

U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549
FORM 10-KSB

(Mark One)

Annual report under Section 13 or 15(d) of the Securities Exchange Act of 1934 (Fee required)

For the fiscal year ended December 31, 1996

Transition report under Section 13 or 15(d) of the Securities Exchange Act of 1934 (No fee required)

For the transition period from to

Commission file number

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION

(Name of Small Business Issuer in Its Charter)

Maryland

52-1261113

(State or Other Jurisdiction of
Incorporation or Organization)

(I.R.S. Employer
Identification No.)

2021 Research Drive, Annapolis, MD

21401

(Address of Principal Executive Officer)

(Zip Code)

(410) 224-8770

(Issuer Telephone Number, Including Area Code)

SECURITIES REGISTERED UNDER SECTION 12(B) OF THE EXCHANGE ACT:

Common Stock, par value \$.01, per share

(Title of Class)

(Title of Class)

Check whether the issuer : (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for part 90 days.
Yes No

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment of this Form 10-KSB.

State issue's revenue for its most recent fiscal year. \$30,648,000

State the aggregate market value of the voting stock held by non-affiliates computed by reference to the price at which the stock was also, or the average bid and marked prices of such stock, as of a specified date within the past 60 days. (See definition of affiliate in Rule 12b-2 of the Exchange Act.) \$17,256,000

Note. IF determining whether a person is an affiliate will involve an unreasonable effort and expense, the issuer may calculate the aggregate market

value of the common equity held by non-affiliates on the basis of reasonable assumptions, if the assumptions are stated.

ISSUERS INVOLVED IN A BANKRUPTCY PROCEEDINGS
DURING THE PAST FIVE YEARS

Check whether the issuer has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Exchange Act after the distribution of securities under a plan confirmed by a court. Yes [] No []

APPLICABLE ONLY TO CORPORATE REGISTRANTS

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practicable date. 4,516,912

Transitional Small Business Disclosure Format (check one) Yes [] No [X]

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PART I

ITEM 1. DESCRIPTION OF BUSINESS.

FTI is a leading provider of litigation support services including visual communications, engineering services and trial consulting. These services are used to assist attorneys and corporations in developing trial themes and strategies, assessing the strength of their cases, and creating state-of-the-art courtroom presentations. Throughout its 15-year history, the Company has developed innovative applications for advanced technologies in the courtroom, such as computer animation and simulation, that greatly enhance the presentation of evidence and expert testimony regarding complex subjects such as airplane crashes, financial disputes, intellectual property resolutions and physical phenomena. The Company believes that increases in the volume, risk, complexity and cost of litigation have driven the need for litigation support services that utilize advanced technologies and innovative fee structures to provide competitive advantages in the courtroom on a cost-effective basis. The Company was incorporated on June 30, 1982 in the State of Maryland.

INDUSTRY OVERVIEW

The litigation process involves the efforts and services of many participants in addition to lawyers. The litigation support services market includes event investigation and analysis, expert testimony, courtroom presentation, visual packaging, computer animation and simulation, jury analysis and selection, and document preparation, storage and retrieval. Participants in the market include the Big Six accounting firms, which specialize in document management and financial due diligence, and medium size firms, such as the Company, which compete to provide multiple services on a local, regional and national basis. In addition, many small companies that rely on one or two key individuals provide services in local markets. The Company believes that the litigation support services market benefits from several broader market trends including the following:

PREVALENCE OF VISUAL COMMUNICATIONS TECHNIQUES. Over the past several years, new media, including animation and image enhancement, have become widespread throughout the general consumer marketplace. At the same time, large litigation cases have become increasingly complex and often involve sophisticated and difficult-to-understand issues, such as toxic tort, intellectual property, evaluation of failures and medical product liability. The presentation of complicated concepts are dramatically enhanced by visual presentation and 3D animation using media commonly accepted and understood by jurors. Consequently, visual technology is becoming increasingly prevalent in the courtroom.

LITIGATION MARKET. According to available statistics from the U.S. Bureau of Census, the market for legal services in the United States was estimated to be \$101 billion for 1993. As litigation expenditures have grown to become a significant expense for FORTUNE 500 companies, courtroom presentation and document management techniques have become more sophisticated. Computerized document management in cases involving millions of pages of deposition testimony and exhibits has become widely accepted in the federal and state court systems. From the clients' perspective, in virtually every case cost and quality of

service are the key elements in selecting litigation support providers. In addition, the Company believes that major users of services view efficient use of expert services, visual communications, trial consulting and technology as a way to provide early focus on the issues, chart a cost effective strategy with regard to resolution and control, and leverage the cost of fees and expenses.

COST CONSCIOUSNESS OF CORPORATIONS. As major corporations become more cost conscious and focus on reducing their legal costs, they are reengineering their management of litigation. In-house corporate general counsel are generally taking a more active role in managing both individual cases and the overall litigation caseload of the corporation. Cost control strategies currently employed include (i) convergence programs that reduce the number of outside law firms and vendors to enhance control and purchasing power, (ii) the unbundling of support services with vendor selection for individual services being increasingly managed in-house, (iii) alternative billing arrangements, such as fixed fees, value-added fees, contingent fees and competitive bidding and (iv) the outsourcing of increasingly sophisticated litigation support services, such as document management, discovery and courtroom graphics.

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BUSINESS STRATEGY

The Company's goal is to become the leading provider of value-added litigation support services. The Company's strategy includes the following key elements:

INCREASE INDUSTRY PROMINENCE. The Company believes that industry prominence is a significant competitive advantage because it facilitates access to clients, particularly large corporations that require a substantial amount of litigation support services. The Company has pursued the strategy of increasing its industry prominence through a number of means, including participation in bar association activities and conventions. In addition to these activities, the Company has developed significant client relationships with DuPont and AT&T and is continuing to pursue such relationships with other major corporations. In 1995, DuPont, considered a leader in litigation management, chose the Company to be one of its four primary litigation support service providers, and the preferred provider for visual communications and jury analysis services.

EXPANSION OF THE RANGE OF SERVICES. The Company focuses on meeting the changing litigation support needs of corporations and law firms by introducing new products and services to address client requirements and changes in the market. The Company's services generally are intended to increase the effectiveness of its clients' cases or reduce the cost and complexity of the litigation process. For example, the Company recognized that computer-based 3D animation could effectively simplify highly-complex issues in jury trials and was one of the first companies to introduce that capability.

The Company believes that the application of advances in communications and technology is essential to successfully resolving the inefficiencies of cost and time that burden the legal system today. The Company is currently developing trial presentation and case preparation hardware and software to facilitate the realization of the "paperless trial."

GEOGRAPHIC EXPANSION. The Company seeks new business opportunities by expanding its operations in strategic geographic markets. The Company believes that the ability to provide services on a nationwide basis is a competitive advantage in securing business from large, geographically diverse corporations. Furthermore, proximity to a client provides a significant cost advantage. The Company's strategy is to expand both the number of offices it maintains and the services provided by each office. Due to the fragmented nature of the litigation support services industry, the Company is presented with a significant number of opportunities to pursue this strategy through acquisition. See "Management's Discussion and Analysis of Results of Operations and Financial Conditions -- Overview."

SIZE AND CRITICAL MASS. Large litigation support contracts often require the service provider to be able to provide services on a number of matters in varying geographic locations. The Company believes that many market participants lack sufficient resources, personnel, service offerings and geographic diversity

to effectively compete for such contracts. To enhance its ability to service such contracts, the Company has pursued a strategy of increasing the number and range of skills provided by its professionals and investing in support equipment, such as animation computers.

COST EFFECTIVE DELIVERY OF SERVICE. The Company is dedicated to providing cost-effective solutions to its clients. The Company offers a disciplined project management approach to ensure adherence to the client's budgets and schedules. The Company also maintains a flexible cost structure by using a mix of employees and outside consultants. This reduces fixed overhead costs while offering solutions and expertise tailored to the specific requirements of a client's case.

PRODUCTS AND SERVICES

VISUAL COMMUNICATION AND ANIMATION ACTIVITIES. In the mid 1980s, the Company helped pioneer the concept of visual packaging and 3D computer simulation to enhance the presentation of scientific findings and other concepts. Visual packaging incorporates a wide range of exhibits for trial, including static graphics, photographs, technical illustrations, live video, computer graphics, computer animations, laser disc and models. The Company assists attorneys in focusing the issues of their case prior to trial

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and in presenting those issues in the most accurate, concise and powerful manner. The Company utilizes production and communications techniques to tailor the subject matter of a presentation or exhibit not only to the characteristics of the judge or jury, but also to the presentation skills of the attorney involved.

Through 3D animation, the Company can illustrate dynamic phenomena that cannot be portrayed in a static presentation. Such animation can then be used to provide a dramatic, true-to-physics presentation of a client's case that is easily understandable by nontechnical audiences such as a jury. The animation group recreates complicated events such as the motion of an airplane, the spread of a fire, mechanical and structural movements and forces or the movement of vehicles and bodies in an automobile accident.

The Company maintains animation capability in its San Francisco and Annapolis offices. The San Francisco office maintains 10 workstations, including four Silicon Graphics workstations, each of which is equipped with advanced simulation and animation software and is generally dedicated to performing animation assignments. An additional 12 workstations, including five Silicon Graphics workstations and software, are located in Annapolis. The use of commercially available hardware and software enhances the Company's ability to have its animations admitted into courtroom proceedings.

The Company's visual communication and animation group has been involved in cases such as the DuPont Plaza Hotel Fire in San Juan, Puerto Rico (in which the Company was the first to apply a computational fluid dynamics computer model to the analysis of fire spread), the Hunt brothers silver market case (in which the importance and flexibility of using video depositions in the courtroom was significantly expanded to allow the admission of assembled portions of selected deposition materials as opposed to the deposition in its entirety) and the Northwest Airlines DC-9 crash in Detroit, Michigan (in which the Company helped develop an animated reenactment of the crash based upon the black box data and voice recorder, allowing viewers to experience the events leading up to the crash).

The Company believes that its experience in applying visual communication techniques to litigation cases and in creating visual packages that can be admitted as evidence has contributed significantly to the development of the visual packaging marketplace and that its state-of-the-art capabilities allow it to undertake projects that others may not be able to complete as effectively or rapidly as the Company.

ENGINEERING AND SCIENTIFIC SERVICES. Since its inception, the Company has provided services in connection with the engineering and scientific investigation and analysis of failures and accidents, with Company personnel often testifying as expert witnesses in connection with the resolution of associated litigation or arbitration. The Company's engineering and scientific services include engineering and scientific analyses of complex physical

phenomena and events, including vehicle accidents; electric and gas utility failures; fires and explosions; and structural defects in buildings, towers and ships. For example, in an accident reconstruction case the Company's services may include the evaluation of highway design, signal device performance, vehicle dynamics, helmet effectiveness, mechanical failure, evasive maneuvers, visibility and vehicle operation. In the area of fires and explosions, the Company provides full-scale fire testing, fire scene laser mapping and computer fire modeling. Structural analysis assignments may include the evaluation of the design, construction, operation, and maintenance of various manmade structures, including buildings, highways, bridges, towers, tunnels, dams, airports and mechanical structures. The Company also provides analyses relating to the failure of electrical and mechanical systems and materials, including metals and composite materials; energy and utility systems; manufacturing processes and machinery, oil refineries and commercial transportation equipment. The Company has access to a wide range of experts in other disciplines including aviation, biomedical, environmental, electrical, chemical, and utility engineering, as well as marine and medical sciences.

The Company's engineering and scientific services group has been involved in a number of high profile cases beginning with the MGM Grand Hotel fire in Las Vegas (in which the Company was hired by the defendant contractor for the new Tracy Tower addition to analyze the cause of fire and smoke spread related to 85 deaths and hundreds of injuries). One of the most comprehensive investigations conducted by the Company involved the Hinsdale Telephone Central Office fire in Chicago, Illinois (in which the Company was selected by the State of Illinois to lead the investigation of the cause and loss of

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telecommunications service). After a full investigation and analyses of the Hinsdale incident, the Company formulated recommendations which formed the basis for new operating laws under the Illinois Administrative Code. The Company has continued to apply its expertise to the solution of complex investigations in other high profile incidents such as the Loma Prieta earthquake structural failures and fires, Amtrak train derailments, as well as several major airline accidents.

Through the acquisition of Teklicon, Inc. on September 30, 1996, the Company significantly enhanced its capabilities to provide high technology consulting and expert witness services to the legal profession and industry clients who require assessment of intellectual property rights and other industry problems that have high technology content. Services in support of litigation or pre-litigation research includes patent portfolio research, expert witness services and intellectual property. Teklicon's registry of experts, many of whom hold advanced degrees, provide technical expertise in a broad spectrum of disciplines including semiconductor and microelectronics, telecommunications, and computer systems architecture and design.

Since the engineering and scientific services group is often engaged soon after the occurrence of an incident and remains active through resolution, the Company has effectively used this service for cross-selling the Company's other services.

TRIAL CONSULTING SERVICES. The Company's trial consulting services group assists attorneys in developing trial strategies and pre-trial negotiation strategies by identifying key psychological factors through market research and statistical analysis to assess the impact of courtroom themes and presentations. The Company entered this market in September 1992 through the acquisition of a company which had 10 years of experience providing these types of services and the hiring of several recognized experts in the field who had been involved in such high profile cases as the Reginald Denny assault trial and the McMartin Preschool trial. Assignments range from providing jury consulting for individual cases to providing jury consulting and negotiation services for a series of cases, or even substantially all the litigation of a major corporation. Pre-trial services include attitude surveys of the relevant community to determine attitudes and characteristics of potential jurors, the use of focus groups and mock trials to test the effectiveness of various themes to be presented at trial. Jury selection services include development of juror profiles and assistance in developing questions to be asked potential jurors during the jury selection process. Trial services include assistance in critiquing witnesses to increase the clarity and effectiveness of their

presentations and assistance in developing, presenting and monitoring the impact of themes used at trial. Negotiation and settlement services include analysis of jury awards and juror profiles to assess the potential magnitude of jury verdicts. For example, in the O.J. Simpson trial, the Company conducted a community attitude survey and focus groups and provided jury selection and trial monitoring services.

NEW BUSINESS INITIATIVES. The Company is developing a desktop computer based trial management system called CB Trial(Trademark), which is designed to provide storage and retrieval to a digitized library of video information during trial. The Company believes this system's ability to store, search and retrieve video deposition information is innovative. Such information includes depositions, briefs and affidavits. The CB Trial(Trademark) system also facilitates computer graphics that allow for rapid and customized display of charts, graphs, photos and other static images.

Additionally, the Company is developing extensive capabilities in the area of interactive, multi-media presentation tools. Such tools will allow the company to expand its market beyond both litigation and the legal industry in general. In particular, the Company has developed an interactive communication tool designed to enhance internal communication within companies and/or law firms with multiple office locations. Such an application has far reaching implications towards inter and intranet access.

CLIENTS

In 1996, the Company performed worked for 1,040 clients, including 813 law firms, 55 of which were rated in the top 100 law firms in 1996 as measured by the American Lawyer based on revenues in the United States, 119 industrial clients, 20 of which were rated in the FORTUNE 500 for 1996, and 108 insurance companies, 15 of which were rated in the FORTUNE 500 for 1996. As of December 31, 1996,

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the Company was actively working on 542 different matters for 347 different clients. Major clients of the Company include DuPont and AT&T. None of the Company's clients represented more than 10% of the Company's revenues during 1996.

COMPETITION

The legal support services market is highly competitive. The Company faces various sources of competition, including several national companies and a large number of smaller firms that provide one or more services to local and regional markets. The source of competition often depends upon the services being provided by the Company. The scientific and engineering services group competes against various regional or national engineering concerns, independent experts and research organizations. The visual communications group and the trial consulting group generally compete against other litigation consulting firms and small sole proprietorships.

In addition to pricing, competitive factors for the Company's services include reputation, geographic locations, performance record, quality of work, range of services provided and existence of an on-going client relationship. On a nationwide basis, the Company's competitors include Engineering Animation, Inc., which provides animation services, Failure Analysis Associates, Inc., which provides engineering analysis services and a limited amount of animation services, Decision Quest, which provides jury analysis, visual packaging and animation services, and S.E.A., Inc., which provides engineering and limited animation services. Certain national support service providers are larger than the Company and, on any given engagement, may have a competitive advantage over the Company with respect to one or more competitive factors. In addition, smaller local or regional firms, while not offering the range of services provided by the Company often are able to provide the lowest price on a specific engagement because of their lower overhead costs and proximity to the engagement. The fragmented nature of the legal support services industry may also provide opportunities for large companies that offer complementary services to enter the market through acquisition. In the future, these and other

competitive pressures could require the Company to reduce its fees or increase its spending for marketing to attract business.

EMPLOYEES

As of December 31, 1996, the Company had 168 employees in its legal support services business. Approximately 109 of the legal support services employees are engaged in activities directly related to revenue generation, and the remaining 59 of such employees are administrative employees. The Company also maintains consulting arrangements with approximately 834 independent consultants, of which approximately 273 were utilized on Company engagements during 1996.

None of the Company's employees are covered by collective bargaining agreements. The Company considers its relationship with its employees to be good.

ITEM 2. DESCRIPTION OF PROPERTIES.

The Company leases its principal facility in Annapolis, Maryland, which totals approximately 39,104 square feet. The Company occupies 25,400 square feet in adjacent buildings under a lease that expires in December 2003. In the immediate vicinity, the Company occupies 13,704 additional square feet under a lease that expires in December 2003.

The Company also leases its regional offices in Chicago, Illinois; Houston, Texas, San Francisco, California; San Marino, California; Hayward, California; Mountain View, California; Stamford, Connecticut; and State College, Pennsylvania. The Company believes that these facilities are adequate for its current needs and that suitable additional space, should it be needed, will be available to accommodate expansion of the Company's operations on commercially reasonable terms.

The Company also owns 5,000 square feet in Germantown, Maryland from which the Company conducted the business of its former Annaplix division. The Company has agreed to lease these premises to Annaplix until March 1997.

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ITEM 3. LEGAL PROCEEDINGS.

The Company is not a party to any material litigation.

ITEM 4. SUBMISSIONS OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

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PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The Company's Common Stock has been traded on the Nasdaq National Market under the symbol FTIC since May 8, 1996. The following table sets forth for the calendar quarter indicated the high and low sales prices of the Common Stock, as reported on the Nasdaq National Market.

1996 -----	HIGH -----	LOW -----
Second Quarter (From May 8, 1996).....	10 1/2	8 3/4
Third Quarter	11 1/2	7 5/8
Fourth Quarter	11 1/4	8 1/2

As of March 25, 1996, there were an estimated 1,700 holders of record of the Common Stock.

The Company has never declared or paid any cash dividends on its Common Stock and does not expect to pay any cash dividends in the foreseeable future.

SALES OF UNREGISTERED SECURITIES

On September 30, 1996, Forensic Technologies International Corporation (the "Company"), FTI Acquisition Corporation ("Newco"), a wholly owned subsidiary of the Company, Teklicon, Inc. ("Teklicon") and The Summers 1992 Trust, Gary J. Summers and Lynda M. Summers as Trustees (the "Teklicon Sole Stockholder") entered into a Plan and Agreement of Reorganization and an Agreement of Merger whereby Newco was merged with and into Teklicon, with Teklicon as the surviving corporation. All of the outstanding capital stock of Newco was converted into a like number of shares of Common Stock, no par value, of Teklicon. The Teklicon Sole Stockholder exchanged all of the outstanding shares of capital stock of Teklicon into 415,000 shares of Common Stock, par value \$.01 per share, of the Company (the "Merger Consideration"). The Merger Consideration was based upon the Company's evaluation of the financial condition, business operations and prospects of Teklicon and was negotiated in an arms length transaction among unrelated and unaffiliated (as defined under Rule 144 promulgated by the Securities and Exchange Commission) parties. Teklicon will continue in operation as a wholly owned subsidiary of the Company. Teklicon is in the business of providing litigation support services, primarily in California, that are complimentary to the businesses of the Company.

The Company relied on Section 4(2) of the Securities Act of 1933, as the exemption for this transaction.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

SELECTED CONSOLIDATED FINANCIAL DATA

The selected financial data for the three years ended December 31, 1996 are derived from the Company's consolidated financial statements. The financial statements for the years ended December 31, 1994, 1995, and 1996 were audited by Ernst & Young LLP. The data below should be read in conjunction with the consolidated financial statements and related notes thereto included elsewhere

in this report and "Management's Discussion and Analysis of Results of Operations and Financial Condition."

	YEARS ENDED DECEMBER 31,		
	1996	1995 (3)	1994 (3)
	(IN THOUSANDS, EXCEPT PER SHARE DATA)		
Statement of Operations Data:			
Revenues	\$30,648	\$23,381	\$20,254
Direct costs of revenues.....	17,020	11,366	10,499
Selling, general and administrative expenses.....	10,786	9,887	8,320
Total costs and expenses.....	27,806	21,253	18,819
Income from operations.....	2,842	2,128	1,435
Other income (expense).....	107	(222)	(110)
Income from continuing operations before income taxes	2,949	1,906	1,325
Income taxes.....	1,235	779	552
Income from continuing operations.....	1,714	1,127	773
Loss from operations of discontinued operations, net of tax(1).....		(65)	
Loss on disposal of discontinued operations, net of tax(1)		(365)	
Net income.....	\$ 1,714	\$ 697	\$ 773
Net income per share from continuing operations, assuming full dilution(2)	\$ 0.42	\$ 0.37	\$ 0.25
Net income per share, assuming full dilution(2)	\$ 0.42	\$ 0.37	\$ 0.25
Shares used in computation.....	4,181	3,358	3,396

	AS OF DECEMBER 31,		
	1996	1995	1994
Balance Sheet Data:			
Working capital	\$13,312	\$ 2,259	\$3,368
Total assets	20,868	10,756	8,071
Long-term debt, capital lease obligations and redeemable stock.....	254	3,941	3,764
Total stockholders' equity.....	17,629	1,463	1,838

- (1) Effective March 31, 1996, the Company sold Annapplix to a group that includes Annapplix's former owner and certain officers and stockholders of the Company. See "Management's Discussion and Analysis of Results of Operations and Financial Condition," and Note 4 to the Consolidated Financial Statements.
- (2) The computation excludes \$31,400 of interest expense, net of tax in 1996, and \$86,400 of interest expense, net of tax in 1995, to adjust for the conversion of the Convertible Debentures into Common Stock on consummation of the Company's initial public offering in May 1996.
- (3) The consolidated financial statements for the year ended December 31, 1995 and 1994 have been restated to include the financial position, results of operations and cash flows of Tekicon, Inc., acquired on September 30, 1996 in a transaction accounted for as a pooling of interests. See Note 4 to "Notes to Consolidated Financial Statements."

OVERVIEW

The Company derives revenue primarily from legal cases and matters in which it is engaged to provide litigation support services. These revenues consist of (i) fees for professional services (ii) fees for use of the Company's equipment and facilities, particularly animation computers (iii) pass-through expenses such as the recruiting of subjects and participants for research surveys and mock trial activities and travel, and (iv) fees associated with work product production, such as, static graph boards, color copies and digital video production. The Company recognizes revenue as work is performed or as related expenses are incurred.

The Company's goal is to provide value added services to its litigation market clients either on a case-by-case basis or through ongoing relationships with major users of litigation services. Over the past three years, the Company has taken several steps to grow the business and its industry prominence. Such steps included acquiring Teklicon, Inc., establishing new offices in Chicago, Houston, Los Angeles, Hayward, CA and Stamford, CT, to expand its geographic coverage, expanding its visual communication staff and hiring recognized professionals in the trial consulting business. During 1993, the Company entered into a strategic alliance agreement with Arthur Andersen for a term of three years which ended on May 31, 1996.

On February 1, 1995, the Company acquired for \$200,000 in cash certain assets of a sole proprietorship doing business as "Applix Software Computer Service," and formed the Annapplix division of the Company. The Annapplix division was a provider of general data processing consulting services and network administration services, and was considered a separate segment of the Company's operations.

In January 1996, the Company determined that Annapplix was a development stage operation not strategic to the Company's business of litigation support services. Effective March 31, 1996, the Company sold Annapplix for \$150,000 to a group that include Annapplix's former owner and certain officers and stockholders of the Company. The Company recorded the results of operations and estimated loss on the sale of Annapplix as a discontinued operation in the 1995 financial statements. The estimated loss on the sale of \$365,109 includes an accrual of \$285,000 for the operating losses, net of the related income tax benefit, for the period from January 1, 1996 through March 31, 1996.

In May, 1996, the Company completed its' initial public offering raising net proceeds of \$11.1 million and issuing 1,520,000 shares of stock.

In September, 1996, the Company acquired Teklicon, Inc., in a transaction accounted for as a pooling of interests as further described in Note 4 of the Notes to Consolidated Financial Statements. This acquisition significantly enhanced the Company's capabilities in providing high technology consulting and expert witness services to the legal profession and industry clients who require assessment of intellectual property rights and other industry problems that have high technology content.

YEARS ENDED DECEMBER 31, 1996, 1995 AND 1994

REVENUES. Total revenues in 1996 increased 31.1% or \$7.3 million from 1995. Of the revenues generated in 1996, \$13.3 million or 43.5% was attributable to visual communications services, \$10.0 million or 32.7% was attributable to engineering and scientific services, \$6.6 million or 21.5% was attributable to trial consulting and \$0.7 million, or 2.3% was attributable to other revenue. The growth in total revenues resulted from a \$4.1 million or 45.8% increase in revenues generated by visual communications services and a \$3.8 million or 139.6% increase in revenues generated by trial consulting services, which was offset by a decline of \$1.1 million or 10.1% in revenues generated by engineering and scientific services. Revenues increased in the visual communications and trial consulting areas as a result of increased market penetration by the Chicago, Houston and Los Angeles offices and continued development of key relationships with major users of litigation support services. Key additions of visual and trial professionals also attracted new clients to the Company. The decrease in revenues generated by engineering and scientific services was caused primarily by the decision to pursue major corporate clients and other large users of litigation support services and to de-emphasize certain individual plaintiff-oriented vehicle accident reconstruction work.

Total revenues in 1995 increased 15.4% or \$3.1 million from 1994. Of the revenues generated in 1995, \$8.8 million or 37.6% was attributable to visual communications services, \$11.1 million or 47.5% was attributable to engineering and scientific services, \$2.9 million or 12.4% was attributable to trial consulting and \$0.6 million was attributable to other revenue. The increase in total revenues resulted primarily from a \$2.2 million or 33.3% increase in revenues generated by visual communications services and a \$1.0 million or 48.1% increase in revenues generated by trial consulting services. Revenues increased in the visual communications and trial consulting areas as a result of the Company's strategic focus on further developing these high growth businesses. This growth was achieved through relationship building with major users of litigation support services and the addition of senior employees who attracted new clients to the Company. In addition, the Company packaged its visual communication and trial consulting services as part of its strategic focus in 1995 to obtain contracts with major corporate clients.

DIRECT COST OF REVENUES. Direct cost of revenues consists primarily of billable employee compensation and related payroll benefits, the cost of consultants assigned to revenue generating activities, and other related expenses billable to clients. Direct cost of revenues as a percent of revenues increased to 55.5% in 1996 from 48.6% in 1994. The increase resulted primarily from a redirection of efforts by certain key personnel from selling, general and administrative activities to revenue generating activities. In the 1996 period, these individuals were accounted for as direct costs. Additionally, direct costs as a percentage of revenue were further impacted by increases in pass-through expenses related to trial consulting activities. The improvement in direct cost of revenues in 1995 from 1994 occurred as a result of the Company's more efficient utilization of the Company's employees and outside consultants.

SELLING GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses consist primarily of salaries and benefits paid to office and corporate staff as well as rent, marketing expenses and corporate overhead expenses. Selling, general and administrative expenses as a percent of revenues decreased to 35.2% in 1996 from 42.3% in 1995. This decrease resulted from the change in allocation of costs of key personnel as well as the fixed or semi-variable nature of many of these expenses. Selling, general and administrative expenses as a percent of revenues in 1995 was generally consistent with 1994.

OTHER INCOME AND EXPENSES. During 1994, the Company recorded a gain of \$122,000 from the sale of internally developed software. Interest expense consists of interest on a line of credit and Convertible Debentures. Additional cash raised from the initial public offering, allowed the Company to payoff the line of credit in mid-1996, thus reducing interest expense and increasing interest income during the second half of 1996. In May 1996 the \$1.8 million of 8% Subordinated Debentures converted into common stock, further contributing to the decrease in interest expense in 1996 as compared to 1995.

INCOME TAXES. The Company's effective tax rate during each of the three years in the period ended December 31, 1996 approximates 41%. See Note 12 of "Notes to Consolidated Financial Statements" for a reconciliation of the federal statutory rate to the effective tax rates during each of these years, and a summary of the components of the Company's deferred tax assets and liabilities.

LIQUIDITY AND CAPITAL RESOURCES

In 1994 and 1995, the Company's working capital needs were generally funded through cash flow from operations and borrowings under a bank line of credit. Due principally to a 31.1% growth in revenues in 1996, and the resultant increase in accounts receivable, unbilled receivables, and inventory, the Company used net cash of \$0.5 million in 1996 to fund operating activities. This needed cash was provided by the initial public offering of common stock in May 1996, which generated \$11.1 million of net proceeds to the Company. A significant portion of the Company's billings are made to clients that in turn remit such billings to third parties, such as insurance companies or product manufacturers, for payment. The Company's average collection period is approximately 110 days, while accounts payable and accrued expenses, a large portion of which consists of consultant remuneration, are generally paid within 30 to 60 days. The Company believes that expected growth in the business will require additional investments in working capital, but that the \$5.9 million of

cash at December 31, 1996 and a \$10.0 bank line of credit will be sufficient to fund its working capital needs through at least 1997.

During 1994 and 1995, the Company expensed and paid \$144,000 of interest to the holders of its 8% Convertible Debentures; similar interest in 1996 amounted to \$53,000. The Convertible Debentures

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automatically converted into Common Stock of the Company upon the closing of the Company's May 8, 1996 initial public offering of Common Stock.

On October 28, 1996 the bank line of credit was increased to provide for borrowings by the Company of up to \$10.0 million. The line of credit is secured by the receivables of the Company and expires on May 31, 1998. Outstanding balances under the line of credit bear interest below the prime rate based on specified measures of the financial condition of the Company. The line of credit requires the Company to satisfy certain specified ratios and net worth requirements (such as "cash flow coverage," "net tangible worth" and "current ratio"). At December 31, 1996, the Company had no borrowings under the line of credit.

The Company expended \$1.7 million, \$1.6 million and \$0.6 million to purchase property and equipment for the years ended December 31, 1996, 1995 and 1994, respectively. The Company expects to incur similar levels of property and equipment additions in 1997 as it implements its strategy of expanding its business into additional cities within the United States. However, no significant commitments currently exist to acquire such additional property and equipment.

The Company believes that its existing cash resources and available borrowings under the bank line of credit will be sufficient to meet anticipated cash requirements for the next 18 months. There can be no assurance that additional capital beyond the amounts currently forecasted by the Company will not be required, nor that any such required additional capital will be available on reasonable terms, if at all, at such time as required by the Company.

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ITEM 7. FINANCIAL STATEMENTS.

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY
AUDITED CONSOLIDATED FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 1996, 1995 AND 1994

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REPORT OF INDEPENDENT AUDITORS

The Board of Directors and Stockholders
Forensic Technologies International Corporation

We have audited the accompanying consolidated balance sheets of Forensic Technologies International Corporation and subsidiary as of December 31, 1996 and 1995, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1996. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of Teklicon, Inc., a wholly-owned subsidiary, for fiscal year 1995, which statements reflect total assets and total revenues constituting 8% and 13%, respectively, of the related 1995 consolidated totals. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to 1995 data included for Teklicon, Inc., is based solely on the report of other auditors.

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

In our opinion, based on our audits and, for 1995, the report of other auditors, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Forensic Technologies International Corporation and subsidiary at December 31, 1996 and 1995, and the consolidated results of their operations and their cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles.

January 31, 1997

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY
CONSOLIDATED BALANCE SHEETS

	DECEMBER 31,	
	1996	1995
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 5,893,897	\$ 244,925
Accounts receivable, less allowance of \$250,877 in 1996 and \$212,262 in 1995	6,296,599	4,633,850
Unbilled receivables, less allowance of \$125,439 in 1996 and \$164,935 in 1995	3,006,953	2,230,674
Inventory.....	332,828	--
Income taxes receivable.....	111,471	--
Deferred income taxes.....	185,926	419,310
Prepaid expenses.....	418,654	145,805
Total current assets.....	16,246,328	7,674,564
Property and equipment:		
Buildings.....	411,241	411,241
Furniture and equipment.....	8,455,373	6,576,259
Leasehold improvements.....	863,821	677,348
	9,730,435	7,664,848
Accumulated depreciation and amortization.....	(5,624,060)	(4,784,174)
	4,106,375	2,880,674
Deferred income taxes.....	--	4,090
Other assets.....	515,722	196,662
Total assets.....	\$20,868,425	\$10,755,990
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses.....	\$ 1,502,076	\$ 1,171,201
Borrowings under line of credit.....	--	2,110,391
Accrued compensation expense.....	783,108	933,841
Incomes tax payable.....	--	208,296
Current portion of capital lease obligations.....	52,804	63,463
Accrued loss on disposal of discontinued operations.....	--	478,828
Advances from clients.....	585,562	276,691
Other current liabilities.....	11,063	172,752
Total current liabilities.....	2,934,613	5,415,463
Long-term debt and capital lease obligations, less current portion	201,296	206,747
Deferred income taxes.....	103,938	--
8% Convertible Subordinated Debentures, due to stockholders	--	1,800,000
Series A Redeemable Convertible Preferred Stock, \$.01 par value, stated at redemption value	--	1,560,000
Common Stock subject to repurchase.....	--	310,930
Commitments and contingent liabilities.....	--	--
Stockholders' equity:		
Preferred stock, \$.01 par value; 4,000,000 shares authorized in 1996, none outstanding ...	--	--
Common stock, \$.01 par value:		
Class A:		
Authorized shares -- 16,000,000 in 1996 and 9,800,000 in 1995; shares issued and outstanding -- 4,516,912 in 1996 and 1,989,059 in 1995 (not subject to repurchase).....	45,169	19,891
Class B:		
Authorized shares --none in 1996 and 6,300,000 in 1995	--	15,246
Issued and outstanding shares -- none in 1996 and 1,524,600 in 1995	--	850
Additional paid-in capital.....	14,429,703	3,153,706
Retained earnings.....	3,153,706	1,455,773
Less: Unearned compensation recorded upon issuance of common stock	--	(28,910)
Total stockholders' equity.....	17,628,578	1,462,850
Total liabilities and stockholders' equity.....	\$20,868,425	\$10,755,990

See accompanying notes.

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF OPERATIONS

YEARS ENDED DECEMBER 31,

1996 1995 1994

Revenues.....	\$30,647,985	\$23,381,303	\$20,253,897
Direct cost of revenues.....	17,020,021	11,366,249	10,499,161
Selling, general and administrative expenses	10,786,421	9,886,791	8,319,848
Total costs and expenses.....	27,806,442	21,253,040	18,819,009
Income from operations.....	2,841,543	2,128,263	1,434,888
Other income (expenses):			
Interest and other income.....	286,701	41,669	172,527
Interest expense.....	(179,523)	(263,824)	(281,850)
	107,178	(222,155)	(109,323)
Income from continuing operations before income taxes.....	2,948,721	1,906,108	1,325,565
Income taxes.....	1,235,194	778,665	552,278
Income from continuing operations.....	1,713,527	1,127,443	773,287
Discontinued operations:			
Loss from discontinued operations (net of income tax benefit of \$44,460)	--	(65,074)	--
Loss on disposal of discontinued operations (net of income tax benefit of \$248,520)	--	(365,109)	--
Net income.....	\$ 1,713,527	\$ 697,260	\$ 773,287
Earnings Per Share Data:			
Per common and common equivalent share:			
Income from continuing operations.....	\$ 0.45	\$ 0.49	\$ 0.33
Net income.....	\$ 0.45	\$ 0.31	\$ 0.33
Per common share, assuming full dilution:			
Income from continuing operations.....	\$ 0.42	\$ 0.37	\$ 0.25
Net income.....	\$ 0.42	\$ 0.23	\$ 0.25

See accompanying notes.

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

	CLASS A COMMON STOCK	CLASS B COMMON STOCK	ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS	UNEARNED COMPENSATION	TOTAL
Balance at January 1, 1994.....	\$22,610	\$ 19,152	\$ 1,118,754	\$ 339,532	\$ (139,073)	\$ 1,360,975
Award of 323,400 shares of Class B Common Stock under the 1992 Employee Stock Bonus Award Program.....		3,234	8,316			11,550
Repurchase of 550,200 shares of Class B Common Stock		(5,502)	(14,148)			(19,650)
Repurchase of 29,400 shares of Class A Common Stock.....	(294)			(104,706)		(105,000)
Purchase of options to purchase 105,000 shares of Class A Common Stock.....			(125,000)			(125,000)
Amortization of unearned compensation ..					66,789	66,789
Dividends paid on Series A Redeemable Convertible Preferred Stock (\$.19 per share).....				(124,800)		(124,800)
Net income for 1994.....				773,287		773,287
Balance at December 31, 1994.....	22,316	16,884	987,922	883,313	(72,284)	1,838,151
Repurchase of 163,800 shares of Class B Common Stock		(1,638)	(4,212)			(5,850)
Repurchase of 184,514 shares of Class A						

Common Stock.....	(1,845)		(722,510)			(724,355)
Amortization of unearned compensation ...				43,374		43,374
Dividends paid on Series A Redeemable Convertible Preferred Stock (\$.19 per share).....			(124,800)			(124,800)
Reclassification of Class A Common Stock subject to repurchase.....	(580)		(310,350)			(310,930)
Other.....			50,000			50,000
Net income for 1995.....			697,260			697,260
Balance at December 31, 1995.....	19,891	15,246	850	1,455,773	(28,910)	1,462,850
Repurchase of 8,400 shares of Class B Common Stock		(84)		(216)		(300)
Repurchase of 54,709 shares of Class A Common Stock.....	(547)		(104,818)	(24,895)		(130,260)
Issuance of 1,520,000 shares of Common Stock, net of expenses of \$1,671,461 in initial public offering of stock	15,200		11,101,340			11,116,540
Conversion of Class B Common Stock into 15,162 shares of Common Stock	151	(15,162)	15,011			--
Conversion of Series A Preferred Stock into 655,200 shares of Common Stock	6,552		1,553,448			1,560,000
Conversion of Convertible Subordinated Debt in 378,000 shares of Common Stock .	3,780		1,796,220			1,800,000
Value of common stock options issued to directors.....			29,000			29,000
Exercise of options to purchase 14,200 shares of Class A Common Stock.....	142		38,652			38,794
Amortization of unearned compensation ...				28,910		28,910
Dividends paid on Series A Preferred Stock.....				(62,396)		(62,396)
Accounting adjustment due to pooling-of-interests.....				71,913		71,913
Net income for 1996.....			1,713,527			1,713,527
Balance at December 31, 1996.....	\$45,169	\$ --	\$14,429,703	\$3,153,706	\$ --	\$17,628,578

See accompanying notes.

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FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION AND SUBSIDIARY
CONSOLIDATED STATEMENTS OF CASH FLOWS

	YEARS ENDED DECEMBER 31,		
	1996	1995	1994
Operating activities			
Net income.....	\$ 1,713,527	\$ 697,260	\$ 773,287
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation.....	757,201	637,837	864,596
Amortization.....	105,597	20,835	17,152
Provision for doubtful accounts.....	(881)	168,714	41,370
Deferred income taxes.....	341,412	(217,921)	(139,424)
Loss on disposal of discontinued Annapplix division....	(478,828)	613,629	--
Other.....	135,661	92,263	(55,200)
Changes in operating assets and liabilities:			
Accounts receivable.....	(1,701,364)	(971,907)	28,624
Unbilled receivables.....	(723,398)	(423,885)	(307,329)
Inventory.....	(332,828)	--	--
Income taxes receivable/payable.....	(319,767)	--	121,867
Prepaid expenses.....	(266,383)	(9,228)	45,367
Accounts payable.....	330,875	560,709	(317,408)
Accrued compensation expense.....	(220,922)	527,455	59,885
Income taxes payable.....	--	96,732	166,297
Advances from clients.....	308,871	(333,333)	(333,333)
Other current liabilities.....	(161,689)	64,802	(214,624)
Net cash provided by (used in) operating activities	(512,916)	1,523,962	751,127
Investing activities			
Proceeds from sale of marketable securities.....	--	--	202,370
Purchase of property and equipment.....	(1,671,502)	(1,608,939)	(625,454)
Acquisition of Applix Software Computer Service	--	(200,000)	--
Acquisition of Anamet Laboratories, Inc.....	(400,000)	--	--

Purchase of other assets.....	(238,397)	(40,975)	(96,934)
Net cash used in investing activities.....	(2,309,899)	(1,849,914)	(520,018)
Financing activities			
Issuance of Class A Common Stock.....	11,116,540	--	--
Repurchase of Class A Common Stock.....	(130,260)	(724,355)	(65,000)
Repurchase of Class A Common Stock subject to repurchase and Class B Common Stock	(311,230)	(5,850)	(19,650)
Proceeds from issuance of Class B Common Stock	--	--	11,550
Exercise of stock options.....	38,794	--	--
Net borrowing (repayments) under line of credit	(2,110,391)	1,538,152	(242,761)
Payments of capital lease obligations.....	(69,270)	(358,188)	(434,970)
Dividends paid.....	(62,396)	(124,800)	(124,800)
Net cash provided by (used in) financing activities	8,471,787	324,959	(875,631)
Net increase (decrease) in cash and cash equivalents ...	5,648,972	(993)	(644,522)
Cash and cash equivalents at beginning of year	244,925	245,918	890,440
Cash and cash equivalents at end of year.....	\$ 5,893,897	\$ 244,925	\$ 245,918

See accompanying notes.

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Forensic Technologies International Corporation and Subsidiary
Notes to Consolidated Financial Statements

DECEMBER 31, 1996

1. DESCRIPTION OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION OF FINANCIAL STATEMENTS

DESCRIPTION OF BUSINESS

Forensic Technologies International Corporation and subsidiary (the Company) provides communication, engineering, and other trial support services to the litigation industry. These services include event investigation and analysis, expert testimony, courtroom visual presentation, computer animation and simulation, jury analysis and selection, exposure assessment and computerized document storage and retrieval. The Company has nine offices serving all regions of the United States.

On September 30, 1996 the Company acquired all of the outstanding common stock of Teklicon, Inc. ("Teklicon") in exchange for 415,000 shares of common stock. The acquisition was accounted for as a pooling of interests and, accordingly, the Company's financial statements have been restated for all periods prior to the merger to include the financial position, results of operations, and cash flows of Teklicon. The accompanying consolidated balance sheet at December 31, 1995 includes the financial position of Teklicon at March 31, 1996, the fiscal year-end of Teklicon. The accompanying consolidated statements of operations, stockholders' equity and cash flows for the years ended December 31, 1994 and 1995 include the results of operations and cash flows of Teklicon for its fiscal years ended March 31, 1995 and 1996, respectively.

PRINCIPLES OF CONSOLIDATION

The consolidated financial statements include the accounts of a wholly-owned subsidiary. All significant intercompany transactions have been eliminated.

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

The Company uses estimates to determine the amount of the allowance for doubtful accounts necessary to reduce accounts receivable and unbilled receivables to their expected net realizable value. The Company estimates the amount of the required allowance by reviewing the status of significant past-due receivables and analyzing historical bad debt trends. The Company has not experienced significant variations in the estimate of the allowance for doubtful accounts, due primarily to credit policies, collection experience, and a lack of concentrations of accounts receivable. Accounts receivable balances are not collateralized.

SIGNIFICANT ACCOUNTING POLICIES

CASH EQUIVALENTS

The Company considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents.

INVENTORY

Inventory, consisting of computer software, is stated at the lower of cost (first-in, first-out) or market value.

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Forensic Technologies International Corporation and Subsidiary Notes to Consolidated Financial Statements - (Continued)

PROPERTY AND EQUIPMENT

Property and equipment is stated at cost and depreciated using the straight-line method. Buildings are depreciated over a period of 40 years, furniture and equipment is depreciated over estimated useful lives ranging from 5 to 7 years, and leasehold improvements are amortized over the lesser of the estimated useful life of the asset or the lease term.

REVENUE RECOGNITION

The Company derives most of its revenues from professional service activities. The majority of these activities are provided under "time and materials" billing arrangements, and revenues, consisting of billed fees and expenses, are recorded as work is performed and expenses are incurred. Revenues recognized in excess of amounts billed to clients have been recorded as unbilled receivables in the accompanying consolidated balance sheets.

The Company also enters into fixed price contracts for its litigation support services that are accounted for using the percentage-of-completion method. Income for these contracts is recognized based on the percentage of contract completion determined by the total expenses incurred to date as a percentage of total estimated expenses at the completion of the contract.

DIRECT COST OF REVENUES

Direct cost of revenues consists primarily of billable employee compensation and related payroll benefits, the cost of consultants assigned to revenue generating activities, and direct expenses billable to clients. Direct cost of revenues does not include an allocation of overhead costs.

ACCOUNTING FOR IMPAIRMENT OF LONG-LIVED ASSETS AND FOR LONG-LIVED ASSETS TO BE DISPOSED OF

In 1995 the Company adopted the provisions of Financial Accounting Standards Board Statement No. 121, Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of, issued in March 1995. The Statement prescribes the accounting for the impairment of long-lived assets, such as property, plant and equipment and intangible assets, as well as the accounting for long-lived assets that are held for disposal. The adoption of this Statement in 1995 did not have a material impact on the reported results of operations of the Company.

STOCK OPTIONS GRANTED TO EMPLOYEES

The Company records compensation expense for all stock-based compensation

plans using the intrinsic value method prescribed by APB Opinion No. 25, Accounting for Stock Issued to Employees. In October 1995 the Financial Accounting Standards Board issued FASB Statement No. 123, Accounting for Stock-Based Compensation ("Statement 123"), which encourages companies to recognize expense for stock-based awards based on their estimated value on the date of grant. Statement 123, effective for 1996, does not require companies to change their existing accounting for stock-based awards, but if the new fair value method is not adopted, pro forma income and earnings per share data should be provided in the notes to the financial statements. The Company has supplementally disclosed in Note 11 the required pro forma information as if the fair value method had been adopted.

INCOME TAXES

The Company uses the liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

2. EARNINGS PER SHARE

HISTORICAL EARNINGS PER SHARE

The following table summarizes the computations of share amounts used in the computation of earnings per share presented in the accompanying consolidated statements of operations.

	DECEMBER 31,		
	1996	1995	1994
PER COMMON AND COMMON EQUIVALENT SHARE:			
Weighted average number of shares of common stock outstanding during the period	3,590,911	2,157,606	2,279,063
Options to purchase common stock issued within one year of registration statement	15,475	41,700	41,700
Dilutive effect of other options and warrants	188,027	83,530	41,686
Total common and common equivalent shares of stock considered outstanding during the year	3,794,413	2,282,836	2,362,449
PER COMMON SHARE, ASSUMING FULL DILUTION:			
Weighted average number of shares of common stock outstanding during the period	3,590,911	2,157,606	2,279,063
Options to purchase common stock issued within one year of registration statement	15,475	41,700	41,700
Dilutive effect of other options and warrants	196,072	125,373	41,686
Assumed conversion of Series A Redeemable Convertible Preferred Stock at beginning of year	239,882	655,200	655,200
Assumed conversion of 8% Convertible Subordinated Debentures at beginning of year	138,393	378,000	378,000
Total fully diluted securities considered outstanding during the year	4,180,733	3,357,879	3,395,649

HISTORICAL EARNINGS PER SHARE

Earnings per common and common equivalent share is based upon the average number of shares of common stock outstanding during each year, adjusted for the dilutive effect of common stock equivalents determined using the treasury stock method. As required by the Securities and Exchange Commission, all options to purchase common stock issued by the Company at exercise prices below the initial public offering price during the twelve-month period prior to the initial public offering date have been included in the computations as

if they were outstanding for all periods included in the initial public offering registration statement, which included the 1994 and 1995 annual periods and the first three months of 1996.

Earnings per common share, assuming full dilution, is calculated on the same basis as the previously described primary computation, except that the calculation in 1994, 1995 and 1996 assumes that the Series A Redeemable Convertible Preferred Stock and the 8% Convertible Subordinated Debentures were converted on the first day of the fiscal year, and that the fair value of the Company's common stock on the last day of the fiscal year (rather than the average fair value during the year) is used to determine the dilutive effect of stock options.

SUPPLEMENTAL EARNINGS PER SHARE

Earnings per common and common equivalent share in 1996, assuming that the Series A Redeemable Preferred Stock and the 8% Convertible Subordinated Debentures were converted into common stock at the beginning of 1996, is \$0.42.

Forensic Technologies International Corporation and Subsidiary
Notes to Consolidated Financial Statements - (Continued)

3. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

The Company paid interest of \$241,536, \$491,375 and \$276,839 and income taxes of \$1,213,228, \$628,984 and \$408,272 during fiscal years 1996, 1995 and 1994, respectively.

4. ACQUISITIONS AND DISCONTINUED OPERATIONS

TEKLICON, INC.

On September 30, 1996, the Company issued 415,000 shares of its common stock for all of the outstanding common stock of Teklicon. Teklicon is based in Mountain View, California and provides expert witness testimony to attorneys and businesses. The merger has been accounted for as a pooling-of-interests and, accordingly, the Company's financial statements have been restated for all periods prior to the acquisition to include the financial position, results of operations and cash flows of Teklicon. Revenues and net income for the individual entities are as follows:

	FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION	TEKLICON	COMBINED
	-----	-----	-----
Year ended December 31, 1994:			
Revenues	\$17,547,055	\$2,706,842	\$20,253,897
Net income	\$ 638,830	\$ 134,457	\$ 773,287
Year ended December 31, 1995:			
Revenues	\$20,327,739	\$3,053,564	\$23,381,303
Net income (loss)	\$ 705,893	\$ (8,633)	\$ 697,260
Nine months ended September 30, 1996 (unaudited):			
Revenues	\$20,338,661	\$2,208,523	\$22,547,184
Net income (loss)	\$ 1,494,797	\$ (52,504)	\$ 1,442,293

APPLIX SOFTWARE COMPUTER SERVICE

On February 1, 1995, the Company acquired for \$200,000 in cash certain assets of a sole proprietorship doing business as "Applix Software Computer Service", and formed the Annapplix division of the Company. The Annapplix

division is a provider of general data processing consulting services and network administration services, and is considered a separate segment of the Company's operations.

The acquisition was accounted for using the purchase method of accounting and the results of operations of the acquired business are included in the accompanying 1995 consolidated statement of operations from February 1, 1995, the date of acquisition, through December 31, 1995. The excess of the cost of the acquisition over the fair value of the assets acquired of \$135,604 was recorded as goodwill.

Forensic Technologies International Corporation and Subsidiary
Notes to Consolidated Financial Statements - (Continued)

In January 1996, the Board of Directors and management of the Company committed to a formal plan to sell the Annaplix division based on an assessment that the division was not complementary to its core litigation support services. In March 1996, the Company agreed to sell the division to a group including the former owner and certain other officers and stockholders of the Company. The Company sold the furniture, equipment, and intangible assets of the division in exchange for cash of \$150,000, and retained ownership of billed and unbilled accounts receivable, buildings and accounts payable. The effective date of the sale was April 1, 1996.

The Company recorded the results of operations and estimated loss on the sale of Annaplix as a discontinued operation in the 1995 consolidated financial statements. The estimated loss on the sale of \$365,109 included an accrual of \$285,000 for the operating losses, net of the related income tax benefit, for the period from January 1, 1996 through March 31, 1996, the date of disposal.

During 1995, Annaplix reported revenues of \$3.2 million and loss before an income tax benefit of \$109,534. Expenses attributable to the segment include interest expense related to debt incurred to purchase assets used by the division and an allocation of \$80,000 of other consolidated interest that is not directly attributable to or related to other operations. The allocated interest, consisting of interest expense on a line of credit, is allocated based on the ratio of the net assets sold to total consolidated net assets excluding the balance of the line of credit.

5. BORROWINGS UNDER LINE OF CREDIT

The Company has a demand line of credit with a bank expiring on May 31, 1998 under which the Company may borrow up to \$10.0 million, subject to restrictions based on the available collateral. Borrowings under this line of credit bear interest at prime plus variable percentages, and are secured by accounts receivable and unbilled receivables. The estimated average borrowing rate during 1996, 1995 and 1994 was 8.0%, 8.3% and 8.1%, respectively. In connection with this credit line, the Company is required to maintain a minimum tangible net worth and comply with certain financial ratios and covenants.

6. LONG-TERM DEBT AND CAPITAL LEASE OBLIGATIONS

LONG-TERM DEBT

Long-term debt consists of a \$79,920 mortgage note payable to a bank bearing interest at the prime rate plus 1.5% (9.75% at December 31, 1996) and secured by the related building. The note requires monthly interest payments of \$444 through December 1, 1998 and a lump-sum payment of the entire principal on January 1, 1999.

CAPITAL LEASES

The Company leases furniture and equipment under capital leases. Property and equipment includes the following amounts for leases that have been capitalized:

Furniture and equipment.....	\$2,529,450	\$2,476,290
Less accumulated amortization.....	2,284,052	2,148,630
	-----	-----
	\$ 245,398	\$ 327,660
	=====	=====

Amortization of leased assets is included in depreciation and amortization expense.

Forensic Technologies International Corporation and Subsidiary
Notes to Consolidated Financial Statements - (Continued)

Future minimum payments under capital lease obligations consist of the following at December 31, 1996:

1997	\$ 57,695
1998	46,070
1999	44,906
2000	41,946
2001	5,389

Total minimum lease payments	196,006
Amounts representing interest	21,826

Present value of net minimum lease payments (including current portion of \$52,804)	\$174,180
	=====

7. CONVERTIBLE SUBORDINATED DEBENTURES

On July 21, 1994 the Company issued \$1,800,000 of 8% Convertible Subordinated Debentures (the "Debentures") to its stockholders, due no later than July 15, 2000. During 1996, 1995 and 1994, the Company expensed and paid approximately \$74,000, \$144,000 and \$144,000, respectively, of interest to the holders of the Debentures.

In May 1996 the Company completed its initial public offering and the Debentures converted into 378,151 shares of Class A Common Stock.

8. STOCK SPLIT

On January 26, 1996, the Board of Directors approved a 4.2-for-1 stock split of the Company's Class A Common Stock. The application of anti-dilution provisions effectively resulted in a 4.2-for-1 split of the Class B Common Stock and Series A Redeemable Preferred Stock. The stated par values of the common and preferred stocks were not changed. All share and per share amounts have been restated to retroactively reflect the split of the Class A Common Stock and effective split of the Class B Common Stock and Series A Redeemable Preferred Stock.

9. SERIES A REDEEMABLE CONVERTIBLE PREFERRED STOCK

The Company had authorized the issuance of 655,200 shares of Series A Redeemable Convertible Preferred Stock ("Preferred Stock"). At December 31, 1995 and 1994, 655,200 shares were outstanding. Each share of Preferred Stock converted into 655,200 shares of Class A Common Stock immediately prior to the closing of the Company's initial public offering in May 1996. The holders of the Preferred Stock had certain rights, including redemption rights, and were entitled to receive, when declared by the Board of Directors, cumulative semi-annual dividends at the annual rate of \$.19 per share.

10. EMPLOYEE STOCK BONUS AWARD PROGRAM AND CLASS B COMMON STOCK

In 1992 the Company adopted the 1992 Employee Stock Bonus Award Program (the Program) which authorized the issuance of 1,500,000 shares of Class B Common Stock. Each employee under the level of senior management was eligible to

receive shares under the Program. The Company issued 323,400 shares during 1994 under the Program. Compensation charged to selling, general and administrative expense during 1994 related to these awards was \$11,550.

Forensic Technologies International Corporation and Subsidiary
Notes to Consolidated Financial Statements - (Continued)

The Company determined the amount of compensation expense to record based on an estimate of the value of the Class B Common Stock at the date of grant, as approved by the Board of Directors. The estimated value of 100 shares of Class B Common Stock was equal to the estimated value of one share of Class A Common Stock (the conversion rate of Class B Common Stock into Class A Common Stock). The estimated value of Class B Common Stock granted to employees was \$.0357 per share in 1994.

The Class B Common Stock automatically converted into 15,162 shares of Class A Common Stock upon the closing of the Company's initial public offering in May 1996, and the Program was terminated.

11. STOCK OPTION PLAN

The 1992 Stock Option Plan ("the Plan") was approved by the stockholders of the Company in May 1992. The Plan provides for the granting to key employees and directors of incentive and non-qualified stock options to purchase up to 1,212,548 shares of common stock. Incentive stock options granted under the Plan allow for the purchase of common stock at prices not less than the fair market value of the common stock at the date of grant for a term of no more than ten years. Non-qualified stock options granted under the plan allow for the purchase of common stock at prices not less than 50% of the fair market value of the common stock at the date of grant, for a term of no more than ten years. Vesting provisions for individual awards are at the discretion of the Board of Directors.

The following table summarizes the option activity under the Plan for the three-year period ended December 31, 1996:

	1996	1996 WEIGHTED AVERAGE EXERCISE PRICE	1995	1994
Options outstanding at January 1	242,659	\$3.14	209,059	125,059
Options granted	353,600	\$7.59	35,700	84,000
Options exercised	(14,200)	\$2.73	--	--
Options forfeited	(5,880)	\$3.57	(2,100)	--
Options outstanding at December 31	576,179	\$5.88	242,659	209,059
Options exercisable at December 31	206,899	\$3.58	103,849	--
Weighted average exercise price per share for options granted during the year	\$ 7.59		\$ 4.76	\$ 3.57
Weighted average exercise price per share of outstanding options at end of year	\$ 5.88		\$ 3.13	\$ 2.86
Weighted average fair value of options granted during the year	\$ 1.56		\$ 0.25	\$ --

All options granted under the Plan have been granted with an exercise price equal to the fair value of the Company's common stock on the date of grant. Of the options exercised in 1996, 10,000 were exercised at \$2.38 per share and 4,200 were exercised at \$3.57 per share. Exercise prices for options outstanding as of December 31, 1996 ranged from \$2.38 to \$9.38. The weighted average remaining contractual life of those options is 8.3 years.

Forensic Technologies International Corporation and Subsidiary
Notes to Consolidated Financial Statements - (Continued)

PRO FORMA DISCLOSURE REQUIRED BY STATEMENT 123

To determine the pro forma data required by Statement 123 for 1996 and 1995, the Company used option pricing models to measure the fair value of options at the date of grant. For all option grants in 1995 and prior to May 1996 (the initial public offering date), the Company used the minimum value method to calculate pro forma compensation expense. For all 1996 grants after May 1996, the Company used the Black-Scholes option pricing model.

The minimum value method calculates the fair value of options as the excess of the estimated fair value of the underlying stock at the date of grant over the present value of both the exercise price and the expected dividend payments, each discounted at the risk-free rate, over the expected life of the option. In determining the estimated fair value of the granted stock options under the minimum value method, the risk-free rate was assumed to be 5.50%, the dividend yield was estimated to be 0%, and the expected life of the granted options varied from one to three years depending upon the vesting period.

Options valued using the Black-Scholes option pricing model assumed the following: risk-free interest rate of 5.50%, dividend yields of 0%, a volatility factor of .445, and an expected life of the granted options which varied from one to three years depending upon the vesting period.

The Black-Scholes option pricing model and other models were developed for use in estimating the fair value of traded options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because the Company's stock options have characteristics significantly different from those of traded options and because changes in the subjective input assumptions can materially affect the fair value estimate, in management's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its stock options.

For purposes of pro forma disclosures, the estimated fair value of the options is amortized to expense over the options' vesting period. The Company's pro forma net income is \$1,585,381 and \$688,335 for the years ended December 31, 1996 and 1995, respectively. Pro forma earnings per common and common equivalent share is \$0.42 and \$0.31 for the years ended December 31, 1996 and 1995, respectively. Pro forma earnings per share, assuming full dilution, is \$0.39 and \$0.23 for the years ended December 31, 1996 and 1995, respectively. The effect of compensation expense from stock options on 1995 pro forma net income reflects only the vesting of options granted in 1995, and all 1995 option grants vested immediately. The effect of compensation expense from stock options on 1996 pro forma net income reflects only the vesting of 1996 awards, which, depending on the individual grant, vest over one year, two years, or three years. Because most of the options granted vest over a three-year period, not until 1998 is the full effect of recognizing compensation expense for stock options representative of the possible effects on pro forma net income for future years.

12. INCOME TAXES

Significant components of the Company's deferred tax assets and liabilities at December 31 are as follows:

	-----	-----
Deferred tax assets:		
Allowance for doubtful accounts.....	\$154,698	\$150,879
Loss on disposal of discontinued Annaplix division....	--	246,097
Accrued vacation.....	80,436	64,030
Accrued bonus.....	6,666	55,556
Alliance agreement revenue.....	--	10,756
	-----	-----
Total deferred tax assets.....	241,800	527,318
Deferred tax liabilities:		
Use of cash basis for income tax purposes by		
subsidiary	20,840	79,831
Capitalized software.....	103,938	--
Prepaid expenses.....	35,034	24,087
	-----	-----
Total deferred tax liabilities.....	159,812	103,918
	-----	-----
Net deferred tax asset.....	\$ 81,988	\$423,400
	=====	=====

Income tax expense (benefit) attributable to continuing operations consisted of the following:

	1996	1995	1994
	-----	-----	-----
Current:			
Federal.....	\$ 725,981	\$575,119	\$ 539,555
State.....	167,801	152,085	152,147
	-----	-----	-----
	893,782	727,204	691,702
Deferred (benefit):			
Federal.....	268,795	37,714	(109,423)
State.....	72,617	13,747	(30,001)
	-----	-----	-----
	341,412	51,461	(139,424)
	-----	-----	-----
	\$1,235,194	\$778,665	\$ 552,278
	=====	=====	=====

The Company's provision for income taxes from continuing operations resulted in effective tax rates that varied from the statutory federal income tax rate as follows:

	1996	1995	1994
	-----	-----	-----
Expected federal income tax provision at			
34%.....	\$1,002,565	\$648,077	\$450,692
Expenses not deductible for tax purposes	47,688	31,383	20,886
State income taxes, net of federal benefit	158,676	107,295	74,375
Other.....	26,265	(8,090)	6,325
	-----	-----	-----
	\$1,235,194	\$778,665	\$552,278
	=====	=====	=====

13. OPERATING LEASES

The Company leases office space under noncancelable operating leases that

expire in various years through 2003. The leases for certain office space contain provisions whereby the future rental payments may be adjusted for increases in maintenance and insurance above specified amounts. The Company also leases certain furniture and equipment in its operations under operating leases having initial terms of less than one year.

Future minimum payments under noncancelable operating leases with initial terms of one year or more consist of the following at December 31, 1996:

1997.....	\$ 908,255
1998.....	757,075
1999.....	555,172
2000.....	446,486
2001.....	473,963
Thereafter.....	817,385

Total minimum lease payments.....	\$3,958,336
	=====

Rental expense consists of the following:

	1996	1995	1994
	-----	-----	-----
Furniture and equipment.....	\$ 96,454	\$ 99,146	\$ 79,450
Office and storage	839,387	818,862	863,280
	-----	-----	-----
	\$935,841	\$918,008	\$942,730
	=====	=====	=====

14. EMPLOYEE BENEFIT PLAN

The Company maintains a qualified defined contribution plan which covers substantially all employees. Under the plan, participants are entitled to make both pre-tax and after-tax contributions. The Company matches a percentage of participant contributions, limited to 6% of the participant's eligible compensation. The percentage match is based on each participant's respective years of service. The Company recorded expense of \$146,020, \$116,201 and \$102,175 during 1996, 1995 and 1994, respectively, related to this plan.

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ITEM 8. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

None.

PART III

The information called for by Items 9 to 12 is incorporated by reference from the Forensic Technologies International Corporation Notice of 1997 Annual Meeting and Proxy Statement, to be filed pursuant to Regulation 14A not later than April 30, 1997.

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS.

ITEM 10. EXECUTIVE COMPENSATION.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K.

(a) Index to Exhibits

- *3.i Amended and Restated Articles of Incorporation of Forensic Technologies International Corporation.
- *3.ii Bylaws of Forensic Technologies International Corporation.
- ***10.1 Financing and Security Agreement dated October 28, 1996, between the Company and NationsBank, N. A. regarding a revolving credit facility in the maximum amount of \$10 million.
- *10.2 1992 Stock Option Plan, as amended.
- *10.3 Employment Agreement dated as of January 1, 1996 between Forensic Technologies International Corporation and Jack B Dunn, IV.
- *10.4 Employment Agreement dated as of January 1, 1996 between Forensic Technologies International Corporation and Joseph R. Reynolds, Jr.
- *10.5 Employment Agreement dated as of January 1, 1996 between Forensic Technologies International Corporation and Daniel W. Luczak.
- **10.6 Agreement and Plan of Reorganization dated September 30, 1996 by and among The Company, Newco, Teklicon, Inc. and the Sole Shareholder.
- **10.7 Agreement of Merger dated September 30, 1996 by and among the Company, Newco, Teklicon, Inc. and the Sole Shareholder.
- 11. Computation of Per Share Earnings (included in Note 2 to the Consolidated Financial Statements included in Item 7., herein).
- 21. Subsidiaries
The Company's only subsidiary is Teklicon, Inc., incorporated in California
- ***23. Consent of Ernst & Young
- ***27. Financial Data Schedule

(b) Reports on Form 8-K

- **1. Form 8-K filed on October 15, 1996, regarding the acquisition of Teklicon, Inc.
- **2. Form 8-K filed on November 27, 1996, with financial information regarding the acquisition of Teklicon, Inc.
- **3. Form 8-K filed on December 31, 1996 regarding the restatement of the Company's financial statements for the years ended December 31, 1995 and 1994, to include the acquisition of Teklicon, Inc., accounted for as a pooling of interests basis.

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- * Filed as an exhibit to the Company's Registration Statement on Form SB-1, as

amended (File No. 333-2002) and incorporated herein by reference.

** Filed as an exhibit the Form 8-K on October 15, 1996 and incorporated herein by reference.

*** Filed as an exhibit to this Form 10-KS

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities and Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION

Date: March 31, 1997 By /s/ Jack B. Dunn, IV

Jack B. Dunn, IV
Chief Executive Officer and President

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the date indicated.

Table with 3 columns: SIGNATURE, TITLE, DATE. Rows include Jack B. Dunn, IV; Gary Sindler; Daniel W. Luczak; Joseph R. Reynolds, Jr.; James A. Flick, Jr.; Peter F. O'Malley; Dennis J. Shaughnessy; George P. Stamas.

FINANCING AND SECURITY AGREEMENT

THIS FINANCING AND SECURITY AGREEMENT (the "Agreement") is made this day of October, 1996, by and among FORENSIC TECHNOLOGIES INTERNATIONAL 28th CORPORATION, a Maryland corporation (the "Borrower"), the Subsidiary listed on the signature page hereto, and NATIONSBANK, N.A., a national banking association, its successors and assigns (the "Lender").

RECITALS

A. The Borrower has applied to the Lender for a revolving credit facility in the maximum principal amount of Ten Million Dollars (\$10,000,000) to be used by the Borrower primarily to support working capital needs and for general corporate purposes, including, but not limited to, financing Bank Financed Acquisitions (as hereinafter defined).

B. The Lender is willing to make the credit facility available to the Borrower upon the terms and subject to the conditions hereinafter set forth.

AGREEMENTS

NOW, THEREFORE, in consideration of the premises, the mutual agreements herein contained, and other good and valuable consideration, the receipt and sufficiency of which are hereby acknowledged, the Borrower, each Subsidiary and the Lender hereby agree as follows:

I. DEFINITIONS

SECTION 1.01 CERTAIN DEFINED TERMS. As used in this Agreement, the terms defined in the Preamble and Recitals hereto shall have the respective meanings specified therein, and the following terms shall have the following meanings:

"Account" individually and "Accounts" collectively mean all presently existing or hereafter acquired or created accounts, accounts receivable, contract rights, notes, drafts, instruments, acceptances, chattel paper, leases and writings evidencing a monetary obligation or a security interest in or a lease of goods, all rights to receive the payment of money or other consideration under present or future contracts (including, without limitation, all rights to receive payments under presently existing or hereafter acquired or created letters of credit), or by virtue of merchandise sold or leased, services rendered, loans and advances made or other considerations given, by or set forth in or arising out of any present or future chattel paper, note, draft, lease, acceptance, writing, bond, insurance policy, instrument, document or general intangible, and all extensions and renewals of any thereof, all rights under or arising out of present or future contracts, agreements or general interest in merchandise which gave rise to any or all of the foregoing, including all goods, all claims or causes of action now existing or hereafter arising in connection with or under any agreement or document or by operation of law

or otherwise, all collateral security of any kind (including real property mortgages) given by any person with respect to any of the foregoing and all proceeds (cash and non-cash) of the foregoing.

"Affiliate" means, with respect to the Borrower, any Person, directly or indirectly controlling, directly or indirectly controlled by, or under direct or indirect common control with the Borrower or any Subsidiary, as the case may be.

"Agreement" means this Financing and Security Agreement and all amendments, modifications and supplements hereto which may from time to time become effective in accordance with the provisions of Section 11.10 hereof.

"Assets" means, at any time, all assets that should, in accordance with GAAP consistently applied, be classified as assets on a combined balance sheet of the Borrower and its Subsidiaries.

"Bank Financed Acquisitions" shall have the meaning set forth in Section 8.04 (b).

"Banking Day" shall mean any day that is not a Saturday, Sunday or banking holiday in the State of Maryland

"Borrowing Base" means eighty percent (80%) of the Eligible Billed Receivables and forty percent (40%) of the Eligible Unbilled Receivables.

"Collateral" shall mean all of the Borrower's Accounts, chattel paper, documents and instruments (whether or not designated with initial capital letters), as those terms are defined in the Uniform Commercial Code as presently adopted and in effect in the State and shall also cover, without limitation, (i) any and all property specifically included in those respective terms in this Agreement or in the Financing Documents and (ii) all proceeds (cash and non-cash, including, without limitation, insurance proceeds) of the foregoing.

"Collection" means each check, draft, cash, money, instrument, item, and other remittance in payment or on account of payment of the Accounts or otherwise with respect to any Collateral, including, without limitation, cash proceeds of any returned, rejected or repossessed goods, the sale or lease of which gave rise to an Account, and other proceeds of Collateral; and "Collections" means the collective reference to all of the foregoing.

"Commonly Controlled Entity" shall mean an entity, whether or not incorporated, which is under common control with the Borrower within the meaning of Section 414(b) or (c) of the Internal Revenue Code.

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"Current Assets" means at any date, the amount which, in conformity with GAAP, would be set forth opposite the caption "total current assets" (or any like caption) on a consolidated balance sheet of the Borrower and its Subsidiaries.

"Current Liabilities" means at any date, the amount which, in conformity with GAAP, would be set forth opposite the caption "total current liabilities" (or any like caption) on a consolidated balance sheet of the Borrower and its Subsidiaries.

"Current Ratio" means the ratio of (a) Current Assets to (b) Current Liabilities, including, without, limitation, the unpaid principal balance of the Revolving Loans outstanding at such time.

"Default" has the meaning described in Article IX.

"Default Rate" means the default rate of interest set forth in the Note.

"Documents" means all documents and documents of title, whether nor existing or hereafter acquired or created, and all proceeds (cash and non-cash of the foregoing).

"EBITDA" means as to the Borrower and its Subsidiaries for any period of determination thereof, the sum of (a) the net profit (or loss) determined in accordance with GAAP consistently applied, plus (b) interest expense and taxes for such period, plus (c) depreciation and amortization of assets for such period.

"EBITDAR" means as to the Borrowers and its Subsidiaries for

any period of determination thereof, the sum of (a) the net profit (or loss) determined in accordance with GAAP consistently applied, plus (b) interest expense and taxes for such period, plus (c) depreciation and amortization of assets for such period, plus (d) rent expense for such period.

"Eligible Billed Receivable" and "Eligible Billed Receivables" mean, at any time of determination thereof, each Account which conforms and continues to conform to the Eligibility Standards and which has been invoiced by the Borrower.

"Eligible Unbilled Receivable" and "Eligible Unbilled Receivables" mean, at any time of determination thereof, each Account which conforms and continues to conform to the Eligibility Standards and which has not been invoiced, but will be invoiced by the Borrower within the next billing cycle.

"Eligibility Standards" means each account which conforms and continues to conform to the following standards: (a) the Account arose from a bona fide outright sale or lease of goods by the Borrower, or from services performed by the Borrower, and (i) such goods have been delivered to the appropriate account debtors or their respective designees, the Borrower has in its possession shipping and delivery receipts evidencing such shipment and delivery, no return,

rejection or repossession has occurred, and such goods have been finally accepted by the account debtor, or (ii) such services have been satisfactorily completed and accepted by the appropriate account debtor; or (b) the Account is a valid, legally enforceable obligation of the account debtor and requires no further act on the part of the Borrower to make the Account payable by the account debtor; (c) the Account is based upon an enforceable order or contract, written or oral, for goods delivered or for services performed, and the same were shipped, held, or performed in accordance with such order or contract; (d) the title of the Borrower to the Account and, except as to the account debtor and any creditor which finances the account debtor's purchase of such goods, to any goods is absolute and is not subject to any prior assignment, claim, Lien, or security interest, except Permitted Liens and Liens created by the account debtors in connection with their interests in the goods, and the Borrower otherwise has the full and unqualified right and power to assign and grant a security interest in it to the Lender as security and collateral for the payment of the Obligations; (e) the amount shown on the books of the Borrower and on any invoice, certificate, schedule or statement delivered to the Lender is owing to the Borrower and no partial payment has been received unless reflected with that delivery; (f) the Account is not subject to any claim of reduction, counterclaim, setoff, recoupment, or other defense in law or equity, or any claim for credits, allowances, or adjustments by the account debtor because of returned, inferior, or damaged goods or unsatisfactory services, or for any other reason; (g) the account debtor has not returned or refused to retain, or otherwise notified the Borrower of any dispute concerning, or claimed nonconformity of, any of the goods or services from the sale of which the Account arose; (h) the Account is not outstanding more than ninety (90) days from the date of the invoice therefor; (i) the Account is not owing by any account debtor for which the Lender has deemed fifty percent (50%) or more of such account debtor's other Accounts due to the Borrower to be non-Eligible Receivables; (j) the Account does not arise out of a contract with, or order from, an account debtor that, by its terms, forbids or makes void or unenforceable the assignment by the Borrower to the Lender of the Account arising with respect thereto; (k) the account debtor is not a Subsidiary or other Affiliate of the Borrower; (l) the account debtor is not incorporated in or primarily conducting business in any jurisdiction located outside of the United States of America; (m) the account debtor is not a foreign governmental authority or agency; (n) the Borrower is not indebted in any manner to the account debtor, with the exception of customary credits, adjustments and/or discounts given to an account debtor by the Borrower in the ordinary course of its business, (o) no bond has been issued or is contemplated with respect to the goods or services furnished by the Borrower or with respect to the project or contract for which those goods or services were furnished, and (p) the Lender in the exercise of its sole and absolute discretion has not deemed the Account ineligible because of uncertainty as to the creditworthiness of the account debtor or because the Lender otherwise considers the collateral value thereof to

the Lender to be impaired or its ability to realize such value to be insecure. In the event of any dispute, under the foregoing criteria, as to whether an Account satisfies the Eligibility Standards, the decision of the Lender in the exercise of its sole and absolute discretion shall control.

"Enforcement Costs" shall mean all expenses, charges, costs and fees whatsoever (including, without limitation, reasonable outside attorney's fees and expenses) of any nature

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whatsoever paid or incurred by or on behalf of the Lender in connection with (a) the collection or enforcement of any or all of the Obligations, (b) the preparation of or changes to this Agreement, the Note, the Security Documents and/or any of the other Financing Documents, (c) the creation, perfection, collection, maintenance, preservation, defense, protection, realization upon, disposition, sale or enforcement of all or any part of the Collateral, including, without limitation, those sums paid or advanced, and costs and expenses, more specifically described in Section 10.3, and (d) the monitoring, administration, processing, servicing of any or all of the Obligations and/or the Collateral.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended from time to time.

"Event of Default" means an event which, with the giving of notice or lapse of time, or both, could or would constitute a Default under the provisions of this Agreement.

"Fees" means the fees described in Section 2.05 hereof.

"Financing Documents" means at any time collectively and include this Agreement, the Note, the Security Documents, and any other instrument, agreement or document previously, simultaneously or hereafter executed and delivered by the Borrower and/or any other Person, singly or jointly with another Person or Persons, evidencing, securing, guarantying or in connection with any of the Obligations and/or in connection with this Agreement, any Note, any of the Security Documents, the Loan and/or any of the Obligations.

"Fixed Charge Coverage Ratio" means the ratio of (i) EBITDAR, less cash dividends paid, to (ii) the sum of interest expense, plus scheduled principal repayments on Indebtedness for Borrowed Money and capitalized leases, plus rent expense, plus income tax expense for such period.

"Funded Debt" means for any period of determination thereof an amount equal to the sum of senior debt, stockholder debt, subordinated debt and the value of all capitalized leases, all as determined on a consolidated basis.

"GAAP" shall mean generally accepted accounting principles in the United States of America in effect from time to time.

"Governmental Authority" means any nation or government, any state or other political subdivision thereof and any entity exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government.

"Hazardous Materials" means (a) any "hazardous waste" as defined by the Resource Conservation and Recovery Act of 1976, as amended from time to time, and regulations promulgated thereunder; (b) any "hazardous substance" as defined by the

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Comprehensive Environmental Response, Compensation and Liability Act of 1980, as amended from time to time, and regulations promulgated thereunder; (c) any substance the presence of which on any property now or hereafter owned or acquired by the Borrower is prohibited by any Law similar to those set forth in this definition; and (d) any other substance which by Law requires special handling in its collection, storage, treatment or disposal.

"Hazardous Materials Contamination" means the contamination (whether presently existing or occurring after the date of this Agreement) by Hazardous Materials of any property owned, operated or controlled by the Borrower or for which the Borrower has responsibility, including, without limitation, improvements, facilities, soil, ground water, air or other elements on, or of, any property now or hereafter owned or acquired by the Borrower, and any other contamination by Hazardous Materials for which the Borrower is, or is claimed to be, responsible.

"Indebtedness for Borrowed Money" of a Person, at any time shall mean the sum at such time of (a) indebtedness of such Person for borrowed money or for the deferred purchase price of property or services, (b) any obligations of such Person in respect of letters of credit, banker's or other acceptances or similar obligations issued or created for the account of such Person, (c) lease obligations of such Person which have been or should be, in accordance with GAAP, capitalized on the books of such Person, (d) all liabilities secured by any Lien on any property owned by such Person, to the extent attached to such Person's interest in such property, even though such Person has not assumed or become liable for the payment thereof, and (e) any obligation of such Person or a commonly controlled entity to a multiemployer plan (as those terms are used under applicable ERISA statutes and regulations).

"Items of Payment" means each check, draft, cash, money, instrument, item, and other remittance in payment or on account of payment of the Accounts or otherwise with respect to any Collateral, including, without limitation, cash proceeds of any returned, rejected or repossessed Goods, the sale or lease of which gave rise to an Account, and other proceeds or products of Collateral; and "Items of Payment" means the collective reference to all of the foregoing.

"Law" or "Laws" means all ordinances, statutes, rules, regulations, orders, injunctions, writs, or decrees of any Governmental Authority or political subdivision or agency thereof, or any court or similar entity established by any thereof.

"Liabilities" means, at any time, all liabilities that should, in accordance with GAAP consistently applied, be classified as liabilities on a combined balance sheet of the Borrower and its Subsidiaries.

"Lien" means any mortgage, deed of trust, deed to secure debt, grant, pledge, security interest, assignment, encumbrance, judgment, lien or charge of any kind, whether perfected or unperfected, avoidable or unavoidable, including, without limitation, any conditional

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sale or other title retention agreement, any lease in the nature thereof, and the filing of or agreement to give any financing statement under the Uniform Commercial Code of any jurisdiction, excluding the precautionary filing of any financing statement by any lessor in a true lease transaction, by any bailor in a true bailment transaction or by any consignor in a true consignment transaction under the Uniform Commercial Code of any jurisdiction or the agreement to give any financing statement by any lessee in a true lease transaction, by any bailee in a true bailment transaction or by any consignee in a true consignment transaction.

"Loan" means a Revolving Loan, and "Loans" mean all Revolving Loans.

"Multiemployer Plan" shall mean a Plan which is a multiemployer plan as defined in Section 4001(a)(3) of ERISA.

"Note" means the Revolving Promissory Note, and "Notes" mean collectively the Revolving Promissory Note, and any other promissory note which may from time to time evidence the Obligations.

"Obligations" means all present and future debts, obligations, and liabilities, whether now existing or contemplated or hereafter arising, of the Borrower to the Lender under, arising pursuant to, in connection with and/or on account of the provisions of this Agreement, the Note, each Security Document, and any of the other Financing Documents, any of the Loans, and the

Loan including, without limitation, the principal of, and interest on, the Note, late charges, fees charged with respect to any guaranty of any letter of credit, and also means all other present and future indebtedness, liabilities and obligations, whether now existing or contemplated or hereafter arising, of the Borrower to the Lender of any nature whatsoever regardless of whether such debts, obligations and liabilities be direct, indirect, primary, secondary, joint, several, joint and several, fixed or contingent; and any and all renewals, extensions and rearrangements of any such debts, obligations and liabilities.

"Overdraft" means any excess of debit entries over collected funds on deposit in any banking account of the Borrower.

"PBGC" means the Pension Benefit Guaranty Corporation.

"Permitted Acquisition" has the meaning set forth in Section 8.04 of this Agreement.

"Permitted Liens" means: (a) Liens for Taxes which are not delinquent or which the Lender has determined in the exercise of its sole and absolute discretion (i) are being diligently contested in good faith and by appropriate proceedings, (ii) the Borrower has the financial ability to pay, with all penalties and interest, at all times without materially and adversely affecting the Borrower, and (iii) are not, and will not be with appropriate filing, the giving of notice and/or the passage of time, entitled to priority over any Lien of the Lender; (b)

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deposits or pledges to secure obligations under worker's compensation, social security or similar laws, or under unemployment insurance in the ordinary course of business; (c) Liens in favor of the Lender; (d) judgment Liens to the extent the entry of such judgment does not constitute an Event of Default under the terms of this Agreement or result in the sale of, or levy of execution on, any of the Collateral; and (e) such other Liens, if any, as are set forth on EXHIBIT C attached hereto and made a part hereof.

"Person" shall mean and include an individual, a corporation, a partnership, a joint venture, a trust, an unincorporated association, a government or political subdivision or agency thereof or any other entity.

"Prime Rate" means the prime rate charged by the Lender as fixed by management of the Lender for the guidance of its loan officers, whether or not such rate is otherwise published or announced. The Prime Rate is not necessarily the lowest rate of interest charged by the Lender to borrowers.

"Reportable Event" shall mean any of the events set forth in Section 4043(b) of ERISA or the regulations thereunder.

"Responsible Officer" means the chief executive officer of the Borrower or the president of the Borrower or, with respect to financial matters, the chief financial officer of the Borrower.

"Restricted Period" means any period where the Borrower's ratio of Funded Debt to EBITDA equals or exceeds 2.0 to 1.0., based on the financial statements most recently received by the Lender pursuant to Section 7.01 of this Agreement.

"Revolving Loan Committed Amount" has the meaning described in Section 2.01(a) herein.

"Revolving Loan" and "Revolving Loans" have the meanings described in Section 2.01(a).

"Revolving Promissory Note" has the meaning described in Section 2.01(c).

"Revolving Loan Account" has the meaning described in Section 2.03.

"Security Documents" shall mean collectively any assignment,

pledge agreement, security agreement, mortgage, deed of trust, deed to secure debt, financing statement and any similar instrument, document or agreement under or pursuant to which a Lien is now or hereafter granted to, or for the benefit of, the Lender on any collateral to secure the Obligations, as the same may from time to time be amended, restated, supplemented or otherwise modified.

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"Senior Management" shall be deemed to refer to the following executive positions: President/CEO, Chairman of the Board, Chief Operating Officer and Chief Financial Officer.

"State" means the State of Maryland.

"Subsidiary" means Teklicon, and any corporation the majority of the voting shares of which at the time are owned directly by the Borrower and/or by one or more Subsidiaries of the Borrower.

"Taxes" mean all taxes and assessments whether general or special, ordinary or extraordinary, or foreseen or unforeseen, of every character (including all penalties or interest thereon), which at any time may be assessed, levied, confirmed or imposed by any Governmental Authority on the Borrower or any of its properties or assets or any part thereof or in respect of any of its franchises, businesses, income or profits.

"Teklicon" means Teklicon, Inc., a California corporation and its successors and assigns.

"Wholly Owned Subsidiary" means any domestic United States corporation all the shares of stock of all classes of which (other than directors' qualifying shares) at the time are owned directly or indirectly by the Borrower and/or by one or more Wholly Owned Subsidiaries of the Borrower.

SECTION 1.02 ACCOUNTING TERMS AND OTHER DEFINITIONAL PROVISIONS. Unless otherwise defined herein, as used in this Agreement and in any certificate, report or other document made or delivered pursuant hereto, accounting terms not otherwise defined herein, and accounting terms only partly defined herein, to the extent not defined, shall have the respective meanings given to them under GAAP. Unless otherwise defined herein, all terms used herein which are defined by the Maryland Uniform Commercial Code shall have the same meanings as assigned to them by the Maryland Uniform Commercial Code unless and to the extent varied by this Agreement. The words "hereof", "herein" and "hereunder" and words of similar import when used in this Agreement shall refer to this Agreement as a whole and not to any particular provision of this Agreement, and section, subsection, schedule and exhibit references are references to sections or subsections of, or schedules or exhibits to, as the case may be, this Agreement unless otherwise specified. As used herein, the singular number shall include the plural, the plural the singular and the use of the masculine, feminine or neuter gender shall include all genders, as the context may require. Reference to any one or more of the Financing Documents and any of the Financing Documents shall mean the same as the foregoing may from time to time be amended, restated, substituted, extended, renewed, supplemented or otherwise modified.

II. BORROWING

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SECTION 2.01 THE REVOLVING LOAN. (a) The Lender agrees to lend to the Borrower and the Borrower agrees to borrow on a revolving basis from time to time the principal amount (the "Revolving Loan") not to exceed at any time outstanding \$10,000,000 or during any Restricted Period, the lesser (the "Revolving Loan Committed Amount") of \$10,000,000, or the Borrowing Base.

(b) If at any time the outstanding principal balance of the Revolving Loan exceeds the limitations provided in subsection (a) above, the Borrower promises to pay to the order of the Lender, on demand, the amount of the excess.

(c) The obligation of the Borrower to repay the advances under the Revolving Loan shall be evidenced by the Borrower's Revolving Promissory Note of even date herewith (the "Revolving Promissory Note") payable to the Lender in the form attached hereto as EXHIBIT A. The Revolving Promissory Note shall bear interest and shall be repaid by the Borrower in the manner and at the times set forth in the Revolving Promissory Note.

(d) The Borrower may prepay the principal sum outstanding on the Revolving Loan only in accordance with the terms of the Revolving Note. Sums borrowed and repaid may be readvanced under the terms and conditions of this Agreement.

(e) The proceeds of the Revolving Loan shall be used by the Borrower for the purposes set forth in Recital A above, and, unless prior written consent of the Lender is obtained, for no other purpose.

SECTION 2.02 REVOLVING LOAN PROCEDURE. (a) The Borrower shall give the Lender at least two (2) Banking Days' notice of each proposed advance.

(b) The Borrower shall furnish to the Lender such schedules, certificates, lists, records, reports, information and documents as required by the Lender from time to time so that the Lender may, in its discretion, determine the Borrowing Base.

(c) In addition, the Borrower hereby irrevocably authorizes the Lender to make advances under the Revolving Loan at any time and from time to time, without further request from or notice to the Borrower, which the Lender, in its sole and absolute discretion, deems necessary or appropriate to protect the Lender's interests under this Agreement or otherwise, including, without limitation, advances made to cover Overdrafts, principal of, and/or interest on, any Loans, fees, and/or Enforcement Costs, prior to, on, or after the termination of this Agreement, regardless of whether the aggregate amount of the advances which the Lender may make hereunder exceeds the Revolving Credit Committed Amount. The Lender shall have no obligation whatsoever to make any advance under this subsection and the making of one or more advances under this subsection shall not obligate the Lender to make other similar advance or advances. Any such advances will be secured by the Collateral.

SECTION 2.03 REVOLVING LOAN ACCOUNT. The Lender will establish and maintain a loan account on its books (the "Revolving Loan Account") to which the Lender will (a) debit (i) the principal amount of each Revolving Loan made by the Lender hereunder as of the date made, (ii) the amount of any interest accrued on the Revolving Loans as and when due, and (iii) any other amounts due and payable by the Borrower to the Lender from time to time under the provisions of this Agreement in connection with the Revolving Loans, including, without limitation, Enforcement Costs, Fees, late charges, and service, collection and audit fees, as and when due and payable, and (b) credit all payments made by the Borrower to the Lender on account of the Revolving Loans as of the date made including, without limitation, funds credited to the Collateral Account and collected and paid to the Lender, the Lender reserving the right, exercised in its sole and absolute discretion from time to time, to provide earlier credit or to disallow credit for any Collection which is unsatisfactory to the Lender.

The Lender may debit the Revolving Loan Account for the amount of any Collection which is returned to the Lender unpaid. All credit entries to the Revolving Loan Account are conditional and shall be readjusted as of the date made if final and indefeasible payment is not received by the Lender in cash or solvent credits. The Borrower hereby promises to pay to the order of the Lender, on demand, an amount equal to the excess, if any, of all debit entries over all credit entries recorded in the Revolving Loan Account under the provisions of this Agreement.

SECTION 2.04 COLLATERAL ACCOUNT. The Borrower will deposit or cause to be deposited to a bank account designated by the Lender and from which the Lender alone has power of access and withdrawal (the "Collateral Account"), all Items of Payment. The Borrower shall deposit Items of Payment for credit to the Collateral Account not later than the next Banking Day after the receipt thereof, and in precisely the form received, except for the endorsements of the Borrower where necessary to permit the collection of any such Items of Payment, which endorsement the Borrower hereby agrees to make. Pending such deposit to the Collateral Account, endorsement and/or other delivery thereof to the Lender, the Borrower will not commingle any Items of Payment with any of its other funds or property, but will hold them separate and apart therefrom in trust and for the account of the Lender. The Lender is not, however, required to credit the Collateral Account for the amount of any Collection which is unsatisfactory to the Lender. In addition, the Borrower shall, if so directed by the Lender, establish a lock box to which Items of Payments may be sent and shall direct the Borrower's customers and others as the Lender may require to forward payments to that lock box. Items of Payment received in the lock box shall be deposited in the Collateral Account or as otherwise directed by the Lender from time to time.

SECTION 2.05 COMMITMENT FEE. The Borrower agrees to pay to the Lender on the first day of each three month period commencing after the date of this Agreement a commitment fee (computed on the basis of a year consisting of three hundred and sixty (360) days for the actual number of days elapsed) of three eighths of one percent (.375%) per annum on the daily average of the unused amount of the Revolving Loan.

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SECTION 2.06 TRANSACTIONS UNDER THIS AGREEMENT BETWEEN THE BORROWER AND THE LENDER. In respect to any advance and all other matters under or in connection with this Agreement and any transactions contemplated hereby, the Borrower authorizes the Lender to accept, rely upon, act upon and comply with, any verbal or written instructions, requests, confirmations and orders of any employee or representative of the Borrower designated by the Borrower in writing delivered to the Lender from time to time. The Borrower acknowledges that the transmission between the Borrower and the Lender of any such instructions, requests, confirmations and orders involves the possibility of errors, omissions, mistakes and discrepancies and agrees to adopt such internal measures and operational procedures to protect its interests. By reason thereof, the Borrower hereby assumes all risk of loss and responsibility for, releases and discharges the Lender from any and all responsibility or liability for, and agrees to indemnify, reimburse on demand and hold the Lender harmless from, any and all claims, actions, damages, losses, liability and expenses by reason of, arising out of or in any way connected with or related to, (i) the Lender's acceptance, reliance and actions upon, compliance with or observation of any such instructions, requests, confirmations or orders, and (ii) any such errors, omissions, mistakes and discrepancies, except those caused by the Lender's gross negligence or willful misconduct.

SECTION 2.07 ACCOUNT STATEMENTS. Any and all periodic or other statements or reconciliations, and the information contained in those statements or reconciliations, of the Revolving Loan Account shall be presumed conclusively to be correct and shall constitute an account stated between the Lender and the Borrower unless the Lender receives specific written objection thereto from the Borrower within thirty (30) Banking Days after such statement or reconciliation shall have been sent by the Lender.

SECTION 2.08 OVERDRAFT ADVANCES. If, after the close of business on any Banking Day, any banking account of the Borrower with the Lender is determined by the Lender to have an Overdraft, the Lender, in its sole discretion on each and any such occasion may (and is hereby irrevocably authorized by the Borrower to), but is not obligated to, make an advance under the Revolving Loan to the Borrower in a principal amount equal to any such Overdraft as of the close of business on such Banking Day. All Overdrafts shall be secured by the Collateral.

III. COLLATERAL

As security for the payment of all of the Obligations, the Borrower hereby assigns, grants and conveys to the Lender and agrees that the Lender

shall have a perfected, continuing security interest in all of the Collateral. The Borrower further agrees that the Lender shall have in respect the Collateral all of the rights and remedies of a secured party under the Maryland Uniform Commercial Code and under other applicable Laws and Security Documents, as well as those provided in this Agreement. The Borrower covenants and agrees to execute and deliver such financing statements and other instruments and filings as are necessary in the opinion of the Lender to perfect such security interest. Notwithstanding the fact that the proceeds of the Collateral constitute a part of the Collateral, the Borrower may not dispose of the Collateral, or any

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part thereof, other than in the ordinary course of its business or as otherwise may be permitted by this Agreement.

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IV. UNCONDITIONAL OBLIGATIONS

The payment and performance by the Borrower of the Obligations shall be absolute and unconditional, irrespective of any defense or any rights of set-off, recoupment or counterclaim it might otherwise have against the Lender and the Borrower shall pay absolutely net all of the Obligations, free of any deductions and without abatement, diminution or set-off; and until payment in full of all of the Obligations, the Borrower: (a) will not suspend or discontinue any payments provided for in the Note; (b) will perform and observe all of its other agreements contained in this Agreement, including (without limitation) all payments required to be made to the Lender; and (c) will not terminate or attempt to terminate this Agreement for any cause.

V. REPRESENTATIONS AND WARRANTIES

To induce the Lender to make the Loan, the Borrower represents and warrants to the Lender and, unless the Lender is notified by the Borrower of a change or changes effecting such representations and warranties, shall be deemed to represent and warrant to the Lender at the time each request for an advance under the Loan is submitted and again at the time any advance is made under the Loan that:

SECTION 5.01 SUBSIDIARIES. The Borrower has no Subsidiaries, except as set forth on the signature page of this Agreement.

SECTION 5.02 GOOD STANDING. The Borrower and each of its Subsidiaries (a) is a corporation duly organized, existing and in good standing under the laws of the jurisdiction of its incorporation, (b) has the corporate power to own its property and to carry on its business as now being conducted, and (c) is duly qualified to do business and is in good standing in each jurisdiction in which the character of the properties owned by it therein or in which the transaction of its business makes such qualification necessary.

SECTION 5.03 POWER AND AUTHORITY. The Borrower and each of its Subsidiaries has full power and authority to execute and deliver this Agreement and each of the other Financing Documents executed and delivered by it, to make the borrowing hereunder, and to incur the Obligations, all of which have been duly authorized by all proper and necessary corporate action. No consent or approval of stockholders or of any public authority is required as a condition to the validity or enforceability of this Agreement or any of the other Financing Documents executed and delivered by the Borrower and each Subsidiary.

SECTION 5.04 BINDING AGREEMENTS. This Agreement and each of the other Financing Documents executed and delivered by the Borrower and each Subsidiary have been properly executed by the Borrower and each Subsidiary, constitute valid and legally binding obligations of the Borrower and each Subsidiary, and are fully enforceable against the Borrower and each Subsidiary in accordance with their respective terms, subject to (a) bankruptcy,

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insolvency, reorganization, moratorium or other laws affecting creditors' rights generally, (b) general principles of equity (regardless of whether such principles of equity are asserted in an action or proceeding at law or in equity) or the discretion of the court before which any action or proceeding may be brought and (c) other applicable laws which may limit the enforceability of certain of the remedial or procedural provisions contained in the Financing Documents.

SECTION 5.05 LITIGATION. There are no proceedings pending or, so far as the Borrower knows, threatened before any court or administrative agency which will materially adversely affect the financial condition or operations of the Borrower or any Subsidiary, or the authority of the Borrower to enter into this Agreement or any of the other Financing Documents executed and delivered by the Borrower or any Subsidiary.

SECTION 5.06 NO CONFLICTING AGREEMENTS. There is (a) no charter, by-law or preference stock provision of the Borrower or any Subsidiary and no provision of any existing mortgage, indenture, contract or agreement binding on the Borrower, or any Subsidiary, or affecting their properties, and (b) to the knowledge of the Borrower and each Subsidiary, no provision of law or order of court binding upon the Borrower or any Subsidiary, which would conflict with or in any way prevent the execution, delivery, or performance of the terms of this Agreement or of any of the other Financing Documents executed and delivered by the Borrower or any Subsidiary, or which would be violated as a result of such execution, delivery or performance.

SECTION 5.07 FINANCIAL CONDITION. The financial statements of the Borrower dated June 30, 1996 are complete and correct and, in the opinion of the Borrower, fairly present the current financial condition of the Borrower and have been prepared in accordance with GAAP applied on a consistent basis throughout the period involved. There are no material liabilities, direct or indirect, fixed or contingent, of the Borrower as of the date of such financial statements which are not reflected therein or in the notes thereto. There has been no adverse change in the financial condition or operations of the Borrower since the date of such financial statements (and to the Borrower's knowledge, no such adverse change is pending or threatened), and the Borrower has not guaranteed the obligations of, or made any investments in or advances to, any company, individual or other entity except as disclosed in such financial statements and in connection with the acquisition of Teklicon. The Borrower agrees to provide the Lender with updated financial statements within forty five (45) days of completion of the acquisition of Teklicon.

SECTION 5.08 TAXES. The Borrower and each Subsidiary has filed or has caused to have been filed all federal, state and local tax returns which, to the knowledge of the Borrower and each Subsidiary, are required to be filed, and has paid or caused to have been paid all taxes as shown on such returns or on any assessment received by it, to the extent that such taxes have become due, unless and to the extent only that such taxes, assessments and governmental charges are currently contested in good faith and by appropriate proceedings by the Borrower or such

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Subsidiary and adequate reserves therefor have been established as required under generally accepted accounting principles.

SECTION 5.09 COMPLIANCE WITH LAW. The Borrower and each Subsidiary is not in violation of any applicable law, ordinance, governmental rule or regulation to which it is subject and the Borrower has obtained any and all material licenses, permits, franchises or other governmental authorizations necessary for the ownership of its properties and the conduct of its business.

SECTION 5.10 PLACE(S) OF BUSINESS AND LOCATION OF COLLATERAL. The Borrower and each Subsidiary warrants that the address of the Borrower's and each Subsidiary's chief executive office is as specified in EXHIBIT B attached hereto and made a part hereof and that the address of each other place of business of the Borrower and each Subsidiary, if any, is as disclosed to the Lender in EXHIBIT B. The Collateral and all books and records pertaining to the Collateral are and will be located at the address indicated on EXHIBIT B. The Borrower will immediately advise the Lender in writing of the opening of any new place of business or the closing of any of its existing places of business, and of any change in the location of the places where the Collateral, or any part thereof, or the books and records concerning the Collateral, or any part thereof, are kept. The proper and only places to file financing statements with respect to the Collateral within the meaning of the Uniform Commercial Code are the State Department of Assessments and Taxation. A copy of a fully executed financing statement shall be sufficient to satisfy for all purposes the requirements of a financing statement as set forth in Article 9 of the Maryland Uniform Commercial Code.

SECTION 5.11 TITLE TO PROPERTIES. The Borrower and each Subsidiary has good and marketable title to all of its properties, including the Collateral, and the Collateral is free and clear of mortgages, pledges, liens, charges and other encumbrances other than the Permitted Liens.

SECTION 5.12 MARGIN STOCK. None of the proceeds of the Loan will be used, directly or indirectly, by the Borrower or any Subsidiary for the purpose of purchasing or carrying, or for the purpose of reducing or retiring any indebtedness which was originally incurred to purchase or carry, any "margin security" within the meaning of Regulation G (12 CFR Part 207), or "margin stock" within the meaning of Regulation U (12 CFR Part 221), of the Board of Governors of the Federal Reserve System (herein called "margin security" and "margin stock") or for any other purpose which might make the transactions contemplated herein a "purpose credit" within the meaning of said Regulation G or Regulation U, or cause this Agreement to violate any other regulation of the Board of Governors of the Federal Reserve System or the Securities Exchange Act of 1934 or the Small Business Investment Act of 1958, as amended, or any rules or regulations promulgated under any of such statutes.

SECTION 5.13 ERISA. With respect to any "pension plan" as defined in Section 3(2) of ERISA, which plan is now or previously has been maintained or contributed to by the

Borrower and/or by any Commonly Controlled Entity: (a) no "accumulated funding deficiency" as defined in Code ss.412 or ERISA ss.302 has occurred, whether or not that accumulated funding deficiency has been waived; (b) no "reportable event" as defined in ERISA ss.4043 has occurred; (c) no termination of any plan subject to Title IV of ERISA has occurred; (d) neither the Borrower nor any Commonly Controlled Entity has incurred a "complete withdrawal" within the meaning of ERISA ss.4203 from any multiemployer plan; (e) neither the Borrower nor any Commonly Controlled Entity has incurred a "partial withdrawal" within the meaning of ERISA ss.4205 with respect to any multiemployer plan; (f) no multiemployer plan to which the Borrower or any Commonly Controlled Entity has an obligation to contribute is in "reorganization" within the meaning of ERISA ss.4241 nor has notice been received by the Borrower or any Commonly Controlled Entity that such a multiemployer plan will be placed in "reorganization".

SECTION 5.14 GOVERNMENTAL CONSENT. Neither the nature of the Borrower or of its business or properties, nor any relationship between the Borrower and any other entity or person, nor any circumstance in connection with the making of the Loan, or the offer, issue, sale or delivery of the Note is such as to require a consent, approval or authorization of, or filing, registration or qualification with, any governmental authority, on the part of the Borrower, as a condition to the execution and delivery of this Agreement or any of the other Financing Documents, the borrowing of the principal amounts of the Loan or the offer, issue, sale or delivery of the Note.

SECTION 5.15 FULL DISCLOSURE. The financial statements referred to in this Part V do not, nor does this Agreement, nor do any written statements furnished by the Borrower to the Lender in connection with the making of the Loan, contain any untrue statement of material fact or omit a material fact necessary to make the statements contained therein or herein not misleading. There is no material fact which the Borrower has not disclosed to the Lender in writing which materially adversely affects or, will or could prove to materially adversely affect the properties, business, prospects, profits or condition (financial or otherwise) of the Borrower or the ability of the Borrower to perform this Agreement.

SECTION 5.16 PRESENCE OF HAZARDOUS MATERIALS OR HAZARDOUS MATERIALS CONTAMINATION. To the best of the Borrower's knowledge, (a) no Hazardous Materials are located on any real property owned, controlled or operated by the Borrower or for which the Borrower is responsible, except for reasonable quantities of necessary supplies for use by the Borrower in the ordinary course of the its current line of business and stored, used and disposed in accordance with applicable Laws; and (b) no property owned, controlled or operated by the Borrower has ever been used as a manufacturing, storage, or dump site for Hazardous Materials nor is affected by Hazardous Materials Contamination at any other property.

SECTION 5.17 INTELLECTUAL PROPERTY. The Borrower owns or possesses all of the material patents, trademarks, service marks, trade names, copyrights and licenses and all rights with respect thereto necessary for the present and planned future operation of its business, to the best of the Borrower's knowledge without any conflict with the rights of any other Person.

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SECTION 5.18 BUSINESS NAMES AND ADDRESSES. In the twelve (12) years preceding the date hereof, the Borrower has not conducted business under any name other than its current name nor conducted its business in any jurisdiction other than those disclosed on EXHIBIT B attached hereto.

SECTION 5.19 NO DEFAULT. There is no Event of Default (as hereinafter defined) and no event has occurred and no condition exists which with the giving of notice or the passage of time would constitute an Event of Default. The Borrower is not in default under the terms of any other agreement or instrument to which it may be a party or by which the Collateral or any of its properties may be bound or subject.

SECTION 5.20 COMPLIANCE WITH ELIGIBILITY STANDARDS. Unless the Lender is advised by the Borrower in writing to the contrary, to the best of the Borrower's knowledge each Account described in any schedule, certificate, record and data furnished to the Lender for purposes of calculating the Borrowing Base will at all times meet and comply with the Eligibility Standards.

SECTION 5.21 ACCOUNTS. With respect to all Accounts and to the best of the Borrower's knowledge (a) they are genuine, and in all respects what they purport to be, and are not evidenced by a judgment, an instrument, or chattel paper (unless such judgment has been assigned and such instrument or chattel paper has been endorsed and delivered to the Lender); (b) they represent undisputed, bona fide transactions completed in accordance with the terms and provisions contained in the invoices and purchase orders relating thereto; (c) the goods sold (or services rendered) which resulted in the creation of the Accounts have been delivered or rendered to and accepted by the account debtor; (d) the amounts shown on the Borrower's books and records, with respect thereto are actually and absolutely owing to the Borrower and are not contingent for any

reason; (e) no payments have been or shall be made thereon except payments turned over to the Lender by the Borrower; (f) there are no set-offs, counterclaims or disputes known by the Borrower or asserted with respect thereto, and the Borrower has made no agreement with any account debtor thereof for any deduction or discount of the sum payable thereunder except regular discounts, or credit adjustments allowed by the Borrower in the ordinary course of its business for prompt payment; (g) there are no facts, events or occurrences known to the Borrower which in any way impair the validity or enforcement thereof or tend to reduce the amount payable thereunder; (h) all account debtors thereof, to the best of the Borrower's knowledge, have the capacity to contract; (i) the goods sold or transferred or the services furnished giving rise thereto are not subject to any liens except the security interest granted to the Lender by this Agreement and Permitted Liens; (j) the Borrower has no knowledge of any fact or circumstance which would impair the validity or collectibility thereof; and (k) there are no proceedings or actions known to the Borrower which are threatened or pending against any account debtor which might result in any material adverse change in its financial condition.

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VI. CONDITIONS OF LENDING

The making of the Loan and any advance thereunder is subject to the following conditions precedent:

SECTION 6.01 OPINION OF COUNSEL FOR THE BORROWER. On the date hereof, the Lender shall receive the favorable written opinion of counsel for the Borrower satisfactory in all respects to the Lender.

SECTION 6.02 APPROVAL OF COUNSEL FOR THE LENDER. All legal matters incident to the Loans and all documents necessary in the opinion of the Lender to make the Loan shall be satisfactory in all material respects to counsel for the Lender.

SECTION 6.03 SUPPORTING DOCUMENTS. The Lender shall receive on the date hereof: (a) a certificate of the Secretary of the Borrower, in a form acceptable to the Lender in all respects, dated as of the date hereof and certifying (i) that attached thereto is a true, complete and correct copy of resolutions adopted by the Board of Directors of the Borrower authorizing the execution and delivery of this Agreement, the Note and the other Financing Documents, and the Obligations, and (ii) as to the incumbency and specimen signature of each officer of the Borrower executing this Agreement, the Note and the other Financing Documents, and a certification by the President or any Vice President of the Borrower as to the incumbency and signature of the Secretary of the Borrower; (b) such other documents as the Lender may reasonably require the Borrower to execute, in form and substance acceptable to the Lender; and (c) such additional information, instruments, opinions, documents, certificates and reports as the Lender may reasonably deem necessary.

SECTION 6.04 FINANCING DOCUMENTS. All of the Financing Documents required by the Lender shall be executed, delivered and, if deemed necessary by the Lender, recorded, all at the sole expense of the Borrower.

SECTION 6.05 INSURANCE. The Borrower shall have satisfied the Lender that any and all insurance required by this Agreement is in effect as of the date of this Agreement, and that, to the extent required by the Financing Documents, the Lender has been named as an insured lienholder.

SECTION 6.06 SECURITY DOCUMENTS. In order to perfect the lien and security interest created by this Agreement, the Borrower shall have executed and delivered to the Lender all financing statements and Security Documents (in form and substance acceptable to the Lender in its sole discretion) deemed necessary by the Lender, in a sufficient number of counterparts for recordation, and, at the Borrower's sole expense, shall record all such financing statements and Security Documents, or cause them to be recorded, in all public offices deemed necessary by the Lender.

SECTION 6.07 TERMINATION STATEMENTS. The Lender shall have received from creditors of the Borrower all termination statements covering the Collateral required by the Lender. The termination statements shall be fully and properly executed, in recordable form and sufficient, in the opinion of counsel for the Lender, to terminate the interests of other creditors of the Borrower in the Collateral.

SECTION 6.08 COMPLIANCE. At the time of the making of each advance hereunder (a) the Borrower and each Subsidiary shall have complied and shall then be in compliance with all the terms, covenants and conditions of this Agreement which are binding upon it, (b) there shall exist no Event of Default and no event which, with the giving of notice or the passage of time, or both, would constitute an Event of Default, and (c) the representations and warranties contained in Part V shall be true with the same effect as though such representations and warranties had been made at the time of the making of the advance.

VII. AFFIRMATIVE COVENANTS OF BORROWER

Until payment in full and the performance of all of the Obligations hereunder, the Borrower shall:

SECTION 7.01 Financial Statements. Furnish to the Lender:

(a) Annual Statements and Certificates. As soon as available but in no event more than one hundred twenty (120) days after the close of each of the Borrower's fiscal years, (i) a copy of the consolidated and consolidating audited financial statement relating to the Borrower and its Subsidiaries in reasonable detail satisfactory to the Lender, including detail with regard to expenses, including, but not limited to, lease expense, non-cash charges and interest expense, prepared in accordance with GAAP and certified by an independent certified public accountant satisfactory to the Lender, which financial statement shall include a balance sheet as at the end of such fiscal year, profit and loss statement and a statement of changes in financial condition, and (ii) a cash flow projection report prepared by the Borrower in a format acceptable to the Lender.

(b) Annual Opinion of Accountant. As soon as available but in no event more than one hundred twenty (120) days after the close of each of the Borrower's fiscal years, a letter or opinion of the independent certified public accountant who examined the annual financial statement relating to the Borrower and its Subsidiaries stating whether anything in such certified public accountant's examination has revealed the occurrence of an event which constitutes an Event of Default or which would constitute an Event of Default with the giving of notice or the lapse of time or both, and, if so, stating the facts with respect thereto.

(c) Quarterly Statements and Certificates. As soon as available but in no event more than forty-five (45) days after the close of each of the Borrower's fiscal quarters, consolidated and consolidating balance sheets of the Borrower and its Subsidiaries as at the close

of such period and consolidated and consolidating income and expense statements for such period, and an aging of accounts receivable, all certified by the principal financial officer of the Borrower. The quarterly statements shall be in such detail as Lender may reasonably require and will provide, among other things, detail with regard to expenses, lease expense, non-cash charges and interest expense and shall be accompanied by a certificate in form and detail satisfactory to the Lender in all material respects (the "Compliance

Certificate") of that officer stating whether any event has occurred which constitutes an Event of Default or which would constitute an Event of Default with the giving of notice or the lapse of time or both, and, if so, stating the facts with respect thereto. Each Compliance Certificate will clearly set forth the methodology used in determining compliance and/or non-compliance and shall be the basis for determining the Additional Percentage and the Additional LIBOR Rate Percentage under the Note.

(d) Reports to SEC and to Stockholders. The Borrower will furnish to the Lender, promptly upon the filing or making thereof, but not later than fifteen (15) days after the date of filing, , at least one (1) copy of all financial statements, reports, notices and proxy statements sent by the Borrower to its stockholders, and of all regular and other reports filed by the Borrower with any securities exchange or with the Securities and Exchange Commission.

(e) Borrowing Base Reports. During any Restricted Period, the Borrower shall deliver to the Lender at the same time as the quarterly financial information required under subsection (c) above, a fully completed certificate (each a "Borrowing Base Certificate" and collectively, the "Borrowing Base Certificates") as of such date in the form of EXHIBIT ___ attached hereto. Each Borrowing Base Certificate shall be effective only as accepted by the Lender (and with such revision, if any, as the Lender may require as a condition to such acceptance), such acceptance to be presumed unless the Lender otherwise notifies the Borrower within five (5) Banking Days after receipt of such Borrowing Base Certificate.

(f) Monthly Funded Debt Report. Within forty five (45) days after the end of each calendar month, a fully completed certificate as of the last day of such month, listing the Borrower's Funded Debt and the EBITDA for the prior twelve (12) month period (the "Funded Debt Report"). If the Borrower determines based on the Funded Debt Report that it is within a Restricted Period, the Borrower will thereafter submit to the Lender a monthly Borrowing Base Certificate pursuant to subsection (e) above.

(g) Additional Reports and Information. With reasonable promptness, such additional information, reports or statements as the Lender may from time to time reasonably request.

SECTION 7.02 Financial Covenants.

(a) FIXED CHARGE COVERAGE RATIO. Maintain at all times, a Fixed Charge Ratio of not less than 1.30 to 1.0 tested as of the last day of each of the Borrower's fiscal quarters for the four (4) quarter period ending on that date.

(b) FUNDED DEBT TO EBITDA. Maintain, a ratio of Funded Debt to EBITDA not to exceed at any time 3.0 to 1.0 tested as of the last day of each of the Borrower's fiscal quarters for the four (4) quarter period ending on that date.

(c) CURRENT RATIO. Maintain, a Current Ratio of not less than 1.30 to 1.0 tested as of the last day of each of the Borrower's fiscal quarters for the four (4) quarter period ending on that date.

SECTION 7.03 TAXES AND CLAIMS. Pay and discharge and cause each of its Subsidiaries to pay and discharge, all taxes, assessments and governmental charges or levies imposed upon it or any of its income or properties prior to the date on which penalties attach thereto, and all lawful claims which, if unpaid, might become a lien or charge upon any of its properties; provided, however, the Borrower and the Subsidiaries shall not be required to pay any such tax, assessment, charge, levy or claim, the payment of which is being contested in good faith and by proper proceedings.

SECTION 7.04 CORPORATE EXISTENCE. Maintain, and cause each of its Subsidiaries to maintain, its corporate existence in good standing in the jurisdiction in which it is incorporated and in each jurisdiction where it is

required to register or qualify to do business.

SECTION 7.05 COMPLIANCE WITH LAWS. Comply, and cause each of its Subsidiaries to comply, with all applicable federal, state and local laws, rules and regulations to which it is subject and the violation of which would have a material adverse effect on the conduct of its business.

SECTION 7.06 GOVERNMENTAL REGULATION. Promptly notify the Lender in the event that the Borrower or any Subsidiary receives any notice, claim or demand from any governmental agency which alleges that the Borrower or any Subsidiary is in violation of any of the terms of, or has failed to comply with any applicable order issued pursuant to any federal or state statute regulating its operation and business, including, but not limited to, the Occupational Safety and Health Act and the Environmental Protection Act.

SECTION 7.07 LITIGATION. Give prompt notice in writing, with a full description to the Lender, of all litigation and of all proceedings before any court or any governmental or regulatory agency affecting the Borrower or any Subsidiary which, if adversely decided, would materially affect the conduct of the Borrower's or such Subsidiary's business, the financial condition of the Borrower or such Subsidiary, or in any manner affect the Collateral.

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SECTION 7.08 USE OF PROCEEDS. Use the proceeds of the Loan for the purpose or purposes set forth in Recital A above and, without the prior written consent of the Lender, for no other purpose or purposes.

SECTION 7.09 MAINTENANCE OF PROPERTIES. Keep, and cause the Subsidiaries to keep and maintain, its properties, whether owned in fee or otherwise, or leased, in good operating condition (normal wear and tear excepted); make and, cause the Subsidiaries to make, all proper repairs, renewals, replacements, additions and improvements thereto needed to maintain such properties in good operating condition; comply, and cause the Subsidiaries to comply, with the material provisions of all material leases to which it is party or under which it occupies property so as to prevent any loss or forfeiture thereof or thereunder; and comply, or cause the Subsidiaries to comply, with all laws, rules, regulations and orders applicable to its properties or business or any part thereof and the violation of which would have a material adverse effect on the conduct of its business.

SECTION 7.10 OTHER LIENS, SECURITY INTERESTS, ETC. Keep, and cause the Subsidiaries to keep, its material properties and assets, including, without limitation, the Collateral, free from all liens, security interests and claims of every kind and nature, other than the security interest granted to the Lender pursuant to this Agreement and the Permitted Liens.

SECTION 7.11 BOOKS AND RECORDS. (a) Keep and maintain and cause the Subsidiaries to keep and maintain accurate books and records, (b) make and cause the Subsidiaries to make entries on such books and records in form satisfactory to the Lender disclosing the Lender's assignment of, and security interest in and lien on, the Collateral and all collections received by the Borrower or any of the Subsidiaries on its Accounts, (c) furnish and cause the Subsidiaries to furnish to the Lender promptly upon request such information, reports, contracts, invoices, lists of purchases of Inventory (showing names, addresses and amount owing) and other data concerning account debtors and the Borrower's and Subsidiaries' Accounts and Inventory and all contracts and collection(s) relating thereto as the Lender may from time to time specify, (d) unless the Lender shall otherwise consent in writing, keep and maintain and cause the Subsidiaries to keep and maintain all such books and records mentioned in (a) above only at the addresses listed in EXHIBIT B, and (e) permit and cause the Subsidiaries to permit any Person designated by the Lender to enter the premises of the Borrower and the Subsidiaries and examine, audit and inspect the books and records at any reasonable time and from time to time without notice.

SECTION 7.12 BUSINESS NAMES. Immediately notify and cause each of the Subsidiaries to notify the Lender of any change in the name under which it conducts its business.

SECTION 7.13 ERISA. Maintain at all times such bonding as is required by ERISA. As soon as practicable and in any event within 15 days after it knows or has reason to know that, with respect to any plan, a "reportable event" has occurred, the Borrower will deliver to the Lender a certificate signed by its chief financial officer setting forth the details of such "re-

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portable event". The Borrower shall agree that with respect to any pension plan which the Borrower and/or any Commonly Controlled Entity maintains or contributes to, either now or in the future, that: (a) such bonding as is required under ERISA will be maintained; (b) as soon as practicable and in any event within 15 days after the Borrower or any Commonly Controlled Entity knows or has reason to know that a "reportable event" has occurred or is likely to occur, the Borrower will deliver to the Lender a certificate signed by its chief financial officer setting forth the details of such "reportable event"; (c) within 15 days after notice is received by the Borrower or any Commonly Controlled Entity that any multiemployer plan has been or will be placed in "reorganization" within the meaning of ERISA ss.4241, the Borrower will notify the Lender to that effect; and (d) upon the Lender's request, the Borrower will deliver to the Lender a copy of the most recent actuarial report, financial statements and annual report completed with respect to any "defined benefit plan", as defined in ERISA ss.3(35).

SECTION 7.14 MANAGEMENT. Promptly notify the Lender of any contemplated changes in its Senior Management subsequent to the date hereof.

SECTION 7.15 BANKING RELATIONSHIP. Maintain the Lender as its principal depository.

SECTION 7.16 NOTIFICATION OF EVENTS OF DEFAULT AND ADVERSE DEVELOPMENTS. The Borrower will promptly notify the Lender upon obtaining knowledge of the occurrence of:

- (a) any Event of Default;
- (b) any Default;
- (c) any event, development or circumstance whereby the financial statements furnished hereunder fail in any material respect to present fairly, in accordance with GAAP, the financial condition and operational results of the Borrower or its Subsidiaries;
- (d) any judicial, administrative or arbitral proceeding pending against the Borrower or any of its Subsidiaries and any judicial or administrative proceeding known by the Borrower to be threatened against it or any of its Subsidiaries which, if adversely decided, could materially adversely affect its financial condition or operations (present or prospective); and
- (e) any other development in the business or affairs of the Borrower and any of its Subsidiaries which may be materially adverse;

in each case describing in detail satisfactory to the Lender the nature thereof and, in the case of notification under clauses (a) and (b), the action the Borrower proposes to take with respect thereto.

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SECTION 7.17 INSURANCE GENERALLY. Maintain, and cause each of its Subsidiaries to maintain, insurance with responsible insurance companies on such of its properties, in such amounts and against such risks as is customarily maintained by similar businesses operating in the same vicinity; maintain general public liability insurance against claims for personal injury, death or property damage in such amounts as are satisfactory to the Lender and workmen's compensation insurance in statutory amounts with such companies as are licensed to do business in the state requiring the same; file, and cause each of its Subsidiaries to file, with the Lender, upon its request, a detailed list of the insurance then in effect and stating the names of the insurance companies, the amounts and rates of the insurance, dates of the expiration thereof and the properties and risks covered thereby; and, within thirty (30) days after notice in writing from the Lender, obtain, and cause each of its Subsidiaries to obtain, such additional insurance as the Lender may reasonably request.

SECTION 7.18 MAINTENANCE OF THE COLLATERAL. Not permit anything to be done to the Collateral which may materially impair the value thereof. The Lender, or an agent designated by the Lender, shall be permitted to enter the premises of the Borrower, and the Subsidiaries, and examine, audit and inspect the Collateral at any reasonable time and from time to time without notice. The Lender agrees to act in a commercially reasonable manner when inspecting, examining or auditing the Collateral. The Lender shall not have any duty to, and the Borrower hereby releases the Lender from all claims of loss or damage caused by the delay or failure to collect or enforce any of the Accounts or to, preserve any rights against any other party with an interest in the Collateral.

SECTION 7.19 DEFENSE OF TITLE AND FURTHER ASSURANCES. At its expense defend the title to the Collateral (or any part thereof), and promptly upon request execute, acknowledge and deliver any financing statement, renewal, affidavit, deed, assignment, continuation statement, security agreement, certificate or other document the Lender may reasonably require in order to perfect, preserve, maintain, protect, continue and/or extend the lien or security interest granted to the Lender under this Agreement and its priority. The Borrower shall pay to the Lender on demand all taxes, costs and reasonable expenses incurred by the Lender in connection with the preparation, execution, recording and filing of any such document or instrument.

SECTION 7.20 SUBSEQUENT OPINION OF COUNSEL AS TO RECORDING REQUIREMENTS. Provide to the Lender a subsequent opinion of counsel as to the filing, recording and other requirements with which the Borrower and the Subsidiaries have complied to maintain the lien and security interest in favor of the Lender in the Collateral in the event that the Borrower or any Subsidiary shall transfer its principal place of business or the office where it keeps its records pertaining to the Accounts.

SECTION 7.21 ASSIGNMENTS OF ACCOUNTS. Promptly, upon request, execute and deliver to the Lender written assignments, in form and content acceptable to the Lender, of specific Accounts or groups of Accounts; provided, however, the lien and/or security interest granted to the Lender under this Agreement shall not be limited in any way to or by the inclusion

or exclusion of Accounts within such assignments. Such Accounts shall secure payment of the Obligations and are not sold to the Lender whether or not any assignment thereof, which is separate from this Agreement, is in form absolute.

SECTION 7.22 NOTICE OF RETURNED GOODS, ETC. Promptly notify and cause the Subsidiaries to promptly notify the Lender of the return, rejection or repossession of any goods sold or delivered in respect of any Accounts, and of any claims made in regard thereto. Whenever the Borrower obtains possession (by return, rejection, repossession or otherwise) of any goods, the sale or lease of which gave rise to an Account, the Borrower will (unless the Lender shall otherwise consent in writing) physically segregate such goods from the Borrower's other property, and label and hold such goods as trustee for the Lender for such disposition as the Lender may direct.

SECTION 7.23 COLLECTIONS. Until such time as the Lender shall notify the Borrower and each of the Subsidiaries of the revocation of such privilege,

the Borrower and each of the Subsidiaries (a) shall at its own expense have the privilege for the account of and in trust for the Lender of collecting its Accounts and receiving in respect thereto all items of payment and shall otherwise completely service all of the Accounts including (i) the billing, posting and maintaining of complete records applicable thereto, and (ii) the taking of such action with respect to such Accounts as the Lender may request or in the absence of such request, as the Borrower and each of the Subsidiaries may deem advisable; and (b) may grant, in the ordinary course of business, to any account debtor, any discount, rebate, refund or adjustment to which the account debtor may be lawfully entitled, and may accept, in connection therewith, the return of goods, the sale or lease of which shall have given rise to an Account. The Lender may, at its option, at any time or from time to time after default hereunder, revoke the collection privilege given to the Borrower and each of the Subsidiaries herein by either giving notice of its assignment of, and lien on the Collateral to the account debtors or giving notice of such revocation to the Borrower and each of the Subsidiaries.

SECTION 7.24 NOTICE TO ACCOUNT DEBTORS AND ESCROW ACCOUNT. In the event (a) an Event of Default exists, (b) an event has occurred or condition exists which, with the giving of notice or the lapse of time will constitute an Event of Default, or (c) demand has been made for any or all of the Obligations, the Borrower and the Subsidiaries shall promptly upon the request of the Lender (a) in such form and at such times as specified by the Lender, give notice of the Lender's lien on the Accounts to the account debtors requiring the account debtors to make payments thereon directly to the Lender, (b) promptly upon receipt deposit the Items of Payment into the Collateral Account in the original form received by the Borrower and the Subsidiaries (except for the endorsement of the Borrower and the Subsidiaries where necessary, which endorsement the Borrower agrees to make, and the Lender, by its duly authorized officers or nominee, is also hereby irrevocably authorized to make such endorsement on the Borrower's behalf). Pending deposit thereof to the Collateral Account, the Borrower and the Subsidiaries shall not commingle any Items of Payment with any of its other funds or property, but will hold them separate and apart therefrom in trust and for the account of the Lender until deposit to the

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Collateral Account or other delivery thereof is made to the Lender. The Lender will in its discretion apply the whole or any part of the collected funds credited to the Collateral Account against the Obligations or credit such collected funds to the depository account of the Borrower with the Lender, the order and method of such application to be in the sole discretion of the Lender.

SECTION 7.25 GOVERNMENT ACCOUNTS. Immediately notify the Lender if any of the Accounts arise out of contracts with the United States or with any state or political subdivision thereof or any department, agency or instrumentality of the United States, or any state or political subdivision thereof, and execute any instruments and take any steps required by the Lender in order that all moneys due and to become due under such contracts shall be assigned to the Lender and notice thereof given to the government under the Federal Assignment of Claims Act or any other applicable law.

SECTION 7.26 HAZARDOUS MATERIALS; CONTAMINATION. The Borrowers agree to (a) give notice to the Lender immediately upon either Borrower's acquiring knowledge of the presence of any Hazardous Materials on any property owned or controlled by either Borrower or for which either Borrower is responsible or of any Hazardous Materials Contamination with a full description thereof, except for reasonable quantities of necessary supplies for use by the Borrower in the ordinary course of the its current line of business and stored, used and disposed in accordance with applicable Laws; (b) promptly comply with any Laws requiring the removal, treatment or disposal of Hazardous Materials or Hazardous Materials Contamination and provide the Lender with satisfactory evidence of such compliance; (c) provide the Lender, within thirty (30) days after a demand by the Lender, with a bond, letter of credit or similar financial assurance evidencing to the Lender's satisfaction that the necessary funds are available to pay the cost of removing, treating, and disposing of such Hazardous Materials or Hazardous Materials Contamination and discharging any Lien which may be established as a result thereof on any property owned or controlled by either Borrower or for which either Borrower is responsible; and (d) defend, indemnify and hold harmless the Lender and its agents, employees, trustees, successors and

assigns from any and all claims which may now or in the future (whether before or after the termination of this Agreement) be asserted as a result of the presence of any Hazardous Materials on any property owned or controlled by either Borrower for which either Borrower is responsible for any Hazardous Materials Contamination.

VIII. NEGATIVE COVENANTS OF BORROWER

Until payment in full and the performance of all of the Obligations, without the prior written consent of the Lender, the Borrower will not and will neither cause nor permit any of its Subsidiaries to, directly or indirectly:

SECTION 8.01 BORROWINGS. Create, incur, assume or suffer to exist any Indebtedness for Borrowed Money in excess of One Million Dollars (\$1,000,000) in the aggregate at any one time, except (a) borrowings in existence on the date hereof and reflected on

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the financial statements which the Borrower furnished to the Lender in writing prior to the date hereof, (b) borrowings secured by Permitted Liens, and (c) Indebtedness for Borrowed Money approved by the Lender in connection with any Permitted Acquisition, which approval will not be unreasonably withheld.

SECTION 8.02 MORTGAGES AND PLEDGES. Create, incur, assume or suffer to exist any Lien on any of its property or assets, whether now owned or hereafter acquired, except for Permitted Liens.

SECTION 8.03 METHOD OF ACCOUNTING. Change the method of accounting employed in the preparation of the financial statements furnished prior to the date of this Agreement to the Lender pursuant to Part V of this Agreement, unless required to conform to GAAP and on the condition that the Borrower's accountants shall furnish such information as the Lender may request to reconcile the changes with the Borrower's prior financial statements.

SECTION 8.04 Merger, Acquisition or Sale of Assets.

(a) The Borrower and each Subsidiary shall not alter or amend its capital structure or authorize any additional class of equity if as a result of such action the Borrower would own less than fifty one percent (51%) of any Subsidiary, or acquire all or substantially all the assets of any Person, or sell, lease or otherwise dispose of any of net assets in excess of Five Hundred Thousand Dollars (\$500,000) in the aggregate, during any twelve (12) month period.

(b) The Borrower may acquire by merger, stock purchase or asset purchase all or substantially all the assets of any Person or make investments in any such Person (each a "Permitted Acquisition" and collectively, the "Permitted Acquisitions") during the existence of this Agreement and in connection with, whether concurrently or subsequent to, any such Permitted Acquisition, alter or amend its capital structure or authorize any additional class of equity, provided that the Person being acquired or invested in shall be in a business complementary to the Borrower's current line of business, the Borrower will own at all times not less than fifty-one percent (51%) of each of its Subsidiaries, and after completing said Permitted Acquisition the Borrower shall remain in compliance with all of the terms and conditions of this Agreement. The Borrower shall provide the Lender with financial information on the Person being acquired within fifteen (15) days of such Permitted Acquisition. The Borrower may advance funds for Permitted Acquisitions (said acquisitions being called "Bank Financed Acquisitions").

(c) Not less than five (5) Business Days prior to finalizing any Bank Financed Acquisition, and in all cases prior to the Lender advancing any monies for such Bank Financed Acquisition, the Borrower shall provide the Lender with a written summary of the transaction, which summary shall set forth, among other things, the structure of the transaction, including whether the transaction shall cause a change in the Borrower's or any Subsidiary's capital structure, require the issuance of stock, or options to purchase stock, or

require the Borrower or

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any Subsidiary to redeem any stock. For purposes hereof, all consideration incurred in connection with each Bank Financed Acquisition including, but not limited to non-compete agreements and the value of assets, stock, warrants, or other property transferred, pledged or given in connection with any Bank Financed Acquisition shall be deemed the "Acquisition Price." In addition, the Borrower shall at the same time provide the Lender with a pro-forma Compliance Certificate which indicates that no default will occur under this Agreement as a result of the contemplated Bank Financed Acquisition. The pro-forma Compliance Certificate may take into consideration the income statement of the targeted acquisition, adjusted for the projected elimination of any officer compensation. However, other projected financial efficiencies as of the result of such acquisition may not be included in the pro-forma. If the target company has had negative income or EBITDA during the prior twelve month period, the income statement will be included by the Borrower in the pro-forma Compliance Certificate.

(d) The Borrower shall seek and obtain the prior written approval of the Lender prior to finalizing any Bank Financed Acquisition, if:

(i) the Acquisition Price is in excess of \$2,500,000;

or

(ii) the total Acquisition Price for all Bank Financed Acquisitions exceeds \$5,000,000; or

(iii) the acquisition is a "hostile" acquisition; or

(iv) the target of the acquisition is a business whose principal office is located outside of the United States.

(e) Upon completion of each Bank Financed Acquisition, the Borrower and each Subsidiary shall promptly provide the Lender with all material details of the transaction requested by the Lender.

(f) In addition, each Person now or hereafter acquired either through a Permitted Acquisition of a Bank Financed Acquisition shall join as a co-maker on the Note, and be added to each of the Financing Documents, including, but not limited to, this Agreement.

SECTION 8.05 ADVANCES AND LOANS. Lend money, give credit or make advances to any person, firm, joint venture or corporation, including, without limitation, officers, directors, employees, Subsidiaries and Affiliates of the Borrower.

SECTION 8.06 CONTINGENT LIABILITIES. Assume, guarantee, endorse, contingently agree to purchase or otherwise become liable upon the obligation of any person, firm, partnership, joint venture or corporation, except (a) by the endorsement of negotiable instruments for deposit or collection or similar transactions in the ordinary course of business and (b) guaran-

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ties by the Borrower of contractual obligations (other than for the payment of borrowed money) of any Wholly Owned Subsidiary of the Borrower.

SECTION 8.07 INVESTMENTS. Purchase or acquire the obligations or stock of, or any other or additional interest in, any person, firm, partnership, joint venture or corporation except (a) in connection with a Permitted Acquisition and/or a Bank Finance Acquisition, (b) general obligations of, or obligations unconditionally guaranteed as to principal and interest by, the United States of America, (c) bonds, debentures, participation certificates or notes issued by any agency or corporation which is or may hereafter be created by Act of the Congress of the United States as an agency or instrumentality thereof, (d)

Public Housing Bonds, Temporary Notes or Preliminary Loan Notes, fully secured by contracts with the United States, and (e) certificates of deposit issued by the Lender.

SECTION 8.08 SUBSIDIARIES. Except as permitted under Section 8.04 of this Agreement, create or acquire any Subsidiaries other than the Subsidiaries existing as of the date hereof.

SECTION 8.09 ADDITIONAL STOCK. Issue any additional stock of any class, except stock of an existing class issued as a stock dividend.

SECTION 8.10 ERISA Compliance. Neither the Borrower nor any Commonly Controlled Entity will: (a) engage in or permit any "prohibited transaction" (as defined in ERISA); (b) cause any "accumulated funding deficiency" as defined in ERISA and/or the Internal Revenue Code; (c) terminate any pension plan in a manner which could result in the imposition of a lien on the property of the Borrower pursuant to ERISA; (d) terminate or consent to the termination of any Multiemployer Plan; or (e) incur a complete or partial withdrawal with respect to any Multiemployer Plan.

SECTION 8.11 PROHIBITION ON HAZARDOUS MATERIALS. The Borrower shall not place, manufacture or store or permit to be placed, manufactured or stored any Hazardous Materials on any property owned, controlled or operated by the Borrower or for which the Borrower is responsible, except for reasonable quantities of necessary supplies for use by the Borrower in the ordinary course of the its current line of business and stored, used and disposed in accordance with applicable Laws.

SECTION 8.12 TRANSFER OF COLLATERAL. Transfer, or permit the transfer, to another location of any of the Collateral or the books and records related to any of the Collateral; provided, however, that the Borrower may transfer the Collateral or the books and records related thereto to another location if (a) the Borrower shall have provided to the Lender prior to such transfer an opinion of counsel addressed to the Lender to the effect that the Lender's perfected security interest shall not be affected by such move or if it shall be affected, setting forth the steps necessary to continue the Lender's perfected security interest together with the commencement of such steps by the Borrower at its expense, and (b) shall have taken such steps.

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SECTION 8.13 SALE AND LEASEBACK. Directly or indirectly enter into any arrangement to sell or transfer all or any substantial part of its fixed assets then owned by it and thereupon or within one year thereafter rent or lease the assets so sold or transferred.

SECTION 8.14 SALE OF ACCOUNTS. Sell, discount, transfer, assign or otherwise dispose of any of its Accounts, notes receivable, installment or conditional sales agreements or any other rights to receive income, revenues or moneys, however evidenced.

SECTION 8.15 LINE OF BUSINESS. Enter into any lines or areas of business which do not complement the Borrower's current line of business.

IX. EVENTS OF DEFAULT

The occurrence of one or more of the following events shall be "Events of Default" under this Agreement, and the terms "Event of Default" or "Default" shall mean, whenever they are used in this Agreement, any one or more of the following events:

SECTION 9.01 FAILURE TO PAY. The Borrower shall fail to (a) make any payment of principal or interest on either of the Note or (b) pay any of the Obligations, when and as the same shall become due and payable.

SECTION 9.02 BREACH OF REPRESENTATIONS AND WARRANTIES. Any representation or warranty made herein or in any report, certificate, opinion (including any opinion of counsel for the Borrower), financial statement or other instrument furnished in connection with the Obligations or with the

execution and delivery of any of the Financing Documents, shall prove to have been false or misleading when made in any material respect.

SECTION 9.03 FAILURE TO COMPLY WITH INSURANCE PROVISIONS. The Borrower shall fail to duly and promptly perform, comply with or observe the terms, covenants, conditions and agreements set forth in SECTION 7.17 .

SECTION 9.04 FAILURE TO COMPLY WITH COVENANTS. Default shall be made by the Borrower in the due observance and performance of any covenant, condition or agreement contained in SECTIONS 7.02, 7.04 or 7.08 hereof or in Part VIII hereof.

SECTION 9.05 OTHER DEFAULTS. Default shall be made by the Borrower in the due observance or performance of any other term, covenant or agreement herein contained, which default shall remain unremedied for thirty (30) days after written notice thereof to the Borrower by the Lender.

SECTION 9.06 DEFAULT UNDER OTHER FINANCING DOCUMENTS. An event of default shall occur under any of the other Financing Documents, and such event of default is not cured within any applicable grace period provided therein.

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SECTION 9.07 RECEIVER; BANKRUPTCY. The Borrower or any Subsidiary shall (a) apply for or consent to the appointment of a receiver, trustee or liquidator of itself or any of its property, (b) admit in writing its inability to pay its debts as they mature, (c) make a general assignment for the benefit of creditors, (d) be adjudicated a bankrupt or insolvent, (e) file a voluntary petition in bankruptcy or a petition or an answer seeking reorganization or an arrangement with creditors or to take advantage of any bankruptcy, reorganization, insolvency, readjustment of debt, dissolution or liquidation law or statute, or an answer admitting the material allegations of a petition filed against it in any proceeding under any such law or if corporate action shall be taken by the Borrower or any Subsidiary for the purposes of effecting any of the foregoing, or (f) by any act indicate its consent to, approval of or acquiescence in any such proceeding or the appointment of any receiver or trustee for any of its property, or suffer any such receivership, trusteeship or proceeding to continue undischarged for a period of sixty (60) days.

SECTION 9.08 JUDGMENT. Unless adequately insured in the opinion of the Lender, the entry of a final judgment for the payment of money involving more than \$10,000 against the Borrower or any Subsidiary and the failure by the Borrower or such Subsidiary to discharge the same, or cause it to be discharged, within thirty (30) days from the date of the order, decree or process under which or pursuant to which such judgment was entered, or to secure a stay of execution pending appeal of such judgment.

SECTION 9.09 EXECUTION; ATTACHMENT. Any execution or attachment shall be levied against the Collateral, or any part thereof, and such execution or attachment shall not be set aside, discharged or stayed within thirty (30) days after the same shall have been levied.

SECTION 9.10 DEFAULT UNDER OTHER BORROWINGS. Default shall be made with respect to any evidence of indebtedness or liability for borrowed money (other than the Loan) if the effect of such default is to accelerate the maturity of such evidence of indebtedness or liability or to permit the holder or obligee thereof to cause any indebtedness to become due prior to its stated maturity.

SECTION 9.11 MATERIAL ADVERSE CHANGE. If the Lender in its sole discretion determines in good faith that a material adverse change has occurred in the financial condition of the Borrower from the financial condition set forth in the financial statements dated June 30, 1996 or from the financial condition of the Borrower most recently disclosed to the Lender in any manner.

SECTION 9.12 IMPAIRMENT OF POSITION. If the Lender in its sole discretion determines in good faith that an event has occurred which impairs the prospect of payment of the Obligations and/or the value of the Collateral.

SECTION 9.13 CHANGE IN MANAGEMENT. Any change in the composition of more than two members of the Senior Management of the Borrower.

SECTION 9.14 AUDIT RESULTS. If the Lender concludes after examining the results of any audits of the Borrower's books and records or the Collateral that the condition of the Borrower is unsatisfactory.

X. RIGHTS AND REMEDIES UPON DEFAULT

SECTION 10.01 DEMAND; ACCELERATION. The occurrence or non-occurrence of an Event of Default under this Agreement shall in no way affect or condition the right of the Lender to demand payment at any time of any of the Obligations which are payable on demand regardless of whether or not an Event of Default has occurred. Upon the occurrence of an Event of Default, and in every such event and at any time thereafter, the Lender may declare the Obligations due and payable, without presentment, demand, protest, or any notice of any kind, all of which are hereby expressly waived, anything contained herein or in any of the other Financing Documents to the contrary notwithstanding.

SECTION 10.02 SPECIFIC RIGHTS WITH REGARD TO COLLATERAL. In addition to all other rights and remedies provided hereunder or as shall exist at law or in equity from time to time, the Lender may, without notice to the Borrower:

(a) request any account debtor obligated on any of the Accounts to make payments thereon directly to the Lender, with the Lender taking control of the cash and non-cash proceeds thereof;

(b) compromise, extend or renew any of the Collateral or deal with the same as it may deem advisable;

(c) make exchanges, substitutions or surrenders of all or any part of the Collateral;

(d) remove from any of the Borrower's or any Subsidiary's place of business all books, records, ledger sheets, correspondence, invoices and documents, relating to or evidencing any of the Collateral or without cost or expense to the Lender, make such use of the Borrower's or any Subsidiary's place(s) of business as may be reasonably necessary to administer, control and collect the Collateral;

(e) repair, alter or supply goods if necessary to fulfill in whole or in part the purchase order of any account debtor;

(f) demand, collect, receipt for and give renewals, extensions, discharges and releases of any of the Collateral;

(g) institute and prosecute legal and equitable proceedings to enforce collection of, or realize upon, any of the Collateral;

(h) settle, renew, extend, compromise, compound, exchange or adjust claims in respect of any of the Collateral or any legal proceedings brought in respect thereof;

(i) endorse the name of the Borrower upon any items of payment relating to the Collateral or on any proof of claim in bankruptcy against an account debtor; and

(j) notify the post office authorities to change the address for the delivery of mail to the Borrower to such address or post office box as the Lender may designate and receive and open all mail addressed to the Borrower.

SECTION 10.03 PERFORMANCE BY LENDER. If the Borrower shall fail to pay the Obligations or otherwise fail to perform, observe or comply with any of the conditions, covenants, terms, stipulations or agreements contained in this Agreement or any of the other Financing Documents, the Lender without notice to or demand upon the Borrower and without waiving or releasing any of the Obligations or any Event of Default, may (but shall be under no obligation to) at any time thereafter make such payment or perform such act for the account and at the expense of the Borrower, and may enter upon the premises of the Borrower for that purpose and take all such action thereon as the Lender may consider necessary or appropriate for such purpose. All sums so paid or advanced by the Lender and all costs and expenses (including, without limitation, reasonable attorneys' fees and expenses) incurred in connection therewith (the "Expense Payments") together with interest thereon from the date of payment, advance or incurring until paid in full at the rate of one percent (1%) per annum in excess of the highest fluctuating interest rate payable under the Note from time to time shall be paid by the Borrower to the Lender on demand and shall constitute and become a part of the Obligations.

SECTION 10.04 UNIFORM COMMERCIAL CODE AND OTHER REMEDIES. Upon the occurrence of an Event of Default (and in addition to all of its rights, powers and remedies under this Agreement), the Lender shall have all of the rights and remedies of a secured party under the Maryland Uniform Commercial Code and other applicable laws, and the Lender is authorized to offset and apply to all or any part of the Obligations all moneys, credits and other property of any nature whatsoever of the Borrower now or at any time hereafter in the possession of, in transit to or from, under the control or custody of, or on deposit with, the Lender. Upon demand by the Lender, the Borrower shall assemble the Collateral and make it available to the Lender, at a place designated by the Lender. The Lender or its agents may enter upon the Borrower's premises to take possession of the Collateral, to remove it, to render it unusable, or to sell or otherwise dispose of it.

Any written notice of the sale, disposition or other intended action by the Lender with respect to the Collateral which is sent by regular mail, postage prepaid, to the Borrower at the address set forth in Part XI hereof, or such other address of the Borrower which may from time to time be shown on the Lender's records, at least ten (10) days prior to such sale, disposition or other action, shall constitute reasonable notice to the Borrower. The Borrower shall pay on demand all costs and expenses, including, without limitation, attorney's fees and expenses,

incurred by or on behalf of the Lender in preparing for sale or other disposition, selling, managing, collecting or otherwise disposing of, the Collateral. All of such costs and expenses (the "Liquidation Costs") together with interest thereon from the date incurred until paid in full at the Default Rate, shall be paid by the Borrower to the Lender on demand and shall constitute and become a part of the Obligations. Any proceeds of sale or other disposition of the Collateral will be applied by the Lender to the payment of the Liquidation Costs and Expense Payments, and any balance of such proceeds will be applied by the Lender to the payment of the balance of the Obligations in such order and manner of application as the Lender may from time to time in its sole discretion determine. After such application of the proceeds, any balance shall be paid to the Borrower or to any other party entitled thereto.

XI. MISCELLANEOUS

SECTION 11.01 NOTICES. All notices, certificates or other communications hereunder shall be deemed given when delivered by hand or courier, or three (3) days after the date when mailed by certified mail, postage prepaid, return receipt requested, addressed as follows:

if to the Lender:	NATIONSBANK, N.A. 6610 Rockledge Drive Bethesda, Maryland 20817 Attn: Barbara P. Levy, Vice President
if to the Borrower:	FORENSIC TECHNOLOGIES INTERNATIONAL

CORPORATION
2021 Research Drive
Annapolis, Maryland 21401
Attn: Mr. Gary Sindler
Chief Financial Officer

with a copy to:

George Stamas, Esquire
Wilmer, Cutler & Pickering
100 Light Street
Baltimore, Maryland 21202

SECTION 11.02 CONSENTS AND APPROVALS. If any consent, approval, or authorization of any state, municipal or other governmental department, agency or authority or of any person, or any person, corporation, partnership or other entity having any interest therein, should be necessary to effectuate any sale or other disposition of the Collateral, the Borrower agrees to execute all such applications and other instruments, and to take all other action, as may be required in connection with securing any such consent, approval or authorization.

SECTION 11.03 Remedies, etc. Cumulative. Each right, power and remedy of the Lender as provided for in this Agreement or in any of the other Financing Documents or now or

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hereafter existing at law or in equity or by statute or otherwise shall be cumulative and concurrent and shall be in addition to every other right, power or remedy provided for in this Agreement or in any of the other Financing Documents or now or hereafter existing at law or in equity, by statute or otherwise, and the exercise or beginning of the exercise by the Lender of any one or more of such rights, powers or remedies shall not preclude the simultaneous or later exercise by the Lender of any or all such other rights, powers or remedies. In order to entitle the Lender to exercise any remedy reserved to it herein, it shall not be necessary to give any notice, other than such notice as may be expressly required in this Agreement.

SECTION 11.04 NO WAIVER OF RIGHTS BY THE LENDER. No failure or delay by the Lender to insist upon the strict performance of any term, condition, covenant or agreement of this Agreement or of any of the other Financing Documents, or to exercise any right, power or remedy consequent upon a breach thereof, shall constitute a waiver of any such term, condition, covenant or agreement or of any such breach or preclude the Lender from exercising any such right, power or remedy at any later time or times. By accepting payment after the due date of any amount payable under this Agreement or under any of the other Financing Documents, the Lender shall not be deemed to waive the right either to require prompt payment when due of all other amounts payable under this Agreement or under any of the other Financing Documents, or to declare a default for failure to effect such prompt payment of any such other amount.

SECTION 11.05 ENTIRE AGREEMENT. The Financing Documents shall completely and fully supersede all other agreements, both written and oral, between the Lender and the Borrower relating to the Obligations. Neither the Lender nor the Borrower shall hereafter have any rights under such prior agreements but shall look solely to the Financing Documents for definition and determination of all of their respective rights, liabilities and responsibilities relating to the Obligations.

SECTION 11.06 SURVIVAL OF AGREEMENT; SUCCESSORS AND ASSIGNS. All covenants, agreements, representations and warranties made by the Borrower herein and in any certificate, in the Financing Documents and in any other instruments or documents delivered pursuant hereto shall survive the making by the Lender of the Loans and the execution and delivery of the Note, and shall continue in full force and effect so long as any of the Obligations are outstanding and unpaid. Whenever in this Agreement any of the parties hereto is referred to, such reference shall be deemed to include the successors and assigns of such party; and all covenants, promises and agreements by or on behalf of the Borrower, which are contained in this Agreement shall inure to the benefit of the successors and assigns of the Lender, and all covenants, promises and agreements by or on behalf of the Lender which are contained in this

Agreement shall inure to the benefit of the permitted successors and permitted assigns of the Borrower, but this Agreement may not be assigned by the Borrower without the prior written consent of the Lender.

SECTION 11.07 EXPENSES. The Borrower agrees to pay all out-of-pocket expenses of the Lender (including the reasonable fees and expenses of its legal counsel) in connection with the preparation of this Agreement, the recordation of all financing statements and such other

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instruments as may be required by the Lender at the time of, or subsequent to, the execution of this Agreement to secure the Obligations (including any and all recordation tax and other costs and taxes incident to recording), the enforcement of any provision of this Agreement and the collection of the Obligations. The Borrower agrees to indemnify and save harmless the Lender for any liability resulting from the failure to pay any required recordation tax, transfer taxes, recording costs or any other expenses incurred by the Lender in connection with the Obligations. The provisions of this Section shall survive the execution and delivery of this Agreement and the repayment of the Obligations. The Borrower further agrees to reimburse the Lender upon demand for all out-of-pocket expenses (including reasonable attorneys' fees and legal expenses) incurred by the Lender in enforcing any of the Obligations or any security therefor, which agreement shall survive the termination of this Agreement and the repayment of the Obligations.

SECTION 11.08 COUNTERPARTS. This Agreement may be executed in any number of counterparts all of which together shall constitute a single instrument.

SECTION 11.09 GOVERNING LAW. This Agreement and all of the other Financing Documents shall be governed by, and construed in accordance with the laws of the State of Maryland.

SECTION 11.10 MODIFICATIONS. No modification or waiver of any provision of this Agreement or of any of the other Financing Documents, nor consent to any departure by the Borrower therefrom, shall in any event be effective unless the same shall be in writing, and then such waiver or consent shall be effective only in the specific instance and for the purpose for which given. No notice to or demand on the Borrower in any case shall entitle the Borrower to any other or further notice or demand in the same, similar or other circumstance.

SECTION 11.11 ILLEGALITY. If fulfillment of any provision hereof or any transaction related hereto or to any of the other Financing Documents, at the time performance of such provision shall be due, shall involve transcending the limit of validity prescribed by law, then ipso facto, the obligation to be fulfilled shall be reduced to the limit of such validity; and if any clause or provisions herein contained other than the provisions hereof pertaining to repayment of the Obligations operates or would prospectively operate to invalidate this Agreement in whole or in part, then such clause or provision only shall be void, as though not herein contained, and the remainder of this Agreement shall remain operative and in full force and effect; and if such provision pertains to repayment of the Obligations, then, at the option of the Lender, all of the Obligations of the Borrower to the Lender shall become immediately due and payable.

SECTION 11.12 EXTENSION OF MATURITY. Should the principal of or interest on the Note become due and payable on other than a Banking Day, the maturity thereof shall be extended to the next succeeding Banking Day and in the case of principal, interest shall be payable thereon at the rate per annum specified in the Note during such extension.

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SECTION 11.13 GENDER, ETC. Whenever used herein, the singular number shall include the plural, the plural the singular and the use of the masculine, feminine or neuter gender shall include all genders.

SECTION 11.14 HEADINGS. The headings in this Agreement are for convenience only and shall not limit or otherwise affect any of the terms hereof.

SECTION 11.15 WAIVER OF TRIAL BY JURY. The parties hereto hereby waive trial by jury in any action or proceeding to which both of them may be parties, arising out of or in any way pertaining to (a) this Agreement, (b) the Loan, Obligations, and Collateral which are the subject of this Agreement, and (c) any and all notes, guarantees, assignments or agreements of any kind relating to the Loan. It is agreed and understood that this waiver constitutes a waiver of trial by jury of all claims against all parties to such actions or proceedings, including claims against parties who are not parties to this Agreement.

This waiver is knowingly, willingly and voluntarily made by each of the parties hereto, and the parties hereby represent that no representations of fact or opinion have been made by any individual to induce this waiver of trial by jury or to in any way modify or nullify its effect. The parties further represent that they have been represented in the signing of this Agreement and in the making of this waiver by independent legal counsel, selected of their own free will, and that they have had the opportunity to discuss this waiver with counsel.

SECTION 11.16 LIABILITY OF THE LENDER. The Borrower hereby agrees that the Lender shall not be chargeable for any negligence, mistake, act or omission of any accountant, examiner, agency or attorney employed by the Lender (except for the willful misconduct of any person, corporation, partnership or other entity employed by the Lender) in making examinations, investigations or collections, or otherwise in perfecting, maintaining, protecting or realizing upon any lien or security interest or any other interest in the Collateral or other security for the Obligations.

[REMAINDER OF PAGE INTENTIONALLY LEFT BLANK]

IN WITNESS WHEREOF, the parties hereto have signed and sealed this Agreement on the day and year first above written.

Borrower:

WITNESS OR ATTEST:

FORENSIC TECHNOLOGIES INTERNATIONAL CORPORATION

- - - - -

By: _____ (SEAL)
Name:
Title:

Subsidiaries:

WITNESS OR ATTEST:

TEKLICON, INC.

By: _____ (SEAL)
Name:
Title:

Lender:

WITNESS:

NATIONSBANK, N.A.

By: /s/ Barbara P. Levy
----- (SEAL)
Barbara P. Levy
Vice President

Exhibit 23.1

CONSENT OF INDEPENDENT AUDITORS

We consent to the incorporation by reference in the Registration Statement (Form S-8 No. 333-19251) pertaining to the 1992 Stock Option Plan of Forensic Technologies International Corporation of our report dated January 31, 1997, with respect to the consolidated financial statements of Forensic Technologies International Corporation included in the Annual Report (Form 10-KSB) for the year ended December 31, 1996.

/s/ Ernst & Young

Baltimore, Maryland
March 26, 1997

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