

SECURITIES AND EXCHANGE COMMISSION

FORM 10KSB

Annual and transition reports of small business issuers [Section 13 or 15(d), not S-B Item 405]

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FILER

EXPERTELLIGENCE INC

CIK: **723533** | IRS No.: **953506403** | State of Incorpor.: **CA** | Fiscal Year End: **0930**
Type: **10KSB** | Act: **34** | File No.: **000-11596** | Film No.: **96687386**
SIC: **7372** Prepackaged software

Business Address
203 CHAPALA STREET
STE B
SANTA BARBARA CA 93101
8059622558

U. S. Securities & Exchange Commission
Washington, D.C. 20549

FORM 10-KSB

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE
SECURITIES AND EXCHANGE ACT OF 1934
For the fiscal year ended September 30, 1996

TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF
THE EXCHANGE ACT

For the transition period from _____ to _____

Commission file Number 0-11596

EXPERTELLIGENCE, INC.

(Exact name of small business issuer)

California 95-3506403

(State of incorporation) IRS Employer Identification number

203 Chapala Street, Suite B, Santa Barbara, CA 93101
(Address of principal executive offices)

(805) 962-2558

(Issuer's telephone number)

Securities registered under Section 12(b) of the Exchange Act:

Title of each class	Name of each exchange on which registered
None	None

Securities registered under Section 12(g) of the Exchange Act:

Preferred Stock, no par (Title of class)	Common Stock, no par (Title of class)
---	--

Check whether the issuer (1) 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	X	NO
-----	---	----

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

Issuers revenues for the most recent fiscal year: \$1,270,773

State the aggregate market value of the voting stock held by non-affiliates, computed by reference to the per share closing bid price thereof on the Over-the-Counter Exchange as of a specified date within the past 60 days: Approximately \$6.1 million based on a \$6.00 per share closing bid price as of November 27, 1996.

State the number of shares outstanding of each of the issuer's classes of common equity, as of the latest practical date.

Class Outstanding at September, 30 1996	
Preferred stock, no par	159,244
Common stock, no par	1,331,321

Documents incorporated by reference: Issuers Proxy Statement for its Annual Meeting on August 15, 1996 is incorporated by reference into Part III.

ExperTelligence, Inc.
Annual Report on Form 10-KSB
For the Fiscal Year Ended September 30, 1996

Table of Contents

Part I

1.	Description of Business	v
2.	Description of Property	vii
3.	Legal Proceedings	vii
4.	Submission of Matters to a Vote of Security Holders	viii

Part II

5.	Market for Common Equity and Related Stockholder Matters	viii
6.	Management's Discussion and Analysis	x
7.	Financial Statements	1-13
8.	Changes In and Disagreements With Accountants on Accounting and Financial Disclosure	xii

Part III

9.	Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act	xii
10.	Executive Compensation	xii
11.	Security Ownership of Certain Beneficial Owners and Management	xiii
12.	Certain Relationships and Related Transactions	xiv
13.	Exhibits and Reports on Form 8-K	xiv

Part I

Item 1. Description of Business

The objective of ExperTelligence is to help companies make their information needs or their information-driven products interactive on the World Wide Web. It does this by providing them software tools and applications based on advanced, object-oriented, Internet-aware software technologies which are designed, developed, integrated, and sold by the Company and its partners.

Last year the company successfully completed its transition to the Internet market by successfully introducing its web data-base server, WebBase TM, and its internet compatible mail merge tool, E-Merge TM. The Company will devote considerable resources this next year to further refining its existing internet products and developing and introducing new ones. WebBase TM, is now being distributed through our internet/telephone sales organization, as well as normal retail distribution channels, a major accomplishment achieved this year.

We concluded our first major OEM WebBase TM license with GemStone, Inc., to resell Gem Builder for the Web, to the Global 2000 business objects market. In addition to opening up the UNIX market to WebBase, it delivers the first web server based on persistent business objects. In addition to cash advances the Company will realize royalties based on product sales. GemStone expects to deliver this product in the first quarter of 1997. In addition ExperTelligence will be able to resell WebBase coupled with GemStone's object data base engine.

The Company has established a presence in the telecommunications industry through sale of ANDE TM (Ameritech Network Design Expert). ANDE has been licensed to Southwestern Bell and Bell Canada, and is marketed to other telephone companies by our development partner, Ameritech.

It is estimated that the internet is growing at over 100% a year, and that the database market is growing at around 40% a year. ExperTelligence is now well positioned to take advantage of both of these markets.

Next year will be devoted to further developing our distribution channels and continuing our technical development efforts for WebBase TM. The Company has signed a distribution agreement with Open Technologies of Japan and expects to introduce a Japanese language version of WebBase early in 1997. In addition we expect to introduce several new internet software products here in the United States. We will pursue our OEM strategy for our WebBase "engine."

ExperTelligence employs thirteen people full time and two people part time. Additional contract workers are hired as necessary to complete specific projects.

Business of Issuer

Software development remains the primary business of ExperTelligence. The Company creates tools and applications both independently and under contract for various customers.

WebBase provides users with easy access to database information over the Internet. It includes full server capabilities and can interface with any of 50 database formats including Microsoft Access, Excel and SQL Server, Sybase SQL Server, Oracle, dBase, Paradox, and Btrieve. Full details about WebBase TM may be found on our web site, <http://www.webbase.com/>.

WebBase provides solutions ranging from simple access to a real estate listing to complex enterprise-wide information system applications in human resources, finance, and sales. It allows existing databases to be enhanced through the addition of hypertext links into other Internet publications.

Ameritech Network Design Expert (ANDE) is a fully integrated design tool which allows users to analyze and determine workable ISDN solutions by illustrating the equipment configurations required to run the applications.

The ANDE co-marketing agreement signed in May of 1994 remains in force. This agreement establishes Ameritech and ExperTelligence as co-owners of ANDE with ExperTelligence entitled to a percentage of all gross sales of the product.

Competitive Information

We were one of the first entrants in the web database server marketplace and have delivered proven solutions to many Fortune 500 customers, but the Internet market is highly dynamic and competitive. Many companies are entering this market.

The rapidly changing nature of the software industry requires that a significant effort be devoted to constantly developing new goods and services.

Regulatory Information

Government approval is not required for the sale of any of the Company's products.

There are no existing or probable government regulations which will have a material effect on the Company, and there is no material cost of compliance to environmental laws.

Item 2. Description of Property

The Company does not own any real property. The following is the Company's principle place of business:

Location	Size	Lease Term
203 Chapala Street, Suite B Santa Barbara, CA 93101	2,100 Sq. Ft.	Two Years

Item 3. Legal Proceedings

The Company is not a party to any litigation.

Item 4. Submission of Matters to a Vote of Security Holders

An annual meeting was held on August 15, 1996. During that meeting the items presented below were submitted to a vote of security holders through solicitation of proxies.

For	Against	Withheld	Abstained
-----	---------	----------	-----------

a.) Election of the Board of Directors

Robert W. Reali	1,258,812	0	2,108	0
Denison W. Bollay	1,258,812	0	2,108	0
Karl A. Marlantes	1,258,812	0	2,108	0
George Mueller	1,258,812	0	2,108	0
Mario Perry	1,258,812	0	2,108	0

b.) Approval of 1996 Equity Participation Plan
1,006,835 10,091 0 3,204

c.) Approved Amendment of Articles of Incorporation to increase the number of shares of common stock.
1,230,472 11,529 0 2,104

d.) Approved Amendment of Articles of Incorporation to limit director liability.
1,242,199 11,529 0 2,104

e.) Approved indemnification agreements for officers, directors, and agents of the company.
1,228,301 12,725 0 3,539

f.) Retention of McGowan Guntermann, Independent Certified Public Accountants, as auditors for the company.
1,256,427 688 0 3,805

Part II

Item 5. Market for Common Equity and Related Stockholder Matters

The Company's common stock is traded on the Over-the-Counter Exchange, under the symbol "EXGP". At September 30, 1996 there were approximately 1,112 holders of record (1,110 holding common stock and 2 holding preferred stock).

As of September 30, 1996 the Company's assets and equity are still below NASD's minimum requirements. As such, quotations of the Company's security are not traded on NASDAQ.

The high and low bid price per share of the Company's common stock on the Exchange for the last two fiscal years was as follows (as these shares are traded on the OTC market, the prices indicated below are not necessarily reflective of actual transactions):

<TABLE>
<CAPTION>

	1996		1995	
	High	Low	High	Low
<S>	<C>	<C>	<C>	<C>
First Quarter	\$ 1.00	\$0.75	\$0.10	\$0.10
Second Quarter	\$14.00	\$8.00	\$0.10	\$0.10
Third Quarter	\$13.00	\$8.50	\$0.40	\$0.10
Fourth Quarter	\$ 5.00	\$4.00	\$6.00	\$0.40

</TABLE>

There were no dividends declared during the past two fiscal years.

No dividends shall be paid or other distributions made (other than those payable solely in Common Stock) with respect to the Common Stock during any fiscal year of the Corporation until dividends in the total amount of \$.18 per share on the outstanding shares of Series A Preferred shall have been paid. The Corporation shall not declare or pay any dividends on any shares of Preferred Stock or any other class or series of stock of the Corporation ranking as to dividends on a parity with the Preferred Stock unless the Corporation shall pay a ratable dividend on the Preferred Stock and such parity stock in proportion to the full dividend preference amounts to which each is entitled. After the payment of the full dividend preference amount on the Series A Preferred and on all other parity stock, and after payment in any fiscal year of the Corporation of \$.18 per share of Common Stock (adjusted to reflect any subdivision or combination of the Common Stock after the Original Issue Date of the Series A Preferred) outstanding on such payment date, if any additional dividend is paid in such fiscal year on the Common Stock, the holders of Series A Preferred shall be entitled to receive, contemporaneously with such additional payment on the Common Stock, an amount per share equal to (i) the amount of such additional dividend paid on the Common Stock, multiplied by (ii) the number of shares of Common Stock into which a share of Series A Preferred is convertible on the date of the payment of the additional

dividend on the Common Stock.

Item 6. Management's Discussion and Analysis

General

The past year has been a period of considerable financial strengthening for ExperTelligence. The Company has reduced debt to zero while maintaining a commitment to investing in new products. We have cash in the bank, sales have doubled, and we are profitable.

Having secured the Company's financial base, our attention is now focused on growth. We have made a successful transition to the Internet market. It is the Company's current goal to create and distribute additional Internet products to meet the needs of this expanding market and grow with it.

Results of Operations

Comparison of Fiscal Year 1996 to Fiscal Year 1995

Sales roughly doubled, increasing 103%. Income from operations increased 42%. Net income after taxes increased by 525% to \$427,707 from \$68,466. (See Note 6.) These results are consistent with the Company's plan to grow with the internet market.

The increase in net income before taxes over the prior year is largely attributable to the sales of WebBase and ANDE licenses. The change in net income after taxes is attributable to a deferred income tax benefit of \$238,000 for 1996.

Liquidity and Capital Resources

Cash increased to \$523,422 in 1996 from \$37,716 in 1995. The difference is caused by sale of stock of \$300,000 and increased profits. Working capital increased over the same period to \$779,513 from \$250,383 .

The net value of property and equipment increased to \$59,769 in 1996 from \$32,567 in 1995 due to the purchase of capital equipment for development work.

The net value of Capitalized Product Development Costs decreased by \$22,125 due to pro-rata amortization of development associated with ANDE. The Company believes product development costs will be recovered in the future as development costs are matched to sales.

Long term debt has been eliminated.

Item 7. Financial Statements

The Financial Statements as of September 30, 1996 and 1995 are presented on the pages that follow.

Item 8. Changes In and Disagreements With Accountants on Accounting and Financial Disclosure

None.

Part III

Item 9. Directors, Executive Officers, Promoters and Control Persons; Compliance with Section 16(a) of the Exchange Act

Name	Age	Position	Year first elected Director
Denison Bollay	44	President, Chairman of the Board	1980
Robert Reali	35	Vice President, Director	1988
Karl Marlantes	51	Chief Operating Officer, Director	1996

Mr. Denison Bollay is the founder and has been the President of the Company and Chairman of its Board of Directors since March 1980. He received his Bachelor of Science Degree in Engineering in 1974 from Harvey Mudd College.

Mr. Robert Reali was appointed to the board on August 1, 1988. He is Vice President of Development. He has been with ExperTelligence, Inc. since 1981. He majored in Computer Science Engineering at the University of California, Santa Barbara.

Mr. Karl Marlantes was appointed to the board on August 15, 1996. He is Chief Operating Officer and has been with ExperTelligence since August 15, 1996. He received his B.A. in Economics from Yale University in 1967 and a Master of Arts Degree in Politics, Philosophy, and Economics from Oxford University in 1972.

Dr. Mueller and Mr. Perry have resigned as directors until the company provides officers and directors liability insurance.

Item 10. Executive Compensation

The following table sets forth as required all compensation to officers for services rendered in all capacities to the Company during or with respect to the 1996 fiscal year.

Name & Position	Year	Salary	Bonus	Other Annual Compensation
Denison Bollay, CEO	1996	\$137,274.00	\$3,000	0
Karl Marlantes, COO	1996	\$ 15,000.00	0	0
Robert Reali, VP Dev	1996	\$ 60,000.00	\$3,000	0

The table on the following page sets forth, as to individuals having received greater than 5% of options granted and as to all executive officers and directors as a group, the following information with respect to stock options: (i) the aggregate number of shares of the Company's common stock subject to options granted under the 1988 Incentive Stock Option Plan and the 1996 Incentive Stock Option Plan through September 30, 1996, (ii) the number of options exercised prior to September 30, 1996, (iii) the number of options currently exercisable as of September 30, 1996, and (iv) the average per share option exercise price. As of September 30, 1996 195,000 options had been exercised.

<TABLE>

<CAPTION>

Identity of group	(i) Options Granted	(ii) Options exercised	(iii) Options exercisable	(iv) Average exercise price
<S>	<C>	<C>	<C>	<C>
Denison Bollay CEO,Dir	75,000	75,000	0	\$0.11
Robert Reali VP,Dir	45,000	45,000	0	\$0.10
Bernadette Bagley	35,000	35,000	0	\$0.10
George Barilla	30,000	30,000	0	\$0.10
Karl Marlantes COO,Dir	60,000	0	0	\$4.00
Brian Colvin	20,000	0	0	\$4.00
Officers and Directors as a Group	180,000	120,000	0	\$1.40

</TABLE>

Item 11. Security Ownership of Certain Beneficial Owners and Management

On September 30, 1996, no person owned beneficially more than five percent (5%) of the outstanding shares of the common and preferred stock of the Company except as set out below. The Company has no securities other than its preferred stock and common stock.

Name and Address of Beneficial Owner	Number of Shares Owned	Percent of Class
Denison Bollay, CEO P.O. Box 5117, Montecito, CA 93150	395,163	26.5%
BNP Venture Capital Corporation c/o Bank of the West 50 W. San Fernando, 2nd Floor San Jose, CA 95113	150,000	10.1%
George Mueller 875 Park Lane Montecito, CA 93108	74,622	5.0%
Officers and Directors as a Group	470,163	31.5%

Item 12. Certain Relationships and Related Transactions

None.

Item 13. Exhibits and Reports on Form 8-K.

Resignations of Registrant's Directors

On September 3, 1996 the board accepted the resignations of Mario J. Perry and Dr. George Mueller from the Board of Directors. These individuals expressed their concern about the company not having officers and directors insurance. The cost of officers and directors insurance is prohibitive and both people stated their interest in serving on the board of ExperTelligence once liability insurance is in place.

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

ExperTelligence, Inc.

December 27, 1996 Denison Bollay,
President, Chief Financial Officer and
Chairman of the Board

December 27, 1996 Robert Reali, Director

December 27, 1996 Karl Marlantes, Director

FINANCIAL STATEMENTS

September 30, 1996 and 1995

EXPERTELLIGENCE, INC.

TABLE OF CONTENTS

	Page
Independent Auditor's Report	1
Financial Statements:	
Balance Sheets	2
Statements of Income	3
Statements of Shareholders' Equity	4
Statements of Cash Flows	5
Notes to Financial Statements	6 - 15

INDEPENDENT AUDITOR'S REPORT

Board of Directors and Shareholders
ExperTelligence, Inc.
Santa Barbara, California

We have audited the accompanying balance sheets of ExperTelligence, Inc., a California corporation, as of September 30, 1996 and 1995, and the related statements of income, shareholders' equity, and cash flows for the years

then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of ExperTelligence, Inc., at September 30, 1996 and 1995, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

December 4, 1996

-1-

<TABLE>
<CAPTION>

EXPERTELLIGENCE, INC.
BALANCE SHEETS
September 30, 1996 and 1995

ASSETS

	1996	1995
<S>	<C>	<C>
CURRENT ASSETS		
Cash:		
Non-interest bearing	\$ 56,653	\$ 13,557
Interest bearing	466,768	24,159
Total Cash	523,422	37,716
Accounts receivable-related party (Note 9)	7,167	-
Accounts receivable-net of allow (Note 1E)	202,526	217,183
Inventory (Note 1C)	68,300	34,583
Prepaid expenses and other current assets	17,280	4,362
Deferred tax assets (Note 1J and 6)	85,000	44,000
Total Current Assets	903,695	337,844
PROPERTY AND EQUIPMENT, NET (Note 2)	59,769	32,567
OTHER ASSETS		
Product development costs, net (Note 1D)	530,258	552,383
Deferred tax assets (Note 1J and 6)	227,000	30,000
Total Other Assets	757,258	582,383
TOTAL ASSETS	\$ 1,720,722	\$ 952,794

LIABILITIES AND SHAREHOLDERS' EQUITY

	1996	1995
CURRENT LIABILITIES		
Accounts payable	\$ 57,932	\$ 14,393
Accrued payroll taxes	178	5,398
Accrued vacation	40,072	29,377
Deferred revenue	26,000	-
Line of credit (Note 10)	-	25,000
Notes payable (Note 9)	-	13,293
Total Current Liabilities	124,182	87,461

SHAREHOLDERS' EQUITY

(Notes 3 and 4):

Preferred stock, no par value, authorized 1,000,000 shares; issued and outstanding 159,244 shares for 1996 and 348,248 shares for 1995 (liquidation preference is \$3 per share, see Note 3)	318,487	696,488
Common stock, no par value, authorized 2,000,000 shares; issued and outstanding 1,331,321 shares for 1996 and 949,451 shares for 1995	3,189,727	2,808,226
Common stock subscribed (Note 5)	300,000	-
Accumulated deficit	(2,211,674)	(2,639,381)
 Total Shareholders' Equity	 1,596,540	 865,333
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$1,720,722	\$ 952,794

</TABLE>

SEE AUDITOR'S REPORT AND NOTES TO FINANCIAL STATEMENTS

-2-

<TABLE>
<CAPTION>

EXPERTELLIGENCE, INC.

STATEMENTS OF INCOME

For the Years Ended September 30, 1996 and 1995

	1996	1995
<S>	<C>	<C>
INCOME (Note 7)	\$1,270,773	\$ 626,437
OPERATING COSTS AND EXPENSES		
Cost of sales	364,808	183,245
Selling and marketing	62,839	1,793
General and administration	564,887	280,164
Research and development	99,363	35,559
Total Operating Costs and Expenses	1,091,897	500,761
INCOME FROM OPERATIONS	178,876	125,676
OTHER EXPENSES (INCOME)		
Interest expense	931	3,424
Interest income	(10,051)	(2,014)
Miscellaneous income	(2,511)	-
Total Other Exp (Income)	(11,631)	1,410
INCOME BEFORE INCOME TAXES	190,507	124,266
INCOME TAXES (Note 6)	(237,200)	55,800
NET INCOME	\$ 427,707	\$ 68,466

EARNINGS PER SHARE AND
COMMON STOCK
EQUIVALENTS (Note 1G):

INCOME BEFORE INCOME TAXES	\$.1368	\$ 0.0987
INCOME TAXES	(.1703)	0.0443
NET INCOME	\$.3071	\$ 0.0544
EQUIVALENT NUMBER OF SHARES	1,392,621	1,258,859

</TABLE>

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EXPERTELLIGENCE, INC.
STATEMENTS OF SHAREHOLDERS' EQUITY
For the Years Ended September 30, 1996 and 1995

<S>	Preferred Stock		Common Stock		Common Stock Subscribed		Net Accumulated Shareholders (Deficit) Equity		
	<C> Shares	<C> Amount	<C> Shares	<C> Amount	<C> Shares	<C> Amount	<C>	<C>	
Balance, 9/30/94	34,824,381	\$696,488	77,442,256	\$2,790,726	-	-	\$(2,707,847)	\$ 779,367	
Stock issued	-	-	17,500,000	17,500	-	-	-	17,500	
Rev. stock split 100:1 (Note 3)	(34,476,133)	-	(93,992,805)	-	-	-	-	-	
Net income	-	-	-	-	-	-	-	68,466	68,466
Balance, 9/30/95	348,248	696,488	949,451	2,808,226	-	-	(2,639,381)	865,333	
1988 ISOP shares issued for cash	-	-	35,000	3,500	-	-	-	3,500	
1988 ISOP shares issued for stock	-	-	160,000	-	-	-	-	-	
Stock redeemed to issue stock	-	-	(145,000)	-	-	-	-	-	
Stock reissued	-	-	142,866	-	-	-	-	-	
Preferred shares converted to Common shares	(189,004)	(378,001)	189,004	378,001	-	-	-	-	
Common stock subscribed (Note 5)	-	-	-	-	100,000	300,000	-	300,000	
Net income	-	-	-	-	-	-	427,707	427,707	
Balance, 9/30/96	159,244	\$ 318,487	1,331,321	\$ 3,189,727	100,000	\$300,000	\$(2,211,674)	\$1,596,540	

</TABLE>

SEE AUDITOR'S REPORT AND NOTES TO FINANCIAL STATEMENTS

<TABLE>
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EXPERTELLIGENCE, INC.

STATEMENTS OF CASH FLOWS

For the Years Ended September 30, 1996 and 1995

<S>	1996	1995
<C>	<C>	<C>
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income	\$ 427,707	\$ 68,466
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	94,781	36,384
Common stock issued as a bonus	-	17,500
Deferred tax expense (benefit)	(238,000)	55,000
Decrease (increase) in:		
Accounts receivable	7,490	(126,784)
Inventory	(33,717)	6,796
Prepaid expenses and other current assets	(12,918)	898
Estimated earnings in excess of billings on uncompleted contracts	-	8,784
Increase (decrease) in:		

Accounts payable and accrued expenses	38,319	(12,075)
Income taxes payable	-	(800)
Accrued vacation	10,695	3,238
Deferred revenue	26,000	(32,167)
NET CASH PROVIDED BY OPERATING ACTIVITIES	320,357	25,240
CASH FLOWS FROM INVESTING ACTIVITIES		
Increase in product development costs	(60,160)	(88,157)
Purchase of property and equipment	(39,698)	(25,966)
NET CASH USED BY INVEST. ACTIVITIES	(99,858)	(114,123)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds (repayments) on line of credit	(25,000)	25,000
Repayments of notes payable	(13,293)	(3,098)
Common stock subscribed	300,000	-
Common stock issued	3,500	-
Repayments of capital lease obligations	-	(14,196)
NET CASH PROVIDED BY FINANCING ACTIVITIES	265,207	7,706
NET INCREASE (DECREASE) IN CASH	485,706	(81,177)
CASH AND EQUIVALENTS - BEGINNING OF YEAR	37,716	118,893
CASH AND EQUIVALENTS - END OF YEAR	\$ 523,422	\$ 37,716

SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION
(Note 11)

Cash paid during the year for:

Interest	\$	931	\$	3,402
Income taxes		800		800

</TABLE>

SEE AUDITOR'S REPORT AND NOTES TO FINANCIAL STATEMENTS

-5-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Business

ExperTelligence, Inc., (the Company) was incorporated in California on March 31, 1980. The Company develops custom software applications for telecommunication and transportation companies and publishes general purpose software products for the Internet.

B. Cash and Cash Equivalents

The Company considers all highly-liquid investments with a maturity of three months or less at the time of purchase to be cash equivalents.

C. Inventory

Inventory consists primarily of product manuals, CD ROMs, and processing boards and is stated at the lower of average cost (determined on the FIFO basis) or market. A reserve for obsolescence of \$242,883 and \$242,883, has been provided for 1996 and 1995, respectively.

D. Product Development Costs

Product development costs represent the costs of new products and new application enhancements to existing products incurred subsequent to establishing technological feasibility of the product and prior to the date the product is available for release to customers. Amortization is calculated using the greater of the straight-line method over its economic

useful life, approximately five years, or on a product-by-product basis in the ratio that current period sales bear to the total of current and anticipated revenues. This policy was adopted by the Company as of April 1, 1986, in accordance with the provisions of Financial Accounting Standards Board Statement No. 86, "Accounting for Software Development Costs." Total costs capitalized during the fiscal years ended September 30, 1996 and 1995, aggregated \$60,160 and \$88,157, respectively. Related amortization, utilizing the straight-line method, for the year ended September 30, 1996 and 1995, aggregated \$82,285 and \$15,824, respectively. Accumulated amortization of product development costs aggregated \$231,143 and \$148,858, at September 30, 1996 and 1995, respectively.

E. Allowance For Doubtful Accounts

The allowance for doubtful accounts at September 30, 1996 and 1995, is \$18,000 and \$0, respectively.

-6-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

F. Revenue

Revenue from software sales is recognized on delivery of the software when no further obligations remain under the sales or licensing agreement. Revenue from software license agreements that include significant product development is recognized upon the percentage of completion method. As of September 30, 1996 and 1995, there were no costs and estimated earnings in excess of billings or billings in excess of costs on uncompleted contracts. Product development services include postcontract customer support and software services. Revenue from postcontract customer support is recognized ratably over the period of the postcontract support arrangement. Revenue from software services is recognized as the services are performed.

G. Earnings Per Share

Earnings per common share and common equivalent share is computed by dividing net income by the weighted average number of shares of common stock and common stock equivalents outstanding during the year. Preferred shares are considered in the computation of earnings per common and common equivalent shares for the years ended September 30, 1996 and 1995. Stock options were not considered in the computation of common equivalent shares for 1995, because the stock options were considered antidilutive.

H. Research and Development

Research and development expenses, not subject to capitalization, are charged to expense as incurred.

I. Property and Equipment

Property and equipment is recorded at cost. Depreciation expense is provided over the useful lives of the assets, which range from three to five years, using the straight-line method.

J. Income Taxes

The Company uses Statement of Financial Accounting Standards No. 109, "Accounting for Income Taxes" (SFAS No. 109) in reporting deferred income taxes. SFAS No. 109 requires a company to recognize deferred tax liabilities and assets for the expected future income tax consequences of events that have been recognized in the company's financial

statements. Under this method, deferred tax assets and liabilities are determined based on temporary differences between the financial carrying amounts and the tax basis of assets and liabilities using enacted tax rates in effect in the years in which the temporary differences are expected to reverse.

-7-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

Note 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
(Continued)

K. Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

Note 2 - PROPERTY AND EQUIPMENT

Depreciation expense at September 30, 1996 and 1995, is \$12,496 and \$20,560, respectively. Property and equipment at September 30, 1996 and 1995, is summarized as follows:

	1996	1995
Furniture and fixtures \$	33,982	\$ 33,730
Purchased software	3,467	3,467
Equipment	366,855	336,693
	404,304	373,890
Less: Accumulated depreciation	344,535	341,323
	\$ 59,769	\$ 32,567

Note 3 - SHAREHOLDERS' EQUITY

In September, 1995, the Company's Board of Directors authorized a 100 to 1 reverse stock split of the Company's common and preferred stock. As a result of the reverse stock split, total common shares issued and outstanding were reduced to 949,451, and total preferred shares issued and outstanding were reduced to 348,248. All references in the accompanying financial statements to the number of common and preferred shares and per-share amounts for 1995 have been restated to reflect the reverse stock split.

17,500,000 shares of common stock (prior to the reverse stock split) in the amount of \$17,500, were issued to the employees of the Company as a bonus in the fiscal year ended September 30, 1995.

-8-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

Note 3 - SHAREHOLDERS' EQUITY (continued)

During the year ended September 30, 1996, the majority of employees under the 1988 Incentive Stock Option Plan (ISOP) used their previously issued shares of the Company's common stock to exercise their options and purchase the common shares (Note 4). In total, 145,000 shares of common stock were

redeemed by employees at a price of \$7.50 per share which was the fair market value of the shares on June 27, 1996. These shares were canceled and 2,134 shares were used to exercise 160,000 shares of common stock under the 1988 ISOP at a price of \$.10 per share. Subsequently, 142,866 shares (145,000 shares - 2,134 shares) of common stock were reissued to the same employees at \$7.50 per share. The remaining 35,000 shares under the 1988 ISOP were exercised with cash.

The preferred stockholders have voting rights equal to that of common stockholders. The preferred stock is convertible into common stock on a one-for-one basis at any time. No shares of preferred stock were issued during the year ended September 30, 1996 and 1995. During the year ended September 30, 1996, 189,004 shares of preferred stock were converted to 189,004 shares of common stock. The preferred stock is nonredeemable, has a preference in liquidation equal to \$3 per share plus any declared but unpaid dividends and provides for dividends to be declared at management's discretion. As of September 30, 1996 and 1995, no dividends have been declared.

Note 4 -STOCK OPTION PLANS

A. 1983 Incentive Stock Option Plan

In June 1983, the Company adopted an employee Incentive Stock Option Plan (1983 ISOP) and a Nonqualified Stock Option Plan (NSOP). Under the 1983 ISOP, the Company reserved a maximum of 55,000 shares to be issued upon the exercise of options. The number of shares that may be issued pursuant to the NSOP is subject to determination of the Board of Directors. Both plans are administered by the Board of Directors. As of September 30, 1996 and 1995, the board has not granted any options under the NSOP. As of September 30, 1996 and 1995, there are no options outstanding under the 1983 ISOP.

B. 1988 Incentive Stock Option Plan

In August 1988, the Board of Directors adopted a new ISOP (1988 ISOP), whereby options may be granted to management and key employees at exercise prices equal to or greater than the fair market value of the Company's common stock on the date of grant. The Company has reserved 200,000 shares of common stock for the exercise of options under this plan. For the year ended September 30, 1995, there were 195,000 options outstanding at exercise prices per share of \$.10 for options with a ten-year term and \$.11 for those options with five-year terms (the estimated fair market value at the date of the grant). No options were exercised during the years ended September 30, 1995.

-9-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

During the year ended September 30, 1996, the remaining stock options of 195,000 shares were exercised. 35,000 shares were issued for cash and 160,000 shares were issued in exchange for stock of the Company.

At September 30, 1996 and 1995, options to purchase -0- shares and 195,000 shares, respectively, of the Company's common stock were exercisable under the 1988 ISOP.

C. 1996 Equity Participation Plan

On August 15, 1996, the Board of Directors adopted the 1996 Equity Participation Plan, whereby options may be granted to employees, consultants, or independent directors. For Incentive Stock Options the exercise price shall be equal to or greater than the fair market value of the Company's common stock on the date of the grant. For Nonqualified Stock Options, the exercise price shall be not less than 85%

of the fair market value of a share of common stock on the date the option is granted. The board of directors shall determine whether options granted under this plan are to be Incentive Stock Options or Nonqualified Stock Options. The Company has reserved a total of 475,000 shares of common stock for the exercise of options under this Plan. On August 23, 1996, 87,500 of options were granted under the Incentive Stock Option Plan to purchase the Company's common stock at \$4 per share (the fair market value on the date of the grant). As of September 30, 1996, options to purchase 87,500 of the Company's common stock were exercisable under the 1996 Incentive Stock Option Plan. No options were granted under the Nonqualified Stock Option Plan.

The Company has elected not to adopt early implementation of Statement of Financial Accounting Standards No. 123 "Accounting For Stock-Based Compensation."

Note 5 - COMMON STOCK SUBSCRIBED

On February 26, 1996, the Company signed a stock subscription agreement for 100,000 shares of common stock at a price of \$300,000. As of September 30, 1996, the Company received the \$300,000, but issued the common shares in October 1996.

Note 6 - INCOME TAXES

Temporary differences have resulted between financial statement and income tax reporting including depreciation, capitalized software costs, non-deductibility of accrued vacation wages not paid within seventy-five days of year end, and net operating loss carryforwards.

-10-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

<TABLE>

<CAPTION>

Note 6 - INCOME TAXES (continued)

Income tax expense (benefit) for the years ended September 30, 1996 and 1995, are as follows:

	1996	1995
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Current	\$ 800	\$ 800
Deferred	(238,000)	55,000
Total	\$ (237,200)	\$ 55,800

Components of the deferred tax assets and (liabilities) recognized in the balance sheet at September 30, 1996, are as follows:

	Current	Non-current
Accrued vacation pay	\$ 17,000	\$ -
Property and equipment	-	(20,000)
Software costs	-	(229,000)
Deferred state tax	5,000	1,000
Net operating losses	63,000	818,000
Deferred tax credits	-	211,000
	85,000	781,000
Deferred tax assets		
valuation allowance	-	(554,000)
Deferred tax asset	\$ 85,000	\$ 227,000

Reconciliation of the difference between income taxes computed at Federal statutory tax rates and provision for income taxes, for the year ended September 30, 1996, is as follows:

Income taxes computed at	
Federal statutory tax rate	\$ 65,000
State tax provision	11,000
Graduated tax rates	8,000
Net operating loss and deferred credits	42,000
Valuation allowance	(363,200)
Provision for income taxes	\$ (237,200)

-11-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

Note 6 - INCOME TAXES (continued)

As of September 30, 1996, the Company had the following approximate net operating loss and tax credit carryforwards available to reduce future federal and state income taxes:

Expiring September 30 <S>	Federal NetOperating Losses <C>	Federal Tax Credits <C>	State NetOperating Losses <C>	State Tax Credits <C>
1997	-	-	225,000	-
1998	-	-	49,000	-
1999	42,000	56,000	-	-
2000	487,000	29,000	-	-
2001	390,000	-	-	-
2002	309,000	-	-	-
2003	125,000	-	-	-
2004	-	6,000	-	-
2005	614,000	30,000	-	-
2006	481,000	39,000	-	9,000
2007	768,000	14,000	-	16,000
2008	-	10,000	-	-
	\$2,516,000	\$184,000	\$274,000	\$25,000

Components of the deferred tax assets and (liabilities) recognized in the balance sheet at September 30, 1995, are as follows:

	Current	Non-current
Accrued vacation pay	\$ 13,000	\$ -
Property and equipment	-	(11,000)
Software costs	-	(239,000)
Deferred state tax	4,000	(5,000)
Net operating losses	27,000	959,000
Deferred tax credits	-	208,000
	44,000	912,000
Deferred tax assets valuation allowance	-	(882,000)
Deferred tax asset	\$ 44,000	\$ 30,000

-12-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

Note 6 - INCOME TAXES (continued)

Reconciliation of the difference between income taxes computed at Federal statutory tax rates and provision for income taxes, for the year ended September 30, 1995, is as follows:

Income taxes computed at Federal statutory tax rate	\$ 43,000
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State tax provision	11,000
Graduated tax rates	13,000
Net operating loss and deferred credits	22,000
Valuation allowance	(33,200)
Provision for income taxes	\$ 55,800

Note 7 - SIGNIFICANT CUSTOMERS AND CREDIT RISK

For the year ended September 30, 1996, 71% of accounts receivable was concentrated among two customers. No one customer accounted for more than 17% of total revenue. For the year ended September 30, 1995, 96% of accounts receivable was concentrated with one customer and this same customer individually accounted for approximately 86% of total revenue.

Note 8 - CASH AND CASH EQUIVALENTS - CONCENTRATION OF CREDIT RISK

Uninsured cash balances were \$379,309 at September 30, 1996, and \$-0- at September 30, 1995.

Note 9 - RELATED PARTY TRANSACTIONS

During the year ended September 30, 1995, computer equipment totaling \$7,570 was purchased from the president of the Company.

During the year ended September 30, 1995, the president and shareholder of the Company loaned \$14,000 to the Company. The \$14,000 was repaid without interest to the president during the year ended September 30, 1995.

During the year ended September 30, 1996, the Company performed work for another entity that is owned 50% by the Company's president. Total revenue for this project is \$294,792 and accounts receivable is \$7,167 at September 30, 1996.

-13-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

Note 9 - RELATED PARTY TRANSACTIONS (continued)

At September 30, 1995, the Company had a note payable due to a related party (a significant shareholder) in the amount of \$13,293. The note was a demand note with monthly payments of \$909, with an annual interest rate of 10%. Interest paid during the year totaled \$528 and \$1,721 for 1996 and 1995, respectively. The note was paid off during the year ended September 30, 1996.

Note 10 - LINE OF CREDIT

During 1995, the Company obtained a \$40,000 collateralized bank line of credit with Sanwa Bank bearing interest at the current prime rate plus 2%, payable monthly, and was secured by all assets of the Company. At September 30, 1995, the interest rate was 10.75% and withdrawals against the line of credit were \$25,000, which was paid of subsequent to that. The line of credit expired January 31, 1996.

Note 11 - NON-CASH TRANSACTIONS

During the year ended September 30, 1995, the Company issued \$17,500 of common stock to employees as a bonus (See note 3).

During the year ended September 30, 1996, the Company exercised 1988 Stock Options for 160,000 shares of common stock at \$.10 per share option price by redeeming 2,134 shares of previously issued common stock at \$7.50 per share (Note 4).

Note 12 - SOFTWARE DEVELOPMENT, LICENSE, AND
DISTRIBUTION AGREEMENT

On September 30, 1996, the Company signed a contract with another company (licensee) to develop and license the Company's software to operate within the licensee's own software (New Product). As part of this contract, the licensee will additionally advance \$250,000 as prepaid royalties. The licensee will pay the Company royalties for sub-licensing the New Product. For the later of 90 days following the licensee's acceptance of the New Product or March 31, 1997, the licensee may convert any then outstanding advance balance into an equivalent number of shares of the Company's common stock. The conversion price will be \$5.25 per share.

-14-

EXPERTELLIGENCE, INC.

NOTES TO FINANCIAL STATEMENTS
September 30, 1996 and 1995

Note 13 - FAIR VALUE OF FINANCIAL INSTRUMENTS

The Company has various financial instruments, none of which are held for trading purposes. The Company estimates that the fair value of all financial instruments at September 30, 1996, does not differ materially from the carrying values of its financial instruments recorded in the accompanying balance sheet. Considerable judgement is necessarily required in interpreting market data to develop the estimates of fair value, and accordingly, the estimates are not necessarily indicative of amounts the Company could realize in a current market exchange.

-15-

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