

1989 ANNUAL REPORT

Relational Technology, Inc.

Ingres

Global Architecture for the future...



COMPANY PROFILE

With \$131 million in annual revenues and a history of technological innovation and profitability, Relational Technology, Inc. is an acknowledged leader in the rapidly growing market for relational database management and distributed database software.

Relational Technology's INGRES family of database management products and application development tools are designed to bridge the islands of information in today's typically heterogeneous, decentralized computer networks, providing the basis for communications between dissimilar computing systems and allowing users prompt, secure access to the information they need, wherever or however it may be stored.

The December 1988 introduction of our powerful, multi-server architected Release 6 relational database management system and the formation of marketing alliances with major computer manufacturers and applications software vendors assure Relational Technology a dynamic role in the information systems industry's continuing transition from monolithic to distributed, multi-vendor computing systems.

INGRES database products are currently installed on more than 10,000 mainframe and minicomputer systems, worldwide. Although we are best known to users of Digital Equipment's DEC VAX computers and the growing numbers of mainframes, minicomputers, and workstations employing UNIX operating systems, our products are used on many other types of computers—over 40, in all.

Founded in 1980, Relational Technology made its initial public stock offering in May 1988. It now ranks among the nation's 10 largest software companies. RTI's 11 million outstanding shares are traded on the NASDAQ National Market System under the symbol RELY.

ABOUT THE COVER

I. M. Pei's Louvre Pyramid in Paris is an architectural masterpiece. Architectural excellence is hard to find but easily recognized.

Major companies around the world recognize the architectural excellence of INGRES products in solving day-to-day problems of information integration. Real examples of how our software products give our customers a competitive edge are described on pages 6 to 13 in this report.

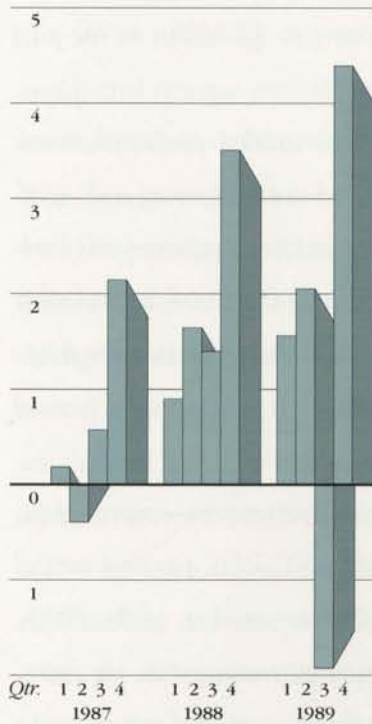
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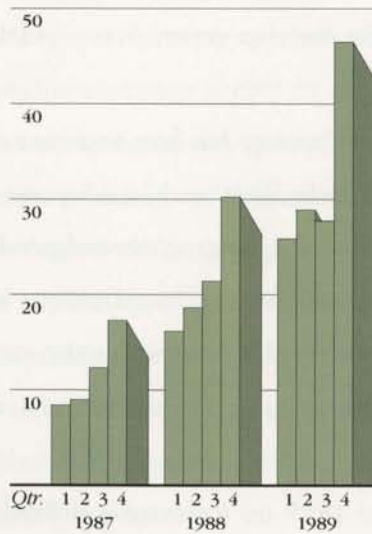
FINANCIAL HIGHLIGHTS

<i>(in thousands, except per share data)</i>	1989	1988	1987	1986	1985
Revenues	\$130,716	\$ 87,386	\$46,565	\$28,138	\$17,271
Operating income	8,855	10,850	3,102	2,503	771
Net income	6,201	7,464	2,477	1,664	555
Net income per share	.50	.76	.29	.23	.08
Working capital	32,112	37,475	12,355	6,979	1,307
Total assets	132,221	100,966	46,364	24,021	11,634
Long-term debt	4,275	3,692	2,955	2,604	2,145
Stockholders' equity	70,525	63,844	24,851	13,898	4,746
Weighted average shares outstanding	12,331	9,873	8,456	7,393	6,825

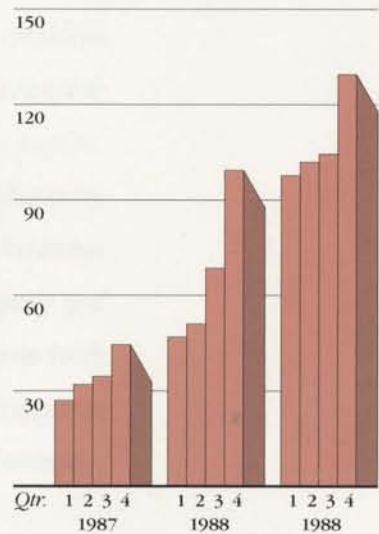
Quarterly Net Income
(dollars in millions)



Quarterly Revenue
(dollars in millions)



Quarterly Assets
(dollars in millions)





Paul E. Newton
President and Chief Executive Officer

Ever since our founding in 1980, Relational Technology has been recognized as a world leader in the development of relational database management systems—one of a handful of major independents serving a segment of the database software market that has grown from virtually nothing to \$2 billion in the past ten years.

Our strategy has been to pursue mainstream markets and applications of our database technology, such as computer integrated manufacturing and management information systems, either independently or in joint ventures with leading computer manufacturers, applications software vendors, and information systems consultants. By navigating the mainstream, where the current flows strongest and deepest, we believe we can outdistance less strategically focused competitors.

In 1989 we executed a difficult tacking maneuver—one that we believe temporarily slowed our momentum, but gained INGRES a critical tactical advantage in exploiting the emerging mainstream database markets of the 1990s.

The INGRES Release 6 database management system we introduced in December 1988 was not just a friendlier, faster version of our previous releases. Two hundred man-years in the making, it embraces a totally re-

engineered architecture specifically designed to support and enhance the high-performance on-line transaction processing capabilities of the new multi-processor "cluster" or parallel computers.

At least equally important, Release 6 is the first database management system to provide a practical means of integrating all types of databases and computers into a single, seamless corporate information network. Supported by powerful new INGRES application development tools and by networking tools that permit communications between previously incompatible database systems, INGRES Release 6 represents a quantum leap in distributed database technology—the new generation of database software upon which we believe the majority of tomorrow's networked computer systems and systems applications will be based.

In the third quarter of fiscal 1989 we began shipments of Release 6 upgrades to the DEC VAX users who comprise over 60 percent of our current customer base. Additionally, by year-end the system had been configured or "ported" to a number of UNIX-based computers (UNIX-based computers account for another 30 percent of our business).

During this introductory period we experienced lower-than-anticipated revenue growth, as prospective customers waited for the new release to become available on their hardware, or on hardware they were planning to acquire. The slowdown did not become evident until late in our third quarter, when a number of large orders we had expected to book in the last few days of the period either failed to materialize or were deferred into the fourth quarter. (In our company and throughout the software industry, it is customary for sales representatives to book most of their business in the last few days each quarter. During the fourth quarter, we changed our sales incentive compensation program to reward earlier bookings, and month-to-month revenues evened out appreciably.)

In any event, third quarter revenues were substantially below our expectations, and that shortfall, on a rapidly growing fixed cost base, produced a loss for the quarter that even our strong fourth quarter rebound could not completely offset. As a result, earnings for the full year were down 17 percent from the prior year.

More work remains to be done before Release 6 is adapted to all of the hardware platforms supported by INGRES, but the most difficult and time-consuming part of the conversion task is now behind us. The multi-year R&D effort required to develop, introduce, and port a totally new systems architecture is largely completed. With the new architecture in place, we are now in a position to focus our R&D and marketing efforts on the introduction of systems enhancements and tool refinements requiring less time-to-market and comparatively high returns on investment.

Had we done nothing but bring Release 6 to market, fiscal 1989 would have been a watershed year for INGRES and Relational Technology. But 1989 also stands out as a period in which a series of major alliances and joint ventures strengthened our mainstream position in the database software industry, raised our market profile, expanded our distribution channels, and established INGRES' advanced application development and distributed data tools as a new industry standard:

- Digital Equipment Corporation chose the INGRES application development and end-user tool kit to support its own strategic relational database product, Rdb. An exclusive agreement permits both companies to sell the new "INGRES tools for Rdb" kits worldwide.

- In addition, Digital announced it will use INGRES as the foundation of its new ULTRIX database offering.

- Tandem Computer announced plans to employ INGRES tools in support of its Non Stop SQL relational database management software.

- BiiN, a partnership of Siemens and Intel, is incorporating our INGRES database into its full line of computers.

- INGRES software will be imbedded in the new Unix-based, DOS-compatible "Open Desktop" developed by Santa Cruz Corporation (SCO) in conjunction with Digital Equipment Corporation, Locus, Tandy, and RTI.

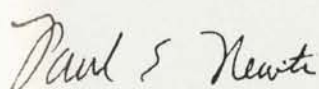
- In addition, many well known applications software vendors, including ASK Computer, Ross Systems, Sematech and Datalogix have elected to provide software based on INGRES capabilities.

We look to these new strategic alliances as important sources of future revenues. Further gains can be expected from these sources as sales of “unbundled” application, end-user, and networking tools assume an increasingly important role in our marketing strategy.

We have also devoted a great deal of time and effort in the past year to the development of our direct sales organization and the strengthening of our sales and marketing executive team. One of our fiscal 1990 priorities will be to increase the overall productivity of INGRES’ rapidly growing sales and field support arm through improved training and incentive programs, greater emphasis on industry-specific team selling, and increased use of telemarketing techniques for small, direct orders.

Computer and software analysts have characterized 1989 as one of the most testing and “chaotic” periods in recent industry history. To a large extent the major changes they speak of relate to the broad movement toward more heterogeneous, distributed, user-oriented computer systems—the “mainstream” in which Relational Technology operates.

We too have gone through a critical transition period, but one which we believe has significantly improved our competitive posture. A lot of fine tuning remains to be done; however, the basic elements are now in place. A technically and operationally superior set of database management systems and tools; a sound, mainstream marketing and product strategy; mutually profitable strategic alliances; outstanding people; and perhaps most important, an unbeatable reputation for integrity and reliability.



Paul E. Newton
President and Chief Executive Officer
August 31, 1989

The Problem

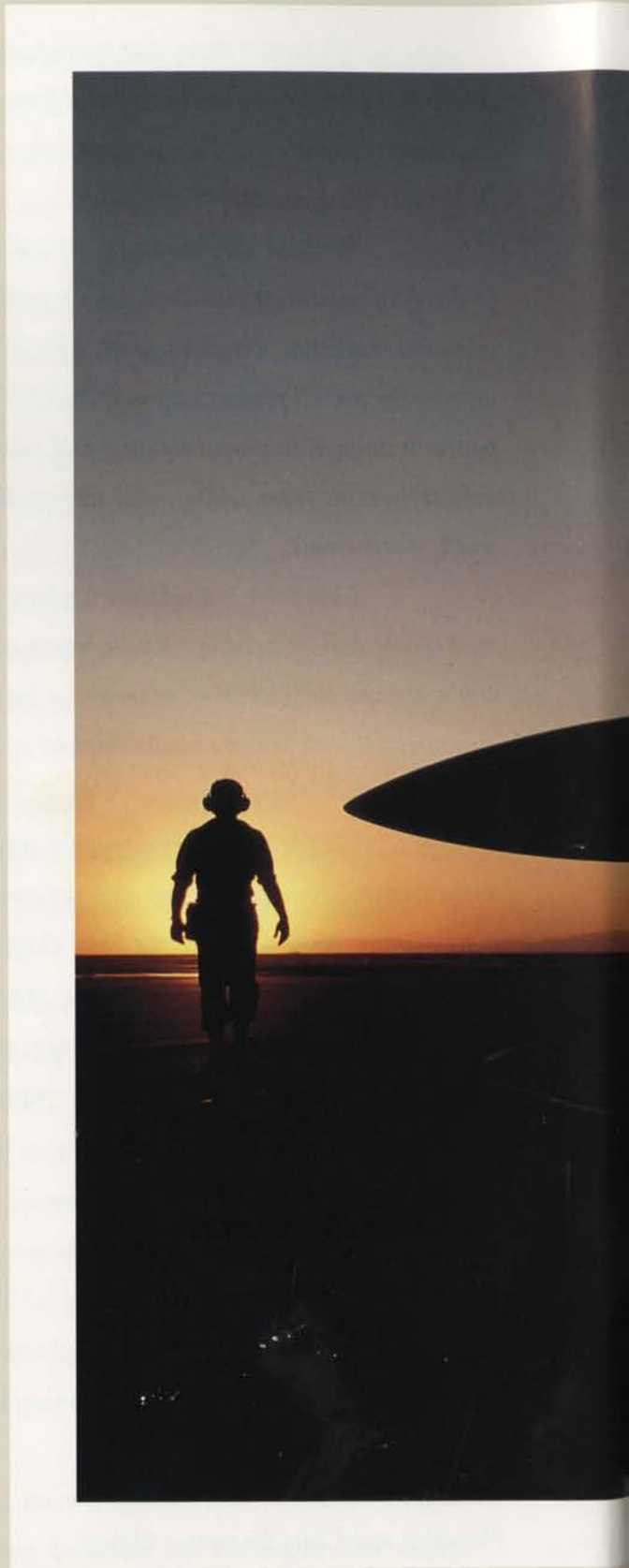
GE's Aircraft Engines Plant III was conceived as our Factory of the Future—a total break from traditional concepts of high tolerance jet engine parts manufacturing. While our main goals were to reduce production costs and improve quality, management also intended that Plant III serve as a test bed for future applications of advanced automation and computer integrated manufacturing (CIM) technologies.

“...We needed a database management system capable of integrating our traditional management information systems with the factory software that controls the plant's manufacturing operations.

“Reliability and performance were critical concerns. The system had to support a round-the-clock production schedule with an absolute minimum of breakdowns and maintenance downtime.”



Phil Sullivan
Manager, CIM Systems Integration
Barry Randall (right)
Manager, Plant III Systems Engineering



Plant III's factory control system was organized into multiple subsystems, each governing a separate manufacturing operation, with INGRES serving as the central database and supporting data communications between subsystems.

"One advantage of the INGRES solution is that, if any part of the system 'crashes', the integrity and availability of the database is preserved. Nothing is lost. We can be up and running again with minimal delay.

"INGRES flexible application development environment and fully relational database really proved their worth during the system's developmental phase, making it possible to break each project into small manageable pieces and simplify the task of modifying or redesigning systems software as the project progressed."



Steve Ross, Field District Manager
Rona Machlin,
Regional Technical Support Manager

At GE's factory of the future, INGRES is...

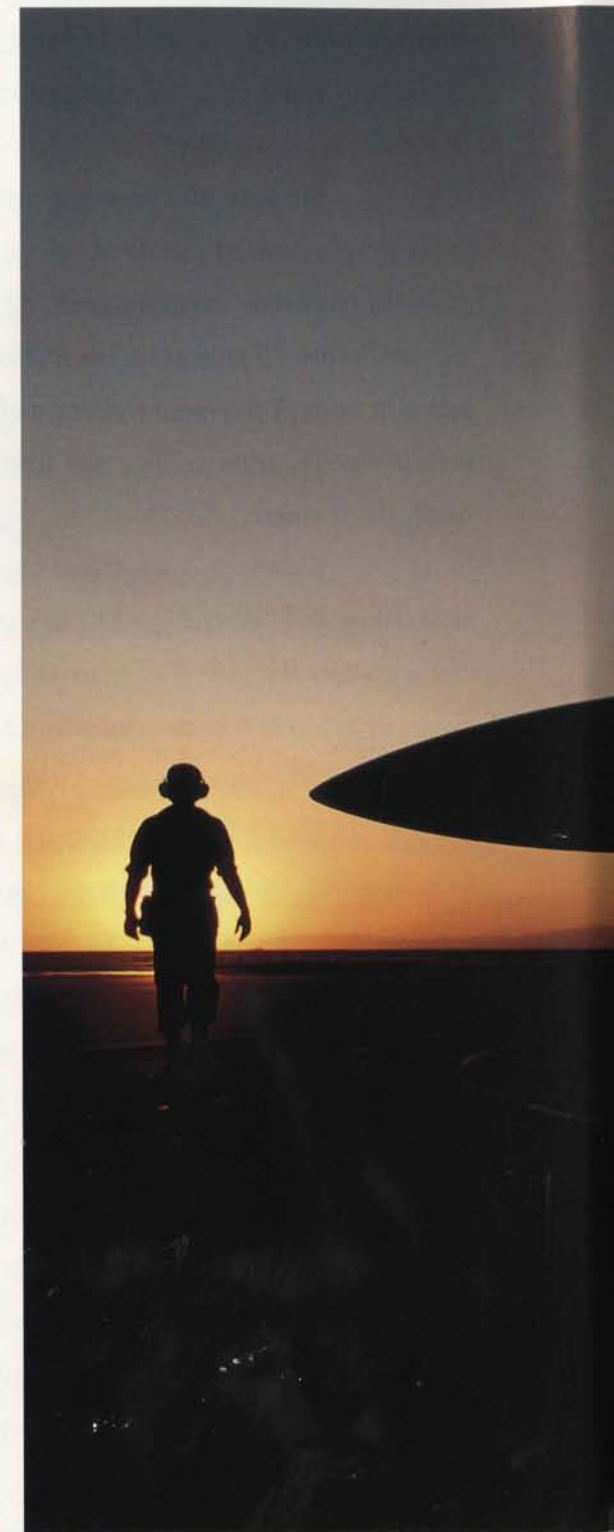
Producing the timely inventory and production status reports, performance-to-plan comparisons, and other MIS data Plant III's management needs to stay on top of this multi-million dollar manufacturing operation...

Helping the plant orchestrate complex sequences of operations, plan tooling requirements, and keep track of thousands of separate parts...

And dynamically monitoring and recording machining operations to assure adherence to precise GE and government measurement requirements.

Thanks to INGRES everyone at GE's Plant III, from factory worker to top management, has timely access to information critical to their jobs and to the factory's overall mission.

INGRES reliability...working for General Electric's Aircraft Engines Division "factory of the future"—and for the pilots of the Navy's F/A18 fighters.





The Problem

Heineken has been brewing beer for more than 150 years, always with a commitment to the highest quality standards. Today we are affiliated with 90 breweries worldwide, and our beer is available in more than 150 countries. ▶

“My department’s task is to develop the integrated management information, process control, and quality assurance systems required to run our highly automated breweries according to those standards. An important element of our assignment has been to develop a generalized data structure, and a set of applications based on that structure, which could be adapted to local requirements, operated by people of different languages and cultures, run on several different hardware platforms, but nevertheless produce uniform results. The key was to find a database management system which was simple and powerful enough to handle the job.” ▶



Peter J. Wever
Departmental Manager,
Information Technology
Heineken Technisch Beheer B.V.



Our Solution

H*TB recommended INGRES to support the integrated production, technical and technological information management system developed for a new brewery in Singapore. We were selected partly because of the ease with which our database management systems and tools allowed applications to be developed for, adapted to, and run on the company's entire arsenal of hardware. The strong technical support our Amsterdam office was able to offer Mr. Wever and his staff was an important contributing factor in the selection of INGRES. And so was the fact that an important software application developed by a third-party vendor happened to be based on our software.*

"In addition to our work on the Singapore plant's Computer Integrated Manufacturing system, INGRES has been asked to provide database software and support for several other projects, including new quality assurance and management programs, and a worldwide coding system for engineering stores at several overseas breweries."



Tjerk Post
Relational Technology, Benelux
Amsterdam

Rene Bonvanie
Technical Support Manager

The Results

F*rom Amsterdam to Singapore, INGRES database systems, application development tools, and networking aids are helping Heineken...*

Provide plant management detailed status reports on raw material and finished product inventories...

Allow brewery managers to centrally monitor and control each step in the brewing process...

Provide the possibility for gathering quality assurance laboratory test results from all over the world via Wide Area Network...

Compare test results against production standards and generate timely exception reports in tabular or graphic form...

And, last but not least, guarantee beer lovers the world over the same superb Heineken taste and quality.

INGRES International...bridging languages, cultures, and technologies to help multinational companies like Heineken N.V. produce consistent results.





The Problem

By 1986 Corning had outgrown the homemade database system supporting our worldwide manufacturing operations. The old system was too slow and rigid. Access to production data was restricted to trained programmers. Analyses of production data were time consuming, and correlating data from different parts of the production process was difficult at best. The criteria we established for the proposed DBMS were demanding. We wanted the systems flexibility that only a relational database could offer. It would have to accommodate ad hoc queries from non-systems people, offer a full complement of 4GL application development tools, and have a 'distributed' networking capability, so people at different locations could access the same data. Finally, it had to provide a gateway to our existing database, so we wouldn't have to rewrite all our applications software. We evaluated several RDBMS, but only INGRES offered everything we needed."



Sat Mayall
Manager, Manufacturing Management
Information Services
Corning Glass Works



At first, Corning's MMIS group had a tough time convincing management that investment in a new database management system was justified. But within six months of our first systems installation, INGRES had more than paid for itself in cost and labor savings, according to the company's own estimates. That sold management.

"We now have ten installations in place at US and overseas manufacturing plants, engineering, R&D, and corporate information services centers—with more to come. In addition to giving plant management instant access to critical process information from their own floor and area controls, the expanded INGRES system bridges the gap between process control and MIS, permitting headquarters staff and management to call up the same data, whenever it's needed, for further query and analysis."



Lori Dreyfus
Associate Field Sales Representative

Fali Shroff
Senior Consultant

At Corning plants in the US and Europe, INGRES-based process analysis systems have significantly improved manufacturing yields by providing better control over the temperature, pressure, and raw material variables that determine glass and ceramic product quality—and by giving management better tools for tracing production problems to their source.

INGRES "front end" tools are facilitating the rapid development and deployment of new manufacturing control software and the creation of new products.

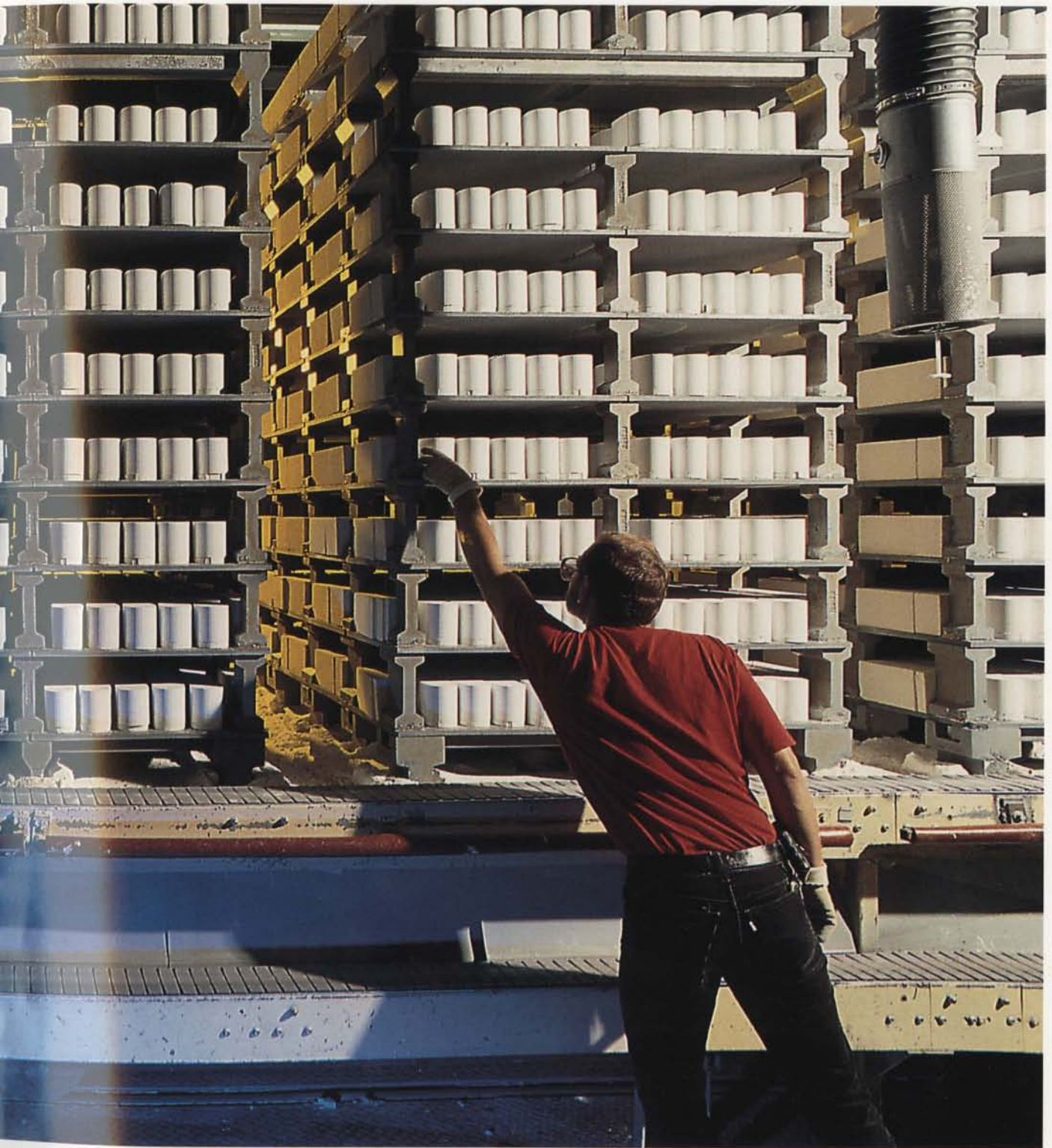
INGRES end-user tools have reduced the time it takes to analyze production data from months to hours.

And INGRES distributed database tools now provide the means for instant, transparent exchanges of information among plants engaged in similar manufacturing operations.

In short, INGRES is giving added meaning to the Corning slogan, "Imagine what we can do together..."

INGRES systems flexibility and power...
helping Corning's Erwin Ceramics Plant
boost productivity.





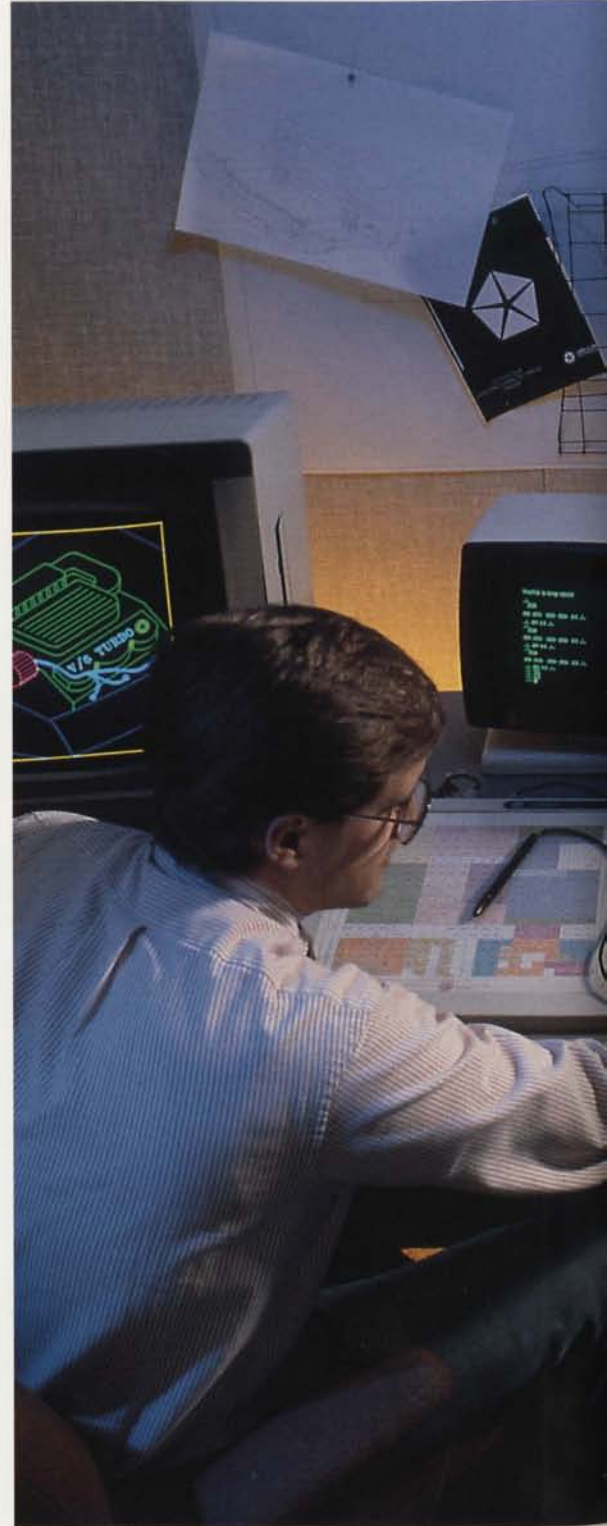
The Problem

The remarkable turnaround in Chrysler's fortunes since 1979 owes much to the company's commitment to overhaul its manufacturing operations and turn itself into the industry's most efficient, lowest-cost producer of cars and trucks.

"...One of our tasks at Chrysler's Outer Drive Manufacturing Technical Center has been to develop computer solutions for coordinating preproduction and manufacturing operations—to create the information and computer networking tools our process, industrial, and quality control engineers need to accomplish their parts of the overall production mission. INGRES has played a central role in this process, practically from the beginning."



Steve Holda
Project Manager
Outer Drive Manufacturing
Technical Center



Chrysler's existing software programs and programming language did not have to be abandoned when they switched to INGRES. We simply imbedded their old FORTRAN language in new INGRES applications. Nothing was lost. On the contrary, using the more powerful INGRES 4GL applications tools, Chrysler programmers were able to bring new systems applications on line in less than a third of the time it used to take, using the old programming language alone.

"The INGRES relational database management system developed for Chrysler in 1985 has been through several upgrades. The latest version has a multi-server architecture that makes optimum use of the power inherent in the company's DEC VAXcluster multiple processor host system and permits users at more than 500 terminals and PCs simultaneous access to a common database."



Joseph Shuster
Regional Support Manager

William Conaghan
Field District Manager

At Chrysler's manufacturing headquarters and at assembly plants throughout the US and Canada, INGRES-based Manufacturing Planning and Control software programs are helping to increase productivity by...

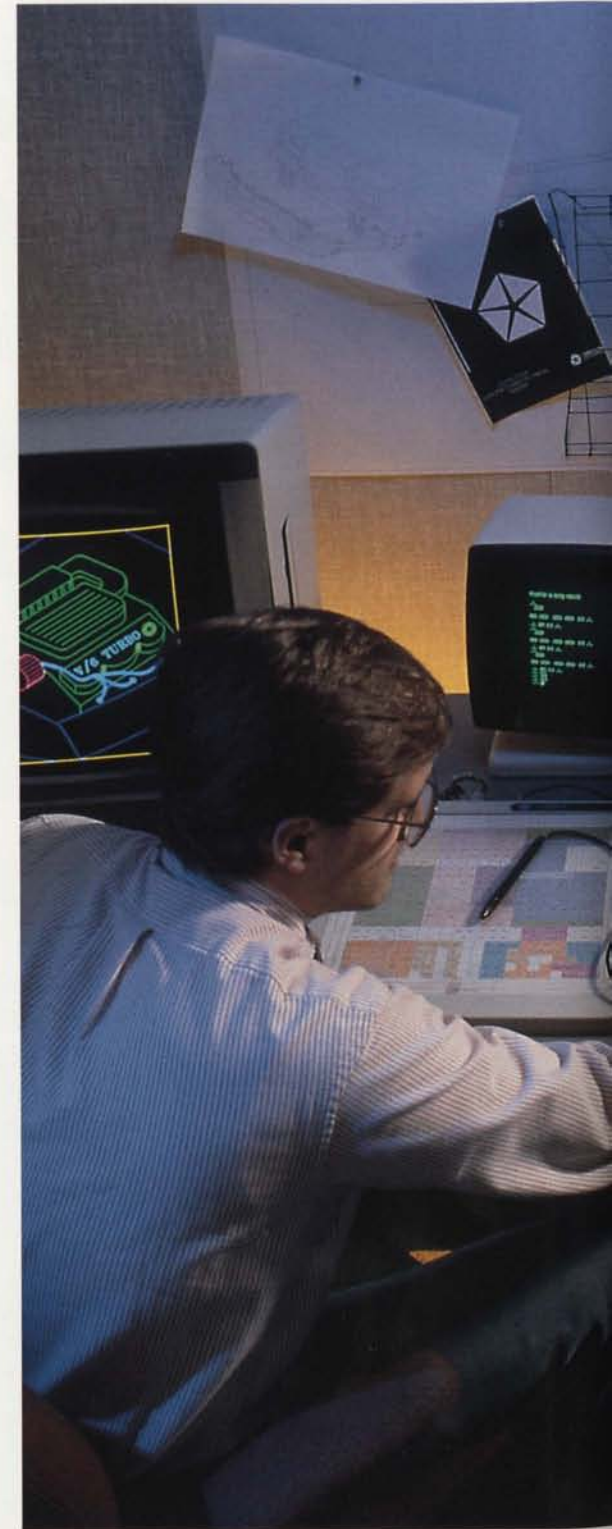
Reducing paperwork and time required to track the design, development, and assembly of the hundreds of tools and dies used in producing Chrysler vehicles...

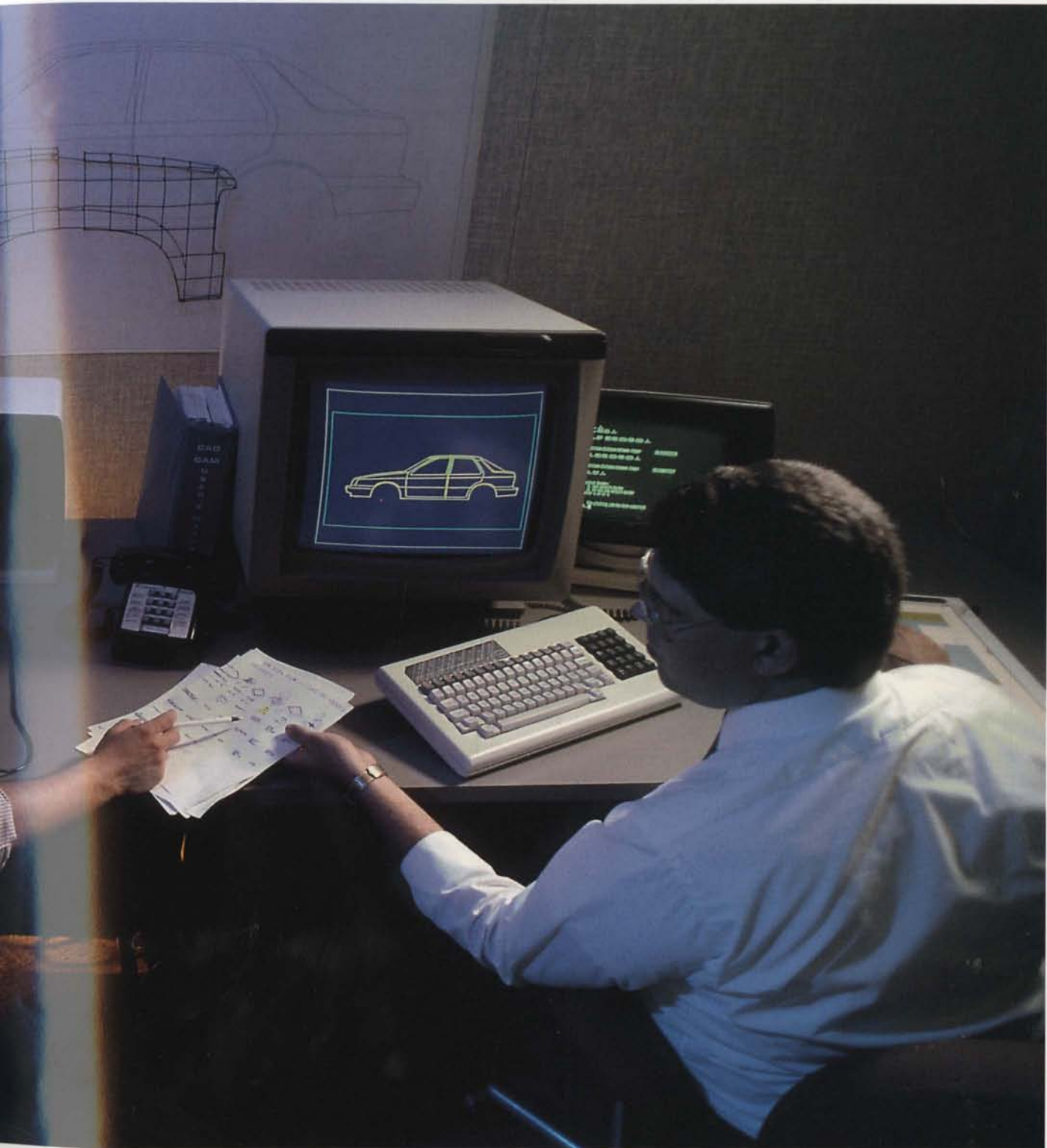
Providing timely solutions to vital questions like "How many hours of real time will it take to build this car at this plant?"...

Generating accurate, timely reports on the construction costs of assembly tools and parts for each vehicle...

And supporting Chrysler's "simultaneous engineering" concept by reducing from weeks to a few days the length of time needed to prepare and disseminate notices of product, process, and tooling changes to plant engineers throughout the organization.

INGRES database systems and application tools...playing a central role in coordinating Chrysler's preproduction and manufacturing operations.





"...We needed a database management system capable of integrating our traditional management information systems with the factory software that controls the plant's manufacturing operations."

"Reliability and performance were critical concerns. The system had to support a round-the-clock production schedule with a minimum of breakdowns and maintenance downtime."

EDUCATION

Academy of Finland
 American Academy of Orthopedic Surgeons
 Australia La Trade University
 Ben Gurion University
 Boston University
 Brigham and Womens Hospital
 Brown University
 Carnegie Mellon University
 Case Western Reserve University
 Columbia University
 Concordia University
 Cornell University
 Duke University
 Erasmus University (Netherlands)
 Fern University (W. Germany)
 Georgetown University
 Harvard University
 Helsinki University of Technology
 Hopital Universitaire de Geneva
 Institut de Pathologie (Belgium)
 Jerusalem Hebrew University
 The Johns Hopkins University
 Kings College
 London School of Economics
 Massachusetts General Hospital
 Memphis State University
 Michigan State University
 Massachusetts Institute of Technology
 North Carolina State University
 National University of Singapore
 Northwestern University
 New York University
 Oregon State University
 Oxford University
 Penn State University
 Princeton University
 Rutgers University
 San Diego State University
 Shriners Hospital
 Smith College
 Smithsonian Institution
 SRI International
 St. Joseph's College
 Stanford University
 Trinity College of Dublin
 UCLA
 University Aix Marseille
 Universitat Frankfurt
 Universitat Stuttgart
 Universite de Geneve
 University of Alabama
 University of California
 University of Chicago
 University of Colorado
 University of Hawaii

University of Hong Kong
 University of Illinois
 University of Minnesota
 University of New Mexico
 University of Pennsylvania
 University of Pittsburgh
 University of Sydney
 University of Utah
 University of Washington
 University of Wisconsin
 UNLV
 Williams College
 Yale University

PETROLEUM

ARAMCO Services Co.
 British Petroleum
 Chevron USA Inc.
 Ciba-Geigy-AG
 Conoco Inc.
 Exxon Corp.
 Husky Oil Operations Ltd.
 Institut Francais du Petrole
 Kuwait National Petroleum
 Mobil Oil Corporation
 Oryx Energy Company
 Schlumberger
 Standard Oil Co.
 Union Texas Petroleum Corp.

GOVERNMENT

AF Army (Israel)
 Alaska Fish and Game
 Army Corps of Engineers
 Commonwealth of Australia
 Defense Communication Agency
 Department of Environment (Eire)
 Department of Foreign Affairs and Trade
 Department of Mines (Australia)
 Deutsche Bundespost
 DIRNSA
 English Tourist Board
 Foreign Offices (Finland)
 GEC Plessey Telecoms Ltd.
 Gendarmerie (Belgium)
 General Services Administration
 Government of Ireland
 H.M. Treasury (UK)
 Internal Revenue Service
 Joint Chiefs of Staff
 Metropolitan Police (London)
 Ministere des Travaux Publiques
 Ministry of Defense (UK)
 Ministry of Health (Israel)
 Ministry of Justice (Finland)
 Municipality of Istanbul
 NASA

National Board of Waters (Norway)
 National Film Board (Canada)
 National Inst. Environmental Health
 National Institute of Mental Health
 National Research Counsel (Canada)
 NATO
 Naval Surface Warfare Center
 New York State Senate
 Oakland (CA) Police Department
 Supreme Court of Canada
 Training Agency (UK)
 US Air Force
 US Army
 US Bureau of Mines
 US Bureau of Reclamation
 US Department of Agriculture
 US Department of Commerce
 US Department of Defense
 US Department of Energy
 US Department of Labor
 US Geological Survey
 US Marines
 US Navy

SERVICE/OTHER

Alabama Power Co.
 Arizona Public Services Co.
 Arthur Andersen
 ASK Computer Systems Inc.
 Australian National Line
 Autodesk, Inc.
 Battelle Development Corp.
 Berkeley Investment Technology, Inc.
 Booz, Allen and Hamilton Inc.
 Bording Data
 Bridgeport Hydraulic Co.
 British Aerospace
 Burlington Northern RR
 Canada Post Corp.
 Carolina Power and Light Co.
 Children's Hospital (Oakland)
 Control Data Corp.
 Dataserv
 Deutsche Lufthansa AG
 EDS
 EG&G Idaho
 Ernst & Young
 Federal Express Corp.
 Gulf States Utilities Co.
 Hale and Dorr
 Henry Ford Hospital
 HOK Computer Services Corp.
 Hopital Saint Louis (France)
 International Computers Limited
 Impell Corp.
 Japanese Airlines
 Jeppeson Sanderson

Jet Propulsion Laboratory
 Le Monde
 Lotus Development Corp.
 Mass Electric Co.
 Massachusetts Port Authority
 Mayo Foundation
 Metalogic Inc.
 Microsoft Corp.
 MITRE
 Mitsubishi Space Software
 New Brunswick Electric Power Co.
 New England Power Service Co.
 Norsk Hydro
 Ontario Hydro
 Panelmatics Systems, Inc.
 Public Broadcasting System
 Reuters International Services
 Reuters S.E. Asia Ltd.
 RR Donnelley Ltd.
 Sales Technology Ltd.
 Sherpa Corp.
 Sacramento Municipal
 Utilities District
 Societe Michelin
 Syntex Research
 Texas Children's Hospital
 Thorn EMI
 Toronto Sun Publishing
 Touche Ross
 Vancouver General Hospital
 Vancouver Grand Hospital
 Vermont Yankee Electric
 WR Grace and Co.
 YMCA Retirement Fund
 Young and Rubicam

MANUFACTURING

Advanced Micro Devices
 ALCAN Rolled Products Co.
 Allen Bradley Co.
 Allied Signal Corp.
 Altos Computer Systems
 Ampex Corp.
 Apple Computer Inc.
 Bethlehem Steel
 BiiN
 Boeing Aerospace Corp.
 Burroughs, Wellcome
 Champion International Corp.
 Chrysler Motors Corporation
 The Clorox Company
 CLSI Inc.
 Colgate Palmolive Co.
 Combustion Engineering Inc.
 Compaq Computer
 Corning Corp.

Cypress Semiconductor
 Data General Corp.
 Digital Equip. Corp.
 Eastman Kodak Co.
 Encore Computer Corp.
 Evans & Sutherland Computer Corp.
 Fiat Auto
 Firestone Tire and Rubber Co.
 General Electric Company
 Gencorp Inc.
 Gerber Scientific Instrument Co.
 Heineken
 Hewlett Packard Company
 Hoechst Celanese Corp.
 Honeywell, Inc.
 Hughes Aircraft Co.
 IBM Corp.
 Intergraph Corp.
 Johnson Controls Inc.
 Kaiser Aluminum and Chemical
 Lockheed Corp.
 L'oreal
 Manville Sales Corp.
 Martin Marietta Corp.
 McDonnell Douglass
 Merrell Dow Pharmaceutical
 Minnesota Mining and Manufacturing
 MIPS Computer Systems, Inc.
 Motorola, Inc.
 Morton Thiokol Inc.
 Northrop Corp.
 Orkem
 Ortho Pharmaceutical Corp.
 Owens Illinois
 Polaroid Corp.
 Pyramid Technology Corp.
 Raytheon Co.
 RCA Corp.
 Rohm and Hass Co.
 Sanders Associates Inc.
 Sematech Inc.
 Sequent Computer Systems Inc.
 Sikorsky Aircraft Div.
 Smith, Kline, Bechman
 Sun Microsystems, Inc.
 Texas Instruments
 Tandem Computers Inc.
 Tektronix, Inc.
 TRW
 Unisys Corp.
 Upjohn Co.
 Varian Assoc.
 Westinghouse Electric

FINANCE

Aetna Life Insurance Co.
 Alexander and Alexander Inc.
 Bankers Trust

Bear Stearns & Co.
 Cantor Fitzgerald Securities Co.
 Chase Manhattan Bank, N.A.
 Citibank N.A.
 Commercial Credit
 Corroon and Black Inc.
 Dean Witter Reynolds
 Drexel Burnham Lambert
 Financier
 Lloyds Bank PLC
 Manufacturers Hanover
 Midland Bank PLC
 Morgan Guaranty Trust Co.
 of New York
 Nomura Securities International Inc.
 Paribas
 Robert Fleming & Co., Ltd.
 S.G. Warburg
 Security Pacific
 Shearson Lehman Brothers, Inc.
 Swiss Bank Corp.
 The World Bank
 World Savings

TELECOMMUNICATIONS

ADC Communications
 Alcatel
 Ameritech Services
 AT&T
 AT&T Bell Laboratories
 Bell Atlantic
 Bell Canada
 Bell of Pennsylvania
 Bell South
 Computer Sciences Corp.
 Corsoft
 GTE Government Systems
 Illinois Bell
 Indiana Bell
 Los Alamos National Laboratory
 Michigan Bell
 Mitel Corp.
 Nynex
 Ohio Bell
 Pacific Bell
 Sandia National Laboratory
 South Central Bell
 Southeastern Bell
 Stromberg Carlson Corp.
 Telco Systems
 Telic Alcatel
 Teltrend
 United Technologies
 Universal Data Systems
 US Sprint Communications
 US West
 Wisconsin Bell

*"We evaluated several RDBMS',
 but only INGRES offered
 everything we needed."*

*"The criteria we established
 for the proposed DBMS
 were demanding...we
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 would have to accommo-
 date ad hoc queries from
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 distributed networking
 capabilities...Finally, it
 had to provide a gateway to
 our existing database..."*

*"Using the more powerful
 INGRES 4GL application
 tools...programmers were able
 to bring new systems' applica-
 tions on line in less than a third
 of the time it used to take..."*

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The Company was founded in July 1980 and shipped its first product in June 1981. Since that time the Company's revenues have substantially increased each year. In the past three fiscal years, the Company has placed increasing emphasis on sales and marketing and has expanded its product line and the geographical scope of its operations.

RESULTS OF OPERATIONS

The following table sets forth for the fiscal year indicated, (a) the percentage of revenues represented by each item in the Company's consolidated statements of income, and (b) the percentage increase in such items from the prior fiscal year.

	For the Year Ended June 30,			Fiscal 1989 Compared to Fiscal 1988	Fiscal 1988 Compared to Fiscal 1987
	1989	1988	1987		
Revenues:					
Licenses	83.6%	83.8%	87.9%	49%	79%
Maintenance	16.4	16.2	12.1	51	151
Total revenues	100.0	100.0	100.0	50	88
Operating expenses:					
Sales and marketing	66.8	62.8	60.8	59	94
Research and development ⁽¹⁾	18.8	16.8	22.4	67	41
General and administrative	7.6	8.0	10.2	44	47
Total operating expenses	93.2	87.6	93.4	59	76
Operating income	6.8	12.4	6.6	(18)	250
Interest income	2.8	1.5	1.7	177	70
Interest expense	(0.9)	(0.7)	(1.2)	81	15
Foreign exchange gain (loss)	(0.9)	0.9	1.4	(233)	33
Income before income taxes	7.8	14.1	8.5	(17)	213
Provision for income taxes	3.1	5.6	3.2	(18)	232
Net income	4.7%	8.5%	5.3%	(17)%	201%

(1) The Company capitalized software development costs equal to 4.5%, 4.5% and 6.1% of revenues during fiscal 1989, 1988 and 1987, respectively.

REVENUES

The Company's revenues increased 88% from fiscal 1987 to fiscal 1988 and 50% from fiscal 1988 to fiscal 1989, reflecting continued increases in the number of customers and installations of the Company's products. Additionally, the increase is attributable to the continuing expansion of the market for relational database management systems which is reflected in significant sales to new customers, as well as continued sales to the existing customer base. In the middle of fiscal 1989, the Company introduced a substantially re-engineered version of its base product. The Company believes that the slowdown in the fiscal 1989 revenue growth rate was in part related to longer sales cycles encountered in the middle of fiscal 1989 as the product transition occurred. In addition, the Company believes that the overall industry growth rate slowed this past fiscal year due to the increased length of sales cycles in general caused by rapid technological change throughout the marketplace.

During the past three fiscal years, the Company's product and customer base has expanded significantly as the Company has increased the types of computers and operating systems on which its INGRES products operate. However, licenses for use on DEC VAX computers have continued to represent a substantial portion of the license revenues in each of the past three fiscal years.

Revenues from international customers were approximately 35%, 44% and 40% of the Company's revenues in fiscal 1987, 1988 and 1989, respectively, reflecting continued acceptance of the Company's products internationally. The Company expects its international operations to continue to represent a significant portion of total revenues.

The Company provides ongoing maintenance services, which include technical support and product updates, for an annual fee. As the Company's existing customer base has expanded, maintenance revenues have increased steadily from \$5,649,000 in fiscal 1987 to \$14,185,000 in fiscal 1988 to \$21,470,000 in fiscal 1989. These amounts represent 12% of revenues in fiscal 1987 and 16% of revenues in fiscal 1988 and 1989. Maintenance revenues have provided a source of recurring revenues and reflect the cumulative growth of the Company's customer base. Most of the Company's customers enter into and renew annual maintenance contracts. Revenues from maintenance contracts are recognized ratably over the annual maintenance period.

OPERATING EXPENSES

Sales and Marketing Expenses. The Company continues to emphasize direct sales through its own sales force, both domestically and internationally. Expansion of the Company's sales offices and staff involve substantial initial costs that are not immediately offset by revenue growth. Sales and marketing expenses were 61% and 63% of revenue in fiscal 1987 and 1988, respectively, and increased to 67% in fiscal 1989, as the Company continues to invest heavily in sales and marketing and customer support. The Company believes that substantial sales and marketing expenditures are essential to revenue growth and to maintaining and enhancing the Company's competitive position. Accordingly, the Company expects these expenses will continue to constitute its most significant operating expense.

Research and Development Expenses. The Company believes that the enhancement of existing products and the development of new products is essential to maintaining its competitive position. Accordingly, the Company is committed to a high level of research and development expenditures. The Company's expenditures for research and development increased 43% from fiscal 1986 to fiscal 1987, 40% from fiscal 1987 to fiscal 1988 and 59% from fiscal 1988 to fiscal 1989 (excluding the impact of amounts capitalized). These increases resulted largely from similar percentage increases in the number of research and development personnel. During fiscal 1987, 1988 and 1989, research and development expenses were approximately \$10.4 million, \$14.7 million and \$24.5 million, respectively, representing 22%, 17% and 19% of the Company's revenues in such years.

The Financial Accounting Standards Board, in its Statement of Financial Accounting Standards (SFAS) No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed," provides that, once technological feasibility has been established, all subsequent software development costs incurred up to the time the product is available for general release to customers must be capitalized and reported at the lower of unamortized cost or net realizable value of the product. Accordingly, in fiscal 1987, 1988 and 1989, the Company capitalized approximately \$2.8 million, \$3.9 million and \$5.9 million of software development costs, representing approximately 21% in 1987 and 1988 and 20% in 1989 of total research and development expenditures.

The amount of product development expenditures required to be capitalized under SFAS No. 86 in future periods is dependent upon both the level of expenditures incurred on projects that meet the feasibility tests specified in SFAS No. 86 and the timing of the release of the completed products to the Company's customers. Accordingly, amounts required to be capitalized may vary significantly from period to period and could increase or decrease as a percentage of total research and development expenditures. Significant costs relating to Ingres Release 6 were capitalized, beginning in fiscal 1987 through December 1988, at which time the product became available for general release to customers.

General and Administrative Expenses. Significant additions to administrative resources have been required to support growth. However, the Company has achieved economies of scale as it has grown, and general and administrative expenses have increased at a lower rate than revenues. Such expenses were 10% of revenues in fiscal 1987, and 8% of revenues in fiscal 1988 and 1989.

INCOME

Operating income in fiscal 1987 was \$3.1 million (7% of revenues), compared with \$10.9 million in fiscal 1988 (12% of revenues) and \$8.9 million in fiscal 1989 (7% of revenues). The Company incurred significant sales and marketing expenses in fiscal 1987 in the expansion of its domestic and international sales and marketing efforts. In fiscal 1988, the Company continued to invest heavily in its sales and marketing programs. However, increases in revenue, combined with reduced operating expense ratios in research and development and general and administrative costs, resulted in a substantial increase in operating income. In fiscal 1989 the Company continued to invest in sales and marketing programs as well as research and development activities; this combined with lower than anticipated revenue in the third quarter, resulted in a decrease in operating income from the previous fiscal year.

The Company believes that its investment in key personnel as well as its continued investment in its sales and marketing organization are necessary to achieve its objective of improved long-term profitability. However, there can be no assurance that higher levels of profitability will occur, due to the difficulty of predicting revenues and to the number of factors that can adversely affect operating results.

In addition to the factors discussed above, the Company's net income for fiscal 1987, 1988 and 1989 was favorably impacted by increased net interest income. Net interest income increased as a result of the investment of proceeds from the initial public offering in May 1988 and preferred stock offerings as well as from an increase in interest recognized on long-term accounts receivable (net interest income was \$215,000 in fiscal 1987, \$672,000 in fiscal 1988 and \$2,468,000 in fiscal 1989). Net income was favorably impacted by foreign exchange gains of \$635,000 and \$842,000 in fiscal 1987 and 1988, respectively, and unfavorably impacted by a foreign exchange loss of \$1,122,000 in fiscal 1989. The Company's net income has not been significantly affected by changes in the effective income tax rate, which increased from 37% in fiscal 1987, to 40% in fiscal 1988, and decreased to 39% in fiscal 1989.

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 96, "Accounting for Income Taxes." SFAS No. 96 mandates the liability method for computing deferred income taxes. Adoption of the new Statement is not expected to have a significant effect on the Company's financial position or results of operations.

Historically, the Company's revenues have increased in each sequential quarter during a fiscal year, except for the third quarter of fiscal 1989, although they have declined in the first fiscal quarter of each year from the final quarter of the preceding year. The Company believes that continued investment in personnel and facilities is essential to achieving revenue growth. Because a significant training period is required before sales and marketing personnel reach full productivity, expenses related to hiring and training precede revenues generated by such personnel. During each fiscal year prior to fiscal 1989, revenues increased substantially in the third and fourth quarters as investments made during previous quarters in operating costs, particularly those related to the hiring and training of sales and marketing personnel, generated increased revenues. Additionally, the Company's sales commission plan, which rewards the sales force with higher commission rates as they progress toward achieving annual sales quotas, tended to concentrate revenues during the second half of the fiscal year. Consequently, the Company has historically achieved greater profitability in its third and fourth quarter. The Company revised its sales commission plan in the fourth quarter of fiscal 1989 to reward the sales force with commission bonuses for closing business early in the quarter rather than at the end of the quarter and earlier in the fiscal year. Despite the revisions to the incentive plan and although the Company has recently achieved profitability in its first and second quarters, the Company anticipates that the first and second quarters of each fiscal year will continue to show relatively weaker operating results than each of the other quarters, and may again show losses.

The Company's quarterly results of operations are difficult to predict and delays in product delivery or in closings of sales near the end of the quarter could cause quarterly revenues and, to a greater degree, net income to fall substantially short of anticipated levels. The Company's revenues occur predominantly in the third month of each fiscal quarter and tend to be concentrated in the latter half of that third month. As operating expenses continue to increase, any significant shortfall in quarterly revenues may lead to an operating loss for the quarter as was experienced in the third quarter of fiscal 1989.

From time to time, the Company has earned substantial revenues from large software license agreements. The impact of these large license agreements can cause significant fluctuations in quarter-to-quarter results of operations. Similar fluctuations may continue to occur in the future.

INFLATION

Inflation has not had a significant impact on the Company's results of operations.

LIQUIDITY AND CAPITAL RESOURCES

For the past three fiscal years, the Company has funded its growth through the proceeds from its initial public offering, the sale of Preferred Stock, internally generated funds and bank borrowings. Working capital has increased from \$12.4 million at the end of fiscal 1987 to \$37.5 million at the end of fiscal 1988 and decreased to \$32.1 million at the end of fiscal 1989, as the Company used the proceeds from its initial public offering in addition to amounts borrowed under its line of credit arrangements for operations and property and equipment additions. Notwithstanding the decrease in working capital, current receivables increased \$34 million from \$39.8 million at June 30, 1988 to \$73.8 million at June 30, 1989. This increase in receivables is due to the overall growth in revenues from \$87 million in fiscal 1988 to \$131 million in fiscal 1989, with a significant portion of this revenue occurring in the fourth quarter of 1989.

In addition, long term receivables increased by approximately \$3.7 million from \$10.3 million at June 30, 1988 to \$14.0 million at June 30, 1989. These receivables result principally from long term agreements with OEM's and VAR's. The Company has historically allowed extended payment terms under such agreements, and expects that it will continue to do so in the future, resulting in increased funding requirements. As with many other companies in the software industry, the Company has historically been, and continues to be, working capital intensive.

The Company has a \$20 million multi-currency revolving line of credit, under which \$4,859,000 was outstanding at June 30, 1989, which expires in October 1989; and capital equipment lines of credit totalling \$4.5 million, under which \$461,000 was outstanding at June 30, 1989, which expire at various dates through December 1989. In addition, the Company also has foreign overdraft facilities that aggregate \$2.1 million under which \$836,000 was outstanding at June 30, 1989; the largest foreign line of credit expires in June 1990. The Company is in compliance with the applicable financial covenants under each of its lines of credit. As of June 30, 1989, cash and cash equivalents aggregated \$3.7 million, a decrease of \$20.1 million from \$23.8 million at June 30, 1988. The Company has a commitment from its bank for a \$30 million line of credit expiring in October 1990. The Company believes available borrowings under these lines of credit, together with existing cash resources and internally generated funds, will be sufficient to meet its anticipated working capital and capital expenditure requirements through at least the end of fiscal 1990.

QUARTERLY RESULTS OF OPERATIONS

The following table sets forth selected unaudited quarterly financial information for the Company's last 12 fiscal quarters. The Company believes that all necessary adjustments have been included in the amounts stated below to present fairly the selected quarterly information when read in conjunction with the financial statements included elsewhere herein.

<i>(in thousands, except per share data)</i>	Fiscal 1989			
	Sept. 30, 1988	Dec. 31, 1988	Mar. 31, 1989	June 30, 1989
Revenues	\$26,503	\$29,213	\$27,810	\$47,190
Operating expenses:				
Sales and marketing	17,147	19,181	22,444	28,590
Research and development ⁽¹⁾	4,883	5,124	6,349	8,174
General and administrative	2,339	2,304	2,435	2,891
Total operating expenses	24,369	26,609	31,228	39,655
Operating income (loss)	2,134	2,604	(3,418)	7,535
Net interest income	681	656	579	552
Foreign exchange gain (loss)	(251)	281	(554)	(598)
Income before income taxes	2,564	3,541	(3,393)	7,489
Provision (benefit) for income taxes	1,024	1,418	(1,450)	3,008
Net income (loss)	\$ 1,540	\$ 2,123	\$ (1,943)	\$ 4,481
Net income (loss) per share	\$.12	\$.17	\$ (.16)	\$.37
Number of shares used in computation	12,444	12,345	12,373	12,164
				Fiscal 1988
<i>(in thousands, except per share data)</i>	Sept. 30, 1987	Dec. 31, 1987	Mar. 31, 1988	June 30, 1988
Revenues	\$16,203	\$18,737	\$22,240	\$30,206
Operating expenses:				
Sales and marketing	10,451	12,476	14,292	17,655
Research and development ⁽¹⁾	3,084	3,257	3,747	4,631
General and administrative	1,405	1,604	1,766	2,168
Total operating expenses	14,940	17,337	19,805	24,454
Operating income	1,263	1,400	2,435	5,752
Net interest income	72	111	127	362
Foreign exchange gain (loss)	45	1,298	(223)	(278)
Income before income taxes	1,380	2,809	2,339	5,836
Provision for income taxes	564	1,112	935	2,289
Net income	\$ 816	\$ 1,697	\$ 1,404	\$ 3,547
Net income per share ⁽²⁾	\$.09	\$.18	\$.15	\$.32
Number of shares used in computation	9,300	9,271	9,665	11,110
				Fiscal 1987
<i>(in thousands, except per share data)</i>	Sept. 30, 1986	Dec. 31, 1986	Mar. 31, 1987	June 30, 1987
Revenues	\$8,498	\$8,701	\$12,048	\$17,318
Operating expenses:				
Sales and marketing	5,057	6,012	7,547	9,697
Research and development ⁽¹⁾	2,118	2,512	2,757	3,036
General and administrative	843	1,018	1,430	1,436
Total operating expenses	8,018	9,542	11,734	14,169
Operating income (loss)	480	(841)	314	3,149
Net interest income	68	53	58	36
Foreign exchange gain (loss)	(295)	186	517	227
Income before income taxes	253	(602)	889	3,412
Provision (benefit) for income taxes	94	(225)	332	1,274
Net income (loss)	\$ 159	\$ (377)	\$ 557	\$ 2,138
Net income (loss) per share ⁽²⁾	\$.02	\$ (.04)	\$.07	\$.25
Number of shares used in computation	8,227	8,457	8,405	8,691

(1) The Company has applied SFAS No. 86, under which the Company capitalized software development costs of approximately \$653,000, \$747,000, \$761,000 and \$667,000, in the first, second, third and fourth quarters of fiscal 1987, \$735,000, \$834,000, \$955,000 and \$1,410,000 in the first, second, third and fourth quarters of fiscal 1988, and \$1,272,000, \$1,477,000, \$1,595,000 and \$1,535,000, in the first, second, third and fourth quarters of fiscal 1989.

(2) The sum of net income per share for the four quarters of a fiscal year does not equal the annual amount as reported on the consolidated statements of income, due to the larger amount of net income reported in the fourth quarter relative to the first three quarters for all periods presented, as well as the impact of the initial public offering on the weighted average shares for the fourth quarter of fiscal 1988.

RELATIONAL TECHNOLOGY, INC.
CONSOLIDATED BALANCE SHEETS

	June 30,	
<i>(dollars in thousands)</i>	1989	1988
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,725	\$ 23,847
Trade and current installment receivables (less allowance for doubtful accounts of \$2,021 and \$1,380)	73,837	39,835
Prepaid expenses and other current assets	8,511	4,323
Total current assets	86,073	68,005
Property and equipment, net	20,793	16,172
Computer software development costs (net of accumulated amortization of \$1,334 and \$299)	11,307	6,463
Long-term installment receivables (less allowance for doubtful accounts of \$626 at June 30, 1989)	14,048	10,326
Total assets	<u>\$132,221</u>	<u>\$100,966</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 8,072	\$ 5,925
Notes payable to bank and current portion of capital lease obligations	7,646	1,254
Deferred revenue	17,055	9,578
Accrued employee compensation	8,943	6,742
Income taxes payable	6,344	4,524
Other current liabilities	5,901	2,507
Total current liabilities	53,961	30,530
Capital lease obligations, less current portion	4,275	3,692
Deferred income taxes	3,460	2,900
Total liabilities	61,696	37,122
Commitments (Note 5)		
Stockholders' equity:		
Preferred stock, \$.001 par value, authorized 5,000,000 shares	—	—
Common stock, \$.001 par value, authorized 25,000,000 shares; 11,001,448 and 10,732,834 shares issued and outstanding at June 30, 1989 and 1988, respectively	53,192	52,138
Retained earnings	18,499	12,298
Foreign currency translation adjustment	(1,166)	(592)
Total stockholders' equity	70,525	63,844
Total liabilities and stockholders' equity	<u>\$132,221</u>	<u>\$100,966</u>

See accompanying notes to consolidated financial statements.

RELATIONAL TECHNOLOGY, INC.
CONSOLIDATED STATEMENTS OF INCOME

<i>(dollars in thousands, except per share data)</i>	For the Year Ended June 30,		
	1989	1988	1987
Revenues:			
Licenses	\$109,246	\$73,201	\$40,916
Maintenance	21,470	14,185	5,649
Total revenues	<u>130,716</u>	<u>87,386</u>	<u>46,565</u>
Operating expenses:			
Sales and marketing	87,362	54,874	28,313
Research and development	24,530	14,719	10,423
General and administrative	9,969	6,943	4,727
Total operating expenses	<u>121,861</u>	<u>76,536</u>	<u>43,463</u>
Operating income	8,855	10,850	3,102
Interest income	3,623	1,309	768
Interest expense	(1,155)	(637)	(553)
Foreign exchange gain (loss)	(1,122)	842	635
Income before income taxes	10,201	12,364	3,952
Provision for income taxes	4,000	4,900	1,475
Net income	<u>\$ 6,201</u>	<u>\$ 7,464</u>	<u>\$ 2,477</u>
Net income per share	<u>\$.50</u>	<u>\$.76</u>	<u>\$.29</u>
Weighted average shares of common stock and common stock equivalents used in computation of net income per share	<u>12,331</u>	<u>9,873</u>	<u>8,456</u>

See accompanying notes to consolidated financial statements.

RELATIONAL TECHNOLOGY, INC.
CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

(dollars in thousands)	Preferred Stock		Common Stock		Note Receivable from Issuance of Common Stock	Retained Earnings	Foreign Currency Translation Adjustment	Total
	Shares	Amount	Shares	Amount				
Balance, June 30, 1986	2,032,540	\$11,129	3,167,989	\$ 463	\$(100)	\$ 2,357	\$ 49	\$13,898
Issue of Series E Preferred stock	824,892	8,425						8,425
Issue of common stock under employee stock option plans			87,319	100				100
Issue of common stock			2,181	5				5
Repurchase of common stock			(38,706)	(5)				(5)
Net income						2,477		2,477
Foreign currency translation adjustment							(49)	(49)
Balance, June 30, 1987	2,857,432	19,554	3,218,783	563	(100)	4,834	—	24,851
Issue of Series F Preferred stock	800,000	9,341						9,341
Issue of common stock in initial public offering			1,800,000	22,593				22,593
Issue of common stock under employee stock option plans			69,224	88				88
Repurchase of common stock			(605)	(1)				(1)
Conversion of preferred shares into common stock	(3,657,432)	(28,895)	5,645,432	28,895				—
Repayment of note receivable					100			100
Net income						7,464		7,464
Foreign currency translation adjustment							(592)	(592)
Balance, June 30, 1988	—	—	10,732,834	52,138	—	12,298	(592)	63,844
Issue of common stock under employee stock option plans			210,768	412				412
Issue of common stock under employee stock purchase plan			76,283	771				771
Repurchase of common stock			(18,437)	(26)				(26)
Additional costs related to initial public offering				(103)				(103)
Net income						6,201		6,201
Foreign currency translation adjustment							(574)	(574)
Balance, June 30, 1989	—	—	11,001,448	\$53,192	—	\$18,499	\$(1,166)	\$70,525

See accompanying notes to consolidated financial statements.

RELATIONAL TECHNOLOGY, INC.
 CONSOLIDATED STATEMENTS OF CASH FLOWS

(dollars in thousands)	For the Year Ended June 30,		
	1989	1988	1987
Net income	\$ 6,201	\$ 7,464	\$ 2,477
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization expense	6,926	4,194	2,718
Provision for doubtful accounts	1,598	608	376
Increase in trade and current installment accounts receivables	(36,660)	(25,430)	(10,823)
(Increase) decrease in long-term installment receivables	(5,301)	1,655	(2,963)
Increase in prepaid expenses and other current assets	(4,315)	(495)	(2,554)
Increase in accounts payable	2,326	2,398	2,093
Increase in accrued employee compensation	2,415	3,951	1,329
Increase in income taxes payable	1,909	4,108	444
Increase in other current liabilities	3,561	531	692
Increase in deferred income taxes	574	114	2,317
Increase in deferred revenue	7,987	4,182	3,309
Net cash provided by (used for) operating activities	(12,779)	3,280	(585)
Cash flows from investing activities:			
Purchases of property and equipment	(8,039)	(5,901)	(3,837)
Computer software development costs	(5,879)	(3,934)	(2,828)
Net cash used in investing activities	(13,918)	(9,835)	(6,665)
Cash flows from financing activities:			
Proceeds from repayment of note receivable from officer	—	100	—
Proceeds from issuance of debt	10,869	5,833	4,918
Payment on debt	(5,000)	(8,666)	(5,099)
Principal payments under capital lease obligations	(1,713)	(783)	(237)
Proceeds from issuance of common stock	1,053	22,681	100
Proceeds from issuance of preferred stock	—	9,341	8,424
Net cash provided by financing activities	5,209	28,506	8,106
Effect of exchange rate changes on cash	1,366	(642)	(174)
Net increase (decrease) in cash and cash equivalents	(20,122)	21,309	682
Cash and cash equivalents at beginning of year	23,847	2,538	1,856
Cash and cash equivalents at end of year	\$ 3,725	\$ 23,847	\$ 2,538
Supplemental disclosures of cash flow information:			
Cash paid during the year for:			
Interest	\$ 1,155	\$ 639	\$ 553
Income taxes	4,210	843	6

See accompanying notes to consolidated financial statements.

NOTE 1 THE COMPANY AND SUMMARY OF ITS SIGNIFICANT ACCOUNTING POLICIES

Relational Technology, Inc. (the Company) was incorporated in July 1980 to develop and market relational database computer software and to provide technical support for its products.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries after elimination of all significant intercompany accounts and transactions.

Revenue Recognition

Revenue is generated from product licenses and maintenance services.

License revenues include fees from direct license agreements with customers, royalties from license agreements with original equipment manufacturers and other distributors, and fees from contracts to develop new products.

Generally, revenue from direct licenses of off-the-shelf software is recognized at contract signing; shipment generally occurs at or shortly following contract signing. Revenue is deferred and recognized upon shipment if the product is not available, nonstandard payment terms exist, or delays in post license support activity are included in the license agreement.

Royalty revenue primarily results from minimum royalty guarantees; such revenue is recognized upon contract signing provided that there are no contingencies of contractual commitments yet to be performed by the Company. In cases where there are further contractual commitments, revenue is deferred until all commitments are satisfied. Royalties may also be received based upon individual sales; these royalties are recorded upon notification by the vendor.

Revenue from development contracts is recognized using the percentage of completion method. There were no material unbilled amounts on development contracts as of June 30, 1989, 1988 and 1987.

Installment contracts are recorded at their present value, based upon the Company's effective borrowing rate.

Maintenance revenues include technical support and update fees. Such fees are recognized ratably over the year to which they relate.

Foreign Currency Translation

Assets and liabilities are translated at the foreign exchange rates in effect at the balance sheet date. Revenues and expenses for the year are translated at the average exchange rates in effect during the year. Translation gains and losses are not included in determining net income, but are accumulated and reported as a separate component of stockholders' equity. Foreign currency transaction gains and losses are reflected in the income statement.

Property and Equipment

Property and equipment, including assets held under capital leases, are stated at cost. Depreciation of computer equipment acquired to perform specific development contracts, which has limited other uses, is computed using the double declining-balance method and an estimated useful life of five years. Depreciation of all other assets is computed using the straight-line method and an estimated useful life of five years, or the lease term if shorter. Amortization of leasehold improvements is computed using the shorter of the remaining lease term or the estimated useful life of the respective assets.

Nonmonetary Transactions

Nonmonetary exchanges of software licenses or royalties for hardware or software are recorded in revenue and equipment at the fair value of the item exchanged or received, whichever is more readily determinable.

Software Development Costs

The Company capitalizes software development costs in accordance with Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." Software costs capitalized in the years ended June 30, 1989 and 1988 were \$5,879 and \$3,934, respectively. Amortization of capitalized computer software costs begins when the products are available for general release to customers and is computed on a product-by-product basis over periods not exceeding five years. Amortization expense for the years ended June 30, 1989, 1988 and 1987 was \$1,035, \$233 and \$66, respectively.

Income Taxes

Deferred income taxes are provided for timing differences between pretax accounting income and taxable income. Deferred United States income taxes are not provided for undistributed earnings of foreign subsidiaries when such earnings are considered permanently invested in the foreign subsidiaries. Investment tax credits reduced the provision for income taxes in the year the related property was placed in service.

Net Income Per Share

Net income per share is computed using the weighted average number of Common Stock and Common Stock equivalent shares outstanding during the related period. Common Stock equivalent shares consist of stock options. In addition, the calculation includes the effect of Preferred Stock as if such stock were converted to Common Stock on its respective original dates of issuance. As described in Note 6, conversion of all outstanding Preferred Stock occurred prior to June 30, 1988.

Pursuant to rules of the Securities and Exchange Commission, Common Stock issued by the Company during the twelve months immediately preceding the Company's initial public offering of stock in May 1988, plus the number of common equivalent shares which were granted during the same period pursuant to stock option plans, have been included in the calculation of common and common equivalent shares as if they were outstanding for all periods prior to the offering date.

NOTE 2 PROPERTY AND EQUIPMENT

	June 30,	
	1989	1988
Computer equipment	\$21,821	\$15,217
Furniture, fixtures and equipment	9,209	6,788
Leasehold improvements	4,422	3,321
	35,452	25,326
Accumulated depreciation and amortization	(14,659)	(9,154)
	<u>\$20,793</u>	<u>\$16,172</u>

Expenses of \$5,891, \$3,961 and \$2,652 were included in depreciation and amortization in 1989, 1988 and 1987, respectively.

NOTE 3 ACCOUNTS RECEIVABLE

The Company has entered into licensing and development contracts which allow for payments on an installment basis. Included in trade and current installment receivables are unbilled installment receivables of \$24,770 and \$10,192 at June 30, 1989 and 1988, respectively. Long-term receivables at June 30, 1989 mature as follows: in fiscal year 1991—\$10,137; 1992—\$6,882; 1993—\$1,759; 1994 and thereafter—\$400. There were no major customers (accounting for 10% or more of sales) in 1989, 1988 or 1987.

NOTE 4 LINES OF CREDIT

The Company has a \$20 million unsecured domestic bank multi-currency revolving line of credit. Amounts borrowed in U.S. dollars bear interest at prime; amounts borrowed in currencies other than U.S. dollars bear interest at the bank's foreign money market rate. The Company is required to maintain various financial ratios including minimum working capital of \$20 million; minimum ratio of tangible net worth to total debt of 1-to-1; minimum tangible net worth of \$60 million plus 50% of net income since June 30, 1988; and certain profitability measures. At June 30, 1989, \$4,859 was outstanding under the revolving line of credit; there were no amounts outstanding at June 30, 1988. The line of credit expires in October 1989.

The Company has several equipment lease lines of credit totaling \$4,500 which bear interest, typically at prime. These lines of credit expire at various dates through December 1989. At June 30, 1989, \$4,039 was available for future financing under these agreements.

The Company also has international lines of credit aggregating \$2,064 which bear interest based on local market conditions (typically above prime). At June 30, 1989, \$836 was outstanding under these agreements; there were no amounts outstanding at June 30, 1988. Amounts borrowed under these lines of credit are secured by local receivables and fixed assets not otherwise pledged.

NOTE 5 LEASING ARRANGEMENTS

The Company leases its corporate headquarters and sales offices under noncancellable operating lease agreements which expire at various dates through 2010. The lease for the Company's headquarters contains an option to extend the term for an additional five years commencing on July 1, 1992. If the term is not extended, the Company is obligated to pay a \$407 cancellation fee. Most of the leases require the Company to pay property taxes, insurance and maintenance expenses. Several of the leases are subject to escalation provisions, based on changes in the consumer price index, at various times during the terms of the leases. Rental expense under operating leases, including month-to-month facilities and equipment rentals was \$9,080, \$5,938 and \$3,504 in 1989, 1988 and 1987, respectively.

Minimum future lease payments under the terms of operating leases as of June 30, 1989 are \$11,079, 1990; \$10,260, 1991; \$9,136, 1992; \$7,804, 1993; \$5,517, 1994 and \$25,795 for 1995 and thereafter. Included in operating lease payments for 1993, 1994, and 1995 and thereafter are payments of \$1,899, \$1,899 and \$5,696 which assumes the exercise of the corporate headquarters lease option described above.

The Company has entered into capital lease agreements for computer equipment and furniture, fixtures and equipment, which are accounted for as the acquisition of an asset and the incurrence of a liability. The lease agreements are secured by the leased equipment and are for noncancellable terms of three to five years, during which the Company is required to pay all taxes, insurance and normal maintenance and repairs. Assets held under capital leases included in the property and equipment amounts in Note 2 are as follows:

	June 30,	
	1989	1988
Computer equipment	\$5,611	\$3,952
Furniture, fixtures and equipment	3,269	2,056
	8,880	6,008
Less—accumulated amortization	(2,463)	(937)
	<u>\$6,417</u>	<u>\$5,071</u>

Minimum future payments under all capital lease agreements as of June 30, 1989 are as follows:

Year Ended June 30:	
1990	\$2,604
1991	2,194
1992	1,328
1993	952
1994	661
Thereafter	565
Total minimum lease payments	8,304
Amount representing interest	(2,078)
Present value of minimum lease payments	6,226
Current maturities	(1,951)
Long-term obligations under capital leases	<u>\$4,275</u>

NOTE 6 PREFERRED STOCK

The Company is authorized to issue 5,000,000 shares of convertible Preferred Stock. The Company currently has no preferred stock outstanding.

The Company has issued preferred shares as follows (all of which has been converted to common stock as described below):

Year Ended June 30:	Preferred Series	Shares Issued	Price Per Share	Proceeds, Net of Issuance Costs
1981	A	305,000	\$ 1.00	\$ 305
1982	B	192,000	5.00	936
1984	C	625,000	4.00	2,500
1986	D	432,000	6.25	2,700
1986	E	478,540	10.50	4,688
1987	E	824,892	10.50	8,425
1988	F	800,000	12.50	9,341
		<u>3,657,432</u>		<u>\$28,895</u>

Each share of Series A and B Preferred Stock was converted into five shares of Common Stock, and each share of Series C, D, and 57,507 shares of Series E Preferred Stock was converted into one share of Common Stock at the closing date of the Company's initial public offering in May 1988. Each remaining share of Series E and F was converted into one share of Common Stock in June 1988, due to an automatic conversion feature in their respective Preferred Stock agreements.

NOTE 7 COMMON STOCK

In May 1988, the Company sold 1,800,000 shares of Common Stock at \$14.00 per share (net proceeds of \$22,593) in an underwritten public offering. The Company has reserved 2,545,496 shares of Common Stock for future issuance under its employee stock plans.

Employee Stock Purchase Plans

In 1981, the Company adopted the Employee Stock Purchase Plan (the Plan). The Plan was administered and terms of stock purchases were established by the Board of Directors. Under the terms of the Plan, shares were sold to certain of the Company's officers, employees and consultants at prices not less than the fair value of the common shares, as determined by the Board of Directors, at the date of purchase. Shares sold under the terms of the plan generally vest ratably over a five-year period commencing from the date of issuance. Unvested stock may not be sold or transferred and in the event a purchaser's relationship with the Company is terminated for any reason during the vesting period, the Company has the right to repurchase such unvested shares at their original issue price. This Plan was terminated on December 31, 1986. As of June 30, 1989, 16,791 shares were subject to repurchase under the terms of the Plan at prices ranging from \$.02 to \$2.50 per share.

In 1988, the Company adopted the Employee Stock Purchase Plan (the ESPP). Under the ESPP, the Company may offer shares of Common Stock to participating employees to purchase shares through payroll deductions at a price of not less than 85% of the fair market value of the Common Stock. The first offering period under this plan commenced July 1, 1988. A total of 76,283 shares were purchased in the year ended June 30, 1989.

Nonqualified Stock Option Plan

In 1981, the Company adopted the Nonqualified Stock Option Plan (the Plan). The Plan was administered and terms of option grants were established by the Board of Directors. Under the terms of the Plan, options were granted to the Company's employees to purchase shares of Common Stock. Options generally become exercisable ratably over a five-year vesting period, and expire over terms not exceeding ten years from the date of grant. The option price for all shares granted under the Plan is not less than the fair value of the Common Stock at the date of grant, as determined by the Board of Directors. The Plan terminated on December 31, 1986. As of June 30, 1989 stock options for 5,000 shares of Common Stock at an exercise price of \$2.50 per share were outstanding; no stock options were granted, exercised or cancelled during the years ended June 30, 1989 or 1988 under this Plan.

Supplemental Stock Option Plan

In 1986, the Company adopted the Supplemental Stock Option Plan (the Plan). The Plan is administered and terms of option grants are established by the Board of Directors. Under the terms of the Plan, options may be granted to certain of the Company's key employees and consultants to purchase shares of Common Stock. Options generally become exercisable ratably over a five-year vesting period and expire over terms not exceeding ten years from the date of grant. The option price for all shares granted under the Plan is not less

than 85% of the fair market value of the Common Stock at the date of grant, as determined by the Board of Directors. A summary of activity under the Supplemental Stock Option Plan is set forth below:

	Shares	Exercise Price
Outstanding at June 30, 1986	—	—
Granted	267,250	\$2.50
Exercised	(17,500)	\$2.50
Terminated	(1,900)	\$2.50
Outstanding at June 30, 1987	247,850	\$2.50
Granted	711,605	\$3.50–\$15.375
Exercised	(1,517)	\$2.50
Terminated	(14,823)	\$3.50–\$6.00
Outstanding at June 30, 1988	943,115	\$2.50–\$15.375
Granted	544,049	\$9.25–\$19.25
Exercised	(41,216)	\$2.50–\$12.75
Terminated	(29,846)	\$2.50–\$19.25
Outstanding at June 30, 1989	1,416,102	\$2.50–\$19.25

At June 30, 1989, options for 526,240 shares were exercisable.

Incentive Stock Option Plan

In 1984, the Company adopted the Incentive Stock Option Plan (the Plan). The Plan is administered and terms of option grants are established by the Board of Directors. Under the terms of the Plan, options may be granted to the Company's employees to purchase shares of Common Stock. Options generally become exercisable ratably over a five-year vesting period and expire over terms not exceeding ten years from the date of grant. The option price for all shares granted under the Plan is equal to the fair market value of the Common Stock at the date of grant, as determined by the Board of Directors.

A summary of the activity under the Incentive Stock Option Plan is set forth below:

	Shares	Exercise Price
Outstanding at June 30, 1986	885,459	\$75–\$2.50
Granted	706,234	\$2.50
Exercised	(69,819)	\$75–\$2.50
Terminated	(245,465)	\$75–\$2.50
Outstanding at June 30, 1987	1,276,409	\$75–\$2.50
Granted	87,638	\$2.50–\$6.00
Exercised	(67,707)	\$75–\$2.50
Terminated	(103,779)	\$75–\$3.50
Outstanding at June 30, 1988	1,192,561	\$75–\$6.00
Granted	—	—
Exercised	(169,552)	\$75–\$6.00
Terminated	(151,760)	\$75–\$6.00
Outstanding at June 30, 1989	871,249	\$75–\$6.00

At June 30, 1989, options for 338,574 shares were exercisable.

NOTE 8 INCOME TAXES

The components of the provision for income taxes are as follows:

	For the Year Ended June 30,		
	1989	1988	1987
Current:			
U.S.	\$4,059	\$2,248	\$ —
Foreign	986	1,365	292
State	1,123	1,322	184
	6,168	4,935	476
Deferred:			
U.S.	(1,384)	544	913
Foreign	(254)	(262)	(36)
State	(530)	(317)	122
	(2,168)	(35)	999
Provision for income taxes	\$4,000	\$4,900	\$1,475

Income before income taxes of the Company's foreign subsidiaries approximates operating profit as summarized in Note 10—Foreign Operations.

Components of the deferred tax provision, which result from timing differences in the recognition of certain items for tax and financial reporting purposes, are as follows:

	For the Year Ended June 30,		
	1989	1988	1987
Cash to accrual basis	\$(1,190)	\$(1,308)	\$1,351
Long-term development contracts	(326)	(259)	(1,026)
Deferral of support and update revenue	(1,537)	(1,017)	(891)
Capitalized software development	1,578	1,569	1,076
Depreciation	202	—	59
Unrealized exchange gains	(762)	355	—
Allowance for doubtful accounts	(419)	(287)	—
Accrued vacation	(212)	—	—
State income tax	246	(162)	(26)
Inventory capitalization	(351)	—	—
Use of research tax credits and loss carryforwards	—	1,166	—
Other, net	603	(92)	456
Total deferred tax provision	<u>\$(2,168)</u>	<u>\$ (35)</u>	<u>\$ 999</u>

The provision for income taxes differs from the amount computed by applying the statutory U.S. federal income tax rate as follows:

	For the Year Ended June 30,		
	1989	1988	1987
Tax provision at statutory rate	34.0%	34.0%	46.0%
Income of foreign operations taxed at various rates	5.6	3.7	3.6
State income taxes, net of federal benefits	3.8	5.4	4.0
Investment, foreign and research tax credits	(4.2)	(3.5)	(15.5)
Other, net	—	—	(.8)
Effective tax rate	<u>39.2%</u>	<u>39.6%</u>	<u>37.3%</u>

Financial Accounting Standard No. 96

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 96, "Accounting for Income Taxes." SFAS 96 mandates the liability method for computing deferred income taxes. The Company has not adopted SFAS 96 in 1989. Adoption of the new Statement is not expected to have a significant effect on the Company's financial position or results of operations.

NOTE 9 TRANSACTIONS WITH RELATED PARTIES

During the years ended June 30, 1989, 1988 and 1987, the Company paid \$96, \$117 and \$108, respectively, in consulting fees to two directors and one officer of the Company who are stockholders but not salaried employees of the Company. These amounts have been expensed as research and development costs.

During the year ended June 30, 1986, the Company issued 73,800 shares of Common Stock at \$1.50 per share (the fair value at date of issuance) to the Company's former chief executive officer for \$11 in cash and a \$100 note payable to the Company bearing interest at 8%. The outstanding principal and interest were paid in full during the year ended June 30, 1988.

NOTE 10 FOREIGN OPERATIONS

The Company operates exclusively in the computer software industry, developing and marketing computer software and providing technical support for its products. The Company sells its products through its own sales organization. Subsidiaries were charged royalties on revenues to unaffiliated customers; such royalties are eliminated in consolidation.

The Company's operations by geographic area are as follows:

	United States	Europe	Other	Consolidated
Year ended June 30, 1989				
Revenues	\$79,014	\$41,948	\$9,754	\$130,716
Operating profit	7,314	1,091	450	8,855
Identifiable assets	85,155	40,331	6,735	132,221
Year ended June 30, 1988				
Revenues	\$50,902	\$30,712	\$5,772	\$ 87,386
Operating profit	9,100	1,493	257	10,850
Identifiable assets	70,325	27,114	3,527	100,966
Year ended June 30, 1987				
Revenues	\$34,076	\$10,613	\$1,876	\$ 46,565
Operating profit (loss)	3,253	120	(271)	3,102
Identifiable assets	36,218	8,633	1,513	46,364

Included in United States revenues are export sales to customers located primarily in Europe of \$2,136 and \$3,716 in fiscal years 1988 and 1987, respectively. There were no significant export sales in 1989.

NOTE 11 RESTATEMENT OF PRIOR YEAR FINANCIAL STATEMENTS

The Company adopted Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows" in 1989. The Consolidated Statements of Changes in Financial Position for the years ended June 30, 1988 and 1987 have been restated to conform with the current year presentation. The Company considers all highly liquid investments purchased with an original maturity of three months or less to be cash equivalents.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors and
Stockholders of Relational Technology, Inc.

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of income, of changes in stockholders' equity and of cash flows present fairly, in all material respects, the financial position of Relational Technology, Inc. and its subsidiaries at June 30, 1989 and 1988, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 1989, in conformity with generally accepted accounting principles. 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 of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

Price Waterhouse

Oakland, California
August 16, 1989

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Paul E. Newton
President, Chief Executive Officer
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Gary J. Morgenthaler
Chairman of the Board

Eugene Wong
Secretary and Director

Other Directors

Charles G. Moore
General Partner
Welsh, Carson, Anderson & Stowe

Lawrence A. Rowe
Professor of Electrical Engineering
and Computer Sciences
University of California, Berkeley

William H. Younger, Jr.
General Partner
Sutter Hill Ventures

Other Officers

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Senior Vice President,
International Operations

Marlyn Bohl
Vice President, Engineering

Christopher H. Greendale
Vice President, Marketing

William M. Smartt
Vice President,
Finance and Administration
and Chief Financial Officer

Michael R. Stonebreaker
Vice President,
Advanced Development

Michael J. Wilson
Vice President, Field Sales

Thomas A. Wilson
Vice President, Corporate Sales

Olivia F. Orr
Vice President, Controller

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Annual Meeting of Stockholders

The annual meeting will be held
on November 8, 1989.

Annual Report/10-K Report

Publications of interest to current and potential Relational Technology, Inc. investors are available upon written request, without charge. These include annual and quarterly reports and the Form 10-K filed with the Securities and Exchange Commission.

Requests should be made to:

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Director, Investor Relations
Relational Technology, Inc.
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Independent Accountants

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Outside Legal Counsel

Cooley, Godward, Castro,
Huddleson & Tatum
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Transfer Agent and Registrar

The First National Bank of Boston
Shareholder Services Division
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617/929-5445

Stock Listings

The Company's stock is traded
publicly in the over-the-counter
National Market on the National
Association of Securities Dealers
Automated Quotation System
(NASDAQ) under the symbol RELY.

Stock Prices	High	Low
Fourth Quarter 1989	15¼ -	8¾
Third Quarter 1989	16¾ -	12¾
Second Quarter 1989	15¾ -	11¾
First Quarter 1989	21¼ -	12¾
Fourth Quarter 1988	18¾ -	14

Prior to the fourth quarter of 1988,
there was no public market for the
Company's shares. As of August 17,
1989 there were 639 shareholders
of record and at the end of trading
on August 17, 1989, the closing sale
price of the Company's stock was
\$8¼ per share.

Relational Technology, Inc.

Ingres