CAPTARIS INC
Form 10-K
March 17, 2008
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-K

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

**For the fiscal year ended: December 31, 2007**

**OR**

¨ **TRANSACTION 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.

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Washington** | **91-1190085** |
| **(State or other jurisdiction of incorporation or organization)** | **(IRS employer identification no.)** |
| **301 116th Avenue SE, Suite 400** | |
| **Bellevue, WA** | **98004** |
| **(Address of principal executive offices)** | **(Zip code)** |

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

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

| Title of each class | Name of each exchange on which registered |
|---|---|
| **Common Stock, $0.01 par value per share Preferred Stock Purchase Rights** | **Nasdaq Global Market** |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ¨ No x

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 twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a small reporting company. See definition of accelerated filer , large accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x

Non-accelerated filer ¨ (Do not check if smaller reporting company) Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Aggregate market value of voting and non-voting stock held by non-affiliates of the registrant as of June 30, 2007 (our most recently completed second quarter) was $138,169,155 (based upon the closing sale price of $5.12 per share on the Nasdaq Global Market on such date). For purposes of this disclosure, shares of common stock held by executive officers and directors of the registrant have been excluded because such persons may be deemed to be affiliates.

Number of shares of common stock outstanding as of February 29, 2008 was 26,345,044.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the registrant s Proxy Statement for its 2008 Annual Meeting of Shareholders to be filed with the Commission pursuant to Regulation 14A not later than 120 days after December 31, 2007 is incorporated by reference in Part III hereof.

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**CAPTARIS, INC.**

**PART I**

*This Annual Report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as anticipate, believe, continue, could, estimate, expect, future, intend, may, plan, potential, predict, seek, should, target, will or the negative of these terms or other terminology. These statements are only predictions. Actual events or results may differ materially. In evaluating these statements, you should specifically consider various factors, including the risks outlined under Item 1A Risk Factors. These factors may cause our actual results to differ materially from any forward-looking statement. Except as required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.*

**Item 1. BUSINESS**

Founded in 1982, Captaris, Inc., ( we , us , our ) is a provider of computer products that automate document-centric business processes. With a comprehensive suite of software, hardware and services, we help organizations gain control over many processes that include the need to integrate documents more securely and efficiently. Our solutions also provide interoperability between documents and business applications and technology platforms.

We develop products and services for document capture, intelligent document recognition and classification, routing, workflow, document management and document delivery. Our product lineup includes the brand names RightFax, FaxPress, Captaris Workflow, Alchemy, Single Click Entry, DOKuStar and RecoStar.

Our products are distributed and supported through a global network of technology partners. This distribution system consists of business partners from all levels of the information technology ( IT ) spectrum: value-added resellers, original equipment manufacturers ( OEMs ), system integrators, distributors, mass market resellers, online retailers, office equipment dealers, and independent software vendors ( ISVs ). We believe the use of multiple distribution channels increases the likelihood that our products will be sold to more customers.

We have a large installed base of customers that includes many Fortune 100 companies, the majority of the Global 2000 companies, and thousands of mid-sized enterprises. Our customers use our products to reduce costs, comply with regulations, increase the performance and productivity of critical business processes, and leverage their IT system investments.

In July 2007, we bolstered our product portfolio, customer base, and distribution capabilities by acquiring Castelle, a provider of all-in-one network fax appliance solutions for businesses and enterprises. Castelle FaxPress products are designed to be easily deployed and maintained and are generally intended for lower volume use at lower price points than our RightFax product offerings. FaxPress provides Captaris with a fax server product that can be positioned in the tier below RightFax for customers looking for basic fax services that are low cost and easily deployable. The FaxPress products are available through a worldwide network of distributors, resellers, and online retailers.

Castelle s expertise in building all-in-one network appliance solutions facilitates our plan to broaden our offerings in the areas of document capture, routing and management. The network appliance design combines software and hardware into a plug and play device, and we believe this design is particularly well suited to support our focus on achieving synergies with multi-function product manufacturers and their dealer networks.

We further increased our product portfolio, customer base and distribution capabilities with the acquisition of Océ Document Technologies GmbH ( ODT ) in January 2008. ODT is a provider of software and solutions for document capture, text recognition, and document classification. ODT, a wholly-owned subsidiary of the Océ Group since 2000, has approximately 178 employees and maintains its global headquarters in Constance, Germany, and its North American office in Bethesda, Maryland. On an unaudited basis, ODT s revenue was about 22.5 million for the 12 months ended November 30, 2007 and their gross margin was about 65%. ODT s revenue includes software licenses, maintenance and support, hardware and professional services. In contrast to our business prior to acquisition, ODT s revenue includes a higher percentage of professional services and a larger portion of their sales are made directly rather than through partners. As a result of these factors, and a smaller revenue and customer base, ODT has a lower gross margin and more revenue variability.

After our acquisition, we re-named ODT to Captaris Document Technologies ( CDT ). CDT develops intelligent document and character recognition technologies that can read and extract the important information from documents needed to drive business processes and decisions.

CDT products include RecoStar, DOKuStar, Single Click Entry and ID-Star. CDT customers include some large ISVs and OEMs with capture offerings, as well as blue chip end-user accounts in Germany. CDT s expertise in intelligent

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document recognition supports our vision of fully enabling document capture, collaboration and workflow. As we continue to merge our products, we anticipate leveraging CDT s technology to enhance capture and routing in both the RightFax and Alchemy platforms. The ability to classify documents and extract critical meta-data will also enable deeper integrations with line of business applications and business process management.

**Industry Background**

Every organization looks to optimize and automate its internal processes to achieve several desirable outcomes: to comply with regulations; to improve customer service; to increase employee productivity; to improve and accelerate revenue flows; to decrease labor, system and program costs; and to more efficiently share, store and retrieve information. With increasing amounts of information to exchange and manage, we believe there is a growing need for organizations to intelligently and securely capture and manage business information and resources throughout the information lifecycle in a more timely and cost-effective manner.

Solutions to these business needs are found within the multi-billion dollar Enterprise Content Management ( ECM ) market. The ECM market is further categorized into several market segments:

- **Capture,** which includes fax servers;
- **Business Process Management,** which includes workflow;
- **Electronic Document Management Systems** which includes document routing and multi-function product solutions;
- **Enterprise Search,** and,
- **Electronic Records Management.**

Captaris offers products that serve all of these market segments.

**Strategy**

We believe the ECM market presents growth opportunities for our products, particularly in the areas of distributed capture, routing, document and business process management. Further, we believe our product portfolio is appropriately targeted for opportunities being created by Microsoft s development of SQL Server, SharePoint Server, the Windows Workflow Foundation, and enterprise search.

The rapid increase in document-based information, combined with the regulatory and legal pressure to control all of the content more closely than ever before, has further accentuated the need for organizations to purchase products and services that can solve their business challenges. With our comprehensive product portfolio, large and diverse distribution channels, and sizable installed base of customers, we believe we are poised to take advantage of these industry trends. The key components of our business strategy include:

*Strengthening our leadership position in distributed document capture solutions.* We believe organizations are moving away from centralized document capture operations designed to achieve economies of scale and moving towards capturing information closer to the point of origin within their enterprises. By capturing information at the point of origin, documents and associated data describing the context, content and structure of the data on the document are more easily integrated into business processes. Fax servers are by their very nature distributed capture solutions that import and route digital documents. Our intent is to add document classification and more robust data extraction technologies, acquired as part of the CDT acquisition, and evolve RightFax from a fax server into a broader distributed capture platform.

*Leveraging our expanded product portfolio across our large channel*. As we integrate the CDT technology into the RightFax and Alchemy platforms and leverage the appliance building capability of Castelle, we believe these technologies will reach a broader market through the larger customer base and distribution capabilities of Captaris. We intend to bring new or improved products to market in ways that fit each channel s strengths.

*Leveraging Captaris multi-function product ( MFP ) vendor relationships to enhance our distribution capabilities.* Based on industry reports, we believe MFP vendors are selling over $1 billion in software licenses per year. Based on these reports, we believe the vast majority of these sales are in the areas of document capture, routing, and management. Over the past several years we have invested in building relationships with the MFP vendors and have established agreements with many large MFP distributors.

*Selling more products into our large installed base of customers*. We plan to grow our existing customer relationships by offering add-on modules, software upgrades and new products. We continually train our sales force and partners with the skills needed to cross-sell our entire product line into our existing customer base.

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*Expanding our strategic technology partnerships worldwide*. We have strategic partner relationships with large technology companies including Canon U.S.A., Inc., Cisco Systems, Inc., Hewlett Packard Company, Microsoft Corporation, Oracle Corporation and Xerox Corporation. We plan to pursue an expansion of similar agreements in the future through our business development efforts.

*Pursuing global opportunities*. We believe that the market for document-centric solutions outside the United States will experience consistent growth over the next few years. To pursue these opportunities, we localize our products into regional languages. We also actively recruit new international resellers, distributors and strategic partners to expand our market coverage and enhance technical expertise.

*Grow through acquisitions*. Growth through acquisitions of complementary technologies, products and distribution channels offers the potential for significant competitive advantages. In July 2007, we acquired Castelle, the maker of a network fax appliance, to expand our fax server offerings and acquire the skills necessary to develop other network appliances. In January 2008, we acquired CDT, a provider of document and character recognition technologies, to expand and strengthen our existing document solutions.

**Products and Services**

Our product suite addresses the key phases of the information lifecycle, from the capture, recognition and routing of documents to processing, management and delivery. Our products can be deployed alone or integrated together to solve challenging business problems and improve organizational efficiency.

Our products and services include the following categories:

- **Intelligent document capture, recognition, classification, and routing solutions** that create smart documents and automatically deliver them to meet the collaboration and compliance needs of today s business environment.

- **Business process management** software that automates both functional and vertical business processes, helps organizations maintain accountability, supports compliance initiatives and increases productivity; and

- **Document management** software products that target business needs for reducing paper by storing and accessing digital content throughout the information lifecycle and supporting compliance and collaboration within organizations.

***Document Capture, Recognition, Classification, and Routing Products***

***Single Click Entry***

Single Click Entry is designed to reduce human error and increase productivity for any application where data from scanned images is currently entered by hand. This application extracts data from an image and automatically transfers it to line of business applications for use within business processes. Powering this simple and easy to use application are a combination of high performance optical character recognition ( OCR ) and forms processing technologies from our CDT subsidiary.

***DOKuStar***

The DOKuStar product suite provides intelligent document recognition and classification, which are essential to reducing human error, improving compliance, and increasing productivity in any document-centric business process. DOKuStar is sold as a tool set to independent software vendors and system integrators for building vertical applications for document capture and forms processing.

***RecoStar***

RecoStar, an OCR product, is embedded into document management applications, providing fast processing speeds without sacrificing accuracy. Although OCR technology has been around for many years, we believe this technology is fundamental to new developments in the areas of information classification and enterprise search.

***RightFax***

RightFax is a solution for distributed capture and processing of business documents, delivering information within or without an organization in a secure and auditable way. The RightFax product suite includes a wide range of solutions: inbound document capture and routing, fax over Internet protocol ( FoIP ), desktop faxing over a network, and high-volume document delivery from back-office software applications such as those from Oracle or SAP. Although fax has been around for many years, we believe the market shift towards distributed capture provides new growth opportunities. When compared to other remote capture and delivery methods, our customers report that fax has advantages for digitizing documents remotely and routing them between users because of the widespread availability, proven security and reliable audit capabilities of faxing.

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***RightFax Connector for Microsoft SharePoint***

The RightFax SharePoint Connector enables documents to be captured remotely and populated into SharePoint enabling collaboration and workflow. This integration routes the inbound document to a specific SharePoint repository, notifies the end-user of the documents arrival, and triggers the start of the business process.

***FaxPress***

FaxPress is an all-in-one network fax appliance for businesses and enterprises. FaxPress is designed to be easily deployed and maintained, and provides an economical solution for companies seeking basic fax services.

***Business Process Automation Products***

***Captaris Workflow***

Captaris Workflow is a workflow platform built on the Microsoft .NET ( .NET ) Framework, developed to take full advantage of the .NET environment. We designed Captaris Workflow to improve operational processes for midsize and large businesses that have standardized on Microsoft technologies. We believe Captaris Workflow offers significant advantages over past workflow automation approaches with a design that, we believe, facilitates rapid, understandable, affordable and robust solutions that are highly scalable.

We are currently developing new versions of Captaris Workflow that leverage and extend the Microsoft Windows Workflow ( WinWF ) foundation. We believe Captaris Workflow adds significant value on top of WinWF by providing higher-level objects interfaces and tools so that end-users, business analysts, and application developers can rapidly create and deploy applications to manage complex business processes, while supporting the users through the entire lifecycle of process-centric solutions.

***Document Management Products***

***Alchemy***

Alchemy provides organizations with a complete solution for document capture, indexing, document management, archiving, records management, search and retrieval. Alchemy is designed specifically for organizations with limited or constrained IT resources, and to be deployed quickly and efficiently by end-users. Alchemy specializes in the management of fixed content that organizations must retain for business, compliance and/or legal purposes.

***Professional Services***

Captaris provides strategic and architectural consulting, custom deployment, integration services to third-party technologies, training and other services. These services are frequently offered as an extension of the capabilities of our channel partners.

**Distribution**

We sell, promote and receive referrals for the use of our products primarily through an indirect channel of resellers and distributors, system integrators, strategic partnerships, OEMs and private label agreements, as well as through our enterprise sales team and national account managers that hold dedicated business relationships with assigned accounts on the Fortune 500 list. We believe the use of multiple distribution channels increases the likelihood that our products will be sold to more customers. No single customer represented more than 10% of our net revenue in 2007, 2006, or 2005.

Our revenue and long-lived assets are classified by geographic area in Note 15 to our Consolidated Financial Statements included herein.

**Product Support**

We sell a variety of customer support packages for all of our products. In addition, we typically bundle a first year maintenance program with our software licenses. Our maintenance and support agreements provide customers with telephone, web and on-location

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**CAPTARIS, INC.**

support and unspecified upgrades and updates, when and if available. We recognize revenue for maintenance and support agreements on a straight-line basis over the service contract term, generally ranging from one to five years. We provide worldwide support 24 hours per day, 7 days per week.

The Captaris Learning Center, our online training program, enables our customers to improve their skill levels around our products and solutions. Customers register for courses online, manage their curriculum, track their class history, receive training announcements on a regular basis, complete online surveys of classes taken and register and take web-based training from one location. We deliver some educational content as a subscription-based service and we recognize the revenue from these services on a straight-line basis over the term of the subscription.

**Product Development**

We have in-house expertise in the development of systems that capture, recognize, classify, index, route, process, render, store, retrieve and deliver documents and data. We also have expertise in integration with back-end office systems and databases. We believe that our expertise in these areas enables us to efficiently bring innovative software products to market.

In 2007 we contracted with multiple outsource companies for maintenance engineering efforts and selected new product development. In conjunction with our outsourcing program, we are in the late stages of completing a restructuring of our development organization. At the end of 2007, we have three primary product development centers: Bellevue, Washington; Morgan Hill, California; and Tucson, Arizona. With the acquisition of CDT, we added a product development center in Constance, Germany.

We internally develop or acquire our defining core technologies, and we license from third parties primarily broad-based, generic or non-strategic components of our products, such as database software, imaging and network connection software. Whenever practical, we license and integrate such technology into our product offerings in order to decrease the cost of development and shorten the time to market for our products. We also believe that acquiring new technologies and new product offerings is consistent with our strategic initiatives, and we will pursue such opportunities as they become available.

For our product offerings to continue to achieve acceptance and remain competitive, we believe it is necessary to develop enhanced versions of our software applications. Our research and development expenditures were $16.2 million, $12.2 million, and $14.0 million in 2007, 2006, and 2005 respectively. Research and development expenses as a percentage of revenue were 17.0%, 13.3% and 16.2% in 2007, 2006, and 2005 respectively. Additional expenses in 2007 that we did not incur in 2006 or 2005 included making changes in our research and development organization s structure to reduce the costs associated with sustaining and maintenance engineering for Alchemy and Captaris Workflow.

We also develop versions of our products for several foreign markets. This globalization effort includes converting client interfaces and documentation into foreign languages and includes the expansion of internal character sets to accommodate a broader set of potential foreign languages. We expect to continue to expend research and development resources on these efforts.

**Proprietary Rights**

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. We own 12 U.S. patents, including six patents acquired in 2000 in the areas of number qualification, unified messaging and fax technology and two patents acquired in 2002 in the areas of speech compression and operating system installation/servicing. These issued patents will expire between 2014 and 2026. We also own 14 pending patent applications in the U.S. and eight internationally in a range of areas, including telephony, fax, unified messaging, workflow technology and mobility-related messaging. In addition, in connection with the acquisition of CDT in January 2008, we acquired approximately 10 patents and patent applications covering certain fields of use that we believe are relevant to CDT s technology.

There can be no assurance that our efforts to protect our proprietary rights will be successful. In particular, there can be no assurance that our current or future patent applications will be granted or that our current or future issued patents will not be challenged, invalidated or circumvented, or that the rights granted under any such patents will provide competitive advantages to us.

We have periodically received letters and other communications from third parties asserting patent rights and requesting royalty payments. Some of these claims are unresolved and continue to be outstanding, even after several years of intermittent communication. Based upon our analysis, we do not believe it necessary, in most cases, to license any of the patent rights. In those cases in which we have determined a license of patent rights was necessary, we have entered into a license agreement.

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We license certain portions of our technology from third parties under written agreements, some of which contain provisions for ongoing royalty payments. Our royalty expense as a percentage of net revenue was 1.3%, 0.9% and 1.0% for the years ended December 31, 2007, 2006 and 2005, respectively.

**Competition**

We compete in several software markets including document capture, fax servers, business process management, and document management software. These markets are quickly evolving, highly competitive and subject to rapid technological change. Moreover, we expect to face increasing competitive pressures from both current and future competitors in the markets we serve. In most cases, we face vendors that are focusing on one particular market. The principal competitive factors applicable to our products and services include:

- breadth and quality of software alternatives;
- the ability to integrate various products with customers existing business applications and networks;
- the ability to respond to technological change;
- the level of customer support and professional services;
- relationships with distributors, strategic partners, value-added resellers and systems integrators;
- an installed base of similar or related products;
- end-user price; and
- channel partner margins.

Our suite of products comprises versatile solutions for the mid-market and enterprise departments provided through a single vendor, which we believe is a competitive advantage of our products. With respect to individual offerings in our product line, our competitive position with respect to the factors above varies depending on the market addressed.

For our **fax server and document delivery** products, our principal competitors are Esker, Inc. S.A., Biscom, Inc., Kofax/TOPCALL, Fenestrae, GFI Software, Ltd. and SAGEM-Interstar. In the overall fax server market we believe we hold the leading market share, based on worldwide revenue. Our fax server products also compete with vendors offering a range of alternative fax solutions, including standalone fax machines, operating systems containing fax and document transmission features, low-end fax modem products, desktop fax software, single-platform fax software products, application service providers and hosted solutions including J2 Global Communications and PTEK Holdings, Inc., bundled fax software and hardware providers, and customized proprietary software solutions. We strive for competitive differentiation by offering complementary products from our extensive product portfolio.

Our **capture** products from the recent CDT acquisition face several competitors. In the RecoStar OCR market, we consider the main competitors to be Nuance s Scansoft division, ABBYY and Iris. We expect increasing competition from emerging OCR companies specializing in Asian languages. In the DOKuStar intelligent document recognition ( IDR ) market, we compete against EMC/Captiva, Dicom/Kofax, and ReadSoft among others; these vendors provide packaged solutions. In comparison, we believe we have an advantage and defensible niche by providing an IDR platform that can be integrated within other applications.

For our **business process automation** products, we face several competitors offering similar products and using similar architecture designed for rapid deployment by knowledge workers. We believe the direct competitors of our business process automation products also utilize the .NET product architecture and would include K2.net (SourceCode Technology Holdings, Ltd.), Metastorm, and Ultimus, Inc. Overall, we believe our products are differentiated from our competitors products due to our deep integration with Microsoft technology and applications, as well as our ability to offer our own capture and document management products to round out solutions. We do not categorize Microsoft s WinWF as a direct competitor but as a new and widely available platform on which to build our workflow and business process management products.

Our **document management** solutions compete primarily in the mid-market and MFP dealer channels based on functionality and price. Our main competitors are Hyland Software, Inc. (OnBase product), EMC Corporation / Documentum (ApplicationXtender product), Westbrook Technologies, Inc. (Fortis product) and Compulink Business Systems, Inc. (Laserfiche product). While these vendors offer products with similar functionality, we strive to differentiate by the simplicity of Alchemy, the respective price/value received, and by the inherent benefits of offering complementary products in the Captaris product suite: RightFax, FaxPress, Single Click Entry and Captaris Workflow.

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**Hardware**

To augment RightFax sales, we currently purchase fax boards from Dialogic Corporation. Similarly, our FaxPress network appliance business is dependent upon our manufacturing partners and component suppliers. If these manufacturers terminate their relationships with us, are unable to fill orders on a timely basis, or experience quality performance issues, we may be unable to meet our customers demands which could delay or decrease our revenue or otherwise have an adverse impact on our operations. In 2007, we made strides in moving beyond our dependence on fax hardware by starting the transition to software-based FoIP which does not rely on fax hardware in many Internet protocol environments. We expect this shift from hardware to software to increase over the next several years.

**Seasonality**

Most of our software product revenue comes from current-quarter orders and sales, of which a substantial portion has, at times, occurred in the last month of the quarter. Our results of operations may fluctuate as a result of seasonal factors and they may cause our operating results to fall below the expectations of securities analysts and investors for a particular quarter. Specifically, due to typical year-end dealer sales patterns and end-user buyer patterns, revenue in our first quarter, without taking into account the effect of acquisitions, has historically declined from the fourth quarter of the previous year. Revenue builds gradually during the second and third quarters ending with the fourth quarter as our largest quarter for revenue. We anticipate this pattern will continue in 2008.

**Employees**

As of December 31, 2007, we had 450 full-time employees, 177 in sales and marketing, 118 in technical support and production, 84 in engineering and product development and 71 in finance, information technology and administration. Our employees enter into agreements containing confidentiality restrictions. We have never had a work stoppage and no employees, other than those with CDT, are represented by a labor organization. We consider our employee relations to be good.

Subsequent to year end, we acquired CDT. CDT has approximately 178 employees.

**Available Information**

Our Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and amendments to reports filed pursuant to Sections 13(a) and 15(d) of the Exchange Act are available free of charge on our Web site as soon as reasonably practicable after the reports have been filed with or furnished to the SEC at http://www.captaris.com under About Us Investor Relations SEC Filings. In addition, the following corporate governance materials of Captaris are also available in the About Us menu by selecting the Corporate Governance link on our Web site at http://www.captaris.com:

- Audit Committee, Compensation Committee and Governance Committee Charters.
- Code of Business Conduct applicable to all directors, officers and employees of Captaris.
- Finance Code of Professional Conduct for our CEO and senior financial officers.

If we waive any material provision of our Code of Business Conduct or Finance Code of Professional Conduct for our CEO and senior financial officers or substantively change the codes, we will disclose that fact on our Web site within four business days. A copy of any of the materials filed with or furnished to the SEC or copies of the corporate governance materials described above are also available free of charge and can be mailed to you upon request to Captaris, Inc., Investor Relations, 301 116th Avenue NE, Suite 400, Bellevue, WA 98004.

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**CAPTARIS, INC.**

**Executive Officers**

Our executive officers as of March 1, 2008 are as follows:

| Name | Age | Position | Executive Officer Since |
|---|---|---|---|
| David P. Anastasi | 51 | President, Chief Executive Officer and Director | 2000 |
| Peter Papano | 58 | Chief Financial Officer and Treasurer | 2003 |
| Douglas F. Anderson | 54 | Senior Vice President of Global Field Operations | 2007 |
| Paul M. Yantus | 46 | Executive Vice President of Marketing and Product Development | 2007 |

*Mr. Anastasi* joined Captaris as President, Chief Executive Officer and a director in November 2000. From May to November of 2000, Mr. Anastasi served as President and Chief Executive Officer of Conversational Computing Corporation, a speech recognition technologies company. Prior to that, he was a founder and President and Chief Executive Officer of the Global Chipcard Alliance, a SmartCard consortium from 1999 to 2000. From 1994 to 1999, Mr. Anastasi served as Vice President and General Manager of the Public Access Solutions and SmartCard Division of U S WEST. Mr. Anastasi currently serves on the Board of Directors of the AeA (formerly known as the American Electronics Association ). Mr. Anastasi holds a B.S. degree in marketing management from Bentley College and a Masters degree with an emphasis in international management from the University of San Francisco.

*Mr. Papano* joined Captaris in September 2003. Prior to joining Captaris, Mr. Papano served as Chief Financial Officer of Evant, Inc., an enterprise software company, from 2000 to 2003; QRS Corporation, a publicly traded e-commerce company, from 1998 to 2000; and The Dialog Corporation, an electronic information company, from 1991 to 1998. Mr. Papano is a certified public accountant. He holds a B.S. degree in business with an emphasis in finance and an M.B.A. degree in accounting from the University of Colorado.

*Mr. Anderson* joined Captaris in July 2005 as Vice President of North American Field Operations. In April, 2007, he was promoted to Senior Vice President Global Sales and Field Operations. Prior to joining Captaris, Mr. Anderson held management positions at IBM from 1976 to 1985, Lotus Development Corporation from 1985 to 1990, Saros Corporation (FileNet) from 1991 to 1994, and executive-level positions with several emerging public and private companies headquartered both in and outside North America. Mr. Anderson holds a bachelor s degree from the University of Washington.

*Mr. Yantus* joined Captaris in April 2007 as Executive Vice President of Marketing and Product Development. Prior to joining Captaris, from March 2005 to September 2006, Mr. Yantus served as President and CEO of Scan-Optics, a provider of information capture and recognition technologies to the financial, government, and education markets. Prior to Scan-Optics, he founded Espire, an ASP solution for managing branded messaging, and served as its President from July 2003 to March 2005. From March 1999 to June 2003, Mr. Yantus served as Senior Vice President of Custom Communications division for MSX International. Mr. Yantus holds a B.B.A. degree from Western Michigan University and a Post Bachelor degree in Computer Science from Wayne State University.

## Item 1A. RISK FACTORS

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

**Our stock price has been highly volatile.**

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

new product announcements or changes in product pricing policies;

quarterly and seasonal fluctuations in our operating results;

announcements of technical innovations;

announcements relating to strategic relationships or acquisitions;

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- changes in earnings estimates by securities analysts; and
- general conditions in the economy and/or levels of information technology spending.

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

**Our quarterly and seasonal sales operating results vary. These operating results may fall below expectations of securities analysts and investors.**

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

- fluctuations in quarterly sales patterns;
- seasonality factors discussed below;
- the timing of customer orders;
- constraints on our manufacturing and assembly operations;
- shortages or increases in the prices of raw materials and components;
- changes in our mix of products and distribution channels;
- customer order deferrals in anticipation of new versions of our products;
- the announcement or introduction of new products by us or our competitors;
- pricing pressures;
- costs related to the acquisition of technologies or businesses;

- costs of maintaining, integrating or expanding our operations;

- costs of hiring qualified personnel;

- technological changes in our market, including changes in standards for protocols, platforms and operating systems applicable to software, hardware and networking environments;

- costs associated with outside service providers, such as legal counsel and auditors, and taxes owed by us;

- general economic conditions; and

- exchange rate fluctuations.

Most of our software product revenue comes from current-quarter orders and sales, of which a substantial portion has, at times, occurred in the last month of the quarter. We do not maintain a large backlog of orders and most of our distributors maintain little or no inventory. Order fulfillment cycles are typically short and often as short as one to two days. Accordingly, the timing of customer orders can cause significant variations in quarterly results of operations. Because we sell our products to end-customers through various third parties, such as value-added resellers and independent distributors, we are unable to predict with certainty the actual orders, sales and revenue these third parties will generate in a given quarter. These factors could impair and delay our ability to know when revenue and earnings will be higher or lower than expected. We plan our expenditure levels and product development on our expected revenue. 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 revenue.

Our results of operations may also fluctuate as a result of seasonal factors and this may cause our operating results to fall below the expectations of securities analysts and investors for a particular quarter. Specifically, due to typical year-end dealer sales patterns and end-user buying patterns, revenue in our first quarter, without taking into account the effect of acquisitions, has historically declined from the fourth quarter of the previous year.

Subsequent to year end, we acquired Océ Document Technologies GmbH and renamed it Captaris Document Technologies GmbH ( CDT ). (We discuss this acquisition in further detail in this report under Subsequent Events in Item 7, Management s

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Discussion and Analysis of Financial Conditions and Results of Operations.) CDT transacts business in Euros and its revenue, expenses and results of operations will be translated to U.S. dollars in our consolidated financial statements. We expect a significant portion of our consolidated revenue in 2008 to come through CDT. As such, our revenue, operating expenses and results of operations may fluctuate as a result of changes in foreign currency rates between the Euro and U.S. dollar. This may cause our operating results to fall below the expectations of securities analysts and investors for a particular quarter or year.

**We depend on third parties for key components of our RightFax product.**

Until October 2007, two domestic suppliers provided fax processing circuit boards to meet our specifications, Dialogic Corporation and Cantata Technology, Inc. Historically, we have relied almost exclusively on Cantata for fax boards primarily because of volume price discounts and the cost and effort required to develop software for alternate fax boards. In October 2007, Dialogic announced that it had acquired all of the outstanding stock of EAS Group, Inc., which owns Cantata. As a result, our suppliers of fax boards are now consolidated under the control of a single parent company, Dialogic. Significant changes in technology, issues regarding quality performance, delays, interruptions or reductions in our supply of fax boards, or unfavorable changes to price and delivery terms could adversely affect our business. We may be relatively more impacted by these issues now that Dialogic controls Cantata.

**We rely heavily on independent distributors, value-added resellers and IT service partners.**

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

**Failure to establish and maintain OEM and strategic relationships could limit our ability to maintain or increase revenue.**

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

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

**Our market is highly competitive.**

The business solutions market is highly competitive and is rapidly changing. We may not have the financial resources, marketing, distribution, 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 software alternatives, product integration capabilities, product functionality, performance, reliability, ease of use, ability to update our products to respond to technological change, relationships with distributors, strategic partners, value-added resellers and systems integrators, price, size of the installed base, level of customer support and professional services.

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In the market for LAN-based fax systems, our principal competitors are Esker, Inc. S.A., Biscom, Inc., TOPCALL International AG, Omtool, Ltd., Fenestrae, GFI Software, Ltd. and SAGEM-Interstar. Our fax server products also compete broadly with vendors offering a range of alternative fax solutions, including operating systems containing fax and document transmission features, low-end fax modem products, desktop fax software, single-platform fax software products, outsource fax providers and customized proprietary software solutions. The direct competitors of our business process automation products include K2.net (SourceCode Technology Holdings, Ltd.), Metastorm and Ultimus, Inc. Our main competitors of our document archiving products are Hyland Software, Inc. (OnBase product), EMC Corporation / Documentum (ApplicationXtender, EmailXtender products) and Compulink Business Systems, Inc. (Laserfiche product). For our capture products, our main competitors are Nuance s Scansoft division, ABBYY and Iris. In addition, we compete against EMC/Captiva, Dicom/Kofax, and ReadSoft among others.

We may not be able to compete successfully against current and future competitors and the competitive pressures we face could harm our business and prospects. We expect the competition in our markets to increase over time. There can be no assurance that our current or future competitors will not develop products comparable or superior in terms of price and performance features to those developed by us or be able to adapt more quickly than we can to new or emerging technologies and changes in market opportunities. Increased competition and competitive pressures may result in changes in market share, decreased sales volumes, price reductions and/or increased operating costs associated with marketing and sales incentives, resulting in related reductions in revenue, gross margins and operating income, any of which could materially adversely affect our ability to achieve our financial and business goals. There can be no assurance in the future that we will be able to successfully compete against current and future competitors.

**Technology and customer demands change rapidly in our industry.**

In our industry, technology and customer demands change rapidly and our competitors frequently introduce new products and features. To succeed, we must identify, develop and market new products, features and services that are compatible with a growing array of computer and peripheral devices, support popular computer and network operating systems and applications, and achieve broad market acceptance by satisfying evolving 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. 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 and accordingly, the results of our operations may be adversely affected.

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

The development and marketing of products requires significant amounts of capital. If we need additional capital resources, we may be required to sell additional equity or debt securities, secure additional lines of credit or obtain other third party financing. The timing and amount of such capital requirements cannot be determined at this time and will depend on a number of other factors, including demand for our existing and new products and changes in technology in the networking industry. We may also need to raise additional funding if we decide to undertake more rapid expansion, including acquisitions of complementary products or technologies. There can be no assurance that additional financing will be available on satisfactory terms when needed, if at all. Failure to raise such additional financing, if needed, may result in our inability to achieve our long-term business objectives. Moreover, if we need to issue equity or convertible debt securities to raise additional capital, any such issuance could result in significant dilution to our shareholders.

**Our business is affected by adverse economic conditions and resulting declines in customers investments in our products.**

Our profitability may be adversely affected by global economic conditions and a prolonged economic slowdown. Generally, we derive net revenue primarily from licensing software as well as follow-on sales of add-on software modules and the sale of maintenance and support agreements. We group our revenues based on whether the revenue is non-recurring revenue (revenues from sales of software) or recurring revenue (revenues from maintenance and support agreements). During a short-term economic slowdown, non-recurring revenue is adversely affected because customers are reluctant to buy software, but this adverse impact is generally offset by recurring revenue from long-term maintenance and service contracts. During a prolonged economic slowdown, however, the reluctance of our customers to invest has an adverse impact on both recurring and non-recurring revenue because both

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types of revenue are to a large extent based on our installed base. As long-term maintenance contracts expire during a prolonged economic slowdown, we enter into fewer new long-term agreements to replace expiring contracts because fewer customers make investments in software during the slowdown.

**We are highly dependent on information technology systems.**

Our operations rely on complex information technology systems and networks, which are potentially vulnerable to damage or interruption from a variety of sources. We are constantly evaluating our current technology and information technology systems. Although we take precautions against interruptions of our information technology systems and networks and the unrestricted disclosure of our proprietary information, a prolonged interruption of our information technology systems or a disclosure of our proprietary data could adversely affect our business.

**We face risks from our international operations.**

Maintaining or growing our revenue depends, in part, on our international product sales. We focus significant management attention and financial resources toward our international operations and, with the acquisition of CDT in January 2008, we have significantly expanded these operations. It is costly to establish international facilities and operations to promote our brand internationally and to develop localized systems. We may not succeed in these efforts. Our net sales from international market segments may not offset the expense of establishing and maintaining the related operations and, therefore, these operations may not be profitable on a sustained basis. Significant portions of our revenue are subject to the risks associated with international operations, which include:

- difficulty adapting products to local languages and technologies;
- inability to respond to changes in regulatory requirements;
- inability to meet special standards requirements;
- exposure to exchange rate fluctuations;
- restrictive governmental actions (such as trade protection measures, including export duties and quotas and custom duties and tariffs);
- import or export licensing requirements, restrictions, tariffs and other regulatory restrictions;
- the burdens of complying with a variety of foreign laws, including more protective employment laws;
- limitations on the repatriation of funds;
- longer receivables cycles;

- difficulties in staffing and managing international operations;
- potentially adverse tax consequences; and
- uncertainties arising from local economic or market conditions, 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, our United States sales and some international sales are denominated in U.S. dollars. We also may price our international sales to Europe in Euros, to the United Kingdom in British pounds sterling, to Canada in Canadian dollars, and to Australia in Australian dollars. Increases in the value of the U.S. dollar against these currencies could cause our products to become relatively more expensive to customers in a particular country or region, leading to reduced revenue or profitability in that country or region. We expect to continue expanding our international operations. As a result, we expect our non-U.S.-dollar-denominated sales and our exposure to gains and losses on international currency transactions will increase, which could have a material adverse effect on our results of operations in a given quarter or year.

**As of the date of this report, a significant amount of our cash is held by our German subsidiary, and if we are not able to repatriate these funds in a timely manner, our liquidity may suffer.**

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Since the acquisition of CDT in early January 2008 and through the date of this report, the majority of our consolidated cash is held by CDT in Germany. As of the date of this report, CDT is restricted under German law from repatriating its cash to Captaris in repayment of an intercompany loan established to fund the acquisition of CDT. As discussed in more detail in Item 7 of this report under Liquidity and Capital Resources, we are taking specific actions which we believe will allow CDT to repatriate its excess cash to Captaris during the second quarter of 2008. There can be no assurances that our actions will be successful or completed in a timely manner. Our inability to complete these actions in a successful and timely manner could have a material adverse effect on our financial condition, results of operations, cash flows and liquidity.

The outstanding intercompany loan to our wholly-owned subsidiary of 31.6 million ($46.2 million) exposes us to significant gains and losses from fluctuations in the exchange rate to U.S. dollars. To mitigate this risk, we have entered into a foreign currency exchange forward contract, agreeing to sell approximately 31.6 million at a future date. This contract is unsecured and matures on April 4, 2008. Under the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, our foreign currency forward contract is an effective hedge of our foreign currency risk exposure on the intercompany loan. However, until our subsidiary can remit cash in repayment of the intercompany loan, which we would then use to settle the foreign currency forward contract, we are exposed to potentially significant U.S. dollar cash flow risks. To the extent that the foreign currency forward contract is in a loss position on the date of maturity, we must settle the contract in U.S. dollars equal to the amount of the loss. Additionally, we intend to continue to hedge our foreign currency exposure on the intercompany loan until it is repaid in full. This will require us to enter into a new foreign currency contract when our existing foreign currency contract expires on April 4, 2008. There can be no assurances that we will be able to obtain a new foreign currency contract at the same rate or similar unsecured terms.

**We are exposed to foreign currency exchange rate volatility in our international operations, which may result in currency translation losses that could have material adverse effect on our results of operations and financial condition.**

The results of operations and financial condition of our international operations and subsidiaries are exposed to foreign exchange rate fluctuations. Upon translation, operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of certain balances denominated in foreign currencies. For example, with respect to our net assets denominated in currencies other than the U.S. dollar, a strengthening U.S. dollar would result in less net assets when converted to U.S. dollars, which could have a material adverse impact on our financial condition or results of operations. As we have expanded our international operations, and particularly with the acquisition of CDT in early January 2008, our exposure to these exchange rate risks has increased. As of the date of this report, a significant portion of our net assets are denominated in Euros and, to a lesser extent, in Canadian dollars, Australian dollars and British pounds sterling. Moreover, with the acquisition of CDT, a significant portion of our consolidated revenue will be denominated in Euros. Historically, we have not hedged our foreign currency translation risk. Although we may do so in the future, there can be no assurance that any such actions will entirely mitigate our exposure to these risks.

**The integration of recent and any future acquisitions may be difficult and disruptive, and we may incur significant costs in connection with the evaluation and negotiation of potential acquisitions.**

We frequently evaluate potential acquisitions of products, technologies and businesses. Any acquisitions we may undertake may direct management s attention away from the day-to-day operations of our business and may pose numerous other risks. We may not be able to successfully integrate technologies, products, personnel or operations of companies that we may acquire or retain customers of the acquired business. In addition, we may be subject to further regulatory approvals, we may be entering markets in which we have limited or no prior experience and we may be unable to retain key employees or to recruit additional managers with the necessary skills to supplement the management of the acquired businesses. In addition, we may need to make significant cash payments and dilutive issuances of our equity securities, incur debt, assume unknown liabilities, write-off purchased in-process research and development, amortize expenses related to other intangible assets and incur restructuring charges as well as costs of integrating personnel and operations. Any of these events could have a material adverse effect on our financial condition or results of operations.

In connection with our evaluation of, and negotiation with, potential acquisition candidates, we may incur significant costs, including legal, accounting and financial advisory fees. We have typically deferred and, upon completion of the transaction, capitalized the acquisition costs as part of the purchase price. However, if the acquisition is abandoned without completion, we would write off the deferred expenses as a charge to operating expenses in the quarter in which we concluded the transaction would not be completed. In some cases, particularly when a potential acquisition is abandoned in the late stages of the due diligence and negotiation process, the acquisition costs may be significant and could have a material adverse effect on our financial results in the quarter and year in which we recognize the charge. Beginning on, but not before, January 1, 2009, our practices with respect to acquisition costs will change to comply with the provisions of SFAS No. 141 (revised 2007) ( SFAS No. 141R ), *Business Combinations*, which

replaces SFAS No. 141 and amends several others. SFAS No. 141R does not allow us to defer acquisition costs and include them as part of the purchase price. Instead, SFAS No. 141R requires us to record all acquisition costs as a charge to operating expenses as we incur them.

**Our average sales prices may decline for some of our products.**

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

**Our business may be seriously harmed by third-party litigation against us relating to alleged violations of the Telephone Consumer Protection Act.**

We have been involved in an ongoing lawsuit in Circuit Court in Cook County, Illinois. The lawsuit was filed by Travel 100 Group, Inc. ( Travel 100 ), against Mediterranean Shipping Company ( Mediterranean ). The complaint alleges violations of the Telephone Consumer Protection Act in connection with the receipt of facsimile advertisements that were transmitted by MediaTel Corporation, a wholly-owned subsidiary of Captaris, on behalf of travel service providers, including Mediterranean. All of the assets of MediaTel were sold to a subsidiary of PTEK Holdings, Inc. on September 1, 2003. Under the Telephone Consumer Protection Act, a court can impose liability of $500 per fax on a party that sends a fax without consent of the recipient and can increase the liability to $1,500 per fax if the sending of the fax is willful.

The Travel 100 complaint sought injunctive relief and unspecified damages and certification as a class action on behalf of Travel 100 and others similarly situated throughout the United States that received the facsimile advertisements. Mediterranean named Captaris as a third-party defendant and asserted that, to the extent that it is liable, Captaris should be liable under theories of indemnification, contribution or breach of contract for any damages suffered by Mediterranean. Both Captaris and MediaTel have denied any liability in the case because, among other facts and defenses, MediaTel understood that the database and lists of travel agent recipients to whom faxes were sent had authorized that information could be sent to them by fax.

On September 29, 2006, the court in the Mediterranean case granted summary judgment in favor of Mediterranean and Captaris and dismissed the case. In granting summary judgment, the court ruled that Travel 100 had invited the facsimile advertisements and there was no violation of the Telephone Consumer Protection Act. Travel 100 filed a motion for reconsideration, which the court denied. Travel 100 then filed a notice of appeal on December 29, 2006. All briefing on the appeal is complete, however no date has been set for oral argument.

Our insurance carrier has agreed to pay defense costs in the Mediterranean case but has reserved its rights to contest their duty to indemnify Captaris with respect to this matter. We are vigorously defending the Mediterranean case, but litigation is subject to numerous uncertainties and we are unable to predict the ultimate outcome of this case. Moreover, even if the plaintiff prevails on the appeal, the plaintiff will still need to certify a class. The amount of any potential liability in connection with the case, will depend, to a large extent, on whether a class is certified, and if one is certified, on what the scope of that class will be, neither of which can be predicted at this time.

We have not recorded a liability related to the Mediterranean case. However, there is no guarantee that we will not determine in the future that an accrual is required or that we will not be required to pay damages in respect of the Mediterranean case in the future, which could materially and adversely affect our results of operations, cash flows and financial condition for the quarter or year in which any accrual is recorded or any damages are paid. We have tendered this claim to our general liability insurance carrier and the carrier has agreed to pay defense costs. However, the carrier has reserved its rights to contest their duty to indemnify Captaris with respect to the matter. Even if coverage is determined to apply, since the potential liability of the claim is substantially in excess of our coverage limits, there can be no assurance that our coverage will be sufficient to satisfy any damages we are required to pay.

Regardless of the outcome, the Mediterranean case may cause us to incur significant expenses and divert the attention of our management and key personnel from our business operations.

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**Our products may suffer from defects or errors, which could result in loss of revenue, delayed or limited market acceptance of our products, increased costs and damage to our reputation.**

Software products as complex as ours may contain errors or defects, especially when first introduced or when new versions are released. Commercial release of past versions of our products were delayed until software problems were corrected, and in some cases, we have provided product updates to correct errors in released products. Our new products or releases may not be free from errors after commercial shipments have begun. Any errors that are discovered after commercial release could result in loss of revenue or delay in market acceptance, diversion of development resources, damages to our reputation, increased service and warranty costs or claims against us.

**Security breach of confidential data may expose us to additional costs and to litigation, which could harm our business.**

Our products may involve the transmission or storage of business-critical, proprietary or confidential information. If the security measures that we incorporate in our products are breached or if there is an inappropriate disclosure of confidential information, we could be exposed to litigation and possible liability. Even if we were not held liable, a security breach or inappropriate disclosure of confidential information could harm our reputation and even the perception of a security risk could inhibit market acceptance of our products and services. In addition, we may be required to invest additional resources to protect us against damages caused by these actual or perceived disruptions of security breaches in the future.

Further, our applications may be vulnerable to unauthorized and illegal access, sabotage, computer viruses and other disruptive problems, including natural disasters. Eliminating computer viruses and addressing other security problems may cause either loss or compromise of data or interruptions, delay or cessation of service to users accessing our business information delivery applications, which could harm our business, expose us to risks of loss or litigation and possible liability. We may be required to expend significant capital or other resources to protect against the threat of security breaches or to alleviate problems caused by breaches.

**We may be unable to adequately protect our proprietary rights.**

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. Our competitors may challenge or circumvent the claims in our patents. Our current patents, or any future patents, may never provide us with any competitive advantages. Other measures that we take to protect our proprietary technology may not prevent or deter misappropriation of our technology or the development of technologies with similar characteristics. Moreover, our use of open systems architecture in the design of our products may make it easier for competitors to misappropriate or replicate our designs and developments.

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

If we are unable to operate without infringing the patents and proprietary rights of third parties, our operating margins may decline as a result. 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 our industry have filed numerous allegations of patent infringement, resulting in considerable litigation.

We periodically receive letters and other communications from third parties asserting patent rights and requesting royalty payments, among other remedies, and will probably receive additional claims in the future. Some of these claims are unresolved and continue to be outstanding, even after several years of intermittent communications. The ultimate outcome of any of these matters that continue to be outstanding or that may arise in the future cannot be determined, and there can be no assurance that the ultimate resolution of these matters will not have a material adverse effect on our results of operations, cash flows and financial condition. 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;

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obtain licenses, which may be unavailable on acceptable terms; or

redesign products or services that use the infringing technology.

**Our insurance coverage may be insufficient to cover existing or future liability claims.**

We maintain third party insurance coverage against various liability risks of property loss. While we believe these arrangements are an effective way to insure against liability and property damage risks, the potential liabilities associated with those risks or other events could exceed the coverage provided by such arrangements.

**Our credit facility contains financial and other covenant restrictions, and if we are unable to comply with these restrictions, the bank may declare an event of default.**

Our credit facility with Wells Fargo Foothill, LLC contains certain loan covenants, including, among others, financial covenants providing for a minimum EBITDA and maximum amount of capital expenditures, and limitations on our ability with regard to the incurrence of debt, the existence of liens, stock repurchases and dividends, investments, and mergers, dispositions and acquisitions, and events constituting a change in control. In addition, the credit facility contains events of default that include, among others, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, bankruptcy and insolvency events, material judgments, and cross defaults to certain other indebtedness. The occurrence of an event of default will increase the applicable rate of interest and could result in the acceleration of our obligations under the credit facility. If we are unable to comply with these covenants, or if an event of default otherwise occurs, our financial condition and liquidity could be adversely affected.

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

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

**If our goodwill or amortizable intangible assets become impaired we may be required to record a significant charge to earnings.**

In accordance with the provisions of SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ), we review our amortizable intangible assets for impairment when events or changes in circumstances indicate the carrying value may not be recoverable. SFAS No. 142 requires us to test our goodwill for impairment at least annually. Factors that may be considered a change in circumstances indicating that the carrying value of our goodwill or amortizable intangible assets may not be recoverable include a decline in stock price and market capitalization, future cash flows, and slower growth rates in our industry. In the event that, in the future, we conclude that our goodwill or our amortizable intangible assets are impaired, we would be required to record a charge to earnings in our financial statements and that charge may significantly decrease our results of operations.

**We develop our products to operate on third party servers and platforms that are beyond our control, and any changes to those platforms or servers could have an adverse impact on our revenues or operating results.**

We believe our product portfolio is appropriately targeted for opportunities being created by third party development of servers and operating platforms such as Microsoft s SharePoint Server and SQL Server. We do not develop these servers or platforms, have no control over changes to their functionality and cannot guaranty that these platforms will remain in the market. As a result, should changes to the platforms occur, we may be forced to incur significant costs to redesign our products or make them compatible with the modified platforms. We may also be forced to completely redesign our product portfolio if one or more of the platforms are no longer available. The costs associated with this could be significant and may have an adverse impact on our overall revenues and/or operating results.

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**In connection with our acquisition of Oce Document Technologies GmbH, we assumed certain unfunded pension liabilities. We have no assurance that we will generate sufficient cash flow to satisfy these obligations.**

In January 2008, we acquired Oce Document Technologies GmbH and, as a part of the transaction, assumed its unfunded pension plan liabilities of approximately $17.9 million as of January 4, 2008. We will be required to fund these obligations through current and future cash flows. Going forward, our net pension liability and cost may be materially affected by the discount rate used to measure these pension obligations and the longevity and actuarial profile of the relevant workforce. A change in the discount rate would result in a significant increase or decrease in the valuation of these pension obligations, affecting the net periodic pension cost in the year the change is made and following years. We have no assurance that we will generate cash flow sufficient to satisfy these obligations. This could have a material adverse effect on our business and results of operations.

## Item 1B. UNRESOLVED STAFF COMMENTS

None.

## Item 2. PROPERTIES

Our United States headquarters is in Bellevue, Washington. As of December 31, 2007, we occupied 38,185 square feet of office space, net of sub-leased office space, in Bellevue, Washington under a lease that ended on February 29, 2008. In February 2008, we relocated our United States headquarters to a new location also in Bellevue, Washington. As of the date of this report, we lease 52,810 square feet of office space under a lease that expires in February 2015.

Our European headquarters is located in Nieuwegein, the Netherlands. We lease 8,094 square feet of office space under a lease that expires in June 2010.

As of December 31, 2007, we have lease commitments for our other offices in the following locations:

| Location | Square Footage | Lease Term | Purpose |
|---|---|---|---|
| Tucson, Arizona | 25,000 | August 2007 to July 2012 | Customer support, sales and software development |
| Morgan Hill, California | 16,600 | July 2007 to May 2009 | Customer support, sales, software development and product distribution |
| Englewood, Colorado | 15,100 | April 2007 to March 2008 | Formerly sales, marketing and software development |
| Calgary, Alberta, Canada | 12,400 | April 2004 to March 2009 | Formerly customer support, sales and software development |
| Sydney, Australia | 3,200 | October 2003 to September 2009 | Sales |
| Greenwood Village, Colorado | 1,400 | March 2008 to February 2010 | Sales and marketing |
| Hong Kong | 1,300 | December 2005 to November 2009 | Sales |

With the exception of Calgary, Alberta, Canada and Englewood, Colorado, we generally occupy and fully utilize all of our leased office spaces. In November 2007, we began moving the functions previously conducted in Calgary and Englewood to Bellevue, Washington, Tucson, Arizona and Greenwood Village, Colorado. As of the date of this report, we minimally utilize our leased spaces in Calgary, Alberta, Canada and Englewood, Colorado.

Subsequent to year end, on January 4, 2008, our wholly-owned subsidiary, Captaris Verwaltungs GmbH, a German limited liability company ( CV GmbH ), acquired Océ Document Technologies GmbH ( ODT ), which we renamed Captaris Document Technologies GmbH ( CDT ). In connection with this acquisition, we assumed the following CDT commitments for leased spaces:

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| Location | Square Footage | Lease Term | Purpose |
|---|---|---|---|
| Constance, Germany | 55,800 | April 2007 to March 2012 | Customer support, sales, software development and product distribution |
| Bethesda, Maryland | 2,400 | January 2007 to February 2012 | Sales |

We believe that our leased spaces for our U.S. headquarters, our European headquarters, and our other offices are adequate to meet our current needs and that suitable additional or alternative space will be available, as needed, in the future on commercially reasonable terms.

**Item 3. LEGAL PROCEEDINGS**

As reported in our Annual Report on Form 10-K for the year ended December 31, 2006, Captaris has been involved in an ongoing lawsuit in Circuit Court in Cook County, Illinois. The lawsuit was filed by Travel 100 Group, Inc. ( Travel 100 ), against Mediterranean Shipping Company ( Mediterranean ). The complaint alleges violations of the Telephone Consumer Protection Act in connection with the receipt of facsimile advertisements that were transmitted by MediaTel Corporation, a wholly-owned subsidiary of Captaris, on behalf of travel service providers, including Mediterranean. All of the assets of MediaTel were sold to a subsidiary of PTEK Holdings, Inc. on September 1, 2003.

The Travel 100 complaint sought injunctive relief and unspecified damages and certification as a class action on behalf of Travel 100 and others similarly situated throughout the United States that received the facsimile advertisements. Mediterranean named Captaris as a third-party defendant and asserted that, to the extent that it is liable, Captaris should be liable under theories of indemnification, contribution or breach of contract for any damages suffered by Mediterranean. Both Captaris and MediaTel have denied any liability in the case because, among other facts and defenses, MediaTel understood that the database and lists of travel agent recipients to whom faxes were sent had authorized that information could be sent to them by fax.

On September 29, 2006, the court in the Mediterranean case granted summary judgment in favor of Mediterranean and Captaris and dismissed the case. In granting summary judgment, the court ruled that Travel 100 had invited the facsimile advertisements and there was no violation of the Telephone Consumer Protection Act. Travel 100 filed a motion for reconsideration, which the court denied. Travel 100 then filed a notice of appeal on December 29, 2006. All briefing on the appeal is complete, however no date has been set for oral argument.

Our insurance carrier has agreed to pay defense costs in the Mediterranean case but has reserved its rights to contest their duty to indemnify Captaris with respect to this matter. We intend to vigorously defend the appeal of the Mediterranean summary judgment ruling; however, litigation is subject to numerous uncertainties and we are unable to predict the ultimate outcome of the Mediterranean case. There is no guarantee that we will not be required to pay damages in respect of this case in the future, which could materially and adversely affect our results of operations, cash flows and financial condition for the quarter or year in which any accrual is recorded or any damages are paid.

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

There were no matters submitted to a vote of security holders during the fourth quarter of 2007.

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**CAPTARIS, INC.**

## PART II

### Item 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED SHAREHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Our common stock is traded on The Nasdaq Global Market under the symbol CAPA . As of February 29, 2008, there were approximately 110 shareholders of record of our common stock. Many of our shares are held by brokers and other institutions on behalf of shareholders, therefore, we are unable to estimate the total number of shareholders represented by these record holders. The following table sets forth the high and low prices for our common stock for the periods indicated. In determining the high and low prices for the periods indicated, we used the high and low sales prices as reported by The Nasdaq Global Market.

**Quarterly Common Stock Price Ranges**

| | 2007 | | 2006 | |
|---|---|---|---|---|
| **Quarter** | **High** | **Low** | **High** | **Low** |
| 1st | $ 9.09 | $ 5.46 | $ 4.65 | $ 3.56 |
| 2nd | 6.30 | 4.74 | 4.71 | 4.00 |
| 3rd | 5.58 | 3.96 | 5.90 | 4.30 |
| 4th | 5.50 | 3.89 | 8.13 | 5.08 |

**Stock Performance Graph**

This performance graph shall not be deemed filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended or otherwise subject to the liabilities under that Section, and shall not be deemed to be incorporated by reference into any filing of Captaris under the Securities Act of 1933, as amended or the Exchange Act.

The following graph compares the five year cumulative total return for our common stock to the cumulative total return of the Nasdaq Composite Index and the S&P SmallCap 600 Application Software Index for the period beginning December 31, 2002 and ending December 31, 2007.

**COMPARISON OF 5 YEAR CUMULATIVE TOTAL RETURN**

**Among Captaris, Inc., the Nasdaq Composite Index**

**and The S&P SmallCap 600 Application Software Index**

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The returns above for our common stock are historical and do not necessarily predict future price performance.

This comparison assumes $100 was invested on December 31, 2002 in (a) our common stock ( CAPA ) (b) the Nasdaq Composite Index, and (c) the S&P SmallCap 600 Application Software Index, with all dividends reinvested.

**Dividends**

We have not paid any cash dividends on our common stock. We intend to retain any future earnings to fund the development and growth of our business and the repurchase of our common stock. Therefore, we do not currently anticipate paying any cash dividends in the foreseeable future.

**Stock Repurchase Plan**

In 2006, our Board of Directors authorized us to enter into a Rule 10b5-1 repurchase plan to facilitate the repurchase of our common stock at times when we ordinarily would not be in the market because of self-imposed trading blackout periods. Transactions under the Rule 10b5-1 repurchase plan began on September 18, 2006, the first trading day after the trading window closed in the third quarter of 2006. Also in 2006, our Board of Directors approved two separate increases to our previously announced stock repurchase program. As of December 31, 2007, $9.6 million remains available to repurchase shares. We may repurchase shares in the future subject to the rules of our Rule 10b5-1 repurchase plan and, in the case of any discretionary purchases made outside of the plan, subject to overall market conditions, stock prices, and our cash position and requirements going forward. The repurchase program will continue until the earlier of (a) such time when the maximum dollar amount authorized has been utilized or (b) the Board of Directors elects to discontinue the repurchase program.

Under our Rule 10b5-1 repurchase plan, as well as stock repurchases we made prior to or outside of the plan during open trading window periods, we repurchased 1,663,839 shares of our common stock for $9.5 million, 2,099,506 shares for $11.3 million, and 1,285,778 shares for $4.9 million in 2007, 2006 and 2005, respectively.

The following table summarizes information regarding shares purchased during the quarter ended December 31, 2007:

| Period | Total Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares Purchased as Part of the Publicly Announced Purchase Program | Maximum Approximate Dollar Value of Shares that May Yet Be Purchased Under the Program |
|---|---|---|---|---|
| October 1 through 31, 2007 | 230,000 | $ 4.91 | 230,000 | $ 9,912,457 |
| November 1 through 30, 2007 | 60,000 | $ 4.64 | 60,000 | 9,633,838 |
| December 1 through 31, 2007 | 10,000 | $ 4.21 | 10,000 | 9,591,752 |
| Three Months Ended December 31, 2007 | 300,000 | $ 4.83 | 300,000 | $ 9,591,752 |

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**Item 6. SELECTED CONSOLIDATED FINANCIAL DATA**

The following selected historical financial data is derived from our audited historical financial statements. The consolidated balance sheet data as of December 31, 2007 and 2006 and the consolidated statement of operations data for the years ended December 31, 2007, 2006 and 2005 are derived from the audited historical financial statements and related notes that are included elsewhere in this report. The consolidated balance sheet data as of December 31, 2005, 2004 and 2003 and the consolidated statement of operations data for the years ended December 31, 2004 and 2003 are derived from the audited historical financial statements and related notes which are not included in this report. The information set forth below should be read in conjunction with our historical financial statements, including the notes thereto and Management s Discussion and Analysis of Financial Condition and Results of Operations, included elsewhere in this report. Historical results are not necessarily indicative of future results.

| | Year Ended December 31, | | | | |
|---|---|---|---|---|---|
| **(in thousands, except per share data)** | **2007** | **2006** | **2005** | **2004** | **2003** |
| **Consolidated Statement of Operations Data:** | | | | | |
| Net revenue | $ 94,829 | $ 91,986 | $ 86,380 | $ 78,036 | $ 83,286 |
| Gross profit | 66,075 | 64,266 | 59,455 | 50,954 | 57,548 |
| Operating expenses | 69,891 | 60,434 | 67,702 | 55,104 | 49,307 |
| Income (loss) from continuing operations | 228 | 3,965 | (4,017) | (540) | 6,218 |
| Income (loss) from discontinued operations, net of income tax expense (benefit) | (4) | 16 | 38 | 647 | 6,315 |
| Net income (loss) | $ 224 | $ 3,981 | $ (3,979) | $ 107 | $ 12,533 |
| **Basic net income (loss) per common share:** | | | | | |
| Income (loss) from continuing operations | $ 0.01 | $ 0.14 | $ (0.14) | $ (0.02) | $ 0.20 |
| Income from discontinued operations | (0.00) | 0.00 | 0.00 | 0.02 | 0.21 |
| Basic net income (loss) per share | $ 0.01 | $ 0.14 | $ (0.14) | $ 0.00 | $ 0.41 |
| **Diluted net income (loss) per common share:** | | | | | |
| Income (loss) from continuing operations | $ 0.01 | $ 0.14 | $ (0.14) | $ (0.02) | $ 0.20 |
| Income from discontinued operations | (0.00) | 0.00 | 0.00 | 0.02 | 0.20 |
| Diluted net income (loss) per share | $ 0.01 | $ 0.14 | $ (0.14) | $ 0.00 | $ 0.40 |
| Weighted average shares used in computation of: | | | | | |
| Basic net income (loss) per share | 27,019 | 27,899 | 28,907 | 31,346 | 30,849 |
| Diluted net income (loss) per share | 27,623 | 28,514 | 28,907 | 31,346 | 31,543 |

| | December 31, | | | | |
|---|---|---|---|---|---|
| **(in thousands)** | **2007** | **2006** | **2005** | **2004** | **2003** |
| **Consolidated Balance Sheet Data:** | | | | | |
| Cash, cash equivalents and total investments available-for-sale | $ 46,182 | $ 59,363 | $ 51,527 | $ 57,339 | $ 95,661 |
| Restricted cash[1] | $ 1,000 | $ 1,000 | $ 1,000 | $ 1,000 | $ 1,000 |
| Working capital, plus long-term investments available-for-sale | $ 37,373 | $ 55,424 | $ 47,734 | $ 52,408 | $ 92,198 |
| Total assets | $ 139,498 | $ 135,948 | $ 131,203 | $ 138,346 | $ 144,755 |
| Redeemable common stock | $ | $ | $ | $ | $ 3,000 |
| Total shareholders equity | $ 93,911 | $ 97,827 | $ 97,779 | $ 106,241 | $ 117,828 |
| Shares outstanding | 26,378 | 27,556 | 28,367 | 29,452 | 32,358 |

(1) A cash deposit supports a $1.0 million letter of credit that serves as collateral pursuant to a lease agreement for our corporate headquarters. This collateral was required through January 31, 2008 at which time we transferred the $1.0 million into our operating account. The lease for our new corporate headquarters has no similar deposit requirement.

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**Item 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

*This Annual Report on Form 10-K and the documents incorporated herein by reference contain forward-looking statements. These statements relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as anticipate, believe, continue, could, estimate, expect, future, intend, may, plan, potential, predict, seek, should, target, will or the negative of these terms or other terminology. These statements are only predictions. Actual events or results may differ materially. In evaluating these statements, you should specifically consider various factors, including the risks outlined under Item 1A Risk Factors. These factors may cause our actual results to differ materially from any forward-looking statements. Except as required by law, we undertake no obligation to publicly release any revisions to these forward-looking statements that may be made to reflect events or circumstances after the date hereof or to reflect the occurrence of unanticipated events.*

**Overview**

Founded in 1982, Captaris, Inc., ( we , us , our ) is a provider of computer products that automate document-centric business processes. With a comprehensive suite of software, hardware and services, we help organizations gain control over many processes that include the need to integrate documents more securely and efficiently. Our solutions also provide interoperability between documents and business applications and technology platforms.

We develop products and services for document capture, intelligent document recognition and classification, routing, workflow, document management and document delivery. Our product lineup includes the brand names RightFax, FaxPress, Captaris Workflow, Alchemy, Single Click Entry, DOKuStar and RecoStar.

Our products are distributed and supported through a global network of technology partners. This distribution system consists of business partners from all levels of the information technology ( IT ) spectrum: value-added resellers, original equipment manufacturers ( OEMs ), system integrators, distributors, mass market resellers, online retailers, office equipment dealers, and independent software vendors ( ISVs ). We believe the use of multiple distribution channels increases the likelihood that our products will be sold to more customers.

We have a large installed base of customers that includes, as of the date of this report, the entire Fortune 100, the majority of the Global 2000 companies, and thousands of mid-sized enterprises. Our customers use our products to reduce costs, comply with regulations, increase the performance and productivity of critical business processes, and leverage their IT system investments.

In July 2007, we bolstered our product portfolio, customer base, and distribution capabilities by acquiring Castelle, a provider of all-in-one network fax appliance solutions for businesses and enterprises. Castelle FaxPress products are designed to be easily deployed and maintained and are generally intended for lower volume use at lower price points than our RightFax product offerings. FaxPress provides Captaris with a fax server product that can be positioned in the tier below RightFax for customers looking for basic fax services that are low cost and easily deployable. The FaxPress products are available through a worldwide network of distributors, resellers, and online retailers.

Included in our single business segment, Castelle s expertise in building all-in-one network appliance solutions facilitates our plan to broaden our offerings in the areas of document capture, routing and management. The network appliance design combines software and hardware into a plug and play device, and we believe this design is particularly well suited to support our focus on achieving synergies with multi-function product manufacturers and their dealer networks.

We further increased our product portfolio, customer base and distribution capabilities with the acquisition of Océ Document Technologies GmbH ( ODT ) in January 2008. ODT is a provider of software and solutions for document capture, text recognition, and document classification. ODT, a wholly-owned subsidiary of the Océ Group since 2000, has approximately 178 employees and maintains its global headquarters in Constance, Germany, and its North American office in Bethesda, Maryland. On an unaudited basis, ODT s revenue was about 22.5 million for the 12 months ended November 30, 2007 and their gross margin was about 65%. ODT s revenue includes software licenses, maintenance and support, hardware and professional services. In contrast to our business prior to acquisition, ODT s revenue includes a higher percentage of professional services and a larger portion of their sales are made directly rather than through partners. As a result of these factors, and a smaller revenue and customer base, ODT has a lower gross margin and more revenue variability.

After our acquisition, we re-named ODT to Captaris Document Technologies GmbH ( CDT ). CDT develops intelligent document and character recognition technologies that can read and extract the important information from documents needed to drive business processes and decisions.

CDT products include RecoStar, DOKuStar, Single Click Entry and ID-Star. CDT customers

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include some large ISVs and OEMs with capture offerings, as well as blue chip end-user accounts in Germany. CDT s expertise in intelligent document recognition supports our vision of fully enabling document capture, collaboration and workflow. As we continue to merge our products, we anticipate leveraging CDT s technology to enhance capture and routing in both the RightFax and Alchemy platforms. The ability to classify documents and extract critical meta-data will also enable deeper integrations with line of business applications and business process management.

**Executive Summary**

We derive net revenue primarily from licensing software as well as follow-on sales of add-on software modules, incremental capacity and the sale of maintenance, support and service agreements, professional services, appliances and the resale of fax boards.

We work with resellers and distributors located throughout the world. These resellers and distributors sell and install our products and they receive discounts based on the volume of sales. Within our selling and marketing groups, we dedicate significant resources to monitor our resellers and distributors and to generate demand and provide market positioning and support.

Utilizing an indirect channel approach provides several advantages, including minimizing our investment in office facilities and personnel in field locations and applying greater resources to sales and implementation efforts. However, with a channel sales model, we have more difficultly tracking the number and location of all end-users utilizing our products. This also limits our ability to capture information around product usage, system integration characteristics, and deployment satisfaction directly from our customers perspective in order to enhance or build new products, solutions and services.

We have extensive service offerings that are sold in conjunction with our products, including: maintenance, support, professional services and solutions. All of these offerings are designed to help customers protect and extend their software investment.

Our $2.8 million revenue growth over the prior year was primarily attributable to the inclusion of Castelle in our results of operations from July 10, 2007 through December 31, 2007, and the continuing growth of our traditional maintenance, support and service revenue. In comparison to 2007, we expect 2008 revenue increases from software, appliances, and services. This expectation is based on including in our 2008 results of operations revenue from both Castelle for the entire year and, as discussed in the Acquisitions and Divestitures section below, CDT, as well as increased customer demand from increased investment in our sales organization. In comparison to 2007, we expect 2008 hardware revenue to decrease as a percentage of overall revenue due to market shifts to software-based fax over Internet protocol, which does not rely on fax hardware in many Internet protocol environments. No single customer represented more than 10% of our net revenue for each of the years ended December 31, 2007, 2006 or 2005.

Our gross profit is the selling price of our products, net of estimated returns, less cost of revenue. Our cost of revenue includes manufacturing and distribution costs, royalties for licensed products, amortization of acquired technology, product warranty costs, operation costs related to product support and costs associated with the delivery of professional services.

Our $1.8 million gross profit increase over the prior year was primarily attributable to the inclusion of Castelle in our results of operations from July 10, 2007 through December 31, 2007, and the continuing growth of our traditional maintenance, support and service revenue. We expect our gross profit will increase in 2008 due to anticipated increases in revenue mentioned above. We expect gross profit as a percentage of revenue will decline in 2008 for two reasons. First, CDT has traditionally recorded lower gross margins than Captaris primarily because of a higher portion of professional services; therefore including CDT in our results of operations will have the effect of reducing our overall gross profit as a percentage of revenue. Secondly, we anticipate recording a portion of the amortization expense related to the technology acquired from CDT in cost of revenue.

Our operating expenses were $69.9 million, $60.4 million and $67.7 million for the years ended December 31, 2007, 2006 and 2005, respectively. The $9.5 million increase from 2006 to 2007 was due primarily to increases in the overall number of employees and occupancy costs of $3.8 million, Castelle operating expenses of $2.7 million and research and development spending of $1.9 million for outsourced engineering. The $7.3 million decrease from 2005 to 2006 was due primarily to a $2.3 million reduction in compensation cost due to the minimum incentive plan obligation for certain Teamplate founders, which was discontinued in late 2005, and a $1.3 million reduction in advertising expenses.

Our income from continuing operations for the year ended December 31, 2007 was $228,000, compared to income of $4.0 million for the year ended December 31, 2006 and a loss from continuing operations of $4.0 million for the year ended December 31, 2005. The decrease in income from continuing operations from 2006 to 2007 was primarily attributable to an overall increase in operating expenses in 2007. The increase in income from continuing operations from 2005 to 2006 was primarily attributable to revenue growth and an overall reduction in operating expenses in 2006. In addition, 2005 operating expenses included corporate reorganizations charges as well as non-cash impairment charges. We did not incur these charges in 2006.

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We recorded an income tax benefit of $1.5 million and $3.3 million, respectively, on losses from continuing operations for the years ended December 31, 2007 and December 31, 2005. For the year ended December 31, 2006, we recorded an income tax provision of $1.8 million on income from continuing operations. Our income tax benefit in 2007 included the reversal of tax liabilities of $403,000 which we determined were no longer probable based on updated information surrounding the related tax return, a research and development tax credit of $173,000, and the tax benefit for tax-exempt interest income of $566,000. Our income tax provision in 2006 included adjustments of $72,000 primarily associated with correcting deferred tax asset balances as of December 31, 2005. The income tax benefits in 2005 included the reversal of tax liabilities of $523,000 which we determined were no longer probable based on updated information surrounding the related tax return. In 2006, we received income tax refunds of $1.9 million that primarily resulted from the carry-back of our 2005 net operating loss to 2003.

Prior to December 31, 2007, our principal sources of liquidity were cash and cash equivalents. In anticipation of our acquisition of CDT in January 2008, we liquidated our investments in cash and cash equivalents ($46.2 million) and entered into a $10.0 million line of credit agreement as described below. As of December 31, 2006, our portfolio consisted primarily of money market funds, adjustable rate mortgage-backed securities, and municipal and United States government agency-backed securities. The balance of cash, cash equivalents and short and long-term investments at December 31, 2006 totaled $59.4 million.

The decrease in cash, cash equivalents and short and long-term investments from 2006 to 2007 was primarily due to the Castelle acquisition of $12.0 million, repurchase of our common stock of $9.5 million and capital purchases of $5.2 million. These decreases were partially offset by increases from our net cash flow provided by operations of $10.6 million and proceeds of $2.2 million from the exercise of stock options. Capital expenditures during the year ended December 31, 2007, consisted primarily of an enterprise resource management system to support the growth of our core business activities. In the first quarter of 2008, we paid $680,000 for management incentive bonuses we accrued in 2007.

On January 1, 2006, we adopted the provisions of FASB Statement of Financial Accounting Standard ( SFAS ) Statement No. 123(R), *Share-Based Payment*, ( SFAS No. 123R ), which, among other things, requires us to measure and recognize compensation expense for all share-based payment awards made to employees and directors including stock options and stock units. Under the provisions of SFAS No. 123R, we recorded $1.4 million and $677,000, respectively, in 2007 and 2006 as stock-based compensation expense relating to stock options and stock units. Prior to 2006, we had only disclosed in the footnotes to our consolidated financial statements, as permitted by SFAS No. 123, pro forma financial results including the effects of share-based compensation expense. For the year ended December 31, 2005, the pro forma stock-based compensation expense was $3.9 million. The decrease in stock-based compensation expense in 2006, compared to our pro forma stock-based compensation expense in 2005, can be attributed to accelerating the vesting of underwater stock options in 2005, the reduction in number of shares granted in 2006 compared to 2005 and differences between accounting for stock options and stock units under SFAS No. 123R in 2006 and SFAS No. 123 in 2005.

**Acquisitions**

***2008***

On January 4, 2008, our wholly-owned subsidiary, Captaris Verwaltungs GmbH, a German limited liability company ( CV GmbH ), acquired Océ Document Technologies GmbH ( ODT ), pursuant to a Sale and Purchase Agreement (the SPA ) by and between CV GmbH and Océ Deutschland Holding GmbH & Co. KG, a German limited partnership (the Seller ), dated December 20, 2007. Under the terms of the SPA, CV GmbH acquired all of the outstanding equity of ODT from the Seller, and ODT became a wholly-owned subsidiary of CV GmbH and an indirect wholly-owned subsidiary of Captaris.

Under the terms of the acquisition agreement, CV GmbH acquired ODT for approximately 10.4 million ($15.4 million), net of ODT s cash balance as of the closing of approximately 21.6 million ($31.8 million). CV GmbH also assumed ODT s operating and financial liabilities, including approximately 12.1 million ($17.9 million) in future retirement obligations. At the closing, €2.0 million ($3.0 million) of the purchase price was deposited in a third-party escrow account for 12 months as security for any post-closing purchase price adjustment and, subject to certain limitations, for indemnification claims against the Seller; however, in connection with the resolution of a post-closing dispute with the Seller, we expect to release the full amount of the escrow to the Seller during the first quarter of 2008.

After our acquisition, we re-named ODT to Captaris Document Technologies GmbH ( CDT ). CDT is a provider of software and solutions for document capture, text recognition and document classification. CDT has approximately 178 employees and maintains its global headquarters in Constance, Germany, and its North American office in Bethesda, Maryland.

***2007***

On July 10, 2007, through our wholly-owned subsidiary, Merlot Acquisition Corporation, a California corporation ( Merger Sub ), we consummated an acquisition of Castelle, a California corporation ( Castelle ), pursuant to an Agreement and Plan of Merger (the Merger Agreement ) by and among Captaris, Castelle and Merger Sub, dated April 25, 2007. In accordance with the terms of the Merger Agreement, Merger Sub was merged with and into Castelle, with Castelle being the surviving corporation (the

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Merger ), and each issued and outstanding share of Castelle common stock was converted into the right to receive $4.14 in cash, after the closing adjustments described in the Merger Agreement. In addition, each outstanding option to purchase shares of Castelle common stock was converted into the right to receive an amount of cash equal to the product of (a) the number of shares as to which such option was vested and exercisable, multiplied by (b) the excess, if any, of the per share merger consideration ($4.14) over the per share exercise price of such option. The aggregate merger consideration described above that we paid was $10.8 million, net of Castelle s cash balance at closing of $1.0 million. Additionally, we assumed $2.3 million of Castelle s liabilities and paid $1.2 million in transaction costs. The assumed liabilities include deferred revenue of $938,000 and accounts payable and other accrued liabilities of $1.4 million. The acquisition of Castelle has been accounted for as a purchase. Our results of operations for the year ended December 31, 2007 include Castelle s results of operations for the period from July 10, 2007 to December 31, 2007 including an in-process research and development charge of $219,000. The primary product offering for Castelle is a server appliance with embedded fax software. The revenue for this new Captaris product offering is recorded within a new appliance product line category beginning in the third quarter of 2007.

**Critical Accounting Judgments and Estimates**

The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States of America, requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities at the date of our financial statements and the reported amounts of revenue and expenses during the reporting period. We base our estimates on historical experience, current conditions and various other assumptions we believe to be reasonable under the circumstances. Our estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources, as well as identifying and assessing our accounting treatment with respect to commitments and contingencies. Actual results may differ significantly from these estimates. To the extent that there are material differences between these estimates and actual results, our presentation of our financial condition or results of operations may be affected.

On an ongoing basis, we evaluate our estimates used, including those related to the valuation of goodwill and other intangible assets, useful lives of intangible assets and equipment and leasehold improvements, inventory valuation allowances, revenue recognition, the estimated allowances for sales returns and doubtful accounts and income tax accruals. We believe that the following accounting policies are critical to understanding our historical and future performance, as these policies may involve a higher degree of judgment and complexity than others. For a detailed discussion on the application of these and other accounting policies, see Note 1 in Notes to Consolidated Financial Statements in Item 8 of this Annual Report on Form 10-K.

Our most critical accounting judgments and estimates relate to the following areas:

- Revenue recognition;
- Allowances for sales returns and doubtful accounts;
- Valuation of inventory at lower of cost or market value;
- Classification of investments and assessment of related unrealized losses;
- Valuation of acquired businesses, assets and liabilities;
- Impairment of goodwill;

Impairment of equipment, leasehold improvements, long-lived assets and other intangible assets;

Useful lives of equipment, leasehold improvements and intangible assets;

Contingencies;

Stock-based compensation plans; and

Accounting for income taxes.

***Revenue recognition.*** Our revenue recognition policies follow the guidelines of the American Institute of Certified Public Accountants ( AICPA ) Statement of Position ( SOP ) No. 97-2, *Software Revenue Recognition*, as amended. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable and collection is reasonably assured.

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We sell products through resellers, distributors, Original Equipment Manufacturers ( OEM ) and other channel partners, as well as directly to end-users. Generally our resellers do not stock product, and except for OEM sales described below, we recognize product revenue upon shipment, net of estimated returns, provided that collection is determined to be probable and no significant obligations remain. If a reseller does stock product, we defer this revenue until the reseller sells the product through to end-users.

Sales of our appliance products are made through stocking distributors. For sales to distributors we recognize revenues on either the sell-through or sell-in method of revenue recognition as determined by the contractual arrangement with each distributor. When the distributor is entitled to stock rotation rights we recognize revenue upon delivery of the products to the distributor less a provision for an estimate of those rights (the sell-in method). Otherwise, revenue is recognized upon delivery of the products to the end-user (the sell-through method).

Revenue from perpetual software licenses is recognized when the software has been shipped, provided that collection for such revenue is deemed probable. Revenue from term software licenses is recognized over the term of the license, generally twelve months.

All software licenses are bundled with 30 days of telephone support. We consider revenue associated with this telephone support to be insignificant, and therefore, we recognize this revenue when the software is shipped and concurrently record an estimate for the related cost of the telephone support.

Whenever a software license, hardware, installation and post-contract customer support ( PCS ) elements are sold together, we allocate the total arrangement fee among each element based on its respective fair value, which is the price charged when that element is sold separately. The amount of revenue assigned to each element is impacted by our judgment as to whether an arrangement includes multiple elements and, if so, whether vendor-specific objective evidence ( VSOE ) of fair value exists for those elements. Changes to the elements in an arrangement and our ability to establish VSOE for those elements could affect the timing of revenue recognition for these elements. Revenue for PCS is recognized on a straight-line basis over the service contract term, ranging from one to five years. PCS includes rights to unspecified upgrades and updates, when and if available, and bug fixes.

Installation revenue is recognized when the product has been installed at the customer s site and accepted by the customer. Recognition of revenue from software sold with installation services is recognized either when the software is shipped or when the installation services are completed, depending on our agreement with the customer and whether the installation services are integral to the functionality of the software.

We have entered into agreements with certain OEMs from which we receive royalty payments periodically. Under the terms of the OEM license agreements, each OEM will qualify our software on their hardware and software configurations. Once the software has been qualified, the OEM will begin to ship products and report net sales to us. Most OEMs pay a license fee based on the number of copies of licensed software included in the products sold to their customers. These OEMs pay fees on a per-unit basis and we record associated revenue when we receive notification of the OEMs sales of the licensed software to an end-user. The terms of the license agreements generally require the OEMs to notify us of sales of our products within 30 to 45 days after the end of the month or quarter in which the sales occur. As a result, we recognize the revenue in the month or quarter following the sales of the product to these OEMs customers.

We provide allowances for estimated returns, and return rights that exist for some customers. In general, customers are not granted return rights at the time of sale. However, we have historically accepted returns and therefore, reduce revenue recognized for estimated product returns. For those customers to whom we do grant return rights, we reduce revenue by an estimate of these returns. If we cannot reasonably estimate these returns, we defer the revenue until the return rights lapse. For software sold to resellers for which we have granted exchange rights, we defer the revenue until the reseller sells the software through to end-users. When customer acceptance provisions are present and we cannot reasonably estimate returns, we recognize revenue upon the earlier of customer acceptance or expiration of the acceptance period.

Professional services are customarily billed at fixed rates, plus out-of-pocket expenses and revenue is recognized when the service has been completed. However, if it is determined that a consulting engagement will be unprofitable, we recognize the loss at the time of such determination. Training revenue is recognized when the training is completed.

***Allowance for sales return.*** We estimate potential future product returns related to current period revenue based on our historical returns, current economic trends, changes in customer demand and acceptance of our products. We periodically review the adequacy of our sales returns allowance and underlying assumptions. If the assumptions we use to calculate the estimated sales returns do not properly reflect future returns, a change in accruals for sales returns would be made in the period in which such a determination was made. Historically, our accruals for sales returns have been adequate.

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***Allowance for doubtful accounts.*** We make ongoing assumptions as to the collectibility of our accounts receivable in our calculation of the allowance for doubtful accounts. In determining the amount of the allowance, we make estimates based on our historical bad debts, the aging of customer accounts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment patterns. Our reserves historically have been adequate to cover our actual credit losses. However, if actual credit losses were to fluctuate significantly from the reserves we have established, our general and administrative expenses could be adversely affected.

***Valuation of inventory at lower of cost or market value.*** Due to rapid changes in technology, it is possible that older products in inventory may become obsolete or that we may sell these products below cost. When we determine that the carrying value of inventories is not recoverable, we write-down inventories to market value. If actual market conditions are less favorable than we project, inventory write-downs may be required, which may have a material adverse effect on our financial results.

***Classification of investments and assessment of related unrealized losses.*** We classify our short-term and long-term investments as available-for-sale. We invest excess cash primarily in money market funds, adjustable rate mortgage-backed securities and municipal and United States government agency-backed securities. We record our portfolio at fair market value. We determine the fair value of our investments based on quoted market prices. Investments with legal maturities of one year or less are classified as short-term. We recognize realized gains and losses upon sale of investments using the specific identification method. We record unrealized gains and losses, net of any income tax effect, as a component of other comprehensive income. We record interest income using an effective interest rate, with the associated premium or discount amortized to interest income over the term of the investment. We recognize an impairment charge for unrealized losses when an investment s decline in fair value is below the cost basis and is judged to be other than temporary. In making this judgment, we evaluate, among other factors, the duration and extent to which the fair value of an investment is less than its cost, the financial condition and near-term business outlook for the investee and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

***Valuation of acquired businesses, assets and liabilities.*** Our business acquisitions typically result in goodwill and other intangible assets, and the recorded values of those assets may become impaired in the future. As of December 31, 2007 our goodwill and intangible assets, net of accumulated amortization, were $49.3 million. The determination of the fair value of such intangible assets and goodwill is a critical and complex consideration that involves significant assumptions and estimates. These assumptions and estimates are based on our best judgments and could materially affect our financial condition and results of operations.

***Impairment of goodwill***. Our judgments regarding the existence of impairment indicators include our assessment of the impacts of legal factors; market and economic conditions; the results of our operational performance and strategic plans; competition and market share; and any potential for the sale or disposal of a significant portion of our principal operations. If we conclude that indicators of impairment exist, we then assess the fair value of goodwill. Our valuation process provides an estimate of a fair value of goodwill using a discounted cash flow model and includes many assumptions and estimates. We test goodwill for impairment on an annual basis in the first quarter of the year, and on an interim basis in certain circumstances. During the period from December 31, 2007 through the date of this report, our stock price declined significantly. In accordance with SFAS No. 142, we performed an analysis and concluded that the decline in our stock price and related market capitalization was caused by routine and temporary fluctuations in our stock price and is not an indication that our goodwill is impaired. In the event that, in the future, we conclude that our goodwill or our amortizable intangible assets are impaired, we would be required to record a charge to earnings in our financial statements and that charge may significantly decrease our results of operations.

***Impairment of equipment, leasehold improvements, long-lived assets and other intangible assets.*** We periodically review long-lived assets, other intangibles and product lines that we may sell or otherwise dispose of before the end of the asset s previously estimated useful life to determine if there is any impairment of these assets. We assess the impairment of these assets, or the need to accelerate amortization, whenever events or changes in circumstances indicate that the carrying value may not be recoverable. Our judgments regarding the existence of impairment indicators are based on legal factors, market conditions and operational performance of our long-lived assets and other intangibles. Future events could cause us to conclude that impairment indicators exist and that the assets should be reviewed to determine their fair value. We assess the assets for impairment based on the estimated future undiscounted cash flows expected to result from the use of the assets and their eventual disposition. If the carrying amount of an asset exceeds its estimated future undiscounted cash flows, an impairment loss is recorded for the excess of the asset s carrying amount over its fair value. Fair value is generally determined based on a valuation process that provides an estimate of a fair value of these assets using a discounted cash flow model, which includes many assumptions and estimates. Once the valuation is determined, we will write-down these assets to their determined fair value, if necessary. Any write-down could have a material adverse effect on our financial condition and results of operations.

On November 3, 2005, we announced a corporate reorganization that included the layoff of certain Teamplate founders and triggered the acceleration of the remaining Teamplate management incentive plan obligation. During this time, we also assessed the effect this layoff had on the valuation of the intangibles related to the Teamplate acquisition and determined that the intangibles were not impaired as a result of the layoff.

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Concurrent with the announcement of the reorganization, we announced that we would record a non-cash impairment charge of $607,000 in the fourth quarter of 2005. This impairment charge included $559,000 of impairment of application systems software projects that would no longer be completed and $48,000 of assets that would be abandoned with the office consolidation. We do not anticipate future cash expenditures in connection with this impairment.

***Useful lives of equipment, leasehold improvements and intangible assets.*** Equipment and leasehold improvements, identifiable intangible assets and certain other long-lived assets are recorded at cost less accumulated amortization and are amortized over their useful lives on a straight-line basis. Useful lives for equipment and leasehold improvements are based on our estimates of the period that the equipment or leasehold improvement will be used, which typically range from two to five years. The useful lives of our leasehold improvements are typically less than the lives of the applicable leases. Useful lives for intangible assets are based on our estimates of the period that the intangible assets will generate cash. Changes in estimated useful lives could have a material effect on our financial condition and results of operations.

***Contingencies.*** We are periodically involved in litigation or claims, including patent infringement claims, in the normal course of our business. We follow the provisions of SFAS No. 5, *Accounting for Contingencies,* to record litigation or claim-related expenses. We evaluate, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of loss. We accrue for settlements when the outcome is probable and the amount or range of the settlement can be reasonably estimated. In addition to our judgments and use of estimates, there are inherent uncertainties surrounding litigation and claims that could result in actual settlement amounts that differ materially from estimates. We expense our legal costs associated with these matters when incurred.

***Stock-based compensation plans***. Our equity option plans are broad-based, long-term retention programs that are intended to attract and retain talented employees and align shareholder and employee interest. We rely on our share-based compensation plans that provide broad discretion to our Board of Directors to create appropriate share-based incentives for members of our Board of Directors, executives and select employees.

***The 2006 Equity Incentive Plan*** *(formerly the 1989 Plan)*

On June 8, 2006, at the 2006 Annual Meeting of Shareholders of Captaris, Inc., our shareholders approved the Captaris, Inc. 2006 Equity Incentive Plan (the 2006 Plan ), which amended and restated the Captaris, Inc. 1989 Restated Stock Option Plan (the 1989 Plan ) to, among other things, expand the types of awards available for grant to include, in addition to stock options, stock appreciation rights, stock awards, restricted stock, restricted stock units ( RSU s ) and other stock or cash-based awards. The 2006 Plan authorizes the issuance of stock options and RSU s to purchase up to 12,900,000 shares of Captaris common stock, the same number authorized under the 1989 Plan. The stock options under the 2006 Plan are generally granted at an exercise price of the average of the high and low market value of our common stock on the date of grant, and generally vest over four years. They have a term of one to ten years from the date of grant and vest at the rate of 25% after one year and 2.0833% per month thereafter. Pursuant to the 2006 Plan, as of December 31, 2007, there were 1,949,450 stock options and RSU s available to grant, and 3,250,841 stock options and 195,081 RSU s outstanding.

*Equity Grant Program for Non-employee Directors*

Effective upon shareholder approval of the 2006 Plan and upon recommendation of the Compensation Committee, the Board of Directors implemented the Terms of Equity Grant Program for Non-employee Directors (the NED Equity Program ) under the 2006 Plan. The NED Equity Program provides for: 1) initial and annual stock option grants with a Black-Scholes or binomial (whichever method is then being used by the Company to value its stock options for financial reporting purposes) value of $20,000 on the date of grant; and 2) initial and annual restricted deferred stock units ( DSU s ) with a $25,000 value based on the fair market value which we currently calculate using the average of the high and low stock price, as reported by The Nasdaq Global Market, of our common stock on the date of grant. The stock options will vest in full one year after the date of grant and have a ten-year term, as long as the non-employee director remains on the Board. The DSU s will be automatically deferred under the Captaris, Inc. Deferred Compensation Plan for Non-employee Directors (the NED Deferred Compensation Plan ) and will vest in full one year after the date of grant. The compensation expense associated with the NED Equity Program is included in our stock-based compensation expense.

*Deferred Compensation Program*

Effective upon shareholder approval of the 2006 Plan and upon recommendation of the Compensation Committee, the Board of Directors also implemented the NED Deferred Compensation Plan, the purpose of which is to further long-term growth of the

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Company by allowing non-employee directors to defer receipt of certain compensation, keeping their financial interests aligned with the Company, and providing them with a long-term incentive to continue providing services. The NED Deferred Compensation Plan is administered by the Compensation Committee of the Board of Directors.

Directors who are not also employees of our Company or our affiliates are eligible to participate in the NED Deferred Compensation Plan. Non-employee directors may elect to defer receipt of 25%, 50%, 75% or 100% of any cash compensation paid to the non-employee director for his or her service on the Board of Directors or any committee of the Board of Directors. Deferred cash compensation will be credited to the non-employee director s account as of the date on which it would have been paid had it not been deferred, and will be deemed to be invested in our common stock at a value equal to the closing price of our common stock on such date. Deferred cash compensation is fully vested upon receipt. In general, a non-employee director s vested account balance will be distributed in a lump sum as soon as administratively practicable after his or her separation from service on the Board of Directors. The compensation expense associated with the NED Deferred Compensation Plan is included in our stock-based compensation expense.

***The 2000 Plan***

Upon the adoption of the 2006 Plan on June 8, 2006, no further awards will be granted under the Captaris, Inc. 2000 Non-Officer Employee Stock Compensation Plan (the 2000 Plan ), which resulted in a reduction in the number of stock options available for grant by 1,050,115 shares. Under the 2000 Plan, stock options generally were granted at the fair market value of our common stock at the date of grant and generally vest over four years. Stock options under the 2000 Plan have a term of ten years from the date of grant and vest at the rate of 25% after one year and 2.0833% per month thereafter. As of December 31, 2007, there were 1,355,321 stock options outstanding under the 2000 Plan.

***Non-plan Option Grants***

As an inducement to employment, on November 15, 2000, we granted our President, Chief Executive Officer and Director of Captaris, a nonqualified stock option grant outside of any Captaris equity incentive plans. In addition, as an inducement to employment, on October 22, 1997, we granted each of two now former employees of Captaris a nonqualified stock option outside of any of Captaris equity incentive plans. As of December 31, 2007, there were 766,000 of these stock options outstanding.

***Stock-Based Compensation Expense.*** We account for stock-based compensation under the provisions of SFAS No. 123(R), *Share-Based Payment* which requires us to recognize expense related to the fair value of our stock-based compensation. We adopted SFAS No. 123R using the modified prospective transition method. Under this transition method, compensation cost recognized for the years ended December 31, 2007 and 2006 includes: (a) compensation cost for all stock-based compensation granted prior to, but not vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based compensation granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R. We chose the straight-line method for recognizing compensation expense. For all unvested stock options outstanding as of January 1, 2006, we recognize the previously measured but unrecognized compensation expense, based on the fair value at the original grant date, on an accelerated basis over the remaining vesting period. For stock-based compensation granted subsequent to January 1, 2006, we recognize compensation expense, based on the fair value on the date of grant, on a straight-line basis over the vesting period.

Our stock-based compensation expense includes expense related to our stock options and our stock units. The amount of stock-based compensation expense, net of forfeitures, recognized in the year ended December 31, 2007 and 2006 was $1.4 million and $677,000, respectively, of which $42,000 and $191,000, respectively, related to stock options granted prior to January 1, 2006. Total unamortized compensation expense as of December 31, 2007 and 2006 was $4.3 million and $1.6 million, respectively, net of estimated forfeitures. Total unamortized stock-based compensation cost will be adjusted for future changes in estimated forfeitures and is expected to be recognized over a weighted average period of three years.

On September 1, 2005, our Compensation Committee and Board of Directors approved the acceleration of vesting of certain unvested stock options granted to our employees and officers under our stock option plans that had an exercise price greater than $3.73 per share, the closing price of our common stock on September 1, 2005. There were 241 employees affected by this modification. Stock options held by non-employee directors were not included in the acceleration. Previously unvested stock options to purchase 2.3 million shares of our common stock became immediately exercisable. The Board also imposed a holding period that requires all executive officers and certain other members of senior management to refrain from selling shares acquired upon the exercise of these stock options, other than shares needed to cover the exercise price and to satisfy withholding taxes and shares transferred by will or by the applicable laws of descent and distribution, until the date on which the exercise would have been permitted under the option s original vesting terms.

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The accelerated vesting eliminated future compensation expenses that we would otherwise recognize in our financial statements with respect to these stock options as a result of adopting SFAS No. 123R. In accordance with APB No. 25 and FASB Interpretation No. 44, no compensation expense was recorded within the financial statements as a result of this modification in 2005 because the stock options had no intrinsic value on the date of the modification due to the exercise price being in excess of the current market price of the stock. Had the stock options not been accelerated, the unamortized fair value-based compensation expense for these stock options at January 1, 2006, would have been $1.9 million, net of estimated forfeitures, compared to the post acceleration unamortized expense of $267,000, net of estimated forfeitures, and would have been expensed under vesting schedules in place prior to the acceleration and recorded in 2006 through 2009. Option expense recorded in the year ended December 31, 2006 would have increased by $1.1 million, net of estimated forfeitures, and the unamortized compensation expense for these stock options would have been $812,000, net of estimated forfeitures, to be recorded in 2007 through 2009.

***Accounting for income taxes.*** We follow the asset and liability method of accounting for income taxes as set forth by SFAS No. 109, *Accounting for Income Taxes*, and account for uncertainties related to income taxes under the provisions of FASB Interpretation No. 48, *Accounting for Uncertainties in Income Taxes an interpretation of FASB Statement No. 109* ( FIN No. 48 ). Accordingly, we are required to estimate our potential income tax claims in each of the jurisdictions in which we operate as part of the process of preparing our consolidated financial statements. Significant judgment is required in evaluating our tax positions and in determining our provision for income taxes. During the ordinary course of business, there are transactions and calculations for which the ultimate tax determination is uncertain. As required by FIN No. 48, we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amounts we recognize in the financial statements are the largest benefit that have a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. We will establish a valuation allowance to reduce deferred tax assets unless it is more likely than not that we will generate sufficient taxable income to allow for the realization of our deferred net tax assets. The provision for income taxes includes the impact of potential tax claims and changes to accruals and valuation allowances that we consider appropriate, as well as the related penalties and interest expense. In addition to our judgments and use of estimates, there are inherent uncertainties surrounding income taxes that could result in actual amounts that differ materially from our estimates. Any adjustments in our tax provision related to these contingencies could have a material effect on our financial condition, results of operations and cash flow.

**Consolidated Results of Operations**

The following table sets forth, for the periods indicated, the percentage of net revenue represented by certain items in our consolidated statements of operations.

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2007[1]** | **2006** | **2005 [1]** |
| Net revenue | 100.0% | 100.0% | 100.0% |
| Cost of revenue | 30.3 | 30.1 | 31.2 |
| Gross profit | 69.7 | 69.9 | 68.8 |
| Operating expenses: | | | |
| Research and development | 17.0 | 13.3 | 16.2 |
| Selling and marketing | 37.0 | 34.6 | 39.9 |
| General and administrative | 19.4 | 17.5 | 21.5 |
| Amortization of intangible assets | 1.1 | 1.4 | 2.0 |
| In-process research and development | 0.2 | | |
| Gain on sale of discontinued product line CallXpress | (1.1) | (1.1) | (1.2) |
| Total operating expenses | 73.7 | 65.7 | 78.3 |
| Operating income (loss) | (4.0) | 4.2 | (9.5) |
| Other income, net | 2.7 | 2.1 | 1.1 |

| | | | |
|---|---|---|---|
| Income (loss) from continuing operations before income tax expense (benefit) | (1.4) | 6.3 | (8.4) |
| Income tax expense (benefit) | (1.6) | 2.0 | (3.8) |
| Income (loss) from continuing operations | 0.2 | 4.3 | (4.6) |
| Income from discontinued operations | | | |
| Net income (loss) | 0.2% | 4.3% | (4.6)% |

(1) For the years ended December 31, 2007 and 2005, respectively, percentages from certain line items do not sum to the total of those line items due to rounding.

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**Net Revenue**

| | 2007 | Percent Change from 2006 | 2006 (in thousands) | Percent Change from 2005 | 2005 |
|---|---|---|---|---|---|
| **Net Revenue:** | | | | | |
| Software revenue | $ 33,164 | (3.7)% | $ 34,428 | 4.8% | $ 32,860 |
| Maintenance, support and services revenue | 40,355 | 11.7% | 36,183 | 13.1% | 31,997 |
| Hardware revenue | 17,773 | (16.9)% | 21,375 | (0.7)% | 21,523 |
| Appliance revenue | 3,537 | (1) | | (1) | |
| Net revenue | $ 94,829 | 3.1% | $ 91,986 | 6.5% | $ 86,380 |

(1) Percent change of appliance revenue is not meaningful because we did not have this revenue in 2006 and 2005.

We calculate net revenue as the selling price of our products less an estimate for returns. We derive net revenue primarily from licensing software as well as follow on sales of add-on software modules, incremental capacity and sales of maintenance, support and service agreements, professional services, appliances and resale of fax boards.

***Years ended December 31, 2007 and 2006.*** Net revenue for the year ended December 31, 2007 increased by $2.8 million compared to the year ended December 31, 2006. The net revenue increase was due primarily to including Castelle appliance and maintenance, support and services revenue, for the period of July 10, 2007 through December 31, 2007, in our 2007 operating results. Additionally, as a result of an increase in the number of underlying agreements, our traditional maintenance, support and services revenue also increased. These increases were partially offset by decreases in revenue from software and hardware.

Software revenue decreased $1.3 million primarily due to a non-recurring $1.8 million strategic licensing arrangement with Xpedite recorded in our 2006 results which we discuss in further detail below.

Hardware revenue decreased in 2007 in comparison to 2006 due to several large sales to large customers in 2006 and fewer comparably large individual software license sales in 2007. Variations in hardware revenue generally trends directly with software revenue as we resell fax boards with a significant number of our RightFax software products. Also, the volume and associated revenue varies from period to period depending upon the mix of software sold and the requirements of each customer.

We believe our net revenue will increase in 2008 primarily due to the addition of CDT revenue from the date of acquisition, a full year of revenue from Castelle, product growth from our existing product lines, and revenue from new product releases. A significant portion of CDT revenue is in Europe, is sold direct and includes a relatively higher portion of professional services.

***Years ended December 31, 2006 and 2005.*** Net revenue for the year ended December 31, 2006 increased by $5.6 million compared to the year ended December 31, 2005. The increase in net revenue was due primarily to the growth of maintenance, support and service agreements and an increase in the volume of our software licenses sold, which we believe to be the result of increased customer deployment during 2006 of RightFax throughout their organizations. In addition, $1.8 million of the increase in revenue was due to a strategic licensing arrangement with Xpedite. This strategic license arrangement began in September 2003. In accordance with this arrangement, Xpedite agreed to pay a minimum of $2.0 million over a three-year period for a license to use and resell our fax-to-mail technology. In September 2004 we recognized $250,000 of revenue in connection with this arrangement but due to a dispute with Xpedite, did not record any revenue in 2005 relating to this arrangement. In February 2006, we resolved the dispute regarding the revenue for 2005. As a result, we recorded $750,000 of revenue related to the 2005 commitment. During the third quarter of 2006 we received an additional $1.0 million from Xpedite.

Revenue from our RightFax product line in the year ended December 31, 2006 increased compared to the year ended December 31, 2005. This increase was due primarily to $1.8 million from the Xpedite strategic licensing arrangement and to the growth of professional services sold and an increase in the volume of RightFax licenses sold resulting from what we believe to be increased capacity needs from existing customers as they further deployed during 2006 RightFax throughout their organizations. RightFax product revenue, which includes revenue from software licenses and hardware sales, was $77.5 million for the year ended December 31, 2006, up 6.7% from the year ended December 31, 2005. Revenue from RightFax software for the year ended December 31, 2006 was $27.1 million, an increase of $1.4 million or 5.4% from the year ended December 31, 2005. RightFax maintenance, support and services revenue was $29.0 million for the year ended December 31, 2006, up $3.6 million or 14.4% from the prior year. RightFax hardware sales for the year ended December 31, 2006 was $21.4 million, relatively flat compared to the prior year.

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Revenue from the Captaris Alchemy and Captaris Workflow product lines increased $711,000 to $14.5 million in the year ended December 31, 2006 compared to $13.8 million the year ended December 31, 2005. This increase was primarily due to increased international Captaris Workflow sales. This increase was partially offset by the decrease in sales of the Alchemy product line. The decrease in sales of Alchemy was primarily due to customer support issues relating to the consolidation of worldwide technical support that took place in 2006.

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | | (in thousands) | |
| **Revenue:** | | | |
| United States of America | $ 65,889 | $ 66,206 | $ 64,076 |
| Canada | 3,492 | 3,551 | 3,404 |
| Europe | 12,163 | 10,562 | 9,874 |
| Asia Pacific | 6,614 | 5,654 | 5,190 |
| Rest of the world | 6,671 | 6,013 | 3,836 |
| Total net revenue | $ 94,829 | $ 91,986 | $ 86,380 |

***Years ended December 31, 2007 and 2006.*** International net revenue, excluding Canada, represented 26.8% of total net revenue for the year ended December 31, 2007 compared to 24.2% for the year ended December 31, 2006, representing an increase of $3.2 million. This increase was attributable to overall growth in international software, maintenance and services, and hardware sales. International revenue from software, maintenance and services, and hardware sales increased 9.4%, 26.0% and 0.8%, respectively, for the year ended December 31, 2007 compared to the year ended December 31, 2006. The overall increase in revenue from our international regions was due to our continued investment and expansion into international markets and to a higher distribution of sales outside North America from our Captaris Alchemy product line. Our revenue from markets outside of the U.S. has increased to 31% of total revenue in 2007 from 28% in 2006 and 26% in 2005. We expect the portion of our revenue derived from international markets will be significantly higher in 2008 due, primarily, to the acquisition of CDT and our continuing expansion of our international operations. We generate a significant portion of CDT revenue in Europe.

We expect our revenue will increase in 2008 due to the acquisitions of Castelle and CDT. In addition we increased our investment in our sales organization in 2007 and plan to continue our investment in our sales organization in 2008. We expect our revenue will increase as a result of these investments. Historically, excluding the effects of acquisitions, our business experiences seasonality with a decline in revenue during the first quarter compared to the prior year s fourth quarter, building gradually during the second and third quarters, and ending with the fourth quarter as our largest quarter for revenue. We anticipate a similar pattern in 2008.

***Years ended December 31, 2006 and 2005.*** International net revenue, excluding Canada, represented 24.2% of total net revenue for the year ended December 31, 2006 compared to 21.9% for the year ended December 31, 2005, representing an increase of $3.3 million. This increase was attributable to overall growth in software, maintenance and services, and hardware sales. International revenue from software, maintenance and services, and hardware sales increased 11.9%, 24.7% and 22.7%, respectively, for the year ended December 31, 2006 compared to the year ended December 31, 2005. The overall increase in revenue from our international regions was due to our continued investment and expansion into international markets and to a higher distribution of sales outside North America from our Captaris Alchemy product line. We believe that our revenue growth for the year ended December 31, 2006 compared to the prior year was largely attributable to the changes we introduced into the sales channels in 2005, and our continued investments in our sales organizations.

**Gross Profit**

Gross profit is calculated as the selling price of our products, net of estimated returns, less cost of revenue. Cost of revenue includes manufacturing and distribution costs for products and programs sold, royalties for licensed products, amortization of acquired technology, product warranty costs, operation costs related to product support and costs associated with the delivery of professional services.

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| | 2007 | Percent Change from 2006 | 2006 (in thousands) | Percent Change from 2005 | 2005 |
|---|---|---|---|---|---|
| Gross profit | $ 66,075 | 2.8% | $ 64,266 | 8.1% | $ 59,455 |
| Percentage of revenue | 69.7% | | 69.9% | | 68.8% |

***Years ended December 31, 2007 and 2006***. Gross profit for the year ended December 31, 2007 increased by $1.8 million compared to the year ended December 31, 2006. The gross profit increase was due primarily to including Castelle appliance and maintenance, support and services revenue, for the period of July 10, 2007 through December 31, 2007, in our 2007 operating results. Additionally, as a result of an increase in the number of underlying agreements, our traditional maintenance, support and services revenue also increased. These increases collectively offset the effect of the 2006 non-recurring $1.8 million from Xpedite, which was 100% margin.

We believe our gross profit will increase in 2008 due to the inclusion of CDT revenue from the date of acquisition, a full year of revenue from Castelle, and continued growth from software, appliance and maintenance, support and services sources. However, we expect gross profit as a percentage of revenue will decline in 2008 for two reasons. First, CDT has traditionally recorded lower gross margins because a significant portion of their revenue is from professional services, which has a lower margin than software. Therefore including CDT in our results of operations will have the effect of reducing our overall gross profit as a percentage of revenue. Secondly, we anticipate recording a portion of the amortization expense relating to the technology acquired from CDT in cost of revenue.

***Years ended December 31, 2006 and 2005***. The increase in gross profit for the year ended December 31, 2006 compared to the year ended December 31, 2005 was primarily due to increased revenue from maintenance, support and service agreements and software licenses including the $1.8 million from Xpedite which was 100% margin. This increase was partially offset by lower margins contributed by professional services and costs associated with our consolidation of our international product support.

**Research and Development**

Research and development expenses consist of the salaries and related benefits for our product development personnel, outside engineering services, prototype materials and expenses related to the development of new and improved products, facilities and depreciation expenses.

| | 2007 | Percent Change from 2006 | 2006 (in thousands) | Percent Change from 2005 | 2005 |
|---|---|---|---|---|---|
| Research and development | $ 16,167 | 32.2% | $ 12,227 | (12.5%) | $ 13,976 |
| Percentage of revenue | 17.0% | | 13.3% | | 16.2% |

***Years ended December 31, 2007 and 2006.*** For the year ended December 31, 2007, research and development expenses increased $3.9 million compared to the year ended December 31, 2006. This was primarily due to an increase in outsourced engineering services of $1.9 million, the inclusion of Castelle s research and development expenses from July 10, 2007 through December 31, 2007 of $1.0 million and organizational transition costs of $353,000 associated with changes in our research and development organization structure relating to sustaining and maintenance engineering. These increases were partially offset by a decrease in depreciation costs of $289,000 as certain assets became fully depreciated. We expect overall research and development expenses to increase in absolute dollars in 2008 compared to 2007 as we will continue the use of outsourced engineering services and realize a full year of Castelle and CDT research and development expenses.

***Years ended December 31, 2006 and 2005.*** For the year ended December 31, 2006, research and development expenses decreased $1.7 million compared to the year ended December 31, 2005, primarily due to a reduction of $852,000 in staffing cost due to a lower headcount, a reduction of $724,000 in compensation cost due to the minimum incentive plan obligation for certain Teamplate founders, which was discontinued in late 2005, a reduction of $276,000 for outsourced research and development and a reduction of $17,000 in other expenses. These decreases were partially offset by an increase of $120,000 in stock-based compensation expense.

**Selling and Marketing**

Selling and marketing expenses consist primarily of salaries and benefits, sales commissions, travel expenses and related facilities costs for our sales, business development, marketing and order management personnel. Selling expenses also include professional fees associated with partner development, as well as costs of programs aimed at increasing revenue, such as advertising, trade shows, public relations and other market development programs.

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| | 2007 | Percent Change from 2006 | 2006 (in thousands) | Percent Change from 2005 | 2005 |
|---|---|---|---|---|---|
| Selling and marketing | $ 35,084 | (10.2%) | $ 31,830 | (7.6%) | $ 34,448 |
| Percentage of revenue | 37.0% | | 34.6% | | 39.9% |

***Years ended December 31, 2007 and 2006.*** For the year ended December 31, 2007, selling and marketing expenses increased $3.3 million compared to the year ended December 31, 2006. This was primarily due to increases in staffing and occupancy costs related to hiring additional sales organization personnel of $2.5 million, the inclusion of Castelle s selling and marketing expenses from July 10, 2007 through December 31, 2007 of $757,000, travel and entertainment associated with an increased investment in our sales organization of $616,000 and commissions on higher compensation plans of $394,000. These increases were partially offset by decreases in consulting fees of $494,000, reseller commissions of $301,000, and planned advertising of $243,000. We expect overall sales and marketing expenses to increase in absolute dollars in 2008 compared to 2007 as a full year of Castelle and CDT sales and marketing expenses will be included in our results of operations.

***Years ended December 31, 2006 and 2005.*** The decrease of $2.6 million or 7.6% in selling and marketing expenses for the year ended December 31, 2006, compared to the year ended December 31, 2005, was due primarily to a decrease of $1.6 million in expenses related to the Teamplate minimum incentive plan obligation which was discontinued in late 2005, a $1.3 million reduction in marketing and advertising programs and a $671,000 reduction in sales commissions resulting from a change in compensation structure. These decreases were partially offset by an increase of $687,000 in staff and occupancy costs relating to a higher headcount, an increase of $227,000 for stock-based compensation expenses and an increase of $91,000 in other expenses.

**General and Administrative**

General and administrative expenses consist of the salaries, benefits and related costs of our executive, finance, information technology, human resource and legal personnel, third-party professional service fees, bad debt charges, facilities, and depreciation expenses.

| | 2007 | Percent Change from 2006 | 2006 (in thousands) | Percent Change from 2005 | 2005 |
|---|---|---|---|---|---|
| General and administrative | $ 18,392 | 14.2% | $ 16,103 | (13.1%) | $ 18,529 |
| Percentage of revenue | 19.4% | | 17.5% | | 21.5% |

***Years ended December 31, 2007 and 2006.*** For the year ended December 31, 2007 general and administrative expenses increased $2.3 million compared to the year ended December 31, 2006. This was primarily due to the inclusion of Castelle s general and administrative expenses from July 10, 2007 through December 31, 2007 of $990,000, staffing and occupancy cost increases, including salaries related to organizational changes that in turn include severance costs of $462,000 relating to the departure of our Chief Operating Officer, stock-based compensation expense of $459,000 associated with additional grants of stock options and stock units, software and hardware purchases and associated maintenance of $383,000 and legal expenses of $233,000. These increases were partially offset by a reduction in depreciation of $343,000 as certain assets became fully depreciated and a decrease in state sales tax expense of $173,000. We expect overall general and administrative expenses to increase in absolute dollars in 2008 compared to 2007 as a full year of Castelle and CDT general and administrative expenses will be included in our results of operations.

***Years ended December 31, 2006 and 2005.*** The $2.4 million decrease in general and administrative expenses in the year ended December 31, 2006 compared to the year ended December 31, 2005 was due primarily to a decrease of $679,000 in staffing and occupancy cost primarily due to decreased headcount, a reduction of $629,000 for costs incurred for consulting services, a decrease in bad debt expense of $544,000, a decrease of $553,000 in costs associated with internal control costs, a decrease of $538,000 in audit and tax fees and an additional decrease of $9,000 in other expenses. These decreases where partially offset by $542,000 in stock-based compensation cost related to the implementation of SFAS No. 123R.

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**Amortization of Intangible Assets**

We amortize acquired intangible assets with definite lives. Amortization expense for acquired core technology and license agreements is recorded in cost of revenue and was $2.0 million, $1.9 million and $1.9 million for the years ended December 31, 2007, 2006 and 2005, respectively. Amortization expense recorded in operating expenses related to acquired intangible assets was $1.0 million, $1.3 million and $1.7 million for the years ended December 31, 2007, 2006 and 2005, respectively. The decrease in amortization expense in 2007 compared to 2006 was due primarily to certain intangible assets becoming fully amortized. The decrease in amortization expense in 2006 compared to 2005 was due primarily to certain intangible assets becoming fully amortized. We expect amortization expense for 2008 to increase from 2007 due to the additional amortization of the combined Castelle and CDT intangibles.

**In-process research and development**

Described above under Acquisitions , we acquired Castelle on July 10, 2007. We recognized an in-process research and development charge of $219,000 as a separate line item on our consolidated statements of operations for the fair value of research and development in-process on the date we acquired Castelle.

**Stock-Based Compensation Expense (Benefit)**

On January 1, 2006, we adopted SFAS No. 123R, which requires us to measure and recognize compensation expense for all share-based payment awards made to employees and directors including employee stock options and stock units. Prior to 2006, we had only shown, as permitted by SFAS No. 123, pro forma financial results including the effects of share-based compensation expense in the footnotes to the financial statements. For the years ended December 31, 2007, 2006 and 2005, we recognized the following in share-based compensation expense:

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| Cost of revenue | $ 29 | $ 12 | $ (12) |
| Research and development | 138 | 46 | (74) |
| Selling and marketing | 238 | 116 | (119) |
| General and administrative | 962 | 503 | (41) |
| Total stock-based compensation expense (benefit) | $ 1,367 | $ 677 | $ (246) |

For the year ended December 31, 2005, the pro forma stock-based compensation expense was $3.9 million. The decrease in stock-based compensation expense in 2006, compared to our pro forma stock-based compensation expense in 2005, can be attributed to accelerating the vesting of underwater stock options in 2005, the reduction in number of shares granted in 2006 compared to 2005 and differences between accounting for stock options and stock units under SFAS No. 123R in 2006 and SFAS No. 123 in 2005.

On September 1, 2005, our Compensation Committee and Board of Directors approved the acceleration of vesting of certain unvested stock options granted to our employees and officers under our stock option plans that had an exercise price greater than $3.73 per share, the closing price of our common stock on September 1, 2005. Stock options held by non-employee directors were not included in the acceleration. Previously, unvested stock options to purchase approximately 2.3 million shares of our common stock became immediately exercisable. The Board also imposed a holding period that will require all executive officers and certain other members of senior management to refrain from selling shares acquired upon the exercise of these stock options, other than shares needed to cover the exercise price and to satisfy withholding taxes and shares transferred by will or by the applicable laws of descent and distribution, until the date on which the exercise would have been permitted under the option s original vesting terms.

The accelerated vesting eliminated future compensation expenses that we would otherwise recognize in our financial statements with respect to these stock options as a result of adopting SFAS No. 123R. In accordance with APB No. 25 and FASB Interpretation No. 44, no compensation expense was recorded within the financial statements as a result of this modification because the stock options had an intrinsic value of $0.00 on the date of the modification due to the exercise price being in excess of the current market price of the stock. In accordance with SFAS No. 123, we included the unamortized compensation expense of $1.1 million (net of income taxes) related to the accelerated stock options in our pro forma net loss and net loss per common share for the year ended December 31, 2005. Had the stock options not been accelerated, the unamortized fair value-based compensation expense for the stock options would have been recorded in 2006 through 2009, under vesting schedules in place prior to the acceleration, which generally would have resulted in fair value-based compensation expenses, net of forfeitures and income taxes, of $748,000 in 2006 and $568,000 in 2007 to 2009.

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**Gain on Sale of the CallXpress Product Line**

In September of 2003, we sold our CallXpress product line. Concurrent with the transaction, we entered into an earn-out agreement with the buyer which entitles us to receive additional payments of up to $1.0 million per year for each of the three years following the sale, depending on the buyer s success in achieving certain revenue targets. In March 2005, we received a report from the buyer and payment of $1.0 million, confirming achievement of the revenue target for 2004. We recognized this payment as an additional gain on the sale of the CallXpress product line and we classified it on our income statement within operating expenses in the first quarter of 2005. In February of 2007 and 2006, respectively, we received notification confirming that the buyer had achieved their revenue target for the applicable year. We received two payments of $1.0 million each in March of 2007 and 2006, respectively. Accordingly, in the first quarters of 2007 and 2006, respectively, we recorded an additional gain on the sale of the CallXpress product line within operating expenses. This agreement expired in 2007 and, therefore, we will no longer receive any payments.

**Other Income, Net**

Other income, net, consists primarily of interest income and foreign currency transaction gains and losses. For the years ended December 31, 2007, 2006 and 2005, other income was $2.5 million, $1.9 million and $911,000, respectively. The increase in other income for the year ended December 31, 2007 compared to 2006 was primarily due to an increase in foreign currency transaction gains. The increase in other income for the year ended December 31, 2006 compared to 2005 was due primarily to an increase in interest income resulting from an increase in our invested cash balances. During 2007, we liquidated substantially all of our invested cash balances enabling us to use the proceeds in connection with the separate purchases of Castelle and CDT. In comparison to 2007, interest income for 2008 will be substantially lower as a result of reduced invested cash balances, and interest expense will be substantially higher due to interest incurred for borrowing on our new credit facility from Wells Fargo Foothill, LLC (see below under Subsequent Events ). Foreign currency transaction gains were $524,000 in 2007, transaction losses were $163,000 in 2006 and transaction gains were $124,000 in 2005.

**Income Tax Expense (Benefit)**

We are subject to income taxes in both the United States and numerous foreign jurisdictions. Significant judgment is required in evaluating our tax positions and determining our provision for income taxes. During the ordinary course of business, there are transactions and calculations for which the ultimate tax determination is uncertain. As required by FIN No. 48, we recognize the financial statement benefit of a tax position only after determining that the relevant tax authority would more likely than not sustain the position following an audit. For tax positions meeting the more-likely-than-not threshold, the amounts we recognize in the financial statements are the largest benefit that have a greater than 50 percent likelihood of being realized upon ultimate settlement with the relevant tax authority. We adjust these accruals in light of changing facts and circumstances, such as the closing of a tax audit or the expiration of statutes of limitations. The provision for income taxes includes the impact of potential tax claims and changes to accruals that we consider appropriate, as well as the related penalties and interest.

Our effective tax rates differ from the statutory rate primarily due to tax exempt interest income, state income taxes, foreign income taxes and accruals for certain tax exposures discussed above. The effective income tax rates on income and losses from continuing operations in 2007, 2006 and 2005 were 117.6%, 31.4% and 45.2%, respectively. We recorded an income tax benefit of $1.5 million and $3.3 million, respectively, on losses from continuing operations for the years ended December 31, 2007 and December 31, 2005. For the year ended December 31, 2006, we recorded an income tax provision of $1.8 million on income from continuing operations. The income tax benefits in 2007 included the reversal of tax liabilities of $403,000 which we determined were no longer probable based on updated information surrounding the related tax return, a research and development tax credit of $173,000, and the tax benefit for tax-exempt interest in taxable income of $566,000. The income tax provision in 2006 included adjustments of $72,000 primarily associated with correcting deferred tax asset balances at December 31, 2005. The income tax benefits in 2005 included the reversal of tax liabilities of $523,000 which we determined were no longer probable based on updated information surrounding the related tax return.

At December 31, 2007, we have available unused net operating losses that may be applied against future taxable income. These net operating losses consist of international losses of $2.6 million that do not expire, federal losses of $7.4 million that expire from 2019 to 2027, and state losses of $13.1 million that expire from 2009 to 2027. Additionally, we have $3.1 million of tax attributes from our Canadian subsidiary which are primarily investment tax credits and deferred research and development expenditures which begin to expire in 2013.

Our policy is to evaluate our deferred tax assets on a jurisdiction by jurisdiction basis and record a valuation allowance for our deferred tax assets if we do not have sufficient positive evidence indicating that we will have future taxable income available to utilize our deferred tax assets. In assessing the need for a valuation allowance, we first examine our historical cumulative three year pre-tax book income (loss). If we have historical cumulative three year pre-tax book income, we consider this to be strong positive evidence

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indicating we will be able to realize our deferred tax assets in the future. Absence the existence of any negative evidence outweighing the positive evidence of cumulative three year pre-tax book income, we do not record a valuation allowance for our deferred tax assets.

If we have historical cumulative three year pre-tax book losses, we then examine our historical cumulative three year pre-tax book losses to determine whether any unusual or abnormal events occurred in this time period which would cause the results not to be an indicator of future performance. As such, we normalize our historical cumulative three year pre-tax results by excluding abnormal items that are not expected to occur in the future. This analysis of normalized historical book income includes material management assumptions that relate to the appropriateness of excluding non-recurring items. If, after excluding non-recurring items, we have normalized historical cumulative three year pre-tax book income, we consider this strong positive evidence indicating we will be able to realize our deferred tax assets in the future. We then assess any additional positive and negative evidence such as the existence or absence of historical cumulative three year taxable income, future reversals of existing taxable temporary differences, future taxable income exclusive of reversing temporary differences and carry forwards and taxable income in prior carry back years. After reviewing and weighing all of the positive and negative evidence, if the positive evidence outweighs the negative evidence then we do not record a valuation allowance for our deferred tax assets. If the negative evidence outweighs the positive evidence, then we record a valuation allowance for our deferred tax assets.

For our U.S. federal jurisdictions, we have incurred U.S. cumulative pre-tax book losses of $2.5 million for the three years ended December 31, 2007. As of December 31, 2007, we continue to believe, based on the weight of available evidence, that no valuation allowance is required at December 31, 2007 for our deferred tax assets related to U.S. federal net operating losses and other U.S. deferred tax assets because the preponderance of objectively verifiable, positive evidence outweighs available negative evidence.

Objectively verifiable positive evidence considered for purposes of this determination includes our normalized cumulative pre-tax book income of $1.0 million for the three years ended December 31, 2007 exclusive of certain expenses in 2005 that we believe were an aberration, including: (1) $2.1 million for incentive compensation paid pursuant to an earn-out agreement with the former founders of Teamplate which we acquired in 2003 and (2) $1.4 million of increased accounting and consulting fees incurred to comply with the Sarbanes Oxley Act of 2002 which we consider to be in excess of our normal and recurring fees for annual compliance. We believe these are unusual items that are not indicative of a continuing condition and should be considered an aberration for purposes of determining our earnings history for assessing the realizability of our deferred tax assets in accordance with the recognition criteria of SFAS No. 109. In addition to the objective positive evidence, we also have positive evidence that is more subjective in nature including projected cumulative 3 year earnings for the period 2006 through 2008, projected cumulative 3 year taxable income for the period 2008 through 2010 and projected future earnings from Castelle which we acquired in 2007. These positive evidences are less certain than the objective positive evidences and therefore carry less weight when evaluating whether a valuation allowance is not needed. Negative evidence we considered was our history of cumulative book losses for the three years ended December 31, 2007, which we believe was an aberration (as discussed above). Based on the weight of all available evidence, we believe it is more likely than not that we will generate sufficient future U.S. taxable income to realize our U.S. deferred tax assets at December 31, 2007. In addition, we believe it is more likely than not that we will utilize our net operating loss carry forwards and they will not be limited by Internal Revenue Code Section 382 before they expire. We also believe that because of our assumptions and judgment involved with this analysis, there is an element of uncertainty that these U.S. federal net operating losses and U.S. deferred tax assets will be utilized in the future. Therefore, in the future we will continue to closely monitor evidence on a quarterly basis. If we believe that our negative evidence outweighs our positive evidence, we will record a valuation allowance against the U.S. net operating losses and the U.S. deferred tax assets at that time.

In Canada, we recorded a full valuation allowance against our investment tax credits because we do not believe it is more likely than not that we will utilize the credits prior to the expiration of the statutory carryforward period. Our Canadian subsidiary has a history of losses, and with projected Canadian income insufficient to support utilization of the investment tax credit carryovers prior to expiration provides substantial negative evidence supporting our conclusion regarding realizability of the tax credit carryovers.

In our other foreign jurisdictions, we believe that our net operating losses are more likely than not to be realized. Our history of income and net operating loss utilization, coupled with an indefinite carryforward period for net operating losses provide sufficient objectively verifiable positive evidence to support our conclusion regarding realizability of these carryforwards.

We anticipate the effective tax rate for 2008 to be in the range of 31% to 34%.

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**Discontinued Operations**

In September of 2003, we completed the sale of the assets of MediaTel. As such, MediaTel s results of operations have been classified as discontinued operations. For the year ended December 31, 2006 we recorded additional net gain of $16,000, net of income taxes of $11,000, related to legal fees and settlement of legal proceedings. In 2005, we recognized a net gain of $38,000, net of income taxes of $25,000, related to insurance reimbursements of legal fees incurred in defense of various legal proceedings.

**Liquidity and Capital Resources**

Our principal sources of liquidity are cash and cash equivalents. Traditionally our principal sources of liquidity have also included short and long-term investments. During 2007, in anticipation of our acquisition of CDT, we liquidated all of our investments. As a result we did not own any short and long-term investments as of December 31, 2007. Therefore, our cash and cash equivalent balance as of December 31, 2007 was $46.2 million. Additionally, subsequent to December 31, 2007, as described below in Subsequent Events , we entered into a $10.0 million line of credit agreement. As of December 31, 2006, when our portfolio consisted primarily of money market funds, adjustable rate mortgage-backed securities, and municipal and United States government agency-backed securities, the balance of cash, cash equivalents and short and long-term investments totaled $59.4 million.

Cash provided by operating activities for 2007 was $10.6 million resulting from changes in working capital components and adjustments to net income for non-cash expenses. Working capital sources of cash were primarily from a decrease in accounts receivable and increases in deferred revenue and accounts payable. Accounts receivable decreased due to better revenue linearity within the fourth quarter of 2007 in comparison to the same period for the prior year. Accounts payable increased primarily due to inventory purchases. Deferred revenue increased primarily due to increased maintenance and support obligations. Working capital uses of cash included increases in prepaid expenses and deferred income taxes. Prepaid expenses increased due to expenditures relating to the CDT acquisition that were recorded as deferred costs of the acquisition. Deferred income taxes increased due to taxes provided for temporary differences between book income and taxable income.

Cash provided by operating activities in 2007 was $10.6 million which was $3.3 million lower compared to 2006 due, primarily, to income of $4.0 million in 2006 compared to income of $224,000 in 2007, as well as increases in prepaid expenses and deferred tax assets. Cash provided by operating activities for 2006 was $13.9 million, primarily from our net income for the year, adjusted by non-cash expenses and changes in working capital components. Working capital sources of cash were primarily from a decrease in taxes receivable and deferred tax assets and an increase in deferred revenue. Deferred revenue increased primarily due to increased maintenance and support obligations. Working capital uses of cash included increases in trade receivables and prepaid expenses.

Cash provided by investing activities was $31.5 million for the year ended 2007 compared to cash used in investing activities of $4.7 million during 2006. Cash provided by investing activities in 2007 consisted primarily of $48.7 million of proceeds from sales and maturities of investments, net of purchases. This was reduced by $12.0 million used for the purchase of Castelle and $5.2 million for purchases of capital equipment. Cash used in investing activities in 2006 was due primarily to $3.5 million of investment purchases, net of proceeds from sales and maturities of investments and $1.3 million of capital asset purchases.

Cash used in financing activities during the year ended December 31, 2007 was $7.0 million compared to cash used of $4.9 million in the year ended December 31, 2006. In 2007, cash used in financing activities included $9.5 million to repurchase 1,663,839 shares of our common stock pursuant to our repurchase program, partially offset by cash provided by the exercise of stock options of $2.2 million through our employee stock option plans, as well as $308,000 of excess tax benefits from stock-based compensation. In 2006, cash used in financing activities included $11.3 million to repurchase 2,099,506 shares of our common stock pursuant to our repurchase program partially offset by cash provided from the exercise of stock options from our employee stock option plans of $5.3 million.

Subsequent to year end, on January 4, 2008, our wholly-owned subsidiary, Captaris Verwaltungs GmbH ( CV GmbH ), a German limited liability company, acquired Océ Document Technologies GmbH ( ODT ). Under the terms of the acquisition agreement, CV GmbH acquired all of the outstanding stock of ODT for approximately 10.4 million ($15.4 million), net of ODT s cash balance as of the closing of approximately 21.6 million ($31.8 million). To finance this transaction, we loaned CV GmbH 31.6 million ($46.2 million), representing the aggregate amount of cash paid to the seller in the acquisition. Since the acquisition, and through the date of this report, the majority of our consolidated cash is held by ODT in Germany. We intend to have ODT remit its excess cash to Captaris in repayment of the intercompany loan. However, in accordance with capital maintenance rules under German law, ODT can only remit to its shareholders cash equal to the amount that its net assets exceeds its registered share capital. As of the date of this report, ODT s net assets do not exceed its registered share capital and therefore no cash can be remitted to Captaris to repay the intercompany loan. We are in the process of merging ODT into CV GmbH, with CV GmbH being the surviving company. CV GmbH s registered share capital is significantly less than ODT s and, as a result of the merger, we expect CV GmbH s net assets to exceed its registered share capital immediately after the merger, therefore freeing up approximately 5.0 million ($7.4 million) of

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cash to be remitted to Captaris in repayment of the intercompany loan. We expect the merger and remittance of the  5.0 million ($7.4 million) to occur late in the second quarter of 2008. We expect CV GmbH to repay the remainder of the intercompany loan over the next 5 years.

The outstanding intercompany loan of  31.6 million ($46.2 million) exposes us to significant gains and losses from fluctuations in the exchange rate of Euros to U.S. dollars. To mitigate this risk, we have entered into a foreign currency exchange forward contract with Wells Fargo Bank N.A., agreeing to sell approximately  31.6 million at a future date. This contract is unsecured and matures on April 4, 2008. Under the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, our foreign currency forward contract is an effective hedge of our foreign currency risk exposure on the intercompany loan. However, until ODT can remit cash in repayment of the intercompany loan, which we would then use to settle the foreign currency forward contract, we are exposed to potentially significant U.S. dollar cash flow risks. To the extent that the foreign currency forward contract is in a loss position on the date of maturity, we will have to settle the contract in U.S. dollars equal to the amount of the loss. Additionally, we intend to continue to hedge our foreign currency exposure on the intercompany loan until it is repaid in full. This will require us to enter into a new foreign currency contract when our existing foreign currency contract expires on April 4, 2008. There can be no assurances that we will be able to obtain a new foreign currency contract at the same rate or similar unsecured terms.

We believe existing cash, cash equivalents and amounts available under our line of credit agreement together with funds generated from operations will be sufficient to meet our anticipated working capital needs and capital expenditure needs for the next twelve months and the foreseeable future.

***Stock Repurchase Plan***

On June 8, 2006, our Board of Directors authorized us to enter into a Rule 10b5-1 repurchase plan to facilitate the repurchase of our common stock at times when we ordinarily would not be in the market because of self-imposed trading blackout periods. Transactions under the Rule 10b5-1 repurchase plan began on September 18, 2006, the first trading day after the trading window closed in the third quarter of 2006.

Under our Rule 10b5-1 repurchase plan as well as stock repurchases we made prior to or outside of the plan during open trading window periods, we repurchased 1,663,839 shares of our common stock for $9.5 million, 2,099,506 shares for $11.3 million, and 1,285,778 shares for $4.9 million in 2007, 2006 and 2005, respectively.

In 2006, the Board of Directors approved two separate increases to our previously announced stock repurchase program, each time bringing the total cash available for repurchase to approximately $15.0 million. As of December 31, 2007, $9.6 million was available under our repurchase program. As of March 1, 2008 we have purchased an additional 33,000 shares under our repurchase plan for $126,000. We may repurchase shares in the future subject to the rules of our Rule 10b5-1 repurchase plan and, in the case of any discretionary purchases made outside of the plan, subject to overall market conditions, stock prices, and our cash position and requirements going forward. The repurchase program will continue until the earlier of (a) such time when the maximum dollar amount authorized has been utilized or (b) our Board of Directors elects to discontinue our repurchase program.

***Contractual Obligations and Commercial Commitments***

We have operating leases for all of our offices and certain equipment. Rental expense for operating leases was $3.1 million, $3.0 million and $3.1 million in 2007, 2006 and 2005, respectively. Certain of our lease agreements provide for scheduled rent increases over the lease term. We recognize minimum rental expenses on a straight-line basis over the term of the lease. As of December 31, 2007, we occupied 38,165 square feet of office space, net of sub-leased office space, in Bellevue, Washington under a lease that ended on February 29, 2008. In February 2008, we relocated our United States headquarters to a new location also in Bellevue, Washington. As of the date of this report, we lease 52,810 square feet of office space under a lease that expires in February 2015. In March 2007, we renewed our lease for the Englewood, Colorado office for another twelve months and reduced the leased space to approximately 15,000 square feet.

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The following table summarizes our contractual obligations and estimated commercial commitments as of December 31, 2007 and the effect such obligations are expected to have on liquidity in future periods:

| Contractual Obligations | Total | Payments Due by Period (in thousands) Less than 1 year | 1-3 years | 4-5 years | More than 5 years |
|---|---|---|---|---|---|
| Operating leases, net of sublease income | $ 14,881 | $ 2,813 | $ 4,758 | $ 3,818 | $ 3,492 |
| Purchase obligations[1]: | | | | | |
| Long-term commitments[2] | 1,245 | 1,245 | | | |
| Total contractual obligations and estimated commercial commitments | $ 16,126 | $ 4,058 | $ 4,758 | $ 3,818 | $ 3,492 |

Notes:

1. These purchase obligations exclude our commitment to purchase CDT pursuant to an agreement signed on December 20, 2007 see Subsequent Events below. Our acquisition of CDT was consummated in January 2008.
2. We have certain obligations to purchase telecommunication services and general purchases for our operating activities.

Subsequent to year end (see Subsequent Events below), we assumed the following CDT commitments for leased spaces and personal property under existing non-cancelable operating leases:

| Contractual Obligations | Total | Payments Due by Period (in thousands) Less than 1 year | 1-3 years | 4-5 years | More than 5 years |
|---|---|---|---|---|---|
| Operating leases | $3,324 | $873 | $1,570 | $881 | $ |

We have a $1.0 million standby letter of credit. We have collateralized the letter of credit with a $1.0 million restricted certificate of deposit, which secures our corporate headquarters and is included in restricted cash as of December 31, 2007.

**New Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 141 (revised 2007) ( SFAS No. 141R ), *Business Combinations*, which replaces SFAS No. 141 and amends several others. The statement retains the purchase method of accounting for acquisitions but changes the way we will recognize assets and liabilities. It also changes the way we will recognize assets acquired and liabilities assumed arising from contingencies, requires us to capitalize in-process research and development at fair value, and requires us to expense acquisition-related costs as incurred. SFAS No. 141R is effective for us on, but not before, January 1, 2009, the beginning of our fiscal 2009 reporting periods. SFAS No. 141R will apply prospectively to our business combinations completed on or after January 1, 2009 and will not require us to adjust or modify how we recorded any acquisition prior to that date.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115*. Under SFAS No. 159, we may elect to measure many financial instruments and certain other items at fair value on an instrument by instrument basis subject to certain restrictions. We adopted SFAS No. 159 on January 1, 2008. Adopting SFAS No. 159 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. We adopted SFAS No. 157 on January 1, 2008. Adopting SFAS No. 157 did not have a material impact on our consolidated financial position, results of operations or cash flows.

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**Subsequent Events**

**Stock Option and Stock Unit Grants**

Subsequent to year end, on February 22, 2008, we granted 223,000 stock options and 194,950 stock units to certain employees. We expect to record stock-based compensation expense of $348,000 and $699,000 for the stock options and stock units, respectively, ratably over a four year period.

**Acquisition of Océ Document Technologies GmbH**

On January 4, 2008, our wholly-owned subsidiary, Captaris Verwaltungs GmbH, a German limited liability company ( CV GmbH ), acquired Océ Document Technologies GmbH ( ODT ), pursuant to a Sale and Purchase Agreement (the SPA ) by and between CV GmbH and Océ Deutschland Holding GmbH & Co. KG, a German limited partnership (the Seller ), dated December 20, 2007. Under the terms of the SPA, CV GmbH acquired all of the outstanding equity of ODT from the Seller, and ODT became a wholly-owned subsidiary of CV GmbH and an indirect wholly-owned subsidiary of Captaris. After our acquisition, we re-named ODT to Captaris Document Technologies GmbH ( CDT ).

Under the terms of the acquisition agreement, CV GmbH acquired CDT for approximately 10.4 million ($15.4 million), net of CDT s cash balance as of the closing of approximately 21.6 million ($31.8 million). CV GmbH also assumed CDT s operating and financial liabilities, including approximately 12.1 million ($17.9 million) in future retirement obligations. At the closing, €2.0 million ($3.0 million) of the purchase price was deposited in a third-party escrow account for 12 months as security for any post-closing purchase price adjustment and, subject to certain limitations, for indemnification claims against the Seller; however, in connection with the resolution of a post-closing dispute with the Seller, we expect to release the full amount of the escrow to the Seller during the first quarter of 2008.

CDT is a provider of software and solutions for document capture, text recognition and document classification. CDT has approximately 178 employees and maintains its global headquarters in Constance, Germany, and its North American office in Bethesda, Maryland.

**Credit Facility**

On January 2, 2008, we entered into a credit agreement providing for a senior secured revolving credit facility with Wells Fargo Foothill, LLC, as arranger, administrative agent, swing lender, and letter of credit issuer, and the other lenders party thereto (the Credit Facility ).

The Credit Facility provides for a $10.0 million revolving line of credit commitment, which may be used (i) for revolving loans, (ii) for swing line advances, subject to a sublimit of $2.0 million and (iii) to request the issuance of letters of credit on our behalf, subject to a sublimit of $5.0 million. On or before January 2, 2009, we may, subject to applicable conditions, request an increase in the commitment under the Credit Facility of up to $10.0 million. The credit available under the Credit Facility may be used to, among other purposes, pay a portion of the purchase price for the acquisition of Océ Document Technologies GmbH as described above and to finance our ongoing working capital, capital expenditure, and general corporate needs. Upon the closing of the Credit Facility on January 2, we obtained an initial cash advance of approximately $9.8 million.

We may, subject to applicable conditions, elect interest rates on our revolving borrowings calculated by reference to (i) the LIBOR rate (the LIBOR Rate ) fixed for given interest periods, plus a margin determined by our average daily balance of the revolving loan usage during the preceding month or (ii) Wells Fargo Bank, National Association s prime rate (or, if greater, the average rate on overnight federal funds plus one half of one percent) (the Base Rate ), plus a margin determined by our average daily balance of the revolving loan usage during the preceding month. For swing line borrowings, we will pay interest at the Base Rate, plus a margin determined by our average daily balance of the revolving loan usage during the preceding month. For borrowings made with the LIBOR Rate, the margin ranges from 250 to 275 basis points, while for borrowings made with the Base Rate, the margin ranges from 100 to 125 basis points.

The Credit Facility matures on January 2, 2013, at which time all outstanding borrowings must be repaid and all outstanding letters of credit must have been cash collateralized.

The Credit Facility provides for the payment of specified fees and expenses, including commitment and unused line fees, and contains certain loan covenants, including, among others, financial covenants providing for a minimum EBITDA and maximum amount of capital expenditures, and limitations on our ability with regard to the incurrence of debt, the existence of liens, stock repurchases and dividends, investments, and mergers, dispositions and acquisitions, and events constituting a change in control. Our obligations under the Credit Facility are guaranteed by certain of our direct and indirect domestic subsidiaries (collectively, the Guarantors ).

The Credit Facility contains events of default that include, among others, non-payment of principal, interest or fees, violation of covenants, inaccuracy of representations and warranties, bankruptcy and insolvency events, material judgments, and cross defaults to certain other indebtedness. The occurrence of an event of default will increase the applicable rate of interest and could result in the acceleration of our obligations under the Credit Facility and the obligations of any or all of the Guarantors to pay the full amount of our obligations under the Credit Facility.

CAPTARIS, INC.

**Item 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

Our company is exposed to market risks, including changes in interest rates and foreign currency exchange rates, each of which could adversely affect the value of certain assets and liabilities. Except as described below, we do not, as of the date of this report, use derivative financial instruments to hedge this risk.

*Interest rate risk*

Historically, we maintained an investment portfolio consisting primarily of investment grade interest bearing securities that were classified as available-for-sale securities. These investments were subject to interest rate risk and would fall in value if market interest rates increased. Conversely, declines in interest rates would have a material impact on the interest earnings of our investment portfolio. For a presentation of the fair value of our available-for-sale investments at December 31, 2006, see Note 6 in Notes to Consolidated Financial Statements in Item 8 of this Annual Report on Form 10-K.

During 2007, we liquidated our investments in order to pursue acquisition opportunities, such as the acquisition of CDT in January 2008. Accordingly, at December 31, 2007, we did not have any interest rate risk related to investments because we did not hold any investment grade interest bearing securities in our investment portfolio. However, we expect to acquire, as we have historically, interest bearing securities or other instruments that carry with them, interest rate risk.

On January 2, 2008, we entered into a credit agreement providing for a senior secured revolving credit facility of $10.0 million. On or before January 2, 2009, we may, subject to applicable conditions, request an increase in the commitment of up to $10.0 million. Upon closing of the credit facility on January 2, 2008, we obtained an initial cash advance of approximately $9.8 million. The interest rate on the credit facility is based upon either: LIBOR plus an applicable margin, or the prime rate or base rate plus an applicable margin. The credit facility matures on January 2, 2013. See Note 20 in Notes to Consolidated Financial Statements in Item 8 of this Annual Report on Form 10-K.

Based on our outstanding credit facility obligation of $9.8 million as of the date of this report, assuming a hypothetical increase of 5%, 10% and 20% in interest rates over the next year, annualized interest expense would increase by approximately $490,000, $980,000 and $2.0 million, respectively. Such potential increases are based on certain simplified assumptions, including an immediate, across-the-board increase in the level of interest rates with no other subsequent changes for the remainder of the periods.

*Foreign currency risk*

Currently, our U.S. sales and some international sales are denominated in U.S. dollars. We may also price our international sales to the United Kingdom in British pounds sterling, to Canada in Canadian dollars, to Australia in Australian dollars and to participating European Community countries in Euros. Increases in the value of the U.S. dollar against any local currencies could cause our U.S.-based products to become relatively more expensive to customers in a particular country or region, leading to reduced revenue or profitability in that country or region. As we continue to expand our international operations, and particularly with the acquisition of CDT in January 2008, we expect our non-U.S.-dollar-denominated revenue, expenses, and intercompany balances and our exposure to gains and losses on international currency transactions to increase.

Based on the net foreign currency denominated balances held by our U.S. parent company at December 31, 2007 of $43.7 million, an assumed hypothetical 5%, 10% and 20% strengthening of the U.S. dollar in relation to the denominated foreign currencies would result in losses of $2.1 million, $4.3 million, and $8.5 million, respectively. We would record these losses in other income (expense), net in our Consolidated Statements of Operations.

In addition, the results of operations and financial condition of our international operations and subsidiaries are exposed to foreign exchange rate fluctuations due to translation to U.S. dollars for reporting purposes. Upon translation, operating results may differ materially from expectations, and we may record significant gains or losses on the remeasurement of certain balances denominated in foreign currencies. For example, with respect to our net assets or net revenue denominated in currencies other than the U.S. dollar, a strengthening U.S. dollar would result in less net assets or net revenue when converted to U.S. dollars, which could have a material adverse impact on our financial condition or results of operations. Conversely, for an entity with various financial instruments denominated in a foreign currency in a net liability position and net expenses, a weakening in the U.S. dollar would result in more net liabilities or net expenses when converted to U.S. dollars. As we have expanded our international operations, and particularly with the acquisition of CDT in early January 2008, our exposure to these exchange rate risks has increased. As of the date of this report, a significant portion of our net assets are denominated in Euros and, to a lesser extent, in Canadian dollars, Australian

**CAPTARIS, INC.**

dollars and British pounds sterling. Moreover, with the acquisition of CDT, a significant portion of our consolidated revenue and expenses will be denominated in Euros. Historically, we have not hedged our foreign currency translation risk, although we may do so in the future. We performed a sensitivity analysis assuming a hypothetical adverse movement in foreign exchange rates to the underlying foreign currency exposures for our asset and liability positions based in foreign currencies, including our investment in CDT on January 4, 2008. The sensitivity analysis indicated that a hypothetical 5%, 10% and 20% adverse movement in foreign currency exchange rates would result in a $2.8 million, $5.7 million and $11.4 million, respectively, loss in fair values of foreign currency based assets and liabilities as of the date of this report compared to a $398,000, $796,000 and $1.6 million, respectively, loss in fair values of foreign currency based assets and liabilities at December 31, 2006. Fluctuations in our foreign denominated assets and liabilities are recorded in accumulated other comprehensive income (loss), a separate component of stockholders equity.

Subsequent to year end, we loaned our wholly-owned subsidiary, Captaris Verwaltungs GmbH ( CV GmbH ), 31.6 million ($46.2 million). Until the intercompany loan is repaid, this loan exposes us to significant gains and losses from fluctuations in the exchange rate of Euros to U.S. dollars. To mitigate this risk, we have entered into a foreign currency exchange forward contract with Wells Fargo Bank N.A., agreeing to sell approximately 31.6 million at a future date. This contract is unsecured and matures on April 4, 2008. Under the provisions of SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, our foreign currency forward contract is an effective hedge of our foreign currency risk exposure on the intercompany loan. However, until CV GmbH can remit cash in repayment of the intercompany loan, which we do not expect to occur prior to the maturity of the current hedging contract, which we would then use to settle the foreign currency forward contract, we are exposed to potentially significant U.S. dollar cash flow risks. To the extent that the foreign currency forward contract is in a loss position on the date of maturity, we must settle the contract in U.S. dollars equal to the amount of the loss. Additionally, we intend to continue to hedge the foreign currency exposure on the intercompany loan until it is repaid in full. This will require us to enter into a new foreign currency contract when our existing foreign currency contract expires on April 4, 2008. There can be no assurances that we will be able to obtain a new foreign currency contract at same rate or similar unsecured terms. For additional information regarding this matter, refer to Item 7 of the report under the heading Liquidity and Capital Resources.

We performed a sensitivity analysis assuming a hypothetical adverse change in the value of the foreign currency forward contract discussed above. The sensitivity analysis indicated that a hypothetical 5%, 10% and 20% adverse movement in foreign currency exchange rates would result in a $ 2.3 million, $ 4.7 million and $ 9.3 million loss, that must be settled in cash on the date of maturity, April 4, 2008.

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**CAPTARIS, INC.**

**Item 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**
**REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM**

To the Board of Directors and Stockholders of

Captaris, Inc.

We have audited the accompanying consolidated balance sheets of Captaris, Inc. and subsidiaries ( the Company ) as of December 31, 2007 and 2006, and the related consolidated statements of operations, shareholders equity and cash flows for each of the years in the three year period ended December 31, 2007. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Captaris Inc. and subsidiaries as of December 31, 2007 and 2006, and the consolidated results of its operations and its cash flows for each of the years in the three year period ended December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Notes 1 and 14 to the financial statements, effective January 1, 2007, the Company adopted the provisions of the Financial Accounting Standards Board Interpretation No. 48 Accounting for Uncertainty in Income Taxes. As discussed in Notes 1 and 10 to the consolidated financial statements, effective January 1, 2006, the Company changed its method of accounting for share-based payment arrangements to conform to Statement of Financial Accounting Standards No. 123(R), Share-Based Payment.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company s internal control over financial reporting as of December 31, 2007, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission, and our report dated March 13, 2008 expressed an unqualified opinion thereon.

/s/ Moss Adams LLP
Seattle, Washington
March 13, 2008

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**CAPTARIS, INC.**

**CONSOLIDATED BALANCE SHEETS**

**(In thousands, except per share data)**

| | December 31, 2007 | December 31, 2006 |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 46,182 | $ 10,695 |
| Restricted cash | 1,000 | |
| Short-term investments, available-for-sale | | 7,084 |
| Accounts receivable, net | 19,348 | 21,347 |
| Inventories | 1,681 | 961 |
| Prepaid expenses and other assets | 4,564 | 2,971 |
| Income tax receivable and deferred tax assets, net | 3,527 | 3,052 |
| Total current assets | 76,302 | 46,110 |
| Long-term investments, available-for-sale | | 41,584 |
| Restricted cash | | 1,000 |
| Other long-term assets | 847 | 303 |
| Equipment and leasehold improvements, net | 7,735 | 4,340 |
| Intangible assets, net | 11,748 | 6,570 |
| Goodwill | 37,522 | 32,199 |
| Deferred tax assets, net | 5,344 | 3,842 |
| Total assets | $ 139,498 | $ 135,948 |
| **LIABILITIES AND SHAREHOLDERS EQUITY** | | |
| Current liabilities: | | |
| Accounts payable | $ 8,621 | $ 5,308 |
| Accrued compensation and benefits | 5,528 | 4,522 |
| Other accrued liabilities | 1,706 | 1,920 |
| Income taxes payable | 327 | 192 |
| Deferred revenue | 22,747 | 20,328 |
| Total current liabilities | 38,929 | 32,270 |
| Accrued liabilities noncurrent | 696 | 307 |
| Deferred revenue noncurrent | 5,962 | 5,544 |
| Total liabilities | 45,587 | 38,121 |
| Commitments and contingencies | | |
| Shareholders equity: | | |
| Preferred stock, par value $0.01 per share, 4,000 shares authorized; none issued and outstanding | | |
| Common stock, par value $0.01 per share, 120,000 shares authorized; 26,378 and 27,556 outstanding, respectively | 264 | 275 |
| Additional paid-in capital | 40,971 | 46,614 |
| Retained earnings | 49,961 | 49,790 |
| Accumulated other comprehensive income | 2,715 | 1,148 |

| | | |
|---|---|---|
| Total shareholders equity | 93,911 | 97,827 |
| Total liabilities and shareholders equity | $ 139,498 | $ 135,948 |

See the accompanying notes to these consolidated financial statements.

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**CAPTARIS, INC.**

**CONSOLIDATED STATEMENTS OF OPERATIONS**

**(In thousands, except per share data)**

| | Year Ended December 31, 2007 | 2006 | 2005 |
|---|---|---|---|
| Net revenue | $ 94,829 | $ 91,986 | $ 86,380 |
| Cost of revenue | 28,754 | 27,720 | 26,925 |
| Gross profit | 66,075 | 64,266 | 59,455 |
| Operating expenses: | | | |
| Research and development | 16,167 | 12,227 | 13,976 |
| Selling and marketing | 35,084 | 31,830 | 34,448 |
| General and administrative | 18,392 | 16,103 | 18,529 |
| Amortization of intangible assets | 1,029 | 1,274 | 1,749 |
| In-process research and development | 219 | | |
| Gain on sale of discontinued CallXpress product line | (1,000) | (1,000) | (1,000) |
| Total operating expenses | 69,891 | 60,434 | 67,702 |
| Operating income (loss) | (3,816) | 3,832 | (8,247) |
| Other income (expense): | | | |
| Interest income | 2,052 | 1,894 | 1,121 |
| Interest expense and other income (expense), net | 467 | 55 | (210) |
| Other income | 2,519 | 1,949 | 911 |
| Income (loss) from continuing operations before income tax expense (benefit) | (1,297) | 5,781 | (7,336) |
| Income tax expense (benefit) | (1,525) | 1,816 | (3,319) |
| Income (loss) from continuing operations | 228 | 3,965 | (4,017) |
| Discontinued operations: | | | |
| Gain (loss) on sale of MediaTel assets, net of income tax expense (benefit) of $(2), $11 and $25, respectively | (4) | 16 | 38 |
| Income (loss) from discontinued operations | (4) | 16 | 38 |
| Net income (loss) | $ 224 | $ 3,981 | $ (3,979) |
| **Basic net income (loss) per common share:** | | | |
| Income (loss) from continuing operations | $ 0.01 | $ 0.14 | $ (0.14) |
| Income from discontinued operations | (0.00) | 0.00 | 0.00 |
| Basic net income (loss) per share | $ 0.01 | $ 0.14 | $ (0.14) |

| | | | |
|---|---|---|---|
| **Diluted net income (loss) per common share:** | | | |
| Income (loss) from continuing operations | $ 0.01 | $ 0.14 | $ (0.14) |
| Income from discontinued operations | (0.00) | 0.00 | 0.00 |
| Diluted net income (loss) per share | $ 0.01 | $ 0.14 | $ (0.14) |
| **Weighted average shares used in computation of:** | | | |
| Basic net income (loss) per share | 27,019 | 27,899 | 28,907 |
| Diluted net income (loss) per share | 27,623 | 28,514 | 28,907 |

See the accompanying notes to these consolidated financial statements.

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**CAPTARIS, INC.**

**CONSOLIDATED STATEMENTS OF CASH FLOWS**

**(In thousands)**

| | Year Ended December 31, | | |
|---|---|---|---|
| | **2007** | **2006** | **2005** |
| Cash flows from operating activities: | | | |
| Net income (loss) | $ 224 | $ 3,981 | $ (3,979) |
| Adjustments to reconcile net income (loss) to net cash provided by operating activities: | | | |
| Depreciation | 2,700 | 3,104 | 3,474 |
| Amortization | 2,980 | 3,198 | 3,675 |
| Stock-based compensation expense (benefit) | 1,367 | 677 | (246) |
| In-process research and development | 219 | | |
| (Gain) loss on disposition of equipment | (7) | 74 | 10 |
| Impairment of long-lived assets and intangibles | 83 | | 607 |
| Provision for doubtful accounts | 114 | 29 | 572 |
| Unrealized gain in foreign currency exchange | (433) | | |
| Deferred income taxes | (1,349) | 3,477 | (1,054) |
| Changes in assets and liabilities, net of acquired assets and liabilities: | | | |
| Accounts receivable, net | 2,658 | (2,563) | (1,108) |
| Inventories | 411 | (411) | 411 |
| Prepaid expenses and other assets | (1,990) | (1,159) | (448) |
| Income taxes receivable and deferred income taxes, net | (628) | (1,185) | (1,905) |
| Accounts payable | 2,603 | 622 | (2,222) |
| Accrued compensation and benefits | 183 | 765 | (623) |
| Other accrued liabilities | (469) | (489) | 813 |
| Income taxes payable | (109) | 111 | (343) |
| Deferred revenue | 2,088 | 3,692 | 3,802 |
| Net cash provided by operating activities | 10,645 | 13,923 | 1,436 |
| Cash flows from investing activities: | | | |
| Purchase of equipment and leasehold improvements | (5,244) | (1,284) | (3,045) |
| Purchases of investments | (38,945) | (71,242) | (50,951) |
| Purchases of businesses, net of cash acquired | (11,974) | | |
| Proceeds from disposals of fixed assets | 55 | 14 | 26 |
| Proceeds from sale of and maturities of investments | 87,618 | 67,790 | 55,721 |
| Net cash provided by (used in) investing activities | 31,510 | (4,722) | 1,751 |
| Cash flows from financing activities: | | | |
| Proceeds from exercise of stock options | 2,165 | 5,278 | 574 |
| Repurchase of common stock | (9,494) | (11,301) | (4,942) |
| Excess tax benefits from stock-based compensation | 308 | 1,116 | |
| Net cash used in financing activities | (7,021) | (4,907) | (4,368) |
| Net increase (decrease) in cash | 35,134 | 4,294 | (1,181) |
| Effect of exchange rate changes on cash | 353 | (19) | 38 |
| Cash and cash equivalents at beginning of period | 10,695 | 6,420 | 7,563 |

| | | | |
|---|---|---|---|
| Cash and cash equivalents at end of period | $ 46,182 | $ 10,695 | $ 6,420 |
| | | | |
| Supplemental disclosures: | | | |
| Cash paid during the period for income taxes | $ 458 | $ 141 | $ 404 |
| | | | |
| Software acquired with three year payment terms: | | | |
| Fair value of software acquired | $ 935 | $ | $ |
| Cash paid for the software | (301) | | |
| | | | |
| Liabilities assumed | $ 634 | $ | $ |
| | | | |
| Castelle acquisition: | | | |
| Fair value of assets acquired | $ 14,281 | $ | $ |
| Cash paid | (11,974) | | |
| | | | |
| Liabilities assumed | $ 2,307 | $ | $ |

See the accompanying notes to these consolidated financial statements.

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**CAPTARIS, INC.**

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY**

**(In thousands)**

| | Common Shares | Common Stock | Additional Paid-in Capital | Accumulated Other Comprehensive Income | Retained Earnings | Total Shareholders Equity | Total Comprehensive Income (Loss) |
|---|---|---|---|---|---|---|---|
| Balance at January 1, 2005 | 29,451,973 | $ 295 | $ 55,410 | $ 748 | $ 49,788 | $ 106,241 | $ 479 |
| Exercise of stock options | 200,793 | 2 | 572 | | | 574 | |
| Repurchase of common stock | (1,285,778) | (13) | (4,929) | | | (4,942) | |
| Stock-based compensation expense | | | (246) | | | (246) | |
| Income tax benefit related to stock-based compensation | | | 28 | | | 28 | |
| Unrealized gain on investments, net of income tax expense of $38 | | | | 63 | | 63 | 63 |
| Foreign currency translation adjustment | | | | 40 | | 40 | 40 |
| Net loss | | | | | (3,979) | (3,979) | (3,979) |
| Balance as of December 31, 2005 | 28,366,988 | $ 284 | $ 50,835 | $ 851 | $ 45,809 | $ 97,779 | $ (3,876) |
| Exercise of stock options | 1,288,365 | 12 | 5,266 | | | 5,278 | |
| Repurchase of common stock | (2,099,506) | (21) | (11,280) | | | (11,301) | |
| Stock-based compensation expense | | | 677 | | | 677 | |
| Income tax benefit related to stock-based compensation | | | 1,116 | | | 1,116 | |
| Unrealized gain on investments, net of income tax expense of $68 | | | | 108 | | 108 | 108 |
| Foreign currency translation adjustment | | | | 189 | | 189 | 189 |
| Net income | | | | | 3,981 | 3,981 | 3,981 |
| Balance as of December 31, 2006 | 27,555,847 | $ 275 | $ 46,614 | $ 1,148 | $ 49,790 | $ 97,827 | $ 4,278 |
| Exercise of stock options | 486,036 | 5 | 2,160 | | | 2,165 | |
| Repurchase of common stock | (1,663,839) | (16) | (9,478) | | | (9,494) | |
| Stock-based compensation expense | | | 1,367 | | | 1,367 | |
| Income tax benefit related to stock-based compensation | | | 308 | | | 308 | |
| Unrealized gain on investments, net of income tax expense of $4 | | | | 10 | | 10 | 10 |
| Cumulative effect of adoption of FASB Interpretation No. 48 | | | | | (53) | (53) | |
| Foreign currency translation adjustment | | | | 1,557 | | 1,557 | 1,557 |
| Net income | | | | | 224 | 224 | 224 |
| Balance as of December 31, 2007 | 26,378,044 | $ 264 | $ 40,971 | $ 2,715 | $ 49,961 | $ 93,911 | $ 1,791 |

See the accompanying notes to these consolidated financial statements.

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**CAPTARIS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**1. Description of the Business and Summary of Significant Accounting Policies**

**The Business**

Captaris, Inc., ( we , us , our ) is a corporation formed in the State of Washington in 1982. Our principal executive offices are located in Bellevue, Washington. We are a provider of computer products that automate document-centric business processes. With a comprehensive suite of software, hardware and services, we help organizations gain control over many processes that include the need to integrate documents more securely and efficiently. Our solutions also provide interoperability between documents and business applications and technology platforms.

We operate under one business unit segment to deliver our product and software solutions. We develop products and services for document capture, intelligent document recognition and classification, routing, workflow, document management and document delivery. Our product lineup includes the brand names RightFax, FaxPress, Captaris Workflow, Alchemy, Single Click Entry, DOKuStar and RecoStar.

Our products are distributed and supported through a global network of technology partners. This distribution system consists of business partners from all levels of the information technology ( IT ) spectrum: value-added resellers, original equipment manufacturers ( OEMs ), system integrators, distributors, mass market resellers, online retailers, office equipment dealers, and independent software vendors ( ISVs ). We believe the use of multiple distribution channels increases the likelihood that our products will be sold to more customers.

**Accounting Principles**

Our consolidated financial statements and accompanying notes are prepared in accordance with accounting principles generally accepted in the United States of America.

**Principles of Consolidation**

Our consolidated financial statements include the accounts of Captaris, Inc. and our wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

**Use of Estimates**

Generally accepted accounting principles in the U.S. require us to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of contingent assets and liabilities as of the date of our consolidated financial statements and the reported amounts of revenue and expenses during the reporting periods presented. We base our estimates on historical experience, current conditions and various other assumptions we believe to be reasonable under the circumstances. Our estimates form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources, as well as identifying and assessing appropriate accrual and disclosure treatment with respect to commitments and contingencies. Actual results may differ significantly from these estimates. To the extent that there are material differences between these estimates and actual results, our presentation of our financial condition or results of operations may be affected.

**Reclassifications**

In 2006, in an effort to provide investors more detail on our expenses, we began separating Selling, general and administrative expenses into two separate categories: Selling and marketing expenses and General and administrative expenses. In addition, in 2006 we reclassified stock-based compensation expense (benefit) from one separate line item on the income statement to the expense categories as disclosed in Note 10. All relative prior period balances have been reclassified to conform to the current period presentation. These reclassifications had no material impact on revenue, gross margin, net income (loss), assets or liabilities in the periods presented.

**Business Combinations**

We include the results of operations of acquired businesses from the date of acquisition. We record net assets acquired at their fair value at the date of acquisition. We include the excess of the purchase price over the fair value of net assets acquired as goodwill in the accompanying consolidated balance sheets. In certain circumstances, we have pushed down the goodwill to the acquiring foreign subsidiary resulting in foreign currency translation differences upon consolidation.

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CAPTARIS, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

**Cash and Cash Equivalents**

We consider all highly liquid debt instruments purchased with an original maturity of three months or less to be cash equivalents. Our cash balances periodically exceed FDIC limits on insurable amounts.

**Investments**

We classify our short-term and long-term investments as available-for-sale. We record our portfolio at fair market value. We determine the fair value of our investments based on quoted market prices. We classify investments with legal maturities of one year or less as short-term. We recognize realized gains and losses upon the sale of investments using the specific identification method. We record unrealized gains and losses, net of any income tax effect, as a component of other comprehensive income. We record interest income using an effective interest rate, with the associated premium or discount amortized to interest income over the term of each investment.

We recognize an impairment charge for unrealized losses when an investment s decline in fair value is below the cost basis and we judge the decline to be other than temporary. In making this judgment, we evaluate, among other factors, the duration and extent to which the fair value of an investment is less than its cost, the financial condition and near-term business outlook for the investee and our intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value.

**Concentration of Credit Risk**

We extend credit to customers and are, therefore, subject to credit risk. We perform initial and ongoing credit evaluations of our customers financial condition and do not require collateral on accounts receivable. To determine our allowance for doubtful accounts, we use estimates based on our historical bad debt experience, the aging of customer accounts, customer concentrations, customer credit-worthiness, current economic trends and changes in our customer payment patterns. Historically, actual credit losses have been within our expectations.

A significant portion of our revenue is derived from sales in the United States. For the years ended December 31, 2007, 2006 and 2005, sales in the United States accounted for 69.5%, 72.0% and 74.2%, respectively, of net revenue. No single customer represented more than 10% of our net revenue in 2007, 2006, or 2005.

**Inventories**

Inventories consist primarily of fax boards, which we either resell or forward integrate into finished goods. We value these inventories on our consolidated balance sheets at the lower of cost or market (as determined by the first-in, first out method). Due to rapid changes in technology, it is possible that older products in inventory may become obsolete or that we may sell these products below cost. If actual market conditions are less favorable than we project, inventory write-downs may be required. When we determine that the carrying value of inventories is not recoverable, we write-down inventories to market value.

Inventories consisted of the following (in thousands):

| | December 31, | |
|---|---|---|
| | 2007 | 2006 |
| Finished goods | $ 1,131 | $ 961 |
| Components | 550 | |
| | $ 1,681 | $ 961 |

**Restricted Cash**

As of December 31, 2007, we had a $1.0 million irrevocable standby letter of credit as collateral pursuant to a lease agreement for our corporate headquarters. Through January 31, 2008, we were required to collateralize this letter of credit with a $1.0 million restricted certificate of deposit. We have included this certificate of deposit in restricted cash on our consolidated balance sheets as of December 31, 2007 in current assets and 2006 in long-term assets.

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**CAPTARIS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Equipment and Leasehold Improvements**

We record equipment and leasehold improvements and certain other long-lived assets at cost less accumulated depreciation. We calculate depreciation on a straight-line basis over the estimated useful lives. We base the useful lives of equipment and leasehold improvements on our estimates of the time period that the equipment or leasehold improvement will be utilized, typically from two to five years. The useful lives of our leasehold improvements are typically less than the lives of the applicable leases. We periodically evaluate the recoverability of equipment and leasehold improvements and take into account events or circumstances that indicate that impairment exists or that the useful lives should be revised. If we conclude that there is a change in the recoverability of equipment or leasehold improvements, we make adjustments accordingly.

**Intangible Assets**

All of our intangible assets, other than goodwill, are subject to amortization. We amortize our intangible assets using the straight-line method over their estimated useful life. We base the useful lives of intangible assets on our estimates of the time period that the intangible assets will generate cash, typically from one to nine years. We periodically evaluate the recoverability of intangible assets and take into account events or circumstances that impairment exists or that the useful lives should be revised. If we conclude that there is a change in the recoverability of our intangible assets, we make adjustments accordingly.

**Goodwill**

Goodwill represents the excess purchase price over the estimated fair value of net assets acquired as of the acquisition date. In accordance with Financial Accounting Standards Board ( FASB ) Statement of Financial Accounting Standards ( SFAS ) No. 142, *Goodwill and Other Intangible Assets,* we perform tests for goodwill impairment on an annual basis and on an interim basis in certain circumstances. If we conclude impairment exists, we adjust goodwill to its fair value. In addition, certain financial statements of our wholly-owned subsidiaries have been translated to U.S. dollars. Accordingly, we have translated the value of goodwill recorded on our subsidiaries financial statements at year end exchange rates and included the adjusted amounts on our consolidated balance sheets as of December 31, 2007 and 2006.

**Fair Value of Financial Instruments**

For certain financial instruments, including accounts receivable, accounts payable and accrued liabilities, recorded amounts presented on our consolidated balance sheets approximate fair value due to the short maturities of these instruments. We record short-term and long-term investments at fair value as the underlying securities are classified as available-for-sale and marked to market at each reporting period. We record any unrealized changes in market value as components of other comprehensive income (loss), net of income taxes.

**Foreign Currency**

The financial statements of our wholly-owned foreign subsidiaries have been translated to U.S. dollars in accordance with SFAS No. 52, *Foreign Currency Translation*. Accordingly, all assets and liabilities of the subsidiaries have been translated at year-end exchange rates and all revenue and expenses have been translated at the average exchange rates for the periods presented. We report any translation gains and losses as components of other comprehensive income (loss).

Foreign currency transaction gains and losses result from foreign exchange rate changes on transactions denominated in currencies other than U.S. dollars. Gains and losses on those foreign currency transactions are included in other income (expense) on our consolidated income statements. Foreign currency transaction gains were $524,000 in 2007, transaction losses were $163,000 in 2006 and transaction gains were $124,000 in 2005.

**Stock-Based Compensation**

We account for stock-based compensation under the provisions of SFAS No. 123(R), *Share-Based Payment* ( SFAS No. 123R ), which requires us to recognize expense related to the fair value of our stock-based compensation. We adopted SFAS No. 123R using the modified prospective transition method. Under this transition method, compensation cost recognized for the years ended December 31, 2007 and 2006 includes: (a) compensation cost for all stock-based compensation granted prior to, but not vested as of January 1, 2006, based on the grant-date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all stock-based compensation granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123R. We chose the straight-line method for recognizing compensation expense. For all unvested stock options outstanding as of January 1, 2006, we recognize the previously measured but unrecognized compensation expense, based on the fair value at the original grant date, on an accelerated basis over the remaining vesting period. For stock-based compensation granted subsequent to January 1, 2006, we recognize compensation expense, based on the fair value on the date of grant, on a straight-line basis over the vesting period.

**CAPTARIS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Revenue Recognition**

Our revenue recognition policies follow the guidelines of the American Institute of Certified Public Accountants ( AICPA ) Statement of Position ( SOP ) No. 97-2, *Software Revenue Recognition*, as amended. We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the selling price is fixed or determinable and collection is reasonably assured.

We sell products through resellers, Original Equipment Manufacturers ( OEM ) and other channel partners, as well as directly to end-users. Generally our resellers do not stock product, and except for OEM sales described below, we recognize product revenue upon shipment, net of estimated returns, provided that collection is determined to be probable and no significant obligations remain. If a reseller does stock product, we defer this revenue until the reseller sells the product through to end-users.

Sales of our appliance products are made through stocking distributors. For sales to distributors we recognize revenues on either the sell-through or sell-in method of revenue recognition as determined by the contractual arrangement with each distributor. When the distributor is entitled to stock rotation rights we recognize revenue upon delivery of the appliances to the distributor less a provision for an estimate of those rights (the sell-in method). Otherwise, revenue is recognized upon delivery of the appliances to the end-user (the sell-through method).

Revenue from perpetual software licenses is recognized when the software has been shipped, provided that collection for such revenue is deemed probable. Revenue from term software licenses is recognized over the term of the license, generally twelve months.

Whenever a software license, hardware, installation and post-contract customer support ( PCS ) elements are sold together, we allocate the total arrangement fee among each element based on its respective fair value, which is the price charged when that element is sold separately. The amount of revenue assigned to each element is impacted by our judgment as to whether an arrangement includes multiple elements and, if so, whether vendor-specific objective evidence ( VSOE ) of fair value exists for those elements. Changes to the elements in an arrangement and our ability to establish VSOE for those elements could affect the timing of revenue recognition for these elements. Revenue for PCS is recognized on a straight-line basis over the service contract term, ranging from one to five years. PCS includes rights to unspecified upgrades and updates, when and if available, and bug fixes.

Installation revenue is recognized when the product has been installed at the customer s site and accepted by the customer. Recognition of revenue from software sold with installation services is recognized either when the software is shipped or when the installation services are completed, depending on our agreement with the customer and whether the installation services are integral to the functionality of the software.

We have entered into agreements with certain OEMs from which we receive royalty payments periodically. Under the terms of the OEM license agreements, each OEM will qualify our software on their hardware and software configurations. Once the software has been qualified, the OEM will begin to ship products and report net sales to us. Most OEMs pay a license fee based on the number of copies of licensed software included in the products sold to their customers. These OEMs pay fees on a per-unit basis and we record associated revenue when we receive notification of the OEMs sales of the licensed software to an end-user. The terms of the license agreements generally require the OEMs to notify us of sales of our products within 30 to 45 days after the end of the month or quarter in which the sales occur. As a result, we recognize the revenue in the month or quarter following the sales of the product to these OEMs customers.

We provide allowances for estimated returns, and return rights that exist for some customers. In general, customers are not granted return rights at the time of sale. However, we have historically accepted returns and therefore, reduce revenue recognized for estimated product returns. For those customers to whom we do grant return rights, we reduce revenue by an estimate of these returns. If we cannot reasonably estimate these returns, we defer the revenue until the return rights lapse. For software sold to resellers for which we have granted exchange rights, we defer the revenue until the reseller sells the software through to end-users. When customer acceptance provisions are present and we cannot reasonably estimate returns, we recognize revenue upon the earlier of customer acceptance or expiration of the acceptance period.

Professional services are customarily billed at fixed rates, plus out-of-pocket expenses and revenue is recognized when the service has been completed. However, if it is determined that a consulting engagement will be unprofitable, we recognize the loss at the time of such determination. Training revenue is recognized when the training is completed.

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**CAPTARIS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Warranty Expense**

We establish a warranty reserve based on our historical experience and an estimate of the amounts necessary to settle future and existing claims on products sold as of our financial statement reporting date. Historically, warranty expenses have not been material.

**Research and Development Costs**

We expense research and development costs as they are incurred. We have not capitalized any software development costs, as technological feasibility is not generally established until substantially all development has been completed.

**Advertising Costs**

We expense advertising costs to selling and marketing expense as they are incurred. Advertising expenses were $4.0 million, $4.1 million and $4.5 million for the years ended December 31, 2007, 2006 and 2005, respectively.

**Income Taxes**

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*. SFAS No. 109 requires an asset and liability approach, under which we record deferred income taxes for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities. We measure these deferred taxes using tax rates expected to be in effect when the temporary differences reverse. We establish valuation allowances to reduce deferred tax assets unless it is more likely than not that we will generate sufficient taxable income to allow for the realization of our deferred net tax assets.

We also account for income taxes in accordance with FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109* ( FIN No. 48 ). Under the provisions of FIN No. 48, we may recognize the tax benefits from uncertain tax positions only if it is more likely than not that the tax positions will be sustained, on examination by the applicable taxing authorities, based on the technical merits of the positions. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosures and transition. Upon adoption, we recognized a $53,000 charge to our beginning retained earnings as a cumulative effect of a change in accounting principle. In accordance with FIN No. 48, we recognize interest accrued and penalties related to unrecognized tax benefits as a component of our income tax expense.

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**CAPTARIS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**Income (Loss) Per Common Share**

We compute basic net income (loss) per common share by dividing net income (loss) by the weighted average number of shares of common stock outstanding during the year. We compute diluted net income (loss) per common share by dividing net income (loss) by the sum of the weighted average number of shares of common stock outstanding during the year and the net additional shares that would have been issued had all dilutive stock options been exercised less shares that would be repurchased with the proceeds from such exercises. Dilutive stock options are those that have an exercise price less than the average stock price during the period. The following table sets forth the computation of basic and diluted income (loss) per common share:

| | Year Ended December 31, | | |
|---|---|---|---|
| | 2007 | 2006 | 2005 |
| | (in thousands, except per share amounts) | | |
| **Numerator:** | | | |
| Income (loss) from continuing operations | $ 228 | $ 3,965 | $ (4,017) |
| Income from discontinued operations | (4) | 16 | 38 |
| Net income (loss) | $ 224 | $ 3,981 | $ (3,979) |
| **Denominator:** | | | |
| Weighted average shares outstanding basic | 27,019 | 27,899 | 28,907 |
| Dilutive effect of common shares from stock options | 604 | 615 | |
| Weighted average shares outstanding diluted | 27,623 | 28,514 | 28,907 |
| **Basic net income (loss) per share:** | | | |
| Income (loss) from continuing operations | $ 0.01 | $ 0.14 | $ (0.14) |
| Income from discontinued operations | 0.00 | 0.00 | 0.00 |
| Basic net income (loss) per share | $ 0.01 | $ 0.14 | $ (0.14) |
| **Diluted net income (loss) per share:** | | | |
| Income (loss) from continuing operations | $ 0.01 | $ 0.14 | $ (0.14) |
| Income from discontinued operations | 0.00 | 0.00 | 0.00 |
| Diluted net income (loss) per share | $ 0.01 | $ 0.14 | $ (0.14) |

For the year ended December 31, 2005, we excluded 206,725 common stock equivalents from the calculation of diluted net income (loss) per share because such securities were antidilutive due to the net loss from continuing operations. Additionally, employee stock options to purchase 2,834,282, 3,474,446 and 4,320,126 shares in the years ended December 31, 2007, 2006 and 2005, respectively, were outstanding, but were not included in the computation of diluted net income (loss) per share because the exercise price of the stock options was greater than the average share price of the common shares.

**Comprehensive Income**

Comprehensive income consists of two components: net income and other comprehensive income. Other comprehensive income includes revenue, expenses, gains and losses that, under generally accepted accounting principles, we record as an element of shareholders equity but are excluded from net income. Our other comprehensive income is comprised of foreign currency translation adjustments from our subsidiaries not using the U.S. dollar as their functional currency and unrealized gains and losses, net of income taxes, on marketable securities categorized as available-for-sale.

The components of accumulated other comprehensive income were as follows (in thousands):

| | December 31, | |
|---|---|---|
| | 2007 | 2006 |
| Accumulated net unrealized loss on available-for-sale investments, net of income tax benefit of $0 and $5 | $ | $ (10) |
| Accumulated foreign currency translation | 2,715 | 1,158 |
| Total accumulated other comprehensive income | $ 2,715 | $ 1,148 |

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**CAPTARIS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**2. New Accounting Pronouncements**

In December 2007, the FASB issued SFAS No. 141 (revised 2007) ( SFAS No. 141R ), *Business Combinations*, which replaces SFAS No. 141 and amends several others. The statement retains the purchase method of accounting for acquisitions but changes the way we will recognize assets and liabilities. It also changes the way we will recognize assets acquired and liabilities assumed arising from contingencies, requires us to capitalize in-process research and development at fair value, and requires us to expense acquisition-related costs as incurred. SFAS No. 141R is effective for us on, but not before, January 1, 2009, the beginning of our fiscal 2009 reporting periods. SFAS No. 141R will apply prospectively to our business combinations completed on or after January 1, 2009 and will not require us to adjust or modify how we recorded any acquisition prior to that date.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115*. Under SFAS No. 159, we may elect to measure many financial instruments and certain other items at fair value on an instrument by instrument basis subject to certain restrictions. We adopted SFAS No. 159 on January 1, 2008. Adopting SFAS No. 159 did not have a material impact on our consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. We adopted SFAS No. 157 on January 1, 2008. Adopting SFAS No. 157 did not have a material impact on our consolidated financial position, results of operations or cash flows.

**3. Business Acquired**

On July 10, 2007, we acquired Castelle, a Morgan Hill, California company. Castelle is in the business of developing, manufacturing, marketing and supporting office automation systems that allow organizations to implement faxing over local area networks and the Internet. Under the terms of the stock purchase agreement, we acquired Castelle for a total of $14.3 million, net of cash acquired. We paid $12.0 million in cash net of Castelle s cash balance at closing of $1.0 million, including transaction costs of approximately $1.2 million and assumed liabilities of $2.3 million. The assumed liabilities include deferred revenue of $938,000 and accounts payable and other accrued liabilities of $1.4 million. The acquisition of Castelle has been accounted for as a purchase.

In accordance with SFAS No. 141, *Business Combinations,* we assigned all identifiable assets and liabilities a portion of the cost of the acquisition based on their respective fair values. We engaged a valuation firm to provide an estimated fair value for all identifiable intangible assets including technology, trade name, customer relationships and non-compete agreements, using an income and a cost approach. The determination of fair value is a critical and complex consideration that involves significant assumptions and estimates. These assumptions and estimates were based on our best judgments and resulted in the allocation of purchase price for this acquisition as detailed below. We allocated the excess of the purchase price over the fair value of the net assets acquired to goodwill. Goodwill in the amount of $4.0 million is deductible for tax purposes.

Castelle was combined in our single business segment, and our results of operations include Castelle s results of operations for the period from July 10, 2007 to December 31, 2007, including an in-process research and development charge of $219,000.

**Castelle Purchase Price Allocation:**

| | **(in thousands)** |
|---|---|
| Acquired technology | $ 8,159 |
| Goodwill | 3,945 |
| Other acquired assets | 1,959 |
| Acquired in-process research and development | 219 |

| | | |
|---|---|---|
| Total purchase price | $ | 14,282 |

We amortize all identified amortizable intangible assets on a straight-line basis over their estimated useful lives, ranging from two to eight years, with no residual value. The weighted-average useful life of these assets is approximately 6.9 years. We will recognize amortization expense for these intangible assets of approximately $1.3 million in 2008, $1.2 million in 2009, $1.1 million in 2010, $1.1 million in 2011, $1.0 million in 2012, $1.0 million in 2013, $664,000 in 2014 and $142,000 in 2015.

**CAPTARIS, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

### 4. Discontinued Operations

On September 15, 2003, Captaris and our wholly-owned subsidiary, MediaTel Corporation (Delaware) ( MediaTel ), entered into an asset purchase agreement, effective as of September 1, 2003, to sell the assets of MediaTel to PTEK Holdings, Inc. ( PTEK ) and its wholly-owned subsidiary, Xpedite Systems, Inc. ( Xpedite ). As such, MediaTel s results of operations have been classified as discontinued operations. MediaTel provided outsourced e-document delivery services. Concurrent with the sale transaction, we also entered into license and reseller agreements with Xpedite pursuant to which we licensed our fax-to-mail technology to Xpedite in return for minimum compensation of $2.0 million over a three year period, and both parties agreed to cooperate in providing mutual resale opportunities for each other s products and services. In 2004, we recognized $250,000 of revenue in connection with these agreements. We did not record any revenue in 2005 relating to the license agreement due to a dispute with Xpedite relating to the outstanding minimum licenses fee. In February 2006, we resolved the dispute regarding the revenue relating to 2005. As a result, in the first quarter of 2006, we recorded an additional $750,000 of revenue related to the 2005 commitment and in the third quarter of 2006, we recorded another $1.0 million of revenue in accordance with the license agreement. This agreement concluded in 2006, therefore, we recognized no related revenue in 2007.

### 5. Sale of Discontinued CallXpress Product Line

In September of 2003, we sold our CallXpress product line. Concurrent with the transaction, we entered into an earn-out agreement with the buyer which entitled us to receive additional payments of up to $1.0 million per year for each of the three years following the sale, depending on the buyer s success in achieving certain revenue targets. In all three subsequent years, the buyer achieved those revenue targets and sent us payments of $1.0 million in March of 2005, 2006 and 2007, respectively. With receipt of each payment, we recognized an additional gain on the sale of the CallXpress product line. We recorded the gains as a component of operating expenses on our consolidated statement of operations.

### 6. Investments

As of December 31, 2006, our available-for-sale investments consisted of the following (in thousands):

| | Cost | Unrealized Gains | Unrealized Losses | Fair Value |
|---|---|---|---|---|
| Classified as current assets: | | | | |
| Municipal bonds | $ 4,560 | $ 1 | $ | $ 4,561 |
| U.S. Agency adjustable rate mortgages | 786 | 1 | (10) | 777 |
| Small Business Administration Pools | 49 | | | 49 |
| Other government agency issues | 1,698 | | (1) | 1,697 |
| Total | $ 7,093 | $ 2 | $ (11) | $ 7,084 |
| Classified as long-term assets: | | | | |
| Municipal bonds | $ 40,693 | $ 7 | $ (2) | $ 40,698 |
| U.S. Agency adjustable rate mortgages | 844 | | (11) | 833 |
| Small Business Administration Pools | 53 | | | 53 |