Porcupine, Inc. Business Plan

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Executive Summary

Porcupine, Inc. ("Porcupine" or the "Company") was formed to create, market, and distribute interactive multimedia software products and services. Porcupine has a strong presence in the commercial services marketplace, and intends to expand into the consumer title marketplace. The Company's long-term mission is to be a preeminent provider of multimedia products and services for delivery to computers and television set-top devices via fiber optics, cable, CD-ROM, and broadcast frequencies.

The Company believes there is an excellent opportunity to fashion a consolidated business that will achieve significant growth in a fluid and fragmented market that is expanding rapidly. Multimedia software industry sales were $3 billion in 1993, and are projected to grow to $15 billion in 1997.

Porcupine recognizes that to compete and grow in the expanding multimedia industry, it is necessary to assemble a critical mass of creative, production, marketing, sales, and management skills into a single entity. Porcupine has developed a powerful strategy and unique merging of resources to establish and sustain a significant market position in this industry.

Porcupine's fundamental assets are:

- Expert creative talent with demonstrated experience in delivering products and services on time and on budget;
- Significant current annual sales and assets;
- Marketing and sales staff with industry contacts in place allowing it to enter the market through a variety of distribution channels;
- Experienced management team;
- Secured rights to intellectual property to be used in selected titles;

- Fortune 500 client base; and
- A systematic and comprehensive plan to achieve a significant share of sales in the multimedia title market.

Porcupine was formed by two multimedia companies with considerable experience developing products for consumer and commercial multimedia markets. Porcupine also has strategic alliances with two multimedia production companies. Porcupine has the multimedia production, marketing and expertise required to succeed in this new industry.

Porcupine is the merger of:

- **The Human Element, Inc.** ("THE"), a multimedia service company with nationally-recognized production teams based in Cincinnati and Minneapolis. THE has produced business and education titles including *In•Terra•Active* and *Statics & Dynamics;*
- **Timestream, Inc.** ("Timestream"), a California-based multimedia services and title development company, headed by multimedia pioneer Tay Vaughan. Timestream has contributed to the design and development of several consumer titles including *The Adventure Disc* and *Digital Video Magic.*

Porcupine has formed strategic alliances with:

- **Aaron Marcus and Associates, Inc.** ("AM+A"), a California-based multimedia, user-interface, and document design firm founded by Aaron Marcus, an internationally recognized expert on the design of user interfaces;
- **Roger East Design, Inc.** ("Roger East Design"), a California-based multimedia company founded by architect Roger East. Roger East Design recently developed the award-winning CD-ROM *Jazz, The Multimedia History;* and

The founding companies predict aggregate sales between $2.2 to 2.6 million in 1994. Porcupine estimates aggregate commercial services sales of $4.9 million in the first year of operations.

Consumer Products

The experience and skill developed over years of client-sponsored multimedia title and product development will be applied to the production of interactive multimedia for the growing consumer marketplace.

Porcupine is a market-driven company. Titles are selected for development only after market research and analysis indicate a reasonable expectation of profitability. Porcupine has already begun work on ten consumer titles. These titles are scheduled to be in retail channels by March 1995. Additional titles are also in development. By producing titles in series, Porcupine will reuse its proprietary assets and code libraries to build efficiently upon initial investment of effort and money.

Porcupine's experienced marketing and sales staff have contacts in place to put the Company's products directly into retail channels. The Company will aggressively enter the CD-ROM market on the three fronts that market analysis indicates will yield the greatest return:

- As a publisher of entertainment, reference, and educational titles sold into retail channels;
- As a direct mail publisher of highly-targeted CD-ROMs to high-affinity audiences; and
- As an Affiliated Label publisher, allowing small developers access to the marketing expertise and distribution channels developed by Porcupine.

Porcupine intends to distribute its products and those of its Affiliated Labels through a variety of distribution alternatives including retail channels, direct sales, and rental outlets. Porcupine will also form strategic alliances with companies developing new distribution channels.

Commercial Products and Services

Porcupine will continue to develop relationships and contracts with commercial clients such as Apple, AT&T, IBM, Kelloggs, McGraw-Hill, and Siemens, while building its consumer title business. The problem-solving and technology-critical demands of this contract work provide a ready research and development experience that is paid for by clients and keeps the Company at the leading edge of advanced interactive communication research.

In addition, some client projects involve royalty payments, access to content, or titles that can be distributed through Porcupine's distribution channels. By integrating title production and commercial services, Porcupine enjoys a technology advantage not shared by our competitors.

Conclusion

The Porcupine founding companies bring complementary experiences and skill sets to the multimedia arena. The merger of these companies into Porcupine allows significant sharing of creative and production resources, and saves in overhead costs. The aggregate experience of the founding companies is unparalleled. Timestream, THE, and their strategic partners AM+A and Roger East Design have produced multimedia products distributed by third parties. Porcupine's founders helped develop authoring tools and systems that are now considered industry standards, and are recognized leaders who have played significant roles in shaping the multimedia industry.

Porcupine is positioned to achieve sales of $9.5 million in its first year, $46.3 million by year three, and $123 million by year five. To achieve these goals, Porcupine seeks $6.75 million in investment capital to fund the production and marketing of consumer products, and for anticipated operating expenses. Upon the close of financing, the founding companies will merge into Porcupine.

Today, no one company controls more than 10% of the multimedia title market. Porcupine has the technical, creative, and business expertise required to gain a significant market position.

The Company

Description

Porcupine, Inc. ("Porcupine" or the "Company") was formed to create, publish, market, and distribute interactive multimedia software products and services. Porcupine's initial focus is on computer-based products. Its long-term mission is to be a preeminent provider of multimedia products and services for delivery to computers and television set-top devices via fiber optics, cable, CD-ROM, and broadcast frequencies.

Porcupine has developed a powerful strategy and unique merging of assets to establish and sustain a significant market position in the expanding multimedia industry.

Porcupine has been formed by two experienced multimedia companies with considerable experience developing products for consumer and commercial multimedia markets. Porcupine also has strategic alliances with two multimedia production companies. Porcupine has the multimedia production, marketing and expertise required to succeed in this new industry. The principals of these companies represent some of the most experienced and highly-regarded multimedia experts in the industry.

Porcupine's founding companies are:

- **The Human Element, Inc.,** an Ohio corporation ("THE"), founded by Robert Zielinski and Scott Risner. Its production team has gained national recognition for excellence in interactive multimedia design and development. THE has produced business and educational titles including *In•Terra•Active* and *Statics & Dynamics*. THE is also a licensed developer and value-added reseller for Macromedia, creator of Authorware Professional and Director.

- **Timestream, Inc.,** a California corporation ("Timestream"), headed by multimedia pioneer Tay Vaughan. Timestream has designed and produced state-of-the-art interactive multimedia products, including *Apple PowerCD Demo,* a CD-ROM bundled with Apple's PowerCD product; portions of *The Adventure Disc,* an award-winning Kodak Photo CD; and a module of the soon to be released *Digital Video Magic* CD-ROM.

Porcupine has formed strategic alliances with:

- **Aaron Marcus and Associates, Inc.,** a California corporation ("AM+A"), founded by Aaron Marcus, an internationally recognized expert on the design of user interfaces, multimedia, and computer graphics.

- **Roger East Design, Inc.,** a California corporation ("Roger East Design"), founded by architect Roger East. Roger East Design specializes in interactive multimedia development, electronic visual databases, and simulation software for consumers, business, and retail clients. Roger East Design recently developed the award-winning CD-ROM *Jazz, The Multimedia History.*

Porcupine was incorporated under the laws of the State of California in 1994. Upon the close of funding, the founding companies will merge into Porcupine to provide the production teams to carry out Porcupine's development efforts and provide integrated management and corporate activities. As used in this document, the terms "Porcupine" and "the Company" refer to the entity that results from the merger of these two companies.

Porcupine has its own experienced and highly regarded marketing and sales force to develop and direct its marketing and sales strategies for both the commercial contract and consumer title arenas, as well as to pursue new projects.

Porcupine will form strategic alliances with companies developing new distribution channels. The Company also will evaluate licensing opportunities with other multimedia companies, as well as potential acquisitions of other businesses, products, and technologies.

Mission

Porcupine's mission is to produce and distribute affordable interactive multimedia products and services, for a variety of platforms, that are technologically advanced, incorporate compelling content, and are engaging to use.

Porcupine's long-term mission is to be a preeminent provider of multimedia products and services for delivery to computers and television set-top devices via fiber optics, cable, CD-ROM, and broadcast frequencies.

Corporate Strategy

Consumer Products

To develop a significant position in the consumer multimedia market, the Company has adopted a unique strategy based on analysis of the market, the various opportunities that market presents, and the specific strengths Porcupine possesses to take advantage of these opportunities.

Porcupine will attack the largest interactive multimedia markets by identifying and developing suites of high-quality products that can rapidly achieve consumer acceptance and sustained appeal.

Key elements of the Company's strategy include:

- **Produce market-driven products.** Porcupine is a market-driven company. Titles will be selected for development only after market research and analysis indicate that they have a reasonable expectation of customer acceptance and profitability.

- **Target a variety of major market segments.** In today's fluid multimedia marketplace, reliance upon a single market segment presents significant financial risk from rapid or unexpected fluctuation in demand. Porcupine will broadly target its products to those established market segments that represent the highest proportion of multimedia CD-ROM sales, and will identify and develop releases for emerging market segments when the customer base is sufficient to support a profitable product release.

- **Produce products for multiple playback formats and platforms.** Porcupine will initially develop products for the MPC and Macintosh platforms because those platforms represent an established and rapidly-expanding installed base. Other platforms will be targeted as markets develop.

- **Produce titles in series.** Porcupine will develop suites of titles that can rapidly achieve consumer acceptance and sustained appeal. By producing titles in series, Porcupine will reuse its proprietary assets and code libraries to build efficiently upon the initial investment of effort and money. Follow-on titles will take advantage of consumer brand recognition.

- **Produce high-quality products.** Porcupine's titles combine high-quality content, superior user interface design, and intuitive user navigation. Product look-and-feel will be based on human factors principles, focus group testing, and as market preferences, Porcupine titles will achieve immediate recognition and acceptance in the multimedia marketplace.

- **Control marketing and distribution.** A major obstacle to profitability for multimedia title developers is the industry's current distribution structure. The distribution structures are still in a state of flux. It is difficult for small developers to be financially successful because middlemen charges destroy profit margins. Further, small developers cannot directly reach retail customers because they lack the critical mass to get placed on shelves. Porcupine will mitigate this difficulty by establishing its own direct distribution in open channels. Porcupine's marketing staff has the proven experience to rapidly place Porcupine's products in distribution channels.

- **Maintain tight production cost control.** A key element to success is Porcupine's low cost production methodology, which enables large scale title development at lower rates.

Commercial Products and Services

Porcupine's integration of consumer title and commercial contract multimedia development work distinguishes it from many of its competitors. Porcupine recognizes that contract work:

- **Represents a significant profit center.**
- **Serves as a profitable R&D center for the Company.** The problem-solving demands typical of custom development work for outside clients provide a challenging environment that keeps Porcupine employees up-to-speed in new technologies and techniques. Porcupine's talent and resource pool becomes more valuable by performing this work.
- **Yields marketable consumer titles.** A review of the client products already produced by Porcupine founders indicates that about ten percent might be spun out as consumer titles. For example, Timestream owns the rights to produce *The Adventure Disc* in all CD-ROM formats except Photo CD, and THE receives royalties from some titles. In addition, client contract work often provides usable content for titles, and many of the "engines " developed for and funded by contract clients can be used for consumer titles.

- **Develops strategic alliances.** Through client product development, Porcupine has already developed strategic marketing, distribution, and content alliances with major corporations in the U.S. and abroad.
- **Strategically positions Porcupine in the business market.** By maintaining its presence in the corporate market through contract work, Porcupine titles targeted at the business market benefit from the established reputations and name recognition of the Company's founders.

Company Positioning

Porcupine is ideally positioned to capitalize on the growth of the market for interactive multimedia products and services by applying its knowledge of the market; its experienced management, sales, and production teams; its technical expertise; and its serious approach to the business of making and selling multimedia.

Porcupine will continue to form strategic alliances with experienced information and entertainment content providers and others to efficiently and cost-effectively obtain compelling, market-proven content. Porcupine will also use its extensive network of contacts in the U.S., European, and Asian multimedia development communities to identify sources of high-quality products and potential partners.

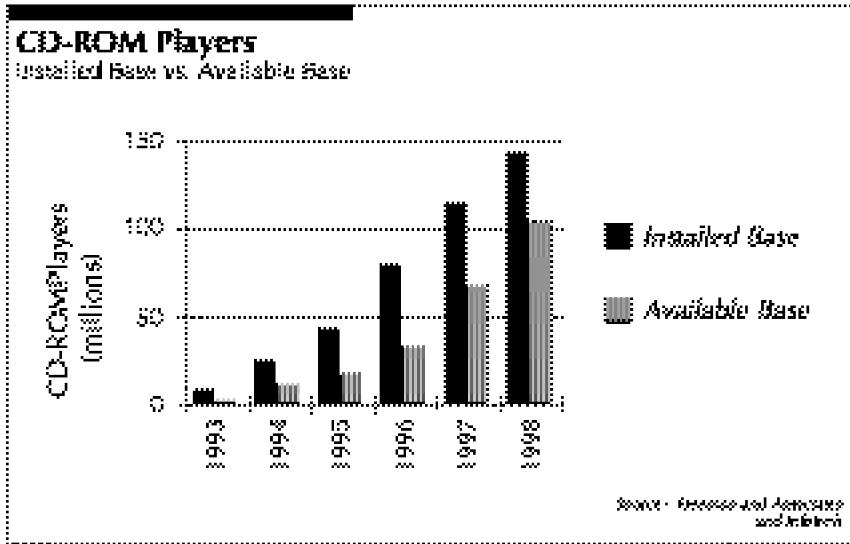
Industry Analysis

In January 1993, the media "discovered" multimedia. After many years of quiet development effort, frenetic press coverage made sudden mergers and joint ventures highly visible. An explosion of interest and purchase of multimedia hardware and software rapidly followed.

Technology

Powerful, low-priced personal computers available through mass market distribution channels have provided a broader base for multimedia in the consumer market. CD-ROMs are currently the primary technology for distribution of multimedia titles.

The largest market share of CD-ROM playback equipment is in the computer environment, with the Windows-based MPC platform maintaining an advantage over Macintosh-based systems. According to Multimedia Marketing, the available installed base of multimedia-equipped computers in U.S. households at the end of 1993 was 3.8 million: 2.5 million MPCs and 1.3 million Macintoshes. The installed base of CD-ROM players grew 300% from the end of 1992 to the end of 1993. The installed base of CD-ROM players is expected to triple again in 1994. The *available installed base* is that fraction of the projected installed base into which consumer/mass market and business titles can be sold. The graph following illustrates the installed base of CD-ROM players and predicted growth rates for the coming years:



"Set-top" CD-ROM players can be connected directly to a television. These players include the Compact Disc-Interactive ("CD-I") player from Philips, the Photo CD player from Kodak, and the 3DO player. Both the 3DO and CD-I systems display graphics and animation and play stereo-quality sound. The combined installed base for Photo CD, CD-I, and 3DO, however, is less than 250,000 units, suggesting that consumers prefer computers with CD-ROM capability rather than these specialized and expensive set-top devices. The Company believes that the installed base of set-top CD-ROM players will not increase fast enough to justify producing titles specific to them at this time. Moreover, the Company believes that these devices soon will be supplanted in the marketplace by a new breed of set-top boxes linked to the "information superhighway."

According to Chris DeVoney, Editor of *Windows Sources* magazine, only 1% of the multimedia market has been tapped. He projects an 80% annual growth rate over the next three years. By 1997, DeVoney projects the multimedia market will be worth $9 billion in computer sales and $15 billion in consumer sales.

The initial focus of Porcupine's product development efforts, as reflected in this document, is to produce multimedia consumer titles for the largest installed base of equipment with multimedia capability:

the personal computer. Titles will be produced for both Macintosh and MPC platforms, primarily in the form of hybrid discs which can be used on either platform.

The Software Market

While sales of interactive programs on computer "floppy" disks still outstrip CD-ROM sales, several activities occurred in 1992 and 1993 to stimulate consumer acquisition of CD-ROM titles.

First... Multimedia products were bundled with up-grade hardware, introducing millions of consumers to the variety and versatility of interactive titles.

Second... Multimedia development tools became very powerful and capable: recent CD-ROM titles incorporate video, 3-D graphics, and complex navigation structures.

Third... The retail price of individual titles declined over the past two years: from an average of $129 per title to $59 per title. During 1993 prices dropped an average of 6% per month.

Finally... Products increasingly became available in channels other than software retail outlets, including mail order catalogs, video rental outlets, music and book stores..

There is rapid growth in consumer demand for CD-ROM titles, triggered by the penetration of multimedia-equipped computers as well as lower title prices. With a market size of $3 billion in 1993, increasing to $15 billion in 1997, the time is right for growing a major multimedia company like Porcupine.

Products and Services

The Company will produce consumer multimedia products for a variety of home, education, and business markets, and will continue to provide commercial contract product development and business-related services.

Consumer Titles

Porcupine titles will be produced in series, which will allow the repeated use of successful "engines" and "templates." Reuse of core programming, scripting, and user interface design techniques as well as content permits more efficient and less expensive development of subsequent titles.

Initial Titles

The initial titles to be produced by the Company are:

- **Ad Astra.** A fictional "history" of human expansion into the cosmos developed with the assistance of aerospace engineer Ron Jones, producer of the Integrated Space Plan (ISP), and of Buzz Aldrin, aerospace consultant and former astronaut. From the vantage point of the year 2130, *Ad Astra* looks back in time to the 20th century, then moves forward, exploring eight generations of human development and the process of populating the universe beyond the earth. (Ages 12 to adult)
- **American Microbrews.** An electronic coffee-table book, travel guide, and documentary for beer lovers and travel agents, with descriptions, music, still photographs, and video clips of the more than 300 U.S. microbreweries. This title includes a history of beer, a guide to beer types, an explanation of how these hand-crafted beers are made, how to make your own beer, travel itineraries for

major brewing regions, and video interviews with brewing experts. The title will be updated annually. (Adult)

- **Bed Time Stories.** A collection of children's stories that can be customized by a child alone or with a parent. The child can apply the names and characteristics of friends, family, and pets to characters in the story. As the story is constructed, each character will animate and speak or make sounds, giving the child a sense of the nature of each character. Stories can be printed out and read to the child at bedtime. Children can also use the stories on the computer; having the story read to them in play-through mode or reading along themselves and turning the pages. (Ages 3-7)

- **Design Your Own Kitchen.** *Design Your Own Kitchen* is a how-to title aimed at do-it-yourselfers. A photo gallery stimulates ideas and shows users a variety of available options. Simulations, using actual on-the-market products and fixtures, allow users to quickly mock up their ideas and encourages them to mix-and-match and move things around to see what combinations best suit their needs and preferences. *Design Your Own Kitchen* provides simple tools to select, design, visualize, and construct a custom kitchen. (Adult)

- **Design Your Own Bath.** See description above.

- **Disasters!** Why did it happen, what really was the cause, and how could it have been prevented? From the sinking of the unsinkable Titanic to the tragic loss of all aboard Pan Am's Flight 101 over Lockerbie, Scotland, *Disasters!* transports users to the scene and then takes them behind the scenes. Put on an investigator's hat and survey the accident, interview witnesses, and review the facts and evidence. Report your findings and compare your own conclusions with those of the official review board. (Ages teen to adult)

- **Gravel Pit.** Oriented towards children and their fascination with heavy machinery, *Gravel Pit* lets them drill rock, load dynamite, blast apart the rock, drive a loader, and run the crusher to make gravel. Gravel pit goes beyond just watching heavy equipment or playing with toy versions, it lets kids run the Big Rigs. Gruff guide Joe the Pit Boss instructs children in equipment use and passes out "assignments," presenting kids with ever more challenging tasks to help them move up the ladder to “powder monkey” status. The wacky cast of characters at The Pit adds a touch of humor. Joe the Pit Boss, Terry the Trucker, and Donna the Dispatcher are ready to provide helpful tips and sage advice. (Ages 7-12)

- **Violence in America – Confronting the War at Home.** *Violence in America* is for parents, educators, policy makers, and counselors who wish to learn more about where violence comes from and how to deal with it on a personal level. *Violence in America* provides dynamic, in-depth explorations of subjects such as violence between spouses, hate crimes, and drugs and violence in schools. This unique, innovative, and extraordinarily powerful work provides detailed statistics and background as well as the many true-life stories that define violence and its social impact on our culture. *Violence in America* provides dynamic, in-depth explorations of subjects such as violence between spouses, hate crimes, and drugs and violence in schools. (Adults)

- **Puzzlers.** Encourages exploration with a variety of games, puzzles, mazes, and activities waiting to be discovered. *Puzzlers'* engaging activities, bright graphics, music, and animated characters capture children's attention and imagination. *Puzzlers* also presents challenges for adults such as 3-D animated puzzles that transform as they are being put together. (Ages 4 to adult)

- **The Want Ads.** Allows a player to create alternative lives through the Want Ads. The player picks a city, buys a house, looks for a job, browses the personal columns, and buys and sells things in the Want Ads. Players may need to hire a plumber, seek legal advice, or find another means of employment to survive the challenges and adventures of this game. (Ages teen to adult)

Additional Titles

A small sampling of the additional titles currently being evaluated include:

- **Diversity in America.** The melting pot has become a battleground where ethnic and racial differences are the flash point for dissension and conflict. While basic assumptions about what it means to be an American are changing rapidly, these changes and their consequences are rarely discussed in open forum. Moving beyond the traditional uses of multimedia for games or reference materials, *Diversity in America* will offer a clear and comprehensive discussion and policy debate about diversity in the U.S. today. *Diversity* will allow users to become informed and educated.

- **It's A Dog's Life.** A comprehensive encyclopedia for the dog owner and prospective dog buyer containing wide-ranging, up-to-date information about dog breeds, care, training, health, and security. Dog buyers can research the breed most suitable for their lifestyle or children, including life span, temperament, cost of daily food consumption, typical genetic weaknesses, shedding propensity, tendency to bark excessively or be overaggressive, and other characteristics.

- **Scavenger Hunt.** *Scavenger Hunt* will combine the best features of a scavenger hunt and a travel adventure. The objective is to successfully drive through all fifty U.S. states finding and collecting specific items in each state and making the trip in as few miles as possible. Travelers will have to answer a variety of questions, play different coordination type games, and find scavenger items in order to complete their journeys. Wrong answers to quizzes will send users on inconvenient detours, forcing them to answer more questions and play more games, and adding mileage to their odometer.

Affiliated Label Program

Through affiliated labels, developers and smaller publishers license their titles to a larger publisher (the "Affiliated Label") who releases an aggregated product line through national distributors and direct sales to retailers. By pooling titles, an Affiliated Label publisher can provide the breadth of product line and total marketing dollars demanded by national distributors and retailers.

Porcupine will become an Affiliated Label publisher for title producers who lack their own distribution network. Porcupine will offer small title producers a significantly better revenue stream than the typical 70%-30% split offered by other Affiliated Label publishers and will provide comprehensive technical and marketing support to its Affiliated Label clients. By husbanding small but excellent multimedia developers and aiding them into the distribution channel, Porcupine will establish long-term relationships with the important creative talents that are currently driving the invention of multimedia. In this way, Porcupine will obtain the best affiliated titles and generate significant revenues.

Title Selection

Porcupine will continue to identify titles for development based on a demanding set of market-driven criteria including:

- The size of the target audience;
- Fit of title to target audience;
- Production time (time to market);
- Production cost;
- Modularity/extensibility;
- Uniqueness;
- Selling price;
- Selling cost;
- Sales volume;

- Longevity/shelf life; and
- Strategic positioning.

The backbone of Porcupine's market strategy is production of high-quality titles that have a long shelf life. Porcupine eschews the Hollywood blockbuster approach to the multimedia marketplace, where a single "hit" supports many "losers;" or the brutally-aggressive game market, where new products must sell ferociously within four months, because their shelf life is short, usually less than nine months. Porcupine titles are intended to sustain ongoing appeal as long as they are technologically viable.

A title, if selected, will go through the design, development, testing, and market analysis steps shown in the diagram on the following page. Quality assurance occurs at every step, and the development process includes checkpoints to review progress and assimilate feedback from many sources.

[INSERT PRODUCTION DIAGRAM HERE]

Licensing Titles

Porcupine will also license properties from other developers to distribute through its channels.

Commercial Products and Services

Porcupine will continue its relationships with its corporate clients by providing the services currently offered by each of the Founders while it builds its consumer title business. The problem-solving and technology-critical demands of commercial service work provide a ready research and development experience that is client-paid and keeps the company at the leading edge of technology development. In addition, some client projects involve royalties, access to content, or titles that can be distributed through Porcupine's distribution channels. By integrating title production and commercial services, Porcupine exercises a technology advantage not shared by its competitors.

The Founders of Porcupine have been in the multimedia industry since its inception. They have built pioneering multimedia products and provided services for many corporate clients including:

- Apple Computer
- AT&T
- Baxter Health Care
- E.I. DuPont de Nemours
- Electric Power Research Institute
- Fluor Daniel Corporation
- Hill Air Force Base
- IAMS Company
- Kimball International
- Lotus
- Macromedia
- Medtronic
- Ashland Chemical
- AT&T Global Info. Solutions
- Best Buy Corporation
- Eastman Kodak
- FAA
- General Electric
- Houghton Mifflin
- Kellogg Company
- Land O'Lakes
- Lutheran Brotherhood
- Martin-Marietta
- McGraw-Hill

- Microsoft
- NCR Corporation
- Ohio State University
- Procter & Gamble
- Reynolds & Reynolds
- Siemens
- Sun Microsystems
- Texas Utilities Company
- Toyota
- University of Michigan
- Varian Associates
- West Publishing
- Monarch Marking Systems
- Novell
- Price Waterhouse
- Quantum Chemical
- Richard D. Irwin
- Southwestern Publishing
- Taylor Corporation
- Tomson Consumer Electronics
- University of Cincinnati
- U.S. Navy
- Visual Scape
- Wright Patterson Air Force Base

In 1994, Porcupine Founders project aggregate sales of $2.2 - 2.6 million from client contracts, and estimate commercial contract sales of $4.9 million in Year 1.

The pool of management and skill resources required to successfully execute client-contracted multimedia products is the same as that required to develop consumer-based titles. Porcupine will draw from its extensive in-house talent and a previously-tested contractor pool for all its multimedia projects.

Production Cycles

Porcupine will balance and control production cycles and costs to maximize the profit margins of all its consumer titles. The production cycles for consumer titles and for client-contracted products and services are greatest in the calendar second and third quarter. Increased pressure on Porcupine's production capacity during these months indicates that hiring of some supplementary contract labor will be required, but this cyclic stress will be mitigated by carefully balancing the release dates of its new titles and by allocating and scheduling its in-house resources. By scheduling a higher level of title production activities during slack contract production periods, Porcupine will utilize its resources more efficiently and significantly reduce the need for costly contracted labor.

Distribution Channels

Overview

Distribution of CD-ROM titles into reseller channels is changing rapidly as consumers increasingly perceive CD-ROMs as entertainment, rather than high-tech computer products.

Porcupine is targeting a flexible distribution mix that utilizes a variety of channels and distribution alternatives to make more effective use of marketing dollars. There are four significant components to this mix: retail sales, direct sales, rentals, and bundling.

• Retail Sales

Virtually all retailers purchase from distributors, rather than buying direct from a publisher or developer. As a distributor with lines of titles and Affiliated Labels, Porcupine will have direct access to retail channels rather than relying on a middleman such as a national distributor.

Consumer retail was the hot emerging channel for Fall 1993, as CD-ROMs become an entertainment commodity. While this is not an inexpensive channel in which to launch products, it is an excellent channel for selling products provided the company has a systematic marketing approach.

The characteristics of this channel are low margins, extremely high volumes, low cost of sale relative to the cost of the product, high advertising costs, high merchandising costs, and low degree of customer contact.

Computer retail stores/Super-stores are a traditional outlet for any software product. Recently, computer retail stores have been carrying more hardware, while allowing software sales to pass to the computer super-store and mass-market channels.

The characteristics of this channel are low margins, medium volumes, low cost of sale relative to the cost of the product, medium advertising costs, medium merchandising costs, and low degree of customer contact.

Bookstores are being tested as a distribution channel for CD-ROM titles in 1994, however significant sales through this retail channel are not expected to occur until 1995. The characteristics of this channel are not yet defined. Porcupine will monitor this channel as it develops.

• Direct Sales

Direct mail to the customer returns the highest per-unit revenue. Selling direct is an excellent channel for mass market consumer titles. In addition, direct mail allows Porcupine to cost effectively target niche titles into clearly defined markets (for example, *American Microbrews* will be distributed through specialized channels catering specifically to microbrewery aficionados).

The characteristics of this channel are high margins, low volumes, high cost of sale relative to the cost of the product, high direct advertising costs, low merchandising costs, and high degree of customer contact.

• Rentals

Audio/video rental outlets are an emerging channel for 1994, as retailers such as Blockbuster start to experiment with CD-ROM rentals. While not ideal for all titles, rental presents an excellent opportunity to showcase titles dealing with games, music, and entertainment.

The characteristics of this channel are medium to low margins, low volumes, low cost of sale relative to the cost of product, low advertising costs, high merchandising costs, and low degree of customer contact.

• OEM Bundling

OEM bundling is sometimes used for products at the end of their life cycle. Because Porcupine will be developing new titles, this channel will not be utilized in a product's initial launch except when advantageous for marketing purposes. Porcupine will, however, use this channel in later years for products as they mature.

• Summary

Porcupine intends to distribute its products and those of its Affiliated Labels through a variety of distribution alternatives including retail channels, direct sales, rental outlets, and OEM bundling. Porcupine will also form strategic alliances with companies developing new distribution channels. Porcupine's flexible distribution mix will place products in the channels that cost effectively advance each title's sales.

Marketing Strategy

Overview

Porcupine will aggressively enter the CD-ROM market on three fronts:

- As a publisher of entertainment, reference, and educational titles sold into retail channels;
- As a direct mail publisher of highly-targeted CD-ROMs to high-affinity audiences; and
- As an Affiliated Label publisher, allowing smaller publishers access to the distribution channels developed by Porcupine.

The Challenge

Porcupine's marketing strategy has five objectives:

- Build strong consumer awareness of the Porcupine name and title lines;
- Produce and market a large library of titles maintaining an emphasis on titles with multi-channel marketing potential;
- Concentrate on titles with strong series and update potential;
- Provide better quality and more competitively priced products than the competition; and
- Enter and gain significant market share in major multimedia distribution channels.

Porcupine's goal is to be one of the biggest and most well known producers of high quality, affordable multimedia titles. We will enter new distribution channels early in order to grab significant market share and help determine the structure of multimedia distribution. Our marketing strategy will be flexible and innovative, seeking new opportunities to form advertising, marketing, and distribution relationships with key players in distribution channels. Key components of this strategy are outlined below:

- **Distribution:**
  - Porcupine will distribute in-house and affiliate label titles through a hybrid approach employing a mix of national and regional distributors, direct marketing, direct mail, and manufacturers sales representatives in applicable markets. Porcupine will also establish direct relationships with major retail accounts. Based upon a channel by channel analysis of CD-ROM title penetration, distribution structure and profit margins, Porcupine will select key channels in which to concentrate its' distribution efforts.

- **Target Sales Channels:**
  - ***Direct to Consumer:*** Porcupine will target a mix of direct sales channels including a mail order catalog; ad placement major software and multimedia mail order catalogs, and on-line catalogs; a presence at major software, multimedia, and publishing trade shows; and coupon returns in appropriate national magazines.
  - ***Retail Sales:*** Retail sales will include established and emerging retail channels such as computer software specialty stores, computer superstores, bookstores, video rental outlets, media superstores and mass merchandisers.

Retail Sales

Retail Goals

The goals of the retail sales program are as follows:

- Release 10 Porcupine titles by March, 1995
- Release 8 Affiliated Label titles by March, 1995
- Release 10 additional Porcupine titles by September, 1995
- Release 8 additional Affiliated Label titles by September, 1995
- Maintain an aggressive strategy for additional title releases in future years
- Maintain an average cost of goods of $3.50 per retail unit
- Devote $900,000 to open retail distribution channels including $67,500 per Porcupine title
- Allocate 10% of projected sales of each Affiliated Label title to marketing.

Retail Strategy

Retail sales will be focused on selling into consumer retail, computer retail, and audio/video rental outlets. Porcupine will pursue retail sales through a combination of direct retail, national distributors, sales representative organizations, and joint venture relationships.

Direct Mail

Direct Mail Goals

The goals of Porcupine's direct mail program are to:

- Achieve a 3% response rate from qualified cooperative mailing lists beginning Spring, 1995

- Increase to 10% Porcupine's direct mail response rate mid-year 1996
- Ship 5,000 units of each title, on an annualized basis.
- Maintain an average cost of goods of $2.50 per unit
- Build Porcupine's customer database to 6,000 by end of year 1995
- Expand Porcupine's customer database to 50,000 by mid-1996.

Direct Mail Strategy

Direct mail will take four tactical approaches to meet its goals:

1. Mailings of a Porcupine title catalog.
2. Mailings promoting a single title or series with a high appeal to target audiences.
3. Follow-on mailings to customers encouraging them to purchase additional Porcupine titles.
4. Financial incentives for customers to purchase multiple titles, raising the average revenue received per order.

Syndication Sales

Porcupine sees great opportunity in the interactive multimedia marketplace for title sponsorship and joint market efforts. The company will negotiate joint development interests, financial participation, advertising space, and sponsorship opportunities for titles that lend themselves to product promotion. Underwriting support and product sponsorship can reduce development costs and allow for larger advertising and promotion campaigns than Porcupine can conduct independently.

Sales Goals

Porcupine's sales goals for Years 1 through Year 5 are presented in the following table:

			Titles		
	Syndication	Service	Affiliated	Porcupine	Total
Year 1	1.2	4.9	0.3	3.1	9.5
Year 2	2.7	8.7	2.1	12.9	26.4
Year 3	4.1	12.6	3.4	26.2	46.3
Year 4	6.1	18.9	6.7	50.9	82.6
Year 5	9.1	28.3	10.1	75.4	123.0

Millions of Dollars

Manufacturing and Inventory

Replication, packaging, and maintenance of inventory for Porcupine's CD-ROM products is straightforward. The cost of manufacturing CD-ROMs in quantities of 3,000 to 5,000 units ranges from $2.50 to $3.50 per unit, including silk screening, labeling, and packaging. Replicators' turn-around times are typically two weeks. Because turn-around times are so fast, inventory maintenance is low: industry practice is to maintain 1,000 units per title in inventory. Porcupine will use an established fulfillment house to support this activity.

Competition

Players in the interactive multimedia marketplace range from small companies with limited resources to large companies with substantially greater financial, technical, and marketing resources than those of Porcupine. According to *CD-ROMs in Print – 1993* (Meckler Publishing, 1993), there are over 1,190 publishers of CD-ROMs worldwide, but only 670 of them publish Macintosh titles and 285 publish MPC titles. According to this source, the vast majority of titles published during 1993 were industry-specific databases for the professional market (for example, *Hungarian Mortality Data & Query Software*).

Porcupine's primary competitors are:

- Microsoft, Time-Warner, Sony, Apple, Paramount, and Electronic Arts. These companies entered the market early and have the economic resources required to sustain losses while the new market develops;
- Moderate-sized multimedia title companies such as Brøderbund, Software Toolworks, Sanctuary Woods, Compton's New Media, Sierra On-Line, Knowledge Adventure, and Voyager and;
- Specialty service contract/title production organizations.

Porcupine expects both large, well-funded media and software companies and moderate-sized multimedia publishers will remain important players in the industry for some time to come. Though the large media companies are a threat to Porcupine, they also serve a valuable function in channel development. They have the financial wherewithal to seed the market, driving up demand for consumer titles and opening up new markets. Porcupine will enter the market just as consumer pull for titles replaces channel push and as the installed base of CD-ROM drives reaches a critical mass. As the large companies expend significant resources expanding the multimedia marketplace, Porcupine will draft along tightly in their wake.

Our analysis also suggests that many of the small developers currently entering the market will not be able to survive as they lack direct access to retail shelves. At the industry standard 70/30 distributor/developer split, these small developers are hard-pressed to cover costs, let alone make a profit.

There is a significant opportunity for Porcupine to serve as a marketing and distribution house for small developers. We will offer friendlier terms to Affiliate Label producers than competitors and will work with developers at all stages of the production process to get their titles onto retailers' shelves.

Porcupine's combination of commercial contract work and consumer title production is unique. While Porcupine is unaware of any other company pursuing an identical design, production, marketing, and sales strategy, it is indeed possible that others may have recognized the need for critical mass and control of distribution in this industry.

Brand and company loyalty is still quite low in the multimedia industry. The installed base of CD-ROM drives is expanding rapidly;millions of new users are buying CD-ROM titles . Porcupine's creative and technical expertise, contacts in the multimedia developer community, and distribution and marketing contacts will ensure the company a profitable share of the burgeoning multimedia market.

Management and Organization

Porcupine's geographical diversity enhances its strategic position in the market. Porcupine is organized into two regions: East and West. During its first year, Porcupine will maintain production centers in Cincinnati, Minneapolis and at its head office in Oakland, California.

An East Coast Office permits the Company to take advantage of lower labor costs and enhances Porcupine's ability to serve contract clients in the eastern United States. A West Coast Office gives Porcupine access the large number of multimedia experts based in northern California.

The Company will manage its geographically dispersed offices in a lean and efficient manner using a wide-area network and modern communications technology. Management is experienced in long-distance voice and electronic communication. Production methods and systems will be standardized, to ensure efficient and cost-effective title development.

The organization chart on the following page shows the Company's operational structure.

[INSERT ORGANIZATIONAL CHART]

Production

Porcupine's current production capabilities are laid out in the matrix on the following page. This matrix shows the experience the founding companies and the production partners bring to Porcupine. Experiences are categorized by job function and project type. The complementary mix of capabilities with experience in a wide range of multimedia services and products provides Porcupine with comprehensive production capabilities few companies can match.

Responsibility for Porcupine's production is based on the production model developed by Founding Company THE. Title development will be supervised by the Vice Presidents of Production and Creative Direction working in coordination with Creative Directors and Resource Managers in each office. All Vice Presidents and Creative Directors have operational experience and are expected to spend substantial time in the trenches with creative and production teams. Their time will be split between production and administration activities such as strategic planning, deal making, and administrative oversight.

The East and West Coast Creative Directors, working in concert with the Vice President of Production, will jointly set standards for design and production. A resource manager will assist the regional Creative Directors as day-to-day administrators, planners, and go-getters for that region's production teams. Project leaders will manage each project team.

INSERT EXPERIENCE MATRIX

Development of state-of-the-art products on-time and within budget requires a combination of experience, technological and development know-how, and aesthetic vision. Porcupine's production executives possess this special combination of abilities.

The nature and purpose of each product will determine project staffing. Production teams will be formed for each new product. Careful and efficient scheduling of title launches will permit efficient use of product teams and allow sharing of talented multimedia specialists including videographers, digital musicians and composers, and 3-D animators.

Marketing and Sales

The Vice President of Sales and Marketing oversees all Porcupine sales and marketing operations, working closely with the Directors of Contract Sales, National Accounts, Distribution Sales, Syndication Sales, and the Director of Acquisitions. The Vice President of Sales and Marketing also manages documentation, advertising, collateral sales development, merchandising, shipping, and public relations.

Company Executives

Porcupine senior management is listed below:

Tay Vaughan	CEO and President
Kent Sokoloff	COO
Mark Holtzman	CFO
Confidential	Vice President of Sales and Marketing
Robert Zielinski	Vice President of Production
Scott Risner	Vice President of Creative Direction

Management Profiles

Tay Vaughan, CEO and President
Mr. Vaughan is an industry-recognized multimedia pioneer and expert. He was a co-founder of HyperMedia Group, Inc., a custom developer of multimedia products and tools. After leaving the HyperMedia Group, Mr. Vaughan founded Timestream, Inc. a multimedia title development and publishing company. Mr. Vaughan is the author of *Using HyperCard* (Que, 1988) and the seminal multimedia book, *Multimedia: Making It Work* (Osborne/McGraw-Hill, 1993). He is also a contributing editor and columnist at *NewMedia* magazine and *Morph's Outpost on the Digital Frontier,* and lectures frequently in the United States and abroad about multimedia technology and the industry. Mr. Vaughan received a BA degree with honors in Anthropology and Sociology from Oberlin College.

Kent Sokoloff, COO
Dr. Sokoloff has a wide range of experience including co-founding and serving as president of Sierra Laser Systems, and serving as a venture capital and general business consultant with recognized expertise in management of emerging companies. He has extensive contacts in the broadcasting and publishing industries, and is experienced in the Japanese market and government relations. Dr. Sokoloff has a BS from Cornell University and Master's and Doctorate degrees in Communication from Pennsylvania State University.

Mark Holtzman, CFO
Mr. Holtzman has eleven years of experience in financial management including financial reporting, treasury functions, information systems and supervision of accounting functions in both distribution and manufacturing environments. Mr. Holtzman has spent the past five years as Vice President and CFO of a large microcomputer software distributor. In this position, he had responsibility for accounting, finance, administration, treasury, human resource and customer service functions including management of a 26 person staff. Mr. Holtzman has a BA from the University of California, an MBA from the University of Michigan. He is also a Certified Public Accountant.

Robert Zielinski, Vice President of Production
In 1992, Mr. Zielinski co-founded The Human Element with Mr. Risner. At THE, Mr. Zielinski holds the title of Principal, Multimedia Services. From 1991 to 1992, Mr. Zielinski was Vice President, Development & Services, with turnkey training technologies, inc. From 1989 until 1991, he was a Senior Design Consultant with Authorware, Inc., specializing in application design and team development. Mr. Zielinski received a BS degree from Eastern Kentucky University and a Master's degree from Ohio State University.

Scott Risner, Vice President, Vice President of Creative Direction
In 1992, Mr. Risner co-founded THE and served as its Principal, Creative Director. Prior to THE, Mr. Risner was the Creative Director for turnkey training technologies, inc. Before turnkey, he was the Director of Macintosh Creative Services at Digital Image. Mr. Risner studied Art at Northern-Campbell Vocational Technical School and the Anneliese's Art Studio. His study emphasized design, illustration, and layout for effective communication in a variety of media.

Vice President of Sales and Marketing
The Vice President of Sales and Marketing is an executive in the microcomputer software industry. He has over 16 years sales and marketing experience focused on bringing new technologies to market in the microcomputer, software, and consumer electronics industries. He managed a worldwide sales organization selling technical information on CD-ROM and other media. He served as a Marketing Vice President for ComputerLand Corporation and as President of Byte Industries, He has a BA from Cal State University, San Francisco and an MBA in Marketing from St. Mary's College.

Employment Agreements

Porcupine has employment agreements with Messrs. Vaughan, Zielinski, Sokoloff, Risner, Holtzman, and the Vice President of

Marketing and Sales. Employment agreements with the founders and these key staff members state that each will be paid an annual salary of at least $85,000 with increases and bonuses to be set at the discretion of the Board. The agreements allow each employee and founder options to purchase at least 30,000 shares of the Common Stock of the Company at a price to be set by the Board. Each agreement provides for a severance payment equal to six months salary, in the event that they are terminated for any reason other than gross negligence or fraud. In the event that any one of these individuals leaves the employ of the Company, a six-month non-compete clause will be triggered. Each agreement is for a period of five years, automatically renewable for one-year periods thereafter.

Pursuant to the terms of their employment agreements, the Merger Agreement, and the Agreement Among Stockholders, Messrs. Vaughan, Zielinski, and Risner will remain on the Board of Directors of the Company for as long as they are employed by or affiliated with Porcupine.

Directors and Director Compensation

The Company's bylaws provide that its Board shall consist of between five and nine members, as determined by the Board. The Board has set the initial number of directors at seven.

Directors of the Company do not receive compensation for their services but are reimbursed for reasonable expenses in attending meetings of the Board of Directors. Each non-employee director (or the entity that is represented by such director) is eligible to participate in the Company's Outside Directors Stock Option Plan.

Employees

Porcupine will have approximately 30 full-time employees upon completion of the merger of the founding companies. The employees and the Company are not parties to any collective bargaining agreements, and the Company believes its relations with its employees are good.

Employee Stock Plan

The 1994 Long-Term Incentive Plan (the “Plan”) was adopted by the Company's Board of Directors and approved by the Company's stockholders in April, 1994. The Plan is designed to offer key employees, including officers, an opportunity to acquire an interest in the Company. Terms have been designed to reward employee effort and loyalty. The Plan provides four types of awards: stock options, incentive stock rights, stock appreciation rights (including limited stock appreciation rights), and restricted stock purchase agreements. It is anticipated that the Company will implement a stock option program as an integral part of employee compensation packages. The Company has reserved 200,000 shares of Common Stock for issuance under the Plan. To date, however, no awards have been made under the Plan.

Outside Professional Firms

Porcupine has engaged the law firm of Bronson, Bronson & McKinnon to serve as legal counsel. Upon completion of the financing, Bronson, Bronson & McKinnon will become the Company's general outside counsel.

Porcupine has engaged the firm of Ernst & Young to provide financial and accounting advice. Upon completion of financing, Ernst & Young will become the Company's provider of financial and accounting services. Ernst & Young has not provided forecasting services with regards to this business plan.

Use of Proceeds

Porcupine seeks $6.75 million in this financing effort. The Company estimates that approximately $5.5 million will be used to fund the development and sale of CD-ROM titles described in this document and for necessary operating expenses.

The Company will use approximately $500,000 of the financing proceeds to pay costs, including but not limited to, legal fees incurred, but accrued, during the pre-funding period. The remaining funds are to be kept as a reserve.

The above represents the Company's best estimate of its allocation of the proceeds from the present financing effort, based upon the Company's current state of business operations and its current plans and projections. The amount and timing of expenditures and apportionment will vary depending on actual and future requirements and opportunities for the Company.

Financial Projections

All projections are yearly, commencing with the start of the third quarter of the calendar year 1994. Thus Year 1 starts in September, 1994 and extends through August, 1995.

Sales Assumptions

Sales assumptions are predicated upon the 1991-1993 sales experience of Ebook, a nationally-known publisher and distributor of CD-ROM titles. Market growth projections were provided by Freeman Associates, Dataquest, Infotech, and GISTICS. Marketing information was independently corroborated by Multimedia Marketing, a Los Angeles-based consulting firm headed by marketing expert Larry Jordan. Multimedia Marketing was hired by Porcupine to review proposed titles, make sales projections, analyze sales margins, and prepare sales estimates and *pro formas* for the initial list of Porcupine consumer titles.

Consumer Titles

1. Based on Ebook's month-by-month sales analysis; for Porcupine titles released in March, 1995, average first year sales are estimated at 22,000 units per title.

2. In years 2-5, sales follow the monthly cycle established in Year 1. Sales increase annually based on the units sales per title assumptions detailed in the table on the following page.

3. Porcupine assumes second year sales of titles will be 20% of the previous years', plus 20% of the increase in the available base; diminishing to 10% in a title's third year.

4. Porcupine assumes that its affiliated labels will have one-third the annual sales volume of Porcupine titles.

5. Marketing expenditures will peak in February and August, at the time of new title launches.

6 Sales projections are based on industry estimates showing the installed base of CD-ROM players at 8.3 million units.

   In years 1 through 3, Porcupine takes a fraction of the projected installed base as the *available installed base* into which consumer/mass market and business titles can be sold. Current estimates are that approximately half of the installed base is available for mass market titles. The following table represents the installed base, the available base, the number of units per new title and affiliated titles Porcupine estimates it will sell into the available base.

	Installed Base (Millions)	Available Base (Millions)	Units per Title (Thousands)	Units per Affiliated Title (Thousands)
1993	8.3	3.8	5	1.6
Year 1	25	14	22.0	7.3
Year 2	44	19	25.4	8.5
Year 3	79	35	46	15.3
Year 4	114	70	92	30.6
Year 5	143	105	138	46

7 The MSRP for all Porcupine titles is $39.00 per unit.

8. Industry experience in CD-ROM direct mail sales to qualified lists demonstrates response rates of 10-25%. Porcupine will work with mail order experts to establish a direct mail campaign. The company estimates a response rate to direct mail drops starting at 3% and rising to 10% in September, 1995, with a selling price of $34/unit. The following tables provide details of the direct mail assumptions:

Mailings

	Starting Number of Drops	Response Rate %
3/95	1	3
9/95	2	6
3/96	4	10

9. Porcupine consultant Multimedia Marketing provided assumptions about the costs of sales for both direct marketing and retail channels. Based on these assumptions, Porcupine estimates a constant revenue yield of $19.50 per title.

10 Porcupine assumes a revenue stream from affiliated label titles based upon a 50/50 split of gross income.

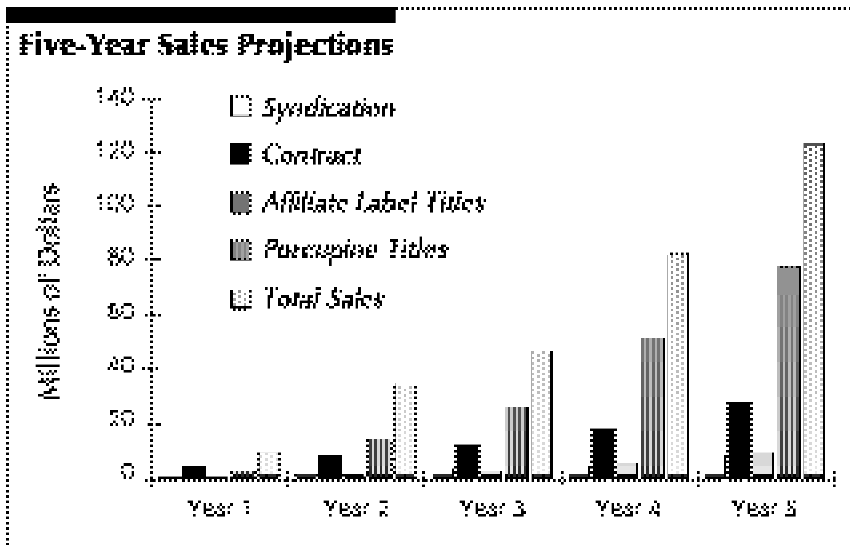
11 On average, the industry spends 10% of title production cost on marketing (about $10,000 to $30,000 each for Porcupine titles). Porcupine believes this number is too low for a new industry. The company has allocated an average of $67,500 per in-house title and 10% of individual title revenues for Affiliate Label titles to marketing.

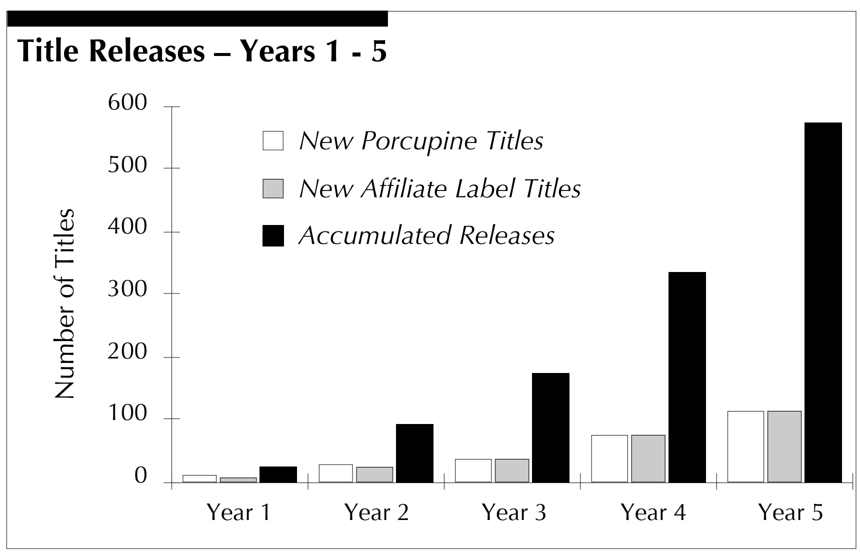
Contract Services Sales

Contract sales for 1994 are based upon projections of work underway, currently in bid, or about to be bid. Future growth is based on modest growth assumptions. There are no reliable estimates regarding growth of the contract sales interactive multimedia market. While GISTICS expects the software/title business market to reach $3.6 billion by 1996, it is clear that most of this market is presently dedicated to traditional software applications. The business training market is a $2 billion/year activity. Porcupine assumes there is ample room for contract sales growth in this market alone.

Summary

The following charts summarize Porcupine's total sales projections and title release rates:





Financial Assumptions

Unless otherwise noted, all data used in the development of the financial pro formas are based on information provided by the

Porcupine member companies, Porcupine management, marketing and sales staff, Ebook, and Larry Jordan of Multimedia Marketing.

1. Industry standard for receivables is less than 60 days on title sales, and standard delivery from the manufacturer is two weeks after receipt of order (ARO). Porcupine assumes a period of 90 days for receivables on both commercial titles and service contracts. Porcupine assumes it will not develop a revolving line of credit to finance receivables during Year 1 or Year 2.

2. All payables are paid on receipt of invoice. The industry standard is 30 days or 2% to 5% net 20 days. From an accounting perspective, Porcupine has no payables. This assumption is for projection purposes only, and does not represent the manner in which Porcupine will conduct its financial affairs.

3. Depreciation is computed at six-years straight-line for G&A and sales, and two-years straight-line for production. The short depreciation schedule in production reflects the rapid obsolescence of computer technology used in multimedia development.

4. The Company has not accounted for the costs of the proposed Employee Stock Option Plan.

5. Porcupine intends to qualify for significant research and development tax credits but has not accounted for them in these projections because of the volatility of the tax code regulations.

6. Although the Company will be cash-positive before the 12th month of operation, Porcupine believes that because of carry-forwards and tax credits, it will not have to pay taxes until the second year of operation.

7. The month-two business start-up costs reflect a one-time fee to Templin Bogen Associates for investment consulting and to

resolve a limited number of liability issues brought into Porcupine by the merged companies.

8. Salaries in G&A reflect a loading of 25% for all Vice Presidents and Creative Directors.

9. The Director of Syndication Sales will obtain joint development money for title production and sell internal advertising space on selected titles. Porcupine assumes that in the first year limited revenues will be derived from this effort.

10. Sales incentive expenses are 7% for all sales. Porcupine assumes this cost as an expense payable upon cash received.

11. Royalty expenses reflect an average across all titles. Many titles will have no out-bound royalty stream, while some titles may have royalty rates as high as 10%. Porcupine assumes that royalties are an expense payable upon cash received.

12. Returns expense is a set-aside that reflects unsold merchandise, customer returns, and a limited number of defective CD-ROMs. A 15% of sales return rate reflects a conservative industry standard. The Company assumes 100% loss of these returns, with no returns to inventory. This expense is deducted at the booking of the order, and (by calculation) has been deducted from the sales statements presented in the pro forma.

13. Manufacturing turn-around time is typically two weeks to one month. Industry standards for production costs range from $2.50 to $3.50 per unit at manufacturing volumes of 3,000 to 5,000 units. Porcupine assumes a one-month turn-around time at $3.50/unit cost retail and $2.50/unit cost for direct mail with no volume discount or reduction in unit cost over the period of the business plan.

14. Short manufacturing turn-around times permit low inventory costs. A large number of qualified vendors offer an average

turn-around of two weeks and payables of 30 days or 2% to 5% net 20 days. The pro formas in this document use a conservative 30-day turn-around for vendors and at-order payables for Porcupine. The industry-standard inventory maintains 1,000 units/title. Inventory management is inexpensive and will be accomplished through a fulfillment house.

15. Negative receivables in Year 3 through Year 5 (shown in the balance sheet) indicate that Porcupine's revenues exceed its receivables needs during this period.

Financial Pro Formas