evolution 2000

Digital Microwave Corporation 2000 Annual Report
(DMC Stratex Networks, Inc.)

Digital Microwave Corporation is leading the advance of wireless solutions into a new generation of broadband transport.

4xOC-3/4xSTM-1
OC-12/STM-4
622 Mbps

Millennium*

2xOC-3/2xSTM-1
311 Mbps

Altium

OC-3/STM-1
155 Mbps

DS-3/E3
45 Mbps

XP4
SPECTRUM II
DXR

T1/E1
1.5 Mbps
DART

* under development

Worldwide, the demand for data is driving networks to higher and higher capacity services. The systems transporting data and voice are changing. T1/E1 lines are yielding to DS-3/E3; DS-3/E3 services are migrating to the fiber-optics-level services of OC-3/STM-1.

As of Fiscal 2000, the Company is leveraging its extensive expertise in network interconnection and is already delivering wireless technologies that augment, complement or take the place of fiber in networks throughout the world. And, higher capacity wireless solutions are on the horizon.

after "ready...set...go."

In our prior year's report to our Stockholders, we detailed the preparation and starting-line plans for Digital Microwave Corporation's recovery and growth following 1998's world economic crises. A year later, we now report our successes and the momentum of the activities triggered by those plans. Compelled and propelled to action, we moved in rapid succession through evolutionary events. We strengthened our financials; streamlined operations; rolled out new products; expanded the range and reach of our solutions; enabled faster deployment of higher capacity networks; became the leader in broadband wireless access. The momentum, the driving energy, and the milestones of the effort are our Fiscal 2000 countdown to new beginnings.

nine [9]

10 Return to profitability in the FY 2000 first quarter spurs momentum for growth throughout the year.

9 Quarter-by-quarter increases in new orders confirm global market recoveries and acceptance of our extensive solutions-based product line.

[8] Heightened demands for data serving voice, Internet, and private network requirements drive the need for broadband communications in buildings not connected to fiber optic networks—especially in the U.S. and Europe.

7 Exceptional year-to-year growth in our broadband access product orders confirms acceptance of our wireless solutions as complements and alternatives to fiber optics in this burgeoning new market.

6 Our rapid rollout of the Altium™ radio product line makes it the most available and popular 155 Mbps broadband access radio in the world—and the most successful product launch in the Company's history.

5 New transmission technology patents and the development of our proprietary *Velocity* chipset mark break-through technical innovations enabling future product developments.

4 Focused on ultra-high-capacity access solutions, we launch Project Millennium—a synergistic, total company program for development of wireless solutions matching higher fiber speeds.

[3] With North America revenues nearly doubling year-to-year, the company takes a leadership position in the growing U.S. broadband wireless access market.

[2] Careful financial management, a solid cash position, and appropriate asset utilization prepare the company financially for future investments and developments.

one[1]

[1] Working as a strategic partner to customers developing networks worldwide, the Company outgrows its product-focused Digital Microwave name. A *new name* for the *new Company* is recommended to the Stockholders: DMC Stratex Networks, Inc.

Understanding the dangers of delay.
Embracing the benefits of change.

Seizing opportunities.
Taking risks. Working hard.

Creating alliances.

These are dynamics that push *evolution* into *revolution*. For DMC Stratex Networks, the countdown of evolutionary events has launched a revolutionary company—one that is new and yet well grounded in a powerful heritage and history; a company positioned to meet the revolutionary needs of communications networks into the future.

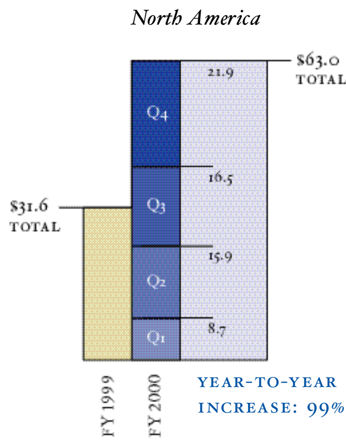
Because of Internet access and high-speed data communications, the global need for speed and network capacity is unprecedented and growing exponentially. DMC Stratex Networks is leading the development of the high- and ultra-high-capacity wireless access solutions that implement quickly, complement fiber optics where it exists, and take the place of fiber where it cannot be installed easily or economically.

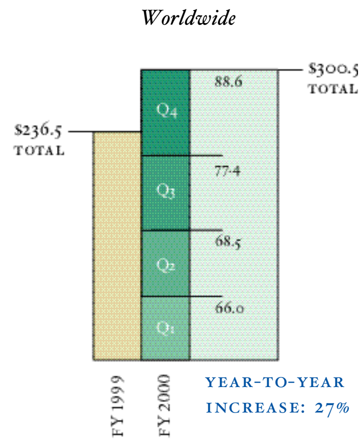
In mobile communications, where the Company has a long history as a transmission systems supplier, the industry is moving toward more and more data services over digital cellular networks. DMC Stratex Networks is the ready solutions provider meeting the higher capacity needs of these networks as they expand services to growing numbers of subscribers.

Broadband. Access. Fixed Wireless. Mobile Networks. The terms connote the industry revolution guaranteeing that future requirements will be different from those of the past.

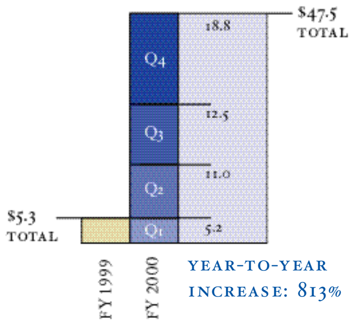
DMC Stratex Networks. The name identifies a company that is revolutionized and ready—equipped by the past and poised for the future—to innovate, develop, deliver, partner, and otherwise participate in this communications revolution.

net sales growth ($ MILLIONS)

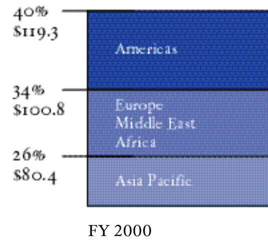




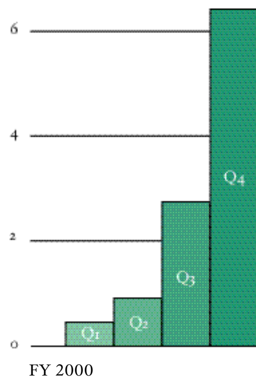
altium net sales growth ($ MILLIONS)



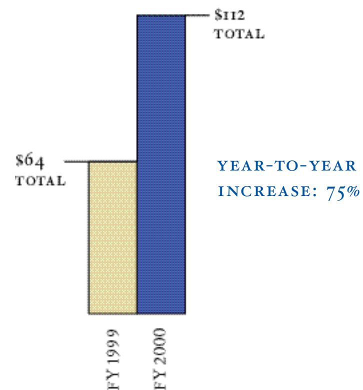
net sales by geography ($ MILLIONS)



net income ($ MILLIONS)



backlog ($ MILLIONS)



to our stockholders,

We are extremely pleased to report that Fiscal Year 2000 was a very positive time for your Company. When we wrote to you a year ago at the end of the 1999 Fiscal Year, we outlined our plans to rebound from a tough year caused by the dramatic and sudden downturn in economies in some of our major world markets. In writing to you now—reporting the results of Fiscal Year 2000—we are pleased to be able to tell you that we not only have rebounded; but that we have emerged as a leader in some of the most dynamic and growing areas of the world communications marketplace.

Our preparation and focus coming into the year created positive results almost immediately. Our own improvements showed progress at about the same time that we began to see positive business indicators, including the increased liquidity that allowed our customers once again to implement their network development plans. We regained profitability in the first quarter, and rapid growth in demand—especially for our new products—followed, providing solid, quarter-to-quarter improvements in top and bottom line results. In addition to our new Altium™, DART™, XP4, and DXR™ 700 radios, we launched ProVision™, a new network management system built on an enterprise-based system serving data networking. Advances in our strengthened product position, coupled with improvements in the balance sheet, set the pace for rapid progress throughout the year.

By the end of the second quarter of Fiscal 2000, our Altium broadband radio was shipping in most of its planned radio frequencies—making it the most successful and fastest product line rollout in the Company's history. Initial shipments of the 38 GHz Altium radio in the fourth quarter, as planned, completed the product rollout. Intensive demands for bandwidth, driven by data and enhanced voice offerings, have propelled Altium to become a high-visibility, industry-leading product line.

During the year, while we continued to receive repeat business from existing customers as they enhanced their networks, we gained new customers at a rapid rate. We also moved into more strategic roles with our customers. We forged partnerships with major network developers, and the Company emerged as a total solutions provider—meeting needs from initial network

planning requirements through support of installed networks. We also opened a new regional service center in the Philippines, complementing existing service and support centers in California, New Zealand, and Scotland.

We strengthened the business infrastructures underlying the operational foundation of the Company to accelerate our growth. We began implementing major new internal systems for manufacturing, services, quality, engineering, and sales.

An important part of our building strength was the enhancement of our management group at both the executive and operations levels during the year. The addition of Harvey Scheingold, Vice President of Quality, to the corporate executive staff underscored our emphasis on quality throughout the Company. We brought in strong general managers at our key manufacturing sites. And, as our signatures on this letter confirm, Sam Smookler moved into expanded responsibilities as President and Chief Executive Officer, allowing Chuck Kissner, as Chairman, to focus more fully on new, strategic areas of business development for the Company.

Now, the Company enjoys a significant position as a premier provider of high-capacity wireless access solutions. Our product offerings in the fiber-level OC-3/STM-1 Altium radio family are augmented by our multiple products at DS-3 and E3 capacities in our XP4, DXR and SPECTRUM II products.

The trend toward higher capacity networks is undeniable, and your Company is at the forefront in providing the best wireless solutions to meet those needs. For example, the Altium radio product family is a vanguard wireless solution for delivery of capacities previously transported only by fiber optics. It is our intention to drive the technology of wireless—as a high-capacity solution—to higher speeds and capacities.

We have now launched a major product development program termed Millennium that aims to create these higher capacity wireless transmission systems to meet future needs. Development this year of a chipset, which we have called Velocity, a proprietary technology, enables and speeds our product developments in this area.

Executive Staff (from left to right):

Charles D. Kissner, *Chairman*

Sam Smookler, *President and CEO*

Carl A. Thomsen, *Senior Vice President, CFO, and Corporate Secretary*

John Brandt, *Vice President and Corporate Controller*

Paul A. Kennard, *Chief Technical Officer*

Carol A. Goudey, *Corporate Treasurer and Assistant Secretary*

Frank Carretta, Jr., *Senior Vice President, Worldwide Sales*

Harvey E. Scheingold, *Vice President, Corporate Quality*

John P. O'Neil, *Vice President, Personnel*

The advances during Fiscal 2000 provided strong indicators that we needed to re-identify the Company for our many audiences. Digital Microwave Corporation has enjoyed a recognized position as a provider of microwave radios. The Company now has also earned a significant and sustainable market position as a provider of broadband wireless access solutions. This position is grounded in the heritage of Digital Microwave Corporation's product expertise, yet it goes beyond the product focus of the historical company both in strategic involvement and in the higher aim of its broadband emphasis.

Access to higher capacity, data-intensive communication services such as the Internet and worldwide private networks is required for survival in today's businesses and in education. While most buildings, even in countries with established communication infrastructures, do not have the fiber-speed access required, we are now equipping networks with just such capacity in cost-effective wireless solutions. And, we expect our leadership in doing so will continue.

The advances, the momentum, and the energy of this year have been revolutionary in their effect. As a result, coincident with this report, we are recommending that our Stockholders approve a new company name: DMC Stratex Networks, Inc. "DMC" recognizes our heritage. "Stratex," based in the meanings of "strategic" and "high" (as in "stratospheric"), is a powerful new name identifying the Company's advances into ultra-high-capacity solutions. "Networks" allies us with our customers, with whom we are playing an increasing role in providing complete network solutions that promise to unite the world with communications.

In conclusion, we thank our many employees for their dedication and accomplishments, and our stockholders and customers who continued to work with us during both the difficult times as well as the more gratifying times that we now are experiencing. We share our confidence that with ongoing focus, dedication, and attentive hard work, the new DMC Stratex Networks, Inc., will continue to lead the advance of communications worldwide.

Sam Smookler
President and CEO

Charles D. Kissner
Chairman of the Board

financial highlights and stock information

	Years ended March 31,				
	2000	1999	1998	1997	1996
	(in thousands, except per share data and number of employees)				
Net sales	**$ 300,503**	$ 236,499	$ 345,116	$ 213,441	$ 174,380
Net income (loss)	**$ 12,136**	$ (96,729)	$ 18,818	$ 6,461	$ (13,533)
Diluted earnings (loss) per share	**$ 0.17**	$ (1.57)	$ 0.35	$ 0.13	$ (0.35)
Total assets	**$ 337,441**	$ 202,164	$ 297,196	$ 200,504	$ 113,597
Working capital	**$ 209,161**	$ 85,247	$ 167,623	$ 105,233	$ 43,684
Stockholders' equity	**$ 264,392**	$ 131,213	$ 226,600	$ 87,947	$ 24,802
Total employees at year end	**974**	873	1,324	939	670
Diluted weighted average shares outstanding	**71,642**	61,601	54,459	50,464	38,604

management's discussion and analysis of financial condition and results of operations

The following Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that involve risks and uncertainties. The Company's actual results could differ materially from those anticipated in these forward-looking statements as a result of certain factors, including those set forth under "Factors That May Affect Future Financial Results" and elsewhere in this Annual Report.

Overview

Digital Microwave Corporation designs, manufactures, and markets advanced wireless solutions for worldwide communication network interconnection and access. The Company was founded in 1984 and has shipped over 163,000 microwave radios worldwide.

The Company has equipment installed in over 90 countries, and a significant portion of the Company's revenue is derived from sales outside the United States. The Company's revenues from sales for equipment and services outside the United States were 79% in Fiscal 2000, 87% in Fiscal 1999, and 93% in Fiscal 1998.

Results of Operations

The following table sets forth the percentage relationships of certain items from the Company's Consolidated Statements of Operations as a percentage of net sales for the periods indicated:

	YEARS ENDED MARCH 31,		
	2000	1999	1998
Net sales	**100.0%**	100.0%	100.0%
Cost of sales	**69.8**	78.4	64.0
Inventory valuation charges	**—**	16.0	1.7
Gross profit	**30.2**	5.6	34.3
Research and development	**8.1**	10.2	7.1
Selling, general, and administrative	**17.3**	23.4	18.9
Merger and restructuring	**—**	12.7	2.5
Operating income (loss)	**4.8**	(40.7)	5.8
Other income, net	**0.2**	0.1	0.8
Income (loss) before provision for income taxes	**5.0**	(40.6)	6.6
Provision for income taxes	**1.0**	0.3	1.1
Net income (loss)	**4.0%**	(40.9)%	5.5%

Year Ended March 31, 2000 Compared to the Year Ended March 31, 1999

Net Sales. Net sales for Fiscal 2000 were $300.5 million, a 27% increase compared to net sales of $236.5 million in Fiscal 1999. The increase in net sales occurred across all the Company's major product families, which includes SPECTRUM™ II, XP4, DXR™ and the Altium™ product lines. Net sales of the Altium product lines, which began volume shipments in January 1999, increased to $47.5 million in Fiscal 2000 from $5.3 million in Fiscal 1999. Net sales of the XP4 product lines increased to $61.7 million in Fiscal 2000 from $32.2 million in Fiscal 1999. Net sales for other products, including older product lines that have been phased out, amounted to $13.6 million in Fiscal 2000 compared to $33.7 million in Fiscal 1999. Service revenue declined to $15.1 million in Fiscal 2000 from $21.0 million in Fiscal 1999. The decline in service revenue was primarily attributable to the sale of the Granger, Inc., operation in the last quarter of Fiscal 1999.

The increase in net sales for Fiscal 2000 compared to Fiscal 1999 occurred across all the Company's geographic regions, except for the Europe/Middle East region. Sales to the Europe/Middle East region customers decreased slightly to $81.8 million in Fiscal 2000, compared to $83.2 million in Fiscal 1999. Net sales increased in the Americas to $119.3 million in Fiscal 2000 from $84.0 million in Fiscal 1999. Net sales to U.S. customers, included in the Americas region, increased to $63.0 million in Fiscal 2000 from $31.8 million in Fiscal 1999. Net sales to customers in Mexico, which also is included in the Americas region, increased to $32.1 million in Fiscal 2000 from $14.6 million in Fiscal 1999. Net sales in the Asia/Pacific region increased to $80.4 million in Fiscal 2000 from $50.3 million in Fiscal 1999. Net sales to China, included in the Asia/Pacific region, increased to $48.3 million in Fiscal 2000 from $18.1 million in Fiscal 1999. See Note 6 of the Notes to Consolidated Financial Statements.

New orders for Fiscal 2000 were $351.1 million, an increase of 49% compared to orders during Fiscal 1999 of $234.9 million. The backlog at March 31, 2000, was $111.8 million compared to $63.9 million at March 31, 1999.

The Company includes in its backlog purchase orders with respect to which a delivery schedule has been specified for product shipment within one year. Orders in the Company's current backlog are subject to changes in delivery schedules, or to cancellation at the option of the purchaser without significant penalty. Accordingly, although useful for scheduling production, backlog as of any particular date may not be a reliable measure of sales for any future period.

Gross Profit. Gross profit as a percentage of net sales increased in Fiscal 2000 to 30.2% from 5.6% in Fiscal 1999. The Company's gross profit in Fiscal 1999 was adversely affected by inventory valuation charges of $37.7 million, or 16.0% of net sales. As a result of the merger with Innova in Fiscal 1999 and the planned introduction of new product lines, the obsolescence of the Company's SPECTRUM II product line was accelerated, requiring the Company to record a $30.3 million reserve for excess and obsolescence in Fiscal 1999. Also, liabilities of $7.4 million were recognized in Fiscal 1999 to account for vendor cancellation charges on purchase order commitments resulting from the reduction in the Company's sales volume compared to the prior year.

Cost of sales, excluding inventory valuation charges, decreased to 69.8% of net sales in Fiscal 2000 from 78.4% in Fiscal 1999. The decrease in cost of sales was primarily the result of improved manufacturing capacity utilization and cost reductions resulting from reductions in facilities and personnel in Fiscal 1999.

Research and Development Expenses. In Fiscal 2000, research and development expenses increased slightly to $24.4 million from $24.1 million in Fiscal 1999. As a percentage of net sales, research and development expenses were 8.1% in Fiscal 2000 compared to 10.2% in Fiscal 1999. Research and development expenses in Fiscal 2000 were primarily incurred for further development of the Altium product line as well as the DXR 700 and XP4*Plus* product lines. New product announcements in Fiscal 2000 include the ultra-high capacity modem chip set termed *Velocity*. The Company intends to continue its new product roll-outs in order to maintain and enhance its competitive position.

Selling, General, and Administrative Expenses. In Fiscal 2000, selling, general, and administrative expenses decreased to $52.0 million from $55.3 million in Fiscal 1999. As a percentage of net sales, selling, general, and administrative expenses decreased to 17.3% in Fiscal 2000 from 23.4% in Fiscal 1999. The decrease in selling, general, and administrative expenses in absolute dollars and as a percentage of net sales for Fiscal 2000 compared to Fiscal 1999 was attributable to workforce reductions and other cost initiatives undertaken in Fiscal 1999.

Merger and Restructuring Expenses. Merger and restructuring charges of $29.9 million were recorded in Fiscal 1999. These charges consisted of $2.7 million for investment banker, legal, and accounting fees related to the Innova merger consummated in October 1998, $4.2 million for severance costs, $4.1 million for facility consolidation costs, a write-off of $5.8 million related to the discontinuance of several projects related to the implementation of software purchased for internal use, and a write-off of goodwill and certain assets related to the Company's subsidiary, Granger, Inc., totaling $13.1 million. The assets of Granger, Inc., were sold in March 1999.

In Fiscal 2000, the Company paid $2.3 million in facility consolidation costs, $0.4 million for extended severance pay and benefits elected by the employee in lieu of a lump sum distribution at date of termination, and $0.4 million for future software commitments. In Fiscal 2001, the Company is obligated to pay the remaining $0.5 million of extended pay and benefits and $0.4 million in future commitments.

Interest Income and Other, Net. Interest income was $2.5 million in Fiscal 2000 compared to $1.5 million in Fiscal 1999. The increase was primarily due to more cash available for investing as a result of approximately $100 million in proceeds from the sale of Company stock in the third and fourth quarter of Fiscal 2000. Other expenses of $1.1 million in Fiscal 2000 and $1.0 million in Fiscal 1999 were primarily due to foreign exchange gains and losses, net.

Interest Expense. Interest expense for Fiscal 2000 was $0.7 million compared to $0.5 million in Fiscal 1999. The increase is primarily attributed to higher average debt in Fiscal 2000.

Provision for Income Taxes. The Company recorded an income tax provision in each of Fiscal 2000 and Fiscal 1999 primarily related to taxable income at certain of the Company's foreign subsidiaries. Additionally, the Fiscal 2000 tax provision includes certain Federal and state minimum taxes. This was less than the statutory rate, primarily due to the utilization of net operating losses, tax credits, and other tax-attributable carry-forwards.

Year Ended March 31, 1999 Compared to the Year Ended March 31, 1998

Net Sales. Net sales for Fiscal 1999 were $236.5 million, a 31% decrease compared to net sales of $345.1 million in Fiscal 1998. The decrease in net sales was in part due to a slowdown in demand for the Company's products in Asia, which began with the downturn in Asian economies. However, such decrease in the Company's net sales was accelerated by the heightened pricing and competitive pressures of the telecommunications market in Europe and other regions of the world. For Fiscal 1999, net sales were $83.2 million in the Europe/Middle East region, $50.3 million in the Asia/Pacific region, $84.0 million in the Americas, and $19.0 million in Africa. In Fiscal 1998, net sales were $146.8 million in the Europe/Middle East region, $96.1 million in the Asia/Pacific region, $85.9 million in the Americas, and $16.3 million in Africa. See Note 6 of the Notes to Consolidated Financial Statements.

Net sales for Fiscal 1999 of SPECTRUM II decreased to $111.8 million from $175.3 million in Fiscal 1998. Net sales of the DXR product line increased to $32.5 million in Fiscal 1999 from $30.6 million in Fiscal 1998. Net sales of the XP4 product line decreased to $32.2 million in Fiscal 1999 from $36.1 million in Fiscal 1998. Net sales of the new Altium product line, which started shipping in Fiscal 1999, were $5.3 million. Net sales for other products and services, including older product lines that have been phased out, amounted to $54.7 million in Fiscal 1999 compared to $103.1 million in Fiscal 1998.

Gross Profit. Inventory valuation charges, included in cost of sales, totaled $37.7 million in Fiscal 1999 and $5.9 million in Fiscal 1998. In Fiscal 1999, these inventory valuation charges consisted primarily of two main components: an excess and obsolescence adjustment, and cancellation charges to vendors for purchase commitments. The merger with Innova and planned introduction of new product lines accelerated the obsolescence of the SPECTRUM II product line. Accordingly, inventory-related charges of $30.3 million were recorded. The reduction in the Company's sales volume compared to the prior year had an adverse effect on purchase order commitments to vendors. Accordingly, liabilities of $7.4 million were recognized to account for vendor cancellation and related charges on purchase order commitments. In Fiscal 1998, the inventory valuation charges were for the phase-out of older product lines. Gross profit margin percentage in Fiscal 1999, excluding inventory valuation charges, was lower than in Fiscal 1998 primarily due to underutilization of manufacturing capacity and lower average selling prices of the SPECTRUM II product line. The Company reduced its workforce at the end of the first quarter of Fiscal 1999 and in the third quarter of Fiscal 1999 to minimize the impact of unfavorable capacity utilization and lower sales.

Research and Development Expenses. Research and development expenses for Fiscal 1999 of $24.1 million were slightly lower than the $24.5 million reported in Fiscal 1998. However, as a percentage of sales, research and development expenses increased from 7.1% for Fiscal 1998 to 10.2% for Fiscal 1999. This increase was due primarily to the decrease in net sales over the comparable period. Research and development expenses for Fiscal 1999 were primarily attributable to the Company's development and improvements of its XP4, DART, and DXR 700 product offerings and its new Altium high-capacity wireless product platform.

Selling, General, and Administrative Expenses. Selling, general, and administrative expenses for Fiscal 1999 decreased by $10.0 million to $55.3 million from $65.3 million in Fiscal 1998. As a percentage of net sales, selling, general, and administrative expenses were 23.4% in Fiscal 1999 compared to 18.9% in Fiscal 1998. This increase in percentage was due primarily to the decrease in net sales over the comparable period. The decrease in selling, general, and administrative expenses in absolute dollars was mostly attributable to the workforce reductions in the first and third quarters of Fiscal 1999. Partially offsetting this decrease is an increase in the provision for bad debts for specific customers, which was included in selling, general, and administrative expenses. The provision for bad debts included in Fiscal 1999 was $4.6 million compared to $0.4 million in Fiscal 1998. The increase in the provision for bad debts from Fiscal 1998 was the result of write-offs taken relating to two customer accounts which totaled $4.3 million.

Merger and Restructuring Expenses. Merger and restructuring charges of $29.9 million were recorded in Fiscal 1999. As a result of the slowdown in the demand for the Company's products, which began with the downturn in various Asian economies in which the Company sells its products, which was accelerated by the heightened pricing and competitive pressures of the telecommunications market in Europe and other regions of the world in Fiscal 1998 and Fiscal 1999, the Company undertook strategic cost savings measures to reflect reduced sales levels and to make the Company more competitive. The Company consolidated its facilities in San Jose, California, and reduced its occupancy, primarily for manufacturing, from approximately 230,000 square feet to 132,000 square feet. Also, the Company discontinued its manufacturing operation in Scotland and subsequently established a regional service and repair center. Additionally, the Company closed various worldwide sales offices, some of which, as a result of the merger with MAS Technology in March 1998, were duplications of regional coverage. The closing of the facilities discussed above was completed in Fiscal 1999. Facility consolidation costs totaled $4.1 million, of which $1.8 million was paid in Fiscal 1999, and $2.3 million was paid in Fiscal 2000.

Concurrent with the facilities closures, the Company reduced its workforce by 312 employees, or 27% of its average Fiscal 1998 workforce of 1,147. Of the 312 employees affected, 71% were manufacturing-related positions, 7% were research and development positions and 22% were in sales, marketing, and administration. The workforce reductions were completed by March 31, 1999. Severance costs totaled $4.2 million in Fiscal 1999, of which $3.3 million was paid in Fiscal 1999, $0.4 million was paid in Fiscal 2000, and $0.5 million remains to be paid during Fiscal 2001. Future severance payments are for extended severance pay and benefits elected by the employee in lieu of a lump sum distribution at date of termination.

The Company also discontinued projects related to the implementation of enterprise-wide software purchased for internal use totaling $5.8 million, of which $0.6 million was paid in Fiscal 1998, $4.4 million was paid in Fiscal 1999, and $0.4 million was paid in Fiscal 2000, and the remaining $0.4 million will be paid during Fiscal 2001 and consists of software commitments.

Merger costs expensed in Fiscal 1999, related to the merger of Innova consummated in October 1998, totaled $2.7 million and consisted of $1.6 million to investment bankers, $0.7 million for legal and accounting services, and $0.4 million for other direct merger-related expenses. All expenses were paid in Fiscal 1999.

As part of the restructuring in the third quarter of Fiscal 1999, the Company concluded that the carrying value of the Company's investment in Granger, Inc., a wholly owned subsidiary, was impaired due to changes in business conditions, including the slowdown in demand for its products in the U.S. PCS market. Accordingly, the Company wrote-off $9.6 million of goodwill related to the Granger acquisition. In addition, the Company wrote-off other assets, primarily assets of Granger, Inc., totaling $3.5 million. No facilities were closed or employees terminated as part of the write-down of assets. In March 1999, Granger was subsequently sold at net book value for $3.2 million with extended payment terms to Granger's former managers.

Interest and Other Income, Net. Interest income was $1.5 million in Fiscal 1999 compared to $3.1 million in Fiscal 1998. This decrease resulted primarily from lower average cash balances. Other Income, Net is primarily due to foreign exchange gains and losses and the cost of foreign currency hedge contracts.

Interest Expense. Interest expense for Fiscal 1999 was $0.5 million compared to $0.9 million in Fiscal 1998. The decrease in interest expense was primarily attributable to lower average lease obligations and debt in Fiscal 1999.

Provision for Income Taxes. The Company recorded an income tax provision in Fiscal 1999 related to taxable income at certain of the Company's foreign subsidiaries. In Fiscal 1998, the Company recorded an income tax provision at an effective rate of 17%. This was less than the statutory rate, primarily due to the utilization of net operating losses, tax credits, and other tax-attributable carry-forwards.

Liquidity and Capital Resources

Net cash provided by operating activities in Fiscal 2000 was $5.9 million, compared to net cash used for operating activities of $10.7 million in Fiscal 1999. The improvement in cash flows from operating activities was primarily the result of a substantial loss for Fiscal 1999 of $96.7 million, compared to net income of $12.1 million for Fiscal 2000. Accounts receivable in Fiscal 2000 increased $41.4 million, or 65%, from Fiscal 1999. The increase in accounts receivable is primarily due to the increase in sales volume in the fourth quarter of Fiscal 2000, to $88.6 million from $59.7 million in the fourth quarter of Fiscal 1999, and to the timing of shipments, as approximately 60% of the Company's fourth quarter shipments occurred in the last month of the quarter compared to 43% in the same quarter a year ago. Accounts payable increased $15.1 million in support of the increase in purchase volume in Fiscal 2000. Other accrued liabilities in Fiscal 2000 decreased $17.3 million from Fiscal 1999 primarily as a result of the Company's payment of the accrued purchase order cancellation and other costs, $10.2 million, set up as part of merger and restructuring expenses in Fiscal 1999.

Purchases of property and equipment decreased to $23.9 million in Fiscal 2000 from $24.7 million in Fiscal 1999. Purchases in Fiscal 2000 were primarily for new test equipment and the installation of new enterprise-wide business and manufacturing systems. In Fiscal 2000 the Company invested $7.3 million for a minority interest in Ensemble Communications, a supplier of broadband wireless access equipment. The Company also placed in escrow an additional $3.0 million for a subsequent investment in August 2000. The subsequent investment is at the option and sole discretion of Ensemble Communications.

On October 1, 1999, the Securities and Exchange Commission declared the Company's registration statement on Form S-3 effective. Under the registration statement, the Company could sell up to $100 million in debt securities, common stock, debt warrants and common stock warrants. During Fiscal 2000 the Company used its shelf registration statement to sell 4,797,368 shares of its common stock and received approximately $99.8 million, net of costs of $0.2 million. The Company currently intends to use the net proceeds for general corporate purposes, including working capital and strategic investments and acquisitions. Additionally, the Company received $22.4 million from the exercise of employee stock options and warrants in Fiscal 2000 compared to $1.2 million in Fiscal 1999.

In December 1999, the Company elected not to renew its $40.0 million asset-based borrowing facility with a U.S. lender and repaid $2.6 million outstanding under the facility.

At March 31, 2000, the Company's principal sources of liquidity consisted of $123.9 million in cash, cash equivalents and short-term investments. In the future, the Company may require additional financing; however, there can be no assurance that the

Company will be able to obtain such additional financing in the required time frame on commercially reasonable terms, or at all. However, the Company believes that it has the financial resources needed to meet its business requirements for the foreseeable future.

Many currently installed computer systems and software products are coded to accept only two digit entries in the date code field. As a result, software that records only the last two digits of the calendar year may not be able to distinguish whether "00" means 1900 or 2000. Residual Year 2000 problems may result in miscalculations, data corruption, system failures or disruption of operations. To date the Company has not experienced any significant Year 2000 problems in its internal technology systems or with vendors of systems the Company believes to be critical to its business. In addition, the Company believes that it is unlikely it will experience any significant Year 2000 problems in the future.

However, the Company's applications operate in complex network environments and directly and indirectly interact with a number of other hardware and software systems. The Company cannot predict whether Year 2000 unknown errors or defects that affect the operation of software and systems that it uses in operating its businesses will arise in the future. If residual Year 2000 problems cause the failure of any of the technology, software, or systems necessary to operate its business, the Company could lose customers, suffer significant disruptions in its business, lose revenues, and incur substantial liabilities and expenses. The Company could also become involved in costly litigation resulting from Year 2000 problems. This could seriously harm the Company's business, financial condition and results of operations.

The Company spent approximately $0.8 million investigating and remedying issues related to Year 2000 readiness involving internal operations, including purchases of software test tools, software upgrades, and upgrading a security system related to Year 2000 readiness. In addition, the Company estimates that $0.5 million of internal personnel costs were incurred to support the Company's Year 2000 readiness plan.

Recent Accounting Standards

In June 1998, the FASB issued Statement of Financial Accounting Standards No. 133 ("SFAS No. 133"), "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 is effective for companies with fiscal years beginning after June 15, 2000, and requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The Company believes that the adoption of this new pronouncement will not have a material effect on the Company's financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 101 provides guidance on applying generally accepted accounting principles to revenue recognition issues in financial statements. The Company will adopt SAB 101 as required in the first quarter of 2001 and is evaluating the effect that such adoption may have on its consolidated results of operations and financial position.

European Monetary Union. In January 1999, a new currency called the "euro" was introduced in certain Economic and Monetary Union ("EMU") countries. During 2002, all EMU countries are expected to be operating with the euro as their single currency. Uncertainty exists as to the effect the euro currency will have on the marketplace. Additionally, all of the rules and regulations have not yet been defined and finalized by the European Commission with regard to the euro currency. The Company has assessed the effect the euro formation will have on its internal systems and the sale of its products. The Company's European sales and operating transactions are based primarily in U.S. dollars or U.K. pounds sterling, neither of which are subject to the euro conversion. While the Company does have some sales denominated in the European Currency Unit, this currency is successfully being converted in the market to the new European Monetary Unit at parity. In addition, the Company upgraded its internal computer systems to convert the European currency to the euro. The cost of upgrading the Company's systems in connection with the euro conversion was not material and no material adverse effect on the Company's business, financial condition, and results of operations is expected due to the upgrade.

Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk. It is Digital Microwave's policy not to enter into derivative financial instruments except for hedging of foreign currency exposures. The Company hedges certain portions of its exposure to foreign currency fluctuations through the use of forward foreign exchange contracts. The Company enters into forward foreign exchange contracts for purposes other than trading; however, the Company does not engage in any foreign

currency speculation. Forward foreign exchange contracts represent agreements to buy or sell a specified amount of foreign currency at a specified price in the future. These contracts generally have maturities that do not exceed one month. At March 31, 2000, the Company had forward foreign exchange contracts to exchange various foreign currencies for U.S. dollars in the aggregate amount of $45.8 million, primarily in New Zealand dollars, British pounds, and European Monetary Units. Gains and losses associated with currency rate changes on forward foreign exchange contracts are recorded currently in income, as they offset corresponding gains and losses on the foreign currency-denominated assets and liabilities being hedged. Therefore, the carrying value of forward foreign exchange contracts approximates their fair value. The Company believes that the credit risk with respect to its forward foreign exchange contracts is minimal because the Company enters into contracts with major financial institutions. Market risk with respect to forward foreign exchange contracts is offset by the corresponding exposure related to the underlying assets and liabilities.

Foreign Currency Rate Risk. Although substantially all of Digital Microwave's sales and expenses are denominated in U.S. dollars, Digital Microwave has experienced some foreign exchange gains and losses to date, and expects to incur additional gains and losses in Fiscal 2001. Digital Microwave did engage in foreign currency hedging activities during Fiscal 2000, as explained above, and intends to continue doing so as needed.

Factors That May Affect Future Financial Results

The Stockholders' Letter and discussions in this Annual Report concerning the Company's future products, expenses, revenues, gross margins, liquidity, and cash needs, as well as the Company's plans and strategies, contain forward-looking statements concerning the Company's future operations and financial results. These forward-looking statements are based on current expectations, and the Company assumes no obligation to update this information. Numerous factors— such as economic and competitive conditions, timing and volume of incoming orders, shipment volumes, product margins, and foreign exchange rates— could cause actual results to differ materially from those described in these statements, and prospective investors and stockholders should carefully consider the factors set forth below in evaluating these forward-looking statements. The Company's backlog may not be representative of actual sales for any succeeding period because of timing of orders, delivery intervals, customer and product mix, the possibility of changes in delivery schedules, and additions or cancellation of orders.

The quarterly operating results of the Company can vary significantly depending on several factors, any of which could have a material adverse effect on the Company's business, financial condition, or results of operations. In particular, the Company's quarterly results of operation can vary due to the volume and timing of product orders received and delivered during the quarter, the ability of the Company and its key suppliers to respond to changes made by customers in their orders, and the timing of new product introductions by the Company and its competitors. The quarterly operating results also may vary significantly depending upon other factors, including the mix of product sold, the cost and availability of components and subsystems, relative prices of the Company's products, adoption of new technologies and industry standards, competition, fluctuations in foreign currency exchange rates, regulatory developments, and general economic conditions.

Manufacturers of digital microwave telecommunications equipment and other wireless networking equipment are experiencing, and are likely to continue to experience, intense pricing pressure that has resulted, and is expected to continue to result, in downward pricing pressure on the Company's products. As a result, the Company has experienced, and expects to continue to experience, declining average sales prices for its products. The Company's future profitability is dependent upon its ability to continue to improve manufacturing efficiencies, reduce material costs of products, and introduce new products and product enhancements.

The markets for the Company's products are extremely competitive, and the Company expects that competition will increase. The Company's existing and potential competitors include established and emerging companies, such as L.M. Ericsson, Siemens AG, Sagem, Microwave Communications Division of Harris Corporation, Alcatel, Nokia, Nera, NEC, and SIAE, many of which have more extensive engineering, manufacturing, and marketing capabilities and significantly greater financial, technical, and personnel resources than the Company. The Company believes that its ability to compete successfully will depend on a number of factors both within and outside its control, including price, quality, availability, customer service and support, breadth of product line, product performance and features, rapid delivery, reliability, timing of new product introductions by the Company, its customers and its competitors, and the ability of its customers to obtain financing. The Company continues to experience customer demands for shorter delivery cycles.

The Company expects that international sales will continue to account for the majority of its net product sales for the foresee-

able future. As a result, the Company is subject to the risks of doing business internationally, including unexpected changes in regulatory requirements, fluctuations in foreign currency exchange rates, imposition of tariffs and other barriers and restrictions, the burdens of complying with a variety of foreign laws, and general economic and geopolitical conditions, including inflation and trade relationships. There can be no assurance that currency fluctuations, changes in the rate of inflation, or any of the aforementioned factors will not have a material adverse effect on the Company's business, financial conditions, or results of operations.

The Company's manufacturing operations are highly dependent upon the delivery of materials by outside suppliers in a timely manner. In addition, the Company depends in part upon subcontractors to assemble major components and subsystems used in its products in a timely and satisfactory manner. The Company does not generally enter into long-term or volume purchase agreements with any of its suppliers, and no assurance can be given that such materials, components, and subsystems will be available in the quantities required by the Company, if at all. The inability of the Company to develop alternative sources of supply quickly and on a cost-effective basis could materially impair the Company's ability to manufacture and deliver its products in a timely manner. There can be no assurance that the Company will not experience material supply problems or component or subsystem delays in the future.

The Company has pursued, and will continue to pursue, growth opportunities through internal development and acquisitions of complementary businesses and technologies. Acquisitions may involve difficulties in the retention of personnel, diversion of management's attention, unexpected legal liabilities, and tax and accounting issues. There can be no assurance that the Company will be able to successfully identify suitable acquisition candidates, complete acquisitions, integrate acquired businesses into its operations, or expand into new markets. Once integrated, acquired businesses may not achieve comparable levels of revenues, profitability, or productivity as the existing business of the Company, or otherwise perform as expected. The Company's failure to manage its growth effectively could have a material adverse impact on the Company's business, financial condition, and results of operations.

During any given quarter, a small number of customers may account for a significant portion of the Company's net sales. In Fiscal 2000, one customer (Beijing Telecommunications Equipment Factory) accounted for 16% of the Company's net sales and three customers accounted for 59% of the Company's March 31, 2000, backlog. The Company's customers typically are not contractually obligated to purchase any quantity of products in any particular period, and product sales to major customers have varied widely from period to period. The loss of any existing customer, a significant reduction in the level of sales to any existing customer, or the failure of the Company to gain additional customers could have a material adverse effect on the Company's business, financial condition, and results of operations.

selected consolidated financial data

	Years Ended March 31,				
	2000	1999	1998	1997	1996
	(In thousands, except per share amounts)				
Consolidated Statements of Operations Data:					
Net sales	**$ 300,503**	$ 236,499	$ 345,116	$ 213,441	$ 174,380
Net income (loss)	**12,136**	(96,729)	18,818	6,461	(13,533)
Diluted earnings (loss) per share	**0.17**	(1.57)	0.35	0.13	(0.35)
Consolidated Balance Sheets Data:					
Total assets	**$ 337,441**	$ 202,164	$ 297,196	$ 200,504	$ 113,597
Long-term liabilities	**—**	2,236	1,174	700	10,097

consolidated balance sheets

	March 31,	
	2000	1999
	(in thousands, except share and per share amounts)	
assets		
Current Assets:		
Cash and cash equivalents	$ 58,339	$ 21,518
Short-term investments	65,603	5,745
Accounts receivable, net of allowances of $4,652 in 2000 and $3,261 in 1999	98,520	60,253
Inventories	48,547	50,610
Deferred tax asset	1,285	3,009
Other current assets	9,916	12,827
Total current assets	282,210	153,962
Property and Equipment:		
Machinery and equipment	94,533	77,236
Land and buildings	6,484	6,090
Furniture and fixtures	11,252	10,327
Leasehold improvements	4,774	4,597
	117,043	98,250
Accumulated depreciation and amortization	(73,242)	(55,225)
Net property and equipment	43,801	43,025
Other assets	11,430	5,177
	$ 337,441	$ 202,164
liabilities and stockholders' equity		
Current Liabilities:		
Current portion of long-term debt	$ —	$ 725
Current maturities of capital lease obligations	167	862
Accounts payable	39,582	25,116
Income taxes payable	2,330	1,399
Accrued liabilities	30,970	40,613
Total current liabilities	73,049	68,715
Long-Term Liabilities:		
Long-term debt	—	1,896
Capital lease obligations, net of current maturities	—	340
Total liabilities	73,049	70,951
Commitments and Contingencies (Note 3)		
Stockholders' Equity:		
Preferred stock, $.01 per value; 5,000,000 shares authorized; none outstanding	—	—
Common Stock, $.01 per value; 95,000,000 shares authorized; 72,691,668 shares in 2000 and 62,144,171 shares in 1999 issued and outstanding	727	621
Additional paid-in capital	372,762	250,602
Deferred stock compensation expense	(12)	(88)
Accumulated deficit	(103,288)	(115,424)
Accumulated other comprehensive loss	(5,797)	(4,498)
Total stockholders' equity	264,392	131,213
	$ 337,441	$ 202,164

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

consolidated statements of operations

	Years Ended March 31,		
	2000	1999	1998
	(In thousands, except per share amounts)		
Net Sales	**$ 300,503**	$ 236,499	$ 345,116
Cost of sales	**209,653**	185,493	221,021
Inventory valuation charges	**—**	37,739	5,850
Gross profit	**90,850**	13,267	118,245
Operating Expenses:			
Research and development	**24,372**	24,131	24,482
Selling, general, and administrative	**51,953**	55,342	65,280
Merger and restructuring	**—**	29,941	8,752
Total operating expenses	**76,325**	109,414	98,514
Income (loss) from operations	**14,525**	(96,147)	19,731
Other Income (Expense):			
Interest income	**2,510**	1,474	3,080
Interest expense	**(729)**	(479)	(856)
Other income, net	**(1,136)**	(970)	720
Total other income, net	**645**	25	2,944
Income (loss) before provision for income taxes	**15,170**	(96,122)	22,675
Provision for income taxes	**3,034**	607	3,857
Net Income (Loss)	**$ 12,136**	$ (96,729)	$ 18,818
Basic earnings (loss) per share	**$ 0.18**	$ (1.57)	$ 0.37
Diluted earnings (loss) per share	**$ 0.17**	$ (1.57)	$ 0.35
Basic weighted average shares outstanding	**65,922**	61,601	51,285
Impact of dilutive stock options and warrants	**5,720**	N/A	3,174
Diluted weighted average shares outstanding	**71,642**	61,601	54,459

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

consolidated statements of stockholders' equity

	YEARS ENDED MARCH 31, 2000, 1999 AND 1998						
	Common Stock Shares	Amount	Additional Paid-In Capital	Deferred Stock Compensation	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total Stockholders' Equity
				(IN THOUSANDS)			
Balance March 31, 1997	38,010	$ 380	$ 126,871	$ —	$ (39,317)	$ 13	$ 87,947
Components of comprehensive income:							
Net income	—	—	—	—	18,818	—	18,818
Unrealized holding gain on available-for-sale securities	—	—	—	—	—	46	46
Translation adjustment	—	—	—	—	—	(1,620)	(1,620)
Total comprehensive income							17,244
Proceeds from sale of stock	11,649	117	62,054	—	—	—	62,171
Conversion of preferred stock	9,116	91	47,678	—	—	—	47,769
Stock issued for options & warrants	2,252	22	9,652	(1,590)	—	—	8,084
Amortization of deferred stock compensation	—	—	—	1,193	—	—	1,193
Tax benefit related to employee stock transactions	—	—	2,192	—	—	—	2,192
Balance March 31, 1998	61,027	610	248,447	(397)	(20,499)	(1,561)	226,600
Components of comprehensive income:							
Net loss	—	—	—	—	(96,729)	—	(96,729)
Unrealized holding loss on available-for-sale securities	—	—	—	—	—	(1,613)	(1,613)
Translation adjustment	—	—	—	—	—	(1,324)	(1,324)
Total comprehensive loss							(99,666)
Proceeds from sale of stock	372	4	904	—	—	—	908
Stock issued for options & warrants	745	7	1,187	—	—	—	1,194
Amortization of deferred stock compensation	—	—	—	309	—	—	309
Tax benefit related to employee stock transactions	—	—	64	—	—	—	64
Adjustment to conform year-end of pooled company	—	—	—	—	1,804	—	1,804
Balance March 31, 1999	62,144	621	250,602	(88)	(115,424)	(4,498)	131,213
Components of comprehensive income:							
Net income	—	—	—	—	12,136	—	12,136
Unrealized holding gain on available-for-sale securities	—	—	—	—	—	1,841	1,841
Translation adjustment	—	—	—	—	—	(3,140)	(3,140)
Total comprehensive income	—	—	—	—	—	—	10,837
Proceeds from sale of stock, net of expense	4,797	48	99,823	—	—	—	99,871
Stock issued for options & warrants	5,751	58	22,337	—	—	—	22,395
Amortization of deferred stock compensation	—	—	—	76	—	—	76
Balance March 31, 2000	**72,692**	**$ 727**	**$ 372,762**	**$ (12)**	**$ (103,288)**	**$ (5,797)**	**$ 264,392**

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

consolidated statements of cash flows

	Years ended March 31,		
	2000	1999	1998
		(in thousands)	
Cash Flows From Operating Activities:			
Net income (loss)	$ 12,136	$ (96,729)	$ 18,818
Adjustments to reconcile net income (loss) to net cash provided by (used for) operating activities:			
Adjustment to conform year-end of pooled company	—	1,804	—
Depreciation and amortization	16,594	25,912	13,411
Provision for uncollectable accounts	853	4,608	356
Provision for inventory reserves	3,262	20,305	12,862
Provision for warranty reserves	8,146	7,023	5,310
Tax benefit of disqualifying dispositions	—	64	2,192
Changes in assets and liabilities:			
Decrease (increase) in accounts receivable	(41,391)	20,620	(27,744)
Decrease (increase) in inventories	(2,185)	1,503	(33,024)
Decrease (increase) in deferred taxes	1,701	3,639	(6,496)
Decrease (increase) in tax refund receivable	4,001	(4,553)	—
Decrease (increase) in other current assets	(1,287)	786	(3,864)
Decrease in other assets	5,292	11,624	6
Increase (decrease) in accounts payable	15,120	(14,283)	9,890
Increase (decrease) in income tax payable	931	102	(1,065)
Increase (decrease) in other accrued liabilities	(17,279)	6,841	(5,810)
Net cash provided by (used for) operating activities	5,894	(10,734)	(15,158)
Cash Flows From Investing Activities:			
Purchase of available-for-sale securities	(118,029)	(16,621)	(27,990)
Maturity/sale of available-for-sale securities	58,171	45,374	11,327
Purchase of property and equipment	(23,928)	(24,711)	(30,471)
Investments in Ensemble Communications	(7,256)	—	—
Acquisition of business, net of cash received	—	(2,286)	(11,491)
Investment in Granger Associates, Ltd.	—	—	(4,000)
Proceeds from the sale of other assets	2,082	610	—
Proceeds from disposal of fixed assets	—	1,194	—
Net cash provided by (used for) investing activities	(88,960)	3,560	(62,625)
Cash Flows From Financing Activities:			
Borrowing from banks	—	2,600	—
Repayments to banks	(2,600)	—	(6,665)
Payment of assumed Granger, Inc., debt	—	—	(3,286)
Payments of capital lease obligations	(1,035)	(1,314)	(1,951)
Proceeds from sale of Common Stock	122,266	2,166	77,143
Net cash provided by financing activities	118,631	3,452	65,241
Effect of exchange rate changes on cash	1,256	(2,345)	(420)
Net increase (decrease) in cash and cash equivalents	36,821	(6,067)	(12,962)
Cash and cash equivalents at beginning of year	21,518	27,585	40,547
Cash and cash equivalents at end of year	$ 58,339	$ 21,518	$ 27,585

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

notes to consolidated financial statements

Note 1. Description of Business

Digital Microwave Corporation (the "Company") designs, manufactures, and markets advanced wireless solutions for worldwide communications network interconnection and access. The Company's high-performance digital wireless systems carry high-speed data and voice across a full spectrum of frequencies and capacities. The Company has sold more than 163,000 radios that operate in nearly every kind of environment around the world. The Company was founded in January 1984 and is traded under the symbol DMIC on the Nasdaq National Market.

Note 2. Summary of Significant Accounting Policies

Basis of Presentation. The consolidated financial statements include the accounts of Digital Microwave Corporation and its wholly owned subsidiaries. Intercompany accounts and transactions have been eliminated. Certain prior-year amounts have been reclassified to conform to the current-year presentation.

Estimates. The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statement, and the reported amounts of revenues and expenses during the reported period. Actual results could differ from those estimates.

Cash and Cash Equivalents. For purposes of the Consolidated Statements of Cash Flows, the Company considers all highly liquid debt instruments with an original maturity of three months or less to be cash equivalents. Cash and cash equivalents consisted of cash, money market funds, and short-term securities as of March 31, 2000 and 1999.

Short-Term Investments. The Company invests its excess cash in high-quality and easily marketable instruments to ensure cash is readily available for use in its current operations. Accordingly, all of the Company's marketable securities are classified as "available-for-sale" in accordance with the provisions of the Statement of Financial Accounting Standards ("SFAS") No. 115. At March 31, 2000, the Company's available-for-sale securities had contractual maturities ranging from 1 month to 21 months, with a weighted average maturity of 5 months.

All investments are reported at fair market value with the related unrealized holding gains and losses reported as a component of stockholders' equity. Unrealized holding gains on the portfolio of approximately $176,000 were recorded as of March 31, 2000, and $1,665,000 of unrealized holding losses were recorded as of March 31, 1999. There were realized gains of approximately $397,000 on the sale of securities during Fiscal 2000 and realized losses of $6,000 in each of Fiscal 1999 and Fiscal 1998.

The following is a summary of short-term and long-term investments as of March 31:

	2000		
	Cost at Each Issue	Market Value at Balance Sheet Date	Unrealized Holding Gain (Loss)
	(in thousands)		
Corporate notes	**$ 53,280**	**$ 53,103**	**$ (177)**
Auction rate preferred notes	**12,500**	**12,500**	**—**
Investment in Granger Associates, Ltd.(1)	**1,796**	**2,149**	**353**
Total	**$ 67,576**	**$ 67,752**	**$ 176**

	1999		
	Cost at Each Issue	Market Value at Balance Sheet Date	Unrealized Holding Gain (Loss)
	(in thousands)		
Corporate notes	$ 5,753	$ 5,745	$ (8)
Investment in Granger Associates, Ltd.(1)	3,399	1,742	(1,657)
Total	$ 9,152	$ 7,487	$ (1,665)

(1)Classified as other assets

Supplemental Statements of Cash Flows Disclosures. Cash paid for interest and income taxes for each of the three fiscal years presented in the consolidated statements of cash flows was as follows:

	Years Ended March 31,		
	2000	1999	1998
	(in thousands)		
Interest expense	**$ 702**	$ 762	$ 856
Income taxes	**$ 559**	$ 2,003	$ 8,885

The following non-cash transactions occurred during the fiscal years ended:

	March 31,		
	2000	1999	1998
	(in thousands)		
Notes payable to stockholders converted into redeemable preferred stock	$ —	$ —	$ 1,500
Estimated fair value of warrant issued in connection with notes payable	$ —	$ —	$ 67
Capital lease obligations incurred to acquire equipment	$ —	$ —	$ 1,922
Conversion of redeemable preferred stock into common stock	$ —	$ —	$ 47,769

Inventories. Inventories are stated at the lower of cost (first-in, first-out) or market, where cost includes material, labor, and manufacturing overhead. Inventories consisted of:

	March 31,	
	2000	1999
	(in thousands)	
Raw materials	$ 22,558	$ 25,616
Work-in-process	13,833	9,537
Finished goods	12,156	15,457
	$ 48,547	$ 50,610

Inventories contained components and assemblies in excess of the Company's current estimated requirements and were, therefore, reserved at March 31, 2000 and 1999. The Company charged $3.3 million in Fiscal 2000 and $20.3 million in Fiscal 1999 to cost of sales due to ongoing inventory valuation analysis for excess and obsolete inventories as a result of product transitions.

Property and Equipment. Property and equipment is stated at cost. Depreciation and amortization are calculated using the straight-line method over the shorter of the estimated useful lives of the assets (ranging from three to five years for equipment and furniture, and forty years for buildings) or the lease term. Included in property and equipment are assets held under capital leases with a cost of $721,000 as of March 31, 2000, and $2,517,000 as of March 31, 1999. Accumulated amortization on leased assets was $320,000 as of March 31, 2000, and $974,000 as of March 31, 1999.

Other Assets. Other assets include goodwill and other intangible assets that are being amortized on a straight line basis over their estimated useful lives, ranging from five to ten years, as well as minority investments accounted for using the cost method of accounting. Goodwill is the excess of the purchase price over the fair value of net assets acquired. Goodwill, gross of accumulated amortization, amounted to $2,778,000 as of March 31, 2000 and March 31, 1999. Accumulated amortization of goodwill amounted to $1,721,000 at March 31, 2000 and $959,000 at March 31, 1999. The Company continually reviews goodwill and other intangible assets to evaluate whether events or changes have occurred that would suggest an impairment of carrying value. An impairment would be recognized when expected future operating cash flows are lower than the carrying value. In accordance with SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of," goodwill of $9.7 million, net of accumulated amortization related to the purchase of Granger, Inc., was written off in the third quarter of Fiscal 1999. This write-off is included in Merger and Restructuring expenses in the Consolidated Statements of Operations. In March 1999, the assets of Granger, Inc., were sold at net book value of $3.2 million with extended payment terms to Granger's former managers.

Accrued Liabilities. Accrued liabilities included the following:

	March 31,	
	2000	1999
	(in thousands)	
Customer deposits	$ 770	$ 3,170
Accrued payroll and benefits	4,703	2,628
Accrued commissions	1,929	4,986
Accrued warranty	5,533	3,033
Accrued restructuring	892	3,998
Accrued purchase order cancellation and other costs	5,296	15,482
Other	11,847	7,316
	$30,970	$ 40,613

Accumulated Other Comprehensive Income. SFAS No. 130, "Reporting Comprehensive Income," establishes standards for reporting and display of comprehensive income (loss) and its components. SFAS No. 130 requires companies to report a "comprehensive income (loss)" that includes unrealized holding gains and losses and other items that have previously been excluded from net income (loss) and reflected instead in stockholders' equity. Comprehensive income (loss) for the Company consists of net income (loss) plus the effect of unrealized holding gains or losses on investments classified as available-for-sale and foreign currency translation adjustments.

The accumulated balances for each component of accumulated other comprehensive income (loss) are as follows:

	March 31,	
	2000	1999
	(in thousands)	
Unrealized holding gain (loss) on available-for-sale securities	**$ 176**	$ (1,665)
Foreign exchange translation adjustments	**(5,973)**	(2,833)
	$ (5,797)	$ (4,498)

Foreign Currency Translation. The functional currency of the Company's subsidiaries located in the United Kingdom and Latin America is the U.S. dollar. Accordingly, all of the monetary assets and liabilities of these subsidiaries are remeasured into U.S. dollars at the current exchange rate as of the applicable balance sheet date, and all non-monetary assets and liabilities are remeasured at historical rates. Sales and expenses are remeasured at the average exchange rate prevailing during the period. Gains and losses resulting from the remeasurement of the subsidiaries' financial statements are included in the Consolidated Statements of Operations. The Company's other international subsidiaries use their local currency as their functional currency. Assets and liabilities of these subsidiaries are translated at the exchange rates in effect at the balance sheet date, and income and expense accounts are translated at the average exchange rates during the year. The resulting translation adjustments are recorded directly to a separate component of stockholders' equity.

Gains and losses resulting from foreign exchange transactions are included in other income (expense) in the accompanying Consolidated Statements of Operations. The net foreign exchange loss was $930,000 in Fiscal 2000, a gain of $799,000 in Fiscal 1999, and a loss of $1,070,000 in Fiscal 1998.

Off-Balance Sheet Financial Instruments. The Company hedges certain portions of its exposure to foreign currency fluctuations through the use of forward foreign exchange contracts. The Company enters into forward foreign exchange contracts for purposes other than trading, but the Company does not engage in foreign currency speculation. Forward foreign exchange contracts represent agreements to buy or sell a specified amount of foreign currency at a specified price in the future. These contracts generally have maturities that do not exceed one month. At March 31, 2000, the Company had forward foreign exchange contracts to exchange various foreign currencies for U.S. dollars in the aggregate amount of $45.8 million, primarily in New Zealand dollars, British pounds, and European Currency Units. Gains and losses associated with currency rate changes on forward foreign exchange contracts are recorded in income if they offset corresponding gains and losses on the foreign currency-denominated assets, liabilities, and shipment of product hedged, or deferred if the foreign currency order has not shipped. Therefore, the carrying value of forward foreign exchange contracts approximates their fair value. The Company believes that the credit risk with respect to its forward foreign exchange contracts is minimal because the Company enters into contracts with major financial institutions. Market risk with respect to forward foreign exchange contracts is offset by the corresponding exposure related to the underlying assets, liabilities, and shipments of product.

Concentration of Credit Risk. Financial instruments that potentially subject the Company to concentrations of credit risk consist principally of temporary cash investments and trade receivables. The Company has cash investment policies that limit the amount of credit exposure to any one financial institution and restrict placement of investments to financial institutions evaluated as highly creditworthy. Trade receivables concentrated with certain customers primarily in the telecommunications industry and in certain geographic locations potentially subject the Company to concentration of credit risk. The Company actively markets and sells products in North America, Europe, China, the Asia/Pacific region, Africa, and Latin America. The Company performs ongoing credit evaluations of its customers' financial conditions and generally requires no collateral, although certain sales to China, the Asia/Pacific region, Europe, Latin America, and Africa are paid through letters of credit.

Revenue Recognition. Revenue from product sales is recognized upon shipment, except when product sales are combined with significant post-shipment installation services provided over an extended period of time. Under this exception, revenue is deferred until such services have been performed. Revenue from product sales is net of third-party commissions, freight, and duty charges. Service revenue, which is less than 10% of net sales for each of the three fiscal years presented, is recognized when the related services are performed.

Product Warranty. The Company provides, at the time of sale, for the estimated cost to repair or replace products under warranty, which is generally for a two-year period.

Research and Development. All research and development costs are expensed as incurred.

Earnings (Loss) Per Share. Basic earnings per share are computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share are computed by dividing net income by the weighted average number of common shares and potentially dilutive securities outstanding during the period. Net loss per share is computed using only the weighted average number of common shares outstanding during the period, as the inclusion of potentially dilutive securities would be anti-dilutive.

As of March 31, 2000, there were 192,000 weighted-average options outstanding to purchase shares of Common Stock that were not included in the computation of diluted earnings per share, as the options exercise prices were greater than the average market price of the shares of Common Stock. As of March 31, 1999, there were 4,344,000 weighted-average options outstanding and 1,983,000 warrants to purchase shares of Common Stock that were not included in the computation of diluted earnings per share because they were anti-dilutive as a result of the net loss incurred in Fiscal 1999. Additionally, there were 1,998,000 weighted-average options outstanding as of March 31, 1998, to purchase shares of Common Stock that were not included in the computation of diluted earnings per share, as the options' exercise prices were greater than the average market price of the shares of Common Stock. Also excluded from the computation of diluted earnings per share were warrants to acquire 2,259,000 shares of Common Stock in Fiscal 1998, as the warrants' exercise prices were greater than the average market price of the shares of Common Stock.

Stock Compensation. The Company adopted the disclosure provisions of SFAS No. 123, "Accounting for Stock-Based Compensation." In accordance with the provisions of SFAS No. 123, the Company applies APB Opinion 25 and related interpretations in accounting for its stock option plans. Note 5 of the Notes to Consolidated Financial Statements contains a summary of the pro forma effects on reported net income (loss) and earnings per share information for Fiscal 2000, 1999, and 1998, based on the fair market value of the options granted at the grant date as prescribed by SFAS No. 123.

Recent Accounting Pronouncements. In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 is effective for companies with fiscal years beginning after June 15, 2000, and requires the Company to recognize all derivatives on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through income. If the derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives will either be offset against the change in fair value of the hedged assets, liabilities or firm commitments through earnings, or recognized in other comprehensive income until the hedged item is recognized in earnings. The Company believes that the adoption of this new pronouncement will not have a material effect on the Company's financial statements.

In December 1999, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 101 ("SAB 101"), "Revenue Recognition in Financial Statements." SAB 101 provides guidance on applying generally accepted accounting principles to revenue recognition in financial statements. The Company will adopt SAB 101 as required in the first quarter of Fiscal 2001 and is evaluating the effect that such adoption may have on its consolidated results of operations and financial position.

Note 3. Commitments and Contingencies

The Company leases certain property and equipment, as well as its headquarters and manufacturing facilities, under noncancelable operating and capital leases that expire at various periods through 2018. At March 31, 2000, future minimum payment obligations under these leases were as follows:

	Years Ending March 31,	
	Capital	Operating
	(In Thousands)	
2001	$ 180	$ 3,731
2002	—	4,640
2003	—	4,267
2004	—	4,231
2005	—	4,281
2006 and beyond	—	29,258
Future minimum lease payments	180	$ 50,408
Less amount representing interest (averaging 15%)	(13)	
Present value of future minimum lease payments	167	
Less current maturities	(167)	
Long-term lease obligations	$ —	

Rent expense under operating leases was approximately $3,897,000 for the year ended March 31, 2000, $5,255,000 for the year ended March 31, 1999, and $6,083,000 for the year ended March 31, 1998.

Legal Contingencies. The Company is a party to various legal proceedings that arise in the normal course of business. In the opinion of management, the ultimate disposition of these proceedings will not have a material adverse effect on the consolidated financial position, liquidity, or results of operations of the Company.

Contingencies in Manufacturing and Suppliers. The Company's manufacturing operations are highly dependent upon the timely delivery of materials and components by outside suppliers. In addition, the Company depends in part upon subcontractors to assemble major components and subsystems used in its products in a timely and satisfactory manner. The Company does not generally enter into long-term or volume-purchase agreements with any of its suppliers, and no assurance can be given that such materials, components, and subsystems will be available in the quantities required by the Company, if at all. The inability of the Company to develop alternative sources of supply quickly and on a cost-effective basis could materially impair the Company's ability to manufacture and deliver its products in a timely manner. There can be no assurance that the Company will not experience component delays or other supply problems in the future.

Note 4. Income Taxes

The Company provides for income taxes using an asset and liability approach, under which deferred income taxes are provided, based upon enacted tax laws and rates applicable to periods in which the taxes become payable.

The domestic and foreign components of income (loss) before provision for income taxes were as follows:

	Years Ended March 31,		
	2000	1999	1998
	(In Thousands)		
Domestic	**$14,006**	$ (91,230)	$ 19,861
Foreign	**1,164**	(4,892)	2,814
	$ 15,170	$ (96,122)	$ 22,675

The provision for income taxes consisted of the following:

	Years Ended March 31,		
	2000	1999	1998
	(In Thousands)		
Current:			
Federal	**$ 38**	$ —	$ 6,770
State	**37**	—	365
Foreign	**2,434**	321	3,047
Total current	**2,509**	321	10,182
Deferred	**525**	286	(6,325)
	$ 3,034	$ 607	$ 3,857

The provision for income taxes differs from the amount computed by applying the statutory Federal income tax rate as follows:

	Years ended March 31, 2000	1999	1998
	(in thousands)		
Expected tax provision (benefit)	**$ 5,310**	$ (32,681)	$ 7,709
State taxes net of Federal benefit	**348**	(2,403)	565
Change in valuation allowance	**(2,873)**	32,385	(4,474)
Non-deductible acquisition costs	**—**	443	2,333
Non-deductible goodwill	**—**	3,863	371
FSC commission	**—**	—	(1,657)
Other	**249**	(1,000)	(990)
	$ 3,034	$ 607	$ 3,857

The major components of the net deferred tax asset consisted of the following:

	Years ending March 31, 2000	1999
	(in thousands)	
Inventory reserves	**$ 10,058**	$ 11,652
Restructuring reserves	**2,472**	7,591
Warranty reserves	**1,980**	1,055
Bad debt reserves	**1,376**	1,067
Accrued commissions	**598**	747
Net operating loss carryforwards	**20,667**	21,841
Tax credits	**9,476**	9,328
Other	**5,261**	3,204
	51,888	56,485
Less: Valuation allowance	**(50,603)**	(53,476)
Net deferred tax asset	**$ 1,285**	$ 3,009

The valuation allowance provides a reserve against deferred tax assets that may expire or go unutilized by the Company. In accordance with SFAS No. 109, "Accounting for Income Taxes," the Company believes it is more likely than not that the Company will not fully realize these benefits and, accordingly, has continued to provide a valuation allowance for them.

At March 31, 2000, the Company had U.S. federal and state net operating loss carryforwards available to offset future taxable income, if any, of approximately $58,000,000 and $966,000, respectively. The net operating losses expire in various years through 2019. In addition, foreign net operating loss carryforwards at March 31, 2000 total $3,200,000. Tax credits include approximately $4,800,000 of federal minimum tax and state research credits that carryforward indefinitely. The remaining tax credits of $4,600,000 are federal and state credits that expire in various years through 2019. The Internal Revenue Code contains provisions which may limit the net operating loss carryforwards to be used in any given year upon the occurrence of certain events, including a significant change in ownership interest.

Note 5. Common Stock

Stock Option Plans. The Company's 1984 Stock Option Plan (the "1984 Plan") provides for the grant of both incentive and nonqualified stock options to key employees and certain independent contractors of the Company. At March 31, 2000, options to purchase 91,376 shares of Common Stock were outstanding under the 1984 Plan, of which 91,376 shares were exercisable at an average exercise price of $8.43 per share. Upon the adoption of the Company's 1994 Stock Incentive Plan ("the 1994 Plan"), the Company terminated future grants under the 1984 Plan.

In July 1994, the stockholders approved 2,366,660 shares of Common Stock to be reserved for issuance under the 1994 Plan over a ten-year term. In August 1996, the stockholders approved the reservation for issuance of 2,000,000 additional shares of Common Stock under the 1994 Plan. In March 1998, the stockholders approved the reservation for issuance of 2,500,000 additional shares of Common Stock under the 1994 Plan. The terms of the 1994 Plan also provide for an automatic increase on the first trading day of each calendar year for five years after the adoption of the 1994 Plan, beginning January 1995, of an amount equal to one percent (1%) of the number of shares of Common Stock outstanding, but in no event is such annual increase to exceed 300,000 shares. The total number of shares of Common Stock reserved for issuance under the 1994 Plan is 7,766,660. At March 31, 2000, options to purchase 4,596,471 shares were outstanding, of which 1,315,900 were exercisable at an average exercise price of $9.64 per share. At March 31, 2000, the number of shares available for future grant was 328,778.

The 1994 Plan contains: (i) a discretionary grant program for key employees and consultants whereby options generally vest over five years and expire after 10 years, (ii) an automatic grant program for non-employee Board members, whereby options vest over three years and expire after 10 years, (iii) a salary reduction grant program under which key employees may elect to have a portion of their base salary reduced each year in return for stock options, (iv) a stock fee program under which the non-employee Board members may elect to apply all or a portion of their annual retainer fee to the acquisition of shares of Common Stock, and (v) a stock issuance program under which eligible individuals may be issued shares of Common Stock as a bonus tied to their performance of services or the Company's attainment of financial milestones, or pursuant to their individual elections to receive such shares in lieu of base salary. The implementation and use of any of these equity incentive programs (other than the automatic grant program and the stock fee program) is within the sole discretion of the Compensation Committee of the Board of Directors of the Company.

In April 1996, the Company adopted the 1996 Non-Officer Employee Stock Option Plan (the "1996 Plan"). The 1996 Plan authorizes 1,000,000 shares of Common Stock to be reserved for issuance to non-officer key employees as an incentive to continue in the service of the Company. The 1996 Plan will terminate on the date on which all shares available have been issued. At March 31, 2000, 598,182 shares were outstanding, of which 129,528 were exercisable at an average exercise price of $6.36 per share, and 48,730 shares were available for future grants.

In November 1997, the Company adopted the 1998 Non-Officer Employee Stock Option Plan (the "1998 Plan"), which became effective on January 2, 1998. The 1998 Plan authorizes 500,000 shares of Common Stock to be reserved for issuance to non-officer key employees as an incentive to continue in the service of the Company. The 1998 Plan will terminate on the date on which all shares available have been issued. At March 31, 2000, there were 371,836 options outstanding, of which 42,716 were exercisable at an average price of $3.13, and 84,160 were available for future grants.

The 1999 Stock Incentive Plan (the "1999 Incentive Plan"), approved by the Company's stockholders in August 1999, provides for the issuance of stock options covering up to 2,500,000 shares of Common Stock of the Company. The 1999 Incentive Plan enables the Company to grant options as needed to retain and attract talented employees. At March 31, 2000, there were 379,525 options outstanding, of which no options were exercisable and 2,120,475 were available for future grant.

In connection with the Company's merger with MAS Technology (see Note 7), the Company assumed the MAS Technology 1997 Stock Option Plan (the "1997 MAS Plan") under the same terms and conditions as were applicable under the 1997 MAS Plan prior to the merger. Each outstanding option to purchase MAS ordinary shares, whether vested or unvested, was assumed and converted into an option to receive 1.20 shares of the Company's Common Stock. The 1997 MAS Plan provided for the grant of stock options to employees and certain independent contractors of MAS. Options granted under the 1997 MAS Plan vest from one to three years from the date of grant. Additionally, options granted under the 1997 MAS Plan automatically vest upon the involuntary termination of the employment of an option holder within 18 months of the change in ownership of the Company. At March 31, 2000, options to purchase 227,088 shares of Common Stock were outstanding under the 1997 MAS Plan, of which 4,000 were exercisable at an average exercise price of $12.91 per share. The 1997 MAS Plan has been terminated as to future grants.

In connection with the Company's merger with Innova Corporation (see Note 7), the Company assumed the 1990 Innova Stock Option Plan and the 1997 Director Stock Option Plan (the "Innova Plans") under the same terms and conditions as were applicable under the Innova Plans prior to the merger. Each outstanding option to purchase Innova common shares was assumed and converted into an option to receive 1.05 shares of the Company's Common Stock. The Innova Plans provided for the grant of stock options to employees, directors, and certain vendors of Innova. At March 31, 2000, options to purchase 104,731 shares of Common Stock were outstanding under the 1990 Innova Stock Option Plan, and 42,000 shares of Common Stock were outstanding under the 1997 Innova Director Stock Option Plan, of which all stock options under both plans were exercisable at an average exercise price of $5.66 per share. The Innova Plans have been terminated as to future grants.

At March 31, 2000, the Company had reserved 8,993,352 shares for future issuance under all stock options plans for which there were options outstanding or available for grant as of March 31, 2000.

The following table summarizes the Company's stock option activity under all of its stock option plans:

	Fiscal years ended March 31,					
	2000		1999		1998	
	Shares	Weighted Avg Exercise Price	Shares	Weighted Avg Exercise Price	Shares	Weighted Avg Exercise Price
	(shares in thousands)					
Options outstanding at beginning of year	**8,871**	**$ 7.51**	7,055	$ 8.86	5,633	$ 6.12
Granted	**1,790**	**18.03**	3,768	6.69	3,778	10.56
Exercised	**(3,726)**	**5.52**	(441)	2.99	(1,424)	5.63
Expired or canceled	**(523)**	**9.45**	(1,511)	12.64	(932)	4.77
Options outstanding at end of year	**6,412**	**$ 10.72**	8,871	$ 7.51	7,055	$ 8.86
Exercisable at end of year	**1,730**		3,928		1,882	
Weighted average fair value of options granted	**$ 11.05**		$ 2.86		$ 5.62	

The following summarizes the stock options outstanding at March 31, 2000:

	Options Outstanding			Options Exercisable	
Actual Range of Exercise Prices	Number Outstanding 3/31/00	Weighted Avg Remaining Contractual Life	Weighted Avg Exercise Price	Number Exercisable 3/31/00	Weighted Avg Exercise Price
	(shares in thousands)				
$ 0.23 – 4.69	1,385	7.90	$ 3.45	302	$ 3.14
$ 4.69 – 9.00	1,597	7.84	7.25	656	6.78
$ 9.06 – 12.13	1,397	7.79	11.30	321	10.30
$ 12.19 – 14.75	1,324	7.83	13.43	350	13.20
$ 15.00 – 41.81	709	8.84	26.53	101	19.62
$ 0.23 – 41.81	6,412	7.95	$ 10.72	1,730	$ 8.84

In accordance with the disclosure requirements of SFAS No.123, if the Company had elected to recognize compensation cost based on the fair market value of the options granted at grant date as prescribed, income and earnings per share would have been reduced to the pro forma amounts indicated in the table below. The pro forma effect on net income for Fiscal 2000, 1999, and 1998 is not representative of the pro forma effect on net income in future years because it does not take into consideration pro forma compensation expense related to grants made prior to Fiscal 1996.

	2000	1999	1998
	(in thousands, except per share amounts)		
Net income (loss) — as reported	**$ 12,136**	$ (96,729)	$ 18,818
Net income (loss) — pro forma	**$ 4,120**	$ (107,515)	$ 9,746
Basic earnings per share — as reported	**$ 0.18**	$ (1.57)	$ 0.37
Basic earnings per share — pro forma	**$ 0.06**	$ (1.75)	$ 0.19
Diluted earnings per share — as reported	**$ 0.17**	$ (1.57)	$ 0.35
Diluted earnings per share — pro forma	**$ 0.06**	$ (1.75)	$ 0.18

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	2000	1999	1998
Expected dividend yield	**0.0%**	0.0%	0.0%
Expected stock volatility	**79.7%**	78.6%	74.7%
Risk-free interest rate	**4.8 - 7.5%**	4.8 - 5.6%	5.5% - 6.4%
Expected life of options from vest date	**1.4 years**	0.9 years	0.8 years
Forfeiture rate	**actual**	actual	actual

Warrants. In connection with the Innova merger, the Company assumed the outstanding warrants of Innova to purchase common stock of Innova. The Innova warrants were issued in conjunction with various financing rounds. No separate values were assigned to the warrants as the values were not significant at the date of issuance, other than warrants for 21,500 shares of Innova common stock with an exercise price of $6.96 per share issued in connection with debt financing in April 1997. There were 21,500 warrants outstanding at March 31, 2000; 1,889,000 outstanding at March 31, 1999; and 2,152,000 outstanding at March 31, 1998. The warrants expire May 31, 1999, through April 30, 2002. Upon exercise of these warrants, each warrant is converted to 1.05 shares of the Company's Common Stock.

Employee Stock Purchase Plans. In August 1996, the Company adopted an Employee Stock Purchase Plan (the "1996 Purchase Plan") and reserved 600,000 shares of Common Stock for issuance under the 1996 Purchase Plan. Employees, subject to certain restrictions, were able to purchase Common Stock under the 1996 Purchase Plan through payroll withholding at a price per share of 85% of the fair market value at the beginning or end of the purchase period, as defined under the terms of the 1996 Purchase Plan. The Company sold 372,345 shares in Fiscal 1999, and 166,597 shares in Fiscal 1998 under the Purchase Plan. At March 31, 1999, no shares remained available for future issuance under the 1996 Purchase Plan. Accordingly, in June 1999, the Company adopted the 1999 Employee Stock Purchase Plan (the "1999 Purchase Plan") and reserved 900,000 shares of Common Stock for issuance under the 1999 Purchase Plan. Employees, subject to certain restrictions, may purchase Common Stock under the 1999 Purchase Plan through payroll withholding at a price per share of 85% of the fair market value at the beginning or end of the purchase period, as defined under the terms of the 1999 Purchase Plan. The Company sold 93,189 shares in Fiscal 2000 under the 1999 Purchase Plan.

Stockholders' Rights Agreement. In October 1991, the Company adopted a Stockholders' Rights Agreement pursuant to which one Preferred Share Purchase Right (a "Right") was distributed for each outstanding share of Common Stock. Each Right, as adjusted to give effect to a stock dividend, which effected a two-for-one stock split in November 1997, entitles stockholders to buy one two-hundredth of a share of Series A Junior Participating Preferred Stock at an exercise price of $50.00 upon certain events. The Rights expire on October 23, 2001, unless earlier redeemed by the Company.

The Rights become exercisable if a person acquires 15% or more of the Company's Common Stock or announces a tender offer that would result in such person owning 15% or more of the Company's Common Stock, other than a person who has reported or is required to report beneficial ownership of the Company's Common Stock on Schedule 13G under the Securities Exchange Act of 1934, as amended, with respect to whom the threshold is 20%. If the Rights become exercisable, the holder of each Right (other than the person whose acquisition triggered the exercisability of the Rights) will be entitled to purchase, at the Right's then-current exercise price, a number of shares of the Company's Common Stock having a market value of twice the exercise price. In addition, if the Company were to be acquired in a merger or business combination after the Rights became exercisable, each Right will entitle its holder to purchase, at the Right's then-current exercise price, stock of the acquiring company having a market value of twice the exercise price. The Rights, as adjusted to give effect to a stock dividend, which effected a two-for-one stock split in November 1997, are redeemable by the Company at a price of $0.005 per Right at any time within ten days after a person has acquired 15% (or 20% in the case of a Schedule G filer) or more of the Company's Common Stock.

Note 6. Operating Segment and Geographic Information

The Company adopted SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," as of March 31, 1999. SFAS No. 131 establishes annual and interim reporting standards for an enterprise's operating segments and related disclosures about products, geographic information, and major customers. Operating segment information for Fiscal 2000, Fiscal 1999, and 1998 is also presented in accordance with SFAS No. 131. See Note 1 for a brief description of the Company's business.

The Company is organized into two operating segments: Products and Services. The Chief Executive Officer ("CEO") has been identified as the Chief Operating Decision-Maker as defined by SFAS 131. Resources are allocated to each of these groups using information on their revenues and operating profits before interest and taxes.

The Products operating segment includes the SPECTRUM II, XP4, DART, Altium, and DXR digital microwave systems for digital transmission markets, and designs, develops, and manufactures these products in Seattle, Washington; San Jose, California; and Wellington, New Zealand. The Services operating segment includes, but is not limited to, installation, repair, network design, path surveys, integration, and other services. The Company maintains regional service centers in San Jose, California; and Lanarkshire, Scotland; and Clark Field, Pampanga, Philippines.

The Company does not identify or allocate assets or depreciation by operating segment, nor does the CEO evaluate these groups on these criteria. Operating segments generally do not sell products to each other, and accordingly, there are no significant inter-segment revenues to be reported. The Company does not allocate interest and taxes to operating segments. The accounting policies for segment reporting are the same as for the Company as a whole.

	2000	1999	1998
	(in thousands)		
Products			
Revenues	**$285,449**	$ 215,545	$ 320,688
Operating profit (loss)	**15,924**	(94,186)	16,572
Services			
Revenues	**15,054**	20,954	24,428
Operating profit (loss)	**(1,399)**	(1,961)	3,159
Total			
Revenues	**$300,503**	$ 236,499	$ 345,116
Operating profit (loss)	**14,525**	(96,147)	19,731

One customer accounted for 16% of net sales for Fiscal 2000. No other customers accounted for more than 10% of net sales during Fiscal 2000, 1999, or 1998. At March 31, 2000, three customers accounted for 59% of the backlog. There can be no assurance that the Company's current customers will continue to place orders with the Company, that orders by existing customers will continue to be at levels of previous periods, or that the Company will be able to obtain orders from new customers. The Company's customers typically are not contractually obligated to purchase any quantity of products in any particular period and product sales to major customers have varied widely from period to period.

Revenues by product from unaffiliated customers for Fiscal 2000, 1999, and 1998 are as follows:

	2000	1999	1998
	(in thousands)		
SPECTRUM II	**$ 122,349**	$ 111,823	$ 175,326
XP4	**61,700**	32,247	36,100
DXR	**40,302**	32,513	30,589
Altium	**47,534**	5,259	—
Quantum*	**—**	7,227	23,936
M-Series*	**—**	3,581	13,596
Other Products	**13,564**	22,895	41,141
Total Products	**285,449**	$ 215,545	$ 320,688
Total Services	**15,054**	20,954	24,428
Total Revenue	**$300,503**	$ 236,499	$ 345,116

*Included in Other Products in Fiscal 2000.

Revenues by geographic region from unaffiliated customers for Fiscal 2000, 1999, and 1998 are as follows:

	2000	1999	1998
		(IN THOUSANDS)	
United States	**$ 62,990**	$ 31,753	$ 25,800
Mexico*	**32,106**	14,619	—
Other Americas	**24,201**	37,592	60,146
Europe/Middle East	**81,761**	83,242	146,812
Africa	**19,087**	19,036	16,283
China**	**48,325**	18,100	—
Other Asia/Pacific	**32,033**	32,157	96,075
Total revenues	**$300,503**	$ 236,499	$ 345,116

*Included in Other Americas in 1998.
**Included in Other Asia/Pacific in 1998.

Long-lived assets consisted primarily of property and equipment during Fiscal 2000 and 1999. Net property and equipment by country was as follows:

	2000	1999
	(IN THOUSANDS)	
United States	**$ 29,423**	$ 28,043
United Kingdom	**9,719**	11,621
Other foreign countries	**4,659**	3,361
Net property and equipment	**$ 43,801**	$ 43,025

Note 7. Mergers and Acquisitions

In May 1997, the Company acquired all of the outstanding shares of Granger, Inc., a U.S. manufacturer of wireless products and provider of installation services. The purchase price of Granger, Inc., including the assumption of debt and the purchase of certain product rights, totaled $14.7 million. A portion of the purchase price was allocated to the net assets acquired based on their estimated fair values. The fair value of the tangible assets acquired was $5.8 million and liabilities assumed was $1.9 million. The purchase price in excess of the net assets acquired of $10.8 million was recorded as goodwill on the balance sheet. (See Note 2 above). The acquisition was accounted for using the purchase method of accounting. Accordingly, the accompanying financial statements include the results of Granger, Inc., since the date of acquisition. No pro forma financial statements for the periods presented have been provided due to the amounts being immaterial.

In addition, concurrent with the acquisition of Granger, Inc., the Company made a minority investment in Granger Associates, Ltd., a privately held company based in the United Kingdom, for $4.0 million. This minority investment has been accounted for using the cost method of accounting. In Fiscal 1999, the Company sold approximately 10% of this investment for $470,000. Also in Fiscal 2000, the Company sold approximately 40% of its remaining investment for proceeds of $2.1 million and realized a gain of $480,000 which is reflected in other income in the accompanying consolidated statement of operation.

In March 1998, the stockholders approved the issuance of Common Stock of the Company pursuant to an agreement to merge with MAS Technology Limited (“MAS Technology”), a New Zealand company, which designs, manufactures, markets, and supports digital microwave radio links for the worldwide telecommunications market. Under the terms of the agreement, the Company exchanged 1.2 shares of its Common Stock for each outstanding share of MAS Technology stock and stock options. The Company issued approximately 8.2 million shares to MAS Technology share and option holders. The combination was qualified as a tax-free reorganization accounted for as a pooling-of-interests transaction. Accordingly, the historical financial statements of the Company have been restated to reflect the results of MAS Technology for all periods presented.

In October 1998, the stockholders approved the issuance of Common Stock of the Company pursuant to an agreement to merge with Innova Corporation (“Innova”), a Washington corporation, which designs, manufactures, markets, and supports digital microwave radio links for the worldwide telecommunications market. Under the terms of the agreement, the Company exchanged 1.05 shares of its Common Stock for each outstanding share of Innova stock, stock options, and warrants. The Company issued approximately 14.7 million shares to Innova shareholders upon consummation of the merger. The combination qualified as a tax-free reorganization accounted for as a pooling-of-interests transaction. Accordingly, the historical financial statements of the Company have been restated to reflect the results of Innova for all periods presented.

The following table shows the reconciliation of the historical results of the Company to the results presented in the accompanying Statements of Operations for Fiscal 1998 for the Innova merger:

	Year Ended March 31	
	1998	
Revenue:		
Digital Microwave	$	310,490
Innova		36,100
Intercompany sales		(1,474)
Total	$	345,116
Net Income:		
Digital Microwave	$	19,878
Innova		(1,060)
Intercompany profit eliminations		—
Total	$	18,818

Merger and restructuring expenses of $8.8 million for Fiscal 1998 included payments of $4.3 million for investment banker, legal, and accounting fees; asset valuation reserves for inventory, receivables, and warranty totaling $1.3 million; as well as various other costs of $3.2 million, which included office closures and contract terminations. As of March 31, 1999, there was no remaining restructuring reserve related to the Fiscal 1998 merger and restructuring.

Merger and restructuring charges of $29.9 million were recorded in Fiscal 1999. As a result of the slowdown in the demand for the Company's products, which began with the downturn in various Asian economies in which the Company sells its products, which was accelerated by the heightened pricing and competitive pressures of the telecommunications market in Europe and other regions of the world in Fiscal 1998 and Fiscal 1999, the Company undertook strategic cost savings measures to reflect reduced sales levels and to make the Company more competitive in the future. The Company consolidated its facilities in San Jose, California and reduced its occupancy, primarily for manufacturing, from approximately 230,000 square feet to 132,000 square feet. Also, the Company discontinued its manufacturing operation in Scotland and subsequently established a regional service and repair center in Scotland. Additionally, the Company closed various worldwide sales offices, some of which, as a result of the merger with MAS Technology in March 1998, were duplications of regional coverage. The closing of the facilities discussed above were completed in Fiscal 1999. Facility consolidation costs totaled $4.1 million, of which $1.8 million was paid in Fiscal 1999 and $2.3 million was paid in Fiscal 2000.

Concurrent with the facilities closures, the Company reduced its workforce by 312 employees, or 27% of its average Fiscal 1998 workforce of 1,147. Of the 312 employees affected, 71% were manufacturing related positions, 7% were research and development positions and 22% were in sales, marketing and administration. The workforce reductions were completed by March 31, 1999. Severance costs totaled $4.2 million in Fiscal 1999, of which $3.3 million was paid in Fiscal 1999, $0.4 million was paid in Fiscal 2000 and $0.5 remains to be paid during Fiscal 2001. Payments in Fiscal 2001 are for extended severance pay and benefits elected by the employee in lieu of a lump sum distribution at date of termination.

The Company also discontinued projects related to the implementation of enterprise-wide software purchased for internal use totaling $5.8 million of which $0.6 million was paid in Fiscal 1998, $4.4 million was paid in Fiscal 1999, $0.4 million was paid in Fiscal 2000, and the remaining $0.4 million will be paid during Fiscal 2001, consisting of software commitments.

Merger costs expensed in Fiscal 1999, related to the merger of Innova consummated in October 1998, totaled $2.7 million and consisted of $1.6 million to investment bankers, $0.7 million for legal and accounting services, and $0.4 million for other direct merger related expenses. All expenses were paid in Fiscal 1999.

As part of the restructuring in the third quarter of Fiscal 1999, the Company concluded that the carrying value of the Company's investment in Granger, Inc., a wholly owned subsidiary, was impaired due to changes in business conditions including the slowdown in demand for its products in the U.S. PCS market. Accordingly, the Company wrote-off $9.6 million of goodwill related to the Granger acquisition. In addition, the Company wrote-off other assets, primarily assets of Granger, Inc., totaling $3.5 million. No facilities were closed or employees terminated as part of the write-down of assets. In March 1999, Granger was subsequently sold at net book value for $3.2 million with extended payment terms to Granger's former managers.

report of independent public accountants

To Digital Microwave Corporation:

We have audited the accompanying consolidated balance sheets of Digital Microwave Corporation (a Delaware corporation) and subsidiaries as of March 31, 2000 and 1999, and the related Consolidated Statements of Operations, Stockholders' Equity and Cash Flows for each of the three years in the period ended March 31, 2000. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Digital Microwave Corporation and subsidiaries as of March 31, 2000 and 1999, and the results of their operations and their cash flows for each of the three years in the period ended March 31, 2000, in conformity with accounting principles generally accepted in the United States.

Arthur Andersen LLP

San Jose, California
April 21, 2000

stock information

The Company's Common Stock is traded on the Nasdaq National Market under the symbol DMIC. The following table sets forth the high and low closing sales prices of the Company's Common Stock as reported by Nasdaq for the periods indicated:

	Fiscal year ended March 31,			
	2000		1999	
	high	low	high	low
1st Quarter	**$ 15.13**	**$ 7.56**	$ 14.50	$ 7.00
2nd Quarter	**16.06**	**10.84**	7.63	2.88
3rd Quarter	**25.00**	**12.81**	6.84	2.38
4th Quarter	**48.50**	**21.09**	10.50	6.50

The Company has not paid cash dividends on its Common Stock and does not intend to pay cash dividends in the foreseeable future in order to retain earnings for use in its business. At March 31, 2000, there were approximately 339 stockholders of record.

corporate directory

Officers

Charles D. Kissner
Chairman of the Board

Sam Smookler
President and
Chief Executive Officer

Frank Carretta, Jr.
Senior Vice President
Worldwide Sales

Carl A. Thomsen
Senior Vice President
Chief Financial Officer and
Secretary

John C. Brandt
Vice President and
Corporate Controller

Carol A. Goudey
Corporate Treasurer and
Assistant Secretary

Paul A. Kennard
Chief Technical Officer

John P. O'Neil
Vice President, Personnel

Directors

Richard C. Alberding
Executive Vice President (Retired)
Hewlett-Packard Company

Paul S. Bachow
President of the Corporate
General Partners
Bachow Investment Partners III, L.P.
Paul S. Bachow Co-Investment Fund, L.P.

John W. Combs
Chief Executive Officer
InternetConnect

Charles D. Kissner
Chairman of the Board

Dr. James D. Meindl, Ph.D.
Director
Microelectronics Research Center
Joseph M. Pettit Chair
Professor of Microelectronics
Georgia Institute of Technology

V. Frank Mendicino
General Partner
Access Venture Partners

Howard Oringer
Managing Director
Communications Capital Group

Sam Smookler
President and
Chief Executive Officer

Independent Public Accounts

Arthur Andersen LLP
San Jose, California

General Legal Counsel

Morrison & Foerster LLP
San Francisco, California

Registrar and Transfer Agent

ChaseMellon
Shareholder Services LLC
San Francisco, California

Principal Subsidiaries

DMC Telecom UK, Limited
Lanarkshire, Scotland

DMC Telecom Canada, Inc.
Etobicoke, Ontario, Canada

DMC do Brazil Ltda.
Campinas, Brazil

DMC de Mexico, S.A. de C.V.
Mexico D.F., Mexico

Digital Microwave India
Private Limited
New Delhi, India

DMC Telecom Philippines, Inc.
Metro Manila, Philippines

Digital Microwave Corporation Limited
Wellington, New Zealand

Digital Microwave (Proprietary) Limited
South Pretoria, Republic of South Africa

Digital Microwave
Asia Pacific (S) Pte. Limited
Singapore

Digital Microwave NW, Inc.
Seattle, Washington, USA

Corporate Headquarters

Digital Microwave Corporation
170 Rose Orchard Way
San Jose, CA95134
United States of America

Sales and Service Offices

North America:
San Jose, California
Plantation, Florida
Lawrenceville, Georgia
Amesbury, Massachusetts
Seattle, Washington
Etobicoke, Ontario, Canada

Central and South America:
Mexico City, Mexico
Santa Fe de Bogota, Colombia
Buenos Aires, Argentina
Campinas, Sao Paulo, Brazil

Europe:
Coventry, England
Lanarkshire, Scotland
Freising, Germany
Athens, Greece

Middle East:
Dubai, United Arab Emirates

Africa:
South Pretoria, South Africa
Francistown, Botswana

Asia/Pacific:
Singapore
Wellington, New Zealand
Beijing, China
Clark Special Economic Zone, Philippines
Manila (Makati City), Philippines
New Delhi, India
Colombo, Sri Lanka
Victoria, Australia
Bangkok, Thailand
Kuala Lumpur, Malaysia

SEC Form 10-K

A copy of the Company's Annual Report on Form 10-Kfiled with the Securities and Exchange Commission is available without charge by writing to:

Digital Microwave Corporation
Attn: Investor Relations
170 Rose Orchard Way
San Jose, CA95134

DIGITAL MICROWAVE CORPORATION

DMC stratex NETWORKS

Digital Microwave Corporation
170 Rose Orchard Way
San Jose, California 95134