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CASTELLE \CA\  
Form 10-Q  
August 10, 2001

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

FORM 10-Q

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

For the quarterly period ended June 29, 2001

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

Commission File Number: 0-220-20

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

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

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

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

Securities registered pursuant to Section 12(b) of the Act: NONE

Securities registered pursuant to Section 12(g) of the Act: COMMON STOCK,  
NO PAR VALUE

Indicate by check mark whether the registrant (1) has filed all reports required  
to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during  
the preceding 12 months (or for such shorter period that the Registrant was  
required to file such reports), and (2) has been subject to such filing  
requirements for the past 90 days. Yes  No

The number of shares of the Registrant's Common Stock outstanding as of August  
3, 2001 was 4,744,795.

CASTELLE  
FORM 10-Q  
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### SPECIAL NOTE ON FORWARD-LOOKING STATEMENTS

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

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caption "Risk Factors" in the Company's Annual Report on Form 10-K and Form 10-K/A for the fiscal year ended December 31, 2000.

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### PART I - FINANCIAL INFORMATION

#### ITEM 1. FINANCIAL STATEMENTS

##### CASTELLE AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS (in thousands)

	June 29, 2001 (unaudited)	De
	-----	-----
<b>Assets:</b>		
Current assets:		
Cash and cash equivalents	\$ 3,600	
Restricted cash	--	
Accounts receivable, net of allowances for doubtful accounts of \$241 in 2001 and \$285 in 2000	1,192	
Inventories, net	1,587	
Prepaid expense and other current assets	156	
	-----	-----
Total current assets	6,535	
Property, plant & equipment, net	681	
Other assets, net	93	
	-----	-----
Total assets	\$ 7,309	
	=====	=====
<b>Liabilities &amp; Shareholders' Equity:</b>		
Current liabilities:		
Long-term debt, current portion	\$ 9	
Accounts payable	608	
Accrued liabilities	2,530	
	-----	-----
Total current liabilities	3,147	
Long-term debt, net of current portion	58	
	-----	-----
Total liabilities	3,205	
<b>Shareholders' equity:</b>		
Common stock, no par value:		
Authorized: 25,000 shares		
Issued and outstanding: 4,745 and 4,741, respectively	28,980	
Deferred compensation	(17)	
Accumulated deficit	(24,859)	
	-----	-----
Total shareholders' equity	4,104	
	-----	-----
Total liabilities & shareholders' equity	\$ 7,309	
	=====	=====

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See accompanying notes to condensed consolidated financial statements.

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

	Three months ended		Si
	June 29, 2001	June 30, 2000	June 29,
Net sales	\$ 2,370	\$ 3,760	\$ 4,719
Cost of sales	842	1,308	1,540
Gross profit	1,528	2,452	3,179
Operating expenses:			
Research and development	481	489	866
Sales and marketing	1,039	1,332	2,165
General and administrative	255	416	699
Restructuring charges	58	--	238
Total operating expenses	1,833	2,237	3,968
Income/(loss) from operations	(305)	215	(789)
Interest income, net	25	45	58
Other income/(expense), net	12	(49)	55
Income/(loss) before provision for income taxes	(268)	211	(676)
Provision for income taxes	--	--	--
Net income/(loss)	\$ (268)	\$ 211	\$ (676)
Earnings per share:			
Net income/(loss) per common share - basic	\$ (0.06)	\$ 0.04	\$ (0.14)
Shares used in per share calculation - basic	4,744	4,732	4,742
Net income/(loss) per common share - diluted	\$ (0.06)	\$ 0.04	\$ (0.14)
Shares used in per share calculation - diluted	4,744	5,077	4,742

See accompanying notes to condensed consolidated financial statements.

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CASTELLE AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(in thousands)  
(unaudited)

	Six months ended	
	June 29, 2001	June
	-----	-----
Cash flows from operating activities:		
Net Income/(Loss)	\$ (676)	\$
Adjustment to reconcile net income/(loss) to net cash provided by operating activities:		
Loss on disposal of fixed assets	9	
Depreciation and amortization	144	
Provision for doubtful accounts and sales returns	52	
Provision for excess and obsolete inventory	89	
Compensation expense related to grant of stock options	4	
Changes in assets and liabilities:		
Accounts receivable	839	
Inventories	(313)	
Prepaid expenses and other current assets	(161)	
Other assets	9	
Accounts payable	(192)	
Accrued liabilities and other long-term liabilities	(151)	
	-----	-----
Net cash provided by/(used in) operating activities	(347)	
	-----	-----
Cash flows from investing activities:		
Return of restricted cash	125	
Purchase of property and equipment	(66)	
	-----	-----
Net cash provided by/(used in) investing activities	59	
	-----	-----
Cash flows from financing activities:		
Repayment of loan	(5)	
Proceeds from issuances of common stock, net of repurchases	--	
	-----	-----
Net cash used in financing activities	(5)	
	-----	-----
Net decrease in cash and cash equivalents	(293)	
Cash and cash equivalents at beginning of period	3,893	4
	-----	-----
Cash and cash equivalents at end of period	\$3,600	\$4
	=====	=====

See accompanying notes to condensed consolidated financial statements.

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## CASTELLE AND SUBSIDIARIES NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (unaudited)

### 1. Basis of Presentation: -----

The accompanying unaudited consolidated financial statements include the accounts of Castelle and its wholly-owned subsidiaries in the United Kingdom and the Netherlands, and have been prepared in accordance with accounting principles generally accepted in the United States of America. All intercompany balances and transactions have been eliminated. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of the Company's financial position, results of operations and cash flows at the dates and for the periods indicated have been included. The result of operations for the interim period presented is not necessarily indicative of the results for the year ending December 31, 2001. Because all of the disclosures required by accounting principles generally accepted in the United States of America are not included in the accompanying consolidated financial statements and related notes, they should be read in conjunction with the audited consolidated financial statements and related notes included in the Company's Form 10-K and Form 10-K/A for the fiscal year-ended December 31, 2000. The year ended condensed balance sheet data was derived from our audited financial statements and does not include all of the disclosures required by accounting principles generally accepted in the United States of America. The income statements for the periods presented are not necessarily indicative of results that we expect for any future period, nor for the entire year.

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

### 2. Net Income/(Loss) Per Share -----

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

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Basic and diluted earnings per share are calculated as follows for the second quarter and first six months of 2001 and 2000, respectively:

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(in thousands, except per share amount)

(Unaudited)

	Three months ended		Six months ended
	June 29, 2001	June 30, 2000	June 29, 2001 June 30, 2000
<b>Basic:</b>			
Weighted average common shares outstanding	4,744	4,732	4,742
Net income/(loss)	\$ (268)	\$ 211	\$ (676)
Net income/(loss) per common share - basic	\$ (0.06)	\$ 0.04	\$ (0.14)
<b>Diluted:</b>			
Weighted average common shares outstanding	4,744	4,732	4,742
Common equivalent shares from stock options and warrants	--	345	--
Shares used in per share calculation - diluted	4,744	5,077	4,742
Net income/(loss)	\$ (268)	\$ 211	\$ (676)
Net income/(loss) per common share - diluted	\$ (0.06)	\$ 0.04	\$ (0.14)

The calculation of diluted shares outstanding for the three months ended June 29, 2001 excludes options to purchase 1,327,089 shares of the Company's common stock, as their effect was antidilutive in the period. The calculation of diluted shares outstanding for the six months ended June 29, 2001, excludes options to purchase 1,319,089 shares of the Company's common stock, as their effect was antidilutive in the period. At June 30, 2000, warrants to purchase 100,000 shares of the Company's common stock were excluded, because the per share exercise price of each of the warrants was greater than the average market price for a share of the Company's common stock for the period.

3. Inventories:

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

	June 29, 2001 (Unaudited)	December 31, 2000
Raw material	\$ 449	\$ 335
Work in process	275	201
Finished goods	863	827
<b>Total inventories</b>	<b>\$ 1,587</b>	<b>\$ 1,363</b>

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4. Revenue Recognition:

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Product revenue is recognized upon shipment if a signed contract exists, the fee is fixed or determinable, collection of the resulting receivables is probable and product returns are reasonably estimable. The Company enters into agreements with certain of its distributors which permit limited stock rotation rights. These stock rotation rights allow the distributor to return products for credit but require the purchase of additional products of equal value. Revenues subject to stock rotation rights are reduced by management's estimates of anticipated exchanges. Provisions for estimated warranty costs and anticipated retroactive price adjustments are recorded at the time products are shipped. The Company recognizes revenue from the sale of extended warranty contracts ratably over the period of the contracts. In January 2001, the Company entered into a separate agreement with a Japanese distributor

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to sell the Company's fax server products in Japan. The Company is entitled to receive a royalty on sales of products by the distributor. Royalty is not recognized as revenue by the Company until the products are sold by the distributor.

5. Segmental Disclosure and Geographic Information:

-----

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

	(Unaudited)			
	Three months ended		Six months ended	
	June 29, 2001	June 30, 2000	June 29, 2001	June 30, 2000
	-----			
North America	\$1,853	\$ 3,005	\$ 3,751	\$5,943
Europe	158	393	477	743
Pacific Rim	359	362	491	1,174
	-----			
Total Revenues	\$2,370	\$ 3,760	\$ 4,719	\$ 7,860
	=====			

6. Comprehensive Income:

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Under the Statement of Financial Accounting Standards ("SFAS") No. 130, "Reporting Comprehensive Income", disclosure of comprehensive income and its components is required in financial statements. Comprehensive income is the change in equity from transactions and other events and circumstances other than those resulting from investments by owners and distributions to



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owners. There are no significant components of comprehensive income excluded from net income, therefore, no separate statement of comprehensive income has been presented.

### 7. Restructuring:

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In April 2001, the Company terminated 17 regular, temporary and contractor positions, which constituted approximately 25% of its workforce. This action resulted in a severance charge of \$58,000 in the second quarter of fiscal 2001. This severance charge is in addition to the restructuring charge of \$180,000 recorded in the first quarter of fiscal 2001, which included an asset write-off and other direct expenses associated with the consolidation of our operations in the United Kingdom and El Dorado Hills, California.

### 8. New accounting pronouncements:

-----

Under SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," companies are required to recognize all derivatives as either assets or liabilities in the statement of financial position and to measure those instruments at fair value. Changes in fair value shall be recognized currently in earnings. This standard was effective for the Company from January 1, 2001. At that time, the Company did not have any derivative instruments, nor has it engaged in hedging activities to date.

In July 2001, the Financial Accounting Standards Board ("FASB") issued SFAS No. 141, "Business Combinations." SFAS 141 requires the purchase method of accounting for business combinations initiated after June 30, 2001 and eliminates the pooling-of-interests method.

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In July 2001, the FASB issued SFAS No. 142, "Goodwill and Other Intangible Assets", which is effective for fiscal years beginning after March 15, 2001. SFAS 142 requires, among other things, the discontinuance of goodwill amortization. In addition, the standard includes provisions upon adoption for the reclassification of certain existing recognized intangibles as goodwill, reassessment of the useful lives of existing recognized intangibles, reclassification of certain intangibles out of previously reported goodwill and the testing for impairment of existing goodwill and other intangibles. We believe that the adoption of SFAS 142 will not have a significant impact on our financial statements.

In June 2001, the FASB issued Emerging Issues Task Force ("EITF") No. 00-25, "Vendor Income Statement Characterization of Consideration Paid to Reseller of the Vendor's Products", which is effective for annual or interim financial statements beginning after December 15, 2001. The issue addresses whether consideration from a vendor to a reseller of the vendor's products is an adjustment of the selling price and should therefore be deducted from revenue or a cost incurred by the vendor for assets or services received. The Company is currently assessing but has not yet determined the impact of EITF 00-25 on its statement of operations.

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

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements that are subject to many risks and uncertainties that could cause actual results to differ significantly from expectations. For more information on forward-looking statements, refer to the "Special Note on Forward-Looking Statements" at the front on this Form 10-Q. The following discussion should be read in conjunction with the Financial Statements and the Notes thereto included in Item 1 of this Quarterly Report on Form 10-Q and in the Company's Form 10-K and Form 10-K/A for the fiscal year ended December 31, 2000.

#### Consolidated Statements of Operations - As a Percentage

	Three months ended		(Unaudited) Six months ended	
	June 29, 2001	June 30, 2000	June 29, 2001	June 30, 2000
	-----	-----	-----	-----
Net sales	100%	100%	100%	100%
Cost of sales	36%	35%	33%	33%
	-----	-----	-----	-----
Gross profit	64%	65%	67%	67%
	-----	-----	-----	-----
Operating expenses:				
Research and development	20%	13%	18%	18%
Sales and marketing	44%	35%	46%	46%
General and administrative	11%	11%	15%	15%
Restructuring charges	2%	--	5%	5%
	-----	-----	-----	-----
Total operating expenses	77%	59%	84%	84%
	-----	-----	-----	-----
Income/(loss) from operations	(13%)	6%	(17%)	(17%)
Interest income, net	1%	*	2%	2%
Other income/(expense), net	1%	*	1%	1%
	-----	-----	-----	-----
Income/(loss) before provision for income taxes	(11%)	6%	(14%)	(14%)
Provision for income taxes	--	--	*	*
	-----	-----	-----	-----
Net income/(loss)	(11%)	6%	(14%)	(14%)
	=====	=====	=====	=====

\* Less than 1%

Net Sales

Net sales for the second quarter of fiscal 2001 were \$2.4 million, as compared to \$3.8 million for the same period in fiscal 2000. The \$1.4 million decrease was largely due to a shortfall in the domestic sales of our fax server products.

Net sales for first the six months were \$4.7 million and \$7.9 million for fiscal 2001 and 2000, respectively. The shortfall in sales was primarily due to the \$2.6 million decline, or 38%, in demand for our fax server products, and a decrease in the sales of our print server products of \$549,000, or 50%.

Domestic sales in the second quarter of fiscal 2001 were \$1.9 million, as compared to \$3 million in the same period in fiscal 2000. For the first six months of fiscal 2001, domestic sales were \$3.8 million, as compared to \$5.9 million, a decrease of 37%, mostly in our fax server product line.

International sales in the second quarter of fiscal 2001 decreased to \$517,000 from \$755,000 for the same period in fiscal 2000, representing 22% and 20%, respectively, of total net sales. International sales for the first six months of fiscal 2001 and 2000 were \$968,000 and \$1.9 million, representing 21% and 24%, respectively, of total net sales. This decline in international sales was mainly the result of reduced demand for our print server products in the Asia Pacific Region and the change made earlier this year from a model of selling our print server products directly to our distributor in Japan to a royalty collection model. The royalty amounts received by us in the first six months of this year were not significant.

Cost of Sales; Gross Profit

Gross profit of \$1.5 million, or 64% of net sales, for the second quarter of fiscal 2001 decreased, as compared to \$2.5 million, or 65% of net sales for the same period in fiscal 2000. The gross profit percentage in the second quarter of fiscal 2001 was comparable to the second quarter of fiscal 2000.

Gross profits for the first six months of fiscal 2001 and 2000 were \$3.2 million, or 67% of net sales and \$4.9 million, or 62% of net sales, respectively. The increase in gross profit for the six months of fiscal 2001 was primarily due to the mix of products that were sold at a higher average selling price. The change in the first quarter of fiscal 2001 to a royalty collection model from directly selling our print server products to our distributor in Japan also contributed to the higher gross profit, even though the amount of royalties received was not significant.

Research & Development

Research and product development expenses were \$481,000, or 20% of net sales for the second quarter of fiscal 2001, as compared to \$489,000, or 13% of net sales for the same period in fiscal 2000. Research and product development expenses for the first six months were \$866,000, or 18% of net sales in fiscal 2001, as compared to \$994,000, or 13% of net sales for the same period in fiscal 2000. This reduction of \$128,000 in the six-month period was mostly due to lower compensation expenses. Research and product development spending in the second quarter of fiscal 2001, however, increased sequentially by \$96,000, primarily due to higher external consulting and compensation expenses.

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### Sales & Marketing

Sales and marketing expenses were \$1 million, or 44% of net sales for the second quarter of fiscal 2001, as compared to \$1.3 million, or 35% of net sales for the same period in fiscal 2000. The reduction of \$293,000 was mostly attributable to lower promotional expenses of \$101,000, lower consulting of \$29,000 and a decrease in other general expenses of \$133,000. For the first six months of fiscal 2001, the expenses were \$2.2 million, or 46% of net sales, as compared to \$2.6 million, or 34% of net sales for the same period in fiscal 2000. This reduction of sales and marketing spending by \$479,000 was mostly attributable to lower promotional expenses of \$103,000, lower compensation of \$65,000 and a decrease in other expenses of \$230,000.

### General & Administrative

General and administrative expenses were \$255,000, or 11% of net sales for the second quarter of fiscal 2001, as compared to \$416,000, or 11% of net sales for the same period in fiscal 2000. The reduction of \$161,000 in the second quarter in fiscal 2001 was principally due to a lower provision for doubtful accounts of \$73,000 and lower legal and consulting expenses of \$47,000. General and administrative expenses for the first six months of fiscal 2001 were \$699,000, or 15% of net sales in fiscal 2001, as compared to \$882,000, or 11% of net sales for the same period in fiscal 2000. The reduction in general and administration expenses of \$183,000 was primarily due to lower legal and consulting expenses of \$97,000 and a \$59,000 decrease in other general administrative expenses.

### Restructuring

In April 2001, we terminated 17 regular, temporary and contractor positions, which constituted approximately 25% of our workforce. This action resulted in a severance charge of \$58,000 in the second quarter of fiscal 2001. This severance charge is in addition to the restructuring charge of \$180,000 recorded in the first quarter of fiscal 2001, which included an asset write-off and other direct expenses associated with the consolidation of our operations in the United Kingdom and El Dorado Hills, California. There was no restructuring charge in fiscal 2000.

### Liquidity and Capital Resources

As of June 29, 2001, we had approximately \$3.6 million of cash and cash equivalents, as compared to \$3.9 million at December 31, 2000. The decrease in cash and cash equivalents of \$293,000 was primarily due to the overall decline in sales, the severance charge in April 2001 and the net loss for the first six months of fiscal 2001.

The restricted cash of \$125,000 appearing on our balance sheet as of December 31, 2000, was a certificate of deposit to collateralize a loan and was returned to us in February 2001. The loan was completely paid off as of December 31, 2000.

We have a \$3 million secured revolving line of credit with a bank from which we may borrow 100% against pledges of cash at the bank's prime rate. As of June 29, 2001, we had no borrowings under this line of credit.

In December 2000, as a source of capital asset financing, we entered into a loan and security agreement with a finance company for an amount of \$75,000.

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This loan is subject to interest of 12.8% and is repayable by December 2006. As of June 29, 2001, the future minimum payments were \$94,000.

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In April 2001, as a source of capital asset financing, we entered into a loan and security agreement with a finance company for an amount of \$25,000. This loan is subject to interest of 12.5% and is repayable by April 2004. As of June 29, 2001, the future minimum payments were \$30,000.

As of June 29, 2001, net accounts receivable were \$1.2 million, down from \$2.1 million at December 31, 2000. The decrease in net accounts receivable was largely attributable to improved collection of outstanding balances and reduced sales in the first six months of fiscal 2001. The number of days for which payment for sales is outstanding improved from 58 days at December 31, 2000 to 45 days at June 29, 2001.

Net inventory as of June 29, 2001 was \$1.6 million, an increase from the \$1.4 million at December 31, 2000. The higher inventory level was partly due to a planned increase for a small build-up of our best selling fax server models to ensure quick turn-around to our customers. The slower than expected sales in some other fax server products also contributed to the overall increase. Inventory turnover improved from an equivalent of 1.9 turns per year in the first quarter of fiscal 2001 to 2.1 turns per year in this current quarter.

Although we believe that our existing capital resources, anticipated cash flows from operations and available lines of credit will be sufficient to meet our capital requirements for at least the next 12 months, we may be required to seek additional equity or debt financing. The timing and amount of such capital requirements cannot be determined at this time and will depend on a number of factors, including demand for our existing and new products and the pace of technological change in the networking industry. There can be no assurance that such additional financing will be available on satisfactory terms when needed, if at all. In order to maximize shareholder value, the Board of Directors continues to evaluate various strategic alternatives that may be available to us.

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

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### PART II - OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

None.

#### ITEM 2. CHANGES IN SECURITIES AND USE OF PROCEEDS

None.

#### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

We considered the provision of Financial Reporting Release No. 48 "Disclosure of Accounting Policies for Derivative Financial Instruments and Derivative Commodity Instruments, and Disclosure of Quantitative and Qualitative Information about Market Risk Inherent in Derivative Financial Instruments, Other Financial Instruments and Derivative Commodity Instruments." We had no

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holdings of derivative financial or commodity instruments at June 29, 2001. However, we are exposed to financial market risks, including changes in interest rates and foreign currency exchange rates. While much of our revenue is transacted in U.S dollars, some revenues and capital spending are transacted in Pounds Sterling. These amounts are not currently material to our financial statements; therefore we believe that foreign currency exchange rates should not materially affect our overall financial position, results of operations or cash flows. The fair value of our money market account or related income would not be significantly impacted by increases or decreases in interest rates due mainly to the highly liquid nature of this investment. However, sharp declines in interest rates could seriously harm interest earnings on this account.

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

None.

ITEM 5. OTHER INFORMATION

In April 2001, we terminated 17 regular, temporary and contractor positions, which constituted approximately 25% of our workforce. This action resulted in a severance charge of \$58,000 in the second quarter of fiscal 2001. This severance charge is in addition to the restructuring charge of \$180,000 recorded in the first quarter of fiscal 2001, which included an asset write-off and other direct expenses associated with the consolidation of our operations in the United Kingdom and El Dorado Hills, California. There was no restructuring charge in fiscal 2000.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

(a) Exhibits:

99.1 Press Release dated July 27, 2001

(b) Reports on Form 8-K

None

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SIGNATURES

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

CASTELLE

By: /s/ Donald L. Rich Date: August 10, 2001  
Donald L. Rich  
Chairman of the Board and Director  
Chief Executive Officer and President  
(Principal Executive Officer)

By: /s/ Paul Cheng Date: August 10, 2001  
Paul Cheng  
Vice President of Finance and Administration  
Chief Financial Officer

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(Principal Financial and Chief Accounting Officer)  
Secretary