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Annual Reports  
DESK

TELECALC  
I N C.  
A N N U A L  
R E P O R T

PROPERTY OF  
SEATTLE PUBLIC LIBRARY

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

## FINANCIAL HIGHLIGHTS

### STATEMENT OF OPERATIONS DATA:

YEAR ENDED JANUARY 31,	1988	1987	1986	1985
Net sales	\$ 4,576,787	\$ 4,759,316	\$5,669,808	\$2,437,088
Net income (loss)	\$(1,168,224)	\$(1,117,191)	\$ 185,685	\$ (489,797)
Net income (loss) per share	\$ (.47)	\$ (.52)	\$ .08	\$ (.32)
Average shares outstanding, including common stock equivalents	2,495,617	2,167,129	2,294,423	1,540,671

### BALANCE SHEET DATA:

AS OF JANUARY 31,	1988	1987	1986	1985
Current assets	\$2,205,314	\$2,523,214	\$3,088,592	\$1,226,384
Total assets	\$3,372,148	\$3,503,138	\$3,546,588	\$1,436,345
Current liabilities	\$1,388,812	\$1,693,974	\$ 647,160	\$1,139,913
Long-term debt	—	—	—	\$ 6,512
Shareholders' equity	\$1,983,336 <sup>2</sup>	\$1,809,164	\$2,899,428 <sup>1</sup>	\$ 289,920

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

<sup>2</sup>Reflects sale of 825,000 shares and net proceeds of \$1,334,000 from the Company's Private Placement of October, 1987.

## 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	1988		1987		1986	
	HIGH	LOW	HIGH	LOW	HIGH	LOW
April 30	5	2 3/4	12 1/4	7 1/2	N/A	N/A
July 31	3 1/4	2 3/4	12 1/4	5 1/4	N/A	N/A
October 31	3 1/4	1 5/8	5 3/4	3 1/2	8 3/4	6
January 31	1 3/4	13/16	6	3 3/4	10	7 1/4

### SHAREHOLDERS:

As of March 30 there were approximately 1,030 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.

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MAY 23 1988

## TO OUR SHAREHOLDERS:

**F**iscal 1988 was a challenging and demanding year for Telecalc. Beta versions of MIS-2, our second generation product, were delivered to major customers in the fourth quarter. Although the product passed functional tests, our customers wanted the interface (which allows users to access that functionality) to look and perform more like our MIS-1 product. We agreed to make this change and accepted the associated development effort. As a result, fourth quarter shipments to major accounts were deferred pending review of progress on MIS-2, and we appropriately wrote-off portions of previously capitalized development costs associated with the interface. The deferred shipments and write-off contributed to a loss of \$1.2 million for the year as detailed below.

The Company's response was to take several major steps including: reducing operating costs by 30%; adding a new President/CEO; giving responsibility for the MIS-2 user interface to the Chairman (who designed the MIS-1 interface); eliminating the position of Vice President of Finance by combining responsibilities with those of the President; and adding several new outside Directors to the Board.

After holding numerous individual meetings and group meetings with all major customers, a new user interface design has been developed. This new design has been presented to our customers with very positive feedback, which subsequently resulted in orders resuming for MIS-1. Many of these systems will later be converted to MIS-2 systems.

### *Financial Results*

The significant events of the fourth quarter played a major role in our financial performance for the fiscal year. Telecalc incurred a loss of \$1.2 million on sales of \$454,000 for the fourth quarter ended January 31, 1988 as compared to a loss of \$293,000 on sales of \$1.3 million for the comparable quarter of the prior fiscal year. Of the fourth quarter loss, \$440,000 represents a write-off of MIS-2 development costs previously capitalized. The balance of the loss of \$735,000 is primarily attributed to lower sales as major customers deferred MIS-1 orders pending review of progress on MIS-2 and certain orders were substantially fulfilled as detailed in Management's Discussion and Analysis.

For the fiscal year ended January 31, 1988 Telecalc incurred a loss of \$1.2 million on sales of \$4.6 million, as compared to a loss of \$1.1 million on sales of \$4.8 million for the fiscal year ended January 31, 1987.

### *Financial Position*

Although Telecalc realized an operating loss for the past year, the Company maintains a relatively sound financial position. The Company was successful in raising \$1.3 million in equity capital during the fall of 1987 and established a bank line of credit to satisfy its short-term borrowing needs for the coming year. The Company also expects the expense reductions, coupled with resumed MIS-1 orders, to enhance its financial position.

### *MIS-2 Product Development*

In addition to the meetings with customers, procedures and policies for software design and development were reviewed by consultants outside the Telecalc engineering development group. Improvements were made wherever necessary. Greater internal controls have been implemented to ensure product development meets established criteria. We continue to work closely with our customers to obtain feedback during final stages of product development. Every possible step is being taken to ensure the release of MIS-2 according to schedule and commitments to our customers. Commercial availability of MIS-2 during the second half of fiscal 1989 is expected to bring future revenue opportunities, in addition to fulfilling existing customer needs. Plans are currently underway to interface MIS-2 to additional host switching systems and expand the product's capabilities to create "add-on" product opportunities.

### *Additional Product Potential*

Telecalc is currently investigating market segments outside the Regional Bell Operating Companies (RBOCs) and outside the CENTREX Universal Call Distribution (UCD) host switching systems. These opportunities are expected to provide diversification for Telecalc's product line and customer base thereby strengthening our financial position. Multiple alternatives, including acquiring new technology or distributing products of other companies, are also being explored.

### *Current Management*

In January, 1988, Thomas R. Fry joined Telecalc as President and Chief Executive Officer. Mr. Fry, also a CPA, was most recently Vice President of Domestic Sales with Execucom Systems Corporation, an Austin, Texas software development firm. He brings to Telecalc a total of 17 years experience in the computer software and services industry, including management roles at EDS of Dallas, Texas, and CompuServe, Inc. of Columbus, Ohio.

Michael S. Bledsoe, Founder of Telecalc, continues as Chairman of the Board, providing overall strategic direction, marketing focus, and creative product design. Craig Morrison will continue as Senior Vice President with responsibilities for Operations, Product Support, and Engineering Development.

### *Future Outlook*

In summary, our immediate focus is on completion of MIS-2 and attaining profitability on expected MIS-1 sales. Besides carefully planning MIS-2 product additions to maximize the return on our investment, we are also considering other technologies to expand our market. Telecalc customers continue to confirm that the new MIS-2 system is needed in the marketplace.





LEFT TO RIGHT:  
CRAIG L. MORRISON,  
SENIOR VICE PRESIDENT;  
THOMAS R. FRY, PRESIDENT  
AND CHIEF EXECUTIVE OFFICER;  
MICHAEL S. BLEDSOE,  
CHAIRMAN OF THE BOARD

Though fiscal 1988 was a trying time, customer support for Telecalc and our new MIS-2 product provided strength and confidence to the Company.

At Telecalc, we take pride in our product and our service. With determination and continued dedication, we intend to provide quality to our customers and value to our investors. Sometimes the greatest opportunities are found within the most difficult challenges.

To our shareholders, customers, employees, and vendors, the management of Telecalc says "thank you" for your continued faith and confidence.

*Thomas R. Fry*  
Thomas R. Fry  
President and CEO

*Michael S. Bledsoe*  
Michael S. Bledsoe  
Chairman of the Board

# BALANCE SHEETS

JANUARY 31,	1988	1987
<i>Assets</i>		
<i>Current Assets</i>		
Cash and cash equivalents	\$ 779,457	\$ 132,612
Accounts and notes receivable—Note B	798,028	1,471,620
Inventories—Notes A and B	598,539	849,548
Prepaid expenses	29,290	69,434
<i>Total Current Assets</i>	<u>2,205,314</u>	<u>2,523,214</u>
<i>Equipment—Note B</i>		
Equipment	796,655	655,497
Furniture and fixtures	102,428	95,384
Leasehold improvements	39,914	34,391
	<u>938,997</u>	<u>785,272</u>
Less accumulated depreciation and amortization	<u>438,485</u>	<u>252,580</u>
	500,512	532,692
<i>Other Assets</i>		
Software development costs, less accumulated amortization of \$120,690 in 1988 and \$40,174 in 1987—Note H	648,294	433,884
Deposits and other assets	18,028	13,348
<i>Total Assets</i>	<u>\$3,372,148</u>	<u>\$3,503,138</u>
<i>Liabilities and Stockholders' Equity</i>		
<i>Current Liabilities</i>		
Notes payable to bank—Note B	\$ 517,897	\$ 560,345
Accounts payable	161,823	240,339
Commissions payable	174,196	361,847
Accrued compensation	145,693	162,920
Accrued expenses	49,666	69,397
Warranty reserve	277,178	263,625
Unearned income	62,359	35,501
<i>Total Current Liabilities</i>	<u>1,388,812</u>	<u>1,693,974</u>
<i>Stockholders' Equity—Note E</i>		
Common Stock, par value \$.01 per share—authorized 5,000,000 shares, issued and outstanding 3,007,800 in 1988 and 2,178,900 in 1987	30,078	21,789
Additional paid-in capital	5,163,941	3,829,834
Retained-earnings (deficit)	(3,210,683)	(2,042,459)
<i>Total Stockholders' Equity</i>	<u>1,983,336</u>	<u>1,809,164</u>
<i>Total Liabilities and Stockholders' Equity</i>	<u>\$3,372,148</u>	<u>\$3,503,138</u>

See notes to financial statements.

## STATEMENTS OF OPERATIONS

YEAR ENDED JANUARY 31,	1988	1987	1986
Net sales—Note F	\$ 4,576,787	\$4,759,316	\$5,669,808
Costs and expenses:			
Cost of sales	2,261,411	2,041,993	1,868,804
Commissions—Note G	421,695	477,248	1,004,888
Other selling	674,711	857,697	844,233
Marketing	262,917	359,288	302,339
Research and development	504,092	919,677	737,128
Amortization of software development costs—Note H	80,516	40,174	—
Write-down of software development costs—Note H	440,000	145,000	—
General and administrative	1,105,408	1,014,005	719,968
	<u>5,750,750</u>	<u>5,855,082</u>	<u>5,477,360</u>
<i>Operating Income (Loss)</i>	<u>(1,173,963)</u>	<u>(1,095,766)</u>	<u>192,448</u>
Other income (expense):			
Interest expense	(67,526)	(43,121)	(61,030)
Interest income	19,083	19,265	47,986
Other, net	54,182	2,431	6,281
	<u>5,739</u>	<u>(21,425)</u>	<u>(6,763)</u>
<i>Income (Loss) Before Income Taxes and Extraordinary Item</i>	<u>(1,168,224)</u>	<u>(1,117,191)</u>	<u>185,685</u>
Provision for income taxes—Note D	—	—	44,000
<i>Income (Loss) Before Extraordinary Item</i>	<u>(1,168,224)</u>	<u>(1,117,191)</u>	<u>141,685</u>
Extraordinary item—income tax benefit from utilization of operating loss carryforwards—Note D	—	—	44,000
<i>Net Income (Loss)</i>	<u><u>\$(1,168,224)</u></u>	<u><u>\$(1,117,191)</u></u>	<u><u>\$ 185,685</u></u>
Earnings (loss) per share—primary and fully diluted—Note E:			
Income (loss) before extraordinary item	<u>\$(.47)</u>	<u>\$(.52)</u>	<u>\$.06</u>
Net income (loss)	<u><u>\$(.47)</u></u>	<u><u>\$(.52)</u></u>	<u><u>\$.08</u></u>
Average shares outstanding, including common stock equivalents	<u>2,495,617</u>	<u>2,167,129</u>	<u>2,294,423</u>

See notes to financial statements.

## STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	COMMON STOCK ISSUED AND OUTSTANDING		ADDITIONAL PAID-IN	RETAINED- EARNINGS	
	SHARES	AMOUNT	CAPITAL	(DEFICIT)	TOTAL
Balance at February 1, 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
Exercise of stock options	12,950	129	26,798	—	26,927
Net loss	—	—	—	(1,117,191)	(1,117,191)
Balance at January 31, 1987	2,178,900	21,789	3,829,834	(2,042,459)	1,809,164
Exercise of stock options	3,900	39	7,917	—	7,956
Sale of Common Stock, net of expenses of \$315,560	825,000	8,250	1,326,190	—	1,334,440
Net loss	—	—	—	(1,168,224)	(1,168,224)
Balance at January 31, 1988	<u>3,007,800</u>	<u>\$30,078</u>	<u>\$5,163,941</u>	<u>\$(3,210,683)</u>	<u>\$1,983,336</u>

See notes to financial statements.



# STATEMENTS OF CHANGES IN FINANCIAL POSITION

YEAR ENDED JANUARY 31,

	1988	1987	1986
<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	\$ 7,956	26,927	—
Net proceeds of Common Stock issue	1,334,440	—	2,363,823
Conversion of debt to Common Stock	—	—	60,000
	1,342,396	38,805	2,682,592
<i>Application of Working Capital</i>			
Net loss	1,168,224	1,117,191	—
Charges to operations not requiring working capital:			
Depreciation and amortization of equipment	(185,905)	(141,424)	—
Amortization and write-down of software development costs	(520,516)	(185,174)	—
<i>Funds Used in Operations</i>	461,803	790,593	—
Acquisition of equipment	153,725	241,346	309,642
Increase in software development costs	734,926	619,058	—
Increase in deposits and other assets	4,680	—	17,989
	1,355,134	1,650,997	327,631
<i>Increase (Decrease) in Working Capital</i>	\$ (12,738)	\$(1,612,192)	\$2,354,961
<i>Changes in Components of Working Capital</i>			
Increase (decrease) in current assets:			
Cash and cash equivalents	\$ 646,845	\$ (664,522)	\$ 736,883
Accounts and notes receivable	(673,592)	291,939	653,044
Inventories	(251,009)	(185,700)	420,641
Prepaid expenses	(40,144)	(7,095)	51,640
	(317,900)	(565,378)	1,862,208
Increase (decrease) in current liabilities:			
Notes payable to bank	(42,448)	560,345	(418,979)
Notes payable to stockholders	—	—	(411,125)
Accounts payable	(78,516)	(20,074)	126,390
Commissions payable	(187,651)	222,555	79,081
Accrued compensation	(17,227)	25,191	59,387
Accrued expenses	(19,731)	46,241	(14,077)
Warranty reserve	13,553	248,625	15,000
Unearned income	26,858	(36,069)	71,570
	(305,162)	1,046,814	(492,753)
<i>Increase (Decrease) in Working Capital</i>	\$ (12,738)	\$(1,612,192)	\$2,354,961

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, namely, the development, manufacture, and sale of microcomputer-based management information systems (MIS) for use in telephone communications.

*Statement of Cash Flows:* In November 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 95, "Statement of Cash Flows." Companies are required to adopt the new method of reporting cash flows for annual financial statements for periods ending after July 15, 1988. The Company elected to defer compliance with these new guidelines until fiscal 1989. Had the Company elected to comply with the new guidelines in fiscal 1988, the cash provided by operations is estimated to approximate \$240,000, as compared to the funds used in operations of \$461,803 as presented in the financial statements. This cash inflow was provided primarily by the decrease of \$964,745 in accounts and notes receivable and inventories.

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

JANUARY 31,	1988	1987
Raw materials	\$283,252	\$396,079
Work in process	81,919	330,471
Finished goods	274,368	122,998
	<u>639,539</u>	<u>849,548</u>
Less reserve for inventory obsolescence	41,000	—
	<u>\$598,539</u>	<u>\$849,548</u>

*Equipment:* Equipment is recorded at cost. Depreciation and amortization of equipment are 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, Customer Maintenance and Support, and Research and 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 commercial 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 MIS-1 installations 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 that 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. The liability at January 31, 1988 and 1987 relating to the warranty policy amounted to \$54,502 and \$47,593, respectively, while customer guarantees accounted for \$165,255 and \$216,032, respectively.

*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, 1988 and 1987, 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 1987 and 1986 financial statements have been reclassified to conform with the 1988 presentation.

### NOTE B

#### NOTES PAYABLE TO BANK

The Company's outstanding draws under debt facilities at January 31, 1988 and 1987 were as follows:

	1988	1987
Demand note drawn under the \$700,000 operating line. Interest payable monthly at the bank's prime rate plus 1½%.	\$436,000	\$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%.	40,230	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%.	41,667	75,000
	<u>\$517,897</u>	<u>\$560,345</u>

At January 31, 1988 the Company had a \$700,000 operating line of credit facility and a \$400,000 revolving equipment line facility with a bank. The line of credit facilities were secured by accounts receivable, inventory, and equipment. The agreement pertaining to these lines expired on December 31, 1987 but was verbally extended through March 31, 1988. In connection with the verbal extension, the operating line was reduced to \$500,000 as of February 16, 1988.

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 with or acquisition of another party.

## NOTES TO FINANCIAL STATEMENTS

The bank waived these covenants through December 31, 1987 and verbally extended this waiver through March 31, 1988. As the bank waived these covenants only through March 31, 1988, the equipment notes have been classified as current.

On March 17, 1988, the Company obtained a \$400,000 operating line of credit facility from another bank that expires July 31, 1988. This line of credit facility is secured by accounts receivable, inventory, and equipment and contains restrictions that, among other things, require maintenance of certain financial ratios, restrict expenditures, and restrict the merger with or acquisition of another party. With funds obtained under this line, the Company paid in full the outstanding balance on the \$500,000 operating line. In addition, the two notes drawn under the equipment line were paid in full subsequent to year-end from the Company's cash reserves.

### NOTE C

#### LEASE OBLIGATIONS

The Company leases production and office space under five operating leases requiring varying monthly lease payments (maximum \$13,500) through April 30, 1988. The leases contain renewal options and provide for increased rentals based on increases in property taxes and building operating expenses.

Total rental expense was approximately \$173,000, \$191,000, and \$128,000 for the fiscal years ended January 31, 1988, 1987, and 1986, respectively.

### NOTE D

#### INCOME TAXES

At January 31, 1988, the Company has net operating loss carryforwards of approximately \$2,645,000 and \$3,061,000 for book and tax purposes, respectively, expiring from the years 2000 to 2003. Research and development and investment tax credit carryforwards totaling \$308,000 and \$34,000, respectively, expire from 1999 to 2003. The investment tax carryforward was reduced 20% during fiscal 1988 and will be reduced an additional 15% during fiscal 1989 as a result of the Tax Reform Act of 1986.

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>

On December 30, 1987, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 96, "Accounting for Income Taxes." The Company is required to adopt the new method of accounting for income taxes no later than fiscal 1990.

The Company has not completed all the analysis required to estimate the impact of the new Statement, and it has not decided whether it will implement the Statement early or restate any periods. However, the adoption of Statement No. 96 is not expected to have an adverse impact on the Company's financial position, due to its net operating loss carryforward position.

### 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, 1988.

*Stock Options:* The Company has a stock option plan under which options to purchase up to an aggregate of 647,000 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 489,558 shares of Common Stock to employees as follows:

SHARES	PRICE PER SHARE	EXPIRATION DATE
7,800	\$2.04	April 1988
1,800	3.00	April 1988
166	3.12	April 1988
5,000	4.00	April 1988
83	4.12	April 1988
18,750	4.40	April 1988
2,528	4.63	April 1988
333	7.25	April 1988
998	9.38	April 1988
30,000	3.00	October 1988
16,400	1.00	March 1989
7,500	3.00	May 1989
16,750	1.00	July-September 1989
15,000	3.00	August 1989
10,000	3.00	October 1989
250	1.00	October 1990
750	1.00	March 1991
5,000	3.00	August 1990
6,000	1.00	August 1991
27,200	1.00	January-March 1992
20,000	3.00	April 1992
7,750	1.00	June-August 1992
1,750	1.00	October 1992
112,750	1.00	December 1992
175,000	1.00	January 1993
<u>489,558</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, 157,442 options remain available for grant.

In January 1988, a plan was approved to exchange all outstanding options granted to current employees for new options at an exercise price of \$1.00 per share. Options outstanding at January 31, 1988 qualifying for exchange totaled 189,600.

*Warrants:* 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. During fiscal 1988, 50,000 of these warrants expired.

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 May 1987, in connection with a payment program for past due commissions, the Company granted to American Telecorp warrants to purchase 33,333 shares of Common Stock at an exercise price of \$3.00 per share.

In connection with the private placement during the year ended January 31, 1988, the Company granted 495,000 warrants (Class A) which enable the holder to purchase one share of the Company's Common Stock at an exercise price of \$3.00 and acquire an additional warrant (Class B) to purchase one share of the Company's Common Stock at an exercise price of \$5.00. Pursuant to an agency agreement with the private placement selling agents, the Company agreed to add four directors to the Board. The agreement also specifies that the new directors are to be granted three-year nonredeemable warrants to purchase 3,750 shares at \$3.00 per share every 90 days of service to a maximum of 45,000 shares each. At January 31, 1988, warrants to purchase 7,500 shares each had been granted to three of the directors. In addition, a fourth director, who subsequently resigned from the Board, received warrants to purchase 7,500 shares of Common Stock at \$3.00 per share.

In connection with the provision of certain financial consulting services, the Company issued Common Stock purchase warrants in January 1987 to purchase an aggregate of 25,000 shares of Common Stock at an exercise price of \$4.50 per share.

The Company entered into a two-year consulting agreement for consulting services related to financial consulting service matters. As consideration for these services, the Company granted five-year nonredeemable Common Stock purchase warrants to purchase 150,000 shares of Common Stock at an exercise price of \$2.00 per share.

In summary, warrants outstanding are as follows:

WARRANTS	PRICE PER SHARE	EXPIRATION DATE
12,500	\$4.00	April 1988
33,333	3.00	July 1989
42,500	7.20	August 1990
510,000	3.00	October 1990
15,000	3.00	December 1990
25,000	4.50	January 1992
150,000	2.00	September 1992
<u>788,333</u>		

#### NOTE F

##### MAJOR CUSTOMERS

For the year ended January 31, 1988, 91% of net sales were to four customers, Pacific Bell, Mountain Bell, Bell of Pennsylvania, and Southern New England Telephone. In 1987, 83% of net sales were to three customers, Pacific Bell, Mountain Bell and Bell of Pennsylvania while in 1986, 86% of net sales were to two customers, Mountain Bell and Northwestern Bell.

#### NOTE G

##### DISTRIBUTION AGREEMENT

The Company entered into an amended distribution agreement under which American Telecorp, Inc. has the exclusive right to sell the Company's MIS product to certain of the Bell operating companies. The commission expense reflected in the statements 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. One-half of the commission is payable upon receipt of a firm order and the balance is due when the Company is paid. However, the Company may, at its option, elect to defer payment of the commission payable upon receipt of the order until the Company receives payment for such order. Any deferred commissions bear interest at the rate of 10.5% per annum from the date such commissions are payable. At August 31, 1987, American Telecorp had received approximately \$2,250,000 on the first \$10,000,000 of commissionable sales. From August 31, 1987, and for a maximum of one year thereafter, American Telecorp will receive a commission from 7.5% to 15% on sales orders from certain Bell operating companies. As of January 31, 1988, American Telecorp has received approximately \$126,000 under the foregoing 7.5% to 15% commission provision.



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 revenue-producing lives.

During the year ended January 31, 1988 and 1987, the Company expensed previously capitalized development costs related to MIS-2 of \$440,000 resulting from a redesign of the user interface and other product features and \$145,000 resulting from a change in the operating system, respectively. MIS-1 enhancements with an original capitalized cost of approximately \$121,000 were fully amortized as of January 31, 1988. No amortization has been recorded on the capitalized development costs of approximately \$642,000 related to the MIS-2 project as the product is not yet available for commercial distribution.

NOTE I

EMPLOYMENT AGREEMENTS

The Chairman of the Board of Directors, has agreed not to compete with the Company for a period of two years, following termination of his employment, should that occur. If his employment is terminated without his consent, or if he resigns for good reason, which may include a reduction in the nature of duties, base salary, or benefits, or a change of location, the Company has agreed to continue his salary for a period of 18 months following such event, provided he is subject to noncompetition and nondisclosure agreements at the time of such event.

NOTE J

COMMITMENTS AND CONTINGENCIES

In December 1987, Company management met with representatives from several of the Regional Bell Operating Companies (RBOC) to review specifications for the refinement of MIS-2. An Engineering Plan specifying release dates in March 1988 (Phase 1) and June 1988 (Phase 2) for the next two versions of MIS-2 was developed and committed to by all parties. The commitment to deliver Phase 1 during March 1988 was satisfactorily met by the Company, and the Company continues to work towards delivery of Phase 2.

In addition, in April 1988, the Company entered into an agreement with one of the RBOCs to waive liquidated damages originally claimed against the Company for late delivery of an acceptable MIS-2 system during the period from October 1987 to March 1988. The waiver runs through June 30, 1988, provided the Company meets the requirements of Phase 2 of the Engineering Plan. If the Company fails to meet such requirements to the RBOC's satisfaction, the Company is to deliver, at no charge, one system per month, until the Phase 2 requirements are met, during the period from July 1, 1988 through October 11, 1988. The retail value of systems supplied under this arrangement is not to exceed \$282,750. However, if the Company fails to meet the requirements of Phase 2 by October 11, 1988 and the total retail value of systems delivered to that time is less than \$282,750, the Company will be liable for the difference. In the opinion of management, the Company will meet the Engineering Plan requirements and, therefore, this agreement will not have a material impact on the Company's financial position.

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, 1988 and 1987, 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, 1988. 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 January 31, 1988 and 1987, and the results of its operations and

changes in its financial position for each of the three years in the period ended January 31, 1988, in conformity with generally accepted accounting principles consistently applied during the period subsequent to the change, with which we concur, made as of February 1, 1986, in the method of accounting for software development costs as described in Note H to the financial statements.

*Ernst & Whinney*

Seattle, Washington  
March 29, 1988 except  
as to Note J as to which  
the date is April 26, 1988



### *General*

During the fourth quarter of the fiscal year ended January 31, 1988, the Company commenced verification testing of Telecalc MIS-2, its second generation product. The development of Telecalc MIS-2 had been subject to significant delays since mid-1986 and had resulted in increased development costs throughout fiscal 1987 and 1988. Although the product substantially met functional requirements in the testing procedures, the user interface did not meet customers' criteria. Accordingly, the Company proposed a revised user interface, which was presented to customers and received very positive feedback. Telecalc MIS-2 is scheduled to be available for major customers approximately mid-1988.

As a consequence of the verification testing process, sales declined sharply in the fourth quarter of fiscal 1988, as major customers deferred orders pending clarification of the Company's development plan and renewed progress. Although sales during the first quarter of fiscal 1989 are substantially higher than the fourth quarter of fiscal 1988, the Company expects sales to be uneven depending upon development progress on the user interface and, ultimately, on the timely completion of all elements of Telecalc MIS-2 for commercial use, expected during the second half of fiscal 1989.

During the fourth quarter of fiscal 1988, the Company began implementing a cost reduction program designed to reduce its monthly cash expenditures to a level which more closely matched its short-term sales expectations and which would allow it to respond more easily to order fluctuations. This program reduced employees from 65 in October 1987 to 37 at January 31, 1988. In addition, the Company has reduced the size of its facilities, limited the use of outside consultants and eliminated other nonessential expenses. The Company estimates that monthly operating expenses have been reduced by approximately 30%. Since the major part of these changes was implemented in late January 1988, the financial statements for fiscal 1988 do not reflect the full impact of the cost reduction program.

### *Results of Operations*

Sales for the fiscal year ended January 31, 1988 decreased 4% to \$4.6 million from \$4.8 million for the fiscal year ended January 31, 1987, which represented a decrease of 16% from the \$5.7 million recorded in the fiscal year ended January 31, 1986. The majority of the decrease experienced in fiscal 1988 occurred in the fourth quarter during which time major customers deferred MIS-1 orders pending renewed progress on Telecalc's MIS-2 product, as described above. In addition, the existing orders for systems to Bell of Pennsylvania under the Bell Atlantic Master Agreement were fulfilled and a contract for systems to Southern New England Telephone was substantially completed. The decrease for fiscal 1987 reflects completion of a major contract and delays in securing additional contracts from two Bell operating companies.

Historically, the Company's sales have been dependent to a great extent on orders from Bell operating companies. For the year ended January 31, 1988, 91% of net sales were to four customers, Pacific Bell, Mountain Bell, Bell of Pennsylvania and Southern New England Telephone. In fiscal 1987, 83% of net sales were to three customers, Pacific Bell, Mountain Bell and Bell of Pennsylvania. In fiscal 1986, 86% of net sales were to two customers, Mountain Bell and Northwestern Bell. As a consequence of its reliance on major contracts, the Company's quarterly sales have fluctuated substantially during the last 24 months, ranging from \$454,000 in the quarter ended January 31, 1988, to \$2,133,000 in the quarter ended October 31, 1986. The Company expects that sales for fiscal 1989 will continue to be dependent on orders from Bell operating companies, including those which have not made material purchases in the past and which are awaiting completion of Telecalc MIS-2 to consider orders.

Cost of sales as a percentage of sales increased to 49% for fiscal year 1988 from 43% for fiscal year 1987, after increasing from 33% for fiscal year 1986. These percentages reflect the effect of the lower sales in fiscal 1988 and 1987 as discussed above, without corresponding reductions in the expenses incorporated in cost of sales. Factors contributing to the increase in the cost of sales for fiscal 1988 include higher proportionate sales of hardware components which have a lower margin, reclassification of certain product support costs which were previously allocated to marketing and inventory adjustments arising from actual reductions and obsolescence. The reductions in inventory caused an associated reallocation of overhead from inventory to cost of sales. Cost of sales increased substantially in fiscal 1987 despite significantly lower sales because the Company had increased its staff and facilities in connection with higher fiscal 1986 sales and in the anticipation that such sales levels would continue. These expense levels were continued through fiscal 1988, until implementation of the cost reduction program, discussed above. Also contributing to the increase in cost of sales for fiscal 1987 was approximately \$133,000 in excess of normal warranty expense to cover certain equipment exchanges for one of the Company's principal customers.

Commission expense reflects primarily sales commissions paid by the Company under its principal distribution agreement relating to Bell operating companies. As a percentage of sales, commission expense decreased to 9% for fiscal 1988 as compared to 10% and 18%, respectively, for fiscal 1987 and 1986. The decreases in commission expense are largely attributable to changes in commission rates under the distribution agreement. The basic rate had decreased from 20% to 15% of commissionable sales in September 1987 and had earlier decreased from 25% to 20% in October 1985. In addition, the distribution agreement provided for a 7.5% commission rate on sales to Bell Atlantic, which commenced in October 1986 and constituted more than 40% of the Company's fiscal 1988 sales. Under the distribution agreement, the Company ceases to pay commissions on sales to Bell operating companies after August 31, 1988.



Other selling expenses for fiscal 1988 decreased as a percentage of sales to 15% from 18% in fiscal 1987 after having increased from 15% in fiscal 1986. The decrease for the current fiscal year is due primarily to staff reductions involving senior personnel in March 1987. Except for this change, the level of other selling expense has remained relatively constant through the three years, although reduced sales have affected these expenses as a percentage of sales.

Marketing as a percentage of sales decreased to 6% for fiscal 1988 from 8% in fiscal 1987 after increasing from 5% in fiscal 1986. The current decrease was primarily a consequence of reclassification of certain customer support expenses from marketing to cost of sales as described above. The increase in fiscal 1987 was due to a combination of lower sales volumes and increased staff.

Research and development expenses as a percentage of sales decreased to 11% in fiscal 1988 from 19% in fiscal 1987 after increasing from 13% in fiscal 1986. The decrease in fiscal 1988 is attributable to capitalization of the Company's software development costs relating to development of MIS-2; fiscal 1988 reflects a full year of such capitalization while fiscal 1987 reflects only six months, as technological feasibility was not established until August 1986. The Company capitalizes software development costs related to the development of MIS-2 in accordance with FASB No. 86 "Accounting for the Costs of Computer Software to be Sold, Leased, or Otherwise Marketed." The increases occurring in fiscal 1987 are attributable to additional software personnel and the use of consultants for development of Telecalc MIS-2. Reduced sales have also resulted in an increase in research and development expense as a percentage of sales. In addition, for the fiscal years ended January 31, 1988 and 1987, the Company recognized amortization of capitalized software development costs of approximately \$81,000 and \$40,000, respectively, related to MIS-1 enhancements.

During the years ended January 31, 1988 and 1987, the Company expensed previously capitalized software development costs related to MIS-2 of \$440,000 resulting from a redesign in the user interface and other product features and \$145,000 resulting from a change in the initial operating system, respectively. No amortization has been recorded on the capitalized development costs of approximately \$642,000 related to the MIS-2 project as the product is not yet available for commercial distribution.

Overall, the Company's combined investment in research and development (including capitalized costs, amortized costs, write-offs, and expenses) has been 27%, 32%, and 13% of sales for fiscal years 1988, 1987, and 1986, respectively.

General and administrative expenses were comparable for fiscal 1988 and 1987. Consulting expenses, legal expenses and costs of seeking a new chief executive officer were to some degree offset by personnel reductions toward the end of fiscal 1988. General and administrative expenses as a percentage of sales increased to 24% in fiscal 1988 from 21% in fiscal 1987 and 13% in fiscal 1986. The increase experienced in fiscal 1988 was

a consequence of reduced sales. General and administrative expenses increased in fiscal 1987 due to costs incurred for the entire year as a publicly held company and a reserve of approximately \$130,000 attributable to liquidated damages under the contract with Pacific Bell.

The fluctuations in interest income and interest expense reflect the level of the Company's borrowings as affected by availability and use of proceeds from its initial public offering in August 1985 and a private placement of securities in October 1987. Other income in fiscal 1988 reflects a one-time payment related to a dispute over rights to a future product.

Net loss for the year ended January 31, 1988 was \$(.47) per share compared to a net loss of \$(.52) per share for the year ended January 31, 1987 and net income of \$.08 per share for the year ended January 31, 1986. The Company's average shares outstanding increased in fiscal 1988 as a consequence of the private placement of common stock completed in October 1987. Following the private placement, the Company has 3,007,800 shares of common stock issued and outstanding and warrants to purchase approximately 788,333 shares of common stock at various prices. For fiscal years 1988 and 1987, common stock equivalents are not included in 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 carryforwards 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, 1988, the Company's working capital was \$817,000, which represents a decline of \$13,000 from working capital existing at January 31, 1987. The decrease is a net result of additional capital of \$1,334,000 (net of expenses) obtained in a private placement of common stock completed in October 1987, an increase in other assets arising from capitalization of MIS-2 system software development costs and loss from operations. At January 31, 1987, the Company's working capital had declined by \$1,612,000 from working capital existing at January 31, 1986 resulting largely from a loss from operations and an increase in other assets arising from capitalization of MIS-2 system software costs.

At January 31, 1988, the Company had a \$700,000 operating line of credit facility and a \$400,000 revolving equipment line facility with a bank. The agreement expired on December 31, 1987 and was verbally extended through March 31, 1988. Subsequent to year-end, the Company obtained a \$400,000 operating line of credit facility from another bank, secured by accounts receivable, inventory, and equipment, maturing July 31, 1988. With funds obtained under this line, the Company paid in full the outstanding balance existing under the operating line at year end. In addition, the Company paid from cash reserves the balance outstanding on the equipment line.



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 1989.

#### *Capital Expenditures*

The Company purchased \$154,000 of fixed assets during fiscal 1988, of which \$141,000 was for new equipment. This compares to capital equipment purchases of \$241,000 in fiscal 1987, of which \$217,000 was for new equipment. The majority of new equipment was for research and development purposes.

#### *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 1988 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 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.

#### *Impact of New Accounting Rules*

During 1987, the Financial Accounting Standards Board issued two final statements of financial standards which the Company will adopt in future years. FASB Statement No. 95, "Statement of Cash Flows," will be required for annual financial statements for periods ending after July 15, 1988. The Company elected to defer compliance with these new guidelines until fiscal 1989. Had the Company elected to comply with the new guidelines in fiscal 1988, the cash provided by operations is estimated to approximate \$240,000 as compared to the funds used in operations of approximately \$462,000 as presented in the financial statements. This cash inflow was provided primarily by the decrease of \$965,000 in accounts and notes receivable and inventories.

FASB Statement No. 96, "Accounting for Income Taxes," may be adopted in either fiscal 1989 or 1990. The Company has not completed all the analysis required to estimate the impact of the new Statement, and it has not decided whether it will implement the Statement early or restate any periods. However, the adoption of Statement 96 is not expected to have an adverse impact on the Company's financial position due to its net operating loss carryforward position.

## **CORPORATE INFORMATION**

### **BOARD OF DIRECTORS**

Michael S. Bledsoe  
*Chairman and Director*

Thomas R. Fry  
*President, Chief Executive Officer,  
and Director*

Roger Clifton  
*Director*

Harry Coin  
*Director*

Robert W. Greer  
*Director*

Dennis W. Wassman  
*Director*

### **OFFICERS**

Michael S. Bledsoe  
*Chairman*

Thomas R. Fry  
*President and Chief Executive Officer*

Craig L. Morrison  
*Senior Vice President*

### **TRANSFER AGENT & REGISTRAR**

First Jersey National Bank  
Shareholder Services  
520 Pike Street, 520 Pike Tower  
Suite 2134  
Seattle, WA 98101-4004

### **LEGAL COUNSEL**

Foster, Pepper & Shefelman  
1111 Third Avenue  
Seattle, WA 98101

### **AUDITORS**

Ernst & Whinney  
999 Third Avenue, Suite 3300  
Seattle, WA 98104

### **INVESTOR RELATIONS COUNSEL**

Corporate Communications, Inc.  
200 W. Mercer, Suite 412  
Seattle, WA 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:

Thomas R. Fry, President and CEO  
4122 - 128th Avenue S.E.  
Bellevue, WA 98006



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