CASTELLE \CA\
Form 10-Q
August 12, 2003

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2003

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

Commission File Number: 0-220-20

CASTELLE
(Exact name of Registrant as specified in its charter)

California	77-0164056
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

855 Jarvis Drive, Suite 100, Morgan Hill, California 95037
(Address of principal executive offices, including zip code)

(408) 852-8000
(Registrant's telephone number, including area code)

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 __

The number of shares of Common Stock outstanding as of August 4, 2003 was 3,269,395.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes __ No |X|

CASTELLE
FORM 10-Q
TABLE OF CONTENTS

PART I - FINANCIAL INFORMATION

ITEM 1. UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

CASTELLE
CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited)
(in thousands)

	June 30, 2003	Dece
Assets:		
Current assets:		
Cash and cash equivalents	$ 3,663	
Accounts receivable, net of allowance for doubtful accounts of $31 and $70, respectively	765	
Inventories	872	
Prepaid expenses and other current assets	262	
Total current assets	5,562	
Property and equipment, net	415	
Other non-current assets	108	
Total assets	$ 6,085	
Liabilities and Shareholders' Equity:		
Current liabilities:		
Long-term debt, current portion	$ 20	
Accounts payable	196	
Accrued liabilities	2,409	
Total current liabilities	2,625	
Long term debt, net of current portion	35	
Total liabilities	2,660	
Shareholders' equity:		
Common stock, no par value:		
Authorized: 25,000 shares		
Issued and outstanding: 3,216 and 3,187, respectively	27,069	
Accumulated deficit	(23,644)	
Total shareholders' equity	3,425	
Total liabilities and shareholders' equity	$ 6,085	

See accompanying notes to unaudited condensed consolidated financial statements.

CASTELLE
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share amounts)
(unaudited)

Three months ended S

	June 30, 2003	June 30, 2002	June 30,
Net sales	$ 2,511	$ 2,261	$ 5,0
Cost of sales	573	669	1,2
Gross profit	1,938	1,592	3,7
Operating expenses:			
Research and development	429	349	7
Sales and marketing	760	780	1,4
General and administrative	509	450	9
Restructuring charges	-	(40)	
Total operating expenses	1,698	1,539	3,24
Income from operations	240	53	4
Interest income, net	4	12	
Other income (expense), net	(14)	(3)	(
Income before provision for income taxes	230	62	4
Provision for income taxes	2	--	
Net income	$ 228	$ 62	$ 4
Income per share:			
Net income per common share - basic	$ 0.07	$ 0.01	$ 0
Net income per common share - diluted	$ 0.06	$ 0.01	$ 0
Shares used in per share calculation - basic	3,200	4,749	3,
Shares used in per share calculation - diluted	4,138	4,765	4,

See accompanying notes to unaudited condensed consolidated financial statements.

CASTELLE
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Six month
	June 30, 2003
Cash flows from operating activities:	
Net income	$ 471
Adjustment to reconcile net income to net cash provided	

by/(used in) operating activities:	
Loss on disposal of fixed assets	--
Depreciation and amortization	109
Provision for doubtful accounts and sales returns	(158)
Provision for excess and obsolete inventory	(67)
Changes in assets and liabilities:	
Accounts receivable	(163)
Inventories	305
Prepaid expenses and other current assets	(174)
Accounts payable	(163)
Accrued liabilities	121
Net cash provided by/(used in) operating activities	281
Cash flows from investing activities:	
Purchase of property and equipment	(99)
Net cash used in investing activities	(99)
Cash flows from financing activities:	
Repayment of long-term debt	(10)
Proceeds from issuances of common stock, net of repurchases	31
Net cash provided by/(used in) financing activities	21
Net increase/(decrease) in cash and cash equivalents	203
Cash and cash equivalents at beginning of period	3,460
Cash and cash equivalents at end of period	$ 3,663

See accompanying notes to unaudited condensed consolidated financial statements.

CASTELLE
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Basis of Presentation:

The accompanying unaudited condensed consolidated financial statements include the accounts of Castelle and its wholly-owned subsidiary in the United Kingdom. These financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America. All intercompany balances and transactions have been eliminated. In the opinion of management, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated have been included. Because all of the disclosures required by accounting principles generally accepted in the United States of America are not included in the accompanying condensed consolidated financial statements and related notes, they should be read in

conjunction with the audited consolidated financial statements and related notes included in the Company's Form 10-K for the year ended December 31, 2002. The condensed balance sheet data as of December 31, 2002 was derived from our audited financial statements and does not include all of the disclosures required by accounting principles generally accepted in the United States of America. The results of operations for the periods presented are not necessarily indicative of results that we expect for any future period, or for the entire year.

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

The Company believes that its existing cash balances and anticipated cash flows from operations will be sufficient to meet its anticipated capital requirements for the next 12 months. However, a decline in future orders and revenues might require the Company to seek additional capital to meet its working capital needs during or beyond the next twelve months if the Company is unable to reduce expenses to the degree necessary to avoid incurring losses. If the Company has a need for additional capital resources, it may be required to sell additional equity or debt securities, secure additional lines of credit or obtain other third party financing. The timing and amount of such capital requirements cannot be determined at this time and will depend on a number of factors, including demand for the Company's existing and new products, if any, and changes in technology in the networking industry. There can be no assurance that such additional financing will be available on satisfactory terms when needed, if at all. Failure to raise such additional financing, if needed, may result in the Company not being able to achieve its long-term business objectives. To the extent that additional capital is raised through the sale of additional equity or convertible debt securities, the issuance of such securities would result in additional dilution to the Company's shareholders.

In addition, because the Company is dependent on a small number of distributors for a significant portion of the sales of its products, the loss of any of the Company's major distributors or their inability to satisfy their payment obligations to the Company could have a significant adverse effect on the Company's business, operating results and financial condition. In the first six months of 2003, Ingram Micro and Tech Data, the Company's two largest distributors, collectively represented approximately 48% of the Company's net sales.

In the same period of 2002, the same distributors collectively represented approximately 52% of the Company's net sales.

2. Revenue Recognition

Castelle recognizes revenue based on the provisions of Staff Accounting Bulletin No. 101 "Revenue Recognition in Financial Statements" and Statement of Financial Accounting Standards ("SFAS") No. 48 "Revenue Recognition When Right of Return Exists."

Product revenue is recognized upon shipment if a signed contract or purchase order exists, the fee is fixed and determinable, collection of the

resulting receivable is probable and product returns are reasonably estimable. Shipment generally occurs and title and risk of loss is transferred when the product is delivered to a common carrier.

The Company enters into agreements with some of its distributors that permit limited stock rotation rights. These stock rotation rights allow the distributor to return products for credit but require the purchase of additional products of equal value. Customers who purchase products directly from Castelle also have limited return rights, which expire 30 days from product shipment. Revenues subject to stock rotation rights are reduced by management's estimates of anticipated exchanges. Castelle establishes its returns allowance for distributors and direct customers based on historic return rates.

Pursuant to the Company's agreements with distributors, the Company also protects its distributors' exposure related to the impact of price reductions. Price adjustments are recorded at the time price reductions are communicated to the Company's distributors.

Revenue for transactions that include multiple elements such as hardware and post-contract customer support is allocated to each element based on its relative fair value and recognized for each element when the revenue recognition criteria have been met for such element. Fair value is generally determined based on the price charged when the element is sold separately.

The Company recognizes revenue from support or maintenance contracts, including extended warranty and support programs, ratably over the period of the contract.

Castelle recognizes royalty income on the sale of LANpress products by a Japanese distributor. Royalties are recognized when the products are sold by the distributor to its end customer.

3. Net Income Per Share:

Basic net income per share is computed by dividing net income available to common shareholders by the weighted average number of common shares outstanding for that period. Diluted net income per share reflects the potential dilution from the exercise or conversion of other securities into common stock that were outstanding during the period. Diluted net income per share excludes shares that are potentially dilutive if their effect is anti-dilutive. Shares that are potentially dilutive consist of incremental common shares issuable upon exercise of stock options.

Basic and diluted earnings per share are calculated as follows for the second quarter and first six months of 2003 and 2002 (in thousands, except per share amounts):

(in thousands, except p

(Unaudite

Three months ended

	June 30, 2003	June 30, 2002	Ju
Basic:			
Weighted average common shares outstanding	3,200	4,749	
Net income	$ 228	$ 62	
Net income per common share - basic	$ 0.07	$0.01	
Diluted:			
Weighted average common shares outstanding	3,200	4,749	
Common equivalent shares from stock options	938	16	
Shares used in per share calculation - diluted	4,138	4,765	
Net income	$ 228	$ 62	
Net income per common share - diluted	$ 0.06	$0.01	

The calculation of diluted shares outstanding for the three months ended June 30, 2003 excludes 15,000 shares of common stock issuable upon exercise of outstanding stock options, as their effect was antidilutive in the period. The calculation of diluted shares outstanding for the six months ended June 30, 2003, excludes 170,000 shares of common stock issuable upon exercise of outstanding stock options, as their effect was antidilutive in the period.

Stock-Based Compensation

The Company accounts for its stock-based compensation plans using the intrinsic value method prescribed in Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Compensation cost for stock options, if any, is measured by the excess of the quoted market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock. SFAS No. 123, "Accounting for Stock-Based Compensation," established accounting and disclosure requirements using a fair-value based method of accounting for stock-based employee compensation plans.

Had compensation costs been determined consistent with SFAS No. 123, the Company's net income or loss would have been changed to the amounts indicated below for the three and six months ended June 30 (unaudited, in thousands, except per share data):

	Three months ended		Six m
	June 30, 2003	June 30, 2002	June 30 2003
Net Income - as reported	$ 228	$ 62	$ 471
Fair value of stock-based compensation	(45)	(49)	(87)
Net income - pro forma	183	13	384

Net income per share - basic - as reported	$ 0.07	$ 0.01	$ 0.15
Net income per share - diluted - as reported	$ 0.05	$ 0.01	$ 0.12
Net income per share - basic - pro forma	$ 0.06	-	$ 0.12
Net income per share - diluted - pro forma	$ 0.04	-	$ 0.10

The Company accounts for stock-based compensation arrangements with non-employees in accordance with Emerging Issues Task Force ("EITF") Abstract No. 96-18, Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction

with Selling, Goods or Services. Accordingly, unvested options and warrants held by non-employees are subject to revaluation at each balance sheet date based on the then current fair market value.

4. Inventories:

Inventories are stated at the lower of standard cost (which approximates cost on a first-in, first-out basis) or market and net of provisions for excess and obsolete inventory. Inventory details are as follows (unaudited, in thousands):

	June 30, 2003	December 31, 2002
Raw material	$ 487	$ 493
Work in process	7	179
Finished goods	378	438
Total inventory	$ 872	$ 1,110

5. Segment Information:

The Company has determined that it operates in one segment. Revenues by geographic area are determined by the location of the end user and are summarized as follows (unaudited, in thousands):

	(Unaudited)			
	Three months ended		Six months ended	
	June 30, 2003	June 30, 2002	June 30, 2003	June 30 2002
United States	$2,020	$ 1,784	$ 4,008	$3,620
Europe	153	172	328	404
Pacific Rim	258	248	500	406
Rest of Americas, excluding United States	80	57	175	199

Total Revenues	$2,511	$ 2,261	$ 5,011	$4,629

Customers that individually accounted for greater than 10% of net sales are as follows (unaudited, in thousands):

	Quarter Ended				Six Months End		
	June 30, 2003		June 30, 2002		June 30, 2003		
Customer	Amount	Percentage	Amount	Percentage	Amount	Percentage	Amo
A	$ 448	18%	$ 597	26%	$ 1,112	22%	$
B	$ 709	28%	$ 530	23%	$ 1,314	26%	$

6. Comprehensive Income:

Comprehensive income is the change in equity from transactions and other events and circumstances other than those resulting from investments by owners and distributions to owners. There are no significant components of comprehensive income excluded from net income, therefore, no separate statement of comprehensive income has been presented.

8

7. Commitments and Contingencies:

Contingencies
From time to time, the Company is involved in various legal proceedings in the ordinary course of business. The Company is not currently involved in any litigation, which, in management's opinion, would have a material adverse effect on its business, operating results, cash flows or financial condition; however, there can be no assurance that any such proceeding will not escalate or otherwise become material to the Company's business in the future.

Lease Commitments
The following represents combined aggregate maturities for all the Company's financing and commitments under operating and capital leases as of June 30, 2003 (unaudited, in thousands):

	Operating Leases	Capital Lease Obligations	Total Commitments
Six months ending December 31, 2003	$ 130	$ 14	$ 144
Year ending December 31, 2004	270	20	290
Year ending December 31, 2005	263	18	281
Year ending December 31, 2006	-	14	14
Total Commitments	$ 663	$ 66	$ 729

The lease on the Company's headquarters facility has a term of 5 years, expiring in December 2005 with one conditional three-year renewal option, which if exercised would extend the lease to December 2008 commencing with rent at ninety-five percent of fair market value.

The Company leases certain of its equipment under various operating and capital leases that expire at various dates through 2006. The lease agreements frequently include renewal, escalation clauses and purchase provisions, and require the Company to pay taxes, insurance and maintenance costs. As of June 30, 2003, the Company had loan and security agreements for an aggregate value of $100,000, which are subject to interest rates of 12.5% to 12.8%.

The Company has a $3.0 million collateralized revolving line of credit with a bank, which expires in March 2004, pursuant to which the Company may borrow 100% against pledges of cash at the bank's prime rate. Borrowings under this line of credit agreement are collateralized by all of the Company's assets. As of June 30, 2003, the Company was in compliance with the terms of the agreement and had no borrowings outstanding under the line of credit.

Product Warranties and Guarantor Arrangements
In November 2002, the Financial Accounting Standards Board ("FASB") issued FIN No. 45 "Guarantor's Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others, an interpretation of FASB Statements No. 5, 57, and 107 and rescission of FASB Interpretation No. 34 ("FIN 45"). FIN 45 requires that a guarantor recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken by issuing the guarantee. FIN 45 also requires additional disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees, warranties and indemnification it has issued.

The Company offers warranties on certain products and records a liability for the estimated future costs associated with warranty claims, which is based upon historical experience and our estimate of the level of future costs. Warranty costs are reflected in the income statement as a cost of sales. A reconciliation of the changes in the Company's warranty liability during the periods is as follows (in thousands):

	(Unaudited)			
	Three months ended		Six months ende	
	June 30, 2003	June 30, 2002	June 30, 2003	June 200
Balance at beginning of period	$33	$ 22	$ 34	$22
Accruals for warranties issued during the period	4	8	33	14
Actual warranty expense	(6)	(8)	(36)	(14)

Balance at end of period	$31	$ 22	$ 31	$22

As permitted under California law, the Company has agreements whereby the Company indemnifies its officers and directors for certain events or occurrences while the officer or director is, or was, serving at the Company's request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has a director and officer insurance policy that limits the Company's exposure and enables the Company to recover a portion of any future amounts paid. As a result of the Company's insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal.

The Company enters into standard indemnification agreements in the ordinary course of business. Pursuant to these agreements, the Company indemnifies, holds harmless, and agrees to reimburse the indemnified party for losses suffered or incurred by the indemnified party, generally the Company's business partners or customers, in connection with any U.S. patent, or any copyright or other intellectual property infringement claim by any third party with respect to the Company's products. The term of these indemnification agreements is generally perpetual following execution of the agreement. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited; however, the Company has never incurred costs to defend lawsuits or settle claims related to these indemnification agreements.

8. Stock Buyback:

In the fourth quarter of 2002, the Company's Board of Directors authorized the Company, from time to time, to repurchase at market prices, up to $2.25 million of its common stock for cash in open market, negotiated or block transactions. The timing of such transactions will depend on market conditions, other corporate strategies and will be at the discretion of the management of the Company. No time limit was set for the completion of this program. At the time of the approval by the Board of Directors, the Company had approximately 4.8 million shares of common stock outstanding. During the fourth quarter of 2002, the Company repurchased from open market and negotiated transactions a total of approximately 1.62 million shares for approximately $1.8 million, at an average per share price of $1.10. During the first quarter of 2003, the Company repurchased from open market transactions a total of

46,500 shares for $49,000, at an average per share price of $1.04. There was no stock repurchased by the Company in the second quarter of 2003. The Company intends to continue to execute its buyback program in 2003 as it deems necessary.

9. Recent Accounting Pronouncements:

In November 2002, the EITF reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"). EITF 00-21 provides guidance on how to account for arrangements that involve the

delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company is currently assessing the impact of the adoption of this pronouncement on its consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). FIN 46 addresses consolidation by business enterprises of variable interest entities. Under that interpretation, certain entities known as Variable Interest Entities ("VIEs") must be consolidated by the primary beneficiary of the entity. The primary beneficiary is generally defined as having the majority of the risks and rewards arising from the VIE. For VIEs in which a significant (but not majority) variable interest is held, certain disclosures are required. FIN46 applies immediately to variable interest entities created after January 31, 2003, and applies in the first year or interim period beginning after June 15, 2003 to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. The Company does not believe the adoption of this interpretation will have a material impact on its consolidated results of operations, financial position or cash flows.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. The new guidance amends SFAS No. 133 for decisions made as part of the Derivatives Implementation Group ("DIG") process that effectively required amendments to SFAS No. 133, and decisions made in connection with other FASB projects dealing with financial instruments and in connection with implementation issues raised in relation to the application of the definition of a derivative and characteristics of a derivative that contains financing components. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. The Company does not believe the adoption of SFAS No. 149 will have a material impact on its consolidated results of operations, financial position or cash flows.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. This Statement is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. For nonpublic entities, mandatorily redeemable financial instruments are subject to the provisions of this Statement for

the first period beginning after December 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in accounting principle for financial instruments created before the issuance date of the

statement and still existing at the beginning of the interim period of adoption. The Company does not believe the adoption of SFAS No. 150 will have a material impact on its consolidated results of operations, financial position and cash flows.

SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements that involve risks and uncertainties. The Company's operating results may vary significantly from quarter to quarter due to a variety of factors, including changes in the Company's product and customer mix, constraints in the Company's manufacturing and assembling operations, shortages or increases in the prices of raw materials and components, changes in pricing policy by the Company or its competitors, a slowdown in the growth of the networking market, seasonality, timing of expenditures, and economic conditions in the United States, Europe and Asia. Words such as "believes," "anticipates," "expects," "intends" and similar expressions are intended to identify forward-looking statements, but are not the exclusive means of identifying such statements. Unless the context otherwise requires, references in this Form 10-Q to "we," "us," or the "Company" refer to Castelle. Readers are cautioned that the forward-looking statements reflect management's analysis only as of the date hereof, and the Company assumes no obligation to update these statements. Actual events or results may differ materially from the results discussed in the forward-looking statements. Factors that might cause such a difference include, but are not limited to the risks and uncertainties discussed herein, as well as other risks set forth under the caption "Risk Factors" below and in the Company's Annual Report on Form 10-K for the year ended December 31, 2002.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that are subject to many risks and uncertainties that could cause actual results to differ significantly from expectations. For more information on forward-looking statements, refer to the "Special Note on Forward-Looking Statements" prior to this section. The following discussion should be read in conjunction with the unaudited Condensed Consolidated Financial Statements and the Notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and the Company's Form 10-K for the year ended December 31, 2002.

Critical Accounting Policies

Castelle's financial statements and accompanying notes are prepared in accordance with generally accepted accounting principles in the United States of America. Preparing financial statements requires management to make estimates

and assumptions that affect the reported amounts of assets, liabilities, sales and expenses. These estimates and assumptions are affected by management's application of accounting policies. Critical accounting policies for Castelle include revenue recognition; distributor programs and incentives; warranty; credit, collection and allowances for doubtful accounts; inventories and related allowance for obsolete and excess inventory; and income taxes, which are discussed in more detail under the caption "Critical Accounting Policies" in the Company's 2002 Annual Report on Form 10-K.

Consolidated Statements of Income - As a Percentage of Net Sales

	Three months ended		Six mont
	June 30, 2003	June 30, 2002	June 30, 2003
Net sales	100%	100%	100%
Cost of sales	23%	30%	25%
Gross profit	77%	70%	75%
Operating expenses:			
Research and development	17%	15%	16%
Sales and marketing	30%	35%	30%
General and administrative	20%	20%	19%
Restructuring charges	--	(2%)	--
Total operating expenses	67%	68%	65%
Income from operations	10%	2%	10%
Interest income, net	*	1%	*
Other income, net	(1%)	*	(1%)
Income before provision for income taxes	9%	3%	9%
Provision for income taxes	*	--	*
Net income	9%	3%	9%

* Less than 1%

Results of Operations

Net Sales

Net sales for the second quarter of 2003 increased 11% to $2.5 million from $2.3 million for the same period in 2002. The increase of $250,000 was primarily attributable to an increase in shipments of our products to domestic customers. Net sales for the first six months of 2003 increased 8% to $5.0 million from $4.6 million for the same period in 2002.

The increase of $382,000 was also due to increased shipments of our products to domestic customers.

Domestic sales in the second quarter of 2003 were $2.1 million as compared to $1.8 million for the same period in 2002, which represents approximately 84% and 81% of total sales in the second quarter of 2003 and 2002, respectively. Domestic sales for the first six months of 2003 were $4.2 million as compared to $3.8 million for the same period in 2002, which represents approximately 83% of total sales for both periods.

International sales in the second quarter of 2003 were $411,000 as compared to $420,000 for the same period in 2002, which represents approximately 16% and 19% of total sales in the second quarter of 2003 and 2002, respectively. International sales for the first six months of 2003 were $828,000 as compared to $810,000 for the same period in 2002, which represents approximately 17% of total sales for both periods.

Cost of Sales; Gross Profit

Gross profit was $1.9 million, or 77% of net sales, for the second quarter of 2003, as compared to $1.6 million, or 70% of net sales, for the same period of 2002. Gross profit for the first six months of 2003 and 2002 was $3.7 million and $3.2 million, or 75% of net sales and 69% of net sales, respectively. Product cost reductions, outsourcing of our manufacturing operations and a continuing shift in product mix, which is resulting in a greater percentage of our sales arising from sales of our fax server products that have a higher gross margin, contributed to the improvements in gross profit.

Research & Development

Research and product development expenses for the second quarter of 2003 were $429,000, or 17% of net sales, as compared to $349,000, or 15% of net sales, for the same period in 2002. The increase was primarily due to an increase in materials consumed for product development. For the first six months of 2003, research and development expenses were $784,000, as compared to $762,000 for the same period in 2002, or 16% of net sales in each period.

Sales & Marketing

Sales and Marketing expenses for the second quarter of 2003 were $760,000, or 30% of total net sales, as compared to $780,000, or 35% of net sales, for the same period in 2002. Sales and Marketing expenses were $1.5 million, for both the first six months of 2003 and 2002, which represents 30% and 33% of net sales, respectively.

General & Administrative

General and administrative expenses were $509,000, or 20% of net sales, for the second quarter of 2003, as compared to $450,000, or 20% of net sales, for the same period in 2002. The increase of $59,000 was primarily due to an increase in investor relations expenses of $50,000 and compensation expenses of $27,000, offset in part by lower consulting expenses of $36,000. For the first six months of 2003, General and Administrative expenses were $966,000, or 19% of net sales, as compared to $854,000, or 18% of net sales, for the same period in 2002. The increase of $112,000 was chiefly due to higher levels of compensation of $93,000, investors relations expenses of $77,000 and legal and accounting expenses

of $31,000, offset partially by lower consulting expenses of $54,000 and a lower provision for doubtful accounts of $49,000.

Liquidity and Capital Resources

As of June 30, 2003, we had approximately $3.7 million of cash and cash equivalents, an increase of $203,000 from December 31, 2002. The increase in cash and cash equivalents was mostly attributable to positive cash flows from operations of $281,000 due to improved net income, offset in part by purchases of equipment of $99,000.

As of June 30, 2003, net accounts receivable were $765,000 compared to $444,000 as of December 31, 2002. The increase in net accounts receivable was mainly attributable to higher sales in June of 2003.

Net inventories as of June 30, 2003 were $872,000 compared to $1.1 million as of December 31, 2002. The reduction in inventory was mainly due to more components being used in production than components purchased in the same period.

We lease our corporate headquarters in Morgan Hill, California. The lease on the Morgan Hill facility has a term of five years, expiring in December 2005, with one conditional three-year renewal option, which if exercised would extend the lease to December 2008 commencing with rent at 95% of fair market value. As of June 30, 2003, future minimum payments under the lease were $663,000.

In December 2000, as a source of capital asset financing, we entered into a loan and security agreement with a finance company for an amount of $75,000. This loan bears interest at 12.8% and is repayable by December 2006. As of June 30, 2003, the aggregate value of future minimum payments was $59,000.

In April 2001, as a source of capital asset financing, we entered into a loan and security agreement with a finance company for an amount of $25,000. This loan bears interest at 12.5% and is repayable by April 2004. As of June 30, 2003, the aggregate value of future minimum payments was $7,000.

We have a $3.0 million collateralized revolving line of credit with a bank, which expires in March 2004, pursuant to which we may borrow 100% against pledges of cash at the bank's prime rate. Borrowings under this line of credit agreement are collateralized by all of our assets. As of June 30, 2003, we were in compliance with the terms of the agreement and had no borrowings outstanding under the line of credit.

We believe that our existing cash balances and anticipated cash flows from operations will be sufficient to meet our anticipated capital requirements for the next 12 months. However, a

decline in future orders and revenues might require us to seek additional capital to meet our working capital needs during or beyond the next twelve months if we are unable to reduce expenses to the degree necessary to avoid incurring losses. If we have a need for additional capital resources, we may be required to sell additional equity or debt securities, secure additional lines of credit or obtain other third party financing. The timing and amount of such capital requirements cannot be determined at this time and will depend on a number of factors, including demand for our existing and new products, if any, and changes in technology in the networking industry. There can be no assurance

that such additional financing will be available on satisfactory terms when needed, if at all. Failure to raise such additional financing, if needed, may result in our inability to achieve our long-term business objectives. To the extent that additional capital is raised through the sale of additional equity or convertible debt securities, the issuance of such securities would result in additional dilution to our shareholders.

In addition, because we are dependent on a small number of distributors for a significant portion of the sales of our products, the loss of any of our major distributors or their inability to satisfy their payment obligations to us could have a significant adverse effect on our business, operating results and financial condition.

We believe that, for the periods presented, inflation has not had a material effect on our operations.

Recent Accounting Pronouncements:

In November 2002, the EITF reached a consensus on Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21"). EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of multiple products, services and/or rights to use assets. The provisions of EITF 00-21 will apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. We are currently assessing the impact of the adoption of this pronouncement on its consolidated financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). FIN 46 addresses consolidation by business enterprises of variable interest entities. Under that interpretation, certain entities known as Variable Interest Entities ("VIEs") must be consolidated by the primary beneficiary of the entity. The primary beneficiary is generally defined as having the majority of the risks and rewards arising from the VIE. For VIEs in which a significant (but not majority) variable interest is held, certain disclosures are required. FIN 46 applies immediately to variable interest entities created after January 31, 2003, and applies in the first year or interim period beginning after June 15, 2003 to variable interest entities in which an enterprise holds a variable interest that it acquired before February 1, 2003. We do not believe the adoption of this interpretation will have a material impact on our consolidated results of operations, financial position or cash flows.

In April 2003, the FASB issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. The new guidance amends SFAS No. 133 for decisions made as part of the Derivatives Implementation Group ("DIG") process that effectively required amendments to SFAS No. 133, and decisions made in connection with other FASB projects dealing with financial instruments and in connection with implementation issues raised in relation to the application of the definition of a derivative and characteristics of a derivative that contains financing components. In addition, it clarifies when a derivative contains a financing

component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. We do not believe

the adoption of SFAS No. 149 will have a material impact on our consolidated results of operations, financial position or cash flows.

In May 2003, the FASB issued SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity." This Statement establishes standards for how an issuer classifies and measures in its statement of financial position certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that is within its scope as a liability (or an asset in some circumstances) because that financial instrument embodies an obligation of the issuer. This Statement is effective for financial instruments entered into or modified after May 31, 2003 and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003, except for mandatorily redeemable financial instruments of nonpublic entities. For nonpublic entities, mandatorily redeemable financial instruments are subject to the provisions of this Statement for the first period beginning after December 15, 2003. SFAS No. 150 is to be implemented by reporting the cumulative effect of a change in accounting principle for financial instruments created before the issuance date of the statement and still existing at the beginning of the interim period of adoption. We do not believe the adoption of SFAS No. 150 will have a material impact on our consolidated results of operations, financial position or cash flows.

RISK FACTORS

Shareholders or investors considering the purchase of shares of our common stock should carefully consider the following risk factors, in addition to other information in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K for the year ended December 31, 2002. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations.

Our revenue and operating results have fluctuated in the past and are likely to fluctuate significantly in the future, particularly on a quarterly basis.

Our operating results may vary significantly from quarter to quarter due to many factors, some of which are outside our control. For example, the following conditions could all affect our results:

|X| changes in our product sales and customer mix;
|X| constraints in our manufacturing and assembling operations;
|X| shortages or increases in the prices of raw materials and components;
|X| changes in pricing policy by us or our competitors;
|X| a slowdown in the growth of the networking market;
|X| seasonality;
|X| timing of expenditures; and
|X| economic conditions in the United States, Europe and Asia.

Our sales often reflect orders shipped in the same quarter in which they are received. In addition, significant portions of our expenses are relatively fixed in nature, and planned expenditures are based primarily on sales forecasts. Therefore, if the Company inaccurately forecasts demand for our products, the impact on net income may be magnified by the Company's inability to adjust spending quickly enough to compensate for the net sales shortfall.

Other factors contributing to fluctuations in our quarterly operating results include:

- changes in the demand for our products;
- customer order deferrals in anticipation of new versions of our products;
- the introduction of new products and product enhancements by us or our competitors;
- the effects of filling the distribution channels following introductions of new products and product enhancements;
- potential delays in the availability of announced or anticipated products;
- the mix of product and revenue derived from the sale of extended warranty contracts;
- the commencement or conclusion of significant development contracts;
- changes in foreign currency exchange rates; and
- the timing of significant marketing and sales promotions.

Based on the foregoing, we believe that quarterly operating results are likely to vary significantly in the future and that period-to-period comparisons of our results of operations are not necessarily meaningful and should not be viewed as indications of future performance.

We have a history of losses and a large accumulated deficit.

We have experienced significant operating losses and, as of June 30, 2003, had an accumulated deficit of $23.6 million. Our development and marketing of current and new products will continue to require substantial expenditures. We incurred $591,000 of losses in 2001 attributable to a slowdown in demand for our products due in part to industry-wide adverse economic factors. We have been profitable since the third quarter of 2001, with total net income of $659,000 in 2002 and $471,000 in the first six months of 2003. There can be no assurance that growth in net sales will be achieved or profitability sustained in future years.

Our common stock is listed on the Nasdaq SmallCap Market, and we have had difficulty satisfying the listing criteria to avoid the delisting of our common stock.

Our common stock has been listed on the Nasdaq SmallCap Market since April 1999. In order to maintain our listing on the Nasdaq SmallCap Market, we must maintain total assets, capital and public float at specified levels, and our common stock generally must maintain a minimum bid price of $1.00 per share. If we fail to maintain the standards necessary to be quoted on the Nasdaq SmallCap Market, our common stock could become subject to delisting. There can be no assurance that we will be able to maintain the $1.00 minimum bid price per share of our common stock and thus maintain our listing on the Nasdaq SmallCap Market. We have traded below $1.00 as recently as December 2002.

If our common stock is delisted, trading in our common stock could be conducted on the OTC Bulletin Board or in the over-the-counter market in what is commonly referred to as the "pink sheets." If this occurs, a shareholder will find it more difficult to dispose of our common stock or to obtain accurate quotations as to the price of our common stock. Lack of any active trading market would have an adverse effect on a shareholder's ability to liquidate an investment in our common stock easily and quickly at a reasonable price. It might also contribute to volatility in the market price of our common stock and could adversely affect our ability to raise additional equity or debt financing on acceptable terms or at all. Failure to obtain desired financing on acceptable terms could adversely affect our business, financial condition and results of operations.

The market for our products is affected by rapidly changing technology and if we fail to predict and respond to customers' changing needs, our business, operating results and financial condition may suffer.

The market for our products is affected by rapidly changing networking

technology, evolving industry standards and the Internet and other new communication technologies.

We believe that our future success will depend upon our ability to enhance our existing products and to identify, develop, manufacture and introduce new products that

|X| conform to or support emerging network telecommunications standards; |X| are compatible with a growing array of computer and peripheral devices; |X| support popular computer and network operating systems and applications; |X| meet a wide range of evolving user needs; and |X| achieve market acceptance.

There can be no assurance that we will be successful in these efforts.

We have incurred, and expect to continue to incur, substantial expenses associated with the introduction and promotion of new products. There can be no assurance that the expenses incurred will not exceed research and development cost estimates or that new products will achieve market acceptance and generate sales sufficient to offset development costs. In order to develop new products successfully, we are dependent upon timely access to information about new technological developments and standards. There can be no assurance that we will have such access or will be able to develop new products successfully and respond effectively to technological change or new product announcements by others.

We expect that printer and other peripheral manufacturers will add features to their products that make them more network accessible, which may reduce demand for our print servers. There can be no assurance that products or technologies developed by others will not render our products non-competitive or obsolete. The fax-on-demand market in general has been negatively affected by the growth of the Internet. Although we have new Web/fax/email products in development, there can be no assurance these products will compete successfully.

Complex products such as those offered by us may contain undetected or unresolved hardware defects or software errors when they are first introduced or as new versions are released. Changes in our or our suppliers' manufacturing processes or the inadvertent use of defective components could adversely affect our ability to achieve acceptable manufacturing yields and product reliability. We have in the past discovered hardware defects and software errors in certain of our new products and enhancements after their introduction. There can be no assurance that despite testing by us and by third-party test sites, errors will not be found in future releases of our products, which would result in adverse product reviews and negatively affect market acceptance of these products.

The introduction of new or enhanced products requires us to manage the transition from the older products to the new or enhanced products or versions, both internally and for customers. We must manage new product introductions so as to minimize disruption in customer ordering patterns, avoid excessive levels of older product inventories and ensure that adequate supplies of new products can be delivered to meet customer demands. We have from time to time experienced delays in the shipment of new products. There can be no assurance that we will successfully manage future product transitions.

Our success depends upon the continued contributions of our key management, marketing, product development and operational personnel.

Our success will depend, to a large extent, upon our ability to retain and continue to attract highly skilled personnel in management, marketing,

product development and operations. Competition for employees in the computer and electronics industries is intense, and there can be no assurance that we will be able to attract and retain enough qualified employees. Volatility or lack of positive performance in our stock price may also adversely affect our ability to retain

and continue to attract key employees, many of whom have been granted stock options. Our inability to retain and attract key employees could have a material adverse effect on our product development, business, operating results and financial condition. We do not carry key person life insurance with respect to any of our personnel.

The introduction of new products may reduce the demand for our existing products and increase returns of existing products.

From time to time, we may announce new products, product versions, capabilities or technologies that have the potential to replace or shorten the life cycles of existing products. The release of a new product or product version may result in the write-down of products in inventory if this inventory becomes obsolete. We have in the past experienced increased returns of a particular product version following the announcement of a planned release of a new version of that product. There can be no assurance that product returns will not exceed our allowance for these returns in the future and will not have a material adverse effect on our business, operating results and financial condition.

If we fail to obtain components of our products from third-party suppliers and assembled finished products from our subcontractors, our business could suffer.

Our products require components procured from third-party suppliers. Some of these components are available only from a single source or from limited sources. In addition, we subcontract a substantial portion of our manufacturing to third parties for the assembly of finished products, and there can be no assurance that these subcontractors will be able to support our manufacturing requirements, at acceptable qualities and to deliver them to us in a timely manner. We purchase components on a purchase order basis, and generally have no long-term contracts for these components. If we are unable to obtain a sufficient supply of high-quality components from our current sources, we could experience delays or reductions in product shipments. Furthermore, a significant increase in the price of one or more of these components or our inability to lower component or sub-assembly prices in response to competitive price reductions could adversely affect our gross margin.

Government regulation could increase our costs of doing business and adversely affect our gross margin.

Certain aspects of the networking industry in which we compete are regulated both in the United States and in foreign countries. Imposition of public carrier tariffs, taxation of telecommunications services and the necessity of incurring substantial costs and expenditure of managerial resources to obtain regulatory approvals, or the inability to obtain regulatory approvals within a reasonable period of time, could have a material, adverse effect on our business, operating results and financial condition. This is particularly true in foreign countries where telecommunications standards differ from those in the United States. Our products must comply with a variety of equipment, interface and installation standards promulgated by communications regulatory authorities in different countries. Changes in government policies, regulations and interface standards could require the redesign of products and result in product

shipment delays which could have a material, adverse impact on our business, operating results and financial condition.

We depend on proprietary technology, and inability to develop and protect this technology or license it from third parties could adversely affect our business, operating results and financial condition.

Our success depends upon our technological expertise and proprietary software technology. We rely upon a combination of contractual rights and copyright, trademark and trade secret laws to establish and protect our technologies. It may be possible for unauthorized third parties to copy our products or to reverse engineer or obtain and use information that we regard as proprietary. In addition, the laws of some foreign countries either do not protect our proprietary rights or offer only limited protection. Given the rapid evolution of technology and uncertainties in intellectual property law in the United States and internationally, there can be no assurance that our current or future products will not be subject to third-party claims of infringement. Any litigation to determine the validity of any third-party claims could result in significant expense and divert the efforts our technical and management personnel, whether or not any litigation is determined in favor of us. In the event of an adverse result in litigation, we could be required to expend significant resources to develop non-infringing technology or to obtain licenses to the technology that is the subject of the litigation. There can be no assurance that the Company would be successful in this development or that any such licenses would be available on commercially reasonable terms. We also rely on technology licensed from third parties. There can be no assurance that these licenses will continue to be available upon reasonable terms, if at all. Any impairment or termination of our relationship with third-party licensors could have a material adverse effect on our business, operating results and financial condition. There can be no assurance that our precautions will be adequate to deter misappropriation or infringement of our proprietary technologies.

We have received, and may receive in the future, communications asserting that our products infringe the proprietary rights of third parties or seeking indemnification against the alleged infringement. There can be no assurance that third parties will not assert infringement claims against us with respect to current or future products or that any assertion may not require us to enter into royalty arrangements or result in costly litigation. Any claims, with or without merit, can be time consuming and expensive to defend. There can be no assurance that any intellectual property litigation will not have a material adverse effect on our business, operating results and financial condition.

Our stock price has been volatile, and is likely to continue to be volatile in the future.

The price of our common stock has fluctuated widely in the past. Sales of substantial amounts of our common stock, or the perception that such sales could occur, could adversely affect prevailing market prices for our common stock. Our management believes past fluctuations may have been caused by the factors identified above, and that these factors may continue to affect the market price of our common stock. Additionally, stock markets have experienced extreme price volatility in recent years. This volatility has had a substantial effect on the market price of our common stock and other high technology companies, often for reasons unrelated to operating performance. We anticipate that prices for our common stock may continue to be volatile. Future stock price volatility may result in the initiation of securities litigation against us, which may divert substantial management and financial resources and have an adverse effect on our business, operating results and financial condition.

We may require additional capital in the future, and may be unable to obtain this capital at all or on commercially reasonable terms.

The development and marketing of products requires significant amounts of capital. A decline in future orders and revenues might require us to seek additional capital to meet our working capital needs during or beyond the next twelve months if we are unable to reduce expenses to the degree necessary to avoid incurring losses. If we need additional capital resources, we may be required to sell additional equity or debt securities, secure additional lines

of credit or obtain other third party financing. The timing and amount of such capital requirements cannot be determined at this time and will depend on a number of factors, including demand for our existing and new products and changes in technology in the networking industry. There can be no assurance that additional financing will be available on satisfactory terms when needed, if at all. Failure to raise such additional financing, if needed, may result in our inability to achieve our long-term business objectives. To the extent that additional capital is raised through the sale of additional equity or convertible debt securities, the issuance of these securities would result in additional dilution to our shareholders.

The costs of compliance with recent developments in corporate governance regulation may affect our business, operating results and financial condition in ways that presently cannot be predicted.

Beginning with the enactment of the Sarbanes-Oxley Act of 2002, a significant number of new corporate governance requirements have been adopted or proposed through legislation and regulation by the Securities and Exchange Commission and the Nasdaq National Stock Market. We may have difficulty in complying with these requirements at all times in the future. Additionally, we expect these developments to increase our legal compliance and accounting costs, and to make some activities more difficult, such as stockholder approval of new stock option plans. We expect these developments to make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. These developments could make it more difficult for us to attract and retain qualified members of our board of directors, or qualified executive officers.

Voting control by officers, directors and affiliates may delay, defer or prevent a change of control.

At August 4, 2003, our officers and directors and their affiliates beneficially owned approximately 25% of the outstanding shares of common stock. Accordingly, together they had the ability to significantly influence the election of our directors and other corporate actions requiring shareholder approval. Such concentration of ownership may have the effect of delaying, deferring or preventing a change in control.

Provisions in our charter documents might deter a company from acquiring us, which could inhibit your ability to receive an acquisition premium for your shares.

Our Board of Directors has authority to issue shares of preferred stock and to fix the rights, including voting rights, of these shares without any further vote or action by the shareholders. The rights of the holders of our common stock will be subject to, and may be adversely affected by, the rights of the holders of any preferred stock that may be issued in the future. The

issuance of preferred stock, while providing desirable flexibility in connection with possible acquisitions and other corporate purposes, could have the effect of making it more difficult for a third party to acquire a majority of our outstanding voting stock, thereby delaying, deferring or preventing a change in control. Furthermore, such preferred stock may have other rights, including economic rights, senior to the common stock, and as a result, the issuance thereof could have a material adverse effect on the market.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We had no holdings of derivative financial or commodity instruments at March 31, 2003. However, we are exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. While much of our revenue is transacted in U.S dollars, some revenues and capital spending are transacted in Pounds Sterling. These amounts are not currently material to our financial statements; therefore, we believe that foreign currency exchange rates should not materially affect our overall financial position, results of operations or cash flows. The fair value of our money market accounts or related income would not be significantly impacted by increases or decreases in interest rates due mainly to the highly liquid nature of this investment.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Regulations under the Securities Exchange Act of 1934 require public companies, including our company, to maintain "disclosure controls and procedures," which are defined to mean a company's controls and other procedures that are designed to ensure that information required to be disclosed in the reports that it files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. Our chief executive officer and our chief financial officer, based upon their evaluation of our disclosure controls and procedures,, concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective for this purpose.

Changes in Internal Controls

There were no significant changes in our internal controls or, to our knowledge in other factors that have materially affected, or are reasonably likely to materially affect, these controls subsequent to the date of their evaluation, which occurred as of the evaluation date referenced in the above paragraph.

PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

None.

ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None

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

None.

ITEM 5. OTHER INFORMATION

In April 2003, our board of directors appointed Donald Rich to its audit committee. Mr. Rich, our former Chief Executive Officer and President, has been a director of the company since 1998. While Mr. Rich is not "independent" as defined by The Nasdaq Stock Market, he was appointed to the audit committee based on an exception that allows the appointment of one director who is not "independent" so long as that director, or his immediate family, is not an employee of the company. Neither Mr. Rich nor any member of his immediate family has been an employee of the company since April 2002.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

Additional Exhibit

In accordance with SEC Release No. 33-8212, Exhibits 32.1 and 32.2 are to be treated as "accompanying" this report rather than "filed" as part of the report.

31.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by Scott C. McDonald, Chief Executive Officer and President of Castelle

31.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, executed by Paul Cheng, Chief Financial Officer of Castelle

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Scott C. McDonald, Chief Executive Officer and President of Castelle

32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, executed by Paul Cheng, Chief Financial Officer of Castelle

(b) Reports on Form 8-K

During the second quarter of 2003, Castelle filed a Form 8-K

on April 23, 2003. Furnished under Item 9, "Regulation FD Disclosure", Castelle filed a press release regarding its financial results for its first fiscal quarter ended March 31, 2003.

SIGNATURES

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

CASTELLE

By: /s/ Scott C. McDonald Date: August 12, 2003
Scott C. McDonald
Chief Executive Officer and President
(Principal Executive Officer)

By: /s/ Paul Cheng Date: August 12, 2003
Paul Cheng
Vice President of Finance and Administration
Chief Financial Officer
(Principal Financial Officer and Principal Accounting Officer)