UNITED STATES

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 September 30, 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 November 10, 2003 was 32,154,531.

Table of Contents

CAPTARIS, INC.

FORM 10-Q/A

For the Quarter Ended September 30, 2003

Table of Contents

			Page
PART I.	**Financial Information**		
	Item 1.	Financial Statements (unaudited)	3
	Item 2.	Management s Discussion and Analysis of Financial Condition and Results of Operations	20
	Item 3.	Quantitative and Qualitative Disclosures about Market Risk	33
	Item 4.	Controls and Procedures	33
PART II.	**Other Information**		
	Item 1.	Legal Proceedings	34
	Item 2.	Changes in Securities and Use of Proceeds	34
	Item 6.	Exhibits and Reports on Form 8-K	35
Signatures			36

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 and nine months ended September 30, 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 and nine months ended September 30, 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.

Table of Contents

Item 1. FINANCIAL STATEMENTS

CAPTARIS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

(unaudited)

	September 30, 2003 (As Restated See Note 2)	December 31, 2002
ASSETS		
Current assets:		
Cash and cash equivalents	$ 29,747	$ 21,971
Short-term investments, available for sale	21,588	30,519
Accounts receivable, net	12,471	17,811
Inventories finished goods	1,464	2,928
Deferred income taxes	2,109	4,308
Prepaid expenses and other	2,147	1,544
Total current assets	69,526	79,081
Long-term investments, available for sale	35,874	20,599
Equipment and leasehold improvements, net	4,882	7,595
Restricted cash	1,000	1,000
Deferred income taxes	1,723	1,546
Goodwill	14,825	8,976
Intangible and other assets, net	7,008	2,480
Total assets	$ 134,838	$ 121,277
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 5,761	$ 7,204
Accrued compensation and benefits	2,990	4,186
Deferred revenue	8,668	8,185
Other accrued liabilities	3,553	3,401
Income taxes payable	1,679	
Current portion of note payable	50	
Total current liabilities	22,701	22,976
Note payable, net of current portion	424	
Commitments and contingencies (Notes 10 and 17)		
Redeemable common stock to be issued	3,000	
Shareholders equity:		

Preferred stock, par value $0.01 per share, 2,000 shares authorized; none outstanding		
Common stock, par value $0.01 per share, 120,000 shares authorized; 30,932 and 30,218 outstanding, respectively	309	302
Additional paid-in capital	65,185	60,539
Retained earnings	42,799	37,148
Accumulated other comprehensive income	420	312
Total shareholders equity	108,713	98,301
Total liabilities and shareholders equity	$ 134,838	$ 121,277

See the accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

CAPTARIS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
	(As Restated See Note 2)		(As Restated See Note 2)	
Net revenue	$ 18,079	$ 17,065	$ 51,917	$ 49,632
Cost of revenue	6,920	6,618	19,154	18,710
Gross profit	11,159	10,447	32,763	30,922
Operating expenses:				
Research and development	2,384	2,643	7,182	7,266
Selling, general and administrative	9,330	9,172	27,733	29,055
Impairment of intangible assets				5,529
Amortization of intangibles	57	76	170	849
Restructuring charges	423		423	2,033
Stock compensation expense (benefit)	1,057	(498)	2,049	(1,016)
Gain on sale of the CallXpress product line	(2,088)		(2,088)	
Patent settlement with AudioFax (Note 12)				875
Total operating expenses	11,163	11,393	35,469	44,591
Operating income (loss)	(4)	(946)	(2,706)	(13,669)
Other income (expense):				
Interest	338	609	1,143	1,917
Other, net	(59)	(115)	(105)	(552)
Other income	279	494	1,038	1,365
Income (loss) from continuing operations before income tax expense (benefit)	275	(452)	(1,668)	(12,304)
Income tax expense (benefit)	105	(204)	(650)	(5,069)
Income (loss) from continuing operations before discontinued operations and cumulative effect of change in accounting principle	170	(248)	(1,018)	(7,235)
Discontinued operations:				
Income (loss) from operations of MediaLinq, net of income taxes	(148)	611	770	1,742
Gain on sale of MediaLinq, net of income taxes	5,899		5,899	

Income from discontinued operations	5,751	611	6,669	1,742
Income (loss) before cumulative effect of change in accounting principle	5,921	363	5,651	(5,493)
Cumulative effect of change in accounting principle				(2,695)
Net income (loss)	$ 5,921	$ 363	$ 5,651	$ (8,188)
Basic income (loss) per common share from continuing operations before discontinued operations and cumulative effect of change in accounting principle	$ 0.00	$ (0.01)	$ (0.03)	$ (0.23)
Basic income per common share from discontinued operations	0.19	0.02	0.22	0.05
Basic loss per common share from cumulative effect of change in accounting principle				(0.08)
Basic net income (loss) per common share	$ 0.19	$ 0.01	$ 0.19	$ (0.26)
Weighted average basic common shares outstanding	30,597	31,914	30,383	31,876
Diluted income (loss) per common share from continuing operations before discontinued operations and cumulative effect of change in accounting principle	$ 0.01	$ (0.01)	$ (0.03)	$ (0.23)
Diluted income per common share from discontinued operations	0.18	0.02	0.22	0.05
Diluted loss per common share from cumulative effect of change in accounting principle				(0.08)
Diluted net income (loss) per common share	$ 0.19	$ 0.01	$ 0.19	$ (0.26)
Weighted average diluted common shares outstanding	31,583	31,914	30,383	31,876

See the accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

CAPTARIS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30,	
	2003	2002
	(As Restated See Note 2)	
Cash flows from operating activities:		
Net income (loss)	$ 5,651	$ (8,188)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	3,184	3,921
Loss on disposition of equipment	118	396
Gain on sale of CallXpress product line	(2,088)	
Gain on sale of MediaLinq, net of income taxes	(5,899)	
Stock compensation expense (benefit)	2,820	(1,254)
Stock issued for consulting services	6	
Impairment of intangibles		5,529
Cumulative effect of change in accounting principle		2,695
Restructuring charges	177	
Changes in current assets and liabilities net of effects from purchase of businesses and sale of MediaLinq and CallXpress:		
Accounts receivable, net	2,152	(1,503)
Inventories	954	(128)
Deferred income taxes	(1,844)	(2,232)
Prepaid expenses and other assets	(756)	359
Accounts payable	(1,666)	122
Accrued compensation and benefits	(1,010)	(2,365)
Deferred revenue	751	505
Other accrued liabilities	672	(473)
Income taxes payable	1,856	
Net cash provided (used) by operating activities	5,078	(2,616)
Cash flows from investing activities:		
Purchase of equipment and leasehold improvements	(2,565)	(2,411)
Purchase of investments	(53,961)	(26,419)
Purchase of businesses, net of cash acquired	(7,253)	(456)
Proceeds from sale of CallXpress product line	2,500	
Proceeds from sale of MediaLinq	14,852	
Proceeds from sale and maturities of investments	47,480	33,954
Net cash provided by investing activities	1,053	4,668

Cash flows from financing activities:		
Proceeds from exercise of common stock options	1,787	513
Settlement of note payable		(1,456)
Lease deposit		(1,000)
Repurchase of common stock	(177)	(87)
Net cash provided (used) by financing activities	1,610	(2,030)
Net increase in cash	7,741	22
Effect of exchange rate changes on cash	35	(13)
Cash and cash equivalents at beginning of period	21,971	19,654
Cash and cash equivalents at end of period	$ 29,747	$ 19,663

See the accompanying notes to unaudited condensed consolidated financial statements.

Table of Contents

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 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 Company s critical accounting policies, financial statements and notes thereto included in Captaris, Inc. s (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.

As described in Note 5, on September 15, 2003, the Company sold its MediaLinq division. As such, in accordance with generally accepted accounting principles, prior period results of operations have been reclassified to reflect MediaLinq s operating results and the gain on sale, net of income taxes, as Discontinued Operations. Further, certain prior-period balances have been reclassified to conform to the current period presentation.

2. Restatements

Subsequent to the issuance of the condensed consolidated financial statements for the quarter and nine months ended September 30, 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. See Note 3 for further discussion of stock based compensation. The effect of the restatement reduces net income for the third quarter of 2003 by $485,000, decreasing reported income per diluted share by $0.01, from $0.20 to $0.19. For the nine-month period ended September 30, 2003, the restatement reduces net income by approximately $605,000, from $6.3 million to $5.7 million and reduces reported diluted income per share by $0.01, from $0.20 to $0.19.

The decrease in net income per diluted share for the nine months ended September 30, 2003 as a result of the correction to stock based compensation expense is offset by a $0.01 increase in net income per diluted share for the nine months ended September 30, 2003 due to a correction in the weighted average common shares used for calculating net income per diluted share. In accordance with Statement of Financial

Accounting Standards (SFAS) No. 128, *Earnings Per Share*, since the Company reported a loss from continuing operations for the nine months ended September 30, 2003, the Company should have excluded incremental common stock equivalents from the number of shares used in the net income per diluted share calculation. The Company has restated the number of shares used in the calculation of net income per diluted share to exclude the incremental common stock equivalents for the nine months ended September 30, 2003. The effects of this restatement are included in the summary below.

The number of shares used in the calculation of net income per diluted share for the three months ended September 30, 2002 has also been restated to exclude incremental common stock equivalents due to the loss from continuing operations for the three months ended September 30, 2002. This restatement had no impact on reported net income per share for the three months ended September 30, 2002. The common stock equivalent shares excluded from the calculation of diluted shares outstanding were restated for the quarter and nine months ended September 30, 2003 and 2002.

Table of Contents

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 2003 and 2002

(Unaudited)

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

	Quarter Ended September 30, 2003		Nine Months Ended September 30, 2003	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Statement of operations data:				
Stock compensation expense	$ 454	$ 1,057	$ 1,267	$ 2,049
Income tax expense (benefit)	334	105	(351)	(650)
Income (loss) from discontinued operations, net of income tax	(37)	(148)	886	770
Net income	6,406	5,921	6,256	5,651
Basic net income per common share	0.21	0.19	0.20	0.19
Diluted net income per common share	0.20	0.19	0.20	0.19
Weighted average basic common shares outstanding	30,597	30,597	30,383	30,383
Weighted average diluted common shares outstanding	31,425	31,583	30,823	30,383
Balance sheet data:				
Deferred income taxes	$ 1,734	$ 2,109		
Total current assets	69,151	69,526		
Additional paid-in capital	64,205	65,185		
Retained earnings	43,404	42,799		
Total shareholders equity	108,338	108,713		

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):

Restatement to correct SFAS No. 123 disclosure including restatement of stock based compensation expense:

	Quarter Ended September 30, 2003		Quarter Ended September 30, 2002	
	As Previously Reported	As Restated	As Previously Reported	As Restated
Net income, as reported	$ 6,406	$ 5,921	$ 363	$ 363
Add: Stock-based compensation expense (benefit), as reported, net of income taxes	450	938	(358)	(379)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of income taxes	297	276	370	369
Net income (loss), pro forma	$ 6,559	$ 6,583	$ (365)	$ (385)
Net income (loss) per share:				
Basic, as reported	$ 0.21	$ 0.19	$ 0.01	$ 0.01
Basic, pro forma	$ 0.21	$ 0.22	$ (0.01)	$ (0.01)
Diluted, as reported	$ 0.20	$ 0.19	$ 0.01	$ 0.01
Diluted, pro forma	$ 0.21	$ 0.21	$ (0.01)	$ (0.01)

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 2003 and 2002

(Unaudited)

	Nine Months Ended September 30, 2003		Nine Months Ended September 30, 2002	
	As Previously Reported	**As Restated**	**As Previously Reported**	**As Restated**
Net income (loss), as reported	$ 6,256	$ 5,651	$ (8,188)	$ (8,188)
Add: Stock-based compensation expense (benefit), as reported, net of income taxes	1,112	1,736	(741)	(728)
Deduct: Total stock-based employee compensation expense (benefit) determined under fair value based method for all awards, net of income taxes	853	803	1,220	1,118
Net income (loss), pro forma	$ 6,515	$ 6,584	$ (10,149)	$ (10,034)
Net income (loss) per share:				
Basic and diluted, as reported	$ 0.20	$ 0.19	$ (0.26)	$ (0.26)
Basic and diluted, pro forma	$ 0.21	$ 0.22	$ (0.32)	$ (0.31)

The Company is also restating its statement of cash flows for the nine months ended September 30, 2003. Previously, the Company had not separately presented the effect of the exchange rate on cash in its cash flow statement in accordance with SFAS No. 95, *Statement of Cash Flows*. Further, the Company made other minor adjustments within the statement of shareholders equity for the nine months ended September 30, 2003.

3. Stock 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 per share. 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 compensation expense (benefit), 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 September 30, 2003 and 2002, the Company had 615,549 and 1,465,215 options, respectively, to purchase common shares subject to variable accounting. The Company recorded a charge of $1,523,000 and a benefit of $639,000 during the third quarter of 2003 and 2002, respectively, for variable stock compensation. For the nine months ended September 30, 2003 and 2002, the Company recorded a charge of $2.8 million and a benefit of $1.3 million, respectively, for variable stock compensation. Allocation of this stock compensation expense (benefit) to the operating categories is as follows:

	Quarter ended September 30,		Nine months ended September 30,	
	2003	**2002**	**2003**	**2002**
		(in thousands)		
Cost of revenue	$ 114	$ (5)	$ 215	$ (8)
Research and development	239	(123)	466	(235)
Selling, general and administrative	704	(370)	1,368	(773)
Total operating expense (benefit)	$ 1,057	$ (498)	$ 2,049	$ (1,016)
Discontinued operations	466	(141)	771	(238)
Total stock compensation expense (benefit)	$ 1,523	$ (639)	$ 2,820	$ (1,254)

The Company accounts for stock options under Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees,* under which no compensation expense has been recognized, as there is no difference between the exercise price and fair market value of stock options at the date of grant. Had compensation expense for stock option grants been determined using the fair value method consistent with SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company s net income (loss) and net

Table of Contents

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 2003 and 2002

(Unaudited)

income (loss) per share would have been as shown in the following pro forma amounts for the quarters and nine months ended September 30, 2003 and September 30, 2002:

	Quarter ended September 30,		Nine months ended September 30,	
	2003	2002	2003	2002
	(in thousands, except per share data)			
Net income (loss), as reported	$ 5,921	$ 363	$ 5,651	$ (8,188)
Add: Stock-based compensation expense (benefit), as reported, net of income taxes	938	(379)	1,736	(728)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of income taxes	276	369	803	1,118
Pro forma net income (loss)	$ 6,583	$ (385)	$ 6,584	$ (10,034)
Net income (loss) per common share:				
Basic as reported	$ 0.19	$ 0.01	$ 0.19	$ (0.26)
Basic pro forma	0.22	(0.01)	0.22	(0.31)
Diluted as reported	0.19	0.01	0.19	(0.26)
Diluted pro forma	0.21	(0.01)	0.22	(0.31)

In calculating the pro forma compensation expense, the fair value of each stock option grant is estimated on the date of grant using the Black-Scholes option pricing model and the following weighted average assumptions:

	Quarter ended September 30,		Nine months ended September 30,	
	2003	2002	2003	2002
Dividend yield	0.0%	0.0%	0.0%	0.0%
Volatility	58.3%	61.4%	61.8%	61.4%
Risk-free interest rate	2.23%	4.48%	2.42%	4.48%
Expected life (in years)	3	5	3.7	5

4. Acquisition of Teamplate

On September 30, 2003, Captaris and its indirect wholly-owned subsidiary, Nova Scotia Company, a Nova Scotia, Canada unlimited liability company, acquired Teamplate, Inc. (Teamplate), an Alberta, Canada corporation. Teamplate s product is the first business process automation product built on the Microsoft .NET framework for Web services. This acquisition enhances the Captaris business strategy to become a market leader in business information delivery solutions for enterprise customers worldwide, and provides resources and market power to further penetrate the business process automation market. Teamplate s technology extends the Captaris business information delivery solutions with streamlined enterprise application integration, rapid solution deployment, sophisticated business rules processing and integrated process monitoring and metrics. The Company believes that combining the technologies of both companies will allow customers to achieve new levels of collaboration, accountability and business agility while reducing overall operational costs. Since the transaction occurred on September 30, 2003, the transaction is included in the quarter-end balance sheet and did not impact the results of operations for the quarter ended September 30, 2003.

Under the terms of the agreement, Captaris acquired all of the stock of Teamplate for $8.15 million in cash, issued 574,727 shares of Captaris common stock valued at approximately $3.0 million that were issued on October 3, 2003, and assumed liabilities of approximately $823,000, all resulting in an aggregate purchase price of $12.3 million, including transaction costs of approximately $282,000. The value of the common stock issued was determined using the closing price of Captaris stock on the NASDAQ National Market on September 30, 2003, the date the acquisition was announced and consummated. The purchase price is subject to a post closing adjustment, as defined, to be determined on December 31, 2003, and collection of certain receivables by September 30, 2004. The common stock will be held in a third-party escrow account for one year as security for certain post closing obligations of the Teamplate shareholders, including indemnification provisions whereby the Teamplate shareholders agreed to indemnify the Company against claims resulting from various representations and warranties made by the former Teamplate shareholders. On the first anniversary of the closing, each Teamplate shareholder will have the option to require Captaris to purchase all of the shareholder s portion of the Captaris common stock issued in the transaction at a price per share of $5.22 if (a) the average of the last sale prices of the common stock for the 20 trading days prior to September 30, 2004 is less than $5.22 per share; and (b) the last sale price of the

Table of Contents

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 2003 and 2002

(Unaudited)

common stock on September 30, 2004 is less than $5.22 per share. As a result of this buyback clause, the Company has recorded the issuance of this common stock as Redeemable Common Stock on the balance sheet. In addition, the Company agreed to indemnify the Teamplate shareholders against claims resulting from various representations and warranties made by the Company. At September 30, 2003, the former Teamplate shareholders have made no indemnification claims.

As part of an incentive program to the management team of Teamplate, if the business plan for the combination achieves certain performance targets, the management team may earn up to $5.5 million over the three year period following the closing. The Company s obligation to pay this incentive compensation is also based on continued employment. Any incentive compensation earned under this program will be recorded as compensation expense in the period earned.

In accordance with SFAS No. 141, *Business Combinations,* all identifiable assets and liabilities were assigned a portion of the cost of the acquisition based on their respective fair values. The Company engaged an independent valuation firm to provide an estimated fair value for all identifiable intangibles including workflow server technology, tradename, customer relationships and reseller agreements, using a discounted cash flow model. The determination of fair value is a critical and complex consideration that involves significant assumptions and estimates. These assumptions and estimates were based on the Company s best judgments and resulted in the allocation of purchase price for this acquisition as detailed below. The excess of the purchase price over the fair value of the assets acquired was allocated to goodwill.

Teamplate Purchase Price Allocation:

	September 30, 2003 (in thousands)
Workflow server technology	$ 4,004
Tradename	90
Customer relationships	469
Reseller agreements	311
Total identified amortizable intangibles	4,874
Goodwill	5,805
Equipment	107
Current assets	1,510

Total purchase price	$	12,296

The purchase price allocation set forth above is subject to additional adjustments related to the ultimate determination of the fair value of a certain liability and ultimate collection of certain accounts receivable. All such adjustments identified during the allocation period, expected to expire on September 30, 2004, would change the carrying amount of the goodwill generated as a result of the acquisition. Based on information available to management after September 30, 2003, the Company estimates the post-closing purchase price adjustment to be an increase in purchase price of approximately $400,000. This post-closing purchase price adjustment when finalized will be recorded as additional goodwill. When finalized, the actual amount of the adjustment may differ from this estimate.

All identified intangible assets will be amortized on a straight-line basis over their estimated useful lives, ranging from fifteen months to seven years. The weighted-average useful life of these assets is approximately 6.9 years. The Company expects to recognize amortization expense for these intangible assets of approximately $189,000 for the quarter ending December 31, 2003, $755,000 for the year ending December 31, 2004 and $683,000 during each of the years ending December 31, 2005 through September 30, 2010. All of the $5.8 million allocated to Goodwill was assigned to the Teamplate reporting unit and is expected to be deductible for tax purposes.

The following summarizes the unaudited pro forma results of operations, on a combined basis, as if the Company s acquisition of Teamplate occurred as of the beginning of each of the periods presented. The pro forma information gives effect to certain adjustments, including amortization of identified intangibles. This unaudited pro forma information is presented for illustrative purposes only and is not necessarily indicative of the results of future operations or results that would have been achieved if the Company had made these acquisitions at the beginning of the specified periods.

Table of Contents

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 2003 and 2002

(Unaudited)

	Quarter Ended September 30,		Nine Months Ended September 30,	
	2003	2002	2003	2002
	(Unaudited)		(Unaudited)	
Net revenue	$ 18,493	$ 17,218	$ 53,158	$ 49,923
Income (loss) from continuing operations before discontinued operations and cumulative effect of change in accounting principle	$ (587)	$ (740)	$ (3,290)	(8,879)
Income from discontinued operations	5,751	611	6,669	1,742
Income (loss) before cumulative effect of change in accounting principle	5,164	(129)	3,379	(7,137)
Cumulative effect of change in accounting principle				(2,695)
Net income (loss)	$ 5,164	$ (129)	$ 3,379	$ (9,832)
Basic loss per common share from continuing operations before discontinued operations and cumulative effect of change in accounting principle	$ (0.02)	$ (0.02)	$ (0.11)	$ (0.27)
Basic income per common share from discontinued operations	0.19	0.02	0.22	0.05
Basic loss per common share from cumulative effect of change in accounting principle				(0.08)
Basic net income (loss) per common share	$ 0.17	$ 0.00	$ 0.11	$ (0.30)
Weighted average basic common shares outstanding	31,172	32,489	30,958	32,451
Diluted loss per common share from continuing operations before discontinued operations and cumulative effect of change in accounting principle	$ (0.02)	$ (0.02)	$ (0.11)	$ (0.27)
Diluted income per common share from discontinued operations	0.18	0.02	0.22	0.05
Diluted loss per common share from cumulative effect of change in accounting principle				(0.08)
Diluted net income (loss) per common share	$ 0.16	$ 0.00	$ 0.11	$ (0.30)
Weighted average diluted common shares outstanding	32,158	32,489	30,958	32,451

5. Discontinued Operations

On September 15, 2003, Captaris and its wholly-owned subsidiary, MediaTel Corporation (Delaware) (MediaTel), entered into an asset purchase agreement, effective as of September 1, 2003, to sell the assets of MediaLinq, an outsourced division of Captaris operated by MediaTel, to PTEK Holdings, Inc. and its wholly-owned subsidiary, Xpedite Systems, Inc. (Xpedite). MediaLinq provides outsourced e-document delivery services. Under the terms of the agreement, Xpedite paid Captaris $14.9 million in cash and assumed certain liabilities. The purchase price is subject to a post-closing net working capital adjustment which will be determined before December 31, 2003. In addition, the Company agreed to indemnify Xpedite against claims resulting from various representations and warranties made by the Company. At September 30, 2003, Xpedite has made no indemnification claims. Concurrent with the sale transaction, the Company and Xpedite also entered into license and reseller agreements under which the Company will license its fax-to-mail technology to Xpedite in return for minimum compensation of $2.0 million over a three year period, and the parties will cooperate in providing mutual resale opportunities for each other s products and services. The Company recognized a gain on the sale of MediaLinq, net of income taxes, of approximately $5.9 million in the quarter ended September 30, 2003.

Table of Contents

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 2003 and 2002

(Unaudited)

For segment reporting purposes, MediaLinq s operations were previously reported in the E-document services segment. MediaLinq s current and prior period results of operations have been reclassified as Discontinued Operations. Components of MediaLinq s operations reflected in the Company s condensed consolidated statements of operations as discontinued operations are as follows:

	Quarter ended September 30,		Nine months ended September 30,	
	2003	2002	2003	2002
	(in thousands)			
Revenue	$ 3,993	$ 6,022	$ 15,812	$ 17,746
Income (loss) from operations, before income tax	$ (245)	$ 1,010	$ 1,274	$ 2,882

Components of MediaLinq s balance sheet reflected in the Company s condensed consolidated balance sheets are as follows:

	September 30, 2003	December 31, 2002
	(in thousands)	
Current assets	$	$ 8,158
Equipment and leasehold improvements, net		2,287
Current liabilities		2,451

6. Sale of CallXpress Product Line

On September 29, 2003, Captaris announced the sale of its CallXpress product line, which primarily includes the Captaris voice and unified messaging assets, to Sound Advantage, LLC (Sound Advantage), a California limited liability company.

Under the terms of the agreement, Sound Advantage acquired the CallXpress product line for $2.5 million in cash and will pay up to an additional $1.0 million per year over a three year period beginning January 1, 2004 pursuant to an earn out arrangement, which is based on achievement of specified revenue targets for the CallXpress business. In addition, Captaris was issued a 10 percent equity interest in Applied Voice and Speech Technologies, Inc. (AVST), a newly formed company established by Sound Advantage to acquire and operate the combined CallXpress and Sound Advantage businesses. RightFax will continue to be a part of AVST s Unified Messaging offering, based on an ongoing OEM agreement. Also, the Company agreed to indemnify AVST against claims resulting from various representations and warranties made by the Company. At September 30, 2003 no indemnification claims have been made by AVST. The Company recognized a gain on the sale of CallXpress of approximately $2.1 million in the quarter ended September 30, 2003.

Components of the CallXpress product line reflected in the Company s condensed consolidated statements of operations are detailed below. Certain components of cost of revenue, operating expenses and operating income directly attributable to the CallXpress product line could not be separated from other product lines. Only direct revenue and cost of revenue directly attributable to the CallXpress product line are detailed below:

	Quarter ended September 30,		**Nine months ended September 30,**	
	2003	**2002**	**2003**	**2002**
	(in thousands)			
Revenue	$ 2,158	$ 3,786	$ 6,957	$ 10,422
Cost of revenue	$ 675	$ 813	$ 1,920	$ 2,342

12

Table of Contents

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 2003 and 2002

(Unaudited)

7. Segment Reporting

Historically, the Company classified its business into two major segments: Software Products and E-document Services. In September 2003, the Company sold it E-document services operating segment (see Note 5). As a result of the sale, the Company now operates in only one operating segment.

The Company s revenue by country, as determined by shipping destination, was as follows:

	Quarter ended September 30,		Nine months ended September 30,	
	2003	2002	2003	2002
	(in thousands)			
United States	$ 13,620	$ 13,016	$ 38,961	$ 37,699
United Kingdom	519	806	2,174	2,713
Canada	792	550	2,177	1,283
Other	3,148	2,693	8,605	7,937
Total net revenue	$ 18,079	$ 17,065	$ 51,917	$ 49,632

8. 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 provided for quarterly payments to be made by Cisco to the Company through mid-2005. However, the timing and amount of these payments were subject to a number of conditions, some of which were beyond the control of the Company, including Cisco s ability to successfully implement the technology. 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, $588,000 and $588,000 were recognized in the first, second and third quarters of 2002, respectively. The Company did not receive a payment, or recognize revenue from Cisco in the first nine months of 2003. On October 30, 2003, the Company reached an agreement with Cisco to accelerate the conclusion of this OEM agreement. See Note 19, Subsequent Event.

9. Note Payable

In connection with the acquisition of Teamplate, see Note 4, the Company assumed a non-interest bearing note payable to the National Research Council of Canada (NRC) with an original principal balance of approximately $366,000. Beginning on October 1, 2003 and at the beginning of every quarter thereafter up to and including April 1, 2006, the Company must pay NRC 2.2% of Teamplate s net revenue for the quarter preceding repayment. If by April 1, 2006, the total amount repaid and owed to NRC is less than $366,000, the Company must continue to make repayments to NRC until the earlier of the full repayment of $366,000 or ten years after the start of the repayment period. If at any time, the total amount paid to NRC equals or exceeds $550,000, the note will be deemed paid in full. Based on an estimate of Teamplate s future revenue, the Company expects to repay the full $550,000 on or before April 1, 2006. The Company estimated the fair value of this note payable to be $474,000 at September 30, 2003 using a discount rate equal to Teamplate s estimated borrowing rate of 7.0%. The balance of the note payable at September 30, 2003 was as follows:

	September 30, 2003
	(in thousands)
Note payable	$ 474
Less current portion of note payable	(50)
Note payable, net of current portion	$ 424

13

Table of Contents

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 2003 and 2002

(Unaudited)

10. Commitments and Contingencies

The Company leases its facilities and certain equipment under non-cancelable operating leases which expire between December 2003 and February 2008. The Company is also obligated to pay a post-closing purchase price adjustment related to the acquisition of Teamplate. See Note 4. At September 30, 2003, the approximate future lease payments for the remainder of the lease terms and estimated post-closing purchase price commitment are as follows:

Commitments

(in thousands)	2003	2004	2005	2006	2007	Thereafter	Total
Operating lease obligations	$ 435	$ 1,397	$ 1,289	$ 1,237	$ 1,012	$ 153	$ 5,523
Estimated post-closing purchase price adjustment for Teamplate acquisition (See Note 4)	400						400
Total commitments	$ 835	$ 1,397	$ 1,289	$ 1,237	$ 1,012	$ 153	$ 5,923

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.

11. Cumulative Effect of Change in Accounting Principle

Effective January 1, 2002, the Company adopted SFAS No. 142, *Goodwill and Other Intangibles Assets,* which eliminated the amortization of goodwill and indefinite-lived intangible assets, prescribed the amortization of intangible assets with finite lives, and prescribed impairment testing and recognition for goodwill and intangible assets. In January 2002, the Company evaluated its intangible assets, including core technology, customer lists, and other intangibles and determined that these assets have finite lives. As a result of the Company s evaluation, the Company recorded a $2.7 million non-cash charge 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.

12. Intangible and Other Assets, Net

On January 1, 2002, the Company adopted SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets.* SFAS No. 144 develops one accounting model for the impairment or disposal of long-lived assets. In the second quarter of 2002, the Company engaged an independent valuation firm to provide an estimated fair value of each of its intangible, long-lived assets using a discounted cash flow model. The determination of fair value is a critical and complex consideration when assessing impairment under SFAS No. 144 that involves significant assumptions and estimates. These assumptions and estimates were based on the Company s best judgments. As a result, the Company determined that certain intangible assets acquired from Infinite Technologies in January 2001 were impaired. Accordingly, the Company recorded an impairment charge of $5.5 million for the mobile delivery reporting unit in the second quarter of 2002. This impairment charge consisted of a write-down of core technology of approximately $2.4 million, a write-down of customer base and marketing channel of approximately $2.2 million and a write-down of tradename of approximately $849,000.

Table of Contents

CAPTARIS, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Periods Ended September 30, 2003 and 2002

(Unaudited)

On September 30, 2003, the Company acquired approximately $4.9 million of intangible assets in connection with the acquisition of Teamplate, Inc. See Note 4. A summary of the Company s intangible and other assets, net at September 30, 2003 and December 31, 2002 is as follows:

Intangible and Other Assets, Net

	September 30, 2003			December 31, 2002		
(in thousands)	Gross Carrying Amount	Accumulated Amortization	Book Value	Gross Carrying Amount	Accumulated Amortization	Book Value
Technology	$ 4,314	$ (70)	$ 4,244	$ 310	$ (28)	$ 282
Tradenames/domain name	1,020	(247)	773	930	(127)	803
Customer relationships and marketing channels	469		469			
Reseller agreements	311		311			
Other	3,020					