

1987 ANNUAL REPORT



COMPANY PROFILE

ROSSDATA develops and markets business solutions for users of Digital Equipment Corporation's VAX computers. Formed from the merger of Ross Systems and Virtual Microsystems, ROSSDATA combines the strength of each of its operating companies into a single organization dedicated to serving the VAX market. ROSSDATA has attracted equity financing from some of the leading venture capital firms and financial institutions in the country, giving it a strong capital base to support its business and growth.

The market for commercial solutions on VAX computers is growing rapidly with the emergence of Digital as a strong contender to IBM in the business computing market. The VAX technology, with its total upward compatibility, its networking capabilities and its interactive processing environment, has gained rapid acceptance as an alternative to IBM in major corporations today. Digital's success has created an opportunity for ROSSDATA to become a large, successful company based on its expertise in this market, its proven products and its large customer base.

ROSSDATA's two subsidiaries are each leaders in their respective market segments, covering two of the most exciting parts of the VAX market—financial software and desktop-to-VAX-connectivity.

Ross Systems—Formed in 1972, Ross Systems is the leading supplier of "Mainframe Class" financial management software systems for VAX computers and is the only major financial software vendor that is completely dedicated to serving the VAX market. Ross offers a complete family of products covering the accounting and decision support functions. These products were written specifically for VAX computers, taking full advantage of the VAX's unique technology. Ross Systems complements these products with a client services organization offering product installation support, custom system development, management consulting and other consulting services.

Virtual Microsystems—Founded in 1982, Virtual Microsystems is the leading supplier of desktop-to-VAX connectivity solutions for network-based computing applications. Virtual offers two distinct, yet complementary product lines providing distributed PC emulation for VAX terminal users and integrated VAX connectivity for PC local area network users. Virtual complements its product offerings with a complete networking services organization offering installation, network engineering and support services.

CONSOLIDATED FINANCIAL HIGHLIGHTS

ROSSDATA Corporation

(in thousands)

Revenue	FY83	FY84	FY85	FY86	FY87
DEC Related Products	2,184	3,785	6,043	8,078	12,151
All Other Revenue	7,815	7,129	5,281	5,659	3,948
Total Revenue	9,999	10,914	11,324	13,737	16,099
Pre-Tax Profit	525	(94)	591	1,730	819*
Total Assets	6,054	5,656	6,187	9,220	14,549
Shareholder's Equity	3,026	2,964	3,311	4,309	8,695

*includes merger expenses not attributable to Ross or Virtual

Financial Summary—ROSSDATA Corporation was formed in 1986 from the merger of Ross Systems and Virtual Microsystems. This event, combined with excellent financial results and the completion of significant venture capital financing has positioned ROSSDATA to play a leading role in the emerging market for Digital VAX commercial solutions. Total revenue for the year increased 17% to \$16,100,000 from last year's \$13,700,000 while net income decreased to \$317,000 from last year's \$1,000,000. Although the overall revenue increase was small, each operating company's core business revenue increased rapidly. Ross Systems' software products' revenue increased 46% over the prior year, and Virtual's DEC-related product revenues increased 61%. This increase in core business was accompanied by a corresponding decrease in other, less strategic areas—timesharing for Ross Systems and in special projects for Virtual. The decrease in net income reflects the extraordinary merger expenses incurred, the shift in fiscal years for Virtual that occurred with the merger, and extraordinary selling expenses incurred by Ross Systems that resulted in higher revenue levels and additional market share. The company has always practiced sound financial management, and we ended the year with cash on hand in excess of \$4 million, net working capital in excess of \$6,000,000 and total shareholder's equity of \$8,700,000. At the end of the year we had 147 employees as compared with 133 last year.

Ross/Virtual Merger—The merger of Ross Systems and Virtual Microsystems was the most significant event in either company's corporate history. The merger combined the resources of two companies, both serving the VAX market, to form a larger and stronger company. And one that is a market leader for a variety of commercial solutions for VAX computers. While both companies operate independently, they share a common philosophy, a common financial structure, common administrative facilities and other elements that together make ROSSDATA one of the largest independent companies dedicated to serving the VAX market. Ross Systems' financial software represents basic applications that most companies buy when they use VAXes for commercial data processing. And Ross Systems complements these products with a variety of services that work to give its customers a total solution. Virtual's expertise in connecting PCs and PC LANs (Local Area Networks) to VAXes has potential at every VAX site in Digital's large installed base, and the networking market is experiencing explosive growth. Many larger companies migrating to VAXes for commercial applications will use the solutions offered by both of these companies.

Market Update—The market for commercial VAX solutions has grown dramatically over the last few years as more companies recognize Digital's cohesive VAX technology as an effective solution for their data processing needs. Digital's capability to deliver compatible computers from

small desktop workstations to large clustered mainframe-sized machines, its interactive environment and its comprehensive networking have made the VAX a viable alternative for business data processing. Today, 46% of the VAX market is composed of computers used at least 50% of the time for commercial applications. There has been in excess of 100,000 units shipped worldwide, and this figure is expected to increase by 50% during FY88. Digital now dominates the departmental computing market and is moving rapidly to expand its market share in the MIS departments of Fortune 1000 companies.

New Financing—We have always felt that a key to success in the software industry is to have strong financial backing that will provide us with the resources to develop superior products, support our customers and grow our company. To that extent we began the process of raising additional equity capital immediately upon the completion of the merger. That process culminated in raising more than \$4 million in March of this year, one of the largest venture financings, we believe, of a VAX-based company. This will provide ROSSDATA with the funds that it needs to continue its success, as it pursues a strategy of acquiring additional products and companies that fit its VAX strategy.

People—ROSSDATA is a team of people, working together to make it successful. And its ability to attract and retain outstanding people will be the most important factor in that success. During the year, we have been successful in building strong management teams both at Ross Systems and Virtual. Together, we have one of the most professional, capable and highly motivated groups of people in the computer industry. At the time of the merger, Richard Giordanella was promoted to President of Ross Systems and Gianluca Rattazzi was promoted to President of Virtual Microsystems. Each of these individuals has many years of experience in his particular market segment and will be instrumental in the success of ROSSDATA. At the end of FY87, we hired Peter Kent as Vice President and Chief Financial Officer of ROSSDATA. He comes to us with significant experience in the software and microcomputer industry.

Conclusion—ROSSDATA and its two operating companies, Ross Systems and Virtual Microsystems, are well-positioned to benefit from the explosive growth of the Digital VAX market. Our experience in this market, our proven products, our strong customer base and our outstanding management team will all contribute to our continued success.



Kenneth Ross
President and CEO

CUSTOMER APPLICATIONS

Ross Systems, Inc.

Avon Products, Inc., a \$3 billion diversified consumer products and health care company, selected Ross Systems' MAPS/GL General Ledger and Financial Management package on a VAX 8200 to prepare its corporate financial consolidations. Avon has over 15 divisions located worldwide and needed a new system to gather, consolidate and report financial data in a variety of formats. MAPS/GL replaced a PC-based system, in place for a number of years, which did not have the flexibility, structure, security and power that Avon needed. MAPS/GL represented an ideal solution to their needs. It provided a data base optimized to hold financial data and complete audit trails from all posting activities. MAPS/GL's chartmaster and multiple consolidation structures made the setup and maintenance of the consolidation system simple yet flexible, easily able to accommodate changes as Avon's business changes. Avon also required the power and flexibility of MAPS/GL's Management Report Writer to prepare a variety of reports for the users of the system. In addition, Avon developed a comprehensive data collection system using a relational data base management system and interfaced it directly with the MAPS/GL chart of accounts for accurate validation of data at its source. Avon utilized the Ross/Start implementation consulting service to rapidly bring this system on-line without significantly impacting the ongoing tasks and responsibilities of its permanent staff.

Digital Equipment Corporation's Common Financial Systems organization has selected Ross' family of financial software for many of its own internal accounting requirements, and many organizations within Digital are implementing various Ross products throughout the world as part of the Digital Financial Architecture. The General International Area in particular is using all of the Ross products in many of their foreign locations, including Mexico, Brazil, Japan, New Zealand, Taiwan and Singapore. Each of these countries is responsible for its own accounting and reporting, using a VAX and Ross' software, while the responsibility for coordinating and supporting this effort lies in the U.S. Each location makes extensive use of the international accounting capabilities of the MAPS family of software, especially its powerful capability for currency conversions. MAPS/GL's multiple segment feature allows books to be kept in both U.S. and local currencies. All of the reports necessary to manage this process are created through the flexibility of the Management Report Writer. Each country using the Ross software has a variety of differing requirements, and the flexibility, variety of reporting options and ease of use make Ross software ideally suited to their applications.

Ford Microelectronics, Inc., a unit of Ford Motor Company, needed a sophisticated, accounting system for their VAX computer. Ford evaluated the available products and chose the complete, integrated Ross Systems' MAPS family of products. Ford required all of the standard "Main-

frame Class" accounting functionality offered by Ross and other accounting software vendors. However, they also wanted a solution tailored to operate efficiently on a VAX, one supported by VAX experts and one that could be operated directly by their users. Ford needed a sophisticated general ledger system with the capability to do multi-level allocations and project accounting. MAPS/GL satisfied these requirements with its flexible chart of accounts capability, a feature which allows a company to tailor the make-up of its account structure to include elements like project codes. As an early customer, the staff at Ford has had the opportunity to participate in the Ross Systems international User's Group, an organization formed to provide feedback to Ross Systems from its customers concerning product features, support and other topics that affect the ongoing relationship between Ross and its customers.

Quaker Oats Company, a \$4 billion producer of brand name packaged foods and consumer products, selected Ross' family of financial software for implementation in the twelve manufacturing plants of their grocery products unit, an organization representing approximately 65% of the company's total revenues. Quaker had a batch accounting system in place and wanted to upgrade to a new, distributed, on-line accounting system. After selecting Digital's VAX computers for their interactive and networking capabilities, Quaker decided on Ross Systems financial software products—MAPS/GL, MAPS/AP and MAPS/MODEL. Ross offered the extensive features that a company like Quaker needed for accounting and budgeting in a distributed environment. They also liked the fact that Ross' products were designed specifically for VAX computers, taking full advantage of the VAX's advanced technology. Quaker also wanted a system that could be operated by the accounting personnel in each plant, without having to rely on the data processing staff. Ross offered a comprehensive set of capabilities to accomplish this: menu driven, easy-to-use products with extensive user documentation, accompanied by professional training to ensure that all of the users were thoroughly familiar with the operations of the products, backed by an expert support organization that understands VAX VMS, accounting and MAPS products.

CUSTOMER APPLICATIONS

Virtual Microsystems, Inc.

Georgia Pacific Corporation's Pulp & Paper Division made a major commitment to Digital's VAX family of computers for many of their business applications. As part of that commitment, Georgia Pacific has selected Virtual's Bridge family of products as their standard for PC emulation. Georgia Pacific uses the VAX for business applications as well as office automation, having standardized on Digital's All-In-1 product. This division has over 10 sites nationwide with its headquarters in Atlanta. Each site has one or more VAXes ranging from MicroVAX systems to large VAX clusters, and all of the division's VAXes are connected together via leased lines and DECnet. Georgia Pacific is also standardized on Lotus 1-2-3 for financial reporting. Each site prepares their reports in Lotus 1-2-3 and subsequently passes them to headquarters for consolidation and reporting purposes. Virtual's Bridge allows any user with a DEC terminal connected to a VAX to run PC applications such as Lotus 1-2-3 directly from their DEC terminal. Therefore, all of the division's VAX users can develop and access financial information without having their own PCs. And since the Bridge uses VAX files to store data, divisional headquarters can use DECnet to easily retrieve and consolidate the information from all of the sites for divisional level reports. These reports are then distributed and accessed through the Bridge's All-In-1 integration.

John H. Harland Co. is a major U.S. printer of bank checks and related forms with over 40 printing plants in the U.S. and Puerto Rico. They had developed and purchased a number of PC applications to operate their business. These applications range from customer services, administration and data base management to the maintenance of an on-line data base of all checks printed over the last 18 months. As the company grew, the problem of integrating the data and applications for their 2,000 workers grew disproportionately, so they turned to Virtual for a solution. Virtual's Bridge products, when combined with VAX computers, solved their problem without the expense of reprogramming their applications and retraining their work force. By running their existing PC applications on Bridges, they dramatically expanded their data storage capacity and obtained increased data security. Since the Bridge uses VAX files to store PC data, Harland is able to use the VAX's proven backup facilities to ensure the integrity of its data. And with all of the data resident on the VAX, and accessible to everyone (with the appropriate security), the problem of integration and communication of corporate data was made significantly easier with a long-term solution. This was also considerably less expensive than purchasing individual PCs.

MCI Corporation, the second largest U.S. long distance phone company, was a pioneer in competing with AT&T in the long distance telephone market. MCI selected Virtual's NCP (Network Co-Processor) and a VAX to tie together four different LANs (Local Area Networks) in different parts of

the organization. PCs in separate departments were linked with their own LAN but had no way to communicate with the PCs in the other departments. Moreover, each department also had terminal users directly connected to the VAX that couldn't access data from any of the PC users. By using the VAX and the NCP as the backbone for this network, MCI was able to link each department's PCs with the same department's DEC terminals. The NCP also enables the LAN-based PCs to act as VAX terminals, accessing VAX data and applications. By using the VAX as a gateway between the independent LANs in the different departments, all of the PC users were able to share and communicate data, no matter where it resided. By using VAX disks and backup procedures for centralized data storage, the PC users obtained additional data security. The NCP uses an extremely efficient combination of hardware and software, so the loading on the VAX for this application was insignificant. And MCI was able to continue to use the VAX for its normal applications without significant degradation in user response times.

Ungermann-Bass, the fourth largest networking company in the U.S., with annual revenues in excess of \$100 million, was faced with the challenge of providing a competitive solution for the rapidly growing Digital marketplace. After an extensive search, they decided to market Virtual's Network Co-Processor on an OEM basis. UB's Net-One networking software supports multiple wiring schemes including Ethernet, token ring and broad band. What they lacked was a fast VAX link that could also effectively connect PC and VAX data. UB wanted to provide a solution for VAX users that allowed a VAX to be used as a high speed server for PCs in a large network, without significantly increasing the load on the VAX. This requirement was an important consideration in companies that already had applications running on the VAX. UB selected Virtual's NCP because it met all of their requirements and selected Virtual because of its knowledge of and commitment to the VAX market. Virtual works closely with Ungermann-Bass on the integration of the two company's products, on joint sales opportunities and future product development efforts. The partnership with Virtual will enable UB to continue to offer state of the art solutions in VAX connectivity.

FINANCIAL HIGHLIGHTS

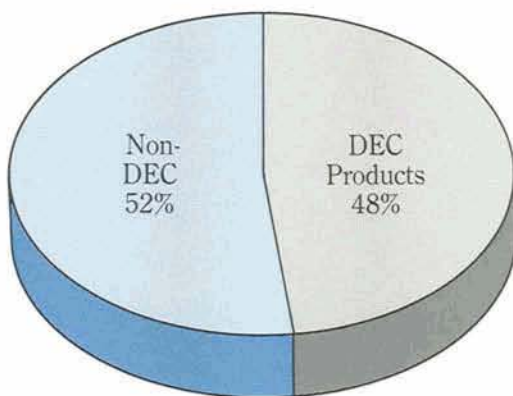
Virtual Microsystems, Inc.

(in thousands)

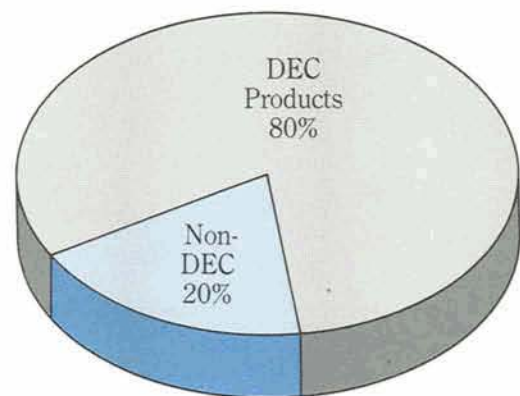
Revenue	FY83	FY84	FY85	FY86	FY87
DEC Related Products	1,221	2,208	2,329	2,403	3,872
Non-DEC Products	0	6	157	1,442	460
Contract Revenue	208	419	588	691	464
Other Revenue	5	7	31	95	28
Total Revenue	1,434	2,640	3,105	4,631	4,824
Cost of Sales	280	592	901	1,111	1,226
Expenses	1,153	1,979	2,117	2,765	3,260
Pre-Tax Profit	1	69	87	755	338

PRODUCT MIX

1986 Product Mix



1987 Product Mix





A **ROSSDATA** Company

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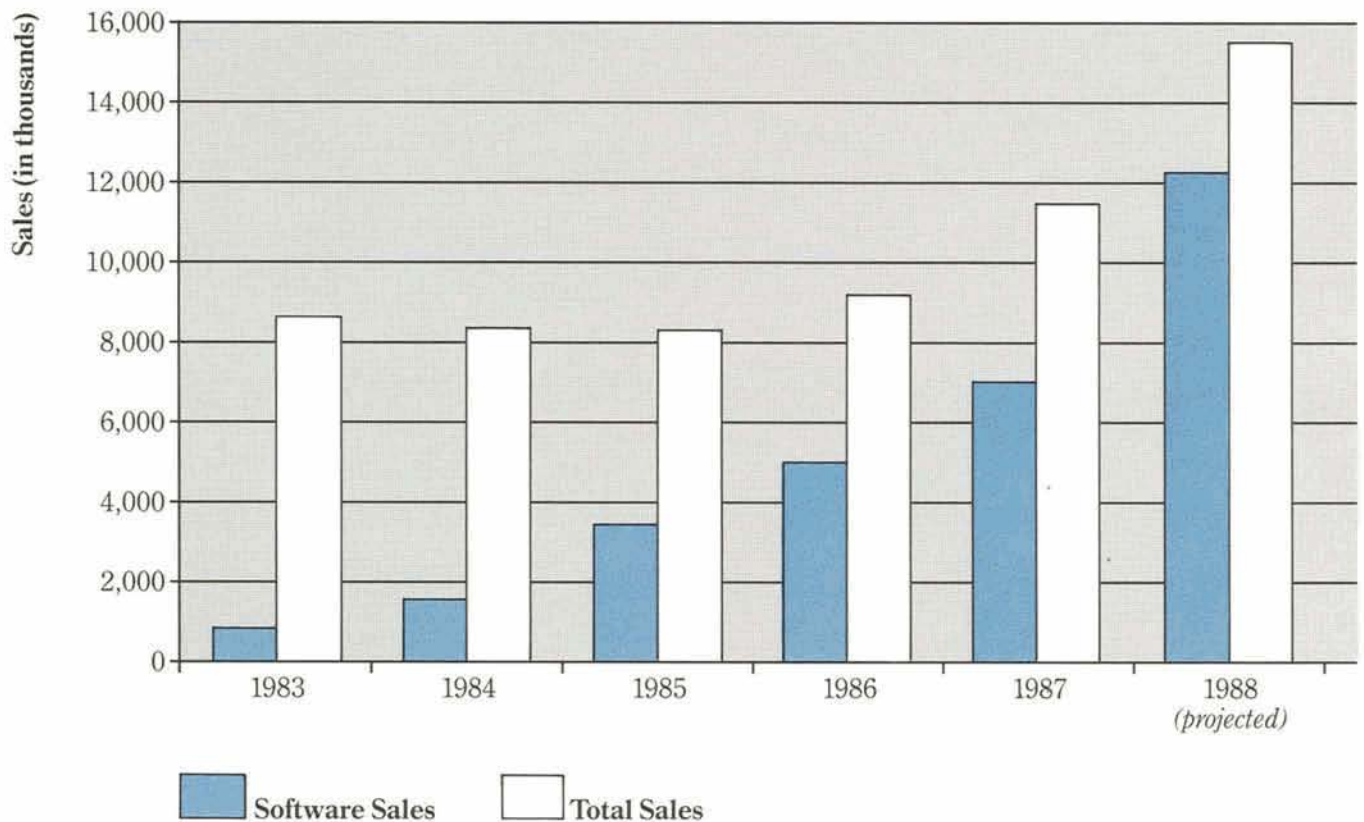
FINANCIAL HIGHLIGHTS

Ross Systems, Inc.

(in thousands)

Revenue	FY83	FY84	FY85	FY86	FY87
Software	860	1,419	3,294	5,048	6,923
Renewable Maintenance	103	158	420	627	1,356
Timesharing	6,236	5,776	3,567	2,516	1,400
Professional Services	1,119	801	786	731	1,206
Other	247	120	152	184	390
Total Revenue	8,565	8,274	8,219	9,106	11,275
Costs and Expenses	8,041	8,437	7,715	8,130	10,584
Pre-Tax Profit	524	(163)	504	976	691

SOFTWARE SALES GROWTH





ROSS SYSTEMS

A ROSSDATA COMPANY

Corporate Offices
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Palo Alto, California 94301
(415) 856-1100

1987 AUDITED FINANCIAL STATEMENTS

CONSOLIDATED BALANCE SHEETS

Assets	<u>June 30,</u>	
	<u>1987</u>	<u>1986</u>
<i>Current Assets:</i>		
Cash	\$ 4,404,000	2,321,000
Accounts receivable less allowance for doubtful accounts of \$466,000 in 1987 and \$211,000 in 1986 (note 5)	6,218,000	4,552,000
Inventories (note 3)	483,000	300,000
Other current assets	<u>472,000</u>	<u>165,000</u>
<i>Total Current Assets</i>	11,577,000	7,338,000
Property and equipment (notes 4 and 6)	1,811,000	1,411,000
Computer software costs (note 11)	940,000	405,000
Other assets	<u>221,000</u>	<u>66,000</u>
	\$ <u>14,549,000</u>	<u>9,220,000</u>
 Liabilities and Stockholders' Equity		
<i>Current Liabilities:</i>		
Bank borrowings (note 5)	\$ 800,000	500,000
Current installments of long-term obligations (note 6)	135,000	157,000
Accounts payable	739,000	691,000
Accrued expenses	1,614,000	1,322,000
Deferred revenue	213,000	425,000
Deferred income taxes (note 8)	<u>1,457,000</u>	<u>1,112,000</u>
<i>Total Current Liabilities</i>	<u>4,958,000</u>	<u>4,207,000</u>
Long-term obligations, excluding current installments (note 6)	642,000	571,000
Deferred income taxes (note 8)	254,000	133,000
<i>Stockholders' Equity</i> (notes 9 and 10):		
Preferred stock	4,067,000	195,000
Common stock	1,783,000	1,316,000
Retained earnings	<u>3,203,000</u>	<u>2,885,000</u>
	9,053,000	4,396,000
Less notes receivable from stockholders	<u>(358,000)</u>	<u>(87,000)</u>
<i>Total Stockholders' Equity</i>	8,695,000	4,309,000
Commitments (note 7)		
	\$ <u>14,549,000</u>	<u>9,220,000</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF EARNINGS

	<u>Years ended June 30,</u>	
	<u>1987</u>	<u>1986</u>
Revenues:		
Computer software sales	\$ 10,759,000	7,841,000
Computer hardware sales	2,528,000	2,422,000
Timesharing	1,400,000	2,516,000
Professional services	1,206,000	731,000
Interest income	170,000	175,000
Other	36,000	52,000
	<u>16,099,000</u>	<u>13,737,000</u>
 Expenses:		
Employee compensation and benefits	7,129,000	5,257,000
Computer hardware costs	864,000	710,000
Other operating costs	4,234,000	3,547,000
Occupancy	1,415,000	1,314,000
Depreciation and amortization	856,000	631,000
Computer communications and maintenance	454,000	449,000
Costs of business combination (note 2)	201,000	-
Interest expense	127,000	98,000
	<u>15,280,000</u>	<u>12,006,000</u>
 Earnings before income tax expense	 819,000	 1,731,000
Income tax expense (note 8)	501,000	660,000
 Net earnings	 \$ 318,000	 1,071,000
 Earnings per share:		
Primary	\$ 0.09	0.29
Fully diluted	\$ 0.08	0.29

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	<u>Years ended June 30,</u>	
	<u>1987</u>	<u>1986</u>
Cash flow from operating activities:		
Net earnings	\$ 318,000	1,071,000
Noncash items:		
Depreciation and amortization	856,000	631,000
Deferred income taxes	466,000	647,000
Loss (gain) on disposal of equipment	<u>22,000</u>	<u>(11,000)</u>
Cash generated by operations	1,662,000	2,338,000
Changes in items affecting operations:		
Accounts receivable	(1,666,000)	(2,091,000)
Inventories	(183,000)	25,000
Other current assets	(307,000)	41,000
Accounts payable	48,000	442,000
Accrued expenses	292,000	102,000
Deferred revenue	<u>(212,000)</u>	<u>391,000</u>
Cash generated (used) by operating activities	<u>(366,000)</u>	<u>1,248,000</u>
Cash flow from financing activities:		
Increase in long-term obligations	465,000	200,000
Increase in bank borrowings, net	300,000	442,000
Payments and current installments of long-term obligations, net	(196,000)	(189,000)
Proceeds from issuances of common stock	106,000	15,000
Proceeds from issuance of preferred stock	4,067,000	-
Acquisition of common stock	(54,000)	(90,000)
Increase in notes receivable from stockholders	(274,000)	(6,000)
Collection or cancellation of notes receivable	<u>3,000</u>	<u>78,000</u>
Cash generated by financing activities	<u>4,417,000</u>	<u>450,000</u>
Cash flow from investment activities:		
Purchases of equipment	(1,062,000)	(484,000)
Computer software costs	(830,000)	(486,000)
Other assets	(155,000)	1,000
Proceeds from sales of equipment	<u>79,000</u>	<u>83,000</u>
Cash used by investment activities	<u>(1,968,000)</u>	<u>(886,000)</u>
Net cash generated	2,083,000	812,000
Cash at beginning of year	<u>2,321,000</u>	<u>1,509,000</u>
Cash at end of year	<u>\$ 4,404,000</u>	<u>2,321,000</u>

See accompanying notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Retained</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Earnings</u>	
Balances at June 30, 1985	25,000	\$ 195,000	3,371,000	\$ 1,391,000	1,814,000	3,400,000
Exercise of stock options	-	-	15,000	15,000	-	15,000
Acquisition of common stock	-	-	(38,000)	(90,000)	-	(90,000)
Net earnings	-	-	-	-	<u>1,071,000</u>	<u>1,071,000</u>
Balances at June 30, 1986	25,000	195,000	3,348,000	1,316,000	2,885,000	4,396,000
Sales of common stock	-	-	26,000	65,000	-	65,000
Exercise of stock options	-	-	26,000	41,000	-	41,000
Acquisition of common stock	-	-	(20,000)	(54,000)	-	(54,000)
Conversion of subordinated debt	-	-	121,000	220,000	-	220,000
Conversion of preferred stock	(25,000)	(195,000)	110,000	195,000	-	-
Sale of Series A preferred stock	1,031,000	4,067,000	-	-	-	4,067,000
Net earnings	-	-	-	-	<u>318,000</u>	<u>318,000</u>
Balances at June 30, 1987	<u>1,031,000</u>	<u>\$ 4,067,000</u>	<u>3,611,000</u>	<u>\$ 1,783,000</u>	<u>3,203,000</u>	<u>9,053,000</u>

See accompanying notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

June 30, 1987 and 1986

Note 1 -- Organization and Summary of Significant Accounting Policies

A. Basis of Presentation

In March 1987, Ross Systems, Inc. amended its Articles of Incorporation and was renamed RossData Corporation (the Company). The consolidated financial statements include the accounts of RossData and its wholly-owned subsidiaries Ross Systems Limited and Virtual Microsystems, Inc. (VMI). All significant intercompany transactions and balances have been eliminated in consolidation. As further discussed in note 2, the Company acquired VMI in a transaction accounted for as a pooling of interests and, accordingly, the consolidated financial statements have been restated for all periods presented.

B. Business of the Company

The Company is engaged in the business of developing and marketing proprietary software packages and hardware products exclusively for Digital Equipment VAX computers. It also provides other services such as product installation, support, professional consulting services, and timesharing.

C. Inventories

Inventories are stated at the lower of cost (first-in, first-out basis) or market (net realizable value).

D. Property and Equipment

Property and equipment is stated at cost. Depreciation is provided on the straight-line and declining-balance methods over the estimated useful lives of the respective assets, generally three to seven years. Leasehold improvements and equipment under capital lease are amortized using the straight-line method over the shorter of the terms of the related leases or the respective useful lives of the assets.

E. Revenue Recognition

The Company recognizes revenue from sales of computer software and hardware upon shipment. Nonrefundable revenues from agreements entitling customers to receive future releases and enhancements of computer software are recognized upon signing the agreement. Timesharing and professional consulting revenues are recognized as the related services are performed. Revenues received related to future performance under certain contractual obligations are deferred until such obligations have been met.

F. Computer Software Costs

Computer software product development costs incurred subsequent to the determination of product technological feasibility are capitalized and amortized over the useful life of the respective products, generally two to three years. Software costs related to maintenance, support and product software costs incurred prior to establishing product technological feasibility are expensed as incurred.

G. Income Taxes

Deferred income taxes are recognized for income and expense items that are reported in different years for financial reporting and income tax purposes. Tax credits are accounted for as a reduction of income tax expense in the year realized.

H. Earnings Per Common and Common Equivalent Share

Primary earnings per share are based on the weighted average number of common shares and common share equivalents outstanding during each year. Common share equivalents include dilutive stock options using the treasury stock method and the assumed conversion of subordinated notes. The number of shares used in determining the primary earnings per share were 3,700,000 and 3,702,000 in 1987 and 1986 respectively.

Fully diluted earnings per share include conversion of preferred stock weighted for the period outstanding during each year. The number of shares used in determining fully diluted earnings per share were 4,112,000 and 3,702,000 in 1987 and 1986, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

Note 2 -- Business Combination

On November 11, 1986, the Company acquired all of the common stock of VMI in exchange for approximately 1,026,000 shares of the Company's common stock in a business combination accounted for as a pooling of interests. Accordingly, the consolidated financial statements for periods prior to the combination have been restated to include the accounts and operations of VMI. Details of the 1987 results of operations for the previously separate entities for the four months prior to the combination that are included in the current 1987 consolidated net earnings and the reconciliation of amounts of 1986 revenues and earnings previously reported by RossData Corporation with the 1986 consolidated amounts currently presented follows:

	(Unaudited) 1987	1986
Revenues:		
RossData Corporation	\$ 2,735,000	9,106,000
Virtual Microsystems, Inc.	<u>1,470,000</u>	<u>4,631,000</u>
Combined	<u>\$ 4,205,000</u>	<u>13,737,000</u>
Net Earnings (loss)		
RossData Corporation	\$ (200,000)	520,000
Virtual Microsystems, Inc.	<u>6,000</u>	<u>551,000</u>
Combined	<u>\$ (194,000)</u>	<u>1,071,000</u>

There were no material transactions between RossData Corporation and VMI prior to the combination.

Note 3 -- Inventories

	1987	1986
A summary of inventories follows:		
Component parts and work-in-process	\$ 194,000	148,000
Finished goods	<u>289,000</u>	<u>152,000</u>
	<u>\$ 483,000</u>	<u>300,000</u>

Note 4 -- Property and Equipment

	1987	1986
A summary of property and equipment follows:		
Computer equipment	\$ 3,241,000	3,029,000
Furniture and fixtures	761,000	597,000
Leasehold improvements	883,000	606,000
Other	<u>33,000</u>	<u>31,000</u>
	4,918,000	4,263,000
Less accumulated depreciation and amortization	<u>3,107,000</u>	<u>2,852,000</u>
	<u>\$ 1,811,000</u>	<u>1,411,000</u>

Included in computer equipment in 1987 is equipment recorded under a capital lease aggregating \$465,000. Related amortization aggregated \$40,000 at June 30, 1987.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

Note 5 -- Bank Borrowings

The Company has a \$2,000,000 revolving line of credit agreement with a bank which expires in November 1988. Outstanding borrowings bear interest, payable monthly at the bank's prime rate plus 1 1/2%, and are secured by accounts receivable.

Note 6 -- Long-Term Obligations

A summary of long-term obligations follows:	<u>1987</u>	<u>1986</u>
Note payable to bank in monthly installments of \$3,333, plus interest at 2% above the bank's prime rate, balance due in April, 1991, secured by equipment	\$ 157,000	197,000
Convertible subordinated notes to stockholders due in November 1990, interest at 8% payable annually	180,000	400,000
Obligations under capital leases (note 7)	427,000	-
Other	<u>13,000</u>	<u>131,000</u>
	777,000	728,000
Less current installments	<u>135,000</u>	<u>157,000</u>
	<u>\$ 642,000</u>	<u>571,000</u>

The subordinated notes are convertible into common stock at the option of the noteholder at a rate of approximately 548 shares for each \$1,000 of principal .

Note 7 -- Commitments

The Company leases facilities and certain equipment under lease agreements classified as operating and capital leases which expire at various dates through 1992. Certain leases include renewal options and rental escalation clauses to reflect changes in price indices, real estate taxes and maintenance costs. Future minimum lease payments under noncancelable leases are as follows:

Fiscal Year	<u>Capital Leases</u>	<u>Operating Leases</u>
1988	\$ 114,000	971,000
1989	114,000	661,000
1990	114,000	519,000
1991	114,000	514,000
1992	<u>55,000</u>	<u>310,000</u>
Total minimum lease payments	511,000	\$ <u>2,975,000</u>
Less amount representing interest	<u>84,000</u>	
Present value of future minimum capital lease payments (note 6)	<u>\$ 427,000</u>	

Rent expense for 1987 and 1986 was approximately \$1,047,000 and \$973,000, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

During 1987, the Company entered into an agreement with the licensor of one of the Company's software products whereby the Company's maximum royalty obligation was established at \$1,500,000. Under the terms of the agreement, the Company paid \$750,000 of this obligation to the licensor in 1987, and will pay a maximum of \$750,000 of this obligation to the licensor in annual installments through 1990. The Company is charging the aggregate maximum royalty obligation to expense on a straight-line basis over the expected five year useful life of the license.

Note 8 -- Income Taxes

The components of income tax expense are as follows:

	<u>Current</u>	<u>Deferred</u>	<u>Total</u>
1987:			
Federal	\$ -	390,000	390,000
State	13,000	76,000	89,000
Foreign	<u>22,000</u>	<u>-</u>	<u>22,000</u>
	<u>\$ 35,000</u>	<u>466,000</u>	<u>501,000</u>
1986:			
Federal	\$ (24,000)	524,000	500,000
State	<u>26,000</u>	<u>134,000</u>	<u>160,000</u>
	<u>\$ 2,000</u>	<u>658,000</u>	<u>660,000</u>

The actual income tax expense for 1987 and 1986 differs from the "expected" tax expense for those years (computed by applying the U.S. Federal corporate income tax rate of 46% to earnings before income taxes) as follows:

	<u>1987</u>	<u>1986</u>
Computed "expected" tax expense	\$ 377,000	796,000
Increase (reduction) in income tax expense resulting from:		
Tax rate differential	(20,000)	(20,000)
State income tax expense, net of Federal income tax effect	49,000	86,000
Costs related to business combination	80,000	-
Nontaxable dividend income	(49,000)	-
Unutilized foreign losses	58,000	-
Investment and other tax credits	-	(174,000)
Other, net	<u>6,000</u>	<u>(28,000)</u>
	<u>\$ 501,000</u>	<u>660,000</u>

Deferred income taxes arise primarily from the effects of reporting income for tax purposes on the cash basis, the excess of tax over book depreciation and the different treatment accorded computer software costs. The Tax Reform Act of 1986 eliminated the election of reporting cash basis income for income tax purposes. Accordingly, the Company will report all future taxable income on the accrual basis.

At June 30, 1987, the Company had net operating and research and development carryforwards available for Federal tax reporting purposes of approximately \$1,300,000 and \$70,000, respectively. These carryforwards will expire through the year 2002. No loss or credit carryforwards exist for financial statement purposes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

Note 9 -- Preferred Stock

The Company has authorized 3,000,000 shares of Series A noncumulative preferred stock.

Each preferred share is convertible into common shares based on the ratio of \$4 to the fair market value of common stock per share at the time of conversion. At June 30, 1987 the conversion ratio was 1.6. Preferred stockholders have voting rights equal to the number of common shares into which the preferred shares are convertible, are entitled to an annual dividend of \$.24 per share, if declared by the Board of Directors, a preference of \$4.00 plus any declared but unpaid dividends in the event of liquidation, and may redeem up to 50% of their shares in 1991 and 100% of their shares in 1993 at \$4.00 per share.

Note 10 -- Common Stock

The Company has authorized 21,000,000 shares of common stock. The notes receivable from stockholders bear interest at rates ranging from 6% to 13% and are secured by the related shares.

The Company has reserved 917,800 shares of common stock for issuance under its 1984 Stock Option Plan, as amended, and its 1979 Stock Option Plan. The Company may issue options to purchase shares of the Company's common stock to eligible employees, officers, directors, independent contractors and consultants at prices not less than the fair market value of the shares as determined by the Board of Directors at the grant date. Generally, all options are immediately exercisable.

In fiscal 1983, the Board of Directors granted to certain key employees options to purchase 158,000 shares of common stock at \$2.00 per share exercisable ratably over eight years. The exercisability of a portion of these options may be accelerated if certain company financial goals are obtained.

A summary of stock option activity follows:

	<u>Options</u>	<u>Price</u>
Balance at June 30, 1985	358,000	\$.96-3.00
Granted	268,000	1.82-2.50
Exercised	(15,000)	.96-2.50
Cancelled or expired	<u>(124,000)</u>	<u>.96-3.00</u>
Balance at June 30, 1986	487,000	.96-3.00
Granted	310,000	1.82-2.50
Exercised	(26,000)	.96-2.50
Cancelled or expired	<u>(112,000)</u>	<u>1.82-3.00</u>
Balance at June 30, 1987 (605,000 exercisable)	<u>659,000</u>	<u>\$ 1.82-3.00</u>

The Company has also reserved 200,000 shares of common stock for issuance under its Stock Purchase Plan. Under this plan, the Board of Directors specifies the number of shares that employees may purchase each year at prices equal to the fair market value of the shares at the purchase date. During 1987, 26,000 shares were sold at \$2.50 per share pursuant to this plan. No share activity occurred during 1986.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(continued)

The Company has an option to repurchase shares issued under its Stock Purchase Plan and Stock Option Plans. This repurchase option expires for 60% of shares owned or under option three years from the holder's date of employment under the Stock Purchase Plan and the 1979 Stock Option Plan and three years from the date of grant under the 1984 Stock Option Plan. Thereafter, the repurchase option expires monthly at the rate of one sixtieth of shares owned or under option for each additional month of employment by the shareholder or optionee.

Note 11 -- Computer Software Costs

The Company has capitalized certain software product development costs in accordance with the provisions of Statement of Financial Accounting Standards No. 86 "Accounting for the Cost of Computer Software to be Sold, Leased or Otherwise Marketed". A summary of capitalized computer software costs follows:

	<u>1987</u>	<u>1986</u>
Capitalized software costs	\$ 1,315,000	485,000
Less accumulated amortization	<u>375,000</u>	<u>80,000</u>
	\$ 940,000	405,000
	=====	=====

Research and development costs which were expensed as incurred totalled approximately \$1,082,000 and \$1,186,000 in 1987 and 1986, respectively.

AUDITOR'S REPORT

The Board of Directors
RossData Corporation:

We have examined the consolidated balance sheets of RossData Corporation as of June 30, 1987 and 1986 and the related consolidated statements of earnings, stockholders' equity and changes in financial position for the years then ended. 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. We did not examine the financial statements of Virtual Microsystems, Inc., a consolidated subsidiary, as of and for the year ended June 30, 1986, which statements reflect total assets constituting 21% and total revenues constituting 34% of the related consolidated totals. These statements were examined by other auditors whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for Virtual Microsystems, Inc. as of and for the year ended June 30, 1986, is based solely upon the report of other auditors.

In our opinion, based upon our examinations and the report of other auditors, the aforementioned consolidated financial statements present fairly the financial position of RossData Corporation and subsidiaries at June 30, 1987 and 1986 and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat Marwick Main + Co.

San Jose, California
August 28, 1987

CORPORATE INFORMATION

Board of Directors

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Independent Investor
Andrew M. Paul
Welsh, Carson, Anderson & Stowe
Kenneth Ross
ROSSDATA Corporation

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Peter S. Kent
Vice President and Chief Financial Officer
Gianluca U. Rattazzi
President, Virtual Microsystems, Inc.

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Hambrecht & Quist
Horsley Keogh & Associates
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