitations.

Any amounts outstanding under the credit agreement will bear interest at the prime rate plus 0.5% (8.5 % at July 31, 1999) or, at the option of the Company, LIBOR plus 3.25% (9.05% at July 31, 1999) The interest rates may decline if the Company achieves consecutive profitable quarters. All such advances and accrued interest under the credit agreement will be payable on the maturity date of May 4, 2001. The Company pays an annual commitment fee of 0.375% on its unused line of credit.

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Any amounts outstanding under the credit agreement will be secured by

substantially all of the Company's assets. The credit agreement requires that the Company maintain certain financial ratios and other covenants. The Company has issued a letter of credit totaling \$1,200 under the line of credit as a lease deposit on one of its facilities. At July 31, 1999, the Company had drawn \$11,200 under the credit line.

10. STOCKHOLDERS' EQUITY

General

In May 1997, VTEL issued 155,040 shares of Common Stock, at the fair market value, to Intel in lieu of repayment of the remaining \$901 advance under the Development Agreement (see Note 11) that was unused at that time.

On March 9, 1999, the Company completed the acquisition of substantially all of the assets of Vosaic LLP, an Internet video software and technology company which involved the issuance of 1,149,000. Of these shares, 200,000 are to be held in escrow and an additional 350,000 warrants remain unearned pending the completion of certain obligations by Vosaic (see Note 3).

Share Repurchase Program

During fiscal 1997, the Company purchased 455,200 shares of its Common Stock for approximately \$3.7 million. All of the repurchased shares were reissued during fiscal 1997 to fulfill requirements for the Company's Common Stock. In February 1997, the Company terminated the stock repurchase program.

During fiscal 1999, the Company initiated a new stock repurchase program and repurchased 526,000 shares of its Common Stock for \$2.3 million. The repurchased shares have been used to fulfill requirements for the Company's stock including stock option exercises or stock issuances under business combination transactions. No additional share repurchases are currently planned, although the Company is authorized to repurchase up to 1,474,000 additional shares.

Stock Subscriptions Receivable

During fiscal 1999, the Company loaned certain employees of the Company amounts to either purchase shares of the Company's stock on the open market, exercise options or participate in the employee stock purchase program. Receivables with recourse totaling \$150 that are related to the exercise of options and the participation of the employee stock purchase program have been classified as a reduction of additional paid-in capital. Receivables with recourse totaling \$750 related to the purchase of shares on the open market have been classified as other long-term assets.

CLI Redeemable Convertible Preferred Stock

On October 25, 1996, CLI completed a private placement of 350,000 shares of Class C Preferred Stock and stock warrants for the purchase of 375,000 shares of CLI Common Stock for approximately \$7,000, before certain issuance costs, pursuant to a purchase agreement with an institutional investor. The preferred stock was exchanged for 1,102,500 shares of VTEL Common Stock and both the number and exercise price of the warrants were converted into warrants for the purchase of VTEL Common Stock based on the exchange ratio of 0.46 in connection with the Merger. The converted warrants, totaling 172,500 VTEL shares, have an exercise price of \$12.39 and expire in October 2001.

Stock and Stock Option Plans

VTEL has three stock option plans, the 1989 Stock Option Plan (the "1989 Plan"), the 1996 Stock Option Plan (the "1996 Plan") and the 1992 Director Stock Option Plan (the "1992 Plan"). The 1989 Plan and the 1996 Plan both provide for the issuance of non-qualified and incentive stock options to employees and consultants of the Company. Stock options are generally granted at

the fair market value at the time of grant, and the options generally vest ratably over 48 months and are generally exercisable for a period of ten years beginning with date of grant. The 1992 Plan provides for the issuance of stock options to nonemployee directors at the fair market value at the time of grant. Effective June 1999, the 1989 Plan expired whereby the company can no longer grant options under the Plan, however, options previously granted remain outstanding. Such options vest ratably over 36 months and are exercisable for a period of ten years beginning with the date of the grant.

CLI had employee and director stock option plans prior to the merger with VTEL. On May 23, 1997, all options outstanding under these plans were converted into options for Common Stock of VTEL. Both the number of shares subject to option and the per share exercise price under each option were adjusted by the exchange ratio of 0.46.

The Company applies APB No. 25 and related interpretations in accounting for its stock option plans. Accordingly, no compensation cost is recognized for its stock option plans unless options are issued at exercise prices which are below the market price on the measurement date. Had compensation cost for the Company's stock option plans been determined based on the fair market value at the grant dates for awards under those plans consistent with the method provided by SFAS No. 123, the Company's net loss and net loss per share would have been reflected by the following pro forma amounts for the years ended July 31, 1997, 1998 and 1999:

		FOR THE YEARS ENDED JULY 31,		
		1997	1998	1999
Net income (loss)	As reported	\$ (52,054)	\$ 2,779	\$ (15,565)
	Pro forma	\$ (55,276)	\$ (1,589)	\$ (20,023)
Basic and diluted net income (loss) per common share	As reported	\$ (2.45)	\$ 0.12	\$ (0.66)
	Pro forma	\$ (2.60)	\$ (0.07)	\$ (0.85)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions used for grants the years ended July 31, 1997, 1998 and 1999:

	FOR THE YEARS ENDED JULY 31,		
	1997	1998	1999
Dividend yield	-	-	-
Expected volatility	92.31%	63.12%	67.67%
Risk-free rate of return	5.90%	5.52%	6.14%
Expected life	5.12 years	5.65 years	6.26 years

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The following table summarizes activity under all Plans for the years ended July 31, 1997, 1998 and 1999. This information includes stock options relating to CLI's stock option plans. Both the number of shares and the per share exercise price have been adjusted by the exchange ratio of 0.46.

	1997		1998		1999	
	SHARES (000'S)	WEIGHTED AVERAGE EXERCISE PRICE	SHARES (000'S)	WEIGHTED AVERAGE EXERCISE PRICE	SHARES (000'S)	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at the						
Beginning of the year	2,187	\$ 9.40	3,648	\$9.42	3,938	\$8.65
Converted from CLI	1,798	17.43	-	-	-	-
Granted	2,098	6.44	896	6.43	1,818	3.40
Exercised	(324)	3.14	(186)	4.00	(134)	2.34
Canceled	(2,111)	14.58	(420)	7.55	(1,074)	7.05
	-----		-----		-----	
Outstanding at the						
end of the year	3,648	\$ 9.42	3,938	\$8.65	4,548	\$7.11
	=====		=====		=====	
Options exercisable at						
Year end	3,402	\$ 9.20	3,710	\$8.42	4,457	\$7.04
	=====		=====		=====	
Weighted average						
fair value of						
options granted						
During the year		\$ 3.42		\$4.12		\$2.48

RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT JULY 31, 1999	OPTIONS OUTSTANDING		OPTIONS EXERCISABLE	
		WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT JULY 31, 1999	WEIGHTED-AVERAGE EXERCISE PRICE
\$ 0.30 - \$ 2.94	860,353	8.47 years	\$ 2.43	860,353	\$ 2.43
3.00 - 4.88	787,302	8.51	3.93	787,302	3.93
4.91 - 6.11	474,561	8.80	5.56	471,227	5.56
6.13 - 6.13	1,122,153	7.88	6.13	1,115,485	6.13
6.19 - 42.66	1,303,665	5.97	13.53	1,222,399	13.70
-----	-----	-----	-----	-----	-----
\$ 0.30 - \$ 42.66	4,548,034	7.65 years	\$ 7.11	4,456,766	\$ 7.04
=====	=====	=====	=====	=====	=====

Generally, options are exercisable immediately upon grant. However, stock issued upon exercise of a stock option is subject to repurchase by the Company at the exercise price until the option vesting period has elapsed. At July 31, 1999, options to purchase 2,140,615 shares were vested. At July 31, 1999, 30,540 unvested options had been exercised.

Employee Stock Purchase Plan

On April 29, 1993, VTEL adopted an Employee Stock Purchase Plan ("Employee Plan") which enables all employees to acquire VTEL stock under the plan. The Employee Plan authorizes the issuance of up to 950,000 shares of VTEL's Common Stock. The Employee Plan allows participants to purchase shares of the Company's Common Stock at a price equal to the lesser of (a) 85% of the fair market value of the Common Stock on the date of the grant of the option or (b) 85% of the fair market value of the Common Stock at the time of exercise. Common Stock issued under the Employee Plan totaled 105,549 shares, 158,073 shares and 203,118 shares respectively, for the years ended July 31, 1997, 1998 and 1999.

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The fair value of the employees' purchase rights was estimated using the Black-Scholes model with the following assumptions for the years ended July 31, 1997, 1998 and 1999:

	FOR THE YEAR ENDED JULY 31, 1997		FOR THE YEAR ENDED JULY 31, 1998		FOR THE YEAR ENDED JULY 31, 1999	
	SECTION 16		SECTION 16		SECTION 16	
	OFFICERS	OTHERS	OFFICERS	OTHERS	OFFICERS	OTHERS
Dividend yield	-	-	-	-	-	-
Expected volatility	82.89%	79.83%	52.10%	51.68%	72.43%	71.00%
Risk-free rate of return	5.31%	5.23%	5.40%	5.34%	5.13%	4.99%
Expected life (in years)	.50	.25	.50	.25	.50	.25
Weighted-average fair value of Purchase rights granted	\$2.54	\$2.11	\$ 1.96	\$ 1.66	\$ 1.46	\$ 1.12

Restricted Stock Plan

On December 17, 1998, the Company adopted a restricted stock plan (the "1998 Plan"). The 1998 Plan authorizes the issuance of up to 1,000,000 shares of VTEL's Common Stock to be used to reward, incent and retain its employees. Shares of restricted stock issued under the 1998 Plan were 80,000 for the year ended July 31, 1999.

11. DEVELOPMENT AND LICENSE AGREEMENT

On October 22, 1993, VTEL entered into a Development and License Agreement (the "Development Agreement") with Intel Corporation ("Intel"), pursuant to which the companies agreed to engage in a series of development efforts with respect to video compression software as well as other video technology such as processes and designs. The agreement contains certain provisions for licensing agreements and royalties between the two companies for the use of the technology developed under the agreement.

The initial term of the Development Agreement has renewed until December 31, 1999 and will continue to automatically renew thereafter for successive terms of one year unless written notice is given by either party six months prior to the expiration of the initial term or any successor term.

VTEL was advanced \$3,000 under the agreement to be used for the initial reimbursements of research and development costs incurred by VTEL in performing the work specified in the Development Agreement. During the year ended July 31, 1997, the Company reduced gross research and development expenses by approximately \$5 for reimbursable research and development costs under the terms of the Development Agreement. No reductions of research and development expenses were recorded during the years ended July 31, 1998 and 1999 as a result of the Development Agreement. In May 1997, VTEL issued 155,040 shares of Common Stock, at the fair market value, to Intel in lieu of repayment of the remaining \$901 advance that was unused at that time. As of July 31, 1999, the Company had no research and development activities in process or planned related to the Development Agreement.

VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share and per share data unless otherwise noted)

12. FEDERAL INCOME TAXES

Under the provisions of SFAS No. 109, the components of the net deferred tax amount are as follows:

DEFERRED TAX ASSETS:		
Net operating loss carryforwards	\$ 29,140	\$ 38,742
Research and development credit carryforwards	3,458	4,379
Minimum tax credit carryforwards	110	110
Inventory and warranty provisions	1,246	1,921
Charitable contributions	22	40
Compensation accruals	635	306
Depreciation	630	-
Deferred revenue	1,796	713
Accrued expenses	841	-
Accounts receivable	3,163	292
Other	558	545
	-----	-----
Gross deferred tax asset	41,599	47,048
	-----	-----
DEFERRED TAX LIABILITIES:		
Capitalized software	(274)	(220)
Depreciation	-	(453)
	-----	-----
Gross deferred tax liability	(274)	(673)
	-----	-----
Valuation allowance	(41,325)	(46,375)
	-----	-----
Net deferred tax asset	\$ -	\$ -
	=====	=====

The Company's net operating loss carryforwards expire in varying amounts from 1999 through 2019. Research and development tax credit carryforwards expire in varying amounts from 1999 through 2019. Minimum tax credit carryforwards do not expire and carry forward indefinitely. Net operating losses related to the Company's foreign subsidiaries (totaling \$ 7,222) are available to offset future foreign taxable income.

The Company has experienced substantial changes in ownership as defined by the Internal Revenue Code. These changes result in annual limitations of the amount of net operating loss carryforward generated prior to each change which can be utilized to offset future taxable income. As a result of the ownership change at CLI at the date of the Merger, a portion of CLI's net operating loss carryforward generated prior to the Merger will never be available to offset future taxable income due to the effect of the annual limitation and the expiration of the related net operating losses.

At July 31, 1999, the Company had total domestic net operating loss carryforwards of \$113,948 (\$40,530 and \$73,418 for VTEL and CLI, respectively). The portions of these carryforwards available for utilization during fiscal 2000 (in consideration of the annual limitations) are \$83,048. Additional net operating losses created prior to the changes in control of \$2,574 become available in each subsequent year and accumulate if not used until such net operating losses expire.

Due to the uncertainty surrounding the timing of realizing the benefits of its favorable tax attributes in future tax returns, the Company has placed a valuation allowance against its net deferred tax asset. Accordingly, no deferred tax benefits have been recorded for the years ended July 31, 1997, 1998, and 1999.

13. COMMITMENTS AND CONTINGENCIES

Lease Commitments

VTEL leases furniture and equipment, manufacturing facilities and office space under noncancelable leases which expire at various dates through 2013. Certain leases obligate VTEL to pay property taxes, maintenance and repair costs.

Future minimum lease payments under all operating leases as of July 31, 1999 were as follows:

FISCAL YEAR ENDING:	
2000	\$ 7,289
2001	7,115
2002	6,647
2003	5,830
2004	5,435
Thereafter	32,380

	\$ 64,696
	=====

Total rent expense under all operating leases for the years ended July 31, 1997, 1998 and 1999 was \$4,601, \$4,301 and \$4,520 respectively.

During the year ended July 31, 1998, the Company completed the planned elimination of duplicate headquarter facilities by terminating the lease for the former CLI headquarters. The landlord paid the Company a \$1,800 termination fee which is recorded (net of termination expenses) as Other Income in the accompanying Statement of Operations.

In connection with the acquisition of certain of the assets of the videoconferencing division of one of its German resellers, (see Note 3), the Company entered into a five year licensing agreement pursuant to which the Company will pay a license fee equal to 4% of the revenues generated by the acquired assets with a minimum annual fee of \$281 to \$393 and a maximum annual fee of \$786.

Contingencies

The Company is the defendant or plaintiff in various actions which arose in the normal course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse affect on our financial condition, results of operation or cash flows.

The Company was previously involved in a legal dispute with Philips Electronics North America Corporation ("Philips"). On May 25, 1999, the Company announced a compromise settlement agreement between Philips and CLI. The settlement agreement, valued at less than \$900, stipulates payment by CLI in the form of cash and a future payment under a note of \$250 (See Note 8), as well as warrants for VTEL common stock. These amounts had previously been accrued as part of the reserve for contingent liabilities related to the merger (See Note 1). In addition, the settlement mutually releases each party from all future claims, demands and causes of action.

14. SEGMENT INFORMATION

In 1999, the company adopted SFAS 131. The Company manages its business primarily on a products and services basis. The Company's reportable segments are Products and Services/Other. The Products segment provides multi-media visual communication (commonly referred to as videoteleconferencing) products to customers primarily through a network of resellers, and to a lesser extent directly to end-users. The Services/Other segment provides custom integrated systems, installations and product support services to customers. The accounting policies of the segments are the same as those described in Note 2.

The Company evaluates the performance of its segments and allocates resources to them based on revenue and operating income; however, there is a charge to allocate corporate operating expenses to the segments. The prior year's segment information has been restated to present the Company's reportable segments.

The table below presents segment information about revenue from unaffiliated customers, depreciation and operating income for the three years ended July 31, 1999:

VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share and per share data unless otherwise noted)

	PRODUCTS -----	SERVICES/ OTHER -----	CORPORATE/OTHER -----	TOTAL -----
FOR THE YEAR ENDING JULY 31, 1999				
Revenues from unaffiliated customers	\$ 105,520	\$ 46,082	\$ -	\$ 151,602
Depreciation and amortization	168	1,884	9,745	11,797
Operating income (loss)	50,353	16,885	(82,803)	(15,565)
FOR THE YEAR ENDING JULY 31, 1998				
Revenues from unaffiliated customers	\$ 134,775	\$ 44,909	\$ -	\$ 179,684
Depreciation and amortization	219	932	7,719	8,870
Operating income (loss)	68,964	15,993	(82,178)	2,779
FOR THE YEAR ENDING JULY 31, 1997				
Revenues from unaffiliated customers	\$ 150,791	\$ 40,232	\$ -	\$ 191,023
Depreciation and amortization*	-	-	12,667	12,667
Operating income (loss)	63,560	11,142	(118,973)	(44,271)

<FN>

* The company deemed it impracticable to determine depreciation and amortization related to its reportable segments for the year ending July 31, 1997.

</FN>

Revenue and long-lived assets related to operations in the United States and foreign countries for the three years ended July 31, 1999 are presented below. Revenues generated between foreign geographic locations have historically been insignificant.

	FOR THE YEARS ENDED JULY 31,		
	1997	1998	1999
Revenue from unaffiliated customers			
United States	\$ 180,811	\$ 163,381	\$ 136,666
Foreign	10,212	16,303	14,936
Long-lived assets at the end of year			
United States	\$ 36,104	\$ 42,116	\$ 51,806
Foreign	1,133	1,487	3,258

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VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

(Amounts in thousands, except share and per share data unless otherwise noted)

15. QUARTERLY INFORMATION (UNAUDITED)

The following tables contain selected unaudited consolidated statement

of income and earnings per share data for each quarter of fiscal year 1999.

	FOR THE THREE MONTHS ENDED			
	OCT. 31, 1998	JAN 31, 1999	APRIL 30, 1999	JULY 31, 1999
REVENUES:				
Products	\$ 25,888	\$ 26,386	\$ 25,133	\$ 28,113
Services and other	11,052	11,369	10,983	12,678
Total revenues	36,940	37,755	36,116	40,791
COST OF SALES:				
Products	13,280	14,483	12,037	15,367
Services and other	7,348	7,485	6,362	8,002
Total cost of sales	20,628	21,968	18,399	23,369
Gross margin	16,312	15,787	17,717	17,422
OPERATING EXPENSES:				
Selling, general and administrative	18,503	15,916	13,254	13,182
Research and development	5,236	4,638	4,427	3,650
Amortization of intangible assets	252	259	379	381
Merger and other	-	-	-	(235)
Restructuring expense	-	2,915	203	(38)
Total operating expenses	23,991	23,728	18,263	16,940
Income (loss) from operations	(7,679)	(7,941)	(546)	482
OTHER INCOME (EXPENSE):				
Interest income	288	248	165	91
Interest expense and other	(48)	(251)	(193)	(231)
	240	(3)	(28)	(140)
Net income (loss) before provision For income taxes	(7,439)	(7,944)	(574)	342
Provision for income taxes	-	-	-	50
NET INCOME (LOSS)	\$ (7,439)	\$ (7,944)	\$ (574)	\$ 392
BASIC AND DILUTED INCOME (LOSS) PER SHARE:	\$ (0.32)	(0.35)	(0.02)	0.02
WEIGHTED AVERAGE SHARES OUTSTANDING:				
Basic	23,085	22,987	23,734	24,235
Diluted	23,085	22,987	23,734	24,919

* *

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

None.

PART III.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS

In accordance with paragraph G(3) of the General Instructions to the Annual Report on Form 10-K, the information contained under the captions "Election of Directors" will be filed with the Company's Definitive Proxy

Statement pursuant to Regulation 14A on or before November 26, 1999.

ITEM 11. EXECUTIVE COMPENSATION

In accordance with paragraph G(3) of the General Instructions to the Annual Report on Form 10-K, the information contained under the caption "Executive Compensation" will be filed with the Company's Definitive Proxy Statement pursuant to Regulation 14A on or before November 26, 1999.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

In accordance with paragraph G(3) of the General Instructions to the Annual Report on Form 10-K, the information contained under the caption "Security Ownership of Certain Beneficial Owners and Management" will be filed with the Company's Definitive Proxy Statement pursuant to Regulation 14A on or before November 26, 1999.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

In accordance with paragraph G(3) of the General Instructions to the Annual Report on Form 10-K, the information contained under the caption "Certain Relationships and Transactions" will be filed with the Company's Definitive Proxy Statement pursuant to the regulation 14A on or before November 26, 1999.

PART IV.

ITEM 14. EXHIBITS, FINANCIAL STATEMENTS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

EXHIBIT NUMBER -----	DOCUMENT DESCRIPTION -----
(a) (1)	The financial statements filed as part of this Report at Item 8 are listed in the Index to Financial Statements and Financial Statement Schedules on page 24 of this Report.
(a) (2)	The financial statement schedule filed as part of this Report at Item 8 is listed in the Index to Financial Statements and Financial Statement Schedules on page 24 of this Report.
(a) (3)	The following exhibits are filed with this Annual Report on Form 10-K:

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EXHIBIT NUMBER -----	DOCUMENT DESCRIPTION -----
2.1	Agreement and Plan of Merger and Reorganization dated as of January 6, 1997 by and among VTEL, VTEL-Sub, Inc. and CLI (incorporated by reference to the Exhibit 99.1 of VTEL's Report on Form 8-K dated January 6, 1997).
3.1	Fourth Amended Restated Certificate of Incorporation (incorporated by reference the Exhibit 3.1 to the Company's quarterly report form 10-Q for the period ended June 30, 1993.)
3.2	Amendment to Fourth Amended and Restated Certificate of Incorporation, as filed on May 27, 1997 with the Secretary of State of Delaware (incorporated by reference the Exhibit 3.1 to the Company's Annual Report on form 10-K for the period ended July 31, 1997.)
3.3	Bylaws of the Company as adopted by the Board of Directors of the Company effective as of June 11, 1989 (incorporated by reference to Exhibit 3.3 to the Company's Registration Statement on Form S-1, File No. 33-45876, as amended).
3.4	Amendment to Bylaws of the Company as adopted by the Board of Directors of the Company effective as of April 28, 1992 (incorporated by reference to

Exhibit 19.1 to the Company's Quarterly Report on Form 10-Q for the three months ended March 31, 1992).

- 3.5 Amendment to the Bylaws of the Company as adopted by the Board of Directors of the Company effective as of July 10, 1996 (incorporated by reference to Exhibit 4.5 to the Company's Current Report on Form 8-K dated July 10, 1996).
- 4.1 Specimen Certificate for the Common Stock (incorporated by reference to Exhibit 4.1 to the Company's Registration Statement on Form S-1, File No. 33-45876, as amended).
- 4.2 Rights Agreement dated as of July 10, 1996 between VTEL Corporation and First National Bank of Boston, which includes the form of Certificate of Designations for Designating Series A Preferred Stock, \$.01 par value, the form of Rights Certificate, and the Summary of Rights to Purchase Series A Preferred Stock (incorporated by reference to Exhibit 4.1 to the Company's Current Report on Form 8-K dated July 10, 1996).
- 10.1 License Agreement, dated as of November 7, 1990, between Universite de Sherbrooke, as Licensor, and the Company, as Licensee (incorporated by reference to Exhibit 10.5 to the Company's Registration Statement on Form S-1, File No. 33-45876, as amended).
- 10.2 VideoTelecom Corp. 1989 Stock Option Plan, as amended (incorporated by reference to Exhibit 4.1 to the Company's Registration on Form S-8, File No. 33-51822).

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EXHIBIT
NUMBER

DOCUMENT DESCRIPTION

- 10.3 Form of VideoTelecom Corp. Nonqualified Stock Option Agreement (incorporated by reference to Exhibit 10.16 to the Company's Registration Statement on Form S-1, File No. 33-45876, as amended).
- 10.4 Form of VideoTelecom Corp. Incentive Stock Option Agreement (incorporated by reference to Exhibit 10.17 to the Company's Registration Statement on Form S-1, File No. 33-45876, as amended).
- 10.5 Distributor Agreement dated January 8, 1990, between US WEST Communications Services, Inc. and the Company (incorporated by reference to Exhibit 10.18 to the Company's Registration Statement on Form S-1, File No. 33-45876, as amended).
- 10.6 Purchase Agreement effective October 1, 1990, between GTE Service Corporation and the Company, as amended July 1, 1991 (incorporated by reference to Exhibit 10.19 to the Company's Registration Statement on Form S-1, File No. 33-45876, as amended).
- 10.7 Distribution Agreement, made and entered into November 1, 1991, by and between Microsoft Corporation and the Company (incorporated by reference to Exhibit 10.22 to the Company's Registration Statement on Form S-1, File No. 33-45876, as amended).
- 10.8 VideoTelecom Corp. 1992 Director Stock Option Plan (incorporated by reference to Exhibit 4.1 to the Company's Registration on Form S-8, File No. 33-51822).
- 10.9 VideoTelecom Corp. Employee Stock Purchase Plan (incorporated by reference to Exhibit 4.1 to the Company's Registration on Form S-8, File No. 33-51822).
- 10.10 Lease agreement, executed by Waterford HP, Ltd. on June 14, 1994, as Landlord, and the Company, as Tenant, together with First Amendment of Lease Agreement between Waterford HP, Ltd., as Landlord, and the Company, as Tenant, dated November 2, 1994, Second Amendment of Lease Agreement between Waterford HP, Ltd., as Landlord, and the Company, as Tenant, dated February 1, 1995, and Net Profits Agreement, executed between Waterford HP, Ltd. on June 14, 1994 and the Company (incorporated by reference to

Exhibit 10.17 to the Company's 1994 Annual Report on Form 10-K).

- 10.11 Subscription Agreement dated June 14, 1995 by and between VTEL Corporation, Accord Video Telecommunications, Ltd., Nizanim Fund (1993) Ltd., the "Star Entities", Manakin Investments BV, Messrs. Gideon Rosenfeld and Sigi Gavish, and Eduardo Shoval (incorporated by reference to Exhibit 10.19 to the Company's 1995 Annual Report on Form 10-K. The schedules referred to in the agreement have been omitted but will be furnished to the Securities and Exchange Commission upon request).
- 10.12 Amendment to the VideoTelecom Corp. 1989 Stock Option Plan and the 1992 Director Stock Option Plan (the terms of which are incorporated by reference to the Company's 1996 Definitive Proxy Statement).

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EXHIBIT NUMBER -----	DOCUMENT DESCRIPTION -----
10.13	The VTEL Corporation 1996 Stock Option Plan (the terms of which are incorporated by reference to the Company's 1995 Definitive Proxy Statement).
10.14	Amendment to the VTEL Corporation 1996 Stock Option Plan (the terms of which are incorporated by reference to the Company's Joint Proxy Statement filed on April 24, 1997).
10.15	Compression Labs, Incorporated 1980 Stock Option Plan - the ISO Plan (incorporated by reference to the Annual Report on Form 10-K of Compression Labs, Inc. for the year ended December 31, 1994).
10.16	Revised forms of Incentive Stock Option and Early Exercise Stock Purchase Agreement used in connection with the issuance and exercise of options under the ISO Plan (incorporated by reference to the Registration Statement on Form S-8 of Compression Labs, Inc. filed on June 6, 1994).
10.17	Consulting and separation agreement between Compression Labs, Incorporated and John E. Tyson dated February 16, 1996 (incorporated by reference to the Annual Report on Form 10-K of Compression Labs, Inc. for the year ended December 31, 1995).
10.18	Lease Agreement, dated January 30, 1998, between 2800 Industrial, Inc., Lessor and VTEL Corporation, Lessee (incorporated by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q for the three months ended April 30, 1998).
10.19	First Amendment, dated March 11, 1998, to Lease Agreement dated January 30, 1998, between 2800 Industrial, Inc., Lessor and VTEL Corporation, Lessee (incorporated by reference to Exhibit 10.2 to the Company's Quarterly Report on Form 10-Q for the three months ended April 30, 1998).
10.20	The VTEL Corporation 1998 Restricted Stock Plan (the terms of which are incorporated by reference to the Company's 1998 Definitive Proxy Statement)
10.21	Loan and Security Agreement, dated May 5, 1999, between Silicon Valley Bank and Comerica Bank-Texas, as Creditors, and the Company, as Borrower.

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EXHIBIT NUMBER -----	DOCUMENT DESCRIPTION -----
10.22	Change-in-Control Agreements with members of senior management of the Company (incorporated by reference to exhibit 10.21 to the Company's Annual Report on Form 10-K for the year ended July 31, 1999)

- 10.22 (a) Stephen L. Von Rump
- 10.22 (b) Rodney S. Bond
- 10.22 (c) Dennis M. Egan
- 10.22 (d) Vinay Goel
- 10.22 (e) Steve F. Keilen
- 10.22 (f) F.H. (Dick) Moeller
- 10.22 (g) Ly-Huong T. Pham
- 10.22 (h) Michael J. Steigerwald
- 10.22 (i) Bob R. Swem
- 10.22 (j) Judy A. Wallace

21.1 - List of Subsidiaries

23.1 - Consent of PricewaterhouseCoopers LLP.

27.1 - Financial Data Schedule (filed electronically only)

- (B) Reports on Form 8-K:
Press release filed on October 1, 1999(incorporated by reference to Form 8-K filed on October 1, 1999).
- (C) See subitem 14(a)(3) above.
- (D) See subitem 14(a)(2) above.

SIGNATURES

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

VTEL Corporation

By /s/ Rodney S. Bond

Rodney S. Bond
CHIEF FINANCIAL OFFICER,
VICE PRESIDENT-FINANCE,
SECRETARY AND ASSISTANT TREASURER

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

Signature -----	Title -----	Date -----
/s/ ----- Stephen L. Von Rump	President and Director (Principal Executive Officer)	October 29, 1999 -----
/s/ ----- Rodney S. Bond	Chief Financial Officer, Vice President - Finance, Secretary and Assistant Treasurer (Principal Financial Officer and Principal Accounting Officer)	October 29, 1999 -----
/s/ ----- Eric L. Jones	Director	October 29, 1999 -----
/s/ ----- Max Hopper	Director	October 29, 1999 -----
/s/ ----- Gordon Matthews	Director	October 29, 1999 -----

/s/	F.H. (Dick) Moeller	Chairman of the Board	October 29, 1999
	-----		-----
	F.H. (Dick) Moeller		
/s/	Dick Snyder	Director	October 29, 1999
	-----		-----
	Dick Snyder		
/s/	T. Gary Trimm	Director	October 29, 1999
	-----		-----
	T. Gary Trimm		

VTEL CORPORATION

VALUATION AND QUALIFYING ACCOUNTS
SCHEDULE II

	BALANCE AT BEGINNING OF PERIOD	PROVISION FOR DOUBTFUL ACCOUNTS RECEIVABLE	WRITE-OFF OF UNCOLLECTIBLE ACCOUNTS RECEIVABLE (IN THOUSANDS)	BALANCE AT END OF YEAR
Accounts receivable - Allowances for Doubtful accounts				
Year ended July 31, 1997	7,875	6,086	(3,239)	10,722
Year ended July 31, 1998	10,722	(119)	(1,156)	9,447
Year ended July 31, 1999	9,447	278	(8,502)	1,223

AMENDED AND RESTATED
 LOAN AND SECURITY AGREEMENT
 BY AND AMONG
 SILICON VALLEY BANK,
 COMERICA BANK-TEXAS
 AND
 VTEL CORPORATION

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AMENDED AND RESTATED
 LOAN AND SECURITY AGREEMENT

This AMENDED AND RESTATED LOAN AND SECURITY AGREEMENT ("Agreement") is entered into as of May 5, 1999, by and among SILICON VALLEY BANK, a California-chartered bank on its own behalf ("SVB"), with its principal place of business at 3003 Tasman Drive, Santa Clara, California 95054 and with a loan production office located at 9020 Capital of Texas Highway North, Building 1, Suite 350, Austin, Texas 78759, COMERICA BANK-TEXAS, a Texas state banking association ("Comerica") with an address of 1601 Elm Street, Dallas, Texas 75201, P.O. Box 650282, Dallas, Texas 75265-0282, as assignee and transferee of Chase Bank of Texas, National Association f/k/a Texas Commerce Bank National Association ("Chase") (each of SVB in its capacity as a lender, but not as an agent, and Comerica individually a "Lender" and collectively "Lenders"), VTEL CORPORATION, a Delaware corporation ("Borrower"), with its principal place of business at 108 Wild Basin Road, Austin, Texas 78746, and SVB, as Servicing Agent for the Lenders ("Servicing Agent").

R E C I T A L S

SVB, Chase and Borrower entered into that certain Loan and Security Agreement and Schedules relating thereto dated as of December 4, 1997, as amended by that certain First Amendment dated as of October 31, 1998, as further amended by that certain Second Amendment dated to be effective October 31, 1998, as further amended by that certain Third Amendment dated to be effective January 31, 1999 ("Original Loan Agreement") whereby SVB, Chase and Borrower set forth the terms and conditions under which SVB and Chase would extend certain credit to Borrower and whereby Borrower would repay amounts owing to SVB and Chase. Chase has transferred all of its right, title and interest in and to the Original Loan Agreement to Comerica. SVB, Comerica and Borrower desire to amend and restate the Original Loan Agreement to properly reflect certain changed terms and conditions with respect to SVB's and Comerica's extension of credit to Borrower and Borrower's repayment of amounts to SVB and Comerica. Accordingly, the Original Loan Agreement is hereby amended and restated in its entirety to hereafter read as follows:

AGREEMENT

The parties agree as follows:

1. DEFINITIONS AND CONSTRUCTION

1.1 Definitions. As used in this Agreement, the following terms shall have the following definitions:

"Accounts" means all presently existing and hereafter

arising accounts, contract rights, and all other forms of obligations owing to Borrower arising out of the sale or lease of goods (including, without limitation, the licensing of software and other technology) or the rendering of services by Borrower, whether or not earned by performance, and any and all credit insurance, guaranties, and other security therefor, as well as all merchandise returned to or reclaimed by Borrower and Borrower's Books relating to any of the foregoing.

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"Advance" or "Advances" means a loan advance under the Committed Revolving Line.

"Affiliate" means, with respect to any Person, any Person that owns or controls directly or indirectly such Person, or any Person that controls or is controlled by or is under common control with such Person (whether by contract, ownership of voting securities or otherwise).

"Borrower's Books" means all of Borrower's books and records including, without limitation: ledgers; records concerning Borrower's assets or liabilities, the Collateral, business operations or financial condition; and all computer programs, or tape files, and the equipment, containing such information.

"Borrowing Base" means an amount equal to eighty percent (80%) of Eligible Accounts, as determined with reference to the most recent Borrowing Base Certificate delivered by Borrower.

"Business Day" means (i) any day that is not a Saturday, Sunday, or other day on which banks in the State of Texas or the State of California are authorized or required to close, and (ii) with respect to all notices and determinations in connection with, and payments of principal and interest on any U.S. Dollar Advance which bears interest by reference to an interbank offering rate and any Advance made in a currency other than U.S. Dollars, any day which is a Business Day described in clause (i) and which is also a day on which commercial banks are open for international business (including dealings in the currency in which such Advance is denominated) in the location of the relevant interbank market and the place where such funds are to be paid or made available.

"Closing Date" means the date of this Agreement.

"Collateral" means the property described on Exhibit A attached hereto, excluding (i) any interests in that agreement entitled "Wild Basin Net Proceeds Agreement" dated March 11, 1998, (ii) any interests in that agreement entitled "Waterford: Memorandum of Net Profits Agreement" dated June 15, 1994, and (iii) any interest in the capital stock of Accord Video Telecommunications Ltd.

"Commitment" means, with respect to each Lender, the amounts set forth in the Addendum to Agreement attached hereto and "Commitments" means, with respect to each Lender or each facility hereunder, as the case may be, all such amounts collectively, as each may be amended from time to time.

"Commitment Percentage" means, as to any Lender, for any credit facility hereunder, the percentage equivalent of such Lender's Commitment for such facility divided by the aggregate amount of all Commitments under such facility.

"Committed Revolving Line" means a credit extension of up to Twenty Million and No/100 Dollars (\$20,000,000.00).

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"Contingent Obligation" means, as applied to any

Person, any direct or indirect liability, contingent or otherwise, of that Person with respect to any Indebtedness, lease, dividend, letter of credit or other obligation of another, including, without limitation, any such obligation directly or indirectly guaranteed, endorsed (otherwise than for collection or deposit in the ordinary course of business), co-made or discounted or sold with recourse by that Person, or in respect of which that Person is otherwise directly or indirectly liable. The amount of any Contingent Obligation shall be deemed to be an amount equal to the stated or determined amount of the primary obligation in respect of which such Contingent Obligation is made or, if not stated or determinable, the maximum reasonably anticipated liability in respect thereof as determined by such Person in good faith; provided, however, that such amount shall not in any event exceed the maximum amount of the obligations under the guarantee or other support arrangement.

"Copyrights" means, any and all copyright rights, copyright applications, copyright registrations and like protections of the Borrower in each work or authorship and derivative work thereof, whether published or unpublished and whether or not the same also constitutes a trade secret, now or hereafter existing, created, acquired or held by Borrower.

"Credit Extension" means each Advance, Letter of Credit (including all issued but undrawn and drawn but unreimbursed Letters of Credit), Letter of Credit Reserve, Exchange Contract, Foreign Exchange Reserve or any other extension of credit by Lenders for the benefit of Borrower hereunder.

"Current Assets" means, as of any applicable date, all amounts that should, in accordance with GAAP, be included as current assets on the consolidated balance sheet of Borrower and its Subsidiaries as at such date.

"Current Liabilities" means, as of any applicable date, all Indebtedness and other amounts that should, in accordance with GAAP, be included as current liabilities on the consolidated balance sheet of Borrower and its Subsidiaries, as at such date, plus, to the extent not already included therein, all outstanding Advances made under this Agreement, but excluding Subordinated Debt and any Indebtedness that is otherwise included in Current Liabilities in accordance with GAAP, but which is renewable or extendable at the option of Borrower to a date more than one year from the date of determination.

"Eligible Accounts" means those Accounts of Borrower (and not any of its Subsidiaries) that arise in the ordinary course of Borrower's business, that Servicing Agent has been granted a first priority Lien against for the benefit of Lenders, and that comply with all of Borrower's representations and warranties to Servicing Agent and Lenders set forth in Section 5.4; provided, that standards of eligibility may be fixed and revised from time to time by Servicing Agent and Requisite Lenders in their reasonable judgement upon notification thereof to Borrower in accordance with the provisions hereof. Unless otherwise agreed to by Requisite Lenders, in writing, Eligible Accounts shall not include the following:

(a) Accounts that the account debtor has failed to pay within ninety (90) days of invoice date;

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(b) Accounts with respect to an account debtor, including Affiliates, twenty-five percent (25%) or more of whose Accounts the account debtor (or its Affiliates, as applicable), has failed to pay within ninety (90) days of invoice date, except for those Accounts listed on the Schedule and as approved in writing by Servicing Agent and Requisite Lenders;

(c) Accounts with respect to an account debtor, including Affiliates, whose total obligations to Borrower exceed twenty-five percent (25%) of all Accounts of Borrower, but only to the extent such obligations exceed the aforementioned percentage, except as approved in writing by Servicing Agent and Requisite Lenders;

(d) Accounts with respect to which the account debtor does not have its principal place of business in the United States,

except for Eligible Foreign Accounts;

(e) Accounts with respect to which the account debtor is (a) the United States government or any department, agency, or instrumentality thereof, or (b) a state or local governmental entity or any department, agency, or instrumentality thereof which requires compliance with such state's or local governmental entity's laws with respect to the assignment of claims or accounts receivable in order for Servicing Agent to obtain a valid, perfected, first-priority security interest in such Account; provided, however, upon compliance with such laws and the valid assignment of such Account, such Account shall be an Eligible Account;

(f) Accounts which are the subject of any dispute or which could reasonably be deemed to result in set-off but only to the extent of the amount in dispute or subject to set-off;

(g) Accounts with respect to which goods are placed on consignment, guaranteed sale, sale or return, sale on approval, bill and hold, or other terms by reason of which the payment by the account debtor may be conditional, sometimes referred to as "contra" accounts;

(h) Accounts with respect to which the account debtor is an Affiliate, officer, employee, or agent of Borrower;

(i) Accounts with respect to which the account debtor disputes liability or makes any claim with respect thereto as to which Servicing Agent believes, in its sole discretion, that there may be a basis for dispute (but only to the extent of the amount subject to such dispute or claim), or is subject to any Insolvency Proceeding, or becomes insolvent, or goes out of business; and

(j) Accounts the collection of which Servicing Agent or any Lender in good faith reasonably determines after reasonable inquiry to be doubtful by reason of the account debtor's financial condition.

"Eligible Foreign Accounts" means Accounts with respect to which the account debtor does not have its principal place of business in the United States and that are: (1) covered by credit insurance in form and amount, and by an insurer, satisfactory to Servicing Agent and Requisite Lenders less the amount of any deductible(s) which may be or become owing thereon; or (2) supported by one or more letters of credit either advised or negotiated through Servicing Agent

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or any Lender or in favor of Servicing Agent or any Lender as beneficiary, in an amount and of a tenor, and issued by a financial institution, acceptable to Servicing Agent and Requisite Lenders; or (3) that all Lenders approve on a case-by-case basis.

"Equipment" means all present and future machinery, equipment, tenant improvements, furniture, fixtures, vehicles, tools, parts and attachments in which Borrower has any interest.

"ERISA" shall mean the Employee Retirement Income Security Act of 1974, as amended from time to time, and all rules, regulations, rulings and interpretations adopted by the Internal Revenue Service or the Department of Labor thereunder.

"ERISA Affiliate" shall mean any trade or business (whether or not incorporated) which together with the Borrower or any Subsidiary of the Borrower would be treated as a single employer under the provisions of Title I or Title IV of ERISA.

"Federal Funds Effective Rate" shall mean, for any day, a rate per annum equal to the weighted average of the rates on overnight Federal funds transactions with members of the Federal Reserve System arranged by Federal funds brokers, as published on the next succeeding Business Day by the Federal Reserve Bank of New York, or, if such rate is not so published for any day which is a Business Day, the average of the quotations for the day of such transactions received by the Servicing Agent from three Federal funds

brokers of recognized standing selected by it.

"Foreign Accounts" means Accounts with respect to which the account debtor does not have its principal place of business in the United States.

"GAAP" means generally accepted accounting principles as in effect in the United States from time to time.

"Guarantor" means any present or future guarantor of the Obligations.

"Indebtedness" means (a) all indebtedness for borrowed money or the deferred purchase price of property or services, including, without limitation, reimbursement and other obligations with respect to surety bonds and letters of credit, (b) all obligations evidenced by notes, bonds, debentures or similar instruments, (c) all capital lease obligations, (d) all Contingent Obligations, and (e) all Indebtedness and obligations secured by any Lien on any property owned by such Person even though such Person has not assumed or has not otherwise become liable for the payment of such Indebtedness or obligation.

"Intellectual Property" means (a) Copyrights, Trademarks, Patents, and Mask Works of Borrower, (b) Any and all trade secrets, and any and all intellectual property rights in computer software and computer software products now or hereafter existing, created, acquired or held by Borrower, (c) Any and all design rights which may be available to Borrower now or hereafter existing, created, acquired or held by Borrower, (d) Any and all claims for damages by way of past, present and future infringement of any of the rights included above, with the right, but not the obligation, to sue for and collect such damages for said use or infringement of the intellectual

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property rights identified above, (e) All licenses or other rights to use any of the Copyrights, Patents, Trademarks, or Mask Works, and all license fees and royalties arising from such use to the extent permitted by such license or rights, (f) All amendments, renewals and extensions of any of the Copyrights, Trademarks, Patents, or Mask Works and (g) All proceeds and products of the foregoing, including without limitation all payments under insurance or any indemnity or warranty payable in respect of any of the foregoing.

"Insolvency Proceeding" means any proceeding commenced by or against any Person or entity under any provision of the United States Bankruptcy Code, as amended, or under any other bankruptcy or insolvency law, including assignments for the benefit of creditors, formal or informal moratoria, compositions, extensions generally with its creditors, or proceedings seeking reorganization, arrangement, or other similar relief.

"Inventory" means all present and future inventory in which Borrower has any interest, including merchandise, raw materials, parts, supplies, packing and shipping materials, work in process and finished products intended for sale or lease or to be furnished under a contract of service, of every kind and description now or at any time hereafter owned by or in the custody or possession, actual or constructive, of Borrower, including such inventory as is temporarily out of its custody or possession or in transit and including any returns upon any accounts or other proceeds, including insurance proceeds, resulting from the sale or disposition of any of the foregoing and any documents of title representing any of the above.

"Investment" means any beneficial ownership (including stock, partnership interest or other securities) of any Person, or any loan, advance or capital contribution to any Person.

"IRC" means the Internal Revenue Code of 1986, as amended, and the regulations thereunder.

"Lenders' Expenses" means all reasonable costs or expenses (including reasonable attorneys' fees and expenses) incurred by the Servicing Agent, SVB, and Comerica, or any one or more of them in connection with the preparation, negotiation, administration, and enforcement of the Loan

Documents; and Servicing Agent's and each Lender's reasonable attorneys' fees and expenses incurred in amending, enforcing or defending the Loan Documents, (including fees and expenses of appeal or review, or those incurred in any Insolvency Proceeding) whether or not suit is brought.

"Letter of Credit" means a letter of credit or similar undertaking issued by Issuing Lender pursuant to Section 2.1.2.

"Letter of Credit Reserve" has the meaning set forth in Section 2.1.2.

"LIBOR Supplement" means the Amended and Restated LIBOR Supplement to Agreement of even date herewith by and among Lenders, Borrower and Servicing Agent as the same may be in effect from time to time.

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"Lien" means any mortgage, lien, deed of trust, charge, pledge, security interest or other encumbrance.

"Loan Documents" means, collectively, this Agreement, any note or notes that may be executed by Borrower in favor of Servicing Agent or any Lender pursuant to this Agreement, and any other present or future agreement entered into by and among Borrower and/or for the benefit of all of the Lenders in connection with this Agreement, all as amended, extended or restated from time to time.

"Mask Works" means all mask work or similar rights available for the protection of semiconductor chips, now owned or hereafter acquired by Borrower;

"Material Adverse Effect" means a material adverse effect on (i) the business operations or condition (financial or otherwise) of Borrower and its Subsidiaries taken as a whole or (ii) the ability of Borrower to repay the Obligations or otherwise perform its obligations under the Loan Documents.

"Maximum Lawful Rate" means the maximum rate of interest and the term "Maximum Lawful Amount" means the maximum amount of interest that are permissible under applicable state or federal law for the type of loan evidenced by the Loan Documents. If the Maximum Lawful Rate is increased by statute or other governmental action subsequent to the date of this Agreement, then the new Maximum Lawful Rate shall be applicable to the payments provided for hereunder from the effective date thereof, unless otherwise prohibited by applicable law.

"Negotiable Collateral" means all of Borrower's present and future letters of credit of which it is a beneficiary, notes, drafts, instruments, securities, documents of title, and chattel paper.

"Net Income" means, as to Borrower and its Subsidiaries on a consolidated basis and for any period, the net income (or loss) after tax for such period without giving effect to any extraordinary gain or gains as determined in accordance with GAAP.

"Obligations" means all debt, principal, interest, Lenders' Expenses and other amounts owed to any Lender or Servicing Agent by Borrower pursuant to this Agreement or any other Loan Document, whether absolute or contingent, due or to become due, now existing or hereafter arising, including any interest that accrues after the commencement of an Insolvency Proceeding and including any debt, liability, or obligation owing from Borrower to others that all of the Lenders or Servicing Agent may have obtained by assignment or otherwise.

"Other Obligor" shall mean any entity or individual, including, without limitation, any Guarantor, who (i) is obligated to pay any Credit Extension or any other Obligation, or (ii) otherwise is or becomes obligated to pay any Credit Extension or any other Obligation (for example, as cosigner or guarantor), or (iii) has pledged property as security for payment of any Credit Extension or any other Obligation.

"PBGC" shall mean the Pension Benefit Guaranty Corporation.

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"Patents" means, all patents, patent applications and like protections of Borrower including, without limitation, improvements, divisions, continuations, renewals, reissues, extensions and continuations-in-part of the same.

"Payment Date" means (a) for Prime Rate Credit Extensions, the last day of each calendar month commencing on the first such date after the Closing Date and ending on the Revolving Maturity Date; and (b) for LIBOR rate Credit Extensions, at the end of the applicable Interest Period (as defined in the LIBOR Supplement).

"Permitted Indebtedness" means:

(a) Indebtedness of Borrower in favor of Lenders or Servicing Agent (but not SVB or Comerica individually in its capacity as a lender) arising under this Agreement or any other Loan Document;

(b) Indebtedness existing on the Closing Date and disclosed in the Schedule;

(c) Subordinated Debt;

(d) Indebtedness to trade creditors incurred in the ordinary course of business;

(e) Indebtedness secured by Permitted Liens;

(f) Capital lease obligations incurred in the ordinary course of business not to exceed Three Million and No/100 Dollars (\$3,000,000.00) in the aggregate for each fiscal year of Borrower (inclusive of any sale-leaseback leases permitted under Section 7.1 hereof);

(g) Operating lease obligations incurred in the ordinary course of business not to exceed (i) Three Million and No/100 Dollars (\$3,000,000.00) in the aggregate for Borrower's fiscal quarters ending April 30, 1999 and July 31, 1999; (ii) Six Million and No/100 (\$6,000,000.00) in the aggregate for Borrower's fiscal year ending July 31, 2000 and (iii) Three Million and No/100 (\$3,000,000.00) in the aggregate for Borrower's fiscal quarters ending October 31, 2000 and January 31, 2001;

(h) Research and development funding advanced by third parties not to exceed Five Million and No/100 Dollars (\$5,000,000.00) in the aggregate incurred after the date of this Agreement;

(i) Letters of credit issued in the ordinary course of Borrower's business by any financial institution (in addition to Letters of Credit issued under the terms of Section 2.1.2 of this Agreement) for the account of Borrower not to exceed Five Hundred Thousand and No/100 Dollars (\$500,000.00) in the aggregate outstanding at any time; and

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(j) Extensions of any of items (a) through (i) above, provided that with respect to the items set forth in (b) through (i) above, the principal amount thereof is not increased or the terms thereof are not modified to impose more burdensome terms upon Borrower.

"Permitted Investment" means:

(a) Investments existing on the Closing Date

disclosed in the Schedule;

(b) (i) marketable direct obligations issued or unconditionally guaranteed by the United States of America or any State or any agency or instrumentality thereof maturing within one (1) year from the date of acquisition thereof, (ii) commercial paper maturing no more than two (2) years from the date of creation thereof and currently having the highest rating obtainable from either Standard & Poor's Corporation or Moody's Investors Service, Inc., (iii) certificates of deposit maturing no more than two (2) years from the date of investment therein issued by SVB or Comerica and (iv) Investments consistent with Borrower's January 18, 1996 Cash Portfolio Investment Policy;

(c) Investments by Borrower in any Subsidiary of Borrower permitted under Section 7.13 hereof; and

(d) Other Investments not otherwise prohibited herein aggregating in excess of not more than One Million and No/100 Dollars (\$1,000,000.00) at any one time.

"Permitted Liens" means the following:

(a) Any Liens existing on the Closing Date and disclosed in the Schedule or arising under this Agreement or the other Loan Documents;

(b) Liens for taxes, fees, assessments or other governmental charges or levies, either not delinquent or being contested in good faith by appropriate proceedings and as to which adequate reserves are maintained on Borrower's Books in accordance with GAAP;

(c) Liens incidental to the conduct of business or the ownership of properties and assets (including warehousemen's and attorneys' liens and statutory landlords' liens) and deposits, pledges or Liens to secure the performance of bids, tenders or trade contracts, or to secure statutory obligations, surety or appeal bonds or other Liens of like general nature incurred in the ordinary course of business and not in connection with the borrowing of money; provided in each case, the obligation secured is not overdue or, if overdue, (i) is being contested in good faith by appropriate actions or proceedings, (ii) adequate reserves therefor have been set-up on the financial statements of Borrower in accordance with GAAP and (iii) such Liens shall not cause interference in any material respect with the ordinary conduct of the business of Borrower;

(d) Liens securing capital lease obligations; provided, that (i) the Indebtedness secured by any such Lien is incurred under clause (f) of the definition of Permitted Indebtedness and (ii) any such Lien encumbers only those assets so leased;

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(e) Liens securing operating lease obligations; provided, that (i) the Indebtedness secured by any such Lien is incurred under clause (g) of the definition of Permitted Indebtedness and (ii) any such Lien encumbers only those assets so leased; and

(f) Liens incurred in connection with the extension, renewal or refinancing of the Indebtedness secured by Liens of the type described in clauses (a) through (e) above, provided that any extension, renewal or replacement Lien shall be limited to the property encumbered by the existing Lien and the principal amount of the Indebtedness being extended, renewed or refinanced does not increase.

"Person" means any individual, sole proprietorship, partnership, limited liability company, joint venture, trust, unincorporated organization, association, corporation, institution, public benefit corporation, firm, joint stock company, estate, entity or governmental agency.

"Plan" shall mean any plan subject to Title IV of ERISA and maintained for employees of the Borrower or of any member of a

"controlled group of corporations," as such term is defined in the Code, of which the Borrower, any of its Subsidiaries or any ERISA Affiliate it may acquire from time to time is a part, or any such plan to which the Borrower, any of its Subsidiaries or any ERISA Affiliate is required to contribute on behalf of its employees.

"Prime Rate" means the variable rate of interest, per annum, quoted in The Wall Street Journal, under the section "Money Rates" as the "Prime Rate", which rate may not be the lowest, best or most favorable rate of interest which SVB, Comerica, or any other Lender may charge on loans to its customers. In the event that more than one prime rate is quoted in The Wall Street Journal, the highest quoted prime rate will be used as the Prime Rate. If The Wall Street Journal ceases publication or if it ceases quoting or publishing the "prime rate", Servicing Agent on behalf of Lenders will choose a new reference or index which is based upon comparable information (that is, an average of leading money center banks' prime rates).

"Quick Assets" means, as of any applicable date, the consolidated cash, cash equivalents, accounts receivable net of contra and GAAP required reserves, and Permitted Investments with maturities not to exceed one (1) year, of Borrower and its Subsidiaries, all as determined in accordance with GAAP.

"Reportable Event" shall mean a Reportable Event as defined in Section 4043(b) of ERISA.

"Requisite Lenders" means, at any time, Lenders then holding at least sixty-six and two-thirds percent (66 2/3%) of the then aggregate unpaid principal amount of all Advances then outstanding or, if no Advances are then outstanding, Lenders then having at least sixty-six and two-thirds percent (66 2/3%) of the aggregate Commitments; provided, that in the event there shall be only two Lenders, both of such Lenders.

"Responsible Officer" means each of the Chief Executive Officer, the Chief Operating Officer, the Chief Financial Officer and the Treasurer of Borrower.

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"Revolving Maturity Date" means May 4, 2001.

"Schedule" means the schedule of exceptions attached hereto, if any.

"Servicing Agent" means SVB, not in its individual capacity, but solely in its capacity as agent for certain loan servicing functions as detailed herein, on behalf of and for the benefit of Lenders, and any successor agent as provided herein from time to time.

"Subordinated Debt" means any debt incurred by Borrower that is subordinated to the debt owing by Borrower to Lenders and Servicing Agent on terms acceptable to Requisite Lenders and Servicing Agent (and identified as being such by Borrower and the Requisite Lenders).

"Subsidiary" means with respect to any Person, any corporation, partnership, company, association, joint venture, or any other business entity of which more than fifty percent (50%) of the voting stock or other equity interests is owned or controlled, directly or indirectly, by such Person or one or more Affiliates of such Person.

"Tangible Net Worth" means as of any applicable date, the consolidated total assets of Borrower and its Subsidiaries minus, without duplication, (i) the sum of any amounts attributable to (a) goodwill, (b) intangible items such as unamortized debt discount and expense, patents, trade and service marks and names, copyrights and research and development expenses, except prepaid expenses, and (c) all reserves not already deducted from assets, and (ii) Total Liabilities.

"Total Liabilities" means as of any applicable date, any date as of which the amount thereof shall be determined, all obligations

that should, in accordance with GAAP, be classified as liabilities on the consolidated balance sheet of Borrower, but specifically excluding Subordinated Debt.

"Trademarks" means any trademark and servicemark rights of Borrower, whether registered or not, applications to register and registrations of the same and like protections, and the entire goodwill of the business of Borrower connected with and symbolized by such trademarks.

1.2 Accounting and Other Terms. All accounting terms not specifically defined herein shall be construed in accordance with GAAP and all calculations and determinations made hereunder shall be made in accordance with GAAP. When used herein, the term "financial statements" shall include the notes and schedules thereto. The terms "including" and "includes" shall always be read as meaning "including (or includes) without limitation", when used herein or in any other Loan Document.

2. LOAN AND TERMS OF PAYMENT

2.1 Credit Extensions. In accordance with the terms hereof, Borrower promises to pay to Servicing Agent for the account of each Lender, in lawful money of the United States of

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America, the aggregate unpaid principal amount of all Credit Extensions made by Servicing Agent and Lenders to Borrower hereunder. Borrower shall also pay interest on the unpaid principal amount of such Advances at rates and at times in accordance with the terms hereof.

2.1.1 Advances. (a) Subject to and upon the terms and conditions of this Agreement, and in reliance upon the representations and warranties of Borrower set forth herein, each Lender severally agrees to make its Commitment Percentage of Advances to Borrower up to the amount of such Lender's respective Commitment; provided that the aggregate outstanding amount of all Advances shall not exceed at any one time (i) the lesser of the Committed Revolving Line and the Borrowing Base, minus (ii) the then outstanding principal balance of all Credit Extensions. Subject to the terms and conditions of this Agreement, amounts borrowed pursuant to this Section 2.1.1 may be repaid and reborrowed at any time during the term of this Agreement.

(b) The Committed Revolving Line shall terminate on the Revolving Maturity Date, at which time all Advances under this Section 2.1.1 and other amounts due under this Agreement shall be immediately due and payable.

(c) To evidence the Credit Extensions, Borrower shall execute and deliver to each Lender a note ("Revolving Note") in the original principal amount of such Lender's respective Commitment in the form of Exhibit E attached hereto.

2.1.2 Letters of Credit.

(a) Subject to the terms and conditions of this Agreement, from the date hereof through the Business Day immediately prior to the Revolving Maturity Date, Lenders agree to issue or cause to be issued Letters of Credit for the account of Borrower in an aggregate outstanding face amount not to exceed (i) the lesser of the Committed Revolving Line and the Borrowing Base minus (ii) the then outstanding principal balance of all Credit Extensions; provided that the face amount of all outstanding Letters of Credit (including drawn but unreimbursed Letters of Credit and any Letter of Credit Reserve) shall not in any event exceed Five Million and No/100 Dollars (\$5,000,000.00) in the aggregate at any time. For purposes of this Agreement, the amount outstanding under a Letter of Credit shall include the face amount of such Letter of Credit, whether such Letter of Credit is issued but undrawn or drawn but unreimbursed, and any Letter of Credit Reserve relating thereto. Each Letter of Credit shall have an expiry date no later than the Revolving Maturity Date. All Letters of Credit shall be, in form and substance, acceptable to the Lender issuing the Letter of Credit (the "Issuing Lender") and the other Lenders and shall be subject to the terms and conditions of the Issuing Lender's form of standard application and Letter of Credit agreement, which shall provide, in

addition to an administrative fee of not more than one-sixteenth of one percent (0.0625%) of the face amount of the Letter of Credit payable to Issuing Lender only, for a Letter of Credit fee of not more than four-tenths of one percent (0.40%) of the face amount of the Letter of Credit payable to Servicing Agent, on behalf of the Issuing Lender and the other Lenders, as more fully set forth in such Letter of Credit Agreement. Each Lender agrees that, in paying any drawing under a Letter of Credit, the Issuing Lender shall not have any responsibility to obtain any document (other than any document expressly required by the Letter of Credit) or to ascertain or inquire as to the validity or accuracy of any such document or the authority of the Person executing or delivering any such document. NEITHER THE ISSUING LENDER NOR ANY OF ITS AFFILIATES,

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CORRESPONDENTS, PARTICIPANTS OR ASSIGNEES, NOR ANY OF THEIR RESPECTIVE OFFICERS, DIRECTORS OR EMPLOYEES, SHALL BE LIABLE TO ANY OTHER LENDER FOR ANY ACTION TAKEN OR OMITTED TO BE TAKEN UNLESS SUCH ACTION OR OMISSION CONSTITUTES GROSS NEGLIGENCE OR WILLFUL MISCONDUCT.

(b) The obligation of Borrower to immediately reimburse the Issuing Lender for drawings made under Letters of Credit shall be absolute, unconditional and irrevocable, and shall be performed strictly in accordance with the terms of this Agreement, the Letter of Credit agreement and such Letters of Credit, under all circumstances whatsoever. BORROWER SHALL INDEMNIFY, DEFEND, PROTECT, AND HOLD SERVICING AGENT AND EACH LENDER HARMLESS FROM ANY AND ALL LOSS, COST, EXPENSE OR LIABILITY, INCLUDING, WITHOUT LIMITATION, REASONABLE ATTORNEYS' FEES, ARISING OUT OF OR IN CONNECTION WITH ANY LETTERS OF CREDIT, OTHER THAN SUCH LOSSES, COSTS, EXPENSES OR LIABILITIES BASED UPON OR ARISING OUT OF THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF THE SERVICING AGENT OR SUCH LENDER.

(c) Borrower may request that Issuing Lender issue a Letter of Credit payable in a currency other than United States Dollars. If a demand for payment is made under any such Letter of Credit, the Issuing Lender shall notify Lenders and Lenders shall treat such demand as an Advance to Borrower of the equivalent of the amount thereof (plus cable charges) in United States currency at the then prevailing rate of exchange in Austin, Texas for sales of that other currency for cable transfer to the country of which it is the currency.

(d) Upon the issuance by any Lender of any Letter of Credit payable in a currency other than United States Dollars, such Lender shall create a reserve under the Committed Revolving Line for Letters of Credit ("Letter of Credit Reserve") against fluctuations in currency exchange rates, in an amount equal to ten percent (10%) of the face amount of such Letter of Credit. The amount of such reserve may be amended by Lender from time to time to account for fluctuations in the exchange rate. The availability of funds under the Committed Revolving Line shall be reduced by the amount of such reserve for so long as such Letter of Credit remains outstanding.

(e) Simultaneously with any Issuing Lender's issuance and delivery of any Letter of Credit, such Issuing Lender shall be deemed, without further action, to have sold to each other Lender, and such other Lender shall be deemed, without further action by any party hereto, to have purchased from such Issuing Lender, a participation interest (which participation shall be nonrecourse to such Issuing Lender) equal to such other Lender's Commitment Percentage at such time in such Letter of Credit and all of the Obligations related to such Letter of Credit; provided, that no such Lender shall be obligated to participate in a particular Letter of Credit if such Letter of Credit was issued or honored solely as a result of such Issuing Lender's gross negligence or willful misconduct. Each Lender acknowledges and agrees that its obligation to acquire participations in each Letter of Credit, as well as its obligation to make the payments specified in this Section 2.1.2 and the right of such Issuing Lender to receive the same in the manner specified herein, are absolute and unconditional and shall not be affected by any circumstances whatsoever, including without limitation, the occurrence and continuance of an Event of Default hereunder, and that each such payment shall be made without any offset, abatement, withholding or reduction whatsoever.

(f) The applicable Issuing Lender shall review, on behalf of the Lenders, each draft and any accompanying documents presented under a Letter of Credit issued by such Issuing Lender. Promptly after it shall have ascertained that any draft and any accompanying documents presented under such Letter of Credit appear on their face to be in conformity with the terms and conditions of such Letter of Credit, such Issuing Lender shall make the appropriate payment to the beneficiary of such Letter of Credit. Such Issuing Lender shall give telephonic or facsimile notice to the Lenders of the receipt and amount of any draft presented under any Letter of Credit and the date on which payment thereon will be made, and each of the Lenders shall, by 2:00 p.m. Central Time on the date such payment is to be made under such Letter of Credit, pay to such Issuing Lender in immediately available funds, an amount equal to the product of (A) such Lender's Commitment Percentage times (B) the amount of such payment to be made by the Issuing Lender to the beneficiary under such Letter of Credit. Any Lender failing to timely deliver its requisite portion of any such payment shall deliver the same to the Issuing Lender as soon as possible thereafter, together with interest on such amount for each day from the due date for such payment to the date of payment by such Lender to the Issuing Lender of such amount at a rate of interest per annum equal to the Federal Funds Effective Rate for such period. Each Lender hereby absolutely and unconditionally assumes, as primary obligor and not as a surety, and agrees to pay and discharge, and to indemnify and hold the Issuing Lender harmless from liability and respect of, such Lender's pro rata share (based on such Lender's Commitment Percentage) of any amounts owing by such Lender to the Issuing Lender in accordance with the immediately preceding sentence. Nothing herein shall be deemed to require any Lender to pay to the Issuing Lender any amount as reimbursement for any payment made by the Issuing Lender to acquire (discount) for its own account prior to maturity thereof any acceptance created under a Letter of Credit.

2.1.3 Foreign Exchange Contract; Foreign Exchange Settlements.

(a) Subject to the terms of this Agreement, Borrower may enter into foreign exchange contracts with any Lender not to exceed in any event Ten Million and No/100 Dollars (\$10,000,000.00) in the aggregate at any time ("Contract Limit"), pursuant to which such Lender shall sell to or purchase from Borrower foreign currency on a spot or future basis ("Exchange Contracts"). Borrower shall not request any Exchange Contracts at any time it is out of compliance with any of the provisions of this Agreement. All Exchange Contracts must provide for delivery of settlement on or before the Revolving Maturity Date. The amount available under the Committed Revolving Line at any time shall be reduced by the following amounts ("Foreign Exchange Reserve") on any given day (the "Determination Date"): (i) on all outstanding Exchange Contracts on which delivery is to be effected or settlement allowed more than two Business Days after the Determination Date, ten percent (10%) of the gross amount of the Exchange Contracts; plus (ii) on all outstanding Exchange Contracts on which delivery is to be effected or settlement allowed within two Business Days after the Determination Date, one hundred percent (100%) of the gross amount of the Exchange Contracts.

(b) Any Lender may, in its discretion, terminate the Exchange Contracts at any time (i) that an Event of Default occurs and is continuing or (ii) that there is not sufficient availability under the Committed Revolving Line and Borrower does not have available funds in its bank account to satisfy the Foreign Exchange Reserve. If any Lender terminates the Exchange Contracts, and without limitation of any applicable indemnities, Borrower agrees to

reimburse each Lender for any and all fees, costs and expenses relating thereto or arising in connection therewith.

(c) Borrower shall not permit the total gross amount of all Exchange Contracts on which delivery is to be effected and

settlement allowed on any one (1) Business Day to be more than Two Million and No/100 Dollars (\$2,000,000.00) ("Settlement Limit") nor shall Borrower permit the total gross amount of all Exchange Contracts to which Borrower is a party, outstanding at any one time, to exceed the lesser of the (i) Contract Limit and (ii) lesser of (A) the Committed Revolving Line minus all outstanding Credit Extensions and (B) the Borrowing Base minus all outstanding Credit Extensions. Notwithstanding the above, however, the amount which may be settled on any one (1) Business Day may be increased above the Settlement Limit up to, but in no event to exceed, the amount of the Contract Limit under either of the following circumstances:

(i) if there is sufficient availability under the Committed Revolving Line in the amount of the Foreign Exchange Reserve as of each Determination Date, provided that Servicing Agent and Lenders in advance shall reserve the full amount of the Foreign Exchange Reserve against the Committed Revolving Line; or

(ii) if there is insufficient availability under the Committed Revolving Line, as to settlements on any one (1) Business Day, provided that Servicing Agent and Lenders, in their sole discretion, may: (A) verify good funds overseas prior to crediting Borrower's deposit account with the applicable Lender (in the case of Borrower's sale of foreign currency); or (B) debit Borrower's deposit account with the applicable Lender prior to delivering foreign currency overseas (in the case of Borrower's purchase of foreign currency).

(d) In the case of Borrower's purchase of foreign currency, Borrower in advance shall instruct Servicing Agent or the applicable Lender upon settlement either to treat the settlement amount as an Advance under the Committed Revolving Line, or to debit Borrower's account for the amount settled.

(e) Borrower shall execute all standard form applications and agreements of the applicable Lender in connection with the Exchange Contracts and, without limiting any of the terms of such applications and agreements, Borrower will pay all standard fees and charges of the applicable Lender in connection with the Exchange Contracts.

(f) WITHOUT LIMITING ANY OF THE OTHER TERMS OF THIS AGREEMENT OR ANY SUCH STANDARD FORM APPLICATIONS AND AGREEMENT OF LENDERS OR SERVICING AGENT, BORROWER AGREES TO INDEMNIFY LENDERS AND SERVICING AGENT AND HOLD THEM HARMLESS, FROM AND AGAINST ANY AND ALL CLAIMS, DEBTS, LIABILITIES, DEMANDS, OBLIGATIONS, ACTIONS, COSTS AND EXPENSES (INCLUDING, WITHOUT LIMITATION, ATTORNEYS' FEES OF COUNSEL OF LENDERS' CHOICE), OF EVERY NATURE AND DESCRIPTION WHICH IT MAY SUSTAIN OR INCUR, BASED UPON, ARISING OUT OF, OR IN ANY WAY RELATING TO ANY OF THE EXCHANGE CONTRACTS OR ANY TRANSACTIONS RELATING THERETO OR CONTEMPLATED THEREBY OTHER THAN SUCH LOSSES, COSTS, EXPENSES OR LIABILITIES BASED

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UPON OR ARISING OUT OF THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF THE SERVICING AGENT OR SUCH LENDER.

(g) Simultaneously with any Lender's entering into with Borrower any Exchange Contract ("Applicable Lender"), such Applicable Lender shall be deemed, without further action, to have sold to each other Lender, and each such other Lender shall be deemed, without further action by any party hereto, to have purchased from such Applicable Lender, participation interest (which participation shall be nonrecourse to such Applicable Lender) equal to such other Lender's Commitment Percentage at such time in such Exchange Contract and all of the Obligations related to such Exchange Contract; provided, that no such Lender shall be obligated to participate in a particular Exchange Contract if such Exchange Contract was issued or honored solely as a result of such Applicable Lender's gross negligence or willful misconduct. Each Lender acknowledges and agrees that its obligation to acquire participations in each Exchange Contract, as well as its obligation to make the payments specified in this Section 2.1.3 and the right of such Applicable Lender to receive the same in the manner specified herein, are absolute and unconditional and shall not be affected by any circumstances whatsoever, including without limitation, the occurrence and continuance of an

Event of Default hereunder, and that each such payment shall be made without any offset, abatement, withholding or reduction whatsoever.

(h) The Applicable Lender with respect to any Exchange Contract shall review, on behalf of the Lenders, all documents presented under such Exchange Contract. Promptly after it shall have ascertained that all accompanying documents presented under such Exchange Contract appear on their face to be in conformity with the terms and conditions of such Exchange Contract, such Applicable Lender shall effect delivery or allow settlement thereof. Such Applicable Lender shall give telephonic or facsimile notice to the Lenders of the amount and the date on which delivery is to be effected or settlement allowed, and each of the Lenders shall, by 2:00 p.m. Central Time on the date such delivery is to be effected or settlement allowed under such Exchange Contract, pay in immediately available funds, an amount equal to the product of (A) such Lender's Commitment Percentage times (B) the amount of such payment to be made by the Applicable Lender under such Exchange Contract. Any Lender failing to timely deliver its requisite portion of any such payment shall deliver the same to the Applicable Lender as soon as possible thereafter, together with interest on such amount for each day from the due date for such payment to the date of payment by such Lender to the Applicable Lender of such amount at a rate of interest per annum equal to the Federal Funds Effective Rate for such period. Each Lender hereby absolutely and unconditionally assumes, as primary obligor and not as a surety, and agrees to pay and discharge, and to indemnify and hold the Applicable Lender harmless from liability and respect of, such Lender's pro rata share (based on such Lender's Commitment Percentage) of any amounts owing by such Lender to the Applicable Lender in accordance with the immediately preceding sentence.

2.2 Overadvances. If, at any time or for any reason, the amount of Obligations owed by Borrower pursuant to Section 2.1.1, 2.1.2 and 2.1.3 of this Agreement is greater than the lesser of (i) the Committed Revolving Line and (ii) the Borrowing Base, Borrower shall immediately pay to Servicing Agent, in cash, for the ratable benefit of Lenders, the amount of such excess.

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2.3 Interest Rates, Payments, and Calculations.

(a) LIBOR Option/Interest Rate. Except as set forth in Section 2.3(b), any and all Advances shall bear interest, on the average daily balance thereof, at a per annum rate equal to, at Borrower's option and subject to the terms hereof, the Prime Rate plus one-half percent (0.5%) or the rate specified in the LIBOR Supplement.

(b) Default Rate. All Obligations shall bear interest, from and after the occurrence, and during the continuance, of an Event of Default, at the "Default Interest Rate." The Default Interest Rate shall be the interest rate applicable immediately prior to the occurrence of the Event of Default plus five (5) percentage points but in no event more than the Maximum Lawful Rate or at a rate that would cause the total interest contracted for, charged or received by any Lender to exceed the Maximum Lawful Amount.

(c) Payments. Interest hereunder shall be due and payable on each Payment Date. Any interest not paid when due shall be compounded by becoming a part of the Obligations, and such interest shall thereafter accrue interest at the rate then applicable hereunder.

(d) Computation.

(i) Changes. In the event the Prime Rate is changed from time to time hereafter, the applicable rate of interest hereunder shall be increased or decreased effective as of 12:01 a.m. on the day the Prime Rate is changed, by an amount equal to such change in the Prime Rate.

(ii) Spreading of Interest. Because of the possibility of irregular periodic balances of principal, the fluctuating nature of the interest rate, or premature payment, the total interest that will accrue under this Agreement cannot be determined in advance. Lenders do not intend to contract for, charge or receive more than the Maximum Lawful Rate or Maximum Lawful Amount permitted by applicable state or federal law, and to

prevent such an occurrence Lenders and Servicing Agent and Borrower agree that all amounts of interest, whenever contracted for, charged or received by Lenders or Servicing Agent, with respect to the loan of money evidenced by the Loan Documents, shall be spread, prorated or allocated over the full period of time the Obligations are unpaid, including the period of any renewal or extension thereof. If the maturity of the Obligations is accelerated for any reason whether as a result of a lawsuit or an Event of Default or otherwise prior to the full stated term, the total amount of interest contracted for, charged or received to the time of such demand shall be spread, prorated or allocated along with any interest thereafter accruing over the full period of time that the Obligations thereafter remain unpaid for the purpose of determining if such interest exceeds the Maximum Lawful Amount.

(iii) Excess Interest. At maturity (whether by acceleration or otherwise) or on earlier final payment of the Obligations, each Lender shall compute the total amount of interest that has been contracted for, charged or received by such Lender or payable by Borrower hereunder to such Lender and compare such amount to the Maximum Lawful Amount that could have been contracted for, charged or received by such Lender. If such computation reflects that the total amount of interest that has been contracted for, charged or received by such Lender or payable by Borrower to such Lender exceeds the Maximum Lawful Amount, then such Lender shall apply such excess to the reduction of the principal balance owing to it and not to the payment of interest;

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or if such excess interest exceeds the unpaid principal balance owing to such Lender, such excess shall be refunded to Borrower. This provision concerning the crediting or refund of excess interest shall control and take precedence over all other agreements between Borrower and Lenders so that under no circumstances shall the total interest contracted for, charged or received by any Lender exceed the Maximum Lawful Amount.

(iv) Daily Computation of Interest. To the extent permitted by applicable law, the Lenders at their option may either (i) calculate the per diem interest rate or amount based on the actual number of days in the year (365 or 366, as the case may be), and charge that per diem interest rate or amount each day, or (ii) calculate the per diem interest rate or amount as if each year has only 360 days, and charge that per diem interest rate or amount each day for the actual number of days of the year (365 or 366 as the case may be). If the Loan Documents call for monthly payments, the Lenders at their option may determine the payment amount based on the assumption that each year has only 360 days and each month has 30 days. In no event shall Lenders compute the interest in a manner that would cause Lenders to contract for, charge or receive interest that would exceed the Maximum Lawful Rate or the Maximum Lawful Amount. The foregoing notwithstanding, all Lenders shall calculate per diem interest in the same manner at all times, and in no event shall the method of daily computation of interest vary between or among any of the Lenders.

(v) Revolving Loan Accounts and Usury Ceiling. In no event shall Chapter 346 of the Texas Finance Code, as supplemented by the Texas Credit Code ("Texas Finance Code") (which regulates certain revolving loan accounts and revolving tri-party accounts) apply to this Agreement or Borrower's payment obligations hereunder. To the extent that Chapter 303 of the Texas Finance Code, is applicable to this Agreement, the "weekly ceiling" specified in such Chapter 303 is the applicable ceiling; provided that, if any applicable law permits greater interest, the law permitting the greatest interest shall apply.

(e) Borrowing Procedures.

(i) Whenever Borrower desires an Advance, Borrower will notify Servicing Agent by facsimile transmission or telephone no later than 1:00 p.m. Central time, one (1) Business Day before the Business Day on which a Prime Rate Advance is to be made and 2:00 p.m. Central Time on the Business Day that is three (3) Business Days prior to the Business Day a LIBOR rate Advance is to be made. Servicing Agent shall promptly deliver such notice to the Lenders, and each Lender shall make its applicable Advance available on the proposed date thereof by paying such amount in immediately available funds

not later than 2:00 p.m. Central Time to Servicing Agent. Any Lender failing to timely deliver its requisite portion of any such payment shall deliver the same to Servicing Agent as soon as possible thereafter, together with interest on such amount for each day from the due date for such payment to the date of payment by such Lender to Servicing Agent of such amount at a rate of interest per annum equal to the Federal Funds Effective Rate for such period. Each such notification by Borrower shall be promptly confirmed by a Payment/Advance Form in substantially the form of Exhibit B hereto or a LIBOR rate Advance Form as attached to the LIBOR Supplement. Servicing Agent is authorized to make Advances under this Agreement or under the LIBOR Supplement, based upon instructions received from a Responsible Officer or a designee of a Responsible Officer, or without instructions if in Servicing Agent's discretion such Advances are necessary to meet Obligations which have become due and remain unpaid. Servicing Agent and

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Lenders shall be entitled to rely on any telephonic notice given by a person whom Servicing Agent or Lenders reasonably believe to be a Responsible Officer or a designee thereof, and BORROWER SHALL INDEMNIFY AND HOLD SERVICING AGENT AND THE LENDERS HARMLESS FROM AND AGAINST ANY DAMAGES OR LOSS SUFFERED BY SERVICING AGENT OR EITHER LENDER AS A RESULT OF SUCH RELIANCE OTHER THAN SUCH LOSSES, COSTS, EXPENSES OR LIABILITIES BASED UPON OR ARISING OUT OF THE GROSS NEGLIGENCE OR WILLFUL MISCONDUCT OF THE SERVICING AGENT OR SUCH LENDER.

(ii) Whenever Borrower desires the issuance of a Letter of Credit, Borrower will notify the applicable Issuing Lender (and the Servicing Agent, if the Servicing Agent is not the applicable Issuing Lender) by facsimile transmission no later than 1:00 p.m. Central time, five (5) Business Days before the Business Day on which the Letter of Credit is to be issued. The applicable Issuing Lender shall promptly deliver such notice to the other Lenders and shall promptly confirm to the other Lenders the actual issuance of such requested Letter of Credit once issued.

2.4 Crediting Payments. Prior to the occurrence of an Event of Default, Servicing Agent shall credit a wire transfer of funds, check or other item of payment paid by Borrower to Servicing Agent, when received, to such deposit account or Obligation as Borrower specifies. After the occurrence, and during the continuance, of an Event of Default, the receipt by Servicing Agent of any wire transfer of funds, check, or other item of payment, whether directed to Borrower's deposit account with Servicing Agent or to the Obligations or otherwise, shall be immediately applied to conditionally reduce Obligations, but shall not be considered a payment in respect of the Obligations unless such payment is of immediately available federal funds or unless and until such check or other item of payment is honored when presented for payment. Notwithstanding anything to the contrary contained herein, any wire transfer or payment received by Servicing Agent after 2:00 p.m. Central time shall be deemed to have been received by Servicing Agent as of the opening of business on the immediately following Business Day. Whenever any payment to Servicing Agent under the Loan Documents would otherwise be due (except by reason of acceleration) on a date that is not a Business Day, such payment shall instead be due on the next Business Day, and additional fees or interest, as the case may be, shall accrue and be payable for the period of such extension.

2.5 Fees. Borrower shall pay to Servicing Agent the following:

(a) Facility Fee.

(i) A facility fee equal to One Hundred Thousand and No/100 Dollars (\$100,000.00) which fee shall be fully earned and non-refundable and which shall be payable to Servicing Agent, for the pro rata benefit of the Lenders based on their respective Commitment Percentage, in four equal quarterly installments of Twenty-Five Thousand and No/100 Dollars (\$25,000.00) beginning on the date hereof and on August 5, 1999, November 5, 1999 and May 5, 2000.

(ii) On the last day of each February, May, August and November during the term through the Revolving Maturity Date, as well as on the Revolving Maturity Date, a fee equal to .375% of the Committed Revolving Line (based on actual days elapsed in a 360 day year) minus the average daily balance of all outstanding Advances for the preceding fiscal quarter (i.e., Borrower's

quarters ending in January, April, July, and October); provided the amount of such fee shall be decreased by One Thousand One Hundred Twenty-Five and No/100 Dollars (\$1,125.00) for the fiscal quarter ending April 30, 1999, July 31, 1999 and October 31, 1999 to properly reflect Borrower's current credit with SVB of Three Thousand Three Hundred Seventy-Five and No/100 Dollars (\$3,375.00). Servicing Agent shall apportion the foregoing fees pro rata between Lenders based upon their respective Commitment Percentages, and SVB's portion of such fees shall be reduced by One Thousand One Hundred Twenty-Five and No/100 Dollars (\$1,125.00) for the above described fiscal quarters to account for SVB's prior receipt of the foregoing monies from Borrower and to insure that each Lender receives its full .375% fee based on its respective Commitment Percentage.

(b) Financial Examination and Appraisal Fees. If an Event of Default has occurred and is continuing, Borrower shall pay each Lender's customary fees and out-of-pocket expenses for Lenders' audits of Borrower's Accounts, and for each appraisal of Collateral and financial analysis and examination of Borrower performed from time to time by Servicing Agent or its agents or any Lender; provided, however, that the fees for the Lenders' audits of Borrower's Accounts prior to the occurrence of an Event of Default shall not exceed Two Thousand and No/100 Dollars (\$2,000.00) per annum without the prior approval of Borrower. Provided further, if no Event of Default exists, (i) all such audits conducted by Lenders at Borrower's expense shall be performed by one (1) audit team and shall not be conducted more often than once each calendar year, and (ii) all such other audits conducted by Servicing Agent or any Lender at the expense and cost of Servicing Agent or such Lender, as applicable, shall not be conducted more often than eleven (11) times during any calendar year. Any verification of any of Borrower's Accounts sent to any account debtor of Borrower while no Event of Default has occurred which is then continuing shall be on a form which is reasonably acceptable to Borrower and the Servicing Agent or the applicable Lender.

(c) Lenders' Expenses. Upon demand from Servicing Agent, including, without limitation, upon the date hereof, all Lenders' Expenses incurred through the date hereof, including reasonable attorneys' fees and expenses (with respect to audit fees, such fees shall be subject to the limitation set forth in Section 2.5(b) above), and, after the date hereof, all Lenders' Expenses, including reasonable attorneys' fees and expenses, as and when they become due.

2.6 Additional Costs. In case any law, regulation, treaty or official directive or the interpretation or application thereof by any court or any governmental authority charged with the administration thereof or the compliance with any guideline or request of any central bank or other governmental authority (whether or not having the force of law):

(a) subjects Servicing Agent or any Lender to any tax with respect to payments of principal or interest or any other amounts payable hereunder by Borrower or otherwise with respect to the transactions contemplated hereby (except for taxes on the overall net income of Servicing Agent or such Lender imposed by the United States of America or any political subdivision thereof);

(b) imposes, modifies or deems applicable any deposit insurance, reserve, special deposit, capital adequacy or similar requirement against assets held by, or deposits in or for the account of, or loans by, Servicing Agent or any Lender; or

(c) imposes upon Servicing Agent or any Lender any other condition with respect to its performance under this Agreement, and the result of any of the foregoing is to increase the cost to Servicing

Agent or such Lender, reduce the income receivable by or rate of return on capital of Servicing Agent or such Lender or impose any expense upon Servicing Agent or such Lender with respect to the Obligations, Servicing Agent or such Lender shall notify Borrower thereof. Borrower agrees to pay to Servicing Agent or such Lender the amount of such increase in cost, reduction in income or rate of return on capital or additional expense as and when such cost, reduction or expense is incurred or determined, upon presentation by Servicing Agent or such Lender of a statement of the amount and setting forth Servicing Agent's or such Lender's calculation thereof, all in reasonable detail, provided, however, that notwithstanding anything herein to the contrary, (a) Borrower shall not be the only borrower of such Lender subject to this type of provision which is requested to pay such amounts for the applicable period and (b) Borrower shall not be liable for any such costs incurred by such Lender more than one hundred eighty (180) days prior to the date of the applicable notice given hereunder.

2.7 Term. Except as otherwise set forth herein, this Agreement shall become effective on the Closing Date and, subject to Section 14.6, shall continue in full force and effect for a term ending on the Revolving Maturity Date. Notwithstanding the foregoing, pursuant to and subject to Section 9.1 below, Lenders shall have the right to terminate their obligation to make Credit Extensions under this Agreement immediately upon the occurrence and during the continuance of an Event of Default with notice thereof to Borrower; provided however, if the Event of Default is an Insolvency Default, then the obligation to make Credit Extensions shall automatically terminate without notice of any kind. Notwithstanding termination of this Agreement, Servicing Agent's Lien on the Collateral shall remain in effect for so long as any Obligations are outstanding. Borrower shall have the right to terminate this Agreement without premium or penalty with notice to Servicing Agent if there are no outstanding Obligations, which Obligations shall include, without limitation, and for purposes of clarification, all four installment payments of the facility fee set forth in Section 2.5(a) (i) above, owing to Servicing Agent or any Lender.

2.8 Pro Rata Treatment.

(a) Except to the extent otherwise provided herein, (i) each Credit Extension from the Lenders hereunder shall be made and each payment of Obligations shall be made and applied for the account of the Lenders, and each termination or reduction of the Commitments of the Lenders shall be applied, pro rata, according to each Lender's Commitment Percentage; (ii) each payment or prepayment by the Borrower of principal of or interest on Advances shall be made to the Servicing Agent for the account of the Lenders pro rata in accordance with the respective unpaid principal amounts of such Advances held by the Lenders; (iii) the Lenders (other than the Issuing Lender) shall purchase from the applicable Issuing Lender participations in the Letters of Credit, to the extent of their respective Commitment Percentage, upon issuance by an Issuing Lender of each Letter of Credit as otherwise provided for herein; and (iv) the Lenders (other than the Applicable Lender) shall purchase from the Applicable Lender participations in the applicable Exchange Contracts entered into by such Applicable Lender, to the extent of their respective Commitment Percentage, upon such Applicable Lender entering into an Exchange Contract as otherwise provided for herein.

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(b) Unless the Servicing Agent shall have been notified in writing by any Lender prior to the date of a proposed Advance that such Lender will not make the amount that would constitute such Lender's Commitment Percentage of such Advance on such date available to the Servicing Agent, the Servicing Agent may assume that such Lender has made such amount available to the Servicing Agent on such date, and the Servicing Agent may, in reliance upon such assumption and subject to the terms and conditions of this Agreement, make such amount available to the Borrower. Any Lender failing to timely deliver its requisite portion of such Advance shall deliver the same to the Servicing Agent as soon as possible thereafter, together with interest on such amount for each day from the due date for such payment to the date of payment by such Lender to the Servicing Agent of such amount at a rate of interest per annum equal to the Federal Funds Effective Rate for such period. In addition, the Borrower hereby agrees that upon demand by the Servicing Agent, the Borrower shall reimburse the Servicing Agent for any such amount which any Lender has failed to timely deliver to the Servicing Agent, but which the Servicing Agent may have previously made available to the Borrower in accordance

with the other provisions of this Section 2.8(b). If a requested Advance shall not occur on any date specified by the Borrower as set forth in the Payment/Advance Form because all of the conditions for such Advance set forth herein or in any of the other Loan Documents shall have not been met, the Servicing Agent shall return the amounts so received from the Lenders in respect of such requested Advance to the applicable Lenders as soon as practicable.

2.9 Sharing of Payments, etc. Borrower agrees that, in addition to (and without limitation of) any right of set-off, bankers' lien or counterclaim a Lender may otherwise have, each Lender shall be entitled after the occurrence of an Event of Default which is continuing, at its option, to offset balances held by it for the account of the Borrower at any of its offices against any principal of or interest on any of such Lender's Obligations of the Borrower hereunder which is not paid when due (regardless of whether such balances are then due to the Borrower), in which case it shall promptly notify the Borrower and the Servicing Agent thereof, provided, that such Lender's failure to give such notice shall not affect the validity thereof. If a Lender shall obtain payment of any principal of or interest on any Obligation then due to such Lender hereunder, through the exercise of any right of set-off, banker's lien, counterclaim or similar right, or otherwise, it shall promptly purchase from the other Lenders participations in Obligations of the Borrower hereunder of the other Lenders in such amounts, and make such other adjustments from time to time as shall be equitable to the end that all the Lenders shall share the benefit of such payment (net of any expenses which may be incurred by such Lender in obtaining or preserving such benefit) pro rata in accordance with their respective Commitment Percentage. To such end, all the Lenders shall make appropriate adjustments among themselves (by the resale of participations sold or otherwise) if such payment is rescinded or must otherwise be restored. Borrower agrees, to the fullest extent it may effectively do so under applicable law, that any Lender so purchasing a participation in the Obligations hereunder of the other Lenders may exercise all rights of set-off, bankers' lien, counterclaim or similar rights with respect to such participation as fully as if such Lender were a direct holder of said Obligations in the amount of such participation. Nothing contained herein shall require any Lender to exercise any such right or shall affect the right of any Lender to exercise, and retain the benefits of exercising, any such right with respect to any other indebtedness or obligation of Borrower.

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3. CONDITIONS OF LOANS

3.1 Conditions Precedent to Initial Credit Extension. The obligation of Lenders to make the initial Credit Extension is subject to the condition precedent that Lenders shall have received, in form and substance satisfactory to Lenders, the following:

(a) this Agreement and the Revolving Notes, all duly executed by Borrower;

(b) a certificate of the Secretary of Borrower with respect to certificate of incorporation, by-laws, incumbency and resolutions authorizing the execution and delivery of this Agreement and all other Loan Documents to be executed by Borrower;

(c) evidence reasonably necessary to confirm a first priority perfected Lien (subject only to Permitted Liens) has been granted by Borrower in favor of Servicing Agent for the benefit of Lenders against all Collateral, including, without limitation, UCC-1 financing statements covering the Collateral and in favor of Servicing Agent on behalf of and for the benefit of Lenders and UCC-3 termination statements or assignments in favor of Servicing Agent on behalf of and for the benefit of the Lenders from each Person that has a security interest in the Collateral or any part thereof;

(d) insurance certificate;

(e) payment of the fees and Lenders' Expenses then due specified in Section 2.5 hereof;

(f) Certificate of Foreign Qualification (if applicable);

(g) the Amended and Restated LIBOR Supplement;

(h) an intellectual property security agreement covering the Intellectual Property; and

(i) such other documents, and completion of such other matters, as Lenders may reasonably deem necessary or appropriate.

3.2 Conditions Precedent to all Credit Extensions. The obligation of Lenders to make each Credit Extension, including the initial Credit Extension, is further subject to the following conditions:

(a) timely receipt by Servicing Agent of the Payment/Advance Form or the LIBOR rate Advance Form as provided in Section 2.1, if applicable;

(b) satisfaction of the terms and conditions contained in the LIBOR Supplement, if applicable;

(c) the representations and warranties contained in Section 5 shall be true and correct in all material respects on and as of the date of such Payment/Advance Form or the

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LIBOR rate Advance Form and on the effective date of each Credit Extension as though made at and as of each such date, and no Event of Default shall have occurred and be continuing, or would result from such Credit Extension; and

(d) receipt by Servicing Agent of a subordination of lien from each and every Person who leases real property to Borrower and at which location Borrower now or hereafter maintains Inventory with a value of Two Million Five Hundred Thousand and No/100 Dollars (\$2,500,000.00) or greater (but in any event at Borrower's locations in Austin, Texas and King of Prussia, Pennsylvania), or evidence satisfactory to Servicing Agent and Lenders in their sole and absolute discretion of the waiver of such landlord's liens from such Person or Persons.

The making of each Credit Extension shall be deemed to be a representation and warranty by Borrower on the date of such Credit Extension as to the accuracy of the facts referred to in Section 3.2(c).

4. CREATION OF SECURITY INTEREST

4.1 Grant of Security Interest. Borrower grants and pledges to Servicing Agent on behalf of and for the benefit of Lenders a continuing security interest in all presently existing and hereafter acquired or arising Collateral and all proceeds thereof, in order to secure prompt payment of any and all Obligations and in order to secure prompt performance by Borrower of each of its covenants and duties under the Loan Documents. Except as set forth in the Schedule, such security interest constitutes a valid, first priority security interest in the presently existing Collateral, and will constitute a valid, first priority security interest in Collateral acquired after the date hereof. Notwithstanding termination of this Agreement, Servicing Agent's Lien on the Collateral shall remain in effect for so long as any Obligations are outstanding.

4.2 Delivery of Additional Documentation Required. Borrower shall from time to time execute and deliver to Servicing Agent, at the request of Servicing Agent or any Lender, all Negotiable Collateral, all financing statements and other documents that Servicing Agent or any Lender may reasonably request, in form reasonably satisfactory to Requisite Lenders, to perfect and continue perfected Servicing Agent's security interests in the Collateral and in order to fully consummate all of the transactions contemplated under the Loan Documents.

4.3 Right to Inspect. Subject to the provisions of Section 2.5(b), including without limitation, any limitation with respect to the number of inspections or audits prior to the occurrence and continuance of an Event of

Default, any Lender (through any of its officers, employees, or agents) shall have the right, upon reasonable prior notice (except that such prior notice shall not be required upon the occurrence and during the continuance of an Event of Default), from time to time during Borrower's usual business hours, so long as Borrower's normal business operations are not unreasonably disrupted, to inspect Borrower's Books and to make copies thereof and to check, test, audit and appraise the Collateral in order to verify Borrower's financial condition or the amount, condition of, or any other matter relating to, the Collateral, including Borrower's Accounts.

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4.4 Single Loan. All of the Obligations of Borrower to Servicing Agent or Lenders arising under or in connection with this Agreement, or any of the Loan Documents, shall constitute one general obligation of Borrower and shall be secured by all of the Collateral.

5. REPRESENTATIONS AND WARRANTIES

Borrower represents and warrants as follows:

5.1 Due Organization and Qualification. Borrower and each Subsidiary of Borrower is a corporation duly existing and in good standing under the laws of its state of incorporation and qualified and licensed to do business in, and is in good standing in, any state in which the conduct of its business or its ownership of property requires that it be so qualified, except for states as to which failure to so qualify would not have a Material Adverse Effect.

5.2 Due Authorization; No Conflict. The execution, delivery, and performance of the Loan Documents are within Borrower's powers, have been duly authorized, and are not in conflict with nor constitute a breach of any provision contained in Borrower's Certificate of Incorporation or By-laws, nor will they constitute an event of default under any material agreement to which Borrower is a party or by which Borrower is bound. Borrower is not in default under any agreement to which it is a party or by which it is bound, which default could have a Material Adverse Effect.

5.3 No Prior Encumbrances. Borrower has good and indefeasible title to the Collateral, free and clear of Liens, except for Permitted Liens. Except as disclosed in the Schedule, Borrower has not acquired any part of the Collateral from an assignor outside the ordinary course of such assignor's business.

5.4 Bona Fide Eligible Accounts. The Eligible Accounts are bona fide existing obligations. The service or property giving rise to such Eligible Accounts has been performed or delivered to the account debtor or to the account debtor's agent for immediate shipment to and unconditional acceptance by the account debtor. Borrower has not received notice of actual or imminent Insolvency Proceeding of any account debtor whose Accounts are included in any Borrowing Base Certificate as an Eligible Account.

5.5 Merchantable Inventory. All Inventory is in all material respects of good and marketable quality, free from all material defects.

5.6 Name; Location of Chief Executive Office. Except as disclosed in the Schedule, Borrower has not done business and will not without at least thirty (30) days prior written notice to Servicing Agent do business under any name other than that specified on the signature page hereof or in the Schedule. The chief executive office of Borrower is located at the address indicated in Section 10 hereof.

5.7 Litigation. Except as set forth in the Schedule, there are no actions or proceedings pending, or, to Borrower's knowledge, threatened by or against Borrower or any

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Subsidiary of Borrower before any court or administrative agency in which an adverse decision could result in damages or costs to Borrower of One Million and No/100 Dollars (\$1,000,000.00) or more or have a Material Adverse Effect.

5.8 No Material Adverse Change in Financial Statements. All consolidated financial statements related to Borrower and any Subsidiary of Borrower that have been delivered by Borrower to Servicing Agent or any Lender fairly present in all material respects Borrower's consolidated financial condition as of the date thereof and Borrower's consolidated results of operations for the period then ended. There has not been a material adverse change in the consolidated financial condition of Borrower since the date of the most recent of such financial statements submitted to Lenders or Servicing Agent on or about the Closing Date.

5.9 Solvency. Borrower is solvent and able to pay its debts (including trade debts) as they mature.

5.10 Regulatory Compliance. Borrower and each Subsidiary of Borrower has met the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA. No event has occurred resulting from Borrower's or any of its Subsidiary's failure to comply with ERISA that is reasonably likely to result in Borrower's or any such Subsidiary's incurring any liability that could have a Material Adverse Effect. Borrower is not an "investment company" or a company "controlled" by an "investment company" within the meaning of the Investment Company Act of 1940. Borrower is not engaged principally, or as one of its important activities, in the business of extending credit for the purpose of purchasing or carrying margin stock (within the meaning of Regulations G, T and U of the Board of Governors of the Federal Reserve System). Borrower and each of its Subsidiaries have complied with all the provisions of the Federal Fair Labor Standards Act, the noncompliance with which would cause a Material Adverse Effect. Neither Borrower nor any of its Subsidiaries has violated any statutes, laws, ordinances or rules applicable to it, violation of which could have a Material Adverse Effect.

5.11 Environmental Condition. None of Borrower's or any of its Subsidiary's properties or assets has ever been used by Borrower or any such Subsidiary or, to the best of Borrower's knowledge, by previous owners or operators, in the disposal of, or to produce, store, handle, treat, release, or transport, any hazardous waste or hazardous substance other than in accordance with applicable law; to the best of Borrower's knowledge, none of Borrower's nor any of its Subsidiary's properties or assets has ever been designated or identified in any manner pursuant to any environmental protection statute as a hazardous waste or hazardous substance disposal site, or a candidate for closure pursuant to any environmental protection statute; no lien, resulting in a Material Adverse Effect, arising under any environmental protection statute has attached to any revenues or to any real or personal property owned by Borrower or any Subsidiary of Borrower; and neither Borrower nor any of its Subsidiaries has received a summons, citation, notice, or directive from the Environmental Protection Agency or any other federal, state or other governmental agency concerning any action or omission by Borrower or any Subsidiary of Borrower resulting in the release, or other disposition of hazardous waste or hazardous substances into the environment.

5.12 Taxes. Borrower and each Subsidiary of Borrower has filed or caused to be filed all tax returns required to be filed on a timely basis except where failure to do so would not

reasonably be expected to result in a Material Adverse Effect, and has paid, or has made adequate provision for the payment of, all taxes reflected therein in accordance with GAAP.

5.13 Subsidiaries. Borrower does not own any stock, partnership interest or other equity securities of any Person, except for Permitted Investments.

5.14 Government Consents. Borrower and each Subsidiary of

Borrower has obtained all consents, approvals and authorizations of, made all declarations or filings with, and given all notices to, all governmental authorities that are necessary for the continued operation of Borrower's and each such Subsidiary's business as currently conducted, the failure of which to obtain would have a Material Adverse Effect on Borrower's financial condition, operations or business.

5.15 Full Disclosure. No representation, warranty or other statement made by Borrower in any certificate or written statement furnished to Servicing Agent or any Lender contains any untrue statement of a fact or omits to state a fact necessary in order to make the statements contained in such certificates or statements not misleading, except which would not result in a Material Adverse Effect.

5.16 Intellectual Property. Borrower is the sole owner of the Intellectual Property Collateral, except for non-exclusive licenses granted by Borrower to its customers in the ordinary course of business. To the best of Borrower's knowledge, each of the Patents is valid and enforceable, and no part of the Intellectual Property Collateral has been judged invalid or unenforceable, in whole or in part, and no claim has been made that any part of the Intellectual Property Collateral violates the rights of any third party other than as disclosed on the Schedule. Except for and upon the filing with the United States Patent and Trademark Office with respect to the Patents and Trademarks and the Register of Copyrights with respect to the Copyrights and Mask Works necessary to perfect the security interests created hereunder and under the Intellectual Property Security Agreement of even date herewith, and except as has been already made or obtained, no authorization, approval or other action by, and no notice to or filing with, any United States governmental authority or United States regulatory body is required either (i) for the grant by Borrower of the security interest granted hereby and in the Loan Documents or for the execution, delivery or performance of Loan Documents by Borrower in the United States or (ii) for the perfection in the United States or the exercise by Servicing Agent and Lenders of their rights and remedies hereunder.

5.17 No Subordinated Debt. No Subordinate Debt is outstanding hereunder, nor has any Subordinated Debt been previously approved by Required Lenders, as of the date hereof.

5.18 Year 2000 Reprogramming. Any reprogramming required to permit the proper functioning in and following the year 2000, of the Borrower's and its Subsidiaries' material (a) computer systems and (b) equipment containing embedded microchips (including systems and equipment supplied by others or with which the Borrower's or any of its Subsidiaries' systems interface), the failure of which to have completed could reasonably be expected to result in a Material Adverse Effect, and the testing of all such systems and equipment as so reprogrammed, will be substantially completed by September 30, 1999. The cost to the Borrower and its Subsidiaries of such reprogramming and testing of the reasonably foreseeable consequences of year 2000 to the

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Borrower and its Subsidiaries (including, without limitation, reprogramming errors and the failure of others' systems or equipment) will not result in an Event of Default or a Material Adverse Effect. Except for such of the reprogramming referred to in the preceding sentence as may be necessary, the computer and management information systems of the Borrower and its Subsidiaries are and, with ordinary course upgrading and maintenance, will continue to be, sufficient to permit the Borrower and its Subsidiaries to conduct its business without any Material Adverse Effect.

6. AFFIRMATIVE COVENANTS

Borrower covenants and agrees that, until payment in full of all outstanding Obligations, and for so long as Lenders may have any Commitment to make a Credit Extension hereunder, Borrower shall do all of the following:

6.1 Good Standing. Borrower shall maintain its and each of its Subsidiaries' corporate existence and good standing in its jurisdiction of incorporation and maintain qualification in each jurisdiction in which the failure to so qualify could have a Material Adverse Effect. Borrower shall maintain, and shall cause each of its Subsidiaries to maintain in force, to the

extent consistent with prudent management of Borrower's business, all licenses, approvals and agreements, the loss of which could have a Material Adverse Effect. Notwithstanding the foregoing, (a) Borrower may dissolve a Subsidiary of Borrower so long as the assets of the Subsidiary remain with Borrower or a wholly-owned Subsidiary of Borrower; and (b) any wholly-owned Subsidiary of Borrower may merge or consolidate with another wholly-owned Subsidiary of Borrower; and (c) any wholly-owned Subsidiary of Borrower may merge or consolidate with Borrower so long as Borrower is the surviving corporation.

6.2 Government Compliance. Borrower shall meet, and shall cause each Subsidiary of Borrower to meet, the minimum funding requirements of ERISA with respect to any employee benefit plans subject to ERISA. Borrower shall comply, and shall cause each Subsidiary of Borrower to comply, with all statutes, laws, ordinances and government rules and regulations to which it is subject, noncompliance with which could have a Material Adverse Effect.

6.3 Financial Statements, Reports, Certificates. Borrower shall deliver to Servicing Agent and each of the Lenders then holding not less than one-third of the total Commitment of the Lenders: (a) as soon as available, but in any event within twenty (20) days after the end of each month (other than the final month of Borrower's applicable fiscal year), a company prepared consolidated balance sheet and income statement covering Borrower's consolidated operations during such period (with each of such financial statements as of the end of any fiscal quarter of Borrower also being in consolidating format), in a form and certified by a Responsible Officer of Borrower; (b) as soon as available, but in any event within ninety (90) days after the end of Borrower's fiscal year, audited consolidated and consolidating financial statements of Borrower prepared in accordance with GAAP, consistently applied, together with an unqualified opinion on such financial statements of an independent certified public accounting firm reasonably acceptable to Servicing Agent and Requisite Lenders; (c) within five (5) days of filing or sending for delivery, as applicable, copies of all statements, reports and notices sent or made available generally by Borrower to its security holders or to any holders of Subordinated Debt and all reports on Form 10-K, 10-Q and 8-K filed with the Securities and Exchange Commission; (d) immediately upon receipt of notice thereof, a report of any

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legal actions pending or threatened against Borrower or any Subsidiary that could reasonably be expected to result in damages or costs to Borrower or any Subsidiary of One Million and No/100 Dollars (\$1,000,000.00) or more; (e) such budgets, sales projections, operating plans or other financial information as Servicing Agent or any Lender may reasonably request from time to time, and (f) prompt notice of any material change in the composition of the Intellectual Property Collateral, including, but not limited to, any subsequent ownership right of the Borrower in or to any Copyright, Patent or Trademark not specified in any intellectual property security agreement between Borrower and Servicing Agent or knowledge of an event that could reasonably be expected to materially adversely effects the value of the Intellectual Property Collateral.

Within twenty (20) days after the last day of each month, Borrower shall deliver to Servicing Agent and each Lender then holding not less than one-third of the total Commitments of the Lenders a Borrowing Base Certificate signed by a Responsible Officer in substantially the form of Exhibit C hereto, together with aged listings of accounts receivable and accounts payable and, with the monthly financial statements, a Compliance Certificate signed by a Responsible Officer in substantially the form of Exhibit D hereto.

6.4 Inventory; Returns. Borrower shall keep all Inventory in good and marketable condition, free from all material defects other than those which would not result in a Material Adverse Effect or for which adequate reserves have been provided for in accordance with GAAP. Returns and allowances, if any, as between Borrower and its account debtors shall be on the same basis and in accordance with the usual customary practices of Borrower so long as in accordance with GAAP. Borrower shall promptly notify Servicing Agent of all returns and recoveries and of all disputes and claims, where the return, recovery, dispute or claim, together with all other such outstanding returns, recoveries, disputes or claims, involves more than One Million and No/100 Dollars (\$1,000,000.00) in the aggregate; provided, however, that such One Million and No/100 Dollars (\$1,000,000.00) threshold amount shall be

automatically reduced by the amount of any such outstanding returns, recoveries, disputes or claims for which no dollar for dollar GAAP reserves have been established by Borrower.

6.5 Taxes. Borrower shall make, and shall cause each Subsidiary of Borrower to make, due and timely payment or deposit of all material federal, state, and local taxes, assessments, or contributions required of it by law, and will execute and deliver to Servicing Agent, on demand if an Event of Default has occurred and is continuing, appropriate certificates attesting to the payment or deposit thereof (provided that Borrower shall confirm such payment in connection with any compliance certificates regularly submitted hereunder); and Borrower will make, and will cause each Subsidiary of Borrower to make, timely payment or deposit of all material tax payments and withholding taxes required of it by applicable laws, including, but not limited to, those laws concerning F.I.C.A., F.U.T.A., state disability, and local, state, and federal income taxes, and will, upon request if an Event of Default has occurred and is continuing, furnish Servicing Agent with proof satisfactory to Servicing Agent and Lenders indicating that Borrower and Subsidiary of Borrower has made such payments or deposits; provided that Borrower or a Subsidiary of Borrower need not make any payment if the amount or validity of such payment does not result in a Material Adverse Effect or is (i) contested in good faith by appropriate proceedings and (ii) is reserved against (to the extent required by GAAP) by Borrower.

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6.6 Insurance.

(a) Borrower, at its expense, shall keep the Collateral insured against loss or damage by fire, theft, explosion, sprinklers, and all other hazards and risks, and in such amounts, as ordinarily insured against by other owners in similar businesses conducted in the locations where Borrower's business is conducted on the date hereof. Borrower shall also maintain insurance relating to Borrower's ownership and use of the Collateral in amounts and of a type that are customary to businesses similar to Borrower's.

(b) All such policies of insurance shall be in such form, with such companies, and in such amounts as are reasonably satisfactory to Servicing Agent and Requisite Lenders. All such policies of insurance shall contain a lenders loss payable endorsement, in a form satisfactory to Servicing Agent and Requisite Lenders, showing Servicing Agent as an additional loss payee thereof and all liability insurance policies shall specify that the insurer must give at least fifteen (15) days notice to Servicing Agent before canceling its policy for any reason. At Servicing Agent's or Requisite Lenders' request, Borrower shall deliver to Servicing Agent and each Lender certified copies of such policies of insurance and evidence of the payments of all premiums therefor. All proceeds payable under any such policy shall, at the option of Servicing Agent and Requisite Lenders, be applied on account of the Obligations, unless the proceeds are payable for any damage or loss other than to Inventory, in which case, such proceeds shall be applied to replace such damaged or lost Inventory prior to the occurrence and continuance of an Event of Default or applied against the Obligations after the occurrence and during the continuance of an Event of Default.

6.7 Quick Ratio. Borrower shall maintain, as of the last day of the fiscal quarter ending April 30, 1999 and the fiscal quarter ending July 31, 1999, a ratio of Quick Assets to Current Liabilities, less the then current portion of deferred maintenance revenue, of at least 1.30 to 1.0. Borrower shall maintain, as of the last day of the fiscal quarter ending October 31, 1999, a ratio of Quick Assets to Current Liabilities, less the then current portion of deferred maintenance revenue, of at least 1.40 to 1.0. Commencing with the fiscal quarter ending January 31, 2000 and for each fiscal quarter thereafter, Borrower shall maintain a ratio of Quick Assets to Current Liabilities, less the then current portion of deferred maintenance revenue, of at least 1.50 to 1.0. Borrower shall maintain, as of the last day of each calendar month, a ratio of Quick Assets to Current Liabilities less the then current portion of deferred maintenance revenue of at least 1.0 to 1.0. The ratio calculation required by this paragraph shall be calculated for Borrower and its Subsidiaries on a consolidated basis.

6.8 Debt-Tangible Net Worth Ratio. Borrower shall maintain, as of the last day of each fiscal quarter, a ratio of Total Liabilities, less deferred maintenance revenue, to Tangible Net Worth plus Subordinated Debt of not more than 1.0 to 1.0. The ratio calculation required by this paragraph shall be calculated for Borrower and its Subsidiaries on a consolidated basis.

6.9 Tangible Net Worth. Borrower shall maintain, as of the last day of each fiscal quarter, a Tangible Net Worth of not less than Forty-Eight Million and No/100 Dollars (\$48,000,000.00), plus fifty percent (50%) of all year-to-date Net Income (without regard to net losses), through the last day of the applicable fiscal quarter. Notwithstanding Borrower's Net Income, Borrower shall maintain a Tangible Net Worth of not less than Fifty Million and No/100

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Dollars (\$50,000,000.00) by July 31, 2000. The Tangible Net Worth calculation required by this paragraph shall be determined for Borrower and its Subsidiaries on a consolidated basis.

6.10 Profitability. Borrower shall have a positive Net Income for each completed fiscal quarter; provided, Borrower may have (i) an aggregate loss for the quarter ending April 30, 1999 not exceeding Five Million Three Hundred Thousand and No/100 Dollars (\$5,300,000.00) and (ii) a quarterly loss for the following fiscal quarters not exceeding the following amounts for the corresponding quarter:

Quarter Ending -----	Maximum Quarterly Loss -----
April 30, 1999	\$1,500,000.00
July 31, 1999	\$1,000,000.00
October 31, 1999	\$ 300,000.00

For purposes of calculating the One Million Five Hundred Thousand and No/100 Dollars (\$1,500,000.00) loss allowed under subparagraph (ii) for Borrower's fiscal quarter ending April 30, 1999 only, the calculation of Net Income shall not include any costs or expenses of any kind or nature incurred in connection with the acquisition by Borrower of substantially all of the assets of Vosaic, L.L.C. The Net Income calculation required by this Section 6.10 shall be calculated for Borrower and its Subsidiaries on a consolidated basis.

6.11 Registration of Intellectual Property Rights.

(a) Within thirty (30) days of the date of this Agreement, Borrower shall register or cause to be registered (to the extent not already registered) with the United States Patent and Trademark Office or the United States Copyright Office, as applicable, those intellectual property rights listed on Exhibits A, B, C and D to the Intellectual Property Security Agreement delivered to Servicing Agent by Borrower in connection with this Agreement. To the extent commercially reasonable and consistent with Borrower's past practices, Borrower shall register or cause to be registered with the United States Patent and Trademark Office or the United States Copyright Office, as applicable, those additional, material intellectual property rights developed or acquired by Borrower from time to time in connection with any product prior to the sale or licensing of such product to any third party, including without limitation revisions or additions to the intellectual property rights listed on such Exhibits A, B, C and D.

(b) Borrower shall execute and deliver such additional instruments and documents from time to time as Servicing Agent or Requisite Lenders shall reasonably request to perfect Servicing Agent's security interest in the Intellectual Property Collateral.

(c) Borrower shall (i) use commercially reasonable efforts to protect, defend and maintain the validity and enforceability of the material Trademarks, Patents, Copyrights, and Mask Works, (ii) use commercially reasonable efforts to detect infringements of the Trademarks, Patents, Copyrights and Mask Works and promptly advise Servicing Agent and each Lender in writing of material infringements detected and (iii) not allow any material Trademarks, Patents, Copyrights, or Mask Works to be abandoned, forfeited or dedicated to the public without the written consent of Servicing

Agent and Requisite Lenders, which shall not be unreasonably withheld, unless

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Servicing Agent or Requisite Lenders determines that reasonable business practices suggest that abandonment is appropriate.

(d) Servicing Agent or Requisite Lenders shall have the right, but not the obligation, to take, at Borrower's sole expense, any actions that Borrower is required under this Section 6.11 to take but which Borrower fails to take, after fifteen (15) days notice to Borrower. Borrower shall reimburse and indemnify Servicing Agent and each Lender for all reasonable costs and reasonable expenses incurred in the reasonable exercise of its rights under this Section 6.11.

6.12 Lockbox Account. Borrower shall immediately establish a lockbox account ("Lockbox Account") with a Lender or another entity selected by Servicing Agent and each Lender in their reasonable discretion for the payment of Borrower's Accounts, including, without limitation, directing all account debtors of Borrower to deposit payments due to Borrower into the Lockbox Account. Borrower shall deposit into the Lockbox Account any Account proceeds which Borrower receives through any other means; provided, however, that prior to the occurrence and continuance of an Event of Default, Borrower shall not be required to deposit into the Lockbox Account any payments received by Borrower if the aggregate amount of such payments received during any Business Day does not exceed Ten Thousand and No/100 Dollars (\$10,000.00). Upon request of Servicing Agent or any Lender, Borrower shall furnish such party with (a) satisfactory evidence that Borrower has notified and directed all of its account debtors to make payments of Borrower's Accounts to the Lockbox Account and (b) a list of all of Borrower's account debtors and their respective current addresses.

6.13 ERISA. At all times Borrower shall: (a) make contributions to each Plan in a timely manner and in an amount sufficient to comply with the minimum funding standard requirements of ERISA; (b) immediately upon acquiring knowledge of (i) any Reportable Event in connection with any Plan for which no administrative or statutory exemption exists or (ii) any "prohibited transaction," as such term is defined in Section 4975 of the IRC in connection with any Plan, that could reasonably be expected to result in the imposition of material damages or a material excise tax on the Borrower or any Subsidiary thereof, furnish the Servicing Agent a statement executed by a Responsible Officer of the Borrower or such Subsidiary setting forth the details thereof and the action which the Borrower or any such Subsidiary proposes to take with respect thereto and, when known, any action taken by the Internal Revenue Service with respect thereto; (c) notify the Servicing Agent promptly upon receipt by the Borrower or any Subsidiary thereof of any notice of the institution of any proceedings or other actions which may reasonably be expected to result in the termination of any Plan by the PBGC and furnish the Servicing Agent with copies of such notice; (d) pay when due, or within any applicable grace period allowed by the PBGC, all required premium payments to the PBGC; (e) furnish the Servicing Agent with copies of the annual report for each Plan filed with the Internal Revenue Service not later than ten (10) days after the Servicing Agent requests such report; (f) furnish the Servicing Agent with copies of any request for waiver of the funding standards or extension of the amortization periods required by Sections 303 and 304 of ERISA or Section 412 of the IRC promptly after the request is submitted to the Secretary of the Treasury, the Department of Labor or the Internal Revenue Service, as the case may be; and (g) pay when due all installment contributions required under Section 302 of ERISA or Section 412 of the IRC or within 10 days of a failure to make any such required contributions when due furnish the Servicing Agent with written notice of such failure.

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6.14 Year 2000 Compliance. Borrower shall complete and furnish such reasonable questionnaires and submit to any additional due diligence

reasonably required by the Servicing Agent or any Lender in order to confirm that the representations and warranties set forth in Section 5.18 hereof are true and correct in all material respects.

6.15 Notice of Events. Borrower shall notify the Servicing Agent and each Lender immediately upon acquiring knowledge of the occurrence of, or if the Borrower or any of its Subsidiaries causes or intends to cause, as the case may be, any of the following: (a) the institution of any lawsuit, administrative proceeding or investigation affecting the Borrower or any of its Subsidiaries, including without limitation, any audit by the Internal Revenue Service, the adverse determination under which could reasonably be expected to have a Material Adverse Effect; (b) any development or change in the business or affairs of the Borrower or any of its Subsidiaries' which has had or which is reasonably likely to have a Material Adverse Effect; (c) any Event of Default, together with a detailed statement by a Responsible Officer on behalf of the Borrower of the steps being taken to cure such Event of Default; (d) the occurrence of any default by the Borrower or any of its Subsidiaries under any agreement or series of related agreements to which it is a party, which default could reasonably be expected to have a Material Adverse Effect; and (e) any violation by, or investigation of any Borrower or any of its Subsidiaries in connection with any actual or alleged violation of any legal requirement imposed by the Environmental Protection Agency, the Occupational Safety Hazard Administration or any other Governmental Authority which has or is reasonably likely to have a Material Adverse Effect.

6.16 Further Assurances. At any time and from time to time, Borrower shall execute and deliver such further instruments and take such further action as may reasonably be requested by Servicing Agent or any Lender to effect the purposes of this Agreement.

7. NEGATIVE COVENANTS

Borrower covenants and agrees that, so long as any Credit Extension hereunder shall be available and until payment in full of the outstanding Obligations or for so long as Lenders may have any commitment to make any Credit Extensions, Borrower will not do any of the following:

7.1 Dispositions. Convey, sell, lease, transfer, pledge, encumber, assign or otherwise dispose of (collectively, a "Transfer"), or permit any of its Subsidiaries to Transfer, all or any part of its business or property (including without limitation, stock held in any Subsidiary), other than Transfers: (i) of inventory in the ordinary course of business, (ii) of non-exclusive licenses and similar arrangements for the use of the property of Borrower or its Subsidiaries in the ordinary course of business; (iii) that constitute payment of normal and usual operating expenses in the ordinary course of business; (iv) of worn-out or obsolete Equipment; (v) of excess Equipment, if sold for the greater of book or market value, so long as the aggregate amount of such excess Equipment sold in any fiscal year does not exceed Five Hundred Thousand and No/100 Dollars (\$500,000.00); (vi) of interests in that agreement entitled "Wild Basin Net Proceeds Agreement" dated March 11, 1998 and that agreement entitled "Waterford: Memorandum of Net Profits Agreement" dated June 15, 1994; (vii) any capital stock held by Borrower in Accord Video Telecommunications Ltd., if sold for not less than its book value; and (viii) the factoring or sale by any of Borrower's Subsidiaries whose principal place of business is located outside the United States of such Subsidiary's accounts arising out of the sale or lease of goods. Notwithstanding the foregoing, Borrower may enter into one or

more sale leaseback transactions so long as no Event of Default exists or would exist after giving effect to such action and so long as the total fair market value or book value, whichever is greater, of the assets so Transferred, together with other capital leases incurred after the date hereof, does not exceed the amount of capital lease obligations permitted under the definition of "Permitted Indebtedness".

7.2 Changes in Business, Ownership, Management, or Chief Executive Office. Engage in any business, or permit any of its Subsidiaries to engage in any business, other than the businesses currently engaged in by Borrower and any business substantially similar or related thereto (or

incidental thereto). Borrower will not, without at least thirty (30) days prior written notification to Servicing Agent, relocate its chief executive office or add or relocate any business location where Borrower maintains Inventory with a value equal to or greater than Two Million Five Hundred Thousand and No/100 Dollars (\$2,500,000.00).

7.3 Mergers or Acquisitions. Except for Borrower's acquisition of substantially all of the assets of Vosaic, L.L.C. (such acquisition hereby being consented to by the Servicing Agent and the Lenders), merge or consolidate, or permit any of its Subsidiaries to merge or consolidate, with or into any other business organization, or acquire, or permit any of its Subsidiaries to acquire, all or substantially all of the capital stock or property of another Person if (i) an Event of Default has occurred and is continuing or would exist after giving effect to such action or (ii) in connection with such action, the total Indebtedness incurred by Borrower (limited to assumption by Borrower of accounts payable of the acquired party) and cash paid by Borrower in connection with all such action after the date of this Agreement totals more than One Million Five Hundred Thousand and No/100 Dollars (\$1,500,000.00) or (iii) such action dilutes what would have been Borrower's earnings for the fiscal quarter in which such action occurs, if not for such action.

7.4 Indebtedness. Subject to Section 7.3, create, incur, assume or be or remain liable with respect to any Indebtedness, or permit any Subsidiary of Borrower so to do, other than Permitted Indebtedness.

7.5 Encumbrances. Create, incur, assume or suffer to exist any Lien with respect to any of the Collateral, or assign or otherwise convey any right to receive income, including the sale of any Accounts, or permit any of its Subsidiaries so to do, except for Permitted Liens.

7.6 Distributions. Pay any dividends or make any other distribution or payment on account of or in redemption, retirement or purchase of any capital stock of Borrower.

7.7 Investments. Directly or indirectly acquire or own, or make any Investment in or to any Person, or permit any of its Subsidiaries so to do, other than Permitted Investments.

7.8 Transactions with Affiliates. Directly or indirectly enter into or permit to exist any material transaction (exclusive of any employment arrangements with the officers of Borrower and exclusive of any of Borrower's benefit or compensation programs for officers and directors) with any Affiliate of Borrower except for transactions that are in the ordinary course of Borrower's business, upon fair and reasonable terms that are no less favorable to Borrower than would be obtained in an arm's length transaction with a nonaffiliated Person.

7.9 Subordinated Debt. Make any payment in respect of any Subordinated Debt, or permit any of its Subsidiaries to make any such payment, except to the extent such payment is allowed under any Subordination Agreement entered into with Servicing Agent and Lenders covering such Subordinated Debt, or amend any provision contained in any documentation relating to the Subordinated Debt if such amendment would adversely affect the interests of Lenders.

7.10 Inventory. Store any Inventory with a bailee, warehouseman, or similar party unless Servicing Agent has received a pledge of any warehouse receipt covering such Inventory and a subordination or waiver of any warehouseman's or other similar Lien held by such party against the applicable Inventory. Except for Inventory sold in the ordinary course of business and except for such other locations as Servicing Agent and Lenders may approve in writing, Borrower shall keep the Inventory only at the locations set forth in the Schedule and such other locations of which Borrower gives Servicing Agent and Lenders prior written notice and as to which Borrower signs and files a financing statement where needed to perfect Servicing Agent's security interest.

7.11 Compliance. Become an "investment company" or a company controlled by an "investment company", within the meaning of the Investment Company Act of 1940, or become principally engaged in, or undertake as one of its important activities, the business of extending credit for the purpose of purchasing or carrying margin stock, or use the proceeds of any Advance for such purpose; fail to meet the minimum funding requirements of ERISA; permit a Reportable Event or Prohibited Transaction, as defined in ERISA, to occur; fail to comply with the Federal Fair Labor Standards Act or violate any other law or regulation, which violation could have a Material Adverse Effect or a material adverse effect on the Collateral or the priority of Servicing Agent's Lien on the Collateral; or permit any of its Subsidiaries to do any of the foregoing.

7.12 Intellectual Property Agreement. Permit the inclusion in any material contract to which it becomes a party of any provisions that could reasonably be expected to in any way prevent the creation of a security interest in Borrower's rights and interests in any property included within the definition of the Intellectual Property Collateral acquired under such contracts.

7.13 Foreign Assets. Permit the aggregate assets of Borrower at any time not located within the United States, including without limitation, all Investments by Borrower in any of its Subsidiaries who does not have its principal place of business in the United States, to exceed fifteen percent (15%) of Borrower's total assets as of the date of such determination.

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7.14 ERISA Compliance.

(a) At any time engage in any "prohibited transaction" as defined in ERISA; or permit any Plan to be terminated in a manner which could result in the imposition of a Lien on any property of the Borrower or any of its Subsidiaries pursuant to ERISA.

(b) Engage in any transaction in connection with which the Borrower or any Subsidiary thereof could reasonably be expected to be subject to either a material civil penalty assessed pursuant to the provisions of Section 502 of ERISA or a material tax imposed under the provisions of Section 4975 of the IRC.

(c) Terminate any Plan in a "distress termination" under Section 4041 of ERISA, or take any other action which could reasonably be expected to result in a material liability of the Borrower or any Subsidiary thereof to the PBGC.

(d) Fail to make payment when due of all amounts which, under the provisions of any Plan, the Borrower or any Subsidiary thereof is required to pay as contributions thereto, or, with respect to any Plan, permit to exist any material "accumulated funding deficiency" (within the meaning of Section 302 of ERISA and Section 412 of the IRC), whether or not waived, with respect thereto.

(e) Adopt an amendment to any Plan requiring the provision of security under Section 307 of ERISA or Section 401(a)(29) of the IRC.

8. EVENTS OF DEFAULT

Any one or more of the following events shall constitute an Event of Default by Borrower under this Agreement:

8.1 Payment Default. If Borrower fails to pay, within five (5) calendar days of when due, any of the Obligations.

8.2 Covenant Default.

(a) If Borrower fails to perform any obligation under Sections 6.3, 6.6, 6.7, 6.8, 6.9, 6.10 or 6.11 or violates any of the covenants contained in Article 7 of this Agreement; provided however, Borrower shall have the following specific grace periods: (i) with respect to Form 10-Q reports to be provided under Section 6.3 above, five (5) days grace, (ii) with

respect to Form 10-K reports to be provided under Section 6.3 above, fifteen (15) days grace, and (iii) with respect to proof of insurance or insurance policies required to be provided under Section 6.6 above, fifteen (15) days grace, or

(b) If Borrower fails or neglects to perform, keep, or observe any other material term, provision, condition, covenant, or agreement contained in this Agreement, in any of the Loan Documents, or in any other present or future agreement between Borrower, Lenders and Servicing Agent related to this Agreement and as to any default under such other term, provision, condition, covenant or agreement that can be cured, has failed to cure such default within thirty (30)

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days after the occurrence thereof (provided that no Credit Extensions will be required to be made during such cure period).

8.3 Material Adverse Change. If there (i) occurs a Material Adverse Effect, or (ii) is a material impairment of the value or priority of Servicing Agent's security interest in the Collateral.

8.4 Attachment. If any material portion of Borrower's assets is attached, seized, subjected to a writ or distress warrant, or is levied upon, or comes into the possession of any trustee, receiver or person acting in a similar capacity and such attachment, seizure, writ or distress warrant or levy has not been removed, discharged or rescinded within thirty (30) days, or if Borrower is enjoined, restrained, or in any way prevented by court order from continuing to conduct all or any material part of its business affairs, or if a judgment or other claim becomes a lien or encumbrance upon any material portion of Borrower's assets, or if a notice of lien, levy, or assessment is filed of record with respect to any of Borrower's assets by the United States Government, or any department, agency, or instrumentality thereof, or by any state, county, municipal, or governmental agency, and the same is not paid within thirty (30) days after Borrower receives notice thereof, provided that none of the foregoing shall constitute an Event of Default where such action or event is stayed or an adequate bond has been posted pending a good faith contest by Borrower (provided that no Credit Extensions will be required to be made during such cure period).

8.5 Insolvency. If an Insolvency Proceeding is commenced by Borrower or if an Insolvency Proceeding is commenced against Borrower (in either case, an "Insolvency Default") and such Insolvency Proceeding commenced against Borrower is not dismissed or stayed within forty-five (45) days (provided that no Advances or Credit Extensions will be made prior to the dismissal of such Insolvency Proceeding).

8.6 Other Agreements. If there is a default in any agreement to which Borrower is a party with a third party or parties resulting in a right by such third party or parties, whether or not exercised, to accelerate the maturity of any Indebtedness in an amount in excess of One Million and No/100 Dollars (\$1,000,000) or that could have a Material Adverse Effect.

8.7 Subordinated Debt. Borrower or any Subsidiary makes any payment in respect of Subordinated Debt, except as permitted by Section 7.9 above.

8.8 Judgments. If a judgment or judgments for the payment of money in an amount, individually or in the aggregate, of at least One Million and No/100 Dollars (\$1,000,000.00) shall be rendered against Borrower and shall remain unsatisfied and unstayed for a period of thirty (30) days (provided that no Credit Extensions will be made prior to the satisfaction or stay of such judgments, and if the aggregate amount of such unsatisfied, but stayed judgments ever exceeds Two Million and No/100 Dollars (\$2,000,000.00) in the aggregate, then no Credit Extensions will be made unless and until the aggregate amount of such unsatisfied, but stayed judgments are reduced to Two Million and No/100 Dollars (\$2,000,000.00) or less).

8.9 Misrepresentations. If any material misrepresentation or material misstatement exists now or hereafter in any warranty, representation, statement or report set forth herein or made

to Servicing Agent or any Lender by Borrower or any officer or director of Borrower pursuant to this Agreement.

8.10 ERISA. Any of the following shall occur: (1) a Reportable Event shall have occurred with respect to a Plan; (2) the filing by the Borrower, any ERISA Affiliate, or an administrator of any Plan of a notice of intent to terminate such Plan in a "distressed termination" under the provisions of Section 4041 of ERISA; (3) the receipt of notice by the Borrower, any ERISA Affiliate or an administrator of a Plan that the PBGC has instituted proceedings to terminate (or appoint a trustee to administer) such a Plan; (4) and other event or condition exists which might, in the opinion of the Servicing Agent, constitute grounds under the provisions of Section 4042 of ERISA for the termination of or the appointment of a trustee to administer any Plan by the PBGC; (5) a Plan shall fail to maintain a minimum funding standard required by Section 412 of the IRC for any plan year or a waiver of standard is sought or granted under the provisions of Section 412(d) of the IRC; (6) the Borrower or any ERISA Affiliate has incurred, or is reasonably likely to incur, a liability under the provisions of Section 4062, 4036, 4046 or 4201 of ERISA; (7) the Borrower or any ERISA Affiliate fails to pay the full amount of an installment required under Section 412(m) of the IRC; or (8) the occurrence of any other event or condition with respect to any Plan which would constitute an event of default or default under any other agreement entered into by the Borrower or any ERISA Affiliate.

9. SERVICING AGENT'S AND LENDERS' RIGHTS AND REMEDIES

9.1 Rights and Remedies. Upon the occurrence and during the continuance of an Event of Default, Servicing Agent may, at its election, or shall, upon request of Requisite Lenders, without notice of its election and without demand, do any one or more of the following, all of which are authorized by Borrower:

(a) Declare all Obligations, whether evidenced by this Agreement, by any of the other Loan Documents, or otherwise, immediately due and payable (provided that upon the occurrence of an Event of Default described in Section 8.5 all Obligations shall become immediately due and payable without any action by Servicing Agent or Lenders);

(b) Cease advancing money or extending credit to or for the benefit of Borrower under this Agreement or under any other agreement between or among Borrower or Servicing Agent or any Lender;

(c) With the continuation of an Event of Default for sixty (60) days or more, settle or adjust disputes and claims directly with account debtors for amounts, upon terms and in whatever order that Servicing Agent, with the approval of Requisite Lenders, reasonably considers advisable;

(d) Without notice to or demand upon Borrower, make such payments and do such acts as Servicing Agent or Requisite Lenders in good faith consider necessary or reasonable to protect Servicing Agent's security interest in the Collateral. Borrower agrees to assemble the Collateral if Servicing Agent or Requisite Lenders so require, and to make the Collateral available to Servicing Agent as Servicing Agent or Requisite Lenders may designate. Borrower authorizes Servicing Agent, on behalf of each Lender, to enter the premises where the Collateral is located, to

take and maintain possession of the Collateral, or any part of it, and to pay, purchase, contest, or compromise any encumbrance, charge, or lien which in the Requisite Lenders' reasonable determination appears to be prior or superior to its security interest and to pay all expenses incurred in connection therewith. With respect to any of Borrower's premises, Borrower hereby grants Servicing Agent, on behalf of and for the benefit of Lenders, a license to enter such premises and to occupy the same, without charge, in order to exercise any of

Lenders' rights or remedies provided herein, at law, in equity or otherwise;

(e) Without notice to Borrower, set off and apply to the Obligations any and all (i) balances and deposits of Borrower held by any Lender or Servicing Agent, or (ii) indebtedness at any time owing to or for the credit or the account of Borrower owed or owing by any Lender or Servicing Agent;

(f) Ship, reclaim, recover, store, finish, maintain, repair, prepare for sale, advertise for sale, and sell (in the manner provided for herein) the Collateral. Servicing Agent is hereby granted a non-exclusive, royalty-free license or other right, solely pursuant to the provisions of this Section 9.1, to use, without charge, Borrower's labels, Patents, Copyrights, Mask Works, rights of use of any name, trade secrets, trade names, Trademarks, service marks, and advertising matter, or any property of a similar nature, as it pertains to the Collateral, in completing production of, advertising for sale, and selling any Collateral and, in connection with Servicing Agent's exercise of its rights under this Section 9.1, Borrower's rights under all licenses and all franchise agreements shall inure to Servicing Agent's benefit;

(g) Sell the Collateral at either a public or private sale, or both, by way of one or more contracts or transactions, for cash or on terms, in such manner and at such places (including Borrower's premises) as Servicing Agent determines is commercially reasonable, and apply the proceeds thereof to the Obligations in whatever manner or order it deems appropriate;

(h) Servicing Agent, on behalf of all Lenders, may credit bid and purchase at any public sale, or at any private sale as permitted by law; and

(i) Any deficiency that exists after disposition of the Collateral as provided above will be paid immediately by Borrower.

9.2 Power of Attorney. Effective only upon the occurrence and during the continuance of an Event of Default, Borrower hereby irrevocably appoints Servicing Agent on behalf of and for the benefit of Lenders (and any of Servicing Agent's designated officers, or employees) as Borrower's true and lawful attorney to: (a) endorse Borrower's name on any checks or other forms of payment or security that may come into Servicing Agent's or Lenders' possession relating to the Collateral or any part thereof; (b) sign Borrower's name on any invoice or bill of lading relating to any Account, drafts against account debtors, schedules and assignments of Accounts, verifications of Accounts, and notices to account debtors; (c) make, settle, and adjust all claims under and decisions with respect to Borrower's policies of insurance relating to the Collateral or any part thereof; (d) settle and adjust disputes and claims respecting the Accounts directly with account debtors, for amounts and upon terms which Servicing Agent or Lenders determines to be reasonable; (e) modify, in its sole discretion, any intellectual property security agreement entered into between Borrower and Servicing Agent, without first obtaining Borrower's approval of or signature to such

modification, for the sole purpose of amending Exhibit A, Exhibit B, Exhibit C, and Exhibit D, thereof, as appropriate, to include reference to any right, title or interest in any Copyrights, Patents, Trademarks or Mask Works acquired by Borrower after the execution hereof or deleting any reference to any right, title or interest in any Copyrights, Patents, Trademarks, or Mask Works in which Borrower no longer has or claims any right, title or interest; (f) transfer the Intellectual Property Collateral into the name of Servicing Agent or a third party to the extent permitted under the Code; and (g) to file, in its sole discretion, one or more financing or continuation statements and amendments thereto, relative to any of the Collateral without the signature of Borrower where permitted by law; and provided Servicing Agent may exercise such power of attorney to sign the name of Borrower on any of the documents described in Section 4.2 regardless of whether an Event of Default has occurred. The appointment of Servicing Agent as Borrower's attorney in fact, and each and every one of Servicing Agent's rights and powers, being coupled with an interest, is irrevocable until all of the Obligations have been fully repaid and performed and Lenders' obligation to provide Credit Extensions hereunder is

terminated.

9.3 Accounts Collection. Upon the occurrence and during the continuance of an Event of Default, Servicing Agent may notify any Person owing funds to Borrower of Servicing Agent's security interest in such funds. Borrower shall collect all amounts owing to Borrower on behalf of Servicing Agent, receive in trust all payments as Servicing Agent's and Lenders' trustee, and if required by Section 6.12, immediately deliver such payments to Servicing Agent in their original form as received from the account debtor, with proper endorsements for deposit.

9.4 Lenders' Expenses. If Borrower fails to pay any amounts or furnish any required proof of payment due to third persons or entities, as required under the terms of this Agreement, then Servicing Agent or Requisite Lenders may do any or all of the following: (a) make payment of the same or any part thereof; (b) set up such reserves under the Committed Revolving Line as Servicing Agent or Requisite Lenders deems necessary to protect Lenders from the exposure created by such failure; or (c) obtain and maintain insurance policies of the type discussed in Section 6.6 of this Agreement, and take any action with respect to such policies as such Lender deems prudent. Any amounts so paid or deposited by Servicing Agent or any Lender shall constitute Lenders' Expenses, shall be immediately due and payable, and shall bear interest at the then applicable rate hereinabove provided, and shall be secured by the Collateral. Any payments made by any Lender or Servicing Agent shall not constitute an agreement by such Lender or Servicing Agent to make similar payments in the future or a waiver by such Lender or Servicing Agent of any Event of Default under this Agreement.

9.5 Lenders' Liability for Collateral. So long as Lenders comply with reasonable banking practices, no Lender shall in any way or manner be liable or responsible for: (a) the safekeeping of the Collateral; (b) any loss or damage thereto occurring or arising in any manner or fashion from any cause; (c) any diminution in the value thereof; or (d) any act or default of any carrier, warehouseman, bailee, forwarding agency, or other person whomsoever other than such losses, costs, expenses or liabilities based upon or arising out of the gross negligence or willful misconduct of the Servicing Agent or such Lender. All risk of loss, damage or destruction of the Collateral shall be borne by Borrower.

9.6 Remedies Cumulative. Lenders' rights and remedies under this Agreement, the Loan Documents, and all other agreements shall be cumulative. Lenders shall have all other rights

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and remedies, not expressly set forth herein, and as provided under the Code, by law, or in equity. No exercise by Lenders of one right or remedy shall be deemed an election, and no waiver by Lenders of any Event of Default on Borrower's part shall be deemed a continuing waiver. No delay by Lenders shall constitute a waiver, election, or acquiescence by it. No waiver by Lenders shall be effective unless made in a written document signed by all Lenders and Servicing Agent and then shall be effective only in the specific instance and for the specific purpose for which it was given.

9.7 Demand; Protest. Borrower waives demand, protest, notice of protest, notice of default or dishonor, notice of payment and nonpayment, notice of any default, notice of intent to accelerate, notice of acceleration, nonpayment at maturity, release, compromise, settlement, extension, or renewal of accounts, documents, instruments, chattel paper, and guarantees at any time held by Lenders or Servicing Agent on which Borrower may in any way be liable.

10. NOTICES

Unless otherwise provided in this Agreement, all notices or demands by any party relating to this Agreement or any other agreement entered into in connection herewith shall be in writing and (except for financial statements and other informational documents which may be sent by first-class mail, postage prepaid) shall be personally delivered or sent by a recognized overnight delivery service, by certified mail, postage prepaid, return receipt requested, or by facsimile to Borrower or Lenders or Servicing Agent, as the case may be, at its addresses set forth below:

If to Borrower: VTEL Corporation
108 Wild Basin Road
Austin, Texas 78746
Attn: Ms. Dianne Johnson, Treasurer
Fax: 512/437-2718

If to Servicing Agent: Silicon Valley Bank
9020 Capital of Texas Highway North
Building 1, Suite 350
Austin, Texas 78759
Attn: Mr. J. Doug Mangum, Senior Vice President
Fax: 512/794-0855

If to SVB: Silicon Valley Bank
9020 Capital of Texas Highway North
Building 1, Suite 350
Austin, Texas 78759
Attn: Mr. J. Doug Mangum, Senior Vice President
Fax: 512/794-0855

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If to Comerica: Comerica Bank-Texas
1601 Elm Street
Dallas, Texas 75201

P.O. Box 650282
Dallas, Texas 75265-0282
Attn: Mr. Gary Orr, Chief Credit Officer

with a copy to: Comerica Bank-Texas
804 Congress Ave., Suite 320
Austin, Texas 78701
Attn: Ms. Robin Ingari, Senior Vice President
Fax: 512/251-7417

The parties hereto may change the address at which they are to receive notices hereunder, by notice in writing in the foregoing manner given to the other. NOTICES TO ONE LENDER SHALL NOT BE DEEMED NOTICE TO ANY OTHER LENDER.

11. CHOICE OF LAW AND VENUE

THE LOAN DOCUMENTS SHALL BE GOVERNED BY, AND CONSTRUED IN ACCORDANCE WITH, THE INTERNAL LAWS OF THE STATE OF TEXAS, WITHOUT REGARD TO PRINCIPLES OF CONFLICTS OF LAW AS IF PERFORMED ENTIRELY WITHIN THE STATE OF TEXAS BY TEXAS RESIDENTS. EACH OF BORROWER, SERVICING AGENT AND LENDERS HEREBY SUBMIT TO THE EXCLUSIVE JURISDICTION OF THE STATE AND FEDERAL COURTS LOCATED IN THE COUNTY OF TRAVIS, STATE OF TEXAS.

12. PARTICIPATION

12.1 Participation Interest. Any Lender may at any time sell to one or more commercial banks or other Persons not Affiliates of Borrower ("Participant") participating interests in any Credit Extensions, the Commitment of such Lender and the other interests of such Lender ("Original Lender") hereunder and under the other Loan Documents; provided, however, that (i) the Original Lender's obligations under this Agreement shall remain unchanged, (ii) the Original Lender shall remain solely responsible for the performance of such obligations, (iii) Borrower shall continue to deal solely and directly with the Original Lender in connection with the Original Lender's rights and obligations under the Agreement and the other Loan Documents, and (iv) no Lender shall transfer or grant any participating interest under which the Participant shall have rights to approve any amendment to, or any consent or waiver with respect to, this Agreement or any other Loan Document.

12.2 No Obligation. Neither Lender shall have any obligation, implied or express, to assign, delegate, sell, offer to sell, purchase, offer to purchase or otherwise transfer in any way to any other party hereunder or any third party any participating interest hereunder or any or all of the Advances,

the Commitments or the other rights and obligations of such Lender hereunder.

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13. THE SERVICING AGENT

13.1 Appointment, Powers and Immunities.

13.1.1 Each Lender hereby appoints SVB as Servicing Agent hereunder and under the other Loan Documents and each Lender hereby irrevocably authorizes Servicing Agent to act hereunder and thereunder as Servicing Agent of such Lender. Servicing Agent agrees to act as such upon the express conditions contained in this Section 13. In performing its functions and duties under this Agreement and under the other Loan Documents, Servicing Agent shall act solely as Servicing Agent of Lenders and does not assume and shall not be deemed to have assumed any obligation towards or relationship of agency or trust with or for Borrower.

13.1.2 Each Lender irrevocably authorizes Servicing Agent to take such actions on such Lender's behalf and to exercise such powers hereunder as are specifically delegated to Servicing Agent by the terms hereof, together with such powers as are reasonably incidental thereto. Servicing Agent shall have only those duties which are specified in this Agreement and it may perform such duties by or through its agents, representatives or employees. In performing its duties hereunder on behalf of Lenders, Servicing Agent shall exercise the same care which it would exercise in dealing with loans made for its own account, but it shall not be responsible to any Lender for the execution, effectiveness, genuineness, validity, enforceability, collectability or sufficiency of all or any of the Loan Documents, or for any representations, warranties, recitals or statements made herein or therein or made in any written or oral statement or in any financial or other statements, instruments, reports, certificates or any other documents furnished or delivered in connection herewith or therewith by Servicing Agent to any Lender or by or on behalf of Borrower to Servicing Agent or any Lender, or be required to ascertain or inquire as to the performance or observances of any of the terms, conditions, provisions, covenants or agreements contained herein or therein or as to the use of the proceeds of the Advances of amounts drawn under the Letters of Credit. Servicing Agent shall not be responsible for insuring the Collateral or for the payment of any taxes, assessments, charges or any other charges or liens of any nature whatsoever upon the Collateral or otherwise for the maintenance of the Collateral, except in the event Servicing Agent enters into possession of a part or all of the Collateral, in which event Servicing Agent shall preserve the part in its possession. Unless the officers of Servicing Agent acting in their capacity as officers of Servicing Agent on Borrower's account have actual knowledge thereof or have been notified in writing thereof by Lenders, Servicing Agent shall not be required to ascertain or inquire as to the existence or possible existence of any Event of Default. Neither Servicing Agent nor any of its officers, directors, employees, representatives or agents shall be liable to Lenders for any action taken or omitted hereunder or under any of the other Loan Documents or in connection herewith or therewith unless caused by its or their gross negligence or willful misconduct. No provision of this Agreement or of any other Loan Document shall be deemed to impose any duty or obligation on Servicing Agent to perform any act or to exercise any power in any jurisdiction in which it shall be illegal, or shall be deemed to impose any duty or obligation on Servicing Agent to perform any act or exercise any right or power if such performance or exercise (i) would subject Servicing Agent to a tax in a jurisdiction where it is not then subject to a tax or (ii) would require Servicing Agent to qualify to do business in any jurisdiction where it presently is not so qualified. Without prejudice to the generality of the foregoing, no Lender shall have any right of action whatsoever against Servicing Agent as a result of Servicing Agent acting or (where so instructed) refraining from acting under this Agreement or under any of the other Loan Documents in accordance with the instructions of Lenders. Unless

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otherwise directed by the Requisite Lenders under Section 9.1 or any other applicable provision of this Agreement, Servicing Agent shall be entitled to refrain from exercising any power, discretion or authority vested in it under this Agreement unless and until it has obtained written instructions of any Lender. The agency hereby created shall in no way impair or affect any of the rights and powers of, or impose any duties or obligations upon Servicing Agent in its individual capacity.

13.2 Representations and Warranties: No Responsibility for Inspection. Each Lender represents and warrants that it has made its own independent investigation of the financial condition and affairs of Borrower in connection with the making of the Advances and issuance of the Letters of Credit hereunder and has made and shall continue to make its own appraisal of the creditworthiness of Borrower. Servicing Agent shall have no duty or responsibility either initially or on a continuing basis to make any such investigation or any such appraisal on behalf of Lenders or to provide any Lender with any credit or other information (other than information obtained under the provisions of this Agreement which Servicing Agent shall make available to each Lender upon request by such Lender) with respect thereto whether coming into its possession before the date hereof or any times or times thereafter and shall further have no responsibility with respect to the accuracy of or the completeness of the information provided to Lenders. With respect to its participation in the Advances and the Letters of Credit hereunder, Servicing Agent shall have the same rights and powers hereunder as any other Lender and may exercise the same rights and powers as though it were not performing the duties and functions delegated to it hereunder and the term "Lender" or "Lenders" or any similar term shall unless the context clearly indicates otherwise include Servicing Agent in its individual capacity. Servicing Agent and each of its affiliates may accept deposits from, lend money to and generally engage in any kind of business with Borrower as if it were not Servicing Agent.

13.3 Reliance by Servicing Agent.

13.3.1 Servicing Agent may consult, and any opinion or legal advice of such counsel who are not employees of Servicing Agent or Borrower or any Affiliate of Borrower shall be full and complete authorization and protection in respect of any action taken or suffered by Servicing Agent hereunder or under any other Loan Documents in accordance therewith. Servicing Agent shall have the right at any time to seek instructions concerning the administration of the Collateral from any court of competent jurisdiction.

13.3.2 Servicing Agent may rely, and shall be fully protected in acting, upon any resolution, statement, certificate, instrument, opinion, report, notice, request, consent, order, bond or other paper or document that it has no reason to believe to be other than genuine and to have been signed or presented by the proper party or parties or, in the case of cables, teletypes and telexes, to have been sent by the proper party or parties. In the absence of its gross negligence or willful misconduct, Servicing Agent may conclusively rely, as to the truth of the statements and the correctness of the opinions expressed therein, upon any certificates or opinions furnished to Servicing Agent and conforming to the requirements of this Agreement or any of the other Loan Documents.

13.3.3 Except as specifically provided for herein, Servicing Agent shall not be under any obligation to exercise any of the rights or powers granted to Servicing Agent by this Agreement and the other Loan Documents at the request or direction of any Lender unless Servicing

Agent shall have been provided by such Lender adequate security and indemnity against the costs, expenses and liabilities that may be incurred by it in compliance with such request or direction.

13.4 Delegation of Duties. Servicing Agent may execute any of the powers hereof and perform any duty hereunder either directly or by or through its agents or attorneys-in-fact. Servicing Agent shall be entitled to advice of counsel concerning all matters pertaining to such powers and duties. Servicing Agent shall not be responsible for the negligence or misconduct of any agents or attorneys-in-fact selected by it without gross negligence or willful

misconduct on the part of Servicing Agent.

13.5 Right to Indemnity. EACH OF LENDERS SEVERALLY, BUT NOT JOINTLY, AGREES (A) TO INDEMNIFY AND HOLD SERVICING AGENT (AND ANY PERSON ACTING ON BEHALF OF SERVICING AGENT) HARMLESS FROM AND AGAINST AND (B) PROMPTLY ON RECEIPT BY EACH LENDER OF SERVICING AGENT'S STATEMENT, TO REIMBURSE SERVICING AGENT, ACCORDING TO SUCH LENDER'S PRO RATA SHARE OF THE AGGREGATE COMMITMENTS, TO THE EXTENT SERVICING AGENT SHALL NOT OTHERWISE HAVE BEEN REIMBURSED BY BORROWER ON ACCOUNT OF AND FOR, ANY AND ALL LIABILITIES, OBLIGATIONS, LOSSES, DAMAGES, PENALTIES, ACTIONS, JUDGMENTS, SUITS, COSTS, EXPENSES (INCLUDING, WITHOUT LIMITATION, THE FEES AND DISBURSEMENTS OF COUNSEL AND OTHER ADVISORS) OR DISBURSEMENTS OF ANY KIND AND NATURE WHATSOEVER WITH RESPECT TO SERVICING AGENT'S PERFORMANCE OF ITS DUTIES UNDER THIS AGREEMENT AND THE OTHER LOAN DOCUMENTS; PROVIDED, HOWEVER, THAT NO LENDER SHALL BE LIABLE FOR THE PAYMENT TO SERVICING AGENT OF ANY PORTION OF SUCH LIABILITIES, OBLIGATIONS, LOSSES, DAMAGES, PENALTIES, ACTIONS, JUDGMENTS, SUITS, COSTS, EXPENSES OR DISBURSEMENTS RESULTING SOLELY FROM SERVICING AGENT'S GROSS NEGLIGENCE OR WILLFUL MISCONDUCT. SUCH REIMBURSEMENT SHALL NOT IN ANY RESPECT RELEASE BORROWER FROM ANY LIABILITY OR OBLIGATION. IF ANY INDEMNITY FURNISHED TO SERVICING AGENT FOR ANY PURPOSE SHALL, IN THE OPINION OF SERVICING AGENT, BE INSUFFICIENT OR BECOME IMPAIRED, SERVICING AGENT MAY CALL FOR ADDITIONAL INDEMNITY AND CEASE, OR NOT COMMENCE, TO DO THE ACTS INDEMNIFIED AGAINST UNTIL SUCH ADDITIONAL INDEMNITY IS FURNISHED.

13.6 Resignation and Appointment of Successor Servicing Agent.

(a) Servicing Agent may resign at any time by giving thirty (30) days prior written notice thereof to Lenders and Borrower: provided, however, that the retiring Servicing Agent shall continue to serve until a successor Servicing Agent shall have been selected and approved pursuant to this Section 13.6. Upon any such notice, Servicing Agent shall have the right to appoint a successor Servicing Agent; provided, however, that if such successor shall not be a Lender under this Agreement, such appointment shall be subject to the consent of Requisite Lenders. At any time other than during the existence of an Event of Default, in each case, such appointment shall be subject to the prior consent of Borrower (such consent to not be unreasonably withheld, delayed or conditioned).

(b) Servicing Agent agrees at all times to abide by the terms and conditions of this Agreement and at all times to maintain the minimum regulatory capital requirements, as set by the Federal Reserve Board, for an adequately capitalized depository institution, and Servicing Agent undertakes and agrees to notify each Lender promptly of any failure by Servicing Agent to

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maintain such minimum regulatory capital requirements. If Servicing Agent ever defaults in the performance of its duties and obligations under this Agreement and such default remains uncured and continues for more than thirty (30) days after written notice of such default is given to Servicing Agent by any Lender, or if Servicing Agent ever allows its regulatory capital requirements to fall below the minimum regulatory capital requirements for an adequately capitalized depository institution, any Lender which is not also acting as the Servicing Agent hereunder may remove such Servicing Agent from acting as Servicing Agent hereunder and appoint a successor Servicing Agent (which may be the Lender so removing the Servicing Agent) by delivering written notice thereof to the Borrower, the Servicing Agent being removed hereunder and any other Lenders, if any; provided, however, that if such successor Servicing Agent shall not be a Lender hereunder, such appointment shall be subject to the prior approval of Borrower (such consent to not be unreasonably withheld, conditioned or delayed), so long as no Event of Default is then occurring hereunder.

(c) Upon the acceptance of any appointment as an Servicing Agent hereunder by a successor Servicing Agent, such successor Servicing Agent shall thereupon succeed to and become vested with all the rights, powers, privileges and duties of the retiring or removed Servicing Agent, and the retiring or removed Servicing Agent shall be discharged from its duties and obligations under this Agreement. After any retiring or removed Servicing Agent's resignation or removal hereunder as Servicing Agent, the provisions of this Section 13 shall inure to its benefit as to any actions taken

or omitted to be taken by it while it was Servicing Agent under this Agreement.

13.7 Conflicts. SVB and its affiliates may accept deposits from, lend money to, act as trustee under indentures of, act as merchant banker in any transaction for, and generally engage in any kind of business with, Borrower and any person who may do business with or own securities of Borrower, all as if SVB were not Servicing Agent and without any duty to account therefor to Lenders or to disclose to Lenders confidential information which SVB may receive from Borrower in connection with such other activity or business.

13.8 No Obligations of Borrower. Nothing contained in this Section 13 shall be deemed to impose upon Borrower any obligation in respect of the due and punctual performance by Servicing Agent of its obligations to Lenders under any provision of this Agreement, and Borrower shall have no liability to Servicing Agent or any Lender in respect of any failure by Servicing Agent or any Lender to perform any of their respective obligations to each other under this Agreement. Without limiting the generality of the foregoing sentence, where any provision of this Agreement relating to the payment of any amounts due and owing under the Loan Documents provides that such payments shall be made by Borrower to Servicing Agent for the account of Lenders, Borrower's obligations to Lenders in respect of such payments shall be deemed to be satisfied upon the making of such payments to Servicing Agent in the manner provided by this Agreement.

13.9 Amendments in Writing; Integration. This Agreement cannot be amended or terminated nor may any provision be waived except by a writing signed by the Requisite Lenders, Servicing Agent and Borrower. Any such waiver shall be effective only in the specific instance and for the specific purpose for which given.

As between Borrower, on the one hand, the Lenders and Servicing Agent on the other hand, all prior agreements, understandings, representations, warranties, and negotiations between the parties

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hereto with respect to the subject matter of this Agreement, if any, are merged into this Agreement and the Loan Documents.

14. GENERAL PROVISIONS

14.1 Successors and Assigns. This Agreement shall bind and inure to the benefit of the respective successors and permitted assigns of each of the parties; provided, however, that neither this Agreement nor any rights hereunder may be assigned by Borrower without each Lender's prior written consent, which consent may be granted or withheld in each Lender's sole discretion.

14.2 INDEMNIFICATION. BORROWER SHALL, INDEMNIFY, DEFEND, PROTECT AND HOLD HARMLESS SERVICING AGENT AND EACH LENDER AND EACH'S RESPECTIVE DIRECTORS, OFFICERS, EMPLOYEES, AND AGENTS AGAINST: (A) ALL OBLIGATIONS, DEMANDS, CLAIMS, AND LIABILITIES CLAIMED OR ASSERTED BY ANY OTHER PARTY IN CONNECTION WITH THE TRANSACTIONS CONTEMPLATED BY THE LOAN DOCUMENTS; AND (B) ALL LOSSES OR LENDER'S EXPENSES INCLUDING WITHOUT LIMITATION REASONABLE ATTORNEYS' FEES AND EXPENSES, IN ANY WAY SUFFERED, INCURRED, OR PAID BY SERVICING AGENT OR ANY LENDER AS A RESULT OF OR IN ANY WAY ARISING OUT OF, FOLLOWING, OR CONSEQUENTIAL TO TRANSACTIONS BY AND AMONG LENDERS, SERVICING AGENT AND BORROWER WHETHER UNDER THE LOAN DOCUMENTS, OR OTHERWISE INCLUDING ANY LENDER'S OR SERVICING AGENT'S NEGLIGENCE BUT EXCLUDING LOSSES CAUSED BY SERVICING AGENT OR ANY LENDER'S GROSS NEGLIGENCE OR WILLFUL MISCONDUCT.

14.3 Time of Essence. Time is of the essence for the performance of all obligations set forth in this Agreement.

14.4 Severability of Provisions. Each provision of this Agreement shall be severable from every other provision of this Agreement for the purpose of determining the legal enforceability of any specific provision. If any term, provision, covenant, or condition of this Agreement is held by a court of competent jurisdiction to be invalid, void, or unenforceable, the remainder of the provisions shall remain in full force and effect and shall in no way be affected, impaired, or invalidated and this Agreement shall be

construed as if such invalid, void or unenforceable provision had never been contained herein.

14.5 Counterparts. This Agreement may be executed in any number of counterparts and by different parties on separate counterparts, each of which, when executed and delivered, shall be deemed to be an original, and all of which, when taken together, shall constitute but one and the same Agreement.

14.6 Survival. All covenants, representations and warranties made in this Agreement shall continue in full force and effect so long as any Obligations remain outstanding. The obligations of Borrower to indemnify Lenders and Servicing Agent with respect to the expenses, damages, losses, costs and liabilities described in Section 14.2 shall survive until all applicable statute of limitations periods with respect to actions that may be brought against Lenders or Servicing Agent have run.

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14.7 Confidentiality. In handling any confidential information of Borrower, Servicing Agent and each Lender shall exercise the same degree of care that it exercises with respect to its own proprietary information of the same types to maintain the confidentiality of any non-public information thereby received or received pursuant to this Agreement, except that disclosure of such information may be made (i) to the Subsidiaries or Affiliates of Servicing Agent and each Lender in connection with their present or prospective business relations with Borrower, (ii) to prospective transferees or purchasers of any interest in the Credit Extensions, provided that they have entered into a comparable confidentiality agreement in favor of Borrower and have delivered a copy to Borrower, (iii) as required by law, regulation, rule or order, subpoena, judicial order or similar order, (iv) as may be required in connection with the examination, audit or similar investigation of Servicing Agent or any Lender, and (v) as Servicing Agent or any Lender may deem appropriate in connection with the exercise of any remedies hereunder. Confidential information hereunder shall not include information that either: (a) is in the public domain or in the knowledge or possession of Servicing Agent or any Lender when disclosed to Servicing Agent or such Lender, provided Servicing Agent or such Lender does not have actual knowledge that such third party is prohibited from disclosing such information, or becomes part of the public domain after disclosure to Servicing Agent or any Lender through no fault of Servicing Agent or such Lender; or (b) is disclosed to Servicing Agent or any Lender by a third party, provided Servicing Agent or such Lender does not have actual knowledge that such third party is prohibited from disclosing such information.

14.8 WAIVER OF JURY TRIAL. SERVICING AGENT, LENDERS AND BORROWER EACH HEREBY WAIVE THEIR RESPECTIVE RIGHTS TO A JURY TRIAL OF ANY CLAIM OR CAUSE OF ACTION BASED UPON OR ARISING OUT OF ANY OF THE LOAN DOCUMENTS OR ANY OF THE TRANSACTIONS CONTEMPLATED THEREIN, INCLUDING CONTRACT CLAIMS, TORT CLAIMS, BREACH OF DUTY CLAIMS, AND ALL OTHER COMMON LAW OR STATUTORY CLAIMS. EACH PARTY RECOGNIZES AND AGREES THAT THE FOREGOING WAIVER CONSTITUTES A MATERIAL INDUCEMENT FOR IT TO ENTER INTO THIS AGREEMENT. EACH PARTY REPRESENTS AND WARRANTS THAT IT HAS REVIEWED THIS WAIVER WITH ITS LEGAL COUNSEL AND THAT IT KNOWINGLY AND VOLUNTARILY WAIVES ITS JURY TRIAL RIGHTS FOLLOWING CONSULTATION WITH LEGAL COUNSEL.

14.9 NOTICE OF FINAL AGREEMENT. THIS AGREEMENT AND THE LOAN DOCUMENTS TOGETHER CONSTITUTE A WRITTEN LOAN AGREEMENT WHICH REPRESENTS THE FINAL AGREEMENT BETWEEN THE PARTIES AND MAY NOT BE CONTRADICTED BY EVIDENCE OF PRIOR, CONTEMPORANEOUS, OR SUBSEQUENT ORAL AGREEMENTS OF THE PARTIES. THERE ARE NO UNWRITTEN ORAL AGREEMENTS BETWEEN THE PARTIES.

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IN WITNESS WHEREOF, the parties hereto have caused this Agreement to be executed as of the date first above written.

VTEL CORPORATION

By: /s/ Dianne Johnson

Dianne Johnson, Treasurer

SILICON VALLEY BANK,
AS SERVICING AGENT AND AS A LENDER

By: /s/ J. Douglas Mangum

J. Douglas Mangum, Senior Vice President

COMERICA BANK-TEXAS

By: /s/ Robin A. Ingari

Robin A. Ingari, Senior Vice President

EXHIBIT 21.1

VTEL CORPORATION
LIST OF SUBSIDIARIES
EXHIBIT 21.1

SUBSIDIARY	LOCATION OF INCORPORATION
Compression Labs, Incorporated	Delaware
VTEL-ICS, Incorporated	Delaware
VTEL Australia Ltd. Pty.	Australia
CLI Belgium	Belgium
CLI Europe Ltd.	United Kingdom
VTEL Europe Ltd.	United Kingdom
VTEL Germany GmbH	Germany
VTEL France S.A.	France
VTEL Brazil LTDA	Brazil

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (Nos. 33-51822, 33-65464, 33-65472, 33-65478, 33-95754, 333-28499, 333-44533, 333-48885 and 333-77733) of VTEL Corporation of our report dated September 24, 1999 appearing in this Annual Report on Form 10-K.

PRICEWATERHOUSECOOPERS LLP

Austin, Texas
November 4, 1999

<ARTICLE>

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<LEGEND>

This schedule contains summary financial information extracted from VTEL Corporation's Balance Sheet as of July 31, 1999 and Income Statement for the year then ended and is qualified in its entirety by reference to the company's Annual Report on Form 10-K for the fiscal period ending July 31, 1999.

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