

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

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FILER

TEKELEC

CIK: **790705** | IRS No.: **952746131** | State of Incorpor.: **CA** | Fiscal Year End: **1231**
Type: **10-Q** | Act: **34** | File No.: **000-15135** | Film No.: **04960529**
SIC: **3663** Radio & tv broadcasting & communications equipment

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2004

or

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

Commission file number 0-15135

TEKELEC

(Exact name of registrant as specified in its charter)

California

*(State or other jurisdiction of
incorporation or organization)*

95-2746131

*(I.R.S. Employer
Identification No.)*

**26580 W. Agoura Road,
Calabasas, California**

(Address and zip code of principal executive offices)

91302

(Zip Code)

(818) 880-5656

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant is an accelerated filer. Yes No

As of July 22, 2004, there were 62,862,900 shares of the registrant's common stock, without par value, outstanding.

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PART I – FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

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Condensed Consolidated Balance Sheets

	June 30, 2004	December 31, 2003
	(Unaudited)	
	(Thousands, except share data)	
Assets		
Current assets:		
Cash and cash equivalents	\$ 37,928	\$ 45,261
Short-term investments, at fair value	51,083	83,800
Accounts receivable, less allowances of \$2,910 and \$2,619, respectively	76,481	52,781
Convertible notes receivable (\$17,300 principal amount)	17,376	17,580
Inventories	31,887	21,434
Deferred income taxes, net	11,490	4,958
Prepaid expenses and other current assets	30,473	22,088
	<hr/>	<hr/>
Total current assets	256,718	247,902
Long-term investments, at fair value	165,060	210,298
Property and equipment, net	28,032	22,172
Investments in privately-held companies	17,322	17,322
Deferred income taxes, net	32,927	7,876
Other assets	6,168	6,342
Goodwill	99,796	68,903
Intangible assets, net	58,383	34,118
	<hr/>	<hr/>
Total assets	\$ 664,406	\$ 614,933
	<hr/>	<hr/>
Liabilities and Shareholders' Equity		
Current liabilities:		
Trade accounts payable	\$ 24,306	\$ 8,974
Accrued expenses	30,958	30,812
Accrued payroll and related expenses	21,927	17,967
Current portion of notes payable	2,812	3,934
Current portion of deferred revenues	62,222	50,105
Income taxes payable	5,253	1,071
	<hr/>	<hr/>
Total current liabilities	147,478	112,863
Notes payable	2,025	2,574
Long-term convertible debt	125,000	125,000
Deferred income taxes	11,297	790
Long-term portion of deferred revenues	2,420	3,687

Total liabilities	288,220	244,914
Minority Interest	23,050	41,208
Commitments and Contingencies (Note J)		
Shareholders' equity:		
Common stock, without par value, 200,000,000 shares authorized; 62,786,100 and 61,625,518 shares issued and outstanding, respectively	213,817	189,908
Deferred stock-based compensation	(3,900)	-
Retained earnings	143,440	137,895
Accumulated other comprehensive income (loss)	(221)	1,008
Total shareholders' equity	353,136	328,811
Total liabilities and shareholders' equity	\$ 664,406	\$ 614,933

See notes to consolidated financial statements.

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Condensed Consolidated Statements of Operations

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
(Unaudited)				
(Thousands, except per share data)				
Revenues	\$ 95,618	\$ 62,922	\$ 174,488	\$ 117,928
Cost of sales:				
Cost of goods sold	23,953	16,440	43,338	29,521
Amortization of purchased technology	2,392	2,607	5,456	5,138
Total cost of sales	26,345	19,047	48,794	34,659
Gross profit	69,273	43,875	125,694	83,269
Operating expenses:				
Research and development	24,169	16,274	44,788	30,487
Selling, general and administrative	38,165	24,386	70,436	46,337
Acquired in-process research and development	8,000	2,900	8,000	2,900
Restructuring	110	–	1,052	–
Amortization of intangible assets	409	425	941	825
Total operating expenses	70,853	43,985	125,217	80,549
Income (loss) from operations	(1,580)	(110)	477	2,720
Other income (expense):				
Interest income	1,077	1,601	2,610	3,049
Interest expense	(1,081)	(2,537)	(2,199)	(4,892)
Other, net	(349)	(234)	(296)	(11)
Total other income (expense)	(353)	(1,170)	115	(1,854)
Income (loss) from operations before provision for income taxes	(1,933)	(1,280)	592	866
Provision for income taxes	6,952	2,015	13,205	2,647
Net loss before minority interest	(8,885)	(3,295)	(12,613)	(1,781)
Minority interest	8,581	4,505	18,158	4,505
Net income (loss)	\$ (304)	\$ 1,210	\$ 5,545	\$ 2,724
Earnings per share:				
Basic	\$ 0.00	\$ 0.02	\$ 0.09	\$ 0.04
Diluted	0.00	0.02	0.09	0.04

Weighted average number of shares outstanding:

Basic	62,458	61,032	62,246	60,983
Diluted	62,458	62,276	65,174	61,954

See notes to consolidated financial statements.

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Condensed Consolidated Statements of Comprehensive Income (Loss)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2004	2003	2004	2003
	(Unaudited) (Thousands)			
Net income (loss)	\$ (304)	\$ 1,210	\$ 5,545	\$ 2,724
Other comprehensive income:				
Foreign currency translation adjustments	58	289	14	30
Net unrealized gain (loss) on available-for-sale securities, net of income taxes	(1,021)	967	(1,243)	967
Comprehensive income (loss)	\$ (1,267)	\$ 2,466	\$ 4,316	\$ 3,721

See notes to consolidated financial statements.

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Condensed Consolidated Statements of Cash Flows

	Six Months Ended	
	June 30,	
	2004	2003
	(Unaudited)	
	(Thousands)	
Cash flows from operating activities:		
Net income	\$ 5,545	\$ 2,724
Adjustments to reconcile net income to net cash provided by operating activities:		
Minority interest	(18,158)	(4,505)
Restructuring accrual	(72)	-
Depreciation	6,974	6,949
Amortization	14,422	9,148
Amortization of deferred financing costs	556	472
Convertible debt accretion	203	2,093
Deferred income taxes	(2,497)	(2,020)
Stock-based compensation	585	197
Tax benefit related to stock options exercised	2,489	212
Changes in operating assets and liabilities, net effects of acquisitions:		
Accounts receivable	(15,618)	6,734
Inventories	(7,807)	714
Income taxes receivable	-	(949)
Prepaid expenses and other current assets	(7,354)	(3,197)
Trade accounts payable	12,305	(3,841)
Accrued expenses	(4,805)	(5,902)
Accrued payroll and related expenses	3,136	(312)
Deferred revenues	9,900	5,412
Income taxes payable	4,178	(1,180)
Total adjustments	(1,563)	10,025
Net cash provided by operating activities	3,982	12,749
Cash flows from investing activities:		
Proceeds from maturity of available-for-sale investments	425,027	209,881
Purchase of available-for-sale investments	(345,525)	(206,850)
Purchase of property and equipment	(8,788)	(2,190)
Cash acquired from Santera	-	12,335
Cash paid for Taqua net of cash acquired	(86,994)	-
Purchase of technology	(1,350)	(41)
Change in other assets	(226)	(22)
Net cash provided by (used in) investing activities	(17,856)	13,113

Cash flows from financing activities:		
Payments on notes payable	(6,886)	(57)
Proceeds from issuance of convertible debt	–	125,000
Debt issuance costs	–	(3,677)
Proceeds from issuance of common stock	13,411	1,232
	<hr/>	<hr/>
Net cash provided by financing activities	6,525	122,498
	<hr/>	<hr/>
Effect of exchange rate changes on cash	16	188
	<hr/>	<hr/>
Net change in cash and cash equivalents	(7,333)	148,548
Cash and cash equivalents at beginning of period	45,261	167,283
	<hr/>	<hr/>
Cash and cash equivalents at end of period	\$ 37,928	\$ 315,831
	<hr/>	<hr/>

See notes to consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note A. Basis of Presentation

The consolidated financial statements are unaudited, other than the consolidated balance sheet at December 31, 2003, and reflect all adjustments, consisting only of normal recurring adjustments, which in the opinion of management are necessary for a fair statement of our financial condition, operating results and cash flows for the interim periods. The consolidated financial statements include the accounts and operating results of our wholly owned subsidiaries including Taqua from the acquisition date of April 8, 2004 (see Note B – Acquisition of Taqua, Inc.) and our majority owned subsidiary, Santera, less minority interest from the acquisition date of June 10, 2003. (See Note C – Acquisition of Majority Interest in Santera).

The results of operations for the current interim periods are not necessarily indicative of results to be expected for the current year. Certain items shown in the prior financial statements have been reclassified to conform with the presentation of the current period.

We operate under a thirteen-week calendar quarter. For financial statement presentation purposes, however, the reporting periods are referred to as ended on the last calendar day of the quarter. The accompanying consolidated financial statements for the three and six months ended June 30, 2004 and 2003 are for the thirteen and twenty-six weeks ended July 2, 2004 and June 27, 2003, respectively.

We conduct business in a number of foreign countries. We expect international sales to account for a significant portion of our revenues in future periods. Accordingly, we have identified four geographic territories for analyzing and reporting sales data. The four territories are: (1) North America, comprised of the United States and Canada, (2) “EMEA” comprised of Europe, the Middle East and Africa, (3) “CALA” comprised of the Caribbean and Latin America including Mexico, and (4) Asia Pacific, comprised of Asia and the Pacific region including China. These territories are presented for the three and six months ended June 30, 2004, with comparative information reclassified for the three and six months ended June 30, 2003.

These condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission. The condensed consolidated balance sheet at December 31, 2003, has been derived from the audited financial statements at that date. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to such rules and regulations.

These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements for the year ended December 31, 2003 and the notes thereto in our Annual Report on Form 10-K for the year ended December 31, 2003.

Recent Accounting Pronouncements

In December 2003, the Financial Accounting Standards Board (“FASB”) revised Statement of Financial Accounting Standards (“SFAS”) No. 132, “Employers’ Disclosures about Pensions and Other Postretirement Benefits.” Revised SFAS No. 132 affects employers’ required disclosures about pension plans and other postretirement benefit plans. It does not change the measurement or recognition of those plans required by SFAS No. 87, “Employers’ Accounting for Pensions,” SFAS No. 88, “Employers’ Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits” and SFAS No. 106, “Employers’ Accounting for Postretirement Benefits Other Than Pensions.” Revised SFAS 132 requires disclosures in addition to those in the original SFAS No. 132. Revised SFAS No. 132 was effective for financial statements with fiscal years ending after December 15, 2003. The interim-period disclosures required by Revised Statement 132 were effective for interim periods beginning after December 15, 2003. Because we do not offer pension or other postretirement benefits, adoption of Revised SFAS No. did not have a material impact on our financial position, results of operations or cash flows.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

In March 2004, the EITF reached a consensus on Issue 03-1, “The Meaning of Other-Than-Temporary Impairment and its Application to Certain Investments.” EITF No. 03-1 requires disclosures on investments in an unrealized loss position. The disclosures are designed to help financial statement users analyze a company’s unrealized losses and to enable them to better understand the basis for any management conclusion that the impairment is temporary. Quantitative and qualitative disclosures for investments accounted for under SFAS No. 115, “Accounting for Certain Investments in Debt and Equity Securities,” are effective for the first annual reporting period ending after December 15, 2003. All new disclosures related to cost method investments are effective for the annual reporting periods ending after June 15, 2004. Comparative information for the periods prior to the period of initial application is not required. We will begin to make these required disclosures in our Annual Report on Form 10-K for the fiscal year ending December 31, 2004. Adoption of EITF No. 03-1 will not have a material impact on our financial position, results of operations or cash flows.

On February 12, 2004, the FASB issued FASB Staff Position (“FSP”) FIN 46(R)-1 “Reporting Variable Interests in Specified Assets of Variable Interest Entities under Paragraph 13 of FASB Interpretation No. 46 (Revised December 2003) (“FIN 46(R)”), Consolidation of Variable Interest Entities” to replace FIN 46-2 as a result of the release of FIN 46R in December 2003. The FSP states that a specified asset of a variable interest entity and the liability secured by that asset should not be deemed a separate variable interest entity. The effective date for this FSP follows the effective date and transition guidance specified in FIN 46R. Adoption of FIN 46(R)-1 will not have a material impact on our financial position, results of operations or cash flows.

In April 2004, the FASB issued FSP 129-1, “Disclosure Requirements under FASB Statement No. 129, Disclosure of Information about Capital Structure, Relating to Contingently Convertible Financial Instruments,” (“FSP 129-1”). FSP 129-1 states that SFAS No. 129 “Disclosure of Information about Capital Structure” applies to all contingently convertible securities, including those containing contingent conversion requirements that have not been met and are not otherwise required to be included in the computation of diluted earnings per share in accordance with SFAS No. 128, “Earnings Per Share.” Paragraph 4 of SFAS No. 129 requires the disclosure of significant terms of the conversion features of the contingently convertible security to enable users of financial statements to understand the circumstances of the contingency and the potential impact of conversion. Disclosures are to indicate whether the shares that would be issued if the contingently convertible securities were converted are included in the calculation of diluted earnings per share, and the reasons why or why not. The guidance in FSP 129-1 is effective immediately upon posting of the final FSP 129-1 to the FASB website and applies to all existing and newly created securities. Because our notes are not contingently convertible, adoption of the provisions of FSP 129-1 did not have an impact on our financial position, results of operations or cash flows, however, we have disclosed the impact of our convertible notes on earnings per share. (See Note M – Earnings Per Share in the Notes to Condensed Consolidated Financial Statements in this Form 10-Q).

Note B. Acquisition of Taqua, Inc.

On April 8, 2004, we completed the acquisition of all of the outstanding shares of capital stock of privately held Taqua, Inc., (“Taqua”). Taqua develops, markets and sells solutions for next-generation switches optimized for the small switch service provider market. The acquisition was accomplished by means of a reverse triangular merger of a new wholly owned subsidiary of Tekelec (“Merger Sub”), with and into Taqua (the “Acquisition”). As a result of the Acquisition, Taqua is the surviving corporation and a wholly owned subsidiary of Tekelec.

We paid an aggregate cash amount of approximately \$86.0 million to the common and preferred stockholders and warrant holders of Taqua in exchange for their interests in Taqua. As part of the acquisition, we assumed all unexercised outstanding options to purchase shares of common stock of Taqua. The assumed

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

options were converted, based on exchange ratios specified in the merger agreement, into options to purchase an aggregate of approximately 500,000 shares of Tekelec Common Stock with an estimated fair value of \$7.8 million using the Black-Scholes option-pricing model. This amount includes approximately \$4.2 million related to the intrinsic value of unvested stock options recorded as deferred stock-based compensation, which will be amortized over the vesting period of the assumed options. The transaction has been accounted for as an acquisition by us under the purchase method, with the Taqua assets acquired and the liabilities assumed reflected at their estimated fair values. The acquisition of Taqua resulted in the recognition of deferred tax assets of approximately \$30.3 million primarily related to acquired temporary differences and net operating loss carryforwards and deferred tax liabilities of approximately \$11.7 million related to acquired intangible assets. The Taqua acquired deferred tax assets are based on a preliminary purchase allocation and may be adjusted upon completion of the final Taqua tax returns through the acquisition date. Taqua's operating results are included in our consolidated results since the date of acquisition.

The transaction has been accounted for using the purchase method of accounting, and resulted in a step-up of approximately \$68.8 million of Taqua's assets and liabilities to fair value as follows:

	(Thousands)
Total cash paid	\$ 85,966
Estimated fair value of stock options issued	7,755
Deferred compensation adjustment for invested stock options	(4,231)
Estimated direct transaction costs	2,649
	92,139
Total fair value of consideration paid and direct transaction costs	92,139
Less: Taqua's net assets acquired	(1,422)
Add: Estimated deferred tax liability	11,739
Less: Estimated deferred tax assets	(30,316)
Less: Other adjustments to tangible assets and liabilities	(3,305)
	\$ 68,835

The total purchase price step-up was allocated among the Taqua assets acquired and liabilities assumed based on their estimated fair values determined by a third party appraisal as follows:

	(Thousands)
In-process research and development	\$ 8,000
Goodwill	31,525
Identifiable intangible assets	29,310
	68,835
Total purchase allocation	\$ 68,835

Based on the purchase price allocation, \$8.0 million of the purchase price represented acquired in-process research and development (“IPRD”) that had not yet reached technological feasibility and had no alternative future use. IPRD was valued using a discounted cash flow approach commonly known as the “excess earnings” approach. The IPRD amount was recorded as an expense in the second quarter of 2004. The identifiable assets created as a result of the acquisition will be amortized over their respective estimated useful

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

lives and the amortization expense of purchased technology and other intangible assets of Taqua for the three and six months ended June 30, 2004 were as follows:

	<u>Asset Amount</u> (Thousands)	<u>Estimated Life in Years</u>
Acquired technology	\$ 26,400	15
Acquired backlog	1,500	1
Trade names and marks	60	1
Existing customer relationships	10	12
Service contracts	630	5
Non-compete agreements	710	1
	<u>\$ 29,310</u>	

The following table shows our pro forma revenue, net income (loss) and earnings (loss) per share giving effect to the Taqua acquisition as of the beginning of 2003:

	<u>Six Months Ended June 30,</u>	
	<u>2004</u>	<u>2003</u>
	(Thousands, except per share amounts)	
Revenues	\$ 177,320	\$ 123,050
Net income (loss)	15,649	(8,445)
Earnings (loss) per share:		
Basic	0.25	(0.14)
Diluted	0.24	(0.14)

Note C. Acquisition of Majority Interest in Santera

On June 10, 2003, we acquired a 51.6% controlling voting ownership interest (57.5% on an as converted basis) in Santera in exchange for cash contribution of \$28.0 million and the contribution of the business operations and certain assets and liabilities of our Packet Telephony Business Unit (“PTBU”). Santera develops, markets and sells solutions for carrier-class, next-generation switches. As part of the acquisition and combination, Santera was recapitalized and we contributed the \$28.0 million in cash to Santera in exchange for 28,000 shares of Santera Series B Preferred Stock. In addition, we received 38,000 shares of Santera Series A Preferred Stock and one share of Santera common stock in exchange for the PTBU. Santera’s existing stockholders received 62,000 shares of Series A Preferred Stock in exchange for their existing shares in Santera and a cash contribution to Santera of \$12.0 million. Each share of Santera’s Series B Preferred Stock has a liquidation preference equal to \$2,000 and is convertible into 1.63 shares of Santera’s common stock. Each share of Santera’s Series A Preferred Stock has a liquidation preference equal to \$1,000 and is convertible into one share of Santera common stock. Under terms of the original purchase

agreement, we made additional cash investments of \$12.0 million in Santera, \$6.0 million in March 2004 and \$6.0 million in May 2004, in exchange for 12,000 shares of Santera Series B Preferred Stock. As a result of this cash investment, our ownership percentage increased to 55.7% (62.5% on an as converted basis). In accordance with generally accepted accounting principles, the capital structure of Santera has been eliminated in consolidation and the minority stockholders' interest in Santera is reflected in our consolidated balance sheet as minority interest. The minority stockholders' interest in Santera is reflected at the fair value of the Santera assets acquired on the date of acquisition.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

The transaction has been accounted for using the purchase method of accounting, and resulted in a step-up of approximately \$56.9 million of Santera's assets and liabilities to fair value as follows:

	(Thousands)
Fair value of Santera	\$ 61,000
Direct acquisition costs	3,700
Less: Santera tangible net assets acquired	(7,767)
Fair value step-up	\$ 56,933

The total purchase price step-up were allocated among the Santera assets acquired and liabilities assumed based on their estimated fair values determined by a third party appraisal as follows:

	(Thousands)
In-process research and development	\$ 2,900
Goodwill	25,835
Identifiable intangible assets	27,200
Acquired backlog	500
Inventory fair value step-up	498
	\$ 56,933

The PTBU assets and liabilities contributed remain at historical cost.

Based on the purchase price allocation, \$2.9 million of the purchase price represented acquired in-process research and development ("IPRD") that had not yet reached technological feasibility and had no alternative future use. IPRD was valued using a discounted cash flow approach commonly known as the "excess earnings" approach. The IPRD amount was recorded as an expense in the second quarter of 2003. The identifiable assets created as a result of the acquisition will be amortized over their estimated useful lives of 15 years, with the exception of acquired backlog, which has an estimated life of one year. Amortization expense of purchased technology and other intangible assets of Santera, including the intangible assets contributed by PTBU, amounted to \$1.0 million and \$2.9 million for the three and six months ended June 30, 2004, respectively.

The following table shows our pro forma revenue, net income and loss per share giving effect to the Santera acquisition as of the beginning of 2003:

Six Months Ended
June 30, 2003

(Thousands, except

	per share amounts)
Revenues	\$ 123,738
Net loss	(1,524)
Loss per share:	
Basic	(0.02)
Diluted	(0.02)

The net income and losses of Santera are allocated between Tekelec and the minority stockholders based on their relative interests in the equity of Santera and the related liquidation preferences. This approach requires net losses to be allocated first to the Series A Preferred Stock until fully absorbed and then to the Series B Preferred Stock. Subsequent net income will be allocated first to the Series B Preferred Stock to the

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

extent of previously recognized net losses allocated to Series B Preferred Stock. Additional net income will then be allocated to the Series A Preferred Stock to the extent of previously recognized losses allocated to Series A Preferred Stock and then to Common Stock in proportion to their relative ownership interests in the equity of Santera. The loss allocated to minority interest of Santera for the six months ended June 30, 2004 was computed as follows (dollars in thousands):

Santera net loss (includes amortization of intangibles of \$2,936)	\$	29,287
Percentage of losses attributable to the minority interest based on capital structure and liquidation preferences		62 %
		62
Minority interest losses	\$	18,158

Since our acquisition of a majority interest in Santera, the total net losses that are allocable to the Series A Preferred Stock is \$61.2 million, leaving \$37.2 million of losses to be allocated to the Series A Preferred Stock until fully absorbed. After the Series A Preferred Stock is fully absorbed, all subsequent net losses of Santera will be allocated to the Series B Preferred Stock, of which Tekelec owns 100%.

In addition to our current ownership interest, we have the right, exercisable during the period from July 1, 2005 through December 31, 2007, to acquire the remaining outstanding shares of Santera from the holders thereof at a price determined in accordance with the terms of the definitive agreements (the “Tekelec Option Price”). In addition, the other stockholders of Santera will have the right, exercisable during the period from January 2006 through February 2008, to require us to purchase their shares at a price equal to 80% of the Tekelec Option Price, provided Santera has been profitable for the two calendar quarters preceding such exercise.

Note D. Convertible Note Receivable from Disposition of Network Diagnostics Business

On August 30, 2002, we completed the sale of NDD to Catapult Communications Corporation (“Catapult”) for \$59.8 million, consisting of \$42.5 million in cash and convertible subordinated promissory notes (the “Notes”) issued by Catapult’s wholly owned Irish subsidiary and guaranteed by Catapult in the total amount of \$17.3 million.

The Notes have a principal amount of \$17.3 million bearing interest at 2% per annum and are due on August 30, 2004. We have the option of converting the Notes into Catapult common stock after August 30, 2003 through maturity at a conversion rate (subject to certain adjustments) of 62.50 shares of Catapult common stock per \$1,000 in principal (approximately 1.1 million shares). Catapult also has the option of repaying one of the Notes at maturity in the principal amount of \$10.0 million by delivery of shares of Catapult common stock valued at a 17.5% discount from trading prices at the time of repayment.

The Notes are reflected in the consolidated balance sheet at their estimated fair value as determined with the assistance of a third party appraisal. The fair value was computed by discounting the face value amount to present value using a fair value rate of interest and then determining the fair value of the conversion option using the Black-Scholes option-pricing model. The carrying value of the Notes is being adjusted to the

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

redemption amount at maturity based on an effective interest amortization method, with periodic charges to interest. The carrying values of the Notes and the conversion option are as follows:

	June 30, 2004	December 31, 2003
Notes: face value at \$17.3 million	\$ 14,869	\$ 14,869
Fair value of conversion option feature	3,246	3,246
	<hr/>	<hr/>
Fair value notes	18,115	18,115
Less, accumulated amortization	(739)	(535)
	<hr/>	<hr/>
Carrying value of notes	\$ 17,376	\$ 17,580
	<hr/>	<hr/>

Note E. Restructuring Costs

In January 2004, we announced a cost reduction initiative that is expected to result in employee terminations and relocations. The cost reduction initiative resulted in restructuring charges of \$110,000 and \$1.1 million for the three and six months ended June 30, 2004, including \$874,000 in severance costs, \$49,000 in retention bonuses, \$46,000 in facility relocation costs and \$83,000 in employee relocation costs. These restructuring costs relate to the implementation of a global strategic manufacturing plan which includes the outsourcing of the majority of our manufacturing operations and the relocation of our remaining signaling product manufacturing operations from Calabasas, California to our facilities in Morrisville, North Carolina which is expected to be complete by the end of 2004.

For the restructuring charges related to relocation costs and retention bonuses, we have applied the provisions of SFAS No. 146, "Accounting for Costs Associated with Exit or Disposal Activities." The principal difference between SFAS No. 146 and previous accounting standards relates to the timing of when restructuring charges are recorded. Under SFAS No. 146, restructuring charges are recorded as liabilities are incurred. Under prior accounting standards, restructuring related liabilities were recorded at the time we committed to a restructuring plan. Retention bonuses are being recognized proratably over the service period. We have applied the provisions of SFAS 112, "Employers' Accounting for Postemployment Benefits" for severance costs because the severance benefits provided as part of this restructuring were part of an ongoing benefit arrangement and we accrued a liability for the severance costs.

The costs related to the restructuring were as follows:

	Total Costs Expected to be Incurred	Costs Incurred for the Three Months Ended June 30, 2004	Cumulative Costs Incurred through June 30, 2004
	<hr/>	<hr/>	<hr/>
	(Thousands)		
Severance costs and retention bonuses	\$ 972	\$ 24	\$ 923
Employee relocation costs	550	40	83
Facility relocation costs	320	46	46

Total	\$	<u>1,842</u>	\$	<u>110</u>	\$	<u>1,052</u>
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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

The restructuring activity has resulted in the following accrual as of June 30, 2004:

	Total Restructuring Charges Accrued, Net	Payments as of June 30, 2004	Balance at June 30, 2004
	(Thousands)		
Severance costs and retention bonuses	\$ 923	\$ (143)	\$ 780
Employee relocation costs	43	(43)	–
Total	\$ 966	\$ (186)	\$ 780

As of June 30, 2004, total restructuring liabilities amounted to \$780,000 and are included in accrued expenses and accrued payroll and related expenses in the accompanying balance sheet. Additional restructuring charges estimated at approximately \$790,000 in total are likely to be incurred throughout the third and fourth quarters of 2004 as a result of the global strategic manufacturing plan and other consolidation activities.

Note F. Certain Balance Sheet Items

	June 30, 2004	December 31, 2003
Inventories consist of the following:		
Raw materials	\$ 19,437	\$ 15,810
Work in process	2,202	128
Finished goods	10,248	5,496
Inventories	\$ 31,887	\$ 21,434
Property and equipment consist of the following:		
Manufacturing and development equipment	\$ 63,338	\$ 61,400
Furniture and office equipment	38,911	29,464
Demonstration equipment	9,760	2,465
Leasehold improvements	10,116	8,989
	122,125	102,318
Less accumulated depreciation	(94,093)	(80,146)
Property and equipment, net	\$ 28,032	\$ 22,172
Intangible assets consist of the following:		
Purchased technology	\$ 108,412	\$ 79,162
Other	24,010	14,600

	132,422	93,762
Less accumulated amortization	(74,039)	(59,644)
Intangible assets, net	\$ 58,383	\$ 34,118

Note G. Financial Instruments

We use derivative instruments, such as forward contracts, to manage our exposure to market risks such as interest rate and foreign exchange risks. We record derivative instruments as assets or liabilities on the Consolidated Balance Sheet, measured at fair value.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

Corresponding gains and losses on these contracts, as well as gains and losses on the items being hedged, are included as a component of other income and expense in our consolidated statement of operations. When we elect not to designate a derivative instrument and hedged item as a fair value hedge at inception of the hedge, or the relationship does not qualify for fair value hedge accounting, the full amount of changes in the fair value of the derivative instrument will be recognized in the consolidated financial statements.

As of June 30, 2004 and 2003, we had no foreign currency forward contracts outstanding. For the three and six months ended June 30, 2004, our other income (loss) from foreign currency forward contracts was \$42,500 and \$(250,000), respectively. For the three and six months ended June 30, 2003, our other loss from foreign currency forward contracts was \$466,000 and \$625,000, respectively.

We may continue to use foreign currency forward contracts to manage foreign currency exchange risks in the future.

Note H. Income Taxes

The income tax provisions from continuing operations for the three and six months ended June 30, 2004 were \$7.0 million and \$13.2 million, respectively, and reflected the effect of non-deductible acquisition-related costs, partially offset by benefits of \$558,000 and \$1.2 million, respectively, from the utilization of deferred tax liabilities related to certain of these acquisition-related costs.

Our provision for income taxes does not include any benefit from the losses generated by Santera due to their losses not being included on our federal consolidated tax return because our ownership interest in Santera does not meet the threshold to consolidate under income tax rules and regulations and a full valuation allowance being established on the tax benefits generated by Santera as a result of their historical operating losses.

Excluding the effect of acquisition-related items and Santera's operating results, our effective tax rate was 35% and 34%, respectively for continuing operations for the three and six month periods ended June 30, 2004 and 2003, and represented federal, state and foreign taxes on our income, reduced primarily by research and development credits, foreign tax credits, and other benefits from foreign sourced income.

Note I. Lines of Credit, Notes Payable and Long-Term Convertible Debt

We have a \$20.0 million line of credit with a U.S. financial institution. Our \$20.0 million credit facility is collateralized by a stock pledge of our holdings in Santera, bears interest at or, in some cases, below the lender's prime rate (4.25% at June 30, 2004) and expires on August 31, 2004, if not renewed. Under the terms of this facility, we are required to maintain certain financial ratios and meet certain net worth and indebtedness covenants. We are in compliance with these covenant requirements as of June 30, 2004. There have been no borrowings under this credit facility.

As a result of the Santera transaction (see Note C – Acquisition of Majority Interest in Santera), we also have two notes payable to U.S. financial institutions with monthly installments of principal and interest. One of the notes has an outstanding balance of \$2.0 million and is secured by the assets purchased under the note, bears interest at 10% and expires in February 2005. The second note for \$2.8 million is secured by the assets purchased under the note and substantially all of Santera's assets, excluding the assets secured under the \$2.0 million note, bears interest at a variable rate based on the two-year treasury note rate (6.36% at June 30, 2004) and expires in November 2005. Under the terms of this facility, we are required to maintain certain financial reporting covenants. We are in compliance with these covenant requirements as of June 30, 2004.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

As a result of the Taqua transaction (see Note B – Acquisition of Taqua, Inc.), we have a \$1.0 million credit facility with a U.S. financial institution. The \$1.0 million credit facility is collateralized by substantially all assets of Taqua, Inc., bears interest at 1.0% above the lenders prime rate (4.25% at June 30, 2004) and expires in April 2005. Under the terms of this facility, we are required to maintain certain financial ratios and meet certain net worth and indebtedness covenants. Taqua is not in compliance with these covenant requirements and accordingly, there are no outstanding borrowings under this credit facility.

In June 2003, we issued and sold \$125.0 million principal amount of our 2.25% Senior Subordinated Convertible Notes due 2008 (the “Notes”). The Notes were issued in a private offering in reliance on Section 4(2) of the Securities Act of 1933, as amended (the “Securities Act”). The initial purchaser of the Notes was Morgan Stanley & Co. Incorporated, which resold the Notes to qualified institutional buyers pursuant to Rule 144A promulgated under the Securities Act. The aggregate offering price of the Notes was \$125.0 million and the aggregate proceeds to Tekelec were approximately \$121.2 million after expenses. The Notes mature on June 15, 2008, and are convertible prior to the close of business on their final maturity date into shares of our common stock at a conversion rate of 50.8906 shares per \$1,000 principal amount of the Notes, subject to adjustment in certain circumstances. There are no financial covenants related to the Notes, and there are no restrictions on us paying dividends, incurring debt or issuing or repurchasing securities.

Note J. Commitments and Contingencies

Indemnities, Commitments and Guarantees

In the normal course of our business, we make certain indemnities, commitments and guarantees under which we may be required to make payments in relation to certain transactions. These indemnities, commitments and guarantees include, among others, intellectual property indemnities to our customers in connection with the sale of our products and licensing of our technology, indemnities for liabilities associated with the infringement of other parties’ technology based upon our products and technology, guarantees of timely performance of our obligations, and indemnities to our directors and officers to the maximum extent permitted by law. The duration of these indemnities, commitments and guarantees varies, and, in certain cases, is indefinite. The majority of these indemnities, commitments and guarantees do not provide for any limitation of the maximum potential future payments that we could be obligated to make. We have not recorded a liability for these indemnities, commitments or guarantees in the accompanying balance sheets as to date no payments have ever been required under any of these indemnities, commitments or guarantees.

Legal Claims

From time to time, various claims and litigation are asserted or commenced against us arising from or related to contractual matters, intellectual property matters, product warranties and personnel and employment disputes. As to such claims and litigation, including those matters discussed below, we can give no assurance that we will prevail. While we currently do not believe that the ultimate outcome of these matters, individually or in the aggregate, will have a material adverse effect on our business or consolidated financial position, litigation is subject to inherent uncertainties. An unfavorable outcome in any of these matters could have a material adverse effect on our business, or our consolidated financial position, results of operations or cash flows in the quarter or annual period in which one or more of these matters are resolved.

Lemelson Medical, Education and Research Foundation, Limited Partnership vs. Tekelec

In March 2002, the Lemelson Medical, Education & Research Foundation, Limited Partnership (“Lemelson”) filed a complaint against thirty defendants, including Tekelec, in the United States District Court for the District of Arizona. The complaint alleges that all defendants make, offer for sale, sell, import, or have imported products that infringe eighteen patents assigned to Lemelson, and the complaint also alleges

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

that the defendants use processes that infringe the same patents. The patents at issue relate to computer image analysis technology and automatic identification technology. Lemelson has not identified the specific Tekelec products or processes that allegedly infringe the patents at issue. Several Arizona lawsuits, including the lawsuit in which Tekelec is a named defendant, involve the same patents and have been stayed pending a non-appealable resolution of a lawsuit involving the same patents in the United States District Court for the District of Nevada. On January 23, 2004, the Court in the District of Nevada case issued an Order finding that certain Lemelson patents covering bar code technology and machine vision technology were: (1) unenforceable under the doctrine of prosecution laches; (2) not infringed by any of the accused products sold by any of the eight plaintiffs; and (3) invalid for lack of written description and enablement. Tekelec currently believes that the ultimate outcome of the lawsuit will not have a material adverse effect on our financial position, results of operations or cash flows.

Syndia Corporation

In January 2002, Syndia Corporation (“Syndia”) sent a letter to Tekelec accusing Tekelec of infringing two patents and offering to license these and other patents to Tekelec. The patents at issue relate to integrated circuit technology. Syndia has not identified the specific Tekelec products or processes that allegedly infringe the patents at issue. Tekelec currently believes that the ultimate outcome of the lawsuit will not have a material adverse effect on our financial position, results of operations or cash flows.

Tekelec v. Telica, Inc.

On August 14, 2003, Tekelec filed a complaint against Telica, Inc. (“Telica”) in the United States District Court for the Central District of California. The complaint alleges that Telica failed and refused to provide to Tekelec certain financial statements, documents and information required to be provided under the Second Amended and Restated Stockholders’ Agreement, dated as of October 4, 2001, as amended by Amendment No. 1 thereto (as so amended, the “Stockholders Agreement”). Tekelec contends, among other things, that Telica’s failure and refusal to deliver the required financial statements, documents and information has injured Tekelec, including by interfering with Tekelec’s ability to monitor its investment in certain preferred stock of Telica, which Tekelec purchased from Telica on December 19, 2001, for approximately \$10 million. In the complaint, Tekelec alleges claims for breach of contract and specific performance and seeks, among other things, compensatory damages, costs, interest and an order and injunction compelling Telica to deliver all financial statements, documents and information required to be delivered under the Stockholders Agreement. On September 15, 2003, Tekelec filed its First Amended Complaint, adding certain individuals as defendants and adding claims for breach of the implied covenant of good faith and fair dealing and breach of fiduciary duty.

On November 7, 2003, Telica filed a Counterclaim against Tekelec, alleging purported claims for breach of contract, breach of the covenant of good faith and fair dealing, fraud, and intentional interference with prospective economic advantage. Telica contends, among other things, that Tekelec misused certain documents and information purportedly provided by Telica. Telica seeks an unspecified amount of compensatory damages, punitive damages, attorneys’ fees, costs and interest. On December 5, 2003, Tekelec filed its Reply to the Counterclaim, denying each and every purported claim therein and asserting various affirmative defenses.

Effective as of June 8, 2004, Tekelec, Telica and the other parties to the action (collectively, the “Parties”) agreed to dismiss all claims and counterclaims alleged in the action, under the terms of a written settlement agreement entered into by the Parties. On July 13, 2004, the Parties lodged a Stipulation of Dismissal of All Claims and Counterclaims. On July 26, 2004, the Court ordered the dismissal of the action in its entirety, as stipulated by the Parties.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

Note K. Stock-Based Compensation

As of June 30, 2004, we have five stock-based employee compensation plans. We account for employee stock option plans in accordance with the provisions of Accounting Principles Board (“APB”) Opinion No. 25, “Accounting for Stock Issued to Employees” and the related interpretations of FIN No. 44, “Accounting for Certain Transactions Involving Stock Compensation.” Accordingly, compensation expense related to employee stock options is recorded, if on the date of the grant, the fair value of the underlying stock exceeds the exercise price.

We also have an Employee Stock Purchase Plan (ESPP), with a maximum term of ten years, the latest of which expires in the year 2006, and under which 1.8 million shares of the Company Common Stock have been authorized and reserved for issuance. Eligible employees may authorize payroll deductions of up to 10% of their compensation to purchase shares of Common Stock at 85% of the lower of the market price per share at the beginning or end of each six-month offering period.

To date, options have been granted at exercise prices that equal or exceed market value of the underlying common stock on the grant date. However, we have modified certain option grants that did require remeasurement on the modification date and accordingly have resulted in stock-based compensation as the exercise prices were below the fair market value on the date of the modification. We account for stock issued to non-employees in accordance with the provisions of SFAS No. 123 and EITF Issue No. 96-18, “Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling, Goods and Services.”

SFAS No. 123 encourages but does not require companies to record compensation cost for stock-based employee compensation plans at fair value for awards granted subsequent to December 31, 1995. We have chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in related interpretations. However, in accordance with the disclosure only requirements of SFAS 123, we have computed the fair value of our stock option grants using the Black-Scholes option-pricing model with the following assumptions: (i) dividend yield of 0%, (ii) expected volatility of 78% and 85%, respectively, for 2004 and 2003, (iii) weighted average risk-free interest rates of 2.6% and 2.1% for 2004 and 2003, respectively, (iv) weighted average expected option lives of 4.1 and 5.0 years for 2004 and 2003, respectively, and (v) assumed forfeiture rate of 49% and 43% for 2004 and 2003, respectively.

The following table illustrates the effect on stock-based compensation, net income and earnings (loss) per share if we had applied the fair value recognition provisions of SFAS No. 123 to stock-based employee compensation.

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
	(Thousands, except per share data)			
Stock-based compensation, net of tax:				
As reported	\$ 52	\$ 82	\$ 166	\$ 129
Additional stock-based compensation expense determined under the fair value method	4,025	4,317	7,415	9,457
Pro forma	\$ 4,077	\$ 4,399	\$ 7,581	\$ 9,586

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
(Thousands, except per share data)				
Net income (loss):				
As reported	\$ (304)	\$ 1,210	\$ 5,545	\$ 2,724
Less: additional stock-based compensation expense determined under the fair value method, net of tax	4,025	4,317	7,415	9,457
Pro forma	\$ (4,329)	\$ (3,107)	\$ (1,870)	\$ (6,733)
Earnings (loss) per share-basic:				
As reported	\$ 0.00	\$ 0.02	\$ 0.09	\$ 0.04
Less: per share effect of additional stock-based compensation expense determined under the fair value method, net of tax	0.06	0.07	0.11	0.15
Pro forma	\$ (0.06)	\$ (0.05)	\$ (0.02)	\$ (0.11)
Earnings (loss) per share-diluted:				
As reported	\$ 0.00	\$ 0.02	\$ 0.09	\$ 0.04
Less: per share effect of additional stock-based compensation expense determined under the fair value method, net of tax	0.06	0.07	0.11	0.15
Pro forma	\$ (0.06)	\$ (0.05)	\$ (0.02)	\$ (0.11)
Weighted average number of shares outstanding:				
Basic	62,458	61,032	62,246	60,983
Diluted	62,458	62,276	65,174	61,954

Note L. Operating Segment Information

The Network Signaling (formerly Network Systems) operating segment develops, markets and sells our Eagle signaling products and portfolio of value-added applications based on our high capacity Tekelec Eagle 5 Signaling Application System (SAS) platform. The Network Signaling segment's product family also includes the Tekelec 1000 Applications Server (APS) (formerly TekServer), a high-density, high-speed processing platform that is backward compatible with existing technology; the Tekelec 500 Signaling Edge (formerly SS7/IP gateway) for signaling in converged networks, and other convergence products; Sentinel, a network monitoring and revenue assurance system; and the ASi 4000 Service Control Point, an advanced database server used for the provisioning of telephony applications.

The Contact Center operating segment develops, markets and sells software-based solutions for call centers, including TotalView Workforce Management and TotalNet Call Routing.

The Next-Generation Switching operating segment develops, markets and sells our Santera and Taqua portfolio of switching solutions that allow network providers to migrate their network infrastructure from circuit-based technology to packet-based technology. Santera's product portfolio includes the Tekelec 3000 Multimedia Gateway Controller (MGC) (formerly SanteraOne OFX) and the Tekelec 8000 Multimedia Gateway (MG) (formerly SanteraOne BoX), a carrier-grade, integrated voice and data switching solution which delivers applications like IXC tandem, Class 4/5, PRI offload, packet/cell switching and Voice over Broadband services. Taqua's product portfolio includes the Tekelec 200 Applications Server (APS) (formerly

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

Taqua EFX200), Tekelec 700 Line Access Gateway (LAG) (formerly Taqua iX700), and Tekelec 7000 Class 5 Packet Switch (C5) (formerly Taqua iX7000).

Transfers between operating segments are made at prices reflecting markets conditions. The allocation of revenues from external customers by geographical area is determined by the destination of the sale.

We conduct business in a number of foreign countries. We expect international sales to account for a significant portion of our revenues in future periods. Accordingly, we have identified four geographic territories for analyzing and reporting sales data. The four territories are: (1) North America, comprised of the United States and Canada, (2) “EMEA”, comprised of Europe, Middle East and Africa, (3) “CALA” comprised of the Caribbean and Latin America including Mexico, and (4) Asia Pacific, comprised of Asia and the Pacific region including China. These territories are presented for the three and six months ended June 30, 2004, with comparative information reclassified for the three and six months ended June 30, 2003.

Our operating segments and geographical information are as follows (in thousands):

Operating Segments

	Revenues			
	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Network Signaling	\$ 72,323	\$ 53,559	\$ 135,563	\$ 99,525
Contact Center	10,352	8,139	19,596	17,179
Next-Generation Switching(1)	12,943	1,224	19,329	1,224
Total	\$ 95,618	\$ 62,922	\$ 174,488	\$ 117,928

	Income (Loss) from Operations			
	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Network Signaling	\$ 32,865	\$ 14,711	\$ 57,828	\$ 24,422
Contact Center	4,153	2,396	7,229	5,735
Next-Generation Switching(1)	(17,529)	(4,016)	(29,742)	(4,016)
General Corporate(2)	(21,069)	(13,201)	(34,838)	(23,421)
Total	\$ (1,580)	\$ (110)	\$ 477	\$ 2,720

- (1) Results for Next-Generation Switching are for the period subsequent to June 10, 2003, the acquisition date of Santera and April 8, 2004, the acquisition of Taqua.

- (2) General Corporate includes acquisition-related charges and amortization of \$10,609 and \$5,797 for the three months ended June 30, 2004 and 2003, respectively, and \$13,973 and \$8,597 for the six months ended June 30, 2004 and 2003, respectively, as well as other corporate expenses not specifically allocated to operating segments or specifically used by operating segment management to evaluate segment performance.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

Enterprise-Wide Disclosures

The following table sets forth, for the periods indicated, revenues from external customers by principal product line:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Network Signaling	\$ 72,323	\$ 53,559	\$ 135,563	\$ 99,525
Contact Center	10,352	8,139	19,596	17,179
Next-Generation Switching	12,943	1,224	19,329	1,224
Total	\$ 95,618	\$ 62,922	\$ 174,488	\$ 117,928

The following table sets forth, for the periods indicated, revenues from external customers by geographic territory:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
North America	\$ 82,310	\$ 49,114	\$ 149,803	\$ 95,524
Europe Middle East and Africa	6,501	8,367	9,080	14,318
Caribbean and Latin America	4,437	1,242	10,440	2,325
Asia Pacific	2,370	4,199	5,165	5,761
Total	\$ 95,618	\$ 62,922	\$ 174,488	\$ 117,928

The following table sets forth, for the periods indicated, long-lived assets by geographic area in which we hold assets:

	June 30,	December 31,
	2004	2003
United States	\$ 208,430	\$ 147,696
Other	1,271	1,161
Total	\$ 209,701	\$ 148,857

Sales to one customer accounted for 14% and 12% of our revenues for the three and six months ended June 30, 2004, respectively, and included sales from our network signaling, contact center, and next-generation switching operating segments. Sales to one other customer

accounted for 12% of our revenues for the three months ended June 30, 2004, and included sales from our next-generation switching operating segment.

Sales to one customer accounted for 17% and 16% of revenues for the three and six months ended June 30, 2003 and included sales from the network signaling and contact center operating segments. Sales to one other customer accounted for 11% of the revenues for the six months ended June 30, 2003 and included sales from both Network Signaling and Contact Center operating segments.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS – (Continued)

(Unaudited)

Note M. Earnings Per Share

The following table provides a reconciliation of the numerators and denominators of the basic and diluted earnings per share computations for the three and six months ended June 30, 2004 and 2003:

	<u>Net Income (Loss)</u> <u>(Numerator)</u>	<u>Shares</u> <u>(Denominator)</u>	<u>Per Share</u> <u>Amount</u>
(Thousands, except per share data)			
For the Three Months Ended June 30, 2004:			
Basic EPS	\$ (304)	62,458	\$ 0.00
Effect of Dilutive Securities – Stock Options and Warrants	—	—	
Diluted EPS	<u>\$ (304)</u>	<u>62,458</u>	\$ 0.00
For the Three Months Ended June 30, 2003:			
Basic EPS	\$ 1,210	61,032	\$ 0.02
Effect of Dilutive Securities – Stock Options and Warrants	—	1,244	
Diluted EPS	<u>\$ 1,210</u>	<u>62,276</u>	\$ 0.02
For the Six Months Ended June 30, 2004:			
Basic EPS	\$ 5,545	62,246	\$ 0.09
Effect of Dilutive Securities – Stock Options and Warrants	—	2,928	
Diluted EPS	<u>\$ 5,545</u>	<u>65,174</u>	\$ 0.09
For the Six Months Ended June 30, 2003:			
Basic EPS	\$ 2,724	60,983	\$ 0.04
Effect of Dilutive Securities – Stock Options and Warrants	—	971	
Diluted EPS	<u>\$ 2,724</u>	<u>61,954</u>	\$ 0.04

The computation of diluted number of shares excludes unexercised stock options and warrants and potential shares issuable upon conversion of our 2.25% senior subordinated convertible notes due 2008 that are anti-dilutive. The numbers of such shares excluded were 19.0 million and 19.8 million for the three months ended June 30, 2004 and 2003, respectively, and 16.7 million and 20.1 million for the six months ended June 30, 2004 and 2003, respectively.

Note N. Subsequent Event

On July 21, 2004, 72 new Tekelec employees hired during the second quarter of 2004 were granted employment inducement stock options under Tekelec's equity incentive plan for new employees to purchase a total of 437,950 shares of Tekelec common stock, pursuant to NASDAQ Marketplace Rule 4350(i)(1)(A)(iv). The number of shares involved in these grants amounts to less than 1% of the outstanding common shares of Tekelec. All option grants have an exercise price equal to Tekelec's closing price on July 21, 2004 of \$16.32, and will vest over a four-year period.

Item 2. *Management's Discussion and Analysis of Financial Condition and Results of Operations*

The following discussion should be read in conjunction with, and is qualified in its entirety by, the consolidated financial statements and the notes thereto included in Item 1 of this Quarterly Report and the Consolidated Financial Statements and notes thereto and Management's Discussion and Analysis of Financial Condition and Results of Operations contained in our Annual Report on Form 10-K for the year ended December 31, 2003. Historical results and percentage relationships among any amounts in the financial statements are not necessarily indicative of trends in operating results for any future periods.

During the second quarter of 2004 Tekelec began a product re-branding to assimilate products acquired through our acquisitions of Santera (See Note C – Acquisition of a Majority Interest in Santera) and Taqua (see Note B – Acquisition of Taqua, Inc.) into an integrated Tekelec family of products. The re-branding of products includes a renaming convention and cosmetic design changes that allow for easy reference and continued expansion.

Our logo, IEX, TALI, and Eagle are registered trademarks of Tekelec, IP7, IP7 Secure Gateway, ASi 4000, VXi, TekWare, TekServer, TotalView, and TotalNet are trademarks of Tekelec. Santera and SanteraOne are registered trademarks of Santera, our majority owned subsidiary. BOX and OFX are trademarks of Santera. Taqua, Taqua Systems and OCX are registered trademarks of Taqua, our wholly owned subsidiary.

Overview

In June 2003, we acquired a 51.6% controlling voting ownership interest (57.5% on an as converted basis) in Santera in exchange for a cash contribution of \$28.0 million and the contribution of the business operations and certain assets and liabilities of our Packet Telephony Business Unit ("PTBU"). Santera develops, markets and sells solutions for carrier-class, next-generation switches. As part of the acquisition, Santera was recapitalized and we contributed the \$28.0 million in cash to Santera in exchange for 28,000 shares of Santera Series B Preferred Stock. In addition, we received 38,000 shares of Santera Series A Preferred Stock and one share of Santera common stock in exchange for the PTBU. Santera's existing stockholders received 62,000 shares of Series A Preferred Stock in exchange for their existing shares in Santera and made an additional cash contribution to Santera of \$12.0 million. Each share of Santera Series B Preferred Stock has a liquidation preference equal to \$2,000 and is convertible into 1.63 shares of Santera common stock. Each share of Santera Series A Preferred Stock has a liquidation preference equal to \$1,000 and is convertible into one share of Santera common stock.

Under terms of the original purchase agreement, we made additional cash investments of \$12.0 million in Santera, \$6.0 million in March 2004 and \$6.0 million in May 2004, in exchange for 12,000 shares of Santera Series B Preferred Stock. There can be no guarantee that the additional funding made to Santera will be adequate to meet their needs. As a result of this cash investment, our ownership percentage increased to 55.7% (62.5% on an as converted basis). In accordance with generally accepted accounting principles, the capital structure of Santera has been eliminated in consolidation and the minority stockholders' interest in Santera is reflected in our consolidated balance sheet as minority interest. The minority stockholders' interest in Santera is reflected at the fair value of the Santera assets on the date of acquisition. (See Note C – Acquisition of Majority Interest in Santera).

On April 8, 2004, we completed our acquisition of Taqua, Inc., a privately held provider of next-generation packet switching systems, located in Richardson, Texas. The purchase price was approximately \$86.0 million cash, plus the assumption of outstanding stock options valued at approximately \$7.8 million using the Black-Scholes option-pricing model. This amount includes approximately \$4.2 million related to the intrinsic value of unvested stock options recorded as deferred stock-based compensation which will be amortized over the vesting period of the assumed options. Additionally, we incurred approximately \$2.6 million in direct acquisition-related costs consisting of investment banking, legal, accounting and other related fees. (See Note B – Acquisition of Taqua, Inc.) Taqua offers a portfolio of circuit and IP voice switching products and services, including next-generation packet Class 5 switches, intelligent line access gateways, application servers, and an element management system. In addition, Taqua offers a suite of professional services

including network design and capacity planning, as well as installation and cutover services. Taqua products became part of our next-generation switching product line in the second quarter of 2004.

Our product offerings are currently organized into three distinct product lines: network signaling, contact center and next-generation switching.

Network Signaling (formerly Network Systems). Our network signaling product line consists principally of the Tekelec Eagle 5 SAS, Tekelec 1000 APS and Tekelec 500 Signaling Edge, as well as our local number portability solution, Sentinel, and other convergence products.

Contact Center. Our IEX contact center products provide planning, management and call routing and control tools for single contact centers and for complex, multiple site contact center environments. This product line includes the TotalView Workforce Management and TotalNet Call Routing solutions.

Next-Generation Switching. Santera's portfolio of switching solutions allows network service providers to migrate their network infrastructure from circuit-based technology to packet-based technology. Santera's product portfolio includes the Tekelec 3000 MGC, and the Tekelec 8000 MG, a carrier-grade, integrated voice and data switching solution which delivers applications like IXC tandem, Class 4/5, PRI offload, packet/cell switching and Voice over Broadband services. Taqua's product portfolio includes the Tekelec 200 APS, Tekelec 700 LAG, and Tekelec 7000 C5.

Our revenues are currently organized into four distinct geographical territories: North America, EMEA, CALA and Asia/ Pacific. North America is comprised of the United States and Canada. EMEA is comprised of Europe, the Middle East and Africa. CALA is comprised of the Caribbean and Latin America including Mexico. Asia Pacific is comprised of Asia and the Pacific region including China. These territories are presented for the three and six months ended June 30, 2004, with comparative information reclassified for the three and six months ended June 30, 2003.

Results of Operations

The following table sets forth, for the periods indicated, the percentages that certain income statement items bear to total revenues:

	Percentage of Revenues			
	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Revenues	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	25.1	26.1	24.8	25.0
Amortization of purchased technology	2.5	4.2	3.2	4.4
Gross profit	72.4	69.7	72.0	70.6
Research and development	25.3	25.9	25.6	25.8
Selling, general and administrative	39.9	38.7	40.4	39.3
Acquired in-process research and development	8.4	4.6	4.6	2.5
Restructuring	0.1	–	0.6	–
Amortization of intangible assets	0.4	0.7	0.5	0.7
Total operating expenses	74.1	69.9	71.7	68.3
Income (loss) from operations	(1.7)	(0.2)	0.3	2.3
Interest and other income (expense), net	(0.3)	(1.8)	–	(1.6)
Income (loss) from continuing operations before provision for income taxes	(2.0)	(2.0)	0.3	0.7
Provision for income taxes	7.3	3.2	7.5	2.2
Income (loss) from continuing operations before minority interest	(9.3)	(5.2)	(7.2)	(1.5)
Minority interest	9.0	7.1	10.4	3.8
Net income	(0.3)%	1.9 %	3.2 %	2.3 %

The following table sets forth, for the periods indicated, the revenues by principal product line as a percentage of total revenues:

	Percentage of Revenues			
	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
Network Signaling	76 %	85 %	78 %	84 %
Contact Center	11	13	11	15
Next-Generation Switching	13	2	11	1

Total

100%

100%

100%

100%

The following table sets forth for the periods indicated, the revenues by geographic territories as a percentage of total revenues:

	Percentage of Revenues			
	Three Months		Six Months	
	Ended		Ended	
	June 30,		June 30,	
	2004	2003	2004	2003
North America	86 %	78 %	86 %	81 %
Europe Middle East and Africa	7	13	5	12
Caribbean and Latin America	5	2	6	2
Asia Pacific	2	7	3	5
	—	—	—	—
Total	100%	100%	100%	100%

Three Months Ended June 30, 2004 Compared with the Three Months Ended June 30, 2003

Revenues. Our revenues increased by \$32.7 million, or 52%, during the second quarter of 2004 due primarily to higher sales in the next-generation switching and network signaling product lines.

Revenues from network signaling products increased by \$18.8 million, or 35%, due primarily to higher sales of signaling upgrades and extensions and local number portability products partially offset by lower sales of initial systems.

Revenues from contact center products increased by \$2.2 million, or 27%, as a result of increased sales of TotalView Workforce Management product and services.

Revenues from next-generation switching products increased \$11.7 million, or 957%, due primarily to higher sales of Santera products as well as the inclusion of Santera for the entire quarter in 2004 compared to the 2003 acquisition date of June 10, 2003.

Revenues in North America increased by \$33.2 million, or 68%, due primarily to higher sales of signaling extensions and upgrades and local number portability sales and secondarily to higher sales of Santera products. EMEA revenues decreased by \$1.9 million, or 22%, due to lower Eagle STP product sales partially offset by higher upgrade and extension sales. CALA revenues increased by \$3.2 million, or 257%, due primarily to higher signaling upgrades and extensions product sales. Revenues in the Asia Pacific region decreased \$1.8 million, or 44%, due primarily to lower Eagle STP product sales. The percentage of revenues from outside the United States for the three months ended June 30, 2004 and 2003 were 17.6% and 23.5%, respectively.

A significant portion of our revenues in each quarter results from orders that are received in that quarter, and are difficult to predict. Further, we typically generate a significant portion of our revenues for each quarter in the last month of the quarter. We establish our expenditure levels based on our expectations as to future revenues, and if revenue levels were to fall below expectations, then such shortfall would cause expenses to be disproportionately high. Therefore, a drop in near-term demand would significantly affect revenues, causing a disproportionate reduction in profits or even losses in a quarter.

We believe that our future revenue growth depends in large part upon a number of factors, including the continued market acceptance, both domestically and internationally, of our products, particularly Eagle products including the Tekelec 1000 APS, and related applications, as well as our suite of products for converged circuit and packet networks, including the Tekelec 500 Signaling Edge and Tekelec 3000 MGC and Tekelec 8000 MG next-generation switching products.

Gross Profit. Gross profit as a percentage of revenues increased to 72.4% in the second quarter of 2004 compared to 69.7% in the second quarter of 2003. The increase in gross profit in 2004 as compared to 2003 was due primarily to a higher proportion of signaling upgrades and extensions and local number portability product sales, which typically carry higher margins than the product mix sold in the corresponding quarter last year.

Research and Development. Research and development expenses increased overall by \$7.9 million, or 49%, but decreased slightly as a percentage of revenues to 25.3% in the second quarter of 2004 from 25.9% in the second quarter of 2003. The increase in 2004 was due primarily to an increase in salary and related expenses attributable to the employment of additional personnel related to the acquisition of Santera completed on June 10, 2003 and the acquisition of Taqua completed on April 8, 2004.

We intend to continue to make substantial investments in product and technology development and believe that our future success depends in large part upon our ability to continue to enhance existing products and to develop or acquire new products that maintain our technological competitiveness, either through internal development or strategic acquisitions.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased by \$13.8 million, or 57%, and increased as a percentage of revenues to 39.9% in the second quarter of 2004 from 38.7% in the second quarter of 2003. This increase was due primarily to an increase in salary and related expenses attributable to additional personnel.

Restructuring Charges. In January 2004, we announced a cost reduction initiative that resulted in restructuring charges of \$110,000 for the three months ended June 30, 2004, including \$24,000 in retention bonuses and \$86,000 in relocation costs. These charges relate to our implementation of a global strategic manufacturing plan which includes outsourcing a majority of our manufacturing operations and relocating our remaining signaling product manufacturing operations from Calabasas, California to our facilities in Morrisville, North Carolina. Additional restructuring charges are likely to be incurred in the third and fourth quarters of 2004 as a result of these actions and relate to general corporate expenses (See Note E – Restructuring Costs).

Interest and Other Income (Expense), net. Interest expense decreased by \$1.5 million, or 57%, due primarily to the additional interest expense as a result of the June 2003 issuance of our new convertible debt that was outstanding concurrently with our previous convertible debt that was retired in July 2003. Interest income decreased \$524,000 or 33% due to lower cash and investment balances in 2004 compared to 2003 as a result of our recent acquisition of Taqua.

Acquired In-Process Research and Development. Acquired in-process research and development expense of \$8.0 million in the second quarter of 2004 represents the write-off of acquired in-process research and development related to our Taqua acquisition. (See Note B – Acquisition of Taqua, Inc). Acquired in-process research and development expense of \$2.9 million in the second quarter of 2003 represents the write-off of acquired in-process research and development related to our Santera acquisition. (See Note C – Acquisition of Majority Interest in Santera).

Amortization of Intangible Assets. Amortization of intangible assets in the second quarter of 2004 remained constant at approximately \$400,000 and decreased slightly as a percentage of revenues to 0.4% for the three months ended June 30, 2004 from 0.7% for the three months ended June 30, 2003.

Income Taxes. The income tax provisions from continuing operations for the three months ended June 30, 2004 and 2003 were \$7.0 million and \$2.0 million, respectively, and reflected the effect of non-deductible acquisition-related costs, partially offset by benefits of \$558,000 and \$969,000 for 2004 and 2003, respectively. Excluding the effects of acquisition-related items and Santera's operating results, our estimated effective tax rate was 35% and 34% was applied for the three month periods ended June 30, 2004 and 2003, respectively, and represented federal, state and foreign taxes on our income, reduced primarily by research and development credits, foreign tax credits and other benefits from foreign sourced income.

Minority Interest. Minority interest represents the losses of Santera allocable to the minority shareholders. See Note C – Acquisition of Majority Interest in Santera. The increase in 2004 represents the full period results of Santera for the second quarter of 2004.

Six Months Ended June 30, 2004 Compared with the Six Months Ended June 30, 2003

Revenues. Our revenues increased by \$56.6 million, or 48%, during the six months ended June 30, 2004 due primarily to higher sales in the network signaling and next-generation switching product lines.

Revenues from network signaling products increased by \$36.0 million, or 36%, due primarily to higher sales of signaling upgrades and extensions and secondarily to higher sales of local number portability products.

Revenues from contact center products increased by \$2.4 million, or 14%, as a result of increased sales of TotalView Workforce Management product and services, partially offset by lower sales of TotalNet product and services.

Revenues from next-generation switching products increased \$18.1 million, or 1,479%, due primarily to higher unit sales from Santera.

Revenues in North America increased by \$54.3 million, or 57%, due primarily to higher sales of Eagle STP systems and local number portability products and secondarily higher sales of Santera products. EMEA revenues decreased by \$5.2 million, or 37%, due primarily to lower sales of Eagle STP products. CALA revenues increased by \$8.1 million, or 349%, due primarily to higher sales of Eagle STP products. Revenues in the Asia Pacific region decreased \$600,000, or 10%, due to lower sales of Eagle STP systems and services. The percentage of revenues outside the United States for the six months ended June 30, 2004 and 2003 were 20.2% and 20.9%, respectively.

Gross Profit. Gross profit as a percentage of revenues increased to 72.0% in the six months ended June 30, 2004 compared with 70.6% in the six months ended June 30, 2003. The increase in gross margins in 2004 as compared to 2003 was due primarily to a higher proportion of sales of Eagle STP upgrades and extensions which typically carry higher margins than that of the product mix sold in the first six months of 2003.

Research and Development. Research and development expenses increased overall by \$14.3 million, or 47%, and decreased as a percentage of revenues to 25.6% in the six months ended June 30, 2004 from 25.8% in the six months ended June 30, 2003. The dollar increase in 2004 was due primarily to an increase in salary and related expenses attributable to the employment of additional personnel related to the acquisition of Santera completed on June 10, 2003 and the acquisition of Taqua completed on April 8, 2004.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased by \$24.1 million, or 52%, and increased as a percentage of revenues to 40.4% in the six months ended June 30, 2004 from 39.3% in the six months ended June 30, 2003. This increase was due primarily to an increase in salary and related expenses attributable to additional personnel.

Restructuring Charges. In January 2004, we announced a cost reduction initiative that resulted in restructuring charges of \$1.1 million for the six months ended June 30, 2004, including \$874,000 in termination costs, \$50,000 in retention bonuses, and \$129,000 in relocation costs. These charges relate to our implementation of a global strategic manufacturing plan which includes outsourcing a majority of our manufacturing operations and relocating our remaining signaling product manufacturing operations from Calabasas, California to our facilities in Morrisville, North Carolina. Additional restructuring charges are likely to be incurred in the third and fourth quarters of 2004 as a result of these actions and relate to general corporate expenses (See Note E – Restructuring Costs).

Acquired In-Process Research and Development. Acquired in-process research and development expense of \$8.0 million in the first half of 2004 represents the write-off of acquired in-process research and development related to our Taqua acquisition. (See Note B – Acquisition of Taqua, Inc). Acquired in-process research and development expense of \$2.9 million in the first half of 2003 represents the write-off of acquired in-process research and development related to our Santera acquisition. (See Note C – Acquisition of Majority Interest in Santera).

Amortization of Intangible Assets. Amortization of intangible assets increased by approximately \$100,000 to \$941,000, and decreased as a percentage of revenues to 0.5% for the six months ended June 30, 2004 from 0.7% for the six months ended June 30, 2003.

Interest and Other Income (Expense), net. Interest expense decreased by \$2.7 million, or 55%, for the six months ended June 30, 2004 compared to 2003, due primarily to the June 2003 issuance of our new convertible debt which carries a lower interest rate than our former convertible debt. Interest income decreased by approximately \$400,000, or 14.4%, due to lower cash and investment balances in 2004 compared to 2003.

Income Taxes. The income tax provisions for the six months ended June 30, 2004 and 2003 were \$13.2 million and \$2.6 million, respectively, and reflected the effect of non-deductible acquisition-related costs and amortization, partially offset by a benefit of \$1.2 million and \$2.0 million, respectively, from the utilization of deferred tax liabilities related to certain of these acquisition-related costs. Excluding the effect of acquisition-related items and Santera operating results, an estimated effective tax rate of 35% and 34% was applied for the six-month periods ended June 30, 2004 and 2003, respectively, and represented federal, state and foreign taxes on our income, reduced primarily by research and development credits, foreign tax credits and other benefits from foreign sourced income.

Minority Interest. Minority interest represents the losses of Santera allocable to the minority shareholders. See Note C – Acquisition of Majority Interest in Santera. The increase in 2004 represents the full period results of Santera for the six months ended June 30, 2004.

Liquidity and Capital Resources

During the six months ended June 30, 2004, cash and cash equivalents decreased by \$7.3 million to \$37.9 million, due primarily to the cash paid for our acquisition of Taqua offset by net proceeds from the maturity of available-for-sale investments. Operating activities, including the effects of exchange rate changes on cash, provided \$4.0 million. Financing activities provided \$6.5 million, which included proceeds from the issuance of common stock upon the exercise of options and warrants amounting to \$13.4 million, partially offset by \$6.9 million of debt payments. Investing activities used \$17.9 million due primarily to the cash paid for Taqua, net of cash acquired, amounting to \$87.0 million, partially offset by net proceeds from the maturity of available-for-sale investments amounting to \$79.5 million, and capital expenditures of \$10.1 million.

Changes in cash provided by operating activities were comprised mainly of net income adjusted for depreciation and amortization, the minority interest impact of Santera losses, an increase in accounts receivable, an increase in accounts payable and an increase in deferred revenue. Net accounts receivable increased 23.6% due primarily to higher sales volume in the next-generation switching and network signaling product lines. Net accounts payable increased by 103% during the first half of 2004 due primarily to our use of contract vendors associated with outsourcing of a majority of our manufacturing operations. Deferred revenue increased during the six months ended June 30, 2004 due primarily to an increase in transactions pending completion of acceptance or delivery requirements and higher extended warranty service billings, which are deferred and recognized ratably over the warranty period. While Tekelec's core signaling unit continues to generate a positive operating cash flow, cash provided by operating activities decreased \$8.8 million for the first six months of 2004 compared to the first six months of 2003 due primarily to cash used in our next-generation switching operating segment.

In addition to the assets acquired with Taqua, capital expenditures of \$10.1 million during the first six months of 2004 represented the planned addition of equipment and technology.

In the ordinary course of business, we periodically identify and evaluate both domestic and international opportunities, which may include acquisitions of, or strategic investments in, other companies in order to gain access to new technologies and markets. As part of this process, we engage from time to time with other companies and interested parties in discussions concerning possible transactions.

Under appropriate circumstances, we may make strategic acquisitions using our cash, stock or a combination thereof. Depending on the size and terms of any such acquisition, and the nature of the

consideration used, such acquisition may be dilutive to our earnings and our current shareholders' ownership percentage, and/or significantly reduce our cash resources thereby increasing our requirement for additional capital.

We have a \$20.0 million line of credit with a U.S. financial institution. Our \$20.0 million credit facility is collateralized by a stock pledge of our holdings in Santera, bears interest at or, in some cases, below the lender's prime rate (4.25% at June 30, 2004) and expires on August 31, 2004, if not renewed. Under the terms of this credit facility, we are required to maintain certain financial ratios and meet certain net worth and indebtedness covenants. We are in compliance with these covenant requirements as of June 30, 2004. There have been no borrowings under this credit facility. We intend to renew our credit line in August 2004.

As a result of the Santera transaction (see Note C – Acquisition of Majority Interest in Santera), we have two notes payable to U.S. financial institutions with monthly installments of principal and interest. One of the notes has an outstanding balance of \$2.0 million and is collateralized by the assets purchased under the note, bears interest at 10% and matures in February 2005. The second note for \$2.8 million is collateralized by the assets purchased under the note and substantially all of Santera's assets, excluding the assets secured under the \$2.0 million note, bears interest at 6.36% and matures in November 2005. Under the terms of this facility, we are required to maintain certain financial reporting covenants. We are in compliance with these covenant requirements as of June 30, 2004.

As a result of the Taqua transaction (see Note B – Acquisition of Taqua, Inc.), we have a \$1.0 million credit facility with a U.S. financial institution. The \$1.0 million credit facility is collateralized by substantially all assets of Taqua, Inc., bears interest at 1.0% above the lenders prime rate (4.25% at June 30, 2004) and expires in April 2005. Under the terms of this facility, we are required to maintain certain financial ratios and meet certain net worth and indebtedness covenants. Taqua is not in compliance with these requirements and accordingly, there are no outstanding borrowings under this credit facility.

In November 1999, we completed the private placement of \$135.0 million principal amount at maturity of 3.25% convertible subordinated discounted notes due in 2004, issued at 85.35% of their face amount (equivalent to gross proceeds of approximately \$115.2 million at issuance before discounts and expenses). The discounted notes were called and subsequently redeemed in July 2003.

In June 2003, we completed the private placement of \$125.0 million principal amount of 2.25% Senior Subordinated Convertible Notes ("Notes") due in 2008. The Notes are convertible into 50.8906 shares of common stock per \$1,000 principal amount, subject to certain adjustments, on their final maturity. There are no financial covenants related to the notes and there are no restrictions on us paying dividends, incurring debt or issuing or repurchasing securities.

On May 24, 2004, Lucent announced that they had entered into an agreement to acquire Telica for \$295 million. As a result of this transaction, our investment in Telica will be exchanged for registered shares of Lucent. We expect that the transaction will close in late August 2004. We expect to liquidate these shares in the short term.

We expect to absorb losses generated from the next-generation switching operating segment throughout 2004. We believe that existing working capital, funds generated through operations, proceeds from the issuance of stock upon the exercise of options, and our current bank credit facility will be sufficient to satisfy operating requirements for at least the next twelve months. Nonetheless, we may seek additional sources of capital as necessary or appropriate to fund acquisitions or to otherwise finance our growth or operations; however, there can be no assurance that such funds, if needed, will be available on favorable terms, if at all.

“SAFE HARBOR” STATEMENT UNDER THE PRIVATE SECURITIES

LITIGATION REFORM ACT OF 1995

The statements that are not historical facts contained in this Management’s Discussion and Analysis of Financial Condition and Results of Operations and other sections of this Quarterly Report on Form 10-Q are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These statements reflect the current belief, expectations, estimates, forecasts or intent of our management and are subject to, and involve certain risks and uncertainties. As discussed in our Annual Report on Form 10-K for 2003 and other filings with the SEC, our future operating results are difficult to predict and subject to significant fluctuations. Factors that may cause future results to differ materially from the Company’s current expectations include, among others: overall telecommunications spending, changes in general economic conditions, the timing of significant orders and shipments, the lengthy sales cycle for the Company’s products, the timing of the convergence of voice and data networks, the success or failure of strategic alliances or acquisitions including the success or failure of the integration of Santera’s and Taqua’s operations with those of the Company, the ability of carriers to utilize excess capacity of signaling infrastructure and related products in the network, the capital spending patterns of customers, the dependence on wireless customers for a significant percentage and growth of the Company’s revenues, the timely development and introduction of new products and services, product mix, the geographic mix of the Company’s revenues and the associated impact on gross margins, market acceptance of new products and technologies, carrier deployment of intelligent network services, the ability of our customers to obtain financing, the level and timing of research and development expenditures, regulatory changes, and the expansion of the Company’s sales, marketing and support organizations, both domestically and internationally, and other risks described in this Quarterly Report, our Annual Report on Form 10-K for 2003 and in certain of our other Securities and Exchange Commission filings. Many of these risks and uncertainties are outside of our control and are difficult for us to forecast or mitigate. Actual results may differ materially from those expressed or implied in such forward-looking statements. We are not responsible for updating or revising these forward-looking statements. Undue emphasis should not be placed on any forward-looking statements contained herein or made elsewhere by or on behalf of us.

Item 3. *Quantitative and Qualitative Disclosures About Market Risk*

There have been no material changes in our market risks during the six-month period ended June 30, 2004.

We conduct business in a number of foreign countries, with certain transactions denominated in local currencies. In certain instances where we have entered into contracts that are denominated in foreign currencies, we have obtained foreign currency forward contracts, principally denominated in Euros or British Pounds, to offset the impact of currency rates on accounts receivable. These contracts are used to reduce our risk associated with exchange rate movements, as gains and losses on these contracts are intended to offset exchange losses and gains on underlying exposures. Changes in the fair value of these forward contracts are recorded immediately in earnings.

We do not enter into derivative instrument transactions for trading or speculative purposes. The purpose of our foreign currency management policy is to minimize the effect of exchange rate fluctuations on certain foreign denominated anticipated cash flows. The terms of currency instruments used for hedging purposes are consistent with the timing of the transactions being hedged. We may continue to use foreign currency forward contracts to manage foreign currency exchange risks in the future.

Fixed income securities are subject to interest rate risk. The fair value of our investment portfolio would not be significantly impacted by either a 100 basis point increase or decrease in interest rates due mainly to the short-term nature of the major portion of our investment portfolio. The portfolio is diversified and consists primarily of investment grade securities to minimize credit risk.

There have been no borrowings under our variable rate credit facilities. All of our outstanding long-term debt is fixed rate and not subject to interest rate fluctuation. The fair value of the long-term debt will increase or decrease as interest rates decrease or increase, respectively.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15(b) under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer and our Chief Financial Officer, of the effectiveness, as of the end of the fiscal quarter covered by this report, of the design and operation of our “disclosure controls and procedures” as defined in Exchange Act Rule 13a-14 promulgated by the SEC under the Exchange Act. Based upon that evaluation, our President and Chief Executive Officer and our Chief Financial Officer concluded that our disclosure controls and procedures, as of the end of the fiscal quarter, were adequate and effective to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and forms.

(b) Changes in Internal Controls

There have not been any significant changes in our internal controls over financial reporting or in other factors that could significantly affect our internal controls over financial reporting during the most recent fiscal quarter.

PART II – OTHER INFORMATION

Item 1. Legal Proceedings

The Company is a party to various legal proceedings that are discussed in the Company’s Annual Report on Form 10-K for the year ended December 31, 2003 (the “Annual Report”) and are updated with subsequent filings with the SEC. The following information supplements the information concerning the Company’s legal proceedings disclosed in the Annual Report and as updated with subsequent filings:

IEX Corporation vs. Blue Pumpkin Software, Inc.

In January 2001, IEX Corporation, a wholly owned subsidiary of Tekelec (“IEX”), filed suit against Blue Pumpkin Software, Inc., in the United States District Court for the Eastern District of Texas, Sherman Division. In its complaint, IEX asserts that certain of Blue Pumpkin’s products and services infringe United States Patent No. 6,044,355 held by IEX. In the suit, IEX seeks damages and an injunction prohibiting Blue Pumpkin’s further infringement of the patent. In February 2001, Blue Pumpkin responded to IEX’s suit denying that Blue Pumpkin infringes IEX’s patent and asserting that such patent is invalid. Discovery in the case closed in December 2002. Blue Pumpkin filed a motion for summary judgment of non-infringement, and the Court granted that motion. IEX filed a notice of appeal. The parties have completed briefing, and the appeal is now before the Federal Circuit Court of Appeals. No oral argument has been scheduled. Tekelec currently believes that the ultimate outcome of the lawsuit will not have a material adverse effect on its financial position, results of operations or cash flows.

Tekelec v. Telica, Inc.

On August 14, 2003, Tekelec filed a complaint against Telica, Inc. (“Telica”) in the United States District Court for the Central District of California. The complaint alleges that Telica failed and refused to provide to Tekelec certain financial statements, documents and information required to be provided under the Second Amended and Restated Stockholders’ Agreement, dated as of October 4, 2001, as amended by Amendment No. 1 thereto (as so amended, the “Stockholders Agreement”). Tekelec contends, among other things, that Telica’s failure and refusal to deliver the required financial statements, documents and information has injured Tekelec, including by interfering with Tekelec’s ability to monitor its investment in certain preferred stock of Telica, which Tekelec purchased from Telica on December 19, 2001, for approximately \$10 million. In the complaint, Tekelec alleges claims for breach of contract and specific performance and seeks, among other things, compensatory damages, costs, interest and an order and injunction compelling

Telica to deliver all financial statements, documents and information required to be delivered under the Stockholders Agreement. On September 15, 2003, Tekelec filed its First Amended Complaint, adding certain individuals as defendants and adding claims for breach of the implied covenant of good faith and fair dealing and breach of fiduciary duty.

On November 7, 2003, Telica filed a Counterclaim against Tekelec, alleging purported claims for breach of contract, breach of the covenant of good faith and fair dealing, fraud, and intentional interference with prospective economic advantage. Telica contends, among other things, that Tekelec misused certain documents and information purportedly provided by Telica. Telica seeks an unspecified amount of compensatory damages, punitive damages, attorneys' fees, costs and interest. On December 5, 2003, Tekelec filed its Reply to the Counterclaim, denying each and every purported claim therein and asserting various affirmative defenses.

Effective as of June 8, 2004, Tekelec, Telica and the other parties to the action (collectively, the "Parties") agreed to dismiss all claims and counterclaims alleged in the action, under the terms of a written settlement agreement entered into by the Parties. On July 13, 2004, the Parties lodged a Stipulation of Dismissal of All Claims and Counterclaims. On July 26, 2004, the Court ordered the dismissal of the action in its entirety, as stipulated by the Parties.

Item 4. *Submission of Matters to a Vote of Security Holders*

(a) On May 14, 2004, we held our 2004 Annual Meeting of Shareholders (the "Annual Meeting").

(b) At the Annual Meeting, the following persons were elected as directors of Tekelec. The numbers of votes cast for each director, as well as the number of votes withheld, are listed opposite each director's name.

Name of Director	Votes Cast for Director	Votes Withheld
Robert V. Adams	53,059,086	5,301,011
Jean-Claude Asscher	49,670,534	8,689,563
Daniel L. Brenner	47,486,063	10,874,034
Martin A. Kaplan	47,258,717	11,101,380
Frederick M. Lax	48,513,758	9,846,339
Jon F. Rager	46,733,418	11,626,679

(c) At the Annual Meeting, the shareholders did not approve, with 24,590,839 votes cast in favor and 27,105,563 votes cast against, an amendment to the Company's 2003 Stock Option Plan to increase the maximum number of shares of Common Stock authorized for issuance thereunder by 5,000,000 shares. There were 26,548 abstentions and 6,637,147 broker nonvotes with respect to this matter.

(d) At the Annual Meeting, the shareholders approved, with 29,148,256 votes cast in favor and 22,429,845 votes cast against, an amendment to the Company's 2003 Stock Option Plan to authorize the grant thereunder of restricted stock and restricted stock units in addition to incentive and nonstatutory stock options. There were 144,849 abstentions and 6,637,147 broker nonvotes with respect to this matter.

(e) At the Annual Meeting, with 57,605,612 votes cast in favor and 728,160 votes cast against, the shareholders ratified the appointment of PricewaterhouseCoopers LLP as independent accountants of the Company for the year ending December 31, 2004. There were 26,325 abstentions with respect to this matter.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

- 10.1 Amended and Restated Non-Employee Director Stock Option Plan
- 10.2 Tekelec Amended and Restated 2003 Stock Option Plan
- 31.1 Certification of President and Chief Executive Officer of Registrant pursuant to Rule 13a-14(a) under the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Senior Vice President and Chief Financial Officer of Registrant pursuant to Rule 13a-14(a) under the Exchange Act, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of President and Chief Executive Officer and Senior Vice President and Chief Financial Officer of Registrant pursuant to Rule 13a-14(b) under the Exchange Act and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(b) Reports on Form 8-K

(i) On June 22, 2004, Registrant filed a Current Report on Form 8-K with the Commission with respect to pro-forma financials of Taqua, Inc.

(ii) On April 23, 2004, Registrant filed a Current Report on Form 8-K with the Commission with respect to its completion of the acquisition of Taqua, Inc.

(iii) On April 22, 2004, Registrant furnished a Current Report on Form 8-K with the Commission with respect to its issuance of a press release announcing the Registrants 2004 first quarter financial results.

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.

TEKELEC

/s/ FREDERICK M. LAX

Frederick M. Lax
President and Chief Executive Officer
(Duly authorized officer)

/s/ PAUL J. PUCINO

Paul J. Pucino
Senior Vice President and Chief Financial Officer
(Principal financial and chief accounting officer)

August 9, 2004

TEKELEC

AMENDED AND RESTATED
NON-EMPLOYEE DIRECTOR STOCK OPTION PLAN

SECTION I. PURPOSE

The purpose of this Tekelec Amended and Restated Non-Employee Director Stock Option Plan (this "Plan") is to provide an incentive which will motivate and reward "Non-Employee Directors" of the Company and promote the best interests and long-term performance of the Company by encouraging the ownership of the Company's stock by such "Non-Employee Directors." None of the options granted pursuant to this Plan will qualify as an Incentive Stock Option, as defined in Section 422 of the Internal Revenue Code of 1986, as amended (the "Code").

SECTION II. CERTAIN DEFINITIONS

A. "1933 Act" shall mean the Securities Act of 1933, as amended from time to time.

B. "Amendment Effective Date" means May 14, 2004, provided that this Plan is approved by the shareholders of the Company at the 2004 Annual Meeting of Shareholders of the Company on such date. If this Plan is not so approved by the shareholders of the Company, then this Plan will not become effective, the Original Plan shall remain in full force and effect and the Company may continue to make grants pursuant to the terms of the Original Plan.

C. "Annual Meeting of Shareholders" shall mean an Annual Meeting of Shareholders of the Company.

D. "Board" or "Board of Directors" means the Board of Directors of the Company.

E. "Common Stock" means the shares of the Common Stock, without par value, of the Company.

F. "Committee" means the Committee appointed by the Board in accordance with Section X.C. of the Plan, if one is appointed.

G. "Company" means Tekelec, a California corporation, or any successor thereto.

H. "Fair Market Value," as of a given date, means the fair market value of one share of Common Stock, determined as follows:

(i) If the Common Stock is listed on any established stock exchange

or on a national market system, including without limitation the Nasdaq National Market or the Nasdaq SmallCap Market of The Nasdaq Stock Market, the fair market value per share shall be the closing sales price (or the closing bid price, if no sales were reported) on such exchange or system on the

date of grant of the option (or, if the date of grant is not a trading day, on the last trading day preceding the date of grant), as such closing sales price (or closing bid price) is reported in The Wall Street Journal or such other source as the Board deems reliable;

(ii) If the Common Stock is regularly quoted by a recognized securities dealer but sales prices are not reported, the fair market value per share shall be the average of the closing bid and asked prices of the Common Stock on the date of grant (or, if there are no such prices for such date, on the last trading day preceding the date of grant on which there were such reported prices) as reported in The Wall Street Journal or such other source as the Board deems reliable; or

(iii) If there is no public market for the Common Stock, the fair market value per share shall be determined by the Board in good faith.

I. "Non-Employee Director" means a person who is a member of the Board of Directors but who is not an employee of the Company or any subsidiary of the Company.

J. "Original Plan" means the Tekelec Non-Employee Director Stock Option Plan as adopted by the Board on March 19, 2002 and as in effect prior to the amendment and restatement of such plan as evidenced by this Plan.

K. "Participant" means a Non-Employee Director who is granted a stock option hereunder.

L. "Plan" means this Tekelec Amended and Restated Non-Employee Director Stock Option Plan.

SECTION III. EFFECTIVENESS OF PLAN

This Plan shall become effective as of May 14, 2004, subject to the approval of the shareholders of the Company at the Annual Meeting of Shareholders scheduled to be held on May 14, 2004 (the "2004 Annual Meeting"). No options will be granted under this Plan prior to obtaining approval of the shareholders of the Company at the 2004 Annual Meeting. If this Plan is not so approved by the shareholders of the Company at the 2004 Annual Meeting, then (i) this Plan will not become effective for any purpose, and (ii) the Original Plan shall remain in full force and effect and the Company may continue to make grants pursuant to the terms and conditions of the Original Plan.

SECTION IV. STOCK

The maximum aggregate number of shares of Common Stock which may be sold under this Plan is 500,000. If an option expires or is terminated or surrendered without having been fully exercised, the unpurchased shares of Common Stock subject to the option shall again be available for the purposes of this Plan.

SECTION V. ELIGIBILITY

Stock options may be granted under the Plan only to Non-Employee Directors. All options shall be automatically granted in accordance with the terms set forth in Section VI hereof.

SECTION VI. INITIAL GRANTS; ANNUAL GRANTS

A. Initial Grants of Stock Options upon Election for the First Time as a Non-Employee Director. Each Non-Employee Director who is elected or appointed for the first time to the Board, whether through election by the shareholders of the Company or through appointment by the Board, shall automatically be granted, effective as of the date of such election or appointment, an option to purchase that number of shares of Common Stock as is determined in accordance with this Section VI.A.; provided, however, that a director who is an employee of the Company and who ceases to be an employee but remains a director shall not be granted any such options upon such initial change in status. The number of shares subject to the options granted to a Non-Employee Director pursuant to this Section VI.A. who is elected prior to the Amendment Effective Date shall be 10,000 shares. The number of shares subject to the options granted to a Non-Employee Director pursuant to this Section VI.A. who is elected on or after the Amendment Effective Date shall be equal to the sum of 25,000 plus (1) 10,000, if the Non-Employee Director is elected or appointed for the first time on the date of an Annual Meeting of Shareholders of the Company, or (2) if the Non-Employee Director is elected or appointed for the first time on a date other than the date of an Annual Meeting of Shareholders, the product obtained by multiplying 10,000 by a fraction, the numerator of which is equal to 12 minus the number of full months that have elapsed since the most recent Annual Meeting of Shareholders and the denominator of which is 12.

B. Annual Grant of Options upon Re-Election as a Non-Employee Director. Each Non-Employee Director shall automatically be granted an option to purchase 10,000 shares of Common Stock on the date of each Annual Meeting of Shareholders at which the Non-Employee Director is re-elected to the Board of Directors; provided, however, that prior to the Amendment Effective Date, a Non-Employee Director shall be entitled to receive a re-election grant under this Section VI.B. only if he or she has been a director of the Company for at least six months preceding the grant date.

C. Option Exercise Price. The exercise price of the Common Stock subject to all options granted hereunder shall be 100% of the Fair Market Value of the Common Stock on the date of the grant of such options.

D. Term and Vesting of Options.

(a) Each option granted prior to the Amendment Effective Date pursuant to Subsections A or B of this Section VI shall have a term of seven years, subject to earlier termination pursuant to Section VII.B. of this Plan.

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(b) Each option granted on or after the Amendment Effective Date pursuant to Subsection A of this Section VI will vest and become exercisable in eight equal quarterly installments commencing on the last day of the calendar quarter in which the option is granted and continuing on the last day of each of the seven calendar quarters thereafter as long as the optionee continues to serve as a Non-Employee Director on such dates. An option may not be exercised for a fraction of a share.

(c) Each option granted on or after the Amendment Effective Date pursuant to Subsection B of this Section VI will vest and become exercisable in four equal quarterly installments commencing on the last day of the calendar quarter in which the option is granted and continuing on the last day of each of the three calendar quarters thereafter as long as the optionee continues to serve as a Non-Employee Director on such dates; provided, however, that with respect to options granted prior to the Amendment Effective Date and except as provided in Subsection F(a) of this Section VI, no option may be exercised at any time unless the Participant is then a Non-Employee Director and has been so continuously since the granting of the option. An option may not be exercised for a fraction of a share.

(d) For options granted on or after the Amendment Effective Date pursuant to Subsections A or B of this Section VI, each vested installment of options shall expire four years after vesting, subject to earlier termination pursuant to Section VII.B. of this Plan.

E. Non-Transferability of Options. Each option granted under the Plan shall by its terms be non-transferable by the Participant other than by will or the laws of descent and distribution or pursuant to a transfer between spouses incident to a divorce. An option may be exercised, during the lifetime of the Participant, only by the Participant.

F. Termination of Service.

(a) For options granted prior to the Amendment Effective Date, if a Participant voluntarily or involuntarily terminates his or her service as a Non-Employee Director for any reason other than death or Disability, the Participant may exercise the options at any time within 90 days after the date of such termination, but only to the extent that the Participant was entitled to exercise the options on the date of termination. In no event shall such options be exercisable after the expiration of the term of the options, and any options not so exercised shall expire. For options granted prior to the Amendment Effective Date, if a Participant's service as a Non-Employee Director is

terminated by reason of death or Disability, the Participant, or the Participant's personal representative if the Participant has died, may exercise any or all of the Participant's unexercised options which are vested on the date of termination, provided such exercise occurs within 12 months after the date of the Participant's death or termination of service as a result of Disability but not after the expiration of the term of the options.

(b) Options granted on or after the Amendment Effective Date shall not terminate or expire as to unexercised vested installments as a result of a Participant's voluntary or involuntary termination of service as a Non-Employee Director, including as a result of his or her death or Disability. In the event of any such termination, the Participant (or his or her personal representative if the Participant has died) may, at any time through the expiration of the four-year

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exercise period for any installment vested on the date of such termination, exercise the options as to all or part of such vested installment. To the extent that the Participant is not entitled to exercise the options at the date of such termination, or to the extent that vested installments of options at the time of termination of service are not exercised prior to the four-year anniversary of the date on which such installments vested, the options shall terminate. In no event shall any such options be exercisable as to any vested installment after the expiration of the four-year exercise period applicable to such installment.

G. Payment of Option Exercise Price. The exercise price is to be paid in full upon exercise of an option, either (i) in cash, (ii) by check, (iii) by consideration received by the Company under a cashless exercise program acceptable to the Company in connection with the Plan, or (iv) by any combination of the payment methods specified in the foregoing clauses (i), (ii) and (iii).

H. Option Agreements. Options granted prior to the Amendment Effective Date shall be evidenced by a written option agreement in substantially the form of the agreement attached hereto as Attachment I. Options granted on or after the Amendment Effective Date shall be evidenced by a written option agreement in substantially the form of the agreement attached hereto as Attachment II.

I. Pro Rata Allocation. In the event that the options to be granted under the Plan on a specific grant date would exceed the number of shares then available for grant hereunder, the shares available for grant shall be allocated on a pro rata basis among the Non-Employee Directors who are entitled to be granted options on such grant date.

J. Procedure for Exercise. An option shall be deemed to be exercised when written notice of such exercise has been given to the Company in accordance with the terms of the option agreement by the person entitled to exercise the option and full payment for the shares with respect to which the option is exercised has been received by the Company. Full payment may consist of any consideration

and method of payment allowable under Subsection G of this Section VI. Until the issuance (as evidenced by the appropriate entry on the books of the Company or of a duly authorized transfer agent of the Company) of the stock certificate evidencing such shares, no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the shares to be issued upon exercise of the option, notwithstanding the exercise of the option. A share certificate for the number of shares acquired upon exercise of an option shall be issued as soon as administratively practicable after such exercise; provided, however, that if the shares are covered by a registration statement under the 1933 Act or can otherwise be issued without a legend restricting their transfer, the Participant may direct that the shares be issued and delivered by electronic transfer to a securities account maintained in the Participant's name. No adjustment will be made for a dividend or other right for which the record date is prior to the date the stock certificate is issued, except as provided in Section VII of the Plan.

Exercise of an option in any manner shall result in a decrease in the number of shares which thereafter may be available, both for purposes of the Plan and for sale under the option, by the number of shares as to which the option is exercised.

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SECTION VII. ADJUSTMENTS UPON
CHANGES IN CAPITALIZATION, DISSOLUTION,
LIQUIDATION, MERGER OR ASSET SALE

A. Changes in Capitalization. Subject to any required action by the shareholders of the Company, the number of shares covered by each outstanding option, or which have been authorized for issuance under the Plan but as to which no options have yet been granted or which have been returned to the Plan upon cancellation or expiration, as well as the exercise price per share of each such outstanding option, shall be proportionately adjusted for any increase or decrease in the number of issued shares of Common Stock resulting from a stock split, reverse stock split, combination or reclassification or the payment of a stock dividend (but only on the Common Stock) or any other increase or decrease in the number of shares of Common Stock issued without receipt of consideration by the Company; provided, however, that the conversion of any convertible securities of the Company shall not be deemed to have been "effected without receipt of consideration." Such adjustment shall be made by the Board, whose determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issuance by the Company of shares of stock of any class, or securities convertible into or exchangeable for shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of shares subject to an option or the number of shares subject to the Plan. Without limiting the generality of the foregoing, no adjustment shall be made to the number of shares subject to the automatic grant provisions of Section VI of the Plan as a result of any changes in capitalization as described in this Section VII.A.

B. Dissolution, Liquidation, Merger or Asset Sale. In the event of the proposed dissolution or liquidation of the Company, the proposed sale of all or substantially all of the assets of the Company, or the merger, consolidation or reorganization of the Company with or into another corporation as a result of which the Company is not the surviving corporation or as a result of which the outstanding shares of Common Stock are exchanged for or converted into cash or property or securities not of the Company, the Board shall declare that all options outstanding under the Plan shall terminate as of a date fixed by the Board which is at least 30 days after notice thereof is given by the Company to all Participants, unless such 30-day period is waived by all Participants and shall give each Participant the right to exercise his or her option or options granted hereunder as to all or any part of the shares subject thereto, including shares which have not vested at such time, until the date of termination of the options, provided, however, that no options may be exercised after their expiration.

C. No Fractional Shares. No fractional shares of Common Stock shall be issuable on account of any action described in this Section VII, and the aggregate number of shares covered by an option, when changed as the result of such action, shall be reduced to the largest number of whole shares resulting from such action.

SECTION VIII. AMENDMENT OR TERMINATION

A. Amendment or Termination. Unless this Plan shall have been earlier terminated as hereinafter provided, this Plan shall terminate, and no stock option shall be granted hereunder, ten

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years from the date of adoption of the Original Plan by the Board (i.e., on March 19, 2012). The Board of Directors may, at any time prior to the date that is ten years after the adoption of the Original Plan by the Board, (i) terminate this Plan or (ii) make such amendments to or modifications of the Plan as the Board may deem advisable; provided, however, that no amendment authorized by the Board will be effective unless approved by the shareholders of the Company if the amendment would (i) increase the number of shares reserved for issuance under the Plan other than an adjustment under Section VII of the Plan; or (ii) amend or modify the Plan in any other way if such amendment or modification requires approval by the shareholders of the Company in order to comply with the requirements of Rule 16b-3 promulgated under the Securities Exchange Act of 1934, as amended, or any other applicable law, regulation or stock exchange or market system rule or requirement.

B. Effect of Amendment or Termination. Any amendment or termination of the Plan shall not affect any options already granted under the Plan. Such options shall remain in full force and effect as if the Plan had not been so amended or terminated.

SECTION IX. WITHHOLDING

The grant of options hereunder and the issuance of shares pursuant thereto is conditioned upon the Company's reservation of the right to withhold, in accordance with any applicable law and from any compensation payable to a Non-Employee Director, any taxes the Company determines that it is required to withhold under federal, state or local law as a result of such grants or the issuance of shares pursuant thereto. To the extent that such compensation, if any, is insufficient to pay any taxes required to be so withheld, the Company may, in its sole discretion, require a Non-Employee Director, as a condition to the issuance of such shares, to pay in cash to the Company an amount sufficient to cover such tax liability or otherwise to make arrangements satisfactory to the Company to enable the Company to satisfy its withholding obligations under federal, state and local law.

SECTION X. MISCELLANEOUS

A. Rights to Continued Service. Nothing in this Plan or in any option granted pursuant to this Plan shall confer on any individual any right to continue as a Non-Employee Director.

B. Investment Undertakings. Until and unless the issuance of shares of Common Stock pursuant to this Plan shall have been registered pursuant to the 1933 Act and applicable state securities laws, each Participant acquiring shares of Common Stock under this Plan may be required, as a condition precedent to such issuance, to execute and deliver to the Company a letter or certificate containing such investment representations, agreements restricting sale (including, without limitation, provision for stop transfer orders and restrictive legends on stock certificates) and confirmation of other relevant facts to support any exemption from the registration requirements under the 1933 Act and such state securities laws on which the Company intends to rely, all as shall be deemed reasonably necessary by counsel for the Company and in such form as such counsel shall determine.

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C. Administration of the Plan. The Plan shall be administered by the Board. The Board may at any time appoint a Committee consisting of not less than two persons to administer the Plan on behalf of the Board, subject to such terms and conditions as the Board may prescribe. The Board or its Committee shall have the authority to make all determinations deemed necessary or advisable for the administration of the Plan; provided, however, that the Board or its Committee shall have no discretion to determine the selection of persons to whom options will be granted, the frequency of option grants or the number of shares subject to option grants (except in accordance with Section VI.I. hereof), the exercise prices of options, or any other material terms of the options. All decisions and determinations of the Board or its Committee with respect to the Plan shall be final and binding.

D. Reservation of Shares. The Company, during the term of this Plan, shall at all times reserve and keep available such number of shares as shall be

sufficient to satisfy the requirements of this Plan.

SECTION XI. EFFECTIVENESS OF THE ORIGINAL PLAN

Effectiveness of the Original Plan was subject to approval by the shareholders of the Company within 12 months after the date on which the Original Plan was adopted by the Board of Directors; provided, however, that options could be granted pursuant to the Original Plan subject to subsequent approval of the Original Plan by the Company's shareholders. Such approval was given at a regular meeting of the shareholders of the Company or at a special meeting of the shareholders duly called and held for such purpose, or by written consent of the shareholders in accordance with applicable law. Grants of options, if any, made prior to shareholder approval of the Original Plan were made subject to the obtaining of such approval and, if such approval had not been obtained as aforesaid, any such grants would not have been effective for any purpose.

* * *

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ATTACHMENT I

TEKELEC

NON-EMPLOYEE DIRECTOR STOCK OPTION PLAN

STOCK OPTION AGREEMENT

Tekelec, a California corporation (the "Company"), hereby grants to _____ (the "Optionee") an option (the "Option") to purchase a total of _____ (_____) shares of Common Stock (the "Shares") of the Company, at the price set forth herein, and in all respects subject to the terms and provisions of the Company's Non-Employee Director Stock Option Plan (the "Plan"), which terms and provisions are hereby incorporated by reference herein. Unless the context herein otherwise requires, the terms defined in the Plan shall have the same meanings herein.

1. NATURE OF THE OPTION. This Option is intended to be a nonstatutory stock option and is not intended to be an incentive stock option within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or to otherwise qualify for any special tax benefits to the Optionee.

2. DATE OF GRANT; TERM OF OPTION. This Option is granted as of _____, and it may not be exercised later than _____.

3. OPTION EXERCISE PRICE. The Option exercise price is \$ _____ per Share, which price is not less than one hundred percent (100%) of the fair market value thereof on the date this Option is granted.

4. EXERCISE OF OPTION. This Option shall be exercisable during its term only in accordance with the terms and provisions of the Plan and this Option as follows:

(a) RIGHT TO EXERCISE. This Option shall vest and become exercisable, cumulatively, in four (4) equal quarterly installments of _____ (_____) Shares commencing on the last day of the calendar quarter during which this Option is granted, with an additional installment vesting on the last day of each of the three (3) calendar quarters thereafter as long as the Optionee remains a Non-Employee Director.

(b) METHOD OF EXERCISE. This Option shall be exercisable by written notice which shall state the election to exercise this Option, the number of Shares in respect to which this Option is being exercised, and such other representations and agreements as to the Optionee's investment intent with respect to such Shares as may be required by the Company hereunder or pursuant to the provisions of the Plan. Such written notice shall be signed by the Optionee and shall be delivered in person or by certified mail to the Secretary of the Company or such other person as may be designated by the Company. The written notice shall be accompanied by payment of the purchase price and an executed Stock Purchase Agreement if required by the Company.

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Payment of the purchase price shall be by cash, check, the delivery of Shares owned by the Optionee having a fair market value equal to the aggregate purchase price of the Shares being purchased, or any combination of such consideration and methods of payment. The purchase price may also be paid by consideration received by the Company under any cashless exercise program acceptable to the Company in connection with the Plan. The certificate or certificates for the Shares as to which the Option shall be exercised shall be registered in the name of the Optionee and shall be legended as set forth in the Plan, the Stock Purchase Agreement, and/or as required under applicable law.

(c) RESTRICTIONS ON EXERCISE. This Option may not be exercised if the issuance of the Shares upon such exercise would constitute a violation of any applicable federal or state securities laws or other laws or regulations. As a condition to the exercise of this Option, the Company may require the Optionee to make any representation and warranty to the Company as may be required by any applicable law or regulation.

5. TERMINATION OF STATUS AS A NON-EMPLOYEE DIRECTOR.

(a) If the Optionee ceases to serve as a Non-Employee Director for any reason other than death or Disability, the Optionee shall have the right to exercise this Option at any time within 90 days after the date of such termination to the extent that the Optionee was entitled to exercise this Option at the date of such termination. To the extent that the Optionee was not entitled to exercise the Option at the date of termination, or to the extent this Option is not exercised within such 90 day period, this Option shall

terminate. Notwithstanding the foregoing, this Option shall not be exercisable after the expiration of the term set forth in Section 2 hereof.

(b) If the Optionee ceases to serve as a Non-Employee Director due to death or Disability, the Optionee (or the personal representative of the Optionee if the Optionee has died) shall have the right to exercise this Option at any time within 12 months after the date of such termination to the extent that the Optionee was entitled to exercise the Option at the date of such termination. To the extent that the Optionee was not entitled to exercise this Option at the date of termination, or to the extent this Option is not exercised within such 12 month period, this Option shall terminate. Notwithstanding the foregoing, this Option shall not be exercisable after the expiration of the term set forth in Section 2 hereof.

6. NONTRANSFERABILITY OF OPTION. This Option may not be sold, pledged, assigned, hypothecated, gifted, transferred or disposed of in any manner, other than by will or by the laws of descent or distribution or pursuant to a transfer between spouses incident to a divorce. This Option may be exercised during the lifetime of the Optionee only by the Optionee. Subject to the foregoing and the terms of the Plan, the terms of this Option shall be binding upon the executors, administrators, heirs, successors and assigns of the Optionee.

7. CONTINUATION AS A DIRECTOR. This Option shall not confer upon the Optionee any right to continue or be nominated as a director of the Company or any of its subsidiaries or limit in any respect the right of the Company to remove the Optionee as a director of the Company at any time.

8. WITHHOLDING. The Company reserves the right to withhold, in accordance with any applicable laws, from any consideration payable to the Optionee any taxes required to be withheld

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by federal, state or local law as a result of the grant or exercise of this Option or the sale or other disposition of the Shares issued upon exercise of this Option. If the amount of any consideration payable to the Optionee is insufficient to pay such taxes or if no consideration is payable to the Optionee, upon the request of the Company, the Optionee shall pay to the Company an amount sufficient for the Company to satisfy any federal, state or local tax withholding requirements it may incur as a result of the grant or exercise of this Option or the sale or other disposition of the Shares issued upon the exercise of this Option.

9. THE PLAN. This Option is subject to, and the Company and the Optionee agree to be bound by, all of the terms and conditions of the Company's Non-Employee Director Stock Option Plan as such Plan may be amended from time to time in accordance with the terms thereof, provided that no such amendment shall deprive the Optionee, without his or her consent, of this Option or any rights hereunder.

Date: _____

Tekelec

By: _____

Title: _____

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The Optionee acknowledges receipt of a copy of the Tekelec Non-Employee Director Stock Option Plan, a copy of which is attached hereto, and represents that he or she has read and is familiar with the terms and provisions thereof, and hereby accepts this Option subject to all of the terms and provisions thereof. The Optionee hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Board of Directors or its Committee upon any questions arising under the Plan.

Date: _____

Signature of Optionee

Address

City State Zip Code

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ATTACHMENT II

TEKELEC

AMENDED AND RESTATED
NON-EMPLOYEE DIRECTOR STOCK OPTION PLAN

STOCK OPTION AGREEMENT

Tekelec, a California corporation (the "Company"), hereby grants to _____ (the "Optionee") an option (the "Option") to purchase a total of _____ (_____) shares of Common Stock (the "Shares") of the Company, at the price set forth herein, and in all respects subject to the terms and provisions of the Company's Amended and Restated Non-Employee Director Stock Option Plan (the "Plan"), which terms and provisions are hereby incorporated by reference herein. Unless the context herein otherwise requires, the terms defined in the Plan shall have the same meanings herein.

1. NATURE OF THE OPTION. This Option is intended to be a nonstatutory stock option and is not intended to be an incentive stock option within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or to otherwise qualify for any special tax benefits to the Optionee.

2. DATE OF GRANT; TERM OF OPTION. This Option is granted as of _____ . Each installment of this Option shall terminate in accordance with Sections 4(a) and 5 below.

3. OPTION EXERCISE PRICE. The Option exercise price is \$ _____ per Share, which price is not less than one hundred percent (100%) of the fair market value thereof on the date this Option is granted.

4. EXERCISE OF OPTION. This Option shall be exercisable during its term only in accordance with the terms and provisions of the Plan and this Option as follows:

(a) RIGHT TO EXERCISE. This Option shall vest and become exercisable, cumulatively, in _____ (___) equal quarterly installments of _____ (_____) Shares commencing on the last day of the calendar quarter during which this Option is granted, with an additional installment vesting on the last day of each of the _____ (___) calendar quarters thereafter as long as the Optionee remains a Non-Employee Director. Each vested installment of this Option will expire on the four-year anniversary of its vesting date (e.g., the installment vesting on _____ will expire at the close of business on _____).

(b) METHOD OF EXERCISE. This Option shall be exercisable by written notice which shall state the election to exercise this Option, the number of Shares in respect to which

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this Option is being exercised, and such other representations and agreements as to the Optionee's investment intent with respect to such Shares as may be required by the Company hereunder or pursuant to the provisions of the Plan. Such written notice shall be signed by the Optionee and shall be delivered in person or by certified mail to the Secretary of the Company or such other person as may be designated by the Company. The written notice shall be accompanied by payment of the exercise price and an executed Stock Purchase Agreement if required by the Company. Payment of the exercise price shall be by cash, check, the delivery of Shares owned by the Optionee having a fair market value equal to the aggregate exercise price of the Shares being purchased, or any combination of such consideration and methods of payment. The exercise price may also be paid by consideration received by the Company under any cashless exercise program acceptable to the Company in connection with the Plan. The certificate or certificates for the Shares as to which the Option shall be exercised shall be registered in the name of the Optionee and shall be legended as set forth in the Plan, the Stock Purchase Agreement, and/or as required under applicable law.

(c) RESTRICTIONS ON EXERCISE. This Option may not be exercised if the issuance of the Shares upon such exercise would constitute a violation of any applicable federal or state securities laws or other laws or regulations. As a condition to the exercise of this Option, the Company may require the Optionee

to make any representation and warranty to the Company as may be required by any applicable law or regulation.

5. TERMINATION OF STATUS AS A NON-EMPLOYEE DIRECTOR. If the Optionee ceases to serve as a Non-Employee Director for any reason, the Optionee shall have the right, as to all or part of any installment vested on the date of such cessation of service, to exercise this Option at any time prior to the four-year anniversary of the date on which such installment vested. To the extent that the Optionee was not entitled to exercise the Option at the date of such termination, or to the extent that a vested installment of this Option is not exercised prior to the four-year anniversary of the date on which such installment vested, this Option shall terminate.

6. NONTRANSFERABILITY OF OPTION. This Option may not be sold, pledged, assigned, hypothecated, gifted, transferred or disposed of in any manner, other than by will or by the laws of descent or distribution or pursuant to a transfer between spouses incident to a divorce. This Option may be exercised during the lifetime of the Optionee only by the Optionee. Subject to the foregoing and the terms of the Plan, the terms of this Option shall be binding upon the executors, administrators, heirs, successors and assigns of the Optionee.

7. CONTINUATION AS A DIRECTOR. This Option shall not confer upon the Optionee any right to continue or be nominated as a director of the Company or any of its subsidiaries or limit in any respect the right of the Company to remove the Optionee as a director of the Company at any time.

8. WITHHOLDING. The Company reserves the right to withhold, in accordance with any applicable laws, from any consideration payable to the Optionee any taxes required to be withheld by federal, state or local law as a result of the grant or exercise of this Option or the sale or other disposition of the Shares issued upon exercise of this Option. If the amount of any consideration

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payable to the Optionee is insufficient to pay such taxes or if no consideration is payable to the Optionee, upon the request of the Company, the Optionee shall pay to the Company an amount sufficient for the Company to satisfy any federal, state or local tax withholding requirements it may incur as a result of the grant or exercise of this Option or the sale or other disposition of the Shares issued upon the exercise of this Option.

9. THE PLAN. This Option is subject to, and the Company and the Optionee agree to be bound by, all of the terms and conditions of the Company's Amended and Restated Non-Employee Director Stock Option Plan as such Plan may be amended from time to time in accordance with the terms thereof, provided that no such amendment shall deprive the Optionee, without his or her consent, of this Option or any rights hereunder.

Date: _____

Tekelec

By: _____

Title: _____

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The Optionee acknowledges receipt of a copy of the Tekelec Amended and Restated Non-Employee Director Stock Option Plan, a copy of which is attached hereto, and represents that he or she has read and is familiar with the terms and provisions thereof, and hereby accepts this Option subject to all of the terms and provisions thereof. The Optionee hereby agrees to accept as binding, conclusive and final all decisions or interpretations of the Board of Directors or its Committee upon any questions arising under the Plan.

Date: _____

Signature of Optionee

Address

City State Zip Code

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TEKELEC
AMENDED AND RESTATED
2003 STOCK OPTION PLAN

1. ESTABLISHMENT AND PURPOSES OF THE PLAN.

Tekelec hereby establishes this Amended and Restated 2003 Stock Option Plan to promote the interests of the Company and its shareholders by (i) helping to attract and retain the services of selected key employees of the Company who are in a position to make material contributions to the successful operation of the Company's business, (ii) motivating such persons, by means of performance-related incentives, to achieve the Company's business goals and (iii) enabling such persons to participate in the long-term growth and financial success of the Company by providing them with an opportunity to purchase stock of the Company.

2. DEFINITIONS.

The following definitions shall apply throughout the Plan:

- a. "AFFILIATE" shall mean any entity that directly or indirectly through one or more intermediaries controls or is controlled by, or is under common control with, the Company.
- b. "AWARD" shall mean any Option, Restricted Stock Award or Restrict Stock Unit granted pursuant to the provisions of the Plan.
- c. "AWARD AGREEMENT" shall mean any written agreement, contract or other instrument or document, including without limitation an Option Agreement, evidencing and reflecting the terms of any Award granted by the Committee hereunder in such form or forms as the Committee (subject to the terms and conditions of the Plan) may from time to time approve.
- d. "BOARD" shall mean the Board of Directors of the Company.
- e. "CODE" shall mean the Internal Revenue Code of 1986, as amended from time to time. References in the Plan to any section of the Code shall be deemed to include any amendment or successor provisions to such section and any regulations issued under such section.
- f. "COMMON STOCK" shall mean the common stock, without par value, of the Company.
- g. "COMPANY" shall mean Tekelec, a California corporation, any "subsidiary" corporation, whether now or hereafter existing, as defined in Sections 424(f) and (g) of the Code, and any Affiliate, whether now or hereafter existing.
- h. "COMMITTEE" shall mean the committee of the Board appointed in accordance with Section 4(a) of the Plan or, if no such committee shall be appointed or in office, the Board.
- i. "CONTINUOUS STATUS AS AN EMPLOYEE" shall mean the absence of any interruption or termination of employment by the Company. Continuous Status as an Employee shall not be considered interrupted in the case of sick leave, military leave or any other leave of absence approved by the Committee or in the case of transfers between locations of the Company.
- j. "DIVIDEND EQUIVALENT" shall mean any right granted under Section 9(b) of this Plan.
- k. "EMPLOYEE" shall mean any employee of the Company, including officers and directors who are also employees and, for purposes of eligibility for Awards other than Incentive Stock Options, shall mean any consultant to the Company, whether or not employed by the Company.
- l. "EXCHANGE ACT" shall mean the Securities Exchange Act of 1934, as amended.
- m. "FAIR MARKET VALUE" shall mean, with respect to Shares, the fair market value per Share on the date an award is granted (or in connection with the Company's right to repurchase the Shares, the date of termination) as determined by the Board in its sole discretion, exercised in good faith;

provided, however, that where there is a public market for the Common Stock, the fair market value per Share shall be the average of the closing bid and asked prices of the Common Stock on the date of grant (or, if there are no such prices for such date, on the first preceding day on which there were such reported prices) as reported in The Wall Street Journal (or, if not so reported, as otherwise reported by the National Association of Securities Dealers Automated Quotations System) or, in the event the Common Stock is listed on a stock exchange or quoted on the Nasdaq National Market System ("Nasdaq"), the fair market value per Share shall be the closing price on the exchange or on the Nasdaq National Market System on the date of grant of the Award (or, if there are no sales on such date, on the first preceding day on which there were reported sales), as reported in The Wall Street Journal.

n. "INCENTIVE STOCK OPTION" shall mean an Option intended to qualify as an incentive stock option within the meaning of Section 422 of the Code.

o. "NONSTATUTORY STOCK OPTION" shall mean an Option which is not an Incentive Stock Option.

p. "OPTION" shall mean a stock option to purchase Common Stock granted to a Participant pursuant to the Plan.

q. "OPTION AGREEMENT" means a written agreement substantially in the form attached hereto as Exhibit A, or such other form or forms as the Committee (subject to the terms and conditions of the Plan) may from time to time approve, evidencing and reflecting the terms of an Option.

r. "OPTIONED STOCK" shall mean the Common Stock subject to an Option granted pursuant to the Plan.

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s. "ORIGINAL PLAN" shall mean the Tekelec 2003 Stock Option Plan, as amended prior to the amendment and restatement provided for herein.

t. "PARTICIPANT" shall mean any Employee who is granted an Award.

u. "PERMITTED TRANSFEREE" shall have the meaning set forth in Section 10.

v. "PLAN" shall mean this Tekelec Amended and Restated 2003 Stock Option Plan.

w. "RESTRICTED STOCK AWARD" shall mean any Shares granted under Section 8 of this Plan and issued with the restriction that the holder may not sell, transfer, pledge or assign such Shares and with such other vesting and other restrictions as the Committee, in its sole discretion, may impose, which restrictions may lapse separately or in combination at such time or times, in installments or otherwise, as the Committee may deem appropriate.

x. "RESTRICTED STOCK UNIT" shall mean any unit granted under Section 9 of this Plan evidencing the right to receive one Share at some future date.

y. "SECURITIES ACT" shall mean the Securities Act of 1933, as amended.

z. "SHARES" shall mean shares of the Common Stock, any shares into which such Shares may be converted in accordance with Section 11 of the Plan and such other securities or property as may become subject to Awards pursuant to this Plan.

3. SHARES RESERVED.

The maximum aggregate number of Shares reserved for issuance pursuant to the Plan shall be 8,000,000 Shares or the number of shares of stock to which such Shares shall be adjusted as provided in Section 11 of the Plan. Such number of Shares may be set aside out of authorized but unissued Shares not reserved for any other purpose, or out of issued Shares acquired for and held in the treasury of the Company from time to time.

Shares subject to, but not sold or issued under, any Award terminating, expiring, forfeited or canceled for any reason prior to issuance of such Shares shall again become available for Awards thereafter granted under the Plan and the same shall not be deemed an increase in the number of Shares reserved for issuance under the Plan.

4. ADMINISTRATION OF THE PLAN.

a. The Plan shall be administered by a Committee designated by the

Board to administer the Plan and consisting of not less than two directors and subject to such terms and conditions as the Board may prescribe. Members of the Committee who are eligible for Awards or have been granted Awards may vote on any matters affecting the administration of the Plan or the grant of any Awards pursuant to the Plan, except that no such member shall act upon the granting of an Award to himself or herself, but any such member may be counted in determining the existence of a quorum at any meeting of the Committee during which action is taken with respect to

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the granting of Awards to him or her. Each director designated by the Board to administer the Plan shall be a "non-employee director" for purposes of Rule 16b-3 under the Exchange Act and an "outside director" as defined in the Treasury regulations issued pursuant to Section 162(m) of the Code. Members of the Committee shall serve for such period of time as the Board may determine. From time to time the Board may increase the size of the Committee and appoint additional members thereto, remove members (with or without cause) and appoint new members in substitution therefor, fill vacancies however caused or remove all members of the Committee and thereafter directly administer the Plan.

b. Subject to the provisions of the Plan, the Committee shall have the authority in its sole discretion to: (i) determine the type or types of Awards (i.e., Incentive Stock Options, Nonstatutory Stock Options, Restricted Stock Awards or Restricted Stock Units) to be granted to each Participant in the Plan, (ii) determine the Fair Market Value per Share in accordance with the terms of the Plan, (iii) determine the exercise price of Options to be granted to Employees in accordance with the terms of the Plan, (iv) determine the Employees to whom, and the time or times at which, Awards shall be granted and the number of Shares subject to each Award, (v) prescribe, amend and rescind rules and regulations relating to the Plan, subject to the limitations set forth in Section 13 of the Plan, (vi) determine the terms and provisions of each Award granted to Participants under the Plan and each Award Agreement (which need not be identical with the terms of other Awards and Award Agreements) and, with the consent of the Participant, to modify or amend an outstanding Award Agreement; provided, however, that the Committee shall not have the authority to amend or adjust the exercise price of any Options previously granted to a Participant under the Plan, whether through amendment, cancellation, replacement grant or otherwise, without the approval of the shareholders of the Company obtained in the manner provided in Section 12 of the Plan, (vii) accelerate the exercise date of any Option or the vesting of any Restricted Stock Award or Restricted Stock Unit, (viii) determine whether any Participant will be required to execute a stock purchase agreement or other agreement as a condition to the issuance of Shares pursuant to an Award, and to determine the terms and provisions of any such agreement (which need not be identical with the terms of any other such agreement) and, with the consent of the Participant, to amend any such agreement, (ix) interpret the Plan or any agreement entered into with respect to the grant of Awards and the issuance of Shares upon exercise of Options or the vesting of Restricted Stock Units, (x) determine the eligibility of an Employee for benefits hereunder and the amount thereof, (xi) authorize any person to execute on behalf of the Company any instrument required to effectuate the grant of an Award previously granted or to take such other actions as may be necessary or appropriate with respect to the Company's rights pursuant to Awards or agreements relating to the grant or exercise thereof and (xii) make such other determinations and establish such other procedures as it deems necessary or advisable for the administration of the Plan.

c. All decisions, determinations and interpretations of the Committee shall be final and binding on all Participants and any other holders of any Awards granted under the Plan.

d. The Committee shall keep minutes of its meetings and of the actions taken by it without a meeting. A majority of the Committee shall constitute a quorum and the actions of a majority at a meeting, including a telephone meeting, at which a quorum is present or acts approved

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in writing by a majority of the members of the Committee without a meeting shall constitute acts of the Committee.

e. The Company shall pay all original issue and transfer taxes with respect to the grant of Awards and/or the issue and transfer of Shares pursuant to the exercise of Options or the vesting of Restricted Stock Awards or Restricted Stock Units and all other fees and expenses necessarily incurred by the Company in connection therewith; provided, however, that the person exercising an Option or to whom an Award is granted or to whom Shares are

otherwise issued pursuant to the Plan shall be responsible for all payroll, withholding, income and other taxes incurred by such person on the date of exercise of the Option or of issuance or vesting of Shares, as applicable.

5. ELIGIBILITY.

Awards may be granted under the Plan only to Employees; provided, however, that consultants shall not be eligible to receive Incentive Stock Options. An Employee who has been granted Awards may, if he or she is otherwise eligible, be granted additional Awards.

6. TERMS AND CONDITIONS OF OPTIONS.

Options granted pursuant to the Plan by the Committee shall be either Incentive Stock Options or Nonstatutory Stock Options and shall be evidenced by an Option Agreement providing, in addition to such other terms as the Board may deem advisable, the following terms and conditions:

a. Time of Granting Options. The date of grant of an Option shall for all purposes be the date on which the Committee makes the determination granting such Option; provided, however, that if the Committee determines that such grant shall be made as of some future date, the date of grant shall be such future date. Notice of the determination shall be given to each Optionee within a reasonable time after the date of such grant.

b. Number of Shares. Each Option Agreement shall state the number of Shares to which it pertains and whether such Option is intended to constitute an Incentive Stock Option or a Nonstatutory Stock Option. The maximum number of Shares which may be awarded as Options under the Plan during any calendar year to any Optionee is 1,000,000 (as may be adjusted pursuant to Section 11 herein) Shares. If an Option held by an Employee or consultant of the Company is canceled, the canceled Option shall continue to be counted against the maximum number of Shares for which Options may be granted to such Employee or consultant and any replacement Option granted to such Employee or consultant shall also count against such limit.

c. Exercise Price. The exercise price per Share for the Shares to be issued pursuant to the exercise of an Option shall be such price as is determined by the Board; provided, however, that such price shall in no event be less than 100% of the Fair Market Value per Share on the date of grant of an Option.

In the case of any Option granted to an Employee who at the time of grant owns or is deemed to own (by reason of the attribution rules applicable under Section 424(d) of the Code or

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otherwise) stock possessing more than ten percent of the total combined voting power of all classes of stock of the Company or any parent or subsidiary corporations of the Company, the exercise price per Share shall be no less than 110% of the Fair Market Value per Share on the date of grant.

d. Medium and Time of Payment. The consideration to be paid for the Shares to be issued upon exercise of an Option shall consist entirely of cash or check payable to the Company or such other consideration and method of payment permitted under any laws to which the Company is subject and which is approved by the Committee, including without limitation (i) by delivery of a promissory note, (ii) by tendering previously acquired Shares (valued at Fair Market Value as of the date of tender) that have been owned for a period of at least six months (or such other period as is necessary to avoid accounting charges against the Company's earnings), (iii) if Shares are traded on a national securities exchange or Nasdaq, through the delivery of irrevocable instructions to a broker to deliver promptly to the Company an amount equal to the exercise price, or (iv) any combination of (i), (ii) and (iii). In connection with all exercises of Options and regardless of the medium of payment, the Optionee shall pay in cash any amount necessary to satisfy the Company's withholding obligations.

e. Term of Options. The term of each Option may be up to ten years from the date of grant thereof; provided, however, that the term of an Incentive Stock Option granted to an Employee who, at the time the Incentive Stock Option is granted, owns or is deemed to own (by reason of the attribution rules of Section 424(d) of the Code) stock possessing more than ten percent of the total combined voting power of all classes of stock of the Company, shall be five years from the date of grant thereof or such shorter term as may be provided in the Option Agreement.

The term of any Option may be less than the maximum term provided for herein as specified by the Committee upon grant of the Option and as set forth in the Option Agreement.

f. Maximum Amount of Incentive Stock Options. To the extent that the aggregate Fair Market Value (determined at the time an Incentive Stock Option is granted) of the Shares with respect to which Incentive Stock Options are exercisable for the first time by an Optionee during any calendar year under all incentive stock option plans of the Company exceeds \$100,000, the Options in excess of such limit shall be treated as Nonstatutory Stock Options.

7. EXERCISE OF OPTION.

A. In General. Any Option granted hereunder to an Employee shall be exercisable at such times and under such conditions as may be determined by the Committee and as shall be permissible under the terms of the Plan, including any performance criteria with respect to the Company and/or the Optionee as may be determined by the Committee.

An Option may be exercised in accordance with the provisions of the Plan as to all or any portion of the Shares then exercisable thereunder from time to time during the term of the Option. However, an Option may not be exercised for a fraction of a Share.

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b. Procedure. An Option shall be deemed to be exercised when written notice of such exercise has been given to the Company at its principal business office in accordance with the terms of the Option Agreement by the person entitled to exercise the Option and full payment for the Shares with respect to which the Option is exercised has been received by the Company, together with (i) any other agreements required by the terms of the Plan and/or Option Agreement or as required by the Committee and (ii) payment by the Optionee of all payroll, withholding or income taxes incurred in connection with such Option exercise (or arrangements for the collection or payment of such tax satisfactory to the Board are made).

c. Decrease in Available Shares. Exercise of an Option in any manner shall result in a decrease in the number of Shares which thereafter may be available, both for purposes of the Plan and for sale under the Option, by the number of Shares as to which the Option is exercised, except if the Option is exercised by tendering Shares, either actually or by attestation.

d. Exercise of Shareholder Rights. Until the Option is properly exercised in accordance with the terms of this Section 7, no right to vote or receive dividends or any other rights as a shareholder shall exist with respect to the Optioned Stock. No adjustment shall be made for a dividend or other right for which the record date is prior to the date the Option is exercised.

e. Termination of Eligibility. If an Optionee ceases to serve as an Employee for any reason other than death or permanent and total disability (within the meaning of Section 22(e) (3) of the Code) and thereby terminates his or her Continuous Status as an Employee, he or she may, but only within 90 days following the date he or she ceases his or her Continuous Status as an Employee (subject to any earlier termination of the Option as provided by its terms), exercise his or her Option to the extent that he or she was entitled to exercise it at the date of such termination. To the extent that he or she was not entitled to exercise the Option at the date of such termination, or if he or she does not exercise such Option (which he or she was entitled to exercise) within the time specified herein, the Option shall terminate. Notwithstanding anything to the contrary herein, the Committee may at any time and from time to time prior to the termination of a Nonstatutory Stock Option, with the consent of the Optionee, extend the period of time during which the Optionee may exercise his or her Nonstatutory Stock Option following the date he or she ceases his or her Continuous Status as an Employee; provided, however, that the maximum period of time during which a Nonstatutory Stock Option shall be exercisable following the date on which an Optionee terminates his or her Continuous Status as an Employee shall not exceed the original term of such Option as set forth in the Option Agreement and that notwithstanding any extension of time during which a Nonstatutory Stock Option may be exercised, such Option, unless otherwise amended by the Committee, shall only be exercisable to the extent the Optionee was entitled to exercise the Option on the date he or she ceased his or her Continuous Status as an Employee.

f. Death or Disability of Optionee. If an Optionee's Continuous Status as an Employee ceases due to death or permanent and total disability (within the meaning of Section 22(e) (3) of the Code) of the Optionee, the Option may be

exercised within 180 days (or such other period of time not exceeding one year as is determined by the Committee at the time of granting the Option) following the date of death or termination of employment due to permanent or total disability (subject to any earlier termination of the Option as provided by its terms), by the

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Optionee in the case of permanent or total disability, or in the case of death by the Optionee's estate or by a person who acquired the right to exercise the Option by bequest or inheritance, but in any case (unless otherwise determined by the Committee at the time of granting the Option) only to the extent the Optionee was entitled to exercise the Option at the date of his or her termination of employment by death or permanent and total disability. To the extent that he or she was not entitled to exercise such Option at the date of his or her termination of employment by death or permanent and total disability, or if he or she does not exercise such Option (which he or she was entitled to exercise) within the time specified herein, the Option shall terminate. Notwithstanding anything to the contrary herein, the Committee may at any time and from time to time prior to the termination of a Nonstatutory Stock Option, with the consent of the Optionee, extend the period of time during which the Optionee may exercise his or her Nonstatutory Stock Option following the date he or she ceases his or her Continuous Status as an Employee; provided, however, that the maximum period of time during which a Nonstatutory Stock Option shall be exercisable following the date on which an Optionee terminates his or her Continuous Status as an Employee shall not exceed the original term of such Option as set forth in the Option Agreement and that notwithstanding any extension of time during which a Nonstatutory Stock Option may be exercised, such Option, unless otherwise amended by the Committee, shall only be exercisable to the extent the Optionee was entitled to exercise the Option on the date he or she ceased his or her Continuous Status as an Employee.

g. Expiration of Option. Notwithstanding any provision in the Plan, including but not limited to the provisions set forth in Sections 7(e) and 7(f), an Option may not be exercised, under any circumstances, after the expiration of its term.

h. Conditions on Exercise and Issuance. As soon as practicable after any proper exercise of an Option in accordance with the provisions of the Plan, the Company shall (i) deliver to the Optionee at the principal executive office of the Company or such other place as shall be mutually agreed upon between the Company and the Optionee, a certificate or certificates representing the Shares for which the Option shall have been exercised or (ii) otherwise arrange for such Shares to be issued to the Optionee. The time of issuance and, if applicable, delivery of the certificate or certificates representing the Shares for which the Option shall have been exercised may be postponed by the Company for such period as may be required by the Company, with reasonable diligence, to comply with any law or regulation applicable to the issuance or delivery of such Shares.

Options granted under the Plan are conditioned upon the Company obtaining any required permit or order from the appropriate governmental agencies authorizing the Company to issue such Options and Shares issuable upon exercise thereof. Shares shall not be issued pursuant to the exercise of an Option unless the exercise of such Option and the issuance and delivery of such Shares pursuant thereto shall comply with all relevant provisions of law, including, without limitation, the Securities Act, the Exchange Act, applicable state law, the rules and regulations promulgated thereunder and the requirements of any stock exchange upon which the Shares may then be listed. Any such issuance may be further subject to the approval of counsel for the Company with respect to such compliance.

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8. TERMS AND CONDITIONS OF RESTRICTED STOCK AWARDS.

a. Grant. Restricted Stock Awards may be granted hereunder by the Committee to Employees either alone or in addition to other Awards granted under the Plan. A Restricted Stock Award shall be subject to such terms and conditions as may be determined by the Committee and may be subject to vesting conditioned upon the satisfaction of such requirements, conditions (such as a condition that the Participant's right to the Shares shall vest in installments over a period of time during which services are to be provided to the Company by the Employee), restrictions or performance criteria as shall be established by the Committee and set forth in the Award Agreement. During any period during which Shares acquired pursuant to a Restricted Stock Award are subject to vesting conditions, such Shares may not be sold, exchanged, transferred, pledged,

assigned or otherwise disposed of by the Participant. The provisions of Restricted Stock Awards need not be the same with respect to each Participant receiving such awards. The Committee has absolute discretion to determine whether any consideration is to be received by the Company as a condition precedent to the issuance of Restricted Stock Awards. The terms of any Restricted Stock Award granted under this Plan shall be set forth in a written Award Agreement which shall contain provisions determined by the Committee which are not inconsistent with the Plan.

b. Rights of Holders of Restricted Stock. Beginning on the date of grant of a Restricted Stock Award and subject to execution of the Award Agreement, the Participant shall become a shareholder of the Company with respect to all Shares subject to the Restricted Stock Award and shall have all of the rights of a shareholder, including the right to vote the Shares subject to the Restricted Stock Award and the right to receive distributions made with respect to such Shares; provided, however, that any Shares or any other property (other than cash) distributed as a dividend or otherwise with respect to any such Shares as to which the restrictions have not yet lapsed shall be subject to the same restrictions as the Shares subject to the Restricted Stock Award.

c. Delivery of Shares. Shares issued upon the grant of Restricted Stock Awards shall, unless otherwise determined by the Committee, be maintained in the custody of or on behalf of the Company until all applicable vesting conditions have been satisfied. Shares subject to Restricted Stock Awards that are no longer subject to restrictions shall be delivered to the Participant promptly after the applicable restrictions lapse or are waived.

d. Termination of Continuous Status as an Employee. Unless otherwise determined by the Committee or unless otherwise provided in the Award Agreement evidencing the Award, in the event of the termination of a Participant's Continuous Status as an Employee, Shares which are subject to a Participant's Restricted Stock Award which are not vested as of the date of such termination shall be automatically forfeited by the Participant and cancelled by the Company for no value.

e. Waiver of Forfeiture. The Committee may, when it finds that a waiver would be in the best interests of the Company and subject to such terms and conditions as the Committee shall deem appropriate, waive in whole or in part any remaining vesting restrictions with respect to any Restricted Stock Award or any other conditions set forth in any Award Agreement.

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9. TERMS AND CONDITIONS OF RESTRICTED STOCK UNITS.

a. Grant. Restricted Stock Units may be issued hereunder to Employees either alone or in addition to other Awards granted under the Plan. A Restricted Stock Unit is a bookkeeping entry that represents the right to receive one Share to be issued and delivered at the end of the applicable vesting period, subject to a risk of cancellation and to the other terms and conditions set forth in the Plan and in any Award Agreement evidencing the Restricted Stock Unit and subject to any additional terms and conditions established by the Committee. The Company shall establish and maintain accounts for Participants in which the Company shall record Restricted Stock Units and the transactions and events affecting such units. Restricted Stock Units and other items reflected in the account will represent only bookkeeping entries by the Company to evidence the Company's unfunded obligations. The provisions of Restricted Stock Units need not be the same with respect to each Participant receiving such Awards. The Committee has absolute discretion to determine whether any consideration is to be received by the Company as a condition precedent to the grant of a Restricted Stock Unit. The terms of any Restricted Stock Unit granted under this Plan shall be set forth in a written Award Agreement which shall contain provisions determined by the Committee which are not inconsistent with the Plan.

b. Rights of Holders of Restricted Stock Units; Dividend Equivalents. Unless the Committee otherwise provides in an Award Agreement for Restricted Stock Units, any Participant holding Restricted Stock Units shall have no rights as a shareholder of the Company with respect to such Restricted Stock Units. The Committee shall be authorized to establish procedures pursuant to which the Company's payment of any Restricted Stock Unit may be deferred. Subject to the provisions of the Plan and any Award Agreement, the recipient of a Restricted Stock Unit may, if so determined by the Committee, be entitled to receive, currently or on a deferred basis and with respect to the number of Shares covered by the Award, payments ("Dividend Equivalents") in amounts equivalent to cash, stock or other property paid by the Company as dividends on the Company's Common Stock prior to the vesting of the Restricted Stock Units.

c. Delivery of Shares in Settlement of Restricted Stock Units.

Restricted Stock Units (if not previously cancelled) will be automatically settled on or about the vesting date or dates set forth in the Award Agreement evidencing the Award. The Company may make delivery of Shares in settlement of Restricted Stock Units by either delivering one or more stock certificates representing such Shares to the Participant, registered in the name of the Participant, or by depositing such Shares into an account maintained for the Participant and established in connection with any Company plan or arrangement providing for investment in Common Stock of the Company.

d. Termination of Continuous Status as an Employee. Unless otherwise determined by the Committee or unless otherwise provided in the Award Agreement evidencing the Award, in the event of the termination of a Participant's Continuous Status as an Employee, the Participant's Restricted Stock Units which are not vested as of the date of such termination shall not vest and shall automatically be cancelled for no value and without issuance of any Shares.

e. Waiver of Forfeiture. The Committee may, when it finds that a waiver would be in the best interests of the Company and subject to such terms and conditions as the Committee shall

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deem appropriate, waive in whole or in part any remaining vesting restrictions with respect to any Restricted Stock Units or any other conditions set forth in any Award Agreement.

10. NONTRANSFERABILITY OF AWARDS.

No Awards granted under the Plan, and no Shares subject to any such Awards, that have not been issued or as to which any applicable vesting restriction, performance or deferral period has not lapsed, may be sold, pledged, assigned, hypothecated, gifted, transferred or disposed of in any manner, either voluntarily or involuntarily by operation of law, other than by will or by the laws of descent or distribution or transfers between spouses incident to a divorce. Options may be exercised during the life of the Optionee only by the Optionee or the Optionee's guardian or legal representative. Notwithstanding the foregoing, a Participant may assign or transfer an Award with the consent of the Committee (each transferee thereof, a "Permitted Transferee"), which consent may be granted or withheld in the Committee's sole discretion, provided that such Permitted Transferee shall be bound by and subject to all of the terms and conditions of the Plan and the Award Agreement relating to the transferred Award and shall execute an agreement satisfactory to the Company evidencing such obligations; and, provided further, that such Participant shall remain bound by the terms and conditions of the Plan. The Company shall cooperate with any Permitted Transferee and the Company's transfer agent in effectuating any transfer permitted under this Section 10.

11. ADJUSTMENT UPON CHANGE IN CORPORATE STRUCTURE.

a. Subject to any required action by the shareholders of the Company, the number and type of Shares covered by each outstanding Award, and the number and type of Shares which have been authorized for issuance under the Plan but as to which no Awards have yet been granted or which have been returned to the Plan upon cancellation, expiration or forfeiture of an Award, as well as the exercise or purchase price per Share, as applicable, covered by outstanding Awards, shall be proportionately adjusted for any increase or decrease in the number of issued Shares resulting from a stock split, reverse stock split or combination or the payment of a stock dividend (but only on the Common Stock) or reclassification of the Common Stock or any other increase or decrease in the number of issued Shares effected without receipt of consideration by the Company (other than stock awards to Employees); provided, however, that the conversion of any convertible securities of the Company shall not be deemed to have been effected without the receipt of consideration. Any such adjustment shall be determined in good faith by the Committee to be appropriate in order to prevent dilution or enlargement of the benefits or potential benefits intended to be made available under the Plan, and the Committee's determination in that respect shall be final, binding and conclusive. Except as expressly provided herein, no issue by the Company of shares of stock of any class, or securities convertible into shares of stock of any class, shall affect, and no adjustment by reason thereof shall be made with respect to, the number or price of Shares subject to the Plan or an Award.

b. In the event of the proposed dissolution or liquidation of the Company, or in the event of a proposed sale of all or substantially all of the assets of the Company (other than in the ordinary course of business), or the merger or consolidation of the Company with or into another

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corporation, as a result of which the Company is not the surviving and controlling corporation, the Board shall (i) make provision for the assumption of outstanding Awards by the successor corporation, (ii) declare that any Option shall terminate as of a date fixed by the Board which is at least 30 days after the notice thereof to the Optionee and shall give each Optionee the right to exercise his or her Option as to all or any part of the Optioned Stock, including Shares as to which the Option would not otherwise be exercisable provided such exercise does not violate Section 7(h) of the Plan, (iii) accelerate the vesting of Restricted Stock Awards and Restricted Stock Units, or (iv) cause any Award outstanding as of the effective date of any such event to be cancelled in consideration of a cash payment or grant of an alternative option or award (whether by the Company or any entity that is a party to the transaction), or a combination thereof, to the holder of the cancelled Award, provided that such payment and/or grant are substantially equivalent in value to the fair market value of the cancelled Award as determined by the Committee.

c. No fractional shares of Common Stock shall be issuable on account of any action aforesaid, and the aggregate number of shares into which Shares then covered by an Award, when changed as the result of such action, shall be reduced to the largest number of whole shares resulting from such action, unless the Board, in its sole discretion, shall determine to issue scrip certificates in respect to any fractional shares, which scrip certificates shall be in a form and have such terms and conditions as the Board in its discretion shall prescribe.

12. SHAREHOLDER APPROVAL.

Effectiveness of the Plan shall be subject to approval by the shareholders of the Company within 12 months before or after the date the Plan is adopted by the Board; provided, however, that Options may be granted pursuant to the Plan subject to subsequent approval of the Plan by such shareholders. Any Option exercised before shareholder approval is obtained must be rescinded if shareholder approval is not obtained within 12 months before or after the Plan is adopted. Such shares shall not be counted in determining whether such approval is obtained. Shareholder approval shall be obtained (i) by the affirmative vote of the holders of a majority of the Shares present or represented and entitled to vote thereon at a meeting of shareholders duly held in accordance with the laws of the State of California or (ii) by written consent of the holders of the outstanding Shares having not less than the minimum number of votes that would be necessary to authorize the approval at a meeting of the shareholders duly held in accordance with the laws of the State of California.

13. AMENDMENT AND TERMINATION OF THE PLAN.

a. Amendment and Termination. The Board may amend or terminate the Plan from time to time in such respects as the Board may deem advisable, subject to any requirement for shareholder approval imposed by applicable law, including the rules and regulations of The Nasdaq Stock Market or any stock exchange on which Shares are listed or quoted, and shall make any amendments which may be required so that Options intended to be Incentive Stock Options shall at all times continue to be Incentive Stock Options for the purpose of Section 422 of the Code; provided, however, that without approval of the Company's shareholders, no such revision or amendment shall (i) materially increase the benefits accruing to participants under the Plan;

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(ii) increase the number of Shares which may be issued under the Plan, other than in connection with an adjustment under Section 11 of the Plan; (iii) materially modify the requirements as to eligibility for participation in the Plan; (iv) materially change the designation of the class of Employees eligible to be granted Awards; (v) remove the administration of the Plan from the Board or its Committee; or (vi) extend the term of the Plan beyond the maximum term set forth in Section 16 hereunder.

b. Effect of Amendment or Termination. Except as otherwise provided in Section 11 of the Plan, any amendment or termination of the Plan shall not affect Awards already granted, and such Awards shall remain in full force and effect as if the Plan had not been amended or terminated, unless mutually agreed otherwise between the Participant and the Company, which agreement must be in writing and signed by the Participant and the Company. Notwithstanding anything to the contrary herein, this Plan shall not adversely affect, unless mutually agreed in writing by the Company and a Participant, the terms and provisions of any Award granted prior to the date the Plan was approved by shareholders as provided in Section 12 of the Plan.

14. INDEMNIFICATION.

No member of the Board or its Committee shall be liable for any act or action taken, whether of commission or omission, except in circumstances involving willful misconduct, or for any act or action taken, whether of commission or omission, by any other member or by any officer, agent or Employee. In addition to such other rights of indemnification they may have as members of the Board, or as members of the Committee, the Board and the Committee shall be indemnified by the Company against reasonable expenses, including attorneys' fees actually and necessarily incurred in connection with the defense of any action, suit or proceeding, or in connection with any appeal therein, to which they or any of them may be a party by reason of any action taken, by commission or omission, in connection with the Plan or any Award granted thereunder, and against all amounts paid by them in settlement thereof (provided such settlement is approved by independent legal counsel selected by the Company) or paid by them in satisfaction of a judgment in any action, suit or proceeding, except in relation to matters as to which it shall be adjudged in such action, suit or proceeding that a Board or Committee member is liable for willful misconduct in the performance of his or her duties; provided that within 60 days after institution of any such action, suit or proceeding, such Board or Committee member shall in writing have offered the Company the opportunity, at its own expense, to handle and defend the same.

15. GENERAL PROVISIONS.

a. Withholding or Deduction for Taxes. The grant of Awards hereunder and the issuance of Shares and all payments and distributions pursuant to this Plan are conditioned upon the Company's reservation of the right to withhold, in accordance with any applicable law, from any compensation or other amounts payable to the Participant, any taxes required to be withheld under Federal, state or local law as a result of the: (i) grant of any Award, (ii) exercise of any Option, (iii) sale of Shares issued upon exercise of Options, (iv) delivery of Shares, cash or other property, (v) lapse of restrictions in connection with any Award, or (vi) any other event occurring pursuant to the Plan. To the extent that compensation and other amounts, if any, payable to the Participant are

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insufficient to pay any taxes required to be so withheld, the Company may, in its sole discretion, require the Participant, including without limitation, as a condition of the exercise of any Option, to pay in cash to the Company an amount sufficient to cover such tax liability or otherwise to make adequate provision for the delivery to the Company of cash necessary to satisfy the Company's withholding obligations under Federal and state law. The Committee shall be authorized to establish procedures for election by Participants to satisfy such obligations for the payment of such taxes by tendering previously acquired Shares (either actually or by attestation, valued at their then Fair Market Value) that have been owned for a period of at least six months (or such other period as may be necessary to avoid accounting charges against the Company's earnings), or by directing the Company to retain Shares (up to the Participant's minimum required tax withholding rate) otherwise deliverable in connection with the Award.

b. Other Plans. Nothing contained in the Plan shall prohibit the Company from establishing additional incentive compensation arrangements.

c. No Enlargement of Rights. Neither the Plan, nor the granting of Awards, nor any other action taken pursuant to the Plan shall constitute or be evidence of any agreement or understanding, express or implied, that the Company will retain an Employee for any period of time, or at any particular rate of compensation. Nothing in the Plan shall be deemed to limit or affect the right of the Company to discharge any Employee at any time for any reason or no reason.

No Employee shall have any right to or interest in Awards authorized hereunder prior to the grant thereof to such eligible person, and upon such grant he or she shall have only such rights and interests as are expressly provided herein and in the related Award Agreement, subject, however, to all applicable provisions of the Company's Articles of Incorporation, as the same may be amended from time to time.

d. Notice. Any notice to be given to the Company pursuant to the provisions of the Plan shall be addressed to the Company in care of its Secretary (or such other person as the Company may designate from time to time) at its principal office, and any notice to be given to a Participant to whom an Award is granted hereunder shall be delivered personally or addressed to him or her at the address given beneath his or her signature on his or her Award Agreement, or at such other address as such Participant or his or her transferee

(upon any permitted transfer) may hereafter designate in writing to the Company. Any such notice shall be deemed duly given when enclosed in a properly sealed envelope or wrapper addressed as aforesaid, registered or certified, and deposited, postage and registry or certification fee prepaid, in a post office or branch post office regularly maintained by the United States Postal Service. It shall be the obligation of each Participant holding Shares purchased upon exercise of an Option or otherwise issued pursuant to Awards hereunder to provide the Secretary of the Company, by letter mailed as provided hereinabove, with written notice of his or her direct mailing address.

e. Applicable Law. To the extent that Federal laws do not otherwise control, the Plan shall be governed by and construed in accordance with the laws of the State of California, without regard to the conflict of laws rules thereof.

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f. Incentive Stock Options. The Company shall not be liable to an Optionee or other person if it is determined for any reason by the Internal Revenue Service or any court having jurisdiction that any Incentive Stock Options are not incentive stock options as defined in Section 422 of the Code.

g. Information to Participants. The Company shall provide without charge to each Participant copies of its annual financial statements (which need not be audited), which may be included within such annual and periodic reports as are provided by the Company to its shareholders generally.

h. Availability of Plan. A copy of the Plan shall be delivered to the Secretary of the Company and shall be shown by him or her to any eligible person making reasonable inquiry concerning it.

i. Severability. In the event that any provision of the Plan is found to be invalid or otherwise unenforceable under any applicable law, such invalidity or unenforceability shall not be construed as rendering any other provisions contained herein as invalid or unenforceable, and all such other provisions shall be given full force and effect to the same extent as though the invalid or unenforceable provision was not contained herein.

j. Form of Shares and Restricted Stock Awards; Stop Transfer Orders. Shares issued or delivered under the Plan, including Shares subject to any Restricted Stock Award, may be evidenced in such manner as the Committee in its sole discretion shall deem appropriate, including, without limitation, book-entry registration or issuance of a stock certificate or certificates. In the event any stock certificate is issued in respect of a Restricted Stock Award, such certificate shall bear an appropriate legend referring to the terms, conditions and restrictions applicable to such Award. All certificates for Shares delivered under the Plan pursuant to any Award shall be subject to such stop transfer orders and other restrictions as the Committee may deem advisable under the rules, regulations and other requirements of the Securities and Exchange Commission, any stock exchange or quotation system upon which the Shares are then listed or quoted, and any applicable federal or state securities law, and the Committee may cause a legend or legends to be put on any such certificates to make appropriate reference to such restrictions.

k. Unfunded Status of the Plan. The Plan is intended to constitute an "unfunded" plan for incentive compensation. With respect to any payments not yet made to a Participant by the Company, nothing contained herein shall give any such Participant any rights that are greater than those of a general creditor of the Company. In its sole discretion, the Committee may authorize the creation of trusts or other arrangements to meet the obligations created under the Plan to deliver the Shares or payments in lieu of or with respect to Awards hereunder; provided, however, that the existence of such trusts or other arrangements is consistent with the unfunded status of the Plan.

16. EFFECTIVE DATE AND TERM OF PLAN.

The Original Plan became effective upon shareholder approval as provided in Section 12 of the Plan, and this Plan shall become effective upon shareholder approval at the 2004 Annual Meeting of Shareholders of the Company in accordance with the shareholder approval provisions of

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Section 12. This Plan shall continue in effect for a term of ten years following the date of shareholder approval of the Original Plan unless sooner terminated under Section 13 of the Plan. This Plan shall not become effective if not approved by the shareholders of the Company at the Company's 2004 Annual Meeting

of Shareholders and, in such case, the Original Plan shall continue in full force and effect.

CERTIFICATE OF SECRETARY

The undersigned Secretary of Tekelec, a California corporation (the "Company"), hereby certifies that the foregoing is a true and correct copy of the Company's Amended and Restated 2003 Stock Option Plan.

IN WITNESS WHEREOF, the undersigned has executed this document as of the date set forth below.

Date: _____, 2004
Ronald W. Buckley, Secretary

[TEKELEC LOGO]

AMENDED AND RESTATED
2003 STOCK OPTION PLAN
STOCK OPTION AGREEMENT

Tekelec hereby grants to you an Option under the Tekelec Amended and Restated 2003 Stock Option Plan (the "Plan"), to purchase the number of shares of Tekelec Common Stock set forth below.

NAME:

EMPLOYEE ID #:

DATE OF GRANT:

TYPE OF OPTION:

NUMBER OF SHARES:

EXERCISE PRICE:

PAYMENT: Payment of the exercise price and applicable taxes may be made (i) by cash or check and/or (ii) pursuant to a "Cashless" exercise (see Option Terms and Conditions attached hereto).

VESTING SCHEDULE: 16 equal quarterly installments; the first installment will vest on M/D/Y, and one additional installment will vest on the last day of each calendar quarter thereafter, as long as you remain an employee of the Company.

EXPIRATION DATE: M/D/Y; provided, however, that in the event of your termination of employment with the Company or your disability or death, the provisions of Sections 6 and 7 of the Option Terms and Conditions attached hereto shall apply to your right to exercise the Option.

This Stock Option Agreement consists of this page and the Option Terms and Conditions and the Notice of Exercise of Stock Option attached hereto. By signing below, you accept the grant of this Option and agree that this Option is subject in all respects to the terms and conditions of the Plan located on Tekelec's internal website at Teksource. Copies of the Plan and Prospectus containing information concerning the Plan are available upon request to _____ at _____ or _____@tekelec.com.

You further acknowledge and agree that (i) you have carefully reviewed this Stock Option Agreement (including the Option Terms and Conditions attached hereto) and the Plan and (ii) this Stock Option Agreement and the Plan set forth the entire understanding between you and the Company regarding this Option and supersede all prior oral and written agreements with respect thereto.

TEKELEC

BY: _____
PRINT NAME: _____ DATE: _____
TITLE: _____

TEKELEC AMENDED AND RESTATED
2003 STOCK OPTION PLAN
STOCK OPTION AGREEMENT - OPTION TERMS AND CONDITIONS

The following Terms and Conditions apply to the nonstatutory stock option granted by Tekelec to the Optionee whose name appears on the Stock Option Agreement to which these Terms and Conditions are attached.

1. AMENDED AND RESTATED 2003 STOCK OPTION PLAN. This Option is in all respects subject to the terms, definitions and provisions of the Tekelec Amended and Restated 2003 Stock Option Plan (the "Plan") adopted by the Company and incorporated herein by reference. The terms defined in the Plan shall have the same meanings herein.
2. NATURE OF THE OPTION. This Option is intended to be a NONSTATUTORY STOCK OPTION and is not intended to be an incentive stock option within the meaning of Section 422 of the Internal Revenue Code of 1986, as amended (the "Code"), or to otherwise qualify for any special tax benefits to the Optionee.
3. METHOD OF PAYMENT. The aggregate exercise price of the Shares purchased upon an exercise, in whole or in part, of the Option may be paid in one or both of the following forms:
 - (a) Check made payable to the Company or its designated agent; and/or
 - (b) Through a special sale and remittance procedure commonly referred to as a "cashless exercise" pursuant to which the Optionee (or any other person(s) entitled to exercise the Option) shall concurrently provide irrevocable written instructions:
 - (i) to a brokerage firm to effect the immediate sale of a sufficient number of the Shares purchased upon the exercise of the Option to enable such brokerage firm to remit out of the sales proceeds available upon the settlement date, sufficient funds to Tekelec to cover the aggregate exercise price payable for the purchased Shares plus all applicable Federal, state and local income and employment taxes required to be withheld by Tekelec by reason of such exercise and/or sale; and
 - (ii) to Tekelec to deliver the certificate(s) for the purchased Shares directly to such brokerage firm in order to complete the sale transaction.

Except to the extent the sale and remittance procedure is utilized in connection with the Option exercise, payment of the aggregate exercise price must accompany the Notice of Exercise delivered by the Optionee to Tekelec in connection with the Option exercise.

4. EXERCISE OF OPTION. This Option shall be exercisable during its term only in accordance with the terms and provisions of the Plan and this Option as follows:
 - (a) This Option shall vest and be exercisable cumulatively as set forth on the first page of the Stock Option Agreement. An Optionee who has been in continuous employment with the Company since the grant of this Option may exercise the exercisable portion of his or her Option in whole or in part at any time during his or her employment; provided, however, that an Option may not be exercised for a fraction of a Share. In the event of the Optionee's termination of employment with the Company or Optionee's disability or death, the provisions of Sections 6 or 7 below shall apply to the right of the Optionee to exercise the Option.
 - (b) This Option shall be exercisable by written notice (in the form of the Notice of Exercise of Stock Option attached hereto, as amended from time to time) which shall state the Optionee's election to exercise this Option and the number of Shares being purchased and set forth such other information as may be required by the Company in connection with the exercise of the Option. Such written notice shall be signed by the Optionee and shall be delivered in person or by facsimile (818.880.0176) or certified mail to the Secretary of the Company or such other person as may be designated by the Company. The written notice shall specify the method of

payment of the aggregate exercise price in accordance with Section 3 above. The certificate or certificates for the purchased Shares shall be registered in the name of the Optionee unless otherwise specified by the Optionee in the Notice of Exercise.

(c) No rights of a shareholder shall exist with respect to the Shares under this Option as a result of the mere grant of this Option or the exercise of this Option. Such rights shall exist only after issuance of a stock certificate in accordance with Section 7(h) of the Plan.

5. RESTRICTIONS ON EXERCISE. This Option may not be exercised if the issuance of Shares upon Optionee's exercise or the method of payment of consideration for such Shares would constitute a violation of any applicable Federal or state securities law or other applicable law or regulation. As a condition to the exercise of this Option, the Company may require the Optionee to make any representation and warranty to the Company as may be required by any applicable law or regulation.
6. TERMINATION OF EMPLOYMENT. If the Optionee ceases to serve as an Employee for any reason other than death or permanent and total disability (within the meaning of Section 22(e)(3) of the Code) and thereby terminates his or her Continuous Employment, the Optionee shall have the right to exercise this Option at any time within 90 days after the date of such termination to the extent that the Optionee was entitled to exercise this Option at the date of such termination. To the extent that the Optionee was not entitled to exercise this Option at the date of termination, or to the extent this Option is not exercised within the time specified herein, this Option shall terminate. Notwithstanding the foregoing, this Option shall not be exercisable after the expiration of the term set forth in Section 8 hereof.
7. DEATH OR DISABILITY. If the Optionee ceases to serve as an Employee due to death or permanent and total disability (within the meaning of Section 22(e)(3) of the Code), this Option may be exercised at any time within 180 days after the date of death or termination of employment due to disability, in the case of death, by the Optionee's estate or by a person who acquired the right to exercise this Option by bequest or inheritance, or, in the case of disability, by the Optionee, but in any case only to the extent the Optionee was entitled to exercise this Option at the date of such termination. To the extent that the Optionee was not entitled to exercise this Option at the date of termination, or to the extent this Option is not exercised within the time specified herein, this Option shall terminate. Notwithstanding the foregoing, this Option shall not be exercisable after the expiration of the term set forth in Section 8 hereof.
8. TERM OF OPTION. This Option may not be exercised more than ten (10) years from the date of grant of this Option and may be exercised during such term only in accordance with the Plan and the terms of this Option Agreement. Notwithstanding any provision in the Plan with respect to the post-employment exercise of an Option, an Option may not be exercised after the expiration of its term.
9. WITHHOLDING UPON EXERCISE OF OPTION. The Company reserves the right to withhold, in accordance with any applicable laws, from any consideration payable to Optionee any taxes required to be withheld by Federal, state or local law as a result of the grant or exercise of this Option or the sale or other disposition of the Shares issued upon exercise of this Option. If the amount of any consideration payable to the Optionee is insufficient to pay such taxes or if no consideration is payable to the Optionee, upon the request of the Company, the Optionee shall pay to the Company in cash an amount sufficient for the Company to satisfy any Federal, state or local tax withholding requirements it may incur as a result of the grant or exercise of this Option or the sale or other disposition of the Shares issued upon the exercise of this Option.
10. NONTRANSFERABILITY OF OPTION. This Option may not be sold, pledged, assigned, hypothecated, gifted, transferred or disposed of in any manner either voluntarily or involuntarily by operation of law, other than by will or by the laws of descent or distribution or transfer between spouses incident to a divorce. Subject to the foregoing and the terms of the Plan, the terms of this Option shall be binding upon the executors, administrators, heirs, successors and assigns of the Optionee.
11. NO RIGHT OF EMPLOYMENT. Neither the Plan nor this Option shall confer upon the Optionee any right to continue in the employment of the Company or limit in any respect the right of the Company to discharge the Optionee at

any time, with or without cause and with or without notice.

12. MISCELLANEOUS.

- (a) Successors and Assigns. This Option Agreement shall bind and inure only to the benefit of the parties to this Option Agreement (the "Parties") and their respective successors and assigns.
- (b) No Third-Party Beneficiaries. Nothing in this Option Agreement is intended to confer any rights or remedies on any persons other than the Parties and their respective successors or assigns. Nothing in this Option Agreement is intended to relieve or discharge the obligation or liability of third persons to any Party. No provision of this Option Agreement shall give any third person any right of subrogation or action over or against any Party.
- (c) Amendments.
 - (i) The Committee reserves the right to amend the terms and provisions of this Option without the Optionee's consent to comply with any Federal or state securities law.
 - (ii) Except as specifically provided in subsection (i) above, this Option Agreement shall not be changed or modified, in whole or in part, except by supplemental agreement signed by the Parties. Either Party may waive compliance by the other Party with any of the covenants or conditions of this Option Agreement, but no waiver shall be binding unless executed in writing by the Party making the waiver. No waiver or any provision of this Option Agreement shall be deemed, or shall constitute, a waiver of any other provision, whether or not similar, nor shall any waiver constitute a continuing waiver. Any consent under this Option Agreement shall be in writing and shall be effective only to the extent specifically set forth in such writing.
- (d) Governing Law. To the extent that Federal laws do not otherwise control, the Plan and all determinations made or actions taken pursuant hereto shall be governed by the laws of the state of California, without regard to the conflict of laws rules thereof.
- (e) Severability. If any provision of this Option Agreement or the application of such provision to any person or circumstances is held invalid or unenforceable, the remainder of this Option Agreement, or the application of such provision to persons or circumstances other than those as to which it is held invalid or unenforceable, shall not be affected thereby.

* * * *

TEKELEC NOTICE OF EXERCISE OF STOCK OPTION

I hereby notify Tekelec that I elect to exercise the options listed below to purchase the number of shares of Tekelec Common Stock indicated below. In connection with the exercise of my options and the purchase of such shares, I have received and carefully reviewed a copy of the Company's Prospectus containing information about the Amended and Restated 2003 Stock Option Plan and the shares of Tekelec Common Stock issuable thereunder.

Section I: Personal Data (Please print legibly)

Name: _____ Employee ID #: _____
 Address: _____ SSN: _____
 City, State, Zip: _____ Phone: (_____) _____

Section II: Statement of Intent to Exercise

<TABLE>		
<S>	<C>	<C>
Type of Option: (check one)	<input type="checkbox"/> Incentive Stock Option (ISO)	<input type="checkbox"/> Nonstatutory Stock Option (NSO)
</TABLE>		

<TABLE>
<CAPTION>

Exercise Price

Total Exercise

Option #	Option Grant Date	# Shares Exercise	per Share	Taxes (NSO only)	Price
<S>	<C>	<C>	<C>	<C> <C>	<C>
_____	_____	_____	X	+ TBD =	\$ _____
_____	_____	_____	X	+ TBD =	\$ _____
_____	_____	_____	X	+ TBD =	\$ _____
Total amount due to TEKELEC:					\$ _____

</TABLE>

NSO EXERCISES ONLY: I understand that for NSO exercises I am required to pay Federal and state income and employment taxes on the gain, as measured, as of the date of exercise, by the difference between the option exercise price and the fair market value of the shares purchased. Tax calculations will be provided by the Stock Plan Administrator.

ISO EXERCISES ONLY: I will promptly notify Tekelec if I sell, transfer, gift or otherwise dispose of any or all of the shares acquired upon the exercise of an ISO at any time (a) within one year after the date hereof; or (b) within two years after the ISO grant date.

Section III: Method of Exercise (Please check one)

<TABLE>
 <S> <C> <C>
 Exercise and hold Same day sale of all shares exercised Same day sale of _____ shares exercised
 </TABLE>

Section IV: Method of Payment (Please check one)

<TABLE>
 <S> <C>
 Cashless Exercise - - proceeds from sale of stock Check made payable to Tekelec
 </TABLE>

Section V: Broker Information

Name of Broker: _____ Address: _____
 Contact Name: _____ Fax No.: _____
 Account No.: _____ Phone No.: _____

Section VI: Certificate Registration (Please check one)

Issue stock in my name individually and mail stock certificate to the above address.

Issue stock in street name and send directly to my Broker at the above address.

Employee signature: _____ Date: _____, 200_____

Please return your completed Notice of Exercise to _____, Tekelec Stock Plan Administrator.

Received by _____ on behalf of Tekelec on _____, 200____. _____
Signature

CERTIFICATION

I, Frederick M. Lax, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tekelec;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ FREDERICK M. LAX

President and Chief Executive Officer

Date: August 9, 2004

CERTIFICATION

I, Paul J. Pucino, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Tekelec;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) for the registrant and have:

(a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(a) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ PAUL J. PUCINO

Senior Vice President and Chief Financial Officer

Date: August 9, 2004

CERTIFICATION PURSUANT TO
18 U.S.C. SECTION 1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report of Tekelec (the "Company") on Form 10-Q for the period ended June 30, 2004 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), we, Frederick M. Lax, President and Chief Executive Officer of the Company, and Paul J. Pucino, Vice President and Chief Financial Officer, certify, pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that:

- 1) The Report fully complies with the requirement of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- 2) The information contained in the Report fairly presents, in all material respects, the Company's consolidated financial position, results of operations and cash flows.

/s/ FREDERICK M. LAX

President and Chief Executive Officer

/s/ PAUL J. PUCINO

Senior Vice President and Chief Financial Officer

Date: August 9, 2004