Interleaf

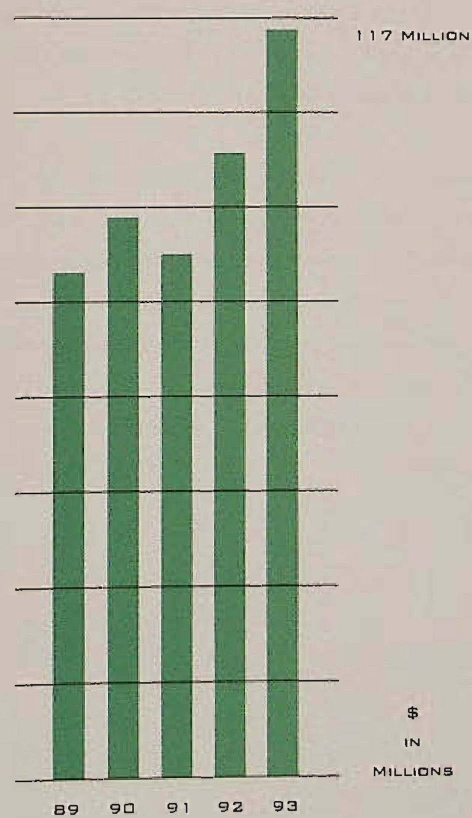
INTERLEAF, INC. ANNUAL REPORT 1993

Interleaf is the leading international provider of document management systems. With the industry's only complete solution, we enable organizations to leverage their valuable investments in information, computer systems and people.

We do this by combining software, services and support that help organizations present information in document form; distribute it on any system, anywhere in the world; organize and control large amounts of it for easy workgroup re-use; and automate and re-engineer document-based business processes.

To Our Shareholders

Interleaf ranks 38 in InformationWeek's 1993 Top Independent Software Vendors



Interleaf Five-Year Revenues Trend

Interleaf closed fiscal 1993 with another year of solid growth. An increase in earnings of 55% over fiscal 1992's profits, revenue growth of 17% and a 67% increase in cash flow all reflect our ability to transform vision into strategy and then into concrete, positive financial results.

The implications of this continued growth are clear. We're seeing major corporations investing in our document management systems. There are many reasons why. These corporations are finding that Interleaf solutions truly address a fundamental need to leverage strategic information stored in documents throughout their organizations. Solutions we implemented as little as six months ago are already enabling our customers to reap substantial benefits. And those who are shopping around are also discovering that Interleaf is the only one in the industry delivering the complete and open solutions they require — and delivering those solutions today.

In addition, market trends (outlined in the following two pages) are validating the strategy and market vision we have been following for the past few years. We believe that the document management market is on the threshold of tremendous growth. Interleaf is prepared for this surge with a strong foundation of products and services.

This year alone, we made strides in executing our strategy. Our document control (RDM) and electronic document distribution (WorldView) products took the industry by storm. We led the industry by co-founding SGML Open, a consortium for educating the market about this international standard for information exchange, and introducing the industry's only complete and easy-to-use SGML document system. We've succeeded in opening our products even further by adding more standard graphical user interfaces and by providing linking tools that allow people to automatically exchange timely data between Interleaf and virtually any other application. We continued to expand and strengthen our worldwide services organization and partnerships. And we established our Japan subsidiary and introduced Interleaf 5 for Japanese, an award-winning product. These accomplishments have been key in helping us to broaden our customer base and to assert our market leadership.

Our transition toward a total document management solutions provider is nearly complete. Although challenges lie ahead in creating market awareness, in continuing to build a profitable services infrastructure and in dealing with a fluctuating European economy, the customer stories highlighted in this annual reveal the size of our opportunity.

With a major share of the document management market and clear competitive advantages, Interleaf is the dominant player in this industry. Now, we're poised to accelerate our strategy.

Mark K. Ruport
President and CEO

Industry Trends

Global competition is increasing. And corporations everywhere are feeling the pressure. An overwhelming majority of them agree that maintaining their competitive advantage hinges upon how well they leverage their business-critical information.

Over a decade of electronic information development has created an abundance of data, most of it in the form of documents such as forms, reports, parts lists, contracts and technical manuals.

Analysts predict that by 1995, businesses will generate a billion documents a day, half of that in electronic form.

With the increase in information comes greater demand for desktop access to that information. One result of this demand is the merging of document and mainstream corporate information systems. Another result is the growing need for control over and management of these strategic documents, the data that goes into them, as well as the entire document-information process.

Aiding the desktop information access trend are the improvements in the power of desktop computers, and the movement away from centralized mainframes and computers toward decentralized, client/server environments. Client/server technology allows multiple desktop computers (clients) to run end-user applications while being connected to host systems (servers) anywhere on the network. This enables members of workgroups to tap into enterprise-wide information bases directly from their desktops.

Corporations are finding that their return on investments in their documents and document systems, as well as the timeliness, accuracy, accessibility and re-usability of their information depend greatly on having the most effective document management application.

Interleaf Advantages

Interleaf understands documents and their role in the world of information. From the outset, we designed all our document software products to be object- and structure-based, so workgroups can easily access, re-use and control every piece of information within documents, even across different computer systems.

We take pride in being the only player in the industry to deliver a complete document management system. Interleaf's suite of products not only helps corporations put information into document form, but it also enables them to distribute large collections of information to everyone in an enterprise-wide network. Interleaf products are also intelligent, so people who need the information can do more than find it — they may also be told what information to find. Then we enable information managers to control that information throughout the workflow process — from creation to reviews to re-use — throughout the information's lifecycle whether that's twenty days or twenty years.

Interleaf's suite of products are open system applications, allowing organizations to protect their investments. They can "plug and play" our products within any major computer hardware and software system. In addition, Interleaf is committed to providing full support for SGML, the international information interchange standard, across all our products, so workgroups can access, share and re-use information with ease from virtually any computer, anywhere around the world.

By choosing

Interleaf document management solutions,

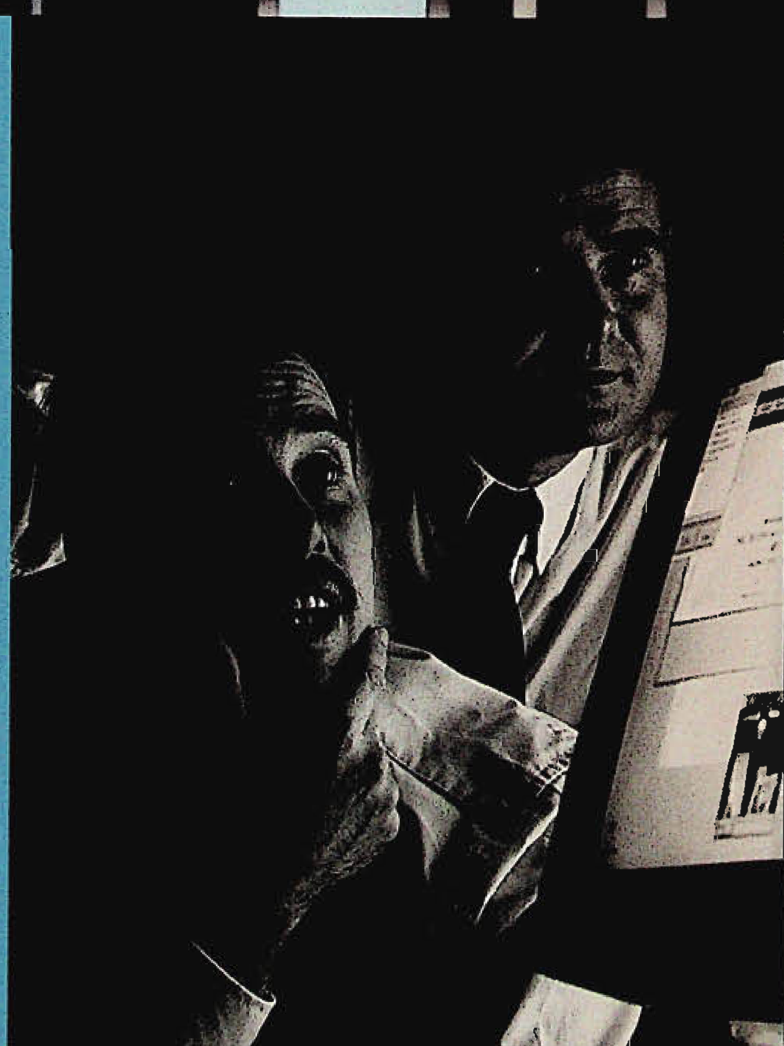
corporations can expect

proven technology and proven solutions,

as our customers will attest to.

British Telecom

A major competitor in the global telecommunications market



"We produce six gigabytes of information per hour. . . . Distributing, storing and revising just one set of documentation was a major business cost. . . . With Interleaf, we're delivering more information for less money."

SIMON WRIGHT
MANAGER
ELECTRONIC SUPPORT FOR SYSTEMS ENGINEERING METHODS
BRITISH TELECOM DEVELOPMENT AND PROCUREMENT
LONDON, ENGLAND

SIMON WRIGHT SEATED WITH JOHN SANDS, SYSTEMS ENGINEERING CONSULTANT

"BT's 17-volume systems engineering documentation alone can fill a very large moving truck, floor to ceiling. Republishing, mailing and storing thousands of copies of it cost hundreds of thousands of pounds per year. Just as important as the costs factors were the loss in productivity and in information accuracy. Finding information manually was enough of a feat that people used the sets of documentation as footstools. And there were so many variations in the sets that there was no guarantee that the engineers were getting accurate and current data.

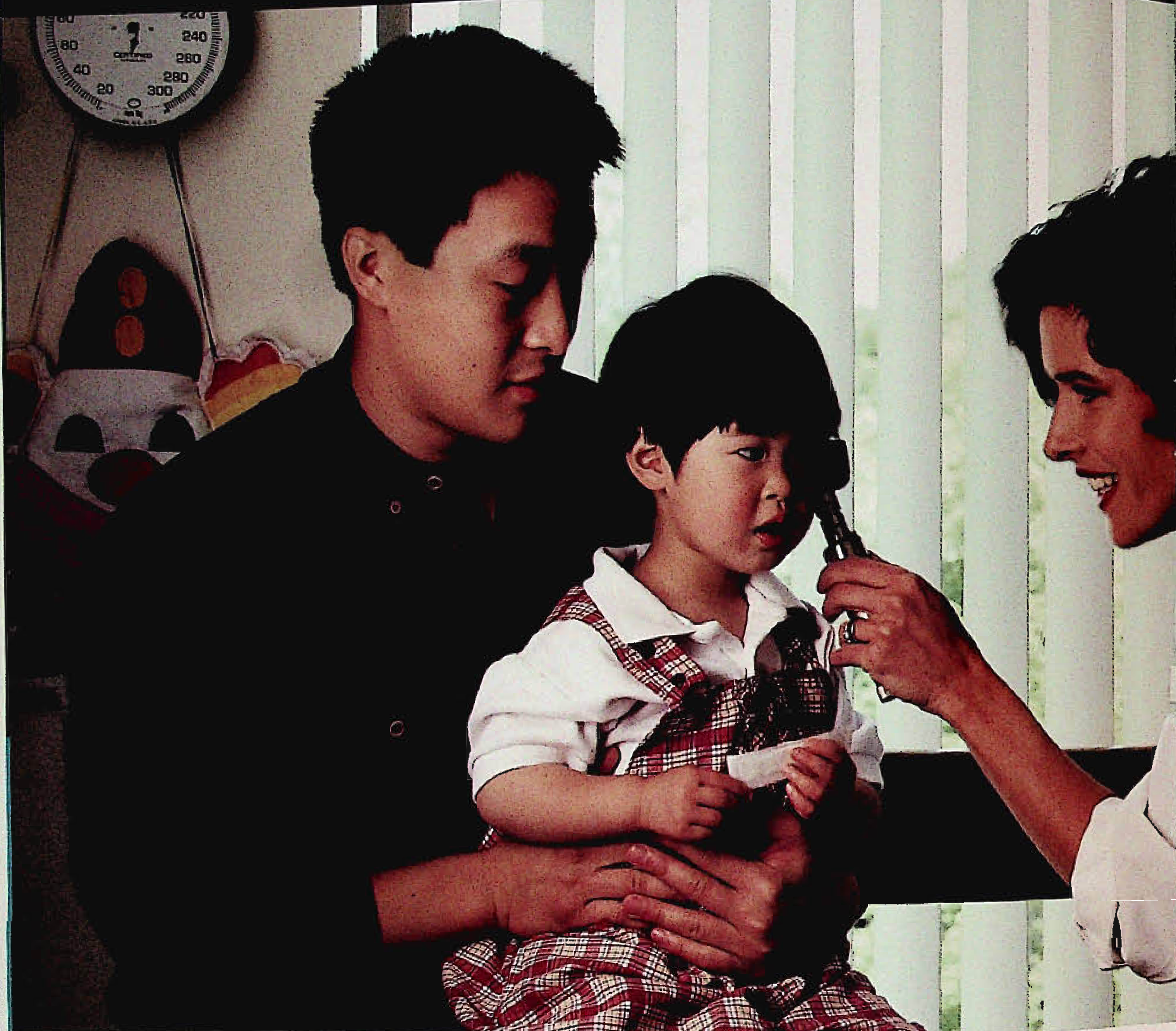
"A combination of business- and user-oriented objectives led us to Interleaf: cost reduction, preservation of existing investments, improvement in usability and information management, and easy user access to an accurate knowledge base. The benefits our Interleaf solution delivered were even greater than we expected.

"Interleaf delivered a high-quality document management system that did more than cut our costs by 80% and save us half a million pounds per release. It increased productivity and eliminated manual work, from handling at the loading docks to page flipping. And it guaranteed information accuracy. We can now process many different types of files, present them in ways that are understandable and preferable by different users, build easy navigational aids to multiple levels of information, and deliver the entire collection over networks at 25 sites. Interleaf lets the engineers click on graphical maps or intelligent indexes to get to information. They no longer have to know where to start to look for information; the system guides them. In the not-so-distant future, this solution will be integrated with other office products — word processors, spreadsheets — throughout other areas of the company for enterprise-wide information access.

"As information systems support for BT, we're very excited by the opportunities Interleaf gives us to make more information available that's usable and user friendly without increasing our costs."

BLUE CROSS & BLUE SHIELD OF RHODE ISLAND

RHODE ISLAND'S LARGEST MANAGED HEALTH CARE ORGANIZATION OFFERING A COMPLETE LINE OF HOSPITAL AND MEDICAL SERVICES COVERAGE



"Our underlying business challenge is information — its access, distribution, communication and re-use among our underwriters, benefits specialists and marketers, as well as the labor intensive process of getting the right information to the customers in a timely fashion. Today, everyone wants tailored benefits programs. We need to be able to respond, do it quickly and be able to manage the information and process to eliminate the proliferation of redundant products and redundant work.

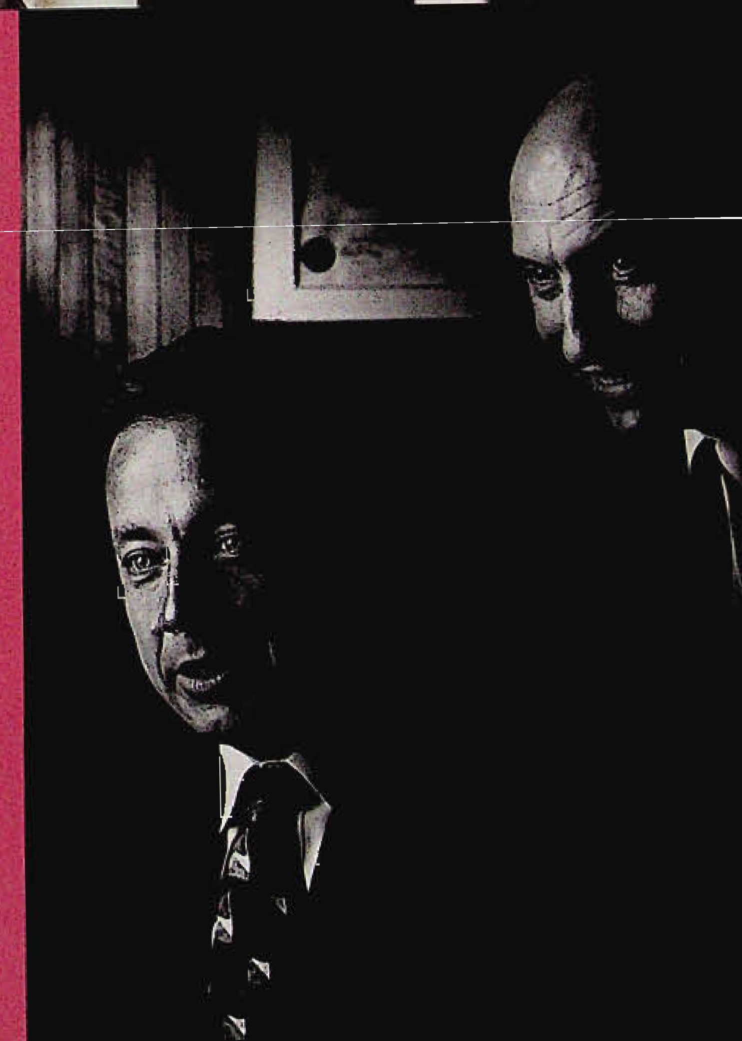
"We don't want improvements to be incremental. Nothing less than a 40 to 50% increase in improvements will do. To get us there, we chose two strategic partners: Interleaf for its unique document management technology and Cambridge Technology Partners, a highly regarded systems integrator. From our thorough cost-benefits analysis, we believe that our Interleaf-based benefits solution — the result of this remarkable partnership — will provide a return on investment in three and a half years, in addition to greatly improving productivity and instantly increasing face-to-face client interaction by 50%. This all translates to greater potential for increased sales and revenues.

"Interleaf is a perfect fit for our benefits application. We're using 60 to 80% of its off-the-shelf features while customizing the remainder. After only five months of development and integration, a pilot core of our marketing and sales force can view available benefits products online on laptops, formulate custom packages and run the ratings on the fly, with the client. In a few short months, this application will be integrated with other databases and Interleaf's document control product (RDM) will manage this repository, providing access throughout the organization for re-use in building proposals and new-product literature, among many other functions.

"There isn't anyone out there providing this complete document management capability except for Interleaf. We looked. Interleaf is the only game in town."

"Quantum leaps in improved information is critical. Whoever controls the data will have the best chance of reigning in this market. . . . Interleaf is giving us a tremendous competitive edge."

RONALD BATTISTA
EXECUTIVE VICE PRESIDENT OF OPERATIONS
BLUE CROSS & BLUE SHIELD, RHODE ISLAND



RONALD BATTISTA SEATED WITH RICHARD COLASANTO, VICE PRESIDENT & ASSISTANT TREASURER

LOCKHEED

An industry leader in aircraft modification and [illegible]

"Before Interleaf, we used to leave our desks whenever we needed information or re-keyed data and batch-processed it overnight on a mainframe. . . . Now we re-use our mainframe information, realtime, to accelerate productivity and output."

ROBERT SWINGLER
Senior Project Supervisor
Technical Documentation
Lockheed
Ontario, California

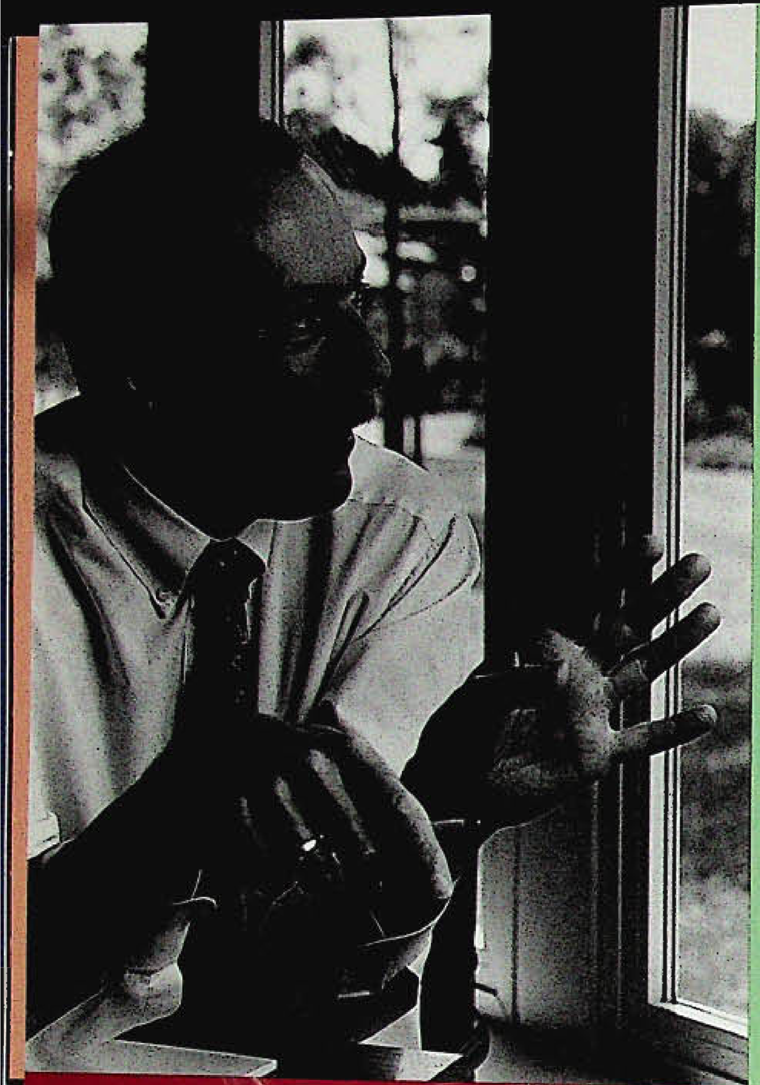
"An Interleaf system is so versatile, we're able to use it in different ways to solve different business challenges — the re-use of information and the effective management of workflow processes. The results: Overall productivity has improved up to 20-fold, particularly for illustrating complex, technical drawings. And time savings have increased by 25 to 50%.

"Interleaf serves as an automated document management system for our illustrated parts breakdowns process. It's eliminating time-consuming tasks and enabling us to re-use 80% of our mainframe parts information. Illustrations information is now stored on a database. Authors access this information directly from their workstations, no longer having to physically go to another computing system. And they automatically assemble formatted documents that have the right illustrations in the right places, without ever having to re-key and batch-process the information overnight on a mainframe.

"It's a management tool that's intelligent enough to fill in repetitive information automatically, run formulas, check and correct input errors, then route the information back to the database.

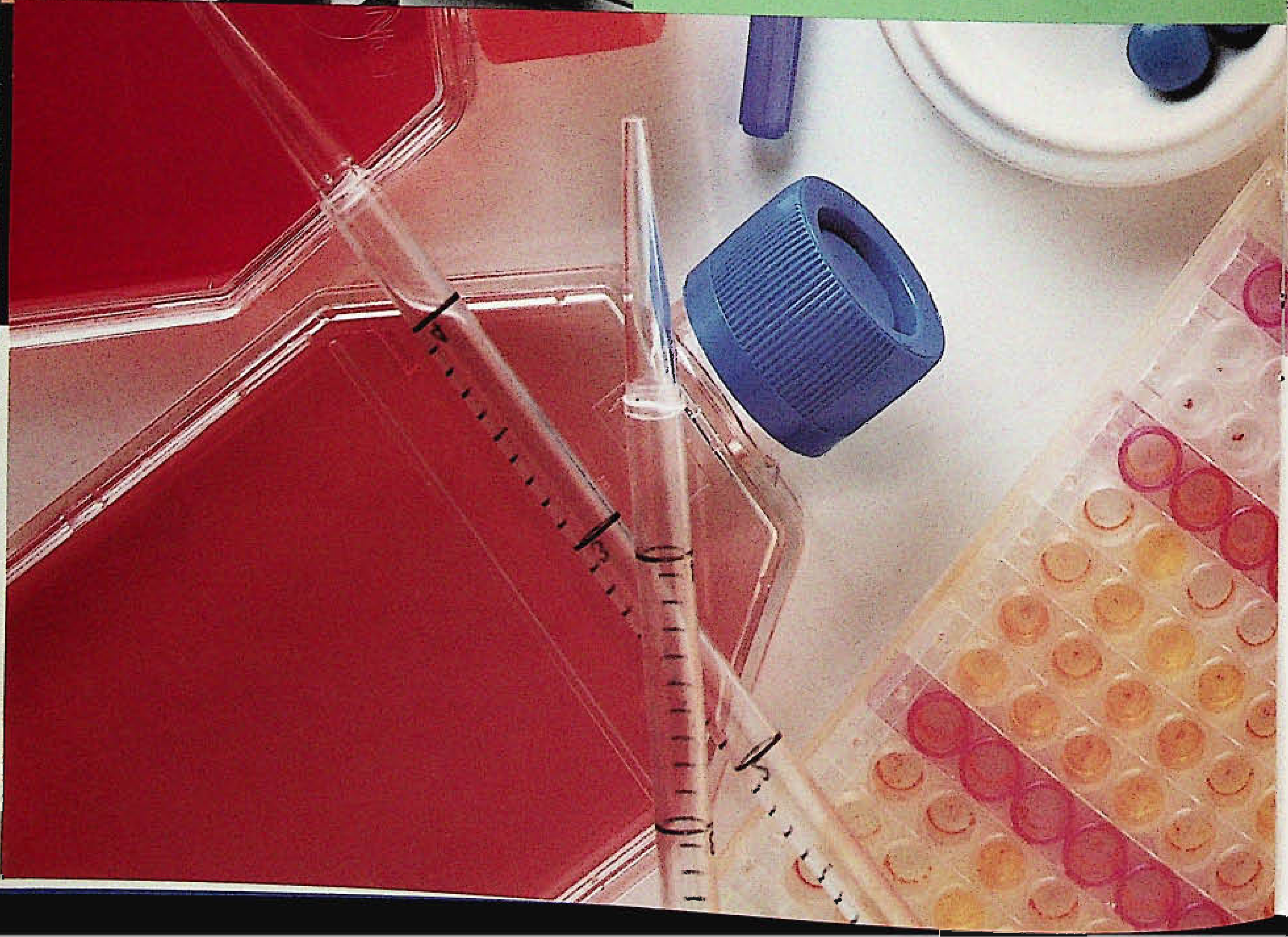
"And it's also a consistency enhancement tool for a very structured environment. We have 250 templates in a central database and Interleaf controls authorized access to those templates and manages the review, revision and version processes. Authors are then empowered to add value to their data without worrying about how their documents look.

"With Interleaf electronic delivery in the wings, we'll be able to see even greater productivity and output gains."



"Just a few days' delay in submitting our new drug dossiers can cost us our competitive edge and unnecessarily extend the time taken to get new drugs to the people who need them. . . . Interleaf lets us shorten our time to market."

CLIVE W. MAKINGS
INTERNATIONAL INFORMATION TECHNOLOGY PROJECT MANAGER
THE WELLCOME FOUNDATION LTD
KENT, ENGLAND



THE WELLCOME FOUNDATION LTD

A MAJOR INTERNATIONAL RESEARCH-BASED PHARMACEUTICAL GROUP

"A large portion of a pharmaceutical company's work is documenting research product findings. Our new drug authorization requests can be hundreds of thousands of pages long and require input from researchers worldwide.

"In this industry, compiling accurate information within a short time-frame is very important. It is imperative that the final compilation of data be accurate and that the dossiers be submitted to the authorities on time, often in time for pre-set review meetings. Our competitive edge depends on it. So does recouping our enormous development costs to fund more research and development into innovative products.

"We used to compile dossiers manually. There was a lot of re-keying and we could only compile dossiers in small batches, so we'd choose and submit our requests to countries in order of need or their market importance.

"Even as far back as five years, Interleaf understood our business challenges — database publishing and document management — while the others were still trying to lay out pages. The Interleaf solution is flexible. It integrates into our existing systems, and it has the power for building large, complex documents and for re-using the information in them.

"Interleaf helped us accelerate the compilation process while maintaining the vital element of accuracy. We can take data from many sources to build a dossier; identify key data and capture it back into the database for re-use; rapidly reformat, cross-reference and index for submitting them simultaneously to many different countries; then track and manage them throughout their life — sometimes as long as 20 years.

"In the end, it's not just about technology, it's also about understanding business processes. Interleaf understands this."

SAAB AIRCRAFT AB

A LEADING MANUFACTURER OF HIGH-QUALITY REGIONAL AIRLINERS

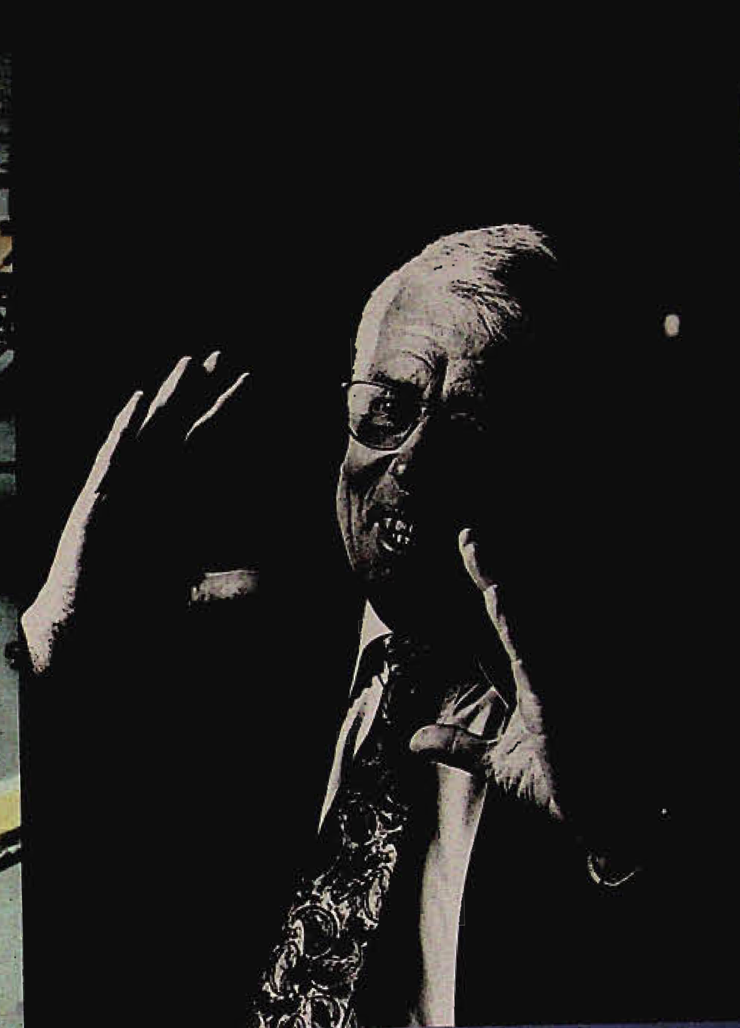
"Ours is a heavily regulated industry. Not only does the Airline Transport Association enforce stringent aircraft maintenance procedures, but it also regulates the documentation for all aircraft. Information that's not correct or current can have legal and safety consequences. Errors in any one of our 20 aircraft manuals, many of which are thousands of pages long, used to mean laborious corrections and costly re-distribution.

"Interleaf has revolutionized our process, slashing both our costs and documentation development time by 50%. The benefits go beyond cost and productivity gains. We've increased the reliability of our information, improved the speed with which we deliver it and increased the amount of information we deliver. We've even tripled our customer base.

"Interleaf automates our documentation routine and makes it possible to not only build multiple, customized versions simultaneously from information in our database, but also to track and manage the information and disseminate it via CD-ROMs.

"This process allows us to deliver accurate, up-to-date information with great speed and to provide our customers with easy information access. They don't need to hunt through thousands of pages manually or substitute change pages. A single CD disk can hold our maintenance manual and illustrated parts catalog, for example, and offer us the potential for adding multimedia. Interleaf's sophisticated and intelligent information linking guides users instantly to the exact information they need. One area in which we're applying this technology is in aircraft maintenance instructions. On any airfield, throughout the world, a technician can load our CD to generate the instructions for performing any maintenance task.

"We trusted Interleaf to give us a competitive edge. We got it. If it's proven technology you want to see, you don't have to look further than the Interleaf systems at SAAB Aircraft AB."



"Information accuracy is critical in our industry. . . . With Interleaf, everything from building multi-version documents from the database with exact accuracy to speedy online distribution takes us half the time and costs millions of dollars less per year."

CURT MURHED
DIRECTOR, COMPUTER SYSTEMS DEVELOPMENT
PRODUCT SUPPORT
SAAB AIRCRAFT AB
LINKÖPING, SWEDEN

LEFT TO RIGHT: PETER CITTADINI, S. V. P., INTERLEAF WORLDWIDE OPERATIONS; LINDA WILK, INTERLEAF; POLLY SUMNER, V. P., ORACLE U.S. CHANNELS ALLIANCES; MARK BOULIE, ORACLE N. E. RESELLER MGR.

PARTNERING FOR SUCCESS

We know we're successful when we've met our customers' business objectives. Most often, one of their main objectives is simply to protect their valuable investments, while implementing a solution that meets their unique requirements. Providing what our customers need is why partnerships are essential to Interleaf.

By integrating with other best-of-breed technologies and partnering with other high-quality systems experts, we are ensuring our ability to provide the most open document management solutions in the industry. Solutions that run on virtually any computer system, integrate with whatever applications our customers use, and automate and re-engineer corporations' business processes to sharpen their competitive edge. The following is a sample of our many partnerships.

SunSoft

"As corporations begin to focus on solutions that provide them with the greatest advantage in a highly competitive global market, they are moving toward strong document management systems. The Interleaf-SunSoft partnership allows both companies to be in the forefront of the document management industry by delivering a powerful solution — Interleaf running on Solaris — for meeting the information challenges facing today's corporations."

EDWARD J. ZANDER, President
SunSoft, Inc.

Phoenix Technologies Ltd

"Interleaf and Phoenix are integrating electronic document distribution with PostScript technology to provide Interleaf users with greater openness and the increased power to handle the widest range of information in a document environment. This partnership represents an increase in market advantages for both companies and exciting new market opportunities for Phoenix."

RONALD FISHER, President and CEO
Phoenix Technologies Ltd

Cambridge Technology Partners

"We're seeing a growing demand for document management systems in the marketplace. And Interleaf is the company the market is looking to for the technology and leadership. Through our partnership, we're seeing the synergy of our two companies' products and services in successfully re-engineering customers' business processes and meeting their specific needs. We also see tremendous opportunities for our joint solution in other companies and industries."

BOB GETT, Executive Vice President
Cambridge Technology Partners

Oracle

"Interleaf is recognized as an industry leader in document management. Oracle is a recognized leader in information technology. Our relationship offers opportunities for both of us to capture and expand our respective market share. Interleaf products provide our customers with a complete document management solution. Corporations continue to buy our products, proving market satisfaction and the success of our alliance."

POLLY SUMNER, Vice President, US Channels Alliances
Oracle

Fulcrum Technologies Inc.

"Our partnership with Interleaf is the perfect example of a win-win relationship. Interleaf and Fulcrum have tightly integrated our two technologies to provide users with the best-of-breed electronic information retrieval. The broad market acceptance of WorldView, Interleaf's electronic document distribution and retrieval product, strengthens Fulcrum's market position as the leading provider of text retrieval development tools."

ERIC GOODWIN, President and CEO
Fulcrum Technologies Inc.

Associative Design Technology

"Interleaf has coupled its superior document management systems with our object-oriented Ptech™ systems analysis tool to provide distinctive consulting services for major organizations. In Interleaf we found an innovative organization that shares a vision for how firms will create, present and manage their expanding information base."

SEAFORTH M. LYLE, general manager
Associative Design Technology

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.

Mark K. Ruport
President and Chief Executive 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 (4) meetings during fiscal 1993. 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 on any auditing matters.

Frederick B. Bamber
Chairman, Audit Committee

Year ended March 31	1993	1992	1991
Revenues	100%	100%	100%
Costs and expenses:			
Cost of products, maintenance, and services sold	25	24	24
Selling, general and administrative	47	50	56
Research and development	14	15	18
Amortization of software and development costs	3	3	3
Total operating costs and expenses	89	92	101
Income (loss) from operations	11	8	(1)
Interest income (expense), net	–	–	–
Other expense	(1)	(1)	(1)
Income (loss) before income taxes	10	7	(2)
Provision for income taxes	2	1	–
Net income (loss)	8%	6%	(2)%

Results of Operation

The Company believes that its revenue growth during its past three fiscal years, FY93', FY92', and FY91', fairly reflects the large and growing global market for the Company's document-based information systems—systems which enable customers to create, distribute and manage documents tailored to meet their specific applications. While the Company's revenue grew 17% over FY92', and 39% over FY91', this growth needs to be analyzed and understood in the context of the major shifts that have occurred to Interleaf's historic customer base and the significant structural changes that the Company has successfully undertaken during this period.

From the Company's inception, a significant portion of its revenues were derived, either directly or indirectly, from the aerospace/defense sector. Moreover, during this period, the Company had incrementally designed its software products for use in dedicated technical publishing environments in this sector. Concurrently, the Company also developed a substantial sales infrastructure focused on this sector.

As U.S. defense spending began to decline in the late 1980's, Interleaf was compelled to seek new opportunities in different and growing markets. Equally important, the Company realized that it had to develop and refine its software products to successfully attract new users in these differing markets and provide solutions to their document management systems needs. As will be described further below, the Company responded to these challenges by significantly changing existing products, such as providing for the extensibility of Interleaf 5 which enables it to be customized without reprogramming the underlying product, introducing new products such as WorldView, its electronic viewing product, and RDM, its relational document management product, and by revamping its sales forces to begin focusing on MIS departments of major companies. Moreover, the Company began a consulting services practice to customize these core Interleaf software products to meet the specific application solution requirements of its new customer base. While the development of the consulting practice during this period has been challenging, the Company believes that it is its now proven ability to deliver total solutions to domestic customers that gives Interleaf a competitive advantage. It is in the context of these evolutionary changes that have occurred in the past three years that the Company's operating performance and financial condition should be analyzed.

Revenue Growth by Geographic Area

The Company was encouraged by the improved revenue growth demonstrated by its domestic operations in FY93'. U.S.-based revenue increased by approximately $9 million, or 15%, when comparing FY93' over FY92'; $17 million, or 32%, when comparing FY93' to FY91'. The Company attributes this increased domestic growth primarily to four factors:

- The Company has begun to successfully penetrate new and growing markets by attractively pricing its products to enable customers to cost effectively implement document management systems. In FY89', of the Company's ten largest domestic customers, eight were either directly or indirectly in the aerospace/defense sector. Of the Company's ten largest customer's in FY93', only three were from this segment, as new areas such as telecommunications, pharmaceuticals and petro-chemicals have generated substantial sources of revenue.
- The Company's increasingly diverse customers are investing in Interleaf's document based information systems, and are focused on disseminating and managing information dynamically as an integral part of their management information network.

- Interleaf's consulting practice, primarily in the U.S., has demonstrated its ability to deliver solutions, and has begun to generate incremental software revenue.
- Domestic sales management has been reorganized to better meet Interleaf's changing customer base by targeting customers' MIS departments.

In contrast to solid domestic growth, Interleaf's European-based revenue for FY93' was not strong, and it experienced limited real growth. The Company attributes this limited growth to three factors:

- While the overall European economy has been weak for the past two years, during FY93' the German economy also stagnated. As a result, the Company's German subsidiary, the Company's strongest performer in prior years, failed to meet its projected revenue target by $3 million and experienced a decreased growth rate. Given the current economic climate in Europe, especially in Germany, the Company will continue to closely manage its expenses and monitor its operations in Europe.
- The Company's consulting practice in Europe is in its early stages and therefore the Company's European operations have not benefited from the incremental software revenue pull that the Company has experienced domestically. In FY94', the Company will focus on expanding its consulting practice into Europe, and believes it will result in improved European-based revenue when the economy recovers.
- The Company, as it did previously in the United States, is undergoing sales management changes in its European operations. Sales management in Sweden, Switzerland, Belgium and the United Kingdom is currently being revamped, while a new country manager in France recently began in late FY93'. The Company expects these changes to ultimately result in improved operating performance but recognizes the challenges and risks it faces in managing these changes and improving processes in Europe.

The Company was very encouraged by the results of its new subsidiary in Japan, as revenue totalled approximately $4 million in FY93'. The Company has expended significant research and development funds on its Japanese authoring product and incurred significant start-up costs, but believes that the results to date validate its investment decision. The Company plans on developing a Japanese version of WorldView and RDM in FY94'.

In the Japanese marketplace the Company has been pursuing a distribution strategy of selling through major systems integrators who have significant system integration capabilities, at attractive pricing for up-front purchases. As a result, these resellers carry inventories of Interleaf software. While this program has been well received in Japan, the ability of these Japanese resellers to sell through to end-users will ultimately determine the long-term success of Interleaf in Japan.

Revenue Growth by Category

The composition of Interleaf's revenue has changed significantly during its past three fiscal years, and can be better understood when broken down into its three major segments: (1) software products, (2) maintenance, and (3) services.

The Company primarily offers three core software products: (1) Interleaf 5, its object oriented authoring product, (2) WorldView, its viewing product that enables customers to disseminate, retrieve and access information electronically, and (3) RDM, its relational document management product. In FY93', Interleaf 5 represented approximately 84% of the Company's worldwide software revenue, down from 92% in FY92', and 98% in FY91'. This trend underscores the rapid market acceptance of the Company's two other core products: WorldView and RDM. WorldView was first introduced in FY92' and nearly doubled in revenues in FY93'. In FY93', RDM also nearly doubled its revenues over FY92', its first year of introduction. The Company expects continued strong growth from these two products in FY94', especially in Europe where they have only recently been introduced.

The Company believes that WorldView and RDM complement its authoring software product, Interleaf 5, and enable the Company to provide a total scalable product offering to customers for authoring, distributing and managing information. Due to their open architecture, these products are also sold on a stand alone basis into different computing environments. The Company does recognize that it must provide Interleaf 5 on standard graphical user interfaces ("GUIS") if it is to remain competitive in the marketplace. The Company did complete its port to Open Look, a standard GUI, and expects to complete its port to MOTIF, the leading GUI for unix workstations, Windows and Macintosh in FY94'.

The Company believes that there will be continued downward price pressure on stand-alone workstation based software products as new networking and operating systems merge personal computer and workstation environments. The Company also believes that the negative impact of the downward price pressure can be offset by premium prices that can be charged for customized software that is key to high volume document management applications, and by increased volume as corporations implement enterprise wide document based information systems.

The Company's maintenance revenue during FY93' grew at approximately 15% over FY92' to approximately $31 million; maintenance revenue, however, from FY91' to FY92' grew at approximately 62%. The Company does not expect to see growth in this area of its business in FY94' for two reasons: (1) The Company's program of back-billing non-maintenance customers who wished to upgrade to Interleaf 5 is completed; and (2) As the pricing of software products continues to decline, as further described below, corresponding maintenance pricing will also decline since it is based on a percentage of the software price.

The Company's services based revenue increased to approximately $20 million in FY93', an increase of nearly 39% from FY92', and a doubling over FY91'. The Company believes that this growth rate favorably reflects the Company's ability to successfully deliver complete solutions to its customers. While gross profit margins from services are significantly lower than from the Company's core software, these services are critical in enabling customers to successfully implement document management solutions, and therefore, the Company believes they generate substantial incremental core software revenue.

The Company's goal for its services group is that it will continue to develop a library of reusable technology which can be redeployed with Interleaf core software in similar projects for different customers. The mission of the Company's consulting group is to primarily customize the Company's core software products to meet customers' document management needs, and not undertake projects where only services are required. Therefore, in pursuing consulting projects, the Company carefully weighs the mix of core software and services being acquired by customers.

Selling, General and Administrative Expenses

The Company continues to tightly manage its operating expenses, as expenses increased by 11% over FY92', while revenues increased during the same period by over 17%. Moreover, as a percentage of total revenue, the Company's selling, general, and administrative ("SG&A") decreased from 56% in FY91' to 50% in FY92' to 47% in FY93'. The Company attributes this positive trend to improvements in sales productivity—the Company has been able to successfully leverage its existing sales force to generate additional revenue. While revenue increased by $17 million in FY93' over FY92', no additional sales people were added in the field, but were supplemented by the establishment of a corporate telesales operation and the expansion of alternate channels in areas where Interleaf had limited presence.

Nevertheless, the Company realizes that it must continue to improve the productivity of its sales force to achieve greater profitability. The Company will continue to devise and implement new strategies to reduce the sales cycle, resulting in improved productivity. As part of this strategy, the Company plans to significantly increase its marketing expenditures by approximately 40% in FY94' to improve customer awareness and more clearly identify Interleaf as a leading document management solutions provider.

Research and Development

The Company continues to maintain a high level of investment in research and development, which was 17% of the total revenue in FY93. This continued high level is required in large part by the rapid change in the operating systems of the 13 different platforms on which Interleaf currently operates, the need to support its software products in nine different foreign languages, the global movement toward standard graphical user interfaces ("GUIs"), and the Company's adoption of new technologies into Interleaf's core software. The rapid adoption of new technology is critical if Interleaf is to remain successful. Accordingly, the Company anticipates that it may expend significant resources to acquire or license technologies which it believes are critical to its success, and can be effectively acquired from third party sources.

The Company believes that structured documents ("SGML") will be required by the marketplace in the future. Unlike the traditional page description layouts, SGML groups information by pre-defined segments, not actual pages. The Company is committed to this direction and will expend resources to develop SGML compliant products.

Operating and Net Income

The Company's operating income for FY93' increased by 72% to $12.6 million or 11% of total revenue of $117 million, compared with operating income of $7.4 million or 7% of total revenue of $100 million in FY92'. In FY91' the Company experienced an operating loss of $.5 million on revenue of $84 million. This large change to the Company's operating income underscores the leverage inherent in increasing the Company's top line revenue because of the Company's relatively high fixed cost structure.

While the Company's operating income increased by 72% over FY92', the Company's net income increased by 56% to $9.3 million, up from $6 million in FY92'. The Company had a net loss of $1.3 million in FY91'. The Company's relatively lower net income in FY93' reflects the Company's higher effective corporate tax rate of approximately 20%. In FY92', this rate was only 8%. This differential is attributable to the utilization of the Company's tax credits and net operating loss carry forwards, primarily from the restructuring charge of approximately $14 million incurred in November 1989. Since these favorable tax attributes have been nearly fully utilized, in FY94' the Company estimates it will be in approximately the 30% effective corporate tax rate, which includes a one time $1.0 million – $2.0 million tax credit due to the Company's adoption of FASB 109. The Company's overall statutory tax rate is expected to be approximately 40%.

Liquidity and Capital Resources

In FY93', the Company continued to improve its long term financial position as cash and marketable securities increased to approximately $30 million at March 31, 1993, up from $18.2 million at March 31, 1992 and $13.6 million at March 31, 1991. This continued improvement during this period reflects the Company's improvement in its overall profitability. In addition, the Company continues to enjoy the benefit of receiving annual pre-paid maintenance, which is reflected as a liability as unearned service revenue on the Company's Consolidated Balance Sheets.

The Company invested approximately $4.6 million in FY93' primarily to upgrade its corporate information network, while depreciation expenses totalled approximately $6 million. The Company expects to spend approximately $6 million on property and equipment in FY94', which will be financed through leases or internal funds.

The Company's capital needs as a provider of software and services are and will continue to remain moderate. The Company, however, anticipates expending resources in FY94' on acquiring, by purchase or license, needed technologies to enhance its core software, and to meet new requirements dictated by the marketplace.

The Company has a joint venture with PruTech Research and Development III ("PruTech"), whereby, on behalf of the venture, it markets WorldView on personal computers and the mainframe, and its CALS product used in U.S. Defense Department procurements. Because of the relatively low level of profitability of the venture, and the need to fund enhancements to the products to remain competitive, the venture made no cash distributions during FY93'. PruTech, however, believes that it is entitled to mandatory cash distributions of 30% of all of the venture's revenues; the Company believes that this position is without merit. PruTech has the right to purchase the Company's interest in the venture under various terms and conditions. In the event PruTech exercises its right to purchase, it could preclude the Company from marketing these and competing products in certain areas of the United States.

With the Company's high fixed cost structure, any fluctuation in revenue will have a significant impact on its profitability. Since the Company's sales cycles have become longer and more complex when involving large document management systems procurements, and given that a large part of the Company's revenues occur in the last month of the quarter in any event, the Company's actual results in any one quarter can be volatile, and are often unknown until the very end of the quarter.

(in thousands except for per share amounts)

Year ended March 31	1993	1992	1991
Revenues			
Products	$ 66,752	$ 59,372	$ 57,149
Maintenance	30,923	26,758	16,554
Services	19,666	14,169	10,615
	117,341	100,299	84,318
Costs and expenses			
Cost of products, maintenance, and services sold	28,901	24,432	20,400
Selling, general and administrative	55,831	50,398	46,987
Research and development	16,302	14,720	14,607
Amortization of capitalized software development costs	3,671	3,382	2,815
Total operating costs and expenses	104,705	92,932	84,809
Income (loss) from operations	12,636	7,367	(491)
Interest expense	(724)	(976)	(1,043)
Interest income	721	962	1,033
Other expense, net	(1,004)	(840)	(527)
Income (loss) before income taxes	11,629	6,513	(1,028)
Provision for income taxes	2,326	529	250
Net income (loss)	$ 9,303	$ 5,984	$ (1,278)
Earnings (loss) per share			
Primary	$ .55	$ .38	$ (.11)
Fully diluted	.55	.38	(.11)
Shares used in computing primary earnings (loss) per share	16,836	15,704	11,956
Shares used in computing fully diluted earnings (loss) per share	16,925	15,747	11,956

See Notes to Consolidated Financial Statements.

(In thousands except for share amounts)

March 31	1993	1992
Assets		
Current assets		
Cash and cash equivalents	$ 26,402	$ 18,227
Marketable securities	4,070	–
Accounts receivable, net of allowance of $725 and $778 for doubtful accounts, respectively	32,051	30,005
Inventories	181	176
Prepaid expenses and other current assets	2,103	1,880
Total current assets	64,807	50,288
Property and equipment, net	9,494	10,884
Excess of purchase price over net assets of businesses acquired	16,402	17,888
Other assets	8,816	8,513
	$ 99,519	$ 87,573
Liabilities and Shareholders' Equity		
Current liabilities		
Accounts payable	$ 3,143	$ 3,541
Accrued expenses	8,414	8,475
Accrued compensation and related items	6,491	5,140
Unearned service revenues	13,589	12,866
Current portion of capital lease obligations	1,458	795
Other liabilities	888	1,938
Total current liabilities	33,983	32,755
Capital lease obligations, less current portion	1,594	1,425
Long-term debt and other liabilities, less current portion	263	1,134
Deferred taxes	553	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 1,928,572 and 2,142,857 shares, respectively (liquidation value $7 per share)	193	214
Common stock, par value $.01 per share, authorized 20,000,000 shares, issued and outstanding 13,064,139 and 12,434,494 shares, respectively	131	124
Additional paid-in capital	63,507	61,682
Retained-earnings deficit	(459)	(9,762)
Equity adjustment for foreign currency translation	(246)	(150)
	63,126	52,108
	$ 99,519	$ 87,573

See Notes to Consolidated Financial Statements.

(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, 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
Conversion of Senior Series B Convertible Preferred stock into common stock	(21)	3	18	–	–	–
Common stock issued in connection with incentive stock options exercised by employees	–	2	923	–	–	925
Common stock issued in connection with employee stock purchase plan	–	2	884	–	–	886
Equity adjustment for foreign currency translation	–	–	–	–	(96)	(96)
Net income	–	–	–	9,303	–	9,303
Balances at March 31, 1993	$ 193	$ 131	$ 63,507	$ (459)	$ (246)	$ 63,126

See Notes to Consolidated Financial Statements.

(In thousands) **Year ended March 31**	**1993**	**1992**	**1991**
Operating activities			
Net income (loss)	$ 9,303	$ 5,984	$ (1,278)
Depreciation and amortization expense	8,043	7,879	7,738
Amortization of capitalized software development costs	3,671	3,382	2,815
Loss from disposal of property and equipment	137	202	372
Provision for deferred income taxes	402	–	(118)
Changes in current accounts excluding the effects of acquisitions:			
Increase unearned revenue	971	3,153	7,041
(Increase) decrease accounts receivable, net	(2,380)	(4,849)	154
(Increase) decrease inventories	(24)	261	1,401
(Increase) decrease other current assets	(204)	802	(688)
Increase accounts payable and other current liabilities	1,056	3,945	864
Decrease in accrued restructuring costs	(522)	(878)	(2,856)
Other, net	62	(330)	(217)
Net cash provided by operating activities	20,515	19,551	15,228
Investing activities			
Increase marketable securities	(4,070)	–	–
Additions to property and equipment	(4,569)	(5,134)	(2,215)
Capitalized software development costs	(4,034)	(3,691)	(3,601)
Payments for acquisitions of businesses, net of cash acquired	–	(7,541)	–
(Increase) decrease in other non-current assets	(847)	(438)	207
Net cash used in investing activities	(13,520)	(16,804)	(5,609)
Financing activities			
Net proceeds from issuance of common stock	1,811	1,511	1,052
Proceeds from capital leases	1,794	2,376	–
Repayment of long-term debt and capital leases	(2,374)	(2,040)	(1,613)
Net cash provided by (used in) financing activities	1,231	1847	(561)
Effect of exchange-rate changes on cash	(51)	12	66
Net increase in cash and cash equivalents	8,175	4,606	9,124
Cash and cash equivalents at beginning of year	18,227	13,621	4,497
Cash and cash equivalents at end of year	$ 26,402	$ 18,227	$ 13,621

See Notes to Consolidated Financial Statements.

Note A Significant Accounting Policies

Business	The Company, a Massachusetts corporation, was incorporated on May 27, 1981 and develops and markets software, services and customized solutions used in the creation, management, and distribution 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 and unrealized 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. Services 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 and Marketable Securities	Cash equivalents represent investments with maturities at date of purchase of less than three months. Marketable securities represent investments with maturities of three to six months. Marketable securities are accounted for at cost which approximates market value. Marketable securities consist of investment grade commercial paper 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 the purchase price over net assets of acquired businesses is amortized over 15-25 year periods to 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 Company will adopt the statement in the first quarter of fiscal year 1994 and has determined that it will not restate prior year financial statements. The impact of adoption is expected to result in the recognition of a deferred tax asset of approximately $1-2 million. The recognition of the deferred tax asset will positively impact net income and will be accounted for as a cumulative effect of a change in accounting principles.
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 1992 amounts have been reclassified to conform to the 1993 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 beginning when the product is available for general release to customers. The amortization is the greater of the amount computed using the ratio of current gross revenues to total current and anticipated gross revenues or straight line over the estimated remaining useful life not to exceed three years. The unamortized portion of capitalized software development costs included in other assets amounted to $5,995,000 and $5,632,000 at March 31, 1993 and 1992, respectively.

Note C *Property and Equipment*

Property and equipment at March 31, 1993 and 1992 consist of the following:

(in thousands)	1993	1992
Office and demonstration equipment	$ 22,805	$ 22,246
Development equipment	9,543	9,137
Furniture	4,245	4,134
Leasehold improvements	593	715
	37,186	36,232
Less allowances for depreciation and amortization	27,692	25,348
	$ 9,494	$ 10,884

Note D *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 have a liquidation preference over all other shareholders of the Company and are entitled to receive $7.00 per share. Thereafter, all other shareholders are 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 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 are 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 are entitled to elect one director and the Company needs 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 was 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. There was no final adjustment to the Conversion Ratio based on the fiscal 1993 earnings release. Therefore, the total effect of the adjustments was an additional 736,607 shares of common stock being issuable at time of conversion. In fiscal 1993, 214,285 shares of Series B Convertible Preferred Stock were converted at the shareholders' request into 287,945 shares of the Company's common stock.

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, 1993, 6,027,822 shares of common stock were reserved for issuance.

The Board of Directors in May, 1993 voted to amend the Company's Restated Articles of Organization to increase the Company's authorized shares of its Common Stock, .01 par value, by an additional 10,000,000 shares, from 20,000,000 to 30,000,000, to be submitted to its shareholders for approval at the Company's Special Meeting in Lieu of an Annual Meeting to be held on August 5, 1993.

Note E Stock Option and Stock Purchase Plans

Under the Company's 1983 Stock Option Plan, options to purchase shares of common stock 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, 1993, options covering 649,922 shares were exercisable, and options covering 551,878 shares were available for future grants. The Company's 1983 Stock Option Plan expires effective June 24, 1993. In May, 1993 the Company's Compensation Committee of the Board of Directors approved the Company's 1993 Stock Option Plan, which contains substantially similar terms and conditions to its existing plan, to be submitted to its shareholders for approval and ratification at the Special Meeting in Lieu of an Annual Meeting to be held on August 5, 1993.

A summary of activity in the Plan is presented below:

	Number of Shares	Price Range of Shares
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
Granted	425,750	8.38 – 11.38
Exercised	(172,701)	.57 – 8.38
Cancelled	(141,777)	3.13 – 16.50
Outstanding at March 31, 1993	1,533,446	$ 1.13 – $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 then 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, 1993 options for the purchase of 30,000 shares were exercisable under the Director Stock Option Plan.

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, 1993, 2,085,324 shares of common stock under the stock option plan and 245,801 shares of common stock under the employee stock purchase plan were reserved for issuance.

Note F Leases and Other Obligations

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, 1993, the gross amount of these assets, was $4,413,000 with accumulated amortization of $1,120,000. Future minimum rental payments at March 31, 1993, under agreements classified as operating and capital leases with non-cancellable terms in excess of one year, are as follows:

(in thousands)

Fiscal years ending March 31	Operating Leases	Capital Leases
1994	$ 7,758	$ 1,637
1995	6,278	1,313
1996	6,050	359
1997	5,351	–
1998	4,969	–
Thereafter	10,739	–
Total minimum lease payments	$ 41,145	3,309
Less amount representing interest (interest rates range from 6 – 8 1/3%)		257
Present value of net minimum lease payments		$ 3,052

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

Rent expense amounted to $9,725,000, $8,728,000, and $10,164,000 for the years that ended March 31, 1993, 1992 and 1991, respectively. Included within accrued liabilities are amounts accrued for rent at March 31, 1993 and 1992 totaling $2,154,000 and $1,604,000, respectively.

On September 30, 1992, the Company allowed its committed, revolving line of $5 million bank credit to expire.

The remaining portion of the Company's long-term debt obligations at March 31, 1993, $654,000, has been classified as other current liabilities and is payable in quarterly installments of $229,167 including interest of 10%.

Note G Income Taxes

The provision for income taxes is composed of the following:

(in thousands)	1993	1992	1991
Current:			
Federal	$ 1,149	$ 170	$ –
State	230	288	162
Foreign	545	71	206
Total current	1,924	529	368
Deferred (credit)	402	–	(118)
	$ 2,326	$ 529	$ 250

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

(in thousands)	1993	1992	1991
Domestic	$ 10,416	$ 6,680	$ 229
Foreign	1,213	(167)	(1,257)
	$ 11,629	$ 6,513	$ (1,028)

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

(In thousands)	1993	1992	1991
Research and development costs, net of amortization	$ 111	$ 104	$ 319
Allowance for uncollectible accounts receivable, vacation and other reserves	26	4	129
Inventory adjustments	(18)	40	40
Excess of financial statement over tax depreciation	8	(507)	(418)
Restructuring reserve less amounts for which no tax benefit was realized	161	299	446
Accrued rent	(169)	(13)	(633)
Deferred software revenue	291	–	–
Other, net	(8)	73	(1)
	$ 402	$ 0	$ (118)

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)	1993	1992	1991
Computed at federal statutory rate of 34%	$ 3,954	$ 2,214	$ (350)
State income taxes, net of federal tax benefit	152	190	18
Nondeductible amortization	341	337	179
Other nondeductible expenses	40	221	21
Loss for which no tax benefit was realized	207	215	619
U.S. and foreign tax rate difference	187	–	–
Benefit of net operating loss carryforward	(807)	(2,642)	(489)
Benefit of tax credits	(1,776)	–	–
Other, net	28	(6)	252
	$ 2,326	$ 529	$ 250

At March 31, 1993, the Company and its subsidiaries had net operating loss carryforwards of approximately $9 million that are available to offset future taxable income. The loss carryforwards are attributable to non-U.S. operations and expire in 1996 and thereafter.

In addition, the Company has research and development tax credit carryforwards of approximately $3.7 million available to reduce future federal income tax liability through the year 2006. During 1993, 1992 and 1991, the Company made $1,530,000, $358,000, and $129,000 in income tax payments, respectively.

Note H 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, 1993 and 1992, and for the years then ended is as follows:

(in thousands)

March 31, 1993 and for the year then ended	North America*	Europe	Asia/Pacific	Eliminations**	Total
Sales to unaffiliated customers	$ 78,730	$ 36,818	$ 1,793	$ –	$ 117,341
Intercompany transfers	10,889	–	–	(10,889)	–
Net revenues	89,619	36,818	1,793	(10,889)	117,341
Income (loss) from operations	11,196	1,659	(219)	–	12,636
Identifiable assets	112,751	14,678	2,206	(30,116)	99,519
Liabilities	29,181	11,182	1,282	(5,252)	36,393

March 31, 1992 and for the year then ended	North America	Europe	Asia/Pacific	Eliminations	Total
Sales to unaffiliated customers	$ 68,734	$ 31,565	$ –	$ –	$ 100,299
Intercompany transfers	11,478	–	–	(11,478)	–
Net revenues	80,212	31,565	–	(11,478)	100,299
Income (loss) from operations	6,675	772	–	(80)	7,367
Identifiable assets	84,585	17,411	–	(14,423)	87,573
Liabilities	28,138	14,875	–	(7,548)	35,465

* The North American geographic area was redefined to include the United States and Canada.

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

Note I 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 or 90% of MLTV's revenues in that fiscal year.

In September, 1988, the Company 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. Through October 1, 1991, all of the profits of the Venture, up to 30% of recorded revenues, were allocated to Interleaf, with remainder being allocated to PruTech. When cash distributions were made by the Venture, 86% were distributed to Interleaf, with the balance to Pru-Tech. Commencing October 1, 1991, PruTech has been allocated all of the profits of the Venture up to 30% of recorded revenues, with the balance being allocated to the Company; 86% of the distributable cash, of the Venture, if any, is to be distributed to PruTech, with the remainder to Interleaf. Since then, the Venture has been using available cash for research and development and no cash has been distributed. PruTech, however, believes that it is entitled to mandatory cash distributions of 30% of all of the Venture's revenues; the Company believes that this position is without merit. 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, subject to certain adjustments, through October 1995 at $6.40 per share. This amount is included in additional paid in capital. An adjustment to the warrant 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. In such event, the Company will lose the right to market the products owned by the venture including WorldView on IBM-compatible personal computers. The Company recorded net revenues form the sale of joint venture products of approximately $1.3 million, $1.3 million, and $2.0 million for fiscal years 1993, 1992 and 1991 respectively.

Note J Acquisition

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)

Year ended March 31	1993	1992	1991
Revenues	$ 117,341	$ 102,743	$ 88,587
Net income (loss)	9,303	5,686	(3,366)
Net income (loss) per share	.55	.36	(.28)

Board of Directors
Interleaf, Inc.

We have audited the accompanying consolidated balance sheets of Interleaf, Inc. and subsidiaries as of March 31, 1993 and 1992, 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, 1993. 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, 1993 and 1992, and the consolidated results of their operations and their cash flows for each of the three years in the period ended March 31, 1993, in conformity with generally accepted accounting principles.

Ernst + Young

Boston, Massachusetts
April 23, 1993

The following summarizes unaudited selected quarterly results of operations for the years ended March 31, 1993 and 1992 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 1993					
Revenues	$ 26,489	$ 28,436	$ 31,039	$ 31,377	$ 117,341
Gross Profit	19,862	21,334	23,428	23,816	88,440
Net income	1,446	1,864	2,956	3,037	9,303
Net income per share	.09	.11	.17	.18	.55
Common stock prices					
High	12 1/2	11	13 3/8	13 5/8	13 5/8
Low	7 7/8	7 3/4	8 7/8	8 5/8	7 3/4
Fiscal 1992					
Revenues	$ 20,975	$ 23,339	$ 26,583	$ 29,402	$ 100,299
Gross Profit	15,817	17,568	20,209	22,273	75,867
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

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 May 6, 1993, there were 963 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	1993	1992 a	1991	1990 b,c	1989
For the year					
Total revenues	$ 117,341	$ 100,299	$ 84,318	$ 88,843	$ 82,780
Net income (loss)	9,303	5,984	(1,278)	(16,008)	863
Net income (loss) per share	0.55	0.38	(0.11)	(1.37)	0.07
At year end					
Total assets	99,519	87,573	71,711	68,502	74,051
Long-term obligations	1,857	2,559	3,048	3,809	13,246
Total shareholders' equity	63,126	52,108	44,731	45,195	45,064

a. Fiscal 1992 results include the impact of the acquisition of Interleaf GmbH in July 1991.
b. Fiscal 1990 results include the impact of the acquisition of Interleaf France S.A.
c. Fiscal 1990 results include the impact of a $13.9 million charge for restructuring of the corporate infrastructure.

Executive Officers

Lawrence S. Bohn
Senior Vice President of Business Development

Peter Cittadini
Senior Vice President of Worldwide Operations

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

John K. Hyvnar
General Counsel & Clerk

Philip E. London
Senior Vice President of Engineering

Mark K. Ruport
President and Chief Executive Officer

Michael P. Thoma
Senior Vice President of Marketing

Board of Directors

Frederick B. Bamber
General Partner
Applied Technology Partners

David A. Boucher
Chairman of the Board
Interleaf, 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 Executive Officer
Interleaf, Inc.

Patrick J. Sansonetti
Senior Vice President
Advent International Corporation

Interleaf Fellows

Tim Anderson

Valerie Beaubien

Mats Borgestedt

James L. Crawford

Mark S. Dionne

Kimbo B. Mundy

Kirk L. Reistroffer

Robert Watkins

David Weinberger

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 5, 1993 at 8:30 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 Office

United States
Phoenix, Arizona; Irvine, El Segundo, Sacramento, Santa Clara, California; Norwalk, Connecticut; Tampa, Florida; Atlanta, Georgia; Oakbrook Terrace, Illinois; Greenbelt, Maryland; Waltham, Massachusetts; Detroit, Michigan; St. Louis, Missouri; Iselin, New Jersey; Raleigh, North Carolina; Irving, Houston, Texas; Bellevue, Washington

Canada
Mississauga, Ottawa, Ontario; Montreal, Quebec

International
Sydney, Australia; Brussels, Belgium; Paris, France; Dusseldorf, Frankfurt, Hamburg, Munich, Stuttgart, Germany; Tokyo, Japan; Breda, The Netherlands; Stockholm, Sweden; Lausanne, Zurich, Switzerland; Weybridge, Surrey, U.K.

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Interleaf Corporate Design Group

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Cindy Ryan
Interleaf Corporate Design Group

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Interleaf Corporate Design Group

Photography
Lou Jones

Michael Lutch, *cover photo*
Page 8, *courtesy of Lockheed*
Page 12, *courtesy of SAAB Aircraft AB*

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