

FINANCIAL HIGHLIGHTS

STATEMENT OF OPERATIONS DATA:

YEAR ENDED JANUARY 31,	1987	1986	1985
Net sales	\$ 4,759,316	\$5,669,808	\$2,437,088
Net income (loss)	\$(1,117,191)	\$ 185,685	\$ (489,797)
Net income (loss) per share	\$ (.52)	\$.08	\$ (.32)
Average shares outstanding, including common stock equivalents	2,167,129	2,294,423	1,540,671

BALANCE SHEET DATA:

AS OF JANUARY 31,	1987	1986	1985
Current assets	\$2,523,214	\$3,088,592	\$1,226,384
Total assets	\$3,503,138	\$3,546,588	\$1,436,345
Current liabilities	\$1,693,974	\$ 647,160	\$1,139,913
Long-term debt	—	—	\$ 6,512
Shareholders' equity	\$1,809,164	\$2,899,428 ¹	\$ 289,920

¹Reflects sale of 488,750 shares and net proceeds of \$2,364,000 from the Company's Initial Public Offering of August 7, 1985.

STOCK PRICE AND INVESTOR INFORMATION

TRADED: Over-The-Counter

NASDAQ SYMBOL: TLCC

The Common Stock of Telecalc, Inc. began trading with the Company's Initial Public Offering August 7, 1985.

HIGH AND LOW BID RANGE SINCE ISSUE:

The table below lists the high and low bid quotations since issue as reported on NASDAQ. Prices represent quotations between dealers, do not include retail markups, markdowns, or commissions, and do not necessarily represent actual transactions.

FISCAL QUARTER ENDED	1987		1986	
	HIGH	LOW	HIGH	LOW
April 30	12 1/4	7 1/2	N/A	N/A
July 31	12 1/4	5 1/4	N/A	N/A
October 31	5 3/4	3 1/2	8 3/4	6
January 31	6	3 3/4	10	7 1/4

SHAREHOLDERS:

As of March 31 there were approximately 576 shareholders of record.

DIVIDEND POLICY:

The Company has paid no dividends on its Common Stock and does not anticipate paying any cash dividend in the foreseeable future, as it intends to retain earnings to support its continuing growth.



TELECALC DESIGNS,
 MANUFACTURES AND
 SUPPORTS COMPUTER-
 BASED MANAGEMENT
 INFORMATION SYSTEMS
 FOR HIGH-VOLUME
 INBOUND TELEPHONE
 CENTERS. THESE MIS
 SYSTEMS PROVIDE AN
 AUTOMATED SOLUTION
 TO THE PROBLEM OF
 MEETING THE DEMAND
 OF CONSTANTLY CHANG-
 ING CALL ACTIVITY WITH
 A CONTROLLABLE SUPPLY
 OF AGENTS.

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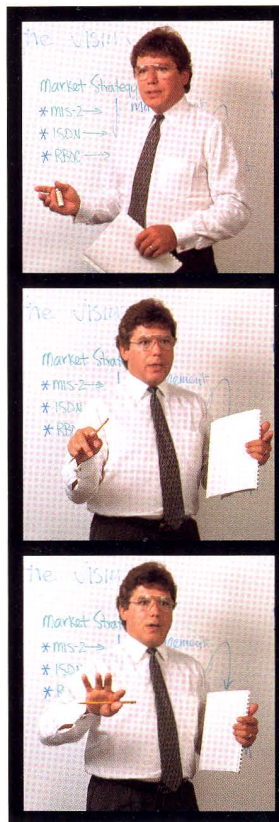
TO OUR SHAREHOLDERS:

Telecalc's vision and plan for the future were tested this past year, which was a period of reduced revenues while customers were awaiting the delivery of the Company's next generation product, MIS-2. Management was presented with an interesting challenge; should MIS-2 development be continued, or should development be canceled to hold revenues in line with expenses? Based on the excellent future prospects for this product, management chose to continue development throughout the year.

Because of this choice, I am reporting to you a significant operating loss but with strong prospects for the future as opposed to marginal earnings and limited future hopes.

During fiscal 1987, Telecalc lost \$1.1 million on sales of \$4.8 million as compared to a profit of \$186,000 on sales of \$5.7 million during fiscal 1986. Research and development expenses in fiscal 1987 were \$1.1 million. The loss resulted mainly from a decline in revenue which was caused by the postponement of orders from major customers awaiting the availability of MIS-2.

During fiscal 1987, Telecalc also expensed \$477,000 in sales commissions to American Telecorp, a sales agent for Telecalc. The con-



tract with American Telecorp calls for a reduced commission rate during the final year of the agreement, which will begin when a specific cumulative sales volume has been reached. The final year of reduced commissions will commence during the middle of fiscal 1988. The lowered commissions will directly reduce expenses on systems sold.

During the past year, Telecalc signed contracts with Bell Atlantic and Pacific Bell which significantly expanded its sales opportunities within the Regional Bell Operating Company (RBOC) marketplace. Potential orders from these two contracts represent a significant opportunity for Telecalc over the next 12 to 18 months.

During the later stages of the MIS-2 development process, several significant trends in the microcomputer industry began to emerge. These changes involved the move away from 8088-based microcomputers to the faster and more powerful 80286 and 80386 microcomputers, and the move away from the single user MSDOS® to the multiuser SCO XENIX® operating system. Telecalc's management determined these changes should be incorporated in MIS-2, and shortly after year end, Telecalc altered the basic design of MIS-2 to take advantage of these new

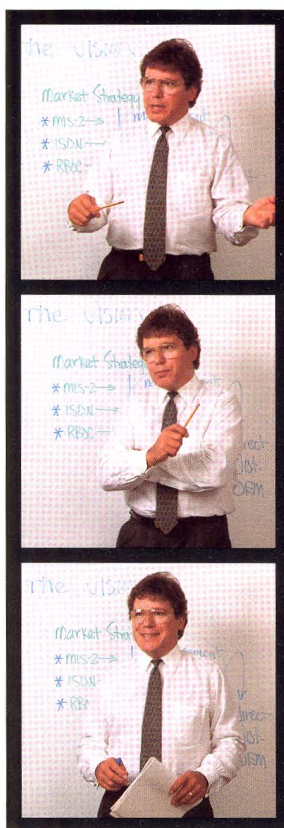
trends. This decision places MIS-2 in a much stronger future market position and allows it to be on the leading edge of the next major wave of microcomputer technology.

This change also resulted in a 5- to 6-month delay in MIS-2 *beta* testing which is expected to be completed in the Third Quarter of next year. MIS-2 has been designed from the ground up with significant input from our major customers. I am confident that after its introduction it will clearly establish new standards of high volume telephone room management.

Besides completion of the MIS-2 project for RBOC customers, Telecalc expects to complete the technology to allow connection of its systems to other host switching systems. This is expected to aid our expansion into market segments outside the RBOC's which will be a major focus next year and beyond.

In the next year, Telecalc plans to strengthen and restructure its management team as it evolves from an innovative to a marketing stage company. Further, we anticipate adding additional capital to take full advantage of the other opportunities we see in the RBOC and commercial markets.

In summary, with MIS-2 nearing completion, Telecalc is proceeding to expand its position as



the dominant supplier of MIS systems within the RBOC market segment. We plan on using this position to advance into other market segments, while at the same time developing and acquiring additional products for delivery through established channels with existing RBOC customers. These two strategies will expand both our product line and market penetration to strengthen our future revenue base.

I want to personally acknowledge Telecalc's customers, shareholders, and employees for their support and dedication during this past year of challenge. With your continued support, I look forward to the realization of our vision and plan for the future.

Warm regards,

Michael S. Bledsoe

Michael S. Bledsoe
Chairman, President and
Chief Executive Officer

THE MIS-1 SYSTEM

Telecalc gives high-volume inbound telephone centers the power to apply proven management techniques in a fast-paced, highly changeable environment. Before MIS-1, these phone rooms operated in uncertainty. Now, they can make studied decisions based on accurate and timely information.

The MIS-1 system is fast, easy to use and very powerful. Phone room managers operate it simply by touching a light pen to a color video monitor. The system automatically displays call activity, trunk line use and employee response as it is happening. It even prints reports automatically.

The remarkable technology of MIS-1 is somewhat invisible because it was designed with a focus on people. By making information instantly accessible, the system provides decision-makers with an increased ability to perform.

What follows is a description of a telephone center's operating needs, and how Telecalc's MIS-1 system offers a better solution.

An Expensive Problem

More than ever before, businesses are dealing with customers over the telephone. This activity presents a tremendous profit opportunity, which many businesses are unable to realize. Many miss revenue opportunities they don't know exist. They often incur labor costs that are unnecessarily high.

Any business can see the relation between good management and increased profitability. But without timely information, businesses have no way of knowing if their phone rooms are well-managed.

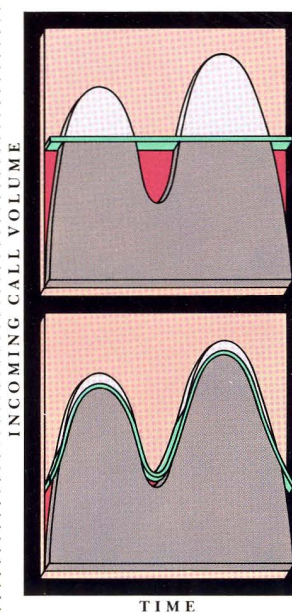
Telecalc has recognized that problem, and has taken steps to solve it.

■ **The Phone Room Balancing Act:** As the charts on this page show, traditional phone room operations are handling the fluctuating peaks and ebbs of incoming call activity with a fairly constant staffing arrangement. The disadvantages of this approach are evident.

When calls peak, many calls are not answered, and revenues are lost. When calls ebb, the company carries an unnecessary labor cost.

The balancing act that phone rooms perform is an attempt to bring just enough, but not too much, answering ability to a constantly changing environment.

■ **The Impact on Quality of Service:** Busy signals will lose customers immediately. Excessive holding time will lose them eventually. Poor per-



■ Supply of Agents
□ Understaffing
■ Overstaffing

WITHOUT MIS-1: THE TOP CHART DEMONSTRATES THE DISADVANTAGES OF MEETING VARIABLE INCOMING CALL ACTIVITY WITH A UNIFORM STAFFING LEVEL. WHEN CALLS PEAK, MANY GO UNANSWERED AND POTENTIAL REVENUES ARE LOST. WHEN CALL VOLUME EBBS, THE PHONE ROOM CARRIES AN UNNECESSARY LABOR COST.

WITH MIS-1: THE BOTTOM CHART DEMONSTRATES HOW THE SYSTEM'S SCHEDULING CAPABILITIES MATCHES THE ANSWERING SUPPLY WITH THE CALLING DEMAND MORE PRECISELY. TELECALC'S POWERFUL SOFTWARE USES OBJECTIVE INFORMATION TO IDENTIFY CYCLES AND CALCULATE STAFFING NEEDS FOR ANY GIVEN MOMENT IN THE FUTURE.

formance by an employee might lose them forever.

Before MIS-1, it was difficult if not impossible to take action to reduce the number of failed call attempts.

■ **The Impact on Profitability:** Losing customers means lost revenues. Unnecessary service costs mean excessive operating expenses.

At any given time during the day, with rare exceptions, most phone rooms are either understaffed or overstaffed. Before MIS-1, most managers could not even tell which state the room was in at any given moment.

■ **The Impact on Productivity:** In addition to negative impacts on profits and customer relations, staffing based on guesswork has a bad effect on employees. Phone room employees are either overworked or underworked throughout the day, depending on call volume.

Effective scheduling requires informed decisions based on reliable data. Where before there was uncertainty, with MIS-1 there can be tangible, objective information.

An Automated Solution

By helping companies realize the tremendous profit potential inherent in a high-volume, inbound telephone center's daily cycle, MIS-1 can pay for itself quickly.

The Telecalc solution meets the management objective of matching the supply of agents (which is controllable) to the demand for answering calls (which is uncontrollable, but can be predictable).

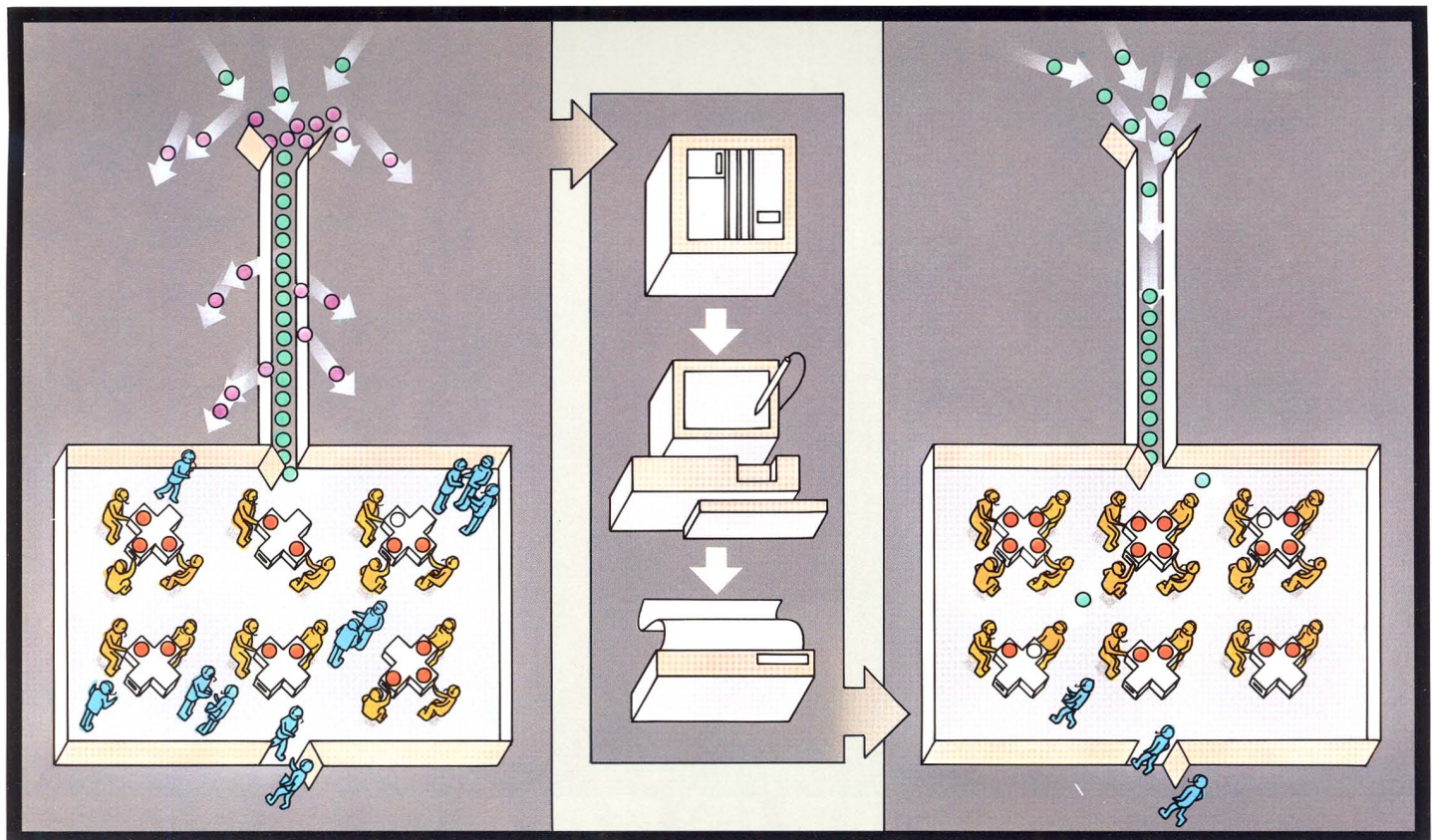
MIS-1 predicts call activity, schedules staff and monitors performance automatically. The system displays data, prints reports, and is configured to match the operations of each user company.

The system is proactive and profit producing. Here are some of the features of the MIS-1 system.

■ **Historical Data:** MIS-1 automatically produces and analyzes reports of past call activity, agent productivity, trunk line utilization and quality of service. Reports can be made for periods as far back as two years.

With this information, the manager can anticipate, not merely react, to trends on a daily, weekly, monthly or yearly basis.

■ **Future Forecasting:** The system produces accurate projections of variable call activity based on objective information. MIS-1 not only estimates call demand, but also calculates the staffing levels needed to meet the demand.



This ability will help increase revenues through better service and decrease operating expenses by minimizing labor costs.

■ **Real-Time Status Displays:** A phone room manager uses a light pen on a color video monitor to see precisely what is happening at any given moment. MIS-1 displays current activity for departments, groups, individuals and trunk lines.

MIS-1 shows at a glance how well callers are being served. This information is automatically fed into other Telecalc modules, which include Forecasting and Scheduling.

■ **Scheduling:** MIS-1 automatically creates significantly improved schedules which optimize the match between call demand and workforce supply. These schedules include lunch and coffee breaks, and can be developed around an agent's individual preferences.

Throughout the workday, the manager can fine tune this match by monitoring the real-time status display and making changes with a manual override.

■ **Executive Polling:** For telephone centers with multiple locations, this feature facilitates centralized management. Up to 150 remote systems in different geographic areas can be polled overnight. The data is automatically rolled up

- Incoming Calls
- Lost calls
- Calls serviced
- Staff on line
- Staff on Break

LEFT: A TYPICAL PHONE ROOM STAFFED BY GUESSWORK WHEN CALL ACTIVITY IS AT A PEAK. AT THE TOP INCOMING CALLS ARE CUT OFF BY BUSY SIGNALS. IN THE QUEUE, CALLS ARE LOST DUE TO EXCESSIVE HOLDING TIME. IN THE PHONE ROOM, THE STAFFING LEVEL IS INADEQUATE. THE BUSINESS IS CONSEQUENTLY LOSING PROFITS.

CENTER: COMPONENTS OF THE MIS-1 SYSTEM. 1] LINE SCANNER MONITORS CALL ACTIVITY. 2] COMPUTER STORES AND ANALYZES CALL DATA. COLOR VIDEO MONITOR DISPLAYS STATUS. 3] PRINTER PRODUCES HARD-COPY REPORTS.

RIGHT: THIS EFFICIENT, CORRECTLY-STAFFED PHONE ROOM IS THE RESULT OF USING THE MIS-1 AUTOMATED SOLUTION. PROFITS ARE UP, LABOR COSTS DOWN, AND QUALITY OF SERVICE IS EXCELLENT.

into reports by location, region and overall performance.

MIS-1 enables central management to see what happened throughout the network on the very next day of operation.

■ **Custom Configurations:** MIS-1 is easily adapted for each user company to meet their specific information needs. The status display is configured to match the customer's floorplan.

These highly configurable modules allow MIS-1 users to keep pace with changes in the real world.

■ **Built-In Maintenance:** The design of MIS-1 incorporates several features which keep service to a minimum. The system has remote diagnostic capabilities, so problems can be handled over the telephone.

MIS-1 was carefully created to be especially reliable and easily maintained.

■ **Training & Follow-Up:** Telecalc has a reputation for being right there and responsive, both in initial training and in follow-up. Since the system is so easy to operate, it is up and running soon after the decision to install it has been made.

MIS-1 is designed for use by real people, not just by those with computer engineering degrees.



THE COMPANY

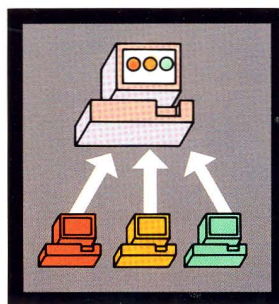
Telecalc designs, manufactures and supports computer-based management information systems for high-volume inbound telephone centers. The Company was formed in 1983.

The experience of the Company's founder, Michael S. Bledsoe, enabled him to find the means to meet the needs of phone rooms for more efficient management. Bledsoe spent seventeen years in the telecommunications industry. Here he recognized how this industry might be better served with a computer-based system for monitoring, staffing and scheduling operations.

To fulfill this demand, Bledsoe organized teams of talented software and hardware engineers to design and build an automated expert system. Via microcomputers, it would generate objective information which could be accessed easily and used immediately to improve management in a fluctuating phone room environment.

The resulting system was an immediate success. Naturally, many organizations expressed interest in the previously unavailable manage-

LEFT TO RIGHT: CRAIG L. MORRISON, VICE PRESIDENT OF OPERATIONS; GEORGE FUTAS, VICE PRESIDENT OF MARKETING AND PRODUCT DEVELOPMENT; DENNIS W. WASSMAN, VICE PRESIDENT OF FINANCE, SECRETARY AND TREASURER; MICHAEL S. BLEDSOE, CHAIRMAN, PRESIDENT AND CHIEF EXECUTIVE OFFICER.



EXECUTIVE POLLING: FOR TELEPHONE CENTERS WITH MULTIPLE LOCATIONS, THIS FEATURE FACILITATES CENTRALIZED MANAGEMENT OF UP TO 150 REMOTE SYSTEMS.

ment tools and techniques offered by Telecalc. They saw how they could employ a computerized method for using real-time data to eliminate the guesswork associated with matching agent supply with call demand.

One of the Company's first major customers was a Regional Bell Operating Company (RBOC). Shortly thereafter, another RBOC made MIS-1 its standard product for inbound telephone center management. On the strength of this validation, other industries, both private and public, came to rely on Telecalc to improve phone room efficiency and profitability.

In August of 1985, Telecalc became a publicly held company. The resulting infusion of capital was applied immediately to continuing research and development efforts.

Today, as the market needs multiply along with the growing reliance on telecommunications, the Company is in a very advantageous position to exploit the emerging opportunities in this expanding arena. New products are being developed for existing markets, and new markets are being targeted for further development.

MARKET ACHIEVEMENTS

During the past year, Telecalc installed MIS-1 successfully in several market segments. Because the problem of matching call demand with agent supply is shared by virtually every inbound telephone center, the Company offers distinct advantages to many types of organizations.

Basically, Telecalc serves two types of customers. The first senses that revenue opportunities are being lost because calls are going unanswered. Even relatively small improvements made by adopting the system will lead to dramatic increases in revenue generation. For these customers, MIS-1 can pay for itself in a matter of months.

The second type of customer is looking to improve service efficiency. MIS-1 allows these customers to cope with increasing call volume while maintaining current staffing levels. The system improves the quality of service through better management of resources, which leads to a significant reduction in service costs per call.

The following examples demonstrate how Telecalc solves the problems associated with high-volume inbound telephone centers in a variety of industries.

■ **Regional Bell Operating Companies:** Telecalc's share in this market has resulted in a growing acceptance of the Company's capabilities on a very large scale.

MIS-1 is the standard product for three of the seven RBOCs: US West, Pacific Telesis and Bell Atlantic. Other RBOCs are now seriously evaluating the system.

■ **Financial Institutions:** Banks and other financial institutions are relying more heavily on incoming phone traffic to serve and expand their customer bases.

MIS-1 is now facilitating management efforts in shareholder service centers and high-volume phone rooms which handle credit card authorizations and account inquiries.

A major mutual fund, which was losing revenue-producing calls, used the system to improve planning and found that MIS-1 paid for itself in a matter of months.



■ **Government Agencies:** Continued budget restraints in the important arena of public services has made MIS-1 an ideal assistant in government agencies. The system provides the ability to deliver more services to more people, and to justify budgets with objective information.

In one state, MIS-1 has been put to work in the Secretary of State's department and in the Highway Patrol's 24-hour dispatching network. Workforce management has been simplified by the system, leading to many cost-saving improvements.

■ **Health Care:** Since competition is keener than ever, this industry is relying more and more on telecommunication solutions.

MIS-1 is now assisting telephone sales managers to improve profitability for a medical equipment supplier.

For a major health care operation, the system has helped a medical advice unit improve service and reduce costs.

■ **Public Utilities:** Phone room efficiency in this sector is especially vital. An expansive customer base which requires immediate service must be accommodated. MIS-1 gives managers the power to maintain an optimum operating level in this busy, high-volume environment.

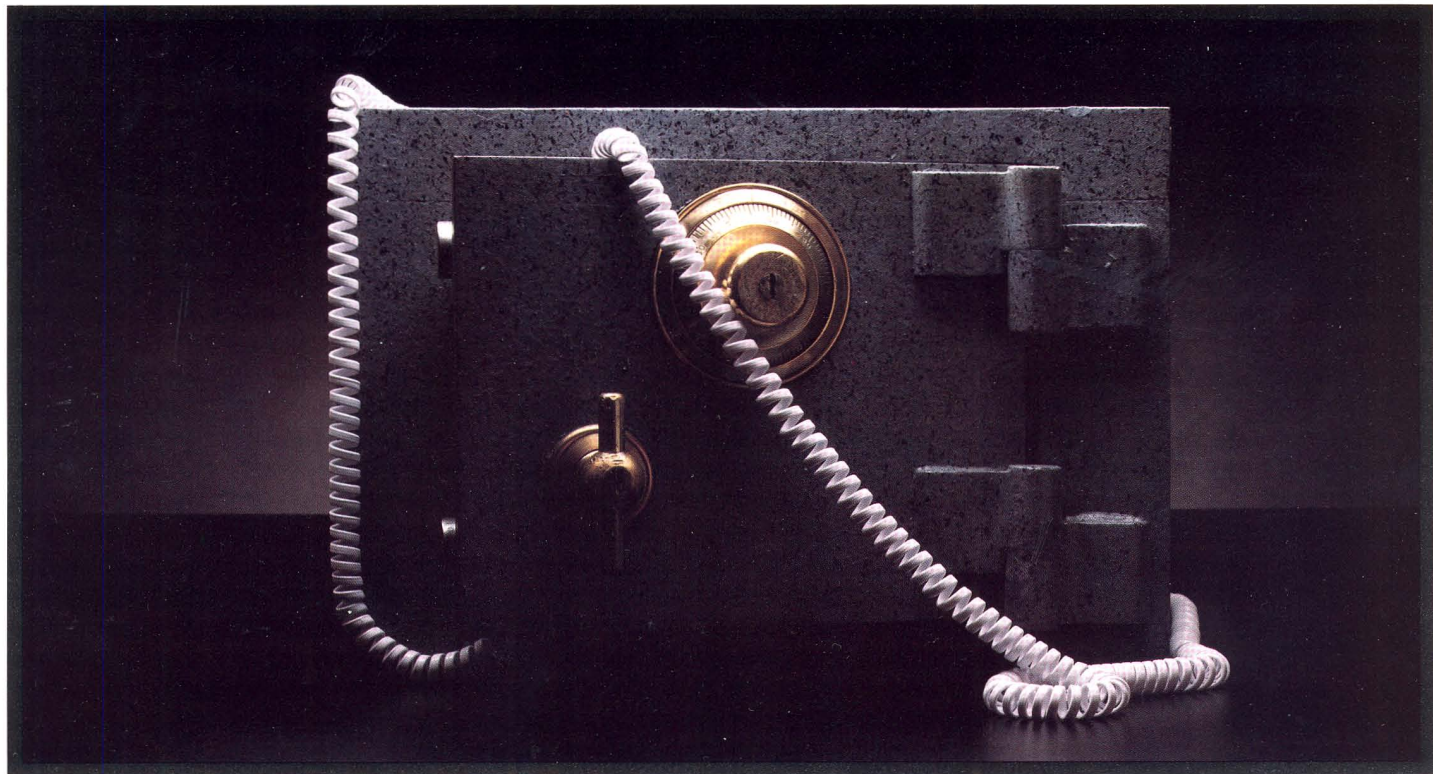
A major gas and electric company is now using MIS-1 in its customer information center with excellent results.

■ **Other Markets Targeted:** Any company with a high volume of inbound calls to sales or service departments will find the system desirable.

Telecalc is strategically positioned to improve efficiency in other phone rooms, such as:

- Airlines and large travel agencies for reservations.
- Insurance companies for claims adjustments.
- Newspaper advertising for classified ad sales.
- Any company which uses telephones to make appointments, handle customer inquiries, fill orders or sell goods.

At present, the market opportunities are vast. And since business and industry come to rely more and more on telecommunications, these opportunities are growing every day.



FUTURE DIRECTIONS

By pinpointing market opportunities, the Company has a clear vision of its future opportunities.

Telecalc intends to remain responsive to the changing needs of the marketplace, and to utilize emerging technologies, so these marketing plans may be readapted occasionally to capitalize on newer opportunities as they arise.

In the main, activities in these four primary areas have a substantial amount of potential:

- I. Expanding the Regional Bell Operating Company (RBOC) client base with MIS products.
- II. Expanding the commercial (non-RBOC) client base with MIS products.
- III. Developing and acquiring new non-MIS products and delivering them through the RBOC channels already established.
- IV. Selling new non-MIS products in the commercial client base after they have been proven by RBOC use.

The first program is well under way, fueled by the success in the three RBOCs. The third program has significant promise for the same reason, but also because involvement in that market has brought to light definite needs which Telecalc is in a position to accommodate.

The second program is also promising since Telecalc is now finding ways to develop interface modules which will connect MIS products

"IN THE FUTURE, AS MORE AND MORE BUSINESS IS CONDUCTED OVER THE TELEPHONE, A COMPANY'S PROFITABILITY WILL BE MORE CLOSELY RELATED TO THE MANAGEMENT EFFECTIVENESS OF ITS TELECOMMUNICATIONS ABILITIES. TELECALC IS STRATEGICALLY POSITIONED TO TAKE ADVANTAGE OF THIS MAJOR TREND."

directly to computer controlled digital switching systems, thereby eliminating the need to install the MIS Line Scanner Unit. The cost savings involved will make the system even more appealing to commercial users.

The fourth program has excellent potential based on the expected validation of new non-MIS products by the RBOCs.

In the longer term, there is a strong possibility that Telecalc can use the MIS technology as a springboard to expand outside the arena of inbound telephone centers.

In the opinion of the Company, one of the next major growth opportunities in the micro-computer field involves the ability of connecting computerized expert systems directly to an active environment.

By harnessing the power of expert micro-computer systems to gather real-time data, efficiencies can be created which would improve profits and reduce costs for many different applications in business and industry.

MIS technology, by design, is flexible as well as powerful. Use in telephone environments could be just one example of its capabilities.

Thus, Telecalc could expand horizontally into new vertical niches. This direction would provide tremendous growth opportunities even beyond the calculated rewards of moving up strongly through one very large market niche.

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

Results of Operations

Sales for the fiscal year ended January 31, 1987 decreased 16% to \$4.8 million from \$5.7 million for the fiscal year ended January 31, 1986, which represented an increase of 133% over sales of \$2.4 million recorded in the fiscal year ended January 31, 1985. The decrease experienced in fiscal 1987 was primarily due to a major contract from the prior year being substantially completed together with delays in securing additional contracts from two Bell operating companies, Pacific Bell and Bell Atlantic. The majority of sales under the Bell Atlantic contract were booked in the third and fourth quarters of fiscal 1987 while the majority of sales under the Pacific Bell contract were booked during the second and third quarters of fiscal 1987. Shipments to Pacific Bell were curtailed during the fourth quarter due to delays in the development of the MIS-2 system described below. The increase for fiscal 1986 was a result of securing a major contract early in the year from one of the seven Regional Bell Operating Companies.

Cost of sales as a percentage of sales increased to 43% for fiscal year 1987, from 33% for fiscal 1986, after having declined from 44% for fiscal 1985. In fiscal 1987, reduced sales volumes, adjustments to overhead allocations in inventory due to lower inventory levels at year end, greater material write-offs due to obsolescence and generally higher manufacturing costs contributed to the increase in this percentage. In addition, approximately \$166,000 was accrued for future warranty claims based on current shipments and anticipated equipment exchanges for one of the Company's customers during fiscal 1988. The decrease experienced during fiscal 1986 was primarily due to increased sales volumes, lower prices paid for its hardware components and improved manufacturing procedures.

Commission expense as a percentage of sales decreased to 10% for fiscal 1987 as compared to 18% and 20% respectively, for fiscal 1986 and 1985. The primary reasons for the decreases were lower commission rates under its primary Distribution Agreement which governs sales to Bell operating companies and greater sales to non-Bell operating companies, which are not subject to the agreement. The third and fourth quarters of fiscal 1987 reflect the first shipments under the Bell Atlantic contract, with applicable commission rates at 7.5% compared to 20% on shipments to other Bell operating companies. The decrease occurring in fiscal 1986 resulted from the same factors, but to a lesser degree.

Other selling expenses as a percent of sales increased to 18% for fiscal 1987 from 15% for fiscal 1986 and 8% for fiscal 1985. These expenses are associated with the establishment of the Company's direct sales organization in the late summer of 1985, which materially increased other selling expenses for fiscal 1986. From fiscal 1986 to fiscal 1987, internal commission rates increased, resulting in higher commission expense, but the Company closed its district sales offices in New York and Southern California and opened a district office in Pennsylvania to support the Bell Atlantic contract. These offsetting factors

resulted in relative constant selling expenses, which increased as a percentage of sales due to reduced sales levels in fiscal 1987.

Customer support as a percentage of sales increased to 8% for fiscal 1987 from 5% in fiscal 1986, after having declined from 9% in fiscal 1985. The increase in 1987 was due to a combination of lower sales volumes and increased staff, including the use of a consultant for a portion of the year. The decrease in 1986 resulted from a rapid increase in sales without a comparable increase in overhead expense.

General and administrative expenses as a percentage of sales increased to 21% for fiscal 1987 from 13% in fiscal 1986, after declining from 23% in fiscal 1985. The increase in fiscal 1987 resulted from direct expense increases associated with additional personnel, investor relations, including the cost of the Company's first annual report, press releases and increased audit fees, combined with lower sales. In addition, the Company has accrued \$130,000 as additional warranty expense, representing liquidated damages associated with delays in development of the MIS-2 system under the Pacific Bell Agreement. The amount accrued represents factory cost of providing certain MIS-1 systems free of charge. The decrease in fiscal 1986 resulted from a rapid increase in sales without a comparable increase in overhead and administrative personnel.

Research and Development expenses increased from \$335,000 in fiscal 1985 to \$737,000 in fiscal 1986, an increase of 120%, and further increased to \$1,105,000 in fiscal 1987, an increase of 50%. As a percentage of sales, research and development expenses were 23%, 13%, and 23% for the three fiscal years, respectively. The increasing research and development expenses relate substantially to the development of the MIS-2 system, which began in late 1985. The development project has experienced delays and increased costs and is now expected to be completed in late summer of 1987. The increases occurring in fiscal 1987 resulted from increases in software personnel from 14 employees to 20 employees and the use of additional consultants for MIS-2 system development. In addition to the amounts reflected as research and development expense, the Company has capitalized \$434,000 of software development costs in accordance with FASB No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." Research and development expenses as a percentage of sales have also been significantly affected by rapid increases in sales in fiscal 1986 and declining sales in fiscal 1987.

Interest expense of \$43,000 for fiscal 1987 was down from \$61,000 for fiscal 1986, due to lower borrowing levels and lower interest rates. Interest expense of \$69,000 for fiscal 1985 reflected substantial borrowings during the Company's start-up period in order to finance its receivables prior to its public offering. Interest income of \$19,000 for fiscal 1987 was lower than the \$48,000 in fiscal 1986, because fiscal 1986 reflected income earned on funds generated from the Company's initial public offering in August 1985.

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

Net loss for the year ended January 31, 1987 amounted to \$(.52) per share compared to a net income of \$.08 per share for the year ended January 31, 1986, and a loss of \$(.32) per share for the year ended January 31, 1985.

For the years ended January 31, 1987 and 1985, common stock equivalents are not included in the earnings per share calculation because they have a dilutive effect on the loss per share.

Fiscal 1986 includes the effect of using net operating loss carry-forwards for federal income tax purposes. The effect on net income and earnings per share is \$44,000 and \$.02, respectively, and has been accounted for as an extraordinary item.

Liquidity and Financial Resources

At January 31, 1987, the Company's working capital was \$829,000, which represents a decline of \$1,612,000 from working capital existing at January 31, 1986. The principal cause of the reduction in working capital was due to the operating loss for fiscal 1987 and to the increase in other assets arising from capitalization of MIS-2 system software costs. Working capital at January 31, 1986 reflected the net proceeds from the Company's initial public offering in August 1985.

The Company currently has an operating line of credit facility totaling \$1,000,000 with interest at 1.5% over prime and a \$400,000 revolving equipment loan with interest at 1.5% over prime. The Company had a maximum borrowings of \$956,000 and \$572,000 in fiscal 1987 and 1986, respectively. At January 31, 1987, the Company had \$425,000 outstanding under its operating line and \$135,000 outstanding under the equipment arrangement.

Capital expenditures during fiscal 1987 were \$241,000, of which \$217,000 was for new equipment. This compares to

capital equipment purchases of \$310,000 in fiscal 1986, of which \$258,000 was for new equipment. The majority of new equipment was for research and development purposes.

The Company believes it currently has adequate financial resources (working capital and short-term borrowing arrangements) and anticipated funds from operations to meet cash requirements for fiscal 1988. Management is, however, currently investigating raising additional capital from various sources.

Impact of Inflation

Inflation has not had a material impact on the operations and financial condition of the Company. The Company's primary inventory consists of electronic parts, computers and peripherals whose prices have remained stable or actually decreased in some instances.

Impact of 1986 Tax Reform

Primarily due to the fiscal 1987 tax net operating loss position, the Company's liquidity was not materially affected by the Tax Reform Act of 1986. In the future certain aspects of the Act, principally, the repeal of the Investment Tax Credit, the reduction of the Investment Tax Credit carryforward, and the lower tax rates could have an effect on the Company's cash flow as well as its net operating results.

The combination of lower tax rates, repeal of the Investment Tax Credit, and lengthening of depreciation lives will increase the real cost of future capital expenditures. The Company is studying these effects and is evaluating its capital expansion plan.

CONSOLIDATED BALANCE SHEETS

JANUARY 31,	1987	1986
<i>Assets</i>		
<i>Current Assets</i>		
Cash and cash equivalents	\$ 132,612	\$ 797,134
Accounts and notes receivable, less allowance of \$12,000 in 1986—Note B	1,471,620	1,179,681
Inventories—Notes A and B	849,548	1,035,248
Prepaid expenses	69,434	76,529
<i>Total Current Assets</i>	<u>2,523,214</u>	<u>3,088,592</u>
<i>Equipment—Note B</i>		
Equipment	655,497	438,778
Furniture and fixtures	95,384	73,929
Leasehold improvements	34,391	31,219
	<u>785,272</u>	<u>543,926</u>
Less accumulated depreciation and amortization	252,580	111,156
	<u>532,692</u>	<u>432,770</u>
<i>Other Assets</i>		
Software development costs, less accumulated amortization of \$40,174 in 1987—Note H	433,884	—
Deposits and other assets	13,348	25,226
	<u>\$3,503,138</u>	<u>\$3,546,588</u>
<i>Liabilities and Stockholders' Equity</i>		
<i>Current Liabilities</i>		
Notes payable to bank—Note B	\$ 560,345	—
Accounts payable	240,339	\$ 260,413
Commissions payable	361,847	139,292
Accrued compensation	162,920	137,729
Accrued expenses	69,397	23,156
Warranty reserve	263,625	15,000
Unearned income	35,501	71,570
<i>Total Current Liabilities</i>	<u>1,693,974</u>	<u>647,160</u>
<i>Stockholders' Equity—Note E</i>		
Common Stock, par value \$.01 per share—authorized 5,000,000 shares	21,789	21,660
Additional paid-in capital	3,829,834	3,803,036
Retained-earnings deficit	(2,042,459)	(925,268)
	<u>1,809,164</u>	<u>2,899,428</u>
	<u>\$3,503,138</u>	<u>\$3,546,588</u>

See notes to financial statements.

STATEMENTS OF OPERATIONS

YEAR ENDED JANUARY 31,

Net sales—Note F

Costs and expenses:

Cost of sales

Commissions—Note G

Other selling

Customer support

Research and development

General and administrative

Operating Income (Loss)

Other income (expense):

Interest expense

Interest income

Other, net

Income (Loss) Before Income Taxes and Extraordinary Item

Provision for income taxes—Note D

Income (Loss) Before Extraordinary Item

Extraordinary item—income tax benefit from utilization of operating loss carryforwards—Note D

Net Income (Loss)

Earnings (loss) per share—primary and fully diluted—Note E:

Income (loss) before extraordinary item

Net income (loss)

Average shares outstanding, including common stock equivalents

See notes to financial statements.

	1987	1986	1985
Net sales—Note F	\$ 4,759,316	\$5,669,808	\$2,437,088
Costs and expenses:			
Cost of sales	2,041,993	1,868,804	1,071,505
Commissions—Note G	477,248	1,004,888	477,726
Other selling	857,697	844,233	194,117
Customer support	359,288	302,339	218,540
Research and development	1,104,851	737,128	334,508
General and administrative	1,014,005	719,968	563,556
	<u>5,855,082</u>	<u>5,477,360</u>	<u>2,859,952</u>
<i>Operating Income (Loss)</i>	(1,095,766)	192,448	(422,864)
Other income (expense):			
Interest expense	(43,121)	(61,030)	(68,635)
Interest income	19,265	47,986	—
Other, net	2,431	6,281	1,702
	<u>(21,425)</u>	<u>(6,763)</u>	<u>(66,933)</u>
<i>Income (Loss) Before Income Taxes and Extraordinary Item</i>	(1,117,191)	185,685	(489,797)
Provision for income taxes—Note D	—	44,000	—
<i>Income (Loss) Before Extraordinary Item</i>	(1,117,191)	141,685	(489,797)
Extraordinary item—income tax benefit from utilization of operating loss carryforwards—Note D	—	44,000	—
<i>Net Income (Loss)</i>	<u>\$(1,117,191)</u>	<u>\$ 185,685</u>	<u>\$ (489,797)</u>
Earnings (loss) per share—primary and fully diluted—Note E:			
Income (loss) before extraordinary item	<u>\$(.52)</u>	<u>\$.06</u>	<u>\$(.32)</u>
Net income (loss)	<u>\$(.52)</u>	<u>\$.08</u>	<u>\$(.32)</u>
Average shares outstanding, including common stock equivalents	<u>2,167,129</u>	<u>2,294,423</u>	<u>1,540,671</u>

STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	COMMON STOCK ISSUED AND OUTSTANDING		ADDITIONAL PAID-IN CAPITAL	RETAINED- EARNINGS DEFICIT	TOTAL
	SHARES	AMOUNT			
Balance at February 1, 1984	1,056,775	\$10,568	\$ 875,462	\$ (621,156)	\$ 264,874
Sale of Common Stock, net of expenses of \$17,213	130,625	1,306	503,981	—	505,287
Stock options exercised	477,800	4,778	4,778	—	9,556
Net loss	—	—	—	(489,797)	(489,797)
Balance at January 31, 1985	1,665,200	16,652	1,384,221	(1,110,953)	289,920
Sale of Common Stock, net of expenses of \$568,677	488,750	4,888	2,358,935	—	2,363,823
Conversion of debt to equity	12,000	120	59,880	—	60,000
Net income	—	—	—	185,685	185,685
Balance at January 31, 1986	2,165,950	21,660	3,803,036	(925,268)	2,899,428
Stock options exercised	12,950	129	26,798	—	26,927
Net loss	—	—	—	(1,117,191)	(1,117,191)
Balance at January 31, 1987	<u>2,178,900</u>	<u>\$21,789</u>	<u>\$3,829,834</u>	<u>\$(2,042,459)</u>	<u>\$1,809,164</u>

See notes to financial statements.

STATEMENTS OF CHANGES IN FINANCIAL POSITION

YEAR ENDED JANUARY 31,	1987	1986	1985
<i>Source of Working Capital</i>			
Income before extraordinary item	—	\$ 141,685	—
Charge to income not requiring working capital—depreciation and amortization of equipment and deferred rent, net	—	73,084	—
<i>Funds Provided from Operations Before Extraordinary Item</i>	—	214,769	—
Extraordinary item—income tax benefit from utilization of operating loss carryforward	—	44,000	—
<i>Funds Provided from Operations</i>	—	258,769	—
Decrease in deposits and other assets	\$ 11,878	—	—
Proceeds from exercise of stock options	26,927	—	\$ 9,556
Net proceeds of Common Stock issue	—	2,363,823	505,287
Conversion of debt to Common Stock	—	60,000	—
	38,805	2,682,592	514,843
<i>Application of Working Capital</i>			
Net loss	1,117,191	—	489,797
Charges to operations not requiring working capital:			
Depreciation and amortization of equipment and deferred rent, net	(141,424)	—	(14,744)
Amortization and write-down of software development costs	(185,174)	—	—
<i>Funds Used in Operations</i>	790,593	—	475,053
Acquisition of equipment	241,346	309,642	191,026
Increase in software development costs	619,058	—	—
Increase in deposits and other assets	—	17,989	7,237
	1,650,997	327,631	673,316
<i>Increase (Decrease) in Working Capital</i>	<u>\$(1,612,192)</u>	<u>\$2,354,961</u>	<u>\$(158,473)</u>
<i>Changes in Components of Working Capital</i>			
Increase (decrease) in current assets:			
Cash and cash equivalents	\$ (664,522)	\$ 736,883	\$ (64,295)
Accounts and notes receivable	291,939	653,044	457,113
Inventories	(185,700)	420,641	444,787
Prepaid expenses	(7,095)	51,640	(57,164)
	(565,378)	1,862,208	780,441
Increase (decrease) in current liabilities:			
Notes payable to bank	560,345	(418,979)	418,979
Notes payable to stockholders	—	(411,125)	365,000
Accounts payable	(20,074)	126,390	23,796
Commissions payable	222,555	79,081	60,211
Accrued compensation	25,191	59,387	40,025
Accrued expenses	46,241	(14,077)	30,903
Warranty reserve	248,625	15,000	—
Unearned income	(36,069)	71,570	—
	1,046,814	(492,753)	938,914
<i>Increase (Decrease) in Working Capital</i>	<u>\$(1,612,192)</u>	<u>\$2,354,961</u>	<u>\$(158,473)</u>

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

NOTE A

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

General: Telecalc, Inc. (the Company) is engaged in one line of business: the development, manufacture, and sale of micro-computer-based management information systems (MIS) for use in telephone communications.

Inventories: Inventories are stated at the lower of cost (first-in, first-out method) or market as noted below:

JANUARY 31,	1987	1986
Raw materials	\$396,079	\$ 453,719
Work in process	330,471	512,427
Finished goods	122,998	69,102
	<u>\$849,548</u>	<u>\$1,035,248</u>

Equipment: Equipment is recorded at cost. Depreciation and amortization of equipment is provided on the straight-line method over the assets' estimated useful lives.

Investment Tax Credits: Investment tax credits will be recorded as a reduction of the provision for income taxes in the year realized (flow-through method).

Capitalized Software Development Costs: Software development costs incurred after the Company's software products and enhancements have completed the planning, designing, and testing stages are capitalized and amortized over their estimated revenue-producing lives, beginning after they are ready for distribution to customers. Costs of product maintenance and customer support are charged to expense when the related revenue is recognized or when those costs are incurred, whichever occurs first. In addition, research and development costs prior to completion of the planning, designing, and testing stage of product development are charged to expense as incurred.

Warranty Costs: The Company has a one-year limited warranty policy on its products. In addition, the Company agreed to convert installations of MIS-1 sold to a certain customer to MIS-2 as the new product becomes available. Furthermore, the Company guaranteed delivery of MIS-2 according to a pre-determined schedule which it has been unable to meet due to an underestimation of the complexity of the system development and the recent change in the operating system. The Company has accrued the future estimated costs related to these items. At January 31, 1987, the liability relating to the warranty policy and customer guarantees amounted to \$47,593 and \$216,032, respectively. The January 31, 1986 liability related entirely to the limited warranty policy.

Earnings Per Share: Earnings per share are computed using the weighted average number of common shares outstanding, including common stock equivalents. Stock options and warrants are considered common stock equivalents when the market

price of the Company's Common Stock exceeds the exercise price. For the years ended January 31, 1987 and 1985, common stock equivalents are not included in the earnings per share calculation because they have a dilutive effect on the loss per share.

Reclassification: Certain amounts in the 1986 and 1985 financial statements have been reclassified to conform with the 1987 presentation.

NOTE B

NOTES PAYABLE TO BANK

The Company has a \$1,000,000 operating line of credit facility and a \$400,000 revolving equipment line facility with a bank. The line of credit facilities are secured by accounts receivable, inventory, and equipment, and expire on June 30, 1987.

The Company's outstanding draws under the line of credit facilities at January 31, 1987 were as follows:

Demand note drawn under the \$1,000,000 operating line.	
Interest payable monthly at the bank's prime rate plus 1½%.	\$425,000
Installment note drawn under the \$400,000 revolving equipment line. Note matures December 31, 1989 with monthly principal payments in the amount of \$1,676 plus interest at the bank's prime rate plus 1½%.	60,345
Installment note drawn under the \$400,000 revolving equipment line. Note matures April 1, 1989 with monthly principal payments in the amount of \$2,778 plus interest at the bank's prime rate plus 1½%.	75,000
	<u>\$560,345</u>

The Company's loan agreement with the bank contains restrictions that, among other things, require maintenance of certain financial ratios, restrict the declaration on payment of dividends, and restrict the merger acquisition of another party. As of January 31, 1987 and subsequent thereto, the Company was in violation of certain of the financial ratio requirements. As the bank has only agreed to waive these covenants through June 30, 1987, the equipment notes have been classified as current liabilities.

NOTE C

LEASE OBLIGATIONS

The Company leases production and office space under five operating leases requiring varying monthly lease payments (maximum \$13,010) through July 1, 1987. The leases contain renewal options and provide for increased rentals based upon increases in property taxes and building operating expenses.

Future minimum lease commitments under all operating leases at January 31, 1987 are \$65,100 for the year ending January 31, 1988.

Total rental expense was approximately \$191,000, \$128,000, and \$76,000 for the fiscal years ended January 31, 1987, 1986, and 1985, respectively.

NOTE D

INCOME TAXES

At January 31, 1987, the Company has net operating loss carryforwards of approximately \$1,487,000 and \$1,819,000 for book and tax purposes, respectively, expiring from the years 2000 to 2001. These carryforwards were increased by the net operating loss experienced for the year ended January 31, 1987. Research and development and investment tax credit carryforwards totaling \$238,000 and \$28,000, respectively, expire from 1999 to 2002.

A portion of the net operating loss carryforward was utilized in fiscal 1986 to offset taxable income. This offset was recorded as an extraordinary credit in the accompanying financial statements.

A reconciliation of the 1986 provision for income taxes at statutory rates to the provision for income taxes is as follows:

Income taxes at statutory rate	\$85,415	46%
Amortization of research and development costs capitalized for tax, not book	(22,331)	(12)
Effect of graduated tax rates	(20,250)	(11)
Other	1,166	1
<i>Provision for Income Taxes</i>	<u>\$44,000</u>	<u>24%</u>

NOTE E

STOCKHOLDERS' EQUITY

Preferred Stock: The Company has authorized 1,000,000 shares of preferred stock, par value of \$.01 per share. No shares are issued or outstanding as of January 31, 1987.

Stock Options: The Company has a stock option plan under which options to purchase up to an aggregate of 750,000 shares of Common Stock can be granted to key employees by the Board of Directors. Options granted are exercisable over periods established when granted at market values determined by the Board of Directors on the date of grant.

Since March 1984, the Company has granted options to purchase 208,771 shares of Common Stock to 65 employees as follows:

SHARES	PRICE PER SHARE	EXPIRATION DATE
20,000	\$4.38	April-May 1987
20,000	4.63	October-November 1987
38,450	2.04	March 1989
54,606	4.00	July-October 1989
18,750	4.40	November 1989
7,500	6.00	August 1990
14,749	7.25	October 1990
3,416	9.38	March 1991
3,750	9.25	May 1991
6,000	4.38	August 1991
21,550	4.63	January 1992
<u>208,771</u>		

One-third of the options are exercisable after each of the first three years after grant, and all options expire five years after grant. Under the plan, 33,728 options remain available for grant.

Warrants: In October 1984, the Company and certain stockholders entered into an agreement to extend credit to the Company. Each stockholder making loans under the agreement (which totaled \$370,000 with interest at 2% over the prime rate) became entitled to warrants to purchase Common Stock of the Company exercisable for a period expiring January 31, 1987 at a price equal to 120% of the fair market value of the Company's Common Stock at January 31, 1985, which exercise price has been determined as \$6 per share.

Pursuant to the agreement, warrants to purchase an aggregate of 61,670 shares at an exercise price of \$6 per share were issued. Of outstanding notes payable related to these warrants, which were payable January 31, 1985, \$370,000 was extended by the stockholders to April 30, 1985. On April 30, 1985, \$100,000 was repaid to certain stockholders and \$60,000 was converted from debt to equity. The remaining \$210,000 was repaid from the proceeds of the Company's public offering in August 1985. As a result of this extension, warrants, expiring April 30, 1987, to purchase an additional 86,670 shares at an exercise price of \$6 were issued.

In January 1985, the Company obtained an additional \$400,000 standby line of credit from a stockholder of the Company. \$100,000 was advanced under this line with interest at 2% above the prime rate. In consideration for extending the commitment and advancing the \$100,000, the stockholder was granted warrants to purchase 62,500 shares of the Company's Common Stock at an exercise price of \$4 per share.

In connection with the public offering during the year ended January 31, 1986, the Company granted the underwriter warrants to purchase 42,500 shares of the Company's Common Stock at an exercise price of \$7.20 per share.

In summary, warrants outstanding are as follows:

WARRANTS	PRICE PER SHARE	EXPIRATION DATE
86,670	\$6.00	April 1987
62,500	4.00	January-April 1988
42,500	7.20	August 1990
<u>191,670</u>		

NOTE F

MAJOR CUSTOMER

For the year ended January 31, 1987, 83% of net sales were to three customers, Pacific Bell, Mountain Bell, and Bell of Pennsylvania. In 1986 and 1985, 86% and 74% of net sales were to two customers, Mountain Bell and Northwestern Bell, and Mountain Bell and Pacific Bell, respectively.

NOTES TO FINANCIAL STATEMENTS

NOTE G

DISTRIBUTION AGREEMENT

The Company has an amended distribution agreement under which American Telecorp, Inc. has the exclusive right to sell the Company's MIS product to certain of the Regional Bell Operating Companies. The commission expense reflected in the statement of operations results from commissions earned by American Telecorp, Inc. per the distribution agreement. Under the agreement, American Telecorp receives commissions of 25% on the first \$5,000,000 in commissionable sales and 20% on the next \$5,000,000 in commissionable sales and a reduced commission of 7.5% for one of the Bell operating companies, at which time the agreement terminates. To date, under the 25% commission provision, American Telecorp has received \$1,250,000; under the 20% and 7.5% commission provision, it has received approximately \$748,000, leaving a maximum balance of approximately \$249,000 in future commissions on the remaining \$1,245,000 in commissionable sales. American Telecorp will also receive a commission from 7.5% to 15% on any sales resulting from contracts to purchase existing at the time the \$10 million commissionable sales level is reached. American Telecorp also has a nonexclusive right to sell the Company's MIS product to customers other than Bell Operating Companies.

REPORT OF INDEPENDENT ACCOUNTANTS

Stockholders and Board of Directors
Telecalc, Inc.
Bellevue, Washington

We have examined the balance sheets of Telecalc, Inc. as of January 31, 1987 and 1986, and the related statements of operations, changes in stockholders' equity, and changes in financial position for each of the three years in the period ended January 31, 1987. 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 Telecalc, Inc. at Janu-

NOTE H

CAPITALIZED SOFTWARE DEVELOPMENT COSTS

During the year ended January 31, 1987, the Company adopted the provisions of Statement of Financial Accounting Standards No. 86, "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." Software development costs incurred after the Company's software product has completed the planning, designing, coding, and testing stages are capitalized. Those products or enhancements which have been completed are amortized over their estimated useful lives. Capitalized software development costs related to the development of MIS-2 and enhancements of MIS-1 totaled approximately \$434,000 at January 31, 1987. During the year ended January 31, 1987, the Company expensed previously capitalized development costs of approximately \$145,000 resulting from a change in the operating system of MIS-2 and, in addition, recognized amortization of approximately \$40,000 related to MIS-1 enhancements. No amortization has been recorded on the capitalized development costs of \$353,368 related to the MIS-2 project as the product is not yet available for distribution.

ary 31, 1987 and 1986, and the results of its operations and the changes in its financial position for each of the three years in the period ended January 31, 1987, in conformity with generally accepted accounting principles consistently applied during the period, except for the change, with which we concur, in the method of accounting for software development costs as described in Note H to the financial statements.

Ernst & Whinney
Seattle, Washington
March 20, 1987

CORPORATE INFORMATION

BOARD OF DIRECTORS

Michael S. Bledsoe

*Chairman, President and Chief Executive Officer
and Director*

Ronald P. Erickson

*Director, Partner in the Seattle law firm of
Kargianis and Austin*

Steven R. Gerbsman

*Director, CEO of consulting and capital
formation company*

Dennis W. Wassman

*Vice President of Finance and Sales, Secretary,
Treasurer and Director*

OFFICERS

Michael S. Bledsoe

Chairman, President and Chief Executive Officer

George Futas

*Vice President of Marketing and Product
Development*

Craig L. Morrison

Vice President of Operations

Dennis W. Wassman

Vice President of Finance, Secretary, Treasurer

TRANSFER AGENT & REGISTRAR

First Jersey National Bank

Shareholder Services

1109 First Avenue, Suite 306

Seattle, Washington 98101

LEGAL COUNSEL

Foster, Pepper & Riviera

1111 Third Avenue

Seattle, Washington 98101

AUDITORS

Ernst & Whinney

999 Third Avenue, Suite 3300

Seattle, Washington 98104

INVESTOR RELATIONS COUNSEL

Corporate Communications, Inc.

200 W. Mercer, Suite 412

Seattle, Washington 98119

FORM 10-K

The Company files an annual report with the Securities and Exchange Commission. Shareholders may obtain a copy of this report without charge by writing:

Dennis W. Wassman, Vice President of Finance
TELECALC, INC.

4122 128th Avenue S.E.

Bellevue, Washington 98006



TELECALC INCORPORATED
4122 128TH AVE. S.E.
BELLEVUE, WASHINGTON 98006