

RELATIONAL TECHNOLOGY, INC.

REPORT ON EXAMINATIONS OF FINANCIAL STATEMENTS
for the years ended June 30, 1983 and 1982

To the Stockholders of
Relational Technology, Inc.:

We have examined the balance sheets of Relational Technology, Inc. as of June 30, 1983 and 1982 and the related statements of income, changes in 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.

In our opinion, the financial statements referred to above present fairly the financial position of Relational Technology, Inc. as of June 30, 1983 and 1982, and the results of its operations and the changes in its financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

San Francisco, California
August 26, 1983

RELATIONAL TECHNOLOGY, INC.
BALANCE SHEETS, June 30, 1983 and 1982

ASSETS	<u>1983</u>	<u>1982</u>
Current assets:		
Cash	\$ 52,524	\$ 63,365
Short-term investments at cost (approximates market)	450,000	738,899
Accounts receivable (less allowance for doubtful accounts of \$1,200 in 1983 and 1982)	527,066	392,564
Prepaid expenses	<u>29,033</u>	<u>7,643</u>
Total current assets	1,058,623	1,202,471
Equipment	731,642	413,566
Long-term receivables, less current portion	122,714	-
Organization costs	7,515	10,855
Other assets	<u>19,627</u>	<u>8,494</u>
	<u>\$1,940,121</u>	<u>\$1,635,386</u>
LIABILITIES & STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	96,409	185,998
Notes payable to bank	120,000	-
Current portion of long-term debt	32,772	35,503
Income taxes payable	11,034	-
Deferred income taxes	4,277	-
Other current liabilities	<u>40,299</u>	<u>40,740</u>
Total current liabilities	304,791	262,241
Long-term debt, excluding current portion	73,737	103,778
Deferred income taxes	<u>10,473</u>	<u>-</u>
	84,210	103,778
Commitments (Note 9).		
Stockholders' equity:		
Preferred stock (no par value); authorized 1,000,000 shares:		
Series A convertible preferred stock; issued and out- standing 305,000 shares	305,000	305,000
Series B convertible preferred stock; issued and out- standing 192,000 shares	936,400	936,400
Common stock (no par value), authorized 25,000,000 shares in 1983 and 5,000,000 shares in 1982; issued and outstanding 2,735,210 shares in 1983 and 477,500 shares in 1982	217,025	179,750
Retained earnings (deficit)	<u>92,695</u>	<u>(151,783)</u>
	1,551,120	1,269,367
	<u>\$1,940,121</u>	<u>\$1,635,386</u>

The accompanying notes are an integral
part of these financial statements.

RELATIONAL TECHNOLOGY, INC.
STATEMENTS OF INCOME
for the years ended June 30, 1983 and 1982

	<u>1983</u>	<u>1982</u>
Revenues	<u>\$3,025,501</u>	<u>\$878,012</u>
Costs and expenses:		
Software development costs	856,376	236,201
Selling, administrative, and general expenses	1,965,718	570,285
Amortization	<u>3,340</u>	<u>3,340</u>
	<u>2,825,434</u>	<u>809,826</u>
Income from operations	200,067	68,186
Interest income	101,058	10,979
Interest expense	<u>30,463</u>	<u>30,658</u>
Income before taxes on income and extraordinary credit	270,662	48,507
Provision for taxes on income	<u>95,578</u>	<u>8,950</u>
Income before extraordinary credit	175,084	39,557
Extraordinary credit - reduction of income taxes arising from utilization of prior year's accounting loss carryforward	<u>69,394</u>	<u>8,950</u>
Net income	<u>\$ 244,478</u>	<u>\$ 48,507</u>

The accompanying notes are an integral part of these financial statements.

RELATIONAL TECHNOLOGY, INC.
 STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
 for the years ended June 30, 1983 and 1982

	<u>Common Stock</u>		<u>Series A Preferred Stock</u>		<u>Series B Preferred Stock</u>		<u>Retained Earnings</u>	<u>Total</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>		
Balances, July 1, 1981	360,000	\$ 36,000	305,000	\$305,000			\$(200,290)	\$ 140,710
Issue of common stock under employee stock purchase plan	117,500	143,750						143,750
Issue of Series B preferred stock					192,000	\$936,400		936,400
Net income							48,507	48,507
Balances, June 30, 1982	477,500	179,750	305,000	305,000	192,000	936,400	(151,783)	1,269,367
Five-for-one common stock split	1,910,000							
Issue of common stock under employee stock purchase plan	332,710	36,675						36,675
Issue of common stock	15,000	600						600
Net income							244,478	244,478
Balances, June 30, 1983	<u>2,735,210</u>	<u>\$217,025</u>	<u>305,000</u>	<u>\$305,000</u>	<u>192,000</u>	<u>\$936,400</u>	<u>\$ 92,695</u>	<u>\$1,551,120</u>

The accompanying notes are an integral part of these financial statements.

RELATIONAL TECHNOLOGY, INC.
 STATEMENTS OF CHANGES IN FINANCIAL POSITION
 for the years ended June 30, 1983 and 1982

	<u>1983</u>	<u>1982</u>
Sources of working capital:		
Net income	\$ 244,478	\$ 48,507
Charges not affecting working capital:		
Depreciation	140,834	41,667
Deferred taxes on income	10,473	-
Loss on sale of equipment	5,564	553
Amortization of organization costs	<u>3,340</u>	<u>3,340</u>
Working capital provided by operations	404,689	94,067
Issuance of common stock for cash	37,275	143,750
Issuance of preferred stock for cash	-	936,400
Increase in long-term debt	-	213,860
Proceeds from sale of equipment	<u>-</u>	<u>1,589</u>
Total sources of working capital	<u>441,964</u>	<u>1,389,666</u>
Uses of working capital:		
Equipment additions	464,474	431,066
Increase in long-term receivables	122,714	-
Decreases in long-term debt	30,041	110,082
Other, net	<u>11,133</u>	<u>7,309</u>
Total uses of working capital	<u>628,362</u>	<u>548,457</u>
Net (decrease) increase in working capital	<u>\$(186,398)</u>	<u>\$ 841,209</u>
(Decrease) increase in working capital accounts:		
Cash	(10,841)	62,908
Short-term investments	(288,899)	618,899
Accounts receivable, net	134,502	387,651
Prepaid expenses	21,390	6,021
Accounts payable	89,589	(164,270)
Notes payable to bank	(120,000)	-
Current portion of long-term debt	2,731	(35,503)
Income taxes payable	(11,034)	(34,497)
Deferred income taxes	(4,277)	-
Other current liabilities	<u>441</u>	<u>-</u>
	<u>\$(186,398)</u>	<u>\$ 841,209</u>

The accompanying notes are an integral part of these financial statements.

RELATIONAL TECHNOLOGY, INC.
NOTES TO FINANCIAL STATEMENTS

1. Summary of Significant Accounting Policies:

Revenue Recognition:

Software license fees are recorded in the accounts when the software is accepted by the customer. Software licenses sold on an installment basis are recorded currently at their present value. Interest income is earned as the payments become due. Software license renewal fees are recorded when earned.

Software Development Costs:

Software development costs are charged to expense in the year incurred.

Equipment:

Equipment is stated at cost. Leasehold improvements are capitalized and amortized over the remaining life of the lease. Depreciation on equipment is computed using the straight-line method beginning the first full month of operation over the following ranges of estimated useful lives:

	<u>Range of Depreciable Lives</u>	<u>1983</u>	<u>1982</u>
Computer equipment	5	\$692,401	\$ 362,960
Office equipment	5	169,639	73,491
Leasehold improvements	Various	<u>53,962</u>	<u>21,498</u>
		916,002	457,949
Less accumulated depreciation and amortization		<u>184,360</u>	<u>44,383</u>
		<u>\$731,642</u>	<u>\$413,566</u>

Organization Costs:

Organization costs are being amortized on a straight-line basis over a period of five years.

Tax Credits:

Investment tax credits and the credit for increasing research activities reduce income tax in the year realized.

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RELATIONAL TECHNOLOGY, INC.
NOTES TO FINANCIAL STATEMENTS, Continued

2. Transactions with Related Parties:

During the years ended June 30, 1983 and 1982, the company paid approximately \$42,150 and \$38,900, respectively, in consulting fees to officers who are shareholders but not salaried employees of the company. This amount is included in software development costs.

During the year ended June 30, 1982, the company borrowed \$50,000 from one of its major stockholders under a demand note at an interest rate of 18% per year. The interest paid to the stockholder amounted to approximately \$700. In lieu of repayment of the note, the funds borrowed were applied toward the purchase of 10,000 shares of Series B preferred stock.

3. Long-Term Receivables:

Long-term receivables consists of installment sales of software licenses at interest rates varying between 13% and 21%. The annual principal payments on these notes are as follows:

1984	\$ 49,175
1985	53,113
1986	35,857
1987	28,533
1988	<u>5,211</u>
	<u>\$171,889</u>

4. Long-Term Debt:

Long-term debt consists of a note from Bank of America dated August 17, 1981. The note is repayable in monthly principal installments of \$2,731 plus interest at 2-1/4% over the bank's prime lending rate, beginning October 1, 1981. The bank's prime rate at June 30, 1983 was 10.5%. The note is collateralized by the company's computer and office equipment.

The annual amount of principal maturities of long-term debt outstanding at June 30, 1983 is as follows:

1984	\$ 32,772
1985	32,772
1986	32,772
1987	<u>8,193</u>
	<u>\$106,509</u>

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RELATIONAL TECHNOLOGY, INC.
NOTES TO FINANCIAL STATEMENTS, Continued

5. Notes Payable to Bank:

Notes payable to bank consist of a line of credit with Bank of America dated August 13, 1982. Interest is payable monthly at 1-1/4% over the bank's prime lending rate. The line is collateralized by the company's accounts receivable and expires on September 30, 1983. The line of credit requires the company, among other things, to maintain current assets equal to at least twice current liabilities and not less than \$300,000 and net worth (as defined) of at least \$900,000.

6. Income Taxes:

The provision for income taxes for the years ended June 30, 1983 and 1982 consists of the following:

	<u>1983</u>	<u>1982</u>
Charge equivalent to federal taxes	\$69,394	\$8,950
State:		
Current	11,434	-
Deferred	<u>14,750</u>	<u>-</u>
	<u>\$95,578</u>	<u>\$8,950</u>

A reconciliation of the effective tax rate to the statutory rate of 46% is as follows:

	<u>1983</u>		<u>1982</u>	
	<u>Amount</u>	<u>% of Pre-Tax Income</u>	<u>Amount</u>	<u>% of Pre-Tax Income</u>
Tax provision at statutory rate	\$124,505	46.0%	\$ 22,313	46.0%
State income taxes, net of federal income tax benefit	14,231	5.3	-	-
Surtax exemption	(19,750)	(7.3)	(13,363)	(27.5)
Investment tax credit	<u>(23,408)</u>	<u>(8.7)</u>	<u>-</u>	<u>-</u>
	<u>\$ 95,578</u>	<u>35.3%</u>	<u>\$ 8,950</u>	<u>18.5%</u>

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RELATIONAL TECHNOLOGY, INC.
 NOTES TO FINANCIAL STATEMENTS, Continued

6. Income Taxes, continued:

The company had carryforward amounts available to offset future federal taxable income and tax liabilities at June 30, 1983 as follows:

	<u>For Financial Reporting Purposes</u>	<u>For Income Tax Purposes</u>
Net operating loss carryforward		\$ 71,612
Investment tax credit carryover	\$ 60,334	83,742
Credit for increasing research activities carryover	155,391	155,391

The principal items that result in a difference in net operating loss carryforward for financial reporting and income tax purposes are accelerated depreciation, state income taxes, and installment sales. The carryforwards and carryovers expire over a three-year period ending June 30, 1998.

7. Stockholders' Equity:

On October 20, 1982, the Board of Directors declared a five-for-one split of the company's common stock. The number of authorized shares of common stock was increased from 5,000,000 to 25,000,000 and the conversion rate of the outstanding shares of Series A and Series B preferred stock was increased from one for one to five for one. All common stock issued during the year ended June 30, 1983 was after the stock split.

Series A and Series B convertible preferred stockholders are entitled to the equivalent number of votes per share of common stock issuable upon conversion. Common stockholders are entitled to one vote per share.

At the option of the Board of Directors, the company has the right at any time after October 31, 1982 for Series A stock and July 31, 1983 for Series B stock, to redeem the preferred stock in whole or part, by paying in cash the price of \$1.00 per share for Series A stock and \$5.00 per share for Series B stock. The company is required to issue a redemption notice to all preferred stockholders 60 days prior to the redemption date. Each share of preferred stock is convertible into five shares of common stock at the option of the stockholder at any time on or prior to the fifth day prior to the redemption date.

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RELATIONAL TECHNOLOGY, INC.
NOTES TO FINANCIAL STATEMENTS, Continued

7. Stockholders' Equity, continued:

fixed by the redemption notice. The company has reserved 1,525,000 and 960,000 shares of common stock for issuance on conversion of the Series A and Series B preferred shares, respectively.

Dividends may not be paid to common stockholders unless a dividend per share equivalent to five times the common dividend has first been paid on Series A and Series B preferred stock in that year. Dividends are paid at the approval of the Board of Directors. In the event of liquidation, holders of Series A and Series B preferred stock are entitled to \$1.00 and \$5.00, respectively, per share in preference to any distribution of any of the assets or surplus funds of the corporation to the holders of the common stock.

The company has reserved 250,000 shares of common stock for an Employee Stock Option Plan, and 1,300,000 shares of common stock for an Employee Stock Purchase Plan. The option or purchase price is determined by the Board of Directors but may not be less than the fair market value of the stock at the date the option is granted or purchase offered. During the years ended June 30, 1983 and 1982, 332,710 and 117,500 shares, respectively, of common stock were sold under the Purchase Plan at the fair market value in effect on the dates of the sales.

8. Information About Business and Major Customers:

The company charges a license fee for each software system sold and an annual license renewal fee of 10% of the then current license fee. Although the company performs continuing services to its clients, annual billings to any particular client may fluctuate based on the number of new licenses and renewals it transacts. During 1982, one customer accounted for 30% of revenues.

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RELATIONAL TECHNOLOGY, INC.

NOTES TO FINANCIAL STATEMENTS, Continued

9. Commitments:

The company leases office space in seven locations, under rental agreements expiring at varying dates between 1984 and 1987. The minimum annual commitments for rent, exclusive of insurance and property taxes (which are paid by the company) under the lease agreement, for future periods are as follows:

<u>Year Ending June 30</u>	<u>Amount</u>
1984	\$211,977
1985	151,618
1986	26,800
1987	4,698

The rental expense on office space leases for the years ended June 30, 1983 and 1982 aggregated \$160,755 and \$50,764, respectively.

