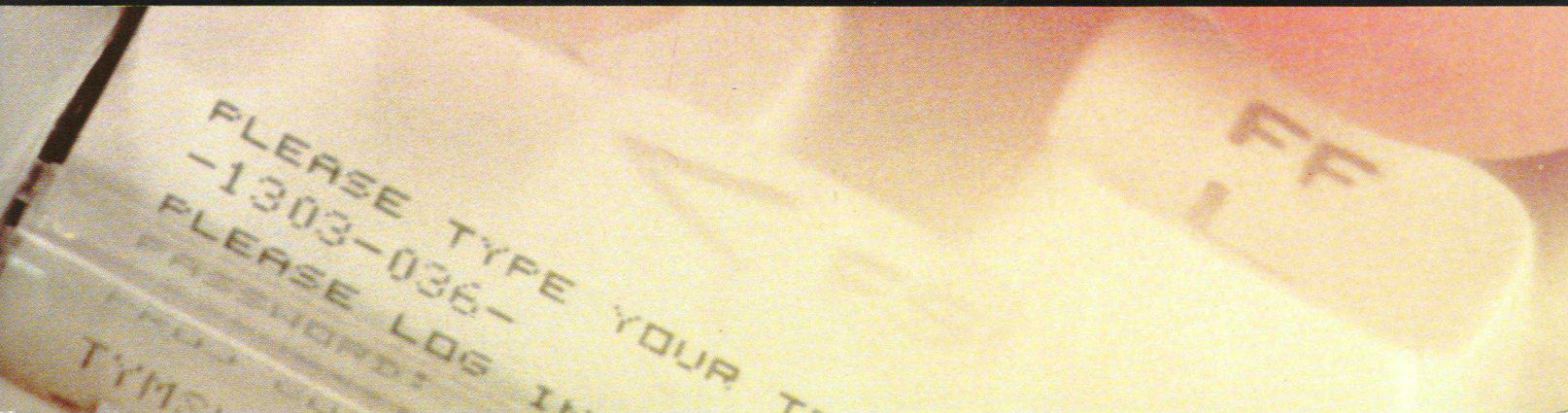
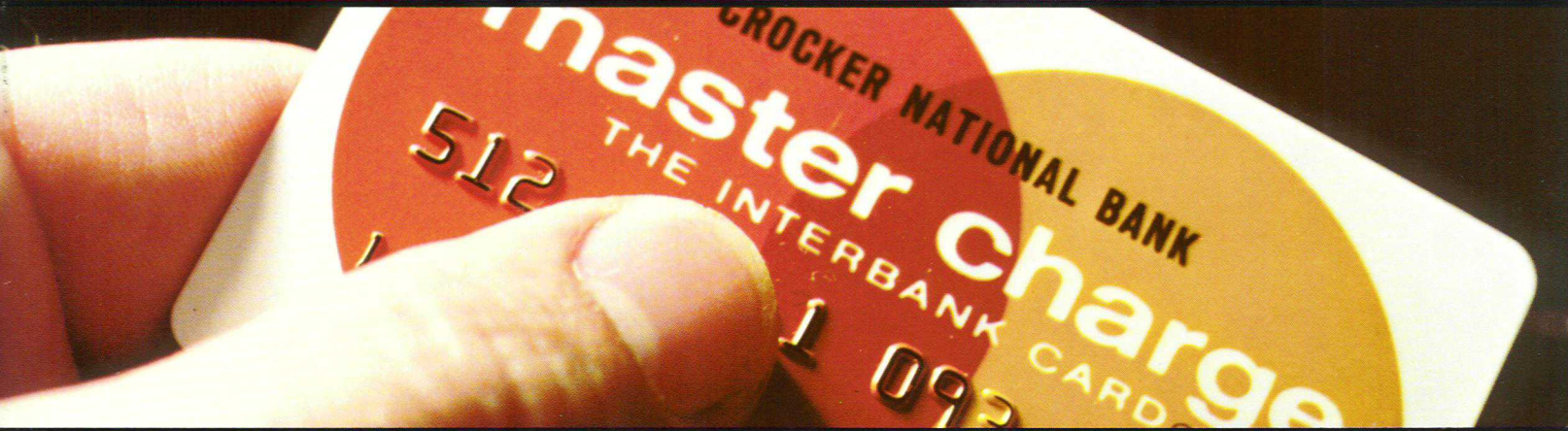
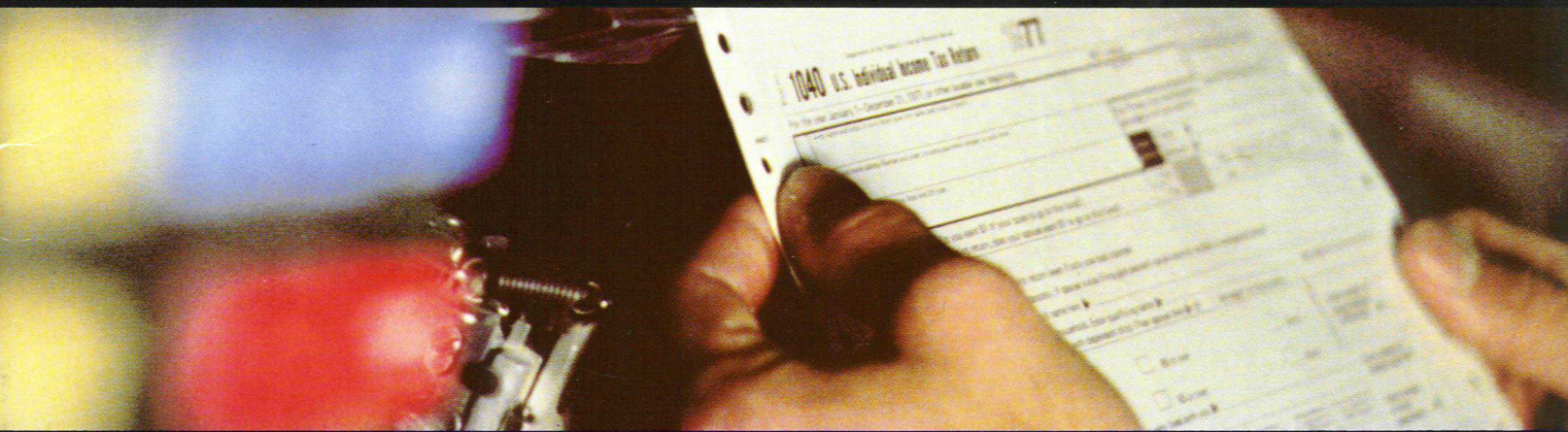


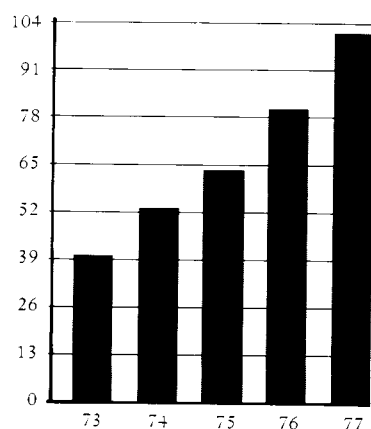
# Tymshare, Inc. 1977 Annual Report



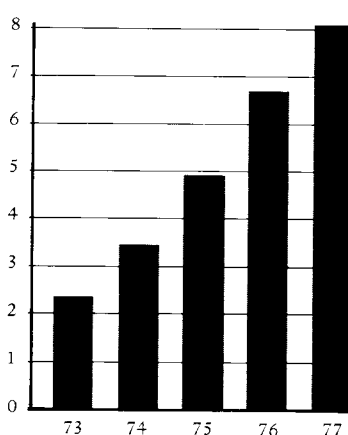


# Five-Year Highlights

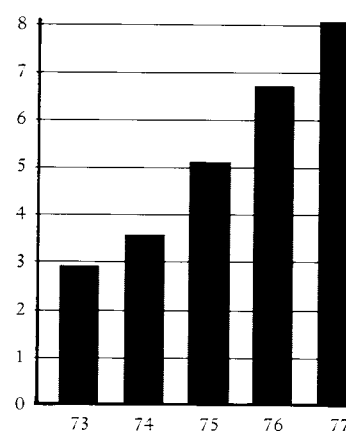
**Revenue**  
*in millions of dollars*



**Income After Taxes**  
*in millions of dollars*



**Net Income**  
*in millions of dollars*



**Year Ended December 31,**  
(In Thousands of Dollars Except Per Share Amounts)

	1973	1974	1975	1976*	1977*
Revenue	\$ 39.513	\$ 52.602	\$ 64.412	\$ 81.837	\$ 101.174
Income after taxes	2.292	3.434	4.969	6.713	8.008
Net income	2.973	3.638	5.094	6.713	8.008
Earnings per share					
Before extraordinary items	\$ .58	\$ .86	\$ 1.19	\$ 1.55	\$ 1.82
Extraordinary items	.17	.05	.03	—	—
Net income	\$ .75	\$ .91	\$ 1.22	\$ 1.55	\$ 1.82

\*Quarterly breakdowns of revenues and income for 1977 and 1976 are presented on page 27 in chart and tabular form.

## To Our Shareholders:

Our Company recorded solid gains in revenues and profits in 1977, our twelfth year in operation and eighth consecutive year of profitable growth, while restructuring upper management responsibilities to manage an organization of increasing diversity. We also completed the acquisition of the Western States Bankcard Association charge card processing operations, the largest acquisition in our history in terms of annual revenue, thereby gaining a significant position in another important segment of the market for financial services. At mid-year, the symbol TYM appeared for the first time on the Big Board trading floor as we listed our common stock on the New York Stock Exchange. Tymnet, Inc. became recognized as the leading public packet network services supplier in its first year as an authorized communications common carrier.

The year combined such visible signs of Tymshare's dynamic presence in its markets with vital, although more subtle, developments designed to strengthen and improve our Company's position as a leader in the entire computer services industry.

We are pleased to let the financial record of the year speak for itself in this report. Highlights of the complete financial results and condition of the Company include:

- Revenues climbed to approximately \$101.2 million, a 24% gain over the \$81.8 million in 1976.
- Net income for 1977 exceeded \$8 million, equal to \$1.82 per share, compared with \$6.7 million, or \$1.55 per share, for the prior year. This represents an increase of 19% in net income.
- Shareholders' equity investment for 1977 rose to slightly more than \$40 million, an increase of 31% over the 1976 level of \$30.5 million, evidence of the Company's growing financial strength.

It should be noted that 1977 operations reflect only the fourth quarter amounts from the acquired Western States Bankcard Association operations, acquired October 1, 1977.

In 1977, three of our senior management people assumed new responsibilities. We restructured our operating divisions and the Tymnet, Inc. subsidiary, creating three new operating groups.

We have aligned the former WSBA organization, now designated Tymshare Transaction Services, with Tymnet, Inc. and our Valcomp Division under Warren Prince as group vice president. Financial and Network Systems. Mr. Prince formerly was vice president and general manager of the Data Services Division.

Ronald W. Braniff, who was vice president of the Marketing Division, took on the additional responsibility for computer operations with his appointment as group vice president. Tymshare Computer Services, our largest operating group.

Field engineering, hardware development, and manufacturing were brought under Laszlo Rakoczi, who moves from vice president of the former Technical Division to the position of group vice president, Technical Services. He retains responsibility for technical research and development activities.

In another important management change, David C. Jung, formerly a corporate vice president of Optimum Systems Inc., was named director of Strategic Planning, a newly created function which will be the focal point for planning and development activities associated with Tymshare's long-term business opportunities. Before joining OSI in 1975, Mr. Jung had been vice president of Quantum Science Corporation, where he directed the computer technology division of this national market research firm.

The integration of people and products brought into Tymshare via acquisitions during 1976 was completed successfully last year. People, resources, and product lines of Medical Data Systems, Unitax, Western Twenty Nine, and Simplified Data Processing were melded into the Industry Services Division of the Tymshare Computer Services Group. With expanded, specialized marketing teams and additional product support, we saw healthy growth in our industry-focused services for hospitals, tax accountants, and travel industry clients, in particular. The on-line fuel oil industry service of the former Simplified Data Processing organization represents a natural complement to our established Computafuel service for fuel oil dealer accounting.

The addition of the low-cost Unitax product is finding a ready market as we expand our Unitax sales effort beyond its traditional California stronghold through our national tax processing service sales force. Tymshare is rapidly approaching a preeminent position in the nation as a supplier of specialized tax processing services. The combination of our Dynatax and Unitax products also fits well into our total range of products and services focused on the accounting profession as a whole. Tymshare is increasingly recognized as a major source of computer services for the accounting profession.

We also expanded our products for application in the manufacturing environment. New modules of MAGNUM OPUS now make this product capable of handling everything from inventory control on the shop floor through sales order processing and accounting.

The evolution of PERS, designed for personnel information management and reporting requirements of

virtually any type of organization, continued in 1977. Industry-oriented versions of PERS are being developed for application in each of our target industry sectors. PERS found enthusiastic acceptance in banks during 1977, with hospitals and government institutions showing excellent promise, also.

Tymnet, Inc. had an excellent year, doing even better than we had forecast in building its public packet network services business as a fledgling common carrier. Message switching service was introduced and demonstrated at the International Communications Association conference in May and installations of this new OnTyme service began in the second half of the year.

With a new and strengthened upper management structure, a coordinated product development and marketing program focused on the industry and market sectors we have selected for long-term growth potential, and more than 2200 dedicated Tymshare people, our Company concluded its best year ever in 1977. We believe that we are well prepared to meet the demanding challenges and take full advantage of the tremendous opportunities in the new generation of our business and our industry.



A large, stylized handwritten signature of T. J. O'Rourke in black ink.

*T. J. O'Rourke*  
*President and Chairman of the Board*

# Computer Services... Into the Third Generation

Tymshare participated profitably in the sustained growth and diverse opportunities of the computer services marketplace over the past year as the flourishing industry crossed the threshold into its third generation. Just as the first generation of computer services was characterized principally by the mechanization of manual accounting functions, and the second saw the melding of computing and communications technologies heralding the remote era, so does the third generation have a distinctive character.

First-generation service bureaus were focused on automating the processing of data and documents, but did little to change the process of management and decision making.

Management and other end users got directly and personally involved with computing and computers in the second generation, because Tymshare and other service firms developed thinking tools, planning simplifiers, and increasingly easier means of remote interaction with analytical and decision-aid software based on time-sharing techniques. Computerized management of complex organizations became widely accepted, and widely available, in the second major era of our industry's development—the remote generation.

The third generation promises to be a significantly more challenging business environment, with proportionately greater rewards for companies equipped to meet the challenge.

The essential change which gives the third generation its distinctive personality has been occurring in the marketplace, where new uses and new users of computing are appearing. The importance of machines, so much in the forefront in the early years, and of technology "breakthroughs" that set the pace in the second era, are increasingly secondary today to the characteristics of information products and services. This is the age of entire new layers and sectors in the marketplace. These markets are open to any supplier who can make the product or service meet precise requirements. Systems and service solutions must fit almost as neatly as a custom-tailored suit to the industry, management function, or business application. And yet the marketing leverage is enormous for those who can develop highly specialized products and services for particular needs and resell them over and over again to others whose needs are the same in all important aspects.

Just as technology is becoming increasingly transparent to the customer, traditional supplier roles and boundaries are blurring. Hardware makers offer a broader array of services. Service firms are incorporating hardware as integral components of a service solution. Batch and remote service modes, or a combination, are assumed to be within the capability of major firms by the customer. Whatever is needed to solve the problem

must be there in the form of a product or service that is, above all, highly specialized to the job at hand. Efficient, economic communications are vital with the growing proliferation of distributed computing power and information management.

Through the entire cycle of market planning, product development, and selling, our people must be as expert in the customer's business as they are in the information technology from which they draw to solve customer problems.

The real challenge, and opportunity, of the present generation is to address an ever-broadening range of specialized demands in industry after industry, with further refinement keyed to specific management functions and information applications which are now susceptible to computerized implementation. First you fit the industry, then the business function, and then the application needs in the precise way that management wants that application to work.

Success in the dynamic marketplace of this new generation places a premium on the supplier's ability to see beyond the traditional business and market orientation, and to manage diversity in applying technology and specialization in product development and marketing. Management must select target markets carefully, choosing those which represent large, long-term growth and which leverage present resources of our business.

Tymshare brings considerable management, financial, technological, and marketing strength to the challenge of the computer industry's third generation. Our fundamental service orientation, since it is basically a cus-

*Tymshare Diversifying . . . moving swiftly to expand financial services and signing initial contracts for charge card processing with savings and loan institutions and credit unions in our newest business . . . experienced sales and applications consultant teams applying Tymshare services for one of the nation's largest soft drink suppliers . . . Tymnet, Inc. launching its communications common carrier business over the largest U.S. public packet network, TYMNET.*



tomer environment perspective, has kept us close to the evolving market demands, which, in turn, have shaped our current and planned service mix. Our technology, although vital to our business success, does not drive the business. We have always been market sensitive and market driven as a business.

By our cumulative growth internally and through acquisition in recent years, we have firmly established Tymshare as a leader in general business computing markets, while quickly and successfully penetrating promising specialized market sectors. This report on 1977 shows your Company changing and more prepared than ever before to exploit our opportunities in the industry's third major period of growth and progress.





# Operating Group Reports

## Financial and Network Systems Group

The 1977 activity of this new group featured two special highlights: the acquisition in early October of the former Western States Bankcard Association credit card processing operations, and the formal startup of Tymnet, Inc. as a communications common carrier offering services under tariffs approved by the Federal Communications Commission effective April 1, 1977. The Valcomp Division, the third component of this

group, began refocusing and broadening its support efforts in 1977.

### Tymshare Transaction Services

The former WSBA processing operations were integrated into the Company as Tymshare Transaction Services during the last quarter of the year. Upon acquisition, the organization of more than 600 people was serving the credit card processing requirements of approximately 270 banks in seven western states and handling more than 125 million credit transactions annually for about 6 million cardholders and 200,000

merchants. Some 12 million credit authorization telephone calls were handled by the authorization center during 1977. The busiest hour all year came on December 23, when nearly 5900 calls came into the center in a single 60-minute period.

The transformation of the former nonprofit WSBA operation to a profit-oriented Tymshare component got underway immediately after the acquisition. Expanded marketing efforts and marketing staff produced contracts before year-end with our first credit card clients in the savings and loan industry and credit union





field. Existing bank customer relationships were quickly strengthened by the announcement of the first of several new services being introduced for banking and thrift market segments. Expansion of the customer base and product line is continuing into 1978, with additional services already implemented or due for introduction soon in such applications as loss prevention, statement mailing, card embossing, private label services, card pickup, and others which are natural supplements to the basic processing service.

Tymshare management believes that the longer-term potential for the financial services associated with credit and debit card transactions is just now beginning to emerge. Posi-

tioned as we now are—with a sizable business base, a new and aggressive marketing and new services development thrust, and sophisticated communications technology expertise—Tymshare expects to achieve a significant share of the market for such services as the financial industry moves toward the era of electronic funds transfer.

### Tymnet, Inc. Subsidiary

Tymnet, Inc., organized and certified as a value-added network common carrier in 1976, officially began offering carrier services April 1, 1977, the effective date of the approved tariff governing service rates filed with the Federal Communications Commission. By mid-year, Tymnet had launched its OnTyme message switching services, available either as a public service over the network or as an in-house system using Tymnet-supplied message switching hardware and software.

OnTyme met a stiff test toward year-end, processing up to 10,000 messages in a single day during the Christmas season for one of its clients which operates a delivery network for florists across the country. Work is now underway to handle an even more demanding message task—carrying floral order traffic for Mother's Day, the biggest day in the floral business.

The number of customer computers connected to the network increased from 87 to 169 by the end of the year. Tymnet also contributed significantly in overseas communications by means of interconnect agreements with all major international common carriers serving foreign communications

administrations. Such agreements were responsible for growth in international access locations from six to eighteen by the end of the year.

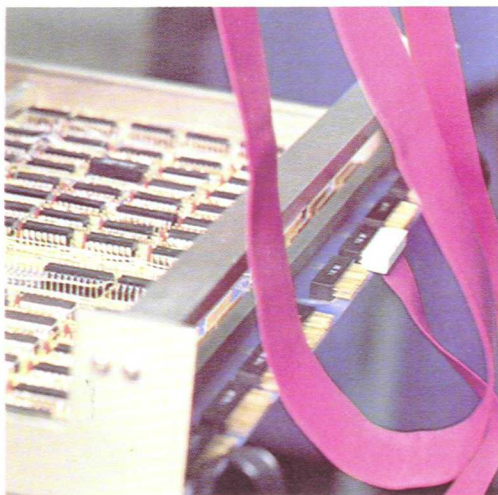
Domestically, locations served by network nodes and foreign exchange access swelled from 70 in January to 114 by December 1977. The average number of characters transmitted per day virtually tripled, increasing from 110,000 to 312,000 during the 12 months. Such growth in Tymnet's business and network capability illustrates both the flexible nature of the network's advanced technological design and the effectiveness of the Tymnet organization in capitalizing on the opportunity of this exciting and fast-growing sector of the information marketplace.

The Technical Services Group discussion which appears later in this report describes some of the major new capabilities being incorporated into TYMNET. Network enhancements and development projects are carried out at the direction of Tymnet Inc. by the Technical Services Group of Tymshare under terms of a development services agreement between the two companies.

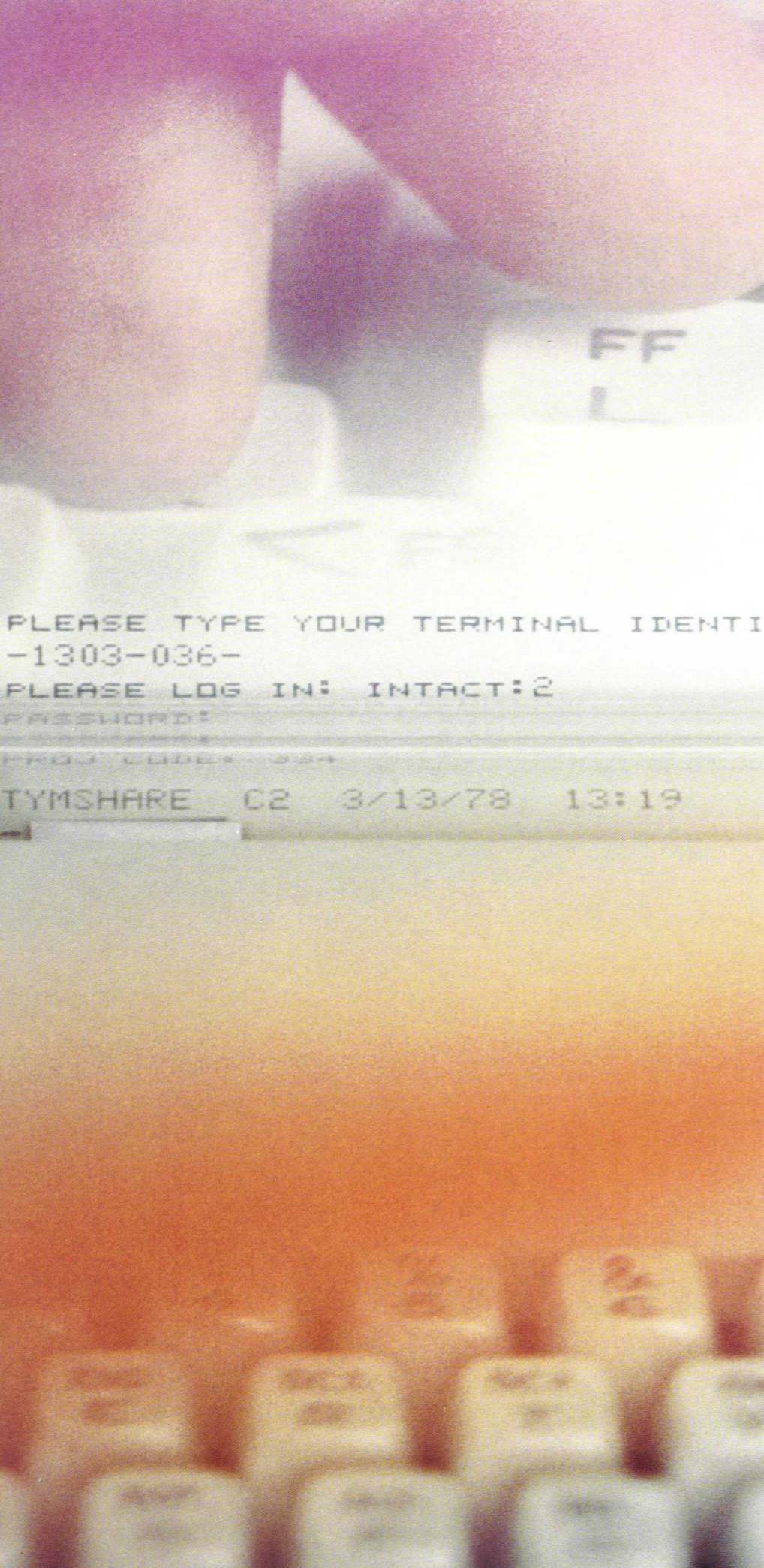
### Valcomp Division

This division maintained its traditional base of business in providing replacement parts and refurbishment services, implemented a computerized inventory system for greater internal efficiency, and completed its first full year as the authorized support organization servicing selected Ampex tape drive equipment. Emphasis began to shift from solely sup-

*Specializing . . . rapidly emerging as the leading volume processor of tax returns for professional accountants in this fast-growing specialized market sector . . . high-growth industry markets and management applications are the targets for Tymshare's industry-oriented marketing professionals . . . innovative, integrated hardware-software developments focus on specific communications and data processing tasks for the expanding distributed processing environment.*







porting older equipment to a broader line of state-of-the-art hardware, and from small-quantity repair and refurbishment work to larger-volume, long-term support contracts directly with equipment manufacturers.

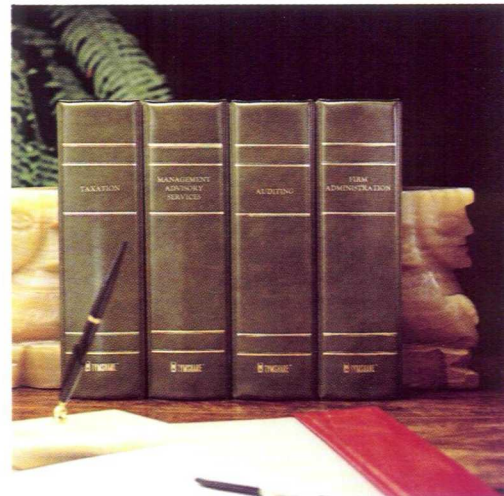
In addition to its outside equipment and systems support activities, Valcomp continues to be an important parts and service support resource for Tymshare's own computer systems.

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### **Tymshare Computer Services Group**

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The Tymshare Computer Services Group now includes responsibility for national computer operations as well as the former Marketing Divisions. Major 1977 achievements resulting in





a coordinated growth program, which balances the overall business from Tymshare's established, mainstream products and services with the specific outlook for each industry segment, are:

- Successful integration of people, products, and facilities from companies acquired over the prior year, and bringing a cohesive marketing orientation to acquired companies.

- Establishment of formal headquarters planning organizations—Industry Marketing and Product Marketing—responsible for market research and product planning and development for specific target industries and corporate functions.

- Strengthening of professional development activity with creation of a separate department responsible for recruiting, comprehensive training programs, and career guidance for individuals.

- Development of new products, notably those for the accounting profession, manufacturing industry, health care field, and banking. Several new state returns were added as part of Tymshare's income tax processing services for accountants. Tymshare also began offering a new version of its Financial Reporting System (FRS) to accounting firms nationwide, and was approved to offer the Association of Independent Certified Public Accountants (AICPA) library of software to the nation's accounting firms over our network. Specialized versions of Tymshare's Personnel Evaluation and Reporting System (PERS) were developed, notably for banking and hospital requirements. MAGNUM OPUS capabilities for manufacturing firms were enhanced by the addition of specialized accounting and order entry modules.

- A major two-year agreement with Western Electric for provision of a wide range of general time sharing and specialized application services to the Bell System.

- Commencement of our service to federal agencies under the General Services Administration Teleprocessing Services (TSP) program. Our marketing organization for government was expanded at all levels, and a separate national branch for state and local government marketing was created.

- Reorientation of product marketing emphasis in data centers at Detroit, Miami, and Syracuse from localized custom products to the marketing of standard Tymshare products for accounting and other high-impact industry market sectors.

- Complete integration of the Unitax product and organization into the overall accounting profession marketing program.

By year-end, Tymshare Computer Services had in place the organization, the management, and product scope to aggressively pursue the continued growth of the general business services market, and to focus specialized marketing and sales resources on selected industry sectors: accounting, government, utilities, health care, manufacturing, distribution, and financial services.

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## Technical Services Group

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The focus of Tymshare's technical development in 1977 was twofold: development and support of specialized industry and application products, and the application of new hardware

and software technology to the Company's integrated computer-communications services delivery system. The system concept that evolved during 1977 is called Dynamic Application Network Architecture (DANA). DANA stands for the concept and development of computer applications within a flexible system environment which provides a balance between centralized and distributed processing power.

Key components of the evolving DANA environment include large central computers, dedicated minicomputers and microprocessors, the network that brings the components together, and the system and programming tools necessary for conveniently developing applications systems.

Applications software development in 1977 took several forms. Refinements were made for tax processing products. A specialized computer language was developed for use in our travel industry automation pilot program. Additional development was directed at manufacturing applications. Creation of applications software tools for high-speed interactive dedicated systems applications was virtually completed.

Technical Services professionals also made substantial progress toward development of the next generation of advanced DANA system components during the year.

Prototypes of a new, integrated hardware-software device—dubbed the "TYMNET engine"—to interface Tymshare and customer computing and terminal equipment to the network were completed and operating

*Responding . . . 40,000 times each day customers log in from their office terminals, many supplied by Tymshare, to use our communications network, computers, or software resources to solve problems . . . Tymshare people and systems provide efficient, reliable service around the clock . . . Tymshare products, such as those designed for the specific needs of the accounting profession, provide economic solutions for tens of thousands of users across some 40 industry sectors here and overseas.*



by year-end. Tymshare designed and will build these devices, both to achieve economies in manufacture and to meet the desired three-to-one gain in load-handling capacity over equipment currently provided by hardware manufacturers. This tripling in capacity is expected to be achieved within a unit cost roughly equivalent to the cost of equipment now in use in the network.

Technical Services also devoted considerable effort in 1977 to the development of unique software to adapt the "TYMNET engine" hardware for use in interconnecting independent international networks to TYMNET. Called the Inter-Systems Interconnection Switch (ISIS), this switching device may also find application in domestic markets to link large, intracompany networks with TYMNET. A key feature of ISIS is its ability to interface TYMNET with multiple networks which employ widely varying technologies and communications protocols.

Evolutionary improvement in the present generation of network communications processors and customer interface equipment continued in 1977. Three different versions of the basic TYMCOM-III device were developed and added to the network—one for synchronous transmission, another handling bisynchronous mode, and a remote transmission unit which, because it does not have to be installed at the customer's site, reduces equipment cost for the user.

An advanced system to handle specialized, large-volume computer printout requirements was developed and installed for limited internal Tymshare usage. Operating under

minicomputer control, data destined for printout on forms at a distant location can be sent at high speeds, at night through TYMNET to unattended disk storage units. When the operator arrives in the morning, the data can be transferred from disk to hardcopy forms via local printers under operator supervision. Applications which involve manual changing of forms require an operator to be present during the printing process. This system accommodates that need in tandem with the benefit of economic, off-hours transmission to disk devices which do not require operator attendance.

Further improvements in the productivity and throughput of our IBM 370 and PDP-10 large-scale computer systems were accomplished in 1977. Carefully chosen refinements in the IBM operating system software increase machine efficiency while maintaining systems reliability at levels well above industry standards, as well as retaining full IBM compatibility. New features also were added to Tymshare's proprietary, highly interactive operating system for the PDP-10 computers.

Another key software achievement last year was the addition of a concurrent file update capability for our proprietary MAGNUM relational data base management system. This feature enables a large number of users to interact with a centralized, shared data base without interfering with one another. Such a capability makes it very efficient to apply MAGNUM to such applications as interactive inventory control, on-line sales order entry, and related accounting functions.

Also completed during 1977 was the technical foundation for a comprehensive, interactive patient

control system for hospital institutions. Implementation of this new system is expected to begin this year in the marketplace served by our Tymshare Medical Systems organization.

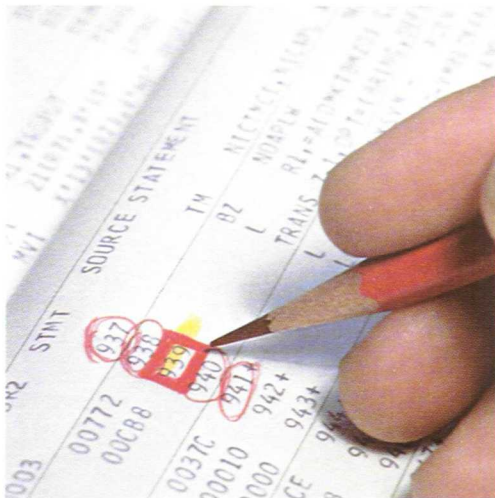
The computer and network maintenance operations of the Equipment Division of Technical Services continued to expand both geographically and in terms of the types of hardware maintained.

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## International Operations Report

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Tymshare's established overseas affiliates, CEGI-Tymshare and Tymshare U.K., experienced steady revenue and profit growth in their respective markets during 1977.



*Continuing to Grow . . . Tymshare continues to improve and expand the reach of our service delivery system, with the backbone of that system being the advanced and proven international communications network that links users with Tymshare services . . . there are now more than 2200 Tymshare people meeting the daily information service requirements of our customer universe . . . skilled technologists translate customer requirements into new service and system solutions in our industry's exciting third generation.*



SLIGOS, the leading service bureau in France in which Tymshare had an 11% ownership position with provision to convert an existing loan into an additional 9% ownership, showed sharp improvement in 1977 with a profitable year on increasing revenues. The loan was converted to equity in March 1978.

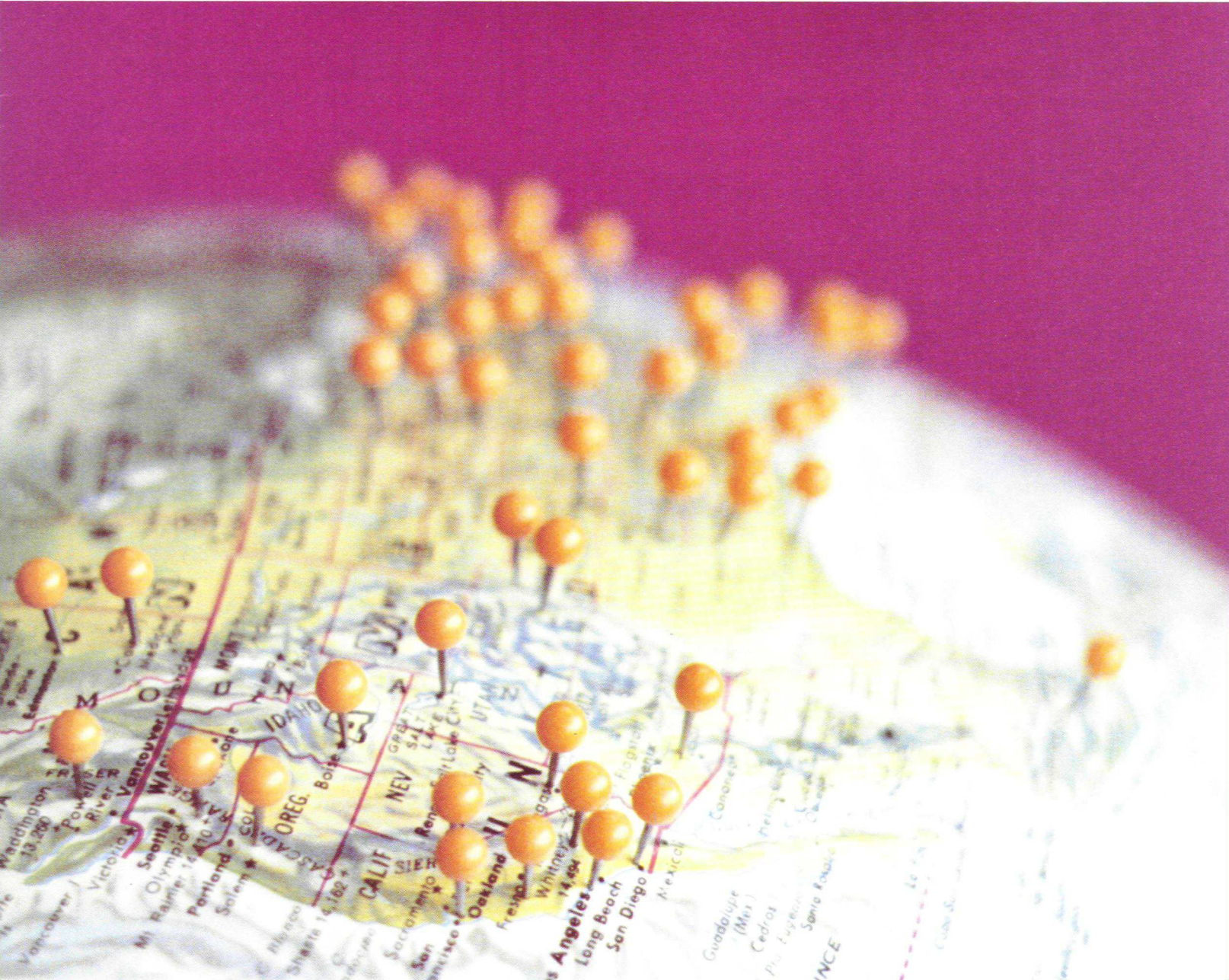
Tymshare's affiliate in West Germany, Taylorix-Tymshare, initiated service in January, operating from Frankfurt and Stuttgart. A customer base was established and the new affiliate company was well ahead of target revenues by year-end. Expan-

sion into Dusseldorf was scheduled for the first quarter of 1978.

In Japan, Kokusai Tymshare, formed in November 1976 as a joint venture with Marubeni, Ltd., completed its preparations for the startup of business, but successive delays were encountered throughout the year due to the Japanese government process for approval of the necessary communications service to launch the business operation. We anticipate completion of this process and the commencement of business in Japan during the first half of 1978.

Tymshare and affiliate business from multinational customers who use our services in the U.S. and abroad gained new impetus from aggressive marketing and expansion of our network access points overseas. Multinational business exceeded goals, more than doubling the revenue over the prior year.

With the expected approvals necessary to offer service in Japan, Tymshare will be participating in all major free markets for computer services in 1978. Tymshare continues to examine other world markets as targets for additional expansion.



Tymshare, Inc. and Subsidiaries  
**Consolidated Balance Sheets**

December 31, 1977 and 1976

**Assets**

	1977	1976
<b>Current assets:</b>		
Cash (Note 3)	\$ 1,687,777	\$ 2,118,709
Certificates of deposit	2,200,000	550,000
Accounts receivable, less allowance of \$950,000 in 1977 and \$650,000 in 1976 for doubtful accounts	21,503,766	14,713,215
Inventories (Note 1)	4,443,523	2,673,949
Prepaid expenses and deposits (Notes 1 and 7)	2,511,412	2,086,526
Total current assets	<u>32,346,478</u>	<u>22,142,399</u>
<b>Property and equipment, at cost (Notes 1, 3, and 4):</b>		
Land and buildings	1,457,014	1,243,510
Computer systems	27,498,771	20,308,082
Terminal and communications equipment	15,436,335	10,755,440
Purchased software	721,068	547,069
Furniture, fixtures, and other equipment	4,359,595	3,409,035
Leasehold improvements	4,720,070	1,615,815
	54,192,853	37,878,951
Less — Accumulated depreciation and amortization	(20,264,316)	(16,132,744)
	<u>33,928,537</u>	<u>21,746,207</u>
<b>Other assets (Notes 1 and 2):</b>		
Cost in excess of net tangible assets acquired	3,610,284	3,566,860
Investment in and loan to affiliates	4,853,769	4,538,250
Deferred charges	3,013,684	261,878
	<u>11,477,737</u>	<u>8,366,988</u>
	<u>\$ 77,752,752</u>	<u>\$ 52,255,594</u>

*The accompanying notes are an integral part of these balance sheets.*



**Liabilities**

	1977	1976
<b>Current liabilities:</b>		
Notes payable to banks, unsecured (Note 3)	\$ 2,000,000	\$ 400,000
Current portion of long-term debt	1,574,532	1,907,768
Accounts payable	8,750,772	4,650,952
Accrued liabilities	3,274,972	2,501,354
Accrued income taxes (Note 7)	3,719,969	2,115,365
Total current liabilities	<u>19,320,245</u>	<u>11,575,439</u>
<b>Deferred income taxes and credits (Note 7)</b>	<u>3,191,000</u>	<u>2,360,000</u>
<b>Long-term debt (Notes 3 and 4)</b>	16,758,976	9,742,011
Less — Current portion shown above	<u>(1,574,532)</u>	<u>(1,907,768)</u>
	<u>15,184,444</u>	<u>7,834,243</u>
<b>Commitments (Note 4)</b>		
<b>Shareholders' investment (Notes 2 and 6):</b>		
Preferred stock, \$10 par value:		
Authorized — 2,000,000 shares, none issued	—	—
Common stock, no par value:		
Authorized — 10,000,000 shares		
Outstanding — 4,347,774 shares in 1977 and 4,204,757 shares in 1976 stated at	16,672,782	15,109,257
Retained earnings	<u>23,384,281</u>	<u>15,376,655</u>
	<u>40,057,063</u>	<u>30,485,912</u>
	<u>\$ 77,752,752</u>	<u>\$ 52,255,594</u>



## Tymshare, Inc. and Subsidiaries

**Consolidated Statement of Income**

For the Years Ended December 31, 1977 and 1976

	1977	1976
		(Note 1)
<b>Revenue from services and sales</b>	<b>\$ 101,173,708</b>	<b>\$ 81,836,721</b>
<b>Cost of services and sales</b>	<b><u>46,949,948</u></b>	<b><u>36,880,189</u></b>
Gross profit	<b><u>54,223,760</u></b>	<b><u>44,956,532</u></b>
<b>Expenses:</b>		
Selling, general and administrative	<b>32,460,523</b>	27,142,984
Technical development	<b><u>5,260,286</u></b>	<b><u>4,254,712</u></b>
	<b><u>37,720,809</u></b>	<b><u>31,397,696</u></b>
Income from operations	<b>16,502,951</b>	13,558,836
<b>Interest expense</b> , less interest income of \$168,927 in 1977 and \$106,566 in 1976	<b><u>695,325</u></b>	<b><u>395,999</u></b>
Income before provision for income taxes	<b><u>15,807,626</u></b>	<b><u>13,162,837</u></b>
<b>Provision for income taxes</b> (Note 7):		
Federal	<b>6,450,000</b>	5,350,000
State	<b><u>1,350,000</u></b>	<b><u>1,100,000</u></b>
	<b><u>7,800,000</u></b>	<b><u>6,450,000</u></b>
Net income	<b><u>\$ 8,007,626</u></b>	<b><u>\$ 6,712,837</u></b>
<b>Earnings per share</b> (Note 8)	<b><u>\$1.82</u></b>	<b><u>\$1.55</u></b>

*The accompanying notes are an integral part of this statement.*



Tymshare, Inc. and Subsidiaries

**Consolidated Statement of Shareholders' Investment**

For the Years Ended December 31, 1977 and 1976

	Common Stock		Retained Earnings	Treasury Stock From Poolings	Total
	Shares	Amount			
<b>Balance, December 31, 1975:</b>	4,060,923	\$ 13,550,265	\$ 8,663,818	\$ (67,200)	\$ 22,146,883
Sale of 909 shares of treasury stock under employee stock option plan	—	(3,040)	—	7,600	4,560
Sale of common stock, net of related expenses:					
Employee stock option plans	102,118	789,979	—	—	789,979
Employee stock purchase plan	39,685	653,653	—	—	653,653
Income tax benefit resulting from early disposition of shares acquired under stock options	—	109,000	—	—	109,000
Cancellation of treasury stock	(9,193)	(59,600)	—	59,600	—
Additional shares issued under 1973 acquisition agreements	7,554	—	—	—	—
Shares issued in acquisition of Western Twenty Nine, Inc.	3,670	69,000	—	—	69,000
Net income for the year	—	—	6,712,837	—	6,712,837
<b>Balance, December 31, 1976:</b>	4,204,757	15,109,257	15,376,655	—	30,485,912
Sale of common stock, net of related expenses:					
Employee stock option plans	57,925	519,813	—	—	519,813
Employee stock purchase plan	34,461	542,202	—	—	542,202
Income tax benefit resulting from early disposition of shares acquired under stock options	—	114,000	—	—	114,000
Issuance of common stock upon exercise of warrants	50,631	387,510	—	—	387,510
Net income for the year	—	—	8,007,626	—	8,007,626
<b>Balance, December 31, 1977</b>	<u>4,347,774</u>	<u>\$ 16,672,782</u>	<u>\$ 23,384,281</u>	<u>\$ —</u>	<u>\$ 40,057,063</u>

*The accompanying notes are an integral part of this statement.*



## Tymshare, Inc. and Subsidiaries

**Consolidated Statement of Changes in Financial Position**

For the Years Ended December 31, 1977 and 1976

	1977	1976
<b>Sources of funds:</b>		
Operations:		
Net income	\$ 8,007,626	\$ 6,712,837
Add — Expenses not requiring outlay of working capital in current period:		
Depreciation and amortization of property and equipment	5,491,199	3,942,127
Amortization of cost of credit card processing agreements	151,000	—
Amortization of cost in excess of net tangible assets acquired	148,652	61,985
Deferred income taxes	631,000	510,000
Increase in deferred tax credits	200,000	550,000
Less — Net equity in earnings of foreign affiliates, which did not increase working capital	(11,000)	(220,000)
	<u>14,618,477</u>	<u>11,556,949</u>
Increase in long-term debt:		
Assumed in acquisition of WSBA credit card processing operations	5,816,494	—
Obligation of \$3,020,000 to member banks of WSBA, less certificate of deposit of \$2,400,000	620,000	—
Other increase, net	913,707	4,489,963
	<u>7,350,201</u>	<u>4,489,963</u>
Proceeds from sale of common stock and treasury stock, net of related expenses	1,449,525	1,448,192
Income tax benefits resulting from early disposition of shares acquired under stock options	114,000	109,000
Issuance of common stock for the acquisition of Western Twenty Nine, Inc.	—	69,000
	<u>1,563,525</u>	<u>1,626,192</u>
Total sources of funds	<u>\$ 23,532,203</u>	<u>\$ 17,673,104</u>
<b>Uses of funds:</b>		
Additions to property and equipment, net:		
Computer systems	\$ 8,382,490	\$ 5,906,228
Terminal and communications equipment	4,837,600	3,162,531
Leasehold improvements	3,105,309	234,402
Furniture, fixtures, and other equipment	960,627	661,413
Other	387,503	80,713
	<u>17,673,529</u>	<u>10,045,287</u>

(Continued on following page)

	1977	1976
<b>Uses of funds (continued):</b>		
Increase in cost in excess of net tangible assets acquired:		
Acquisition of Western Twenty Nine, Inc.	\$ —	\$ 202,280
Acquisition of WSBA credit card processing operations:		
Purchase price	219,223	—
Direct acquisition costs	91,351	—
Liabilities assumed:		
Long-term	5,816,494	—
Current	2,581,737	—
	<u>8,708,805</u>	<u>—</u>
Less amounts assigned to:		
Computer systems	(5,029,362)	—
Leasehold improvements	(2,663,230)	—
Other property and equipment	(361,653)	—
Current assets	<u>(483,209)</u>	<u>—</u>
	<u>(8,537,454)</u>	<u>—</u>
	<u>171,351</u>	<u>202,280</u>
Increase in investment in and loan to affiliates	<u>325,244</u>	<u>4,178,250</u>
Increase (decrease) in deferred charges	<u>2,902,806</u>	<u>(459,326)</u>
Increase (decrease) in working capital:		
Cash and certificates of deposit	1,219,068	(1,571,782)
Accounts receivable	6,790,551	3,014,815
Inventories	1,769,574	(40,879)
Prepaid expenses and deposits	424,886	(79,309)
Notes payable	(1,600,000)	951,610
Current portion of long-term debt	333,236	(1,335,255)
Accounts payable	(4,099,820)	2,506,241
Accrued liabilities	(773,618)	(63,350)
Accrued income taxes	<u>(1,604,604)</u>	<u>324,522</u>
	<u>2,459,273</u>	<u>3,706,613</u>
Total uses of funds	<u><u>\$ 23,532,203</u></u>	<u><u>\$ 17,673,104</u></u>

*The accompanying notes are an integral part of this statement.*



Tymshare, Inc. and Subsidiaries

## Notes to Consolidated Financial Statements

December 31, 1977

### 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

#### Consolidation

The consolidated financial statements include the accounts of Tymshare, Inc. and its majority-owned subsidiaries after elimination of intercompany accounts and transactions. The accounts of foreign subsidiaries (which are not significant in relation to the consolidated financial statements) have been translated into U.S. dollars at current or historical rates of exchange, as appropriate. The outside minority interests in the two foreign subsidiaries are not significant in amount.

The Company has a 45% equity interest in each of two affiliated companies, one in France and one in Japan. These investments are accounted for on the equity method. The Company's share of the affiliates' earnings or losses is included in revenue from services and sales, and is not significant to the consolidated results of operations.

#### Inventories

Inventories are stated principally at the lower cost (first-in, first-out) or market and are comprised of computer parts and equipment used for maintenance or held for resale, technical manuals, and tax preparation and other data processing supplies.

#### Software Development

The cost of software developed by the Company is charged to expense as incurred.

#### Depreciation and Amortization

Depreciation and amortization are provided generally on the straight-line method, using the following estimated useful lives:

Computer systems	3 to 10 years
Buildings	10 to 40 years
Terminal and communications equipment	3 to 7 years
Purchased software	5 to 6 years
Furniture, fixtures, and other equipment	3 to 10 years
Leasehold improvements	Life of lease

Maintenance and repairs are charged to expense as incurred. The cost of renewals or betterments that increase the useful life of the property is capitalized and depreciated over the estimated remaining useful life of the property. The net gain or loss on property retired or otherwise disposed of is credited or charged to income, and the asset cost and related accumulated depreciation are removed from the accounts.

#### Cost in Excess of Net Tangible Assets Acquired

Costs associated with acquisitions in 1971 and thereafter are being amortized generally over 40 years; costs associated with acquisitions in prior years are not being amortized (see Note 2).

### **Income Tax Preparation Services**

The Company's income tax preparation services are highly seasonal with virtually all the revenue being derived in the months of February through April each year. Certain direct expenses associated with the income tax preparation services are deferred and charged against income during the months the revenues are derived.

### **Reclassifications**

Certain costs previously charged to cost of services and sales (\$1,330,000) and selling, general, and administrative expenses (\$220,000) during the year ended December 31, 1976 have been reclassified to technical development expense on the accompanying consolidated statement of income to reflect the reorganization, effective January 1, 1977, of certain of the Company's technical development efforts.

### **Segment Information**

The Company operates in the computer services industry. Its predominant business is to provide a wide range of computer services for the access, interpretation, and use of information by the customer through a variety of methods using a combination of input and output devices.

## **2. ACQUISITIONS AND INVESTMENTS**

### **Tymshare Transaction Services, Inc.**

In October 1977, the Company acquired the credit card processing operations and certain assets of Western States Bankcard Association (WSBA) for \$219,223 and the assumption of certain liabilities. The purchase price exceeded the fair value of tangible net assets by \$80,000, which has been included in cost in excess of net tangible assets acquired together with \$91,351 of direct acquisition costs. The Company has transferred the assets and operations to Tymshare Transaction Services, Inc. (TTS), a newly formed subsidiary.

The Company has entered into separate credit card processing agreements with member banks of WSBA which accounted for a substantial portion of WSBA's service revenues. Under these agreements, the Company is obligated to pay the banks the vested portion of \$3,020,000 in October 1981. A bank's vested portion of this amount is based upon the length of time the bank continues to receive services from the Company until September 30, 1981. As security for the payment, the Company has purchased a certificate of deposit and placed it in trust for WSBA.

If a bank terminates the services to be provided under the credit card processing agreement, the bank must pay the Company a termination fee. If all banks were to terminate all services prior to April 30, 1979, the maximum fees due the Company would be approximately \$5,000,000. Such maximum fees decrease, generally on a straight-line basis, to zero on September 1, 1980.

The Company has accounted for this acquisition as a purchase and included the results of the acquired operations in its financial statements from October 1, 1977. The cost of the credit card processing agreements is included in deferred charges in the accompanying balance sheet and is being amortized on a straight-line basis over five years.

The results of operations of WSBA are not necessarily indicative of the results to be expected from TTS because, as a membership organization, WSBA's prices for its services were established principally to cover costs and to provide for a break-even level of operations through a combination of unit price charges and assessments. However, for the nine months ended September 30, 1977, WSBA incurred a loss from operations of approximately \$2,000,000 and did not assess the mem-



bership to cover the deficiency. The pro forma results of operations for the years ended December 31, 1977 and 1976, as though the acquisition had occurred on January 1, 1976, are summarized as follows:

	<u>1977</u>	<u>1976</u>
	(In Thousands of Dollars Except Per Share Amounts)	
Revenue from services and sales	\$ 116,223	\$ 105,839
Net income	\$ 6,906	\$ 6,680
Earnings per share	\$ 1.57	\$ 1.54

Effective July 1, 1976, WSBA changed its reporting period from a fiscal year ending June 30 to a fiscal year ending December 31. Accordingly, the above pro forma condensed results of operations for 1976 combines the consolidated results of operations of Tymshare for the year ended December 31, 1976 with the results of operations of WSBA for its year ended June 30, 1976.

The above pro forma results of operations include pro forma entries to give effect to the following: amortization of the cost in excess of net tangible assets acquired and the cost of acquired credit card processing agreements, adjustments resulting from the Company's purchase of equipment previously subject to a lease and from the financing arrangements for the acquisition, and an adjustment of the provision for income taxes to give effect to the pro forma combination and related pro forma entries.

#### Acquisitions and Investments in 1976

During 1976, the Company acquired three companies accounted for as poolings of interests. These companies were included in the financial statements for the full year 1976 and prior years' financial statements were restated to reflect the poolings. Also in 1976, the Company acquired Western Twenty Nine, Inc. in a transaction accounted for as a purchase. The Company has agreed to issue shares of its common stock up to a maximum of \$667,000 at market value under an earn-out provision based upon Western Twenty Nine revenue growth through June 1979.

In August 1976, the Company increased its equity ownership in CEGI-Tymshare (previously CEGOS-Tymshare) from 20% to 45%, for \$1,125,000 cash. The additional investment exceeded the underlying equity in net assets acquired by \$796,000, which is being amortized over 40 years. Also in August 1976, the Company obtained the right to acquire up to a 20% interest in SLIGOS S.A., a French corporation. The Company's initial investment was in the form of \$1,526,625 cash for an 11% equity interest, and a convertible note for \$1,526,625, guaranteed by a bank, convertible at the option of the Company into an additional 9% equity interest. The Company converted this note to equity in March 1978.

#### Cost in Excess of Net Tangible Assets Acquired

Acquisitions in 1977 and prior years have given rise to costs in excess of net tangible assets acquired (\$1,738,617 of which is not being amortized), as follows:

	<u>1977</u>	<u>1976</u>
Balance beginning of year	\$ 3,566,860	\$ 3,426,565
Acquisitions:		
Western Twenty Nine	—	202,280
TTS	171,351	—
Less—Amortization charged to expense	(127,927)	(61,985)
Balance end of year	\$ 3,610,284	\$ 3,566,860

### 3. BANK LINES OF CREDIT AND LONG-TERM DEBT

#### Bank Lines of Credit

The Company has separate unsecured lines of credit with five banks which expire in April 1978 through March 1979. At December 31, 1977, the remaining availability under these lines was \$37,850,000, including \$24,050,000 which, if advanced to the Company, could be converted to term loans. The Company is required to maintain compensating balances amounting to \$765,000 at December 31, 1977 under four of the lines. The lines provide, among other conditions, that the Company maintain minimum levels of net worth (\$38,000,000) and quarterly pretax income and minimum ratios of current assets to current liabilities and of total unsubordinated liabilities to tangible net worth. The Company was in compliance with all these conditions at December 31, 1977.

Short-term borrowings under the above lines of credit were not significant until December 31, 1977, at which date \$2,000,000 had been borrowed, with interest at the banks' prime rate.

#### Long-term Debt

#### December 31, 1977

##### Notes payable to banks:

Term note due January 1983, payable in 12 quarterly installments of \$850,000, commencing April 1980, plus interest at prime in 1978, at prime plus $\frac{1}{4}\%$ in 1979, and at prime plus $\frac{1}{2}\%$ thereafter ( $7\frac{3}{4}\%$ at December 31, 1977)	\$ 10,200,000
Term note due August 1981, payable \$210,000 quarterly plus interest at prime plus $\frac{1}{2}\%$ ( $8\frac{1}{4}\%$ at December 31, 1977)	3,150,000
Lease contract obligations assumed in the acquisition of WSBA credit card processing operations, due in varying amounts to 1981 with interest rates of 8% to 9%	1,652,922
Obligation of \$3,020,000 to member banks of WSBA due in October 1981, plus interest at prime, less certificate of deposit of \$2,400,000 (see Note 2)	620,000
Other, due in varying amounts to 1998 with interest rates of 6% to 9%	1,136,054
	<u>16,758,976</u>
Less—Current maturities	<u>1,574,532</u>
	<u>\$ 15,184,444</u>

Property and equipment with an original cost of approximately \$4,080,000 has been pledged to secure certain of the above indebtedness.

The maturities of long-term debt as of December 31, 1977 are:

<u>Payable During</u>	<u>Amount</u>
1978	\$ 1,574,532
1979	1,572,020
1980	3,964,983
1981	4,876,030
1982	3,488,884
1983–98	1,282,527
	<u>\$ 16,758,976</u>



#### 4. LEASE COMMITMENTS

The Company leases computers and related equipment and office and computer facility space for periods to 1992. Approximate future lease commitments under these leases as of December 31, 1977 are:

Year(s)	Computers and Equipment		Facility Space	Total
	Capital Leases	Operating Leases		
1978	\$ 2,020,000	\$ 1,395,000	\$ 3,265,000	\$ 6,680,000
1979	1,235,000	900,000	2,980,000	5,115,000
1980	710,000	95,000	2,485,000	3,290,000
1981	490,000	80,000	2,120,000	2,690,000
1982	165,000	10,000	2,025,000	2,200,000
1983-87	—	—	8,135,000	8,135,000
1988-92	—	—	5,120,000	5,120,000
	<u>\$ 4,620,000</u>	<u>\$ 2,480,000</u>	<u>\$ 26,130,000</u>	<u>\$ 33,230,000</u>

If the capital lease commitments plus purchase options were capitalized, the effect upon results of operations would not be significant. The amounts which would have been included on the balance sheets were:

	December 31,	
	1977	1976
Computer systems	\$ 10,904,000	\$ 13,820,000
Less—Accumulated depreciation	<u>6,776,000</u>	<u>7,672,000</u>
	<u>\$ 4,128,000</u>	<u>\$ 6,148,000</u>
Obligations under capital leases:		
Current	\$ 1,814,000	\$ 2,160,000
Noncurrent	<u>2,866,000</u>	<u>4,680,000</u>
	<u>\$ 4,680,000</u>	<u>\$ 6,840,000</u>

The average interest rates used to compute the above obligations under capital leases were 10.4% and 10.2% at December 31, 1977 and 1976, respectively. The range of interest rates was 5.0% to 13.7%.

Rental expense (including operating leases with terms of less than 12 months) by type of lease was:

	1977	1976
Operating leases:		
Computers and equipment	\$ 5,474,000	\$ 4,878,000
Facility space	2,968,000	2,129,000
Capital leases	<u>2,600,000</u>	<u>2,944,000</u>
	<u>\$ 11,042,000</u>	<u>\$ 9,951,000</u>

## 5. LITIGATION

The Company is a party to certain litigation and other proceedings arising from its business activities. In the opinion of management, the outcome of these matters will not significantly affect the Company's financial position or results of its operations.

## 6. COMMON STOCK

The Company has reserved shares of its common stock for the following:

	Number of Shares at December 31,	
	1977	1976
Employee stock options	489,996	374,373
Employee stock purchase plan	183,754	68,215
Warrants	—	50,631
	<u>673,750</u>	<u>493,219</u>

Options have been granted generally at 100% of the fair market value on the date of grant. However, certain stock option plans permit the Company to grant options at less than fair market value. Options are exercisable on a cumulative basis at various dates and expire five years from the date granted.

At December 31, 1976, options for 358,752 shares were outstanding at prices ranging from \$5.75 to \$16.75 and aggregating \$4,526,262. During 1977, options for 57,925 shares were exercised at prices ranging from \$5.75 to \$16.75 and options for 36,057 shares were cancelled. At December 31, 1977, options for 264,770 shares were outstanding at prices ranging from \$5.75 to \$16.75 and aggregating \$3,512,412. Options for 80,473 shares at prices ranging from \$5.75 to \$16.75 and aggregating \$990,802 became exercisable during 1977.

Under the employee stock purchase plan, eligible employees may elect to purchase shares of common stock at 85% of the lower of the fair market value at the beginning or end of a 12-month offering period. In July 1977, 34,461 shares were issued to participants at \$15.73 per share, which was 85% of the fair market value at the end of the fourth offering period. At December 31, 1977, payroll deductions for the fifth offering period ending June 30, 1978 amounted to \$506,011. At the beginning of this offering period, 85% of the fair market value was \$15.73 per share.

The proceeds received upon exercise of stock options or in connection with stock purchase plans are credited to the common stock account. No amounts have been reflected in the income statement with respect to stock options or stock purchase plans.



## 7. INCOME TAXES

Income tax expense for 1977 and 1976 is made up of the following components:

	<u>U.S. Federal</u>	<u>State</u>	<u>Total</u>
Year ended December 31, 1977:			
Current portion	\$ 5,732,000	\$ 1,226,000	\$ 6,958,000
Increase in deferred tax credits	200,000	—	200,000
Deferred tax expense and reversal of prepaid tax expense	<u>518,000</u>	<u>124,000</u>	<u>642,000</u>
	<u>\$ 6,450,000</u>	<u>\$ 1,350,000</u>	<u>\$ 7,800,000</u>
Year ended December 31, 1976:			
Current portion	\$ 4,096,000	\$ 956,000	\$ 5,052,000
Increase in deferred tax credits	550,000	—	550,000
Deferred tax expense and reversal of prepaid tax expense	<u>704,000</u>	<u>144,000</u>	<u>848,000</u>
	<u>\$ 5,350,000</u>	<u>\$ 1,100,000</u>	<u>\$ 6,450,000</u>

The above amounts for 1976 have been reclassified to give effect to certain changes in the method of reporting depreciation and state tax deductions on the Company's tax returns which were made subsequent to issuing the 1976 financial statements. These reclassifications have also been reflected on the 1976 consolidated balance sheet. At December 31, 1977 and 1976, prepaid tax expenses of \$497,000 and \$508,000, respectively, were included in the consolidated balance sheet in prepaid expenses and deposits.

Prepaid and deferred tax expenses result from timing differences in the recognition of certain costs and expenses for financial and tax reporting purposes. The primary timing difference was the excess (\$597,000 in 1977 and \$832,000 in 1976) of tax depreciation over book depreciation.

The Company accounts for investment tax credits using the deferral method. Deferred tax credits represent investment tax credits reported for tax purposes in excess of credits reported for book purposes to December 31, 1977.

Deferred income taxes and credits in the accompanying balance sheet are comprised of the following:

	<u>1977</u>	<u>1976</u>
Deferred income taxes relating to timing differences	\$ 1,141,000	\$ 510,000
Deferred investment tax credits	<u>2,050,000</u>	<u>1,850,000</u>
	<u>\$ 3,191,000</u>	<u>\$ 2,360,000</u>

The tax provision for 1977 and 1976 differs from the amount computed by applying the prevailing federal and state rates to income before taxes, primarily because of the application of investment tax credits of \$540,000 in 1977 and \$360,000 in 1976.

The Internal Revenue Service has completed an examination covering the federal income tax returns of Tymshare, Inc. and its subsidiary Tymshare East, Inc. for the years 1973 and 1974. The Company has not agreed to tax deficiencies of \$1,100,000 proposed by the agent and is contesting the issues involved, which include both permanent and timing difference adjustments. Management is of the opinion that resolution of these issues will not significantly affect working capital or results of operations.

## 8. EARNINGS PER SHARE

Earnings per share have been computed based on the average number of common shares and common equivalent shares (stock options, warrants, and employee stock purchase plans) outstanding during each period. The average number of shares used in the computation was 4,408,568 in 1977 and 4,337,189 in 1976. Earnings per share assuming full dilution are substantially the same as earnings per share shown.

## 9. QUARTERLY FINANCIAL INFORMATION (UNAUDITED)

	<u>First</u>	<u>Second</u>	<u>Third</u>	<u>Fourth</u>	<u>Total</u>
	(In Thousands Except Per Share Amounts)				
Revenues:					
1977	\$ 26,235	\$ 23,747	\$ 22,027	\$ 29,165	\$ 101,174
1976	<u>23,375</u>	<u>19,894</u>	<u>19,002</u>	<u>19,566</u>	<u>81,837</u>
Income before taxes:					
1977	\$ 5,321	\$ 4,427	\$ 3,475	\$ 2,585	\$ 15,808
1976	<u>4,929</u>	<u>3,152</u>	<u>2,322</u>	<u>2,760</u>	<u>13,163</u>
Net income:					
1977	\$ 2,621	\$ 2,227	\$ 1,775	\$ 1,385	\$ 8,008
1976	<u>2,475</u>	<u>1,598</u>	<u>1,180</u>	<u>1,460</u>	<u>6,713</u>
Earnings per share:					
1977	\$ .60	\$ .51	\$ .40	\$ .31	\$ 1.82
1976	<u>.57</u>	<u>.37</u>	<u>.27</u>	<u>.34</u>	<u>1.55</u>

As discussed in Note 2, the Company acquired certain assets and assumed certain liabilities of WSBA in October 1977. The results of the acquired operations are included in the consolidated results of operations from October 1, 1977. Revenues from the acquired operations were approximately \$6,100,000 in the fourth quarter of 1977, with no significant effect upon net income.



## **Auditors' Report**

### **To the Shareholders and the Board of Directors of Tymshare, Inc.:**

We have examined the consolidated balance sheets of Tymshare, Inc. (a California corporation) and subsidiaries as of December 31, 1977 and 1976, and the related consolidated statements of income, shareholders' investment, and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of Tymshare, Inc. and subsidiaries as of December 31, 1977 and 1976, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

**Arthur Andersen & Co.**

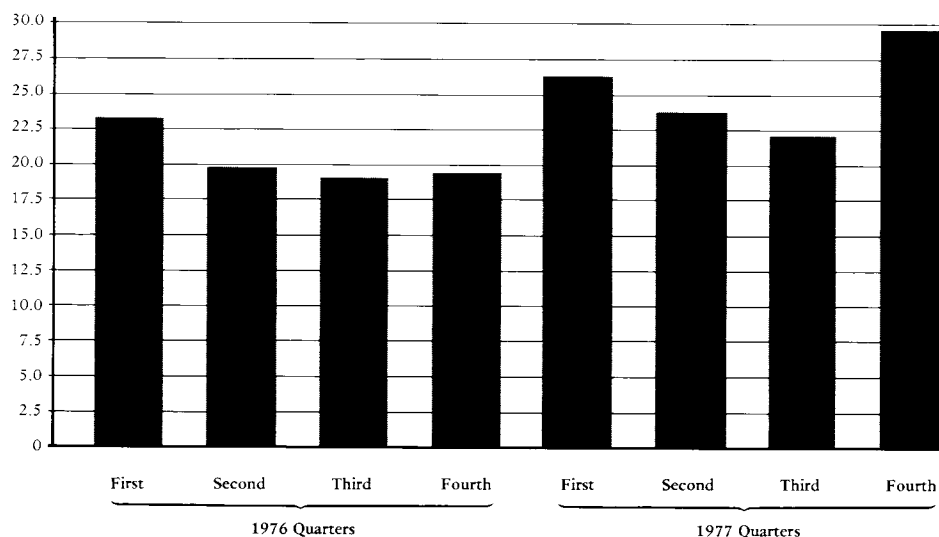
San Jose, California

March 2, 1978

# 1977 and 1976 Quarterly Highlights

The following consolidated financial information is unaudited.

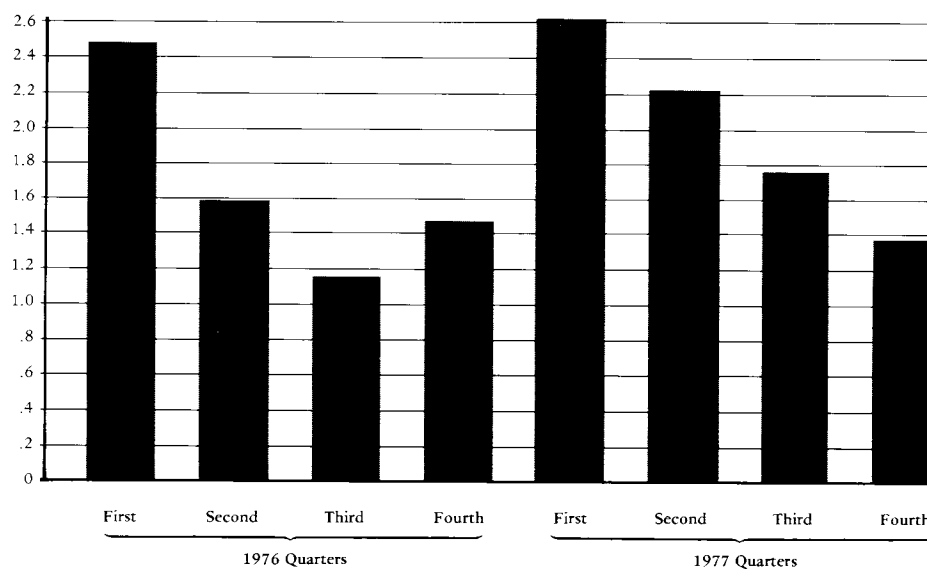
**Revenue**  
*in millions  
of dollars*



Year	Quarter	Revenue	Income		Income Margin	
			Before Taxes	Net	Before Taxes	Net
(In Thousands of Dollars)						
1976	First	\$23,375	\$4,929	\$2,475	21.1%	10.6%
	Second	19,894	3,152	1,598	15.8	8.0
	Third	19,002	2,322	1,180	12.2	6.2
	Fourth	19,566	2,760	1,460	14.1	7.5
1977	First	26,235	5,321	2,621	20.2	10.0
	Second	23,747	4,427	2,227	18.6	9.4
	Third	22,027	3,475	1,775	15.8	8.1
	Fourth	29,165	2,585	1,385	8.9	4.7

As discussed in Note 2, the Company acquired certain assets and assumed certain liabilities of WSBA in October 1977. The results of the acquired operations are included in the consolidated results of operations from October 1, 1977. Revenues from the acquired operations were approximately \$6.1 million in the fourth quarter of 1977 with no significant effect upon net income.

**Net Income**  
*in millions  
of dollars*





# Five-Year Consolidated Summary of Operations

	Year Ended December 31,				
	1977	1976	1975	1974	1973
	(In Thousands Except Per Share Amounts)				
<b>Revenue from services and sales</b>	<u>\$ 101,174</u>	<u>\$ 81,837</u>	<u>\$ 64,412</u>	<u>\$ 52,602</u>	<u>\$ 39,513</u>
<b>Costs and expenses:</b>					
Cost of revenue and operating expenses	84,671	68,278	54,406	45,405	34,504
Interest	<u>695</u>	<u>396</u>	<u>148</u>	<u>487</u>	<u>633</u>
	<u>85,366</u>	<u>68,674</u>	<u>54,554</u>	<u>45,892</u>	<u>35,137</u>
Income before provision for income taxes	15,808	13,163	9,858	6,710	4,376
<b>Provision for income taxes</b>	<u>7,800</u>	<u>6,450</u>	<u>4,889</u>	<u>3,276</u>	<u>2,084</u>
Income before extraordinary items	8,008	6,713	4,969	3,434	2,292
<b>Extraordinary items</b> —Primarily federal income tax reduction from carryforward of prior years' losses	<u>—</u>	<u>—</u>	<u>125</u>	<u>204</u>	<u>681</u>
Net income	<u><u>\$ 8,008</u></u>	<u><u>\$ 6,713</u></u>	<u><u>\$ 5,094</u></u>	<u><u>\$ 3,638</u></u>	<u><u>\$ 2,973</u></u>
<b>Earnings per share:</b>					
Income before extraordinary items	\$ 1.82	\$ 1.55	\$ 1.19	\$ .86	\$ .58
Extraordinary items	<u>—</u>	<u>—</u>	<u>.03</u>	<u>.05</u>	<u>.17</u>
Net income	<u><u>\$ 1.82</u></u>	<u><u>\$ 1.55</u></u>	<u><u>\$ 1.22</u></u>	<u><u>\$ .91</u></u>	<u><u>\$ .75</u></u>
<b>Average shares used to compute earnings per share</b>	<u>4,408,568</u>	<u>4,337,189</u>	<u>4,159,191</u>	<u>3,999,130</u>	<u>3,985,193</u>

## Management's Discussion and Analysis of the Consolidated Summary of Operations

### General

The consolidated summary of operations for Tymshare, Inc. and subsidiaries shows increasing revenue and income from the prior year for each year of the period shown. Management believes that the major factors contributing to such growth were: (1) continued diversification of the Company's capabilities and services, (2) greater market penetration of the Company's products and services into new industries, (3) geographic expansion of the data communications network, (4) the addition of new computer systems and the enhancement of installed systems, and (5) economies of scale.

### 1977 Compared With 1976

Revenues for 1977 increased by approximately \$19.3 million (24%) compared with 1976. In October 1977, the Company acquired the operations of Western States Bankcard Association (WSBA) and accounted for the acquisition as a purchase. Revenues from the acquired operations from October 1, 1977 to the end of the year were approximately \$6.1 million, with no significant effect on net income. Exclusive of the revenues from WSBA, revenues grew by \$13.2 million (16%), which management attributes principally to the continued diversification and market penetration of its services and products.

Total cost of revenue and operating expenses, excluding interest, increased by approximately \$16.4 million (24%) compared with 1976, producing an operating profit margin of 16.3% of revenue as compared with 16.6% in 1976. The increase in costs is primarily the result of the corresponding increase in revenue and generally conforms to the pattern of prior years. The WSBA acquisition, however, did not contribute significantly to net income, and operational startup costs associated with the Company's joint ventures in Japan and West Germany also affected 1977 profit margins.

The increase in interest expense (net) from approximately \$400,000 in 1976 to approximately \$700,000 in 1977 was primarily due to the additional debt incurred for transactions involving the WSBA acquisition, and the borrowings made in late 1976 to finance the expansion of foreign interests and the purchase of additional computer equipment.

### 1976 Compared With 1975

Revenue for the year ended December 31, 1976 increased by approximately \$17.4 million (27%) compared with the prior year. However, two acquisitions made in December 1975 and accounted for as purchases, contributed approximately \$6.0 million to 1976 revenues. The revenue growth exclusive of such acquisitions was 18%, which management attributes to the general expansion of the Company's business, primarily derived through the internal growth of its existing service revenue.

Total cost of revenue and operating expenses for 1976, excluding interest, increased by approximately \$13.9 million (26%) compared with the prior year, producing an operating profit margin of 16.6% of revenue as compared with 15.5% in the prior year. Management attributes the increase in costs primarily to the corresponding increase in revenue, and notes that such increase in costs is in line with the relative increases in costs as compared with increases in revenue in each of the prior three years. Further, substantial costs were incurred in 1976 in connection with the Company's acquisition of four domestic companies and the significant expansion of its foreign interests. The increase in interest expense (net) of approximately \$250,000 resulted primarily from borrowings made during 1976 to finance the Company's investments in foreign affiliates and for its purchase of additional computer equipment.



**Board of Directors**

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President and  
Chairman of the Board,  
Tymshare, Inc.

MAX B. E. CLARKSON  
Dean of Faculty of  
Management Studies,  
University of Toronto

BERNARD GOLDSTEIN  
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Tymshare, Inc.

ANTHONY M. LAMPORT  
First Vice President,  
Drexel Burnham Lambert,  
Incorporated,  
Investment Bankers

ROGER L. MOSHER  
Partner,  
Wilson, Mosher & Sonsini,  
Attorneys-at-Law

GEORGE QUIST  
Partner,  
Hambrecht & Quist,  
Investment Bankers

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Group Vice President

ALBERT A. EISENSTAT  
Vice President and  
Corporate Counsel

EDWARD J. FIELD  
Vice President and Treasurer

BERNARD GOLDSTEIN  
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Vice President

WARREN F. PRINCE  
Group Vice President

LASZLO RAKOCZI  
Group Vice President

**Audit Committee**

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Director,  
Dean of Faculty of Management  
Studies, University of Toronto

ANTHONY M. LAMPORT,  
Director,  
First Vice President,  
Drexel Burnham Lambert,  
Incorporated

**General Legal Counsel**

Wilson, Mosher & Sonsini,  
Palo Alto, Calif.

**Auditors**

Arthur Andersen & Co.,  
San Jose, Calif.

**Registrar and Transfer Agent**

Bank of America N.T. & S.A.,  
San Francisco, Calif.

**Stock Symbol**

Tymshare stock is traded on the  
New York Stock Exchange,  
symbol TYM

### Market Prices of Common Stock

Tymshare's common stock was traded in the over-the-counter market until June 24, 1977, when it began trading on the New York Stock Exchange. As reported by NASDAQ, the high and low bid prices of Tymshare's common stock in the over-the-counter market during 1976 and 1977 are shown below, as well as the range of closing prices on the New York Stock Exchange from June 24, 1977 through the first quarter of 1978:

O-T-C		
	High Bid	Low Bid
<b>1976</b>		
First quarter	27 <sup>3</sup> / <sub>4</sub>	18 <sup>1</sup> / <sub>2</sub>
Second quarter	27 <sup>5</sup> / <sub>8</sub>	22 <sup>1</sup> / <sub>2</sub>
Third quarter	27 <sup>1</sup> / <sub>8</sub>	17 <sup>1</sup> / <sub>4</sub>
Fourth quarter	19 <sup>1</sup> / <sub>2</sub>	14 <sup>1</sup> / <sub>4</sub>
<b>1977</b>		
First quarter	19 <sup>1</sup> / <sub>2</sub>	14
Second quarter (to June 23)	17 <sup>3</sup> / <sub>4</sub>	15 <sup>1</sup> / <sub>2</sub>
NYSE		
	High	Low
<b>1977</b>		
Second quarter (from June 24)	19	18 <sup>1</sup> / <sub>8</sub>
Third quarter	23 <sup>1</sup> / <sub>8</sub>	18 <sup>1</sup> / <sub>2</sub>
Fourth quarter	23 <sup>1</sup> / <sub>8</sub>	17 <sup>7</sup> / <sub>8</sub>
<b>1978</b>		
First quarter	22 <sup>7</sup> / <sub>8</sub>	18 <sup>1</sup> / <sub>8</sub>

These quotations do not include retail mark-up, mark-down, or commission, and may not represent actual transactions. The Company has never paid dividends.

Shareholders are entitled to receive, without charge and upon written request, a copy of the Company's Form 10-K Report for the year ended December 31, 1977, which has been filed with the Securities and Exchange Commission.

Address requests to:  
Edward J. Field,  
Vice President and Treasurer,  
Tymshare Corporate  
Headquarters.

## Principal Marketing Locations

### COMPUTER SERVICES GROUP

#### Information Services Division

*Western Region*  
Houston, Tex.  
713/785-7720

*Eastern Region*  
Darien, Conn.  
203/655-8961

*Consulting and  
Professional Services (CAPS)*  
Mountain View, Calif.  
415/941-6010

*Utility Industry Marketing*  
New York, N.Y.  
212/490-6700

*Government Marketing*  
Arlington, Va.  
703/841-3400

#### Industry Services Division

*Banking Software Systems*  
Birmingham, Ala.  
205/942-6700

*Cable TV Industry*  
Cablefacts  
Lexington, Ky.  
606/269-2323

*Computerized Tax Processing*  
Dynatax  
Cupertino, Calif.  
408/446-6273

Unitax  
Anaheim, Calif.  
714/956-3640

*Fuel Oil Distribution Industry*  
Computafuel/Telefuel  
Syracuse, N.Y.  
315/437-7081

*Hospital/Health Care Industry*  
Tymshare Medical Systems  
Mahwah, N.J.  
201/825-1100

*Travel Industry*  
Western 29  
San Francisco, Calif.  
415/885-2929

### FINANCIAL AND NETWORK SYSTEMS GROUP

#### Tymnet, Inc.

*Corporate Headquarters*  
Cupertino, Calif.  
408/446-7000

*Central Region*  
Houston, Tex.  
713/780-4455

*Western Region*  
Cupertino, Calif.  
408/446-7031

*Eastern Region*  
Rockville, Md.  
301/770-5710

**Tymshare Transaction Services, Inc.**  
San Francisco, Calif.  
415/393-0200

#### Valcomp Division

Westlake Village, Calif.  
213/889-6031

### INTERNATIONAL AFFILIATES

#### Belgium

CEGI-Tymshare  
Brussels, Belgium

#### England

Tymshare U.K., Ltd.  
London, England

#### France

CEGI-Tymshare  
Paris, France

#### Japan

Kokusai Tymshare, Ltd.  
Tokyo, Japan

#### The Netherlands

CEGI-Tymshare  
The Hague, Netherlands

#### West Germany

Taylorix-Tymshare GmbH  
Frankfurt, West Germany



*Sales offices in most major U.S. cities*



