

CERTAIN FACTORS

The following factors should be carefully considered in evaluating the Company and its business before purchasing the shares of Common Stock offered by this Prospectus:

1. **Losses and Variations in Operating Results.** Interleaf was incorporated in May 1981. The Company's cumulative revenues from its inception through March 31, 1986 were \$27,306,020, and its cumulative net loss during that period was \$5,892,665. There can be no assurance that the Company will operate on a profitable basis in the future. The Company's revenues have and may continue to fluctuate, causing significant variations in quarterly operating results. See "Management's Discussion and Analysis of Financial Condition and Results of Operations".
2. **600-S Contract.** To date, the Company's revenues from contracts with government entities have been less than 5% of total revenues. However, the Company is a principal subcontractor to an affiliate of Electronic Data Systems Corporation ("EDS") under its printing services contract (the "600-S Contract") with the United States Government Printing Office awarded in January 1986. Although the Company believes that it may derive significant revenues as a result of this contract, the Company does not control the amount or timing of orders, and there can be no assurance that the Company will have significant sales to EDS. Furthermore, competing vendors have protested the award of the 600-S Contract to the General Services Administration Board of Contract Appeals, claiming that proper contract award procedures were not followed. On May 5, 1986, the United States Court of Appeals for the Federal Circuit ordered the dismissal of this protest. However, it is possible that this order will be appealed or that the competing vendors will institute proceedings before another agency or court. See "Business - Sales and Distribution - Direct Sales".
3. **Relationships with Certain Key Vendors.** The Company's hardware manufacturing operations consist primarily of the integration of third-party workstations, mass storage devices and specialized peripherals, such as scanners and laser printers. The Company believes it has developed adequate alternate sources for all key components. A significant number of the systems shipped by the Company utilize 32-bit workstations manufactured by Sun, although the Company also ships systems with workstations manufactured by Digital and Apollo. Any failure of Sun to meet Interleaf's workstation requirements would have a material adverse effect on the Company's operations for several months because the Company would be required to shift its marketing emphasis to other workstations. See "Business - Manufacturing and Suppliers".
4. **Competition.** The computer-aided publishing industry is highly competitive and characterized by rapid technological change. The Company competes with both established and start-up companies which sell electronic publishing and business graphics products. In addition, other companies may introduce products in the CAP market, either developed internally or acquired from other software suppliers. Some of the Company's existing and potential competitors have significantly greater financial, technical and marketing resources than Interleaf. See "Business - Product Development and Engineering" and "Business - Competition".
5. **Shares Eligible for Future Sale.** Without the agreements described below, approximately 960,560 shares of the Company's Common Stock outstanding before this offering could be sold without restriction as of the date of this Prospectus. Approximately 4,281,000 additional shares would become eligible for sale 90 days after the date of this Prospectus subject to compliance with Rule 144 under the Securities Act of 1933. The Company has obtained the agreement of the holders of approximately

Atlanta
Boston
Dallas
Denver
Houston

Los Angeles (2 offices)
Minneapolis
New York (3 offices)
Philadelphia
San Francisco (3 offices)

San Diego
Seattle
Washington, D.C.

The Company intends to open additional offices during calendar 1986, including offices in Chicago and Detroit.

The Company is a principal subcontractor to an affiliate of Electronic Data Systems Corporation ("EDS") under its printing services contract (the "600-S Contract") with the United States Government Printing Office awarded in January 1986. The 600-S Contract involves the provision of printing services to the United States Army at approximately 200 locations worldwide. Although the Company believes that it may derive significant revenues as a result of this contract, the Company does not control the amount or timing of orders, and there can be no assurance that the Company will have significant sales to EDS. Furthermore, competing vendors have protested the award of the 600-S Contract to the General Services Administration Board of Contract Appeals, claiming that proper contract award procedures were not followed. On May 5, 1986, the United States Court of Appeals for the Federal Circuit ordered the dismissal of this protest. However, it is possible that this order will be appealed or that the competing vendors will institute proceedings before another agency or court.

In the fiscal years ended March 31, 1985 and 1986, direct sales revenues aggregated approximately \$4,864,832 and \$14,171,711, respectively, or 58% and 76% of total revenues, respectively.

OEM Distribution

The Company has entered into OEM agreements with a number of companies, including IBM for the RT PC, Digital for the VAXstation II, Kodak, Apollo, Siemens, Computervision Corporation, FileNet Corporation and CAE Systems, Inc. The Company distributes primarily WPS through this OEM channel.

Under these agreements, Interleaf typically receives a combination of advance payments and royalties from OEMs for a license to market Interleaf software. The pricing terms of each agreement reflect the Company's estimate of the future volume of software sales under the agreement, the degree of difficulty of the port of Interleaf's software to the OEM's workstation, the software features licensed, and upgrade rights, if any.

Kodak has been licensed to distribute TPS on hardware manufactured by Sun and accompanied by value-added components provided by Kodak. As of March 31, 1986, Kodak held approximately 7.4% of the outstanding Common Stock of the Company, all of which Kodak is selling as a Selling Shareholder in this offering. See "Management - Certain Transactions" and "Principal and Selling Shareholders".

The Company also has entered into a technology development and licensing agreement with Dataproducts Corporation ("Dataproducts") under which the Company, in exchange for advance payments and continuing royalties, has licensed and delivered to Dataproducts certain raster image processing hardware and software technology which is also used by the Company in its own systems. Dataproducts has incorporated this technology in a recently introduced laser printer product line.

The Company has established a Third-Party Operations Group to identify OEM prospects, administer and support sales under Interleaf's existing OEM agreements and provide training of the OEMs' sales personnel.

During the fiscal years ended March 31, 1985 and 1986, revenues attributable to OEM sales totalled \$3,347,980 and \$3,357,158, respectively, or 40% and 18% of total revenues, respectively.