

MAI SYSTEMS CORP
Form 10-K/A
September 22, 2005

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, DC 20549

**Amendment No. 1
to**

FORM 10-K

ý Annual report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the fiscal year ended December 31, 2004 or

o Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934.

For the transition period from to .

Commission file number: 1-9158

MAI Systems Corporation

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

22-2554549
(IRS Employer Identification No.)

26110 Enterprise Way, Lake Forest, CA 92630

Address of principal executive offices

Registrant's telephone number including area code (949) 598-6000

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: Common Stock, Par Value \$0.01
Preferred Stock, Par Value \$0.01
(Title of Class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 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 the past 90 days. Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not 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-K or any amendment to this Form 10-K.

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

Yes No

The aggregate market value of the common stock held by non-affiliates of the registrant, based upon the last sale price of the Common Stock reported on the National Association of Securities Dealers Automated Quotation National Market System on June 27, 2003 was \$1,403,684.

The number of shares of common stock outstanding as of July 18, 2005 was 57,847,862. The aggregate market value of the common stock held by non-affiliates of the registrant, based upon the last sale price of the Common Stock reported on the Over-the-counter Bulletin Board on September 16, 2005 was \$510,669.

DOCUMENTS INCORPORATED BY REFERENCE

(To the Extent Indicated Herein)

EXPLANATORY NOTE

The amendment is due to the Goodwill allocation of purchase price that should be \$6,372,000 and the total should be \$13,819,000. Both figures were wrong on the original filing.

PART IV

ITEM 15. EXHIBITS, FINANCIAL STATEMENTS AND SCHEDULE AND REPORTS ON FORM 8-K

(a) 1. Financial Statements

Report of Independent Registered Public Accounting Firm
Consolidated Balance Sheets
Consolidated Statements of Operations
Consolidated Statements of Stockholders' Deficiency and
Comprehensive Income (Loss)
Consolidated Statements of Cash Flows
Notes to Consolidated Financial Statements

The consolidated financial statements of the Company, the notes thereto and the Report of the Independent Registered Public Accounting Firm are incorporated herein by reference to the Company's 2004 Annual Report.

2. Financial Statement Schedule

Schedule II Valuation and Qualifying Accounts

3. Exhibits:

| Number | Exhibit |
|---------------|---|
| 2.1 | First Amended Joint Chapter II Plan of Reorganization of MAI Systems Corporation, Brooke Acquisition Corp. and CLS Software, Inc., as confirmed by the United States Bankruptcy Court for the District of Delaware, on November 13, 1993, filed as Exhibit 2.1 to the Registrant's Current Report on Form 8-K dated January 15, 1994. |
| 2.2 | Consent Order Modifying Confirmed Plan of Reorganization and Fixing Effective Date, as entered by the United States Bankruptcy Court for the district of Delaware on January 27, 1994, as filed as Exhibit 2.2 to the Registrant's Current Report on form 8-K dated February 9, 1994. |
| 3.1 | Amended and Restated Certificate of Incorporation of MAI Systems Corporation, filed as Exhibit 3.1 to the Company's 1996 Annual Report on Form 10-K. |
| 3.2 | Amendment No. 1 to the Amended and Restated Certificate of Incorporation of MAI Systems Corporation, filed as Exhibit 3.2 to the Company's 1996 Annual Report on Form 10-K. |
| 3.3 | By-laws of MAI Systems Corporation, filed as Exhibit 2(b) to the Registrant's Registration Statement on Form 8-A/A filed with the Securities and Exchange Commission on February 24, 1994. |
| 3.4 | Amendment No. 2 to the Amended and Restated Certificate of Incorporation of MAI Systems Corporation, filed as Exhibit 3.4 to the Company's 1998 Annual Report on Form 10-K. |
| 3.5 | Amendment No. 3 to the Amended and Restated Certificate of Incorporation of MAI Systems Corporation, filed on August 25, 2004 as Appendix B to the Company's Definitive Proxy Statement. |
| *10.1 | Amended and Restated MAI Systems Corporation 1993 Stock Option Plan (previously filed). |
| *10.2 | Amended and Restated 1995 Non-Employee Directors Stock Option Plan (previously filed). |

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- 10.3 Amended and Restated 2001 Restricted Stock Plan, filed on August 25, 2004 as Appendix C to the Company's Definitive Proxy Statement.
- 10.4 Coast Business Credit Loan and Security Agreement, dated April 23, 1998, filed as Exhibit 10.2 to the Company's 1998 Annual Report on Form 10-K.
- 10.5 Amendment Number One dated September 30, 1998 to the Loan and Security Agreement between Coast Business Credit and the Company dated April 23, 1998, filed as Exhibit 10.2 to the Company's 1999 Annual Report on Form 10-K.
- 10.6 Amendment Number Two dated March 2, 1999 to the Loan and Security Agreement between Coast Business Credit and the Company dated April 23, 1998, filed as Exhibit 10.3 to the Company's 1999 Annual Report on Form 10-K.

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- 10.7 Amendment Number Three dated June 16, 1999 to the Loan and Security Agreement between Coast Business Credit and the Company dated April 23, 1998, filed as Exhibit 10.4 to the Company's 1999 Annual Report on Form 10-K.
- 10.8 Amendment Number Four dated July 28, 1999 to the Loan and Security Agreement between Coast Business Credit and the Company dated April 23, 1998, filed as Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q for the period ending September 30, 1999.
- 10.9 Letter Agreement Amendment dated October 1, 1999 to the Loan and Security Agreement between Coast Business Credit and the Company dated April 23, 1998, filed as Exhibit 10.6 to the Company's 1999 Annual Report on Form 10-K.
- 10.10 Amendment Number Five dated April 13, 2000, to the Loan and Security Agreement between Coast Business Credit and the Company dated April 23, 1998, filed as Exhibit 10.20 to the Company's 1999 Annual Report on Form 10-K.
- 10.11 Amendment Number Six dated September 12, 2000, to the Loan and Security Agreement between Coast Business Credit and the Company dated April 23, 1998, filed as Exhibit 10.31 to the Company's 2000 Annual Report on Form 10-K.
- 10.12 Amendment Number Seven dated September 13, 2001, to the Loan and Security Agreement between Coast Business Credit and the Company dated April 23, 1998, filed as Exhibit 10.12 to the Company's 2001 Annual Report on Form 10-K.
- *10.13 Amendment Number Eight dated January 13, 2003, to the Loan and Security Agreement between Coast Business Credit and the Company dated April 23, 1998 (previously filed)
- 10.14 Pledge, Assignment and Security Agreement dated September 7, 2001 between Coast Business Credit, the Company, MAI Systems International and MAI Development Corporation, filed as Exhibit 10.13 to the Company's 2001 Annual Report on Form 10-K.
- 10.15 Collateral Release Agreement dated September 28, 2001 between Coast Business Credit and the Company filed as Exhibit 10.14 to the Company's 2001 Annual Report on Form 10-K.
- 10.17 Forebearance Agreement between MAI Systems Corporation and CPI Securities LP, The Value Realization Fund, L.P., The Canyon Value Realization Fund and GRS Partners II dated October 28, 1999, filed as Exhibit 10.7 to the Company's Quarterly Report on Form 10-Q for the period ending September 30, 1999.
- 10.18 Amendment No. 1 dated February 14, 2000 to Forebearance Agreement between MAI Systems Corporation and CPI Securities LP, The Value Realization Fund, L.P., The Canyon Value Realization Fund and GRS Partners II dated October 28, 1999, filed as Exhibit 10.18 to the Company's 1999 Annual Report on Form 10-K.
- 10.19 Amendment No. 2 dated April 13, 2000 to Forebearance Agreement between MAI Systems Corporation and CPI Securities LP, The Value Realization Fund, L.P., The Canyon Value Realization Fund and GRS Partners II dated October 28, 1999, filed as Exhibit 10.19 to the Company's 1999 Annual Report on Form 10-K.
- 10.20 Supplement and Amendment dated January 31, 2001 to Forebearance Agreement between MAI Systems Corporation and CPI Securities LP, The Value Realization Fund, L.P., The Canyon Value Realization Fund and GRS Partners II dated October 28, 1999, filed as Exhibit 10.32 to the Company's 2000 Annual Report on Form 10-K.
- *10.21 Collateral Release Agreement dated September 28, 2001 between MAI Systems Corporation and CPI Securities LP, The Value Realization Fund, L.P., The Canyon Value Realization Fund and GRS Partners II (previously filed).
- *10.22 Amendment No. 3 dated January 13, 2003 to Note Purchase Agreement between MAI Systems Corporation and CPI Securities LP, The Value Realization Fund, L.P., The Canyon Value Realization Fund and GRS Partners II dated October 28, 1999 (previously filed).
- *10.23 Amendment No. One dated January 13, 2003 to Intercreditor and Subordination Agreement dated April 23, 1998 between MAI Systems Corporation and CPI Securities LP, The Value Realization Fund, L.P., The Canyon Value Realization Fund, GRS Partners II and Coast Business Credit (previously filed).
- *10.24 Warrant Agreement between CPI Securities LP, The Value Realization Fund, L.P., The Canyon Value Realization Fund and GRS Partners II (previously filed).

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*10.25 Registration Rights Agreement between CPI Securities LP, The Value Realization Fund, L.P., The Canyon Value Realization Fund and GRS Partners II (previously filed).

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- 10.26 Settlement Agreement dated December 1, 2000 between CSA and MAI Systems Corporation, filed as Exhibit 10.27 to the Company's 2000 Annual Report on Form 10-K.
- 10.27 Security Agreement dated December 1, 2000 between CSA and MAI Systems Corporation, filed as Exhibit 10.28 to the Company's 2000 Annual Report on Form 10K.
- 10.28 Amendment to Subordinated Note Due 2003 dated as of April 18, 2002 between CSA Private Limited and MAI Systems Corporation, filed as an Exhibit to the Company's Quarterly Report on Form 10-Q for the period ending March 31, 2002.
- 10.29 Consulting Agreement dated as of August 15, 1994, as amended as of October 17, 1994, August 16, 1996, August 31, 1997, August 31, 1998, August 31, 1999, August 31, 2000, August 31, 2001, August 31, 2002 and August 31, 2003 by and between the Company and Orchard Capital Corporation, relating to the services of Richard S. Ressler, Chairman of the Board. The original agreement and the October 17, 1994 amendment are incorporated herein by reference to the Company's 1994 Annual Report on Form 10-K. The August 16, 1996 amendment is incorporated herein by reference to the Company's 1996 Annual Report on Form 10-K. The August 31, 1997 amendment is incorporated herein by reference to the Company's 1997 Annual Report on Form 10-K. The August 31, 1998 amendment is incorporated herein by reference to the Company's 1998 Annual Report on Form 10-K. The August 31, 1999 amendment is incorporated herein by reference to the Company's 1999 Annual Report on Form 10-K. The August 2000 amendment is incorporated herein by reference to the Company's 2000 Annual Report on Form 10-K. The August 2001 amendment is incorporated herein by reference to the Company's 2001 Annual Report on Form 10-K. The August 2002 amendment is incorporated herein by reference to the Company's 2002 Annual Report on Form 10-K. The August 2003 amendment is incorporated herein by reference to the Company's 2003 Annual Report on Form 10-K.
- 10.30 Stock Purchase Agreement dated March 31, 2004 between CSA Private Limited and HIS Holding, LLC; filed on April 20, 2004 as Exhibit 99.1 to the Schedule 13D filed by HIS Holding, LLC.
- 10.31 Stock Purchase Agreement between MAI Systems Corporation and HIS Holding, LLC for the acquisition of 10,000,000 shares of MAI Systems Corporation common stock by HIS Holding, LLC, filed on November 12, 2004 as Exhibit 99(a) to the Schedule 13D filed by HIS Holding, LLC;
- 10.32 Secured Subordinated Promissory Note dated March 31, 2004 which has been converted to 33,172,110 shares of MAI Systems Corporation common stock,. filed on November 12, 2004 as Exhibit 99(b) to the Schedule 13D filed by HIS Holding, LLC.
- 10.33 Limited Liability Company (Operating) Agreement for HIS Holding, LLC, filed on March 18, 2005 as Exhibit 99D to Amendment No. 2 to the Company's Schedule 13E-3.
- *14.1 Code of Ethics (All Employees)
- *14.2 Code of Ethics (Chief Executive and Chief Financial Officers and Other Senior Accounting Personnel)
- *21.1 Subsidiaries of MAI Systems Corporation.
- 23.1 Report of Independent Registered Public Accounting Firm from BDO Seidman LLP.
- 23.2 Consent of BDO Seidman, LLP.
- 31.1 Certification of Chief Executive Officer as required by Section 302 of Sarbanes-Oxley Act of 2002.
- 31.2 Certification of Chief Financial Officer as required by Section 302 of Sarbanes-Oxley Act of 2002
- 32.1 Certification of Chief Executive Officer as required by 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002.
- 32.2 Certification of Chief Financial Officer as required by 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of Sarbanes-Oxley Act of 2002.

*

previously filed

(b)

Reports on Form 8-K

1. Filed April 5, 2004
2. Filed April 12, 2004
3. Filed June 3, 2004
4. Filed September 28, 2004
5. Filed October 1, 2004
6. Filed December 2, 2004
7. Filed December 8, 2004

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.

MAI SYSTEMS CORPORATION

By: /s/ William B. Kretzmer
William B. Kretzmer
Chief Executive Officer and President

Dated: September 21, 2005

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 indicated on September 19, 2005.

| Signatures | Title |
|---|---|
| /s/Richard S. Ressler Richard S. Ressler | Chairman, Director |
| /s/William B. Kretzmer William B. Kretzmer | Chief Executive Officer and President (Principal Executive Officer) |
| /s/James W. Dolan James W. Dolan | Chief Operating Officer and Chief Financial Officer (Principal Financial and Accounting Officer) |
| /s/Zohar Loshitzer Zohar Loshitzer | Director |
| /s/Stephen Ross Stephen Ross | Director |
| /s/Steven F. Mayer Steven F. Mayer | Director |

QUARTERLY DATA (Unaudited)

(in millions, except share data)

| | 1st Quarter 2003 | 2nd Quarter 2003 | 3rd Quarter 2003 | 4th Quarter 2003 | 1st Quarter 2004 | 2nd Quarter 2004 | 3rd Quarter 2004 | 4th Quarter 2004(1) |
|---|------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|------------------------|---------------------------|
| Revenue | \$ 5.2 | \$ 4.8 | \$ 4.8 | \$ 4.6 | \$ 5.2 | \$ 4.9 | \$ 4.9 | \$ 5.1 |
| Gross profit | 3.7 | 3.5 | 3.5 | 3.1 | 3.7 | 3.7 | 3.5 | 3.6 |
| Income (loss) before income taxes | 0.2 | (0.1) | 0.1 | 0.1 | 0.2 | 0.1 | (0.1) | (1.3) |
| Net income (loss) | 0.3 | (0.1) | 0.1 | 0.1 | 0.2 | 0.1 | (0.1) | (1.3) |
| Income (loss) per share: | | | | | | | | |
| Basic | \$ 0.02 | \$ (0.01) | \$ 0.01 | \$ | \$ 0.01 | \$ 0.01 | \$ | \$ (0.03) |
| Diluted | 0.02 | (0.01) | 0.01 | | 0.01 | 0.01 | | (0.03) |
| Weighted average common shares used in determining income (loss) per share (in thousands): | | | | | | | | |
| Basic | 14,426 | 14,426 | 14,575 | 14,575 | 14,575 | 14,676 | 14,676 | 43,458 |
| Diluted | 14,876 | 14,426 | 14,875 | 14,875 | 14,875 | 14,676 | 14,676 | 43,458 |

(1) The fourth quarter ended December 31, 2004 represents the combined pre- and post- recapitalization periods of January 1, 2004 through October 31, 2004 and November 1, 2004 through December 31, 2004, respectively, as a result of the Management Equity/Conversion Transaction. Additionally, in connection with the Management Equity/Conversion Transaction, in the fourth quarter of 2004, the company recorded a \$995,000 debt modification charge and a \$187,500 stock compensation charge (see note 2 to the consolidated financial statements).

Exhibit 13.1

THE COMPANY'S ANNUAL REPORT TO STOCKHOLDERS

Sections of the Registrant's Annual Report to Stockholders Incorporated by Reference:

- 13.1.1 Selected Financial Information
- 13.1.2 Management's Discussion and Analysis of Financial Condition and Results of Operations
- 13.1.3 Report of Independent Registered Public Accounting Firm
- 13.1.4 Consolidated Balance Sheets
- 13.1.5 Consolidated Statements of Operations
- 13.1.6 Consolidated Statements of Stockholders' Equity and Comprehensive Income (Loss)
- 13.1.7 Consolidated Statements of Cash Flows
- 13.1.8 Notes to Consolidated Financial Statements

Exhibit 13.1.1 SELECTED FINANCIAL INFORMATION

The following table summarizes our selected financial data derived from our financial statements.

The financial data set forth below should be read in conjunction with, and is qualified in reference to, Management's Discussion and Analysis of Financial Condition and Results of Operations, our consolidated financial statements and the related notes to those financial statements, included elsewhere in this report.

SELECTED FINANCIAL DATA

(in thousands, except per share data)

STATEMENT OF OPERATIONS DATA

| | For the Years Ended December 31, | | | | For the Periods | |
|---|---|-------------|-------------|-------------|---------------------------------------|---|
| | 2000 | 2001 | 2002 | 2003 | Jan. 1, 2004 Oct. 31, 2004 | Nov. 1, 2004 Dec. 31, 2004 |
| Revenue | \$ 27,321 | \$ 23,768 | \$ 21,937 | \$ 19,346 | \$ 16,317 | \$ 3,754 |
| Income (loss) from continuing operations | 1,444 | 3,657 | 417 | 353 | (1,158) | (37) |
| Income (loss) from discontinued operations | (627) | (1,525) | (1,767) | | | |
| Net income (loss) | 817 | 2,132 | (1,350) | 353 | (1,158) | (37) |
| Income (loss) per share from continuing operations: | | | | | | |
| Basic income (loss) per share | \$ 0.13 | \$ 0.28 | \$ 0.03 | \$ 0.02 | \$ (0.08) | \$ |
| Diluted income (loss) per share | \$ 0.13 | \$ 0.28 | \$ 0.03 | \$ 0.02 | \$ (0.08) | \$ |
| Income (loss) per share from discontinued operations: | | | | | | |
| Basic income (loss) per share | \$ (0.06) | \$ (0.12) | \$ (0.13) | \$ | \$ | \$ |
| Diluted income (loss) per share | \$ (0.06) | \$ (0.12) | \$ (0.13) | \$ | \$ | \$ |
| Net Income (loss) per share: | | | | | | |
| Basic income (loss) per share | \$ 0.07 | \$ 0.16 | \$ (0.10) | \$ 0.02 | \$ (0.08) | \$ |
| | \$ 0.07 | \$ 0.16 | \$ (0.10) | \$ 0.02 | \$ (0.08) | \$ |

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Diluted income (loss) per share

Weighted average common shares used in determining income (loss) per share:

| | | | | | | |
|---------|--------|--------|--------|--------|--------|--------|
| Basic | 10,923 | 13,091 | 13,945 | 14,538 | 14,676 | 57,848 |
| Diluted | 11,206 | 13,263 | 13,945 | 14,838 | 14,676 | 57,848 |

BALANCE SHEET DATA

| | | | | | | |
|------------------------------|----------|----------|----------|----------|------------|---------|
| Working capital deficiency | (10,811) | (3,787) | (8,649) | (10,399) | (7,311)(2) | (7,536) |
| Total assets | 16,445 | 8,288 | 6,177 | 7,465 | 16,611(2) | 15,921 |
| Long-term debt | 7,792 | 10,966 | 10,523 | 10,781 | 7,781(2) | 7,652 |
| Stockholders' deficiency (1) | (12,110) | (12,992) | (14,782) | (14,586) | (1,086)(2) | (2,213) |

(1) No cash dividends have been declared by the Company.

(2) Unaudited

Exhibit 13.1.2 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion should be read in conjunction with the audited consolidated financial statements included elsewhere herein. Except for the historical information contained herein, the matters discussed in this Annual Report are forward-looking statements that involve a number of risks and uncertainties. There are certain important factors and risks, including the rapid change in hardware and software technology, market conditions, competitive factors, seasonality and other variations in the buying cycles of certain of our customers, the timing of product announcements, the release of new or enhanced products, the introduction of competitive products and services by existing or new competitors, the significant risks associated with the acquisition of new products, product rights, technologies or businesses, our ability to retain technical, managerial and other personnel, and the other risks detailed from time to time in our SEC reports, including reports on Form 10-K and Form 10-Q, that could cause results to differ materially from those anticipated by the statements made herein. Therefore, historical results and percentage relationships will not necessarily be indicative of the operating results of any future period. See Risk Factors elsewhere in this Annual Report on Form 10-K.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect our reported assets, liabilities, revenues and expenses. On an on-going basis, we evaluate our estimates, including those related to revenue recognition, accounts receivable and intangible assets. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances. This forms the basis of judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may materially differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies and the related judgments and estimates affect the preparation of our consolidated financial statements:

Software Development Costs

All costs incurred to establish the technological feasibility of software products to be sold to others are expensed as research and development. Once technological feasibility has been established, all software production costs are capitalized. Amortization is computed on an individual product basis and is recognized over the greater of the remaining economic lives of each product or the ratio that current gross revenues for a product bear to the total of current and anticipated revenues for that product, commencing when the products become available for general release to customers. Software development costs are generally amortized over a three-year period. The Company continually assesses the recoverability of software development costs by comparing the carrying value of individual products to their net realizable value.

The Company capitalized \$896,000 and \$1,065,000 of software development costs during 2003 and 2004 respectively, relating to our new N-Tier, Internet-native corporate application suite of products written in java. The modules to this suite of applications became available for general release in the first quarter of 2005 at which time amortization of such costs shall commence. We believe that these new products will produce new sales adequate to recover amounts capitalized.

Revenue Recognition

The Company earns revenue from sales of hardware, software and professional services and from arrangements involving multiple elements of each of the above. Revenue for multiple element arrangements are recorded by allocating revenue to the various elements based on their respective fair values as evidenced by vendor specific objective evidence. The fair value in multi-element arrangements is determined based upon the price charged when sold separately. Revenue is not recognized until persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility is probable. Sales of network and computer equipment are recorded when title and risk of loss transfers. Software revenues are recorded when application software programs are shipped to end users, resellers and distributors, provided the Company is not required to provide services essential to the functionality of the software or significantly modify, customize or produce the software. Professional services fees for software development, training and installation are recognized as the services are provided. Maintenance revenues are recorded evenly over the related contract period.

Accounts Receivable

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The amount of our reserves is based on historical experience and our analysis of the accounts receivable balances outstanding. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required which would result in an additional general and administrative expense in the period such determination was made. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past.

Intangible and Long-Lived Assets

At December 31, 2003 and 2004, goodwill and other long-lived assets represented 49% and 80%, respectively, of the Company's total assets.

Goodwill must be tested at least annually for impairment at a level of reporting referred to as the reporting unit and more frequently if adverse events or changes in circumstances indicate that the asset may be impaired. The Company did not record an impairment charge upon its annual impairment reviews at December 31, 2002, 2003 and 2004.

Long-lived assets consist of property and equipment and other identifiable intangible assets. These assets are depreciated or amortized over their estimated useful life, and are subject to impairment reviews. The Company periodically reviews long-lived assets whenever adverse events or changes in circumstances indicate the carrying value of such assets may not be recoverable. In assessing recoverability, the Company must make assumptions regarding estimated future cash flows and other factors to determine if an impairment loss may exist, and, if so, estimate fair value. The Company also must estimate and make assumptions regarding the useful lives assigned to its long-lived assets. If these estimates, or their related assumptions, change in the future, the Company may be required to record impairment losses or change the useful life including accelerating depreciation or amortization for these assets.

Accrued Expenses

The Company reviews its contingent liabilities, which arise primarily from litigation and litigation defense costs, in accordance with Statement of Financial Accounting Standards No. 5 (SFAS 5), Accounting for Contingencies. Contingent liabilities are recorded as liabilities when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. Contingent liabilities are often resolved over long periods. Estimating probable losses requires judgments about both the amount of liability, which may or may not be readily determinable, and the likelihood of liability, which involves ranges of probability that can at times be broad and depend on the potential actions of third parties.

Provision for Income Taxes

Provision for income taxes is based upon the Company's estimate of taxable income or loss for each respective accounting period. An asset or liability is recognized for the deferred tax consequences of temporary differences between the tax bases of assets and liabilities and their reported amounts in the financial statements. These temporary differences will result in taxable or deductible amounts in future periods when the reported amounts of assets are recovered or liabilities are settled. The Company regularly reviews its deferred tax assets to determine the amount that is more likely than not to be realized. When this amount is less than the deferred tax asset recorded, the Company records a valuation allowance to reduce the asset to its estimated realizable value. If the Company determined that it was not going to be able to fully realize its recorded deferred tax assets, it would make an adjustment to the valuation allowance. This would reduce net income in the period that the Company made its determination. Similarly, if the Company realized that it was going to be able to fully realize a deferred tax asset in excess of its net recorded value, net income would be increased in the period that the Company made its determination.

The Company also reviews its deferred tax liabilities on a regular basis to determine that the amount recorded is adequate to cover the expected reversal of temporary income tax liabilities. In the event that the amount recorded was less than adequate, the deferred tax liability would be increased to its estimated realizable value and net income would be decreased accordingly. In the event that the deferred tax liability was determined to be overstated, it would be reduced to its estimated realizable value and net income would increase accordingly.

The Company generally determines its effective tax rate by considering the statutory federal income tax rate, the statutory state and local tax rates (net of the federal income tax benefit) and any nondeductible expenses. This rate could also be affected by increases or decreases to deferred tax assets or liabilities as described above.

Liquidity and Capital Resources

At December 31, 2004, our working capital deficiency improved from a working capital deficiency of \$10,399,000 at December 31, 2003 to a working capital deficiency of \$7,536,000. Excluding unearned revenue of \$3,456,000, working capital deficiency at December 31, 2004 was \$4,080,000. Excluding unearned revenue of \$3,209,000, the Company's working capital deficiency at December 31, 2003 would be \$7,190,000. Excluding unearned revenue, the decrease in the working capital deficiency of \$3,110,000 was primarily attributable to decreases in current portion of long term debt of \$2,643,000, customer deposits of \$1,088,000, accrued liabilities of \$158,000 offset by an increase in accounts payable of \$173,000 and decreases in cash of \$469,000, accounts receivable of \$77,000 and prepaids and other assets of \$66,000. The decrease in the current portion of long term debt was mainly attributable to the conversion of approximately \$3,317,000 indebtedness to common stock on November 1, 2004.

Net cash used in investing activities for the period ended December 31, 2004 totaled \$1,260,000, which is comprised of capital expenditures of \$195,000 and capitalized software of \$1,065,000.

Net cash provided by financing activities for the period ended December 31, 2004 totaled \$124,000, which represents \$1,000,000 of new cash proceeds into the company from a private placement in September 2004 offset by \$876,000 in repayments on long-term debt. On January 13, 2003, the Company converted its credit facility to a term loan which requires monthly principal and interest payments of \$58,000 and matures on February 28, 2006. In addition, the Company amended its subordinated note to require monthly interest only payments of \$52,000 through February 28, 2006, at which time it will convert to a term loan to be amortized over a three year period. The restructured debt, pursuant to the original intercreditor agreement between Canyon and Coast, which was sold to Wamco on May 15, 2003, contains various restrictions and covenants, including a minimum quick ratio of 0.20 to 1.00 and minimum debt service coverage ratio of .50 to 1.00. In the event that we were not in compliance with the various restrictions and covenants and were unable to receive waivers for non-compliance, the term debt would be immediately due and payable. The Company was not in compliance with but received waivers for its covenants through December 31, 2004. There is no guaranty that the Company will meet its debt covenants in the future.

Stockholders' deficiency decreased from \$14,586,000 at December 31, 2003 to \$2,213,000 at December 31, 2004, mainly as a result of the purchase accounting adjustments recorded in connection with the Management Equity/Conversion Transaction (see note 2 to the consolidated financial statements).

Although the Company has a net stockholders' deficiency of \$2,213,000 and a working capital deficit of \$7,536,000 at December 31, 2004, the Company believes it will generate sufficient funds from operations or obtain additional financing to meet its operating and capital requirements for at least the next 12 months. The Company expects to generate positive cash flow from its continuing operations during 2005 from shipping out products and services from its current backlog as of December 31, 2004 as well as new orders. In the event that the Company cannot generate positive cash flow from its continuing operations during 2005, the Company can substantially reduce its research and development efforts to mitigate cash outflow to help sustain its operations. There can be no assurance that the Company will be able to sustain profitability generate positive cash flow from operations or obtain additional financing as necessary. These financial statements have been prepared assuming the Company will continue to operate as a going concern. If the Company is unsuccessful in the aforementioned efforts, the Company could be forced to liquidate certain of its assets, reorganize its capital structure and, if necessary, seek other remedies available to the Company.

Contractual Obligations and Commercial Commitments

The following table summarizes the Company's obligations and commitments as of December 31, 2004:

| Contractual Cash Obligations | Total | Payments Due by Period (in thousands) | | | |
|------------------------------|-----------|---------------------------------------|-----------|-----------|---------------|
| | | Less Than 1 Year | 2-3 Years | 4-5 Years | After 5 Years |
| Long-Term Debt | \$ 7,652 | \$ 1,003 | \$ 3,496 | \$ 2,570 | \$ 583 |
| Operating Leases | 3,160 | 594 | 885 | 804 | 877 |
| Consulting Agreements | 96 | 96 | | | |
| | \$ 10,908 | \$ 1,693 | \$ 4,381 | \$ 3,374 | \$ 1,460 |

Factors Affecting Future Operating ResultsDemand for the Company's Products and Operating Efficiencies

The Company's future operating results will depend, in large part, upon the Company's ability to achieve and maintain a significant market demand and presence for its products and to operate profitably and efficiently. The Company's ability to accomplish these objectives will depend on a number of factors, including the following:

Market demand for information technology in the hospitality industry in general;

Completion of development, launch and market success and acceptance of our software solutions;

Price, performance, quality and other characteristics of the Company's products and of competing and substitute products rumored, announced or introduced by other vendors;

Emergence of any competing solutions as industry standards;

Success of the Company in meeting targeted availability dates for new and enhanced products;

Success of the Company's efforts to provide and maintain customer service and satisfaction;

Public perception of the Company and its products, including statements made by industry analysts or consumers and adverse publicity resulting from such statements or from litigation filed against the Company;

Worldwide economic conditions, including overall market demand for information technology and other products with which the Company's products can be used;

Ability of the Company to profitably and efficiently manage its development of products and key components, and to avoid disruptions in the development thereof;

Ability of the Company to maintain profitable relationships with distributors and other resellers of the Company's products;

The Company's ability to attract and retain competent, motivated employees;

Ability of the Company to comply with applicable laws, regulations, ordinances and other legal requirements in the numerous countries in which it does business;

Ability of the Company to successfully manage litigation, including enforcing its rights, protecting its interests and defending itself from claims made against it and;

Ability of the Company to successfully implement its restructuring of debt, to achieve and maintain an appropriate cost structure and to minimize unforeseen and extraordinary expenses.

The Company cannot provide any assurance that it will be able to successfully manage, satisfy or influence any of these factors.

Year Ended December 31, 2003 Compared to Year Ended December 31, 2004.

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| (dollars in thousands) | December 31, 2003 | Percentage of Revenue | December 31, 2004(1) | Percentage of Revenue |
|--|----------------------|--------------------------|-------------------------|--------------------------|
| Revenue | 19,346 | 100.0% | 20,071 | 100.0% |
| Gross profit | 13,826 | 71.5% | 14,487 | 72.2% |
| Selling, general and administrative expenses | 9,596 | 49.6% | 9,427 | 47.0% |
| Research and development costs | 2,828 | 14.6% | 3,708 | 18.5% |
| Amortization of intangibles | | | 96 | 0.5% |
| Stock compensation expense | | | 188 | 0.9% |
| Other operating expense | 62 | 0.3% | 92 | 0.5% |
| Interest expense, net | 1,217 | 6.3% | 2,112 | 10.5% |
| Other non-operating expense | 81 | 0.4% | 28 | 0.1% |
| Income tax (benefit) expense | (311) | (1.6)% | 31 | 0.2% |
| Net income (loss) | 353 | 1.8% | (1,195) | (6.0)% |

(1) The year ended December 31, 2004 represents the combined pre- and post- recapitalization periods of January 1, 2004 through October 31, 2004 and November 1, 2004 through December 31, 2004, respectively, as a result of the Management Equity/Conversion Transaction (see note 2 to the consolidated financial statements).

The increase in revenue in 2004 was mainly attributable to an increase in service volume and rates as the general health of the hospitality industry continues to improve from the detrimental effects of 9/11 that severely affected the hospitality and travel industries, which resulted in an increase of approximately \$726,000. Revenue for 2004 was \$20,071,000 compared to \$19,346,000 in 2003 or a 3.8% increase. The increase was mainly a result of increased professional and software support services driven by an increase in the number of customers combined with slight price increases. Our continuing hospitality business is expected to generate sufficient cash from operations to adequately fund its ongoing operating activities.

Gross profit for 2004 increased to \$14,487,000 from \$13,826,000 in 2003. The increase in gross profit is mainly due to the increase in professional and support services revenues.

Selling, general and administrative expenses (SG&A) decreased from \$9,596,000 in 2003 to \$9,427,000 in 2004. The decrease is mainly due to the closing of the Company's Mexico office in January, 2004 and the ongoing effects of the management cost control program resulting in reduced, building rent and consulting services.

Research and development costs increased from \$2,828,000 in 2003 to \$3,708,000 in 2004. The company capitalized \$896,000 and \$1,065,000 of software development costs in 2003 and 2004, respectively. The increase is mainly due to the Company continued efforts to invest in product development of its new internet native suite of applications as well as our core product offerings. The increase was primarily the result of the addition of approximately 15 engineers and quality assurance personnel in the Company's Malaysia operations, including associated overhead costs as well as engineering consulting services contracted in the United States.

Amortization of intangibles was \$96,000 in 2004 as a result of the Company recording approximately \$10.1 million of intangible assets in connection with the Management Equity/Conversion Transaction on November 1, 2004, of which approximately \$7,684,000 related to identifiable intangible assets which commenced amortization in November 2004 over their estimated useful lives of seven to fifteen years.

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The Company incurred a charge of \$187,500 of non-cash compensation expense relating to the private placement of \$1 million into the Company by the Investor Group at a below market price. There was no such transaction during 2003.

Net interest expense was \$1,217,000 in 2003 compared to \$2,112,000 in 2004. The increase was due to a \$995,000 debt modification charge relating to the conversion of approximately \$3.3 million of indebtedness by the Investor Group to the Company's common stock at a below market price recorded to interest expense during 2004. There was no such transaction during 2003. This charge was offset by lower balances of interest bearing debt during 2004 as compared to 2003 mainly due to the conversion of approximately \$3.3 million of indebtedness by the Investor Group to the Company's common stock on November 1, 2004.

The income tax benefit in 2003 is due to the Company recording a domestic income tax receivable during the period to recover taxes previously paid. There were no such receivables recorded in 2004.

Results of Operations

Year Ended December 31, 2002 Compared to Year Ended December 31, 2003.

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| (dollars in thousands) | December 31, 2002 | Percentage of Revenue | December 31, 2003 | Percentage of Revenue |
|--|----------------------|--------------------------|----------------------|--------------------------|
| Revenue | 21,937 | 100.0% | 19,346 | 100.0% |
| Gross profit | 15,017 | 68.5% | 13,826 | 71.5% |
| Selling, general and administrative expenses | 9,363 | 42.7% | 9,596 | 49.6% |
| Research and development costs | 3,307 | 15.1% | 2,828 | 14.6% |
| Amortization of intangibles | 134 | 0.6% | | |
| Other operating expense | 212 | 1.0% | 62 | (0.3)% |
| Interest expense, net | 1,490 | 6.8% | 1,217 | 6.3% |
| Other non-operating expense | 64 | 0.3% | 81 | 0.4% |
| Income tax expense (benefit) | 30 | 0.1% | (311) | (1.6)% |
| Income from continuing operations | 417 | 1.9% | 353 | 1.8% |
| Loss on disposal of discontinued operations | (1,021) | (4.7)% | | |
| Loss from discontinued operations | (746) | (3.4)% | | |
| Net income (loss) | (1,350) | (6.2)% | 353 | 1.8% |

Revenue for 2003 was \$19,346,000 compared to \$21,937,000 in 2002 or a 12.0% decrease. Revenue decreased \$2,591,000 in 2003, as a result of decreased professional services and maintenance services mainly due to decreased capital spending on information technology in 2003 due to the effects of a downturn and post 9/11 economy on the hospitality industry.

The decrease in revenue in 2003 was mainly attributable to a decrease in service volume and rates as many hotels have reduced their operating costs by canceling or reducing contracted services, including support, as well as reduced volume of product purchases, in a post 9/11 economy, which resulted in a decrease of approximately \$1.1 million in the volume of revenue from professional services and a decrease of approximately \$1.2 million in software and hardware revenue from 2002 to 2003. Many hotels have requested that their suppliers reduce the cost of service or delay any price increases while they are experiencing reduced guest occupancy and lower average daily rates on their inventory of rooms. Certain hotels have also established their own help desks to further reduce costs. As a result, the Company postponed increasing its support prices until the first quarter of 2003 and agreed, with certain of its clients, to provide, at reduced rates, a second line of support versus a first line of support that was previously provided to such clients, which resulted in a decrease in support revenues of approximately \$285,000 from 2002 to 2003. Our continuing hospitality business is expected to generate sufficient cash from operations to adequately fund its ongoing operating activities.

Gross profit for 2003 decreased to \$13,826,000 (71.5%) from \$15,017,000 (68.5%) in 2002. The decrease in gross profit is mainly due to the decrease in software and maintenance services revenues, which was offset by the Company's cost reductions during the period.

Selling, general and administrative expenses (SG&A) increased from \$9,363,000 in 2002 to \$9,596,000 in 2003. The increase is mainly due to an increase in marketing expenses for trade shows, advertisement and travel as the Company continues to actively and aggressively market its enterprise suite of applications and services which are scheduled for general release in the first quarter of 2005.

Research and development costs decreased from \$3,307,000 in 2002 to \$2,828,000 in 2003. The decrease is due to the capitalization of \$861,000 and \$896,000 of software development costs in 2002 and 2003, respectively, associated with the Company's product development of its new internet native suite of applications. The decrease is also due to a decrease in headcount associated with the Company's focus on reducing costs.

Other operating expense was \$212,000 in 2002 and \$62,000 in 2003. Other operating expense in 2003 was offset due to receipt of approximately \$46,000 of cash resulting from a legal settlement.

The decrease in amortization of intangibles in 2003 versus the comparable period of 2002 is due to the fact that the Company amortized \$134,000 of software development costs in 2002 relating to costs capitalized in 1999. These costs were fully amortized during 2002.

Net interest expense was \$1,490,000 in 2002 compared to \$1,217,000 in 2003. The decrease is due to lower balances of interest bearing debt during 2003 as compared to 2002.

Other non-operating expense increased from \$64,000 in 2002 to \$81,000 in 2003. Non-operating expense relates to pension expense under a defined benefit plan for former employees.

The income tax benefit in 2003 is due to a settlement agreement on a tax claim with the United States Internal Revenue Service that resulted in a one-time gain of \$262,000 (see note 8 to the consolidated financial statements), as well as the Company recording a domestic income tax receivable during the period to recover taxes previously paid.

During 2002, loss from discontinued operations was \$746,000. In the fourth quarter of 2002, the Company sold all the assets and liabilities of its Process Manufacturing and Canadian subsidiaries to third parties, resulting in a loss on disposal of discontinued operations of \$1,021,000.

RECENT ACCOUNTING PRONOUNCEMENTS

In December 2004, the FASB issued SFAS No. 123r, *Share-Based Payment* (SFAS 123r). SFAS 123r provides accounting guidance for stock-based payments to employees. SFAS 123r revises SFAS 123 by eliminating the choice of using the recognition and measurement provisions of APB No. 25 and requiring all companies to use the fair value method of measuring stock compensation expense. SFAS 123r clarifies and expands SFAS 123's guidance in several areas, including measuring fair value, classifying an award as equity or a liability, attributing compensation cost to reporting periods as well as adding several new disclosure requirements. SFAS 123r also changes the accounting for the tax effects of options, including the presentation of the tax effects on the consolidated statements of cash flows. SFAS 123r is effective for public companies with the first interim or annual period that begins after June 15, 2005. As discussed above, the Company is currently accounting for all of its stock-based compensation under the intrinsic value method as outlined in APB 25 and will adopt SFAS 123r beginning in the first quarter of 2006. The Company still needs to evaluate the impacts of SFAS 123r.

In December 2004, the FASB issued SFAS No. 153 (SFAS 153), *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions*. SFAS 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for periods beginning after June 15, 2005. We do not expect that adoption of SFAS 153 will have a material effect on our consolidated financial position, consolidated results of operations, or liquidity.

Exhibit 13.1.3

Report of Independent Registered Public Accounting Firm

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The Board of Directors and Stockholders of

MAI Systems Corporation

Lake Forest, California

We have audited the accompanying consolidated balance sheets of MAI Systems Corporation and subsidiaries as of December 31, 2003 and 2004 and the related consolidated statements of operations, stockholders' deficiency and comprehensive income (loss) and cash flows for each of the years in the two-year period ended December 31, 2003 and for the period from January 1, 2004 to October 31, 2004 and for the period from November 1, 2004 to December 31, 2004. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of MAI Systems Corporation and subsidiaries as of December 31, 2003 and 2004 and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2003 and for the period from January 1, 2004 to October 31, 2004 and for the period from November 1, 2004 to December 31, 2004, in conformity with accounting principles generally accepted in the United States of America.

/s/ BDO Seidman, LLP

Costa Mesa, California

April 25, 2005

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| | | | |
|--|-----------|----|----------|
| Unearned compensation | (53) | | |
| Accumulated deficit | (231,790) | | (49,334) |
| Total stockholders' deficiency | (14,586) | | (2,213) |
| Total liabilities and stockholders' deficiency | \$ 7,465 | \$ | 15,921 |

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

Exhibit 13.1.5 Consolidated Statements of Operations
MAI SYSTEMS CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

| (in thousands, except per share data) | For the Years Ended December 31, | | For the Periods | |
|---|----------------------------------|---------------|-------------------------------|-------------------------------|
| | 2002 | 2003 | Jan. 1, 2004 Oct. 31, 2004 | Nov. 1, 2004 Dec. 31, 2004 |
| Revenue: | | | | |
| Software | \$ 4,585 | \$ 3,855 | \$ 3,223 | \$ 766 |
| Network and computer equipment | 996 | 485 | 386 | 87 |
| Services | 16,356 | 15,006 | 12,708 | 2,901 |
| Total revenue | 21,937 | 19,346 | 16,317 | 3,754 |
| Direct costs: | | | | |
| Software | 437 | 587 | 381 | 111 |
| Network and computer equipment | 770 | 370 | 318 | 79 |
| Services | 5,713 | 4,563 | 3,823 | 872 |
| Total direct costs | 6,920 | 5,520 | 4,522 | 1,062 |
| Gross profit | 15,017 | 13,826 | 11,795 | 2,692 |
| Selling, general and administrative expenses | 9,363 | 9,596 | 7,656 | 1,771 |
| Research and development costs | 3,307 | 2,828 | 3,039 | 669 |
| Amortization of intangibles | 134 | | | 96 |
| Stock compensation charge | | | 188 | |
| Other operating expense | 212 | 62 | 64 | 28 |
| Operating income | 2,001 | 1,340 | 848 | 128 |
| Interest income | 5 | 2 | 1 | |
| Interest expense (including debt modification charge) | (1,495) | (1,219) | (1,966) | (147) |
| Other non-operating expense | (64) | (81) | (26) | (2) |
| Income (loss) from continuing operations before income taxes | 447 | 42 | (1,143) | (21) |
| Income tax benefit (expense) | (30) | 311 | (15) | (16) |
| Income (loss) from continuing operations | 417 | 353 | (1,158) | (37) |
| Discontinued operations: | | | | |
| Loss on disposal of discontinued operations | (1,021) | | | |
| Loss from discontinued operations | (746) | | | |
| Total loss from discontinued operations | (1,767) | | | |
| Net income (loss) | \$ (1,350) | \$ 353 | \$ (1,158) | \$ (37) |
| Income (loss) per share: | | | | |
| Continuing Operations: | | | | |
| Basic income (loss) per share | \$ 0.03 | \$ 0.02 | \$ (0.08) | \$ |

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| | | | | | | | |
|---|----|--------|----|--------|----|--------|--------|
| Diluted income (loss) per share | \$ | 0.03 | \$ | 0.02 | \$ | (0.08) | \$ |
| Discontinued Operations: | | | | | | | |
| Basic (loss) per share | \$ | (0.13) | \$ | | \$ | | \$ |
| Diluted (loss) per share | \$ | (0.13) | \$ | | \$ | | \$ |
| Net income (loss) per share: | | | | | | | |
| Basic income (loss) per share | \$ | (0.10) | \$ | 0.02 | \$ | (0.08) | \$ |
| Diluted income (loss) per share | \$ | (0.10) | \$ | 0.02 | \$ | (0.08) | \$ |
| Weighted average common shares used in determining income (loss) per share: | | | | | | | |
| Basic | | 13,945 | | 14,538 | | 14,676 | 57,848 |
| Diluted | | 13,945 | | 14,838 | | 14,676 | 57,848 |

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

Exhibit 13.1.6 Consolidated Statements of Stockholders Deficiency

MAI SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIENCY AND COMPREHENSIVE INCOME (LOSS)

(in thousands)

| | Common Stock | Additional Paid-In Capital | Accumulated Other Comprehensive Income (Loss) | Unearned Compensation | Accumulated Deficit | Total Stockholders Deficiency | Total Comprehensive Income (Loss) |
|--|-----------------|----------------------------------|--|--------------------------|------------------------|-------------------------------------|---|
| Balance at December 31, 2001 | 140 | 218,022 | (361) | | (230,793) | (12,992) | \$ 1,691 |
| Issuance of common stock | 3 | 74 | | | | 77 | |
| Minimum pension liability | | | (457) | | | (457) | (457) |
| Exercise of stock options | 1 | 8 | | | | 9 | |
| Unearned compensation | 6 | 147 | | (153) | | | |
| Amortization of unearned compensation | | | | 62 | | 62 | |
| Translation adjustments | | | (131) | | | (131) | (131) |
| Net loss | | | | | (1,350) | (1,350) | (1,350) |
| Balance at December 31, 2002 | \$ 150 | \$ 218,251 | \$ (949) | \$ (91) | \$ (232,143) | \$ (14,782) | \$ (1,938) |
| Issuance of common stock | 2 | 18 | | | | 20 | |
| Issuance of warrants | | 42 | | | | 42 | |
| Legal settlement | | (199) | | | | (199) | |
| Minimum pension liability | | | (87) | | | (87) | (87) |
| Amortization of unearned compensation | | | | 38 | | 38 | |
| Translation adjustments | | | 29 | | | 29 | 29 |
| Net loss | | | | | 353 | 353 | 353 |
| Balance at December 31, 2003 | \$ 152 | \$ 218,112 | \$ (1,007) | \$ (53) | \$ (231,790) | \$ (14,586) | \$ 295 |
| Push down accounting adjustments | | (175,324) | 835 | 17 | 183,651 | 9,179 | |
| Issuance of common stock for cash | 100 | 900 | | | | 1,000 | |
| Issuance of common stock as a result of debt conversion | 332 | 2,985 | | | | 3,317 | |
| Debt modification charge | | 995 | | | | 995 | |
| Stock compensation charge | | 188 | | | | 188 | |
| Amortization of unearned compensation | | | | 31 | | 31 | |
| Translation adjustments | | | (52) | | | (52) | (52) |
| Net loss | | | | | (1,158) | (1,158) | (1,158) |
| Balance at October 31, 2004 | \$ 584 | \$ 47,856 | \$ (224) | \$ (5) | \$ (49,297) | \$ (1,086) | \$ (1,210) |
| Minimum pension liability | | | (1,037) | | | (1,037) | (1,037) |

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| | | | | | | | | | | | | |
|---------------------------------------|----|-----|------|--------|----|---------|------|----------|------|---------|----|---------|
| Amortization of unearned compensation | | | | 5 | | | | 5 | | | | |
| Translation adjustments | | | (58) | | | | | (58) | (58) | | | |
| Net loss | | | | | | | (37) | (37) | (37) | | | |
| Balance at December 31, 2004 | \$ | 584 | \$ | 47,856 | \$ | (1,319) | \$ | (49,334) | \$ | (2,213) | \$ | (1,132) |

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

Exhibit 13.1.7 Consolidated Statements of Cash Flows

MAI SYSTEMS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

| | For the years ended December 31, | | For the Periods | |
|---|----------------------------------|--------|-------------------------------|-------------------------------|
| | 2002 | 2003 | Jan. 1, 2004 Oct. 31, 2004 | Nov. 1, 2004 Dec. 31, 2004 |
| Cash flows from operating activities: | | | | |
| Net income (loss) | \$ (1,350) | \$ 353 | \$ (1,158) | \$ (37) |
| Loss from discontinued operations | 746 | | | |
| Loss (gain) on disposal of discontinued operations | 1,021 | | | |
| Income (loss) from continuing operations | 417 | 353 | (1,158) | (37) |
| Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities, net of business acquisitions and dispositions: | | | | |
| Gain on IRS settlement | | (262) | | |
| Amortization of intangibles | 134 | 38 | | 136 |
| Depreciation and amortization | 515 | 474 | 448 | 54 |
| Amortization of debt discount | 170 | 44 | 39 | 8 |
| Debt modification charge | | | 995 | |
| Stock compensation charge | 62 | | 188 | |
| Provision for doubtful accounts receivable and inventory | 89 | 66 | 170 | 76 |
| Changes in assets and liabilities: | | | | |
| (Increase) decrease in receivables | 592 | 469 | (208) | (58) |
| (Increase) decrease in inventories | 30 | | (31) | 4 |
| (Increase) decrease in prepaids and other asset | 327 | (185) | 138 | (114) |
| (Increase) decrease in other assets | 68 | (67) | 44 | (1) |
| (Decrease) increase in accounts payable and customer deposits | (445) | 366 | (799) | (116) |
| (Decrease) increase in accrued liabilities | (522) | 1,052 | 363 | 496 |
| (Decrease) increase in income taxes payable | (151) | (4) | 17 | 1 |
| (Decrease) increase in unearned revenue | 1,700 | (484) | 367 | (120) |
| (Decrease) increase in other liabilities | 42 | (421) | (286) | 61 |
| Net cash provided by (used in) continuing operations | 3,028 | 1,439 | 287 | 390 |
| Net cash provided by (used in) discontinued operations | (2,509) | | | |
| Net cash provided by (used in) operating activities | 519 | 1,439 | 287 | 390 |
| Cash flows from investing activities: | | | | |
| Capital expenditures | (101) | (346) | (129) | (66) |

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| | | | | |
|--|--------|---------|---------|--------|
| Payments received on note receivable | 500 | 250 | | |
| Software development costs | (861) | (896) | (906) | (159) |
| Acquisition of unconsolidated subsidiary | | (79) | | |
| Net cash used in investing activities | (462) | (1,071) | (1,035) | (225) |
| Cash flows from financing activities: | | | | |
| Repayments of long-term debt | (102) | (239) | (739) | (137) |
| Net decrease in line of credit | (623) | | | |
| Issuance of common stock | | | 1,000 | |
| Net provided by (cash used) in financing | (725) | (239) | 261 | (137) |
| Effect of exchange rate changes on cash | (11) | (10) | (4) | (6) |
| Net increase (decrease) in cash | (679) | 119 | (491) | 22 |
| Cash at beginning of period | 1,224 | 545 | 664 | 173 |
| Cash at end of period | \$ 545 | \$ 664 | \$ 173 | \$ 195 |
| Cash paid during the period for: | | | | |
| Interest | \$ 990 | \$ 826 | \$ 535 | \$ 20 |
| Income taxes | \$ 176 | \$ 6 | \$ 35 | \$ |

Supplemental disclosure of noncash investing and financing activities (see note 2)

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

Exhibit 13.1.8 Notes to Consolidated Financial Statements

MAI SYSTEMS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Description of the Business

MAI Systems Corporation (the Company or MAI) provides total information technology solutions to the hospitality, resort and destination industry. The solutions provided by the Company typically include applications software, computer hardware, peripherals and wide and local area network design, implementation, installation and support. The software applications are generally the Company's proprietary software, or software which is licensed to the Company on an exclusive basis. The hardware, peripherals and networking systems are generally third-party products, which we distribute. Directly and through arrangements with third parties, we provide on-site and off-site service and support to users of network and systems hardware.

Liquidity

Although the Company has a net stockholders' deficiency of \$2,213,000 and a working capital deficit of \$7,536,000 at December 31, 2004, the Company believes it will continue to generate sufficient funds from operations or obtain additional financing to meet its operating and capital requirements for at least the next 12 months. The Company expects to generate positive cash flow from its continuing operations during 2005 from shipping out products and services from its current backlog as of December 31, 2004 as well as new orders. In the event that the Company cannot generate positive cash flow from its continuing operations during 2005, the Company can substantially reduce its research and development efforts to mitigate cash outflow to help sustain its operations. There can be no assurance that the Company will be able to sustain profitability, generate positive cash flow from operations or obtain additional financing as necessary. These financial statements have been prepared assuming the Company will continue to operate as a going concern. If the Company is unsuccessful in the aforementioned efforts, the Company could be forced to liquidate certain of its assets, reorganize its capital structure and, if necessary, seek other remedies available to the Company.

The restructured debt, pursuant to the original inter-creditor agreement between Canyon Capital and Coast, which was sold to Wamco on May 15, 2003, contains various restrictions and covenants. In the event that the Company were not in compliance with the various restrictions and covenants and were unable to receive waivers for non-compliance, the term debt would be immediately due and payable. The Company was not in compliance with, but have received waivers for, its covenants through December 31, 2004 (see note 8). There is no guaranty that the Company will meet its debt covenants in the future.

Principles of Consolidation

The consolidated financial statements of the Company include the accounts of its domestic operations and its majority and wholly owned subsidiaries. All significant intercompany transactions and accounts have been eliminated in consolidation.

Use of Estimates

The consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States of America. In preparing the consolidated financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities as of the dates of the balance sheets and revenues and expenses for the periods. Actual results could materially differ from those estimates.

Revenue Recognition

The Company earns revenue from sales of hardware, software and professional services and from arrangements involving multiple elements of each of the above. Revenue for multiple element arrangements are recorded by allocating revenue to the various elements based on their respective fair values as evidenced by vendor specific objective evidence. The fair value in multi-element arrangements is determined based upon the price charged when sold separately. Revenue is not recognized until persuasive evidence of an arrangement exists, delivery has occurred, the fee is fixed or determinable and collectibility

is probable. Sales of network and computer equipment are recorded when title and risk of loss transfers. Software revenues are recorded when application software programs are shipped to end users, resellers and distributors, provided the Company is not required to provide services essential to the functionality of the software or significantly modify, customize or produce the software. Professional services fees for software development, training and installation are recognized as the services are provided. Maintenance revenues are recorded evenly over the related contract period.

Cash Equivalents

Cash equivalents consist of highly liquid investments which are readily convertible into known amounts of cash and have original maturities of three months or less, when purchased.

Allowance for Doubtful Accounts

The Company records an allowance for doubtful accounts based on specifically identified amounts that it believes are uncollectible. The Company also records additional allowances based upon certain percentages of our aged receivables, which are determined based on historical experience and or assessment of the general financial conditions affecting our customer base. If the Company's actual collection experience changes, revisions to its allowance may be required. Any unanticipated change in the Company's customer's credit worthiness or other matters affecting the collectibility of amounts due from such customers, could have a material affect on its results of operations in the period in which such changes or events occur. After all attempts to collect a receivable have failed, the receivable is written off against the allowance.

Inventories

Inventories are valued at the lower of first in, first out cost or market.

Furniture, Fixtures and Equipment

Furniture, fixtures and equipment are recorded at cost and depreciated on a straight-line basis over estimated useful lives ranging from 3 to 5 years. Leasehold improvements are amortized on a straight-line basis over the shorter of the lease term or their estimated useful lives. Expenditures for additions and major improvements are capitalized. Repairs and maintenance costs are charged to operations as incurred. Management of the Company assesses the recoverability of property and equipment by determining whether the depreciation and amortization of such assets over their remaining lives can be recovered through projected, undiscounted cash flows.

Impairment of Long-Lived Assets and Long-Lived Assets to be Disposed Of

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Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets provides a single accounting model for long-lived assets to be disposed of. SFAS No. 144 also changes the criteria for classifying an asset as held for sale, and broadens the scope of businesses to be disposed of that qualify for reporting as discontinued operations and changes the timing of recognizing losses on such operations.

In accordance with SFAS No. 144, long-lived assets, such as furniture, fixtures and equipment are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to estimated undiscounted future cash flows expected to be generated by the asset. If the carrying amount of an asset exceeds its estimated future cash flows, and an impairment charge is recognized by the amount by which the carrying amount of the asset exceeds the fair value of the asset. Assets to be disposed of would be separately presented in the balance sheet and reported at the lower of the carrying amount or fair value less costs to sell, and are no longer depreciated. The assets and liabilities of a disposed group classified as held for sale would be presented separately in the appropriate asset and liability sections of the balance sheet.

Goodwill

Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets, (SFAS No. 142) provides that goodwill and all intangible assets having indefinite useful economic lives are not to be amortized until their lives are determined to be finite, however, a recognized intangible asset with an indefinite useful life should be tested for impairment annually or on an interim basis if events or circumstances indicate that the fair value of the asset has decreased below its carrying value. At December 31, 2004, the Company evaluated its goodwill and determined that fair value had not decreased below carrying value and no adjustment to impair goodwill was necessary in accordance with SFAS No. 142.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss carryforwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. The realizability of the deferred tax asset is assessed throughout the year and a valuation allowance is established accordingly.

Comprehensive Income (Loss)

In accordance with SFAS No. 130, Reporting Comprehensive Income, the Company reports accumulated other comprehensive income (loss) in its Consolidated Balance Sheets. Comprehensive income (loss) includes net income (loss), minimum pension liability and other comprehensive income (loss), which includes current period foreign currency translation adjustments and amortization of unearned compensation.

Stock Option Plans

In December 2002, the FASB issued FAS No. 148, Accounting for Stock-Based Compensation - Transition and Disclosure, which amended FAS No. 123, Accounting for Stock-Based Compensation. The new standard provides alternative methods of transition for a voluntary change to the fair market value based method for accounting for stock-based employee compensation. Additionally, the statement amends the disclosure requirements of FAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. In compliance with FAS No. 148, the Company elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation plan as defined by APB No. 25.

At December 31, 2004, the Company had two stock-based employee compensation plans, which are described more fully in Note 12. Under APB No. 25, compensation expense relating to employee stock options is determined based on the excess of the market price of the Company's stock over the exercise price on the date of grant, the intrinsic value method, versus the fair value method as provided under FAS No. 123. Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant date for awards for years ended December 31, 2002, 2003 and 2004 (which includes the periods for January 1, 2004 through October 31, 2004 and November 1, 2004 through December 31, 2004), consistent with the provisions of FAS No. 123, the Company's net loss and loss per share or net income and net income and net income per share would have increased or decreased respectively.

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The following table represents the effect on net income and earnings per share if the Company had applied the fair value based method and recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation:

| (in thousands, except per share data) | | Years ended December 31, | | For the Periods | |
|---------------------------------------|--|--------------------------|---------|-------------------------------|-------------------------------|
| | | 2002 | 2003 | Jan. 1, 2004 Oct. 31, 2004 | Nov. 1, 2004 Dec. 31, 2004 |
| Net income (loss): | As reported | \$ (1,350) | \$ 353 | \$ (1,158) | \$ (37) |
| | Add: Stock-based employee compensation expense recorded | 62 | | | |
| | Less: Stock based employee compensation expense determined under fair value calculations | (193) | (67) | (32) | (6) |
| | Pro forma | \$ (1,481) | \$ 286 | \$ (1,190) | \$ (43) |
| Basic income (loss) per share: | As reported | \$ (0.10) | \$ 0.02 | \$ (0.08) | \$ |
| | Add: Stock-based employee compensation expense recorded | | | | |
| | Less: Stock based employee compensation expense determined under fair value calculations | (0.01) | | | |
| | Pro forma | \$ (0.11) | \$ 0.02 | \$ (0.08) | \$ |
| Diluted income (loss) per share: | As reported | \$ (0.10) | \$ 0.02 | \$ (0.08) | \$ |
| | Add: Stock-based employee compensation expense recorded | | | | |
| | Less: Stock based employee compensation expense determined under fair value calculations | (0.01) | | | |
| | Pro forma | \$ (0.11) | \$ 0.02 | \$ (0.08) | \$ |

Pension Plan

The Company established a defined benefit plan for employees that were employed by the Company's maintenance service business acquired in 1988. The plan provides benefits based upon a percentage of the participant's career income with the Company or years of service while an employee of the Company. The funding policy is to contribute annually an amount to fund pension costs as actuarially determined by an independent pension consulting firm.

Foreign Currency Translation

The functional currency for all foreign subsidiaries is the applicable local currency. Accordingly, all translation adjustments for foreign subsidiaries, and gains and losses on intercompany foreign currency transactions that are of a long-term nature, are included in accumulated other comprehensive income (loss) as a separate component of stockholders' deficiency.

There were no material net foreign currency transaction gains (losses) in 2002, 2003 and 2004. These amounts are included in selling, general and administrative expenses in the accompanying consolidated statements of operations.

Software Development Costs

All costs incurred to establish the technological feasibility of software products to be sold to others are expensed as research and development. Once technological feasibility has been established, all software production costs are capitalized. Amortization is computed on an individual product basis and is recognized over the greater of the remaining economic lives of each product or the ratio that current gross revenues for a product bear to the total of current and anticipated revenues for that product, commencing when the products become available for general release to customers. Software development costs are generally amortized over a three-year period. The Company continually assesses the recoverability of software development costs by comparing the carrying value of individual products to their net realizable value.

The Company capitalized \$896,000 and \$1,065,000 of software development costs during 2003 and 2004 (which includes the periods for January 1, 2004 through October 31, 2004 and November 1, 2004 through December 31, 2004), respectively, relating to our new N-Tier, Internet-native corporate application suite of products written in java. The modules to this suite of applications became available for general release in the first quarter of 2005 at which time amortization of such costs commenced. We believe that these new products will produce new sales adequate to recover amounts capitalized.

Research and Development Costs

During 2002, 2003, and 2004, we incurred \$3,307,000, \$2,828,000 and \$3,708,000, respectively (net of capitalized software of \$861,000, \$896,000 and \$1,065,000 for 2002, 2003 and 2004 (which includes the periods for January 1, 2004 through October 31, 2004 and November 1, 2004 through December 31, 2004), respectively) for research and development activities, which are expensed as incurred. Our research and development expenditures related to the support and extension of existing software products and the development of new products.

Fair Value of Financial Instruments

As of December 31, 2003 and 2004, the carrying value of account receivables, accounts payable, accrued liabilities, income taxes payable and other liabilities approximate fair value due to the short-term nature of such instruments. The carrying value of long-term debt approximates fair value as the related interest rates approximate rates currently available to the Company.

Income (Loss) per Share of Common Stock

Basic and diluted income (loss) per share is computed using the weighted average shares of common stock outstanding during the period. Consideration is also given in the dilutive income per share calculation for the dilutive effect of common stock equivalents which might result from the exercise of stock options and warrants.

Recent Accounting Pronouncements

In December 2004, the FASB issued SFAS No. 123r, *Share-Based Payment* (SFAS 123r). SFAS 123r provides accounting guidance for stock-based payments to employees. SFAS 123r revises SFAS 123 by eliminating the choice of using the recognition and measurement provisions of APB No. 25 and requiring all companies to use the fair value method of measuring stock compensation expense. SFAS 123r clarifies and expands SFAS 123's guidance in several areas, including measuring fair value, classifying an award as equity or a liability, attributing compensation cost to reporting periods as well as adding several new disclosure requirements. SFAS 123r also changes the accounting for the tax effects of options, including the presentation of the tax effects on the consolidated statements of cash flows. SFAS 123r is effective for public companies with the first interim or annual period that begins after June 15, 2005. As discussed above, the Company is currently accounting for all of its stock-based compensation under the intrinsic value method as outlined in APB 25 and will adopt SFAS 123r beginning in the first quarter of 2006. The Company still needs to evaluate the impacts of SFAS 123r.

In December 2004, the FASB issued SFAS No. 153 (SFAS 153), *Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions*. SFAS 153 eliminates the exception from fair value measurement for nonmonetary exchanges of similar productive assets in paragraph 21(b) of APB Opinion No. 29, *Accounting for Nonmonetary Transactions*, and replaces it with an exception for exchanges that do not have commercial substance. SFAS 153 specifies that a nonmonetary exchange has commercial substance if the future cash flows of the entity are expected to change significantly as a result of the exchange. SFAS 153 is effective for periods beginning after June 15, 2005. We do not expect that adoption of SFAS 153 will have a material effect on our consolidated financial position, consolidated results of operations, or liquidity.

Reclassifications

Certain prior year amounts have been reclassified to conform with the 2004 presentation.

NOTE 2 MANAGEMENT EQUITY/CONVERSION TRANSACTION AND PRIVATIZATION PLANS

Management Equity/Conversion Transaction

On April 9, 2004, an investor group, consisting of Canyon, the Company's Chairman of the Board, Chief Executive Officer & President and Chief Financial & Operating Officer (Investor Group), acquired 2,433,333 shares of the Company's common stock held by CSA and \$3,133,344 of secured indebtedness owed to CSA for \$1 million in cash (see note 8). On September 22, 2004, the Company received approval from its shareholders for the Investor Group to convert the Company's secured indebtedness acquired from CSA plus any accrued interest through the date of conversion for shares of the Company's common stock based upon a conversion price of \$0.10 per share. Additionally, the shareholders also approved for the Investor Group to invest \$1,000,000 of new cash proceeds into the Company, which the Company received on September 24, 2004, in a private placement at \$0.10 per share (the Management Equity/Conversion Transaction). On November 1, 2004, the Company issued 10 million shares of its common stock to the Investor Group in exchange for the \$1,000,000 of cash proceeds and the \$3,133,344 secured note, together with \$183,867 of accrued interest, was converted into 33,172,110 shares of the Company's common stock.

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As the carrying value of the acquired indebtedness of \$3,317,211 as of November 1, 2004 was lower than the fair value (quoted market price) of the 33,172,110 shares issued in connection with the debt conversion of \$4,312,374 (33,172,110 shares \$0.13 per share), the Company recorded a debt extinguishment charge of \$995,163, which has been measured as of the conversion date (commitment date) of November 1, 2004 for accounting purposes.

In addition, the market price for our common stock was \$0.13 per share on November 1, 2004, the date of issuance of the 10,000,000 shares of our common stock to the Investor Group. Accordingly, we recorded a \$187,500 charge to stock compensation expense since certain members of our management are also members of the Investor Group. The amount of the charge is based on the 6,250,000 shares attributable to members of management based on their ownership share in the Investor Group multiplied by the amount that the market price of our common stock of \$0.13 per share exceeded the \$0.10 per share on the date of issuance of such shares.

We believe that the aforementioned transaction permits but does not require us to use new basis or push down accounting since the members of the Investor Group will hold between 80% and 94% of the voting shares of the company upon completion of the transaction. Application of push-down accounting requires that the acquiring parent or control group obtain at least an 80% ownership interest, either in a single transaction, or through a series of transactions. The Investor Group has acquired 78.84%, and the members of the Investor Group previously personally held 17.85% ownership, not within the Investor Group. The 17.85% personal ownership of the members outside of the Investor Group was reduced to 4.53% after the Investor Group's acquisition of 78.84% of the Company's common stock. The basis for considering the members as part of a control group is due to the fact that the group's intent was to mutually promote the acquisition and to collaborate on the subsequent control of the Company and, as such, should be viewed effectively as one investor/group. The 78.84% interest held by the Investor Group effectively ties the four members together into a control group, and that the remaining outside holdings of 4.53% (totaling 83.37%) should also be treated as held by the control group for purposes of applying push-down accounting (therefore the Investor Group controls 83.37% of the Company's common stock). Accordingly, the Company has elected to apply push down accounting, and in accordance with SFAS No. 141 and using the guidance in Topic D-97. This has resulted in a new valuation of the assets and liabilities of the Company based upon fair values as of the date of the transaction.

As of November 1, 2004, the Company had a stockholders' deficit of approximately \$14,582,000 (excluding the \$1 million of cash infused by the Investor Group) and an accumulated deficit of approximately \$232 million. After application of the push down accounting, the portion of the historic deficit attributable to the Investor Group's new ownership was eliminated, and stockholders' deficit has been partially reset based on the Investor Group's new basis in the Company of \$2.0 million. Post push down stockholders' deficiency was calculated as follows (in thousands):

| | | |
|--|----|--------------|
| Non-Investor Group: | | |
| Adjusted historic stockholders' deficiency at November 1, 2004 | \$ | (14,582) (a) |
| Non-Investor Group Ownership (100% - 83.37%) | | 16.63% |
| Non-Investor Group basis to carry over | \$ | (2,425) |
| Investor Group: | | |
| New basis to push down | \$ | 2,000 (b) |
| Adjusted historic stockholders' deficiency at November 1, 2004 | \$ | (14,582) |
| Investor Group pre-existing ownership percentage | | 4.53% |
| | | (661) |
| New stockholders' deficiency as of November 1, 2004 | \$ | (1,086) |

(a) Historic stockholders' deficiency was adjusted to exclude the \$1 million of common stock subscribed by the Investor Group on September 24, 2004 since the amount has been included in the Investor Group's new basis calculation (see note (b) below).

(b) The Investor Group's new basis is calculated as follows:

| | | |
|--|----|-----------|
| Investor Group's cash to purchase MAI common stock and indebtedness from CSA | \$ | 1,000,000 |
| Investor Group's cash to purchase 10 million shares of MAI common stock | | 1,000,000 |
| Investor Group's new basis | \$ | 2,000,000 |

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Based on the balance sheet as of November 1, 2004, and considering the additional equity investment and debt conversion by the Investor Group, application of push down accounting resulted in a step-up in basis of the net assets of the Company of approximately \$10,179,000 calculated as follows (in thousands):

| | | |
|--|----|----------|
| Adjusted historical stockholders' deficiency at November 1, 2004 | \$ | (14,582) |
| Conversion of Investor Group debt at book value | | 3,317 |
| Step up in value of net assets | | 10,179 |
| Post push-down accounting stockholders' deficiency | \$ | (1,086) |

Below is the purchase price allocation relating to the net liabilities acquired (representing the excess of fair value over net historical net assets). The Company completed a valuation of its assets and liabilities and determined the fair value to be the book value for all assets and liabilities except for furniture, fixtures and equipment (valued at estimated replacement costs) and intangible assets (valued based upon estimated future revenue streams). Following is our allocation of the purchase price at estimated fair values (in thousands):

| | Adjusted Historical Book Value-Pre Push Down Accounting (1) | Fair Value | Excess of Fair Value Over Book Value | Investor Group's 65.52% of Excess(2) | Purchase Price Allocation |
|--|---|------------|--|---|---------------------------------|
| Furniture, fixtures and equipment | \$ 470 | \$ 687 | \$ 217 | \$ 142 | \$ 612 |
| Capitalized software development costs | 2,661 | 2,503 | (158) | (158) | 2,503 |
| Goodwill | 1,121 | 7,374 | 6,253 | 5,251 | 6,372 |
| Trade names | | 4,059 | 4,059 | 2,659 | 2,659 |
| Customer relationships | | 3,487 | 3,487 | 2,285 | 2,285 |
| Other net liabilities | (15,517) | (15,517) | | | (15,517) |
| Net Book /Fair Value of Assets and Liabilities | \$ (11,265) | | | \$ 10,179 | \$ (1,086) |

(1) Other net liabilities exclude the \$3,317,000 of secured debt that was converted to equity in conjunction with the application of push down accounting. Historical book value is adjusted to exclude the \$1 million of common stock subscribed by the Investor Group on September 24, 2004 since the amount has been included in the Investor Group's new basis calculation (see note (b) above and note 7).

(2) Investor Group's percentage of excess of fair value over book value represents the Investor Group's acquired ownership percentage of 78.84% less the decrease in the Investor Group's previously personally held ownership of 13.32% (17.85% before the transaction reduced to 4.53% after the transaction).

In connection with the Management Equity/Conversion Transaction, the Company assigned a new useful life for furniture, fixtures and equipment effective as of November 1, 2004. Following is our allocation of the purchase price at estimated fair values and amortization periods (useful lives) for the groups of assets affected:

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| | Allocation of Purchase Price | Amortization Period (Useful Life) |
|-----------------------------------|------------------------------------|---|
| Furniture, fixtures and equipment | \$ 612,000 | 3 years |
| Intangible assets: | | |
| Goodwill | \$ 6,372,000 | * |
| Tradenames | 2,659,000 | 15 years |
| Customer relationships | 2,285,000 | 7 years |
| Capitalized software | 2,503,000 | 7 years |
| | \$ 13,819,000 | |

* Reviewed annually for impairment, not amortized, as goodwill has an indefinite life (in accordance with SFAS No. 142).

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The following reflects the unaudited pro forma effect of the Management Equity/Conversion Transaction on continuing operations for the year ended December 31, 2003 and for the period from January 1, 2004 to October 31, 2004 (in thousands):

| | Year ended December 31, 2003 | Period from Jan. 1, 2004 Oct. 31, 2004 |
|-----------------------------|------------------------------------|--|
| Revenue | \$ 19,346 | \$ 16,317 |
| Operating income (loss) | 747 | (593) |
| Net income (loss) | 92 | (1,328) |
| Net income (loss) per share | \$ 0.01 | \$ (0.09) |

The unaudited pro forma information provided above has been prepared by adjusting historical amounts for the periods to give effect to the Management Equity/Conversion Transaction as if it had occurred on January 1, 2003 and 2004, respectively. The pro forma adjustments to the historical results of operations for the year ended December 31, 2003 and the period from January 1, 2004 to October 31, 2004 include the pro forma impact of the push down accounting resulting in the reduction of depreciation expense of \$268,000 and \$272,000, respectively, and an increase of amortization of identifiable intangible assets of \$861,000 and \$718,000, respectively. The pro forma adjustments to the historical results of operations for the year ended December 31, 2003 and the period from January 1, 2004 to October 31, 2004 include the pro forma impact of the debt conversion resulting in the reduction of interest expense of \$332,000 and \$276,000, respectively.

Privatization Plans

Our Board of Directors and the Investor Group are in the process of furnishing an information statement to all holders of record of the issued and outstanding shares of our common stock, \$0.01 par value, in connection with a proposed Amendment to the Company's Amended and Restated Certificate of Incorporation (Amendment) to effectuate a 1-for-150 reverse stock split. If consummated, the reverse stock split would enable the Company to terminate its periodic reporting obligations under Sections 13 and 15(d) of the Securities Exchange Act of 1934, as amended (Exchange Act), the registration of our common stock under Section 12(g) of the Exchange Act and the quotation of our common stock on the OTC Bulletin Board and become a private company.

NOTE 3 INVENTORIES, NET

Inventories are summarized as follows:

| | 2003 | December 31, (in thousands) | 2004 |
|-------------------|-------|--------------------------------|------|
| Finished goods | \$ 39 | \$ | 65 |
| Replacement parts | 8 | \$ | 6 |
| | \$ 47 | \$ | 71 |

The Company has purchased many products and components from single sources of supply. Because the Company's current products are industry standard, the Company believes that alternative sources of supply of similar products would be available to the Company in the event of any interruption of delivery of a single source supplier.

NOTE 4 BUSINESSES HELD FOR SALE

In the fourth quarter of 2001, the Company's Board of Directors adopted a plan to sell its Process manufacturing and Legacy divisions. The Process manufacturing business division designed, sold, installed and supported total technology solutions featuring complex wide and local area networks to the process manufacturing industry. The Legacy business provided a wide array of products and services to its customers who continued to use its proprietary host-based computer

systems, including field engineering services, new and replacement equipment, operating systems and software application products. These products and services upgraded, enhanced and integrated the legacy systems with currently available computer technologies.

During the fourth quarter of 2002, the Company successfully sold its Process Manufacturing and Legacy businesses (see note 6).

In accordance with SFAS No. 144, the Company has reflected the operating results of these businesses as discontinued operations in the consolidated statements of operations for all periods presented.

Summarized below is historical financial information about Process Manufacturing and Legacy (in thousands):

| | 2002 | |
|--------------------------|-------------|---------|
| Revenue | \$ | 2,344 |
| Loss, net of tax of zero | \$ | (1,767) |

NOTE 5 FURNITURE, FIXTURES AND EQUIPMENT

The major classes of furniture, fixtures and equipment are as follows:

| | 2003 | (in thousands) | 2004 |
|---|-------------|-----------------------|-------------|
| Furniture, fixtures and equipment | \$ | 914 | \$ 108 |
| Office equipment | | 793 | 425 |
| Leasehold improvements | | 247 | 144 |
| Total | | 1,954 | 677 |
| Less: accumulated depreciation and amortization | | (1,196) | (48) |
| | \$ | 758 | \$ 629 |

During 2003, the Company moved its corporate office and wrote off certain fully depreciated assets that were disposed of pursuant to the move.

NOTE 6 ACQUISITIONS, DIVESTITURE, AGREEMENTS AND FINANCING

Hospitality Services & Solutions

On June 23, 2002, the Company acquired substantially all of the assets and assumed certain liabilities of Hospitality Services & Solutions (HSS) including a 35% ownership in AMDB HIS (AMDB) pursuant to a stock purchase agreement for 100,000 shares of common stock valued at \$32,000 (the quoted market price of the common stock at the time the terms were agreed), and \$75,000 in cash. Additionally, the shareholders of HSS received a 20% minority interest in the Company s combined operations in Asia. HSS was acquired for the Company to expand its operations in the Asian marketplace, strengthen its management team in the territory and create new opportunities for its new enterprise capable suite of products. The assets acquired from HSS are used in the business of software design, engineering and service relating to hotel information systems. The assets also include subsidiaries of HSS in Malaysia, Singapore and Thailand. The net liabilities of HSS acquired by the Company totaled \$190,000. The Company recorded \$297,000 of goodwill (deductible for tax purposes) in connection with the acquisition of HSS.

Included in the acquired assets of HSS was a 35% interest in AMDB, an online reservation service, originally purchased by HSS for \$66,000. On February 20, 2003, the Company entered into an agreement whereby it acquired the remaining 65% for \$79,000 payable over 6 month installments. The net liabilities of \$15,000 acquired are used to support an online reservation service related to hotel information systems. The Company recorded \$159,000 of goodwill in connection with the acquisition of AMDB.

Gaming Systems International

On June 19, 1999, the Company sold Gaming Systems International (GSI) for an amount in excess of the book value of net assets sold. Assets sold of approximately \$3,749,000 consisted of accounts receivable of \$1,514,000, inventories of \$364,000, furniture, fixtures and equipment of \$218,000, intangible assets of \$1,573,000 and prepaid expenses of \$80,000. Liabilities assumed by the buyer consisted of accounts payable and accrued liabilities of \$197,000, deposits of \$100,000, unearned revenue of \$351,000 and long-term debt of 446,000. The Company received three promissory notes totaling \$4,925,000 with face values of \$1,100,000, \$1,500,000 and \$2,325,000, respectively. Interest was paid monthly at the rate of 10% per annum on both the \$1,100,000 and \$1,500,000 notes, with the principal due and payable on June 19, 2001 and June 19, 2003, respectively. The \$1,100,000 promissory note was guaranteed by a third party. Principal payments and interest, at prime plus 1%, was to commence for the \$2,325,000 promissory note on October 1, 2002 in 48 monthly installments of approximately \$48,000 of principal, plus accrued interest.

On April 6, 2001 the Company entered into an agreement with the maker of the Notes whereby the maker reconveyed 100% of the Common Stock of GSI to the Company for the purpose of selling GSI to a third party. In connection with the agreement, the Company canceled the Notes and entered into a new \$1.1 million secured promissory note with the same party. The maker will be paid a commission of 30% of cash receipts from the third party, which will be first applied to the \$1.1 million note and paid in cash to the maker thereafter. On July 27, 2001, the Company entered into an Asset Purchase Agreement (Agreement) with the third party for approximately \$3.2 million whereby all of the assets of GSI were acquired and all of the liabilities assumed, except for approximately \$300,000 of obligations, which will remain with GSI. The payment terms under the Agreement required a \$1 million non-refundable cash payment to the Company, which was received on July 27, 2001 and a \$1.5 million payment, which was received in December 2001. The Company also received a secured promissory note in the amount of \$750,000, of which \$500,000 was received in December 2002 and \$250,000 in January 2003. The third party was also required to pay an additional \$250,000 subject to a maximum \$250,000 reduction pursuant to the resolution of certain uncertainties as of the date of the Agreement, which, as part of the settlement, in January 2003 the Company received \$46,000.

MAI Canada

On December 6, 2002, the Company sold all the assets and certain liabilities of its Canadian operations, including all legacy divisions, to the management of this subsidiary pursuant to a stock purchase agreement. In connection with the sale, the Company also entered into a software distribution agreement whereby the buyer has a non-exclusive right and license to market and install the Company's hospitality products in Canada. The sale resulted in a loss of approximately \$630,000, which is included in the loss on disposal of discontinued operations. Prior to the sale, the Canadian operations incurred a net loss of \$305,000 during 2002, which is included in loss from discontinued operations in the accompanying statements of operations.

Process Manufacturing

On December 6, 2002, the Company entered into an Asset Purchase Agreement whereby all the assets and certain liabilities of its process manufacturing software division were sold to a third party for cash of \$250,000. The sale resulted in a loss of approximately \$391,000, which is included in the loss on disposal of discontinued operations. Prior to the sale, Process Manufacturing operations incurred a net loss of \$441,000 during 2002, which is included in loss from discontinued operations in the accompanying statements of operations.

NOTE 7 INTANGIBLE ASSETS AND GOODWILL

As of December 31, 2004, intangible assets consist of developed technology, software trade names, customer lists and goodwill (which represents the excess of the purchase price over the estimated fair value of the net assets of the acquired businesses) and capitalized software. Identifiable intangible assets other than goodwill are amortized on a straight-line basis over their estimated useful lives. Goodwill is not to be amortized until its life is determined to be finite, however, a recognized intangible asset with an indefinite useful life should be tested for impairment annually or on an interim basis if events or circumstances indicate that the fair value of the asset has decreased below its carrying value. At December 31, 2004, the Company evaluated its goodwill and determined that fair value had not decreased below carrying value and no adjustment to impair goodwill was necessary.

Intangible assets as of December 31, 2003 and 2004 are as follows:

| | December 31, (in thousands) | |
|---|--------------------------------|----------|
| | 2003 | 2004 |
| Gross carrying amount of intangible assets: | | |
| Capitalized software | \$ 1,755 | \$ 2,662 |
| Software trade names | | 2,659 |
| Customer relationships | | 2,285 |
| Total intangible assets | 1,755 | 7,606 |
| Accumulated amortization: | | |
| Capitalized software | | (39) |
| Software trade names | | (41) |
| Customer relationships | | (56) |
| Total accumulated amortization | | (136) |
| Intangible assets, net | \$ 1,755 | \$ 7,470 |
| Goodwill | \$ 1,121 | \$ 4,622 |

As of December 31, 2003, goodwill is comprised of \$665,000 on the purchase of Hotel Information Systems Inc. (HIS) in 1996, \$297,000 on the purchase of HSS in 2002 and \$159,000 on the purchase of AMDB in 2003 (see note 6).

A roll forward of goodwill for the year ended December 31, 2004 is as follows (in thousands):

| | |
|--|----------|
| Goodwill at December 31, 2002 | \$ 962 |
| Goodwill from purchase of AMDB | 159 |
| Goodwill at December 31, 2003 | 1,121 |
| Goodwill from Management Equity/Conversion Transaction | 5,251 |
| Private placement by Investor Group (note 2) | (1,000) |
| Year end adjustment to minimum pension liability | (750) |
| Impairment identified in 2004 | |
| Goodwill at December 31, 2004 | \$ 4,622 |

The Company's amortization period for customer relationships is the greater of seven years on a straight line basis or specific identification. Capitalized software and software trade names are being amortized on a straight line basis over seven and fifteen years, respectively. The following table shows the estimated amortization expense for these assets for each of the succeeding years:

| Year Ending December 31, (in thousands) | |
|--|--------|
| 2005 | \$ 861 |
| 2006 | 861 |
| 2007 | 861 |
| 2008 | 861 |

| | |
|------------|----------|
| 2009 | 861 |
| Thereafter | 3,165 |
| | \$ 7,470 |

NOTE 8 LONG-TERM DEBT**Wamco 32 Ltd.**

On January 13, 2003, the Company re-negotiated the terms of its credit facility with Coast Business Credit (Coast) whereby the outstanding balance of \$1,828,000 was converted to a secured term loan which accrues interest at 9.25% per annum and requires monthly payments of \$58,000 over a 36 months period commencing March 1, 2003. The loan is secured by all the tangible and intangible assets for the Company, including intellectual property. On February 7, 2003, the Federal Deposit Insurance Corporation (FDIC) put Coast and its parent company, Southern Pacific Bank, into receivership and held all of Coast 's assets for sale to third parties. On May 15, 2003, the loan was sold to Wamco 32, Ltd. (Wamco). This sale of the loan by the FDIC did not change any of the terms of the Company 's loan agreement.

The loan matures on February 28, 2006, at which time all remaining principal and accrued interest is due and payable. The Company will also be required to pay Wamco additional principal payments on a quarterly basis based upon an EBITDA-based formula commencing March 31, 2003. For the years ended December 31, 2003 and 2004, there were no additional principal payments required under the EBITDA-based formula. As of December 31, 2003 and 2004, the balance of the term loan was \$1,366,000 and \$774,000 respectively.

The loan, pursuant to the original inter-creditor agreement between Canyon Capital and Coast, which was sold to Wamco on May 15, 2003, contains various restrictions and covenants, including a minimum quick ratio of .20 to 1.00 and minimum debt service coverage ratio of .50 to 1.00. In the event that the Company were not in compliance with the various restrictions and covenants and were unable to receive waivers for non-compliance, the term loan would be immediately due and payable. The Company was not in compliance with, but has received waivers for, such covenants through December 31, 2004. There is no guaranty that the Company will meet its debt covenants in the future.

Canyon Capital Management LP

On January 13, 2003, the Company modified its 11% secured subordinated notes payable agreement with Canyon Capital Management LP (Canyon), whereby the Company is required to make monthly interest payments of \$52,000 until the Wamco term loan is paid off in full at which time the note payable will be converted into a three-year amortizing loan which will accrue interest at 11% per annum and requires equal monthly payments of principal and interest such that the subordinated debt will be paid in full at the end of the amended term. Upon the repayment of the Wamco debt in full, the Company will also be required to pay Canyon additional principal payments on a quarterly basis based upon an EBITDA-based formula. Additionally, in connection with the January 13, 2003 modification, the Company issued to Canyon 200,000 shares of its common stock valued at \$20,000 (the quoted market price of the common stock at the time the terms were agreed) and agreed to issue one million warrants at an exercise price of \$0.40 per share valued at \$42,000 (using the Black-Scholes option-pricing model with the following weighted-average assumptions: risk-free interest rate of 6.5%, volatility of 80% and an expected life of 5 years). The \$62,000 is being amortized to interest expense over the term of the modified note. The subordinated notes are secured by all the tangible and intangible assets for the Company, including intellectual property, which lien is junior to the lien granted to Wamco. The principal balance outstanding on the subordinate notes payable to Canyon was approximately \$5,662,000 and \$5,660,000 at December 31, 2003 and 2004, respectively.

CSA Private Limited

In connection with a settlement agreement in February 2001 with CSA Private Limited (CSA), the Company issued \$2.8 million of subordinated debt to CSA. The \$2.8 million of debt was secured by all the tangible and intangible assets for the Company, including intellectual property, which was subordinate to Wamco and Canyon, accrued interest at 10% per annum and required payments of \$37,500 from March 1, 2002 through September 1, 2002 and monthly payments of \$107,500 commencing on October 1, 2002 until October 2003 when all remaining unpaid principal and accrued interest was to be paid in full.

The agreement with CSA was amended whereby the Company was required to make payments under the subordinated note unless and until it paid \$1 million by December 31, 2002. Upon payment of the \$1 million, contractual payments under the subordinated note would have ceased until a final payment in the amount of \$400,000 is paid by February 28, 2003. If the Company did not make all of the modified payments to CSA, the subordinated note would revert back to its original terms. The Company did not make the modified payment and have not made any payments since September 2002. CSA did not formally notify the Company of its default.

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On April 9, 2004, the Company successfully amended its agreement with CSA whereby the principal balance and accrued interest through March 31, 2004, totaling \$3,633,000, were converted to two new secured notes. The first note for \$500,000 accrues interest at 10% per annum and provides for monthly payments of \$10,000 until the Wamco and Canyon debt is paid in full. Thereafter, the note provides for monthly payments in an amount equal to the greater of i) \$10,000 or ii) the amount required to fully amortize all remaining principal and interest in 24 equal monthly payments. The second note for \$3,133,344 (Other Note) also accrues interest at 10% per annum and provides for monthly payments of \$7,500, or such other interest amount, not to exceed \$10,000 per month, that Wamco and Canyon will allow. Under the terms of the amended subordination agreement between Wamco, Canyon and CSA, all payments under the new notes are subordinated to the payment in full of the Wamco and Canyon loan agreements. The Company has not made any payments on the \$500,000 note as of December 31, 2004 and is currently in default. The interest rate has been increased to 12.5% in line with the terms of that note until the Company becomes current on its contractual payments. As of December 31, 2004, the Company's accrued and unpaid interest relating to the \$500,000 secured note was \$49,000.

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On April 9, 2004, an investor group, consisting of Canyon, the Company's Chairman of the Board, Chief Executive Officer and Chief Financial and Operating Officer (Investor Group), acquired 2,433,333 shares of the Company's common stock held by CSA and the Other Note for \$1 million in cash . On November 1, 2004, the \$3,133,344 Other Note, together with \$183,867 of accrued interest, was converted into 33,172,110 shares of the Company's common stock (see note 2).

Tax Claims

On September 30, 2003, the Company entered into a settlement agreement with the United States Internal Revenue Service (the Service) on a tax claim which resulted from the Company's 1993 Chapter 11 proceedings whereby it agreed to pay \$489,000 in equal monthly installments of \$7,438 over a period of six (6) years at an interest rate of 6%. The \$489,000 settlement is reflected as debt in the financial statements and resulted in a one-time gain of \$262,000 which is included in income tax benefit. In the event that the Company fails to pay the Service any payment, and such payment failure continues for sixty days after written notice of such failure, \$1,832,100, plus accrued interest thereon, less any payments made by the Company will be immediately due and payable to the Service. As of December 31, 2003 and 2004, the debt balance was \$428,000 and \$363,000, respectively.

In connection with the settlement agreement with the Service, the Company's 1993 Chapter 11 proceedings were officially closed pursuant to Court order effective as of September 30, 2003.

Long-term debt outstanding is as follows:

| | December 31, | |
|---|-----------------------|-------------|
| | (in thousands) | |
| | 2003 | 2004 |
| 11% subordinated debt, net of discount of \$50,000 and 37,000, respectively | \$ 5,612 | \$ 5,623 |
| 12.5% subordinated debt | 2,800 | 500 |
| 9.25% debt | 1,366 | 774 |
| Tax Claims | 428 | 363 |
| Other | 575 | 392 |
| | 10,781 | 7,652 |
| Less: current installments | (3,646) | (1,003) |
| Non-current portion | \$ 7,135 | \$ 6,649 |

Aggregate maturities of long-term debt are as follows:

| | Year Ending December 31, | |
|------|---------------------------------|--|
| | (in thousands) | |
| 2005 | \$ 1,003 | |
| 2006 | 1,557 | |
| 2007 | 1,939 | |
| 2008 | 2,145 | |

| | |
|------------|----------|
| 2009 | 425 |
| Thereafter | 583 |
| | \$ 7,652 |

NOTE 9 - ACCRUED LIABILITIES

Accrued liabilities consist of the following:

| | 2003 | (in thousands) | 2004 |
|---------------------------------|----------|----------------|----------|
| Salaries, wages and commissions | \$ 960 | | \$ 768 |
| Accrued insurance & sales taxes | 85 | | 148 |
| Accrued vacation | 409 | | 469 |
| Accrued interest | 747 | | 274 |
| Other | 858 | | 1,242 |
| Total | \$ 3,059 | | \$ 2,901 |

NOTE 10 - INCOME TAXES

The components of income (loss) from continuing operations before income taxes are as follows (in thousands):

| | Years Ended December 31, | | For the Periods | |
|---------|--------------------------|--------|-------------------------------|-------------------------------|
| | 2002 | 2003 | Jan. 1, 2004 Oct. 31, 2004 | Nov. 1, 2004 Dec. 31, 2004 |
| U.S. | \$ 702 | \$ 454 | \$ (1,805) | \$ (31) |
| Foreign | (255) | (412) | 662 | 10 |
| Total | \$ 447 | \$ 42 | \$ (1,143) | \$ (21) |

The income tax provision (benefit) is comprised of the following (in thousands):

| | Years Ended December 31, | | For the Periods | |
|------------------|--------------------------|----------|-------------------------------|-------------------------------|
| | 2002 | 2003 | Jan. 1, 2004 Oct. 31, 2004 | Nov. 1, 2004 Dec. 31, 2004 |
| Current: | | | | |
| U.S. Federal | \$ | \$ (326) | \$ 5 | \$ 1 |
| State | 3 | 6 | | |
| Foreign | 27 | 9 | 10 | 15 |
| | 30 | (311) | 15 | 16 |
| Deferred: | | | | |
| U.S. Federal | | | | |
| Foreign | | | | |
| Total | \$ 30 | \$ (311) | \$ 15 | \$ 16 |

Deferred tax assets and liabilities result from differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities. The significant components of the deferred income tax assets and deferred income tax liabilities are as follows:

| | December 31, (in thousands) | |
|--------------------------------------|--------------------------------|----------|
| | 2003 | 2004 |
| Deferred tax assets: | | |
| Net operating loss carryforwards | \$ 21,521 | \$ 2,922 |
| Furniture, fixture and equipment | 69 | 25 |
| Capitalized software and intangibles | 363 | |
| Inventory write-downs | 10 | 3 |
| Allowance for doubtful accounts | 58 | 92 |
| Accrued expenses | 167 | 396 |
| Total deferred tax assets | 22,188 | 3,438 |

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| | | |
|-----------------------------------|----------|---------|
| Deferred tax liability: | | |
| Furniture, fixtures and equipment | | (57) |
| Identifiable intangible assets | | (3,121) |
| Total deferred tax liabilities | | (3,178) |
| Net deferred tax assets | 22,188 | 260 |
| Less: valuation allowance | (22,188) | (260) |
| Net deferred tax assets | \$ | \$ |

The Company has recorded a valuation allowance in the amount set forth above for certain deductible temporary differences where it is not more likely than not the Company will receive future tax benefits. The net change in the valuation allowance for the years ended 2002, 2003 and 2004 was \$(3,806,000), \$(179,000) and \$(18,750,000), respectively. As a result of the Company applying purchase accounting (see note 2), the Company has adjusted its deferred tax assets to reflect the change in the difference between the carrying amounts for certain assets and liabilities for income tax purposes versus the carrying

amounts for financial statement purposes. These differences resulted, most notably, in the recording of a deferred tax liability related to certain intangible assets. The recording of this deferred tax liability resulted in a corresponding reduction in the amount of valuation allowance required.

As of December 31, 2004, the Company has Federal and state net operating losses (NOL) carryovers of approximately \$7,309,000 and \$2,800,000, respectively. These NOL carryovers will expire in the years 2005 through 2021. The Company has net operating losses that may be subject to limitations under Internal Revenue Code (IRC) section 382; which is triggered in the event of an ownership change. During the current period the Company experienced an ownership change, as defined under IRC section 382. The Company is currently evaluating the impact of the IRC section 382 limitation. The Company believes that the amount of net operating losses shown in the financial statements as deferred tax assets represents the expected minimum amount of net operating losses available for future use under the IRC section 382 base limitation; however, the Company will continue to evaluate available IRC guidance that could increase the limitation, and in the event the limitation is increased, the Company will increase the amount of net operating losses shown as deferred tax assets, which increase will be fully offset with a valuation allowance, resulting in a net zero impact to the financial statements.

On September 11, 2002, the State of California enacted one of the budget trailer bills that implemented the state's 2002-2003 Budget Bill (A425). The new law suspends the NOL carryover deduction for tax years 2002 and 2003. To compensate for the deduction suspension, the period of availability for these NOL deductions has been extended for two years. In 2004, the NOL suspension expired and commencing on January 1, 2004, NOL's generated are applied at 100% and carried forward up to ten years.

The provision (benefit) for income taxes differs from the amount computed by applying the Federal corporate income tax rate of 34% to income (loss) from continuing operations before income taxes as follows (in thousands):

| | Years Ended December 31, | | For the Periods | |
|--|--------------------------|----------|-------------------------------|-------------------------------|
| | 2002 | 2003 | Jan. 1, 2004 Oct. 31, 2004 | Nov. 1, 2004 Dec. 31, 2004 |
| Statutory tax at 34% | \$ 152 | \$ 14 | \$ (389) | \$ (7) |
| Change in valuation allowance | (3,036) | (187) | (395) | (18,354) |
| Expiration of state NOLs | 22 | | 48 | |
| Effect of foreign operations | 2,729 | 140 | (215) | 11 |
| Adjustments of NOL carry forwards and deferred tax assets pursuant to the finalization of the IRS examination and other analysis | | (326) | 803 | 18,466 |
| Stock compensation charge | | | 64 | |
| Change in estimates | | 48 | | |
| Other | 163 | | 99 | (100) |
| Income tax expense (benefit) | \$ 30 | \$ (311) | \$ 15 | \$ 16 |

Undistributed earnings of the Company's foreign subsidiaries are considered to be indefinitely reinvested and, accordingly, no provision for U.S. federal and state income taxes has been provided thereon. Upon distribution of those earnings in the form of dividends or otherwise, the Company would be subject to U.S. income taxes and possibly withholding taxes payable to the foreign countries, but may be able to offset unrecognized foreign tax credit carryforwards. Determination of the amount of unrecognized deferred U.S. income tax liability is not practicable because of the complexities associate with its hypothetical calculation.

NOTE 11 - SEGMENTS

The Company provides total information technology solutions to the hospitality, resort and destination industry. The solutions provided by the Company typically include applications software, computer hardware, peripherals and wide and local area network design, implementation, installation and support. The Company is organized and operates in three segments: United States, Asia and United Kingdom. For purposes of applying SFAS No. 131, Disclosures about Segments of an Enterprise and Related Information, management views the United States, Asia and United Kingdom segments separately in operating the business, although the products and services are similar for each segment.

Information with respect to the Company's operations by significant geographic area is set forth below. Other foreign includes operations in Mexico and Canada, both of which have been discontinued. Asia includes operations in Singapore, Malaysia, Hong Kong and China.

| | Years ended December 31, | | For the Periods | |
|--|--------------------------|-----------|-------------------------------|-------------------------------|
| | 2002 | 2003 | Jan. 1, 2004 Oct. 31, 2004 | Nov. 1, 2004 Dec. 31, 2004 |
| Revenue from unaffiliated customers (based on subsidiary location): | | | | |
| United States | \$ 17,592 | \$ 15,439 | \$ 12,313 | \$ 2,832 |
| Asia | 2,783 | 2,871 | 2,691 | 695 |
| United Kingdom | 1,110 | 1,024 | 1,314 | 227 |
| Other foreign | 452 | 12 | | |
| | \$ 21,937 | \$ 19,346 | \$ 16,317 | \$ 3,754 |
| United States revenue from foreign affiliates | \$ 298 | \$ 313 | \$ 495 | \$ 132 |
| Operating income (loss): | | | | |
| United States | \$ 2,256 | \$ 1,748 | \$ (303) | \$ 118 |
| Asia | 70 | 185 | 199 | 33 |
| United Kingdom | (176) | (463) | (43) | (23) |
| Other foreign | (149) | (130) | | |
| | \$ 2,001 | \$ 1,602 | \$ (147) | \$ 128 |
| Identifiable assets: | | | | |
| United States | \$ 4,329 | \$ 4,985 | \$ 14,953 | \$ 14,146 |
| Asia | 1,352 | 1,159 | 1,375 | 1,502 |
| United Kingdom | 422 | 314 | 283 | 273 |
| Other foreign | 74 | 72 | | |
| | \$ 6,177 | \$ 6,530 | \$ 16,611 | \$ 15,921 |
| Long-lived assets: | | | | |
| United States | \$ 2,315 | \$ 3,109 | \$ 12,540 | \$ 12,198 |
| Asia | 492 | 541 | 492 | 494 |
| United Kingdom | 46 | 38 | 45 | 44 |
| Other foreign | 7 | 4 | | |
| | \$ 2,860 | \$ 3,692 | \$ 13,077 | \$ 12,736 |

United States revenue from foreign affiliates consists of net intercompany sales and services from the United States to the Company's foreign subsidiaries and is eliminated from consolidated net revenue. Intercompany sales are based on current selling prices or list prices less discounts. Discounts typically are influenced by competitive pricing, market conditions and relative foreign exchange rates.

Customers

During 2002 and 2003, the Joint Armed Services was the only customer accounting for ten percent or more of our revenues. Total revenue from the Joint Armed Services for 2002 and 2003 was \$2,880,000 and \$3,535,000, respectively. There were no customers that accounted for ten percent or more of our revenues in 2004.

NOTE 12 - STOCKHOLDERS DEFICIENCY

Stock Option Plans

The Company adopted the MAI Systems Corporation 1993 Stock Option Plan (the 1993 Plan) which became effective on January 27, 1994. Under the 1993 Plan, 2,500,000 authorized shares of Common Stock are reserved for issuance of options. Options under the 1993 Plan may be granted at exercise prices determined by the Compensation Committee of the Board of Directors, provided that the exercise prices shall not be less than the fair market value of the Common Stock on the date of grant. At December 31, 2004, 1,266,500 and 1,121,667 options under the 1993 Plan were outstanding and exercisable, respectively, and the weighted-average exercise price of these options was \$0.99.

In July 1995, the Board of Directors adopted the Non-Employee Director s Stock Option Plan (the Director s Plan). Under the Director s Plan, certain directors who are not employees of the Company or any affiliate of the Company are eligible to receive stock options. The Director s Plan provides that each non-employee director may also be granted an option to purchase 6,250 shares of Common Stock on the date of each annual meeting of the Company s stockholders at which the director is reelected to the Company s Board. These options vest 25% on the date of each subsequent annual meeting of the Company s stockholders which the director is reelected to the Board. The number of shares of Common Stock reserved for issuance pursuant to the Director s Plan is 250,000 shares. The exercise price shall not be lower than the fair market value of the Common Stock on the date of grant. As of December 31, 2004, 106,250 and 87,500 options under the Director s Plan were outstanding and exercisable, respectively, and the weighted-average exercise price of these options was \$1.48.

At December 31, 2004, there were 850,397 additional shares available for grant under the stock option plans. The per share weighted-average fair value of stock options granted during 2002 was \$0.22, on the date of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: risk-free interest rate of 6.5%, volatility of 80% and an expected life of 5 years.

On April 26, 2002, the Company granted 424,500 options to purchase shares of the Company s common stock to employees for services rendered. The exercise price of the options is \$0.34 per share. The options vest 33.3% per year and have a term of 10 years. The Company recorded no expense related to the granting of options to these employees.

On June 24, 2002, the Company granted 50,000 options to purchase shares of the Company s common stock to an employee for services rendered. The exercise price of the options is \$0.32 per share. The options vest 33.3% per year and have a term of 10 years. The Company recorded no expense related to the granting of options to this employee.

On June 3, 2002, the Company granted 25,000 options to purchase shares of the Company s common stock to members of the board of directors for services rendered. The exercise price of the options is \$0.32 per share. The options vest 33.3% per year and have a term of 10 years. The Company recorded no expense related to the granting of options to the member s of the board of directors.

The Company accounts for stock-based compensation utilizing the intrinsic value method in accordance with the provisions of Accounting Principles Board Opinion No. 25 (APB 25) Accounting for Stock Issued to Employees and related interpretations. Accordingly, no compensation expense is recognized for fixed option plans because the exercise prices of employee stock options equaled or exceeded the market prices of the underlying stock on the dates of grant.

The following is a summary of stock option activity under the Company's stock option plans:

| | Number of shares | | Weighted-average Exercise price |
|--|------------------|----|------------------------------------|
| Options outstanding at December 31, 2001 | 1,670,667 | \$ | 1.58 |
| Granted | 499,500 | | 0.34 |
| Exercised | (107,167) | | |
| Forfeited | (41,250) | | 0.67 |
| Options outstanding at December 31, 2002 | 2,021,750 | | 0.79 |
| Forfeited | (192,750) | | 2.28 |
| Options outstanding at December 31, 2003 | 1,829,000 | | 1.10 |
| Forfeited | (456,250) | | 1.58 |
| Options outstanding at October 31 and December 31, 2004 | 1,372,750 | \$ | 0.94 |

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At December 31, 2004, the exercise prices ranged from \$0.28 to \$9.75 per share and the weighted-average remaining contractual life of outstanding options under the Company's stock option plans was 6.7 years.

The following is a summary of stock options as of December 31, 2004:

| Range Exercise Prices | | | Number Outstanding December 31, 2004 | Weighted Average Remaining Contractual Life | Weighted Average Exercise Price | Number Exercisable December 31, 2004 |
|--------------------------|---|--------|---|---|------------------------------------|---|
| \$0.28 | - | \$0.63 | 952,250 | 7.50 | \$ 0.34 | 788,667 |
| 1.00 | - | 1.65 | 131,250 | 4.54 | 1.03 | 131,250 |
| 2.38 | - | 2.81 | 262,500 | 4.69 | 2.75 | 262,500 |
| 3.25 | - | 9.75 | 26,750 | 3.74 | 4.14 | 26,750 |
| | | | 1,372,750 | | | 1,209,167 |

Restricted Stock Plan

In May 2001, the Board of Directors adopted the 2001 Restricted Stock Plan. Under the plan, 5,500,000 authorized shares of the Company's Common Stock are reserved for issuance to officers and directors of the Company. The shares will be issued as Restricted Stock within the meaning of Rule 144 of the Securities Act of 1933, as amended. The Compensation Committee of the Board of Directors shall have the discretion to determine what terms and conditions shall apply, including the imposition of a vesting schedule.

In May 2002, the Company issued 612,500 shares of restricted common stock to its members of the board of directors and certain of its corporate officers which vest equally over a four-year period. Recipients are not required to provide consideration to the Company other than rendering the service and have the right to vote the shares. Under APB 25, compensation cost is recognized for the fair value of the restricted stock awarded, which is its quoted market price at the date of grant, which was \$0.25 per share. The total market value of the shares of \$153,000 was treated as unearned compensation and is being amortized to expense in proportion to the vesting schedule. The unamortized balance as of December 31, 2003 is \$53,000 and is included in accumulated other comprehensive loss in the accompanying consolidated balance sheet. Unearned compensation was fully amortized as of December 31, 2004.

Preferred Stock

On May 20, 1997, the Company authorized the issuance of up to 1,000,000 shares of \$0.01 par value preferred stock. The Board of Directors has the authority to issue the preferred stock, in one or more series, and to fix the rights, preferences, privileges and restrictions thereof without any further vote by the holders of Common Stock.

Stock Warrants

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On January 13, 2003, in connection with the modification of the subordinated notes payable with Canyon (see note 8), the Company granted one million warrants to Canyon at an exercise price of \$0.40 per share valued at \$42,000 which is being amortized to interest expense over the term of the modified note. The warrants vest equally over a period of five years and expire on February 1, 2010.

On April 26, 2002, the Company granted 25,000 warrants to purchase shares of the Company's common stock to a consultant for services rendered. The exercise price of the warrants is \$0.34 per share. The warrants vest equally over a three-year period and have a term of 10 years. The Company recorded no expense related to the granting of warrants to this consultant.

On February 2, 2001, the Company granted 25,000 warrants to purchase shares of the Company's common stock to a consultant for services rendered. The exercise price of the warrants is \$0.36 per share. The warrants vest equally over a three-year period and have a term of 10 years. The Company recorded no expense related to the granting of warrants to this consultant.

On May 26, 2000, the Company issued warrants to its Chief Executive Officer to purchase 225,000 shares of Common Stock at \$0.56 per share. The exercise price of these warrants will increase with the fair market value of Common Stock when the fair market value exceeds \$2.81 per share. As the exercise price is not fixed, the warrants are accounted for as a variable award and, accordingly, are re-measured at each reporting date. The warrants vest equally over a three-year period and expire on March 24, 2010.

NOTE 13 - EMPLOYEE BENEFITS**Savings Plans**

On October 1, 1995, the Company established a Savings and Investment Plan covering substantially all the Company's domestic employees (the Domestic Plan). The Domestic Plan qualifies under Sections 401(k) and 401(a) of the Internal Revenue Code. Participating employees are allowed to contribute from 1% to 15% of their annual compensation. During 2002, 2003 and 2004 the Company did not make contributions to the Domestic Plan.

Defined Benefit Plans

The Company established a defined benefit plan for employees that were employed by the Company's maintenance service business acquired in 1988.

In April 1992, the Company elected to cease benefit accruals under the defined benefit plan to current participants. The curtailment had no effect on the accrued pension cost of the defined benefit plan and, accordingly, the Company's accumulated benefit obligation and projected benefit obligation are the same as of the end of each of the years presented below.

Company contributions under this plan are funded annually. Plan assets are comprised primarily of guaranteed investment/annuity contracts. Employee benefits are based on years of service and the employees' compensation during their employment.

The actuarially computed components of net periodic benefit cost included the following components (in thousands):

| | Year Ended December 31, | | |
|-----------------------------------|-------------------------|-------|---------|
| | 2002 | 2003 | 2004(1) |
| Service costs | \$ | \$ | \$ |
| Interest costs | 142 | 143 | 143 |
| Amortization of unrecognized loss | 16 | 38 | 39 |
| Expected return on plan assets | (107) | (100) | (144) |
| Net periodic pension expense | \$ 51 | \$ 81 | \$ 38 |

The following table sets forth the funded status and amounts recognized in the Company's consolidated statements of operations (in thousands):

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| | Years Ended December 31, | | |
|---|--------------------------|----------|----------|
| | 2002 | 2003 | 2004(1) |
| Change in Benefit Obligation: | | | |
| Projected Benefit Obligation, beginning of year | \$ 1,993 | \$ 2,154 | \$ 2,331 |
| Service cost | | | |
| Interest cost | 142 | 143 | 143 |
| Benefits paid | (79) | (83) | (86) |
| Actuarial loss/(gain) | 98 | 117 | 225 |
| Projected Benefit Obligation, end of year | \$ 2,154 | \$ 2,331 | \$ 2,613 |
| Change in Plan Assets: | | | |
| Plan assets, beginning of year | \$ 1,531 | \$ 1,236 | \$ 1,685 |
| Actual return on plan assets | (279) | 182 | 86 |
| Employer contribution | 63 | 350 | 276 |
| Benefits paid | (79) | (83) | (86) |
| Plan assets, end of year | \$ 1,236 | \$ 1,685 | \$ 1,961 |
| Unfunded status | \$ (918) | \$ (646) | \$ (652) |
| Unrecognized (gain)/loss | 1,008 | 1,005 | 1,250 |
| Net amount recognized | \$ 90 | \$ 359 | \$ 598 |

(1) The year ended December 31, 2004 represents the combined pre- and post- recapitalization periods of January 1, 2004 through October 31, 2004 and November 1, 2004 through December 31, 2004, respectively, as a result of the Management Equity/Conversion Transaction (see note 2).

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The weighted average discount rates used in determining the actuarial present value of the benefit obligations were 6.75%, 6.25% and 5.75% for 2002, 2003 and 2004, respectively. The long-term rate of return on assets was 7%, 8% and 8% for 2002, 2003 and 2004, respectively.

The Company expects to contribute approximately \$197,000 to the defined benefit plan during 2005. Expected benefit payments are as follows:

| Year Ending December 31, (in thousands) | |
|--|--------|
| 2005 | \$ 197 |
| 2006 | 140 |
| 2007 | 155 |
| 2008 | 177 |
| 2009 | 188 |
| Thereafter | 1,124 |

The following table describes the plan asset descriptions and allocation of investment funds:

| Asset Category | Target Allocation | Percentage of Plan Assets at December 31, | |
|----------------------|-------------------|--|--------|
| | | 2003 | 2004 |
| a. Equity Securities | 55.0% | 56.0% | 57.0% |
| b. Bond Fund | 45.0% | 44.0% | 43.0% |
| e. Total | 100.0% | 100.0% | 100.0% |

The policy, as established by the Pension Finance Committee, is to provide for growth of capital with a moderate level of volatility by investing assets per the target allocations stated above. The assets will be reallocated quarterly to meet the above target allocations. The investment policy will be reviewed on a quarterly basis, under the advisement of a certified investment advisor, to determine if the policy should be changed.

The expected long-term rate of return for the plan's total assets is based on the expected return of each of the above categories, weighted based on the median of the target allocation for each class. Equity securities are expected to return 10% to 11% over the long-term, while bond funds are expected to return between 4% and 6%. Based on historical experience, the Committee expects that the Plan's asset managers will provide a modest (.5% to 1.0% per annum) premium to their respective market benchmark indices.

NOTE 14 - COMMITMENTS AND CONTINGENCIES

Leases

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The Company leases certain facilities and equipment, under both month-to-month and fixed-term agreements. The aggregate minimum rentals under operating leases with non-cancelable terms of one year or more are as follows:

| Year Ending December 31, (in thousands) | |
|--|----------|
| 2005 | \$ 594 |
| 2006 | 499 |
| 2007 | 386 |
| 2008 | 397 |
| 2009 | 407 |
| Thereafter | 877 |
| | \$ 3,160 |

Rental expense was approximately, \$953,000, \$755,000 and \$716,000 for the years ended December 31, 2002, 2003, and 2004, respectively.

Legal Proceedings

Hotel Information Systems, Inc.

On March 25, 2003, the Company entered into a settlement agreement with Hotel Information Systems (HIS) and one of its former corporate officers whereby (i) the parties dismissed all claims, known and unknown, against each other; (ii) the Company forgave and wrote off a note receivable from the former corporate officer of HIS in the amount of \$66,000 (which was expensed to other expense in the 2002 consolidated statement of operations); (iii) the Company paid \$50,000 in cash and issued a non-interest bearing unsecured promissory note which requires 35 consecutive monthly payments of \$5,000 each commencing April 1, 2003; and (iv) the remaining 374,116 shares in the escrow account will be released to the Company. If the Company is delinquent four times in any twelve-month period during the term of the unsecured promissory note in making its \$5,000 monthly payments to HIS, and HIS issues respective valid default notices, the Company will be subject to a \$225,000 penalty. As of December 31, 2004, the Company was current on its payments to HIS. The 374,116 shares have been received by MAI together with the HIS authorization to legally transfer such shares to MAI.

Imputing interest at 11%, the present value of the \$175,000 promissory note at the date of the settlement was \$149,000. The Company recorded the present value of this debt issuance and the \$50,000 cash payment as a reduction to additional paid-in capital.

Logix Development Corporation

The Company entered into a settlement agreement with Logix Development Corporation (Logix) in July of 2002 whereby we (i) issued Logix 200,000 shares of our Common Stock (ii) required the Company to make various cash installment payments totaling \$175,000 to be paid within 1 year and (iii) executed a contract with Logix for a consulting project in the amount of \$50,000. The Company has made all required payments to Logix under this settlement agreement.

In December 2003, the Company entered into another settlement agreement with Logix whereby it (i) issued 200,000 free trading shares in exchange for the 200,000 restricted Common Shares from the original settlement agreement in July 2002 (ii) required the Company to make monthly payments totaling \$187,500 over a 25 month period and (iii) mutually released each other of all past, present and future claims associated with the lawsuit. As of December 31, 2004, the Company was current on its payments to Logix.

Other Litigation

The Company is also involved in various other legal proceedings that are incident to its business. Management believes the ultimate outcome of these matters will not have a material adverse effect on our consolidated financial position, results of operations or liquidity.

Related Party Transactions

Under the terms of a consulting agreement, and subsequent amendments (which expired on August 31, 2003 but which is automatically renewed each year unless proper notice is given between either party), between Orchard Capital Corporation (Orchard) and the Company, Orchard provides the services of Richard S. Ressler as the Company's Chairman. Orchard was paid a consulting fee of \$24,000 per month through September 30, 2004 when the consulting fee was modified to \$12,000 per month. The consulting agreement was automatically renewed through August 31, 2005.

NOTE 15 - INCOME (LOSS) PER SHARE

The following table illustrates the computation of basic and diluted income (loss) per share under the provisions of SFAS No. 128.

| (in thousands) | Year Ending December 31, | | For the Periods | |
|---|--------------------------|---------|-------------------------------|-------------------------------|
| | 2002 | 2003 | Jan. 1, 2004 Oct. 31, 2004 | Nov. 1, 2004 Dec. 31, 2004 |
| Numerator: | | | | |
| Numerator for basic and diluted income (loss) per share - net income (loss) | \$ (1,350) | \$ 353 | \$ (1,158) | \$ (37) |
| Denominator: | | | | |
| Denominator for basic income (loss) per share - weighted average number of common shares outstanding during the period | 13,945 | 14,538 | 14,676 | 57,848 |
| Incremental common shares attributable to restricted stock grants and to the exercise of outstanding options and warrants | | 300 | | |
| Denominator for diluted income (loss) per share | 13,945 | 14,838 | 14,676 | 57,848 |
| Basic income (loss) per share | \$ (0.10) | \$ 0.02 | \$ (0.08) | \$ |
| Diluted income (loss) per share | \$ (0.10) | \$ 0.02 | \$ (0.08) | \$ |

The number of antidilutive options and warrants that were excluded from the computation of incremental common shares were, 2,676,355, 3,104,000 and 2,647,750 in 2002, 2003 and 2004, respectively.

NOTE 16 QUARTERLY RESULTS OF OPERATIONS (Unaudited)

(in millions, except share data)

| | 1 st Quarter 2003 | 2 nd Quarter 2003 | 3 rd Quarter 2003 | 4 th Quarter 2003 | 1 st Quarter 2004 | 2 nd Quarter 2004 | 3 rd Quarter 2004 | 4 th Quarter 2004(1) |
|---|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|------------------------------------|---------------------------------------|
| Revenue | \$ 5.2 | \$ 4.8 | \$ 4.8 | \$ 4.6 | \$ 5.2 | \$ 4.9 | \$ 4.9 | \$ 5.1 |
| Gross profit | 3.7 | 3.5 | 3.5 | 3.1 | 3.7 | 3.7 | 3.5 | 3.6 |
| Income (loss) before income taxes | 0.2 | (0.1) | 0.1 | 0.1 | 0.2 | 0.1 | (0.1) | (1.3) |
| Net income (loss) | 0.3 | (0.1) | 0.1 | 0.1 | 0.2 | 0.1 | (0.1) | (1.3) |
| Income (loss) per share: | | | | | | | | |
| Basic | \$ 0.02 | \$ (0.01) | \$ 0.01 | \$ | \$ 0.01 | \$ 0.01 | \$ | \$ (0.03) |
| Diluted | 0.02 | (0.01) | 0.01 | | 0.01 | 0.01 | | (0.03) |
| Weighted average common shares used in determining income (loss) per share (in thousands): | | | | | | | | |
| Basic | 14,426 | 14,426 | 14,575 | 14,575 | 14,575 | 14,676 | 14,676 | 43,458 |
| Diluted | 14,876 | 14,426 | 14,875 | 14,875 | 14,875 | 14,676 | 14,676 | 43,458 |

(1) The fourth quarter ended December 31, 2004 represents the combined pre- and post- recapitalization periods of January 1, 2004 through October 31, 2004 and November 1, 2004 through December 31, 2004, respectively, as a result of the Management Equity/Conversion Transaction. Additionally, in connection with the Management Equity/Conversion Transaction, in the fourth quarter of 2004, the company recorded a \$995,000 debt modification charge and a \$187,500 stock compensation charge (see note 2).

Schedule II**Valuation and Qualifying Accounts**

Years Ended December 31, 2002 and 2003 and for the periods from January 1, 2004 through October 31, 2004 and November 1, 2004 through December 31, 2004

(dollars in thousands)

| | Balance Beginning of Period | Charged to Costs and Expenses | Reductions Due to Sale of Subsidiary | Write-offs | Balances Period of Year |
|--|--|--|---|-------------------|--|
| Year ended December 31, 2002: | | | | | |
| Allowance for doubtful accounts | \$ 1,023 | \$ 89 | \$ (103) | \$ (673) | \$ 336 |
| Year ended December 31, 2003: | | | | | |
| Allowance for doubtful accounts | \$ 336 | \$ 52 | \$ | \$ (53) | \$ 335 |
| January 1, 2004 through October 31, 2004: | | | | | |
| Allowance for doubtful accounts | \$ 335 | \$ 205 | \$ | \$ (217) | \$ 323 |
| November 1, 2004 through December 31, 2004: | | | | | |
| Allowance for doubtful accounts | \$ 323 | \$ 41 | \$ | \$ (43) | \$ 321 |