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TELESTREAM, INC. AND SUBSIDIARIES

CONSOLIDATED FINANCIAL STATEMENTS

AS OF AND FOR THE YEARS ENDED

DECEMBER 31, 2008 AND 2007

AND

INDEPENDENT AUDITOR'S REPORT

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TELESTREAM, INC. AND SUBSIDIARIES
CONSOLIDATED FINANCIAL STATEMENTS
For the Years Ended December 31, 2008 and 2007

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INDEPENDENT AUDITOR'S REPORT

Board of Directors and Management
Telestream, Inc. and Subsidiaries
Nevada City, California

We have audited the accompanying consolidated balance sheet of Telestream, Inc. and Subsidiaries (the "Company") as of December 31, 2008 and 2007, and the related consolidated statements of income, stockholders' 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 auditing standards generally accepted in the United States of America. 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 consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of December 31, 2008 and 2007, and the results of its operations and its cash flows for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Perry-Smith LLP

August 20, 2009

TELESTREAM, INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEET

December 31, 2008 and 2007

ASSETS	2008	2007
Current assets:		
Cash and cash equivalents	\$ 2,808,022	\$ 8,726,336
Accounts receivable, net of allowance for doubtful accounts of \$25,626 and \$18,435, respectively	3,120,846	3,184,314
Deferred income taxes (Notes 11 and 14)	794,000	736,000
Prepaid expenses and other current assets	356,681	244,581
Inventories (Note 2)	920,744	864,855
Total current assets	<u>8,000,293</u>	<u>13,756,086</u>
Equipment, net (Note 3)	980,219	868,564
Goodwill	129,595	149,368
Other intangible assets, net (Note 4)	5,570,356	32,780
Deferred income taxes (Notes 11 and 14)	4,079,000	3,912,000
Total assets	<u>\$ 18,759,463</u>	<u>\$ 18,718,798</u>
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 183,316	\$ 312,544
Accrued liabilities (Note 5)	639,686	1,002,888
Accrued compensation and other benefits	997,126	1,848,699
Deferred revenue (Note 6)	2,374,387	1,977,498
Current portion of capital lease obligation (Note 7)	5,236	5,272
Dividends payable		2,028,992
Related party notes payable (Note 8)	1,881,013	
Total current liabilities	<u>6,080,764</u>	<u>7,175,893</u>
Capital lease obligation, less current portion (Note 7)	21,060	
Related party notes payable (Note 8)	979,746	
Total liabilities	<u>7,081,570</u>	<u>7,175,893</u>
Commitments and contingencies (Note 13)		
Stockholders' equity (Notes 9 and 10):		
Series A through E convertible preferred stock, \$0.001 par value, noncumulative; 10,271,075 shares authorized and 10,144,962 shares issued and outstanding; total liquidation preference of outstanding shares in 2008 and 2007, \$19,287,193	10,145	10,145
Common stock, \$0.001 par value, 16,125,000 shares authorized, 3,193,891 and 3,109,776 shares issued and outstanding at December 31, 2008 and 2007, respectively	3,194	3,110
Additional paid-in capital	19,413,004	19,380,636
Accumulated deficit	(7,719,177)	(7,845,506)
Accumulated other comprehensive loss	(29,273)	(5,480)
Total stockholders' equity	<u>11,677,893</u>	<u>11,542,905</u>
Total liabilities and stockholders' equity	<u>\$ 18,759,463</u>	<u>\$ 18,718,798</u>

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

TELESTREAM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF INCOME
For the Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Revenues:		
Net sales	\$ 20,813,382	\$ 21,305,505
Cost of sales	<u>4,918,464</u>	<u>4,663,898</u>
Gross profit	<u>15,894,918</u>	<u>16,641,607</u>
Operating expenses:		
Sales and marketing	5,745,894	5,424,367
Administrative	2,489,354	2,058,630
Engineering	5,177,205	4,292,196
International development	<u>2,552,197</u>	<u>2,510,427</u>
Total operating expenses	<u>15,964,650</u>	<u>14,285,620</u>
(Loss) income from operations	(69,732)	2,355,987
Other income:		
Interest income, net	8,102	183,813
Other, net	<u>(7,041)</u>	<u>(3,536)</u>
Total other income	<u>1,061</u>	<u>180,277</u>
(Loss) income before benefit from (provision for) income taxes	(68,671)	2,536,264
Benefit from (provision for) income taxes (Notes 11 and 14)	<u>195,000</u>	<u>(1,245,000)</u>
Net income	<u>\$ 126,329</u>	<u>\$ 1,291,264</u>

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

TELESTREAM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
For the Years Ended December 31, 2008 and 2007

	<u>Preferred Stock</u>		<u>Common Stock</u>		<u>Additional Paid-In Capital</u>	<u>Accumulated Deficit</u>	<u>Other Compre- hensive Loss</u>	<u>Total Stockholders' Equity</u>	<u>Compre- hensive Income</u>
	<u>Shares</u>	<u>Amount</u>	<u>Shares</u>	<u>Amount</u>					
Balance, January 1, 2007, as previously reported	10,144,962	\$ 10,145	2,955,776	\$ 2,956	\$ 19,332,667	\$ (6,615,778)	\$ (3,249)	\$ 12,726,741	
Restatement (Note 14)						(492,000)		(492,000)	
Balance, January 1, 2007, as restated (Note 14)	10,144,962	10,145	2,955,776	2,956	19,332,667	(7,107,778)	(3,249)	12,234,741	
Issuance of common stock under stock option plan (Note 9)			154,000	154	33,086			33,240	
Share-based compensation (Note 9)					14,883			14,883	
Foreign currency translation							(2,231)	(2,231)	\$ (2,231)
Net income (Note 14)						1,291,264		1,291,264	1,291,264
Dividends declared (\$0.20 per share of preferred stock)						(2,028,992)		(2,028,992)	
Balance, December 31, 2007	10,144,962	10,145	3,109,776	3,110	19,380,636	(7,845,506)	(5,480)	11,542,905	\$ 1,289,033
Issuance of common stock under stock option plan (Note 10)			84,115	84	12,188			12,272	
Share-based compensation (Note 10)					20,180			20,180	
Foreign currency translation							(23,793)	(23,793)	\$ (23,793)
Net income						126,329		126,329	126,329
Balance, December 31, 2008	10,144,962	\$ 10,145	3,193,891	\$ 3,194	\$ 19,413,004	\$ (7,719,177)	\$ (29,273)	\$ 11,677,893	\$ 102,536

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

TELESTREAM, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENT OF CASH FLOWS
For the Years Ended December 31, 2008 and 2007

	<u>2008</u>	<u>2007</u>
Cash flows from operating activities:		
Net income	\$ 126,329	\$ 1,291,264
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	614,101	331,978
(Gain) loss on disposals of equipment	(7,945)	2,896
Share-based compensation	20,180	14,883
Deferred income taxes	(225,000)	1,067,000
Changes in operating assets and liabilities:		
Accounts receivable	63,468	(386,392)
Prepaid expenses	(112,100)	(69,393)
Inventories	(55,889)	(294,376)
Accounts payable	(129,228)	(49,881)
Accrued expenses	(363,202)	313,997
Accrued compensation and other benefits	(851,573)	(207,708)
Deferred revenue	396,889	545,731
Net cash (used in) provided by operating activities	<u>(523,970)</u>	<u>2,559,999</u>
Cash flows from investing activities:		
Purchase of property and equipment	(547,970)	(711,641)
Business acquisition, net	(5,685,272)	
Other	(2,372)	
Net cash used in investing activities	<u>(6,235,614)</u>	<u>(711,641)</u>
Cash flows from financing activities:		
Proceeds from new related party borrowings	3,360,759	
Dividends paid	(2,028,992)	
Payments on related party borrowings	(500,000)	
Increase in capital lease obligations	28,401	
Payments on capital lease obligations	(7,377)	(5,536)
Proceeds from issuances of common stock	12,272	33,240
Foreign currency translation	(23,793)	(2,231)
Net cash provided by financing activities	<u>841,270</u>	<u>25,473</u>
Net (decrease) increase in cash	(5,918,314)	1,873,831
Cash, beginning of year	<u>8,726,336</u>	<u>6,852,505</u>
Cash, end of year	<u>\$ 2,808,022</u>	<u>\$ 8,726,336</u>
Supplemental disclosure of cash flow information:		
Cash paid during the year for:		
Interest	\$ 45,916	\$ 14,078
Taxes	\$ 114,920	\$ 147,000
Non-cash financing activities:		
Dividends declared, but not paid	\$ -	\$ 2,028,992

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

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Founded in 1998, Telestream, Inc. (the "Company"), a Delaware corporation, specializes in products that simplify the access and exchange of high-quality video and audio over data networks. The Company's software applications, encoding components, and hardware appliances provide content owners, creators, and distributors with fast, efficient digital alternatives to handling, dubbing and shipping tape. Telestream, Inc. products are used by the world's leading media and entertainment companies, as well as a growing number of government, education and corporate enterprises.

Company headquarters are located in Nevada City, California. With the 2006 acquisition of encoding specialist Popwire AB, Telestream added a development center in Stockholm, Sweden.

On August 26, 2008, the Company acquired 100 percent of the stock of VARA Software Ltd. in exchange for \$2,000,000 in cash and \$3,500,000 in notes payable. VARA Software Ltd. is located in England and was founded in 2003. VARA Software Ltd. is in the business of selling webcast tools that allow users to combine multiple types of media to make a web-based broadcast. The total acquisition cost of \$5,685,272 was allocated to intellectual property. The acquisition cost is comprised of the purchase price of \$5,500,000 plus transaction costs of \$370,097 less the discount for the imputed interest on the related note payable of \$184,825.

Consolidation

The consolidated balance sheet, statement of income and statement of cash flows include the accounts of the Company and its wholly-owned subsidiaries, Popwire AB and VARA Software Ltd. All significant intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America 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 revenue and expenses during the reporting period. Actual results could differ from these estimates.

Cash and Cash Equivalents

All highly liquid investments with an original remaining maturity at the date of purchase of three months or less are considered to be cash equivalents. The Company maintains its cash in bank deposit or money market accounts which, from time to time, exceed the federally insured limit. The Company has not experienced any losses in such accounts and believes it is not exposed to any significant risk on cash.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Concentration of Credit Risk

Financial instruments which subject the Company to potential credit risk consist of its cash and cash equivalents and accounts receivable. The Company invests with high-credit quality financial institutions. Collection terms of 30 days are extended upon issuance of an invoice, but the Company does not require collateral and provides reserves for potential credit losses. The Company believes the financial risks associated with these financial instruments are minimal.

Revenue and Cost Recognition

Revenues are generated from the sale of hardware products and software licenses, which include maintenance and support activities, training services and consulting services. Software license revenues are primarily generated from licensing the Company's software to end-user customers. The nature of each licensing arrangement determines how revenues and the related costs are recognized.

Software license revenues are recognized when a noncancelable license agreement has been signed, the license has been delivered electronically to the customer, the fees are fixed or determinable and collectibility is probable. Hardware product revenues are recognized when a purchase order has been received, the product has been shipped and collectibility is probable.

Customer license contracts are generally multiple element arrangements that may include a software license, maintenance and support, customer training and consulting services. Elements that are undelivered at the time of product delivery typically include professional services, maintenance and training. The residual method is used to allocate revenues to the undelivered elements of the arrangement.

The fees for services and maintenance are unbundled from the software license fees using objective evidence of fair value for each of these undelivered elements. This objective evidence of fair value consists of the customary rates for maintenance and the customary rates charged for consulting and training services when they are sold separately. The contract value is allocated to the undelivered elements of the contract based on the objective evidence of fair value described above, and then the remaining balance is allocated to the delivered elements, regardless of any separate prices stated within the contract.

Services are performed on a "best efforts" basis and are generally billed under fixed-fee arrangements. The resultant revenues and expenses are recognized as services are performed. Revenues from maintenance activities, which consist of fees for ongoing support and maintenance and management services, are recognized over the term of the maintenance contract and the associated costs are expensed as incurred.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Revenue and Cost Recognition (Continued)

Customers are generally not offered the right to return software products. The Company has a fifteen working days right of return on hardware products. Historically, returns of hardware products have been minimal; therefore, the Company does not have an allowance against these returns.

Deferred Revenue

Cash received in advance of sales or services provided is recorded as deferred revenue. Revenues from these advance payments is recognized upon the sale when hardware products are shipped or over the period services are provided on a straight-line basis.

Accounts Receivable

Receivables are recorded when billed or accrued and represent claims against third parties that will be settled in cash. The carrying value of receivables, net of the allowance for doubtful accounts, represents their estimated net realizable value. The allowance for doubtful accounts is based on historical collection trends, age of outstanding receivables and existing economic conditions. If events or changes in circumstances indicate that a specific receivable balance may be impaired, further consideration is given to the collectibility of those balances and the allowance is adjusted accordingly. Past-due receivable balances are written-off when internal collection efforts have been unsuccessful in collecting the amount due. During 2008, there was an increase of \$7,191 in the allowance for doubtful accounts.

Inventories

Inventories are recorded at the lower of cost or market using the first-in first-out method. An inventory reserve is recorded for 100% of obsolete inventory.

Research and Development

Research and development costs related to software products are expensed to operations as incurred and consist primarily of employee compensation and related costs incurred in connection with software development activities.

Software Development Costs

Costs for the development of new software products and substantial enhancements to existing software products are expensed as incurred until technological feasibility has been established, at which time any additional development costs are capitalized. The Company believes its current process for developing software is essentially completed concurrently with the establishment of technological feasibility and, accordingly, no internal costs have been capitalized to date.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Equipment and Improvements and Software Licenses

Equipment and improvements and software licenses are stated at cost. Depreciation and amortization is computed using the straight-line method over the estimated useful lives of three to seven years. Leasehold improvements and equipment under capital lease obligations are amortized over the shorter of the lease term or the useful lives of the improvements or equipment. Repairs and maintenance costs are expensed as incurred. Upon disposition, the cost and related accumulated depreciation or amortization are removed from the account and the resulting gain or loss is reported in income for the period.

Impairment of Long-Lived Assets

Long-lived assets are evaluated for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. As of December 31, 2008, management believes that there was no impairment of long-lived assets.

Other Intangible Assets

Identifiable intangible assets with finite lives are amortized over their expected useful lives, ranging from one to fifteen years using the straight-line method.

Goodwill

Goodwill is recorded when the purchase price paid for an acquisition exceeds the estimated fair value of the net assets acquired, including identified intangible assets. Goodwill is not amortized, rather it is evaluated at least annually for impairment. The Company performs an annual review in the fourth quarter of each year, or more frequently if indicators of potential impairment exist, to determine if the carrying value of goodwill is impaired by comparing the fair value of the reporting unit in which goodwill resides to its carrying value. Reporting units may be operating segments as a whole or an operation one level below an operating segment, referred to as a component. At December 31, 2008, management determined that goodwill was not impaired.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Income Taxes

Deferred income taxes are recorded based on the difference between financial statement and income tax basis of assets and liabilities and available loss and credit carryforwards. A valuation allowance is established to reduce deferred tax assets if it is more likely than not that all, or some portions of such deferred tax assets will not be realized. Realization of deferred income tax assets is dependent upon sufficient future taxable income during the period that deductible temporary differences and carryforwards are expected to be available to reduce taxable income. At December 31, 2008, management recorded a valuation allowance of \$273,000 for estimated unused state loss carryforwards, which expire in 2010. Management believes it is more likely than not that the remaining net deferred income tax assets will be used before their expiration.

Foreign Currency

The financial statements of the foreign subsidiary are translated using the exchange rate in effect at year end for balance sheet accounts and the average rate in effect during the period for revenue and expense accounts. Translation gains and losses are excluded from the statement of operations and are instead reported as a currency translation adjustment component of accumulated other comprehensive loss.

Foreign currency transaction gains and losses arising from differences between the functional and billing currencies are recognized in the consolidated statement of income.

Royalties

Royalties payable to outside parties are governed by contracts signed with licensing authorities representing the owners of key video format patents. Royalties are recognized on a per-unit sold basis and are expensed in the month the product is sold.

Stock Options

The Company's Stock Option Plan (the "Option Plan") provides for a maximum of 2,525,313 shares, as amended, of authorized but unissued common stock to be available for grant to eligible employees, non-employee Directors and consultants at an exercise price of at least fair market value as determined by the Board of Directors at the date of grant. As determined by the Board of Directors' Compensation Committee, shares vest over a period from one to four years from the date of grant. At December 31, 2008 and 2007, the Company has 366,319 and 426,983 shares, respectively, available for granting under the Option Plan.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

Stock Options (Continued)

Management estimates the fair value of each option award as of the date of grant using a Black-Scholes-Merton option pricing formula and the following assumptions noted in the following table. Dividend yield is based on an assumed \$.20 dividend multiplied by management's estimate of the stock price shares at grant date. Expected volatility is based on historical volatility of similar entities over a preceding period commensurate with the expected term of the option because the Company's common stock is not publicly traded. Historical data is used to estimate options exercised and employee terminations within the valuation model. The risk-free rate is based on the United States of America Treasury yield curve in effect at the time of grant with substantially the same remaining term as the expected term of the option. In addition to these assumptions, management makes estimates regarding forfeitures that will impact total compensation expense recognized under the Plan.

The fair value of each option is estimated on the date of grant using the Black-Scholes-Merton option-pricing model with the following assumptions at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Dividend yield	24%	30%
Expected volatility	45.2%	45.5%
Risk-free interest rate	3.0%	4.4%
Expected option life	6 years	6 years

New Financial Accounting Standards

Accounting for Noncontrolling Interests in Consolidated Financial Statements

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, *Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51*, (SFAS No. 160). SFAS No. 160 establishes accounting and reporting standards for noncontrolling interests in a subsidiary and for the deconsolidation of a subsidiary. Minority interests will be recharacterized as noncontrolling interests and classified as a component of equity. It also establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary and requires expanded disclosures. This statement is effective for fiscal years beginning on or after December 15, 2008, with early adoption prohibited. SFAS No. 160 will be effective for the Company on January 1, 2009. The Company does not believe the adoption will have a material impact on its consolidated financial statements.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

New Financial Accounting Standards (Continued)

Accounting for Uncertainty in Income Taxes

In July 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes – an Interpretation of FASB Statement 109* (FIN 48). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in a company's financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. The Company presently recognizes income tax positions based on management's estimate of whether it is reasonably possible that a liability has been incurred for unrecognized income tax benefits by applying FASB Statement No. 5, *Accounting for Contingencies*. FIN 48 prescribes a comprehensive model for recognizing, measuring, presenting and disclosing in the financial statements tax positions taken or expected to be taken on a tax return. For the Company, FIN 48 is effective for fiscal years beginning after December 15, 2008. If there are changes in net assets as a result of the application of FIN 48, these will be accounted for as an adjustment to the opening balance of retained earnings. Management will adopt FIN 48 in the first quarter of 2009 and does not expect the adoption to have a material impact on the Company's financial position or results of operations.

Business Combinations

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), *Business Combinations* (SFAS No. 141R). SFAS No. 141(R), among other things, establishes principles and requirements for how the acquirer in a business combination (i) recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any noncontrolling interest in the acquired business, (ii) recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase, and (iii) determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Company is required to adopt SFAS No. 141(R) for all business combinations for which the acquisition date is on or after January 1, 2009. Earlier adoption is prohibited. This Standard will change the Company's accounting treatment for business combinations on a prospective basis.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

New Financial Accounting Standards (Continued)

The Hierarchy of Generally Accepted Accounting Principles

In May 2008, the Financial Accounting Standards Board (FASB) issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles* (SFAS No. 162). This standard identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principals (GAAP). It establishes that the GAAP hierarchy should be directed to entities because it is the entity (not the auditor) that is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. SFAS No. 162 was effective November 15, 2008. The implementation of SFAS No. 162 did not have any effect on the Company's consolidated financial statements.

Subsequent Events

In May 2009, the FASB issued FASB Statement No. 165 (SFAS No. 165), *Subsequent Events*. SFAS No. 165 establishes general standards of accounting for and disclosure of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. Specifically, SFAS No. 165 defines, (1) the period after the balance sheet date during which management of a reporting entity should evaluate events or transactions that may occur for potential recognition or disclosure in the financial statements, (2) the circumstances under which an entity should recognize events or transactions occurring after the balance sheet date in its financial statements, and (3) the disclosures that an entity should make about events or transactions that occurred after the balance sheet date. The provisions of SFAS No. 165 are required to be adopted by the Plan for the year ending December 31, 2009. Management does not expect the adoption of SFAS No. 165 to have a significant impact on the Company's financial position or results of operations.

2. INVENTORIES

Inventories at December 31, 2008 and 2007 are comprised of the following:

	<u>2008</u>	<u>2007</u>
Raw materials	\$ 66	\$ 66
Work-in-process	2,942	442
Finished goods	1,035,220	969,075
Inventory reserve	<u>(117,484)</u>	<u>(104,728)</u>
	<u>\$ 920,744</u>	<u>\$ 864,855</u>

TELESTREAM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

3. EQUIPMENT

Equipment at December 31, 2008 and 2007 is comprised of the following:

	<u>2008</u>	<u>2007</u>
Equipment:		
Furniture and office equipment	\$ 1,028,130	\$ 1,001,937
Computer hardware	849,907	673,884
Computer software	411,220	306,215
Leasehold improvements	<u>107,120</u>	<u>57,779</u>
	2,396,377	2,039,815
Less accumulated depreciation and amortization	<u>(1,416,158)</u>	<u>(1,171,251)</u>
Equipment, net	<u>\$ 980,219</u>	<u>\$ 868,564</u>

Depreciation and amortization expense for the years ended December 31, 2008 and 2007 was \$444,260 and \$292,469, respectively.

4. OTHER INTANGIBLE ASSETS

Other intangible assets at December 31, 2008 and 2007 is comprised of the following:

	<u>2008</u>	<u>2007</u>
Intellectual property	\$ 5,685,272	
Software licenses	65,520	\$ 65,520
Other	<u>56,914</u>	<u>34,769</u>
	5,807,706	100,289
Less accumulated amortization	<u>(237,350)</u>	<u>(67,509)</u>
	<u>\$ 5,570,356</u>	<u>\$ 32,780</u>

Other intangible assets consist of software licenses and intellectual property. Software licenses are amortized over one to three years and intellectual property is amortized over fifteen years.

Amortization expense for the years ended December 31, 2008 and 2007 was \$169,841 and \$39,509, respectively.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

5. ACCRUED LIABILITIES

Accrued liabilities at December 31, 2008 and 2007 is comprised of the following:

	<u>2008</u>	<u>2007</u>
Royalty related liabilities	\$ 473,958	\$ 661,399
Other	<u>165,728</u>	<u>341,489</u>
	<u>\$ 639,686</u>	<u>\$ 1,002,888</u>

6. DEFERRED REVENUE

Deferred revenue represents cash received in advance of sales or services provided. It includes both the sales of warranty for products greater than one year of age plus the first year of warranty that is included in the selling price. The table below summarizes the activity and balance in deferred revenue for the years ended December 31, 2008 and 2007.

	<u>2008</u>	<u>2007</u>
Balance, January 1	\$ 1,977,498	\$ 1,431,767
Cash additions	2,250,895	2,007,326
Revenue recognized	<u>(1,854,006)</u>	<u>(1,461,595)</u>
Balance, December 31	<u>\$ 2,374,387</u>	<u>\$ 1,977,498</u>

7. CAPITAL LEASE OBLIGATION

The Company leases certain office equipment accounted for as a capital lease. The cost of equipment under capital lease obligations aggregated is \$28,401 and net book value aggregated is \$26,035 at December 31, 2008.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

7. CAPITAL LEASE OBLIGATION (Continued)

Future minimum lease payments under the capitalized lease obligation are as follows:

<u>Years Ending December 31,</u>	<u>Capital Lease</u>
2009	\$ 6,432
2010	6,432
2011	6,432
2012	6,432
2013	<u>3,752</u>
Future minimum lease payments	29,480
Less amounts representing interest	<u>(3,184)</u>
Present value of future minimum lease payments	26,296
Less current maturities	<u>(5,236)</u>
Capital lease obligation, net	<u>\$ 21,060</u>

8. RELATED PARTY NOTES PAYABLE

In connection with the acquisition of the stock of VARA Software Ltd., the Company issued notes payable totaling \$3,500,000 to the former stockholders. The notes have an imputed effective interest rate of 5.50% and require quarterly payments of \$500,000 beginning November 24, 2008 with final quarterly payments to be made in May 2010.

The notes payable at December 31, 2008 are comprised of the following:

Notes payable	\$ 3,000,000
Less unamortized discount	<u>(139,241)</u>
Notes payable less unamortized discount	2,860,759
Less current portion	<u>(1,881,013)</u>
Long-term portion of notes payable	<u>\$ 979,746</u>

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

8. RELATED PARTY NOTES PAYABLE (Continued)

The aggregate principal maturities of the notes for each of the two years subsequent to December 31, 2008 are as follows:

<u>Years Ending December 31,</u>	<u>Amount</u>
2009	\$ 1,881,013
2010	<u>979,746</u>
	<u>\$ 2,860,759</u>

9. PREFERRED STOCK

The Company has five classes of preferred stock: Series A preferred stock (Series A), Series B preferred stock (Series B), Series C preferred stock (Series C), Series D preferred stock (Series D) and Series E preferred stock (Series E). The number of preferred shares outstanding as of December 31, 2008 and 2007, is as follows:

<u>Class</u>	<u>Common Shares Represented</u>
Series A Preferred Stock	4,920,000
Series B Preferred Stock	1,622,661
Series C Preferred Stock	2,159,970
Series D Preferred Stock	1,124,000
Series E Preferred Stock	<u>318,331</u>
	<u>10,144,962</u>

The rights, preferences and privileges granted to the Series A, Series B, Series C, Series D, and Series E preferred stock holders are as follows:

Dividend Provisions

The holders of shares of Series A through E preferred stock are entitled to receive dividends at the rate of \$0.10, \$0.15, \$0.278, \$0.40 and \$0.45 per share respectively, when and if declared by the Board of Directors. Such dividends are not cumulative.

TELESTREAM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

9. PREFERRED STOCK (Continued)

Liquidation Preference

The Series A through E preferred stock rank equally with each other. In the event of a liquidation, the holders of Series A, Series B, Series C, Series D, and Series E preferred stock are entitled to receive prior to and in preference to any distribution of the assets of the Company \$1.00, \$1.50, \$2.78, \$4.00 and \$4.50 per share, respectively. If the assets to be distributed are insufficient to permit the payment to Series A, Series B, Series C, Series D, and Series E shareholders, then the assets available for distribution are to be distributed ratably in proportion to the preferential amount each holder is otherwise entitled to receive. After payment is made to the holders of Series A, Series B, Series C, Series D, and Series E preferred stock, the remaining assets, if any, will be paid to all preferred and common shareholders ratably by share.

Redemption Rights

The Series A through E preferred stock holders have the right to submit a request from a majority of preferred stock holders to redeem their securities for cash consideration for a price equal to the liquidation preference of each class.

Conversion

The Series A through E preferred stock are convertible, at the holder's option, into shares of common stock at a conversion price equal to the initial liquidation preference price.

Anti-dilution Privileges

The Series A through E preferred stock holders are entitled to receive an adjustment to their conversion price should additional shares be issued at a price below the purchase price of a class of preferred stock.

Voting Rights

The holders of Series A through E preferred stock have the right to one vote for each share of common stock into which such preferred stock could then be converted.

TELESTREAM, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Continued)

10. STOCK OPTIONS

Options activity for the years ended December 31, 2008 and 2007 is as follows:

	Outstanding Options		
	Options	Weighted Average Exercise Price	Weighted Average Remaining Contractual Term (Years)
Options outstanding, January 1, 2007	1,917,251	\$ 0.39	<u>6.35</u>
Options granted	230,000	\$ 0.66	
Options exercised	(115,000)	\$ 0.21	
Options canceled/forfeited	<u>(255,000)</u>	\$ 0.45	
Options outstanding, December 31, 2007	<u>1,777,251</u>	\$ 0.43	<u>5.87</u>
Options granted	90,000	\$ 0.85	
Options exercised	(84,115)	\$ 0.15	
Options canceled/forfeited	<u>(120,000)</u>	\$ 0.57	
Options outstanding, December 31, 2008	<u>1,663,136</u>	\$ 0.46	<u>5.40</u>
Options exercisable, December 31, 2008	<u>1,377,995</u>	\$ 0.43	<u>3.33</u>

The weighted average fair value of options granted during 2008 and 2007 was \$0.40 and \$0.33 per share, respectively. As of December 31, 2008, the unrecognized compensation cost related to non-vested stock option awards totaled \$60,696. That cost is expected to be amortized on a straight-line basis over a weighted average period of 4.1 years and may be adjusted for subsequent changes in estimated forfeitures. The total fair value of options vested was \$20,180 for the year ended December 31, 2008. The total intrinsic value of options at time of exercise was \$55,229 and \$51,750 for the years ended December 31, 2008 and 2007, respectively.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

11. PROVISION FOR INCOME TAXES

The (benefit from) provision for income taxes is comprised of the following for the years ended December 31, 2008 and 2007:

	<u>Federal</u>	<u>State</u>	<u>Total</u>
<u>2008</u>			
Current	\$ (29,000)	\$ 59,000	\$ 30,000
Deferred	(158,000)	(150,000)	(308,000)
Valuation allowance		83,000	83,000
	<u> </u>	<u> </u>	<u> </u>
Total income tax benefit	<u>\$ (187,000)</u>	<u>\$ (8,000)</u>	<u>\$ (195,000)</u>
<u>2007</u>			
Current	\$ 93,000	\$ 85,000	\$ 178,000
Deferred	640,000	237,000	877,000
Valuation allowance		190,000	190,000
	<u> </u>	<u> </u>	<u> </u>
Total provision for income tax expense	<u>\$ 733,000</u>	<u>\$ 512,000</u>	<u>\$ 1,245,000</u>

Deferred tax assets is comprised of the following at December 31, 2008 and 2007:

	<u>2008</u>	<u>2007</u>
Deferred tax assets:		
Net operating loss carryforwards	\$ 2,602,000	\$ 2,482,000
Research tax credits and deductions	1,638,000	1,460,000
Deferred revenue	937,000	855,000
Accrued expenses	59,000	78,000
Other, net	282,000	313,000
Valuation allowance	<u>(273,000)</u>	<u>(190,000)</u>
	<u> </u>	<u> </u>
Total deferred tax assets	<u>5,245,000</u>	<u>4,998,000</u>
Deferred tax liabilities:		
State deferred taxes	<u>(372,000)</u>	<u>(350,000)</u>
	<u> </u>	<u> </u>
Net deferred tax assets	<u>\$ 4,873,000</u>	<u>\$ 4,648,000</u>

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

11. PROVISION FOR INCOME TAXES (Continued)

Net deferred tax assets included in the consolidated balance sheet at December 31, 2008 and 2007 are classified as follows:

	<u>2008</u>	<u>2007</u>
Deferred tax assets – current	\$ 794,000	\$ 736,000
Deferred tax assets – noncurrent	<u>4,079,000</u>	<u>3,912,000</u>
Net deferred tax assets	<u>\$ 4,873,000 4,873,000</u>	<u>\$ 4,648,000</u>

At December 31, 2008, the Company has federal and state loss carryforwards for tax purposes of approximately \$6,430,000 and \$1,623,000, respectively, which expire beginning in 2019 for federal purposes and 2011 for state purposes.

At December 31, 2008 and 2007, the Company has recorded a valuation allowance of \$273,000 and \$190,000, respectively, for estimated unused state loss carry forwards.

At December 31, 2008, the Company had federal and state research tax credit carryforwards of approximately \$983,000 and \$655,000, respectively, which expire beginning in 2013.

12. EMPLOYEE BENEFIT PLAN

The Company has a 401(k) Savings Plan (the "Plan"), which covers all full time employees. Participants may contribute a portion of their earnings to the Plan, up to the maximum allowed under the law. The Company contributes a match of 50% of the employee's first 6% of compensation contributed. For the year ended December 31, 2008 and 2007, the Company contributed \$152,446 and \$137,266, respectively, to the Plan.

13. COMMITMENTS AND CONTINGENCIES

Operating Leases

Office facilities and certain equipment are leased under noncancelable operating leases which expire in 2009. The facility lease includes a renewal option. As of December 31, 2008, future minimum commitments under noncancelable operating leases were \$292,200 through 2009.

Contingencies

The Company is subject to legal proceedings and claims which arise in the ordinary course of business. In the opinion of management, the amount of ultimate liability with respect to such actions will not materially affect the financial position or results of operations of the Company.

TELESTREAM, INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Continued)

14. PRIOR PERIOD ADJUSTMENT

The financial statements for the year ended December 31, 2007 and 2006 have been restated to properly record certain deferred tax assets. The adjustment to the 2006 financial statements decreased retained earnings and deferred income tax assets by \$492,000. The adjustment to the December 31, 2007 decreased tax expense, increased income and deferred tax assets by \$142,000.