Interleaf

# Interleaf Annual Report 1991

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## Becoming a Dominant Supplier of Document Systems and Services

*To Our Shareholders*

A year after our decision to exit the hardware business — a major restructuring endeavor — Interleaf has made significant progress and has firmly established itself as a dominant international supplier of document-based information systems and services. We continued to leverage our wealth of expertise and our unique active document technology to capture opportunities and build for continued growth.

This progress is most evident in our financial results. Earnings grew steadily from quarter to quarter. And our positive cash flow raised cash balances from $4.4 million at the end of fiscal 1990 to $13.6 million at the end of fiscal 1991, placing the company on strong financial footing.

For nearly a decade, Interleaf has lead the industry in providing state-of-the-art document technology to help organizations convey information effectively. Along the way, we pioneered new technologies — workgroup publishing, sophisticated database management of documents, electronic storage and distribution of documents and even artificial intelligence for documents — leading to a complete document system that helps organizations better manage and control their information and document production processes.

In November of 1989, we made a major shift from selling "turnkey document systems" (*i.e.*, reselling hardware which we bundled with our software) to concentrate solely on software and services. Our leading-edge products, our expertise and major installations in large corporations worldwide provided the strong foundation we needed to help us make the transition. Interleaf is now an integral part of complex information management systems in major corporations around the world.

This year, successes in such notable corporations as Boeing, Exxon Production Research Co., Ford, Pratt & Whitney, Lockheed Missiles and Space Company, Inc., Ontario Hydro and Alcatel confirm the validity of our strategy.

## Building on Our Unique and Innovative Technology

Focusing on specific industries is another important aspect of our strategy because it allows us to leverage our expertise and solutions. Our first *vertical market* business unit, set up to serve the commercial aviation industry, has already established Interleaf's strong presence in this key market. We have won major accounts, including America West, Canadair, Deutsche Airbus, Grumman, Saab Aircraft and Trans World Airlines.

We have also begun to penetrate other vertical markets, such as the petroleum and the pharmaceutical industries. At Amoco, we built an "intelligent" engineering forms application that automates the process of producing lengthy engineering specifications. Amoco now markets the forms to other oil companies and Interleaf sells the software that runs the forms.

For multi-national pharmaceutical companies such as Boehringer Ingelheim, Gist-Pharma and Hoffmann-La Roche, we provided document systems that automate and streamline the process of producing new drug applications for submission to international regulatory agencies.

A great number of these sales also involved integration of workgroup systems — for Hoffmann-La Roche that meant interchanging information across the Atlantic from their New Jersey to U.K. offices and Swiss-based headquarters.

The applications we built for these companies can be used as models for other potential vertical markets such as telecommunications, utilities, automotive and electronics — industries which, we believe, provide major opportuniries for Interleaf.

When it comes to technology, we believe Interleaf has a clear competitive edge. Our flagship product, Interleaf 5, which was shipped to initial customers in December, was chosen as one of the top UNIX products of the year by *UNIX World* magazine.

More than text and graphics, Interleaf 5 provides the ability to modify and extend existing functionality, build "active documents" and develop entirely new applications. An active document is an Interleaf document programmed to have "intelligence." It can provide interactive guidance to authors producing documents that must meet industry or corporate standards; it can automate tasks, such as retrieving data files and importing them directly into an Interleaf table; it can provide specialized tools for individual applications; it can even offer its own specialized interface.

Our customers can achieve greater productivity because they can change Interleaf 5's functionality to fit their unique workflows and environments. Systems integrators can use Interleaf 5's library of functions for accessing, presenting and interacting with information to build customized information systems. For software developers, Interleaf 5 is a sophisticated programming environment that allows them to rapidly develop powerful new applications. Interleaf VARs have the opportunity to add revenue and genuine value by developing new applications that can be *layered* onto Interleaf 5. And for Interleaf, this innovative product means we can deliver highly customized solutions without having to re-program our core software — we can simply re-program documents.

Also important are our products which complement Interleaf 5 — Viewstation, Mainframe View and Print, and Relational Document Manager (RDM). In the past, these technologies sold only as part of customized systems. This year, we packaged them to broaden their commercial appeal. Already, we are realizing substantial revenue from this strategy. We recently received a multi-million dollar order for software and services from McDonnell Douglas Systems Integration Company whose Manufacturing and Engineering Division is integrating Interleaf ViewstationPLUS with its UNIGRAPHICS products so users can retrieve, view and annotate over 14,000 pages of fully formatted text and graphics documentation.

## Building on Our Expertise

As services take on increased importance in our business, we aggressively promoted and strengthened our service organizations. We increased our systems integration and professional services capability, and plan more growth in fiscal 1992; we structured a menu of à la carte professional services, such as consulting and project management; we packaged products with services; and we expanded training to include customized courses and Interleaf 5 programming courses.

## Developing Our Partnerships

Indirect distribution and strategic partnerships are also important elements of our strategy. Revenues from our VAR partners continue to grow significantly. And we continue to work closely with Andersen Consulting, Apple, Digital Equipment, EDS, Hewlett-Packard, IBM, Sun and Xerox, in joint marketing activities and in pursuing large integration opportunities.

## Strong Course for Growth

This year, both Digital Equipment and IBM selected Interleaf as the electronic publishing component of their computer-aided software engineering (CASE) strategy. IBM is also using Interleaf to produce their documentation for the RS/6000 workstation.

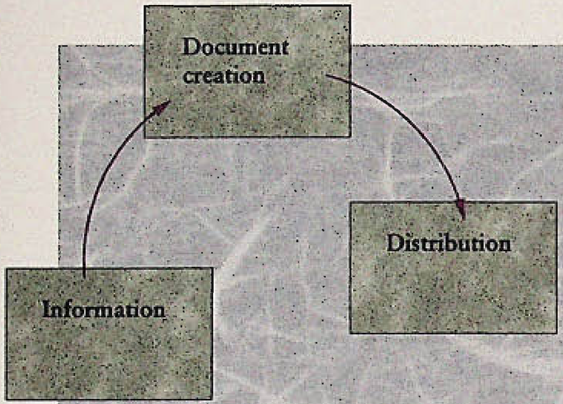
We added Data General AViiON, Hewlett-Packard Series 700 and IBM RS/6000 workstations, and the IBM PC and Apple Macintosh to our family of compatible hardware platforms for Interleaf 5. We also signed a distribution agreement with Data General for its sales force and VARs to sell Interleaf solutions.

Projects are underway with both IBM and Hewlett-Packard to develop a full-featured version of Interleaf 5 for the Japanese market.

The key elements of our strategy are in place. We have a family of products that address the complex document and information needs of our markets. We have a mix of unique technology and expertise that clearly establishes us as the industry leader. The critical challenge we face is to increase our productivity through enhancing Interleaf's ability to provide services which leverage our proprietary technologies. By aggressively educating our markets about what our technology can do for them, by providing opportunities for people to add value to our software, by replicating and enhancing custom systems, and by poising our service organizations to meet increased demand, we believe Interleaf can exploit our current market advantage for further growth in 1992.

David A. Boucher
*CEO and Chairman*

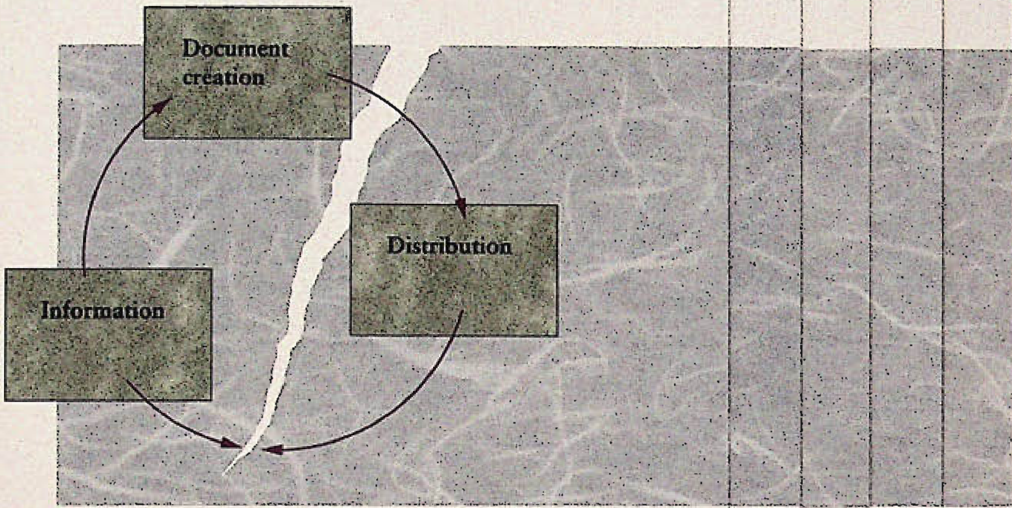
Mark K. Ruport
*President and COO*




Interleaf Document Systems

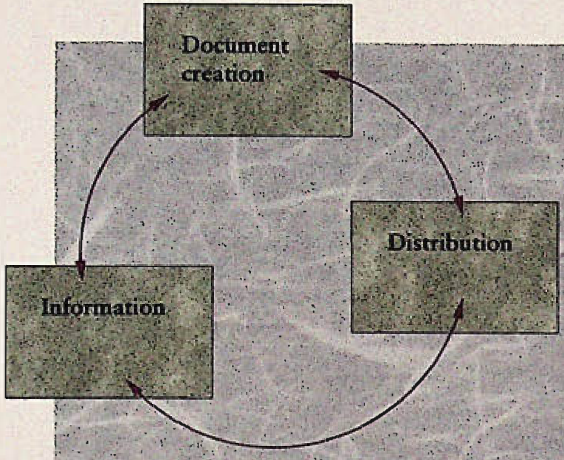
Documents — text and graphics together on a page — provide easy access to information. With a structure perfected over centuries and universally understood, documents are the world's most effective medium for disseminating information, on paper or electronically.

## Financial Statements




But the traditional information process is a dead end — documents are created and distributed to people who are cut off from the information source, and information quickly becomes outdated.

## Financial Statements




Interleaf completes the information loop.

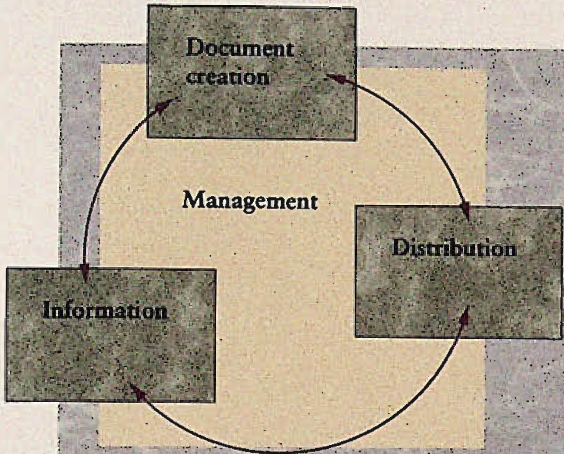
Our unique active document technology enables

people to interact with information directly

through a familiar, document-based interface,

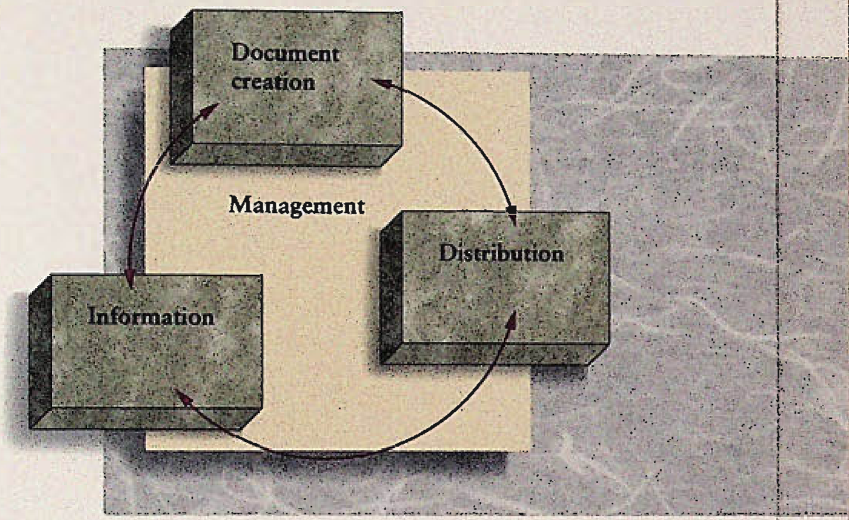
so information is never out of date.

# Financial Statements



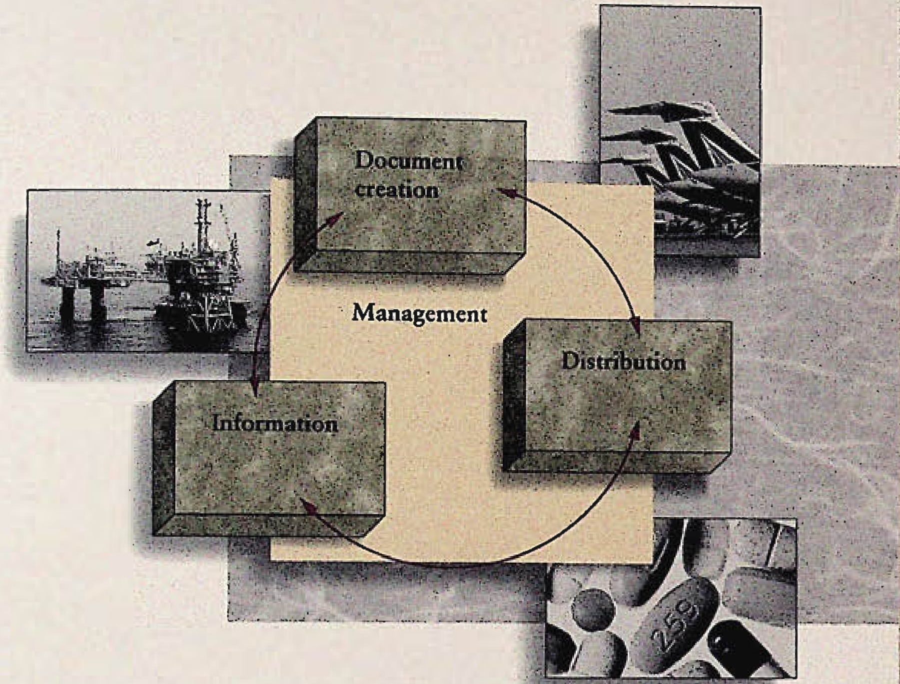

Our document management technology enables people to track, store and share information in a document database. But technology is only one dimension.

# Financial Statements




Interleaf provides three-dimensional solutions — products that address the document creation and management process; tools that extend these products for specialized applications, and services that range from training to systems integration.

# Financial Statements




Interleaf systems help solve the complex information needs of major corporations in industries such as aerospace, commercial aviation, electronics, petroleum, pharmaceuticals and telecommunications around the world. With over 100,000 users worldwide, Interleaf is the leading international supplier of document information systems and services.

# Financial Statements

# Financial Statements

## Report of Management

The management of Interleaf, Inc. and its subsidiaries is responsible for preparing the accompanying financial statements and for ensuring their integrity. The statements were prepared in accordance with generally accepted accounting principles. In instances where exact measurement is not possible, the financial statements include amounts that are based on management's best estimates and judgments. Management also prepared the other financial information in this Annual Report and is responsible for its accuracy and consistency with the financial statements.

In meeting its responsibility for the Company's consolidated financial statements, management maintains a system of internal accounting control, which is reviewed and evaluated on a regular basis. This system is designed to provide reasonable assurance that assets are safeguarded and that transactions are properly recorded and executed in accordance with management's authorization. However, there are inherent limitations that should be recognized in considering the assurances provided by any system of internal accounting control. The concept of reasonable assurance recognizes that the costs of a system of internal accounting control should not exceed the benefits to be derived.

The consolidated financial statements of Interleaf, Inc. and its subsidiaries have been audited by Ernst & Young, independent auditors, whose report is contained herein. Their audit includes an evaluation of the Company's accounting systems and internal controls, as well as performance of other auditing procedures to reasonably ensure that the consolidated financial statements are fairly presented.

David A. Boucher
*Chief Executive Officer, Chairman*

Mark K. Ruport
*President, Chief Operating Officer*

David J. Collard
*Chief Financial Officer*

## Report of Audit Committee Chairman

The Audit Committee of the Board of Directors is composed of three independent directors. The Committee held five meetings during fiscal 1991. The Committee oversees the Company's financial reporting process on behalf of the Board of Directors. In fulfilling its responsibility, the Committee recommended to the Board of Directors the appointment of Ernst & Young as the Company's independent auditors. The Committee discussed with Ernst & Young the overall scope and specific plans for their audit and the adequacy of the Company's internal controls. The Committee met with Ernst & Young, without management present, to discuss the results of their audit, their evaluation of the Company's internal controls and the overall quality of the Company's financial reporting. Meetings during the year were also designed to encourage confidential discussions as to any auditing matters.

Frederick B. Bamber
*Chairman, Audit Committee*

## Management's Discussion and Analysis of Financial Condition and Results of Operations

| Year ended March 31 | 1991 | 1990 | 1989 |
|---|---|---|---|
| Revenues | 100% | 100% | 100% |
| Costs and expenses: | | | |
| Cost of products and services sold | 24 | 28 | 34 |
| Selling, general and administrative | 56 | 56 | 50 |
| Research and development | 18 | 16 | 12 |
| Amortization of software and development costs | 3 | 2 | 1 |
| Restructuring charge | – | 15 | – |
| Total operating costs and expenses | 101 | 117 | 97 |
| Income (loss) from operations | (1) | (17) | 3 |
| Interest income (expense), net | – | (1) | (1) |
| Other expense | (1) | – | – |
| Income (loss) before income taxes | (2) | (18) | 2 |
| Provision for income taxes | – | – | 1 |
| Net income (loss) | (2)% | (18)% | 1% |

Results of Operation The Company began fiscal 1991 in the midst of a major transition from its previous position as a provider of workstations bundled with its software to its current position as a provider of software and customized services. In adopting this restructuring, the Company recognized the inherent benefits of being a software and services provider; far less property, equipment and inventory would be required to support a services-based business and therefore more resources could be channeled into the long-term creation of value and competitive advantage—the Company's software and services.

In fiscal 1991, the Company's financial condition, cash flows and operating results reflect the benefits of these more favorable business fundamentals. In January of 1991, the Company consolidated its three separate operating facilities, totalling over 400,000 square feet, into one facility totalling approximately 140,000 square feet, resulting in annual savings to the Company of approximately $2.5 million, and concurrently improved operating efficiency. Over the past two fiscal years, the Company's asset base in property and equipment declined from approximately $19.1 million at the end of fiscal 1990 to $11.6 million at the end of fiscal 1991. Moreover, since hardware was no longer resold as part of the Company's business, the Company's inventory declined from $11.6 million at March 31, 1989 to $1.4 million at March 31, 1990, to $.2 million at March 31, 1991.

Finally, while overall employment remained relatively flat compared with fiscal 1990 at approximately 770, its composition during fiscal 1991 changed as approximately 50 software engineers, project managers and related technical personnel were hired to support the Company's software and service oriented business.

In fiscal 1991, the Company continued to execute its strategy to specifically develop and market software and specialized tools that will be responsive to the needs of a particular industry or requirements of a specific application. The Company has realized that the needs of its customer base have changed as customers' document requirements have grown beyond merely requiring text and graphics editing capabilities and the laser-printer output of documents. Customers are increasingly treating documents as an integral part of their information systems that need to be managed, integrated and distributed.

A review and analysis of the Company's past operating performance and its future direction can only be understood in the context of the continuous transition outlined above. Total revenues for fiscal 1991 were $84.3 million compared with $88.8 million in fiscal 1990, and $82.8 million in fiscal 1989. For this same period, however, the Company's gross profits increased from $54.2 million in fiscal 1989 to approximately $64 million in fiscal 1991. This significant improvement reflects the relatively lower costs of products and services inherent in being a software and services provider. As a percentage of revenues, these costs declined from 35% in fiscal 1989 to 28% in fiscal 1990, to 24% in fiscal 1991. In the future, the Company expects that services will become an increasingly greater percentage of the Company's total revenues, and therefore the costs of products and services percentage should increase since services generate lower margins than software sales. The Company realizes that its "SG&A," as described further below, will have to be improved to achieve and sustain overall profitability for the Company.

Apart from understanding the higher gross margins in the Company's current business, it must also be recognized that revenues recorded for fiscal 1990 and 1989 include hardware-based revenue. For fiscal 1990, the year the Company exited the hardware business, approximately $8.4 million in hardware-based revenue was recorded. When comparing revenues for fiscal 1991 with fiscal 1990, if this $8.4 million amount is eliminated, revenue of software and services actually grew in fiscal 1991 by 5% over fiscal 1990.

Even with these considerations, actual revenue growth experienced in fiscal 1991 was not strong. The central factors affecting the Company's ability to achieve growth are the following:

- The opportunity for competitive differentiation simply on the basis of superior text and graphics editing tools is diminishing, as "WYSIWYG" editing capabilities have become widespread in the marketplace. This has created downward price pressure.
- The Company believes there is a strong opportunity for growth in the areas of electronic publishing related to information management, and with its new technologies the Company is well positioned to capitalize on this growth area. To fully exploit these opportunities, however, the Company must continue to build its capacity to design, implement, and support customized "solutions environments" for its current and potential customers. Successfully building this "infrastructure" is critical to the long-term success of the Company.

The Company recognizes that it cannot develop internally the resources to efficiently provide a solutions environment to every industry. The Company has, therefore, targeted select vertical markets which it believes have significant revenue and growth opportunities and which effectively can be serviced through dedicated engineering and sales efforts: commercial aviation, telecommunications, pharmaceuticals, manufacturing, aerospace/defense, electronics, and heavy manufacturing. In other markets, the Company is actively developing reseller channels which can provide the required marketing expertise and technical added value.

With the changing marketplace and refinement of the Company's strategy, the Company recognizes that its existing distribution channel also must adapt. The Company's distribution channel needs to be organized to reflect the Company's more focused and select marketing efforts. Selling, general and administrative expenses ("SG&A") accounted for approximately 56% of revenues in both fiscal 1991 and 1990 (excluding the one-time restructuring charge recorded in fiscal 1990).

In fiscal 1992, to reduce the relative costs of this channel, the Company expects to cluster its direct force sales around its vertical markets, and also generate additional billable hours for value-added services. Moreover, the Company will also seek out additional value-added resellers ("VARs") to develop layered applications for opportunities outside of its vertical markets. While the Company's revenues from this channel increased to $2.4 million in fiscal 1991, a three-fold improvement over fiscal 1990, the Company believes that the opportunity for significant revenue growth exists in this channel. In fiscal 1992, a major challenge to the Company will be to achieve greater productivity from its investment in SG&A.

Research and Development In fiscal 1991, the Company continued to expend significant resources for research and development ("R&D"). During the year, the Company spent $18.2 million or approximately 22% of its revenues to (i) complete development of Interleaf 5, the Company's main product offering, on the different hardware platforms and operating systems which the Company supports, (ii) continue development of filters that support emerging government and commercial standards for the electronic interchange of documents, and (iii) further the development of its document management and viewing technologies. The Company is also porting Interleaf 5 to personal computers and the Apple Macintosh II.

Overall, the Company supports 10 different workstation platforms in 13 languages, and is also seeking to develop a Japanese-capable product on two different platforms. While supporting these different platforms and their changing operating systems is costly, interoperability of the Company's software across different platforms is one of its major strengths and will continue to require a high level of commitment to R&D by the Company in fiscal 1992.

Profitability The Company's overall operating results in fiscal 1991 were an improvement over fiscal 1990. While the Company was profitable for the last three quarters of fiscal 1991, the Company still reported an earnings loss of $.11 per share for all of fiscal 1991. This loss was minimized by the strong performance of the Company's international operations compared with its domestic operations, as overall international revenues accounted for 38% of the Company's total revenues in fiscal 1991, compared with 30% and 22% of revenues for fiscal years 1990 and 1989, respectively. The Company believes that its strategy of providing a solutions environment to select vertical markets will fully leverage its reduced asset structure and position the Company for the future both domestically and internationally. The timely implementation and successful execution of the Company's strategy will be critical to its success in fiscal 1992 and beyond.

Liquidity and Capital Resources Among the benefits of being a provider of software and specialized services are that the Company's capital needs are significantly reduced. In fiscal 1991, the Company spent only $2.2 million on new capital equipment, while it incurred depreciation expense of approximately $7 million. The Company's investment in inventories at March 31, 1991 totalled approximately $.2 million, and comprises primarily documentation, compared with $11.6 million invested at March 31, 1989, the Company's last full year as a reseller of hardware. Net property and equipment requirements decreased significantly, declining by approximately 40% from fiscal 1990, due to the Company's facilities consolidation, and reduction and/or elimination of assets previously used to support the Company's hardware business.

These reduced capital requirements enabled the Company to more efficiently use and preserve cash generated from its operations. In fiscal 1991, the Company's cash balances increased to $13.6 million, an increase of over $9 million from fiscal 1990. This increase in cash balances is also attributable to the effectiveness of the Company's cash management program. The Company currently charges its customers for support annually. This has resulted in an incremental $7 million in cash, with a corresponding liability recorded as unearned service revenue. Because of the introduction of Interleaf 5, and its related support requirements, however, the Company expects to increase its need for capital equipment in fiscal 1992 to approximately $4 to $5 million.

The Company believes its working capital needs can be satisfied from its existing cash and cash generated from future operations. The Company does, however, have certain arrangements which could materially affect its long-term capital needs and liquidity. The Company has entered into two joint ventures to facilitate the development and sale of certain software products (See Note L to Consolidated Financial Statements). In January of 1991, the Company acquired all of the rights in its venture with ML Technology Ventures, L.P. for consideration of $2.75 million, payable over 12 equal quarterly installments. The Company believes that funds for this obligation can be generated from its operations. In its other joint venture, the Company let its option to buy-out its partner, PruTech Research and Development III ("PruTech"), expire in October of 1990. This option would have required the Company to pay approximately $7 million for the venture, which the Company believed would not be a prudent use of its resources based on the venture's revenues. The Company, however, continues to review with PruTech the possible acquisition of its interest in the venture. Currently, the Company is required to pay PruTech up to a maximum of 5% of revenues generated by the venture, which has averaged approximately $35,000 per quarter. Under the terms of the venture, the maximum percentage could increase to up to 30% of the venture's revenues on October 1, 1991 if a negotiated purchase does not occur.

The Company's right to purchase its exclusive distributor for Germany, Spain and Portugal, Interleaf GmbH, will expire July 27, 1991. To exercise this option, the Company would be required to pay approximately $8 million. In the event it does not purchase Interleaf GmbH, the royalty rate for its products it currently receives from Interleaf GmbH would decline significantly, and while difficult to estimate, it is possible the Company could lose approximately $2–4 million annually in net income. The Company is currently in negotiations over these exclusive distribution rights.

Depending upon the actual terms, including the ability to obtain payment terms over time from the respective sellers, the Company believes that the funds to pay for these possible acquisitions can be generated substantially from internal sources and does not anticipate using external financing sources described in Note D.

## Consolidated Statements of Operations

*(in thousands except for per share amounts)*

| Year ended March 31 | 1991 | 1990 | 1989 |
|---|---|---|---|
| **Revenues** | | | |
| Products | $56,820 | $ 62,903 | $67,694 |
| Service | 16,554 | 14,830 | 11,437 |
| Training, porting and distribution rights | 10,944 | 11,110 | 3,649 |
| | 84,318 | 88,843 | 82,780 |
| **Costs and expenses** | | | |
| Cost of products and services sold | 20,400 | 24,569 | 28,564 |
| Selling, general and administrative | 46,987 | 49,788 | 40,811 |
| Research and development | 14,607 | 13,577 | 9,531 |
| Amortization of capitalized software development costs | 2,815 | 2,058 | 1,147 |
| Restructuring charge | – | 13,900 | – |
| Total operating costs and expenses | 84,809 | 103,892 | 80,053 |
| Income (loss) from operations | (491) | (15,049) | 2,727 |
| Interest expense | (1,043) | (1,312) | (1,255) |
| Interest income | 1,033 | 384 | 271 |
| Other expense | (527) | (341) | (215) |
| Income (loss) before income taxes | (1,028) | (16,318) | 1,528 |
| Provision (credit) for income taxes | 250 | (310) | 665 |
| Net income (loss) | $ (1,278) | $ (16,008) | $ 863 |
| **Earnings (loss) per share** | $ (.11) | $ (1.37) | $ .07 |
| Shares used in computing earnings (loss) per share | 11,956 | 11,643 | 11,895 |

*See Notes to Consolidated Financial Statements.*

# Consolidated Balance Sheets

*(in thousands except for share amounts)*

| March 31 | 1991 | 1990 |
|---|---|---|
| ***Assets*** | | |
| **Current assets** | | |
| Cash and cash equivalents | $13,621 | $ 4,497 |
| Accounts and royalties receivable, net of allowance of $761 and $641 for doubtful accounts, respectively | 23,943 | 23,981 |
| Inventories | 240 | 1,421 |
| Prepaid expenses and other current assets | 2,475 | 1,698 |
| Total current assets | 40,279 | 31,597 |
| Property and equipment, net | 11,565 | 19,147 |
| Excess of purchase price over net assets of businesses acquired | 11,524 | 12,051 |
| Other assets | 8,343 | 5,707 |
| | $71,711 | $68,502 |
| ***Liabilities and Shareholders' Equity*** | | |
| **Current liabilities** | | |
| Accounts payable | $ 3,416 | $ 3,733 |
| Accrued expenses | 5,306 | 4,169 |
| Accrued compensation and related items | 2,935 | 2,513 |
| Unearned service revenues | 9,397 | 2,391 |
| Current portion of long-term debt and capital lease obligations | 1,805 | 1,582 |
| Current portion of accrued restructuring costs | 922 | 4,841 |
| Total current liabilities | 23,781 | 19,229 |
| Long-term debt, less current portion | 2,023 | 1,601 |
| Capital lease obligations, less current portion | 50 | 311 |
| Long-term portion of accrued restructuring costs, less current portion | 975 | 1,897 |
| Deferred taxes | 151 | 269 |
| **Shareholders' equity** | | |
| Preferred stock, par value $.10 per share, authorized 5,000,000 shares: | | |
| Series A Junior Participating, none issued and outstanding | | |
| Senior Series B Convertible, issued and outstanding 2,142,857 shares (liquidation value $7 per share) | 214 | 214 |
| Common stock, par value $.01 per share, authorized 20,000,000 shares, issued and outstanding 12,064,882 and 11,768,941 shares, respectively | 121 | 118 |
| Additional paid-in capital | 60,174 | 59,125 |
| Retained-earnings deficit | (15,746) | (14,468) |
| Equity adjustment for foreign currency translation | (32) | 206 |
| | 44,731 | 45,195 |
| | $71,711 | $68,502 |

*See Notes to Consolidated Financial Statements.*

## Consolidated Statements of Changes in Shareholders' Equity

*(in thousands)*

| | Preferred Stock Senior Series B | Common Stock | Additional Paid-in Capital | Retained Earnings (Deficit) | Equity Adjustment | Total Shareholders' Equity |
|---|---|---|---|---|---|---|
| Balances at March 31, 1988 | – | $113 | $42,143 | $ 677 | $ 59 | $ 42,992 |
| Common stock issued in connection with incentive stock options exercised by employees | – | 1 | 311 | – | – | 312 |
| Common stock issued in connection with employee stock purchase plan | – | 1 | 705 | – | – | 706 |
| Proceeds from sale of warrant | – | – | 180 | – | – | 180 |
| Equity adjustment for foreign currency translation | – | – | – | – | 11 | 11 |
| Net income | – | – | – | 863 | – | 863 |
| Balances at March 31, 1989 | – | 115 | 43,339 | 1,540 | 70 | 45,064 |
| Senior Series B Convertible Preferred Stock issued | $214 | – | 14,427 | – | – | 14,641 |
| Common stock issued in connection with incentive stock options exercised by employees | – | 1 | 212 | – | – | 213 |
| Common stock issued in connection with employee stock purchase plan | – | 2 | 997 | – | – | 999 |
| Proceeds from sale of warrant | – | – | 150 | – | – | 150 |
| Equity adjustment for foreign currency translation | – | – | – | – | 136 | 136 |
| Net loss | – | – | – | (16,008) | – | (16,008) |
| Balances at March 31, 1990 | 214 | 118 | 59,125 | (14,468) | 206 | 45,195 |
| Common stock issued in connection with incentive stock options exercised by employees | – | 1 | 149 | – | – | 150 |
| Common stock issued in connection with employee stock purchase plan | – | 2 | 900 | – | – | 902 |
| Equity adjustment for foreign currency translation | – | – | – | – | (238) | (238) |
| Net loss | – | – | – | (1,278) | – | (1,278) |
| Balances at March 31, 1991 | $214 | $121 | $60,174 | $(15,746) | $ (32) | $ 44,731 |

*See Notes to Consolidated Financial Statements.*

## Consolidated Statements of Cash Flows

*(in thousands)*

| Year ended March 31 | 1991 | 1990 | 1989 |
|---|---|---|---|
| **Operating activities** | | | |
| Net income (loss) | $ (1,278) | $(16,008) | $ 863 |
| Non-cash restructuring charge | – | 10,953 | – |
| Depreciation and amortization expense | 10,553 | 10,087 | 6,627 |
| Loss from disposal of property and equipment | 372 | – | – |
| Provision for deferred taxes | (118) | (464) | 202 |
| Changes in operating expenses and liabilities: | | | |
| Increase unearned revenue | 7,041 | 525 | 143 |
| (Increase) decrease accounts receivable, net | 154 | 6,265 | (10,463) |
| (Increase) decrease inventories | 1,401 | 6,280 | (244) |
| (Increase) decrease other current assets | (688) | 1,531 | (1,498) |
| Increase (decrease) accounts payable and other current liabilities | 864 | (4,212) | 1,587 |
| Decrease in accrued restructuring costs | (2,856) | – | – |
| Other, net | (217) | (299) | 12 |
| Cash from (used in) operating activities | 15,228 | 14,658 | (2,771) |
| **Investment activities** | | | |
| Additions to property and equipment | (2,215) | (9,151) | (9,716) |
| Disposal of property and equipment at net book value | – | 1,536 | – |
| Capitalized software development costs | (3,601) | (3,396) | (2,515) |
| Payments for acquisitions of businesses, net of cash acquired | – | (7,055) | (500) |
| (Increase) decrease in other non-current assets | 207 | (230) | (949) |
| Cash used in investing activities | (5,609) | (18,296) | (13,680) |
| **Financing activities** | | | |
| Net proceeds from issuance of preferred stock | – | 14,641 | – |
| Net proceeds from issuance of common stock | 1,052 | 1,212 | 1,018 |
| Proceeds from sale of warrant | – | 150 | 180 |
| Proceeds from long-term debt | – | 20,417 | 12,865 |
| Repayment of long-term debt and capital lease obligations | (1,613) | (31,822) | (4,428) |
| Cash from (used in) financing activities | (561) | 4,598 | 9,635 |
| Effect of exchange-rate changes on cash | 66 | 39 | 14 |
| Net increase (decrease) in cash and cash equivalents | 9,124 | 999 | (6,802) |
| Cash and cash equivalents at beginning of year | 4,497 | 3,498 | 10,300 |
| Cash and cash equivalents at end of year | $13,621 | $ 4,497 | $ 3,498 |

*See Notes to Consolidated Financial Statements.*

## Notes to Consolidated Financial Statements

*Note A*
*Significant Accounting Policies*

Business The Company, a Massachusetts corporation, was incorporated on May 27, 1981, to design, develop and market turnkey systems and software for computer-aided publishing applications. In November 1989, the Company exited from the hardware business and has focused on developing, designing and marketing software, services and customized solutions for the design and management of complex documents.

Principles of Consolidation The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Foreign Currency Translation The translation of assets and liabilities of foreign subsidiaries is made at year-end rates of exchange, and revenue and expense accounts are recorded at average rates of exchange. The resulting translation adjustments are excluded from net income and are accumulated as a separate component of shareholders' equity. Realized exchange gains or losses from transaction adjustments were reflected in operations and were not material.

Revenue Recognition Product revenues principally include the sale of software products that are recognized at the time of shipment, and royalty revenues which are recognized upon notification of shipment of the Company's software by the licensee to the end user. Contractual service revenues are recognized ratably over the contract period, which is generally one year, and noncontractual service revenues and training revenues are recognized as the services are performed. Porting and distribution rights revenues are recognized as the Company successfully performs the obligations specified under the agreements.

Cash Equivalents Cash equivalents represent short-term investments with maturities at date of purchase of generally three months or less.

Property and Equipment Property and equipment are stated at cost. Depreciation and amortization are determined on the straight-line method over the estimated useful lives of the related assets. Expenditures for repairs and maintenance are charged to operations as incurred.

Intangible Assets The excess of purchase price over net assets of acquired businesses is amortized over 25-year periods and is included in other expense.

Income Taxes The Company provides for income taxes actually payable and for deferred taxes related to temporary differences between financial and taxable income. Investment and other tax credits are accounted for under the flow-through method.

Earnings (Loss) Per Share Earnings (loss) per share is based on the weighted average number of common shares and, when dilutive, common stock equivalents outstanding during the year. Common stock equivalents are attributable to stock options, common stock warrants and convertible preferred stock.

Basis of Presentation Certain 1990 and 1989 amounts have been reclassified to conform to the 1991 method of presentation.

*Note B*
*Capitalized Software Development Costs*

Costs incurred in the research, design and development of software for sale to others are charged to expense until technological feasibility is established, after which remaining software development costs are capitalized and amortized on a straight-line basis over periods not to exceed three years beginning when the product is offered for sale. The unamortized portion of capitalized software development costs included in other assets amounted to $5,323,000 and $4,537,000 at March 31, 1991 and 1990, respectively.

*Note C*
*Property and Equipment*

Property and equipment at March 31, 1991 and 1990, consist of the following:
*(in thousands)*

| | 1991 | 1990 |
|---|---|---|
| Office and demonstration equipment | $19,675 | $20,936 |
| Development equipment | 6,349 | 8,675 |
| Furniture | 3,941 | 4,491 |
| Leasehold improvements | 654 | 4,384 |
| | 30,619 | 38,486 |
| Less allowances for depreciation and amortization | 19,054 | 19,339 |
| | $11,565 | $19,147 |

*Note D*
*Credit Arrangements*

The Company has a committed, revolving line of bank credit of $15 million, which is unsecured and bears interest at prime rate plus 1/4%. Under the terms of this credit line, the Company may borrow up to the lesser of $15 million or a borrowing base amount consisting of 80% of qualified domestic accounts receivable and 50% of certain qualified international accounts receivable. A commitment fee of 3/8% of the amount of unused credit (computed on an annual basis) is charged quarterly. The Company is required to repay any borrowings under this revolving credit agreement commencing December 31, 1991, in equal quarterly installments through September 30, 1993, with interest at prime rate plus 1 1/2%. The Company may, however, pay the total amount outstanding at any time without penalty. The credit agreement includes certain operating covenants relating to the Company's current ratio, tangible net worth and level of profitability, which must be met on a quarterly basis, as well as restrictions on acquisitions and the payment of dividends. During fiscal 1991, the Company was required to obtain waivers of certain of these covenants. The Company is in the process of renegotiating certain of these covenants. At March 31, 1991, there were no borrowings outstanding under this line of credit.

***Note E***
***Long-term Debt***

Long-term debt at March 31, 1991 and 1990, is as follows:
*(in thousands)*

| | 1991 | 1990 |
|---|---|---|
| Loan payable in quarterly installments of principal and interest at 10% of $229,000 | $2,180 | – |
| Loan payable in monthly principal installments of $41,667 plus interest at prime rate plus 1/2% | 875 | $1,375 |
| Loan payable in monthly principal installments of $30,000 plus interest at prime rate plus 1/2% | 540 | 900 |
| Loan payable in monthly principal installments of $14,667 with interest at 8.85% | 134 | 295 |
| Loan payable in monthly principal installments of $9,225 plus interest at prime rate plus 3/4% | – | 37 |
| Other | – | 16 |
| | 3,729 | 2,623 |
| Less current portion | (1,706) | (1,022) |
| | $2,023 | $1,601 |

Property and equipment with a net book value at March 31, 1991, of approximately $767,000 is pledged as collateral for outstanding long-term debt.

Maturities of long-term debt during each future fiscal year are as follows: 1992 – $1,706,000; 1993 – $1,369,000; 1994 – $654,000.

Interest paid approximated interest expense in each of the three years in the period ended March 31, 1991.

***Note F***
***Shareholders' Equity***

On July 15, 1988, the Company declared a dividend distribution of one Preferred Stock Purchase Right (a "Right") for each outstanding share of the Company's common stock to shareholders of record on July 25, 1988, and for shares of the Company's common stock issued and outstanding thereafter. Each Right entitles the holder to purchase a unit consisting of one-hundredth of a share (a "Unit") of Series A Junior Participating Preferred Stock, $.10 par value (the "Preferred Stock"), at a purchase price of $65.00 in cash. The Rights initially trade with the shares of common stock and are not exercisable. The Rights will separate from the common stock and become exercisable 10 days after a public announcement that a person or group (an "Acquiring Person") acquires beneficial ownership of 20% or more of the outstanding shares of common stock, or 10 business days after commencement of a tender offer that would result in a person or group beneficially owning 30% or more of the outstanding shares of common stock. In the event that the Company is not the surviving corporation in a merger with an Acquiring Person, or the acquisition of 25% of common stock by any person (except pursuant to a tender offer for all shares of common stock determined to be fair by certain directors of the Company), or upon certain self-dealing transactions or increases in an Acquiring Person's ownership of common stock, each holder of an outstanding Right other than an Acquiring Person will receive, upon exercise of a Right, the number of shares of the Company's common stock that equals the exercise price of the Right divided by one half of the current market price of the Company's common stock. In the event that the Company is not the surviving corporation in a merger, or if more than 50% of its assets or earning power is sold or transferred after any person has become an Acquiring Person, each holder of an outstanding Right other than any Acquiring Person will receive, upon exercise of a Right, the number of shares of common stock of the acquiring company that equals the exercise price of the Right divided by one half of the current market price of the acquiring company's common stock. The Rights are nonvoting, expire on July 15, 1998 and may be redeemed at any time prior to becoming exercisable at a price of $.01 per Right.

*Note F*
*Shareholders' Equity (Continued)*

On September 29, 1989 the Company completed a private placement of 2,142,857 shares of its Senior Series B Convertible Preferred Stock, at $7.00 per share. In the event of liquidation, the Series B holders shall have a liquidation preference over all other shareholders of the Company and be entitled to receive $7.00 per share. Thereafter, all other shareholders would be entitled to receive, on a per share basis, an amount equal to $15 million divided by the toral number of shares of common stock that the Series B holders would have been entitled to receive upon conversion. Finally, the Series B holders and common shareholders would share ratably in the remainder, if any, with each share of Series B being deemed to have been converted to common stock. Series B holders shall be entitled to vote on all matters submitted to the common shareholders as a single class with the common shareholders, receiving the number of votes equal to the number of common shares that they would have received upon conversion, except that the Series B holders shall be entitled to elect one director and the Company shall need the approval of the majority of the Series B holders on certain significant events.

The Series B holders could originally convert their preferred stock into common stock on a one-for-one basis ("Conversion Ratio"). This Conversion Ratio is subject to three adjustments based upon the average closing price of the Company's common stock in the National Market System as reported by NASDAQ for periods ranging from ten to twenty days after the release of earnings for the fiscal years ending 1990, 1992 and 1993. An adjustment with respect to fiscal 1990 was made, and the Conversion Ratio increased to 1.09375, which resulted in an additional 200,000 shares of common stock being issuable upon conversion. The second adjustment, if any, will occur at the end of fiscal 1992 and could result in an increase in the Conversion Ratio of up to .25, resulting in up to an additional 535,000 shares of common stock, which amounts will proportionally decrease as the average closing price for the Company's common stock increases from $12.80 per share to $16.47 per share. Finally, the Conversion Ratio may be adjusted with respect to fiscal 1993 so that the total market value of the common stock in the aggregate that the Series B holders are entitled to receive upon conversion is substantially comparable to the amount originally invested by the Series B holders.

The Senior Series B Convertible Preferred Stock may be redeemed by the Company at $21.00 per share, at any time, provided at least 20% of the then outstanding Senior Series B Convertible Preferred Stock are redeemed. Preferred shareholders shall share ratably in any dividends declared on the common stock, as if each Series B share had been converted to common stock.

Effective March 31, 1989, the Company entered into an exclusive distribution agreement for its products in Latin America with ABS Ventures II Limited Partnership ("ABS"). In conjunction therewith, the Company received $150,000 from ABS for the issuance of certain warrants to purchase the Company's common stock through March 31, 1996, at which point the options expire. Under these warrants, ABS can purchase up to 273,438 shares, at a per share exercise price of $6.40. However, the warrant covering 136,719 shares cannot be exercised until March 31, 1992.

As of March 31, 1991, 5,460,268 shares of common stock were reserved for issuance.

*Note G*
*Stock Option and Stock Purchase Plans*

Under the Company's 1983 Stock Option Plan, options to purchase shares of common stock at prices not less than fair market value at date of grant may be granted to key officers and employees. The options are exercisable in whole or in part at any time prior to expiration. The options expire after 10 years from date of grant. Options remain subject to vesting provisions and buyback provisions by the Company in the event of voluntary or involuntary termination of the employee. Options are nontransferable other than in the event of death. At March 31, 1991, options covering 421,870 shares were exercisable, and options covering 258,605 shares were available for future grants.

A summary of activity in the Plan is presented below:

| | Number of Shares | Price Range of Shares |
|---|---|---|
| Outstanding at April 1, 1989 | 1,550,693 | $ .57 - 19.38 |
| Granted | 686,849 | 6.25 - 9.00 |
| Exercised | (60,342) | .57 - 5.00 |
| Cancelled | (224,413) | 4.00 - 19.38 |
| Outstanding at March 31, 1990 | 1,952,787 | .57 - 19.38 |
| Granted | 1,768,805 | 3.00 - 6.63 |
| Exercised | (45,860) | 1.13 - 5.00 |
| Cancelled | (1,873,296) | 3.13 - 19.38 |
| Outstanding at March 31, 1991 | 1,802,436 | $ .57 - 19.38 |

During fiscal 1991, the Board of Directors, subject to shareholder ratification at the Special Meeting of Shareholders in Lieu of Annual Meeting to be held August 9, 1991, approved the cancellation and reissuance of certain stock options, upon the request of the participant, that had been granted to such participant during the period from the Plan's inception to November, 1990. This exchange program resulted in the cancellation of options covering 1,435,805 shares, at exercise prices ranging from $4.00 to $19.38 per share and the issuance of options covering 1,435,805 shares, at an exercise price of $3.13 per share which represented fair market value at that date. Options cancelled and then reissued at that date began a new vesting period of the same duration as the original grants.

In March 1989, the Board of Directors adopted the 1989 Director Stock Option Plan, which was subsequently approved by the Company's shareholders. Under the terms of this Plan, 150,000 shares of common stock were reserved for the issuance of options to non-employee directors. Each current non-employee director received an option covering 12,000 shares, vesting over three years (beginning one year after the date of grant), at the fair market value of $8.13 on the date of grant and surrendered his or her outstanding option covering 4,500 shares that were issued under the 1983 Stock Option Plan. In future years, each newly elected non-employee director may receive options to purchase up to 20,000 shares of common stock upon election as director. At March 31, 1991 options for the purchase of 24,000 shares were exercisable under the Director Stock Option Plan. No options have been exercised.

During fiscal 1987, the Company adopted, with shareholder approval, an Employee Stock Purchase Plan whereby eligible officers and employees could invest up to 12% of their total compensation in shares of the Company's common stock. The purchase price is 85% of the fair market value of the stock on the offering commencement date or the offering termination date (typically six months after commencement date), whichever is lower. In May 1989, the Board of Directors reserved an additional 400,000 shares for issuance under the Plan, and extended the term of the Plan for an additional two years, all of which were subsequently ratified by the shareholders. The total number of shares reserved under the Plan is limited to 600,000 shares of common stock, of which all shares were issued in connection with the first eight offerings completed during the period from November 6, 1987 to May 3, 1991. In April of 1991, the Board of Directors, subject to shareholder ratification at the Special Meeting in Lieu of Annual Meeting of Shareholders to be held August 9, 1991, reserved for issuance under the Plan an additional 400,000 shares, extended the term for an additional two years, and provided for annual in lieu of semi-annual offerings. As of March 31, 1991, 2,061,041 shares of common stock under the stock option plan and 67,000 shares of common stock under the employee stock purchase plan were reserved for issuance.

*Note H*
*Leases*

The Company leases its facilities, including sales offices, and certain equipment under various operating and capital leases, which expire through 2000. Future minimum rental payments at March 31, 1991, under agreements classified as operating and capital leases with noncancellable terms in excess of one year, are as follows:

*(in thousands)*

| Fiscal years ending March 31 | Operating Leases | Capital Leases |
|---|---|---|
| 1992 | $ 7,636 | $113 |
| 1993 | 6,866 | 47 |
| 1994 | 4,996 | 10 |
| 1995 | 4,927 | – |
| 1996 | 4,400 | – |
| Thereafter | 18,674 | – |
| Total minimum lease payments | $47,499 | 170 |
| Less amount representing interest | | 21 |
| Present value of net minimum lease payments | | $149 |

The operating lease minimum payments are based on the Company's existing leases including certain renewal options.

Rent expense amounted to $10,164,000, $10,697,000 and $8,077,000 for the years ended March 31, 1991, 1990 and 1989, respectively.

Included within accrued liabilities are amounts accrued for rent at March 31, 1991 and 1990 totaling $1,565,000 and $554,000 respectively.

*Note I*
*Restructuring*

In fiscal 1990, the Company initiated a significant restructuring of its corporate infrastructure and began a repositioning of its basic business direction. Due to deteriorating sales and profitability of its turnkey systems business, the Company accelerated its transition from being a reseller of workstations manufactured by others, bundled with the Company's software, to a software and specialized services provider, reallocated certain resources to the services component of the Company's business and reduced and/or eliminated assets that were formerly required to support the turnkey systems business of the Company. The restructuring also required that the organization of the Company be streamlined to reflect the shift in the Company's direction.

Specifically, during the third quarter of fiscal 1990, the Company recorded a $13.9 million pre-tax charge to operations relating to its plan of restructuring. Included in this charge to operations were $6 million relating to the elimination of inventory and fixed assets, $5.9 million for the consolidation of the Company's home office facilities and $2 million for employee severance costs. At March 31, 1991, the accrued restructuring charge relates primarily to future lease obligations on unutilized properties.

## Note J
## Income Taxes

The provision for income taxes is comprised of the following:

| (in thousands) | 1991 | 1990 | 1989 |
|---|---|---|---|
| Current: | | | |
| Federal | $ – | $ 288 | $ 235 |
| State | 162 | – | 68 |
| Foreign | 206 | (134) | 165 |
| Total current | 368 | 154 | 468 |
| Deferred (credit) | (118) | (464) | 197 |
| | $ 250 | $ (310) | $ 665 |

The provision for income taxes is based on the following amounts of income (loss) before income taxes:

| (in thousands) | 1991 | 1990 | 1989 |
|---|---|---|---|
| Domestic | $ 229 | $(15,375) | $1,131 |
| Foreign | (1,257) | (943) | 397 |
| | $(1,028) | $(16,318) | $1,528 |

The components of the Company's deferred income tax provision are as follows:

| (in thousands) | 1991 | 1990 | 1989 |
|---|---|---|---|
| Research and development costs, net of amortization | $ 319 | $ 542 | $ 547 |
| Allowance for uncollectible accounts receivable, vacation and other reserves | 129 | 11 | (281) |
| Inventory adjustments | 40 | 217 | (228) |
| Net operating loss and tax credit carryforwards | – | – | 92 |
| Excess of tax over financial statement depreciation | (418) | (235) | 65 |
| Restructuring reserve less amounts for which no tax benefit was realized | 446 | (990) | – |
| Accrued rent | (633) | – | – |
| Other, net | (1) | (9) | 2 |
| | $ (118) | $ (464) | $ 197 |

Total income taxes reported are different than the amount that would have been computed applying the federal statutory tax rate to income before income taxes. The difference is attributable to the following:

| (in thousands) | 1991 | 1990 | 1989 |
|---|---|---|---|
| Computed at federal statutory rate of 34% | $ (350) | $ (5,548) | $ 520 |
| State income taxes, net of federal tax benefit | 18 | (130) | 60 |
| Nondeductible amortization | 179 | 191 | 70 |
| Other nondeductible expenses | 21 | 34 | 42 |
| Loss for which no tax benefit was realized | 619 | 5,174 | – |
| Tax credits | – | – | (45) |
| Benefit of net operating loss carryforward | (489) | – | – |
| Other, net | 252 | (31) | 18 |
| | $ 250 | $ (310) | $ 665 |

At March 31, 1991, the Company has a net operating loss carryforward of approximately $9.8 million that expires in 2006, and approximately $1.5 million of research and development tax credit carryforwards available to reduce future federal income tax liability through 2003.

During 1991, 1990 and 1989, the Company made $129,000, $327,000 and $881,000 in income tax payments, respectively.

*Note K*
***Industry Segment, Geographic and Customer Information***

The Company, which operates in a single industry segment, designs, develops and markets systems and software for computer-aided publishing applications.

Information regarding geographic areas at March 31, 1991 and 1990, and for the years then ended is as follows:
*(in thousands)*

| March 31, 1991 and for the year then ended | United States | Canada | Europe | Eliminations | Total |
|---|---|---|---|---|---|
| Sales to unaffiliated customers | $ 57,642 | $ 5,789 | $20,887 | $ – | $ 84,318 |
| Intercompany transfers | $ 7,555 | $ – | $ – | $ (7,555) | $ – |
| Net revenues | $ 65,197 | $ 5,789 | $20,887 | $ (7,555) | $ 84,318 |
| Income (loss) from operations | $ 39 | $ (504) | $ (335) | $ 309 | $ (491) |
| Identifiable assets | $ 71,310 | $ 1,703 | $12,868 | $(14,170) | $ 71,711 |
| Liabilities | $ 22,614 | $ 995 | $14,121 | $(10,750) | $ 26,980 |
| **March 31, 1990 and for the year then ended** | | | | | |
| Sales to unaffiliated customers | $ 68,820 | $6,845 | $13,178 | – | $ 88,843 |
| Intercompany transfers | $ 6,176 | – | – | $ (6,176) | – |
| Net revenues | $ 74,996 | $6,845 | $13,178 | $ (6,176) | $ 88,843 |
| Loss from operations | $(14,225) | $ (205) | $ (599) | $ (20) | $(15,049) |
| Identifiable assets | $ 65,010 | $4,082 | $12,142 | $(12,732) | $ 68,502 |
| Liabilities | $ 17,178 | $4,168 | $13,029 | $(11,068) | $ 23,307 |

Intercompany transfers between geographic areas are accounted for at prices that approximate prices charged to unaffiliated customers.

U. S. export sales approximated 4%, 8% and 7% of revenues during fiscal 1991, 1990 and 1989, respectively.

*Note L*
***Research and Developement Agreements***

On March 31, 1987, the Company entered into an arrangement with ML Technology Ventures, L.P. (MLTV) to perform ongoing product development for the personal-computer and international electronic publishing markets. MLTV, a research and development limited partnership sponsored by Merrill Lynch Capital Markets, provided the Company with $3.5 million for services performed through fiscal 1989. In connection with the arrangment, MLTV obtained a warrant at a cost of $378,125 to purchase 125,000 shares of the Company's common stock through March 1994. The Company incurred $800,000 and $2,700,000 in expenses during the years ended March 31, 1989 and 1988, respectively, attributable to research performed under this arrangement. The reimbursement for these expenses has been presented in the consolidated financial statements net of the related research and development costs of the same amount.

Under the terms of a related agreement, the Company purchased an option on March 31, 1987 for $378,125 to enter into a joint venture with MLTV for commercialization of the products developed as a result of the research and development. The Company exercised this option in September 1987 and made an initial cash investment of $25,000 in the joint venture. This agreement also provided the Company with the option to acquire all of MLTV's rights in the joint venture for $5.5 million. During the three year period ended March 31, 1991 the Company recorded net revenues from the sale of joint venture products of $1,830,000 in 1991, $7,069,000 in 1990 and $7,475,000 in 1989. These amounts represented 90% of the joint venture's revenues in 1991 and 97.5% of such revenues in 1990 and 1989.

In January of 1991, the Company exercised its option to purchase all of MLTV's rights in the joint venture under the following modified terms: (i) payment of $2,750,000, payable in twelve equal quarterly installments commencing March 1, 1991, (ii) issuance of a warrant to purchase 150,000 shares of the Company's common stock through December, 1995 at a per share exercise price of $3.50, and (iii) a reduction of the per share exercise price to $3.50 for the original warrant covering 125,000 shares and its extension to December, 1995.

On October 21, 1988, the Company entered into a joint venture with PruTech Research and Development Partnership III (PruTech) to perform ongoing product development for various electronic publishing markets. PruTech, a research and development limited partnership sponsored by Prudential-Bache Securities Inc., has provided the Company with $3 million for services that were completed as of March 31, 1990.

The Company incurred $400,000 and $2,600,000 in expenses during the years ended March 31, 1990 and 1989, respectively, attributable to research performed under this arrangement. The reimbursement for these expenses has been presented in the consolidated financial statements net of the related research and development costs of the same amount.

The Company is committed to manufacture and market the products so developed for this joint venture. In return, the Company receives 95% of the revenues from the sale of such products during the first three years and 70% of such revenues commencing October 1, 1991. In October 1989 the Company made a $50,000 payment to retain its option to purchase PruTech's interest in the joint venture. The Company had the right to purchase PruTech's interest at any time prior to October 15, 1991, for $7,106,000, less any profits received to date by PruTech from the joint venture. In October of 1990, however, this right to so purchase lapsed at the Company's election. Commencing February 1, 1992, and for each quarter thereafter, PruTech can purchase the Company's interest in the joint venture at a price equal to 10 times the joint venture's net profits for the previous quarter. In connection with the arrangement, PruTech obtained a warrant at a cost of $180,000, effective May 22, 1990, to purchase 290,039 shares of the Company's common stock through October 1995 at $6.40 per share. This amount is included in additional paid-in capital. The Company also received $150,000 from the joint venture as a licensing fee for the use of certain underlying technology by the joint venture. The Company recorded net revenues form the sale of joint ventured products of $1,985,132 in 1991 and $1,916,116 in 1990.

***Note M***
***Acquisition***

On November 2, 1989, the Company completed its acquisition of Interleaf France S.A., the exclusive distributor of the Company's products in France, Switzerland, Belgium and Luxembourg at a price of $7,055,000. The acquisition was accounted for under the purchase method of accounting. Accordingly, the balance sheet accounts of Interleaf France S.A. and the results of its operations have been included in the consolidated statements of the Company since the date of acquisition. The excess of the Company's investment in Interleaf France S.A. at the date of final acquisition, over the fair market value of assets acquired of $4,092,000 and liabilities of $4,725,000 assumed of the company, amounted to approximately $7,688,000 and is being amortized over a period of 25 years.

Had the acquisition occurred at April 1, 1989 the pro forma unaudited consolidated results of operations would have been as follows:
*(in thousands except per share amounts)*

| Year ended March 31 | 1991 | 1990 |
|---|---|---|
| Revenues | $84,318 | $ 92,057 |
| Net loss | $ (1,278) | $(16,755) |
| Net loss per share | $ (.11) | $ (1.44) |

## Report of Ernst & Young, Independent Auditors

Board of Directors
Interleaf, Inc.

We have audited the accompanying consolidated balance sheets of Interleaf, Inc. and subsidiaries as of March 31, 1991 and 1990, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period ended March 31, 1991. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Interleaf, Inc. and subsidiaries at March 31, 1991 and 1990, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 1991, in conformity with generally accepted accounting principles.

Ernst + Young

Boston, Massachusetts
April 29, 1991

## Supplemental Financial Information

The following summarizes unaudited selected quarterly results of operations for the years ended March 31, 1991 and 1990, and the market range for the Company's common stock for those periods:

*(In thousands except for per share amounts)*

| Quarter ended | June 30 | September 30 | December 31 | March 31 | Year |
|---|---|---|---|---|---|
| **Fiscal 1991** | | | | | |
| Revenues | $18,012 | $20,689 | $22,524 | $23,093 | $84,318 |
| Net income (loss) | (2,929) | 55 | 670 | 926 | (1,278) |
| Net income (loss) per share | (0.25) | – | 0.05 | 0.06 | (0.11) |
| Common stock prices | | | | | |
| High | 8 | 7 7/8 | 4 1/2 | 6 7/8 | 8 |
| Low | 5 1/4 | 2 1/2 | 2 3/4 | 3 | 2 1/2 |
| **Fiscal 1990** | | | | | |
| Revenues | $22,424 | $22,005 | $21,516 | $22,898 | $88,843 |
| Net income (loss) | 126 | (968) | (15,316) | 150 | (16,008) |
| Net income (loss) per share | .01 | (.08) | (1.31) | .01 | (1.37) |
| Common stock prices | | | | | |
| High | 9 5/8 | 8 1/8 | 7 1/8 | 7 3/8 | 9 5/8 |
| Low | 7 3/4 | 6 7/8 | 5 3/4 | 5 1/2 | 5 1/2 |

The Company has never paid cash dividends on its common stock. The Company presently intends to retain earnings for use in its business and therefore does not anticipate paying any cash dividends in the foreseeable future.

The Company's common stock has been traded on the NASDAQ National Market System since its initial public offering in June 1986.

On May 6, 1991, there were 1,209 holders of record of the Company's common stock.

## Selected Five-Year Financial Data

*(In thousands except for per share amounts)*

| Year ended March 31 | 1991 | 1990 | 1989 | 1988 | 1987 |
|---|---|---|---|---|---|
| **For the year** | | | | | |
| Total operating revenues | $84,318 | $88,843 | $82,780 | $58,389 | $37,173 |
| Net income (loss) | (1,278) | (16,008) | 863 | 6,980 | (410) |
| Net income (loss) per share | (0.11) | (1.37) | 0.07 | 0.59 | (0.04) |
| **At year end** | | | | | |
| Total assets | 71,711 | 68,502 | 74,051 | 61,762 | 44,734 |
| Long-term obligations | 3,048 | 3,809 | 13,246 | 4,813 | 1,363 |
| Total shareholders' equity | 44,731 | 45,195 | 45,064 | 42,993 | 35,290 |

## *Executive and Other Officers*

William W. Barnes
*Vice President of Human Resources*

Lawrence S. Bohn
*Vice President of Business Development*

David A. Boucher*
*Chief Executive Officer and Chairman*

David J. Collard*
*Senior Vice President of Finance and Administration and Chief Financial Officer*

Stephen J. Cummings*
*Vice President of International Operations*

Frederick J. Egan
*Vice President of Corporate Relations*

Robert A. Fisher
*Vice President of Customer Support*

John K. Hyvnar*
*General Counsel*

Dianne E. Jenett
*Regional Sales Vice President*

Edward B. Mallen*
*Vice President of U.S. Sales*

James M. Meyer
*Vice President of Systems Integration*

Stephen D. Pelletier*
*Vice President of Engineering and Chief Technical Officer*

Mark K. Ruport*
*President and Chief Operating Officer*

Laura K. Scarbro
*Vice President of Workstation Engineering*

Matthew Szulik
*Regional Sales Vice President*

Andrew J. Van Abs
*Vice President of Engineering Solutions*

Karen S. Warner
*Vice President of Engineering Planning*

*Executive Officer

## *Board of Directors*

Frederick B. Bamber
*General Partner*
*Applied Technology Partners*

David A. Boucher
*Chief Executive Officer and Chairman*
*Interleaf, Inc.*

Dr. Michael Hammer
*President*
*Hammer & Company, Inc.*

André Harari
*Directeur Général*
*Compagnie Financière du Scribe*

Clinton P. Harris
*Senior Vice President*
*Advent International Corporation*

George D. Potter, Jr.
*Vice President of Marketing*
*GESCAN International, Inc.*

Mark K. Ruport
*President and Chief Operating Officer*
*Interleaf, Inc.*

Patrick J. Sansonetti
*Senior Vice President*
*Advent International Corporation*

## *Interleaf Fellows*

Elected by the engineering staff in recognition of technical excellence:

Valerie Beaubien
James L. Crawford
Mark S. Dionne
K. Deborah Landsman
Kimbo B. Mundy
Kirk L. Reistroffer
Patrick J. Slaney
Timothy Walters
Robert Watkins

## *Shareholder Information*

Common Stock
Interleaf's common stock is traded over the counter on the NASDAQ National Market System — symbol LEAF.

Annual Meeting
The Annual Meeting of Shareholders will be held on August 9, 1991 at 9 a.m. at the Bank of Boston, 100 Federal Street, Boston, MA.

Form 10-K
Copies of Interleaf's Annual Report on Form 10-K are available upon request from:
Investor Relations, Interleaf, Inc.,
Prospect Place, 9 Hillside Avenue,
Waltham, MA 02154

Transfer Agent
The First National Bank of Boston, Boston, MA

Shareholder Change of Address
You may report a change of address by sending a signed and dated letter or postcard stating you are an Interleaf shareholder, the name in which the stock is registered, and your previous and current address to:
The First National Bank of Boston,
Shareholder Services Division,
PO Box 644, Boston, MA 02102–0644.

Investor Relations
To receive further information about Interleaf, please contact: Investor Relations
(617) 290.0710

Independent Auditors
Ernst & Young
Boston, MA

Legal Counsel
Hale and Dorr
Boston, MA

## *Corporate Directory*

Corporate Headquarters
Interleaf, Inc., Prospect Place, 9 Hillside Avenue
Waltham, MA 02154

Sales Offices

United States
Phoenix, Arizona; Irvine, Los Angeles, Sacramento, San Diego, Santa Clara, California; Denver, Colorado; Norwalk, Connecticut; Tampa, Florida; Atlanta, Georgia; Chicago, Illinois; Greenbelt, Maryland; Boston, Massachusetts; Detroit, Michigan; St. Louis, Missouri; Iselin, New Jersey; Raleigh, North Carolina; Cleveland, Ohio; Philadelphia, Pennsylvania; Dallas, Houston, Texas; Seattle, Washington

Canada
Vancouver, British Columbia; Ottawa, Toronto, Ontario; Montreal, Quebec

International
Adelaide, Canberra, Melbourne, Sydney, Australia; Brussels, Belgium; Paris, France; Hong Kong; Milan, Rome, Italy; Amsterdam,The Netherlands; Zurich, Switzerland; Stockholm, Sweden; Richmond, Manchester, U.K.; Dusseldorf, Frankfurt, Hamburg, Munich, Stuttgart, West Germany

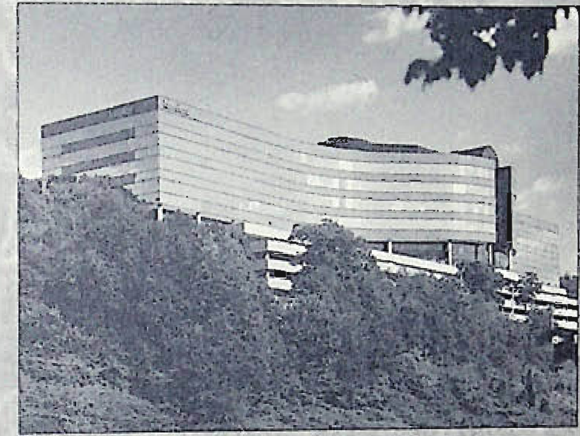
## *About This Annual Report*

This annual report was created by Interleaf's Corporate Design Group with Interleaf software. Text and financial information were entered by people in various departments throughout the Company and transferred electronically to the Design Group. The illustrations were created with Interleaf's on-line drawing tools. Files were sent to a typesetter for final output of camera-ready pages.

Copy:
Adeline Chan,
*Interleaf Corporate Design Group*

Design:
Pamela Simonds,
*Interleaf Corporate Design Group*

Photography:
David Leifer
Wayne Soverns, Jr.



Interleaf, founded in 1981, is a leading international supplier of document information systems and services. Interleaf solutions allow even the largest organizations to more productively manage the document lifecycle, from accessing information to distributing it electronically or on paper. Interleaf's family of configurable technology supports all major standards and runs on every major hardware platform, from personal computers to mainframes. Interleaf has over 50 sales offices, subsidiaries and distributors worldwide and more than 100,000 users.

Interleaf

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