

Relational Technology, Inc.

Common Stock

Of the 2,000,000 shares of Common Stock offered hereby, 1,500,000 shares are being sold by the Company and 500,000 shares are being sold by the Selling Stockholders. See "Principal and Selling Stockholders." The Company will not receive any of the proceeds from the sale of the shares by the Selling Stockholders.

Prior to this offering, there has been no public market for the Common Stock of the Company. For the factors to be considered in determining the initial public offering price, see "Underwriting."

See "Risk Factors" for a discussion of certain factors which should be considered by prospective purchasers of the Common Stock offered hereby.

THESE SECURITIES HAVE NOT BEEN APPROVED OR DISAPPROVED BY THE SECURITIES AND EXCHANGE COMMISSION NOR HAS THE COMMISSION PASSED UPON THE ACCURACY OR ADEQUACY OF THIS PROSPECTUS.

ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

	Initial Public Offering Price	Underwriting Discount (1)	Proceeds to Company(2)	Proceeds to Selling Stockholders (2)
Per Share		\$0.98	\$13.02	\$13.02
Total(3)	\$28,000,000	\$1,960,000	\$19,530,000	\$6,510,000

- (1) The Company and the Selling Stockholders have agreed to indemnify the Underwriters against certain liabilities, including liabilities under the Securities Act of 1933.
- (2) Before deducting estimated expenses of \$714,920 payable by the Company and \$240,806 payable by the Selling Stockholders.
- (3) The Company has granted the Underwriters an option for 30 days to purchase up to an additional 300,000 shares at the initial public offering price per share, less the underwriting discount, solely to cover over-allotments. If such option is exercised in full, the total initial public offering price, underwriting discount and proceeds to Company will be \$32,200,000, \$2,254,000, and \$23,436,000, respectively. See "Underwriting."

The shares are offered severally by the Underwriters, as specified herein, subject to receipt and acceptance by them and subject to their right to reject any order in whole or in part. It is expected that certificates for the shares will be ready for delivery at the offices of Goldman, Sachs & Co., New York, New York on or about May 24, 1988.

Goldman, Sachs & Co. Robertson, Colman & Stephens

The Company intends to furnish its stockholders annual reports containing audited financial statements reported on by an independent public accounting firm and quarterly reports containing unaudited financial information for the first three quarters of each fiscal year.

Except in the Consolidated Financial Statements and as otherwise noted herein, all information contained in this Prospectus relating to the Company's Common Stock is based on shares outstanding as of March 31, 1988, and is adjusted to reflect the conversion of each outstanding share of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and Series D Preferred Stock, as well as 57,507 shares of Series E Preferred Stock, into an aggregate of 3,599,507 shares of Common Stock upon the closing of the offering covered by this Prospectus. Upon the closing of the offering, 1,245,925 shares of Series E Preferred Stock and 800,000 shares of Series F Preferred Stock will remain outstanding. See "Description of Capital Stock — Preferred Stock."

INGRES and substantially all other Relational Technology, Inc. product names referred to herein are trademarks of the Company. The following terms referred to herein are trademarks of the following companies: IBM, XT, AT, RT PC, PS/2, DB2 and PC-DOS—International Business Machines Corporation; Lotus 1-2-3—Lotus Development Corporation; UNIX—AT&T Bell Laboratories; Oracle—Oracle Corporation; dBase II and III—Ashton-Tate Corporation; Informix—Informix Corporation; Unify—Unify Corporation; DataServer—Sybase Corporation; DEC, VAX, VMS, DECNET, RMS, ULTRIX—Digital Equipment Corporation; Multiplan and MS-DOS—Microsoft Corporation; Multimate—Multimate International Corporation; IDMS—Cullinet Software, Inc.; Wordstar—Micropro International Corporation; Ethernet—Xerox Corporation; and Fortune 1000—Time Corporation.

IN CONNECTION WITH THIS OFFERING, THE UNDERWRITERS MAY OVER-ALLOT OR EFFECT TRANSACTIONS WHICH STABILIZE OR MAINTAIN THE MARKET PRICE OF THE COMMON STOCK OF THE COMPANY AT A LEVEL ABOVE THAT WHICH MIGHT OTHERWISE PREVAIL IN THE OPEN MARKET. SUCH STABILIZING, IF COMMENCED, MAY BE DISCONTINUED AT ANY TIME.

PROSPECTUS SUMMARY

The following summary is qualified in its entirety by the more detailed information and consolidated financial statements appearing elsewhere in this Prospectus.

The Company

Relational Technology develops, markets and supports a family of software products used for database management and application development. The Company's principal product is the INGRES relational database management system. INGRES is offered with powerful application development tools that provide users with increased productivity and flexibility in application development.

The Company is a leading supplier of relational database management and application development software to users of DEC VAX computers and minicomputers running UNIX operating systems. INGRES has been ported to a broad range of computers, including mainframes, minicomputers, workstations and personal computers from such manufacturers as DEC, International Computers Limited, Sun Microsystems, Hewlett-Packard, Data General, IBM and Apollo Computer. INGRES adheres to IBM's SQL database language as well as other industry standard interfaces and communications protocols.

Relational Technology's strategy is to address the emerging need of large corporations, government agencies and major universities for an integrated and distributed data management solution. INGRES was designed with an open architecture which the Company believes is required to integrate information across the diverse hierarchy of computers found in large organizations. The Company's distributed database management product, INGRES/STAR, allows users to access and utilize data on different computers in a network as if the data were on a single computer. INGRES/STAR is currently available for networks of DEC VAX computers running the VMS operating system. The Company is developing extensions of INGRES/STAR to enable it to function on other operating systems. In addition, the Company has introduced "database gateway" technology which allows connectivity to DEC's RMS database and Ashton-Tate's dBase III database. The Company is currently developing database gateways for other widely used DBMS products, including those of IBM, DEC and others. The Company believes that its distributed database technology represents a significant advance in data management and is an important competitive factor in the emerging market for corporate-wide database management solutions.

The Offering

Common Stock offered by the Company	1,500,000 shares(1)
Common Stock offered by Selling Stockholders	500,000 shares
Common Stock to be outstanding after the offering	
NASDAQ symbol	
Use of proceeds by the Company	

Selected Financial Data (in thousands, except per share data)

(in thousai	nds, exce	pt per sh	are data)				
		Fiscal Years Ended June 30,				Nine Months Ended March 31,	
	1983	1984	1985	1986	1987	1987	1988
Income Statement Data:							
Total revenues	\$2,910	\$7,585	\$17,271	\$28,138	\$46.565	\$29,247	\$57,180
Operating income (loss)	84	218	771	2,503	3,102	(48)	. ,
Net income	140	198	555	1,664	2,477	339 [°]	3,917
Net income per share	\$.03	\$.03	\$.08	\$.23	\$.29	\$.04	\$.41
Number of shares used in computation	5,543	6,083	6,825	7,393	8,456	8,370	9,486
					March 3	1, 1988	
	June 3	0, 1987	-	Actual		As Adjuste	d(1)(3)
Balance Sheet Data:							
Working capital	\$11	,036	(\$15,678		\$31.6	43
Total assets	45	,045	•	69,256		88,0	71

(1) Assumes the Underwriters' over-allotment option is not exercised. See "Underwriting."

Stockholders' equity

2.955

24,851

4,078

2,845

57,565

(3) Gives effect to the sale of the shares offered by the Company hereby and the anticipated use of a portion of the proceeds therefrom to repay certain bank indebtedness. See "Use of Proceeds" and "Capitalization."

⁽²⁾ Includes 2,045,925 shares of Common Stock issuable upon conversion of Series E Preferred Stock and Series F Preferred Stock that will remain outstanding after the offering. Excludes 2,122,873 shares of Common Stock reserved for issuance upon exercise of outstanding stock options. See "Capitalization."

THE COMPANY

Relational Technology develops, markets and supports a family of software products used for database management and application development. The Company's principal product is the INGRES relational database management system. INGRES is offered with powerful application development tools that provide users with increased productivity and flexibility in application development.

The Company is a leading supplier of relational database management and application development software to users of Digital Equipment Corporation ("DEC") VAX computers and minicomputers running UNIX operating systems. INGRES has been ported to a broad range of computers, including mainframes, minicomputers, workstations and personal computers from such manufacturers as DEC, International Computers Limited, Sun Microsystems, Inc., Hewlett-Packard Company, Data General Corporation, IBM and Apollo Computer Inc. INGRES adheres to IBM's SQL database language as well as other industry standard interfaces and communications protocols.

Relational Technology's strategy is to address the emerging need of large corporations, government agencies and major universities for an integrated and distributed data management solution. INGRES was designed with an open architecture which the Company believes is required to integrate information across the diverse hierarchy of mainframes, minicomputers, workstations and personal computers found in large organizations. The Company's distributed database management product, INGRES/STAR, allows users to access and utilize data on different computers in a network as if the data were on a single computer. INGRES/STAR is currently available for networks of DEC VAX computers running the VMS operating system. The Company is developing extensions of INGRES/STAR to enable it to function on other operating systems. In addition, the Company has introduced "database gateway" technology which allows connectivity to DEC's RMS database and Ashton-Tate's dBase III database. The Company is currently developing database gateways for other widely used DBMS products, including those of IBM, DEC and others. The Company believes that its distributed database technology represents a significant advance in data management and is an important competitive factor in the emerging market for corporate-wide database management solutions.

The Company markets its products primarily through its domestic and international sales organization, as well as through OEMs, VARs and joint marketing arrangements. The Company has OEM agreements with British Telecommunications PLC, Data General Corporation, ELXSI, Gould Inc., Honeywell Bull, Inc., International Computers Limited, Matra System, MIPS Computer Systems, Inc., Pyramid Technology Corporation, Sequent Computer Systems, Inc., Unisys Corporation and other computer manufacturers and software developers. In addition, the Company has entered into OEM agreements under which DEC markets INGRES for use on VAX/ULTRIX systems and IBM markets INGRES for use on its RT PC workstation and PS/2 personal computers running the AIX operating system.

The Company was incorporated in California in July 1980 and was reincorporated under the laws of Delaware in May 1988. Unless the context indicates otherwise, the "Company" and "Relational Technology" refer to the Delaware corporation, its predecessor company and its subsidiaries.

The Company's principal executive offices are located at 1080 Marina Village Parkway, Alameda, California 94501, and its telephone number at that location is (415) 769-1400.

RISK FACTORS

The following risk factors should be carefully considered in evaluating the Company and its business before purchasing the shares offered hereby.

Fluctuations in Quarterly Performance. The Company's revenues and, to a greater degree, net income vary substantially from quarter to quarter. The Company's revenues occur predominantly in the third month of each fiscal guarter and tend to be concentrated in the latter half of that third month. Accordingly, 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 is expanding its sales and marketing organization and product development efforts in fiscal 1988 and expects to continue this expansion in fiscal 1989. As a result, and because most of the Company's operating expenses are fixed in the short term, any shortfall in revenues will have a significant negative effect on net income. From time to time, the Company has earned substantial revenues from large software license agreements. In addition, the announcement of price increases by the Company may have the effect of accelerating revenues into earlier quarterly periods. The impact of these large license agreements or announced price increases can cause significant quarter-toquarter fluctuations in the results of operations. No assurance can be given that quarterly fluctuations or losses will not occur in the future. See "Management's Discussion and Analysis of Financial Condition and Results of Operations—Quarterly Results of Operations."

Competition. The market for database management system products is intensely competitive and rapidly changing. Numerous companies are engaged in the research, development and commercialization of relational database management system products and related application development tools. Many of the Company's competitors and potential competitors have significantly greater financial, technical and marketing resources than the Company. There can be no assurance that other companies have not developed or will not develop competitive products that are superior to the Company's products. In addition, a substantial portion of the Company's revenues to date have resulted from sales of INGRES for use on DEC computers. DEC also markets its own competitive database management product for use on its computers. There can be no assurance that DEC will not devote its significantly greater financial, technical and marketing resources to more aggressively market its own database management product or develop an enhanced product for use on its computers, thereby reducing the Company's sales to the DEC market. Competitive pressures from DEC and others could also result in reductions in the prices of the Company's products, which would have an adverse effect on the Company's operating results. See "Business—Competition."

Recent Product Upgrade. Since its inception in 1980, the Company has developed six major versions of INGRES, each with increased capabilities and performance. In March 1988, the Company commenced initial shipments of a new version of INGRES for users of DEC VAX/VMS systems. The Company expects this new version to be generally available to users of DEC VAX/VMS and a limited number of other computer systems during the second half of calendar 1988. This new version changed the architecture and significant parts of INGRES. As a result, the development effort has been greater in scope and in technical difficulty than that undertaken for previous versions. Although 40 customers have used test versions of the system, it is common for programs as complex as those distributed by the Company to contain undetected errors or "bugs" when first released, which are discovered only after the product has been used with many different computer systems and in varying applications. Identifying and correcting the errors typically is an expensive and time-consuming process. In addition, a significant effort is still required to adapt or "port" this new version to multiple computers and operating systems. The Company's future business is dependent in large part on the timely and successful debugging and porting of this new version. Any significant delay in shipping, correcting, or porting the new version of INGRES would have a material adverse effect on the Company's results of operations. Although the Company is not aware of any significant unresolved technical problems with the new version of INGRES, there can be no assurance that errors will not be discovered or porting will not be delayed, either of which will cause delays in securing market acceptance and could adversely affect the Company's operating results. See "Business-Product Development."

Dependence on Single Product Line and DEC Market. Substantially all of the Company's revenues are based on the Company's INGRES product line. This dependence on a single product line makes the Company more vulnerable than companies with broader product lines. Although INGRES has been ported to run on computers from numerous manufacturers, a substantial portion of the Company's revenues to date have resulted from sales of INGRES for use on DEC computers. Accordingly, the Company's future operating results will depend in part on the continued growth of the installed base of DEC computers. In addition, the Company's product pricing is typically based on the size and capabilities of the computer system on which the product runs. As a result, if technological changes or other conditions cause customers to purchase fewer large computer systems in favor of smaller systems, the Company's operating results could be adversely affected.

Future Products. The market for DBMS products is characterized by rapid changes in technology and user needs. The Company's ability to compete successfully depends on its ability to enhance its existing products and to develop or acquire new products on a timely basis that meet the changing needs of users and that incorporate or respond to advances in computer software and hardware technology. In addition, the Company believes that the ability to offer a distributed DBMS will become a significant competitive factor. The Company has introduced a distributed database management product, INGRES/STAR, which is currently available for networks of DEC VAX computers running the VMS operating system. The Company is developing extensions of INGRES/STAR to enable it to function on other operating systems, as well as database gateways to allow connectivity to other widely used DBMS products. There can be no assurance, however, that these or other development efforts will be successful, or that any resulting products will achieve market acceptance. See "Business—Product Development."

Foreign Currency Exchange Risks. A substantial portion of the Company's revenues is derived from international sales priced in foreign currencies, thereby making operating results subject to changes in currency exchange rates. If the dollar strengthens in relation to certain international currencies, the Company's revenues from international sales may be adversely affected. See "Management's Discussion and Analysis of Financial Condition and Results of Operations."

Key Employees. Competition for qualified employees in the software industry is intense. The Company's future success is highly dependent on its continued ability to recruit and retain highly skilled management, sales, marketing and technical employees. None of these individuals is subject to an employment agreement for a specified term or a post-employment noncompetition agreement. The Company's operating plans for fiscal 1988 and 1989 contemplate the addition of a significant number of sales and marketing personnel, who the Company believes are essential to achieve continued growth in revenues, and a corresponding increase in financial and administrative staff. The Company's operating results would be adversely affected if the Company is unable to attract, assimilate and retain successfully these personnel, or if revenues fail to increase at a rate sufficient to absorb the resulting increased expenses. See "Business—Employees."

Product Protection. The Company seeks to protect its software through copyrights, trade secret laws, restrictions on disclosure and use and technical measures. Despite these precautions, it may be possible for third parties to copy aspects of the Company's products or to obtain and use information that the Company regards as proprietary without authorization. Computer software generally cannot be patented, and existing copyright laws afford only limited practical protection. The Company also relies on "shrink wrap" licenses that are not signed by licensees and therefore may be unenforceable under the laws of certain jurisdictions. In addition, the laws of certain foreign countries do not protect the Company's proprietary rights in its products to the same extent as do the laws of the United States. See "Business—Product Protection."

Outstanding Preferred Stock. Following this offering, 1,245,925 shares of Series E Preferred Stock and 800,000 shares of Series F Preferred Stock will remain outstanding. Holders of Series E Preferred Stock and Series F Preferred Stock are entitled to certain significant preferences over holders of Common Stock. In any proposed acquisition or liquidation of the Company, the holders of

Series E Preferred Stock and Series F Preferred Stock have a separate class vote and certain significant preferential rights on distribution of the resulting proceeds. In addition, the Series E Preferred Stock and Series F Preferred Stock each have certain antidilution protections in the event that the Company issues additional securities at a price less than \$10.50 and \$12.50 per share, respectively. See "Description of Capital Stock—Preferred Stock."

No Prior Market, Possible Volatility of Stock Price and Dilution. There has been no public market for the Common Stock prior to this offering. The initial public offering price of the Common Stock will be determined by negotiations among the Company, the Selling Stockholders and the representatives of the Underwriters. The market price of the Company's Common Stock may be extremely volatile. Factors such as the announcement of technological innovation or the introduction of new products by the Company or its competitors, quarterly fluctuations in the Company's operating results and general conditions in the computer software or hardware industries may have a significant impact on the market price of the Common Stock offered hereby. In addition, the stock market has recently experienced extreme price and volume fluctuations, which have particularly affected the market prices for many high technology companies and which have often been unrelated to the operating performance of the specific companies. In addition, this offering involves immediate substantial dilution to new investors. See "Dilution" and "Underwriting."

Shares Eligible for Future Sale. Sales of substantial amounts of Common Stock of the Company in the public market following the offering made hereby could adversely affect prevailing market prices. On the date of this Prospectus, in addition to the 2,000,000 shares offered hereby (assuming no exercise of the Underwriters' over-allotment option), approximately 722,275 shares of Common Stock held by current stockholders will be eligible for immediate sale in the public market without restriction. Beginning 90 days after the date of this Prospectus, approximately 26,270 additional shares will become eligible for sale subject to the restrictions of Rule 144 under the Securities Act of 1933. Beginning 120 days after the date of this Prospectus, approximately 1,406,980 additional shares of Common Stock (including shares of Preferred Stock convertible into Common Stock) will become eligible for sale in the public market upon the expiration of lock-up agreements with the Company. Beginning 150 days after the date of this Prospectus, approximately 4,843,250 additional shares of Common Stock (including shares of Preferred Stock convertible into Common Stock) will become eligible for sale in the public market upon the expiration of lock-up agreements with the Underwriters. In addition, the Company intends to register approximately 2.048.500 shares reserved for issuance under the Company's employee stock option and stock purchase plans approximately 110 days after the date of this Prospectus. See "Description of Capital Stock—Shares Eligible for Future Sale."

USE OF PROCEEDS

The net proceeds to be received by the Company from the sale of the 1,500,000 shares of Common Stock being offered by the Company are estimated to be \$18,815,080 (\$22,721,080 if the over-allotment option granted to the Underwriters is exercised in full). The Company will not receive any proceeds from the sale of shares by the Selling Stockholders.

The Company intends to use the net proceeds of the offering to repay borrowings under international lines of credit (\$839,000 at March 31, 1988) and a term loan and for working capital. The term loan (\$2,011,000 at March 31, 1988), which was incurred to purchase equipment, bears interest at the rate of prime plus .5% per annum and has a final maturity of October 1990. See Note 4 of Notes to Consolidated Financial Statements. A portion of the net proceeds may also be used by the Company to acquire complementary businesses and software products. No such acquisitions are being planned or negotiated as of the date of this Prospectus. Pending their use, the Company intends to invest the net proceeds in short-term, interest-bearing securities.

The Company believes that the level of financial resources is a significant competitive factor in its industry. Therefore, the Company believes that it is advantageous to raise capital at this time, even though it has not identified specific uses for the proceeds. Management of the Company will have broad discretion in determining the specific purposes to which such proceeds will be applied.

DILUTION

The net tangible book value of the Company at March 31, 1988, was \$3.77 per share of Common Stock after giving pro forma effect to the conversion of all outstanding shares of Series A, B, C and D Preferred Stock and the assumed conversion of Series E and F Preferred Stock. Net tangible book value per share is determined by dividing the number of outstanding shares of Common Stock into the tangible book value of the Company (tangible assets less total liabilities). Without taking into account any other changes in such net tangible book value after March 31, 1988, other than to give effect to the sale by the Company of the 1,500,000 shares offered hereby at a price of \$14.00 per share (before deduction of underwriting discounts and offering expenses), the pro forma net tangible book value of the Company at March 31, 1988 would have been \$5.24 per share, representing an immediate increase of \$1.47 per share to existing stockholders and an immediate dilution of \$8.76 per share to new investors. The following table illustrates this per share dilution:

Public offering price		\$14.00
Net tangible book value before offering	\$3.77	
Increase attributable to new investors	1.47	
Pro forma net tangible book value after offering		5.24
Dilution to new investors(1)		\$ 8.76

The following table summarizes on a pro forma basis as of March 31, 1988 the difference between the number of shares purchased from the Company, the total consideration paid, and the average price per share paid by the existing stockholders and by the investors purchasing shares of Common Stock in this offering:

	Shares Pure	chased	Total Considera	Average Price Per	
	Number	Percent	Amount	Percent	Share
Existing stockholders(2)	8,917,722	85.6%	\$30,779,000	59.4%	\$ 3.45
New investors	1,500,000	14.4	21,000,000	40.6	14.00
Total	10,417,722	<u>100.0</u> %	\$51,779,000	100.0%	

- (1) Dilution is determined by subtracting net tangible book value per share after this offering from the amount of cash paid by a new investor for a share of Common Stock.
- (2) Assumes conversion of all outstanding shares of Preferred Stock. Sales by Selling Stockholders in the offering will reduce the number of shares held by existing stockholders to 8,417,722 or 81% of the total shares of Common Stock outstanding, and will increase the number of shares held by new investors to 2,000,000 or 19% of the total shares of Common Stock outstanding after the offering.

The foregoing tables assume no exercise of the Underwriters' over-allotment option or of any of the outstanding stock options. At March 31, 1988, there were outstanding stock options to purchase an aggregate of 1,911,893 shares of Common Stock at a weighted average exercise price of \$2.91 per share. Subsequent to March 31, 1988, the Company granted additional options to purchase 236,280 shares of Common Stock having a weighted average exercise price of \$6.20 per share. To the extent that these options are exercised, there will be further dilution to new investors. See "Management—Stock Option Plans."

DIVIDEND POLICY

The Company has never paid cash dividends on its Common Stock. The Company presently intends to retain earnings for use in its business and therefore does not anticipate paying any cash dividends in the foreseeable future. In addition, no dividend may be paid or declared and set apart for payment on the Common Stock unless a dividend equal to the amount to be paid or set apart per share of Common Stock has first been paid on each outstanding share of Series E Preferred Stock and Series F Preferred Stock. See "Description of Capital Stock—Preferred Stock."

CAPITALIZATION

The following table sets forth the capitalization of the Company at March 31, 1988 and as adjusted to give effect to the sale by the Company of the 1,500,000 shares offered hereby and the anticipated use of a portion of the proceeds therefrom to repay certain indebtedness.

	March 31, 1988	
	Pro Forma	Pro Forma— As Adjusted
	(in tho	usands)
Short-term debt(1)	<u>\$ 2,597</u>	\$ 980
Long-term debt(1)	4,078	2,845
Stockholders' equity: Preferred Stock, \$.001 par value; authorized 5,000,000 shares; outstanding 2,045,925 shares(2) Common Stock, \$.001 par value; authorized 25,000,000 shares; outstanding 6,871,797 shares; as adjusted	21,875	21,875
8,371,797 shares(3)	7,648	26,463
Note receivable from stockholder	(100)	(100)
Retained earnings	8,751	8,751
Foreign currency translation adjustment	576	576
Total stockholders' equity	38,750	57,565
Total capitalization	\$42,828	\$60,410

⁽¹⁾ See Notes 4 and 5 of Notes to Consolidated Financial Statements for information concerning the Company's indebtedness and lease obligations. A portion of the proceeds of the offering will be used to repay all outstanding debt excluding capitalized lease obligations.

⁽²⁾ Reflects the conversion of the Company's outstanding Series A, B, C and D Preferred Stock and 57,507 shares of the Series E Preferred Stock into an aggregate of 3,599,507 shares of Common Stock. See "Description of Capital Stock—Preferred Stock" and Note 6 of Notes to Consolidated Financial Statements.

⁽³⁾ Reflects the conversion of the Company's outstanding Preferred Stock described in footnote 2 above. Excludes 2,045,925 shares of Common Stock reserved for issuance upon conversion of outstanding Series E Preferred Stock and Series F Preferred Stock; if all such shares are converted, the total Common Stock outstanding as adjusted would be 10,417,722 shares. As of March 31, 1988, options to purchase an aggregate of 1,911,893 shares were outstanding, with a weighted average exercise price of \$2.91 per share. Subsequent to March 31, 1988, the Company granted additional options to purchase 236,280 shares of Common Stock having a weighted average exercise price of \$6.20 per share. See "Management—Stock Option Plans" and Notes 6 and 7 of Notes to Consolidated Financial Statements.

SELECTED CONSOLIDATED FINANCIAL DATA

The selected consolidated financial data presented below for, and as of the end of, each of the years in the five-year period ended June 30, 1987 and for the nine months ended March 31, 1988, have been derived from the consolidated financial statements of the Company, which statements have been examined by Price Waterhouse, independent accountants, for the year ended June 30, 1987 and for the nine months ended March 31, 1988, and by Coopers & Lybrand, independent accountants, for the prior years. See "Experts." This data should be read in conjunction with the consolidated financial statements, related notes and other financial information included elsewhere in this Prospectus. The data for the nine months ended March 31, 1987 has been derived from unaudited financial statements appearing herein and which, in the opinion of the Company, include all adjustments, consisting only of normal recurring adjustments, necessary for a fair statement of the results for the unaudited interim period. The Statement of Income data for the nine months ended March 31, 1988 is not necessarily indicative of the results that may be expected for the entire fiscal year ending June 30, 1988.

	Fiscal Years Ended June 30.					Nine Months Ended March 31,	
	1983	1984	1985	1986	1987	1987	1988
			a)				
Consolidated Statement of Income:							
Revenues: Licenses	\$2,720 190	\$7,169 416	\$15,767 1,504	\$25,318 2,820	\$40,916 5,649	\$25,482 3,765	\$47,294 9,886
Total revenues	2,910	7,585	17,271	28,138	46,565	29,247	57,180
Operating expenses: Sales and marketing Research and development(1) General and administrative	941 1,175 710	3,548 2,545 1,274	8,827 5,921 1,752	13,450 9,198 2,987	28,313 10,423 4,727	18,617 7,387 3,291	37,219 10,088 4,775
Total operating expenses	2,826	7,367	16,500	25,635	43,463	29,295	52,082
Operating income (loss)	84 101 (30)	218 58 (55)	771 86 (230)	2,503 135 (395)	3,102 768 (553)	(48) 568 (389)	5,098 764 (454
Foreign exchange gain (loss)	\ <u>-</u> '		(21)	<u>`(37</u>)	635	<u>`409</u>	1,120
Income before income taxes Provision for income taxes	155 15	221 23	606 51	2,206 542	3,952 1,475	540 201	6,528 2,611
Net income	\$ 140	\$ 198	\$ 555	\$ 1,664	\$ 2,477	\$ 339	\$ 3,917
Net income per share	\$.03	\$.03	\$.08	\$.23	\$.29	\$.04	\$.41
Number of shares used in computation of net income per share(2)	5,543	6,083	6,825	7,393	8,456	8,370	9,486
				ne 30,			ch 31,
		1983	1984		 -	1987 1	988
O Balance Object Date:				(in thous	ands)		
Consolidated Balance Sheet Data:		504 6 4	470 6 4	007 6 0	070 644	000 641	- 670
Working capital	\$	591 \$1	,470 \$ 1	,307 \$ 6	,9/9 \$11	,036 \$15	5,678

⁽¹⁾ Research and development expenses for fiscal 1987 and the nine months ended March 31, 1987 and 1988 were reduced by the Company's application of Statement of Financial Accounting Standards No. 86, which resulted in the capitalization of software development costs of approximately \$2.8 million, \$2.2 million and \$2.5 million, respectively, during such periods. See Note 1 of Notes to Consolidated Financial Statements.

6.935

4,188

52

11,634

2,145

4,746

24,021

2,604

13,898

1.940

1,399

74

Total assets

Long-term debt

Stockholders' equity

45,045

24.851

2,955

69,256

4,078

38.750

⁽²⁾ See Note 1 of Notes to the Consolidated Financial Statements for an explanation of the determination of shares used in computing net income per share.

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

The Company was founded in July 1980 and shipped its first product in June 1981. For the fiscal year ended June 30, 1987, the Company achieved revenues of \$46.6 million and net income of \$2.5 million. For the nine months ended March 31, 1988, the Company achieved revenues of \$57.2 million and net income of \$3.9 million. The Company's growth reflects continued market acceptance of the Company's products both in the United States and internationally, expansion of the Company's sales and marketing organization and the rapid expansion of the market for relational database systems.

Results of Operations

The following table sets forth for the fiscal periods indicated the percentage of revenues represented by certain items in the Company's consolidated statements of income.

	Fiscal Years Ended June 30,			Nine Months End March 31,		
	1985	1986	1987	1987	1988	
Revenues:	· ·		,			
Licenses	91.3%	90.0%	87.9%	87.1%	82.7%	
Maintenance	<u>8.7</u>	10.0	12.1	12.9	17.3	
Total revenues	100.0	100.0	100.0	100.0	100.0	
Operating expenses:						
Sales and marketing	51.1	47.8	60.8	63.7	65.1	
Research and development(1)	34.3	32.7	22.4	25.2	17.6	
General and administrative	10.2	<u> 10.6</u>	10.2	11.3	8.4	
Total operating expenses	95.6	91.1	93.4	100.2	91.1	
Operating income (loss)	4.4	8.9	6.6	(0.2)	8.9	
Interest income	.5	.4	1.7	1.9	1.3	
Interest expense	(1.3)	(1.4)	(1.2)	(1.3)	(8.)	
Foreign exchange gain (loss)	<u>(.1</u>)	<u>(.1</u>)	1.4	1.4	2.0	
Income before income taxes	3.5	7.8	8.5	1.8	11.4	
Provision for income taxes	3	1.9	3.2	0.7	4.5	
Net income	3.2%	<u>5.9</u> %	<u>5.3</u> %	<u>1.1</u> %	<u>6.9</u> %	

⁽¹⁾ Pursuant to SFAS No. 86, the Company capitalized software development costs equal to 6.1%, 7.4% and 4.4% of revenues during fiscal 1987 and the nine month periods ended March 31, 1987 and 1988, respectively. See Note 1 of Notes to Consolidated Financial Statements.

Revenues

The Company's revenues increased 63% from fiscal 1985 to fiscal 1986 and 65% from fiscal 1986 to fiscal 1987 reflecting continued increases in the number of customers and installations of the Company's products. Prior to fiscal 1987, the Company typically priced its relational DBMS and application development tools as a single package. A portion of the revenue increase in fiscal 1987 resulted from price increases associated with the unbundling of these products.

The Company's product and customer base has broadened significantly during the past three fiscal years as the Company has increased the types of computers and operating systems on which INGRES operates. 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 15%, 31% and 35% of the Company's revenues in fiscal 1985, 1986 and 1987, respectively. 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. Maintenance revenues have increased steadily from 9% of revenues in fiscal 1985 to 10% of revenues in fiscal 1986 and 12% of revenues in fiscal 1987. Maintenance revenues have provided a source of recurring revenues and reflect the cumulative

growth of the Company's customer base. Substantially all of the Company's customers enter into and renew annual maintenance contracts. Revenues from maintenance are recognized ratably over the annual maintenance period.

Operating Expenses

Sales and Marketing Expenses. Beginning in the second half of fiscal 1986, the Company significantly increased its emphasis, both domestically and internationally, on direct sales through its own sales force. The opening and staffing of new sales offices, and the rapid increase in staffing at existing offices, involve substantial initial costs that are not immediately offset by revenue growth. While the expansion of the domestic and international sales and marketing organizations led to increased expenses, these expenses as a percentage of revenues decreased from 51% to 48% from fiscal 1985 to fiscal 1986. This decrease is attributable to the effect of several large software license agreements completed during the latter half of fiscal 1986. Sales and marketing expenses increased substantially from 48% of revenues in fiscal 1986 to 61% of revenues in fiscal 1987 as the Company invested 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's expenditures for research and development increased 55% from fiscal 1985 to fiscal 1986 and 43% from fiscal 1986 to fiscal 1987 (excluding the impact of amounts capitalized in 1987). These increases resulted largely from similar percentage increases in the number of research and development personnel. 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. During fiscal 1985, 1986 and 1987, research and development expenses were approximately \$5.9 million, \$9.2 million and \$10.4 million, respectively, representing 34%, 33% and 22% of the Company's revenues in such years.

Prior to fiscal 1987, the Company followed the prevailing practice of charging to expense all research and development expenditures as incurred. The Financial Accounting Standards Board, in its Statement of Financial Accounting Standards No. 86 ("SFAS No. 86"), now 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 be capitalized and reported at the lower of unamortized cost or net realizable value of the product. Accordingly, in fiscal 1987, the Company capitalized approximately \$2.8 million of software development costs, representing approximately 21% of total research and development expenditures. Including this capitalized amount, total research and development expenditures in fiscal 1987 were approximately \$13.2 million, or 28% of revenues. 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 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. See Note 1 of Notes to Consolidated Financial Statements.

General and Administrative Expenses. General and administrative expenses have increased at approximately the same rate as revenues, as significant additions to administrative resources have been required to support growth. Such expenses were 10%, 11% and 10% of revenues in fiscal 1985, 1986 and 1987, respectively.

Income

Operating income in fiscal 1985 was \$771,000 (4% of revenues), compared with approximately \$2.5 million in fiscal 1986 (9% of revenues) and approximately \$3.1 million in fiscal 1987 (7% of revenues). Profit margins in fiscal 1986 were favorably affected by the impact of certain large license agreements completed in the latter half of the fiscal year. The decrease in income as a percentage of revenues from fiscal 1986 to fiscal 1987 was primarily attributable to substantially higher sales and marketing expenses associated with the expansion of the Company's domestic

and international sales and marketing organizations. The Company's adoption of SFAS No. 86 at the beginning of fiscal 1987 resulted in capitalization of approximately \$2.8 million of software development costs, with a corresponding increase in operating income. The Company believes that its investment in key personnel as well as its continuing investment in the 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 because of the difficulty of predicting revenues and the number of factors which can adversely affect operating results.

In addition to the factors discussed above, the Company's net income for fiscal 1987 was favorably impacted by foreign exchange gains of \$635,000 compared to nominal amounts in prior years. The Company's net income has also been affected by changes in the effective income tax rate, which has increased from 8% and 25% in fiscal 1985 and 1986, respectively, to 37% in fiscal 1987. The Company does not believe that the Tax Reform Act of 1986 will have any material effect on the Company's effective tax rate in the future; potential benefits from the lower maximum tax rates are expected to be offset by the reduction in research and development credits and the elimination of investment tax credits. The effective tax rate in fiscal 1988 is expected to be approximately 40%. See Note 8 of Notes to Consolidated Financial Statements.

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96, Accounting for Income Taxes. SFAS 96 mandates the liability method for computing deferred income taxes. The Company does not intend to adopt SFAS 96 in 1988. Adoption of the new Statement is not expected to have a significant effect on the Company's financial position or results of operations.

Interim Results

Revenues for the first nine months of fiscal 1988 were \$57.2 million, representing a 96% increase over the comparable period of fiscal 1987. The increase is attributable to the rapid expansion of the market for relational database management systems, which is reflected in significant sales to new customers, particularly international customers, as well as continued sales into the existing customer base. In addition, as the existing customer base has expanded, maintenance revenues have increased significantly. Sales to international customers increased significantly, primarily as a result of the increased acceptance of the Company's products internationally.

Sales and marketing expenses increased at approximately the same rate as revenues, as the Company focused resources on marketing programs and on the expansion of its domestic and international direct sales organization. Research and development expenses increased 31% prior to the capitalization of \$2.2 million and \$2.5 million of software development costs in the first nine months of fiscal 1987 and 1988, respectively. Increased research and development expenses relate directly to increases in the number of personnel assigned to research and development projects. General and administrative expenses increased at a substantially lower rate than revenues, reflecting economies of scale at this stage of the Company's growth.

As a result of the above factors, the Company had operating income of \$5.1 million in the first nine months of fiscal 1988 compared to a loss of \$48,000 in the comparable period in fiscal 1987. In addition to the increase in operating income described above, pre-tax income in the first nine months of fiscal 1988 includes \$1.1 million of foreign exchange gains. This foreign exchange gain principally relates to domestic accounts receivable which were denominated in foreign currencies. As of March 31, 1988 no domestic receivables were denominated in foreign currencies. The Company's estimated effective tax rate for fiscal 1988 is approximately 40%. Accordingly, pre-tax income of \$6.5 million for the first nine months of fiscal 1988 resulted in \$3.9 million in net income compared to \$339,000 in the first nine months of fiscal 1987.

Quarterly Results of Operations

The following table sets forth selected unaudited quarterly financial information for the Company's last 11 fiscal quarters. The Company has not previously prepared interim financial information for public use and the quarterly data provided herein is based on a retrospective review by the

Company of its quarterly results. 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.

	Fiscal 1986			Fiscal 1987				Fiscal 1988			
	Sept. 30, 1985	Dec. 31, 1985	Mar. 31, 1986	June 30, 1986	Sept. 30, 1986	Dec. 31, 1986	Mar. 31, 1987	June 30, 1987	Sept. 30, 1987	Dec. 31, 1987	Mar. 31, 1988
						is, except p	er share data)			
Revenues	\$4,721	\$5,165	\$7,772	\$10,480	\$8,498	\$8,701	\$12,048	\$17,318	\$16,203	\$18,737	\$22,240
Operating expenses: Sales and marketing Research and develop-	2,456	2,907	3,461	4,626	5,057	6,012	7,547	9,696	10,451	12,476	14,292
ment(1)	1,998 543	2,210 659	2,355 754	2,635 1,031	2,118 843	2,512 1,018	2,757 1,430	3,036 1,436	3,084 1,405	3,257 1,604	3,747 1,766
Total operating expenses	4,997	5,776	6,570	8,292	8,018	9,542	11,734	14,168	14,940	17,337	19,805
Operating income (loss)	(276)	(611)	1,202	2,188	480	(841)	314	3,150	1,263	1,400	2,435
Net income (loss)	\$ (248)	\$ (461)	\$ 785	\$ 1,588	\$ 159	\$ (377)	\$ 557	\$ 2,138	\$ 816	\$ 1,697	\$ 1,404
Net income (loss) per share	\$ (.04)	\$ (.06)	\$.11	\$.21	\$.02	\$ (.04)	\$.07	\$.25	\$.09	\$.18	\$.15
Number of shares used in computation	7,029	7,449	7,384	7,724	8,227	8,457	8,405	8,691	9,300	9,271	9,665

⁽¹⁾ Beginning with fiscal 1987, the Company has applied SFAS 86, under which the Company capitalized software development costs of approximately \$653,000, \$747,000, \$761,000, \$667,000, \$735,000, \$834,000, and \$995,000 in the first, second, third and fourth quarters of fiscal 1987 and the first, second and third quarters of fiscal 1988, respectively.

Historically the Company's revenues have increased in each sequential quarter during a fiscal year, 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 achieve revenue growth. Because a significant training period is required before sales and marketing personnel reach full productivity, expenses related to hiring and training precede revenue generated by such personnel. During each fiscal year prior to fiscal 1988, 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 revenue. 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 revenue during the second half of the fiscal year. Consequently, the Company has historically achieved greater profitability in the third and fourth quarters. More recently the Company has implemented incentives which are designed to increase the proportion of annual revenues recognized in the first half of the fiscal year. Although the Company has recently achieved profitability in its first and second quarter results, 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.

Quarterly net income during fiscal 1988 has also been impacted by foreign exchange gains and losses. See "Interim Results." Pretax foreign exchange gains (losses) for the first three quarters of fiscal 1988 were \$45,000, \$1,298,000 and (\$223,000), respectively.

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 quarter-to-quarter fluctuations in results of operations. Similar fluctuations may continue to occur in the future.

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. Accordingly, 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. As operating expenses continue to increase, any significant shortfall in quarterly revenues may lead to an operating loss for the quarter.

Inflation

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

Liquidity and Capital Resources

Historically, the Company has funded its growth through the sale of Preferred Stock, internally generated funds and bank borrowings. Working capital has increased from approximately \$1.3 million at the end of fiscal 1985 to \$15.7 million at March 31, 1988. At March 31, 1988, the Company had an \$8 million revolving line of credit, and a \$3 million capital equipment line of credit. No amounts were outstanding under either of these agreements at March 31, 1988. The Company also has domestic equipment lease lines of credit aggregating \$6.0 million, under which \$2.2 million was outstanding at March 31, 1988. These domestic lines of credit expire in October 1988. In addition, the Company also has foreign overdraft facilities and secured lines of credit that aggregate \$2.0 million, under which \$839,000 was outstanding at March 31, 1988. The Company is in compliance with the applicable financial covenants under each of its lines of credit. As of March 31, 1988, cash and cash equivalents aggregated \$7.0 million. The principal foreign line of credit expires in April 1989. See Notes 4 and 6 of Notes to Consolidated Financial Statements.

The Company believes that the net proceeds from this offering, together with existing cash resources, available borrowings under its lines of credit and internally generated funds, will be sufficient to meet its anticipated working capital and capital expenditure requirements through at least the end of fiscal 1989. The Company had no material commitments for capital expenditures as of June 30, 1987 or March 31, 1988.

BUSINESS

Relational Technology develops, markets and supports a family of software products used for database management and application development. The Company's principal product is the INGRES relational database management system. INGRES is offered with powerful application development tools that provide users with increased productivity and flexibility in applications development. The Company's distributed database management product, INGRES/STAR, allows users to access and utilize data on different computers in a network as if the data were on a single computer. The Company believes that its distributed database technology represents a significant advance in data management and gives it a competitive advantage in the emerging market for corporate-wide database management solutions.

Background

Database management systems ("DBMS") are used to organize, store, retrieve and modify computer data. Because one of the principal functions of computers is to manage various types of data, DBMS are fundamental to most computer applications and are used with all classes of computers.

There are three kinds of DBMS software: hierarchical, network and relational. Hierarchical and network DBMS first gained commercial acceptance in the 1960's and 1970's, respectively. Both hierarchical and network DBMS require users to know how and where their data is stored, to navigate through the database and access that data step-by-step, according to predefined sequences.

Relational DBMS software, which gained commercial acceptance in the 1980's, provides greater flexibility and productivity than hierarchical and network DBMS. Relational DBMS allow users to specify the data they wish to retrieve or modify without knowing how or where the data is stored in the computer. Because relational systems navigate to the desired data automatically, database information is more readily accessible to users of all experience levels. In addition, professional programmers are able to increase productivity significantly and reduce software maintenance expense by avoiding the more extensive programming and reprogramming required by traditional DBMS architectures.

The market for relational DBMS is growing rapidly. Relational systems, by permitting end user ad hoc inquiry and analysis, have created a major new category of usage not possible with traditional DBMS technology. Improvements in the performance of relational DBMS, combined with the availability of powerful application development tools, have led users to select relational systems over conventional DBMS software for traditional applications such as accounting, order processing and inventory and personnel management. The Company believes further performance and feature enhancements will extend the use of relational DBMS to transaction processing applications such as stock market trading, reservations and automated banking. In addition, the proliferation of powerful 16- and 32-bit workstations and personal computers has substantially expanded the potential user base for relational DBMS software.

Large organizations increasingly require a corporate-wide solution that allows the sharing and integration of data from different parts of their organization. The demand for such a data management solution has created a need for software portable across the diverse hierarchy of computer systems and operating environments. This need, coupled with the emergence of industry standards and the proliferation of advanced networking technology, is eroding boundaries between the traditional mainframe, minicomputer, workstation, and personal computer market segments. The Company believes these changes create a significant market opportunity and competitive advantage for companies that can provide a uniform, integrating, distributed solution across all computer segments.

Strategy

Relational Technology's strategy is to address the emerging need of large corporations, government agencies and major universities for an integrated and distributed data management solution.

Historically, the Company has marketed relational DBMS software and application development tools to departmental users of mid-range computing platforms, principally DEC VAX computers and computers running UNIX operating systems. The Company has pursued this focus due to (i) the large and rapidly growing installed bases of VAX and UNIX computers, (ii) the increasing importance of these systems in the commercial data processing and government markets, both in the United States and internationally, (iii) the relatively low penetration of this market by DBMS in general and relational DBMS in particular, and (iv) its belief that these systems are well suited to run relational DBMS. In addressing these markets, the Company has emphasized application development productivity and database performance. The Company is today a leading supplier of relational DBMS in the VAX and UNIX markets and expects these markets will continue to be primary markets for its products.

The Company's strategy is to become a leading supplier in the emerging market for corporate-wide data management solutions in large organizations by building upon its strength in the DEC and UNIX markets. This emerging market will require a distributed database management product that enables users to integrate information across the diverse hierarchy of mainframes, minicomputers, workstations and personal computers found in large organizations. INGRES was designed with an open architecture which enables the Company to offer a relational DBMS that is (i) easily portable to most types of computers used by large organizations, (ii) adherent to widely accepted standards for database languages and communication protocols, and (iii) layered in design to facilitate interface with communications networks, display technologies, user applications and development tools. The Company intends to extend its open architecture to develop (iv) a fully distributed database management product, and (v) database gateways to allow connectivity to DBMS products offered by IBM, DEC and other vendors.

The principal elements of the Company's open architecture strategy are discussed below:

- Portability to Most Computer Systems. Because large organizations typically have related requirements on multiple types of computers, portability across diverse computer systems is highly desirable, if not essential. INGRES has been ported to numerous computer systems and, as a result, users often choose INGRES over database management products offered by hardware manufacturers that run only on the computer systems they supply. INGRES currently runs on mainframe computers manufactured by IBM, DEC and Amdahl Corporation; minicomputers and workstations, including those manufactured by Apollo Computer, Inc., AT&T, Data General Corporation, DEC, Hewlett-Packard Company, IBM (RT PC), International Computers Limited and Sun Microsystems, Inc.; and personal computers, including the IBM PC/AT, PC/XT and PS/2 and compatibles.
- Adherence to Standards. INGRES conforms to broadly accepted standards for communications protocols and relational DBMS languages, including SQL. IBM's relational DBMS products for mainframes, SQL/DS and DB2, as well as its recently announced OS/2 Extended Edition for personal computers, have caused its SQL relational DBMS command language to emerge as an industry standard. Standardization on SQL is part of a broader industry trend in which large organizations require vendor adherence to standards in order to preserve their investment in software applications. The Company is committed to conform to industry standards and is actively involved in their formulation.
- Layered Design. INGRES is designed and constructed in layers. Each layer can be accessed
 during application development, and industry standard interfaces are implemented whenever
 available. As a result, INGRES and applications using INGRES can be easily interfaced with

most communications networks, display technologies, user applications and development tools.

Distributed Database Technology. The Company believes distributed database technology is
essential to overcoming the difficulty large organizations face in sharing data among
corporate, departmental and personal computer users. Advantages of distributed database
technology include:

Connectivity. Users can access information anywhere in the network—regardless of the hardware, operating system, data management system or network involved—without specifying the location of that information.

Expandability. Computers may be added incrementally in support of expanding applications needs without rewriting applications code or replacing existing computers.

Parallel Processing. Performance for certain transaction-oriented applications, such as banking automation, reservations processing and stock market trading, can be substantially improved by making concurrent use of multiple computers operating in parallel using the same database.

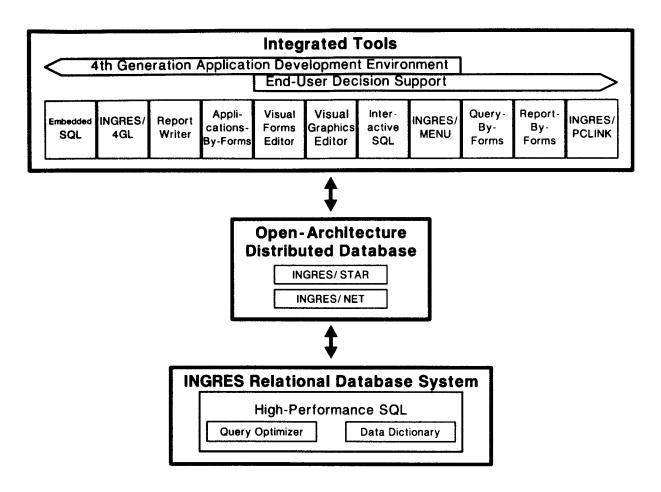
Fault Tolerance. Distributed database technology provides the potential for fault tolerance and recovery from certain kinds of hardware and software errors by maintaining copies of critical data at multiple computers within a network, combined with error recovery and restart logic.

The Company's distributed database management product, INGRES/STAR, allows users to access and utilize data on different computers in a network as if the data were on a single computer. INGRES/STAR is currently available for networks of DEC VAX computers running the VMS operating system. The Company is developing extensions of INGRES/STAR to enable it to function on other operating systems. The Company is also enhancing INGRES to provide greater expandability and increased parallel processing and fault tolerance capabilities.

· Database Gateways. The Company is developing database gateways that it believes will allow other widely-used databases, such as those from IBM, DEC and others, to be incorporated into INGRES/STAR distributed databases. The Company recently introduced such gateways to allow connectivity to DEC's RMS database and Ashton-Tate's dBase III database. The Company believes that this strategy will allow Company to complement and not compete with other standard database products. The Company's database gateways will be based on SQL and support a common catalog and datatype interface. SQL's high-level syntax and semantics allow translation of its commands to other relational systems, and, to a lesser extent, non-relational systems. The Company believes that the ability to integrate the wide range of currently installed databases in large organizations without restructuring the data will accelerate acceptance of its distributed database products.

Products

The Company's products include the high performance INGRES relational DBMS, which can be sold with powerful INGRES application development and end user tools and the INGRES distributed DBMS. The following diagram illustrates the architecture of the Company's products:



INGRES Relational DBMS

The Company's principal product is the INGRES relational DBMS, which gives users the ability to efficiently organize, store, retrieve and modify computer data. INGRES allows users to access and manipulate data without knowing how the data is physically stored. Programming effort is reduced and the user is assured that data is handled efficiently and protected from loss or accidental change.

INGRES' ease of use is enhanced because access to the data is "non-procedural," which means that the users specify database operations only in terms of what they want done, not how to do it. Because INGRES handles all data access, application programs can be written without regard to database structure and the database structure can be modified with little or no change to the program. This architecture speeds development and reduces maintenance efforts substantially. Efficiency is enhanced by two types of optimization. First, there are several alternatives for the physical structure of the data (all transparent to the user) so that the time and resources required to locate a specific data element can be minimized. These alternatives are not commonly offered on other relational DBMS. Second, INGRES employs artificial intelligence techniques to provide "query optimization." Statistical data is maintained within an INGRES database that indicates how many

data elements of a given type exist and how often various data is used. When a user makes a complex request for data, INGRES uses these statistics to determine which method or "strategy" for extracting the data will require the least resources.

Relational DBMS now support many complex and high-volume applications that were formerly the domain of conventional mainframe DBMS products. INGRES offers a wide range of features that make it particularly well-suited for these applications. For example, INGRES offers scalable performance which allows utilization of the multiple-processor computers designed for high-volume transaction processing. INGRES provides concurrency control, which allows simultaneous access to shared data by multiple users without endangering the consistency of on-line data. INGRES maintains the integrity of data even if hardware or application failure occurs during a complex transaction. Data security is ensured against unauthorized access by an extensive set of controls. Data accuracy is enhanced by a comprehensive set of data validation checks. All information about databases and applications is maintained within the INGRES data dictionary and is automatically updated when changes are made to the database. Additionally, INGRES has been designed to execute efficiently across a broad range of applications and has been tested to ensure reliability in managing data.

INGRES supports SQL, the industry standard command language from IBM, and closely conforms to the SQL implementation of IBM's DB2 and SQL/DS products, as well as the SQL standards approved by the American National Standards Institute and X/OPEN. INGRES also supports a proprietary version of QUEL, a command language used in engineering and scientific markets that has greater functionality than SQL.

INGRES Application Development and End User Tools

Relational DBMS software can be utilized directly by formulating database access or update commands using a structured language such as SQL. Professional application programmers often find it preferable, however, to use a fourth generation language ("4GL") or to embed SQL requests into conventional programming languages such as COBOL or FORTRAN. End users executing simple queries or decision support systems may not want to learn a language like SQL and prefer a "fill-in-the-blanks" approach or an interface to a familiar personal computer program such as LOTUS 1-2-3. INGRES accommodates both types of usage by providing a broad range of development and query tools.

One of INGRES' strengths is that most of its application development tools utilize a "forms-based" approach called "Visual Programming." This technique shows data elements on a form displayed on a computer terminal and allows the user to specify format and manipulate data without having to write "code." Another strength of INGRES is that a user can develop each part of an application using a different development tool. Consequently, a developer might quickly "prototype" a complete application using a simple tool and then gradually replace parts of the application as it grows more complex with more sophisticated tools. This powerful facility provides quick implementation, while allowing continued expansion.

The Company's application development and end user tools, which are designed for both the professional developer and casual user, are outlined below.

Application Development Tools

- INGRES/Forms allows the user to define, create and edit forms interactively to be used by applications, with specifications for validation checks, ranges and relative field values of data during entry.
- INGRES/Reports allows the user to lay out the format of a report visually on the screen as it would be seen on the printed page, and thereby generate the report from this simple specification.
- INGRES/Graphics allows data to be displayed visually with many graph types, including bar charts, pie charts, multi-line plots, and scatter plots. This capability is currently available on DEC/VAX and several UNIX environments.

- INGRES/4GL is a comprehensive applications development system for developing sophisticated applications rapidly without conventional coding.
- INGRES/Embedded Languages allow a user programming in a conventional language such as COBOL, BASIC, FORTRAN, C, PASCAL or ADA to make SQL (or the equivalent QUEL) commands within his regular program. This embedded language capability is available for those languages that are widely used on each hardware system to which INGRES has been ported.

End-User Tools

- INGRES/Menu is an interactive menu that facilitates user access to various INGRES functions.
- INGRES/Query allows users to express queries and perform transactions by simply filling in the blanks on a form. The entered information acts as search criteria for retrieving or updating data in the database.
- INGRES/PC Link allows corporate personal computer users to browse through the contents
 of INGRES databases on certain larger computer systems, extract desired data, transfer the
 data across a network and store the data in the users' personal computer files. INGRES/PC
 Link automatically downloads and reformats data for processing by popular personal
 computer applications such as Lotus 1-2-3, Multiplan, dBase II/III, Multimate and Wordstar.

INGRES Distributed DBMS

The Company has focused its efforts in recent years on addressing the emerging market need for distributed DBMS products. The Company's first product for this market was INGRES/NET, which was introduced in 1984. In 1986, the Company introduced INGRES/STAR, the Company's distributed DBMS product.

- INGRES/NET allows the user to utilize the INGRES application development and end user
 tools on his local computer while employing data from an INGRES database on a remote
 computer. Thus, a user can treat any remote INGRES database as if it were his local
 database (subject to security checks built into the software). INGRES/NET is designed to be
 independent of the underlying communications hardware and networking software and has
 been implemented on various industry standard networking protocols, including DECNET
 (Ethernet), TCP/IP and SNA.
- INGRES/STAR allows the user to access and utilize the data from INGRES databases on multiple remote computers simultaneously, as if all the data were on the user's local computer. For example, the user could define a "logical" data base for employee information composed of payroll records on a computer in New York, job skills data in Boston and manpower utilization data kept in Washington. This distributed capability allows users to connect "islands of information" which frustrate users in major organizations that know data exists but are unable to access and use it where it is needed. Although revenues from sales of INGRES/STAR have not been significant to date, the Company believes that the availability of this product is an important competitive factor in the Company's sales of other INGRES products.

INGRES/STAR Release 5.0 accommodates query from multiple remote databases simultaneously, but currently offers only limited update capability. The Company intends in future releases to accommodate updates of information contained on multiple computers without specifying the location of that information. INGRES/STAR is currently available for networks of DEC VAX computers running the VMS operating system. The Company is developing extensions of INGRES/STAR to enable it to function on other operating systems, and to add parallel processing and fault tolerance. The Company has announced plans to make INGRES/STAR available on IBM mainframe and personal computers. The Company has also entered into agreements to develop

database gateways to interconnect databases using IBM's DB2, SQL/DS and IMS products. See "Product Development."

INGRES Operating Environments

Consistent with the Company's objective to provide an open architecture, INGRES Version 5.0 has been ported to a wide range of computer models and operating systems, including the following systems:

Manufacturer	Model	Operating System(s)(1)
Mainframes:		
Amdahl Corporation	470, 58xx	VM/CMS, UTS
DEC	VAX	VMS, ULTRIX, UNIX
		System V, 4.2/4.3BSD
IBM & compatibles	370, 303x, 308x,3090	VM/CMS, VM/IS, UNIX
Minicomputers:		
Alliant Computer Systems Corpora-		
tion	FX Series	Concentrix
AT&T	3B Series	UNIX System V
Arete	1200, 1600	ARIX 3.6
British Telecommunications	M6000	Uniplus+ 5.2
CCI	Power 6/32	UNIX System V
Convergent, Inc	Megaframe II	UNIX System V
Data General Corporation	MV Series	DG/UX 3.0
DEC	VAX	VMS, ULTRIX, UNIX System V, 4.2BSD
Gould Inc	PowerNode Series	UTX/32
Hewlett-Packard Company	9000/320, 9000/8xx	HP-UX
Honeywell Inc	XPS-100 Series	UNIX System V
IBM	9370, 43xx	VM/CMS, VM/IS, UNIX
ICL	CLAN Series	UNIX System V
NCR Corporation	Tower 32	UNIX System V
Pyramid Technology Corporation	90x, 98x, 98xx	OSx
Sequent Computer Systems, Inc	Balance 8000, 21000	UNIX System V, 4.2BSD
Unisys Corporation	7000, 5000/50, 5000/70, 5000/80, 5000/90	UNIX System V, 4.2BSD
Workstations and Personal Computers:		
AT&T	PC6300	MS-DOS 2.0
Apollo Computer Inc	DN Series	Domain/IX
Compaq Computer Corporation	Plus, AT	MS-DOS
DEC	MicroVAX, VAXstation, VAXmate	MicroVMS, MicroULTRIX, MS-DOS
Hewlett-Packard Company	150	MS-DOS
IBM & compatibles	PC/XT, PC/AT, PS/2	PC-DOS, MS-DOS
IBM	RT PC	AIX 2.1
ICL	DRS300	C-DOS
Sun Microsystems, Inc	Sun 2 & Sun 3 Series	4.2BSD

⁽¹⁾ A number of the models and operating systems designated above are trademarks of the manufacturers identified.

Porting software to new equipment is a continuous and extensive process. As new releases of INGRES are introduced to expand features or correct problems, they are normally ported to most of the computer models and operating systems listed above. The Company commenced initial shipment of a new version of INGRES in March 1988 and plans to port the new version to most of the hardware and operating systems currently supported. The porting of a new product to multiple systems, however, requires a significant amount of time, and any substantial delay in porting this new version would adversely affect the Company's results of operations.

Marketing and Customers

The Company markets its products in the United States and Canada primarily through its domestic direct sales and support force, which as of March 31, 1988, consisted of 193 employees. The Company sells and supports its products from its headquarters in Alameda, California and from field offices located in the metropolitan areas of Atlanta, Boston, Chicago, Cleveland, Dallas, Denver, Detroit, Houston, Los Angeles, Minneapolis, Montreal, New York, Ottawa, San Francisco, Seattle, Toronto and Washington, D.C.

The Company markets its products outside the United States and Canada primarily through the sales and support forces of five wholly owned subsidiaries, which as of March 31, 1988, employed 184 persons. These subsidiaries sell and support the Company's products in Australia, Austria, Belgium, Denmark, Finland, France, Indonesia, Ireland, Japan, Luxembourg, the Middle East, the Netherlands, New Zealand, Norway, Spain, Sweden, Switzerland, the United Kingdom and West Germany.

The Company also markets its products in certain foreign countries through international distributors, including distributors in Belgium, Finland, Hong Kong, Indonesia, Ireland, Israel, Italy, Malaysia, New Zealand, Norway, Phillipines, Singapore, Spain and Sweden.

The Company significantly expanded its domestic and international sales and support capability from 106 to 237 employees in fiscal 1987 and to 377 employees as of March 31, 1988, and expects this expansion to continue through fiscal 1988 and 1989. The Company believes that the successful expansion of its sales and marketing organization is critical to its continued success.

The Company also markets its products through hardware original equipment manufacturers ("OEMs") and software value added remarketers ("VARs") that combine INGRES with their computer hardware or software applications packages and redistribute them together. OEMs who have the right to distribute INGRES under agreements with the Company include British Telecommunications PLC, Data General Corporation, DEC (for VAX/ULTRIX), ELXSI, Gould Inc., Honeywell Bull, Inc., IBM (for RT PC and PS/2 computers running the AIX operating system), ICL, Matra System, MIPS Computer Systems, Inc., Pyramid Technology Corp., Sequent Computer Systems, Inc. and Unisys Corporation. The Company has also licensed a number of VARs to distribute INGRES, although revenues to date from VARs have not been significant.

Prospective customers, OEMs and VARs often perform detailed technical evaluations of the Company's software, as well as of competitive products as part of the DBMS selection process. Therefore, the Company's sales representatives are teamed with support specialists who answer technical questions, help customers run comparative tests against competitive products and develop prototype applications.

The INGRES product line is targeted at Fortune 1000 companies and other large organizations in the manufacturing, finance, telecommunications, government and education sectors. The Company's customers include the following entities or their divisions or subsidiaries:

Manufacturing /Industrial:

BP America Inc.
The Boeing Company

The British Petroleum Company p.l.c.

Celanese Corporation

Champion International Corporation

Chevron Corporation Chrysler Corporation Colgate-Palmolive Co. Corning Glass Works

E.I. duPont de Nemours and Company

Eastman Kodak Company Ford Motor Company General Dynamics Corp. General Electric Company General Motors Corporation

Honeywell, Inc.

Hughes Aircraft Company

L'Oréal Group

Lockheed Corporation

Martin Marietta Corporation

Minnesota Mining and Manufacturing

Corporation Nestle S.A.

Northrop Corporation Philips Industries, N.V. Polaroid Corporation Schlumberger N.V. Siemens A.G.

SmithKline Beckman Corporation

TRW Incorporated Tektronix, Incorporated

Texas Instruments Incorporated United Technologies Corporation

Upjohn Company

Westinghouse Electric Corporation

Finance:

Citicorp

J.P. Morgan & Co. Incorporated

Lloyds Bank

London Stock Exchange

Midland Bank

Telecommunications:

Alcatel AT&T

Bell Canada

Bell Communications Research

Bell South Corporation
British Telecommunications

GEC Telecom Northwestern Bell

Southwestern Bell Corporation

US West

Government:

Agriculture Canada Deutsche Bundespost

Government of Ontario, Ministry of Community and Social Services

Jet Propulsion Laboratory

Lawrence Livermore Laboratory
London Metropolitan Police
Los Alamos Laboratory

NASA

Sandia National Laboratory U.K. National Health Service

U.K. Navy U.S. Air Force U.S. Army

U.S. Department of Defense U.S. Department of Interior

U.S. Navy

Education:

Boston University

Carnegie Mellon University Johns Hopkins University London School of Economics

Massachusetts Institute of Technology

Princeton University

University of California, Berkeley

University of Colorado University of Michigan University of North Carolina University of Wisconsin In fiscal 1987, International Computers Limited accounted for 8% of the Company's revenues. No other customer accounted for more than 5% of the Company's revenues in fiscal 1987. No customer accounted for more than 5% of the Company's revenues in the first nine months of fiscal 1988.

The Company typically ships products within a few days of its receipt of an order. Accordingly, the Company does not maintain any meaningful backlog.

Revenues from international customers amounted to approximately 15%, 31% and 35% of the Company's revenues in fiscal 1985, 1986 and 1987, respectively, and 45% for the first nine months of fiscal 1988. Revenues from international distributors, and most of the revenues from the Company's international subsidiaries, are denominated in local currencies, thereby making operating results subject to changes in currency exchange rates. In particular, if the dollar strengthens in relation to certain international currencies, the Company's revenues from international sales may be adversely affected.

Product Development

Since inception the Company has made substantial investments in research and product development. The Company believes this investment has enabled it to become a leader in the relational DBMS marketplace. The Company intends to continue a high level of research and development expenditures in the future to maintain and enhance its competitive position. As of March 31, 1988, the Company had 203 persons in product development.

The Company's current significant product development efforts include the following:

- Completion of a new version of INGRES, the development of which has included redesign of internal coding structures to support production application requirements of high transactional performance, large numbers of concurrent users, high reliability and availability, and large database support.
- Adaptation of INGRES to new hardware and operating systems, including IBM mainframe and personal computer environments.
- Implementation of SQL query language support with full compatibility to IBM's DB2 product.
- New product and technology development, including extensions to the INGRES/STAR distributed database system and new DBMS gateway technology.

The Company has jointly funded product development efforts with several companies, including General Motors Research, Hewlett-Packard Company, J.P. Morgan & Company, Incorporated, Lotus Development Corp., Novell, Inc., Sun Microsystems, Inc., Pansophic Systems, The Boeing Company and others. These joint development projects have enabled the Company to identify new DBMS applications without a major financial investment. The Company believes that such joint development efforts enable it to be more aggressive in introducing new products and more responsive to the needs of its markets.

Since its inception in 1980, the Company has introduced six major versions of INGRES, each with increased capabilities and performance. In March 1988, the Company commenced initial shipments of a new version of INGRES for users of DEC VAX/VMS systems. This new version changes the architecture and significant parts of INGRES. The development effort has been greater in scope and in technical difficulty than that undertaken for previous versions. Although 40 customers have used test versions of the system, it is common for programs as complex as this to contain undetected errors or "bugs" when first released, which are discovered only after the product has been used with many different computer systems and in varying applications. Identifying and correcting the errors typically is an expensive and time-consuming process. In addition, a significant effort is still required to port this new version to multiple computers and operating systems. The Company's future business is dependent in large part on the timely and successful debugging and porting of this new version. Any significant delay in shipping, correcting, or porting the new version of INGRES would have a material adverse effect on the Company's results of

operations. There can be no assurance that errors will not be discovered or porting will not be delayed, either of which will cause delays in securing market acceptance and could adversely affect the Company's operating results.

The Company's expenditures for research and development increased 55% from fiscal 1985 to fiscal 1986 and 43% from fiscal 1986 to fiscal 1987 (excluding the impact of amounts capitalized in 1987). These increases resulted largely from similar percentage increases in the number of research and development personnel. During fiscal 1985, 1986 and 1987, research and development expenses were approximately \$5.9 million, \$9.2 million and \$10.4 million, respectively, representing 34%, 33% and 22% of the Company's revenues in such years. During the first nine months of fiscal 1988, research and development expenses were \$10.1 million, representing 18% of the Company's revenues in such period.

Prior to fiscal 1987, the Company followed the prevailing practice of charging to expense all research and development expenditures as incurred. The Financial Accounting Standards Board, in its Statement of Financial Accounting Standards No. 86 ("SFAS No. 86") now 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 be capitalized and reported at the lower of unamortized cost or net realizable value of the product. Accordingly, in fiscal 1987 and the first nine months of fiscal 1988, the Company capitalized approximately \$2.8 and \$2.5 million of software development costs, respectively. These amounts represented approximately 21% and 20% of total research and development expenditures for the respective periods. Including this capitalized amount, total research and development expenditures in fiscal 1987 and the first nine months of fiscal 1988 were approximately \$13.2 and \$12.4 million, respectively, or 28% and 22% of revenues. The amount of product development expenditures required to be capitalized under SFAS No. 86 in future periods is dependent both upon the level of expenditures incurred on projects that meet the feasibility tests specified in SFAS No. 86 and upon the timing of 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. See Note 1 of Notes to Consolidated Financial Statements.

Competition

The market for DBMS products is intensely competitive and rapidly changing. Numerous companies are engaged in the research, development and commercialization of relational database management system products and related application development tools. Many of the Company's competitors and potential competitors have significantly greater financial, technical and marketing resources than the Company. There can be no assurance that other companies have not developed or will not develop competitive products that are superior to the Company's products. In addition, a substantial portion of the Company's revenues to date have resulted from sales of INGRES for use on DEC computers. DEC also markets its own competitive database management product for use on its computers. There can be no assurance that DEC will not devote its significantly greater financial, technical and marketing resources to more aggressively market its own database management product or develop an enhanced product for use on its computers, thereby reducing the Company's sales to the DEC market. Competitive pressures from DEC and others could also result in reductions in the prices of the Company's products, which would have an adverse effect on the Company's results of operations.

The Company competes with various companies in the different markets it addresses. No company has a large market share across all markets in which INGRES competes. In the DEC VAX/VMS market, which is the Company's principal market, INGRES' chief competitors are Rdb from DEC, Oracle from Oracle Systems Corporation ("Oracle") and, to a lesser extent, DataServer from Sybase Corporation. In the UNIX marketplace, INGRES' chief competitors are Informix from Informix Corporation, Oracle from Oracle, DataServer from Sybase Corporation and Unify from Unify Corporation. In the IBM mainframe market, INGRES' chief competitors are DB2 and SQL/DS

from IBM, Oracle from Oracle and, to a lesser degree, products from independent software vendors such as IDMS/R from Cullinet Software, Inc. On personal computers, INGRES' chief competitors are dBase II and III from Ashton-Tate Corporation, Informix from Informix Corporation and Oracle from Oracle.

Competition in the database management market is based on product quality and reliability; performance; availability across mainframes, minicomputers, workstations and personal computers; productivity in developing applications; ease of understanding and operation; service and support; strength in distribution and marketing; brand name recognition; and price. The Company believes that its products are competitive in each of these areas. Although revenues from sales of INGRES/STAR have not been significant to date, the Company believes that the availability of this product is an important competitive factor in the Company's sales of other INGRES products.

Product Protection

The Company relies on a combination of trade secret, copyright and trademark laws, license agreements and technical measures to protect its rights in its software products. Like many software companies, the Company has no patents.

The initial version of INGRES was developed at the University of California, Berkeley ("UC"). Certain of the Company's founders (including one of its directors) participated in the development of the initial version of INGRES at UC. The Company commenced its development activities with the public domain version of INGRES developed at UC, and added substantial proprietary technology in developing a product with enhanced performance and functionality, as well as new products, marketed under the trademark INGRES. UC continues to offer licenses on the initial version of INGRES under that name. Although it has not registered "INGRES" as a trademark in the United States, the Company believes it has the right to use INGRES as a trademark.

The Company's products are generally licensed to end users on a "right to use" basis pursuant to a perpetual license that restricts the use of the products to the customer's internal purposes on a single computer at a single site. The Company also relies on copyright laws and on "shrink-wrap" licenses that are not signed by the end user. Copyright and trade secret protection for source code and other software products may be unavailable in certain foreign countries. In addition, "shrink-wrap" licenses may be unenforceable under the laws of certain jurisdictions.

The Company protects the human readable, source code version of its products as a trade secret and as an unpublished copyrighted work. The Company has made portions of the source code available to its customers only under very limited circumstances, and for restricted uses. The Company has entered into source code escrow agreements with a number of its customers that require release of source code to the customer in the event there is a bankruptcy proceeding by or against the Company, the Company ceases to do business, or the Company breaches its maintenance obligation to the customer. In the event of a release of the source code to a customer, the customer is required to maintain its confidentiality and, in general, to use the source code solely for internal purposes or for the purpose of providing maintenance to its customers.

The Company believes that, because of the rapid pace of technological change in the computer software industry, patent, trade secret and copyright protection are less significant than factors such as the knowledge, ability and experience of the Company's personnel, new product introduction, frequent product enhancement, name recognition and ongoing product maintenance.

Product Revenue

The Company's standard end user license agreement for INGRES provides for payment of an initial license fee to use the product on a customer's specific computer. As of March 31, 1988, initial license fees ranged from \$950 to \$3,000 for INGRES on personal computers and single user workstations, and from \$5,000 to \$160,000 for INGRES on minicomputers and mainframe com-

puters. Other separately priced products are licensed similarly. A customer may obtain additional licenses at the same site at a discount. Fees from licenses with acceptance periods are not recognized as revenues until the end of the acceptance period. Because the Company's product pricing is typically based on the size and capabilities of the computer system on which the product runs, the Company's operating results could be adversely affected if technological changes or other conditions cause customers to purchase fewer large computer systems in favor of smaller systems.

End users generally acquire and renew annually maintenance service contracts, consisting of either a support or update package for each INGRES license. A typical fee for an annual support or update package is approximately 15% and 7½%, respectively, of the current initial license fee for the applicable license at the time of renewal or initial acquisition. A support package consists of technical support, including telephone consultation on the use of the products and problem resolution, and system updates for software products and user documentation. An update package consists of system updates only. Annual support or update fees are generally payable in advance, and are recognized as revenues proportionately over the year. To date, a substantial majority of the Company's customers have renewed their support or update packages annually.

The Company generally receives sublicense fees from distributors, hardware OEMs and software VARs based on the revenues generated by the distributor, OEM or VAR. Sublicense fees from distributors are typically a percentage of the Company's list price. OEM agreements are negotiated on a case-by-case basis and typically include an initial nonrefundable payment (in the form of an initial fee plus advance sublicense fees, some or all of which is payable upon the signing of the contract) and sublicense fees based on the number of copies of the Company's products distributed by the OEM. Agreements with software VARs typically include a development license for INGRES. Sublicense fees are based on the number of copies of the Company's products distributed by the VAR.

Fixed license fees from major end user customers and advance sublicense fees from OEMs and VARs are generally recognized when a customer unconditionally commits to payment. Initial non-refundable payments relating to services to be performed by the Company are recognized either proportionately over the period during which the applicable service is to be performed or on a services-performed basis. Non-guaranteed per-copy sublicense fees from distributors, OEMs and VARs are recognized as revenue when they are reported by the distributor, OEM or VAR.

Employees

As of March 31, 1988, the Company employed 668 persons, including 377 in sales and marketing, 203 in product development and 88 in management, administration and finance. Of such employees, 484 were located in the United States and Canada and 184 were employed in Europe and Australia.

Competition in recruiting personnel in the software industry is intense. The Company believes that its future success will depend in part on its continued ability to recruit and retain highly skilled management, sales, marketing and technical personnel. In particular, the Company's operating plans for fiscal 1988 and 1989 contemplate the addition of a significant number of sales and marketing personnel, whom the Company believes are essential to achieve continued growth in revenues, and a corresponding increase in financial and administrative staff. The Company's operating results would be adversely affected if the Company is unable to attract, assimilate and retain these personnel, or if revenues fail to increase at a rate sufficient to absorb the resulting increased expenses.

None of the Company's employees is represented by a labor union. The Company has experienced no work stoppages and believes that its employee relations are good.

Facilities

The Company's principal administrative, marketing and research and development facilities are located in Alameda, California, 12 miles southeast of San Francisco. The Company occupies approximately 139,000 square feet under leases expiring May 31, 1992 through June 30, 1993. The Company has an option to renew each of such leases for a period of six years. The annual base rental payment (not including operating expenses, insurance, property taxes and assessments) is \$2,928,000.

The Company also leases sales and service space in 21 locations within the United States and 7 locations internationally. The Company's total payments under its sales and service office leases for fiscal 1987 were approximately \$1.1 million.

The Company believes that its existing facilities are adequate for its current needs and that suitable additional or substitute space will be available as needed to accommodate the Company's operations and expansion. The Company also leases a variety of computers and computer-related equipment. See Notes 4 and 5 of Notes to Consolidated Financial Statements for information regarding the Company's lease obligations.

MANAGEMENT

Executive Officers and Directors

The executive officers and directors of the Company and their ages as of March 31, 1988 are as follows:

Name	Age	Position
Gary J. Morgenthaler	39	Chairman of the Board, Chief Executive Officer and Director
Paul E. Newton	44	President, Chief Operating Officer and Director
Nicholas Birtles	43	Vice President, International Operations
Robert Healy	45	Vice President, Marketing
Lawrence A. Rowe	39	Vice President, Advanced Development
P. Michael Seashols	42	Vice President, Sales and Marketing
William M. Smartt	45	Vice President, Finance and Administration and Chief Financial Officer
Martin J. Sprinzen	40	Vice President, Engineering
Eugene Wong	53	Secretary
Robert C. Miller(1)	44	Director
Charles G. Moore(1)(2)	44	Director
Michael R. Stonebraker	44	Director
William H. Younger, Jr. (1)(2)	38	Director

- (1) Member of the Compensation Committee
- (2) Member of the Audit Committee

All directors hold office until the next annual meeting of stockholders of the Company and until their successors have been duly elected and qualified. Executive officers serve at the discretion of the Board. There are no family relationships among any of the directors and officers.

Mr. Morgenthaler, a founder of the Company, has served as Chief Executive Officer and Chairman of the Board of Directors of the Company since early 1987. He served as President and Chief Executive Officer from January 1984 to early 1987, and as Executive Vice President and Chief Operating Officer from October 1980 to January 1984. Mr. Morgenthaler has served as a director of the Company since its inception. Prior to founding the Company, he was a consultant with McKinsey & Company, Inc., a management consulting firm. Mr. Morgenthaler holds a B.A. from Harvard University.

Mr. Newton has served as President and Chief Operating Officer and a director of the Company since early 1987. Between 1968 and early 1987, Mr. Newton was employed in various positions by UCCEL Corporation, a computer services and software company. Between 1984 and 1986, Mr. Newton served as Senior Vice President and General Manager of Software at UCCEL. Mr. Newton holds a B.S. in physics and an M.S. in management from M.I.T.

Mr. Birtles joined the Company in 1984 as Managing Director of European Operations and became Vice President, International Operations in early 1986. Prior to his employment by the Company, Mr. Birtles was employed for 13 years by Comshare, a computer services company, most recently as its European Sales Director, where he was responsible for 12 sales offices in the United Kingdom.

Mr. Healy has served as Vice President, Marketing of the Company since April 1987. From 1983 to April 1987, Mr. Healy served as Senior Vice President, Marketing and International Sales of General Electric Software International, a software manufacturing and distribution company. Between 1969 and 1983, he held various positions, most recently, Division Vice President, Marketing, for Automatic Data Processing, Inc., an electronic data processing service company. Mr. Healy holds a B.S. in business administration from Upsala College.

Dr. Rowe, a founder of the Company, has been Vice President, Advanced Development of the Company since October 1987. Dr. Rowe also serves as a consultant to the Company. Since 1976, Dr. Rowe has been a Professor of Electrical Engineering and Computer Sciences at the University of California, Berkeley. Dr. Rowe holds a B.A. in mathematics and a Ph.D. in information and computer sciences from the University of California, Irvine.

Mr. Seashols joined the Company in April 1986 as Vice President, Sales and Marketing. Between 1983 and 1986, Mr. Seashols was employed by Oracle Corporation, a software manufacturing company, most recently in the position of Vice President for Sales and Service. Mr. Seashols also was a Senior Vice President at EXO Systems Corporation, a software manufacturing company, during 1983. Mr. Seashols holds a B.A. in mathematics from Manchester College.

Mr. Smartt has served as Vice President, Finance and Administration and Chief Financial Officer of the Company since February 1986. From 1977 to 1986, Mr. Smartt was employed by DiGiorgio Corporation, a diversified holding company, in various financial positions, most recently as Vice President, Finance and Administration and Chief Financial Officer. Mr. Smartt holds a B.S. in business from the University of California, Berkeley.

Mr. Sprinzen was elected Vice President, Engineering of the Company in May 1988, and is expected to commence employment in May 1988. From September 1986 to May 1988, Mr. Sprinzen served as President of Nastec, Inc., a computer aided software engineering company. From July 1984 to September 1986, Mr. Sprinzen served as Vice President, Engineering of the Company. From 1981 to July 1984, Mr. Sprinzen was Vice President, Technical Services of Candle Corporation, a supplier of systems software. Mr. Sprinzen received his B.S. in electrical engineering from the Cooper Union.

Dr. Wong, a founder of the Company, has been Secretary of the Company since 1980. Dr. Wong also serves as a consultant to the Company. Since 1962, Dr. Wong has been a Professor of Electrical Engineering and Computer Sciences at the University of California, Berkeley, where he is currently Chairman of the Electrical Engineering and Computer Sciences Department. Dr. Wong holds a Ph.D. in electrical engineering and computer science from Princeton University.

Mr. Miller has been a director of the Company since 1987. Mr. Miller currently serves as Chairman and Chief Executive Officer of MIPS Computer Systems, Inc., a computer manufacturing company. Before joining MIPS, Mr. Miller was employed by Data General Corporation, a computer manufacturing company, where he was employed for six years, most recently as a Senior Vice President of their Information Systems Group. Mr. Miller received his B.S. in engineering from Bucknell University and an M.S. in engineering from Stanford University.

Dr. Moore has been a director of the Company since 1982. Dr. Moore has been a general partner of the Welsh, Carson, Anderson & Stowe venture capital investment partnerships since 1982. From 1975 to 1981, Dr. Moore was employed by the Network Services Division of Automated Data Processing, Inc., where he served as Executive Vice President. Dr. Moore holds a B.A. in mathematics from Dartmouth College and an M.A. and Ph.D. in computer and communications sciences from the University of Michigan.

Dr. Stonebraker, a founder of the Company, has served as a director of the Company since 1980. Dr. Stonebraker also serves as a consultant to the Company. Since January 1971, Dr. Stonebraker has been a Professor of Electrical Engineering and Computer Sciences at the University of California, Berkeley. He holds a Ph.D. in computer information and control engineering and an M.S. from the University of Michigan.

Mr. Younger has been a director of the Company since 1983. He held the position of Chairman of the Board from August 1983 to early 1987. From August 1983 to January 1984, Mr. Younger served as President. Mr. Younger is a general partner of Sutter Hill Ventures, a venture capital investment firm, with which he has been associated since 1981. Mr. Younger obtained his B.S. in electrical engineering from the University of Michigan and an M.B.A. from Stanford University.

Executive Compensation

The following table sets forth the cash compensation paid to each of the five most highly compensated executive officers of the Company whose cash compensation exceeded \$60,000, and to all executive officers as a group for services rendered in all capacities during the fiscal year ended June 30, 1987.

Individual or Persons in Group	Capacities in Which Served	Cash Compensation(1)(2)
Gary J. Morgenthaler	Chairman of the Board and Chief Exec- utive Officer	\$ 170,739
Paul E. Newton	President, Chief Operating Officer and Director	\$ 120,142(3)
P. Michael Seashols	Vice President, Sales and Marketing	\$ 180,481
William M. Smartt	Vice President, Finance and Administration and Chief Financial Officer	\$ 180,481 \$ 143,799
Nicholas Birtles	Vice President, International Operations	\$ 130,332
All executive officers as a group	•	
All executive officers as a group (11 persons)(1)(2)(3)(4)(5)		\$1,057,231

- (1) Includes amounts deferred pursuant to Section 401(k) of the Internal Revenue Code of 1986, as amended. See "Deferred Profit-Sharing Plan."
- (2) Excludes bonuses earned in fiscal 1986 but paid in fiscal 1987, consisting of \$48,910 and \$26,116 paid to Mr. Morgenthaler and Mr. Smartt, respectively, and \$150,428 paid to all executive officers as a group.
- (3) Includes approximately \$20,634 paid to Mr. Newton during the fiscal year as reimbursement for expenses incurred in connection with his relocation to California. Mr. Newton began his service as President of the Company in early 1987.
- (4) Includes \$36,000 paid to each of Lawrence A. Rowe and Eugene Wong, respectively, for the provision of consulting services to the Company.
- (5) Includes compensation paid to two former executive officers of the Company.

Stock Option Plans

The Company adopted its 1984 Incentive Stock Option Plan (the "Incentive Plan") in April 1984, and its 1986 Supplemental Stock Option Plan (the "Supplemental Plan") in November 1986. The Company's Incentive Plan provides for the grant to employees of the Company and its affiliates of options to purchase shares of Common Stock, which options are intended to qualify as incentive stock options under the provisions of Section 422A of the Internal Revenue Code of 1986 (the "Code"). The Company's Supplemental Plan provides for the grant to employees and officers of and consultants to the Company and its affiliates of options to purchase Common Stock, which options are not intended to qualify as incentive stock options ("nonqualified options"). The aggregate number of shares reserved for issuance under the Incentive Plan, the Supplemental Plan and the Company's 1987 Employee Stock Participation Plan has been increased periodically to a current aggregate of 2,300,000 shares. See "Management—Employee Stock Participation Plan." In 1981, the Company adopted its 1981 Nonqualified Stock Option Plan (the "Nonqualified Plan"), which provided for the grant to employees of nonqualified options. The Nonqualified Plan terminated prior to the Company's adoption of the Supplemental Plan. As of March 31, 1988, an option to purchase 5,000 shares at \$2.50 per share was outstanding under the Nonqualified Plan.

At March 31, 1988, 156,306 shares had been issued upon exercise of options granted under the Incentive Plan and Supplemental Plan, there were options outstanding to purchase 1,891,893 shares at a weighted average exercise price of approximately \$2.91 per share, and an aggregate of 151,801 shares remained available for future grants under the Incentive Plan and Supplemental Plan. At March 31, 1988, outstanding options to purchase an aggregate of 540,598 shares were exercisable under these two plans.

The Incentive Plan and the Supplemental Plan are administered by the Compensation Committee of the Company's Board of Directors, which has discretion to select grantees, to designate the

number of shares to be covered by each option, to establish vesting schedules, to specify the type of consideration to be paid to the Company upon purchase and, subject to certain restrictions, to specify other terms of the options. The maximum term of options under either plan is ten years. The aggregate fair market value of the Common Stock for which any employee may be granted options under the Incentive Plan that are first exercisable in any one calendar year may not exceed \$100,000, plus certain carryover allotments.

The exercise price of options granted under the Incentive Plan must equal at least the fair market value of the Common Stock on the date of grant. The exercise price of options granted under the Supplemental Plan must equal at least 85% of the fair market value of the Common Stock on the date of grant. To date, the exercise price of options granted pursuant to the Supplemental Plan has equaled the fair market value of the Common Stock on the date of grant. Shares covered by currently outstanding options under the two plans typically become exercisable at the rate of 20% per year over the five years following the date of grant.

The following table sets forth as to certain of the executive officers named in the compensation table above, and as to all executive officers as a group, for the 1987 fiscal year: (1) the number of shares of Common Stock subject to options granted during the period and the weighted average exercise price per share for such options; and (2) the net value realized (estimated fair market value at date of exercise less exercise price) upon exercise of options during the period.

Fiscal 1987	Paul E. Newton	P. Michael Seashols	Nicholas Birtles	All Executive Officers as a Group (11 Persons in Fiscal 1987)(1)
Options Granted: Number of shares		25,000 \$2.50	25,000 \$2.50	347,500 \$2.50
Options Exercised: Number of shares Net value realized		_		51,500 \$59,500

⁽¹⁾ No options were granted to Messrs. Morgenthaler or Smartt in fiscal 1987.

During the period from July 1, 1987 through May 9, 1988, Mr. Seashols purchased 13,437 shares of Common Stock upon exercise of an option at a per share exercise price of \$1.50. The net value realized by Mr. Seashols pursuant to such exercise (estimated fair market value at the date of exercise less exercise price) was \$26,874. During this period, Messrs. Birtles, Smartt and Sprinzen were granted options to purchase 15,000, 10,000 and 100,000 shares of Common Stock at a per share purchase price of \$6.00. In addition, Mr. Miller received during this period in connection with his service as a member of the Company's Board of Directors an option to purchase 15,000 shares of Common Stock at a per share purchase price of \$3.50.

During the period from July 1, 1984 through June 30, 1986, Messrs. Seashols, Smartt and Birtles were granted options to purchase 66,666, 65,000 and 50,000 shares of Common Stock with average per share exercise prices of \$1.50, \$1.73 and \$1.50, respectively. During this period, other executive officers and directors were granted options for an aggregate of 20,000 shares of Common Stock with an average per share exercise price of \$1.50.

Employee Stock Participation Plan

In May 1988, the Board of Directors of the Company adopted its 1987 Employee Stock Participation Plan (the "Participation Plan"), which is intended to qualify as an employee stock purchase plan within the meaning of Section 423 of the Code. Under the Participation Plan, the Board may authorize the participation by employees (excluding executive officers) in offerings of up to 100,000 shares of its Common Stock in any twelve month offering period. Employees who participate in an offering must elect to participate at the beginning of an offering period as specified by the Board, by deciding to have not more than 10% of their salary withheld pursuant to the Participation Plan. The salary so withheld is then used to purchase shares of Common Stock of the Company at a price equal to not less than 85% of the value of the Common Stock on the date that

the offering commenced or the date the offering ends, whichever price is lower. To date, no shares have been issued under the Participation Plan. The Company expects to implement the Participation Plan commencing July 1, 1988.

Deferred Profit-Sharing Plan

In May 1985, the Company adopted a deferred profit-sharing plan (the "Profit Sharing Plan") covering all of the Company's employees working at least 20 hours per week. The Profit Sharing Plan is intended to qualify under Section 401 of the Code so that contributions by employees to the plan are not taxable to employees until withdrawn from the plan. As of March 31, 1988, of the Company's 484 domestic full-time employees, 366 were participants in the Profit Sharing Plan.

Executive Bonus Plan

In August 1987, the Board adopted an Executive Bonus Plan, under which executive officers of the Company may be awarded cash bonuses for attaining certain financial, organizational, and/or management goals delineated at the start of the fiscal year. If all goals are met, the bonuses to be paid to executive officers under the Executive Bonus Plan in fiscal 1988 range from approximately 33% to 95% of the executive officer's current annual salary. Additional amounts will be paid pursuant to the Executive Bonus Plan if certain financial goals are exceeded in fiscal 1988.

Certain Relationships and Other Transactions

On April 30, 1986, the Company sold and issued to Gary Morgenthaler, an officer and director of the Company, 73,800 shares of Common Stock for a cash payment of \$11,070 and a promissory note for \$99,630, secured by the stock purchased and bearing interest at an annual rate of 8.08%. As of March 31, 1988, the outstanding indebtedness, including accrued interest, under such note was \$113,318. Principal and interest under the note are due and payable on April 29, 1991 or earlier under certain circumstances. Mr. Morgenthaler will repay the outstanding indebtedness under the note with a portion of the proceeds from his sale of shares in this offering. Loans to officers, directors, key employees or their affiliates have been and will continue to be approved by a majority of the independent and disinterested outside members of the Board of Directors.

On May 9, 1986, September 23, 1986, May 13, 1987 and June 3, 1987, the Company sold and issued shares of Series E Preferred Stock to the following principal stockholders, director and executive officer of the Company at a cash purchase price of \$10.50 per share:

Purchaser	of Series E Preferred Stock	
Entities associated with Citibank, N.A.(1)	285,000	
Morgenthaler Management Partners II(2)	9,524	
P. Michael Seashols	20,000	
Sutter Hill Ventures (3)		
TR Berkeley Development Limited	285,714	
Dunedin Berkeley Development Capital Limited	190,476	
Westpac Investment Management Pty. Limited	285,714	
Welsh, Carson, Anderson & Stowe II (4)	17,600	
William H. Younger, Jr.(3)	1,428	

- (1) Consists of 132,619 shares held by Citibank, N.A., as Custodian for Citiventure; 47,619 shares held by Citibank, N.A., as Investment Manager for GTE Service Corporation Pension Plans; 47,619 shares held by Boston Safe Deposit and Trust Company, U.S. WEST Master Trust; 47,619 shares held by Mellon Bank, N.A., Master Trustee for Bell Atlantic Master Pension Trust; 4,762 shares held by State Street Bank, Trustee for Leeway & Co.; and 4,762 shares held by First National Bank of Minneapolis as Trustee, Citicorp Investment Management Inc. as Investment Manager for Dayton Hudson Corp. Plans.
- (2) David Morgenthaler, a general partner of Morgenthaler Family Partners, which is the general partner of Morgenthaler Management Partners II, is the father of Gary J. Morgenthaler, an officer and director of the Company.
- (3) William H. Younger, Jr., a director of the Company, is a general partner of Sutter Hill Ventures, of which Imasco Venture Holdings B.V., a principal stockholder of the Company, is a limited partner.
- (4) Charles G. Moore, a director of the Company, is a general partner of Welsh, Carson, Anderson & Stowe II.

On March 25, 1988, the Company issued 240,000, 240,000, 160,000, 80,000 and 80,000 shares of Series F Preferred Stock, at a cash purchase price of \$12.50 per share, to CDFC Berkeley Limited, SPI Berkeley Development Capital, KB Berkeley Japan Development Capital Limited, Berkeley Australia Development Capital Limited and TR Berkeley Development Capital, respectively. CDFC Berkeley Limited, SPI Berkeley Development Capital and KB Berkeley Japan Development Capital Limited each holds five percent or more of the Preferred Stock to be outstanding upon the closing of the offering covered by this Prospectus.

Transactions with officers, directors and affiliates of the Company have been and will continue to be on terms no less favorable to the Company than could be obtained from unaffiliated third parties, and have been and will continue to be approved by a majority of disinterested directors.

The Company's Bylaws provide that the Company will indemnify its directors and may indemnify its officers to the full extent permitted by law. The Company believes that indemnification under its Bylaws covers at least negligence and gross negligence by directors and officers, and requires the Company to advance litigation expenses in the case of stockholder derivative actions or other actions, against an undertaking by the officer or director to repay such advances if it is ultimately determined that the director or officer is not entitled to indemnification.

In addition, the Company's Certificate of Incorporation provides that, pursuant to Delaware law, its directors shall not be liable for monetary damages for breach of the directors' fiduciary duty of care to the Company and its stockholders. This provision in the Certificate of Incorporation does not eliminate the duty of care, and in appropriate circumstances equitable remedies such as injunctive or other forms of non-monetary relief will remain available under Delaware law. In addition, each director will continue to be subject to liability for breach of the director's duty of loyalty to the Company for acts or omissions not in good faith or involving intentional misconduct, for knowing violations of law, for actions leading to improper personal benefit to the director, and for payment of dividends or approval of stock repurchases or redemptions that are unlawful under Delaware law. The provision also does not affect a director's responsibilities under any other law, such as the federal securities laws or state or federal environmental laws.

At present, there is no pending litigation or proceeding involving a director or officer of the Company as to which indemnification is being sought nor is the Company aware of any threatened litigation that may result in claims for indemnification by any officer or director.

PRINCIPAL AND SELLING STOCKHOLDERS

The following tables and notes thereto set forth certain information regarding the beneficial ownership of the Company's voting securities as of March 31, 1988, after giving effect to the conversion into Common Stock of all of the Company's Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and Series D Preferred Stock and 57,507 shares of Series E Preferred Stock, and after the sale of Common Stock offered by the Company and the Selling Stockholders hereby (assuming no exercise of the Underwriters' over-allotment option) by (i) all those known by the Company to be beneficial owners of more than five percent of (A) its Common Stock or (B) Series E Preferred Stock and Series F Preferred Stock; (ii) each director; (iii) all officers and directors of the Company as a group; and (iv) other Selling Stockholders. Unless otherwise indicated, each of the stockholders has sole voting and investment power with respect to the shares beneficially owned, subject to community property laws where applicable.

того арривалог	Shares Beneficially Owned Prior to Offering		Shares	Shares Beneficially Owned After Offering	
Common Stock:	Number	Percent of Class	to Be Sold	Number	Percent of Class
Imasco Venture Holdings B.V	1,407,640	20.5%	270,692	1,136,948	13.6%
Welsh, Carson, Anderson & Stowe II(2) One World Financial Center Suite 3601 New York, NY 10281	767,600	11.2%	33,800	733,800	8.8%
Gary J. Morgenthaler(3)	438,175	6.4%	33,908	404,267	4.8%
Lawrence A. Rowe(4)	363,041	5.3%	36,000	327,041	3.9%
Michael R. Stonebraker (4)	363,041	5.3%	36,034	327,007	3.9%
Eugene Wong(4)(5)	350,041	5.1%	20,000	330,041	3.9%
Paul M. Wythes(6)	347,552	5.1%	17,378	330,174	3.9%
Calm & Co	321,524	4.7%	52,102	269,422	3.2%
Robert C. Miller(4)	2,750	*		2,750	*
Charles G. Moore(2)	767,600	11.2%		733,800	8.8%
Paul E. Newton(7)	74,916	*		74,916	*
William H. Younger, Jr. (1)	40,315	*		40,315	*
Joseph Russoniello	860	*	86	774	*
All Officers and Directors as a Group					
(13 persons) (4) (8)	2,574,137	36.5%	125,942 (Tabl	2,448,195 e continued on	28.7% next page)

	Owned Prior to and After Offering	
	Number	Percent of Class
Preferred Stock:		
Entities associated with Citibank, N.A.(9)	285,714	14.0%
Westpac Investment Management Pty. Limited	285,714	14.0%
CDFC Berkeley Limited	240,000	11.7%
Dunedin Berkeley Development Capital Limited	190,476	9.3%
KB Berkeley Japan Development Capital Limited	160,000	7.8%
SPI Berkeley Development Capital	240,000	11.7%
TR Berkeley Development Capital Limited	362,514	17.7%
William H. Younger, Jr.(10)	2,026	*
All Officers and Directors as a Group (2 persons)(4)(11)	60,888	3.0%

Shares Beneficially

- (1) Imasco Venture Holdings B.V. ("Imasco"), a limited partner of Sutter Hill Ventures, received such shares in a distribution from Sutter Hill Ventures. William H. Younger, Jr., a director of the Company, is a general partner of Sutter Hill Ventures. Includes 21,262 shares of Common Stock held by Imasco which Mr. Younger has a right to purchase from Imasco through June 30, 1988 at a per share purchase price of \$10.50.
- (2) Charles G. Moore, a director of the Company, is a general partner of Welsh, Carson, Anderson & Stowe II and may be deemed to share voting and investment power with respect to such shares.
- (3) Includes 30,000 shares held of record by three trusts for the benefit of Mr. Morgenthaler's children, as to which shares Mr. Morgenthaler disclaims beneficial ownership.
- (4) Includes shares such persons have the right to acquire under options exercisable within 60 days of May 15, 1988.
- (5) Includes 11,000 shares held by Mr. Wong as custodian for one of his children. Also includes 8,000 shares held of record by one of Mr. Wong's children.
- (6) Represents shares held of record by a trust for the benefit of Mr. Wythes and his wife.
- (7) Includes 57,416 shares that Mr. Newton has the right to acquire under options exercisable within 60 days of May 15, 1988. Excludes 146,917 shares subject to options which are not currently exercisable.

^{*} Less than 1%.

- (8) Includes the shares described in Note 2 above in addition to shares held of record and beneficially by directors and officers.
- (9) Includes 132,619 shares held by Citibank, N.A., as Custodian for Citiventure; 47,619 shares held by Citibank, N.A., as Investment Manager for GTE Service Corporation Pension Plans; 47,619 shares held by Boston Safe Deposit and Trust Company, U.S. WEST Master Trust; 47,619 shares held by Mellon Bank, N.A., Master Trustee for Bell Atlantic Master Pension Trust; 4,762 shares held by State Street Bank, Trustee for Leeway & Co.; and 4,762 shares held by First National Bank of Minneapolis as Trustee, Citicorp Investment Management Inc. as Investment Manager for Dayton Hudson Corp. Plans.
- (10) Includes 360 shares of Series E Preferred Stock held by Imasco, which Mr. Younger has a right to purchase from Imasco through June 30, 1988 at a per share purchase price of \$10.50.
- (11) Includes 17,600 shares of Series E Preferred Stock held by Welsh, Carson, Anderson & Stowe II, with respect to which Charles G. Moore, a director of the Company, may be deemed to share voting and investment power.

DESCRIPTION OF CAPITAL STOCK

The Company's authorized capital stock consists of 5,000,000 shares of Preferred Stock, \$.001 par value, and 25,000,000 shares of Common Stock, \$.001 par value.

Common Stock

The Company is authorized to issue 25,000,000 shares of Common Stock. As of March 31, 1988, there were 6,871,797 shares of Common Stock outstanding (including Common Stock issuable upon conversion of all outstanding shares of Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and Series D Preferred Stock and 57,507 shares of Series E Preferred Stock, but not including 2,045,925 shares of Common Stock issuable upon the conversion of the Series E Preferred Stock and Series F Preferred Stock which will remain outstanding immediately after this offering or 1,911,893 shares of Common Stock issuable upon the exercise of outstanding options) held of record by approximately 277 holders.

The holders of shares of Common Stock are entitled to one vote for each share held of record on all matters submitted to a vote of stockholders. Subject to preferences that may be applicable to any outstanding Preferred Stock, holders of Common Stock are entitled to receive ratably such dividends as may be declared by the Board of Directors out of funds legally available therefor. In the event of a liquidation, dissolution or winding up of the Company, holders of Common Stock are entitled to share ratably in all assets remaining after payment of liabilities and the liquidation preferences of any outstanding Preferred Stock. Holders of Common Stock have no preemptive rights and have no right to convert their Common Stock into any other securities. The outstanding shares of Common Stock are, and the Common Stock to be outstanding upon completion of this offering will be, duly authorized, validly issued and fully paid and non-assessable.

Preferred Stock

The Company is authorized to issue 5,000,000 shares of Preferred Stock. The Company has designated six series of Preferred Stock consisting of 305,000 shares of Series A Preferred Stock, 192,000 shares of Series B Preferred Stock, 625,000 shares of Series C Preferred Stock, 432,000 shares of Series D Preferred Stock, 1,303,432 shares of Series E Preferred Stock and 800,000 shares of Series F Preferred Stock. As of March 31, 1988, there were 305,000 shares of Series A Preferred Stock, 192,000 shares of Series B Preferred Stock, 625,000 shares of Series C Preferred Stock, 432,000 shares of Series D Preferred Stock, 1,303,432 shares of Series E Preferred Stock and 800,000 shares of Series F Preferred Stock outstanding. On the closing of this offering, each outstanding share of Series A Preferred Stock and Series B Preferred Stock will be converted into five shares of Common Stock, each outstanding share of Series C Preferred Stock and Series D Preferred Stock will be converted into one share of Common Stock, respectively, and 57,507 shares of Series E Preferred Stock will be converted into 57,507 shares of Common Stock. Following such conversion and the amendment of the Company's Certificate of Incorporation to eliminate the Series A Preferred Stock, Series B Preferred Stock, Series C Preferred Stock and Series D Preferred Stock, there will remain 5,000,000 authorized shares of Preferred Stock, 1,303,432 of which will have been designated Series E Preferred Stock and 1,245,925 of which will be outstanding after the offering and 800,000 of which will have been designated Series F Preferred Stock, all of which will be outstanding after the offering.

No dividend may be paid or declared and set apart for payment on the Common Stock unless a dividend equal to the amount to be paid or set apart per share of Common Stock has first been paid on each outstanding share of Series E Preferred Stock and Series F Preferred Stock. The Series E Preferred Stock and Series F Preferred Stock may be converted into Common Stock at any time at the holder's option. Currently, each share of Series E Preferred Stock and Series F Preferred Stock may be converted into one share of Common Stock. If, under certain circumstances, however, the Company sells and issues Common Stock or other securities convertible into Common Stock (other

than pursuant to employee stock plans) for a per share purchase price of less than \$10.50 or \$12.50, the conversion formula applicable to the Series E Preferred Stock or Series F Preferred Stock, respectively, will be adjusted on a weighted average basis to increase the number of shares of Common Stock issuable upon conversion of each share of Series E Preferred Stock or Series F Preferred Stock, respectively. In addition, the conversion formula for the Series F Preferred Stock will be adjusted in the event the initial public offering price is less than \$12.50. The maximum number of additional shares that could be issued as a result of such adjustment is 152,380. In the event of a merger or consolidation of the Company or sale of substantially all of the Company's assets in which the cash or value of the property that would otherwise be distributed per share of Series F Preferred Stock (the "transaction price") is less than any of the following amounts, the conversion formula of the Series F Preferred Stock will be adjusted to increase the number of shares issuable upon conversion of the Series F Preferred Stock by up to 19%: (1) if such transaction is consummated prior to July 1, 1988 and the transaction price is less than \$12.50 per share; (2) if such transaction is consummated after June 30, 1988 but prior to January 1, 1989 and the transaction price is less than \$15.75; (3) if such transaction is consummated after December 31, 1988 but prior to January 1, 1990 and the transaction price is less than \$20.48 per share; or (4) if such transaction is consummated after December 31, 1989 and the transaction price is less than \$26.62 per share. Holders of Series E Preferred Stock and Series F Preferred Stock are entitled to liquidation preferences over the Common Stock of \$10.50 and \$12.50 per share held, respectively, plus any declared but unpaid dividends on such stock, in the event of the liquidation, dissolution. winding up, merger or consolidation of the Company or the sale of all or substantially all of the Company's assets. Holders of Series E Preferred Stock and Series F Preferred Stock, voting together as a single class, have the right to a separate class vote with respect to any proposed merger, consolidation or liquidation of the Company or similar transaction. In addition, any amendment to the Company's Certificate of Incorporation that would change or alter the rights, preferences or privileges of the Series E Preferred Stock or the Series F Preferred Stock or provide for any shares with rights superior to or on a parity with those of the Series E Preferred Stock or the Series F Preferred Stock, requires the approval of the holders of such series of Preferred Stock. On all other matters submitted for a vote of the Company's stockholders, the holders of Series E Preferred Stock and Series F Preferred Stock vote with the holders of Common Stock on an asconverted basis, except as otherwise required by law.

The Series E Preferred Stock and Series F Preferred Stock will automatically be converted into Common Stock upon the earliest of the following: (a) the effectiveness of a public offering of the Company's Common Stock at a per share offering price of at least \$15.75, with net proceeds to the Company of at least \$5,000,000; (b) the occurrence of 15 consecutive trading days in which the closing sales prices on the principal stock exchange on which the Company's Common Stock is listed or the closing sales prices or bid quotations on the NASDAQ National Market System or Automated Quotation System on each such day equals or exceeds \$15.75; (c) March 24, 1990, if, on or prior to that date, there has been a public offering of the Company's Common Stock; or (d) with respect to the shares of either of such series of Preferred Stock, if holders of a majority of the then outstanding shares of such series consent in writing to such conversion. All of the outstanding shares of Series E Preferred Stock and Series F Preferred Stock have been duly authorized and validly issued and are fully paid and non-assessable.

The Board of Directors can, without stockholder approval, issue the 2,954,075 shares of authorized but undesignated Preferred Stock with voting and conversion rights that could adversely affect the voting power of the common stockholders. Depending upon the rights of such Preferred Stock, the issuance of Preferred Stock could have the effect of delaying or preventing a change in control of the Company and could make more difficult the removal of the present management of the Company. Such issuance of Preferred Stock may also adversely affect, among other things, the rights of existing stockholders. The Company has no present plans to issue any of the Preferred Stock.

Fair Price Provision

The Company's Certificate of Incorporation contains a provision (the "Fair Price Provision") that requires the approval of the holders of 66% percent of the Company's voting power as a condition of a merger or certain other business transactions with a holder of more than 10% of the Company's voting power and certain assignees of such 10% holders (an "interested stockholder"), except in cases where the disinterested directors approve the transaction or certain minimum price criteria and other procedural requirements are met. The minimum price criteria are complex, but generally require that in a transaction in which stockholders are to receive payments, holders of Common Stock must receive a value equal to the higher of (i) the highest price paid by the interested stockholder for Common Stock during the prior two years or in the transaction in which it became an interested stockholder, whichever is higher, and (ii) the fair market value of the Common Stock on the day the transaction is announced or the date on which the interested stockholder became an interested stockholder, whichever is higher, and that such payment be made in cash or in the type of consideration paid by the interested stockholder for the greatest portion of its shares. Any solicitation of stockholder approval of a transaction subject to the Fair Price Provision must be pursuant to a proxy statement meeting the requirements of the proxy rules under the Securities Exchange Act of 1934, as amended.

The Fair Price Provision is intended to provide some protection against the form of corporate takeover in which the acquiror seeks as a first step to acquire a controlling equity interest in a company and then as a second step to acquire the remaining equity interest by paying the remaining stockholders a price for their shares that is lower than the price paid to acquire control and/or is in a less desirable form of consideration, frequently in the form of securities of the purchaser that do not have an established trading market at the time of issue. The Company's Board of Directors believes that the Fair Price Provision will help assure that all the Company's stockholders will be treated similarly if certain kinds of business combinations are effected. However, the Fair Price Provision may make it more difficult to accomplish certain transactions that are opposed by the incumbent Board of Directors and that could be beneficial to stockholders.

Shares Eligible for Future Sale

Upon completion of this offering, the Company will have outstanding 8,372,997 shares of Common Stock and 2,045,925 shares of Preferred Stock (assuming no exercise of the overallotment option). The 2,000,000 shares sold in this offering will be freely tradeable without restrictions under the Securities Act of 1933, as amended (the "Act"), except for any shares purchased by an "affiliate" of the Company, which will be subject to the resale limitations of Rule 144 adopted under the Act.

The remaining 8,418,922 shares of Common Stock and Preferred Stock held by existing stockholders are "restricted" securities within the meaning of Rule 144. On the date of this Prospectus, approximately 722,275 of such shares will be eligible for immediate sale in the public market without restriction pursuant to Rule 144(k). Beginning 90 days after the date of this Prospectus, approximately 26,270 additional such shares become eligible for sale subject to the provisions of Rule 144. Beginning 120 days after the date of this Prospectus, approximately 1,406,980 additional such shares will become eligible for sale in the public market. Beginning 150 days after the date of this Prospectus approximately 4,843,250 additional such shares will be available for immediate sale in the public market upon the expiration of lock-up agreements with the Underwriters described below.

In general, under Rule 144 as currently in effect, a person (or persons whose shares are aggregated) who has beneficially owned shares for at least two years, including an "affiliate" as that term is defined under the Act, is entitled to sell, within any three-month period commencing 90 days after the date of this Prospectus, a number of shares that does not exceed the greater of (a) 1% of the then outstanding shares of the Company's Common Stock (approximately 83,730)

shares immediately after the offering) or (b) the average weekly trading volume in the Company's Common Stock during the four calendar weeks preceding such sale, subject to certain limitations and restrictions. A person (or persons whose shares are aggregated) who is not deemed an "affiliate" of the Company, and who has beneficially owned shares for at least three years is entitled to sell such shares under Rule 144 without regard to the limitations described above. For a description of the Company's agreements with certain stockholders to register their Common Stock under the Act, see "Registration Rights."

The Company, its officers and directors and certain other holders of the Company's Common Stock have agreed with the Representatives of the Underwriters not to offer, sell or grant any option to purchase or otherwise dispose of any shares of Common Stock owned by them (an aggregate of 4,843,250 shares) for a period of 150 days after the date of this Prospectus, without the prior written approval of the Representatives of the Underwriters (except that the Company may, without such consent, grant options or sell stock pursuant to the Incentive Plan, Supplemental Plan and Participation Plan).

The Company intends to file a registration statement under the Act to register the shares of Common Stock reserved for issuance and certain of the shares of Common Stock previously issued to its officers and employees under the Incentive Plan, Supplemental Plan and Participation Plan. Such registration statement is expected to become effective approximately 110 days after the date of this Prospectus. Shares issued upon exercise of outstanding stock options under such plans and sold pursuant to such plans after the effective date of such registration statement generally will be available for sale in the public market. As of March 31,1988, options to purchase a total of 1,896,893 shares of Common Stock were outstanding under the Incentive Plan, Supplemental Plan and Nonqualified Plan.

Prior to this offering, there has been no public market for the Common Stock of the Company, and no precise predictions can be made as to the effect, if any, that public sales of shares or the availability of shares for sale will have on the market price prevailing from time to time. Nevertheless, sales of substantial amounts of the Common Stock of the Company in the public market could adversely affect prevailing market prices.

Registration Rights

The holders of approximately 5,771,365 shares of Common Stock or their permitted transferees (the "Holders") are entitled to certain rights with respect to the registration of such shares under the Act in the future. Under the terms of a registration rights agreement between the Company and such Holders, if following this offering the Company proposes to register any of its securities under the Act for its own account, such Holders are entitled to notice of such registration and are entitled to include shares of such Common Stock therein; provided, among other conditions, that the underwriters of any such offering have the right to limit the number of shares included in such registration. In addition and subject to certain limitations, commencing 120 days after the date of this offering, Holders may require the Company to prepare and file a registration statement under the Act with respect to at least 20% of the shares entitled to registration rights (or shares having an aggregate proposed offering price to the public of at least \$5,000,000). The Company is not obligated to effect more than two of these stockholder-initiated registrations. Generally, the Company is required to bear the expense of all such registrations.

Transfer Agent and Registrar

The Company has appointed The First National Bank of Boston as the transfer agent and registrar for its Common Stock, Series E Preferred Stock and Series F Preferred Stock.

UNDERWRITING

Subject to the terms and conditions set forth in the Underwriting Agreement, the Company and the Selling Stockholders have agreed to sell to each of the Underwriters named below, and each of the Underwriters, for whom Goldman, Sachs & Co. and Robertson, Colman & Stephens are acting as representatives, has severally agreed to purchase from the Company and the Selling Stockholders, the respective number of shares of Common Stock set forth opposite their names below:

Underwriter	Number of Shares
Goldman, Sachs & Co	269,000
Robertson, Colman & Stephens	269,000
Advest, Inc.	28,000
Arnhold and S. Bleichroeder, Inc.	16,500
Bateman Eichler, Hill Richards Incorporated	16,500
Bear, Stearns & Co. Inc.	41,500
William Blair & Company	28,000
Brean Murray, Foster Securities Inc	8,000
Alex. Brown & Sons Incorporated	41,500
Cable, Howse & Ragen Incorporated	16,500
The Chicago Corporation	16,500
Cowen & Co	16,500
Crowell, Weedon & Co	8,000
Dillon, Read & Co. Inc.	41,500
Donaldson, Lufkin & Jenrette Securities Corporation	41,500
Drexel Burnham Lambert Incorporated	41,500
A. G. Edwards & Sons, Inc.	28,000
The First Boston Corporation	41,500
Furman Selz Mager Dietz & Birney Incorporated	16,500
Gartner Securities Corporation	8,000
Hambrecht & Quist Incorporated	41,500
Hayes & Griffith, Inc.	8,000
Homans, McGraw, Trull, Valeo & Company, Inc.	8,000
Howard, Weil, Labouisse, Friedrichs Incorporated	16,500
Interstate Securities Corporation	16,500
Johnson, Lane, Space, Smith & Co., Inc.	16,500
Kidder, Peabody & Co. Incorporated	41,500
Lazard, Frères & Co	41,500
Mabon, Nugent & Co	16,500
McDonald & Company Securities, Inc.	28,000
Merrill Lynch, Pierce, Fenner & Smith Incorporated	41,500
Montgomery Securities	41,500
Morgan, Olmstead, Kennedy & Gardner Incorporated	8,000
Morgan Stanley & Co. Incorporated	41,500
Needham & Company, Inc	16,500
Neuberger & Berman	16,500
Oppenheimer & Co., Inc.	28,000
PaineWebber Incorporated	41,500
Piper, Jaffray & Hopwood Incorporated	28,000
Prescott, Ball & Turben, Inc.	28,000
Prudential-Bache Securities Inc.	41,500
Raymond James & Associates, Inc	16,500
The Robinson-Humphrey Company, Inc.	28,000
L.F. Rothschild & Co. Incorporated	41,500
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Underwriter	Number of Shares
Salomon Brothers Inc	41,500
Seidler Amdec Securities Inc	8,000
Shearson Lehman Hutton Inc	41,500
Smith Barney, Harris Upham & Co. Incorporated	41,500
Stifel, Nicolaus & Company Incorporated	16,500
Sutro & Co. Incorporated	16,500
Swergold, Chefitz & Sinsabaugh, Inc	8,000
Tucker, Anthony & R. L. Day, Inc.	28,000
Van Kasper & Company	8,000
Volpe & Covington	16,500
Wedbush Securities, Inc	8,000
Wertheim Schroder & Co. Incorporated	41,500
Wheat, First Securities, Inc.	28,000
Dean Witter Reynolds Inc	41,500
William K. Woodruff & Company Incorporated	8,000
Total	2,000,000

Excluding shares subject to the over-allotment option, each of the Underwriters is to purchase from the Company and each of the Selling Stockholders, respectively, that number of shares which bears the same proportion to the total number of shares to be sold by the Company and the Selling Stockholders to the Underwriters as the total number of shares to be purchased by such Underwriter bears to the total number of shares to be purchased by all of the Underwriters.

Under the terms and conditions of the Underwriting Agreement, the Underwriters are committed to take and pay for all of the shares offered hereby, if any are taken.

The Underwriters propose to offer the shares of Common Stock in part directly to the public at the initial public offering price set forth on the cover page of this Prospectus and in part to certain securities dealers at such price less a concession of \$0.50 per share. The Underwriters may allow, and such dealers may reallow, a concession not in excess of \$0.10 per share to certain brokers and dealers. After the shares of Common Stock are released for sale to the public, the offering price and other selling terms may from time to time be varied by the representatives.

The Company has granted the Underwriters an option exercisable for 30 calendar days after the date of this Prospectus to purchase up to an aggregate of 300,000 additional shares of Common Stock to cover over-allotments, if any. If the Underwriters exercise their over-allotment option, the Underwriters have severally agreed, subject to certain conditions, to purchase approximately the same percentage thereof that the number of shares to be purchased by each of them, as shown in the foregoing table, bears to the 2,000,000 shares of Common Stock offered hereby. The Underwriters may exercise such option only to cover over-allotments made in connection with the sale of the 2,000,000 shares of Common Stock offered hereby.

The Company, its officers and directors, the Selling Stockholders and certain other stockholders have agreed not to offer, sell or otherwise dispose of any shares of Common Stock for a period of 150 days after the date of this Prospectus without the prior written consent of the representatives, except that the Company may, without such consent, grant options, or issue stock upon exercise of outstanding options, pursuant to the Incentive Plan, the Supplemental Plan and the Participation Plan. Certain other stockholders have agreed to not offer, sell or otherwise dispose of any shares of Common Stock for a period of 120 days after the date of this Prospectus without the prior written consent of the Company. See "Description of Capital Stock—Shares Eligible for Future Sale."

The representatives have informed the Company that they do not expect sales to discretionary accounts by the Underwriters to exceed five percent of the total number of shares of Common Stock

offered by them and that sales to discretionary accounts by the representatives will be less than one percent of the total number of shares of Common Stock offered by them.

Prior to this offering, there has been no public market for the shares. The initial public offering price will be negotiated among the Company, the Selling Stockholders and the representatives of the Underwriters. Among the factors to be considered in determining the initial public offering price of the Common Stock, in addition to prevailing market conditions, are the Company's historical performance, estimates of the business potential and earnings prospects of the Company, an assessment of the Company's management and the consideration of the above factors in relation to market valuation of companies in related businesses.

The Company and the Selling Stockholders have agreed to indemnify the several Underwriters against certain civil liabilities, including liabilities under the Act.

LEGAL MATTERS

The validity of the Common Stock to be offered hereby will be passed upon for the Company and the Selling Stockholders by Cooley, Godward, Castro, Huddleson & Tatum, San Francisco, California, and for the Underwriters by Wilson, Sonsini, Goodrich & Rosati, P.C., Palo Alto, California. As of the date of this Prospectus, members and employees of Cooley, Godward, Castro, Huddleson & Tatum, or investment partnerships of which such persons are partners, beneficially owned 29,140 shares of the Company's Common Stock.

EXPERTS

The consolidated financial statements for the year ended June 30, 1987, the adjustments to restate the consolidated financial statements for the years ended June 30, 1985 and 1986 (such financial statements were examined by other independent accountants) and the computation of net income per share for the years ended June 30, 1985 and 1986 included in this Prospectus have been so included in reliance on the report of Price Waterhouse, independent accountants, given on the authority of said firm as experts in auditing and accounting.

The consolidated balance sheet of Relational Technology, Inc. as of June 30, 1986 and the related consolidated statements of income (except for earnings per share data), changes in stockholders' equity, and changes in financial position and the related schedules for each of the two years in the period ended June 30, 1986, before the restatement described in Note 11 to the consolidated financial statements in this Prospectus and Registration Statement, have been incorporated herein in reliance on the report of Coopers & Lybrand, independent accountants, given on the authority of that firm as experts in accounting and auditing.

ADDITIONAL INFORMATION

The Company has filed with the Securities and Exchange Commission, Washington, D.C. 20549, a Registration Statement under the Securities Act of 1933, as amended, with respect to the Common Stock offered hereby. This Prospectus does not contain all of the information set forth in the Registration Statement and the exhibits, and schedules thereto. For further information with respect to the Company and the Common Stock, reference is hereby made to the Registration Statement, exhibits and schedules, which may be obtained from the Commission's principal office in Washington, D.C. upon payment of the fees prescribed by the Commission.

REPORT OF INDEPENDENT ACCOUNTANTS

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

We have examined the consolidated balance sheets of Relational Technology, Inc. and its subsidiaries as of June 30, 1987 and March 31, 1988, and the related consolidated statements of income, of changes in stockholders' equity and of changes in financial position for the year ended June 30, 1987 and for the nine months ended March 31, 1988. Our examinations were 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.

The consolidated financial statements for the years ended June 30, 1985 and 1986 (prior to restatement and except for earnings per share data) were examined by other independent accountants whose opinion for the year ended June 30, 1986, dated August 22, 1986, was qualified as to the consistent application of accounting principles due to a change in fiscal 1986, with which they concurred, in the method of accounting for maintenance revenues. As described in Note 11 to Consolidated Financial Statements, the consolidated financial statements for the years ended June 30, 1985 and 1986 have been restated for this change resulting in the consistent application of the accounting policy for maintenance revenues for all years presented.

In our opinion, the consolidated financial statements examined by us present fairly the financial position of Relational Technology, Inc. and its subsidiaries at June 30, 1987 and March 31, 1988, and the results of their operations and the changes in their financial position for the year ended June 30, 1987 and for the nine months ended March 31, 1988, in conformity with generally accepted accounting principles consistently applied during the period except for the change as of July 1, 1986, with which we concur, in the method of accounting for software development costs as described in Note 1 to Consolidated Financial Statements.

We also examined the adjustments described in Note 11 that were applied to restate the consolidated financial statements for the years ended June 30, 1985 and 1986 and the computations of net income per share for those years. In our opinion, such adjustments are appropriate and have been properly applied to those financial statements and such computations are appropriate and have been properly presented in those financial statements.

PRICE WATERHOUSE

San Francisco, California April 28, 1988

REPORT OF INDEPENDENT ACCOUNTANTS

To the Stockholders of Relational Technology, Inc.:

We have examined the consolidated balance sheet of Relational Technology, Inc. as of June 30, 1986 and the related consolidated statements of income (except for earnings per share data), changes in stockholders' equity, and changes in financial position for each of the two years in the period ended June 30, 1986, before the restatements described in Note 11. Our examinations were 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, except for the earnings per share data which we did not examine, the consolidated financial statements referred to above present fairly the financial position of Relational Technology, Inc. as of June 30, 1986, and the results of its operations and the changes in its financial position for each of the two years in the period ended June 30, 1986, before the restatements described in Note 11, in conformity with generally accepted accounting principles applied on a consistent basis, except for the change, with which we concur, in the method of accounting for revenue from maintenance fees prior to its restatement as described in Note 11 to the consolidated financial statements.

COOPERS & LYBRAND

San Francisco, California August 22, 1986

CONSOLIDATED BALANCE SHEETS

ASSETS

	June	30,	March 31,
	1986	1987	1988
Current assets:			
Cash and cash equivalents	\$ 1,856,000	\$ 2,538,000	\$ 6,983,000
Trade and current instalment receivables (less al-			
lowance for doubtful accounts of \$407,000,			
\$674,000 and \$1,403,000)	10,999,000	21,774,000	30,474,000
Prepaid expenses and other current assets	1,177,000	2,498,000	3,141,000
Total current assets	14,032,000	26,810,000	40,598,000
Property and equipment, net	7,388,000	9,973,000	14,353,000
Computer software development costs, net		2,762,000	5,119,000
Long-term trade receivables, less current portion	2,537,000	5,302,000	9,186,000
Other assets	64,000	<u>198,000</u>	
Total assets	<u>\$24,021,000</u>	<u>\$45,045,000</u>	\$69,256,000
LIABILITIES AND STOCKH	OLDERS' EQUI	ITY	
Current liabilities:			
Accounts payable	\$ 1,362,000	\$ 3,514,000	\$ 4,053,000
Notes payable to bank and current portion of long-			
term debt	829,000	1,461,000	2,597,000
Deferred revenue	2,240,000	5,612,000	8,554,000
Accrued employee compensation	1,468,000	2,815,000	5,005,000
Income taxes payable	4.454.000	453,000	2,508,000
Other current liabilities	1,154,000	<u>1,919,000</u>	2,203,000
Total current liabilities	7,053,000	15,774,000	24,920,000
Long-term debt, less current portion	2,604,000	2,955,000	4,078,000
Deferred income taxes	466,000	1,465,000	1,508,000
Total liabilities	10,123,000	20,194,000	30,506,000
Commitments (Note 5)			
Stockholders' equity:			
Preferred stock, \$.001 par value, authorized			
5,000,000 shares; 2,032,540, 2,857,432 and			
3,657,432 shares issued and outstanding at June			
30, 1986 and 1987 and March 31, 1988, respectively; aggregate liquidation preference of			
\$20,151,000 at June 30, 1987 and \$30,151,000 at			
March 31, 1988	11,129,000	19,554,000	28,895,000
Common stock, \$.001 par value, authorized	11,120,000	10,001,000	20,000,000
25,000,000 shares; 3,167,989, 3,218,783 and			
3,272,290 shares issued and outstanding at			
June 30, 1986 and 1987 and March 31, 1988,			
respectively	463,000	563,000	628,000
Note receivable from issuance of common stock to		_	
officer	(100,000)	(100,000)	(100,000)
Retained earnings	2,357,000	4,834,000	8,751,000
Foreign currency translation adjustment	49,000		576,000
Total stockholders' equity	13,898,000	24,851,000	38,750,000
Total liabilities and stockholders' equity	\$24,021,000	\$45,045,000	\$69,256,000

CONSOLIDATED STATEMENTS OF INCOME

	For the	Year Ended Ju	ne 30,	For Nine Mont Marc	hs Ended
	1985	1986	1987	1987	1988
				(unaudited)	
Revenues:					
Licenses	\$15,767,000	\$25,318,000	\$40,916,000	\$25,482,000	\$47,294,000
Maintenance	1,504,000	2,820,000	5,649,000	3,765,000	9,886,000
Total revenues	17,271,000	28,138,000	46,565,000	29,247,000	57,180,000
Operating expenses:					
Sales and marketing	8,827,000	13,450,000	28,313,000	18,617,000	37,219,000
Research and development	5,921,000	9,198,000	10,423,000	7,387,000	10,088,000
General and administrative	1,752,000	2,987,000	4,727,000	3,291,000	4,775,000
Total operating expenses	16,500,000	25,635,000	43,463,000	29,295,000	52,082,000
Operating income (loss)	771,000	2,503,000	3,102,000	(48,000)	5,098,000
Interest income	86,000	135,000	768,000	568,000	764,000
Interest expense	(230,000)	(395,000)	(553,000)	(389,000)	(454,000)
Foreign exchange gain (loss)	(21,000)	(37,000)	635,000	409,000	1,120,000
Income before income taxes	606,000	2,206,000	3,952,000	540,000	6,528,000
Provision for income taxes	51,000	542,000	1,475,000	201,000	2,611,000
Net income	\$ 555,000	\$ 1,664,000	\$ 2,477,000	\$ 339,000	\$ 3,917,000
Net income per share	<u>\$.08</u>	\$.23	\$.29	\$.04	\$.41
Weighted average shares of common stock and common stock equivalents used in computation of					
net income per share	6,825,000	7,393,000	8,456,000	8,370,000	9,486,000

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

			-			Note Receivable from Issuance of		Foreign Currency	
	Prefer Shares	red	Amount	Commo		Common	Retained	Translation	T-1-1
		_		Shares	<u>Amount</u>	Stock	Earnings	Adjustment	Total
Series A	305,000	\$	305,000						
Series B	192,000		936,000						
Series C		_	2,500,000						
Balances, June 30, 1984	1,122,000		3,741,000	3,177,679	\$309,000		\$ 138,000		\$ 4,188,000
Issue of common stock under employee stock purchase plan				266	_				
Issue of common stock				300					
Repurchase of common stock				(64,220)	(9,000)	1			(9,000)
Net income				(01,220)	(0,000)	•	555,000		555,000
Foreign currency translation adjustment							000,000	\$ 12,000	12,000
Balances, June 30, 1985	1,122,000	_	3,741,000	3,114,025	300,000		693,000	12,000	4,746,000
Issue of Series D Preferred stock	432,000		2,700,000	0,111,000	,		000,000	12,000	2,700,000
Issue of Series E Preferred	102,000		2,100,000						2,700,000
stock	478,540		4,688,000						4,688,000
Issue of common stock under employee incentive stock									,,000,000
option plan				15,548	12,000				12,000
Issue of common stock				107,334		\$(100,000)			61,000
Repurchase of common stock				(68,918)	(10,000)				(10,000)
Net income							1,664,000		1,664,000
Foreign currency translation adjustment				****				37,000	37,000
Balances, June 30, 1986	2,032,540	1	1,129,000	3,167,989	463,000	(100,000)	2,357,000	49,000	13,898,000
Issue of Series E Preferred									
stock	824,892		8,425,000						8,425,000
Issue of common stock under employee stock option				07.040	400 000				
plans				87,319	100,000				100,000
Issue of common stock				2,181	5,000				5,000
Repurchase of common stock Net income				(38,706)	(5,000)		0 477 000		(5,000)
Foreign currency translation adjustment							2,477,000	(49,000)	2,477,000
Balances, June 30, 1987	2 957 422	_	0.554.000	2.010.700	500,000	(100,000)	4 004 000	(49,000)	(49,000)
Issue of Series F Preferred stock	800,000		9,554,000 9,341,000	3,218,783	563,000	(100,000)	4,834,000	_	24,851,000
Issue of common stock under employee stock option	000,000		3,541,000						9,341,000
plans				54,112	66,000				66,000
Repurchase of common stock				(605)	(1,000)				(1,000)
Net income							3,917,000		3,917,000
Foreign currency translation adjustment							1	576,000	576,000
Balances, March 31, 1988	3,657,432	\$2	8,895,000	3,272,290	\$628,000	<u>\$(100,000</u>)	\$8,751,000	\$576,000	\$38,750,000

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	For the Year Ended June 30,			Nine Mon	the ths Ended th 31,
	1985	1986	1987	1987 (unaudited)	1988
Net cash provided by (used for) operations:				(unaudited)	
Net income Charges (credits) to income not involving cash:	\$ 555,000	\$ 1,664,000	\$ 2,477,000	\$ 339,000	\$ 3,917,000
Depreciation and amortization expense	932,000	1,713,000	2,718,000	1,760,000	2,988,000
Deferred income taxes	35,000	468,000	999,000	289,000	43,000
Deferred revenue	472,000	1,060,000	3,372,000	2,598,000	2,942,000
Increase (decrease) in cash due to changes in:	472,000	1,000,000	0,072,000	2,000,000	2,0 12,000
Trade accounts receivable	(1,948,000)	(5,897,000)	(10,775,000)	(6,453,000)	(8,700,000)
Prepaid expenses and other current	(,, , , , , , , , , , , , , , , , , ,	,	, , , , ,	, , , ,	• • • • •
assets	(212,000)	(908,000)	(1,321,000)	(768,000)	(643,000)
Accounts payable	(447,000)	515,000	2,152,000	2,196,000	539,000
Accrued employee compensation	789,000	496,000	1,347,000	901,000	2,190,000
Income taxes payable	(21,000)	(34,000)	453,000	(71,000)	2,055,000
Other current liabilities	91,000	969,000	765,000	13,000	284,000
Cash provided by operations	246,000	46,000	2,187,000	804,000	5,615,000
Net cash provided by (used for) investing activities:					
Short-term investment	1,000,000	_	_		_
Equipment additions	(3,812,000)	(3,838,000)	(5,237,000)	(3,821,000)	(7,201,000)
costs			(2,828,000)	(2,160,000)	(2,524,000)
Long-term trade receivables	(17,000)	(2,307,000)	(2,765,000)	(1,145,000)	(3,884,000)
Other assets	48,000	17,000	(134,000)	(536,000)	198,000
	(2,781,000)	(6,128,000)	(10,964,000)	(7,662,000)	_(13,411,000)
Net cash provided by (used for) funding activities:					
Increase in debt	5,961,000	4,114,000	6,327,000	4,567,000	8,946,000
Decrease in debt	(2,448,000)	(4,353,000)	(5,344,000)	(727,000)	(6,687,000)
Issuance of preferred stock Issuance of common stock, net of re-		7,388,000	8,425,000	2,804,000	9,341,000
purchases	(8,000)	63,000	100,000	47,000	65,000
Foreign currency translation adjust- ment	12,000	37,000	(49,000)	(79,000)	576,000
	3,517,000	7,249,000	9,459,000	6,612,000	12,241,000
Increase (decrease) in cash and cash			•		
equivalents	\$ 982,000	\$ 1,167,000	\$ 682,000	<u>\$ (246,000</u>)	\$ 4,445,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

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.

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

Summary of Significant Accounting Policies

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. 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 or 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, 1986 and 1987, and March 31, 1988.

Instalment 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 period 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.

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

estimated useful life of five years. 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

Effective July 1, 1986, the Company began capitalizing 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". Prior to July 1, 1986, all such costs were charged to expense in the period incurred. Software costs capitalized in the year ended June 30, 1987 and for the nine months ended March 31, 1987 and 1988 were \$2,828,000, \$2,160,000 and \$2,524,000, 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 year ended June 30, 1987 and for the nine months ended March 31, 1988 was \$66,000 and \$167,000, respectively. The net effect of this change in accounting principle was to increase income before taxes by \$2,762,000 and \$2,357,000, and net income by \$1,686,000 (\$.20 per share) and \$1,349,000 (\$.14 per share) for fiscal 1987 and the nine months ended March 31, 1988, 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 equivalent shares consist of stock options. In addition, the calculation also 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 may occur upon closing of a public offering of the Company's Common Stock.

Pursuant to rules of the Securities and Exchange Commission, Common Stock issued by the Company during the twelve months immediately preceding the offering date, 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 presented.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

The weighted average number of common and common equivalent shares outstanding are as follows (in thousands):

	June 30,			Marc	h 31,
	1985	1986	1987	1987	1988
Common Stock	3,157	3,107	3,188	3,180	3,240
Preferred Stock	3,110	3,501	4,313	4,220	4,866
Common Stock equivalents-stock					
options(1)(2)	_	227	397	412	822
Shares issued during the twelve months preceding offering date:					
	558	558	_558	558	_558
Weighted average shares outstanding	6,825	7,393	8,456	8,370	9,486

- (1) Calculated using the treasury stock method.
- (2) Not dilutive in 1985
- (3) Calculated using the treasury stock method and the highest proposed offering price.

Interim Financial Statements

The unaudited interim consolidated financial statements for the nine month period ended March 31, 1987 reflect, in the opinion of management, all adjustments (which include only normal recurring adjustments) necessary for a fair presentation of the Company's financial position as of March 31, 1987 and the results of its operations and changes in its financial position for the nine month period ended March 31, 1987. The results for the interim period ended March 31, 1988 are not necessarily indicative of the results expected for the entire year.

Note 2—Property and Equipment

	June	March 31,	
	1986	1987	1988
Computer equipment	\$ 7,582,000	\$10,925,000	\$14,094,000
Furniture, fixtures and equipment	1,833,000	3,057,000	5,564,000
Leasehold improvements	894,000	1,564,000	3,089,000
	10,309,000	15,546,000	22,747,000
Accumulated depreciation and amortization	(2,921,000)	(5,573,000)	(8,394,000)
	\$ 7,388,000	\$ 9,973,000	\$14,353,000

Depreciation and amortization expense was \$932,000, \$1,713,000 and \$2,652,000 in 1985, 1986 and 1987, respectively, and \$2,821,000 for the nine months ended March 31, 1988.

Note 3—Long-Term Accounts Receivable

The Company has entered into long-term licensing and development contracts which allow for payments on an instalment basis. Long-term receivables at March 31, 1988 mature as follows: in the last quarter of fiscal 1989—\$2,169,000; in fiscal years: 1990—\$4,999,000; 1991—\$3,498,000; 1992 and thereafter—\$2,773,000. Approximately eighty-eight percent of long-term receivables are denominated in foreign currencies.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

Note 4—Debt Financing

Long term debt

	June	March 31,	
	1986	1987	1988
Term loans payable to bank, interest at prime plus 1/2%,			
principal and interest payable monthly through 1991	\$2,852,000	\$2,597,000	\$2,011,000
Capital leases (Note 5)	491,000	1,497,000	3,825,000
Instalment notes, due at various dates through November 1988, secured by equipment, interest at 12% to			, ,
20%, payable in monthly instalments	90,000	49,000	
	3,433,000	4,143,000	5,836,000
Current maturities	<u>(829,000</u>)	(1,188,000)	<u>(1,758,000</u>)
Long-term debt	\$2,604,000	\$2,955,000	\$4,078,000

The agreements require the Company to maintain certain financial ratios which are similar to those described for borrowings under line of credit agreements described below.

Aggregate annual maturities of long-term debt as of March 31, 1988 (excluding capital leases—see Note 5) are as follows: remaining in fiscal 1988—\$195,000; in fiscal years: 1989—\$778,000; 1990—\$778,000; and 1991—\$260,000.

Lines of credit

In November 1987, the Company (a) replaced its existing \$5,000,000 domestic bank line of credit with an \$8,000,000 domestic bank revolving line of credit bearing interest at .25% above prime; (b) replaced its term loan payable to bank with a term loan bearing interest at .50% above prime payable in equal monthly instalments through October 31, 1990; and (c) obtained a \$3,000,000 equipment financing line of credit bearing interest at .50% above prime. Any amounts borrowed before October 31, 1988 under the equipment financing line of credit will be payable in equal monthly instalments through October 31, 1992. The Company is required to maintain various financial ratios including minimum working capital of \$8,000,000; minimum ratio of tangible net worth to total debt of 1 to 1; minimum tangible net worth of \$24,000,000 until June 30, 1988 and \$26,000,000 thereafter; and certain profitability measures. At March 31, 1988, there were no amounts outstanding under either the revolving line of credit or the equipment financing line of credit. Both lines of credit expire in October 1988.

The Company also has international lines of credit aggregating \$1,956,000 which bear interest based on local market conditions (typically above prime). At March 31, 1988, \$839,000 was outstanding under these arrangements.

The term loans and domestic and international lines of credit are secured by all of the Company's receivables and fixed assets not otherwise pledged.

Note 5—Leasing Arrangements

The Company leases its corporate headquarters and sales offices under noncancelable 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 six years commencing on July 1, 1991. If the term is not extended, the Company is obligated to pay a \$488,000 cancellation fee. Most of the leases require the Company to pay property taxes, insurance,

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

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 \$1,004,000, \$1,980,000, \$3,504,000, in 1985, 1986 and 1987, respectively and \$4,010,000 for the nine months ended March 31, 1988.

Minimum future lease payments under the terms of operating leases as of March 31, 1988 are \$1,533,000—1988; \$6,258,000—1989; \$6,149,000—1990; \$5,272,000—1991; \$5,085,000—1992; \$4,219,000—1993 and \$16,677,000 for 1994 and thereafter. Included in operating lease payments for 1992 and thereafter are payments of \$10,968,000, which assumes the exercise of the corporate headquarters lease option described above.

The Company entered into capital lease agreements for computer 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 noncancelable 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,		March 31,
	1986	1987	1988
Computer equipment	\$491,000	\$1,798,000	\$4,418,000
Less—accumulated amortization		(234,000)	(703,000)
	\$491,000	\$1,564,000	\$3,715,000
	<u> </u>	(234,000)	(70

Minimum future payments under all capital lease agreements as of March 31, 1988 are as follows:

Year Ended June 30:	
1988	\$ 332,000
1989	1,321,000
1990	1,249,000
1991	900,000
1992	368,000
1993	255,000
Thereafter	329,000
Total minimum lease payments	4,754,000
Amount representing interest	(929,000)
Present value of minimum lease payments	3,825,000
Current maturities	(980,000)
Long-term obligations under capital leases	\$2,845,000

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

Note 6-Preferred Stock

The Company is authorized to issue 5,000,000 shares of convertible Preferred Stock.

The Company has issued preferred shares as follows:

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

Each share of Series A and B Preferred Stock is convertible into five shares of Common Stock, and each share of Series C, D, E, and F Preferred Stock is convertible into one share of Common Stock at the stockholders' option and will convert automatically in the event of a public offering of the Company's Common Stock in which the net proceeds to the Company equals or exceeds \$5,000,000 and the per share sales price to the public equals or exceeds \$15.75. The conversion rate for Preferred Stock is subject to adjustment in the event of stock splits, stock dividends, or other similar changes in the Company's capitalization. The conversion rate for Series E and F is subject to adjustment in the event of certain dilutive stock issuances. The holders of Preferred Stock are entitled to voting rights in proportion to their Common Stock equivalent and vote as a single class with common stockholders, except in certain situations where the preferred stockholders vote as a separate class.

In connection with the issuance of Series F Preferred Stock, the Company's Articles of Incorporation were amended to authorize the Series F Preferred Stock, and to provide for the automatic conversion of outstanding shares of Series E Preferred Stock and Series F Preferred Stock upon the earlier of (a) a public offering of the Company's Common Stock at a per share price of at least \$15.75, in which the net proceeds to the Company are at least \$5,000,000, (b) the occurrence of 15 consecutive trading days in which the closing sales prices on the NASDAQ National Market System or Automated Quotation System on each such day is at least \$15.75, or (c) March 24, 1990, if, on or prior to such date, there has been a public offering of the Company's Common Stock. See Note 7—Common Stock for a description of proposed changes in conversion rights of Series A, B, C, and D Preferred Stock.

In the event of liquidation, holders of Preferred Stock are entitled to receive 100% of the original purchase price of preferred shares before any distributions may be made to common stockholders. Such preferences amount to \$30,151,000. Series E and F preferred stockholders are entitled to receive 100% of the original purchase price before any distribution to other preferred stockholders in the event there are not sufficient funds available for the entire liquidation preference; Series F has liquidation preferences senior to Series E.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

Series A and B stockholders are entitled to dividends per share equivalent to five times the dividend paid to common stockholders in a given year. Series C, D, and E stockholders are entitled to a dividend equal to the dividend paid to the common stockholders. Dividends due Preferred Stockholders must be paid prior to payment of dividends due common stockholders. Dividends are payable when and as declared by the Board of Directors.

As described above, shares of Preferred Stock automatically convert into shares of Common Stock in the event of a public offering at specified prices. The following table shows the Company's stockholders' equity on a pro forma basis assuming the conversion of all shares of Series A, B, C and D Preferred Stock and 57,507 shares of Series E Preferred Stock.

	March 31, 1988		
	Actual	Pro Forma (unaudited)	
Preferred stock	\$28,895,000	\$21,875,000	
Common stock	628,000	7,648,000	
officers	(100,000)	(100,000)	
Retained earnings	8,751,000	8,751,000	
Foreign translation adjustment	576,000	576,000	
	\$38,750,000	\$38,750,000	

Note 7—Common Stock

The Company has reserved 7,850,432 shares of Common Stock for future issuance as follows: 5,645,432 shares upon conversion of preferred shares, 5,000 shares under the Nonqualified Stock Option Plan, and 2,200,000 shares under the Employee Incentive Stock Option Plan and Supplemental Stock Option Plan.

In April 1988, the Company's shareholders approved (a) the reincorporation of the Company as a Delaware corporation (the reincorporation will not result in any material change in the business or management of the Company, nor does it affect the Consolidated Financial Statements) and a provision in the Delaware Certificate of Incorporation requiring, in certain circumstances, the approval by two-thirds of the voting shares of a merger and certain other business transactions with a holder of more than ten percent of the voting shares, (b) a change in the conversion rights of the Series A, B, C and D Preferred Stock as described in Note 6 to require their conversion upon either (i) the closing of an initial public offering of the Company's common stock in which the proceeds to the Company (less underwriters' discounts) is at least \$5,000,000 or (ii) with respect to the shares of any individual series, if holders of a majority of the then outstanding shares of such series consent in writing to such conversion.

Employee Stock Purchase Plan

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 market 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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

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 March 31, 1988, 42,131 shares were subject to repurchase under the terms of the Plan at prices ranging from \$.02 to \$2.50 per share.

In October 1987, the Board of Directors approved the adoption of an Employee Stock Participation Plan (the Participation Plan). Under the Participation Plan the Company may offer up to 100,000 shares of Common Stock to participating employees to purchase shares through payroll deductions at a price of not less than 85% of the fair value of the Common Stock.

Stock Option Plans

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 market 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 March 31, 1988, 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 year ended June 30, 1987 and the nine months ended March 31, 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 <u>Price</u>
Outstanding at June 30, 1986		
Granted		\$2.50
		\$2.50
Terminated	(1,900)	\$2.50
Outstanding at June 30, 1987	247,850	\$2.50
Granted	440,130	\$3.50-\$6.00
Exercised	(100)	\$2.50
Terminated	(9,167)	\$3.50-\$5.00
Outstanding at March 31, 1988	678,713	\$2.50-\$6.00

At March 31, 1988, 74,760 options were exercisable.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

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 <u>Price</u>
Outstanding at June 30, 1985	438,282	\$.75
Granted	564,170	\$.75-\$2.50
Exercised	(15,548)	\$.75
Terminated	<u>(101,445</u>)	\$.75-\$1.50
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	(54,012)	\$.75-\$2.50
Terminated	(96,855)	\$.75-\$3.50
Outstanding at December 31, 1987	1,213,180	\$.75-\$6.00

At March 31, 1988, there were 465,838 options exercisable.

Note 8-Income Taxes

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

	For	Ended March 31.		
	1985	1986	1987	1988
Current: U.S	_		_	\$1,257,000
Foreign		\$ 37,000	\$ 292,000	578,000
State	\$16,000	37,000	184,000	733,000
	16,000	74,000	476,000	2,568,000
Deferred:				
U.S		247,000	913,000	287,000
Foreign	_	48,000	(36,000)	
State	35,000	173,000	122,000	(244,000)
	35,000	468,000	999,000	43,000
Provision for income taxes	<u>\$51,000</u>	\$542,000	\$1,475,000	\$2,611,000

Nine Months

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

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,			Nine Months Ended March 31.	
	1985	1986	1987	1988	
Long-term development contracts	\$ 7,000	\$ 532,000	\$ 325,000	\$ (182,000)	
Deferral of support and update revenue			(891,000)	(813,000)	
Capitalized software development			1,076,000	1,008,000	
Depreciation	66,000	_	59,000	49,000	
Unrealized exchange gains	_		_	271,000	
Allowance for doubtful accounts	_		_	(236,000)	
Other, net	(38,000)	(64,000)	430,000	(54,000)	
Total deferred tax provision	\$ 35,000	\$ 468,000	\$ 999,000	\$ 43,000	

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

	For the Year Ended June 30,			Nine Months Ended March 31.
	1985	1986	1987	1988
Tax provision at statutory rate Income of foreign operations taxed at various	46.0%	46.0%	46.0%	34.0%
rates		8.2	3.6	5.6
State income taxes, net of federal benefits	4.3	4.7	4.0	4.9
Investment and research tax credits	(39.9)	(35.3)	(15.5)	(4.5)
Surtax exemption	(1.8)		<u> </u>	· —
Other, net	(.2)	1.0	<u>(8.) </u>	_=
Effective tax rate	<u>8.4</u> %	24.6%	<u>37.3</u> %	<u>40.0</u> %

The tax provision for the nine months ended March 31, 1988 was calculated using the estimated effective tax rates for the fiscal year; this effective tax rate uses substantially all of the available tax credit carryovers.

Financial Accounting Standard No. 96

In December 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96, Accounting for Income Taxes. SFAS 96 mandates the liability method for computing deferred income taxes. The Company does not intend to adopt SFAS 96 in 1988. 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, 1985, 1986 and 1987 and the nine months ended March 31, 1988, the Company paid \$76,000, \$100,000, \$108,000 and \$85,000, respectively, in consulting fees to a director and two officers of the Company who are stockholders but not salaried employees of the Company. These amounts have been charged to expense as research and development.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

During the year ended June 30, 1986, the Company issued 73,800 shares of Common Stock at \$1.50 per share (the fair market value at date of issuance) to the Company's chief executive officer for \$11,070 in cash and a \$99,630 note payable to the Company. The principal and annual interest of 8.08% are due and payable on April 29, 1991, or earlier in the event the chief executive officer ceases to be an employee of the Company. In the event of a public offering of the Company's Common Stock, accrued and unpaid interest on the note becomes due within six months of such offering.

Note 10—Significant Customer and 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 currently sells its products through its own sales organization; prior to 1985, products were sold in foreign countries through distributors. Subsidiaries were charged royalties on revenues to unaffiliated customers at rates of up to 50% in 1985 and 1986 and 40% in 1987 and 1988; such royalties are eliminated in consolidation.

One major customer (accounting for 10% or more of sales) accounted for 13% and 12% of revenue during the years ended June 30, 1985 and 1986, respectively. There were no major customers in 1987 or for the nine months ended March 31, 1988.

The Company's operations by geographic area are as follows (in thousands):

	United States	Europe	Other	Consolidated
Nine months ended March 31, 1988:				
Revenues	\$32,730	\$21,333	\$3,117	\$57,180
Operating Profit	4,135	672	291	5,098
Identifiable Assets	42,081	24,892	2,283	69,256
Fiscal year ended 1987:				
Revenues	\$34,076	\$10,613	\$1,876	\$46,565
Operating Profit(Loss)	3,253	120	(271)	3,102
Identifiable Assets	34,899	8,633	1,513	45,045
Fiscal year ended 1986:				
Revenues	\$22,940	\$ 4.230	\$ 968	\$28,138
Operating Profit(Loss)	2,884	(353)	(28)	2,503
Identifiable Assets	19,961	3,576	484	24,021
Fiscal year ended 1985:				
Revenues	\$16,363	\$ 494	\$ 414	\$17,271
Operating Profit	597	63	111	771
Identifiable Assets	10,914	500	220	11,634

Included in United States revenues are export sales to customers located primarily in Europe of \$1,716,000, \$3,599,000 and \$3,716,000 and \$1,689,000 in fiscal years 1985, 1986, 1987 and for the nine months ended March 31, 1988, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS—(Continued) (Information as of March 31, 1987 and for the nine months ended March 31, 1987 is unaudited)

Note 11—Restatement of Prior Year Financial Statements

The Company changed its accounting policy in 1987 from straight line to accelerated depreciation for computer equipment acquired to perform specific development contracts. In 1986 the Company changed its accounting policy from recognizing maintenance revenues upon contract signing or anniversary date to recognizing such revenues ratably over the period to which they relate. Both accounting changes result in a better matching of costs and revenues. In accordance with the initial registration of securities exemption in Accounting Principles Board Opinion No. 20 the effects of these accounting changes have been reflected in the consolidated financial statements by retroactively restating all years prior to the respective years in which the changes were adopted which results in all years being consistently presented. The effect of these changes was to decrease maintenance revenues for 1985 by \$472,000; increase depreciation expense for 1985, 1986 and 1987 by \$40,000, \$206,000 and \$157,000, respectively; and decrease net income for 1985, 1986 and 1987 by \$474,000 (\$.07 per share), \$156,000 (\$.02 per share), and \$97,000 (\$.01 per share), respectively.

No person has been authorized to give any information or to make any representa-tions other than those contained in this Prospectus, and, if given or made, such information or representations must not be relied upon as having been authorized. This Prospectus does not constitute an offer to sell or the solicitation of an offer to buy any securities other than the securities to which it relates or any offer to sell or the solicitation of an offer to buy such securities in any circumstances in which such offer or solicitation is unlawful. Neither the delivery of this Prospectus nor any sale made hereunder shall, under any circumstances, create any implication that there has been no change in the affairs of the Company since the date hereof or that the information contained herein is correct as of any time subsequent to its date.

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Until June 11, 1988 (25 days after the date of this Prospectus), all dealers effecting transactions in the Common Stock offered hereby, whether or not participating in this distribution, may be required to deliver a Prospectus. This is in addition to the obligation of dealers to deliver a Prospectus when acting as underwriters and with respect to their unsold allotments or subscriptions.

2,000,000 Shares Relational Technology, Inc. Common Stock



Goldman, Sachs & Co.

Robertson, Colman & Stephens

Representatives of the Underwriters