

Interleaf

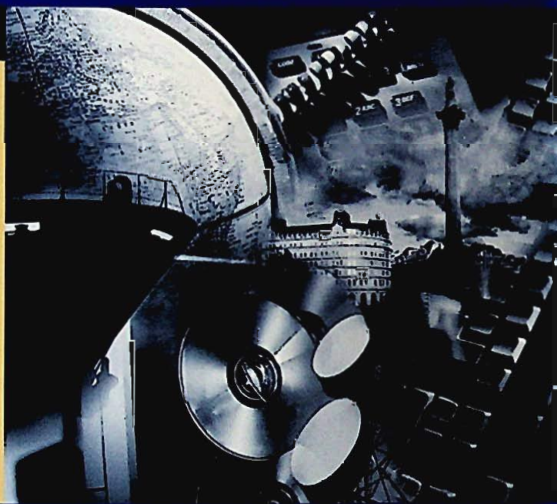
ANNUAL REPORT

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COMPANY OVERVIEW

INTERLEAF, INC. IS A LEADING WORLDWIDE SUPPLIER OF INTEGRATED DOCUMENT MANAGEMENT APPLICATIONS AND SERVICES FOR NETWORKED AND WEB-BASED BUSINESS SOLUTIONS. OUR SUITE OF ADVANCED, OPEN SOFTWARE PRODUCTS INTEGRATE ELECTRONIC PUBLISHING, DOCUMENT MANAGEMENT AND INTERNET TECHNOLOGIES, MAKING IT EASY FOR OUR CUSTOMERS TO ASSEMBLE, MANAGE, RETRIEVE, DISTRIBUTE, AND PUBLISH BUSINESS-CRITICAL INFORMATION ACROSS THE ENTERPRISE.

INTERLEAF IS HEADQUARTERED IN WALTHAM, MASSACHUSETTS, WITH OFFICES AROUND THE WORLD.



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TO OUR SHAREHOLDERS

Fiscal 1996 was a challenging and, in most respects, successful year for Interleaf. Revenues increased slightly – a significant achievement given the amount of change the Company went through during the year. The Company also enjoyed its first profitable year since fiscal 1993.

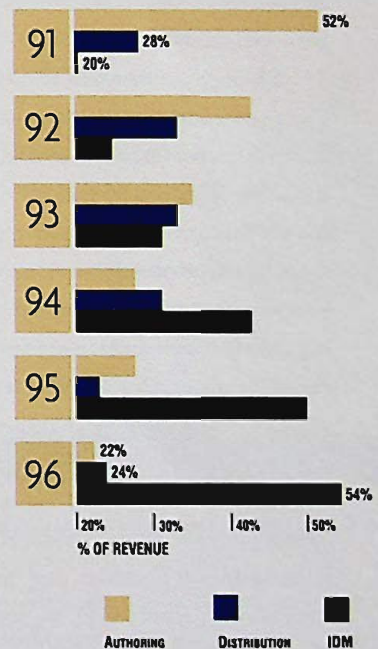
We released major enhancements across our entire product line as well as several important new products. We re-established ourselves with our customers and greatly improved market visibility. We rebuilt our worldwide sales team with a focus on solution selling. And we strengthened our management team, our business practices, and our infrastructure.

Our major disappointment was that we were not able to generate greater revenue growth, but we believe we made solid progress in repositioning the Company to remain the leader in the rapidly growing Integrated Document Management (IDM) market. Profitable revenue growth is our primary goal for the future.

Revenues in fiscal 1996 were \$88.6 million, up slightly from \$87.9 million in fiscal 1995. The balance sheet clean-up and operational improvements over the past 18 months enabled us to reduce operating expenses by approximately \$18.0 million. As a result, the Company had net income of \$0.3 million compared with the fiscal 1995 loss of \$48.4 million, and cash increased \$2.3 million compared with a decrease of \$12.9 million in the prior year.

Our disappointing revenue growth can be attributed primarily to a basic shift in our business, from authoring to IDM, and the productivity of our new sales team. Interleaf's direction and business model have changed dramatically, from selling authoring and publishing tools to providing IDM solutions. The result is seen in the chart to the right. In five years, authoring tools have gone from over 50% of revenues to about 20%. This decline in revenue from a mature market has obscured significant growth in IDM from about 20% to over 50% of revenues.

Our focus on IDM solutions required new people at all levels of our worldwide sales organization; people who knew how to sell solutions rather than point products and technology. This required tearing down, then rebuilding the sales organization; by the fourth quarter of fiscal 1996, approximately two-thirds of our sales force, as well as sales management, had been with the Company fewer than twelve months. New sales people require several months to get up to speed, and the



Interleaf's revenue mix has tracked our change in mission from selling authoring tools to providing Integrated Document Management Applications.

sales cycle for IDM solutions can take 9-12 months. Combined, these factors resulted in low sales force productivity in fiscal 1996. We are convinced, however, that we have a strong sales team going forward.

Lack of market visibility going into fiscal 1996 also impacted sales. The positive developments at the Company over the past 18 months, along with a low-cost but aggressive marketing campaign, have made the marketplace take notice of us again. International Data Corporation and The Delphi Consulting Group recently recognized Interleaf as the leading vendor of IDM solutions, and our new products and strategic direction have been well received.

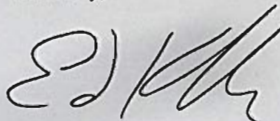
Through the first part of fiscal 1996, the Company focused on updating our existing line of products, porting them to additional platforms including Windows 95 and NT, and opening up the product architecture to enable integrated solutions. The accelerated flow of new and enhanced products has helped restore credibility in the existing customer base and strengthen our position in the marketplace. Our new Intellecte/BusinessWeb solution, which combines advanced document management technology with the ease-of-use of standard Web browsers for end-user access to information, has received a very positive reaction from customers, prospects, and the trade press. Combined with products from Internet security specialists Open Market, Inc. – one of several key alliances announced during the year – we will be at the leading edge of the trend toward integration of document management and Internet/Intranet technologies.

Going forward, we will leverage our strengths: the broadest suite of IDM products; unparalleled experience in implementing solutions that solve pressing business problems; and a proven track record for helping organizations achieve significant return on investment. We expect Interleaf applications to play a vital and increasingly important role across a wide range of industries. Examples include quality and safety issues in manufacturing, and customer reporting in the financial services industry.

In May 1996 we acquired The Learning Alliance and made it a strategic business unit of Interleaf, capitalizing on the major opportunity of sales force automation applications. Our exciting new application, Intellecte/SalesTeam, combines Intellecte/BusinessWeb with The Learning Alliance's sales methodology and sales process management software into a powerful sales force automation application. KPMG Peat Marwick LLP simultaneously announced that they will promote Intellecte/SalesTeam in their consulting practice.

This highlights some of the more significant developments at the Company over the past year. The rapid growth of the IDM market and the explosion of Internet/Intranet technology gives us an excellent opportunity. We believe we have made great strides in the Company's comeback, and it is now up to us to drive sales and all other aspects of the business to take advantage of that opportunity.

Sincerely,



Ed Koepfler
President and Chief Executive Officer

“B

y putting Integrated Document Management tools on the desktop, we're making technology adapt to people's needs, instead of the other way around.”

INTERLEAF HELPS COMPANIES TURN INFORMATION INTO KNOWLEDGE.

Successful businesses today are distinguished by their ability to access, enhance, and share business-critical information that is captured on word processors, graphic applications, spreadsheets, Internet and World Wide Web documents, and virtually every other kind of application running on multiple computer platforms.

This increased reliance on disparate data sources, combined with the sheer volume of information and the rapid pace of business, has made it difficult, if not impossible, for most companies to manage information effectively.

INTERLEAF IS THE INTEGRATED DOCUMENT MANAGEMENT LEADER.

As a leader in the field of document management, we offer a level of expertise, insight, and technical capability no other company can match. Only Interleaf helps companies turn information into a business advantage through Integrated Document Management Applications that allow users to manage converging technologies on the desktop.

Our products combine the benefits of Document Management, Electronic Publishing, and the Internet, allowing companies to easily create, manage, and share business-critical information. As a result, Interleaf's customers increase productivity, improve product quality, lower costs, shorten time-to-market, and experience significant return on investment.

As technology continues to evolve, Interleaf will remain positioned to equip our customers with the tools and support they need to leverage the power of information.

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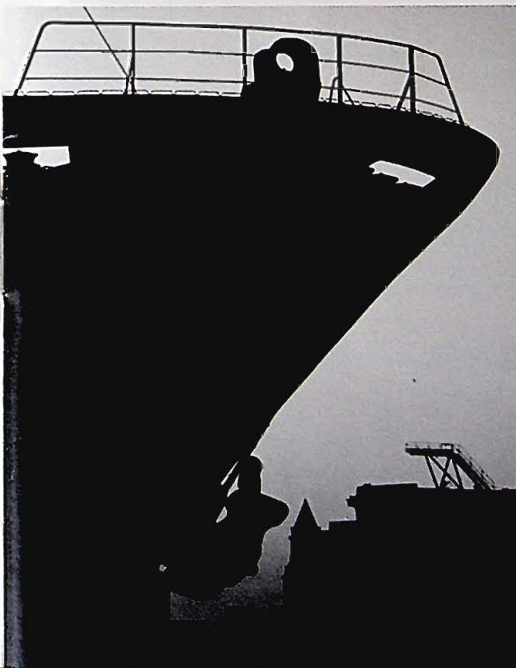
HOW MITSUBISHI STREAMLINED THEIR SPECIFICATION SHEET CREATION SYSTEM

MITSUBISHI HEAVY INDUSTRIES, LTD., IS ONE OF THE WORLD'S LEADING MANUFACTURERS OF SHIPS, STEEL STRUCTURES, POWER SYSTEMS, AND MACHINERY.

WITH OVER 700 DIFFERENT PRODUCTS ACROSS A RANGE OF INDUSTRIES, THE COMPANY WAS FINDING THE CREATION OF SPECIFICATION SHEETS AN ARDUOUS AND TIME-CONSUMING TASK. LOCATING THE RIGHT DATA FOR EACH SHEET TOOK UP VALUABLE MAN-HOURS. REVISING SHEETS REQUIRED MANUAL CUTTING AND PASTING. AND GETTING THE SHEETS COMPLETED IN TIME TO MEET CUSTOMERS' NEEDS WAS PRACTICALLY IMPOSSIBLE. MITSUBISHI LOOKED TO INTERLEAF FOR ANSWERS. AFTER STUDYING THE PROBLEM, INTERLEAF CONSULTANTS – IN CONJUNCTION WITH AN INTERLEAF RESELLER – DEVELOPED A CUSTOMIZED DOCUMENT CREATION AND ASSEMBLY SYSTEM.

OUR SOLUTION STREAMLINED THE PROCESS OF CREATING THE SPECIFICATION SHEETS. NOW, THE SYSTEM AUTOMATICALLY CREATES DATA SHEETS IN STANDARDIZED FORMATS, WITH FULL INTEGRATION WITH MITSUBISHI'S EXISTING BILL OF MATERIALS SYSTEM.

MITSUBISHI'S CUSTOMERS RECEIVE PRODUCT SPECIFICATION SHEETS IN A FRACTION OF THE TIME REQUIRED BY THE OLD, PAPER-BASED SYSTEM. IN ADDITION, INTERLEAF'S SOLUTION HAS LOWERED COSTS SIGNIFICANTLY.



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he array of information sources available to businesses today is staggering, especially when you consider that most of them don't work together very well.”

BUSINESS-CRITICAL INFORMATION: A VITAL ASSET.

Information is quite possibly the most vital asset of businesses around the globe. Whether it is assembly instructions on the shop floor, sales projections from international operations, or the latest marketing literature for a mutual fund, an organization cannot function effectively without timely and accurate information.

THE VALUE OF INTEGRATED DOCUMENT MANAGEMENT APPLICATIONS.

Interleaf's Integrated Document Management Applications make access to business-critical information easy and cost-effective. Our approach begins with the idea that a document rarely stands alone; rather, it is part of a related set of information across the enterprise. Our solutions let users combine multiple documents and make the connections among them transparent.

An electronic document collection, such as word processing or graphics files, is assembled from many sources, distributed for review, managed for accuracy, published on the Internet or an Intranet, and easily retrieved in a language everyone can read, in the right format, for the right platforms.

No single product could make all this possible. Only through the careful integration of Interleaf technology, working in tandem with technology from Interleaf's leading partners, can information be used so effectively for business advantage.

INTERLEAF OPEN SOLUTIONS ANSWER CRITICAL BUSINESS NEEDS.

The smartest organizations around the world are optimizing their use of LANs, WANs, the Internet, Intranets, and the World Wide Web with effective document management. Through integration, they are combining these key technologies with their desktop systems to solve real business problems. From quality control to regulated safety data, to policies and procedures, access to business-critical documents is universal and secure.

INTERLEAF'S INTELLECTE/BUSINESSWEB TIES THE INTERNET TO THE CORPORATE DATABASE.

Interleaf is committed to managing business-critical information across multiple sites for the World Wide Web, providing access to information across the widest array of presentations and formats.

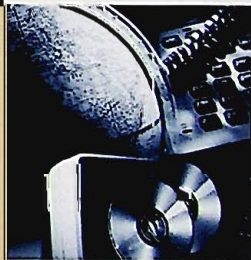
Intellecte/BusinessWeb is a unique, cross-enterprise, document management solution that exploits and controls the power of the World Wide Web. It gives users easy access to enterprise information without the time-consuming and costly process of converting documents to HTML, posting them on the Web server, updating them, and maintaining the links between documents.



ON INVESTMENT

HOW ABBEY NATIONAL PLC SAVED MORE THAN 1.5 MILLION £

FOUNDED OVER 150 YEARS AGO, ABBEY NATIONAL PLC IS ONE OF THE LARGEST BANKS IN THE UK, WITH ASSETS OF MORE THAN 104 BILLION £. AS THE BANK'S PRODUCT PORTFOLIO HAS EXPANDED, SO HAS THE NEED FOR IMPROVED COMMUNICATIONS BETWEEN HEADQUARTERS AND 675 BRANCHES AND SUPPORT CENTERS THROUGHOUT THE UK. COMPETITION, NEW BUSINESS VENTURES, AND DEMANDING BANKING AND INVESTMENT LEGISLATION HAVE ALSO ADDED TO THE URGENT NEED FOR CLEAR, ACCURATE, LOW COST, AND TIMELY INFORMATION DISTRIBUTION THROUGHOUT THE COMPANY.



IN THE PAST, ABBEY NATIONAL RELIED ON PAPER-BASED DOCUMENT CREATION AND DELIVERY, A SYSTEM THAT PUT ENORMOUS STRAINS ON THE COMPANY. NOW, WITH THE HELP OF INTERLEAF, ABBEY NATIONAL'S BUSINESS-CRITICAL, TIME-SENSITIVE DOCUMENTS ARE DISTRIBUTED TO BRANCH OFFICES VIA SATELLITE AND ARE EASILY ACCESSIBLE ON DESKTOP COMPUTERS. BY PLACING CORPORATE KNOWLEDGE AT THE FINGERTIPS OF STAFF IN THIS WAY, ABBEY NATIONAL CAN ROLL OUT NEW PRODUCTS TO ITS BRANCHES FAR MORE QUICKLY AND CAN ENSURE A CONSISTENT CORPORATE RESPONSE TO CUSTOMER INQUIRIES.

THE INTERLEAF SOLUTION HAS ENABLED ABBEY NATIONAL TO DELIVER CORPORATE REFERENCE MATERIAL FASTER, MORE RELIABLY, AND WITH TOTAL CONFIDENCE IN THE ACCURACY OF INFORMATION. THE NEW SYSTEM GREATLY REDUCED PRINTING AND SHIPPING COSTS, SAVING MORE THAN 1.5 MILLION £. ABBEY NATIONAL ALSO ENSURED LEGISLATIVE COMPLIANCE WHILE FREEING UP THE TIME OF STAFF TO FOCUS ON CUSTOMER SATISFACTION.

With this solution, corporate information can reside in multiple document management repositories or Web servers, where it is structured and secure. Using any standard Web browser, users can bring documents from environments that include revision control and workflow management directly to their desktops in virtually any file format.

INTELLECTE/SALESTEAM HELPS COMPANIES INCREASE SALES COST-EFFECTIVELY.

Interleaf and its new strategic business unit, The Learning Alliance, recently introduced a new product targeted at corporate sales departments. Intellecte/SalesTeam combines the flexibility of the Web with business-focused sales force automation tools and advanced document management. Using it, sales teams in the field can instantly access information from corporate libraries, share proven sales methodologies, and learn value-added consulting techniques. For a broad range of businesses worldwide, Intellecte/SalesTeam offers the potential to increase sales win rates while reducing costs.

HOW NORTHERN TELECOM (NORTEL) INCREASED PRODUCTIVITY AND ENHANCED CUSTOMER SERVICE.

NORTHERN TELECOM (NORTEL), A GLOBAL LEADER IN THE TELECOMMUNICATIONS INDUSTRY, SUPPLIES ADVANCED DIGITAL COMMUNICATIONS EQUIPMENT AND SERVICES. WITH HUNDREDS OF PRODUCT OFFERINGS, AND DOCUMENTS AVERAGING THOUSANDS OF PAGES, THE CHALLENGE OF PRODUCING AND DELIVERING TECHNICAL DOCUMENTATION FOR CUSTOMIZED SOFTWARE BUILDS WAS TIME-CONSUMING AND COSTLY.

INTERLEAF PROVIDED THE SOFTWARE PLATFORM FOR A SOLUTION. CAPITALIZING ON THE EXTENSIBLE CAPABILITIES OF INTERLEAF SOFTWARE, NORTEL DEVELOPED A SYSTEM TO MAKE IT EASY FOR DOCUMENTS TO BE PRODUCED IN LESS TIME. INSTEAD OF WRITING EACH DOCUMENT FROM START TO FINISH, THE DOCUMENTS WERE DIVIDED INTO TEMPLATES CONTAINING "INFORMATION CHUNKS" THAT COULD BE RE-USED IN DIFFERENT COMBINATIONS DEPENDING ON THE SYSTEM CONFIGURATION.

THE INTERLEAF APPLICATION ALSO CHECKED FOR ILLEGAL FONTS, INCOMPLETE FILES, VALIDITY OF CONTENT OR OTHER PROBLEMS, ENSURING CUSTOMERS RECEIVED THE HIGHEST QUALITY DOCUMENTATION. MANUALLY, THESE CHECKS TOOK AN AVERAGE OF 25 HOURS FOR EACH BOOK. NOW IT IS DONE IN AN AVERAGE OF TWO HOURS.

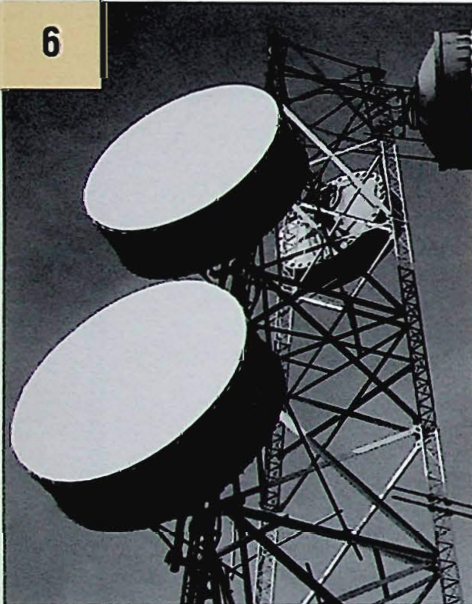
THE RESULT FOR NORTEL? BETTER CUSTOMER SERVICE, MORE ACCURATE DOCUMENTATION, AND HIGHER PRODUCTIVITY.

WORLD-CLASS SERVICE AND SUPPORT.

Interleaf has the largest, most comprehensive staff of consultants, service and support personnel in the document management industry. Our depth of experience and resources ensures that all customers, no matter where they are located, receive the full benefits of working with Interleaf's Integrated Document Management Applications.

LOOKING AHEAD

Interleaf will continue to develop Integrated Document Management Applications that solve business problems and deliver significant return on investment for specific market segments. For companies with unique needs, we will tailor solutions. And, for our broad customer base across every industry, we will continue to deliver the excellent products, services, and support that have made Interleaf the global document management leader.



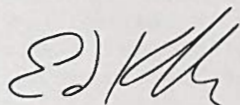
Report of Management

The financial statements, including all related financial information presented in the Annual Report, were prepared by management, and management is responsible for their fairness, integrity and objectivity. These statements have been prepared in accordance with generally accepted accounting principles, and include amounts that are based on management's best estimates and judgement and incorporate accounting policies that are reasonable and prudent for the Company's business environment. The financial statements have been audited by our independent public accountants, Ernst & Young LLP, and their report is included elsewhere herein.

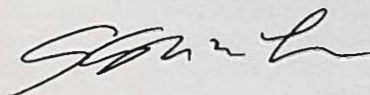
The Company maintains accounting and control systems that are subject to modification based on recommendations from Ernst & Young LLP. Management believes the internal control systems in use are sufficient to provide reasonable assurance that assets are safeguarded against material loss and are properly accounted for, and that transactions are properly recorded in the financial records used in preparing the financial statements.

The Company has distributed throughout the organization its policies for financial control. Management believes that its policies and the monitoring of compliance with these policies provide reasonable assurance that its operations are adhering to prescribed financial policy.

The Board of Directors carries out its responsibility for these financial statements through its Audit Committee, composed of nonemployee Directors. The Audit Committee reviews the financial statements before they are released for publication. The Committee meets periodically with the senior financial officers and Ernst & Young LLP. It reviews the audit scope, significant financial transactions, major accounting issues and recommendations of Ernst & Young LLP. Ernst & Young LLP has full and free access to the Audit Committee and meets with its members, with and without management being present, to discuss internal control, auditing and financial reporting matters.



Ed Koepfler
President
and Chief Executive Officer



G. Gordon M. Large
Executive Vice President
and Chief Financial Officer

SELECTED FIVE-YEAR FINANCIAL DATA

(in thousands except for per share amounts)

Year ended March 31	1996 a	1995 b	1994 c	1993	1992 d
Total revenues	\$ 88,557	\$ 87,856	\$ 111,229	\$ 117,341	\$ 100,299
Net income (loss)	311	(48,362)	(8,448)	9,303	5,984
Net income (loss) per share	\$ 0.02	\$ (3.47)	\$ (0.63)	\$ 0.55	\$ 0.38
Shares used in computing net income (loss) per share	18,495	13,938	13,384	16,836	15,704
Total assets	\$ 48,916	\$ 50,793	\$ 96,884	\$ 99,519	\$ 87,573
Long-term obligations	3	625	1,565	1,857	2,559
Total shareholders' equity	\$ 15,419	\$ 10,615	\$ 56,632	\$ 63,126	\$ 52,108
Common stock outstanding	16,698	14,203	13,631	13,064	12,434

- a. Fiscal 1996 results include a \$1.2 million benefit from the settlement of a long-term dispute with a joint venture partner.
- b. Fiscal 1995 results include a \$17.2 million charge for the write-down of intangible assets, a \$7.1 million charge for restructuring of the Company's worldwide operations, and a \$1.9 million charge for revaluation of the Company's deferred tax asset.
- c. Fiscal 1994 results include a \$4 million charge for acquired in-process research and development in connection with the acquisition of Avalanche Development Company in June 1993, a \$3 million charge for restructuring of the Company's worldwide operations, and a \$1.9 million benefit upon adoption of Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes," effective April 1, 1993.
- d. Fiscal 1992 results include the impact of the acquisition of Interleaf GmbH in July 1991.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Results of Operations

Overview: During the last three fiscal years, fiscal 1994 through 1996, the Company has experienced significant changes to all aspects of its business: a new management team is in place, the Company's cost structure has been significantly reduced, and the Company's business strategy has evolved into a focus on developing and supporting integrated document management (IDM) solutions. As a result of these changes, the Company's operating results have improved from net losses of approximately \$8.4 million and \$48.4 million in fiscal 1994 and 1995 respectively, to earning a small profit of approximately \$0.3 million in fiscal 1996. The Company had historically derived a majority of its product revenue from its authoring products. Authoring product license revenue experienced slowing growth in fiscal 1993, declined in fiscal 1994, and by the end of fiscal 1995, had declined significantly from the beginning of fiscal 1993. As a result, during fiscal 1994 and 1995, the Company initiated two restructurings, resulting in a new senior management team, a 25% reduction in the Company's worldwide employment during fiscal 1995, and the elimination and/or consolidation of its corporate headquarters and 23 sales offices. These initiatives resulted in annual cost savings of approximately \$18 million in fiscal 1996, when compared with fiscal 1995.

In fiscal 1996, the Company began to realize some of the benefits of the initiatives taken in fiscal 1994 and 1995, as it succeeded in returning to profitability. Revenue stabilized as a continued decline in authoring product license revenue was offset by growing IDM solution revenues. The focus on IDM solutions required major changes in the worldwide sales organization; by the fourth quarter of fiscal 1996, about two-thirds of the Company's sales force, as well as sales management, had been with the Company fewer than twelve months. In addition, the Company released major enhancements across its entire product line as well as several important new products during fiscal 1996, and expects to release a number of additional new products in fiscal 1997. Based on anticipated increasing productivity of the sales force and favorable acceptance of the new and enhanced products, the Company expects to show improved results during the latter part of fiscal 1997.

REVENUES

Product: Total revenues were relatively stable in fiscal 1996 from 1995, compared to a decrease of 21% in fiscal 1995 from 1994. The decrease in fiscal 1995 was due to an approximately \$26.3 million (43%) reduction in product license revenue, specifically from the decline in licensing of the Company's authoring products. This was primarily attributable to the increasing power of personal computers and popularity of Windows-based publishing software, for which the Company did not have any offerings until fiscal 1996, and the saturation of UNIX-based high-end authoring software in the aerospace/defense industry, where the Company had historically derived most of its authoring product license revenue. This trend continued during fiscal 1996 as a decline in authoring product license revenue was offset by increases in IDM solution revenue. Moreover, during fiscal 1996, the Company has concentrated on rebuilding and strengthening its worldwide sales force. The expected improvement in sales force productivity has taken longer than planned, resulting in a slower return to product license growth.

Maintenance: Maintenance revenue, resulting from contracts to provide telephone support and upgrades to the Company's software products, was relatively stable in fiscal 1996, 1995 and 1994. This stability, during a time of decreasing product licensing, was largely attributable to renewals from the Company's very large, long-term customers primarily in the aerospace/defense industry. Future maintenance revenue is dependent on the Company's ability to maintain its existing customer base and to increase maintenance contract volume related to the new IDM solution sales. This will be necessary to offset the general downward pricing pressure on maintenance in the software industry.

Services: Services revenue, consisting of consulting and customer training revenue, decreased by \$1.1 million (5%) in fiscal 1996 from 1995, compared to an increase of \$3.0 million (15%) in fiscal 1995 from 1994. The Company leverages software product licenses with services to provide IDM solutions to its customers. During fiscal 1995, the Company worked on several large service projects which were completed during early fiscal 1996. The increase in fiscal 1995 from 1994 was primarily due to these projects, which increased employee utilization rates, and price increases implemented during 1995. The decline in fiscal 1996 was primarily attributable to the decrease in product license revenues during the last two quarters of fiscal 1996, a decrease in services personnel, and lower training revenue associated with the decline in authoring software product licensing.

North America: Revenues were approximately \$57.1 million (64%), \$60.0 million (68%), and \$72.4 million (65%) of total revenues during fiscal 1996, 1995, and 1994, respectively. The decline in fiscal 1996 was primarily due to a decrease in product license and training revenues. The decrease in fiscal 1995, when compared with fiscal 1994, was due to a significant decline in authoring product license revenues, partially offset by an increase in services revenue.

International: Revenues from the Company's international operations were approximately \$31.5 million (36%), \$27.9 million (32%), and \$38.8 million (35%) of total revenues during fiscal 1996, 1995, and 1994, respectively. The increase in fiscal 1996 was primarily due to an increase in electronic distribution software licensing agreements in Europe and increased demand from resellers in Japan, partially offset by a decline in European services. The decrease in fiscal 1995, when compared with fiscal 1994, was due to a significant reduction in product license revenues in Europe, primarily authoring products, and a decrease in demand from resellers in Japan. This was partially offset by increased services revenue in Europe.

Product license revenue in Japan is volatile because the Company distributes its products through a network of large credit-worthy resellers and integrators who typically enter into large upfront fixed fee license agreements. Revenue in Japan during a given period is dependent on the success of the resellers and integrators in licensing the Company's products to end-user customers.

Fiscal 1997: During fiscal 1997, the Company plans to develop several IDM-based product offerings which solve specific business problems such as sales force automation and integration, quality and health and safety compliance in manufacturing, and customer reporting in the financial services industry. As part of this strategy, the Company acquired The Learning Alliance, Inc. (TLA) in May 1996 and recently announced Intellecte/Sales Team, a product offering that combines the Company's Intellecte/BusinessWeb solution with TLA's sales methodology and sales process management software into a sales force automation application. Growth in revenues during fiscal 1997 will be largely dependent on improving sales force productivity, the effectiveness of the Company's increased investment in marketing and lead generation programs, customer acceptance of the new and enhanced software products released in fiscal 1996 and planned for the next year, and the Company's success in leveraging software products with services to provide IDM solutions to its customers.

COSTS OF REVENUES

Cost of product revenues includes amortization of capitalized software development costs; product media, documentation materials, packaging and shipping costs; and royalties paid for licensed technology. Cost of product revenues declined approximately \$4.4 million (41%) in fiscal 1996 from 1995, compared to an increase of approximately \$1.2 million (13%) in fiscal 1995 from 1994. In the fourth quarter of fiscal 1995, the Company recorded a write-down of capitalized software development costs associated with older software products for which revenue projections did not support the capitalized amounts. Also contributing to the high cost of product revenues during fiscal 1995 were fixed overhead costs and certain time-based royalty agreements. The decrease in fiscal 1996, when compared with fiscal 1995, was primarily related to lower amortization of capitalized software development costs, due to the fiscal 1995 write-down, and a decline in royalties associated with certain time-based royalty agreements. Further savings from the fiscal 1996 level are not anticipated. Cost of maintenance revenue decreased by approximately \$1.0 million (16%) in fiscal 1996 from 1995, compared to a decrease of approximately \$0.7 million (11%) in fiscal 1995 from fiscal 1994. The decreases in the last two years were primarily related to a reduction in customer support personnel associated with the Company's fiscal 1995 restructuring. Further savings from the fiscal 1996 level are not anticipated. The decrease in cost of services revenue of approximately \$1.3 million (7%) in fiscal 1996 from 1995 and approximately \$1.0 million (5%) in fiscal 1995 from fiscal 1994, was primarily related to a decline in services personnel during the last two years. Costs of services in fiscal 1997 is dependent on the Company's revenue associated with combining software products and services into IDM solutions.

OPERATING EXPENSES

Selling, General and Administrative (SG&A): SG&A expenses decreased by approximately \$12.5 million (23%) in fiscal 1996 from 1995, compared to a decrease of approximately \$3.7 million (6%) in fiscal 1995 from fiscal 1994. The decline in SG&A expenses over the last two years was primarily due to significant personnel and facilities expense reductions related to the Company's fiscal 1995 restructuring. Also contributing to lower SG&A expenses in fiscal 1996 was the settlement of a long-term dispute with a joint venture partner that resulted in a non-recurring expense reduction of approximately \$1.2 million (see Note 12 to the Consolidated Financial Statements for further discussion). Further SG&A expense reductions are not anticipated as the full benefit of the restructuring programs have been realized. Additionally, the Company intends to increase its investment in marketing expenditures to increase its visibility and create new sales opportunities. The Company will continue to manage SG&A expenses to keep costs in line with revenue.

Research and Development (R&D): R&D expenses consist primarily of personnel expenses to support product development offset by capitalized software development costs. R&D expenses decreased by approximately \$1.0 million (6%) in fiscal 1996 from 1995, compared to a decrease of approximately \$0.5 million (3%) in fiscal 1995 from fiscal 1994. The decrease in fiscal 1996, when compared with fiscal 1995, was primarily due to reduced personnel expenses associated with the Company's fiscal 1995 restructuring and increased capitalization of software development costs. During fiscal 1996, 1995, and 1994, R&D expenses were approximately 18%, 19%, and 16%, respectively, of total revenues. R&D spending, which excludes the offset for capitalized software development costs, represented approximately 23%, 24%, and 19% of total revenues, respectively. During fiscal 1996, the Company completed enhancements across all of its product lines; ported its authoring product to the Windows 95 and Windows NT operating systems; and introduced Liaison, a new strategic open Application Programming Interface for simplifying the creation of IDM solutions, and Intellecte/BusinessWeb, which provides easy access to business information by enabling the use of all popular web browsers to locate and retrieve documents from enterprise document repositories utilizing the Company's document management product. The Company's product development plans for fiscal 1997 will focus on IDM-based product offerings and continued investment in product enhancements and ports. R&D expenses are expected to remain fairly stable but are dependent on the capitalization of software development costs associated with the fiscal 1997 product development plans.

One-Time Charges: The Company incurred restructuring charges of approximately \$7.1 million in fiscal 1995, related to a worldwide reorganization and a reduction in the size of its operations; and approximately \$3.0 million in fiscal 1994, related to reorganization of certain international subsidiaries. During the fourth quarter of fiscal 1995, the new management team performed a strategic and operational review of the Company's sales and marketing processes, distribution channels, product development plans, and customer support operations. As a consequence of this review and associated changes in the Company's business strategy and operations, the Company evaluated the carrying value of its long-lived assets, principally goodwill and capitalized software development costs, which resulted in a write-down of these assets of approximately \$17.2 million. During fiscal 1994, a non-recurring charge of approximately \$4.0 million was recorded for purchased in-process research and development associated with the Company's acquisition of Avalanche Development Company. See Notes 4, 8 and 13 to the Consolidated Financial Statements for additional information.

INCOME TAXES

In fiscal 1994, the Company adopted SFAS No. 109, *Accounting for Income Taxes*, which resulted in a benefit of approximately \$1.9 million recorded as a cumulative effect of a change in accounting principle. This amount represented the Company's estimate of research and development tax credit carryforwards that it considered probable of realization based on anticipated domestic taxable income prior to the expiration of the credit carryforwards. Fiscal 1995 was negatively impacted by an adjustment to the beginning deferred tax asset valuation allowance of approximately \$1.9 million when an analysis of the Company's actual and anticipated operating results indicated, at that time, that the deferred tax asset established in fiscal 1994 was not expected to be realized.

The Company has net operating loss carryforwards of approximately \$38.8 million in several tax jurisdictions to offset future taxable income. In addition, the Company has tax credit carryforwards of approximately \$7.1 million to offset federal and state income tax liabilities. Therefore, the Company expects to pay minimal income taxes for the foreseeable future.

Liquidity and Capital Resources

The Company had approximately \$12.7 million of cash and cash equivalents at March 31, 1996, an increase of approximately \$2.3 million from March 31, 1995. The increase was primarily attributable to positive cash flow from operating activities during fiscal 1996 and proceeds from common stock issuances related to its stock option plans and employee stock purchase plan of approximately \$2.8 million. This positive impact was partially offset by expenditures to liquidate capital lease obligations of approximately \$1.7 million and restructuring payments of approximately \$2.0 million. Capital expenditures were approximately \$1.6 million, a significant reduction from the prior fiscal year. Interleaf's German subsidiary, Interleaf GmbH, has been notified that it is liable for German withholding taxes related to payments remitted to the United States from Germany in 1990. The Company is appealing this assessment. At March 31, 1996, the Company had approximately \$1.1 million of cash restricted for potential payment of German withholding taxes, and approximately \$0.2 million as collateral for various lease commitments.

Future capital commitments consist primarily of operating leases related to both open and closed facilities. The Company expects to commit to capital expenditures and operating leases totaling approximately \$3.0 million for improvements to its information systems infrastructure.

Accrued restructuring charges were approximately \$1.3 million at March 31, 1996. The Company relocated part of its headquarters operations and sub-leased all major closed facilities during fiscal 1996. The reduction in office space and rental rate and sub-lease of the vacated headquarters space will result in annual cash and expense savings slightly in excess of \$1.0 million beginning in fiscal 1997. The restructuring reserve should be sufficient to cover remaining expenditures, primarily attributable to operating lease payments, net of sublease receipts, for closed facilities. These expenditures are anticipated to continue through the year 2000.

In May 1995, the Company obtained a revolving line of credit from a major commercial lender. Borrowings from the line of credit are secured by substantially all domestic assets of the Company. At March 31, 1996, there were no loans outstanding under this line of credit. As of May 17, 1996, approximately \$1.0 million of standby letters of credit were outstanding and the amount available for borrowings was approximately \$3.3 million. See Note 5 to the Consolidated Financial Statements regarding borrowing limits and restrictive covenants associated with the credit agreement.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

In November 1995, the Company issued 190,000 shares of common stock associated with an agreement between the Company and a joint venture partner (see Note 12 to the Consolidated Financial Statements for further discussion). On May 1, 1996, the Company acquired The Learning Alliance, Inc. for \$2,690,000. The Company issued approximately 350,000 shares of common stock to the selling shareholders of TLA for the entire purchase amount.

The Company believes that its existing cash and cash equivalents, available line of credit, and cash generated from operations will provide sufficient funds to meet the Company's planned operations for the foreseeable future.

Risk Factors

From time to time, information provided by the Company or statements made by its employees may contain forward-looking information. The Company's actual future results may differ materially from those projections or suggestions made in such forward-looking information as a result of various potential risks and uncertainties including, but not limited to, the factors discussed below.

The Company's future operating results are dependent on its ability to develop and market integrated document management software products and services that meet the changing needs of organizations with complex document management requirements. There are numerous risks associated with this process, including rapid technological change in the information technology industry and the requirement to bring to market IDM solutions that solve complex business needs in a timely manner. In addition, the existing document publishing, electronic distribution, and document management markets are highly competitive. The Company competes against a number of companies for sales of its software products on both an individual product basis and integrated with services in large IDM solution sales.

Sales cycles associated with IDM solution sales are long because organizations frequently require the Company to solve complex business problems that typically involve reengineering of their business processes. In addition, a high percentage of the Company's product license revenues are generally realized in the last month of a fiscal quarter and can be difficult to predict until the end of a fiscal quarter. Accordingly, given the Company's relatively fixed cost structure, a shortfall or increase in product license revenue will have a significant impact on the Company's operating results.

The Company markets its software products and services worldwide. Global and/or regional economic factors, currency exchange rate fluctuations, and potential changes in laws and regulations affecting the Company's business could impact the Company's financial condition or future operating results.

The market price of the Company's common stock may be volatile at times in response to fluctuations in the Company's quarterly operating results, changes in analysts' earnings estimates, market conditions in the computer software industry, as well as general conditions and other factors external to the Company.

CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands except for per share amounts)

Year ended March 31	1996	1995	1994
REVENUES			
Products	\$ 34,786	\$ 34,602	\$ 60,924
Maintenance	32,281	30,652	30,725
Services	21,490	22,602	19,580
Total revenues	88,557	87,856	111,229
COSTS OF REVENUES			
Products	6,443	10,878	9,640
Maintenance	5,179	6,178	6,918
Services	18,270	19,605	20,577
Total costs of revenues	29,892	36,661	37,135
Gross margin	58,665	51,195	74,094
OPERATING EXPENSES			
Selling, general and administrative	42,774	55,283	58,958
Research and development	15,875	16,855	17,332
Write-down of intangible assets	-	17,173	-
Restructuring expense	-	7,109	3,000
Charge for purchased research and development	-	-	3,985
Total operating expenses	58,649	96,420	83,275
Income (loss) from operations	16	(45,225)	(9,181)
Other income (expense)	325	(1,019)	(749)
Income (loss) before income taxes and cumulative effect of change in accounting principle	341	(46,244)	(9,930)
Provision for income taxes	30	2,118	418
Income (loss) before cumulative effect of change in accounting principle	311	(48,362)	(10,348)
Cumulative effect of change in accounting for income taxes	-	-	1,900
Net income (loss)	\$ 311	\$(48,362)	\$ (8,448)
INCOME (LOSS) PER SHARE			
Income (loss) before cumulative effect of change in accounting principle	\$ 0.02	\$ (3.47)	\$ (0.77)
Cumulative effect of change in accounting for income taxes	-	-	0.14
Net income (loss)	\$ 0.02	\$ (3.47)	\$ (0.63)
Shares used in computing income (loss) per share	18,495	13,938	13,384

See Notes to Consolidated Financial Statements.

CONSOLIDATED BALANCE SHEETS

(in thousands except for share and per share amounts)

March 31	1996	1995
<i>Assets</i>		
CURRENT ASSETS		
Cash and cash equivalents	\$ 12,725	\$ 10,441
Accounts receivable, net of reserve for doubtful accounts of \$1,695 in 1996 and \$1,953 in 1995	19,771	22,766
Prepaid expenses and other current assets	2,112	2,122
TOTAL CURRENT ASSETS	34,608	35,329
Property and equipment, net	7,800	11,058
Intangible assets	6,164	3,801
Other assets	344	605
TOTAL ASSETS	\$ 48,916	\$ 50,793
<i>Liabilities and Shareholders' Equity</i>		
CURRENT LIABILITIES		
Accounts payable	\$ 2,908	\$ 2,687
Accrued expenses	13,252	16,193
Unearned revenue	15,986	15,649
Other current liabilities	1,348	5,024
TOTAL CURRENT LIABILITIES	33,494	39,553
Other liabilities	3	625
TOTAL LIABILITIES	33,497	40,178
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 923,304 in 1996 and 1,728,573 in 1995 (liquidation value \$7 per share)	92	173
Common stock, par value \$.01 per share, authorized 30,000,000 shares, issued and outstanding 16,697,988 in 1996 and 14,203,027 in 1995	167	142
Additional paid-in capital	72,348	67,382
Retained earnings (deficit)	(56,958)	(57,269)
Cumulative translation adjustment	(230)	187
TOTAL SHAREHOLDERS' EQUITY	15,419	10,615
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 48,916	\$ 50,793

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

<i>(in thousands)</i>	Preferred Stock Senior Series B	Common Stock	Additional Paid-in Capital	Retained Earnings (Deficit)	Equity Adjustment	Total Shareholders' Equity
Balances at March 31, 1993	\$ 193	\$ 131	\$63,507	\$ (459)	\$(246)	\$63,126
Net loss	—	—	—	(8,448)	—	(8,448)
Conversion of Senior Series B Convertible Preferred stock into common stock	(14)	2	12	—	—	—
Common stock issued in connection with stock options exercised by employees	—	2	615	—	—	617
Common stock issued in connection with employee stock purchase plan	—	1	1,293	—	—	1,294
Income tax benefit related to exercise of stock options	—	—	124	—	—	124
Equity adjustment for foreign currency translation	—	—	—	—	(81)	(81)
Balances at March 31, 1994	179	136	65,551	(8,907)	(327)	56,632
Net loss	—	—	—	(48,362)	—	(48,362)
Conversion of Senior Series B Convertible Preferred stock into common stock	(6)	1	5	—	—	—
Common stock issued in connection with stock options exercised by employees	—	2	660	—	—	662
Common stock issued in connection with employee stock purchase plan	—	2	1,167	—	—	1,169
Common stock issued in connection with warrants exercised	—	1	(1)	—	—	—
Equity adjustment for foreign currency translation	—	—	—	—	514	514
Balances at March 31, 1995	173	142	67,382	(57,269)	187	10,615
Net income	—	—	—	311	—	311
Conversion of Senior Series B Convertible Preferred stock into common stock	(81)	11	70	—	—	—
Common stock issued in connection with stock options exercised by employees	—	7	2,087	—	—	2,094
Common stock issued in connection with employee stock purchase plan	—	1	685	—	—	686
Income tax benefit related to exercise of stock options	—	—	30	—	—	30
Common stock issued in connection with warrants exercised	—	4	(4)	—	—	—
Common stock issued in connection with acquisition	—	2	2,098	—	—	2,100
Equity adjustment for foreign currency translation	—	—	—	—	(417)	(417)
Balances at March 31, 1996	\$ 92	\$ 167	\$72,348	\$(56,958)	\$(230)	\$15,419

See Notes to Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

Year ended March 31	1996	1995	1994
CASH FLOWS FROM OPERATING ACTIVITIES			
Net income (loss)	\$ 311	\$(48,362)	\$ (8,448)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Cumulative effect of change in accounting principle	-	-	(1,900)
Charge for purchased research and development	-	-	3,985
Write-down of intangible assets	-	17,173	-
Restructuring expense	-	7,109	3,000
Gain from settlement of legal dispute	(1,230)	-	-
Depreciation and amortization expense	7,754	12,188	10,544
Loss from disposal of property and equipment	11	261	153
Deferred income taxes	-	1,860	89
Income tax benefit from stock options exercised	30	-	124
Changes in assets and liabilities, net of effects from company purchased:			
(Increase) decrease in accounts receivable, net	2,950	13,550	(2,641)
(Increase) decrease in other assets	97	(610)	(676)
Increase (decrease) in accounts payable and accrued expenses	(1,068)	(3,188)	3,314
Increase in unearned revenue	507	439	1,052
Decrease in other liabilities	(2,532)	(5,333)	(2,092)
Other, net	76	(385)	(41)
Net cash provided by (used in) operating activities	6,906	(5,298)	6,463
CASH FLOWS FROM INVESTING ACTIVITIES			
Decrease in marketable securities	-	-	4,070
Capital expenditures	(1,597)	(4,827)	(5,232)
Capitalized software development costs	(4,138)	(3,831)	(4,064)
Payment for company purchased, net of cash acquired	-	-	(5,342)
Net cash used in investing activities	(5,735)	(8,658)	(10,568)
CASH FLOWS FROM FINANCING ACTIVITIES			
Net proceeds from issuance of common stock	2,780	1,831	1,911
Property and equipment financing	-	682	1,375
Repayment of long-term debt and capital leases	(1,688)	(1,819)	(2,254)
Net cash provided by financing activities	1,092	694	1,032
Effect of exchange-rate changes on cash	21	339	35
Net increase (decrease) in cash and cash equivalents	2,284	(12,923)	(3,038)
Cash and cash equivalents at beginning of year	10,441	23,364	26,402
Cash and cash equivalents at end of year	\$12,725	\$ 10,441	\$23,364

See Notes to Consolidated Financial Statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Company

Interleaf, Inc. and its subsidiaries (the Company) develop and market integrated document management software and services worldwide for networked and Web-based business solutions. The Company's software is used for the electronic assembly, management, retrieval, distribution and publishing of business-critical documents.

Note 2 Summary of Significant Accounting Policies

Principles of Consolidation: The consolidated financial statements include the accounts of Interleaf, Inc. and its subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Revenue Recognition: Revenue from the license of software products is recognized when the products are shipped, provided there are no significant vendor obligations remaining and collection of the receivable is considered probable. Costs associated with insignificant vendor obligations are accrued. Maintenance revenue is recognized ratably over the contract period. Services (consulting and training) revenue is recognized as the related services are performed on either a time and materials basis or pro-rata based on project or contract completion.

Unearned revenue represents the remaining amount of revenue to be recognized in future periods primarily related to maintenance and service contracts.

Cash and Cash Equivalents: Cash equivalents, consisting primarily of bank notes, commercial paper and treasury bills, represent highly liquid investments with maturities at date of purchase of three months or less. These investments are stated at cost, which approximates market value.

At March 31, 1996, the Company had approximately \$1.1 million of cash restricted for potential payment of German withholding taxes, and approximately \$0.2 million as collateral for various lease commitments.

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. The estimated useful lives generally range from 3 to 5 years. Expenditures for repairs and maintenance are charged to operations as incurred.

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 included in product costs of revenue 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 of the product not to exceed three years. The Company continually compares the unamortized portion of capitalized software development costs to the net realizable value of the related product. The net realizable value is the estimated future gross revenues from that product reduced by the estimated future costs of completing and disposing of that product. The amount by which the unamortized capitalized costs exceed the net realizable value is written-off.

See Note 4 for discussion of Intangible Asset write-downs recorded during fiscal 1995.

Foreign Currency Translation: The translation of assets and liabilities of foreign subsidiaries is made at year-end rates of exchange, and revenues and expenses 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 foreign currency transactions are reflected in the statements of operations and are not material.

Income Taxes: Income taxes have been provided using the liability method in accordance with FASB Statement No. 109, *Accounting for Income Taxes*.

Income (Loss) Per Share: Per share amounts are calculated using the weighted average number of common shares and common share equivalents outstanding during periods of net income. Common share equivalents are attributable to stock options, common stock warrants and convertible preferred stock. Per share amounts are calculated using only the weighted average number of common shares outstanding during periods of net loss. Fully diluted earnings per share is not materially different from reported primary earnings per share.

Stock Options: The Company grants stock options for a fixed number of shares to employees with an exercise price not less than the fair market value of the shares on the date of grant. The Company accounts for stock option grants in accordance with APB Opinion No. 25, *Accounting for Stock Issued to Employees*, and, accordingly, recognizes no compensation expense for the stock option grants.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (con't)

Note 2 Summary of Significant Accounting Policies (con't)

Concentrations of Credit Risk: Financial instruments which potentially subject the Company to concentrations of credit risk consist principally of cash investments and accounts receivable. The Company places its cash investments in investment grade instruments with maturities of three months or less and limits the amount of investment with any one financial institution. The credit risk associated with accounts receivable is limited due to the Company's credit evaluation process and the large number of customers and their dispersion over different industries and geographic areas.

Use of Accounting Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from these estimates.

Basis of Presentation: Certain 1994 and 1995 amounts have been reclassified to conform to the 1996 basis of presentation.

Note 3 Property and Equipment

Property and equipment at March 31 consisted of the following:

<i>(in thousands)</i>	1996	1995
Office, demonstration and other equipment	\$ 29,142	\$ 29,492
Development equipment	13,118	12,753
Furniture	4,296	4,766
Leasehold improvements	1,818	823
	48,374	47,834
Less allowances for depreciation and amortization	40,574	36,776
	\$ 7,800	\$ 11,058

Note 4 Intangible Assets

During fiscal 1995, the Company recorded a write-down of intangible assets principally associated with goodwill and capitalized software development costs. The charge to write-down goodwill was approximately \$15.2 million, primarily related to the Company's acquisitions in prior years of its exclusive distributors in Canada, France, and Germany. During fiscal 1994, these subsidiaries began to experience declines in profitability. To improve the profitability of its international operations, the Company implemented a restructuring program in September 1993. The Company's operations continued to perform below expectations during fiscal 1995. Further headcount reductions and consolidation of facilities were implemented in these subsidiaries as part of the Company's worldwide restructuring program in the second quarter of fiscal 1995 (see Note 8). In conjunction with the fiscal 1996 planning process, the Company's new management team completed a strategic and operational review of all operations. As a consequence of this review, management determined in the fourth quarter of fiscal 1995 that there was a permanent impairment in the Company's carrying value of its goodwill. This was based on the continued deteriorating operating results in Canada, France, and Germany; the need to recapitalize certain of these subsidiaries; and an assessment that the factors which contributed to the valuations at the time of the respective acquisitions were no longer in evidence. The Company discounted the expected future cash flows from these subsidiaries and determined that the goodwill had no future value.

The charge to write-down capitalized software development costs and related other assets was approximately \$3.2 million. Of this total, \$2 million was primarily related to the cancellation of software development projects associated with the Company's decision to discontinue development efforts related to the Windows 3.1, 16-bit operating system to concentrate on development for the Windows 95 and Windows NT, 32-bit operating systems. The remaining \$1.2 million write-down to net realizable value, included in product costs of revenue, related to revenue projections which no longer adequately supported the capitalized amounts associated with certain older software products.

The unamortized portion of capitalized software development costs was \$6,164,000 and \$3,801,000 at March 31, 1996 and 1995, respectively. Amortization and write-down to net realizable value of capitalized software development costs was approximately \$3.2 million, \$5.3 million, and \$3.9 million during fiscal 1996, 1995, and 1994, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (con't)

Note 5 Credit Agreement

In May 1995, the Company obtained a revolving line of credit of up to \$10 million. The credit agreement also provides for the issuance of letters of credit of up to \$2 million. Borrowings from the line of credit bear interest at the higher of 9% or prime rate plus 2% and are secured by substantially all domestic assets of the Company. Outstanding letters of credit bear interest at 2%. The credit agreement expires in May 1997, but may be extended annually for successive one year periods with the consent of the lender. At March 31, 1996, there were no loans outstanding under this line of credit. Borrowings under the credit agreement are based on the level of eligible North American accounts receivable, modified by cash collections during the previous 90 days. As of May 17, 1996, approximately \$1.0 million of standby letters of credit were outstanding and the amount available for borrowings was approximately \$3.3 million. The agreement contains certain financial covenants relating to the Company's current ratio, tangible net worth, and working capital, as well as restrictions on certain additional indebtedness, acquisitions, capital expenditures, and dividend payments.

Note 6 Accrued Expenses

Accrued expenses at March 31 consisted of the following:

<i>(in thousands)</i>	1996	1995
Accrued compensation and related items	\$ 4,790	\$ 4,785
Taxes, other than income	2,460	2,523
Royalties	706	2,351
Rent	1,561	1,927
Other	3,735	4,607
	\$13,252	\$16,193

Note 7 Lease Commitments

The Company leases its headquarters and sales offices, and certain equipment under various operating leases, which expire through the year 2000. Rent expense amounted to approximately \$6.6 million, \$9.4 million, and \$9.4 million during fiscal 1996, 1995 and 1994, respectively. Future minimum rental payments at March 31, 1996 under agreements classified as operating leases with non-cancellable terms in excess of one year are as follows:

<i>(in thousands)</i>	Operating Leases
Years ending March 31	
1997	\$ 4,869
1998	4,299
1999	3,394
2000	2,978
2001	2,275
Thereafter	129
Total minimum lease payments	\$17,944

Lease commitments associated with closed facilities are accrued at March 31, 1996 and therefore are excluded from the amounts disclosed above.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (con't)

Note 8 Restructuring

Restructuring charges include costs associated with employee termination benefits and facility closures and related costs. Employee termination benefits include severance, wage continuation, notice pay and related fringe benefits. Facility closure and related costs include lease payments, lease buyout costs, disposal of property and equipment, and related costs.

During the second quarter of fiscal 1994, the Company recorded a restructuring charge of approximately \$3 million. The restructuring plan was to reduce employment by approximately 50 people and to consolidate four sales offices in North America and Europe.

During the second quarter of fiscal 1995, as part of a Company reorganization and to reduce its size of operations, the Company recorded a restructuring charge of approximately \$7.1 million. The restructuring plan was to reduce worldwide employment and to consolidate sales offices in North America and Europe. The employment reduction primarily related to the marketing, sales, general and administrative, and research and development groups. Approximately \$4.6 million of the restructuring charge was for employee termination benefits and \$2.5 million for facility closures and related costs. As a result of the restructuring program, worldwide employment was reduced by approximately 150 people, 19 sales offices were consolidated and a part of headquarters operations was relocated.

From the accrued restructuring reserve, the Company paid approximately \$0.7 million and \$4.4 million for employee termination benefits during fiscal 1996 and 1995, respectively. Payments for facility closures and related costs, net of sublease receipts, were approximately \$1.3 million and \$1.2 million during fiscal 1996 and 1995, respectively. Expenditures for facility closures, primarily lease payments, are anticipated to continue through the year 2000.

Note 9 Income Taxes

The provision for income taxes is composed of the following:

<i>(in thousands)</i>	1996	1995	1994
Current:			
Federal	\$ 30	\$ -	\$171
State	-	-	50
Foreign	-	258	108
Total current	30	258	329
Deferred:			
Federal	-	1,860	35
State	-	-	54
Total deferred	-	1,860	89
	\$ 30	\$2,118	\$418

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

<i>(in thousands)</i>	1996	1995	1994
Domestic	\$ 3,793	\$(43,607)	\$(4,184)
Foreign	(3,452)	(2,637)	(5,746)
	\$ 341	\$(46,244)	\$(9,930)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (con't)

Note 9 Income Taxes (con't)

Total income taxes reported are different from 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)	1996	1995	1994
Computed at federal statutory rate	\$ 116	\$(15,723)	\$(3,376)
Loss for which no tax benefit was realized	—	9,051	2,131
Purchased research and development	—	—	1,355
Nondeductible amortization	51	397	385
Nondeductible write-downs	—	5,021	—
Other nondeductible expenses	66	101	61
Benefit of net operating loss carryforward	(195)	—	(153)
Other temporary differences for which no tax benefit was realized	—	1,262	—
Adjustment to beginning of the year deferred tax asset valuation allowance	—	1,860	—
U.S. and foreign tax rate difference	—	123	—
State income taxes, net of federal tax benefit	—	—	33
Other, net	(8)	26	(18)
	\$ 30	\$ 2,118	\$ 418

Deferred taxes result from temporary differences in the recognition of revenues and expenses for tax and financial reporting purposes. The components of the Company's deferred tax assets and liabilities as of March 31 are as follows:

(in thousands)	1996	1995	1994
Deferred tax assets:	\$14,919	\$13,453	\$ 5,691
Net operating loss carryforwards	7,120	6,950	5,724
Tax credit carryforwards	601	738	897
Accrued rent	—	—	—
Reserve for doubtful accounts receivable, vacation and other accruals	401	475	583
Restructuring	337	888	137
Other	55	—	—
Total deferred tax assets	23,433	22,504	13,032
Deferred tax asset valuation allowance	(21,294)	(20,594)	(8,922)
	2,139	1,910	4,110
Deferred tax liabilities:			
Capitalized software development costs	(1,891)	(1,464)	(2,382)
Depreciation	(225)	(422)	(451)
Other	(23)	(24)	(19)
Total deferred tax liabilities	(2,139)	(1,910)	(2,852)
Net deferred tax asset	\$ —	\$ —	\$1,258

Realization of total deferred tax assets is contingent upon future taxable income. A 100% valuation allowance of net deferred tax assets has been established due to the uncertainty of realization of these tax benefits. The deferred tax asset valuation allowance increased \$700,000 and \$11,672,000 during fiscal 1996 and 1995, respectively, and by \$2,282,000 from the adoption of SFAS No. 109 on April 1, 1993 to March 31, 1994. In the second quarter of fiscal 1995 the Company recorded an adjustment of approximately \$1.9 million to the beginning of the year balance when an analysis of the Company's actual and anticipated operating results indicated, at that time, that utilization of the deferred tax asset was not expected to be realized.

At March 31, 1996, the Company and its subsidiaries had net operating loss carryforwards of approximately \$38.8 million that are available to offset future taxable income. The loss carryforwards are attributable to operations in several tax jurisdictions and expire in 1998 and thereafter. In addition, the Company has research and development and other tax credit carryforwards of approximately \$7.1 million available to reduce future federal and state income tax liabilities. The tax credit carryforwards expire in 1999 and thereafter. During fiscal 1996, 1995 and 1994, income tax payments made were approximately \$252,000, zero, and \$49,000, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (con't)

Note 10 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 can convert each share of preferred stock into 1.34375 shares of common stock. Series B holders converted 805,269, 57,142, and 142,857 shares of Series B Convertible Preferred Stock into shares of the Company's common stock during fiscal 1996, 1995, and 1994, respectively.

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.

The Company had issued warrants to purchase the Company's common stock at various prices in connection with certain research and development agreements and exclusive distribution agreements. The Company issued 366,113 and 72,368 shares of common stock in connection with the exercise of warrants during fiscal 1996 and 1995, respectively. The Company received no proceeds upon the conversion of the warrants into common stock. There are no warrants outstanding as of March 31, 1996.

Stock Option Plans: The Company has stock option plans that provide for the granting of non-qualified and incentive stock options to employees, consultants, and officers. The Board of Directors determines the option price, the option term, and the vesting period. Incentive stock options are granted at a price not less than the fair market value on the date of grant. On July 14, 1994, the Board of Directors adopted the 1994 Employee Stock Option Plan which provides for a maximum of 750,000 shares of common stock to be issued and sold under the plan. On August 3, 1994, the Board of Directors authorized the repricing of approximately 746,000 stock options and the cancellation and re-grant of approximately 297,000 stock options ranging in price from \$4.00 to \$19.38 to the fair market value of \$2.75 on that date. At the Annual Meeting of Shareholders on August 17, 1995, shareholders approved an amendment to the Company's 1993 Stock Option Plan to increase the number of shares of common stock available for issuance under the plan by 750,000.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (con't)

Note 10 Shareholders' Equity (con't)

A summary of activity for these stock option plans is as follows:

<i>(in thousands, except price range of shares)</i>	Number of Shares	Price Range of Shares
Outstanding at March 31, 1993	1,533	\$ 1.13 - \$19.38
Granted	485	6.75 - 9.50
Exercised	(192)	1.13 - 7.50
Cancelled	(273)	3.13 - 15.87
Outstanding at March 31, 1994	1,553	1.13 - 19.38
Granted	1,574	2.75 - 7.25
Exercised	(216)	1.13 - 3.63
Cancelled	(951)	2.75 - 15.63
Outstanding at March 31, 1995	1,960	2.75 - 10.75
Granted	798	5.50 - 7.38
Exercised	(689)	2.75 - 5.75
Cancelled	(250)	2.75 - 10.63
Outstanding at March 31, 1996	1,819	\$ 2.75 - \$10.75

At March 31, 1996, there were approximately 695,000 shares available for grant. Options exercisable were approximately 912,000, 915,000, and 916,000 at March 31, 1996, 1995, and 1994, respectively. In May 1996, the Board of Directors approved an amendment to the Company's 1994 Employee Stock Option Plan to increase the number of shares of common stock available for issuance under the plan by 750,000.

The Company also has stock option plans for non-employee directors. In September 1993, the Board of Directors approved, with subsequent ratification by the shareholders, the Company's 1993 Director Stock Option Plan. The 1993 Director Stock Option Plan replaced the 1989 Director Stock Option Plan. Options are granted at the fair market value at date of grant and are exercisable one year later. Each non-employee director received a grant of 5,000 options at the inception of the 1993 Director Stock Option Plan. Each newly elected non-employee director receives a grant of 5,000 options as of the first date of his or her election as a director. Every April 1, each non-employee director automatically receives a grant of 5,000 options. During fiscal 1996, 10,000 options were exercised. At March 31, 1996, there were options outstanding to purchase 105,000 shares and 65,000 shares were available for grant. Options exercisable were 105,000, 85,000, and 36,000 at March 31, 1996, 1995, and 1994, respectively.

Employee Stock Purchase Plan: The Company's Employee Stock Purchase Plan allows eligible officers and employees to withhold up to 10% of their total compensation to purchase shares of the Company's common stock. The purchase price is 85% of the fair market value of the stock on the date a one-year offering commences or the date an offering terminates, whichever is lower. Shares issued to employees were approximately 157,000, 208,000, and 182,000 during fiscal 1996, 1995, and 1994, respectively.

At March 31, 1996, approximately 4,500,000 shares of common stock were reserved for issuance primarily related to Series B Convertible Preferred Stock, various stock option plans and the Employee Stock Purchase Plan.

Note 11 Employee Benefit Plans

The Company's retirement savings plan (401(k) plan) allows eligible employees to make tax-deferred contributions. Participants in the 401(k) plan may contribute up to 20% of their total annual compensation, not to exceed the specified statutory limit. Participants are 100% vested in their own contributions. The 401(k) plan permits, but does not require, the Company to make contributions to the 401(k) plan. The Company made contributions of \$100,000 during fiscal 1995; no contributions were made during fiscal 1996 and 1994.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (con't)

Note 12 Research and Development Agreement

In October 1988, the Company entered into a joint venture (the Venture) with PruTech Research and Development Partnership III (PruTech), for the purpose of developing and marketing certain products. PruTech contributed approximately \$2,950,000 in cash to the Venture; the Company licensed to the Venture certain base technology and was required to perform certain development, marketing and administrative services for the Venture.

In March 1994, PruTech commenced an arbitration action against the Company, alleging, among other things, (i) that the Company had mismanaged the Venture; (ii) that PruTech was entitled to cash distributions of 30% of Venture revenues; and (iii) that certain Venture-owned technology was used in the Company's other products. In November 1995, the Company and PruTech reached an agreement. The Company paid PruTech \$2.1 million (the Purchase Price) in consideration of (i) the acquisition by the Company of PruTech's interest in the Venture, and (ii) the settlement of the pending arbitration action and the release by PruTech of all claims that it may have had against the Company arising out of the formation and operation of the Venture. The Company issued to PruTech 190,000 common stock shares for payment of the Purchase Price. The settlement of the arbitration action resulted in an expense reduction of approximately \$1.2 million, which is included in selling, general and administrative expenses in the Consolidated Statements of Operations. The Venture-owned technology acquired by the Company was valued at \$1.4 million and is included in Intangible assets in the Consolidated Balance Sheets. The technology is being amortized in the same manner as other capitalized software development costs.

Note 13 Acquisitions

On June 16, 1993, the Company purchased all of the outstanding equity securities of Avalanche Development Company (Avalanche) for cash of \$5,500,000. Avalanche is a leading provider of document analysis and conversion technology and services, with particular emphasis on Standard Generalized Markup Language (SGML), the leading international standard for electronic interchange of documents and data.

The acquisition was accounted for using the purchase method of accounting, whereby the purchase price was allocated to the assets acquired and liabilities assumed based on their respective fair values as of the date of the acquisition. In connection with this acquisition, a portion of the purchase price was allocated to purchased in-process research and development, resulting in a charge to the Company's operations of \$3,985,000. The charge was not deductible for tax purposes.

On May 1, 1996, the Company purchased all of the outstanding equity securities of The Learning Alliance, Inc. (TLA) for \$2,690,000. The Company issued approximately 350,000 shares of common stock to the selling shareholders of TLA for the entire purchase amount. TLA provides sales training services and develops and markets related software for the sales force automation and integration marketplace. The acquisition will be accounted for using the purchase method of accounting.

Note 14 Contingencies

In the ordinary course of its business activities, the Company is subject to various investigations, claims and legal proceedings. Each of these matters is subject to various uncertainties, and it is possible that some of these matters may be resolved unfavorably to the Company. Management believes that the ultimate resolution of these matters will not have a material adverse effect on the financial position or results of operations of the Company.

Interleaf's German subsidiary, Interleaf GmbH, has been notified that it is liable for certain German withholding taxes related to payments remitted to the United States from Germany. The Company is appealing this assessment; however, approximately \$1.1 million of the cash and cash equivalents balance at March 31, 1996 has been restricted for potential payment of the German withholding taxes. The Company believes the final outcome will not have a material adverse effect on the financial position or results of operations of the Company.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (con't)

Note 15 Industry Segment and Geographic Information

The Company operates in a single industry segment: developing and marketing integrated document management software and services worldwide.

Information regarding geographic areas at March 31, 1996, 1995 and 1994, and for the years then ended is as follows:

(in thousands)

March 31, 1996
and for the year then ended

	U.S.	Non-U.S.	Eliminations	Total
Sales to unaffiliated customers	\$ 54,953	\$33,604	\$ -	\$ 88,557
Intercompany royalties and transfers	8,770	-	(8,770)	-
Net revenues	63,723	33,604	(8,770)	88,557
Income (loss) from operations	2,651	(2,722)	87	16
Identifiable assets	63,734	17,590	(32,408)	48,916

March 31, 1995
and for the year then ended

	U.S.	Non-U.S.	Eliminations	Total
Sales to unaffiliated customers	\$ 56,853	\$31,003	\$ -	\$ 87,856
Intercompany royalties and transfers	7,076	18	(7,094)	-
Net revenues	63,929	31,021	(7,094)	87,856
Income (loss) from operations	(35,538)	(9,687)	-	(45,225)
Identifiable assets	61,679	18,877	(29,763)	50,793

March 31, 1994
and for the year then ended

	U.S.	Non-U.S.	Eliminations	Total
Sales to unaffiliated customers	\$ 68,529	\$42,700	\$ -	\$111,229
Intercompany royalties and transfers	12,008	-	(12,008)	-
Net revenues	80,537	42,700	(12,008)	111,229
Income (loss) from operations	(3,919)	(5,262)	-	(9,181)
Identifiable assets	107,661	21,945	(32,722)	96,884

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

REPORT OF ERNST & YOUNG LLP, INDEPENDENT AUDITORS

Board of Directors

Interleaf, Inc.

We have audited the accompanying consolidated balance sheets of Interleaf, Inc. as of March 31, 1996 and 1995, 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, 1996. 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. at March 31, 1996 and 1995, and the consolidated results of its operations and its cash flows for each of the three years in the period ended March 31, 1996, in conformity with generally accepted accounting principles.

Ernst & Young LLP

Boston, Massachusetts

April 26, 1996

SUPPLEMENTAL FINANCIAL INFORMATION

The following summarizes unaudited selected quarterly results of operations for the years ended March 31, 1996 and 1995 and the market range for the Company's common stock for those periods:

<i>(in thousands except for per share amounts)</i> Quarter ended	June 30	September 30	December 31	March 31	Year
FISCAL 1996					
Revenues	\$ 23,127	\$ 23,311	\$ 21,255	\$ 20,864	\$ 88,557
Gross margin	15,289	15,666	13,883	13,827	58,665
Net income (loss)	472	922	429 ^a	(1,512)	311
Net income (loss) per share	0.03	0.05	0.02	(0.09)	0.02
Common stock prices					
High	8	11	12 5/8	10 3/8	12 5/8
Low	4 1/4	7 1/4	7 1/4	6 1/8	4 1/4
Close	7 3/8	10	10 1/8	8 7/8	8 7/8
FISCAL 1995					
Revenues	\$ 19,240	\$ 23,011	\$ 21,824	\$ 23,781	\$ 87,856
Gross margin	10,781	13,931	12,493	13,990	51,195
Net income (loss)	(8,153)	(14,556) ^b	(5,782)	(19,871) ^c	(48,362)
Net income (loss) per share	(0.59)	(1.05)	(0.41)	(1.41)	(3.47)
Common stock prices					
High	7 1/2	4 7/8	4 5/8	6	7 1/2
Low	5	2 1/2	3 1/4	2 7/8	2 1/2
Close	5 1/4	4 3/8	3 1/2	4 7/8	4 7/8

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The Company has never paid cash dividends. The Company is restricted from paying cash dividends during the term of the credit agreement.

The Company's common stock is traded on the over-the-counter market and is quoted on the NASDAQ National Market tier of the NASDAQ Stock Market under the symbol LEAF. On May 17, 1996, there were 939 holders of record of the Company's common stock. This number does not reflect persons or entities who hold their stock in nominee or "street name" through various brokerage firms.

Notes to Supplemental Financial Information

- Includes a \$1.2 million benefit from the settlement of a long-term dispute with a joint venture partner.
- Includes a \$7.1 million charge for restructuring of the Company's worldwide operations and a \$1.9 million charge for revaluation of the Company's deferred tax asset.
- Includes a \$17.2 million charge for the write-down of intangible assets.

Corporate Officers

Ed Koepfler
President and Chief Executive Officer

Mark H. Cieplik
Vice President, Americas

Stanley C. Douglas
Senior Vice President,
Software Operations

Frederick J. Egan
Vice President, Asia/Pacific/Japan

Stephen J. Hill
Vice President, Europe

G. Gordon M. Large
Executive Vice President and
Chief Financial Officer

Robert T. Maher
Vice President, Engineering

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Board of Directors

Frederick B. Bamber
General Partner
Applied Technology Partners, L.P.

David A. Boucher
Chairman of the Board
Interleaf, Inc. and
General Partner
Applied Technology Partners, L.P.

Clinton P. Harris
Senior Vice President
Advent International Corporation

Ed Koepfler
President and Chief Executive Officer
Interleaf, Inc.

George D. Potter, Jr.
President
Quality Systems International

Shareholder Information

Common Stock

Interleaf's common stock is traded over the counter on the NASDAQ National Market tier of the NASDAQ Stock MarketSM—symbol LEAF

Annual Meeting

The Annual Meeting of Shareholders will be held on August 8, 1996 at 8:30 a.m. at the Wyndham Gardens Hotel, 420 Totten Pond Road, Waltham, MA

Form 10-K

Copies of Interleaf's Annual Report on Form 10-K are available upon request from:
Investor Relations, Interleaf, Inc.
62 Fourth 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:

Bank of Boston
c/o Boston EquiServe, L.P.
PO Box 644
Mail Stop: 45-02-64
Boston, MA 02102-0644

Investor Relations

To receive further information about Interleaf, please contact: Investor Relations 617.290.0710

Independent Auditors

Ernst & Young LLP
Boston, MA

Legal Counsel

Hale and Dorr
Boston, MA

Corporate Directory

Corporate Headquarters

Interleaf, Inc.
62 Fourth Avenue
Waltham
Massachusetts
02154 USA

FIELD OFFICES

North America

El Segundo, Redwood Shores, California;
Boulder, Colorado; Atlanta, Georgia;
Schaumburg, Illinois; Greenbelt, Maryland;
Waltham, Massachusetts; Dallas, Texas;
Ottawa, Ontario

International

Melbourne, Sydney, Australia; Brussels, Belgium;
Paris, France; Frankfurt, Hamburg, Munich,
Germany; Milan, Italy; Tokyo, Japan; Madrid,
Spain; Stockholm, Sweden; Zurich, Switzerland;
London, U.K.



Interleaf

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