CAPTARIS INC
Form 10-Q
May 14, 2001

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934
for the quarterly period ended March 31, 2001

Commission File Number 0-25186

CAPTARIS, INC.
(Name of Registrant as Specified in Its Charter)

Washington (State of incorporation)	91-1190085 (I.R.S. Employer Identification Number)

11410 NE 122nd Way
Kirkland, WA 98034
(Address of principal executive offices)

Registrant's telephone number, including area code: (425) 820-6000

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

The number of outstanding shares of the Registrant's Common Stock as of May 8, 2001 was 32,367,641.

CAPTARIS, INC.

FORM 10-Q

For the Quarter Ended March 31, 2001

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Part I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

CAPTARIS, INC.

CONSOLIDATED BALANCE SHEETS

(Unaudited)

	March 31, 2001	
ASSETS		(in thousand
Current assets:		
Cash and cash equivalents	$ 23,634	
Short-term investments	53,123	
Accounts receivable, net	13,259	
Inventories	6,291	
Deferred and prepaid income taxes	5,665	
Prepaid expenses and other	1,999	
Total current assets	103,971	
Equipment and leasehold improvements, net	6,903	
Goodwill, intangibles and other, net	22,305	
Deferred income taxes	3,208	

	$136,387

LIABILITIES AND SHAREHOLDERS' EQUITY

Current liabilities:	
Accounts payable	$ 3,304
Accrued compensation and benefits	4,238
Other accrued liabilities	9,893
Current portion of note payable	469
Total current liabilities	17,904
Note payable, net of current portion	881
Commitments and contingencies	
Shareholders' equity:	
Preferred stock, par value $.01 per share, 2,000,000 authorized; none outstanding	-
Common stock, par value $.01 per share, 120,000,000 authorized; 32,332,141 and 30,666,319 shares outstanding, respectively, and additional paid-in capital	66,031
Retained earnings	51,571
Total shareholders' equity	117,602
	$136,387

See accompanying notes to consolidated financial statements.

CAPTARIS, INC.

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

	Quarter ended March 31,	
	2001	
	(in thousands, except per sh	
Net sales	$ 20,428	$ 2
Cost of sales	7,347	
Gross profit	13,081	1
Operating expenses:		
Research and development	3,390	

Sales, general and administrative	15,205	1
Non-recurring charges	2,942	
Total operating expenses	21,537	1
Operating (loss) income	(8,456)	
Other income, net	860	
(Loss) Income before income taxes	(7,596)	
Income tax (benefit) provision	(2,659)	
Net (loss) income	$ (4,937)	$
Basic net (loss) income per common share	$ (0.15)	$
Weighted average common shares outstanding	32,232	3
Diluted net (loss) income per common share	$ (0.15)	$
Weighted average common and common equivalent shares outstanding	32,232	3

See accompanying notes to consolidated financial statements.

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CAPTARIS, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Three months March
	2001
	(in thou
Cash flows from operating activities:	
Net (loss) income	$ (4,937)
Adjustments to reconcile net income to net cash provided by operating activities:	
Depreciation and amortization	1,963
Deferred and prepaid income taxes	(2,659)
Gain on sale of marketable securities	-
Purchased in-process research and development, expensed	1,900
Stock option income tax benefit	-
Changes in current assets and liabilities:	
Accounts receivable	2,948
Inventories	(31)
Prepaid expenses and other assets	(31)
Accounts payable	(2,178)
Accrued compensation and benefits	650
Other accrued liabilities	808

Federal income taxes payable	-
Net cash (used) provided by operating activities	(1,567)
Cash flows from investing activities:	
Purchase of equipment and leasehold improvements	(1,258)
Purchase of short-term investments, net	(1,444)
Proceeds from sale of marketable securities	-
Cash paid in acquisition, net	(8,800)
Purchase of intangibles and other long-term assets	(41)
Net cash used by investing activities	(11,543)
Cash flows from financing activities:	
Proceeds from exercise of stock options	-
Net cash provided by financing activities	-
Net (decrease) increase in cash and cash equivalents	(13,110)
Cash and cash equivalents at beginning of period	36,744
Cash and cash equivalents at end of period	$ 23,634
Supplementary disclosures of cash flows:	
Cash paid for income taxes	$ -

See accompanying notes to consolidated financial statements.

CAPTARIS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Interim Financial Statements

The accompanying consolidated financial statements of Captaris, Inc. and subsidiaries (the Company) are unaudited. In the opinion of the Company's management, the financial statements include all adjustments, consisting only of normal recurring adjustments, necessary to state fairly the financial information set forth therein. Results of operations for the three-month period ended March 31, 2001 are not necessarily indicative of future financial results.

Certain notes and other information have been condensed or omitted from the interim financial statements presented in this quarterly report on Form 10-Q. Accordingly, these financial statements should be read in conjunction with the Company's Annual Report on Form 10-K for the year ended December 31, 2000.

2. Businesses Acquired

On January 3, 2001 the Company acquired all of the outstanding stock of

Infinite Technologies, a privately held global supplier of wireless applications and wireless infrastructure solutions for a total consideration of $24,083,000. At closing, the Company paid approximately $9.1 million in cash and issued 1,631,600 shares of the Company's common stock valued at $8,058,000. The Company will pay approximately $2,900,000 in a combination of cash and the Company's common stock under a deferred payment arrangement over the next three years, which was recorded at the time of closing as a note payable of $1,351,000, net of imputed interest, and stock to be issued totaling $1,480,000. In addition the Company will pay up to an additional $3,900,000 in a combination of cash and the Company's common stock under an earn-out arrangement over the next three years which will be expensed as compensation by the Company. The Company has accounted for the business combination as a purchase. In connection with the acquisition, the Company recorded a one-time charge in the first quarter of 2001 related to purchased in-process research and development in the amount of $ 1.9 million. The total consideration of $24,083,000 was allocated as follows:

	(in thousands)
Goodwill	$ 8,383
Purchased in-process research & development, expensed	1,900
Other intangibles	9,900
Total purchase price	20,183
Earn-out	3,900
Total consideration	$24,083

All goodwill and identified intangibles associated with the acquisition are being amortized over lives ranging from two to seven years.

3. Segment Reporting

The Company has adopted Statement of Accounting Standard No. 131 "Disclosures about Segments of an Enterprise and Related Information"(SFAS No. 131). This standard is based on a management approach, which requires segmentation based upon the Company's internal organization and disclosure of revenue and operating income based upon internal accounting methods. The segment information provided reflects the two distinct business models of the Company's organizational structure: software products and e-document delivery services. Interest and other debt expense, provision for income taxes, interest income and gains and losses on the disposition of marketable securities are centrally managed at the corporate level and, accordingly, such items are not presented by segment since they are excluded from the measure of segment profitability reviewed by the Company's management. Reconciling items include corporate expense items and non-recurring charges, which are not allocated to operating segments. The Company's assets are managed on a company-wide basis versus by segment and accordingly, asset information is not reported.

	Software Products	E-document Services	Reconcil Amount
		(in thousands)	
Quarter ended March 31, 2001			
Net Sales................................	$14,760	$5,668	$
Operating Income (loss)..................	(1,604)	481	(7,
Quarter ended March 31, 2000			
Net Sales................................	$17,229	$7,646	$
Operating Income.........................	2,336	2,010	(1,

The Company's sales by country were as follows:

	Quarter Ended March 31, 2001	Quarter Ended March 31, 2000
	(in thousands)	
United States..	$15,653	$20,445
Canada...	699	743
United Kingdom...	1,400	1,363
Other..	2,676	2,324
	$20,428	$24,875

CAPTARIS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

4. Earnings Per Share

	Quarter ended Mar	
	2001	
	(in thousands, except p	
	Basic	Diluted
Net income	$(4,937)	$(4,937)
Computation of common and common		

Equivalent shares outstanding:		
Common Stock	32,232	32,232
Options	-	-
Common and common equivalent shares Used in computing per share amounts	32,232	32,232
Net income per share	$ (0.15)	$ (0.15)

5. Non-recurring Charges

On March 15, 2001, the Company announced the consolidation of its two primary product groups, Computer Telephony Software Group and Document Exchange Software Group, resulting in a 14% reduction of its workforce and a one-time charge of approximately $1 million which consisted of mainly severance and other employee benefits and consulting services.

6. Changes in Shareholders' Equity

Beginning balance at December 31, 2000	$113,001
Net loss	(4,937)
Stock issued for Infinite acquisition	8,058
Stock to be issued for Infinite acquisition	1,480
Ending balance at March 31, 2001	$117,602

CAPTARIS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

7. Legal Proceedings

In March 2000 several class-action lawsuits were filed in the United States District Court for the Western District of Washington alleging that during the period January 20, 2000 through March 17, 2000, the Company and several officers and directors made or participated in misrepresentations about the Company's ability to achieve revenue expectations for the first quarter of 2000. The court has approved appointment of three plaintiffs to act as Lead Plaintiffs and has consolidated all lawsuits into a single action. No class has been certified. On January 25, 2001, the Court granted Captaris' motion to dismiss the consolidated complaints on the grounds that "none of the four events relied upon by plaintiffs, whether considered separately or in combination, gives rise to a strong inference that any of the defendant directors or officers acted with knowledge or deliberate recklessness." The Court dismissed the claims against four Captaris officers and directors with prejudice. Based on additional representations made by plaintiffs' counsel at oral argument, the Court granted plaintiffs' request that they be allowed to file an amended complaint to attempt to correct the legal deficiencies the Court identified in the consolidated complaint as to Captaris and two officers. Plaintiffs filed their Second

Consolidated Amended Complaint on February 25, 2001. Captaris and the two remaining individual defendants have filed a motion to dismiss the Second Consolidated Amended Complaint with prejudice. This motion is currently scheduled to be considered by the Court in May 2001. The Company believes that the allegations of the lawsuits are without merit and intends to continue to vigorously defend the lawsuit if the claims are not dismissed.

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

The discussion in this report contains forward-looking statements that involve risks and uncertainties. Captaris' actual results could differ materially from those discussed below. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Additional Factors that May Affect Our Business, Future Operating Results and Financial Condition," included elsewhere in this report. When used in this document, the words "believes," "expects," "anticipates," "intends," "plans" and similar expressions are intended to identify certain of these forward-looking statements. However, these words are not the exclusive means of identifying such statements. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements.

The Company is a leading provider of business to business communication solutions for small, medium and enterprise-sized organizations. The Company provides flexible, cost-effective products that address the unified messaging, voice messaging, fax server, production fax and outsourced document delivery markets, and distributes these products primarily through independent distributors, value-added resellers and OEM's. The Company's products run on off-the-shelf hardware, support Windows NT and Windows 2000, and interface with a wide variety of telephony and computer equipment. The Company also offers add-on modules and software upgrades that provide increased capacity and functionality.

The Company's product lines include both telephony-oriented and computer-oriented products, and outsourced electronic document (e-document) delivery services. 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. 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. E-document delivery services target the outsourced mass fax and email markets for time-critical business-to-business (B2B) communications. These services include high-volume, instantaneous IP fax and email 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 telephony-oriented products include: CallXpress, and CallXpress Enterprise, a multi-application, high capacity unified messaging platform and PhoneXpress, a full-featured advanced messaging system for small to medium-sized enterprises. The Company's data oriented enhanced fax products include RightFAX and RightFAX Enterprise, the Company's LAN-based fax server lines for Windows NT / Windows 2000, 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 e-document delivery services, branded under the name MediaLinq, offer high-volume, simultaneous delivery of fax and email documents via the web, from desktop software or a fax machine.

On January 3, 2001 the Company acquired Infinite Technologies, a privately held global supplier of wireless applications and wireless infrastructure solutions. As described in Note 2 to the Consolidated Financial Statements, total consideration paid under terms of the merger agreement approximated $24 million.

On March 15, 2001, the Company announced a new business strategy based on the Mobile Business Solutions market. In conjunction with this announcement the Company announced the consolidation of its two primary product groups, Computer Telephony Software Group and Document Exchange Software Group, resulting in a 14% reduction of its workforce and a one-time charge of approximately $1 million. During the transition period following this consolidation, the Company expects that its net sales will be relatively flat for the remainder of 2001. Additionally, as this new strategy is implemented, expenditures in the areas of research and development and sales, general and administrative, are expected to increase from the amounts expended in the year ended December 31, 2000 and for the quarter ended March 31, 2001.

Results of Operations

Net sales. Net sales decreased 17.9% to $20,428,00 in the quarter ended March 31, 2001, from $24,875,000 in the comparable 2000 quarter. Software product sales decreased 14.3% while E-document services decreased 25.9% over the preceding year. International sales for the quarter increased 7.8% compared to the first quarter of 2000, and represented 23.4% of total net sales.

Gross profit. Gross profit as a percentage of net sales decreased to 64.0% in the quarter ended March 31, 2001, as compared to 65.5% in the comparable prior-year quarter, mainly as a result of the low sales volume and the impact of the non-volume-related fixed costs such as technical support and system integration operations.

Research and development. As a percentage of sales, research and development expenses for the current quarter increased to 16.6% compared with 9.9% of net sales in the comparable prior-year quarter. Research and development expenses increased to $3,390,000 in the quarter ended March 31, 2001 from $2,463,000 in the comparable prior-year period. This increase reflects the addition of staff from the acquisition of Infinite Technologies and increases associated with new product development. The Company currently expects to continue to invest in research and development at greater than historical levels as it expands its mobile business solutions and other product offerings.

Sales, general and administrative. Sales, general and administrative expenses increased to $15,205,000 in the quarter ended March 31, 2001 from $10,827,000 in the comparable prior-year quarter, due primarily to the addition of the operations of Infinite Technologies, an additional provision for doubtful accounts of $650,000 which management believes is reflective of current economic conditions, and the corporate re-branding program begun during the quarter. Sales, general and administrative costs for the current quarter represented 74.4% of net sales, an increase from 43.5% in the comparable prior-year quarter. The Company currently anticipates such expenditures to increase as the Company continues to invest in its mobile business solutions and the infrastructure necessary to support this and other direct selling opportunities.

Non-recurring charges. In the first quarter of 2001 non-recurring charges of $1,042,000 were incurred related primarily to the consolidation of the operations of the Tucson and Kirkland product groups and consisted of mainly severance and other employee benefits and consulting services. Additionally, $1,900,000 of acquired in-process research and development related to the acquisition of Infinite Technologies was written off during the quarter.

Operating (loss) income. Operating loss for the quarter ended March 31, 2001 was $8,456,000 compared to operating income of $2,991,000, or 12.0% of net sales, in the comparable prior-year quarter.

Other income, net. Net other income was $860,000 in the quarter ended March 31, 2001, as compared to $2,558,000 in the comparable prior-year quarter, due to a one-time $1,784,000 realized gain on the sale of a marketable security held for investment and increased interest income on investments during the first quarter of 2000.

Income tax. The effective tax benefit rate for the quarter ended March 31, 2001 was 35.0% compared with an effective tax rate of 36.0% for the prior year period. Income tax benefit for the

quarter ended March 31, 2001 was $2,659,000 compared with income tax expense of $1,998,000 in the comparable prior-year quarter.

Net (loss) income. The Company recognized a net loss of $4,937,000 or $0.15 per diluted common share for the quarter ended March 31, 2001, as compared to net income of $3,551,000 or $0.10 per diluted common share for the comparable prior-year quarter.

Historical Segment Revenue

Effective with the combination of certain product groups in the quarter ended March 31, 2001, the Company is providing the following comparative revenue information by segment:

	Software Products	E-document Services	Total
Net Sales for Quarter ended:			
March 31, 1999	$ 22,621	$ 6,222	$ 28,843
June 30, 1999	24,675	7,189	31,864
September 30, 1999	26,137	7,110	33,247
December 31, 1999	29,426	6,844	36,270
Total 1999	$102,859	$27,365	$130,224
Net Sales for Quarter ended:			
March 31, 2000	$ 17,229	$ 7,646	$ 24,875
June 30, 2000	18,828	6,412	25,240
September 30, 2000	19,673	5,738	25,411
December 31, 2000	19,859	5,152	25,011
Total 2000	$ 75,589	$24,948	$100,537

Liquidity and Capital Resources

Cash used by operating activities in the three months ended March 31, 2001 was $1,567,000 due primarily to the loss from operations and the consolidation of product groups. The accounts receivable collection period was approximately 58 days at March 31, 2001 compared to 54 days in the comparable prior year period. Accounts receivable decreased from $16.0 million at December 31, 2000 to $13.3 million at March 31, 2001.

As further described in Note 2 of the Consolidated Financial Statements, on January 3, 2001 the Company acquired Infinite Technologies, a privately held global supplier of wireless applications and wireless infrastructure solutions. The Company has accounted for the business combination as a purchase. Under the terms of the merger agreement, the Company will pay up to an additional $3.9 million in a combination of cash and the Company's common stock under an earn-out arrangement over the next three years which will be expensed as compensation by the Company.

Subsequent to the first quarter of 2001, the Company repurchased approximately 228,000 shares, utilizing approximately $446,000. The Company may continue to repurchase shares subject to overall market conditions, its stock price, and the Company's cash position and requirements going forward.

The Company maintains a $4.0 million unsecured revolving line of credit, none of which is outstanding. The Company's line of credit expires in August 2001, and contains certain financial

covenants and restrictions as to various matters. The Company is currently in compliance with all such covenants and restrictions. Borrowings under the line of credit bear interest at the bank's prime rate or its interbank offering rate plus 1.50%, at the Company's option.

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

Additional Factors that May Affect our Business, Future Operating Results and Financial Condition

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

Our recently expanded business strategy to focus on the mobile business solutions market, which is a new and unproven market, may not be successful.

In March 2001, we announced that we are expanding our business strategy to focus on the mobile business solutions market, which we believe is a higher-growth opportunity. In order to implement this strategy, we will be required to design, develop and introduce competitive new wireless products, improve our marketing of such products and build credibility among customers that we are capable of delivering advanced mobile business solutions. Implementation of this strategy will involve substantial increased costs and, as a result, our expenses will increase disproportionately to revenue in the near term. Moreover, implementation on this strategy may disrupt our existing operations and distract management, which could have a material adverse effect on our operating results.

There can be no assurance that we will realize a return on our investment in the mobile business solutions market. If we are not successful in implementing our strategy, our revenue could decline. Even if we are successful, our revenue may still decrease if the market opportunity for mobile wireless solutions does not develop in the ways we anticipate. This market opportunity is in its early stages and we can not guarantee that the demand for mobile business solutions will develop as fast as we anticipate, 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 as this market opportunity develops.

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 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 customer 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, and sometimes a majority, occurs in the last month of each 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 dealers, 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 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 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 sales in our first quarter, without taking into account the effect of acquisitions, have in the past declined from the fourth quarter of the previous year.

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

A substantial majority of our net sales depends on a network of independent telephone equipment dealers and computer-oriented value-added resellers. There is intense competition for the attention of these independent dealers and resellers from our competitors and from providers of other products distributed through these channels. Many of these dealers and 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 dealers and resellers in the future. Moreover, our dealers and 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 suffer.

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

Creation and maintenance of 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 director marketing efforts. We currently have strategic relationships with Ericsson, NEC Corporation, Fujitsu Limited, Lotus Development Corporation, Xerox Corporation 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 them could reassess their commitment to us in the future. Further, our 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 increase sales.

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 made 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 goodwill and other intangible assets.

Technology and customer needs change rapidly in our industry.

In our industry, technology and customer demands change rapidly, and our competitors and we 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. In addition, in the future, we intend to pursue new revenue streams by leveraging our expertise in voice and data communication to integrate these capabilities in unified messaging and mobile wireless delivery, among other possible areas. The market for unified messaging software and mobile wireless delivery is relatively new and as yet unproven. 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 or product enhancements that we develop.

Our market is highly competitive.

The computer-telephony market is highly competitive. Moreover, we believe the competitive pressures we face are likely to intensify, particularly as our competitors make new offerings based on the Windows operating system. 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 a Company's sales force, price, size of the installed base, level of customer support and professional services.

In the telephony-oriented market for messaging systems, our principal competitors are independent suppliers such as Avaya Inc., Mitel Corporation, Active Voice Inc., Cisco Systems, Inc. and Callware Technologies, Inc.

In addition to independent suppliers of computer-telephony solutions, we also compete with private branch exchange and key telephone systems manufacturers. Those manufacturers offer integrated voice messaging systems, unified messaging systems and automatic call distribution systems of their own design or under various OEM agreements. Competitors in this category include Lucent Technologies, Inc., Nortel Networks Corporation, Siemens Business Communication Systems, Inc., Mitel Corporation and NEC America, Inc.

In the market for LAN-based facsimile systems, our principal competitors are Omtool, Ltd., Optus Software, Inc., Esker, S.A. and Computer Associates International, Inc. Our fax server products also compete with vendors offering a range of alternative facsimile solutions, including operating systems containing facsimile and document transmission features, low-end fax modem products, desktop fax software, single-platform facsimile software products and customized proprietary software solutions. In the market for production facsimile systems, our principal competitors are Biscom, Inc., Esker, S.A. and Topcall International AG. In the market for document distribution products, our principal competitors include the Xpedite division of PTEK Holdings, Inc. and other telecommunications providers such as Cable & Wireless, Inc. The competitors of our newly acquired Infinite Technologies include Openwave Systems, Inc., Aether Systems, Inc. and 724 Solutions, Inc.

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 we do. In addition, some of our competitors have a marketing advantage because they can sell their call processing equipment or facsimile solutions as part of their broader product offerings. Recently 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.

Our average sales prices have declined for some of our products.

The average sales prices in our basic voice messaging products have declined due to competitive pressures. In the future, prices may decline in some of our other product lines. If the average sales prices of our more significant product lines fall, our overall gross margins will likely fall. To offset and forestall declining 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 our broadcast fax and document delivery markets, pricing pressures for our services.

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 one patent in the area of unified messaging, but our competitors may challenge or circumvent the claims in that patent. Our current patent, 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 parties and will probably receive additional claims in the future. While none of those claims has led to litigation, they may yet result in litigation. 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 face risks from expansion of our international operations.

Our growth depends in part on continued expansion of our international sales. International sales generated approximately 15%, 18% and 19% of our net sales in the years ended December 31, 1998, 1999 and 2000, respectively. We have spent significant management attention and financial resources on our international operations. A significant portion 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 United States. 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.

Currently, substantially all of our international sales are denominated in U.S. dollars. Increases in the value of the dollar against local currency could cause our products to become relatively more expensive to customers in a particular country, leading to reduced sales or profitability in that country. As we continue to expand our international operations, we expect our non-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.

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

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To succeed, we must attract and retain key personnel in engineering, research and development, marketing, sales, finance and administration. In particular, as we implement our recently announced strategy of focusing on mobile business solutions, we will need to hire employees with experience developing and providing wireless products and services. 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 persons in any functional area, our current operations and new product development efforts could be adversely affected. Competition for skilled personnel is intense. When our stock price is lower than our employees' stock option price, it is particularly difficult to retain skilled personnel. We do not maintain material key person life insurance.

We may experience difficulties in managing our growth.

Growth in our business has placed, and will continue to place, significant demands on our management and operations. To succeed, our officers and key employees must manage growth successfully. We must continue to implement and improve our operational, financial and management information systems. In addition, we must expand, train and manage our employee base. We may be unable to timely and successfully accomplish these tasks.

We depend on third parties for certain key components of our products.

We use standard computer hardware for our products. Most of the components we use are readily available. However, only three domestic suppliers can provide voice processing circuit boards in the quantities we need. In addition, only two domestic suppliers can provide our facsimile processing circuit boards in the quantity we require. Historically, we have relied almost exclusively on Dialogic Corporation (now a part of Intel Corporation) for our voice cards, and on Dialogic and Brooktrout, Inc. for our fax cards. We rely on those suppliers primarily because of volume price discounts and the cost and effort required to develop software for an alternate voice or fax card. Significant delays, interruptions or reductions in our supply of voice or fax cards, or unfavorable changes to price and delivery terms could adversely affect our business.

Our stock price may be highly volatile.

The market price of our common stock has been, and may continue to be, highly volatile. The future price of the common stock will fluctuate in response to factors such as

- new product announcements or changes in product pricing policies by us or our competitors;
- 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 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. These broad market fluctuations may adversely affect the market price of our common stock.

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 a short-term investment portfolio consisting of interest bearing securities with an average maturity of less than one year. 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, 2001, the fair value of the portfolio would decline by an immaterial amount. Because the Company has the current 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 current 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.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

In March 2000 several class-action lawsuits were filed in the United States District Court for the Western District of Washington alleging that during the period January 20, 2000 through March 17, 2000, the Company and several officers and directors made or participated in misrepresentations about the Company's ability to achieve revenue expectations for the first quarter of 2000. The court has approved appointment of three plaintiffs to act as Lead Plaintiffs and has consolidated all lawsuits into a single action. No class has been certified. On January 25, 2001, the Court granted Captaris' motion to dismiss the consolidated complaints on the grounds that "none of the four events relied upon by plaintiffs, whether considered separately or in combination, gives rise to a strong inference that any of the defendant directors or officers acted with knowledge or deliberate recklessness." The Court dismissed the claims against four Captaris officers and directors with prejudice. Based on additional representations made by plaintiffs' counsel at oral argument, the Court granted plaintiffs' request that they be allowed to file an amended complaint to attempt to correct the legal deficiencies the Court identified in the consolidated complaint as to Captaris and two officers. Plaintiffs filed their Second Consolidated Amended Complaint on February 25, 2001. Captaris and the two remaining individual defendants have filed a motion to dismiss the Second Consolidated Amended Complaint with prejudice. This motion is currently scheduled to be considered by the Court in May 2001. The Company believes that the allegations of the lawsuits are without merit and intends to continue to vigorously defend the lawsuit if the claims are not dismissed.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

None.

(b) Reports on Form 8-K
The Company did not file any reports on Form 8-K during the quarter ended March 31, 2001.

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.

Captaris, Inc.
(Registrant)

Date: May 14, 2001

By: /s/ Jeffrey B. deCillia

Jeffrey B. deCillia
Executive Vice President,
Chief Financial Officer

Signing on behalf of registrant and as principal financial officer