Interleaf

Interleaf, Inc.

Annual Report 1992

Interleaf is a leading international supplier of document systems for major corporations in industries ranging from automotive, commercial aviation, petroleum and pharmaceuticals to electronics, telecommunications, investment and banking. Interleaf document systems solutions—products, tools and services—help organizations manage the document lifecycle, from accessing information to distributing it electronically or on paper. Our products include Interleaf 5 for document creation, WorldView for electronic viewing and distribution of documents, and Relational Document Manager for database management of Interleaf documents, as well as data from other sources. Interleaf tools extend these products for specialized applications. And our expert services help organizations with every aspect of implementing a successful document system, including business analysis, application engineering, training and systems support.

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To Our Shareholders

Interleaf closed fiscal 1992 with record revenues. We set out to lead the industry with innovative document technologies, creating products that help corporations leverage their most important investment—information. We also set out to strengthen our international presence. Our growth in fiscal 1992 was largely based on Interleaf's progress toward achieving these objectives.

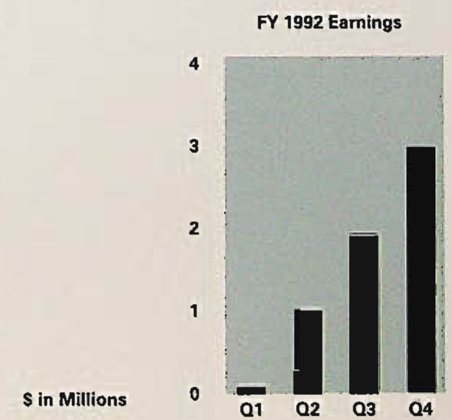
Record Revenues

The numbers tell a story of solid business growth. Revenues for fiscal 1992 were $100.3 million, up 19 percent compared to $84.3 million for fiscal 1991. The Company's earnings were $6.0 million ($.38 per share) in fiscal 1992 compared to a loss of $1.3 million for fiscal 1991.

We grew both through sales to our prior customer base and through sales to new customers. Upgrades to our Interleaf 5 electronic publishing product increased the Company's maintenance revenues by 62 percent. And services—for consulting, customizing Interleaf products and automating business processes—grew 33 percent. This is a testament to Interleaf's ability and commitment to respond to customers' complex and specialized requirements.

Strong Cash Flow

An increase in our strong cash flow also reflects the Company's growth. Interleaf began fiscal 1992 with $13.6 million in cash and equivalents and closed with $18.2 million—a 34 percent increase—despite the $7.5 million purchase of our German distributor in the second quarter. Our ability to generate substantial cash flow and the solid balance sheet that results provide a strong foundation for the business.



Market and Technology Progress

This year, Interleaf launched our WorldView system, the first electronic document viewing and distribution system in the industry that allows organizations to accept text and graphics from virtually any source and to view them on virtually any computer. We leveraged our ability to modify and extend our products to move beyond manufacturing industries into the banking, insurance and investment markets. We also expanded our foothold in the European Community market and made significant progress toward opening the document systems industry in Japan. Furthermore, we continued to make our software architecture even more open, adhering to international standards in line with the worldwide movement toward open software applications, which can share common data formats.

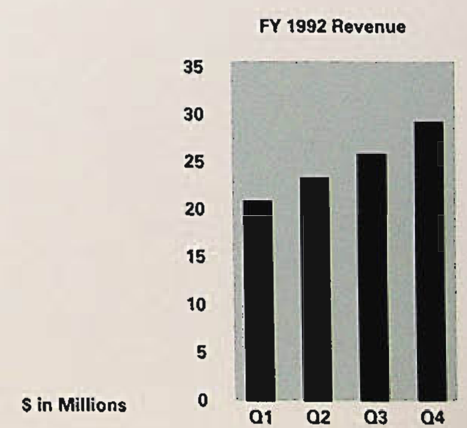
Summary

Interleaf is in a strong position. Sustaining financial health in an adverse economy, increasing revenues while expanding worldwide and delivering technological innovations that keep pace with the business needs of a wide range of industries go along with Interleaf's position as the most innovative multi-national supplier of document systems solutions.

We believe that our business foundation is very solid and that the opportunity is clear for even greater growth in fiscal 1993.

David A. Boucher
CEO and Chairman

Mark K. Ruport
President and COO



Another Year of Interleaf Achievements and Growth

Continuing Technology Leadership

One of Interleaf's competitive advantages is our ability to lead the industry with innovative technology. Interleaf was among the first in the industry to see beyond documents as static stacks of paper. We envisioned and are delivering products and technologies that allow electronic documents to be intelligent and to be active participants in the business information process.

We took the lead again this year with the introduction of our WorldView system.

WorldView is the first electronic document viewing and distribution system that accepts text and graphics from virtually any source and allows users to view them on virtually any computer. With WorldView, Interleaf customers have a low-cost system for sending information to thousands of people and powerful, yet easy-to-use features for finding specific information from volumes of documents.

We launched WorldView in January and are continuing to receive very positive reviews:

"[Interleaf takes] into account what people actually need to do with information—see it, read it, annotate it, print it."

Ronni Marshak, Editor-in-Chief,
The Office Computing Report, *as quoted in*
Computer Reseller News, *February 24, 1992.*

"The WorldViewer package enables Interleaf to go beyond their traditional market. Before, the tools made available were for the people who create documents. With this product, they're geared towards the reader or consumer. This software enables people to view mission critical documents. . . ."

Joel Wecksell, Vice-President,
The Gartner Group, computer industry market research firm,
as quoted in Info Canada, *April 1992.*

"The [WorldView] system gives users fast access to any information, including text, graphics, tables and charts. . . . Because the document is linked to the software, the user has guaranteed accuracy and is up to date."

Stephen Buckley, Publications Manager,
MOSS Systems, a CAD company in the U.K., as quoted in
Computer Weekly, *England, March 26, 1992.*

Growing Business Opportunities

All our products are extensible. Interleaf, as well as our customers, can modify the interface, extend functions, integrate with other applications and add intelligence to documents.

The ability to extend Interleaf products allows organizations to have highly tailored and highly automated applications. Many Interleaf customers and strategic partners have developed sophisticated active documents to guide them through complex tasks, such as aircraft maintenance procedures, and to automatically manage the structure of their documents for adherence to stringent industry or company standards.

Extensibility also allows users to interact with data through documents. Using documents as an interface to data can facilitate and enhance many business processes. This ability to provide document-based ways of interacting with non-document data is making it possible for Interleaf to move beyond our traditional markets—aerospace, automotive, pharmaceutical—to other markets, such as banking, insurance and investment. This year, Interleaf acquired many new customers in these industries, such as Abbey National Bank in the U.K. and Fidelity Investments in the U.S., whose applications are highlighted later in this report.

Supporting International Standards

One of the challenges facing organizations today is the difficulty in accessing, sharing, reusing and managing information across enterprise-wide workgroups. The computer industry continues to embrace open systems, which enable workgroups to interchange information freely across different software applications and hardware platforms without compromising data integrity or losing data.

Interleaf has a firm foundation for document-based open systems. Our software architecture provides organizations with the flexibility to choose the system configuration that best suits their enterprise-wide publishing and information processes, and to modify any part of the system for unique and evolving requirements. Interleaf systems are also object-oriented, treating documents and their components as individual objects, thereby enabling organizations to structure, manage and program intelligence into documents. Being object-oriented is a key aspect of any open system.

Having an open system architecture also enables us to enhance our products by integrating with other state-of-the-art technologies, such as video animation and sound for multi-media solutions, and with other sources of data, such as statistical analysis and Computer-Aided Software Engineering (CASE) applications.

This year, Interleaf further increased support for international standards. We introduced the CALS Solutions Portfolio, a comprehensive combination of software and services. This product suite allows organizations to comply with the U.S. Department of Defense's (DoD) Computer-Aided Acquisition and Logistics Support (CALS) initiative for using Standard Generalized Markup Language (SGML) in the exchange and management of electronic data. SGML is a machine-neutral document definition language. It allows organizations to interchange information freely among departments and across organizations, eliminating the need for converting documents or for re-keying information. The CALS Solution Portfolio provides users with easy-to-use tools for creating and revising documents in SGML format. With more and more organizations worldwide adopting SGML, it is fast becoming the leading international standard for open systems. The CALS Solutions Portfolio paves the way for an Interleaf SGML-based open system.

In addition, Interleaf announced support for leading graphical user interfaces (GUIs)—the first being Interleaf 5 for OPEN LOOK—which will help occasional users of our products to learn and use our products more quickly. Support for Motif, Microsoft Windows and Macintosh user interfaces will follow soon.

Expanding International Market Presence

Interleaf is successfully building a strong market presence worldwide and is increasing the segment of our business outside North America. This year, sales in Europe and Asia accounted for 40 percent of the Company's total sales revenue.

Our German subsidiary has played a key part in the Company's international growth. Acquired in the second quarter as a wholly owned subsidiary, Interleaf GmbH brought many assets: a successful operation consisting of a direct sales force and distributors throughout Germany, a strong marketing organization, a growing services team and a foothold in major vertical markets. This subsidiary has already achieved substantial success in penetrating the German automotive industry with Interleaf products on site at every major automotive manufacturer in Germany.

With 14 sales and support offices in the European Community (EC) countries and with strong multi-lingual products, Interleaf is establishing a firm stronghold in the EC market.

Interleaf is also making progress in the Asian market with the Beta release of Interleaf 5, Japanese version. Interleaf 5 is technologically very advanced compared with other products in this market, and we are preparing to take full advantage of our position.

Interleaf Applications in Major Corporations Worldwide

Extensible, open document systems and expertise in solving complex information challenges are Interleaf's hallmarks. The following pages highlight six Interleaf customer applications from fiscal 1992.

Abbey National

Abbey National is one of the largest financial organizations in the United Kingdom. Getting the right information in a timely manner to its 700 branches is more than a matter of efficiency and good customer service. An error in any one of Abbey's forms or in its 30 different procedures manuals could have adverse legal consequences.

When you consider that legislative changes occur frequently, it's clear why Abbey National needs an effective document process. Producing documents using word processors and delivering them using the postal system or courier services proved ineffective. Information was often out of date and inaccurate. And the process was expensive and time consuming.

With Interleaf's help, Abbey is redesigning its entire document process, enabling the firm to produce hundreds of revision pages and to distribute those pages daily. Abbey's authoring group will use Interleaf 5 to publish and manage revision pages from manuals. Soon, branch personnel running WorldViewer on PCs will be able to access the latest versions of forms and procedures electronically. And with WorldViewer's Notes feature, end users can affect and improve the documentation they use by noting inaccuracies for authors to incorporate in future releases. The next phase in Abbey's implementation plan—the transmission of Interleaf documents directly to the branches using satellite technology—prepares Abbey National for twenty-first century information distribution.

photograph courtesy of Abbey National

Fidelity Investments

Fidelity Investments is the largest mutual fund company in the U.S., managing over $150 billion in assets. Though providing investment management to the mutual funds is the company's primary service, supporting clients with publications, such as shareholder reports, is vital for maintaining Fidelity's reputation for service excellence.

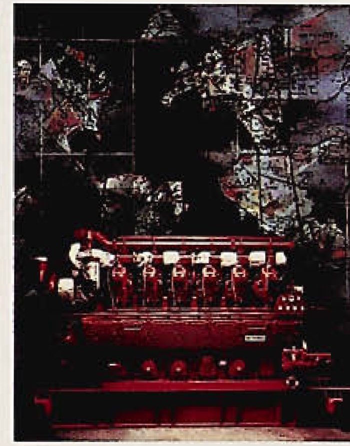
Producing shareholder reports semi-annually for over 180 funds is a challenge. Multiple departments contribute and review information; text and financial data are re-keyed from different reports; and many paper copies of the shareholder report go through numerous iterations during the review cycle. This method of producing shareholder reports creates risks in maintaining information accuracy and impairs the timely delivery of the reports.

As a first step toward streamlining and improving information sharing, report composition and the review process, an Interleaf and Fidelity project team is integrating publishing functionality, active document technology and WorldView with the fund accounting database. The Fund Reporting Automation System, as the database is called, will supply the required financial data while an Interleaf active report template will automatically import and filter that data into a finished document. Using WorldView, Fidelity will then distribute the completed reports online to reviewers.

photograph of the New York Stock Exchange
by permission of Superstock, Inc.

Waukesha Engine

Waukesha Engine, a division of Dresser Industries, Inc., is a full-line manufacturer of natural gas engines for the petroleum, power generation and municipal markets worldwide. Each engine Waukesha manufactures is custom-built and complex, consisting of thousands of parts and having a long life span. And for every engine, there is a set of extensive documentation, including operation and maintenance manuals, repair and overhaul manuals, as well as parts and price lists.



Interleaf is enabling Waukesha to help its distributors respond more quickly to customer requests. Waukesha is using a WorldView-based electronic parts identification system—complete with parts illustrations and bills of materials in three different price guides—to distribute engine information electronically. Distributors can use an engine serial number to access data and can also search and retrieve all the parts and pricing information needed to service or overhaul the engine. The distributors can then electronically copy the parts, service and pricing information into on-demand proposals and parts orders.

Waukesha envisions many other applications for WorldView. The manufacturer plans to provide every sales representative with finger-tip access to thousands of pages of product information stored on CD, enabling the entire sales force to respond more effectively to prospect and customer interest. The use of motion video in CD-based operation, maintenance and service procedures is also part of Waukesha's future plans. Another application may be the integration of procedural documentation with computer-aided online engine monitoring systems, giving customers and Waukesha service personnel access to information for the troubleshooting and maintenance processes.

photograph of a Waukesha engine
courtesy of Waukesha Engine

Tektronix

Tektronix is a billion-dollar, international electronics manufacturer recognized for its innovative and extensive product line, which includes test and measurement equipment, X terminals and color printers. To achieve one of its business objectives—to deliver products faster—Tektronix is standardizing on Interleaf document systems for its worldwide operations.

Tektronix produces thousands of technical manuals to support its products. Each manual can take 3 to 8 months to produce, and the process involves numerous workgroups throughout the organization. Furthermore, documents are in effect for the life of the products they support. For some products, such as certain popular oscilloscope models, the life span could be as long as 20 years. Maintaining these documents and managing such a complex process so the right person accesses and uses the right version of a document are great challenges.

The Interleaf document system will touch every aspect of Tektronix's enterprise-wide document process. Using Interleaf 5 as the standard publishing software will enable Tektronix to ensure information consistency, eliminate redundant tasks and improve productivity. Interleaf 5 will also allow Tektronix to create and revise documents in several languages, including Japanese. And Relational Document Manager will provide information-intensive departments with powerful management for the entire document process—from data access and version control to configuration and review-cycle management. Tektronix is planning to enhance other document and engineering processes by customizing the Interleaf system and by creating active document applications, such as an expert editor that aids authors in adhering to industry or company standards.

photograph of the Tektronix XP18 terminal
courtesy of Tektronix

Ford of Europe

Ford of Europe (FoE), a subsidiary of Ford Motor Company, USA, has many sites throughout Europe that manufacture and distribute motor vehicles to the European market. The company's authoring, translation and communication processes span Europe and cross the Atlantic. FoE's Interleaf solution is a combination of products and services that is helping the company develop an open document system to support global work processes.

An efficient authoring software for publishing technical documentation was just one component of the document solution FoE was seeking. With a network of multi-site, multi-national workgroups contributing to the production of documentation for an extensive line of automobiles, FoE also needed a system that could manage the authoring process—from information access to approval cycles—and that could store, track and manage multiple versions of documents.

Interleaf 5 provides the authoring capabilities. Our systems experts are developing SGML document type definitions that will allow authors to exchange data among FoE and other Ford divisions in the U.S. without having to perform time-consuming data conversions. Interleaf is also developing specifications for a database that would enable the reuse of existing documents and information. And our Relational Document Manager guides Technical Service Bulletins (TSB) through the correct editing, review and approval procedures, and also tracks released and in-process TSBs.

photograph of the Ford Fiesta XR21
courtesy of Ford of Europe
and photograph of Ford assembly line by
permission of Superstock, Inc.

Canadair

Canadair, a group of Bombardier, Inc., based in Montreal, manufactures a state-of-the-art passenger airplane for regional travel. This Regional Jet, designed with the latest aviation technologies, can carry more passengers in greater comfort and travel 35 to 70 percent faster than the manufacturer's current aircraft. The Regional Jet offers carriers the potential to open new routes, to increase flight frequencies and to provide more non-stop flights.

Each jet requires operation and maintenance documentation that must adhere to Air Transport Association (ATA) standards. ATA standards are stringent because they are designed to protect public safety and to provide information consistency throughout the industry. And these standards change continually.

Canadair believed that a twenty-first century aircraft demanded a document system that is just as advanced to help the organization adhere to ATA standards and to respond better to changes. The company chose Interleaf. With Interleaf 5, authors can build custom manuals and revision pages automatically from boilerplate text and CAD illustrations that are stored in a database. An Interleaf active document expert editor ensures that the documents adhere to the latest standards. Interleaf's Relational Document Manager (RDM) not only manages the databased objects but also automates the entire document process from information access to revision-cycle routing and revision tracking. RDM also serves as a management tool for determining the impact of change and the resources that will be affected. And because Interleaf products are open and extensible, Canadair has the ability to respond to future changes —evolving ATA standards and organizational requirements, such as integration with more departments and modification of workflow.

photograph of the Regional Jet
courtesy of Canadair

Financials

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 four meetings during fiscal 1992. 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 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	1992	1991	1990
Revenues	100%	100%	100%
Costs and expenses:			
Cost of products and services sold	24	24	28
Selling, general and administrative	50	56	56
Research and development	15	18	16
Amortization of software and development costs	3	3	2
Restructuring charge	-	-	15
Total operating costs and expenses	92	101	117
Income (loss) from operations	8	(1)	(17)
Interest income (expense), net	-	-	(1)
Other expense	(1)	(1)	-
Income (loss) before income taxes	7	(2)	(18)
Provision for income taxes	1	-	-
Net income (loss)	6%	(2)%	(18)%

Results of Operation The Company began fiscal 1992 at the end of a year and a half transition, which started in November 1989, from being a reseller of workstations bundled with the Company's authoring software to being a provider of document systems solutions to large diverse companies. During the period of fiscal 1990 through the end of fiscal 1991, the Company successfully consolidated its operating facilities, resulting in an annual savings of approximately $2.5 million, reduced its fixed asset base from approximately $19 million to approximately $12 million and eliminated all hardware inventory. Resources of the Company previously allocated to inventory, plant, equipment and other assets could be deployed toward software and the human capital necessary to be a software solutions provider in the document management process of large corporations.

The Company also recognized that the overall market requirements were shifting from more efficient production of paper documents to total document information systems. To pursue high-value market opportunities, the Company recognized that it would need to provide complete document solutions—creation, management and distribution—and designed its products to meet these opportunities. The Company's Interleaf 5 authoring software can be modified to meet specific and complex document needs of these customers without actually reprogramming the underlying software. The Company's document management product, RDM, facilitates the management of large document databases. The Company's distribution product, WorldView, enables documents to be electronically distributed and retrieved.

Critical to the success of this strategy, however, is the ability to provide services. These services customize and tailor the software products described above to meet the specific needs of the Company's customers. The Company believes that this will lead to increased software sales as specialized services will help differentiate Interleaf's software products from stand-alone authoring software.

Historically, the Company had limited expertise in the delivery of these specialized services. In fiscal 1992, the Company experimented, reorganized and altered both the structure and composition of its consulting services group, and believes that this reorganization will begin to contribute to real growth in Interleaf revenue, as described below.

In summary, in fiscal 1990 and 1991, the Company altered its tangible infrastructure—plant, equipment, inventory and facilities. In fiscal 1992, this restructuring continued to perhaps a more challenging environment—its people.

A review and analysis of the Company's operating performance in fiscal 1992 and its future direction can only be understood in the context of strategy previously described. The Company was encouraged by the nearly 19% increase in revenues over fiscal 1991, and its improved profitability to nearly $6 million in fiscal 1992, compared with losses of approximately $1.3 million in fiscal 1991 and $16 million in fiscal 1990. The Company believes that these results validate its strategy and lay a solid foundation for continued improvement in its operating performance.

- **In fiscal 1992, Interleaf began to successfully focus on offering total document systems solutions as the market for its traditional technical publishing software has been maturing.**

The Company recognizes that its stand-alone software product sales, overall, showed limited growth in fiscal 1992. If the Company is to expand into new and growing markets, it must provide total document systems to be successful. This requires the successful delivery of services. Because of the importance of these document systems, customers frequently require pilot programs and projects to validate the systems. The long sales cycles required in these projects, however, do not show immediate results. Interleaf is currently building a pipeline of these projects, and is very encouraged by its diversity—e.g., pharmaceuticals, financial services and telecommunications.

- **Revenues from services showed continued improvement throughout fiscal 1992.**

The Company's services based revenue in fiscal 1992 grew by approximately 33%, or $3.6 million, over its services revenue in both fiscal 1991 and 1990. Services revenues primarily consist of consulting and training. This revenue growth is encouraging as it demonstrates that the difficult and critical task of developing the capacity to deliver services is taking hold and, the Company believes it should begin to increasingly drive software product sales as described above.

- **The Company's maintenance revenues continue to grow.**

The Company's maintenance-based revenues continued to show strong growth as these revenues increased from approximately $16.6 million in fiscal 1991 to approximately $26.8 million in fiscal 1992, a 62% increase. From fiscal 1990 to fiscal 1992, the maintenance revenues increased by approximately 81%. The Company's maintenance support consists of telephone assistance and software product upgrades. This growth reflects the Company's continued efforts to capture maintenance contracts on all new software product sales and strong back billing for customers who wish to upgrade to Interleaf 5 but were previously not under maintenance contracts. The Company recognizes that it is unlikely that this high growth rate will continue as back billings are eventually captured.

- **The Company's international revenues increased by 25% versus an increase of 15% in domestic revenue.**

Overall, international revenues increased by 25% in fiscal 1992. The Company's German subsidiary, Interleaf GmbH, was the major contributor to this increase. Outside of Germany, international growth was negatively impacted by (1) the sluggish European economy, and (2) the expected maturing of demand for stand-alone technical publishing software in Europe. Overall, international revenues accounted for 40% of total Company revenues, up slightly from 38% in fiscal 1991 and 30% in fiscal 1990. The Company believes that as it builds its services capability in Europe, it will result in increased software sales. The Company's European operations have not yet, however, fully developed the in-house capability to deliver services for large solutions.

The Company believes that its German operation validates this strategy. Interleaf GmbH has never sold hardware and has taken the initiative in providing services to leverage software sales. The Company expects that the success of its German operations should be able to be replicated in the other subsidiaries in Europe.

- **While the cost of products and services remained relatively flat, the Company expects this amount to increase in the future.**

The Company's cost of products and services in fiscal 1992 showed little change over fiscal 1991, as it accounted for approximately 24% of revenues. The high cost of products and services in fiscal 1990, 28% of revenues, reflects the cost of acquiring third-party hardware for resale, a business that the Company exited in November 1989. As described above, the Company expects to increase its services group globally. While the Company believes that this will generate incremental revenue in both software products and services, gross profit margins from services are lower due to the higher cost of labor. Thus, if the services component of revenues increases, as expected, the gross profit margin should be lower. Nevertheless, the Company expects to continue to maintain high gross margins in the future as the majority of its revenue will be generated from the sale of software products.

- **Selling, General and Administrative (SG&A) expenses as a percentage of revenues have begun to decline.**

The Company lowered the relative costs of distribution of its software products. In fiscal 1992, the Company's SG&A declined from approximately 56% of total revenues in both fiscal 1991 and fiscal 1990 to 50% of total revenues in fiscal 1992. The Company has recognized that the distribution channel for its software products is costly and has made improvements to this expense by consolidating sales offices and streamlining sales management. Nevertheless, the Company realizes

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

continued...

that it must continue to improve productivity in SG&A to improve operating profits. The Company believes that as the pipeline previously described begins to open up in the future, SG&A will also continue to decline as a percentage of revenue since most of the selling (and therefore the associated costs) will have occurred in pilot stages of these projects.

- **Research and Development (R&D) expenses shall continue to remain at a high level.**

In fiscal 1992, the Company continued to expend significant resources for R&D. During the year, the Company expensed $18.1 million (which includes amortization expenses of $3.4 million offset by capitalized R&D of $3.7 million) or approximately 18% of its revenues to (1) complete development of Interleaf 5, the Company's main product offering, on the different hardware platforms and operating systems that the Company supports, (2) continue development of filters that support emerging government and commercial standards for the electronic interchange of documents, and (3) further the development of its document management product, RDM and viewing product, WorldView. The Company also continues to port Interleaf 5 to personal computers and the Apple Macintosh II.

As the Company's marketing strategy has shifted away from exclusively selling into dedicated technical publishing environments, it has become necessary to support standard graphical user interfaces (GUIs): OPEN LOOK, Windows NT, Motif, on the various platforms that Interleaf supports. While Interleaf's proprietary user interface serves the Company's dedicated users well, as the Company begins to market to secondary users, it is critical to operate on standard graphical interfaces with which they are already familiar. The Company has expended significant resources in this area, and will continue to do so in fiscal 1993 when it expects to complete this project.

Overall, the Company supports 11 different platforms in 13 languages, and is also developing a Japanese-capable product on three different platforms. While supporting these different platforms, with their changing operating systems and different graphical user interfaces 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 1993.

- **The Company's effective income tax rate should begin to increase.**

The Company's overall effective income tax rate during the last three years has been nominal due to a restructuring charge of approximately $14 million recorded in November 1990 and its relatively low level of operating profitability. This has resulted, both domestically and internationally, in significant net operating loss carryforwards, which the Company expects to substantially reduce in fiscal 1993. Therefore, the Company expects its effective income tax rate to increase.

Liquidity and Capital Resources The Company continued to enjoy the benefits of being a software and services provider as its capital needs remained significantly lower. As noted above, prior to the Company's restructuring in November 1990, the Company's business of being a reseller of workstations required the commitment of significant resources to plant, equipment and inventory.

These reduced capital requirements enabled the Company to more efficiently use and preserve cash generated from its operations. In fiscal 1992, the Company's cash balances increased from $13.6 million in fiscal 1991 to $18.2 million at March 31, 1992. Moreover, this 34% increase does not include the approximately $7.5 million of cash used to buy Interleaf GmbH in July 1991, which is reflected by a $6.4 million net increase in goodwill over fiscal 1991. The Company's continued ability to generate substantial cash from its operations reflects the positive fundamentals of being a software provider and will enable the Company to direct its resources where it adds true value: software and services.

The Company invested approximately $5 million in fiscal 1992 mainly to upgrade its corporate computer networks and provide workstations to its growing services operation. Depreciation of fixed assets for the year was approximately $6 million. The Company believes its working capital needs can be satisfied from its existing cash and cash generated from future operations.

The Company had entered into two joint ventures to facilitate the development and sale of certain software products (See Note L to Consolidated Financial Statements). In January 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. Currently, approximately $1.2 million remains outstanding. In its other joint venture, the Company let its option to buy-out its partner, PruTech Research and Development III (PruTech), expire in October 1990. This option would have required the Company to pay approximately $7 million for the venture, which the Company believed would not have been a prudent use of its resources based on the venture's revenues. Currently, PruTech is allocated up to a maximum of 30% of revenues generated by the venture as its share of the venture's profits, which allocation has averaged approximately $100,000 per quarter. PruTech has the right to buy out the Company's interest in the venture at a price equal to ten times the venture's quarterly profit. In such event, PruTech could preclude the Company from marketing its WorldView product on personal computers and filtering technology used in U.S. Department of Defense procurements, CALS.

Given its cash reserves at June 1, 1992, the Company does not anticipate using the external financing source described in Note D in fiscal 1993.

Consolidated Statements of Operations

(in thousands except for per share amounts)

Year ended March 31	1992	1991	1990
Revenues			
Products	$ 59,372	$ 57,149	$ 63,544
Maintenance	26,758	16,554	14,830
Training and consulting	14,169	10,615	10,469
	100,299	84,318	88,843
Costs and expenses			
Cost of products and services sold	24,432	20,400	24,569
Selling, general and administrative	50,398	46,987	49,788
Research and development	14,720	14,607	13,577
Amortization of capitalized software development costs	3,382	2,815	2,058
Restructuring charge	-	-	13,900
Total operating costs and expenses	92,932	84,809	103,892
Income (loss) from operations	7,367	(491)	(15,049)
Interest expense	(976)	(1,043)	(1,312)
Interest income	962	1,033	384
Other expense, net	(840)	(527)	(341)
Income (loss) before income taxes	6,513	(1,028)	(16,318)
Provision (credit) for income taxes	529	250	(310)
Net income (loss)	$ 5,984	$ (1,278)	$(16,008)
Earnings (loss) per share	$ .38	$ (.11)	$ (1.37)
Shares used in computing earnings (loss) per share	15,747	11,956	11,643

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets

(in thousands except for share amounts)

Assets

March 31	1992	1991
Current assets		
Cash and cash equivalents	$ 18,227	$ 13,621
Accounts and royalties receivable, net of allowance of $778 and $761 for doubtful accounts, respectively	30,005	23,943
Inventories	176	240
Prepaid expenses and other current assets	1,880	2,475
Total current assets	50,288	40,279
Property and equipment, net	10,884	11,565
Excess of purchase price over net assets of businesses acquired	17,888	11,524
Other assets	8,513	8,343
	$ 87,573	$ 71,711

Liabilities and Shareholders' Equity

March 31	1992	1991
Current liabilities		
Accounts payable	$ 3,541	$ 3,416
Accrued expenses	8,475	5,306
Accrued compensation and related items	5,140	2,935
Unearned service revenues	12,866	9,397
Current portion of long-term debt	1,399	1,706
Current portion of long-term capital lease obligations	795	99
Current portion of accrued restructuring costs	539	922
Total current liabilities	32,755	23,781
Long-term debt, less current portion	654	2,023
Capital lease obligations, less current portion	1,425	50
Long-term portion of accrued restructuring costs, less current portion	480	975
Deferred taxes	151	151
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 12,434,494 and 12,064,882 shares, respectively	124	121
Additional paid-in capital	61,682	60,174
Retained-earnings deficit	(9,762)	(15,746)
Equity adjustment for foreign currency translation	(150)	(32)
	52,108	44,731
	$ 87,573	$ 71,711

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, 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
Common stock issued in connection with incentive stock options exercised by employees	-	2	1,324	-	-	1,326
Common stock issued in connection with employee stock purchase plan	-	1	184	-	-	185
Equity adjustment for foreign currency translation	-	-	-	-	(118)	(118)
Net income	-	-	-	5,984	-	5,984
Balances at March 31, 1992	$ 214	$ 124	$ 61,682	$ (9,762)	$(150)	$ 52,108

See Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

(in thousands)

Year ended March 31	1992	1991	1990
Operating activities			
Net income (loss)	$ 5,984	$ (1,278)	$ (16,008)
Non-cash restructuring charge	-	-	10,953
Depreciation and amortization expense	11,261	10,553	10,087
Loss from disposal of property and equipment	202	372	-
Provision for deferred taxes	-	(118)	(464)
Changes in current accounts excluding the effects of acquisitions:			
Increase unearned revenue	3,153	7,041	525
(Increase) decrease accounts receivable, net	(4,849)	154	6,265
Decrease inventories	261	1,401	6,280
(Increase) decrease other current assets	802	(688)	1,531
Increase (decrease) accounts payable and other current liabilities	3,945	864	(4,212)
Decrease in accrued restructuring costs	(878)	(2,856)	-
Other, net	(330)	(217)	(299)
Net cash provided by operating activities	19,551	15,228	14,658
Investing activities			
Additions to property and equipment	(5,134)	(2,215)	(9,151)
Disposal of property and equipment at net book value	-	-	1,536
Capitalized software development costs	(3,691)	(3,601)	(3,396)
Payments for acquisitions of businesses, net of cash acquired	(7,541)	-	(7,055)
(Increase) decrease in other non-current assets	(438)	207	(230)
Net cash used in investing activities	(16,804)	(5,609)	(18,296)
Financing activities			
Net proceeds from issuance of preferred stock	-	-	14,641
Net proceeds from issuance of common stock	1,511	1,052	1,212
Proceeds from sale of warrant	-	-	150
Proceeds from long-term debt and capital leases	2,376	-	20,417
Repayment of long-term debt and capital leases	(2,040)	(1,613)	(31,822)
Net cash provided by (used in) financing activities	1847	(561)	4,598
Effect of exchange-rate changes on cash	12	66	39
Net increase in cash and cash equivalents	4,606	9,124	999
Cash and cash equivalents at beginning of year	13,621	4,497	3,498
Cash and cash equivalents at end of year	$ 18,227	$ 13,621	$ 4,497

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 are reflected in operations and are not material.

Revenue Recognition The Company recognizes revenue from the license of software upon delivery of the software product to the customer. The Company's software products generally do not involve significant obligations to the customer subsequent to delivery. When payment terms for the license of software exceed one year, the Company recognizes as revenue only payments for which collection is more than reasonably assured, which generally represents payments due within one year of the balance sheet date.

Contractual maintenance revenues are recognized ratably over the contract period, generally one year, and non-contractual maintenance revenues are recognized as the services are performed.

Training and consulting revenues are recognized as the Company successfully performs the obligations specified under agreements with its customers.

The Company generates revenue from sales of its products and services to a large number of customers across different industries and diverse geographic areas. Credit is extended based on evaluation of the customer's financial condition and collateral is not required. Credit losses have been incidental to the Company's operations.

Cash Equivalents Cash equivalents represent highly liquid investments with maturities at date of purchase of three months or less. The Company's investments are placed in highly liquid investment grade debt instruments, and the amount of credit exposure to any one commercial issue is limited.

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 15-25 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, attributable principally to depreciation, restructuring and research and development costs. Investment and other tax credits are accounted for under the flow-through method. Statement of Financial Accounting Standards No. 109 "Accounting for Income Taxes" was issued in February 1992. The statement is required to be adopted by the Company for the fiscal year beginning on April 1, 1993. The statement provides for the option of treating the impact of adoption as a cumulative effect of an accounting change or restating prior years' financial statements. The Company has not had sufficient time to properly analyze the effects of adopting the statement and therefore, no decision has been made as to the timing or method of adoption. The Company believes at this time that adoption would not result in a material impact on its financial statements.

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 1991 and 1990 amounts have been reclassified to conform to the 1992 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 $5,632,000 and $5,323,000 at March 31, 1992 and 1991, respectively.

Note C
Property and Equipment

Property and equipment at March 31, 1992 and 1991 consist of the following:

(in thousands)	1992	1991
Office and demonstration equipment	$ 22,246	$ 19,675
Development equipment	9,137	6,349
Furniture	4,134	3,941
Leasehold improvements	715	654
	36,232	30,619
Less allowances for depreciation and amortization	25,348	19,054
	$ 10,884	$ 11,565

Note D
Credit Arrangements

The Company has a committed, revolving line of bank credit of up to $5 million, which is unsecured and bears interest at prime rate plus 1/4%. The Company amended its credit agreement on September 30, 1991, retroactive to March 31, 1991, and on May 6, 1992 elected to reduce the available funds from $10 million to $5 million. Under the terms of this credit line, the Company may borrow up to the lesser of $5 million or a borrowing base consisting of 80% of qualified domestic accounts receivable and of certain qualified international accounts receivable plus 30% of the net book value of unencumbered furniture and equipment less the amount of deferred maintenance revenue which relates to the qualified 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 January 31, 1993, in equal quarterly installments through October 31, 1994, 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. At March 31, 1992 and 1991, there were no borrowings outstanding under this line of credit.

Note E
Long-term Debt

Long-term debt at March 31, 1992 and 1991 is as follows:

(in thousands)	1992	1991
Loan payable in quarterly installments of $229,167 including interest at 10%	$ 1,455	$ 2,180
Loan payable in monthly principal installments of $41,667 plus interest at prime rate plus 1/2%	375	875
Loan payable in monthly principal installments of $30,000 plus interest at prime rate plus 1/2%	180	540
Other	43	134
	2,053	3,729
Less current portion	1,399	1,706
	$ 654	$ 2,023

Maturities of long-term debt during future fiscal years are as follows: 1993 - $1,399,000 and 1994 - $654,000.

Property and equipment with a net book value at March 31, 1992 of approximately $98,000 is pledged as collateral for outstanding long-term debt.

Interest paid approximated interest expense in each of the three years for the period ending March 31, 1992.

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 non-voting, expire on July 15, 1998 and may be redeemed at any time prior to becoming exercisable at a price of $.01 per Right.

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 total 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 on 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 200,893 shares of common stock being issuable upon conversion. A second adjustment with respect to fiscal 1992 was made, and the Conversion Ratio increased to 1.34375, which resulted in an additional 535,714 shares of common stock being issuable upon conversion. Therefore, the total effect of the first two adjustments was an additional 736,607 shares of common stock being issuable at time of conversion. In fiscal 1993, the conversion ratio may be adjusted 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 shares of 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 335,892 shares at a per share exercise price of $5.21.

As of March 31, 1992, 6,154,822 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 expire after 10 years from date of grant. Options are subject to vesting provisions generally between three to five years. Options are nontransferable other than in the event of death. At March 31, 1992, options covering 470,539 shares were exercisable, and options covering 335,751 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
Granted	188,700	5.25 - 12.50
Exercised	(303,116)	1.13 - 10.00
Cancelled	(265,846)	3.13 - 19.38
Outstanding at March 31, 1992	1,422,174	$ .57 - 19.38

During fiscal 1991, the Board of Directors, with subsequent shareholder ratification, approved the cancellation and reissuing of certain stock options, upon the request of the participant, that had been granted to the 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.

Under the Company's 1989 Director Stock Option Plan, options to purchase up to 150,000 shares of common stock at a price equal to fair market value at the date of grant may be issued to non-employee directors. In March 1989, 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. In future years, each newly elected non-employee director may receive options to purchase up to 20,000 shares of common stock, which vest over a three-year period, upon election as director. On the fourth anniversary date of the initial grant of options, and on each annual anniversary date thereafter, each non-employee director who continues to serve as a director of the Company will be granted an option to purchase 3,000 shares of common stock at the then current fair market value, which is exercisable on the date of grant. At March 31, 1992 options for the purchase of 36,000 shares were exercisable under the Director Stock Option Plan. No options have been exercised.

Under the Company's Employee Stock Purchase Plan, eligible officers and employees may 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 (one year after commencement date), whichever is lower. The Plan, as amended, allows for the purchase of up to 1,000,000 shares of common stock.

As of March 31, 1992, 1,757,925 shares of common stock under the stock option plan and 400,255 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 leases, which expire through the year 2000. The Company leases certain assets under capitalized leases. Equipment under capital leases has been included with company-owned assets under the caption property and equipment, net, in the balance sheet.

At March 31, 1992, the gross amount of these assets, which were acquired in 1992, was $2,376,000 with accumulated amortization of $204,000. Future minimum rental payments at March 31, 1992, under agreements classified as operating and capital leases with non-cancelable terms in excess of one year, are as follows:

(in thousands)

Fiscal years ending March 31	Operating Leases	Capital Leases
1993	$ 7,872	$ 942
1994	5,870	911
1995	4,296	618
1996	4,350	-
1997	3,958	-
Thereafter	14,580	-
Total minimum lease payments	$ 40,926	2,471
Less amount representing interest (interest rates range from 7 1/2% to 8 1/3%)		251
Present value of net minimum lease payments		$ 2,220

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

Rent expense amounted to $8,728,000, $10,164,000 and $10,697,000 for the years that ended March 31, 1992, 1991 and 1990, respectively.

Included within accrued liabilities are amounts accrued for rent at March 31, 1992 and 1991 totaling $1,604,000 and $1,565,000, 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, 1992, the accrued restructuring charge related primarily to future lease obligations on unutilized properties. Balances at March 31, 1992 and 1991 were $1,019,000 and $1,897,000, respectively.

Note J
Income Taxes

The provision for income taxes is composed of the following:

(in thousands)	1992	1991	1990
Current:			
Federal	$ 170	$ -	$ 288
State	288	162	-
Foreign	71	206	(134)
Total current	529	368	154
Deferred (credit)	-	(118)	(464)
	$ 529	$ 250	$ (310)

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

(in thousands)	1992	1991	1990
Domestic	$ 6,680	$ 229	$(15,375)
Foreign	(167)	(1,257)	(943)
	$ 6,513	$ (1,028)	$(16,318)

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

(in thousands)	1992	1991	1990
Research and development costs, net of amortization	$ 104	$ 319	$ 542
Allowance for uncollectible accounts receivable, vacation and other reserves	4	129	11
Inventory adjustments	40	40	217
Excess of financial statement over tax depreciation	(507)	(418)	(235)
Restructuring reserve less amounts for which no tax benefit was realized	299	446	(990)
Accrued rent	(13)	(633)	-
Other, net	73	(1)	(9)
	$ 0	$ (118)	$ (464)

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)	1992	1991	1990
Computed at federal statutory rate of 34%	$ 2,214	$ (350)	$ (5,548)
State income taxes, net of federal tax benefit	190	18	(130)
Nondeductible amortization	337	179	191
Other nondeductible expenses	221	21	34
Loss for which no tax benefit was realized	215	619	5,174
Benefit of net operating loss carryforward	(2,642)	(489)	-
Other, net	(6)	252	(31)
	$ 529	$ 250	$ (310)

At March 31, 1992, the Company and its subsidiaries had tax and financial accounting net operating loss carryforwards of approximately $10.1 million and $7.9 million, respectively, that are available to offset future taxable income. Tax and financial accounting loss carryforwards of approximately $4.0 million and $1.8 million, respectively, are attributable to U.S. operations and expire in the years 2005 and 2006. Loss carryforwards of approximately $6.1 million attributable to non-U.S. operations expire in 1996 and thereafter.

In addition, the Company has research and development tax credit carryforwards of approximately $1.8 million available to reduce future federal income tax liability through the year 2006. During 1992, 1991 and 1990, the Company made $358,000, $129,000 and $327,000 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 software used in the creation, management and distribution of complex documents, integrated with customized services.

Information regarding geographic areas at March 31, 1992 and 1991, and for the years then ended is as follows:
(in thousands)

March 31, 1992 and for the year then ended	United States	Canada	Europe	Eliminations	Total
Sales to unaffiliated customers	$ 63,141	$ 5,593	$ 31,565	$ -	$ 100,299
Intercompany transfers	$ 11,478	$ -	$ -	$ (11,478)	$ -
Net revenues	$ 74,619	$ 5,593	$ 31,565	$ (11,478)	$ 100,299
Income (loss) from operations	$ 7,470	$ (795)	$ 772	$ (80)	$ 7,367
Identifiable assets	$ 82,286	$ 2,299	$ 17,411	$ (14,423)	$ 87,573
Liabilities	$ 26,108	$ 2,030	$ 14,875	$ (7,548)	$ 35,465
March 31, 1991 and for the year then ended					
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

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

Note L
Research and Development Agreements

In January 1991, the Company exercised an option relating to a research and development arrangement entered into in 1987 to purchase the remaining rights in a joint venture with ML Technology Ventures L.P. (MLTV). Under the terms of the agreement, the Company exercised its option to purchase all of MLTV's rights in the joint venture under the following modified terms: (1) payment of $2,750,000 in twelve equal quarterly installments commencing March 1, 1991, (2) issuance of a warrant to purchase 150,000 shares of the Company's common stock through December 1995 at an exercise price of $3.50, (3) a reduction of the per share exercise price to $3.50 for the original warrant covering 125,000 shares and extended its maturity to December 1995. The Company recorded net revenues from the sale of MLTV's products prior to the acquisition of the remaining joint venture interest in the amount of $1,830,000 in 1991 and $7,069,000 in 1990. These amounts represented 90% and 97.5% of MLTV's revenues in 1991 and 1990, respectively.

The Company has entered into a joint venture with PruTech Research and Development Partnership III (PruTech) under which it markets products developed by the venture. The Company receives 65% of revenues from the sale of such products for expenses incurred. Through October 1, 1991, 30% of recorded revenues were allocated to Interleaf and the balance to PruTech. Thereafter PruTech is allocated up to 30% of venture revenues. The Company recorded revenues from the sale of joint venture products of $1,319,864 in 1992, $1,985,132 in 1991 and $1,916,116 in 1990. In connection with the arrangement, PruTech obtained a warrant at a cost of $180,000 effective May 22, 1990 under the terms contained herein and could 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. An adjustment with respect to fiscal 1992 was made in May 1992 with shares increasing to 356,286 at a reduced price of $5.21 per share. 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.

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 by the Company, amounted to approximately $7,688,000 and is being amortized over a period of 25 years.

On July 25, 1991, the Company purchased all of the outstanding equity in Interleaf GmbH for consideration of $592,186. In addition, the Company also acquired certain indebtedness of Interleaf GmbH from First Chicago Investment Corporation and Madison Dearborn Partnership IV for consideration of $7,698,426. Interleaf GmbH, a corporation organized under the laws of the Federal Republic of Germany, was the company's exclusive distributor of its software products in Germany, Spain, Portugal and Austria. The acquisition was accounted for under the purchase method of accounting. Accordingly, the balance sheet accounts of Interleaf GmbH 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 GmbH at the date of acquisition, over the fair market value of assets acquired of $5,017,460 and liabilities of $3,835,616 assumed by the Company amounted to approximately $7,354,000 and is being amortized over a period of 15 years.

Had the Interleaf GmbH acquisition occurred at April 1, 1990, the pro forma unaudited consolidated results of operations would have been as follows:
(in thousands except per share amounts)

Year ended March 31	1992	1991
Revenues	$102,743	$ 88,587
Net income (loss)	$ 5,686	$ (3,366)
Net income (loss) per share	$ .36	$ (.28)

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, 1992 and 1991, and the related consolidated statements of operations, changes in shareholders' equity and cash flows for each of the three years in the period that ended March 31, 1992. 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, 1992 and 1991, and the consolidated results of their operations and their cash flows for each of the three years in the period that ended March 31, 1992, in conformity with generally accepted accounting principles.

Ernst + Young

Boston, Massachusetts
April 24, 1992, except for Note D as to which the date is May 6, 1992.

Supplemental Financial Information

The following summarizes unaudited selected quarterly results of operations for the years that ended March 31, 1992 and 1991 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 1992					
Revenues	$ 20,975	$ 23,339	$ 26,583	$ 29,402	$100,299
Net income	88	1,008	1,920	2,968	5,984
Net income per share	.01	.07	.12	.18	.38
Common stock prices					
High	8 1/2	7 1/2	10 1/2	15	15
Low	5 1/4	4 7/8	6 1/4	7 1/2	4 7/8
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

The Company has never paid cash dividends. 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 April 10, 1992, there were 995 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	1992*	1991	1990	1989	1988
For the year					
Total operating revenues	$100,299	$ 84,318	$ 88,843	$ 82,780	$ 58,389
Net income (loss)	5,984	(1,278)	(16,008)	863	6,980
Net income (loss) per share	0.38	(0.11)	(1.37)	0.07	0.59
At year end					
Total assets	87,573	71,711	68,502	74,051	61,762
Long-term obligations	2,559	3,048	3,809	13,246	4,813
Total shareholders' equity	52,108	44,731	45,195	45,064	42,993

*Fiscal 1992 results include the impact of the acquisition of Interleaf GmbH in July 1991.

Executive Officers

David A. Boucher
Chief Executive Officer and Chairman of the Board

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

John K. Hyvnar
General Counsel & Clerk

Peter Cittadini
Senior Vice President of North American Operations

Philip E. London
Senior Vice President of Engineering

Mark K. Ruport
President and Chief Operating Officer

Board of Directors

Frederick B. Bamber
General Partner
Applied Technology Partners

David A. Boucher
Chief Executive Officer and Chairman of the Board
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.
President
Software Technology Marketing, 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 21, 1992 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, Santa Clara, California; Denver, Colorado; Norwalk, Connecticut; Tampa, Florida; Atlanta, Georgia; Chicago, Illinois; Greenbelt, Maryland; Waltham, Massachusetts; Detroit, Michigan; St. Louis, Missouri; Iselin, New Jersey; Raleigh, North Carolina; Cleveland, Ohio; Dallas, Houston, Texas; Seattle, Washington

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

International
Brussels, Belgium; Paris, France; Breda, The Netherlands; Zurich, Switzerland; Stockholm, Sweden; Richmond, Manchester, U.K.; Dusseldorf, Frankfurt, Hamburg, Munich, Stuttgart, Germany

This annual report was designed by Interleaf's Corporate Design Group using Interleaf software. Text and financial information were entered by people in various departments throughout the Company using linked copies of the book catalog existing in the Design Group. The cover illustration was designed with Adobe Photoshop.

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Interleaf

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