SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K/A

(MARK ONE)

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

OR

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

FOR THE FISCAL YEAR ENDED JULY 31, 1998

Commission file number 0-20008

VTEL CORPORATION

A Delaware Corporation IRS Employer ID No. 74-2415696

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

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

None

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ].

Indicate by check mark if disclosure of delinquent filings pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of the Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K, or any amendment to this Form 10-K. ( ).

The aggregate market value of 21,215,873 shares of the registrant's Common Stock held by nonaffiliates on September 18, 1998 was approximately $84,863,492. For purposes of this computation all officers, directors and 5% beneficial owners of the registrant are deemed to be affiliates. Such determination should not be deemed an admission that such officers, directors and beneficial owners are, in fact, affiliates of the registrant.

At October 8, 1998 there were 23,282,700 shares of the registrant's Common Stock, $.01 par value, issued and outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

None

VTEL Corporation, a Delaware corporation (the "Company"), hereby amends, as set forth herein, the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission on October 26, 1998.

The item numbers and responses thereto are in accordance with the requirements of Form 10-K. All capitalized terms used and not otherwise defined herein shall have the meaning specified in the Company's Annual Report on Form 10-K.

The Company hereby amends and restates in its entirety item 7 and the Consolidated Financial Statements of the Company's Annual Report on Form 10-K.

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

On May 23, 1997, shareholders of VTEL and CLI approved the Merger of VTEL-Sub, Inc., a Delaware corporation and direct wholly-owned subsidiary of VTEL ("Merger Sub"), with and into CLI, pursuant to an Agreement and Plan of Merger and Reorganization (the "Merger Agreement"), with CLI becoming a direct wholly-owned subsidiary of VTEL. As a result of the Merger, (i) the outstanding shares of CLI's Common Stock, par value $.001 per share ("CLI Common Stock"), were converted into the right to receive 0.46 shares of Common Stock of VTEL, par value $.01 per share ("VTEL Common Stock"), per share of CLI Common Stock converted (or cash in lieu of fractional shares otherwise deliverable in respect thereof), and (ii) the outstanding shares of CLI Series C Preferred Stock, par value $.001 per share ("CLI Preferred Stock"), were converted into the right to receive 3.15 shares of VTEL Common Stock per share of CLI Preferred Stock converted (or cash in lieu of fractional shares otherwise deliverable in respect thereof). The CLI shares were exchanged for a total of 8,424,741 shares of VTEL Common Stock. The acquisition was accounted for as a pooling of interests and accordingly, the consolidated financial information has been restated for all periods to include the accounts of both VTEL and CLI.

The restatement of the consolidated financial information combines the financial information of VTEL and CLI giving retroactive effect to the Merger as if the two companies had operated as a single company for all periods presented. However, the two companies operated independently prior to the Merger that was consummated in May 1997 and the historical changes and trends in the financial condition and results of operations of these two companies resulted from independent activities. Nonetheless, the following Management's Discussion and Analysis of Financial Condition and Results of Operations attempts to relate the activities which resulted in the changes in financial condition and results of operations of the combined company, taking into consideration that a trend or change in the historical results of the combined entity was caused by many events related to each individual company operating independently as competitors. The financial information presented on a historical restated basis

is not indicative of the financial condition and results of operations that may have been achieved in the past or will be achieved in the future had the companies operated as a single entity for the periods presented. The following discussion of the consolidated operations and financial condition of the Company should be read in conjunction with the Company's consolidated financial statements and related notes thereto included elsewhere herein.

In May 1996, the Company changed its fiscal year end from December 31 to July 31. The accompanying financial information includes the results of operations and cash flows for the seven month transition period ended July 31, 1996 with comparative presentation of the unaudited results for the seven months ended July 31, 1995. Results of operations for the seven month periods ended July 31, 1996 and 1995 are not necessarily indicative of the operating results which would be expected for a full year.

RESULT OF OPERATIONS

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

	FOR THE YEAR ENDED DECEMBER 31,	FOR THE SEVEN MONTHS ENDED JULY 31,		FOR THE YEARS ENDED JULY 31,	
	1995	1995 (UNAUDITED)	1996	1997	1998
Revenues	100.0%	100.0%	100.0%	100.0%	100.0%
Gross margin	35.0	40.8	37.1	39.1	47.3
Selling, general and	32.7	32.0	40.1	34.2	36.1

administrative					
Research and development	11.1	12.1	16.8	12.8	11.1
Total operating expenses	44.4	45.0	58.0	62.9	46.8
Other income, net	0.4	0.2	1.8	0.6	1.1
Net income (loss) from continuing operations	(9.1)	(4.4)	(19.1)	(23.2)	1.6
Net income (loss)	(28.2)%	(3.9)%	(19.1)%	(27.3)%	1.6%

FOR THE YEARS ENDED DECEMBER 31, 1995 AND JULY 31, 1997 AND 1998 AND THE SEVEN MONTHS ENDED JULY 31, 1995 AND 1996.

Revenues

The following table summarizes the Company's group digital visual communication and multipoint control unit sales activity:

	FOR THE YEAR ENDED DECEMBER 31,	FOR THE SEVEN MONTHS ENDED JULY 31,		FOR THE YEARS ENDED JULY 31,	
	1995	1995 (Unaudited)	1996	1997	1998
Large-group digital visual communication systems	3,607	1,903	1,654	3,595	3,518
Small-group digital visual communication systems	334	201	69	690	632
Multipoint control units	223	113	81	213	140
Total units	4,164	2,217	1,804	4,498	4,290

Consolidated revenues decreased from $191.1 million in fiscal 1995 to $191.0 million in fiscal 1997 and to $180.0 million in fiscal 1998. Consolidated revenues decreased from $98.1 million for the seven months ended July 31, 1995 to $97.0 million for the seven months ended July 31, 1996.

Revenues for the year ended December 31, 1995 included amounts generated from the broadcast products division which was sold by the Company's wholly-owned subsidiary, CLI, in June 1996. Revenues for the year ended July 31, 1997 were consistent with revenues for the year ended December 31, 1995 due to an increase in revenues generated by sales of digital visual communications systems and professional services which replaced the decline in revenues as a result of the sale of the broadcast products division.

Revenues for the year ended July 31, 1998 decreased in comparison with revenues for the year ended July 31, 1997 due to Merger transition issues. During the year ended July 31, 1998, the Company combined the sales forces of VTEL and CLI, migrated to a single product platform by eliminating the former CLI platform, and combined the management and operations of the two companies into a single organization. The Company has completed all Merger transition activities and is operating effectively as a single organization. The Company expects to be able to continue to improve operational efficiency and to increase revenues in the future.

Revenues decreased from the seven months ended July 31, 1995 to the seven months ended July 31, 1996 as a result of a trend of decreasing digital visual communication product revenues by the Company's wholly-owned subsidiary, CLI. The decrease in revenue was due to product transition issues and the distraction of the attention of CLI's management in an attempt to diversify the broadcast products division that ultimately was sold in June 1996.

The Company has experienced a trend of revenue growth in consolidated service and other revenues as a result of an increase in service and systems integration revenues generated from the assets acquired in the ICS Transaction in November 1995 (see Note 3 to the Consolidated Financial Statements) and an increase in the installed base of digital visual communication products resulting in a larger revenue base for services.

International sales as a percentage of total consolidated product revenues were 23%, 26% and 24% for the years ended December 31, 1995 and July 31, 1997 and 1998 and were 22% and 21% for the seven months ended July 31, 1995 and 1996. These revenue percentages represent export sales from the Company's domestic operations, as well as sales from its Foreign subsidiaries. While the Company has been able to penetrate foreign markets such as Europe, China, the Far East and Latin America, the decline in international revenue as a percentage of total revenue during fiscal 1998 is the result of the economic downturn ongoing in the Far East.

One of the Company's initiatives is to grow revenues from non-U.S. markets. Non-U.S. operations are subject to certain risks inherent in conducting business abroad including price and currency exchange fluctuations and restrictive government actions. The Company believes its foreign currency exposure to be relatively low as foreign sales are predominantly in U.S. dollars. The Company utilizes currency hedging programs that utilize foreign currency forward contracts on a limited basis and reviews the credit worthiness of its customers to mitigate foreign currency exchange and credit risk. There can be no assurance that the Company's foreign currency hedging program will effectively hedge foreign currency exchange risk.

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

Gross margin

Gross margins were 35%, 39% and 47% for the years ended December 31, 1995 and July 31, 1997 and 1998 and were 41% and 37% for the seven months ended July 31, 1995 and 1996.

The Company's gross margin trend has been positively affected by changes in the Company's sales mix to higher margin products with more features and lower per unit manufacturing costs realized by the distribution of relatively fixed manufacturing overhead costs. This trend has been offset by the impact of lower average selling prices and a higher proportion of service and systems integration revenues, which generally carry a lower gross margin than the Company's digital visual communication products. The gross margin for the year ended December 31, 1995 reflects an $11.0 million charge taken in November 1995 by the Company's subsidiary, CLI, to reduce the carrying amount of certain assets, primarily inventory and capitalized software related to a restructuring of its digital videoconferencing products division. During fiscal 1998, the products that were previously developed by the Company's wholly-owned subsidiary, CLI, represented a smaller proportion of total product revenue due to the transition of the Company's combined product offering to the Company's ESA-based products. The products of the Company's wholly-owned subsidiary, CLI, generally have a lower gross margin than the ESA-based products. During the year ended July 31, 1997 the Company's restated combined revenues consisted of a higher proportion of revenues from CLI, which resulted in a lower gross margin on a combined basis. The higher proportion of product revenues from the ESA platform products resulted in a higher blended gross margin for the year ended July 31, 1998.

Gross margins declined from the seven months ended July 31, 1995 to the seven months ended July 31, 1996 as service and integration revenues became a larger proportion of total revenues during the seven months ended July 31, 1996 due to incremental revenues generated by the Company's systems integration and service operations which were acquired in November 1995. The Company's systems integration and service operations carry a lower gross margin percentage than its product revenues such that the Company's overall gross margin is lower. Although the systems integration and service revenues related to assets acquired in connection with the ICS Transaction generally carry a lower gross margin, the systems integration and service activities also generally carry lower operating expenses than the Company's other revenue sources.

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

Selling, general and administrative

Selling, general and administrative expenses of $64.8 million in fiscal 1998 decreased by 1% from $65.4 million in fiscal 1997, which increased by 5% from $62.5 million in fiscal 1995. Selling, general and administrative expenses were 33%, 34% and 36% of revenues for the years ended December 31, 1995 and July 31, 1997 and 1998.

Selling, general and administrative expenses increased from the year ended December 31, 1995 to the year ended July 31, 1997 despite consistent revenues during these periods. The increase in selling, general and administrative expenses is due to the incremental selling, general and administrative expenses associated with the Company's Professional Services Group which was acquired in connection with the ICS Transaction in November 1995. The selling, general and administrative expenses incurred by the Professional Services Group resulted in an increase of nearly 100% in professional services revenues from the year ended December 31, 1995 to the year ended July 31, 1997.

Selling, general and administrative expenses as a percentage of revenue increased from the year ended July 31, 1997 to the year ended July 31, 1998 despite a decline in revenues during these periods. The proportionate increase was due to investments made by the

Company during the year ended July 31, 1998 related to marketing and branding campaigns which were designed to provide brand awareness for VTEL's products and to establish VTEL as an industry leader in digital visual communications. Additionally, Merger transition issues related to the combination of the sales forces of VTEL and CLI contributed to an increase in selling, general and administrative expenses without a proportionate increase in revenues. The Company has completed all Merger transition activities and its sales force is operating effectively as a single organization. Therefore, the Company expects to be able to generate higher revenue productivity in the future from the combined sales force.

Selling, general and administrative expenses increased from $31.4 million for the seven months ended July 31, 1995 to $38.8 million for the seven months ended July 31, 1996, an increase of 24%. Selling, general and administrative expenses were 32% and 40% of revenues for the seven months ended July 31, 1995 and 1996. Selling, general and administrative expenses increased from the seven months ended July 31, 1995 to the seven months ended July 31, 1996 due to the incremental selling, general and administrative expenses associated with the Professional Services Group acquired in connection with the ICS Transaction in November 1995 and a $1.7 million charge taken by the Company's wholly-owned subsidiary, CLI, during the seven months ended July 31, 1996 to restructure its videoconferencing business. The charges related primarily to severance and related costs associated with headcount reductions.

Research and development expense

Research and development expenses of $19.9 million in fiscal 1998 decreased by 19% from $24.5 million in fiscal 1997, which increased by 15% from $21.3 million in 1995. Research and development expenses were 11%, 13% and 11% of revenues for the years ended December 31, 1995 and July 31, 1997 and 1998. The increase in research and development expenses from the year ended December 31, 1995 to the year ended July 31, 1997 is the result of higher software development costs capitalized during the year ended December 31, 1995. Subsequent to December 31, 1995, the Company's wholly-owned subsidiary, CLI, reduced its development emphasis on projects which required software capitalization resulting in a reduction of capitalized software development costs during the year ended July 31, 1997. Merger-related expenses recorded during the year ended July 31, 1997 included a $3.2 million charge for the write-off of capitalized research and development cost incurred by CLI for products that were discontinued subsequent to the Merger.

The decrease in research and development expenses from the year ended July 31, 1997 to the year ended July 31, 1998 reflects the efficiencies realized by combining the research and development efforts of VTEL and CLI subsequent to the Merger. The Company migrated to a single product platform by eliminating CLI's product platform. The research and development capabilities of both companies were then focused on a single platform such that Company could make a larger investment in its ESA(TM) platform while reducing the overall research and development expenses of the combined companies. Additionally, during the year ended July 31, 1998, the Company capitalized $0.98 million of software development costs related to new product developments resulting in a reduction in research and development expenses recorded during the year.

Research and development expenses increased from $11.9 million for the seven months ended July 31, 1995 to $16.3 million for the seven months ended July 31, 1996, an increase of 37%. Research and development expenses were 12% and 17% of revenues for the seven months ended July 31, 1995 and 1996. Research and development expenses increased from the seven months ended July 31, 1995 to the seven months ended July 31, 1996 as a result of the Company's efforts to develop its Leadership Conferencing(TM) and Team Conferencing(TM) systems which were introduced at the end of calendar 1995 and the beginning of calendar 1996, respectively. Research and development expenses also increased as a result of the reassignment of Company research and development personnel who had been involved with the Intel joint development projects in 1995 to the Company's other projects (see Note 9 to the Company's Consolidated Financial Statements). Additionally, research and development expenses increased as a result of the Company's wholly-owned subsidiary, CLI, shifting its development efforts from software development to hardware development during the seven months ended July 31, 1996, which resulted in less capitalization of development costs related to software development.

The market for the Company's products is characterized by rapidly changing technology, evolving industry standards and frequent product introductions. New products are generally characterized by increased functionality and better picture quality at lower bandwidths and at reduced prices. The introduction of products, by either the Company or its competitors, embodying new technology and the emergence of new industry standards may render existing products obsolete and unmarketable. The Company's ability to successfully develop and introduce on a timely basis new and enhanced products that embody new technology, anticipate and incorporate evolving industry standards and achieve levels of functionality and prices acceptable to the market will be a significant factor in the Company's ability to grow and to remain competitive. Although the percentage of revenues invested by the Company in research and development may vary from period to period, the Company is committed to investing in its research and development programs.

Merger and other expense

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

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

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

Interest income and expense

Interest income was $1.8 million, $2.7 million and $1.2 million for the years ended December 31, 1995 and July 31, 1997 and 1998 and was $0.7 million and $1.9 million for the seven months ended July 31, 1995 and 1996. Changes in interest income are based on interest rates earned on invested cash and cash balances available for investment. In October 1995, the Company completed a secondary offering which generated net proceeds of approximately $57.0 million. The increase in the cash balances of the Company resulted in the increases in interest income for the seven months ended July 31, 1996 and the year ended July 31, 1997. Similarly in October 1996, the Company's wholly-owned subsidiary, CLI, completed a private placement of preferred stock which generated net proceeds of approximately $7.0 million. The resulting increase in cash balances caused interest income for fiscal 1997 to be higher as compared with the previous periods presented. The decrease in the interest income during fiscal 1998 is the result of the reduced cash balances due to Merger related expenditures incurred.

Interest expense was $1.1 million, $1.6 million and nil for the years ended December 31, 1995 and July 31, 1997 and 1998 and was $0.7 million and $0.4 million for the seven months ended July 31, 1995 and 1996. Interest expense relates almost entirely to the Company's wholly-owned subsidiary, CLI, which relied on lines of credit to fund working capital and capital investment requirements. Interest expense increased from the year ended December 31, 1995 to the year ended July 31, 1997 as a result of higher average borrowings at higher interest rates during the year ended July 31, 1997. The Company incurred less interest expense during the seven months ended July 31, 1996 in comparison with the seven months ended July 31, 1995 as a result of a decrease in average borrowings during the seven months ended July 31, 1996. No interest expense was incurred during fiscal 1998 as the Company repaid all outstanding debt prior to July 31, 1997.

Income taxes

The Company has experienced substantial changes in ownership as defined by the Internal Revenue Code. These changes result in annual limitations of the amount of net operating loss carryforward generated prior to each change which can be utilized to offset future taxable income. As a result of the ownership change at CLI at the date of the Merger, a portion of CLI's net operating loss carryforward generated prior to the Merger will never be available to offset future taxable income due to the effect of the annual limitation and the expiration of the related net operating losses. Therefore, the unavailable portion of the net operating loss carryforward is not considered in determining the deferred tax asset at July 31, 1998.

At July 31, 1998, the Company had total domestic net operating loss carryforwards of $85.7 million ($26.6 million and $59.1 million for VTEL and CLI, respectively). The portions of these carryforwards available for utilization during fiscal 1999 (in consideration of the annual limitations) are $52.7 million. Additional net operating

losses created prior to the changes in control of $2,574 become available in each subsequent year and accumulate if not used until such net operating losses expire.

Due to the uncertainty surrounding the timing of realizing the benefits of its favorable tax attributes in future tax returns, the Company has placed a full valuation allowance against its net deferred tax asset. Accordingly, no deferred taxes have been recorded for the year ended December 31, 1995, for the seven months ended July 31, 1996 and for the years ended July 31, 1997 and 1998.

Discontinued operations

In November 1995, the Company's wholly-owned subsidiary, CLI, adopted a plan to discontinue operations of its broadcast products division and focus its efforts and resources in developing and marketing videoconferencing products. CLI subsequently developed a restructuring plan for its videoconferencing products division which resulted in adjustments that were recorded during the year ended December 31, 1995 related to the carrying amounts of certain assets, primarily inventories, capitalized software development costs and accounts receivable. During the seven months ended July 31, 1996, CLI also reduced its workforce and identified a number of offices that would be closed as management of CLI determined that these offices would not produce future economic benefit. Severance and office closure expenses totaling approximately $1.7 million associated with these actions are reflected in the result of operations for the seven months ended July 31, 1996. All employees were terminated, office closures were effected and amounts paid prior to the Merger of VTEL & CLI.

In June 1996, CLI completed the sale of certain assets of its broadcast products division. During the year ended July 31, 1997, CLI revised the amount of loss associated with disposing of the broadcast products division and recorded an additional charge of $7.8 million, primarily due to additional at-risk receivables that were subsequently identified (see Note 6 to the Consolidated Financial Statements).

Net income (loss)

The Company generated net losses from continuing operations of $17.3 and $44.3 million for the years ended December 31, 1995 and July 31, 1997 and $4.3 million and $18.5 million for the seven months ended July 31, 1995 and 1996. In fiscal 1998, the Company recorded net income from continuing operations of $2.8 million. The net loss incurred during the year ended December 31, 1995 reflects charges taken by CLI related to settlement of litigation and restructuring charges. A larger net loss was incurred for the year ended July 31, 1997 due to charges of $29.4 million taken related to the Merger (see Note 1 to the Consolidated Financial Statements). The Company generated net income during fiscal 1998 as a result of a reduction of operating expenses which was greater than the decline in revenues and several nonrecurring events. The reduction of operating expenses was due to operating efficiencies gained by combining VTEL and CLI after the Merger, including the elimination of duplicate costs and focusing combined company resources on a single product platform and operating plan. Additionally, the Company generated income of approximately $1.3 million (net of expenses) from a planned non-recurring real estate transaction which eliminated duplicate corporate headquarter facilities. During the year ended July 31, 1998, the Company capitalized approximately $0.8 million of internal costs associated with the implementation of the Oracle(R) Enterprise Resource Planning System and $0.98 million of software development costs. Due to the favorable resolution of certain Merger-related issues during the year ended July 31, 1998, the Company was able to record a net credit to income of approximately $1.5 million due to the reversal of certain Merger and other accruals that were recorded as of July 31, 1997. As management had anticipated the additional income increase and operating expense reductions, the Company was able to take advantage of these benefits by investing in discretionary marketing and branding campaigns to provide brand awareness for VTEL's products and to establish VTEL as an industry leader in digital visual communications.

The increase in net losses incurred from the seven months ended July 31, 1995 to the seven months ended July 31, 1996 is the result of independent charges taken by both VTEL and its wholly-owned subsidiary, CLI, related to restructuring activities and the effect of CLI's decision to discontinue operations relating to its broadcast products division in November 1995.

Other factors affecting results of operations

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

There can be no assurance that the present and potential customers of the Company will continue their current buying patterns without regard to the Merger, and any significant delay or reduction in orders could have an adverse effect on the near-term business and results of operations of the combined company.

Generally, the shares issued by the Company to consummate the Merger are freely tradable, subject to certain resale restrictions for affiliates pursuant to Rules 144 or 145 under the Securities Act. An aggregate of approximately 1.1 million of the shares issued in the Merger are beneficially owned by affiliates of CLI and therefore, subject to resale restrictions. However, the Company provided certain registration rights to the holders of such shares. The sale of a significant number of the foregoing shares could cause substantial fluctuations in the price of the Company's Common Stock over short time periods.

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

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

Share repurchase program

During the seven months ended July 31, 1996, the Company adopted a share repurchase program pursuant to which the Company repurchased shares of its Common Stock in the open market. During fiscal 1997, the Company purchased 455,200 shares of its Common Stock for approximately $3.7 million. All of the repurchased shares were reissued during fiscal 1997 to fulfill requirements for the Company's Common Stock. In February 1997, the Company terminated the stock repurchase program.

In August 1998, the Company announced its plan to repurchase up to 2,000,000 shares of VTEL Common Stock. As of October 12, 1998, the Company had repurchased approximately 465,000 shares of its Common Stock for approximately $2.0 million. The repurchased shares will be used to fulfill requirements for the Company's stock including stock option exercises or stock issuances under business combination transactions.

Liquidity and capital resources

At July 31, 1998, the Company had working capital of $41.5 million, including $29.7 million in cash, cash equivalents and short-term investments. Cash provided by operating activities was $8.8 million for the year ended December 31, 1995. Cash used by operating activities was $15.2 million for the year ended July 31, 1997. Cash provided by operating activities was $19.6 million for the year ended July 31, 1998. Cash used by operating activities was $1.0 million and $11.1 million for the seven months ended July 31, 1995 and 1996. Changes in cash from operating activities are primarily the result of the net losses or income generated by the Company and changes in working capital, primarily increases and decreases in accounts receivable, inventories and accounts payable.

Cash used in investing activities was $77.9 million for the year ended December 31, 1995 as compared to cash provided by investing activities of $23.3 million for the year ended July 31, 1997. Cash used in investing activities during the 1995 period was the result of increased capital expenditures for property and equipment used to support the growth in the Company's operations, primarily sales and marketing and product development efforts, and the investment of the cash proceeds from the Company's secondary offering in November 1995 which netted approximately $57.0 million less the cash used of approximately $10.7 million to purchase the systems integration and service operations in connection with the ICS Transaction. During fiscal 1997, cash provided by investing activities was primarily due to the net sale of investments to finance the Company's operations during the period, which included large cash requirements associated with the Merger. Cash used in investing activities was $10.6 million for the year ended July 31, 1998 and was primarily the result of expenditures related to leasehold improvements in Austin and Sunnyvale, the implementation of the Oracle(R) Enterprise Resource Planning System and purchases of equipment.

Cash used in investing activities was $16.4 million for the seven months ended July 31, 1995 compared with cash provided by investing activities of $1.2 million for the seven months ended July 31, 1996. Cash used in investing activities was primarily the result of capital expenditures. Capital expenditures were $11.0 million and $11.1 million for the seven months ended July 31, 1995 and 1996. Cash provided by investing activities during the seven months ended July 31, 1996 included the proceeds from the sale of assets related to discontinued operations of the Company's wholly-owned subsidiary, CLI.

Cash provided by financing activities was $69.2 million for the year ended December 31, 1995 as compared to cash used by financing activities of $5.1 million for the year ended July 31, 1997 and cash provided by financing activities of $1.6 million for the year ended July 31, 1998. Cash used in financing activities during fiscal 1997 was primarily the result of the purchase of treasury stock by the Company and the repayment of debt by the Company's wholly-owned subsidiary, CLI, offset by the sale of preferred stock by CLI during the year ended July 31, 1997. Cash provided by financing activities for the year ended July 31, 1998 relates to the issuance of stock under the Company's stock option and stock purchase plans (see Note 8 to the Company's Consolidated Financial Statements).

Cash provided by financing was $4.9 million for the seven months ended July 31, 1995 compared to cash used in financing activities of $3.9 million for the seven months ended July 31, 1996. Cash provided by financing activities during the seven months ended July 31, 1995 was related to the sale of stock by the Company's wholly-owned subsidiary, CLI, which netted approximately $4.9 million. Cash used in financing activities during the seven months ended July 31, 1996 was related to the reduction in borrowings of approximately $4.4 million from cash generated from the sale of the broadcast products division in June 1996 by CLI.

The Company has a $25.0 million revolving line of credit available with a banking syndicate. The Company has issued a letter of credit totaling $1.2 million under its revolving line of credit as a lease deposit on one of its facilities. No amounts have been drawn under the syndicated line of credit. The Company's principal sources of liquidity at July 31, 1998 consist of $29.7 million of cash, cash equivalents and short-term investments and amounts available under the Company's revolving line of credit.

Legal Matters

CLI is currently engaged in several legal proceedings relating to matters arising prior to the Merger. There can be no assurance that CLI's legal proceedings can be resolved favorably to CLI or VTEL. Such legal proceedings, if continued for an extended period of time, could have an adverse effect upon CLI's working capital and management's ability to concentrate on its business. An unfavorable outcome in any one or several such legal proceedings could have a material adverse effect on CLI and hence, VTEL.

In a complaint filed on December 20, 1993 in the United States District Court in Dallas, Texas, Datapoint Corporation ("Datapoint") alleged that CLI had infringed two United States patents owned by Datapoint relating to video conferencing networks. The complaint sought a judgement of infringement, monetary damages, injunctive relief and attorneys' fees. CLI responded to the complaint by denying the material allegations of the complaint and asserting affirmative defenses. In July 1998, the United States District Court dismissed the civil action filed by Datapoint.

In June 1997, Keytech, S.A. ("Keytech") filed suit against CLI in the United States District Court in Tampa, Florida. Keytech was a distributor of satellite encoder and decoder products manufactured by a division of CLI which was sold by CLI in June 1996. Keytech has asserted that the equipment sold was defective and did not conform to contract specifications and express and implied warranties. Keytech has asserted damages in excess of $20 million based on its allegations of breach of contract, breach of warranties and fraud. CLI has filed an answer denying liability and has asserted cross-claims against Keytech for amounts due and unpaid for equipment sold by CLI to Keytech.

Impact of Year 2000

Many computer systems experience problems handling dates beyond the year 1999. Therefore, some computer hardware and software will need to be modified prior to the Year 2000 in order to remain functional. The Company believes that its products are Year 2000 compliant. While the Company is not currently aware of any Year 2000 compliance issues with its products, no assurances can be made that problems will not arise such as customer problems with other software programs, operating systems or hardware that disrupt their use of the Company's products. There can be no assurances that such disruption would not negatively impact costs and revenues in future years.

The Company has been assured by the vendor of its Enterprise Resource Planning System that the system is Year 2000 compliant. The Company began assessing Year 2000 issues and Year 2000 testing of its significant management information systems during fiscal 1998.

The Company presently believes that with modifications to existing software and conversions to new software, the Year 2000 issue can be mitigated. It is not anticipated that there will be a significant increase in costs as much of the Year 2000 activities will be a continuation of the on-going process to improve all the Company's systems. The Company has not estimated the total costs of Year 2000 compliance and related contingency planning as Year 2000 compliance assessments are still in process. However, the company does not anticipate that Year 2000 issues will result in material incremental costs to the Company. The Company plans to complete the Year 2000 project during fiscal 1999. However, if such modifications and conversions are not made, or are not completed in a timely manner, the Year 2000 issue could have a material impact on the operations of the Company. Specific factors that might cause a material impact include, but are not limited to, availability and cost of personnel trained in this area, the ability to locate and correct all relevant computer codes, failure by third parties to timely convert their systems, and similar uncertainties.

Recent Accounting Pronouncements

In June 1997, the Financial Accounting Standards Board (FASB) issued SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 will require the Company to report, in addition to net income, comprehensive income and its components including, as applicable, foreign currency items and unrealized gains and losses on certain investments in debt and equity securities. The Company is required to adopt SFAS No. 130 for its fiscal year ended July 31, 1999. The Company expects that the adoption of SFAS No. 130 will not have a material impact on its financial position or its results of operations.

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for reporting information about a company's operating segments. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Under SFAS No. 131, operating segments are to be determined consistent with the way management organizes and evaluates financial information internally for making operating decisions and assessing performance. The Company is required to adopt SFAS No. 131 for its fiscal year ended July 31, 1999. The Company expects that the adoption of SFAS No. 131 will not have a material impact on its financial position or its results of operations.

In June 1998, FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. SFAS No. 133 requires the recognition of all derivatives as either assets or liabilities in the statement of financial position and the measurement of those instruments at fair value. The Company is required to adopt this standard in the first quarter of fiscal 2000. The Company expects that the adoption of SFAS No. 133 will not have a material impact on its financial position or its results of operations.

In October 1997, the American Institute of Certified Public Accountants issued Statement of Position (SoP) 97-2, "Software Revenue Recognition," which provides guidance for recognizing revenue on software sales such that certain amounts are deferred for future obligations such as software upgrades and product support. The Company will adopt SOP 97-2 effective August 1, 1998. The Company does not expect that the new pronouncement will have a material impact on its financial position or results of operations.

In March 1998, the Accounting Standards Executive Committee of the American institute of Certified Public Accountants, issued Statement of Position 98-1 (SoP 98-1), "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use," which requires the capitalization of certain internal costs related to the implementation of computer software obtained for internal use. In consideration of the Company's implementation of the Oracle Enterprise Resource Planning Software System, the Company's Management resource planning, transaction processing and financial accounting system, the Company early adopted SoP 98-1 during fiscal 1998. In accordance with SoP 98-1, the Company capitalized $0.8 million of internal costs associated with the implementation of the Oracle Enterprise Resource Planning Software System during the year ended July 31, 1998. The system was placed into operation on August 1, 1998 and will be amortized over 5 years.

* * *

INDEX TO FINANCIAL STATEMENTS

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and
Stockholders of VTEL Corporation

In our opinion, based upon our audits and the report of other auditors, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of VTEL Corporation and its subsidiaries at July 31, 1997 and 1998, and the results of their operations and their cash flows for the year ended December 31, 1995, for the seven months ended July 31, 1996, and for each of the two years in the period ended July 31, 1998 in conformity with generally accepted accounting principles. 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 did not audit the financial statements of Compression Labs, Incorporated, which statements reflect total revenues of $112,979,000 for the year ended December 31, 1995. Those statements were audited by other auditors whose report thereon has been furnished to us, and our opinion expressed herein, insofar as it related to the amounts included for Compression Labs, Incorporated, is based solely on the report of the other auditors. We conducted our audits of the consolidated financial statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP

Austin, Texas
September 22, 1998

INDEPENDENT AUDITORS' REPORT

The Stockholders and Board of Directors
of Compression Labs, Incorporated

We have audited the consolidated statements of operations, changes in stockholders' equity and of cash flows of Compression Labs, Incorporated and subsidiaries for the year ended December 31, 1995 (not presented herein). In connection with our audits of the aforementioned consolidated financial statements, we have also audited the financial statement schedule. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. 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 consolidated financial statements of Compression Labs, Incorporated referred to above present fairly, in all material respects, the results of their operations and their cash flows for the year ended December 31, 1995, in conformity with generally accepted accounting principles. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth herein.

KPMG LLP

Mountain View, California
March 13, 1996

VTEL CORPORATION

CONSOLIDATED BALANCE SHEET
(AMOUNTS IN THOUSANDS, EXCEPT SHARE AND PER SHARE AMOUNTS)

	JULY 31, 1997	JULY 31, 1998
ASSETS		
Current assets:		
Cash and equivalents	$ 4,757	$ 15,191
Short-term investments	20,299	14,484
Accounts receivable, net of allowance for doubtful accounts of $10,722 and $9,447 at July 31, 1997 and 1998	43,707	40,527
Inventories	22,244	12,951
Prepaid expenses and other current assets	2,891	2,533
Total current assets	93,898	85,686
Property and equipment, net	21,660	28,106
Intangible assets, net	12,768	11,812
Other assets	2,809	3,685
	$ 131,135	$ 129,289
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 25,699	$ 22,600
Accrued merger and other expenses	9,704	1,741
Accrued compensation and benefits	4,552	5,258
Other accrued liabilities	3,070	2,791
Deferred revenue	11,345	11,793
Total current liabilities	54,370	44,183

Long-term liabilities	--	3,848
Total liabilities	54,370	48,031
Commitments and contingencies (Note 11)	--	--
Stockholders' equity:		
Preferred stock, $.01 par value; 10,000,000 authorized; none issued or outstanding	--	--
Common stock, $.01 par value; 40,000,000 authorized; 22,873,000 and 23,227,000 issued and outstanding at July 31, 1997 and 1998	229	232
Additional paid-in capital	254,880	256,594
Accumulated deficit	(178,234)	(175,455)
Cumulative translation adjustment	5	(37)
Unearned compensation	(115)	(76)
Total stockholders' equity	76,765	81,258
	$ 131,135	$ 129,289

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

VTEL CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS
(AMOUNTS IN THOUSANDS, EXCEPT PER SHARE AMOUNTS)

	FOR THE YEAR ENDED DECEMBER 31	FOR THE SEVEN MONTHS ENDED JULY 31,		FOR THE YEARS ENDED JULY 31,	
	1995	1995 (UNAUDITED)	1996	1997	1998
REVENUES:					
Products	$ 169,455	$ 89,207	$ 74,098	$ 150,791	$ 134,775
Services and other	21,619	8,872	22,864	40,232	44,909
	191,074	98,079	96,962	191,023	179,684
COST OF SALES:					
Products	109,653	52,523	44,390	87,231	65,811
Services and other	14,578	5,585	16,592	29,090	28,916
	124,231	58,108	60,982	116,321	94,727
Gross margin	66,843	39,971	35,980	74,702	84,957
Selling, general and administrative	62,511	31,397	38,842	65,399	64,802
Research and development	21,283	11,878	16,274	24,460	19,892
Merger and other	897	897	553	29,397	(1,536)
Amortization of intangible assets	80	--	560	960	960
Total operating expenses	84,771	44,172	56,229	120,216	84,118
Income (loss) from operations	(17,928)	(4,201)	(20,249)	(45,514)	839
OTHER INCOME (EXPENSE):					
Interest income	1,802	699	1,901	2,736	1,242
Interest expense	(1,142)	(655)	(424)	(1,582)	(27)
Other	54	164	265	77	762
	714	208	1,742	1,231	1,977
Net income (loss) from continuing operations before benefit (provision) for income taxes	(17,214)	(3,993)	(18,507)	(44,283)	2,816
Benefit (provision) for income taxes	(87)	(342)	--	12	(37)
Net income (loss) from continuing operations	(17,301)	(4,335)	(18,507)	(44,271)	2,779
DISCONTINUED OPERATIONS:					
Net income (loss) from discontinued operations	(1,941)	524	--	(7,783)	--
Loss on disposal	(34,601)	--	--	--	--

Net income (loss) from discontinued operations	(36,542)	524	--	(7,783)	--
Net income (loss)	$ (53,843)	$ (3,811)	$ (18,507)	$ (52,054)	$ 2,779
COMPUTATION OF NET INCOME (LOSS) PER SHARE:					
Net income (loss) from continuing operations	$ (17,301)	$ (4,335)	$ (18,507)	$ (44,271)	$ 2,779
Deemed preferred stock dividend related to conversion discount	--	--	--	(2,527)	--
Adjusted net income (loss) from continuing operations	(17,301)	(4,335)	(18,507)	(46,798)	2,779
Net income (loss) from discontinued operations	(36,542)	524	--	(7,783)	--
Net income (loss) applicable to common stock	$ (53,843)	$ (3,811)	$ (18,507)	$ (54,581)	$ 2,779
BASIC AND DILUTED INCOME (LOSS) PER COMMON SHARE:					
Income (loss) from continuing operations	$ (0.90)	$ (0.24)	$ (0.87)	$ (2.10)	$ 0.12
Income (loss) from discontinued operations	(1.91)	0.03	--	(0.35)	--
Net income (loss) per share	$ (2.81)	$ (0.21)	$ (0.87)	$ (2.45)	$ 0.12
WEIGHTED AVERAGE SHARES OUTSTANDING					
Basic	19,131	17,821	21,393	22,255	23,057
Diluted	19,131	17,821	21,393	22,255	23,458

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

VTEL CORPORATION

CONSOLIDATED STATEMENT OF CHANGES IN STOCKHOLDERS' EQUITY
(AMOUNTS IN THOUSANDS)

	COMMON STOCK NUMBER OF SHARES	COMMON STOCK AMOUNT	ADDITIONAL PAID-IN CAPITAL	ACCUMULATED DEFICIT	OTHER	TOTAL STOCKHOLDERS' EQUITY
BALANCE AT DECEMBER 31, 1994	16,759	$ 168	$ 175,235	$ (51,363)	$ 145	$ 124,185
Proceeds from sale of stock	3,312	33	61,927	--	--	61,960
Proceeds from stock issued under employee plans	546	5	3,220	--	--	3,225
Exercise of stock warrants	15	--	249	--	--	249
Stock issued for acquired assets (Note 3)	260	3	3,721	--	--	3,724
Amortization of unearned compensation	--	--	--	--	21	21
Foreign currency translation adjustment	--	--	--	--	(9)	(9)
Net loss	--	--	--	(53,843)	--	(53,843)
BALANCE AT DECEMBER 31, 1995	20,892	209	244,352	(105,206)	157	139,512
Proceeds from stock issued under employee plans	178	2	1,237	--	--	1,239
Proceeds from exercise of stock warrants	428	4	(4)	--	--	--
Foreign currency translation adjustment	--	--	--	--	(6)	(6)
Net loss	--	--	--	(18,507)	--	(18,507)
BALANCE AT JULY 31, 1996	21,498	215	245,585	(123,713)	151	122,238
Proceeds from sale of stock	1,258	13	7,703	--	--	7,716
Proceeds from stock issued under employee plans	572	1	2,503	--	--	2,504
Purchase and issuance of treasury stock	(455)	--	(1,275)	(2,467)	--	(3,742)
Unearned compensation	--	--	364	--	(364)	--
Amortization of unearned compensation	--	--	--	--	249	249
Foreign currency translation adjustment	--	--	--	--	(146)	(146)
Net loss	--	--	--	(52,054)	--	(52,054)
BALANCE AT JULY 31, 1997	22,873	229	254,880	(178,234)	(110)	76,765
Proceeds from stock issued under employee plans	344	3	1,473	--	--	1,476
Common stock and warrants issued for acquisition	10	--	153	--	--	153
Unearned compensation	--	--	88	--	(88)	--

Amortization of unearned compensation	--	--	--	--	127	127
Foreign currency translation adjustment	--	--	--	--	(42)	(42)
Net income	--	--	--	2,779	--	2,779
BALANCE AT JULY 31, 1998	23,227	$ 232	$ 256,594	$(175,455)	$ (113)	$ 81,258

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

VTEL CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS
(AMOUNTS IN THOUSANDS)

	FOR THE YEAR ENDED DECEMBER 31, 1995	FOR THE SEVEN MONTHS ENDED JULY 31, 1995 (UNAUDITED)	FOR THE SEVEN MONTHS ENDED JULY 31, 1996	FOR THE YEARS ENDED JULY 31, 1997	FOR THE YEARS ENDED JULY 31, 1998
CASH FLOWS FROM OPERATING ACTIVITIES:					
Net income (loss)	$ (53,843)	$ (3,811)	$ (18,507)	$ (52,054)	$ 2,779
Adjustments to reconcile net income (loss) to net cash from operations:					
Depreciation and amortization	20,898	7,858	8,294	12,667	8,870
Provision for doubtful accounts	40	8	18	4,145	(119)
Amortization of unearned compensation	21	11	--	249	127
Amortization of deferred gain	(100)	(57)	(56)	--	--
Foreign currency translation gain (loss)	40	(83)	(216)	(3)	112
(Increase) decrease in accounts receivable	(4,007)	(15,651)	10,324	106	3,299
(Increase) decrease in inventories	9,647	(725)	(7,367)	7,064	10,758
(Increase) decrease in prepaid expenses and other current assets	2,107	(76)	2,522	(492)	358
Increase (decrease) in accounts payable	7,430	263	(11,216)	5,005	(3,099)
Increase (decrease) in accrued expenses	16,156	3,973	(14,562)	6,535	(5,505)
(Decrease) in research and development advance	(190)	(190)	--	(5)	--
Increase (decrease) in deferred revenues	(912)	(1,098)	(1,378)	2,195	2,172
Increase (decrease) in accrued expenses, discontinued operations	11,503	8,614	21,016	(657)	--
Net cash provided by (used in) operating activities	8,790	(964)	(11,128)	(15,245)	19,752
CASH FLOWS FROM INVESTING ACTIVITIES:					
Purchases of short-term investments	(707,280)	(65,148)	(241,994)	(391,628)	(247,223)
Sales and maturities of short-term investments	664,545	68,327	253,671	419,636	253,038
Purchases of property and equipment	(16,759)	(11,027)	(11,139)	(18,781)	(15,835)
Sales of property and equipment	1,775	1,054	1,307	11,208	260
Cash paid for acquired assets (Note 3)	(10,684)	--	--	--	--
(Increase) decrease in capitalized software	(9,371)	(2,958)	(681)	3,561	(984)
(Increase) decrease in other assets	(103)	(6,662)	69	(745)	104
Net cash provided by (used in) investing activities	(77,877)	(16,414)	1,233	23,251	(10,640)
CASH FLOWS FROM FINANCING ACTIVITIES:					
Net proceeds from issuance of stock	65,434	6,255	1,014	8,044	1,476
Purchase of treasury stock	--	--	--	(3,742)	--
Proceeds from the sale of treasury stock	--	--	--	1,275	--
Principal payments under capital lease obligations	(844)	(436)	(549)	--	--
(Payments) borrowings under line of credit agreements	2,993	(2,801)	(2,766)	--	--
Collateralized borrowings (payments)	1,597	1,850	(1,589)	--	--
Repayment of short-term debt	--	--	--	(10,656)	--
Net cash provided by (used in) financing activities	69,180	4,868	(3,890)	(5,079)	1,476
Effect of translation exchange rates on cash	(49)	125	210	(143)	(154)
Net increase (decrease) in cash and equivalents	44	(12,385)	(13,575)	2,784	10,434
Cash and equivalents at beginning of period	15,504	15,504	15,548	1,973	4,757
Cash and equivalents at end of period	$ 15,548	$ 3,119	$ 1,973	$ 4,757	$ 15,191
SUPPLEMENTAL CASH FLOW INFORMATION:					
Income taxes paid	$ 74	$ 27	$ --	$ --	$ --
Interest paid	$ 1,142	$ 655	$ 424	$ 1,582	$ --

Stock issued for acquired assets (Note 3)	$ 3,724	$ --	$ --	$ --	$ 153
Note payable issued for acquired asset	$ --	$ --	$ --	$ --	$ 837
Stock issued in lieu of repayment of research and development advance	$ --	$ --	$ --	$ 901	$ --

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

VTEL CORPORATION

NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS
(Amounts in thousands, except share and per share data unless otherwise noted)

1. THE COMPANY

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

On May 23, 1997, shareholders of VTEL and Compression Labs, Incorporated, a Delaware corporation ("CLI"), approved the merger (the "Merger") of VTEL-Sub, Inc., a Delaware corporation and direct wholly-owned subsidiary of VTEL ("Merger Sub"), with and into CLI, pursuant to an Agreement and Plan of Merger and Reorganization (the "Merger Agreement"), with CLI becoming a direct wholly-owned subsidiary of VTEL. As a result of the Merger, (a) the outstanding shares of CLI's Common Stock were converted into the right to receive 0.46 shares of Common Stock of VTEL for each share of CLI Common Stock converted (or cash in lieu of fractional shares otherwise deliverable in respect thereof), and (b) the outstanding shares of CLI Series C Preferred Stock were converted into the right to receive 3.15 shares of VTEL Common Stock for each share of CLI Preferred Stock converted (or cash in lieu of fractional shares otherwise deliverable in respect thereof). The CLI shares were exchanged for a total of 8,424,741 shares of VTEL Common Stock.

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

	VTEL	CLI	TOTAL
YEAR ENDED DECEMBER 31, 1995			
Revenues	$ 78,095	$ 112,979	$ 191,074
Net income (loss) from continuing operations	3,739	(21,040)	(17,301)
Net income (loss)	3,739	(57,582)	(53,843)
SEVEN MONTHS ENDED JULY 31, 1996			
Revenues	$ 50,109	$ 46,853	$ 96,962
Net loss from continuing operations	(9,899)	(8,608)	(18,507)
Net loss	(9,899)	(8,608)	(18,507)
YEAR ENDED JULY 31, 1997 *			
Revenues	$ 124,438	$ 66,585	$ 191,023
Net loss from continuing operations **	556	(44,827)	(44,271)
Net loss	(508)	(51,546)	(52,054)

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

*   Information for CLI is through the date of the Merger, May 23, 1997.
**   Includes loss of $29,397 related to the merger.

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

TRANSACTION EXPENSES:	
Investment banking fees	$ 2,391
Legal and accounting fees	1,600
Other	1,663
	5,654
RESTRUCTURING AND OTHER:	
Asset impairments	12,469
Reserve for contingent liabilities	5,271
Severance and termination benefits	3,457
Other	2,546
	23,743
Total	$ 29,397

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

The restructuring activities related to the Merger involved the involuntary termination of approximately 150 employees over the period from May 23, 1997 (the date of the Merger) to November 30, 1997. The Company expects to pay the remaining severance and termination benefit liabilities by October 31, 1999.

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

Write-down of recorded value of discontinued CLI inventory due to discontinuance of the CLI product line	$ 3,500
Write-off of capitalized software development cost due to discontinuance of the CLI product line	3,200
Write-off of purchased software deemed redundant as a result of the Merger	1,300
Write-off of unproductive CLI assets (primarily furniture, fixtures, equipment and leasehold improvements) due to workforce reduction subsequent to the Merger	2,800

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

Reserve for uncollectible receivables related to sales of products which were subsequently discontinued and no longer supported	1,669
Total	$ 12,469

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

Changes to accrued merger and other and the reserve for asset impairments during the year ended July 31, 1998 were as follows:

	BALANCE AT JULY 31, 1997	PAID IN FISCAL 1998	ADDITIONAL CHARGES IDENTIFIED IN FISCAL 1998	DISPOSALS IN FISCAL 1998	REVERSED IN FISCAL 1998	BALANCE AT JULY 31, 1998
ASSET IMPAIRMENTS	$ 5,617	$ --	$ 1,000(1)	$ (6,235)	$ --	$ 382
ACCRUED MERGER AND OTHER EXPENSES:						
Reserve for contingent liabilities	$ 5,162	$ (1,056)	$	$ --	$ (2,622)(2)	$ 1,484
Severance and termination Benefits	2,414	(2,243)	86	--	--	257
Other	2,128	(2,128)	--	--	--	--
	$ 9,704	$ (5,427)	$ 86	$ --	$ (2,622)	$ 1,741

(1) Represents an expense of $1.0 million for the final write-off and disposal costs of remaining unsold CLI inventory which was discontinued, and previously had been held for sale.

(2) Based on favorable events which occurred during fiscal 1998, including the resolution of certain litigation and other matters, the Company recorded a credit to income of $2.6 million related to the reversal of certain accruals.

Contingent liabilities of $5.2 million accrued at July 31, 1997 reflect amounts accrued for the discharge of pending and threatened litigation against the Company's wholly-owned subsidiary, CLI, and amounts accrued to discharge known and probable vendor disputes related to CLI. These amounts include management's estimate of the probable costs expected to be incurred to settle, discharge or litigate the matters. In 1998, payments were made to discharge substantially all of the vendor disputes and to resolve certain lawsuits pending against CLI. The remaining accrual at July 31, 1998 primarily represents amounts that are expected to be incurred by the Company to bring all pending litigation and disputes to a final discharge subsequent to July 31, 1998.

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2. SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The consolidated financial statements have been prepared in accordance with generally accepted accounting principles and include the accounts of VTEL's wholly-owned subsidiaries. All significant intercompany transactions and balances have been eliminated in consolidation. Preparation of the consolidated financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The more significant estimates made by management include the provision for doubtful accounts receivable, inventory write-downs for potentially excess or obsolete inventory, warranty reserves, the valuation allowance for the gross deferred tax asset, contingency reserves and the amortization period for intangible assets. Actual amounts could differ from the estimates made. Management periodically evaluates estimates used in the preparation of the financial statements for continued reasonableness. Appropriate adjustments, if any, to the estimates used are made prospectively based upon such periodic evaluation.

In May 1996, VTEL changed its fiscal year end from December 31 to July 31. The accompanying consolidated financial statements include the results of operations and cash flows for the seven-month transition period ended July 31, 1996 with comparative presentation of the unaudited results for the seven months ended July 31, 1995.

Revenue Recognition

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

Warranty Costs

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

Software Development Costs

Costs incurred in connection with the development of software products are accounted for in accordance with Statement of Financial Accounting Standards ("SFAS") No. 86, "Accounting for the Costs of Computer Software to Be Sold, Leased or Otherwise Marketed." Costs incurred prior to the establishment of technological feasibility are charged to research and development expense. Amortization of capitalized software begins upon initial product shipment. Software development costs are amortized (a) over the estimated life of the related product (generally thirty-six months), using the straight-line method or (b) based on the ratio of current revenues from the related products to total estimated revenues for such products, whichever is greater.

The Company capitalized internal software development costs of $9,276, $1,622 and $984 for the years ended December 31, 1995 and July 31, 1997 and 1998, respectively, and $2,957 and $563 for the seven months ended July 31, 1995 and 1996. Amortization of such costs was $17,411, $1,827 and $50 for the years ended December 31, 1995 and July 31, 1997 and 1998, respectively, and $1,996 and $947 for the seven months ended July 31, 1995 and 1996, respectively. In connection with the Merger, the Company recorded an impairment charge of $3,218 related to capitalized software development costs during the year ended July 31, 1997 due to the elimination of the product line to which the capitalized software development costs related.

Cash and Equivalents

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

Short-term Investments

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

The Company accounts for investment securities under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." SFAS No. 115 requires investment securities to be classified as held-to-maturity, trading or available-for-sale based on the characteristics of the securities and the activity in the investment portfolio. At July 31, 1997 and 1998, all investment securities are classified as available-for-sale. No unrealized gains or losses have been recorded as a separate component of equity for the current period or prior year as market values approximate cost due to the short-term nature of the investments.

Inventories

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

Property and Equipment

Property and equipment is recorded at cost. Internal support equipment is used internally for purposes such as Company meetings, testing, troubleshooting customers problems, and engineering, and is recorded at manufactured cost. Depreciation and amortization are provided using the straight-line method over the estimated economic lives of the assets, ranging from two to ten years, or over the lease term or life of the improvement of the respective assets, as applicable. Repair and maintenance costs are expensed as incurred.

Intangible Assets

During the year ended December 31, 1995, VTEL acquired certain assets and a service and support infrastructure related to an operating group of another company (see Note 3). The estimated value of the intangible assets is being amortized over a period of 15 years, which is the period over which the Company expects to be able to continue to effectively utilize the service and support infrastructure to support its resellers in the offering of broader services to users of digital visual communication equipment. In accordance with Accounting Principles Board Opinion ("APB") No. 17, "Intangible Assets," the Company periodically evaluates the amortization period associated with the acquired intangible assets based upon anticipated periods of future benefit, including factors such as loss of employees with key or unique knowledge, the Company's ability to continue to successfully utilize the specialized integration and process knowledge to provide integration and support services, and other relevant factors which could require revision of the estimate of the amortization period. Appropriate adjustments, if any, to the amortization period will be made prospectively based upon such periodic evaluation.

Foreign Currency Translation

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

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

Income Taxes

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

Net Income (Loss) Per Share

During the fiscal year ended July 31, 1998, the Company adopted SFAS No. 128, "Earnings Per Share." Under SFAS No. 128, basic earnings per share is based on the weighted effect of all common shares issued and outstanding, and is calculated by dividing net income available to common stockholders by the weighted average shares of common stock outstanding during the period. Diluted earnings per share is calculated by dividing net income available to common stockholders by the weighted average number of common shares used in the basic earnings per share calculation plus the number of common shares that would be issued assuming conversion of all potentially dilutive shares outstanding. All historical earnings per share data have been restated to conform to the current year presentation.

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

	FOR THE YEAR ENDED DECEMBER 31,	FOR THE SEVEN MONTHS ENDED JULY 31,		FOR THE YEARS ENDED JULY 31,	
	1995	1995	1996	1997	1998
		(UNAUDITED)			
Weighted average shares Outstanding - basic	19,131	17,821	21,393	22,255	23,057
EFFECT OF DILUTIVE SECURITIES:					
Stock options	--	--	--	--	400
Warrants to purchase common stock	--	--	--	--	1
Dilutive potential common shares	--	--	--	--	401
Weighted average shares Outstanding - diluted	19,131	17,821	21,393	22,255	23,458
Antidilutive securities	3,880	4,001	4,435	3,648	1,764

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

Concentration of Credit Risk

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

Fair Value of Financial Instruments

The carrying amount of the Company's financial instruments, including cash and equivalents, short-term investments and short-term trade receivables and payables, approximates fair value. The carrying amount of short-term investments approximates fair value because of the short maturity and nature of these instruments. The Company places its cash in investment quality financial instruments and limits the amount invested in any one institution or in any type of instrument. The Company has not experienced any significant losses on its investments.

Long-lived Assets

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

Employee Stock Plans

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

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

Recent Accounting Pronouncements

In June 1997, the Financial Accounting Standards Board (FASB) issued SFAS No. 130, "Reporting Comprehensive Income." SFAS No. 130 will require the Company to report, in addition to net income, comprehensive income and its components including, as applicable, foreign currency items and unrealized gains and losses on certain investments in debt and equity securities. The Company is required to adopt SFAS No. 130 for its fiscal year ended July 31, 1999. The Company expects that the adoption of SFAS No. 130 will not have a material impact on it financial position or its results of operations.

In June 1997, the FASB issued SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information." SFAS No. 131 establishes standards for reporting information about a company's operating segments. It also establishes standards for related disclosures about products and services, geographic areas and major customers. Under SFAS No. 131, operating segments are to be determined consistent with the way management organizes and evaluates financial information internally for making operating decisions and assessing performance. The Company is required to adopt SFAS No. 131 for its fiscal year ended July 31, 1999. The Company expects that the adoption of SFAS No. 131 will not have a material impact on it financial position or its results of operations.

In June 1998, FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives) and for hedging activities. SFAS No. 133 requires the recognition of all derivatives as either assets or liabilities in the statement of financial position and the measurement of those instruments at fair value. The Company is required to adopt this standard in the first quarter of fiscal 2000. The Company expects that the adoption of SFAS No. 133 will not have a material impact on it financial position or its results of operations.

In October 1997, the American Institute of Certified Public Accountants issued Statement of Position (SoP) 97-2, "Software Revenue Recognition," which provides guidance for recognizing revenue on software sales such that certain amounts are deferred for future obligations such as software upgrades and product support. The Company will adopt SOP 97-2 effective August 1, 1998. The Company does not expect that the new pronouncement will have a material impact on its financial position or results of operations.

In March 1998, the Accounting Standards Executive Committee of the American institute of Certified Public Accountants, issued Statement of Position 98-1 (SoP 98-1), "Accounting for the Cost of Computer Software Developed or Obtained for Internal Use," which requires the capitalization of certain internal costs related to the implementation of computer software obtained for internal use. In consideration of the Company's implementation of the Oracle Enterprise Resource Planning Software System, the Company's management resource planning, transaction processing and financial accounting system, the Company early adopted SoP 98-1 during fiscal 1998. In accordance with SoP 98-1, the Company capitalized $808 of internal costs associated with the implementation of the Oracle Enterprise Resource Planning Software System during the year ended July 31, 1998. The system was placed into operation on August 1, 1998 and will be amortized over 5 years.

Reclassifications

Certain amounts related to the year ended July 31, 1997 have been reclassified to conform to the current year presentation.

3. PURCHASE TRANSACTIONS

In November 1995, VTEL purchased certain assets and a service and support infrastructure related to the Integrated Communications Systems Group of another company (the "ICS Transaction"). The transaction resulted in VTEL acquiring certain tangible assets primarily consisting of inventories, prepaid expenses and fixed assets and assuming certain deferred revenues related to extended warranty service contracts. The acquired service and support infrastructure includes a trained workforce possessing specialized systems integration and process knowledge. The transaction will allow VTEL to enhance its ability to support its resellers' abilities to offer systems integration, installation and end-user support to the ultimate purchaser of its products, thereby allowing the resellers to more effectively provide an essential part of the services that are integral to the purchase of the Company's products.

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

VTEL completed the ICS Transaction with the payment of $10,684 in cash, which includes $142 of transaction expenses, and the issuance of 260,000 shares of VTEL's unregistered Common Stock with an estimated market value at the time of the transaction of $3,723. The transaction was accounted for under the purchase method pursuant to which VTEL determined that approximately $14,400 of the purchase price related to intangible assets which are primarily represented by the service and support infrastructure. Amortization of the intangible asset was $80, $560, $960, $960 for the year ended December 31, 1995, the seven months ended July 31, 1996 and the years ended July 31, 1997 and 1998, respectively.

As part of the Company's initiative to expand its international presence, the Company consummated the acquisition of certain of the assets of the videoconferencing division of one of its German resellers effective July 1, 1998. The consideration paid by the Company consisted of restricted stock, warrants, a note payable, and the assumption of certain payables and other liabilities. Subsequent to July 31, 1998, the Company completed the acquisition of one of its French resellers through a stock for stock transaction. The consideration paid by the Company consisted of restricted stock. The total consideration paid for both acquisitions was less than $3 million.

4. INVENTORIES

Inventories consist of the following:

	JULY 31, 1997	JULY 31, 1998
Raw materials	$ 9,493	$ 5,938
Work-in-process	4,143	517
Finished goods	7,490	5,833
Finished goods held for Evaluation and rental Agreements	1,118	663
	$ 22,244	$ 12,951

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

5. PROPERTY AND EQUIPMENT

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

	JULY 31, 1997	JULY 31, 1998
Furniture, machinery and equipment, 2-10 years	$ 28,803	$ 30,045
Internal support equipment, 2-4 years	10,991	12,513

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

Customer service assets, 4-6 years	11,752	15,263
Leasehold improvements, lease term or life of the improvement.	2,872	6,686
	54,418	64,507
Less accumulated depreciation	(32,758)	(36,401)
	$ 21,660	$ 28,106

Depreciation and amortization expense relating to property and equipment was approximately $20,818, $8,379, $12,991 and $7,910 for the year ended December 31, 1995, the seven months ended July 31, 1996, and the years ended July 31, 1997 and 1998, respectively.

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6. DISCONTINUED OPERATIONS

During November 1995, CLI adopted a strategic plan to discontinue operations of its broadcast products division. This division generally manufactured and sold broadcast video products to commercial end-users. The results for the division have been accounted for as discontinued operations in accordance with APB No. 30, "Reporting the Results of Operations - Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions," and the accompanying consolidated financial statements have been presented to reflect the discontinuation of the division.

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

Revenues from the discontinued division were approximately $36,974 for the year ended December 31, 1995 and $11,201 for the seven months ended July 31, 1996. No revenues from discontinued operations were recorded during the years ended July 31, 1997 and 1998.

7. LINES OF CREDIT

On December 4, 1997, the Company executed a credit agreement with a banking syndicate which established a $25,000 revolving line of credit. Under the line of credit, the Company may borrow up to 80% of eligible accounts receivable. The credit agreement also provides that the Company may request the issuance of letters of credit up to a maximum of $10,000 and foreign exchange contracts up to a maximum of $10,000. Each of the aforementioned provisions are subject to certain limitations.

Any amounts outstanding under the credit agreement will bear interest at the prime rate (8.5 % at July 31, 1998) or, at the option of the Company, LIBOR plus a range of basis points (7.1% to 7.6% at July 31, 1998) based on the number of profitable quarters the Company has achieved at the time of the credit advance (LIBOR) option. All such advances and accrued interest under the credit agreement will be payable on the maturity date of December 3, 1999 unless the Company converts the revolving advances to a two-year term loan, which will bear interest at the prime rate or the LIBOR option rate and will be payable in equal monthly installments. The Company pays an annual commitment fee of 0.2% on its unused line of credit.

Any amounts outstanding under the credit agreement will be secured by the Company's inventory and accounts receivable. The credit agreement requires the Company to maintain certain financial ratios and other covenants. The Company has issued a letter of credit totaling $1,200 under the line of credit as a lease deposit on one of its facilities. At July 31, 1998, the Company had no amounts drawn under the credit line.

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8. STOCKHOLDERS' EQUITY

General

In October 1995, VTEL completed a secondary offering of its Common Stock which consisted of the sale of 3,000,000 shares of VTEL's Common Stock generating net proceeds to VTEL of approximately $57,000.

In June 1995, Intel purchased 51,898 shares of VTEL's common stock for approximately $396 pursuant to an agreement, since terminated, which enabled Intel to maintain its percentage ownership interest in VTEL. In October 1995, Intel delivered notice of its intent to exercise its warrant to purchase 1,199,124 shares of VTEL's Common Stock at an exercise price of $11.50 per share under an agreement which modified the provisions of the common stock and Warrant Purchase Agreement (the "Stock Agreement") between VTEL and Intel. Pursuant to the modified agreement, Intel agreed to sell to VTEL concurrently with the exercise of the warrant, and VTEL agreed to purchase from Intel, 771,464 shares of VTEL's Common Stock at a price of $17.875, the closing price of VTEL's Common Stock on the day immediately preceding the date in which Intel delivered notice of its intent to exercise the warrant. During the seven months ended July 31, 1996, VTEL completed the warrant exercise and related stock redemption transaction such that Intel increased its ownership of VTEL's Common Stock by 427,660 shares. The modified agreement also resulted in Intel agreeing to terminate certain of its rights specified in the Investor Rights Agreement between the Company and Intel. VTEL registered the shares acquired by Intel as provided under the Stock Agreement. In May 1997, VTEL issued 155,040 shares of Common Stock, at the fair market value, to Intel in lieu of repayment of the remaining $901 advance under the Development Agreement (see Note 9 to the Consolidated Financial Statements) that was unused at that time.

In November 1995, VTEL issued 260,769 shares of its unregistered Common Stock in connection with the ICS Transaction (see Note 3).

Share Repurchase Program

During the seven months ended July 31, 1996, VTEL adopted a share repurchase program pursuant to which VTEL repurchased shares of its Common Stock in the open market. During the year ended July 31, 1997, VTEL repurchased 455,200 shares of its Common Stock for approximately $3,700. In February 1997, VTEL terminated the stock repurchase program. All repurchased shares were issued from time to time prior to the CLI Merger in May 1997. VTEL applies the cost method of accounting for its treasury stock.

In August 1998, the Company announced its plan to repurchase up to 2,000,000 shares of VTEL Common Stock. As of October 12, 1998, the Company had repurchased approximately 465,000 shares of its common stock for approximately $2,000.

CLI Redeemable Convertible Preferred Stock

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

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

Stock and Stock Option Plans

VTEL has three stock option plans, the 1989 Stock Option Plan (the "1989 Plan"), the 1996 Stock Option Plan (the "1996 Plan") and the 1992 Director Stock Option Plan (the "1992 Plan"). The 1989 Plan and the 1996 Plan both provide for the issuance of non-qualified and incentive stock options to key employees, directors and consultants of the Company. Stock options are generally granted at the estimated fair market value at the time of grant, and the options vest ratably over 48 months and are generally exercisable for a period of ten years beginning with date of grant. The 1992 Plan provides for the issuance of stock options to nonemployee directors at the estimated fair market value at the time of grant. Such options vest ratably over 36 months and are exercisable for a period of ten years beginning with the date of the grant.

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

The Company applies APB No. 25 and related Interpretations in accounting for its stock option plans. Accordingly, no compensation cost is recognized for its stock option plans unless options are issued at exercise prices which are below the market price on the measurement date. Had compensation cost for the Company's stock option plans been determined based on the fair market value at the grant dates for awards under those plans consistent with the method provided by SFAS No. 123, the Company's net loss and net loss per share would have been reflected by the following pro forma amounts for the seven months ended July 31, 1996 and the years ended July 31, 1997 and 1998:

		FOR THE SEVEN MONTHS ENDED JULY 31, 1996	FOR THE YEARS ENDED JULY 31, 1997	1998
Net income (loss)	As reported	$ (18,507)	$ (52,054)	$ 2,779
	Pro forma	$ (20,638)	$ (55,276)	$ (1,589)
Basic and diluted net income (loss) per common share	As reported	$ (.87)	$ (2.45)	$ 0.12
	Pro forma	$ (.96)	$ (2.60)	$ (0.07)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option- pricing model with the following weighted-average assumptions used for grants during the seven months ended July 31, 1996 and the years ended July 31, 1997 and 1998:

	FOR THE SEVEN MONTHS ENDED JULY 31, 1996	FOR THE YEARS ENDED JULY 31, 1997	1998

Dividend yield	--	--	--
Expected volatility	84.83%	92.31%	63.12%
Risk-free rate of return	6.56%	5.90%	5.52%
Expected life	4.94 years	5.12 years	5.65 years

The following table summarizes activity under all Plans for the year ended December 31, 1995, the seven months ended July 31, 1996 and the years ended July 31, 1997 and 1998. This information includes stock options relating to CLI's stock option plans. Both the number of shares and the per share exercise price have been adjusted by the exchange ratio of 0.46.

	1995		1996		1997		1998	
	SHARES (000'S)	WEIGHTED AVERAGE EXERCISE PRICE	SHARES (000'S)	WEIGHTED AVERAGE EXERCISE PRICE	SHARES (000'S)	WEIGHTED AVERAGE EXERCISE PRICE	SHARES (000'S)	WEIGHTED AVERAGE EXERCISE PRICE
Outstanding at the								
beginning of the year	1,638	$ 3.97	1,879	$ 8.80	2,187	$ 9.40	3,648	9.42
Converted from CLI	--	--	--	--	1,798	17.43	--	--
Granted	701	17.37	449	10.99	2,098	6.44	896	6.43
Exercised	(371)	3.66	(77)	3.13	(324)	3.14	(186)	4.00
Canceled	(89)	8.88	(64)	10.39	(2,111)	14.58	(420)	7.55
Outstanding at the end of the year	1,879	$ 8.80	2,187	$ 9.40	3,648	$ 9.42	3,938	$ 8.65
Options exercisable at year end	1,851	$ 8.74	2,165	$ 9.40	3,402	$ 9.20	3,710	$ 8.42
Weighted average fair value of options granted during the year		$ 12.07		$ 7.77		$ 3.42		$ 4.12

	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
RANGE OF EXERCISE PRICES	NUMBER OUTSTANDING AT JULY 31, 1998	WEIGHTED-AVERAGE REMAINING CONTRACTUAL LIFE	WEIGHTED-AVERAGE EXERCISE PRICE	NUMBER EXERCISABLE AT JULY 31, 1998	WEIGHTED-AVERAGE EXERCISE PRICE
$0.30 - $5.75	710,094	6.59 years	$ 3.92	710,094	$ 3.92
5.78 - 6.11	201,994	9.09	6.02	187,326	6.02
6.13 - 6.13	1,368,837	8.87	6.13	1,354,169	6.13
6.19 - 7.88	646,012	8.38	7.00	636,345	7.00
8.06 - 42.66	1,010,979	6.04	16.96	822,282	17.72
$0.30 - $42.66	3,937,916	7.66 years	$ 8.65	3,710,216	$ 8.42

Generally, options are exercisable immediately upon grant. However, stock issued upon exercise of a stock option is subject to repurchase by the Company at the exercise price until the option vesting period has elapsed. At July 31, 1998, options to purchase 1,852,530 shares were vested. At July 31, 1998, no unvested options had been exercised.

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

Employee Stock Purchase Plan

On April 29, 1993, VTEL adopted an Employee Stock Purchase Plan ("Employee Plan") which enables all employees to acquire VTEL stock under the plan. The Employee Plan authorizes the issuance of up to 950,000 shares of VTEL's Common Stock. The Employee Plan allows participants to purchase shares of the Company's Common Stock at a price equal to the lesser of (a) 85% of the fair market value of the Common Stock on the date of the grant of the option or (b) 85% of the fair market value of the Common Stock at the time of exercise. Shares of Common Stock issued under the Employee Plan totaled 66,087, 37,121, 105,549 and 158,073 respectively, for the year ended December 31, 1995, the seven months ended July 31, 1996 and the years ended July 31, 1997 and 1998.

The fair value of the employees' purchase rights was estimated using the Black-Scholes model with the following assumptions for the seven months ended July 31, 1996 and the years ended July 31, 1997 and 1998:

	FOR THE SEVEN MONTHS ENDED JULY 31, 1996		FOR THE YEAR ENDED JULY 31, 1997		FOR THE YEAR ENDED JULY 31, 1998	
	SECTION 16 OFFICERS	OTHERS	SECTION 16 OFFICERS	OTHERS	SECTION 16 OFFICERS	OTHERS
Dividend yield	--	--	--	--	--	--
Expected volatility	95.78%	90.29%	82.89%	79.83%	52.10%	51.68%
Risk-free rate of return	5.18%	5.12%	5.31%	5.23%	5.40%	5.34%
Expected life (in years)	.50	.25	.50	.25	.50	.25
Weighted-average fair value of purchase rights granted	$3.13	$2.30	$2.54	$2.11	$1.96	$1.66

9. DEVELOPMENT AND LICENSE AGREEMENT

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

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

VTEL was advanced $3,000 under the agreement to be used for the initial reimbursements of research and development costs incurred by VTEL in performing the work specified in the Development Agreement. During the years ended December 31, 1995 and July 31, 1997, the Company reduced gross research and development expenses by approximately $190 and $5, respectively, for reimbursable research and development costs under the terms of the Development Agreement. No reductions of research and development expenses were recorded during the seven months ended July 31, 1996 and the year ended July 31, 1998 as a result of the Development Agreement. In May 1997, VTEL issued 155,040 shares of Common Stock, at the fair market value, to Intel in lieu of repayment of the remaining $901 advance that was unused at that time. As of July 31, 1998, the Company had no research and development activities in process or planned related to the Development Agreement.

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10. FEDERAL INCOME TAXES

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

	JULY 31, 1997	JULY 31, 1998
DEFERRED TAX ASSETS:		
Net operating loss carryforwards	$ 23,198	$ 29,140
Research and development credit carryforwards	3,376	3,458
Minimum tax credit carryforwards	110	110
Inventory and warranty provisions	3,562	1,246
Charitable contributions	--	22
Compensation accruals	1,932	635
Depreciation	2,698	630
Deferred revenue	703	1,796
Accrued expenses	2,385	841
Accounts receivable	3,996	3,163
Other	281	558
Gross deferred tax asset	42,241	41,599
DEFERRED TAX LIABILITIES:		
Capitalized software	--	(274)
Gross deferred tax liability	--	(274)
Valuation allowance	(42,241)	(41,325)
Net deferred tax asset	$ --	$ --

The Company's net operating loss carryforwards expire in varying amounts from 1999 through 2013. Research and development tax credit carryforwards expire in varying amounts from 1998 through 2013. Minimum tax credit carryforwards do not expire and carry forward indefinitely. Net operating losses related to the Company's foreign subsidiary (totaling $5,033) are available to offset future foreign taxable income.

The Company has experienced substantial changes in ownership as defined by the Internal Revenue Code. These changes result in annual limitations of the amount of net operating loss carryforward generated prior to each change which can be utilized to offset future taxable income. As a result of the ownership change at CLI at the date of the Merger, a portion of CLI's net operating loss carryforward generated prior to the Merger will never be available to offset future taxable income due to the effect of the annual limitation and the expiration of the related net operating losses. Therefore, the unavailable portion of the net operating loss carryforward is not considered in determining the deferred tax asset at July 31, 1998.

At July 31, 1998, the Company had total domestic net operating loss carryforwards of $85,705 ($26,592 and $59,113 for VTEL and CLI, respectively). The portions of these carryforwards available for utilization during fiscal 1999 (in consideration of the annual limitations) are $52,660. Additional net operating losses created prior to the changes in control of $2,574 become available in each subsequent year and accumulate if not used until such net operating losses expire.

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

Due to the uncertainty surrounding the timing of realizing the benefits of its favorable tax attributes in future tax returns, the Company has placed a valuation allowance against its net deferred tax asset. Accordingly, no deferred taxes have been recorded for the year ended December 31, 1995, for the seven months ended July 31, 1996 and for the years ended July 31, 1997 and 1998.

The tax provisions reflected in the accompanying consolidated financial statements is due primarily to federal alternative minimum taxes and state income taxes.

11. COMMITMENTS AND CONTINGENCIES

Lease Commitments

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

Future minimum lease payments under all operating leases as of July 31, 1998 were as follows:

FISCAL YEAR ENDING:	
1999	$ 7,430
2000	7,082
2001	6,771
2002	6,592
2003	6,315
Thereafter	21,377
	$ 55,567

Total rent expense under all operating leases for the years ended December 31, 1995, for the seven months ended July 31, 1996, and for the years ended July 31, 1997 and 1998 was $6,188, $4,713, $4,601 and $4,301 respectively.

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

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

Contingencies

CLI is currently engaged in several legal proceedings relating to matters arising prior to the Merger. There can be no assurance that CLI's legal proceedings can be resolved favorably to CLI or VTEL. Such legal proceedings, if continued for an extended period of time, could have an adverse effect upon CLI's working capital and management's ability to concentrate on its business. The Company has recorded an estimate of the costs to defend and discharge the claims. Such amount is included in the charges recorded as contingent liabilities (see Note 1 to the Consolidated Financial Statements). In the opinion of management, such reserves should be sufficient to discharge the liabilities, if any. However, an unfavorable outcome in any one or several such legal proceedings could have a material adverse effect on CLI and hence, VTEL.

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

In a complaint filed on December 20, 1993 in the United States District Court in Dallas, Texas, Datapoint Corporation ("Datapoint") alleged that CLI had infringed two United States patents owned by Datapoint relating to video conferencing networks. The complaint sought a judgment of infringement, monetary damages, injunctive relief and attorneys' fees. CLI responded to the complaint by denying the material allegations of the complaint and asserting affirmative defenses. In July 1998, the United States District Court dismissed the civil action filed by Datapoint.

In June 1997, Keytech, S.A. ("Keytech") filed suit against CLI in the United States District Court in Tampa, Florida. Keytech was a distributor of satellite encoder and decoder products manufactured by a division of CLI which CLI sold in June 1996. Keytech has asserted that the equipment sold was defective and did not conform to contract specifications and express and implied warranties. Keytech has asserted damages in excess of $20 million based on its allegations of breach of contract, breach of warranties and fraud. CLI has filed an answer denying liability and has asserted cross-claims against Keytech for amounts due and unpaid for equipment sold by CLI to Keytech.

12. GEOGRAPHIC INFORMATION

The Company operates in one industry. Transfers between geographic areas are recorded at cost plus a markup. The United Kingdom and China represent the Company's two largest Foreign markets, and in total represented 9% of revenues. Information about the Company's operations in different geographic areas is as follows:

	FOR THE YEAR ENDED JULY 31, 1998			
	UNITED STATES	EUROPE AND OTHER	ELIMINATIONS	CONSOLIDATED
Sales to unaffiliated customers	$ 163,264	$ 16,420	$ --	$ 179,684
Transfer between geographic areas	9,616	--	(9,616)	--
Total sales	$ 172,880	$ 16,420	$ (9,616)	$ 179,684
Net income (loss) from continuing operations	$ 2,155	$ 530	$ 94	$ 2,779
Net income (loss)	$ 2,155	$ 530	$ 94	$ 2,779
Identifiable assets	$ 132,914	$ 9,871	$ (13,496)	$ 129,289

FOR THE YEAR ENDED JULY 31, 1997			
UNITED STATES	EUROPE AND OTHER	ELIMINATIONS	CONSOLIDATED

Sales to unaffiliated customers	$ 180,811	$ 10,212	$ --	$ 191,023
Transfer between geographic areas	12,612	--	(12,612)	--
Total sales	$ 193,423	$ 10,212	$ (12,612)	$ 191,023
Net loss from continuing operations	$ (40,942)	$ (3,144)	$ (185)	$ (44,271)
Net loss	$ (48,725)	$ (3,144)	$ (185)	$ (52,054)
Identifiable assets	$ 139,051	$ 8,008	$ (15,924)	$ 131,135

FOR THE SEVEN MONTHS ENDED JULY 31, 1996

	UNITED STATES	EUROPE AND OTHER	ELIMINATIONS	CONSOLIDATED
Sales to unaffiliated customers	$ 93,728	$ 3,234	$ --	$ 96,962
Transfer between geographic areas	2,383	--	(2,383)	--
Total sales	$ 96,111	$ 3,234	$ (2,383)	$ 96,962
Net loss	$ (16,721)	$ (1,834)	$ 48	$ (18,507)
Identifiable assets	$ 179,799	$ 3,131	$ (7,838)	$ 175,092

FOR THE YEAR ENDED DECEMBER 31, 1995

	UNITED STATES	EUROPE AND OTHER	ELIMINATIONS	CONSOLIDATED
Sales to unaffiliated customers	$ 184,471	$ 6,603	$ --	$ 191,074
Transfer between geographic areas	3,475	--	(3,475)	--
Total sales	$ 187,946	$ 6,603	$ (3,475)	$ 191,074
Net loss from continuing operations	$ (16,912)	$ (520)	$ 131	$ (17,301)
Net loss	$ (53,454)	$ (520)	$ 131	$ (53,843)
Identifiable assets	$ 219,616	$ 3,445	$ --	$ 223,061

* * *

SIGNATURES

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

VTEL Corporation

By /s/ Rodney S. Bond

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

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

Signature	Title	Date
/s/ Jerry S. Benson, Jr. Jerry S. Benson, Jr.	Chief Executive Officer, President and Director (Principal Executive Officer)	May 3, 1999
/s/ Rodney S. Bond Rodney S. Bond	Chief Financial Officer, Vice President- Finance, Treasurer and Secretary (Principal Financial Officer and Principal Accounting Officer)	May 3, 1999
/s/ Eric L. Jones Eric L. Jones	Director	May 3, 1999
/s/ Max Hopper Max Hopper	Director	May 3, 1999
/s/ Gordon Matthews Gordon Matthews	Director	May 3, 1999
/s/ F.H. (Dick) Moeller F.H. (Dick) Moeller	Chairman of the Board	May 3, 1999
/s/ Dick Snyder Dick Snyder	Director	May 3, 1999
/s/ T. Gary Trimm T. Gary Trimm	Director	May 3, 1999

Index to Exhibits

Exhibit Number	Description
23.1	Consent of PricewaterhouseCoopers LLP.
23.2	Consent of KPMG LLP.

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (Nos. 33-65464, 33-65472, and 33-65478) of VTEL Corporation of our report dated September 22, 1998, which appears in this Annual Report on Form 10-K/A.

PricewaterhouseCoopers LLP

Austin, Texas
May 3, 1999

EXHIBIT 23.2

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in the registration statements (Nos. 33-65464, 33-65472, and 33-65478) on Form S-8 of VTEL Corporation of our report dated March 13, 1996, relating to the consolidated statements of operations, stockholders' equity, and cash flows of Compression Labs, Incorporated for the year ended December 31, 1995, and the related financial statement schedule, which report appears in the July 31, 1998, Annual Report on Form 10-K/A of VTEL Corporation.

KPMG LLP

Mountain View, California
May 3, 1999