

KL B308

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N.M.



Report of Independent Accountants

To the Sole Director
Allen Systems Group, Inc.
Naples, Florida

We have audited the accompanying balance sheets of Allen Systems Group, Inc. as of December 31, 1996 and 1995, and the related statements of operations, changes in stockholder's equity and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Allen Systems Group, Inc. as of December 31, 1996 and 1995, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Fort Myers, Florida
April 3, 1997

Allen Systems Group, Inc.

Balance Sheets

December 31, 1996 and 1995

	1996	1995
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 570,207	\$ 596,608
Accounts receivable, less allowance for doubtful accounts of \$77,000 in 1996 and \$80,350 in 1995	2,644,894	2,835,416
Prepaid expenses	269,209	185,688
Advances	885,262	629,781
Notes receivable	46,433	203,852
Other receivables	0	67,529
Total current assets	<u>4,416,005</u>	<u>4,518,874</u>
PROPERTY AND EQUIPMENT, net	<u>1,670,512</u>	<u>1,396,288</u>
CAPITALIZED COMPUTER SOFTWARE COSTS, net	<u>3,730,261</u>	<u>1,627,725</u>
OTHER ASSETS		
Notes receivable	50,000	96,433
Copyrights and trademark, net	628,667	813,250
Other intangibles, net	162,560	194,932
Deposits and other	117,200	94,509
Total other assets	<u>958,427</u>	<u>1,199,124</u>
Total assets	<u>\$ 10,775,205</u>	<u>\$ 8,742,011</u>

(continued)

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

Allen Systems Group, Inc.

Balance Sheets

December 31, 1996 and 1995

(continued)

	1996	1995
LIABILITIES AND STOCKHOLDER'S EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 272,709	\$ 392,869
Current maturities of long-term debt	1,487,627	1,371,303
Royalties payable	318,940	512,155
Commissions payable	159,793	113,378
Accrued expenses and other	537,406	644,435
Deferred revenue	821,197	748,321
Total current liabilities	3,597,672	3,782,461
LONG-TERM DEBT	2,377,086	1,976,880
DEFERRED REVENUE	109,114	0
COMMITMENTS AND CONTINGENT LIABILITIES (Notes 8 and 9)		
STOCKHOLDER'S EQUITY		
Common stock, no par value, authorized 1,000 shares, issued and outstanding 200 shares	102,000	102,000
Retained earnings	4,543,907	2,837,747
Foreign currency translation adjustment	45,426	42,923
Total stockholder's equity	4,691,333	2,982,670
Total liabilities and stockholder's equity	\$ 10,775,205	\$ 8,742,011

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

Allen Systems Group, Inc.
Statements of Operations
years ended December 31, 1996 and 1995

	1996	1995
Revenues		
License fees	\$ 8,849,748	\$ 8,012,288
License renewal fees	13,716,925	11,811,245
Other	506,602	410,970
Total revenues	23,073,275	20,234,503
Sales returns and allowances	(182,321)	(132,006)
Total net revenues	22,890,954	20,102,497
Cost of revenues	1,926,852	2,677,243
Gross margin	20,964,102	17,425,254
Operating expenses		
Selling, general and administrative	16,914,333	14,535,055
Amortization	1,088,118	865,102
Total operating expenses	18,002,451	15,400,157
Operating income	2,961,651	2,025,097
Nonoperating income (expense)		
Interest expense	(361,906)	(300,362)
Interest income	77,561	29,492
Loss on foreign currency exchange	(19,707)	(8,668)
Other	149,677	4,043
Total nonoperating expense	(154,375)	(275,495)
Income before extraordinary item	2,807,276	1,749,602
Extraordinary item, early extinguishment of debt (Note 12)	0	318,893
Net income	\$ 2,807,276	\$ 2,068,495

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

Allen Systems Group, Inc.
Statements of Changes in Stockholder's Equity
years ended December 31, 1996 and 1995

	<u>Common Stock Shares</u>	<u>Common Stock Amount</u>	<u>Retained Earnings</u>	<u>Translation Adjustment</u>	<u>Total</u>
Balances at December 31, 1994	200	\$ 102,000	\$ 977,969	\$ 32,308	\$ 1,112,277
Net income	0	0	2,068,495	0	2,068,495
Distributions to stockholder	0	0	(208,717)	0	(208,717)
Translation adjustment	<u>0</u>	<u>0</u>	<u>0</u>	<u>10,615</u>	<u>10,615</u>
Balances at December 31, 1995	200	102,000	2,837,747	42,923	2,982,670
Net income	0	0	2,807,276	0	2,807,276
Distributions to stockholder	0	0	(1,101,116)	0	(1,101,116)
Translation adjustment	<u>0</u>	<u>0</u>	<u>0</u>	<u>2,503</u>	<u>2,503</u>
Balances at December 31, 1996	<u>200</u>	<u>\$ 102,000</u>	<u>\$ 4,543,907</u>	<u>\$ 45,426</u>	<u>\$ 4,691,333</u>

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

Allen Systems Group, Inc. **Statements of Cash Flows**

years ended December 31, 1996 and 1995

	1996	1995
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	\$ 2,807,276	\$ 2,068,495
Adjustments to reconcile net income to net cash provided by operating activities		
Extraordinary gain on debt extinguishment	0	(318,893)
Loss on disposal of fixed assets	1,570	9,825
Write off of advances	0	300,694
Depreciation	324,131	224,696
Amortization	1,088,118	865,102
Foreign currency loss	19,707	8,668
Other	0	52,392
Changes in assets and liabilities		
(Increase) decrease in:		
Accounts receivable	190,522	(473,699)
Prepaid expenses	(83,521)	(63,609)
Advances	(255,481)	379,812
Notes receivable	53,852	(16,848)
Other receivables	67,529	(67,529)
Deposits and other	(30,037)	14,319
Increase (decrease) in:		
Accounts payable	(119,826)	(160,927)
Royalties payable	(193,215)	(2,603)
Commissions payable	46,415	(84,702)
Accrued expenses and other current liabilities	(107,029)	274,405
Deferred revenue	181,990	468,808
Net cash provided by operating activities	<u>3,992,001</u>	<u>3,478,406</u>
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchase of property and equipment	(616,611)	(331,856)
Proceeds from sale of property and equipment	16,686	3,219
Purchase of computer software	(2,783,265)	(365,002)
Net cash used in investing activities	<u>(3,383,190)</u>	<u>(693,639)</u>

(continued)

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

Allen Systems Group, Inc. **Statements of Cash Flows**

years ended December 31, 1996 and 1995
(continued)

	1996	1995
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from line-of-credit agreement	\$ 524,026	\$ 400,000
Repayments under line-of-credit agreement	(924,026)	(714,000)
Principal payments of borrowing under software acquisition agreement	0	(120,000)
Principal payments of stockholder loan	0	(1,146,250)
Proceeds from long-term debt	2,450,000	0
Principal payments of long-term debt	(1,433,538)	(629,733)
Proceeds from note payable	0	1,600,000
Principal payments of note payable	0	(1,600,000)
Payments on lease obligations	(158,763)	(49,397)
Distributions to stockholder	(1,101,116)	(208,717)
Net cash used in financing activities	(643,417)	(2,468,097)
Effect of exchange rate changes on cash	8,205	2,876
Net increase (decrease) in cash	(26,401)	319,546
Cash and cash equivalents at beginning of year	596,608	277,062
Cash and cash equivalents at end of year	<u>\$ 570,207</u>	<u>\$ 596,608</u>

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:

Cash paid during the year for interest	<u>\$ 362,703</u>	<u>\$ 314,082</u>
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Noncash investing and financing activities:

In 1996, reduction of a \$150,000 note receivable and a \$66,500 note payable resulted from the purchase of a software asset.

In 1996, the Company acquired a software product by executing a note payable for \$125,000.

In 1995, capital lease obligations entered into were \$375,433.

In conjunction with the purchase of a software company, the Company executed notes payable to the sellers aggregating \$2,494,499 in 1995.

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

Allen Systems Group, Inc.

Notes to Financial Statements

1. Nature of Business and Significant Accounting Policies:

Nature of Business

Allen Systems Group, Inc. (the Company) is a computer software company which acquires, develops, and markets software products for the IBM mainframe marketplace.

Significant Accounting Policies

Revenue Recognition: Under the provisions of the American Institute of Certified Public Accountants Statement of Position No. 91-1, revenue from software license fees is recorded upon the delivery and acceptance of programs by the customer. Annual license renewal fees are recognized as revenue on the anniversary date of the initial license agreement, net of related costs.

Property and Equipment: Property and equipment is recorded at cost. Depreciation of property and equipment has been computed using the straight-line method over the estimated useful lives of the assets. Upon sale or retirement of property and equipment, the cost and related accumulated depreciation is removed from the accounts and the difference between the carrying value and any proceeds realized on disposition is charged or credited to income.

Purchased Software Rights: The costs to acquire licenses or ownership of certain computer software products are being amortized using the straight-line method over the estimated economic lives of the products, normally five years. The Company assesses the carrying value of its computer software in order to determine whether a change has occurred, taking into account both historical and forecasted cash flows. It is possible that the estimates of the remaining economic life of the software will be reduced in the near term due to competitive pressures or changes in customers.

Certain provisions of these and other agreements require royalty payments when the Company collects revenue from licensing the products to its customers or through license renewal fees. These royalty payments are included in cost of revenues.

Computer software costs are shown net of accumulated amortization of \$4,551,066 and \$3,687,259 in 1996 and 1995, respectively. Amortization charged to expense was \$863,806 and \$735,620 for the years ended December 31, 1996 and 1995, respectively.

Intangible Assets: The costs of copyrights, covenants not to compete and trademark are being amortized on the straight-line method over their respective useful lives (two to eight years). Goodwill is being amortized on the straight-line method over ten years. Copyrights, trademark and other intangibles are shown net of accumulated amortization of \$418,666 and \$201,711 in 1996 and 1995, respectively. Amortization expense charged to operations was \$216,955 and \$127,877 for the years ended December 31, 1996 and 1995, respectively.

Notes to Financial Statements, Continued

1. Nature of Business and Significant Accounting Policies, continued

Significant Accounting Policies, continued

Foreign Currency Translation: The financial position and results of operations of the Company's foreign divisions are measured using local currency as the functional currency. Current assets and liabilities of these divisions are translated to the U.S. dollar at the exchange rate in effect at year-end. Income statement accounts are translated at the average rate of exchange prevailing during the year. Translation adjustments arising from differences in exchange rates from period to period are recorded in stockholder's equity. Realized gains and losses resulting from foreign currency transactions are included in net income.

Cash and Cash Equivalents: For purposes of the statement of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

Income Taxes: The Company elected to have its income taxed under Section 1362 of the Internal Revenue Code and a similar section of the Florida income tax law (S Corporation election). These laws provide that, in lieu of corporate income taxes, the Company's taxable income will be passed through to the stockholder of the Company and taxed at the individual level.

Impairment of Long-Lived Assets: The Company adopted Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of" (SFAS 121) as of January 1, 1996. SFAS 121 requires that long-lived assets and certain identifiable intangibles to be held and used be reviewed for impairment whenever events or changes in circumstances indicate that their carrying amount may not be recoverable. In assessing recoverability, estimates of future cash flows expected to result from the use of the asset and its eventual disposition should be used. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, an impairment loss is recognized based on the value of the asset.

Management's Use of Estimates: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Notes to Financial Statements, Continued

2. Advances:

The Company has entered into various agreements relating to the prepayment of developer royalties, commissions and other employee advances. Advances consisted of the following at December 31:

	1996	1995
Royalties	\$ 855,389	\$ 595,994
Commissions	29,030	971
Other	843	32,816
	<u>\$ 885,262</u>	<u>\$ 629,781</u>

3. Property and Equipment:

Property and equipment consisted of the following at December 31:

	1996	1995
Computer equipment	\$ 1,433,071	\$ 934,022
Computer equipment under capital leases	197,512	197,512
Office equipment	523,613	529,951
Office equipment under capital leases	198,607	198,607
Furniture and fixtures	334,301	240,507
Leasehold improvements	42,482	37,388
Vehicles	11,103	11,102
	<u>2,740,689</u>	<u>2,149,089</u>
Less accumulated depreciation	<u>(1,070,177)</u>	<u>(752,801)</u>
	<u>\$ 1,670,512</u>	<u>\$ 1,396,288</u>

Depreciation expense was \$324,131 and \$224,696 at December 31, 1996 and 1995, respectively.

The Company leases certain equipment under agreements which are classified as capital leases. As of December 31, 1996 and 1995, accumulated amortization related to these capital leases included in accumulated depreciation was \$116,183 and \$39,593, respectively.

Notes to Financial Statements, Continued

4. Notes Receivable:

Notes receivable consisted of the following at December 31:

	1996	1995
Note receivable from an individual, uncollateralized, interest only payable monthly at 10%, due June 30, 1996	\$ 0	\$ 150,000
Notes receivable from customers, collateralized by software products, interest at 0 - 7%, due 1996 - 1999	96,433	150,285
	<u>96,433</u>	<u>300,285</u>
Less current portion	<u>(46,433)</u>	<u>(203,852)</u>
	<u>\$ 50,000</u>	<u>\$ 96,433</u>

5. Long-Term Debt and Capital Leases:

Long-term debt and capital leases consisted of the following at December 31:

	1996	1995
Note payable to financial institution, collateralized by accounts receivable and certain computer software programs and guaranteed by stockholder, monthly payments of \$33,333 plus interest at 3/8% above the prime rate (8.25% at December 31, 1996). Final payment due August 31, 1999.	\$ 1,100,000	\$ 1,466,666
\$1,000,000 line of credit, collateralized by accounts receivables and certain computer software programs and guaranteed by stockholder, interest payable monthly at 3/8% above the prime rate (8.25% at December 31, 1996), expires September 1999.	0	400,000
Note payable to financial institution, collateralized by a first mortgage on certain real property owned by the sole stockholder, monthly payments of \$20,533 plus interest at 1.5% above the prime rate (8.25% at December 31, 1996). Final payment due June 1997.	105,333	351,733
Note payable to individual, uncollateralized, interest payable annually at 10%, due June 30, 1996.	0	66,500
Note payable to corporation, collateralized by software product, monthly payments of \$10,000, non-interest bearing (interest imputed at 10%). Final payment due May 1998.	<u>157,895</u>	<u>256,674</u>
Balance carried forward	<u>1,363,228</u>	<u>2,541,573</u>

Notes to Financial Statements, Continued

5. Long-Term Debt and Capital Leases, continued

	1996	1995
Balance brought forward	\$ 1,363,228	\$ 2,541,573
Note payable to corporation, collateralized by computer software and certain assets purchased by the Company, interest at 7.34%, all accrued interest and principal due March 31, 1996.	0	363,079
Notes payable to corporation, uncollateralized, non-interest-bearing, payable quarterly through January 1999.	74,417	117,494
Note payable to financial institution, collateralized by accounts receivable, contract rights and certain computer software programs. The loan is guaranteed by stockholder and collateralized by a mortgage on certain real property owned by the stockholder. Monthly payments are \$51,041 plus interest at prime rate (8.25% at December 31, 1996). Final payment is due July 2000.	2,194,796	0
Note payable to corporation, collateralized by software product, non-interest bearing (interest imputed at 10%). Payment of \$30,000 due April 1997 and payment of \$35,000 due April 1998.	65,000	0
Capital lease obligation, interest at 8.723%, collateralized by leased equipment, monthly payments of \$5,887, including interest, due November 1998.	119,367	181,162
Capital lease obligation, interest ranging from 8.94% - 10.57%, collateralized by leased equipment, monthly payments of \$8,849, including interest, due June 1997.	47,905	144,875
	<u>\$ 3,864,713</u>	<u>\$ 3,348,183</u>

The Company had a \$36,000 irrevocable standby letter of credit outstanding at December 31, 1996 and 1995, which is collateralized under the line of credit. No amounts have been drawn on the letter of credit as of December 31, 1996 or 1995.

The scheduled maturities of long-term debt and capital lease obligations at December 31, 1996 are approximately as follows:

1997	\$ 1,487,627
1998	1,172,527
1999	898,309
2000	306,250
	<u>3,864,713</u>
Less current maturities	<u>(1,487,627)</u>
	<u>\$ 2,377,086</u>

Notes to Financial Statements, Continued

6. Savings Plan:

Effective January 1, 1994, the Company established a defined contribution savings plan (Plan) under Section 401(k) of the Internal Revenue Code for all eligible employees. The Plan allows employees to defer up to 15% of their gross earnings on a pretax basis through contributions to the Plan. In accordance with the provisions of the Plan, the Company is required to match 25% of employee contributions up to a maximum amount of 6% of gross pay. The Company recorded expense for the matching contributions of \$42,102 and \$38,141 for the years ended December 31, 1996 and 1995, respectively.

7. Related Party Transactions:

The Company leases space for its general offices from its sole stockholder. The lease is classified as an operating lease and provides for monthly lease payments of \$12,720 through December 1997. Total payments made under this lease arrangement were approximately \$153,000 for the years ended December 31, 1996 and 1995. The Company also reimburses the sole stockholder for cleaning and taxes relating to the office. Payments were approximately \$32,000 and \$20,000 for the years ended December 31, 1996 and 1995, respectively.

The Company uses product escrowing services from an entity in which the sole stockholder of the Company owns an interest. The expense for these services was approximately \$18,000 for the years ended December 31, 1996 and 1995.

In 1996, the Company signed a 10-year lease for a building being constructed by the sole stockholder. The lease payments will begin the later of five business days from the date of certification of occupancy or January 1, 1998. Management anticipates that this lease will commence in January 1998. This lease is classified as an operating lease, and the future minimum lease payments are included in Note 8.

8. Operating Leases:

The Company leases office space and equipment under operating leases expiring in various years through 1999. Rental expense under operating leases was approximately \$1,486,000 and \$1,258,000 for the years ended December 31, 1996 and 1995, respectively.

Notes to Financial Statements, Continued

8. Operating Leases, continued

Future minimum lease payments under non-cancelable operating leases having remaining terms in excess of one year as of December 31, 1996 for their remaining terms and in the aggregate are:

<u>Year Ending December 31,</u>	<u>U.S. Lease Obligations</u>	<u>Foreign Lease Obligations</u>
1997	\$ 1,077,417	\$ 91,791
1998	1,358,321	85,154
1999	1,196,556	39,717
2000	1,232,643	0
Thereafter	<u>7,682,400</u>	<u>0</u>
	<u>\$ 12,547,337</u>	<u>\$ 216,662</u>

9. Computer Software Sales Agreements:

The Company has entered into various software marketing agreements. The agreements require the payment of royalties based upon percentages of future sales. In the event that the royalties are not paid from software sales proceeds during the life of the marketing agreements, the Company may be required to pay the royalties from sources other than sales proceeds. However, in the opinion of management, future sales of these software products are expected to liquidate all amounts due.

10. Acquisition:

On May 31, 1995, the Company acquired substantially all of the assets of a software company for a total cost of \$2,852,724. The assets purchased consisted primarily of software, trademark, accounts and notes receivable and equipment. The acquisition was funded by notes payable to seller of \$2,494,499 and cash of \$125,000 (See Note 11 below). In addition, the purchase agreement requires contingent consideration, based on future revenues over the next five years, up to a maximum of \$2.8 million. The contingent consideration is not included in the acquisition cost and will be recorded as royalty expense in future periods when the revenues requirement has been met. In 1996, approximately \$922,000 of contingent consideration was paid and has been recorded as royalty expense.

The acquisition has been accounted for as a purchase and, accordingly, the purchase price has been allocated to the assets purchased and the liabilities assumed based upon their estimated fair market values at the date of acquisition. The excess of purchase price over the estimated fair values of the net assets acquired was \$107,893 and has been recorded as goodwill, which is being amortized on a straight-line basis over ten years.

Notes to Financial Statements, Continued

11. Extraordinary Item:

In September 1995, the Company prepaid a note payable with a discounted value of approximately \$1.9 million to a software company with proceeds from a \$1.6 million note payable to a financial institution. Accordingly, the reduction in debt was classified as early retirement of debt and has been recorded as an extraordinary gain in the statement of operations for the year ended December 31, 1995.