SECURITIES AND EXCHANGE COMMISSION

# FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1999-07-27** | Period of Report: **1999-06-30**
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## FILER

**PULSEPOINT COMMUNICATIONS**
CIK:**718576**| IRS No.: **953222624** | State of Incorp.:**CA** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **000-18280** | Film No.: **99671152**
SIC: **3661** Telephone & telegraph apparatus

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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D. C. 20549

(X) Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the quarterly period ended June 30, 1999

or

(_) Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ____________ to ____________.

Commission File Number: 0-18280

PULSEPOINT COMMUNICATIONS

(Exact name of Registrant as specified in its charter)

| California | 95-3222624 |
| --- | --- |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |

| 6307 Carpinteria Avenue, Carpinteria, California | 93013 |
| --- | --- |
| (Address of principal executive offices) | Zip Code |

Registrant's telephone number, including area code (805) 566-2000

(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months or for such shorter period that the Registrant was required to file such reports, and (2) has been subject to such filing requirements for the past 90 days.

Yes X No ___

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The number of shares outstanding of Registrant's common stock as of July 25, 1999 was 8,043,384.

PULSEPOINT COMMUNICATIONS

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PART I - FINANCIAL INFORMATION

PULSEPOINT COMMUNICATIONS

CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

<CAPTION>

| | JUNE 30, | DECEMBER 31, |
| --- | --- | --- |

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| | 1999 | 1998 |
|---|---|---|
| | (Unaudited) | |
| ASSETS | | |
| <S> | <C> | <C> |
| Current assets: | | |
| Cash, cash equivalents and pledged cash | $ 6,830 | $ 11,473 |
| Accounts receivable, less allowance for doubtful accounts of $598 and $725 at June 30, 1999 and December 31, 1998, respectively | 5,405 | 4,215 |
| Inventories, net | 7,307 | 7,652 |
| Other current assets | 545 | 516 |
| Total current assets | 20,087 | 23,856 |
| Property and equipment, at cost: | | |
| Computers and other equipment | 11,397 | 10,334 |
| Furniture and fixtures | 999 | 999 |
| Leasehold improvements | 1,931 | 1,955 |
| | 14,327 | 13,288 |
| Less accumulated depreciation and amortization | (9,933) | (9,046) |
| | 4,394 | 4,242 |
| Other assets: | | |
| Investment securities | 653 | 1,101 |
| Other assets | 1,075 | 1,328 |
| Total other assets | 1,728 | 2,429 |
| Total assets | $ 26,209 | $ 30,527 |
| LIABILITIES & SHAREHOLDERS' EQUITY | | |
| Current liabilities: | | |
| Credit line | $ 1,990 | $ 540 |
| Notes payable, current | 877 | 613 |
| Accounts payable | 3,844 | 5,335 |
| Accrued payroll and related | 2,201 | 2,264 |
| Other accrued liabilities | 1,708 | 3,115 |
| Total current liabilities | 10,620 | 11,867 |
| Trade-in allowance | 1,656 | 1,360 |
| Notes payable, long-term | 1,619 | 1,498 |
| Commitments and contingencies | | |
| Shareholders' equity: | | |
| Preferred stock, 15,000,000 shares authorized: | | |
| Series A, no par value, no shares issued and outstanding at June 30, 1999 and December 31, 1998 | - | - |
| Series B, no par value, 3,208,534 and 3,333,334 shares issued and outstanding at June 30, 1999 and December 31, 1998, respectively | 23,787 | 24,723 |
| Common stock, no par value - 50,000,000 shares authorized, 5,577,728 and 5,237,699 shares issued and outstanding at June 30, 1999 and December 31, 1998, respectively | 70,881 | 69,820 |
| Accumulated deficit | (82,354) | (78,741) |
| Total shareholders' equity | 12,314 | 15,802 |
| Total liabilities & shareholders' equity | $ 26,209 | $ 30,527 |

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See accompanying notes.
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PULSEPOINT COMMUNICATIONS

CONSOLIDATED STATEMENT OF OPERATIONS

(In thousands, except per share data)

<CAPTION>

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| | June 30, 1999 | June 30, 1998 | June 30, 1999 | June 30, 1998 |
| | | (Unaudited) | | |
| <S> | <C> | <C> | <C> | <C> |
| Net sales | $ 7,488 | $ 6,842 | $ 14,579 | $ 11,043 |
| Cost of sales | 3,405 | 3,875 | 6,282 | 5,754 |
| Gross margin | 4,083 | 2,967 | 8,297 | 5,289 |
| Selling, general and administrative expenses | 2,538 | 3,767 | 5,283 | 7,287 |
| Engineering and development expenses | 3,360 | 2,534 | 6,510 | 5,178 |
| Total operating expense | 5,898 | 6,301 | 11,793 | 12,465 |
| Loss from operations | (1,815) | (3,334) | (3,496) | (7,176) |
| Interest and other income (expense), net | (53) | 189 | (117) | 395 |
| Loss before provision for income taxes | (1,868) | (3,145) | (3,613) | (6,781) |
| Provision for income taxes | - | - | - | - |
| Net loss and comprehensive loss | $ (1,868) | $ (3,145) | $ (3,613) | $ (6,781) |
| Loss per common share - basic and diluted | $ (0.34) | $ (0.61) | $ (0.67) | $ (1.31) |
| Weighted average common and common equivalent shares outstanding | 5,425 | 5,172 | 5,346 | 5,157 |

See accompanying notes.
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PULSEPOINT COMMUNICATIONS

CONSOLIDATED STATEMENT OF CASH FLOWS

(In thousands)

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| | JUNE 30, 1999 | JUNE 30, 1998 |
|---|---|---|
| | (Unaudited) | (Unaudited) |
| <S> | <C> | <C> |
| Cash flows from operating activities: | | |
| Net loss | $ (3,613) | $ (6,781) |
| Adjustments to reconcile net loss to net cash used in operations: | | |
| Depreciation and amortization | 1,264 | 1,314 |
| Provision for losses on accounts receivable | (127) | 110 |
| Provision for losses on inventory | 214 | 150 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,063) | (1,986) |
| Inventories | 131 | (921) |
| Other current assets | (29) | 23 |
| Other assets | (108) | - |
| Accounts payable | (1,490) | 34 |
| Accrued payroll and related | (62) | (559) |
| Trade-in allowance | 296 | - |
| Other accrued liabilities | (1,408) | 241 |
| Net cash used in operations | (5,995) | (8,375) |
| Cash flows from investing activities: | | |
| (Increase) decrease in investment securities | 448 | (9) |
| Additions to property and equipment | (1,039) | (675) |
| Net cash used in investing activities | (591) | (684) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of long-term debt | 768 | - |
| Principal payments of long-term debt | (383) | - |
| Proceeds from issuance of common stock | 108 | 284 |
| Net proceeds from line of credit | 1,450 | 671 |
| Net cash provided by financing activities | 1,943 | 955 |
| Net increase (decrease) in cash and equivalents | (4,643) | (8,104) |
| Cash and equivalents at beginning of period | 11,473 | 20,973 |
| Cash and equivalents at end of period | $ 6,830 | $ 12,869 |

See accompanying notes.

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PULSEPOINT COMMUNICATIONS

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

JUNE 30, 1999

(Unaudited)

NOTE 1. General

All interim financial data is unaudited, but in the opinion of PulsePoint Communications (the "Company") such unaudited statements include all adjustments, consisting of normal recurring accruals, necessary for a fair presentation of the results for the interim periods. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. Nevertheless, the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading.

The results of operations for the current interim period are not necessarily indicative of results to be expected for the current year.

REVENUE RECOGNITION. Generally sales are recognized when products are shipped or when services are performed. Warranty costs are accrued at time of sale. Revenue from sales of extended warranties is accounted for as deferred revenues and recognized into income over the warranty or maintenance period.

In October 1997, the American Institute of Certified Public Accountants (AICPA) issued Statement of Position (SOP) 97-2, "Software Revenue Recognition" ("SOP 97-2"). SOP 97-2 establishes standards relating to the recognition of all aspects of software revenue. SOP 97-2 is effective for transactions entered into in fiscal years beginning after December 15, 1997. The Company adopted the provisions of SOP 97-2 as of June 30, 1998. The adoption had no effect on the financial statements.

PRINCIPLES OF CONSOLIDATION. In September 1998, the names of the corporation's wholly-owned subsidiaries DGSD Malaysia Corporation and Digital Sound International Corporation were changed, respectively, to PulsePoint Communications Malaysia Corporation and PulsePoint Communications International Corporation. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, as noted above. All significant intercompany transactions and balances have been eliminated.

SHORT TERM INVESTMENTS. The Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("SFAS 115"). The Company adopted the provisions of SFAS 115 for investments held as of December 31, 1995. The adoption had no effect on the financial statements. Short-term investments (principally commercial paper and discount notes with maturity dates generally within 90 days that are considered cash equivalents) are classified as "held to maturity" based on the Company's positive intent and ability to hold the securities until maturity. The securities are presented at amortized cost which approximates fair value. Amortization and interest on securities classified as "held to maturity" are included in investment income.

COMPREHENSIVE INCOME (LOSS). As of January 1, 1998, the Company adopted Statement of Financial Accounting Standards No. 130, "Reporting Comprehensive Income" ("SFAS 130"). SFAS 130 establishes new rules for the reporting and display of comprehensive income (loss) and its components; however, the adoption

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of SFAS 130 had no impact on the Company's financial statements.

CASH, CASH EQUIVALENTS AND PLEDGED CASH. The Company considers as cash equivalents only those investments that are short-term, highly liquid, readily convertible to cash, and so near their maturity that they present insignificant risk of changes in value because of changes in interest rates. The Company classifies as cash equivalents only those investments with maturities of three months or less. Pledged cash consists of funds deposited under lease agreements with BancBoston Leasing Inc. which become available within 90 days.

RECLASSIFICATION. Certain data in the 1998 financial statements have been reclassified to conform to the 1999 presentation.



These financial statements should be read in conjunction with the financial statements and the notes thereto included in the Company's Form 10-K for the fiscal year ended December 31, 1998, as filed with the Securities and Exchange Commission.

NOTE 2. Segment Information

On December 31, 1998, the Company adopted Statement of Financial Accounting Standards No. 131 "Disclosures about Segments of an Enterprise and Related Information" ("SFAS 131"). The new rules establish revised standards for public companies relating to the reporting of financial and descriptive information about their business segments and their enterprise-wide operations. The Company operates in one segment.

Enterprise-wide information required by SFAS 131 is as follows:

Revenue by product or service:

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| (In thousands) | June 30, 1999 | June 30, 1998 | June 30, 1999 | June 30, 1998 |
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| Voice Information Services (VIS) | $ 6,419 | $ 5,973 | $ 12,657 | $ 9,029 |
| Customer Premises Equipment (CPE) | 1,069 | 869 | 1,922 | 2,014 |
| | $ 7,488 | $ 6,842 | $ 14,579 | $ 11,043 |

Revenue by geographic area (based on domicile of customer):

| | Three Months Ended | | Six Months Ended | |
|---|---|---|---|---|
| (In thousands) | June 30, | June 30, | June 30, | June 30, |

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| | 1999 | 1998 | 1999 | 1998 |
|---|---|---|---|---|
| | (Unaudited) | (Unaudited) | (Unaudited) | (Unaudited) |
| Domestic | $ 7,460 | $ 6,727 | $ 14,364 | $ 10,924 |
| International | 28 | 115 | 215 | 119 |
| | $ 7,488 | $ 6,842 | $ 14,579 | $ 11,043 |

All of the Company's long-lived assets are located in the United States.

NOTE 3. Inventories

Inventories are stated at the lower of standard cost (which approximates the first-in, first-out method) or market:

| (In thousands) | JUNE 30, 1999 | DECEMBER 31, 1998 |
|---|---|---|
| | (Unaudited) | |
| Raw material and purchased parts | $ 4,573 | $ 6,399 |
| Work-in-process | 43 | 751 |
| Finished goods | 2,691 | 502 |
| | $ 7,307 | $ 7,652 |



NOTE 4. Debt

On March 31, 1999, the Company's Security and Loan Agreement (the "Credit Line") with Imperial Bank was renewed to September 30, 1999. At June 30, 1999, the Company was in violation of one of the covenants of the Credit Line and has received a one-time waiver from the bank of this covenant violation. The waiver eliminated any restricted access to the Credit Line that might have otherwise been imposed due to the covenant violation. Continued access to the Credit Line is subject to the Company's compliance with monthly and quarterly covenant calculations. If compliance does not occur, the Company would seek an additional waiver or to procure alternative financing sources, though no assurance can be provided that such could be accomplished on terms favorable to the Company, if at all.

NOTE 5. Equity

Common and Common Equivalent Stock

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At June 30, 1999, there were 5,577,728 shares of the Company's Common Stock outstanding and 10,761,722 shares of common stock equivalents, as follows:

| | | Number of Common Shares Outstanding and Potentially Issuable Common Shares |
|---|---|---|
| (A) Common Stock outstanding | | 5,577,728 |
| (B) Conversion of Series B Convertible Preferred Stock | 8,021,335 | |
| (C) Options granted - 1983 Stock Option Plan | 1,321,742 | |
| (D) Options granted - Unisys Corporation | 1,109,937 | |
| (E) Warrants | 264,808 | |
| (F) Options granted - Directors' Stock Option Plan | 43,900 | |
| Additional shares potentially issuable | | 10,761,722 |
| Total potential shares of Common Stock | | 16,339,450 |

(A) Number of shares of Common Stock outstanding at June 30, 1999.

(B) Shares of Common Stock issuable upon conversion of the Company's Series B Convertible Preferred Stock outstanding at June 30, 1999.

(C) Number of shares of Common Stock issuable pursuant to options granted under the Company's 1983 Stock Option Plan (assuming full vesting). Note: Of these 1,321,742 options, 676,608 have exercise prices below the Company's June 30, 1999 closing stock price of $5.97.

(D) Number of shares of Common Stock issuable pursuant to options granted as a condition and inducement of Unisys Corporation's willingness to enter into a merger agreement with the Company.

(E) Warrants to purchase the Company's Common Stock at June 30, 1999, composed of 100,000 warrants issued to Imperial Bank, 73,846 warrants issued to Transamerica Business Credit Corporation, 18,462 warrants issued to Priority Capital and 72,500 warrants issued to NEXTLINK Communications, Inc.

(F) Number of shares of Common Stock issuable pursuant to options granted under the Company's Directors' Option Plan (assuming full vesting). Note: Of these 43,900 options, 6,250 have exercise prices below the Company's June 30, 1999 closing stock price of $5.97.



Reverse Split of Common Stock

On April 10, 1998, the Company's Shareholders approved and on April 20, 1998, the Company effected a 1 for 4 reverse split of the Company's Common Stock. In accordance with SAB 83, the financial statements and footnote disclosure reflects the reverse stock split for all reporting periods. In addition, the calculations of earnings (loss) per share have given effect to the reverse stock split.

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## Warrants

In January 1999, the Company entered into an agreement with Leap Wireless International, Inc. ("Leap"), whereby warrants to purchase the Company's Common Stock will be issued to Leap upon certain EAP purchase milestones by Leap or a Leap affiliate. At June 30, 1999 Leap had not made any EAP purchases from the Company. The Company entered into a similar agreement with NEXTLINK Communications, Inc. in 1998.

## NOTE 6. Per Share Information

Earnings (loss) per common and common equivalent share are computed based upon the weighted average number of outstanding shares of common stock and common stock equivalents. Antidilutive common stock equivalents were excluded from this calculation for the periods in which a loss was incurred.



# MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

## Results of Operations

### Three Months Ended June 30, 1999 Compared to Three Months Ended June 30, 1998

Net sales increased 9% from $6.8 million in 1998 to $7.5 million in 1999. Consistent with the Company's focus on the Voice Information Services ("VIS") market, sales to network service providers totaled $6.4 million, or 86%, of the sales in the three month period ended June 30, 1999, compared with sales of $6.0 million, or 87%, of sales during the same period in 1998. Sales to the Customer Premise Equipment ("CPE") market represented the remaining $1.1 million, or 14%, of sales in the three month period ended June 30, 1999, compared with $0.9 million, or 13%, of sales during the same period in 1998.

Gross margin as a percentage of net sales increased to 55% in the 1999 period as compared to 43% for the same period in 1998. The gross margin improvement resulted from higher production volumes, which allowed for the wider spreading of fixed costs, coupled with an increase in the number of larger system sales.

Selling, general and administrative expenses decreased from $3.8 million in the 1998 period to $2.5 million in the 1999 period as the Company continued company-wide cost control measures. As a result of these controls and the higher volume in net sales, selling, general and administrative expenses were lower as a percentage of sales (34%) in the second quarter of 1999 as compared to the same quarter in 1998 (55%).

Engineering and development expenses increased from $2.5 million in the second quarter of 1998 to $3.4 million in 1999. Engineering and development expenses reflect the Company's strategy of continued investment in new product development and product enhancements. As a result of the increased expenditures, engineering and development expenses were higher as a percentage of sales in

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1999 (45%) as compared to 1998 (37%).

There was no provision for income taxes in the second quarter of 1999 or 1998 due to the losses from operations.

As a result of the above, the Company's net loss for the three months ended June 30, 1999 was $1.9 million, an improvement of 41% as compared to a net loss of $3.1 million for the comparable period last year.

## Six Months Ended June 30, 1999 Compared to Six Months Ended June 30, 1998

Net sales increased 32% from $11.0 million in 1998 to $14.6 million for the first six months of 1999. Consistent with the Company's focus on the Voice Information Services ("VIS") market, sales to network service providers totaled $12.7 million, or 87%, of sales during the first six months of 1999, while sales into the Customer Premise Equipment ("CPE") market represented the remaining $1.9 million, or 13%, as compared to $9.0 million, or 82%, of sales for VIS and $2.0 million, or 18%, for CPE during the same period in 1998.

Gross margin as a percentage of net sales increased to 57% in the 1999 period as compared to 48% for the same period in 1998. The gross margin improvement resulted from higher production volumes, which allowed for the wider spreading of fixed costs, coupled with an increase in the number of larger system sales.

Selling, general and administrative expenses decreased from $7.3 million in 1998 to $5.3 million in 1999 as the Company continued company-wide cost control measures. As a result of these controls and the higher volume in net sales, selling, general and administrative expenses were lower as a percentage of sales (36%) in 1999 as compared to 1998 (66%).

Engineering and development expenses increased from $5.2 million in 1998 to $6.5 million in 1999. Engineering and development expenses reflect the Company's strategy of continued investment in new product development and product enhancements. As a result of the higher volume in net sales in the first six months of 1999, engineering and development expenses were lower as a percentage of sales in 1999 (45%) as compared to 1998 (47%).



There was no provision for income taxes for the six months ended June 30, 1999 or 1998 due to the losses from operations.

As a result of the above, the Company's net loss for the six months improved 47% from a net loss of $6.8 million for the six months ended June 30, 1998 to a $3.6 million net loss for the comparable period of 1999.

## Factors That May Affect Future Results

The Company operates in a rapidly changing environment that involves a number of risks, some of which are beyond the Company's control. These risks are discussed in the Company's 1998 Annual Report to Shareholders and incorporated by reference to the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998.

For the past several years, the Company has relied upon sales and services related to its VoiceServer family of products. In February 1998, the Company

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introduced its new product line, the PulsePoint(TM) Enhanced Application Platform ("EAP"). The EAP is a carrier-grade, internet-ready open-system enhanced services solution based on Microsoft(R) Windows NT(TM) Server. It is designed for the messaging needs of small- to large-sized network service providers and resellers. Its architecture supports a wide variety of port capacities from tens to thousands of ports.

In July 1998, the Company announced the renewal of its multi-year contract with GTE. As part of that renewal, GTE provided a $50 million minimum purchase commitment, subject to the Company meeting certain delivery milestones. Also in July 1998, the Company announced that one of those milestones had been missed and as such, GTE now has the option of choosing to reduce, cancel, or maintain the purchase commitment clause within the overall contract. Through July 26, 1999, no action has been taken to modify the purchase commitment clause. The Company also announced in July 1998 that the EAP was in integration testing and standardization at GTE and in February 1999 the Company announced that GTE had completed testing and standardization of the EAP. The Company continues to maintain its goal of deployment of the EAP with GTE and other customers, but there can be no assurance that this goal will be achieved.

Though demand for the Company's VoiceServer product lines remains strong, the Company's management believes that future sales will depend largely upon the successful completion, standardization, and build-out of the EAP product line. There can, however, be no assurance that this goal will be achieved.

The Company's strategy has been to develop new technology and to expand its marketing capabilities, with the goal of creating successful new products and marketing them effectively, thereby returning the Company to profitability. The Company's ongoing investments in technology and marketing require funds and the Company's financial resources are limited so that the Company's funds will be exhausted if the Company is unsuccessful in creating, developing, and marketing new products such as the EAP product line and is unable to raise additional working capital.

## Year 2000 Update

Certain computer programs and embedded computer chips are unable to distinguish between the year 1900 and the year 2000 (the "Year 2000 Problem"). The Company has undertaken a comprehensive program to address the effects of the Year 2000 Problem on its products and systems ("The Program"). The Program addresses the Year 2000 Problem as it impacts the Company in three distinct areas: (1) the Company's products; (2) the Company's internal systems; and (3) third parties with which the Company has material relationships.

The Company sold certain equipment prior to 1992 that may still be in service but which the Company no longer supports. As the Company no longer takes responsibility for any aspect of this equipment, the Company does not believe it has any responsibility to remediate the Year 2000 Problem with regard to these systems. Though the Company does not anticipate receiving any requests for such remediation, there can be no assurance that these claims will not occur.



The Company believes that the products it currently supports are either Year 2000 compliant or that Year 2000 compliant solutions are available for those products. Although the Company has not received any customer complaints, there can be no assurance that such complaints will not be received. The Company's newest product, the EAP, is a carrier-grade and open-systems based product that integrates many third party components, including, but not limited

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to, software. In the Company's previously published Year 2000 Update, the Company had tested the EAP under its Published Functionality that is described in the documentation set that accompanies the EAP when purchased ("Published Functionality"). The Company believed that the tests utilized were sufficient to determine the EAP to be Year 2000 compliant. Since that time the Company has completed a review of all of the third party software products in the EAP for Year 2000 compliance. Through this review the Company has become aware of a small percentage of third party software in the EAP with Year 2000 compliance issues. The vendors for these third party software components have Year 2000 compliant solutions available. As a result, the Company has expanded its Year 2000 testing to determine whether these products will affect the Published Functionality of the EAP. The Company believes that these tests will be adequate to identify potential Year 2000 problems relating to the Published Functionality. If necessary, the Company will apply the appropriate vendor solutions. There is the possibility that such a problem could remain undetected. If an aspect of a third party product that relates to the Published Functionality remains non-Year 2000 compliant, the non-compliance of such products could have material adverse effects upon the operations of the Company. In addition, should the EAP be utilized in a manner other than its Published Functionality, these third party software issues may affect the EAP's performance.

In 1997, the Company replaced its primary internal accounting, manufacturing, and inventory systems with a new system which the vendor warrants is Year 2000 compliant. The Company is approximately 90% complete with its testing of other internal systems and imbedded processors. These include, among many others, the Company's payroll, internal networking, engineering development and office security systems. The systems with which the Company performs warranty, maintenance and support services have been warranted by the vendors as being Year 2000 compliant. The Company expects to complete testing of the remaining 10% and to have repaired or replaced any mission critical business systems found to be non-Year 2000 compliant by September 30, 1999. As part of The Program, the Company has developed a contingency plan for all of the mission critical business systems. The Company will continue to remediate non-mission critical business systems through December 31, 1999 in accordance with The Program.

The Program has identified third parties with which the Company has material relationships. At July 25, 1999, all of these third parties have responded to the Company's queries regarding their Year 2000 compliance and, to date, none of these third parties have disclosed any material risk to the Company. In many cases, the Company is not in a position to confirm independently the accuracy of the information reported by these third parties. If any of these third parties remain non-Year 2000 compliant, it could have material adverse effects upon the operations of the Company.

The Company expects the total cost of The Program to be approximately $0.8 million. To date, the Company has incurred approximately $0.6 million of these costs. Should the Company encounter unexpected problems in any area of compliance with the Year 2000 Problem, this amount could be substantially increased. The Company currently plans to have The Program completed not later than September 30, 1999, which is prior to any anticipated impact on the Company's operating systems. While the Company does not expect the Year 2000 Problem to cause any significant operational problems, there can be no assurance that such problems will not occur.

## Liquidity and Capital Resources

For the six months ended June 30, 1999, net working capital decreased by $2.5 million to $9.5 million compared to $12.0 million at December 31, 1998. The decrease in working capital resulted principally from a reduction in cash of $4.6 million, an increase in accounts receivable of $1.2 million, a decrease in

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inventory of $0.3 million, an increase in amounts borrowed under the Company's Credit Line of $1.5 million, an increase in the current notes payable of $0.3 million and a decrease in accounts payable and accrued liabilities of $3.0 million.



At June 30, 1999, the Company had cash and cash equivalents of $6.8 million and $2.4 million of long-term debt, $0.8 million of which was due within twelve months. The Company's borrowings under the Credit Line were $2.0 million, which was the maximum permissible borrowing under the agreement. The Credit Line matures on September 30, 1999. The Company anticipates that it will seek to renew the Credit Line, but there can be no assurance that the line will be renewed at that time. For the six months ended June 30, 1999, net cash used by operations was $6.0 million, and capital expenditures were $1.0 million. The Company has never paid any cash dividends on its stock and anticipates that, for the foreseeable future, it will continue to retain any earnings for use in the operation of its business.

## Proposed Merger

On June 15, 1999 PulsePoint Communications and Unisys Corporation ("Unisys") announced that they had signed an agreement for Unisys to acquire the Company in a tax-free, stock-for-stock merger. The acquisition, which will be accounted for as a pooling of interests, is expected to close in the third quarter of 1999. The transaction is subject to approval by the Company's common and preferred shareholders, as well as regulatory approvals and customary closing conditions. Although the Company expects this merger to occur, there can be no assurances that this will be the case.



# PART II - OTHER INFORMATION

## PULSEPOINT COMMUNICATIONS

## Item 1. Legal Proceedings

As reported in Note 13 to the Company's financial statements included in the Company's 1998 Annual Report to Shareholders and incorporated by reference in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 1998, the Company is involved in patent litigation with Theis Research, Inc. ("Theis"). This action was stayed pending resolution of Theis' patent infringement action against Octel Communications Corporation (now a division of Lucent Technologies) and Northern Telecom Inc. In 1997, the U.S. Court of Appeals affirmed a district court's decision that the claims of the five patents Theis asserted against both Octel and Northern Telecom were each either invalid, not infringed or both. Theis' writ of certiorari to the U.S. Supreme Court was denied on June 26, 1998, exhausting Theis' appeals. On September 29, 1998, the district court entered a judgment that the claims of a sixth patent asserted against Northern Telecom are invalid. Theis filed a notice of appeal to the U.S. Court of Appeals for the Federal Circuit on October 29, 1998. On July 21, 1999, the Company filed a motion to dismiss. A hearing date has been scheduled for August 27, 1999. On July 23, 1999, the court indicated that they intend to

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dismiss the case without prejudice, though the Company has not received a written order as of July 26, 1999.

Item 6. Exhibits and Reports on Form 8-K

a) Exhibits

10.29 Agreement and Plan of Merger dated as of June 14, 1999, between PulsePoint Communications, Unisys Corporation and ShellCo Inc. (incorporated by reference to Exhibit 2.1 of the Company's Current Report on Form 8-K filed June 14, 1999).

10.30 Stock Option Agreement dated as of June 14, 1999, between Unisys Corporation and PulsePoint Communications, as Grantor (incorporated by reference to Exhibit 10.1 of the Company's Current Report on Form 8-K filed June 14, 1999).

10.31* Form of Voting Agreement dated as of June 14, 1999 (incorporated by reference to Exhibit 10.2 of the Company's Current Report on Form 8-K filed June 14, 1999).

10.32** Form of Letter Agreement (incorporated by reference to Exhibit 10.3 of the Company's Current Report on Form 8-K filed June 14, 1999).

* Attached as Exhibit B to the Merger Agreement. Unisys Corporation has entered into a Voting Agreement in substantially the form filed herewith with Oak Investment Partners V, Limited Partnership; Oak Investment Partners VII, Limited Partnership; Oak Investment Partners III, A Limited Partnership; Oak VII Affiliates Fund, Limited Partnership; Oak V Affiliates Fund, Limited Partnership; and Bandel L. Carano (collectively, the "Oak Entities"); Frederick J. Warren; Microsoft Corporation; Citiventure 96 A.P. Partnership Fund, L.P.; Chancellor Private Capital Offshore Partners II, L.P.; Chancellor Private Capital Partners III, Limited Partnership; Chancellor Private Capital Offshore Partners I, C.V.; Moore Global Investments, Ltd. and Remington Investment Strategies, L.P.

** Unisys and PulsePoint have received letters in substantially the form filed herewith from the Oak Entities; Frederick J. Warren; Microsoft Corporation; Citiventure 96 A.P. Partnership Fund, L.P.; Chancellor Private Capital Offshore Partners II, L.P.; Chancellor Private Capital Partners III, Limited Partnership; Chancellor Private Capital Offshore Partners I, C.V.; Moore Global Investments, Ltd. and Remington Investment Strategies, L.P.; provided that the letter from the Oak Entities provides for the conversion of thirty three percent (33%) of the PulsePoint Preferred shares held by them.

b) Reports on Form 8-K

During the quarter ended June 30, 1999 the Company filed a Current Report on Form 8-K, dated June 14, 1999 to report under Items 5 and 7 of such Form.



SIGNATURES

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Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on July 27, 1999.

PULSEPOINT COMMUNICATIONS

By: /s/ Mark C. Ozur
---------------------------
Mark C. Ozur
President, Chief Executive Officer

By: /s/ B. Robert Suh
---------------------------
B. Robert Suh
Vice President, Finance and
Chief Financial Officer



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