SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

(Mark One)

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

For the quarterly period ended March 31, 2003

or

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

For the transition period from ______ to ______.

Commission File Number 0-25186

CAPTARIS, INC.

(Name of Registrant as Specified in Its Charter)

Washington	**91-1190085**
(State of incorporation)	**(I.R.S. Employer Identification Number)**
10885 N.E. 4th Street, Suite 400	
Bellevue, WA	**98004**
(Address of principal executive offices)	**(Zip code)**

Registrant s telephone number, including area code: (425) 455-6000

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 whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes x No ¨

The number of outstanding shares of the registrant s common stock as of May 9, 2003 was 30,293,611.

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CAPTARIS, INC.

FORM 10-Q/A

For the Quarter Ended March 31, 2003

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PART I.

FINANCIAL INFORMATION

Explanatory Note: This amendment of our Quarterly Report on Form 10-Q/A of Captaris, Inc. sets forth restated financial statements and related disclosures to correct a computational error in the calculation of stock compensation expense for options subject to variable accounting for the three months ended March 31, 2003. See Note 2 to our unaudited condensed consolidated financial statements for further discussion of the restatement. Financial Statements (Part I, Item 1) and Management s Discussion and Analysis of Financial Condition and Results of Operations (Part I, Item 2) have been revised to reflect the restatement. For convenience and ease of reference, we are filing this Quarterly Report in its entirety, as amended. However, this amendment amends and restates only those Items of the previously filed Quarterly Report on Form 10-Q for the fiscal quarter ended March 31, 2003 which have been affected by the restatement as noted above. In order to preserve the nature and character of the disclosures set forth in such items as originally filed, no attempt has been made in this amendment to modify or update the disclosures in the original Quarterly Report on Form 10-Q except as required to reflect the effects of the restatement, to make revisions to the Notes to the unaudited condensed consolidated financial statements and to make the other revisions described above. As a result, this Quarterly Report on Form 10-Q/A contains forward-looking information, which has not been updated for events subsequent to the date of the original filing, and the Company directs you to its SEC filings made subsequent to that original filing date for additional information.

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Item 1. FINANCIAL STATEMENTS

CAPTARIS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

(unaudited)

	March 31, 2003 (As Restated See Note 2)	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 24,789	$ 21,971
Short-term investments, available for sale	18,926	30,519
Accounts receivable, net	15,570	17,811
Inventories	2,187	2,928
Deferred and income tax receivable	4,473	4,308
Prepaid expenses and other	2,101	1,544
Total current assets	68,046	79,081
Long-term investments, available for sale	28,058	20,599
Equipment and leasehold improvements, net	7,570	7,595
Restricted cash	1,000	1,000
Deferred income taxes	1,553	1,546
Goodwill	9,000	8,976
Intangible and other assets, net	2,365	2,480
Total assets	$ 117,592	$ 121,277
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 5,492	$ 7,204
Accrued compensation and benefits	3,435	4,186
Deferred revenue	8,385	8,185
Other accrued liabilities	2,295	3,401
Total current liabilities	19,607	22,976
Commitments and contingencies (Note 12)		
Shareholders equity:		
Preferred stock, par value $0.01 per share, 2,000,000 shares authorized; none outstanding		
Common stock, par value $0.01 per share, 120,000,000 shares authorized; 30,268,180 and 30,217,955 outstanding, respectively	303	302
Additional paid-in capital	61,282	60,539

Retained earnings	36,170	37,148
Accumulated other comprehensive income	230	312
Total shareholders equity	97,985	98,301
Total liabilities and shareholders equity	$ 117,592	$ 121,277

See the accompanying notes to unaudited condensed consolidated financial statements.

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CAPTARIS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Quarter Ended March 31,	
	2003	2002
	(As Restated See Note 2)	
Net sales:		
Software products	$ 15,700	$ 15,801
E-document services	5,910	5,742
Total net sales	21,610	21,543
Cost of sales:		
Software products	5,794	6,068
E-document services	2,108	2,096
Total cost of sales	7,902	8,164
Gross profit	13,708	13,379
Operating expenses:		
Research and development	2,805	2,698
Selling, general and administrative	12,147	12,095
Amortization of intangible assets	56	387
Restructuring charges (Note 6)		2,119
Stock compensation expense (benefit) (Note 7)	624	(204)
Patent settlement with AudioFax (Note 10)		875
Total operating expenses	15,632	17,970
Operating loss	(1,924)	(4,591)
Other income (expense):		
Interest	455	736
Other, net	(43)	(362)
Other income	412	374
Loss before income tax benefit and cumulative effect of change in accounting principle	(1,512)	(4,217)
Income tax benefit	(534)	(2,109)
Loss before cumulative effect of change in accounting principle	(978)	(2,108)

Cumulative effect of change in accounting principle (Note 5)		(2,695)
Net loss	$ (978)	$ (4,803)
Basic and diluted loss per common share prior to cumulative effect	$ (0.03)	$ (0.07)
Cumulative effect of change in accounting principle		(0.08)
Basic and diluted loss per common share	$ (0.03)	$ (0.15)
Weighted average common shares outstanding	30,220	31,824

See the accompanying notes to unaudited condensed consolidated financial statements.

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CAPTARIS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Quarter Ended March 31,	
	2003	2002
	(As Restated See Note 2)	
Cash flows from operating activities:		
Net loss	$ (978)	$ (4,803)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	1,137	1,420
Stock compensation expense (benefit)	624	(204)
Stock issued for consulting services	6	
Cumulative effect of change in accounting principle		2,695
Restructuring and other charges		1,561
Changes in current assets and liabilities:		
Accounts receivable, net	2,266	328
Inventories	743	205
Prepaid expenses and other assets	(556)	(883)
Deferred tax asset	(176)	793
Accounts payable	(1,720)	(1,722)
Accrued compensation and benefits	(751)	(1,730)
Other accrued liabilities	(930)	1,772
Deferred tax liability		(1,935)
Net cash used by operating activities	(335)	(2,503)
Cash flows from investing activities:		
Purchase of equipment and leasehold improvements	(997)	(495)
Purchase of investments	(17,166)	(10,075)
Proceeds from sale of and principal pay downs on investments	21,236	9,793
Net cash provided (used) by investing activities	3,073	(777)
Cash flows from financing activities:		
Proceeds from exercise of common stock options	114	260
Net cash provided by financing activities	114	260
Net increase (decrease) in cash	2,852	(3,020)
Effect of exchange rate changes on cash	(34)	
Cash and cash equivalents at beginning of period	21,971	19,654

Cash and cash equivalents at end of period	$ 24,789	$ 16,634

See the accompanying notes to unaudited condensed consolidated financial statements

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CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Quarters ended March 31, 2003 and 2002

(Unaudited)

1. Interim Financial Statements

In the opinion of management, the accompanying unaudited condensed consolidated balance sheets and related interim consolidated statements of operations and cash flows have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, they do not include all of the information and notes required by accounting principles generally accepted in the United States of America for complete financial statements. All adjustments considered necessary for fair presentation have been included. Interim results are not necessarily indicative of results for a full year. These unaudited condensed consolidated financial statements should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the fiscal year ended December 31, 2002. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 amounts may differ from those estimates.

Certain prior-period balances have been reclassified to conform to the current period presentation.

2. Restatements

Subsequent to the filing of the Form 10-Q for the quarter ended March 31, 2003, management determined that certain employee stock based compensation subject to variable accounting had been computed incorrectly and that the financial statements must be restated to correct the error. The restatement involves a non-cash charge, which reflects the impact of a computational error in the calculation of stock compensation expense for options subject to variable accounting. The effect of the restatement increases net loss for the first quarter of 2003 by $88,000, having no effect on reported loss per share. The restatement adjustment recorded in the quarter ended March 31, 2003 includes amounts related to prior years which were not material. See also Note 7 for further discussion of stock based compensation.

A summary of the significant effects of the restatement (in thousands, except per share data) is as follows:

Quarter Ended

	March 31, 2003	
	As Previously Reported	As Restated
Restatement to correct stock compensation expense:		
Statement of operations data:		
Stock compensation expense	$ 482	$ 624
Income tax benefit	(480)	(534)
Net loss	(890)	(978)
Basic and diluted net loss per common share	(0.03)	(0.03)
Balance sheet data:		
Deferred and income tax receivable	$ 4,419	$ 4,473
Total current assets	67,992	68,046
Additional paid-in capital	61,137	61,282
Retained earnings	36,258	36,170
Total shareholders equity	97,931	97,985

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CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Quarters ended March 31, 2003 and 2002

(Unaudited)

In addition, the Company incorrectly calculated its stock compensation amounts for its pro forma disclosure under Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock Based Compensation,* as follows (in thousands, except per share data):

	Quarter Ended March 31, 2003	
	As Previously Reported	As Restated
Restatement to correct SFAS No. 123 disclosure including restatement of stock based compensation expense:		
Net loss, as reported	$ (890)	$ (978)
Add: Stock-based compensation expense, as reported, net of income taxes	313	384
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of income taxes	357	290
Net loss, pro forma	$ (934)	$ (884)
Net loss per share:		
Basic and diluted, as reported	$ (0.03)	$ (0.03)
Basic and diluted, pro forma	$ (0.03)	$ (0.03)

The Company is also restating its statement of cash flows for the three months ended March 31, 2003. Previously, the Company had not separately presented the effect of exchange rate changes on cash in its cash flow statement in accordance with SFAS No. 95, *Statement of Cash Flows.* The Company made other minor adjustments within the statement of shareholders equity for the three months ended March 31, 2003. Further, the common stock equivalent shares excluded from the calculation of diluted shares outstanding were restated for the quarter ended March 31, 2003 and 2002.

3. Segment Reporting

The Company has adopted SFAS No. 131, *Disclosures about Segments of an Enterprise and Related Information*. This standard requires segmentation based upon the Company s internal organization and disclosure of revenue and operating income based upon internal accounting methods. The segment information is provided for software products and e-document delivery services. Software products include the Company s telephony and computer-oriented products, as well as the Company s mobility products. Interest and other debt expense, provision for income taxes, interest income, and gains and losses on the disposition of marketable securities are not presented by segment since they are excluded from the measure of segment profitability reviewed by the Company s management. Corporate items include corporate expense items, impairment, restructuring, stock compensation and other charges, which are not allocated to operating segments. The Company s assets are managed on a company-wide basis; and, accordingly, asset information is not reported.

	Software Products	E-document Services	Corporate	Total
		(in thousands)		
Quarter ended March 31, 2003				
Net sales	$ 15,700	$ 5,910	$	$ 21,610
Operating income (loss)	(1,868)	999	(1,055)	(1,924)
Quarter ended March 31, 2002				
Net sales	$ 15,801	$ 5,742	$	$ 21,543
Operating income (loss)	(4,501)	747	(837)	(4,591)

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CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Quarters ended March 31, 2003 and 2002

(Unaudited)

The Company s sales by country, as determined by shipping destination, were as follows:

	Quarter Ended March 31,	
	2003	**2002**
	(in thousands)	
United States	$ 17,298	$ 17,420
Canada	771	407
United Kingdom	619	1,044
Other	2,922	2,672
Total net sales	$ 21,610	$ 21,543

4. OEM Agreement

In January 2002, the Company entered into an original equipment manufacturing (OEM) agreement with Cisco Systems, Inc., under which the Company has granted Cisco an exclusive third-party license to certain enabling technology. The agreement generally provides for quarterly payments to be made by Cisco to the Company through mid-2005. However, the timing and amount of these payments are subject to a number of conditions, some of which are beyond the control of the Company, and there can be no assurance that any additional payments will be received. Future payments depend on Cisco s ability to successfully implement the technology and, under certain conditions, Cisco may accelerate the payments at a discounted rate or terminate the license and make no further payments. The Company received a payment of $833,000 in 2001 and received payments of $2.5 million in 2002. The Company recognized $3.3 million in revenue from this agreement in 2002, of which $98,000 was recognized in the first quarter of 2002. The Company did not receive a payment, or recognize revenue, from Cisco in the first quarter of 2003. Revenue related to the Company s OEM agreement with Cisco Systems is generally recorded as cash payments are received. However, if payments are received ahead of schedule, a portion would be deferred to account for future support periods.

5. Cumulative Effect of Change in Accounting Principle

Effective January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangibles Assets,* which eliminates the amortization of goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with finite lives, and addresses impairment testing and recognition for goodwill and intangible assets. The company evaluated its other intangible assets, including core technology, customer lists, and other and determined that these assets have finite lives. Additionally, a $2.7 million non-cash charge was recognized in the first quarter of 2002 as a cumulative effect of change in accounting principle as a result of the impairment of goodwill. SFAS No. 142 prescribes an impairment testing of goodwill to be performed at least annually. The Company completed this annual evaluation during the first quarter of 2003 noting no additional impairment.

6. Restructuring Charge

In January 2002, the Company announced a reduction of its workforce, affecting approximately 90 employees, or 18% of the total Company workforce. This reduction in force, primarily affecting the software products segment, resulted in the recognition of a restructuring charge of $2.1 million primarily related to severance. All costs associated with this reduction in force were paid as of December 31, 2002.

7. Stock Based Compensation

During the second quarter of 2001, the Company offered a limited non-compulsory exchange of employee stock options on a less than one-for-one basis. The exchange (which closed on July 10, 2001) resulted in the voluntary cancellation of employee stock options to purchase 3,135,720 shares of our common stock with varying exercise prices greater than $10.00 per share in exchange for 1,286,790 employee stock options with an exercise price of $2.11. The option exchange offer resulted in variable accounting treatment for a total of 1,993,250 options, representing the 1,286,790 new options granted in the exchange, as well as all employee options modified during the year. Variable accounting will continue until all options subject to variable accounting treatment are exercised, cancelled or expired. Variable accounting treatment will result in charges or credits, recorded to Stock-based compensation , dependent on fluctuations in quoted prices for the Company s common stock, multiplied by the number of stock options subject to variable accounting that are outstanding for the period, neither of which can be predicted. At March 31, 2003 and 2002 the Company had 1,282,806 and 1,598,752 options to purchase common shares subject to variable accounting. The Company recorded a charge of $624,000 and a benefit of $204,000 for the first quarter of 2003 and 2002, respectively.

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CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Quarters ended March 31, 2003 and 2002

(Unaudited)

Allocation of this stock compensation expense (benefit) to the operating categories is as follows:

	Quarter Ended March 31,	
	2003	2002
	(in thousands)	
Cost of sales	$ 47	$ (7)
Research and development	121	(35)
Selling, general and administrative	456	(162)
Total	$ 624	$ (204)

The Company accounts for stock options under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* under which no compensation cost has been recognized, as there is no difference between the exercise price and fair market value at the date of grant. Had compensation cost for stock option grants made in the first quarter of 2003 been determined using the fair value method consistent with SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company s net loss and loss per share would have been as shown in the following pro forma amounts:

	Quarter Ended March 31,	
	2003	2002
	(in thousands, except per share data)	
Net loss, as reported	$ (978)	$ (4,803)
Add: Stock-based compensation expense (benefit), as reported, net of income taxes	384	(106)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of income taxes	290	389

Net loss, pro forma	$ (884)	$ (5,298)
Net loss per share:		
Basic as reported	$ (0.03)	$ (0.15)
Basic pro forma	$ (0.03)	$ (0.17)
Diluted as reported	$ (0.03)	$ (0.15)
Diluted pro forma	$ (0.03)	$ (0.17)

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:

	Quarter Ended March 31,	
	2003	**2002**
Dividend yield	0.0%	0.0%
Volatility	69%	61.4%
Risk-free interest rate	2.81%	4.48%
Expected life (in years)	5	5

8. Net Income (Loss) Per Share

Basic earnings (loss) per common share were computed by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the year. Diluted earnings per common share were computed by dividing net income by the sum of the weighted average number of shares of common stock outstanding during the year, plus the net additional shares that would have been issued had all dilutive options and warrants been exercised less shares that would be repurchased with the proceeds from such exercise. Dilutive options are those that have an exercise price that is less than the average stock price during the period.

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CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Quarters ended March 31, 2003 and 2002

(Unaudited)

Potentially issuable common shares of 4,135,789 and 4,549,765 were excluded from the calculation of diluted shares outstanding for the quarters ended March 31, 2003 and 2002, respectively, as they were antidilutive.

9. Changes in Shareholders Equity

	Common Stock	Additional Paid in Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
			(in thousands)		
Beginning balance at December 31, 2002	$ 302	$ 60,539	$ 37,148	$ 312	$ 98,301
Net loss*			(978)		(978)
Exercise of stock options*	1	113			114
Stock based compensation expense*		624			624
Stock issued for consulting services*		6			6
Unrealized loss on investments, net of income tax*				(64)	(64)
Foreign currency translation adjustment*				(18)	(18)
Ending balance at March 31, 2003*	$ 303	$ 61,282	$ 36,170	$ 230	$ 97,985

* As restated. See Note 2.

Total comprehensive loss was $1,060,000 for the quarter ended March 31, 2003. Total comprehensive loss was $4,803,000 for the quarter ended March 31, 2002.

10. Patent Settlement with AudioFax

In April 2002, the Company entered into a nonexclusive license agreement with AudioFax IP LLC, settling a patent infringement suit filed by AudioFax on November 30, 2001. The Company paid a one-time fee to license the technology until the patents expire in 2008 and 2011. In the first quarter of 2002, the Company recorded an other charge of $875,000, reflecting management s assessment of the fair value of the portion of the license fee that relates to prior years. The balance of the license fee was capitalized and is being amortized over the remaining life of the licensor s patents. Amortization expense was $22,000 in the first quarter of 2003.

11. Legal Proceeding

On September 25, 2002, Lan-Aces, Inc. filed a complaint in the District Court of Harris County, Texas against the Company seeking damages of $600,000 plus attorney s fees for breach of contract. The Company removed the action to Federal Court in the Southern District of Texas on October 18, 2002. On January 23, 2003, Lan-Aces, Inc. filed an amended complaint adding unspecified statutory damages under the Copyright Act. The amended complaint alleges that the Company either breached an alleged agreement between the plaintiff and Infinite Technologies, Inc., or infringed plaintiff s copyright, with respect to software incorporated in the MailandNews.com website, a free Internet service acquired as part of the Infinite Technologies acquisition and subsequently transferred to an unrelated third party. Although the Company does not believe the ultimate outcome of this proceeding will have a material adverse effect on its results of operations, there can be no assurance in this regard.

12. Commitments and Contingencies

The Company periodically receives letters and other communications from third parties asserting patent rights and requesting royalty payments, and will probably receive additional claims in the future. For example, over the past six years, the Company has been involved in intermittent communications with Avaya, which was spun off from Lucent Technologies in 2001.

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CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Quarters ended March 31, 2003 and 2002

(Unaudited)

Over this period of time, Lucent/Avaya asserted that the Company was infringing on their patents or technology, eventually identifying 10 patents as including claims that allegedly cover the Company s current or former products and/or services. Several communications and meetings between the Company and Lucent/Avaya have occurred. The Company has also been in communication with BellSouth since December of 2001, at which time BellSouth asserted that the Company was infringing on two of its patents. Analysis of both patents in light of the Company s current and former products/services is still underway. The last communication with representatives of BellSouth was on June 19, 2003. The ultimate outcome of these matters cannot presently be determined. Accordingly, the ultimate resolution of these matters could have a material adverse effect on the Company s financial position, cash flow and results of operations.

13. New Accounting Pronouncements

In April 2003, the Financial Accounting Standards Board (FASB) issued SFAS No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. SFAS No. 149 amends and clarifies certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. SFAS No. 149 is effective for certain contracts entered into or modified by the Company after June 30, 2003. The adoption of SFAS No. 149 is not expected to have a material impact on the Company s financial position or results of operations.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments With Characteristics of Both Liabilities and Equity. SFAS No. 150 establishes standards for how the Company would classify and measure financial instruments with characteristics of both liabilities and equity and requires the Company to classify a financial instrument that is within the scope of SFAS No. 150 as a liability (or an asset in some circumstances). SFAS No. 150 also revises the definition of a liability to encompass obligations that the Company can or must settle by issuing equity shares, depending on the nature of the relationship established between the Company and a holder of its stock. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003. The adoption of SFAS No. 150 is not expected to have a material impact on the Company s financial position or results of operations.

In November 2002, the Emerging Issues Task Force (EITF) published its consensus on EITF No. 00-21, *Revenue Arrangements with Multiple Deliverables*. EITF No. 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 No. 00-21 apply to revenue arrangements entered into in fiscal periods beginning after June 15, 2003. The Company adopted EITF No. 00-21 on July 1, 2003. The adoption of EITF No. 00-21 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

In November 2002, the FASB issued FASB Interpretation (FIN) No. 45, *Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. FIN No. 45 elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under guarantees issued. FIN No. 45 also clarifies that a guarantor is required to recognize, at inception of a guarantee, a liability for the fair value of the obligation undertaken. In addition, FIN No. 45 also requires a guarantor to make significant new disclosures, even when the likelihood of making any payments under the guarantee is remote. In general, FIN No. 45 applies to contracts or indemnification agreements that contingently require the guarantor to make payments to the guaranteed party based on changes in an underlying obligation that is related to an asset, liability or an equity security of the guaranteed party. The initial recognition and measurement provisions of FIN No. 45 are applicable to guarantees issued or modified after December 31, 2002. The disclosure requirements are effective for financial statements of interim and annual periods ending after December 15, 2002. The adoption of FIN No. 45 did not have a material impact on the Company s consolidated financial position, results of operations or cash flows.

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

This discussion and analysis should be read in conjunction with our unaudited condensed consolidated financial statements and accompanying notes included in this document and the 2002 audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on March 31, 2003.

The following discussion of our financial condition and results of operations contains forward-looking statements that involve risks and uncertainties, such as statements of our plans, objectives, expectations and intentions. Words such as believes, expects, anticipates, intends, plans and similar expressions are intended to identify forward-looking statements. Captaris actual results could differ materially from those anticipated in these forward-looking statements for many reasons, including the factors described below and under the caption Factors that May Affect Our Business, Future Operating Results, Financial Condition and Market Price of Our Stock set forth at the end of this Item 2. You should not place undue reliance on these forward-looking statements, which apply only as of the date of this Form 10-Q.

Restatement

The accompanying management s discussion and analysis of financial condition and results of operations gives effect to the restatement of the condensed consolidated financial statements for the period ended March 31, 2003 as described in Note 2 to the condensed consolidated financial statements.

Overview

The Company is a leading provider of business communication software solutions for medium and large-sized enterprises, which the Company considers to be primarily enterprises with 250-5,000 employees. The Company provides flexible, cost-effective products for information delivery, unified communications, and mobile business solutions. These products address the electronic document (e-document) delivery, fax server, unified messaging, voice messaging, and mobile wireless markets and are distributed primarily through independent distributors and value-added resellers worldwide. The Company s products run on industry standard server hardware, support Windows-based operating systems, and interface with a wide variety of leading enterprise applications and telephony and computer equipment. The Company also offers an e-document delivery service, including both broadcast fax and permission-based e-mail services. These services are offered to customers primarily through a direct sales force.

The Company s product lines include electronic document delivery and unified communications products, as well as, outsourced electronic document delivery services. The Company s computer-oriented product lines target the fax server and production fax markets and focus on high-performance fax processing and unified messaging, as well as Internet, corporate intranet and phone-based information access. The Company s telephony-oriented product lines serve the messaging markets and focus on voice and call processing, unified messaging, and personal and workgroup call management. E-document delivery services target the outsourced mass fax and permission e-mail markets for time-critical business-to-business (B2B) communications. These services include high-volume, IP fax and e-mail broadcast and merge offerings, fax reply and fax-on-demand applications as well as industry-specific services and custom workflow solutions for unique customer requirements.

The Company sells its products primarily through an indirect channel of resellers and distributors, as well as through direct sales, OEM and private label agreements. The Company s data oriented enhanced fax products include RightFax and RightFax Enterprise, the Company s

LAN-based fax server lines for Windows based operating systems, and the RightFax Production System, a high-volume production-oriented server that enables fax and other forms of electronic transmission for electronic commerce applications. The Company s telephony-oriented products include: CallXpress, and CallXpress Enterprise, a multi-application, high capacity voice and unified messaging platform and PhoneXpress, a full-featured advanced messaging system for small to medium-sized enterprises. The Company s e-document delivery services, branded under the name MediaLinq, offer high-volume, simultaneous delivery of fax and e-mail documents via the Web, from desktop software or a fax machine.

Results of Operations

The Company derives net sales primarily from initial sales of software and licenses, outsourced e-document delivery services as well as follow-on sales of add-on software modules and product upgrades. Sales to resellers, distributors and end-users are recognized when the products are shipped unless the sale includes acceptance provisions. Sales of fully integrated systems are no longer significant. The Company continues to distribute both fax and voice circuit boards with a significant number of its software product sales for which the Company receives a margin significantly less than the margin on its software products. The sales mix among the Company s product categories and the circuit board content of its product sales affect both net sales and gross margin. Additionally, the Company receives maintenance fees for providing technical support and/or product upgrades. The Company recognizes maintenance revenue ratably over the life of the maintenance contract. Revenue from outsourced e-document delivery services is recognized at the time the service is provided.

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Net Sales and Gross Margin

	Quarter ended March 31, 2003	% of total net sales	Change from prior year quarter	Quarter ended March 31, 2002	% of total net sales
			(in thousands)		
Net Sales:					
E-document products	$ 13,358	61.8%	$ 1,146	$ 12,212	56.7%
Other software products	2,342	10.8	(1,247)	3,589	16.6
Total software products	15,700	72.6	(101)	15,801	73.3
E-document services	5,910	27.4	168	5,742	26.7
Total net sales	$ 21,610	100%	$ 67	$ 21,543	100%
Gross Margin:					
Software products	$ 9,906		$ 173	$ 9,733	
E-document services	3,802		156	3,646	
Total gross margin	$ 13,708	63.4%	$ 329	$ 13,379	62.1%

Net Sales

E-document product sales, which represent sales of the Company s RightFax products and related maintenance and upgrade revenues, increased 9.4% over the first quarter of 2002. Management attributes this increase in sales to a renewed focus on, and investment in, marketing efforts that began in the prior year and continued into 2003. E-document product sales were primarily generated through the Company s indirect channel of distributors. The decline in other software products net sales is attributable to a decline in demand for the Company s messaging products. The Company believes demand for these messaging products has been slow industry-wide, and that net sales for messaging products has been negatively impacted by levels of IT spending and continued softness in telephony related spending in general. Net sales of mobility products are also included in other software products and continue to be insignificant.

The Company did not receive a payment, nor did it recognize revenue, from its OEM agreement with Cisco Systems during the first quarter of 2003. Revenue from this agreement was $98,000 in the first quarter of 2002. The company does not currently expect a payment from Cisco in the second quarter of 2003. Revenue from this agreement is currently anticipated to range between $3.0 million and $5.0 million for 2003. However, this anticipated revenue depends on the receipt of future payments from Cisco. The timing and amount of these payments are subject to a number of conditions, some of which are beyond the control of the Company and there can be no assurance that any additional payments will be made. In particular, future payments depend on Cisco s ability to successfully implement the technology. In addition, under certain conditions Cisco may accelerate the payments at a discounted rate or terminate the license and make no further payments.

Outsourced e-document services net sales are derived from the Company s MediaLinq services group that is a provider of broadcast fax and permission email services. Net sales of these services increased 2.9% over the first quarter of 2002 and are attributable to increases in revenue from permission email and the Company s ability to increase volume with relatively stable pricing for its broadcast fax business. There can be no assurances that recent relatively stable pricing trends will continue.

International sales increased 4.6% over the first quarter of 2002 and represented 20.0% and 19.1% of total net sales for the first quarter of 2003 and 2002, respectively.

Gross Profit

Gross margin for software products increased to 63.1% in the first quarter of 2003 as compared to 61.6% for the first quarter of 2002. This increase is attributable to favorable product mix, which contained a greater portion of higher margin RightFax product sales. Gross margin for the services group increased from 63.5% in the first quarter of 2002 to 64.3% in the same period in 2003. The increase reflects the Company s ability to manage its switch and service related costs and continued favorable pricing on long distance rates that are a significant portion of this group s cost of providing services. The Company expects gross margin percentages to remain relatively constant and could increase later in the year depending on the amount and timing of future revenues from the Company s OEM agreement with Cisco Systems. Realization of revenue from the Cisco OEM agreement has a material impact on the Company s margin percentage as this revenue carries a significantly higher margin than normal product and service sales.

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Research and Development

	2003	Change from 2002	2002
		(in thousands)	
Research and development	$ 2,805	$ 107	$ 2,698

Research and development costs were 13.0% and 12.5% of sales in the first quarter of 2003 and 2002, respectively. The increase in such expenses is nominal and represents normal fluctuation in spending. Research and development costs are expected to remain relatively constant throughout 2003.

Selling, General and Administrative

	2003	Change from 2002	2002
		(in thousands)	
Selling, general and administrative	$ 12,147	$ 52	$ 12,095

Selling, general and administrative costs remained consistent as a percentage of sales and increased slightly in total. Headcount in these areas is down over the first quarter of last year but the Company has increased its investment in marketing and promotion in an effort to maintain or increase sales volume over 2002. The Company anticipates such levels of spending to remain relatively constant throughout 2003. The Company s relocation of its corporate headquarters office did not result in significant out of pocket charges as such costs were primarily covered by allowances contained in its new lease.

Restructuring and Other Charges

In January 2002, the Company announced a reduction of its workforce, affecting approximately 90 employees, or 18% of the total Company workforce. This reduction in force, primarily affecting the software products segment, resulted in the recognition of a restructuring charge of $2.1 million related to severance, impairment of certain assets and non-cancelable lease obligations. All costs associated with this reduction in force were paid as of December 31, 2002.

In April 2002, the Company entered into a nonexclusive license agreement with AudioFAX IP LLC, settling a patent infringement suit filed by AudioFAX on November 30, 2001. The Company paid a one-time fee to license the technology until the patents expire in 2008 and 2011. In the first quarter of 2002, the Company recorded a charge of $875,000, included in other charges, reflecting management s assessment of the fair value of the portion of the license fee that relates to prior years. The balance of the license fee, the amount of which is confidential, was capitalized and is being amortized over the remaining life of the licensor s patents. Amortization expense in the first quarter of 2003 totaled $22,000.

Stock-Based Compensation

During the second quarter of 2001, the Company offered a limited non-compulsory exchange of employee stock options on a less than one-for-one basis. The exchange (which closed on July 10, 2001) resulted in the voluntary cancellation of employee stock options to purchase 3,135,720 shares of our common stock with varying exercise prices greater than $10.00 per share in exchange for 1,286,790 employee stock options with an exercise price of $2.11. The option exchange offer resulted in variable accounting treatment for a total of 1,993,250 options, representing the 1,286,790 new options granted in the exchange as well as all employee options modified during the year. Variable accounting treatment will result in charges or credits, recorded to Stock-based compensation, dependent on fluctuations in quoted prices for the Company s common stock, multiplied by the number of stock options subject to variable accounting that are outstanding for the period, neither of which can be predicted. At March 31, 2003 and 2002 the Company had 1,282,806 and 1,598,752 options to purchase common shares subject to variable accounting. The Company recorded a charge of $624,000 and a benefit of $204,000 for the first quarter of 2003 and 2002, respectively.

Other Income, Net

Other income, net remained relatively constant in total as a result of the offsetting effects of the decline in interest income versus the decline in other expenses for which the prior year amounts are items that did not reoccur in the first quarter of 2003. The decline in interest income was driven by the decrease in available interest rates. Assuming interest rates remain at recent levels, the Company expects interest income to further decline, as rates on maturing investments are greater than rates currently available.

Income Tax Benefit

The effective income tax benefit rate for the first quarter of 2003 was 35.3%.

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Cumulative Effect of Change in Accounting Principle

Effective January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangibles Assets,* which eliminates the amortization of goodwill and indefinite-lived intangible assets, addresses the amortization of intangible assets with finite lives, and addresses impairment testing and recognition for goodwill and intangible assets. The company evaluated its other intangible assets, including core technology, customer lists, and other and determined that these assets have finite lives. Additionally, a $2.7 million non-cash charge was recognized as a cumulative effect of change in accounting principle as a result of the impairment of goodwill. SFAS No. 142 prescribes an impairment testing of goodwill to be performed at least annually. The Company completed this annual evaluation during the first quarter of 2003 noting no additional impairment.

Liquidity and Capital Resources

Cash used by operating activities in the three months ended March 31, 2003 was $335,000 driven primarily by the quarter net loss and changes in working capital accounts. The accounts receivable collection period was approximately 64 days at March 31, 2003. The Company faces credit risks with customers and partners in its distribution model and therefore maintains appropriate accruals for such exposures, while continuing to closely monitor reserves. Net accounts receivables decreased from $17.8 million at December 31, 2002 to $15.6 million at March 31, 2003.

In August 2000, the Board of Directors approved a plan to repurchase up to $15 million of the Company s common stock. At March 31, 2003, $10 million remains available under this repurchase program. No repurchases were made during the first quarter of 2003 or the first quarter of 2002. The Company may repurchase shares in the future subject to open trading windows, overall market conditions, stock prices, and the Company s cash position and requirements going forward.

The Company expects that its current cash, short-term investments, and available bank line of credit will provide sufficient working capital for operations for the foreseeable future.

Contractual Obligations and Commercial Commitments

The following table summarizes the Company s contractual obligations and commercial commitments as of March 31, 2003 and the effect such obligations are expected to have on liquidity in future periods:

	Payments Due by Period				
Contractual Obligations	**Total**	**Less than 1 year**	**1-3 years**	**3-5 years**	**After 5 years**
			(in thousands)		
Operating Lease Obligations	$ 7,122	$ 2,028	$ 2,921	$ 2,173	
Co-op advertising	507	507			

The Company periodically receives letters and other communications from third parties asserting patent rights and requesting royalty payments, and will probably receive additional claims in the future. For example, over the past six years, the Company has been involved in intermittent communications with Avaya, which was spun off from Lucent Technologies in 2001. Over this period of time, Lucent/Avaya asserted that the Company was infringing on their patents or technology, eventually identifying 10 patents as including claims that allegedly cover the Company s current or former products and/or services. Several communications and meetings between the Company and Lucent/Avaya have occurred. The Company has also been in communication with BellSouth since December of 2001, at which time BellSouth asserted that the Company was infringing on two of its patents. Analysis of both patents in light of the Company s current and former products/services is still underway. The last communication with representatives of BellSouth was on June 19, 2003. The ultimate outcome of these matters cannot presently be determined. Accordingly, the ultimate resolution of these matters could have a material adverse effect on the Company s financial position, cash flow and results of operations.

At March 31, 2003, the Company had a $4.0 million unsecured revolving line of credit, $2.0 million for unsecured borrowings and $2.0 million dollars reserved for letters of credit. As of March 31, 2003, the Company utilized $1.0 million of its letter of credit capacity in conjunction with its corporate headquarters lease. The Company has placed $1.0 million in a restricted certificate of deposit with the bank that supports the letter of credit. The Company did not borrow under its line of credit during the year ended December 31, 2002 and did not borrow in the quarter ended March 31, 2003. The line expires in August 2004, and contains certain financial covenants and restrictions as to various matters, including restrictions on the Company s ability to pay cash dividends without the bank s prior approval. Borrowings under the line of credit bear interest at the bank s prime rate or, at the Company s option, the one, two, three or six month LIBOR rate plus 1.50%.

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FACTORS THAT MAY AFFECT OUR BUSINESS, FUTURE OPERATING RESULTS,

FINANCIAL CONDITION AND MARKET PRICE OF OUR STOCK

The following factors may materially adversely affect the Company s business, financial condition or results of operations. In that event, the trading price of the Company s common stock could decline and shareholders may lose part or all of their investment, therefore, shareholders should carefully consider the risks described below before making an investment decision.

Our stock price may be highly volatile.

The market price of our common stock may continue to be highly volatile. The future price of our common stock may fluctuate in response to factors, involving our competitors, or us, such as

- new product announcements or changes in product pricing policies;
- quarterly fluctuations in our operating results;
- announcements of technical innovations;
- announcements relating to strategic relationships or acquisitions;
- changes in earnings estimates by securities analysts; and
- general conditions in the economy, levels of IT spending and/or the computer-telephony market.

In addition, the market prices of securities issued by many companies, particularly in high-technology industries, are volatile for reasons unrelated to the operating performance of the specific companies. This industry volatility, along with broad market fluctuations may adversely affect the market price of our common stock.

Our operating results fluctuate from quarter to quarter, which could cause our operating results to fall below expectations of securities analysts and investors.

We expect our operating results to fluctuate significantly from quarter to quarter in the future. Because of these fluctuations, our operating results for a particular quarter may fall below the expectations of securities analysts and investors. If this occurs, the trading price of our common stock may decline. Such fluctuations could cause period-to-period comparisons to be less than meaningful. Numerous factors contribute to the unpredictability of our operating results, including

- the timing of customers orders;
- changes in our mix of products and distribution channels;
- the announcement or introduction of new products by us or our competitors;
- pricing pressures; and
- general economic conditions.

Most of our software product revenue comes from current-quarter orders and sales, of which a substantial portion has, at times, occurred in the last month of the quarter. We do not maintain a large backlog of orders, and most of our distributors maintain little or no inventory. Order fulfillment cycles are typically short, and often as short as one to two days. Accordingly, the timing of customer orders can cause significant variations in quarterly results of operations. Because we sell our products to end-customers through various third parties such as telephone system manufacturers, value-added resellers, telephone interconnect resellers, and others, we are unable to project with certainty the actual orders, sales, and revenues these third parties will generate in a given quarter. The combination of these factors impairs and delays our ability to know when revenues and earnings will be higher or lower than expected. We base product development and other operating expenses on our expected revenues. Because our expenses are relatively fixed in the short term, we may be unable to adjust our spending in time to compensate for any unexpected shortfall in quarterly revenues.

Our revenue, and therefore our results of operations, may also fluctuate based on the amount of revenue, if any, we receive pursuant to our original equipment manufacturing (OEM) agreement with Cisco Systems, Inc. Under the agreement, the Company has granted Cisco an exclusive third-party license to certain enabling technology. The agreement generally provides for quarterly payments to be made by Cisco to the Company through mid-2005. The Company received a payment of $833,000 in 2001 and received payments totaling $2.5 million in 2002. The Company recognized $3.3 million in revenue from this agreement in 2002. The Company received no payments and recognized no revenue in the first quarter of 2003. The timing and amount of any future payments under the agreement are subject to a number of conditions, some of which are beyond our control. In particular, future payments depend on Cisco s ability to successfully implement the technology. In addition, under certain conditions, Cisco may accelerate the payments at a discounted rate or terminate the license and make no further payments. Accordingly, there can be no assurance that any additional payments will be made under the agreement or that any payments that are made will be made on the schedule we anticipate, which could have an adverse impact on our results of operations generally or in a particular quarter.

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Our operating results may vary by season, which could cause our operating results to fall below expectations of securities analysts and investors.

Our results of operations may fluctuate as a result of seasonal factors, and this may cause our operating results to fall below the expectations of securities analysts and investors for a particular quarter. Specifically, due to typical year-end dealer sales patterns and end-user buying patterns, net product sales in our first quarter, without taking into account the effect of acquisitions, have historically declined from the fourth quarter of the previous year. Historically, the services segment has experienced seasonally low net sales in the fourth quarter as a result of the impact of the holiday season on broadcast fax and email services.

We depend on third parties for certain key components of our products and for certain services necessary to the delivery of our broadcast fax and email services.

Our products operate on standard computer hardware, most of which is readily available. However, only two domestic suppliers can provide fax processing circuit boards to meet our specifications. In addition, only three domestic suppliers can provide voice-processing circuit boards to meet our specifications. Historically, we have relied almost exclusively on Brooktrout, Inc. for fax cards and on Dialogic Corporation (now a division of Intel Corporation) for voice cards. We rely on these suppliers primarily because of volume price discounts and the cost and effort required to develop software for an alternate fax or voice card. Significant changes in technology, issues regarding quality performance, delays, interruptions or reductions in our supply of fax or voice cards, or unfavorable changes to price and delivery terms could adversely affect our business.

In the Company s services segment, we are dependent on long distance service providers to provide access to the PSTN and on ISP s to provide access to the Internet.

We rely heavily on telephone system manufacturers, independent equipment resellers and value-added resellers.

A substantial majority of our net sales depends on a network of computer-oriented value-added resellers and independent telephone equipment resellers. There is intense competition for the attention of these resellers from our competitors and from providers of other products distributed through these channels. Many of these resellers do not have the financial resources to withstand a downturn in their businesses. We may not be able to maintain or expand our network of resellers in the future. Moreover, our resellers may not maintain or expand their present level of efforts to sell our products. If we lose a major dealer or reseller, or if our dealers and resellers lose interest in selling our products, our business, results of operations and financial condition may be adversely affected.

Failure to establish and maintain strategic relationships could limit our ability to maintain or increase sales.

Creating and maintaining strategic relationships is important to our success because these relationships enable us to market and distribute our products to a larger customer base than we could otherwise reach through our direct marketing efforts. We currently have strategic relationships with Ericsson, IBM (Lotus), Verizon, Xerox Corporation, Cisco Systems and others. However, we may not be successful in creating new strategic relationships on acceptable terms, if at all. Moreover, although we view our strategic relationships as an important factor in the successful commercialization of our products and services, our current strategic partners may not view their relationships with us as significant for their own businesses and any one of them could reassess their commitment to us in the future. Further, our strategic relationships are generally non-exclusive, which means our strategic partners may develop relationships with some of our competitors. Failure of one or more of our strategic partners to successfully develop and sustain a market for our services, or the termination of one or more of our strategic relationships, could adversely affect our ability to maintain or increase sales.

Additionally, our strategic partners from time to time require us to customize our products and/or develop further enhancements or capabilities. If we are unable to meet these requests in a timely manner, our relationships with our partners and operating results could be negatively impacted.

Our market is highly competitive.

The business communications market is highly competitive. We may not have the financial resources, marketing, distribution and service capability, and depth of key personnel or technological knowledge to continue to compete successfully in each of our markets.

We believe the main competitive factors affecting our business are breadth and quality of application software, product integration, ability to respond to technological change, quality of our sales force, price, size of the installed base, level of customer support and professional services.

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In the market for LAN-based fax systems, our principal competitors are Esker, S.A., ACCPAC International, Inc., TOPCALL International AG, Omtool, Ltd., Optus Software, Inc., and Biscom, Inc. Our fax server products also compete with vendors offering a range of alternative fax solutions, including operating systems containing fax and document transmission features, low-end fax modem products, desktop fax software, single-platform fax software products and customized proprietary software solutions. In the market for production fax systems, our principal competitors are Biscom, Inc., Esker, S.A. and Topcall International AG. In the e-document delivery services market, the Company s services segment, principal competitors are the Xpedite division of PTEK Holdings, telecommunications companies who provide fax services and other regionally-based specialty providers. Competitors to our mobility offerings include companies such as Research In Motion Limited, Microsoft Corporation (Mobile Information Server-MIS), IBM Corporation (International Business Machine s Lotus Domino Everyplace), Aether Systems, Inc., Wireless Knowledge, Fenestrae BV, Mobeon AB, and Openwave Systems, Inc.

In the telephony-oriented market for messaging systems, our principal competitors include PBX manufacturers like Avaya, Inc., Cisco Systems, Inc., Interactive Intelligence, Inc., Mitel Corporation, NEC America, Inc., Nortel Networks Corporation and Siemens. In addition, there are independent suppliers of computer-telephony solutions such as Cycos AG, Esna Technologies, Inc., and Teleware plc, who offer integrated voice-messaging systems and unified messaging systems that integrate with multiple PBX products, sold independently or as an OEM offering.

Further acceptance of open systems architectures and the development of industry standards in the call processing market may eliminate some of the technical barriers to entry, allowing additional competitors to enter the market. Many of our existing competitors have larger customer and installed bases and substantially greater technical, financial and marketing resources than the Company. In addition, some of our competitors have a marketing advantage because they can sell their call processing equipment or fax solutions as part of their broader product offerings. We believe our business has been, and may continue to be, adversely affected by the introduction of next-generation IP-PBX switches as potential customers delay purchasing decisions as they evaluate these new product offerings. We expect our competitors will continue to offer improved product technologies and capabilities. The availability of these products could cause sales of our existing products to decline. For these reasons, we may be unable to compete successfully against our current and future competitors.

Technology and customer demands change rapidly in our industry.

In our industry, technology and customer demands change rapidly, and the Company and its competitors frequently introduce new products and features. To succeed, we must identify, develop and market new products, features and services that achieve broad market acceptance by satisfying those changing customer needs and keeping pace with those technological developments. To do this, we must spend substantial funds on product development. We regularly devote significant resources to technologies that we anticipate will be widely adopted. The market for unified messaging software has not developed at the rate forecasted by many industry analysts. The market for mobile business solutions is relatively new and has, to date, not developed at the rate originally anticipated. To be successful, we must, among other things, develop and market products and services that achieve broad market acceptance. We may not be able to develop new products or product enhancements on a timely basis. Even if we do, the market may not accept the new products, product enhancements, or hosted services that we develop and accordingly, the results of our operations may be adversely affected.

We face risks from expansion of our international operations.

Maintaining or growing our revenue depends, in part, on continued expansion of our international product sales. We have focused significant management attention and financial resources on our international operations. Significant portions of our revenues are subject to the risks associated with international sales, which include

- difficulty adapting products to local languages and telephone system technology;
- inability to respond to changes in regulatory requirements;
- inability to meet special standards requirements;
- exposure to exchange rate fluctuations;
- tariffs and other trade barriers;
- difficulties in staffing and managing international operations;
- potentially adverse tax consequences; and
- uncertainties arising from local business practices and cultural considerations.

In addition, the laws of some foreign countries are uncertain or do not protect intellectual property rights to the same extent as the U.S. Moreover, we could be sued for patent infringement or other intellectual property violations in a foreign country where it could be very costly to defend such a lawsuit.

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Currently, substantially all of our sales are denominated in U.S. dollars. We do price our international sales to the United Kingdom and to participating European Community countries in U.K. Pounds and the Euro, respectively. Increases in the value of the dollar against any local currencies could cause our products to become relatively more expensive to customers in a particular country or region, leading to reduced sales or profitability in that country or region. As we continue to expand our international operations, we expect our non-U.S.-dollar-denominated sales and our exposure to gains and losses on international currency transactions to increase. We do not currently engage in transactions to hedge against the risk of currency fluctuations, but we may do so in the future.

Our investment in the mobile business solutions market, which is an unproven market, may not be successful.

In March 2001, we announced that we were expanding our business strategy to focus on the mobile business solutions market, which we believed to be a potential higher-growth opportunity. We continue to believe that this market is likely to develop over time, but it has been slower to develop than we anticipated. Certain early entrants to this market have not achieved their publicly forecasted financial results. While we will continue to invest in this strategy, we have slowed our investment rate and intend to invest cautiously until the market develops. There can be no assurance that we will realize a return on our past or future investment in this unproven mobile business solutions market.

In the future, if the market for mobile business solutions develops, competing in this market would likely require an increase in our development and marketing efforts disproportionate to potential revenue streams. Accordingly, the results of our operations may be negatively impacted. Moreover, future focus on this strategy could disrupt our other operations and distract management, which could have a material adverse effect on our operating results. We cannot guarantee that the demand for mobile business solutions will develop in the future, that new technologies will not cause the market to evolve in a manner different from what we expect or that we will be able to obtain a leadership position if this market opportunity develops.

Our average sales prices may decline for some of our products and hosted services.

If the average sales prices of our more significant product lines fall, our overall gross margins will likely fall. To offset and forestall potential declines in average sales prices, we must continue to develop product enhancements and new products with advanced features that are likely to generate higher-margin incremental revenue. If we are unable to do so in a timely manner, or if our products do not achieve significant customer acceptance, our business, results of operations and financial condition may suffer.

Additionally, we have experienced, as have others in the broadcast fax and permission e-mail markets, pricing pressure for our services. To compensate for potential declines in average pricing, we must continue to develop additional value added services and seek reductions in our costs from various third party access providers.

The integration of recent and any future acquisitions may be difficult and disruptive.

We frequently evaluate potential acquisitions of products, technologies and businesses. Since January 1997, we have completed five strategic acquisitions, including the January 2001 acquisition of Infinite Technologies. Our recent and any future acquisitions may direct management s attention away from the day-to-day operations of our business and may pose numerous other risks. For instance, we may not be able to successfully integrate any technologies, products, personnel or operations of companies that we may acquire.

In making acquisitions, we may need to make dilutive issuances of our equity securities, incur debt, write-off purchased in-process research and development, and amortize expenses related to other intangible assets.

The discontinuance or divestiture of any of our product lines or operating units may be necessary and could be disruptive.

The Company believes that to maximize profitability and shareholder return, it must place a greater emphasis on focusing its resources on strategic products and services. The Company regularly evaluates its product lines and operating units not only for their contribution to current results, but also for their potential for benefiting the Company long-term. Based upon the results of such evaluations, the Company may discontinue, divest or take other actions to improve the performance of product lines and/or operating units. The discontinuance or divestiture of a product line, or operating unit, could cause disruption in our operations and may be distracting to management or our workforce in general. Although any such actions would be designed to improve our long-term results of operations, our near term results could suffer. In addition, there can be no assurance that we would realize the benefits of any such disposition or divestiture.

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We may be unable to adequately protect our proprietary rights.

To succeed, we must adequately protect our proprietary technology. We rely on a combination of patents, copyrights, trademarks and trade secret laws, nondisclosure and other agreements, and technical measures to protect our proprietary technology, but those measures may be insufficient. We have seven patents, but our competitors may challenge or circumvent the claims in our patents. Our current patents, or any future patents, may never provide us with any competitive advantages. Other measures that we take to protect our proprietary technology may not prevent or deter misappropriation of our technology or the development of technologies with similar characteristics. Moreover, our use of open systems architecture in the design of our products may make it easier for competitors to misappropriate or replicate our designs and developments.

Other companies may claim that we infringe their intellectual property or proprietary rights, which could cause us to incur significant expenses or be prevented from selling our products.

Our success depends on our ability to operate without infringing the patents and proprietary rights of third parties. Product development is inherently uncertain in a rapidly evolving technological environment in which there may be numerous patent applications pending, many of which are confidential when filed, with regard to similar technologies. Historically, competitors in the computer-telephony software industry have filed numerous allegations of patent infringement, resulting in considerable litigation. We have received claims of patent infringement from several third parties and will probably receive additional claims in the future. Any litigation, regardless of our success, would probably be costly and require significant time and attention of our key management and technical personnel. Litigation could also force us to

- stop or delay selling, or using, products that use the challenged intellectual property;
- pay damages for infringement;
- obtain licenses, which may be unavailable on acceptable terms; or
- redesign products or services that use the infringing technology.

We may not be able to hire and retain highly skilled employees, which could affect our ability to compete effectively.

To succeed, we must attract and retain key personnel in engineering, research and development, marketing, sales, finance and administration. We also depend, to a significant degree, on the efforts of our senior management team. If we fail to recruit such personnel or lose the services of existing key personnel in any functional area, our current operations and new product development efforts could be adversely affected. Competition for skilled personnel is intense. Past reductions in force and any additional reductions in force we undertake may adversely impact employee morale and impair our ability to attract and retain highly qualified personnel. We do not maintain material key person life insurance.

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk related to changes in interest rates and foreign currency exchange rates, each of which could adversely affect the value of the Company s investments. The Company does not currently use derivative financial instruments.

The Company maintains an investment portfolio consisting primarily of investment grade interest bearing securities. These securities are classified as available for sale securities. The interest bearing securities are subject to interest rate risk and will fall in value if market interest rates increase. If market interest rates were to increase immediately and uniformly by 10% from levels at March 31, 2003, the fair value of the portfolio would decline by an immaterial amount. Because the Company has the ability to hold its fixed income investments until maturity, it does not expect its operating results or cash flows to be affected to any significant degree by a sudden change in market interest rates on its securities portfolio.

The Company has assets and liabilities denominated in certain foreign currencies related to the Company s international sales operations. The Company has not hedged its translation risk on these currencies as the Company has the ability to hold its foreign-currency denominated assets indefinitely and does not expect that a sudden or significant change in foreign exchange rates would have a material impact on future net income or cash flows.

Item 4. CONTROLS AND PROCEDURES

In July 2002, the Company engaged new independent accountants, Deloitte & Touche LLP (D&T), to audit the Company s 2002 financial statements. In addition, in October 2002, the Company engaged D&T to audit the Company s 2001 restated financial statements. In connection with the completion of its audit of, and the issuance of an unqualified report on, the Company s financial statements for the years ended December 31, 2001 and 2002, D&T advised management of the Company and the Audit Committee of its Board of Directors of certain deficiencies that existed in the design or operation of the Company s internal accounting controls which, considered collectively, constituted a material weakness in the Company s internal controls pursuant to standards established by the American Institute of Certified Public Accountants. These deficiencies included the design of controls surrounding timely reconciliation of accounts and supervision and monitoring of staff who have significant roles in internal control.

The Company has taken appropriate steps to correct the deficiencies identified by D&T and is continuing to implement improvements to its policies, procedures, systems and staff who have significant roles in internal control to address these matters. The steps taken and to be taken to correct the weaknesses and deficiencies identified by D&T (1) constitute changes to the Company s internal control over financial reporting during the fiscal quarter covered by this report and (2) may constitute changes that have materially affected the Company s internal control over financial reporting.

Under the supervision and with the participation of the Company s management, including the Company s Chief Executive Officer (the CEO) and Chief Financial Officer (the CFO), the Company has evaluated the internal control weaknesses identified by D&T and the effectiveness of the Company s disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e)) as of the end of the period covered by this report (the Evaluation). During the course of the Evaluation, the CEO and CFO took note of, and considered as part of the Company s disclosure controls and procedures, the additional procedures performed and controls instituted by the Company to supplement its internal controls in order to mitigate the effect of the weaknesses identified by D&T, including the steps taken by the Company to correct those weaknesses and deficiencies. Based on the Evaluation, the CEO and CFO concluded, as of the date of the Evaluation, that the Company s disclosure controls and procedures, including the additional procedures, were effective to ensure that information required to be disclosed by the Company in this report is recorded, processed, summarized and reported within the appropriate time periods.

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Part II. OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

31.1 Rule 13a-14(a) Certification (Chief Executive Officer)

31.2 Rule 13a-14(a) Certification (Chief Financial Officer)

32.1 Section 1350 Certification (Chief Executive Officer)

32.2 Section 1350 Certification (Chief Financial Officer)

(b) Reports on Form 8-K

The Company filed a Current Report on Form 8-K (Item 9) on February 7, 2003 relating to its preliminary financial results for its financial results for its fourth quarter and year ended December 31, 2002, and results of the re-audit of its 2001 financial statements.

The Company filed a Current Report on Form 8-K (Item 9) on March 26, 2003 relating to its financial results for its fourth quarter and year ended December 31, 2002.

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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 on the 12th day of March 2004.

CAPTARIS, INC.

By: /s/ PETER PAPANO

Peter Papano

Chief Financial Officer and Secretary