

MAI SYSTEMS CORP  
Form PRER14C  
September 28, 2005

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**SCHEDULE 14C**

**Information Statement  
Pursuant to Section 14(c) of the Securities Exchange Act of 1934**

Check the appropriate box:

- a.  Preliminary Information Statement
- b.  Confidential, for Use of the Commission Only (as permitted by Rule 14c-5(d) (2))
- c.  Definitive Information Statement

## MAI SYSTEMS CORPORATION

(Name of Registrant as Specified in its Charter)

Payment of Filing Fee (Check the appropriate box):

- No fee required.
- Fee computed on table below per Exchange Act Rules 14c-5(g) and 0-11

- (1) Title of each class of securities to which transaction applies:
- (2) Aggregate number of securities to which transaction applies:
- (3) Per unit price or other underlying value of transaction computed pursuant to Exchange Act Rule 0-11 (set forth the amount on which the filing fee is calculated and state how it was determined):\$
- (4) Proposed maximum aggregate value of transaction: \$
- (5) Total fee paid: \$

- Fee paid previously with preliminary materials.
- Check box if any part of the fee is offset as provided by Exchange Act Rule 0-11(a) (2) and identify the filing for which the offsetting fee was paid previously. Identify the previous filing by registration statement number, or the Form or Schedule and the date of its filing.

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

- (1) Amount Previously Paid: \$
  - (2) Form, Schedule or Registration Statement No.:
  - (3) Filing Party:
  - (4) Date Filed:
-

**MAI SYSTEMS CORPORATION**

26110 Enterprise Way

Lake Forest, California 92630

(949) 598-6000

**INFORMATION STATEMENT**

**WE ARE NOT ASKING YOU FOR A PROXY AND**

**YOU ARE REQUESTED NOT TO SEND US A PROXY.**

Our Board of Directors and the Investor Group described below are furnishing this information statement to all holders of record of the issued and outstanding shares of our common stock, \$0.01 par value, as of the close of business on December 30, 2004 (the Approval Record Date), in connection with a proposed Amendment to our Amended and Restated Certificate of Incorporation ( Amendment ) to effectuate a 1-for-150 reverse stock split. If consummated, the reverse stock split would enable us to terminate our periodic reporting obligations under Sections 13 and 15(d) of the Securities Exchange Act of 1934, as amended ( Exchange Act ), the registration of our common stock under Section 12(g) of the Exchange Act and the quotation of our common stock on the OTC Bulletin Board. .

Section 242 of the Delaware General Corporation Law requires us to obtain stockholder approval of the Amendment. We have one class of capital stock outstanding, our common stock. Only stockholders of record at the close of business on the Approval Record Date are entitled to approve and adopt the Amendment. As of the Approval Record Date, 57,847,862 shares of our common stock were issued and outstanding, held of record by approximately 577 stockholders. Each share of common stock issued and outstanding on the Approval Record Date is entitled to one vote with regard to the approval and adoption of the Amendment. There are no dissenters' rights of appraisal with respect to the Amendment.

Under the Delaware General Corporation Law and our bylaws, our stockholders may approve the Amendment without a meeting, without prior notice and without a vote if a written consent to the Amendment is signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote on the action were present and voted (here, a majority of the outstanding shares of common stock). The holders of a majority of the outstanding shares of our common stock are members of HIS Holding, LLC, an investor group consisting of two members of our senior management, W. Brian Kretzmer and James W. Dolan, the Chairman of the Board, Richard S. Ressler, and certain of our principal senior lenders, The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P ( Investor Group ). The Investor Group has approved the Amendment by written consent dated effective as of December 30, 2004. Accordingly, your consent is not required and is not being solicited in connection with the Amendment. See The Reverse Stock Split- Approval of the Reverse Stock Split By Our Directors and Stockholders at page 7 for further details.

We will pay the expenses of furnishing this information statement, including the cost of preparing, assembling and mailing this information statement. We anticipate that this information statement will be sent or given on or about October , 2005 to the record holders of common stock as of close of business on the Approval Record Date, and that the Amendment will be filed with the Delaware Secretary of State and become effective no earlier than the twentieth day after this information statement is sent or given to those holders of common stock.

**Neither the Securities and Exchange Commission nor any state securities commission has approved or disapproved of the reverse stock split, passed upon the merits or fairness of the reverse stock split, or passed upon the adequacy or accuracy of the disclosure in this information statement. Any representation to the contrary is a criminal offense.**

---

TABLE OF CONTENTS

Section

Summary Term Sheet

Summary of the Proposed Reverse Stock Split

Special Factors

The Reverse Stock Split

Special Committee of the Board of Directors

Special Factors Considered in Approving the Reverse Stock Split

Reasons for the Reverse Stock Split

Substantive and Procedural Factors Considered by the Special Committee and Our Board of Directors as to the Fairness of the Reverse Stock Split

Procedural Factors Favoring the Reverse Stock Split

Procedural Factors Disfavoring the Reverse Stock Split; Interests of our Chairman and Executive Officers in the Reverse Stock Split

Substantive Factors Favoring the Reverse Stock Split

Substantive Factors Disfavoring the Reverse Stock Split

Effects of the Reverse Stock Split on Stockholders Who Hold Fewer than 150 Shares of Common Stock in a Single Account

Effects of the Reverse Stock Split on Stockholders Who Hold More Than 150 Shares of our Common Stock in a Single Account

Procedure for Shareholders Who Hold Shares in Street Name

General Examples of Potential Effects of the Reverse Stock Split

Effect of the Reverse Stock Split on Option Holders

Effect of the Reverse Stock Split on Our Company

Certain Material Federal Income Tax Consequences

Other Information

Regulatory Approvals

Background Information Concerning Our Directors, Executive Officers and Controlling Stockholders

Prior Transactions Between the Investor Group and Our Company

Interests of Certain Persons in or Opposition to the Reverse Stock Split - Security Ownership of Certain Beneficial Owners and Management

Market Prices of Our Common Stock and Dividend Policy

Pro Forma Financial Data

Financial Statements, Supplementary Financial Information, Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk

Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

Forward-Looking Statements

Where You Can Find More Information

Appendix A - Form of Certificate of Amendment of Certificate of Incorporation of MAI Systems Corporation

Appendix B- Pro Forma Financial Data

Pro Forma Financial Information

Pro Forma Consolidated Balance Sheet as of September 30, 2004 June 30, 2005

Pro Forma Consolidated Statement of Operations for the year ended December 31, 2004

Pro Forma Consolidated Statement of Operations for the three months ended September 30, 2004 June 30, 2005

Pro Forma Consolidated Statement of Operations for the nine months ended September 30, 2004 June 30, 2005

Footnotes to Pro Forma Financial Statements

Appendix C - Financial Statements, Supplementary Financial Information and Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk Relating to the Interim Periods ended September 30, 2004 and 2003 and the Years Ended December 31, 2004, 2003 and 2002

Selected Financial Data

Quarterly Data

Management's Discussion and Analysis of Financial Condition and Results of Operations

Qualitative and Quantitative Disclosures about Market Risk

Financial Statements for the Years Ended December 31, 2004, 2003 and 2002:

Report of Independent Registered Public Accounting Firm- BDO Seidman, LLP

Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statements of Stockholders' Deficiency and Comprehensive Loss

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

Financial Statements for the Interim Periods Ended June 30, 2005 and 2004:

Condensed Consolidated Balance Sheets

Condensed Consolidated Statements of Operations

Condensed Consolidated Statements of Cash Flows

Notes to Condensed Consolidated Financial Statements

**SUMMARY TERM SHEET**

**Summary of the Proposed Reverse Stock Split**





*Purpose of the Reverse Stock Split*

The purpose of the reverse stock split is to position ourselves to terminate our public reporting so that we may continue future operations as a private company, relieving us of the costs, administrative burdens and competitive disadvantages associated with operating as a public company. We intend to accomplish this purpose by reducing the number of holders of record of our common stock to fewer than 300 by cashing out the fractional shares that would otherwise result from the reverse stock split. See *Reasons for the Reverse Stock Split* at page 15.

*Establishment and Findings of Special Committee*

Our Board of Directors adopted resolutions on November 15, 2004 establishing a Special Committee of the Board of Directors to investigate whether the Amendment to our Amended and Restated Certificate of Incorporation to implement the reverse stock split was advisable, in the best interests of, and substantively and procedurally fair to, our unaffiliated stockholders, whether they are cashed out and/or remain as our stockholders. The form of the Amendment is attached to this information statement as **Appendix A**. See *Special Committee of the Board of Directors* at page 9.

The Special Committee retained its own legal counsel to advise it on all matters related to the reverse stock split. The Special Committee did not obtain a third party fairness report, opinion, appraisal, or other independent assessment of the fairness of the terms of the reverse stock split or the value of our common stock, but did rely on an internal company study. See *Procedural Factors Disfavoring the reverse stock split; Interests of our Chairman and Executive Officers in the reverse stock split - The Special Committee and Our Board of Directors Did Not Obtain a Fairness Report* at page 17.

In determining the price to be paid in lieu of issuing fractional shares of \$0.17 per share, the Special Committee considered, among other things, the historical market price for our common stock for the 30-, 60- and 90-day periods prior to December 1, 2004. The Special Committee also reviewed an internal study prepared by management that considered historical market prices and recent transactions, earnings value, discounted cash flow value, net asset value (liquidation value) and net book value in evaluating the fairness of the price being offered to all stockholders. See *Financial Analysis and Summary of Factors Reviewed to Determine \$0.17 Per Share Fractional Share Purchase Price* at page 11 and *Financial Analysis Performed by Management* at page 11.

After a complete review of the reverse stock split proposal and consultation with legal counsel, the Special Committee on December 2, 2004 presented its findings to the Board of Directors. The Special Committee reported on each of the three principal means of reducing our number of shareholders: merger, tender offer and reverse stock split. The Special Committee found that the reverse stock split was the most viable and cost-effective alternative available to us to reduce the number of our stockholders below 300, thereby positioning us to terminate our public reporting obligations. The Special Committee further concluded that by continuing future operations as a private company, we would be relieved of the costs, administrative burdens and competitive disadvantages associated with operating as a public company. See *Special Committee of the Board of Directors* at page 9; *Background of the Reverse Stock Split; Alternatives Considered by the Special Committee and the Board of Directors* at page 14; and *Special Factors Considered in Approving the Reverse Stock Split* at page 14.

The Special Committee further found that the advantages of the reverse stock split to the unaffiliated stockholders (both those being cashed out and those remaining as stockholders after the reverse stock split) outweighed the disadvantages, and that it was substantively and procedurally fair, and, therefore, that the transaction was in all of our stockholders' best interests. See "Special Committee of the Board of Directors" at page 9 and "Special Factors Considered in Approving the Reverse Stock Split" at page 14.

The Special Committee met on September 23, 2005 to receive an updated report from management on the reverse stock split. At this meeting, the Special Committee reaffirmed the reverse stock split and all of their prior findings and confirmed that the transaction was still substantively and procedurally fair and in the best interests of all of the shareholders.

*Approval of Board of Directors*

On December 2, 2004, our Board of Directors (with Richard S. Ressler, our Chairman, recusing himself because he is the controlling shareholder of Orchard Capital Corporation, the managing member of the Investor Group) adopted resolutions authorizing and approving the Amendment and the implementation of the reverse stock split. The Board of Directors directed management to submit the Amendment to our stockholders for approval and reserved the right to

abandon the Amendment and the reverse stock split at any time prior to its effective time. See *The Reverse Stock Split - Approval of the Reverse Stock Split By Our Board of Directors and Stockholders* at page 7 and *Substantive and Procedural Factors Considered by the Special Committee and Our Board of Directors as to the Fairness of the Reverse Stock Split* at page 16.

*Approval of Stockholders*

We had approximately 577 stockholders of record holding an aggregate of 57,847,862 shares of common stock outstanding as of the Approval Record Date. Of those shares, approximately 83.5%, or 48,312,968 shares, were controlled by the Investor Group. Each stockholder is entitled to one vote per share. The proposed action to implement the reverse stock split requires the affirmative vote or written consent of the holders of a majority of the outstanding shares of our common stock as of the Approval Record Date. Members of the Investors Group that hold a majority of our voting power approved the Amendment by written consent effective as of December 30, 2004. See *The Reverse Stock Split - Approval of the Reverse Stock Split By Our Board of Directors and Stockholders* at page 7.

The Board of Directors met on September 23, 2005 to receive an updated report from management on the reverse stock split. At this meeting, the Board of Directors also received the recommendation of the Special Committee reaffirming the reverse stock split and all of their prior findings and confirmed that the transaction was still substantively and procedurally fair and in the best interests of all of the shareholders. At this time, the Board of Directors (with Richard S. Ressler again recusing himself) voted to reaffirm the implementation of the reverse stock split.

*Recent Transactions and Potential Conflicts of Interest with Investor Group*

Members of the Investor Group that control the majority of our common stock include the Chairman of our Board of Directors, Richard S. Ressler, two of our executive officers, W. Brian Kretzmer and James W. Dolan, and certain of our senior lenders, The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P. See *Other Information - Background Information Concerning Our Directors, Executive Officers and Controlling Stockholders*, page 25.

In April 2004, the Investor Group acquired 2,433,333 of our shares of common stock and approximately \$3.1 million of our indebtedness from CSA Private Limited, a subsidiary of Computer Sciences Corporation. See *Prior Transactions Between the Investor Group and Our Company - Investor Group Purchase of Company Shares Owned by Computer Sciences Corporation*, page 27.

In September 2004, the Investor Group acquired a controlling interest in the Company by converting approximately \$3.3 million in company indebtedness and investing \$1 million in our company for approximately 42 million shares of our common stock. See *Prior Transactions Between the Investor Group and Our Company -*

September 22, 2004 Stockholder Approval of the Management Equity/Conversion Transaction that Resulted in a Change in Control of Our Company, page 27.

There are potential conflicts of interest between the Investor Group and our unaffiliated shareholders. For example, the reverse stock split will increase the percentage ownership interest of the Investor Group in our common stock. In addition, the reverse stock split will reduce the liquidity of our common stock, which may have a greater impact on our unaffiliated stockholders than on the Investor Group. See Procedural Factors Disfavoring the Reverse Stock Split; Interests of our Chairman and Executive Officers in the Reverse Stock Split, page 17.

*Estimated Effective Time*

We anticipate that the Amendment will be filed with the Delaware Secretary of State and the reverse stock split will become effective on or about October , 2005. However, in no event will the reverse stock split be consummated earlier than that twentieth day after this information statement is sent or given to those persons or entities that held common stock as of the Approval Record Date. See The Reverse Stock Split - Effective Time of the Reverse Stock Split at page 7.

*Implementation and Effects of Reverse Stock Split*

Following the reverse stock split, we anticipate that we will have approximately 250 stockholders of record holding an aggregate of approximately 385,000 outstanding shares of our common stock. See Effects of the Reverse Stock Split on our Company at page 20.

Every holder of record of common stock at the effective time will be entitled to receive one share of our common stock in exchange for every 150 shares of common stock held by that holder immediately prior to the effective time. No fractional shares will be issued. Instead, in lieu of issuing fractional shares to holders who would otherwise be entitled to receive a fractional share of our common stock as a result of the reverse stock split, we will pay cash consideration at the rate of \$0.17 for each share of common stock that was outstanding before the effective time but

was not converted into a full share of post-split common stock. See *The Reverse Stock Split - Basic Terms* at page 6; *Effects of the Reverse Stock Split on Stockholders Who Hold Fewer than 150 Shares of common stock in a Single Account* at page 19; and *Effects of the Reverse Stock Split on Stockholders Who Hold More Than 150 Shares of our common Stock in a Single Account* at page 19.

We plan to pay the expenses and cash consideration for the reverse stock split using our available cash. We estimate that we will use approximately \$75,000 in cash to complete the reverse stock split, which includes professional fees and other expenses related to the transaction and cash payments to be made in lieu of issuing fractional shares. We estimate that the fractional shares that would otherwise be issued in the reverse stock split would aggregate to approximately 139,000 pre-split whole shares of common stock, resulting in cash payments to cashed-out stockholders of approximately \$24,000 (139,000 whole shares at \$0.17). See *Source of Funds and Financial Effect of the Reverse Stock Split* at page 8.

Our common stock is traded over-the-counter on the OTC Bulletin Board under the symbol MAIY.OB. On December 8, 2004, the last trading price for our common stock prior to the announcement of the proposed reverse stock split was \$0.16. The closing trading price for our common stock on September 23, 2005 was \$0.055. The cash consideration to be paid for fractional shares represents a premium of approximately 11%, 10% and 7% over the weighted average closing trading price of the common stock over the 30-, 60- and 90- day periods, respectively, prior to the announcement of the reverse stock split and a premium of 209% over the closing trading price of \$0.055 on September 23, 2005. See *Market Prices of Our Common Stock and Dividend Policy* at page 29.

**Following the reverse stock split, we plan to terminate our public reporting, which means that our common stock will not qualify to be traded on any automated quotation system operated by a national securities association and will no longer be traded on the OTC Bulletin Board. Our common stock may be eligible to trade in the Pink Sheets, however we have no present plans to apply for our common stock to be traded in the Pink Sheets. For this reason, stockholders will experience a loss of liquidity after the reverse stock split and may be required to hold their shares of common stock for an indefinite period of time. See *Substantive Factors Disfavoring the Reverse Stock Split - Cessation of Public Sale Opportunities* at page 18.**



Following the reverse stock split and the termination of our public reporting, we will no longer be a public-reporting company, but rather will operate as a private company. We expect our business and operations to continue as they are currently being conducted and, except as disclosed in this information statement, the reverse stock split is not anticipated to materially affect the conduct of our business. We expect to be subject to substantially the same risks and uncertainties after the reverse stock split. See *Conduct of our Business after the Reverse Stock Split Future Company Plans* at page 21.

We believe the reverse stock split will be treated as a tax-free recapitalization for federal income tax purposes, which will result in no material federal income tax consequences to us. Depending on each stockholder's individual situation, the reverse stock split may give rise to certain income tax consequences for stockholders. See *Certain Material Federal Income Tax Consequences* at page 22.

## **SPECIAL FACTORS**

### **The Reverse Stock Split**





*Basic Terms*

Under the terms of the reverse stock split, every holder of record at the effective time will be entitled to receive one share of our common stock in exchange for every 150 shares held by such person immediately prior to the effective time. No fractional shares will be issued. Instead, in lieu of issuing fractional shares to stockholders who would otherwise be entitled to receive a fractional share of our common stock as a result of the reverse stock split, we will pay cash consideration at the rate of \$0.17 for each share of common stock that was outstanding immediately prior to the effective time but was not converted into a full share of post-split common stock.

To avoid being completely cashed out as a result of the reverse stock split, a stockholder may:

purchase a sufficient number of shares of common stock on the open market and have them registered in the stockholder's name and consolidated with its current record account if it is a record holder, or have them entered in its account with a nominee, such as its broker or bank, in which the stockholder currently holds shares of common stock,

so that the stockholder holds at least 150 shares of common stock in its account immediately prior to the effective time; or

if applicable, consolidate the stockholder's accounts, or accounts with nominees, so that the stockholder holds at least 150 shares of common stock in a single record account immediately prior to the effective time.

For payment purposes, we intend for the reverse stock split to treat stockholders holding common stock in a street name through a nominee, such as a bank or broker, in the same manner as stockholders whose shares are registered in their own names. Nominees will be instructed to effect the reverse stock split for their beneficial holders. Accordingly, we also refer to those street name holders who receive a cash payment instead of fractional shares as cashed-out stockholders. However, nominees may have different procedures, and stockholders holding shares in street name should contact their nominees.

The reverse stock split is structured to be a Rule 13e-3 transaction under the Exchange Act because it is intended to, and if completed will likely, reduce the number of record holders of our common stock to fewer than 300, which will position us to terminate our public reporting. In connection with the reverse stock split, we and the members of the Investor Group have filed a Rule 13e-3 Transaction Statement on Schedule 13E-3 with the Commission. We intend to apply for the termination of our public reporting obligations as soon as practicable after the effective time.

*Effective Time of the Reverse Stock Split*



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

The time for determining the shares of our common stock that will be subject to the reverse stock split will be the time that the Amendment is filed with the Delaware Secretary of State and becomes effective by its terms, which we estimate will be no later than 5:00 p.m. Eastern Standard Time on October 1, 2005. In no event, however, will the effective time of the reverse stock split be earlier than the twentieth day after this information statement is sent or given to those persons or entities that held our common stock as of the Approval Record Date.

### *Approval of the Reverse Stock Split By Our Board of Directors and Stockholders*

As detailed below in Special Committee of the Board of Directors, our Board of Directors has approved the Amendment and the implementation of the reverse stock split and reserved the right to abandon the Amendment and the reverse stock split at any time prior to the effective time. Under the Delaware General Corporation Law and our bylaws, our stockholders may approve the Amendment and reverse stock split without a meeting, without prior notice and without a vote if a written consent to the Amendment is signed by the holders of outstanding shares having not less than the minimum number of votes that would be necessary to authorize or take such action at a meeting at which all shares entitled to vote on the action were present and voted (here, a majority of the outstanding shares of common stock). The Investor Group, which holds a majority of the outstanding shares of our common stock, has approved the Amendment by written consent dated effective as of December 30, 2004. Accordingly, no other stockholder approval is required and is not being solicited in connection with the Amendment.

Information about the Investor Group that consented to the Amendment and the number of shares of common stock owned as of the Approval Record Date and included in the written consent approving the reverse stock split is as follows:

<b>Name of Stockholder</b>	<b>Number of Shares</b>
HIS Holding, LLC 6922 Hollywood Boulevard, Suite 900 Los Angeles, California 90028	43,172,110

The managing member of HIS Holding, LLC is Orchard Capital Corporation, a California corporation, of which Richard S. Ressler is president and the controlling shareholder. The number of shares shown as owned and included in the written consent approving the reverse stock split excludes shares held separately by the four members of HIS Holding, LLC because shares held separately were not made part of the written consent. The members of HIS Holding, LLC include Richard S. Ressler, our Chairman, W. Brian Kretzmer, our Chief Executive Officer and President, James W. Dolan, our Chief Financial and Operating Officer, and certain of our principal lenders, The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P. Additional beneficial ownership information is contained below in Interests of Certain Persons in or Opposition to the Reverse Stock Split- Security Ownership of Certain Beneficial Owners and Management.

*Stock Certificates*



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Our transfer agent, Mellon Investor Services, has been appointed as our exchange agent to carry out the exchange of existing common stock certificates for new common stock certificates and to send cash payments in lieu of issuing fractional shares. Promptly following the effective time, the transfer agent will send a letter of transmittal to each stockholder. The letter will describe the procedures for surrendering stock certificates in exchange for new common stock certificates and/or the cash consideration. Upon receipt of the stock certificates and properly completed letters of transmittal, the transfer agent will issue the appropriate new stock certificates and/or make the appropriate cash payment within approximately 20 business days.

No service charges will be payable by our stockholders in connection with the exchange of certificates or the payment of cash in lieu of issuing fractional shares because we will bear those expenses. We will not pay interest on cash sums due to any stockholder in connection with the reverse stock split.

All stock certificates outstanding immediately prior to the effective time evidencing ownership of our common stock will be deemed cancelled without further action by their holders as of the effective date. Please do not send any stock certificates to our transfer agent or us in connection with the reverse stock split until you receive and complete a letter of transmittal.

### *Provision for Unaffiliated Stockholders*

Neither we, nor any executive officer or director of our company nor any person controlling us has made any provision in connection with the reverse stock split to grant unaffiliated stockholders access to our corporate files or to obtain counsel or appraisal services for such stockholders. In lieu of such provisions, we appointed a Special Committee to protect the interests of our unaffiliated stockholders. Even though the Special Committee consists of directors of our company and therefore is not completely unaffiliated from us, committees of independent directors are a commonly used mechanism to ensure fairness in transactions of this type. The Special Committee determined that an appraisal of the value of our common stock or fairness opinion regarding the reverse stock split were not required. See discussion below under Special Committee of the Board of Directors And Procedural Factors Disfavoring the Reverse Stock Split; Interests of our Chairman and Executive Officers in the Reverse Stock Split.

### *Source of Funds and Financial Effect of the Reverse Stock Split*





## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Given that the actual number of shares of common stock that we will purchase is unknown at this time, the total cash we will pay to stockholders is currently unknown, but is estimated to be approximately \$24,000. The \$24,000 estimate is based upon actual shares held in individual accounts per our transfer agent records plus the actual number of accounts held in street name per records received from ADP considering that the maximum number of shares acquired from each account will be 149 fractional shares. This amount was calculated by multiplying all estimated fractional shares to be repurchased by the \$0.17 per share repurchase price. We expect to pay the cash consideration to be paid in connection with the reverse stock split and other expenses for the reverse stock split through our available cash. The reverse stock split and the use of approximately \$75,000 in cash to complete the reverse stock split, which includes professional fees and other expenses related to the transaction and cash payments to be made in lieu of issuing fractional shares, are not expected to adversely affect our capitalization, liquidity, results of operations or cash flow. We will bear all expenses, excluding brokerage commissions and taxes, if any, related to implementation of the reverse stock split.

### *Fees and Expenses*



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

The following is a reasonably itemized statement of the fees and expenses that have been incurred or that are estimated to be incurred in connection with the reverse stock split and the transactions related thereto: \$24,000 in cash consideration for fractional shares; \$5,000 to our auditors; \$25,000 to our legal counsel; \$11,000 for printing and other costs in connection with the mailing of this information statement; and \$10,000 for exchange agent services.

### *Accounting Consequences*

The reverse stock split will not affect the par value of our common stock, which remains \$0.01 per share. The reverse stock split will result in an increase in per share net income or loss and net book value of our common stock because fewer shares of our common stock will be outstanding. Our financial statements, supplementary financial information and quantitative and qualitative disclosures about market risk, included in **Appendix C** of this information statement, do not reflect the reverse stock split. See **Appendix B** of this information statement for pro forma financial information reflecting the reverse stock split.

*Certain Legal Matters*



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

We are not aware of any license or regulatory permit that appears to be material to our business that might be adversely affected by the reverse stock split, nor any approval or other action by any governmental, administrative or regulatory agency or authority, domestic or foreign, that would be required to consummate the reverse stock split, other than approvals, filings or notices required under federal and state securities laws and the corporate laws of the States of Delaware and California.

### **Special Committee of the Board of Directors**

Subsequent to our 2004 annual stockholders meeting that was held on September 22, 2004, our Board of Directors requested that our senior management and legal counsel present to our Board of Directors an analysis of the positive and negative factors relating to the privatization of our company. At the first Board of Directors meeting following the annual stockholders meeting, the Board first considered and discussed a going private transaction as a means of substantially reducing our general and administrative expenses and allowing senior management to redirect its focus on maximizing revenues. Thereafter, pursuant to a unanimous written consent dated September 22, 2004, all Board members requested that a review of possible privatization of our company be commenced.

On November 15, 2004, our Board of Directors held a special meeting during which our senior management and David M. Griffith, our in-house general counsel, described the benefits and detriments of and various alternatives for taking our company private, including merger, tender offer and reverse stock split. As prior counsel to our special committee formed to review the Management Equity/Conversion Transaction, Rutan & Tucker, LLP, Costa Mesa, California, participated telephonically in a portion of this meeting because of their expertise in going private transactions. Our Board of Directors and management determined that the reverse stock split would be the best means of accomplishing this goal.

In view of the possible conflicts of interest involved in the reverse stock split, our Board of Directors unanimously decided on November 15, 2004, that it would be advisable to form the Special Committee of independent members of our Board of Directors. Some of the potential conflicts of interest that were discussed at this special meeting included those that could arise between the Investor Group and our unaffiliated stockholders because the reverse stock split will increase the percentage ownership interest of the Investor Group in our common stock. In addition, the reverse stock split will reduce the liquidity of our common stock, which may have a greater impact on our unaffiliated stockholders than on the Investor Group.

The Board of Directors decided to appoint to the Special Committee the same independent disinterested directors that had reviewed the Management Equity/Conversion Transaction discussed below under Prior Transactions Between the Investor Group and Our Company. The Special Committee was formed consisting of Messrs. Mayer and Ross, with Mr. Ross as the Chairman, to evaluate the reverse stock split proposal and assess whether the proposal is in the best interests of our stockholders. Neither of these directors is employed by or affiliated with our company or the Investor Group or any of their affiliates (except in the capacity as a director of our company). However, Mr. Ross's son is an employee (but not an executive officer) of CIM Group, an affiliate of MAI. CIM Group is a real estate development company that is affiliated with MAI because it is an entity under the control of Richard S. Ressler, our Chairman and majority beneficial stockholder.

Our Board of Directors further determined that it would be prudent for the Special Committee to retain independent legal counsel to assist in reviewing the reverse stock split proposal. On November 15, 2004, the Special Committee interviewed Rutan & Tucker, LLP, Costa Mesa, California, and decided to retain this firm. The principal role that Rutan & Tucker, LLP played in the reverse stock split was as legal counsel to the Special Committee, although this firm has also advised us on issues related to preparation of this information statement. Other than its representation of the Special Committee, Rutan & Tucker, LLP has no relationship (legal or otherwise) with any of the independent directors that constitute the Special Committee. The Special Committee also instructed senior management to prepare an internal study of the reverse stock split and a pricing analysis for the price to be paid to stockholders in lieu of issuing fractional shares in the reverse stock split.

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

On November 30, 2004, senior management presented to the Special Committee and its legal counsel, Rutan & Tucker, LLP, an internal company study of the reverse stock split and a pricing analysis for the repurchase of fractional shares. During the course of the presentation, the Special Committee raised numerous questions and requested additional information and analysis, each of which was responded to by our senior management and our in-house legal counsel, David M. Griffith, and attorneys of Rutan & Tucker, LLP.

The Special Committee determined that it would not be cost-effective to obtain a third party fairness report, opinion, appraisal, or other independent assessment of the fairness of the terms of the reverse stock split or the value of our common stock, and was satisfied that they could rely on the internal company study for their pricing analysis. The Special Committee came to this



conclusion because we had very recently incurred the expense of having a fairness opinion issued for the Management Equity/Conversion Transaction. The estimated cost to update this fairness opinion equaled or exceeded the initial opinion cost of \$35,000. The updating of the opinion was done by the same members of senior management, W. Brian Kretzmer, our Chief Executive Officer and President, and James W. Dolan, our Chief Financial and Operating Officer, who had worked closely with the firm that had produced the initial fairness opinion, by supplying them with the financial information and other data required for them to fully complete their analysis from their opinion on the fairness of the share price used in the Management Equity/Conversion Transaction. Based on their substantial experience with the process of preparing the assumptions and analysis that went into the fairness opinion, the Special Committee concluded that they could rely on the study prepared by Messrs. Kretzmer and Dolan. See the discussion below under Financial Analysis Performed by Management.

On December 1, 2004, the Special Committee approved a price to be paid in lieu of issuing fractional shares in connection with the reverse stock split. Each of the Special Committee members reviewed the information set forth below under Financial Analysis and Summary of Factors Reviewed to Determine \$0.17 Per Share Fractional Share Purchase Price . The Special Committee, by written consent dated as of December 2, 2004, approved a 1-for-150 reverse split of our common stock, with \$0.17 per share to be paid in cash in lieu of issuing fractional shares. The selected split ratio was a result of calculations intended to determine how many stockholders needed to be cashed out to achieve our goal of going private.

On December 2, 2004 the Special Committee presented its findings to our Board of Directors at a special meeting of the Board. The Special Committee found that the purpose of the reverse stock split was to reduce the number of our stockholders below 300, thereby positioning us to terminate our public reporting and continue future operations as a private company and relieving us of the substantial costs, administrative burdens and competitive disadvantages associated with operating as a public company. The Special Committee further reported that the advantages of the reverse stock split to the unaffiliated stockholders (both those being cashed out and those remaining as stockholders after the reverse stock split) outweighed the disadvantages, and that it was substantively and procedurally fair, and therefore, in the best interests of our company and our unaffiliated stockholders. The Special Committee found that for those smaller unaffiliated stockholders holding less than 150 shares who would be cashed out, that the price paid to them exceeded what they would receive in an open market sale after deducting commissions. For those unaffiliated stockholders holding more than 150 shares who would remain as stockholders after the reverse stock split, the Special Committee found that although they would experience a reduction in liquidity of their shares, the value of their shares may increase as a result of our anticipated reduced annual general and administrative expenses associated with being a non-reporting entity.

At the December 2, 2004 special meeting, our Board of Directors reviewed the Special Committee's presentation and the internal company study of the reverse stock split and pricing analysis. Our Board of Directors asked questions and received answers regarding the reverse stock split from the Special Committee and representatives of senior management. The Special Committee advised our Board of Directors that it had approved the reverse stock split, and recommended that our Board of Directors approve the reverse stock split. After extensive consideration and discussion, at this special meeting our Board of Directors (with Richard S. Ressler, our Chairman, recusing himself because he is the controlling shareholder of Orchard Capital Corporation, the managing member of the Investor Group), then adopted the Special Committee's recommendation regarding the reverse stock split based on the Special Committee's determination that the reverse stock split was fair and in the best interests of our company and our unaffiliated stockholders (both those being cashed out and those remaining as stockholders after the reverse stock split).

On September 23, 2005, both our Special Committee and our Board of Directors met to receive an updated report from management on the reverse stock split. At this meeting the Board of Directors also received the recommendation of the Special Committee reaffirming the reverse stock split and all of their prior findings and confirmed that the transaction was still substantively and procedurally fair and in the best interests of all of the shareholders. At this time the Board of Director (with Richard S. Ressler again recusing himself) voted to reaffirm the implementation of the reverse stock split.

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

### *Fairness Determination by Certain Members of the Investor Group and Filing Persons*

Certain of the members of the Investor Group and those individuals or entities deemed filing persons for purposes of Schedule 13E-3 have adopted the findings of our Special Committee and Board of Directors regarding the material factors upon which it was determined that the reverse stock split was fair to our unaffiliated stockholders. Specifically, Richard S. Ressler, Orchard Capital Corporation, James W. Dolan, W. Brian Kretzmer, HIS Holding, LLC have stated their belief as to the fairness of the proposed transaction to unaffiliated stockholders, both those who will be cashed out by the reverse stock split and those who will remain as stockholders after the reverse split, based upon their ratification of the analysis and conclusions of our Special Committee and Board as to the reverse stock split. There are potential conflicts of interest between the Investor Group and our unaffiliated shareholders. For example, the reverse stock split will increase the percentage ownership interest of the Investor Group in our common stock. In addition, the reverse stock split will reduce the liquidity of our common stock, which may have a greater impact on our unaffiliated stockholders than on the Investor Group. See Procedural Factors Disfavoring the Reverse Stock Split; Interests of our Chairman and Executive Officers in the Reverse Stock Split, page 17.

*Disclosure of Financial Interests of Special Committee Members*



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

As of September 23, 2005, the Special Committee members each held options to purchase 12,500 shares of common stock and each was the beneficial owner of 37,500 shares of common stock. Mr. Ross is employed by (but not an executive officer of) CIM Group, an affiliate of our company.

### *Financial Analysis and Summary of Factors Reviewed to Determine \$0.17 Per Share Fractional Share Purchase Price*

In determining the price to be paid in lieu of issuing fractional shares, the Special Committee considered, among other things, the historical market price for our common stock for the 30-, 60-, and 90-day periods prior to December 1, 2004 and the closing trading price on September 23, 2005. As discussed below, the Special Committee also considered our going concern value (which includes earnings value and discounted cash flow value) net asset value (liquidation value) and net book value in reviewing the fairness of the price being offered to unaffiliated stockholders. In determining the \$0.17 per share price to be paid for fractional shares, substantial weight (80%) was given to the historical market price analysis. Of the remaining 20%, 15% weight was given to the net asset value (liquidation value) analysis and net book value analysis, in the aggregate, the remaining 5% weight was given to the earnings value (earnings times an appropriate multiplier) analysis and the discounted cash flow (net present value of projected cash flows) analysis, in the aggregate, with most of the 5% weight given to the earnings value analysis. Management also put substantial weight on the fact that on September 22, 2004, our shareholders approved the conversion of over \$3 million of indebtedness and the private placement of \$1 million by the Investor Group at \$0.10 per share. Although management determined that the payment of a purchase price of \$0.10 per share in lieu of issuing fractional shares in connection with the reverse stock split was fair, we intend to pay a purchase price of \$0.17 per share, representing a premium of \$0.07 per share (70%) over the fair value as determined by management below. In determining this premium, we considered, among other things, that the weighted average closing prices of our common stock for the 30-, 60- and 90-day periods preceding December 1, 2004 and the closing trading price on September 23, 2005 were approximately \$0.153, \$0.154, \$0.159 and \$0.055 per share, respectively. We also considered that the fractional shares that would otherwise be issued in the reverse stock split would aggregate to approximately 139,000 pre-split whole shares of common stock, resulting in cash payments to cashed-out stockholders of approximately \$24,000 based on the \$0.17 per share price. This cash total represents only an additional aggregate \$10,000 above the cash payments that would be calculated based on management's estimated fair value of our common stock of \$0.10 per share, which amount is not material to us.

### *Financial Analysis Performed by Management*

The following paragraphs summarize the financial analyses performed by management as of November 29, 2004 to assist the Special Committee and our Board of Directors in determining the price to be paid in lieu of issuing fractional shares in the reverse stock split. Management recommended to the Special Committee a fractional share price of \$0.10 per share.

Management reviewed the information, data and methodology used by the firm that had issued the fairness opinion that was included in our 2004 proxy statement relating to the valuation of our common stock in connection Management Equity/Conversion Transaction at \$0.10 per share. Management updated the analysis based on current information and data. Management's update indicated that there were no material changes in the analysis that would alter the basis for a valuation of \$0.10 per share. Accordingly, management concluded that the \$0.10 per share valuation is fair to our unaffiliated stockholders.

In arriving at its recommendation, management relied on both financial and other information and assured the Special Committee that it was not aware of any facts or circumstances that would make any such information inaccurate or misleading. With respect to the preliminary financial projections utilized, management assumed that those projections were reasonable based on the best currently available estimates and judgments, and that those projections provide a reasonable basis upon which it could form a recommendation. Management also assumed that the reverse stock split would be consummated substantially in accordance with the terms as generally set forth in this information statement.

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Management's recommendation is based upon market, economic and other conditions as they existed on, and could be evaluated as of, the date of their analyses. The estimates contained in management's analyses and the ranges of valuations resulting from any particular analysis are not necessarily indicative of actual values or future results, which may be significantly more or less favorable than those suggested by such analyses. In addition, analyses relating to the value of businesses or securities do not necessarily purport to be appraisals or to reflect the prices at which businesses or securities actually may be sold. Accordingly, management's analyses and estimates are inherently subject to uncertainty.

Management presented six material factors in its financial analyses supporting its recommendation:

historical market price of our common stock;

our going concern value, which included:

earnings value (earnings times an appropriate multiplier); and

discounted cash flow (net present value of projected cash flows);

net asset value (liquidation value); and

net book value.

Each of these factors was analyzed in comparison with similar companies to ours and similar transactions to the reverse stock split transaction and is summarized below.

**Historical Market Price Analysis.** Management utilized a historical stock price analysis to review and compare our stock performance to the price recommended in the reverse stock split. In addition, management reviewed the liquidity of our shares in the public trading markets and the daily closing market price and trading volume of our shares for various periods ended November 30, 2004 and as of September 23, 2005. While the 30-, 60- and 90-day average price of \$0.153, \$0.156 and \$0.163 per share, respectively, were higher than the consideration price recommended by management of \$0.10 per share, management concluded that trading of our stock on the OTC Bulletin Board may not reflect the fair price of the stock because of the thin trading market, wide bid-ask spread, the stock dilution from the recent Management Equity/Conversion Transaction that was approved by our stockholders on September 22, 2004 and resulted in the issuance on November 1, 2004 of approximately 43,172,000 shares of our common stock, and high historical volatility of our stock price. Additionally, the average daily trading volume of our common stock for the three- and twelve-month periods prior to November 30, 2004 were approximately 14,000 and 15,000 shares, respectively, and approximately 2,000 shares for the month of August 2005. As there has not been a market for large share transactions in our common stock, any large transaction may result in significantly lower trading prices than the historical prices noted above.

**Going Concern Value.** Management reviewed projections that assume that we are a going concern based upon the current status of our business. Management analyzed the reasonableness of the projections based upon historical performance, current financial conditions and industry comparisons. Management was then able to arrive at a going concern value based on the earnings value (total invested capital) and discounted cash flow value discussed below.

**Earnings Value.** Management reviewed our historical revenues and earnings before interest, taxes, depreciation and amortization ( EBITDA ) and compared these figures to the total invested capital value (market capitalization plus debt) of \$13.0 million that is implied by using a share price of \$0.153, which represents the weighted average daily closing market price of our common stock for the 30-day period ended November 30, 2004. The implied multiples for the ratio of total invested capital to revenues for 2003 and for the average of the five years ending December 31, 2003, were 0.7 and 0.5, respectively. The implied multiples for the ratio of total invested capital to EBITDA for 2003 and for the average of the five years ending December 31, 2003 were 5.1 and 9.4, respectively. Management then compared these implied multiples for us to those publicly traded companies operating in the software and IT consulting industries. Factors considered in this analysis included our size in terms of revenues and assets, declining revenues and profitability, financial distress in terms of negative working capital and non-compliance with debt covenants, the absence of highly comparable public companies, and the fact that we are in a highly competitive software and IT consulting industry. Based on these factors, we used the same screening criteria and publicly traded companies as used by the firm that opined on the fairness of the price of our common stock for purposes of the Management Equity/Conversion Transaction for comparable software and IT companies having a debt-to-equity ratio greater than 80%. Several of the comparable companies also had negative EBITDA. The publicly traded comparable software and IT technology companies identified included eight companies: Anacomp Inc., Brightstar Information Technology Group Inc., Datatec Systems Inc., Datec Group Ltd., ePlus Inc., Internet Initiative Japan Inc., Sapiens International Corp, USDATA Corp. We then calculated the multiples for the ratio of total invested capital to revenues and EBITDA for these eight comparable companies. The multiples for the ratio of total invested capital to revenues for these comparable companies averaged 0.93 to 1. The multiples for the ratio of total invested capital to EBITDA for these comparable companies averaged 14.4 to 1. At \$0.10 per share, our ratios were 0.69 to 1 and 13.7 to 1, respectively, which are comparable to the aforementioned comparable company ratios. Although little weight was put on this analysis, the reverse stock split consideration price of \$0.10 per share was determined to be fair under this analysis.



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Following is a table that reconciles our historical earnings to EBITDA for each of the last five fiscal years used for purposes of the aforementioned analysis:

	1999		2000		2001		2002		2003	
Income (loss) from continuing operations before income taxes	\$	(11,993)	\$	1,606	\$	3,833	\$	447	\$	42
Depreciation and amortization	\$	2,208	\$	1,489	\$	1,452	\$	819	\$	512
EBITDA	\$	(9,785)	\$	3,095	\$	5,285	\$	1,266	\$	554

**Discounted Cash Flow Value.** Based upon forecasts and after review of historical performance, current financial conditions, industry outlook, competitive market landscape, and other analyses, management developed projected cash flows that it deemed reasonable and valid at the time of valuation. The projected cash flows incorporated various assumptions, including, but not limited to, net sales growth, profit margins, income taxes, depreciation, capital expenditures, and working capital levels, all of which are critical to the development of projected cash flows. These projected cash flows were then discounted at a weighted cost of capital of 20% as calculated using the capital asset pricing model. Management believed that the discount rate of 20% was appropriate for us and our industry.

The following assumptions were utilized to determine our discounted cash flow value (see our historical financial information included in **Appendix C** which should be read in conjunction with these assumptions which are based upon such historical results):

### **Overall:**

Management did not foresee any material change in the business environment or substantial change in our operations. The present business model was expected to continue and for that reason management believed our projections represent performance consistent with the last three years. There will be some cautious growth as new products are introduced. A full hospitality industry recovery was not expected yet and, therefore, the overall market conditions will not materially change. Management therefore did not anticipate any material gain in market share

### **Revenue:**

Revenue in a continuingly uncertain industry is expected to grow only slightly at a rate of 6.4% per year over the period. Although our revenues have decreased at an average rate of approximately 14% per year from 1999 to 2003, management believed this forecasted growth to be reasonable and achievable. Management believed this forecasted growth was reflective of our market position, industry challenges and the overall expected acceptance of our new products. Management believed that during the initial 24 months of selling the new products, we will be successful, but will be limited by our capacity to install. We will therefore be selective in the acquisition of new business to ensure our success and profitability. This assumption reflects our belief that the life cycle for our new products is 5 to 10 years and that the new products will carry us through 2010.

### **Operating Expenses:**

Management expects that operating expenses will increase at a rate of approximately 3.5% over the period reflecting our recently demonstrated ability to manage costs from 2000-2004. In 2005, development expenses shall increase as our previous new products become available for general release in 2005. Selling general and administrative efforts will slightly increase as we bring the new products to market and we gain

momentum in 2006 and beyond as we expect revenues to increase at a rate of 6.45% per year.

**Gross Margins:**

Management anticipates the overall gross margins percentage of revenue to be sustainable around 70%, excluding amortization of any intangible assets to cost of sales (see financial statements at **Appendix C**). Our direct costs are well understood and tightly controlled and we are not subject to major changes in our business model.

Our discounted cash flow value was calculated to be approximately \$8.7 million. Subtracting our debt of approximately \$7.7 million results in approximately \$1 million of value to the stockholders, or about \$0.02 per share (\$1 million divided by 57.8 million shares outstanding). Based upon this analysis, the reverse stock split consideration price of \$0.10 per share was determined to be fair to our unaffiliated stockholders.

**Net Asset Value (Liquidation Value).** Management concluded that our total debt may approximate or exceed any asset value upon liquidation, leaving little if any value to equity holders in liquidation. Based upon this determination, the fractional share price of \$0.10 per share may be greater than our net asset value.

**Net Book Value.** Management determined that in valuing us on a net book value, we have a negative book value, and therefore, the value represented by the recommended fractional share price of \$0.10 per share was significantly greater than the net book value of our company.

**Conclusion.** Based upon its review of these and other factors, management concluded that as of the date of its analyses, the recommended price of \$0.10 per share to be paid in lieu of issuing fractional shares in connection with the reverse stock split was fair from a financial point of view to the unaffiliated stockholders. While the foregoing summary describes the material analyses and factors reviewed by management, it does not purport to be a complete description of the presentations by management to the Special Committee or the analyses performed by management in arriving at its conclusion. The preparation of this analysis is a complex process and is not necessarily susceptible to partial analysis or summary description. Management believes that its analyses must be considered as a whole and that selecting portions of its analyses and of the factors considered by it, without considering all analyses and factors, could create a misleading view of the processes underlying the recommendation. As noted above, management's recommendation was most heavily weighted (80%) on the historical market price analysis as the trading price of our stock is the most objective analysis to rely upon. Of the remaining 20%, 15% weight was given to the net asset value (liquidation value) analysis and net book value analysis, in the aggregate. The remaining 5% weight was given to the our earnings value (earnings times an appropriate multiplier) analysis and discounted cash flow (net present value of projected cash flows) analysis, in the aggregate, with most of the 5% weight given to our earnings value analysis, as certain of the various assumptions used in the discounted cash flow analysis are subjective in nature and, accordingly, less reliable than calculations using historical or market trading data. As certain assumptions are more or less probable than other assumptions, the range of valuations resulting from certain of these lesser weighted analysis described above should not be taken to be management's view of our actual value. In performing these other analyses, management made numerous assumptions with respect to industry performance, general business and economic conditions and other matters, many of which are beyond our control. Management also put substantial weight on the fact that on September 22, 2004, our stockholders approved the conversion of over \$3 million of indebtedness and the private placement of \$1 million by the Investor Group at \$0.10 per share. The analyses performed by management are not necessarily indicative of actual values or actual future results, which may be significantly more or less favorable than suggested by such analyses. The analyses performed were prepared solely as part of management's analysis of the fairness, from a financial point of view, of management's recommended price per share to be paid in lieu of issuing fractional shares in connection with the reverse stock split, and were provided to the Special Committee solely in connection with the delivery of the management recommendation.

### Special Factors Considered in Approving **the Reverse Stock Split**



*Purpose of the Reverse Stock Split*

The purpose of the reverse stock split is to position us to terminate our public reporting and enable us to continue future operations as a private company, thereby relieving us of the costs, administrative burdens and competitive disadvantages associated with operating as a public company. We intend to accomplish this purpose by reducing the number of holders of record of our common stock to fewer than 300 by cashing out the fractional shares that would otherwise result from the reverse stock split.

*Background of the Reverse Stock Split; Alternatives Considered by the Special Committee and the Board of Directors*

Faced by a continuing lack of interest from public market investors and the need to increase our working capital and reduce our administrative expenses, we determined that maintaining our public company status came at a significant cost to us with no significant benefit. We determined that terminating our public reporting would result in substantial cost savings and better competitive positioning, which would help us maximize stockholder value. In order to terminate our public reporting, we must reduce the number of record holders of our common stock to fewer than 300.

The Special Committee and our Board of Directors reviewed several alternatives for reducing our number of record holders. The first alternative involved a tender offer. In a tender offer, publicly held shares are purchased directly from a company's stockholders. The proponent of the transaction approaches the target company to consider the proposal. When the two sides reach an agreement, the acquiror sends the stockholders a written offering document, the offer to purchase, which contains disclosures required by Commission rules, and a letter of transmittal, which stockholders may use to tender their shares. The target company issues a press release announcing, among other things, that the company recommends that stockholders accept the offer and tender their shares. Tender offers are commonly conditioned on the acquiror holding at least 90% of each class of stock of the company following the closing of the offer, which provides the acquiror with the ability to complete a short-form merger without holding a meeting of stockholders or soliciting proxies. In a short-form merger, the shares that were not tendered are typically converted into the right to receive the same consideration that was paid to the

tendering stockholders or the right to assert appraisal rights. At the conclusion of the short-form merger, the target company typically has one stockholder, a subsidiary of the acquiror.

The second alternative considered was a merger with a third party. A common form is a reverse triangular merger in which an entity formed by the acquiror merges with and into the target company, which survives the merger. As a result of the merger, the outstanding shares of the target company's stock, other than shares owned by the acquiror, are converted into the right to receive the merger consideration. The merger consideration is the cash paid to the stockholders of the target corporation. A merger typically leaves the surviving company with one stockholder, a subsidiary of the acquiror.

The final alternative considered was the reverse stock split. We have made repeated attempts over a significant period of time to merge our company with a variety of other companies and have been unsuccessful in our attempts to do so on acceptable terms. Additionally, we believe that a tender offer would fail to achieve the desired results because we have a significant number of stockholders who own a small number of shares. As of the Approval Record Date, we had approximately 577 stockholders of record, including approximately 69 owning fewer than five shares, approximately 291 owning fewer than 100 shares, and approximately 328 owning fewer than 150 shares.

Because the results of a reverse stock split are more predictable and automatic, our Board of Directors believes that the reverse stock split is the most expeditious and economical way of reducing the number of holders of record to fewer than 300 and positioning us to effect the termination of our public reporting. As a result, on December 2, 2004, and reaffirmed on September 23, 2005, our Board of Directors (with Richard S. Ressler recusing himself because he is the controlling shareholder of Orchard Capital Corporation, Managing Member of the Investor Group), approved a 1-for-150 reverse stock split of our common stock, subject to stockholder approval. The selected split ratio was a result of calculations intended to determine how many record holders needed to be cashed out to achieve our goal of going private.

#### **Reasons for the Reverse Stock Split**



*Cost Savings*

We incur direct and indirect costs associated with our status as a public company. Among the most significant are the costs associated with compliance with the public reporting obligations imposed by the Commission, which have been greatly increased as a result of the Sarbanes-Oxley Act of 2002. Many of the requirements of this legislation are only now being felt by our company as a result of the phase-in schedule for smaller public companies. The timing of the reverse stock split relates to the expenses of operating for another year as a public reporting company, as a large portion of these expenses are incurred at the beginning of the fiscal year. Direct costs associated with compliance with the Commission's public reporting requirements include, but are not limited to auditing fees, legal fees, financial printer fees and miscellaneous clerical and other administrative expenses, such as word processing, conversion to EDGAR, telephone and fax charges associated with the preparation and filing of periodic reports, proxy materials and other reports and statements with the Commission.

Based on our experience in prior years, our direct costs of complying with the Commission's public reporting requirements are estimated to approximate \$600,000 annually, based on estimated annual audit and accounting fees of \$80,000, estimated annual legal fees of \$40,000, estimated financial printer fees of \$45,000, estimated transfer agent fees of \$35,000, estimated costs associated with filing reports with the Commission (including internal administrative staff) of \$50,000, estimated costs for directors' and officers' insurance of \$150,000, estimated ongoing costs associated with Sarbanes-Oxley compliance of \$140,000 (estimated at \$250,000 in 2005) and estimated miscellaneous costs of \$60,000. Indirect costs associated with compliance with our public reporting obligations include, among other things, the time our executive officers expend to prepare and review our periodic reports. Because we have only a few executive personnel, these indirect costs are substantial. Due to additional regulations and compliance procedures required of public companies under the Sarbanes-Oxley Act of 2002, we expect that the direct and indirect costs identified above will increase in the future.

The cost of administering each registered stockholder's account is the same regardless of the number of shares held in that account. As of the Approval Record Date, our common stock was held of record by approximately 577 stockholders, and approximately 328 stockholders of record held fewer than 150 shares, representing approximately 57% of the total number of holders of record of our Common stock. These accounts holding fewer than 150 shares represented approximately 2% of the total number of outstanding shares of our common stock. Assuming that the reverse stock split does not occur, the estimated cost relating to our public reporting for each stockholder account, will be approximately \$1,040 in 2005.

Our Board of Directors considered the cost to us of continuing to file periodic reports with the Commission and complying with the proxy and annual report requirements under the Exchange Act compared to the benefits to us and our stockholders of continuing to operate as a public company. Under the circumstances, our Board of Directors determined that the benefits that we and our stockholders would typically expect to derive from our status as a public company are not being



realized and are not likely to be realized in the foreseeable future. As a result, our Board of Directors concluded that the elimination of the costs of complying with our public reporting obligations outweighed the benefits of continuing to incur such costs. We are, therefore, undertaking the reverse stock split at this time to save us the substantial costs, which we expect to increase over time, and resources required to comply with the public reporting and other obligations associated with operating as a public company. However, the actual savings to be realized from terminating our public reporting may be higher or lower than our estimates.

#### *Lack of Capital from Public Markets*

We have been unable to take advantage of the capital available through the public markets due to our historically low stock price. Further, our Board of Directors does not presently intend to raise capital through sales of our securities in a public offering or to acquire other business entities using our common stock as the consideration for the acquisition. Accordingly, we have not, and are not likely to make use of, or benefit from, the advantages generally associated with operating as a public company.

#### *Competitive Disadvantage*

As a public company, we are required to make certain disclosures in connection with our public reporting. Those public disclosures can place us at a competitive disadvantage by providing our non-public competitors with strategic information about our business, operations and results while not having access to similar information about those competitors.

In light of our limited size and resources, competitive disadvantages related to our public reporting obligations and our lack of intent to raise capital through a public offering or effect acquisitions using our stock, our Board of Directors does not believe the costs associated with maintaining our public reporting and maintaining our stockholder accounts with less than 150 shares are justified. Our Board of Directors believes that it is in the best interests of us and our stockholders as a whole to eliminate the administrative burden and costs associated with maintaining our public reporting and maintaining stockholder accounts of fewer than 150 shares.

### **Substantive and Procedural Factors Considered by the Special Committee and Our Board of Directors as to the Fairness of the Reverse Stock Split**

Our Special Committee and Board of Directors have analyzed the reverse stock split and its anticipated effects on our stockholders and have deemed the reverse stock split and related termination of our public reporting to be substantively and procedurally fair to, and in the best interests of, our affiliated and unaffiliated stockholders, whether they are cashed out or remain as stockholders following the reverse stock split. In reaching this conclusion, our Special Committee and Board of Directors also considered, in no particular order and without preference, the factors described below.

#### **Procedural Factors Favoring the Reverse Stock Split**



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

### *The Reverse Stock Split Provides Certain Smaller Stockholders with Liquidity*

Many of our stockholders hold small positions of less than 150 shares which cannot be cost effectively sold because the brokerage commission in an open market transaction would eliminate most or all of the proceeds to the stockholder. The reverse stock split will provide stockholders who hold fewer than 150 shares at the effective time the opportunity to liquidate their investment in us by not being required to pay a brokerage commission.

### *The Reverse Stock Split Includes the Opportunity to Remain a Stockholder of our Company*

Prior to the effective time, a current holder of fewer than 150 shares of our common stock may elect to remain a stockholder of our company by acquiring sufficient shares so that they hold at least 150 shares in their account immediately prior to the effective time. Our Board of Directors considers the structure of the reverse stock split to be fair to all unaffiliated stockholders because it allows them to control the decision of whether to remain a stockholder of our company following the reverse stock split or to receive the cash consideration offered in connection with the reverse stock split.

### *No Unusual Conditions to the Reverse Stock Split*

Our Board of Directors also considered the likelihood that the reverse stock split would be implemented. In this regard, it considered that there are no unusual requirements or conditions to the reverse stock split, and that we have the financial resources to implement the reverse stock split expeditiously.

*The Reverse Stock Split Ratio was Calculated Without Bias Toward Any Particular Group of Stockholders and Will Apply Equally to All Shares of our Common Stock*

The purpose of the reverse stock split is to reduce the number of record holders to fewer than 300 so that we can file to terminate our public reporting and continue future operations as a private company. The split ratio is a result of calculations that were intended to determine how many stockholders needed to be cashed out in order to reduce the number of record holders to fewer than 300. Our Board of Directors feels the current ratio of 1-for-150 is fair because it was calculated without bias toward any one group of stockholders. The ratio will be applied equally to all shares of our common stock.

### **Procedural Factors Disfavoring the Reverse Stock Split; Interests of our Chairman and Executive Officers in the Reverse Stock Split**

*The Reverse Stock Split Was Approved by our Affiliated Stockholders Without a Vote by Unaffiliated Stockholders*

The Investor Group, comprised principally of certain of our officers and directors, recently acquired a 85.09% controlling interest in our Company in September 2004. Based upon this controlling interest, this affiliated stockholder now holds sufficient shares of our common stock to approve the reverse stock split without securing the approval of our other affiliated or unaffiliated stockholders. Nevertheless, our Board of Directors believe that this potential conflict is outweighed by the substantive features and procedural safeguards of the reverse stock split, including the equal application of the reverse stock split to all shares of our common stock, the fact that all unaffiliated stockholders will have the option to remain stockholders of our company (by purchasing additional shares prior to the effective time), and the fairness of the price offered to all stockholders.

*The Special Committee and Our Board of Directors Did Not Obtain a Fairness Report*

The Special Committee and our Board of Directors did not obtain a fairness report, opinion, appraisal or other independent assessment on behalf of the unaffiliated stockholders because the reverse stock split is structured in such a way that it will apply equally to both affiliated and unaffiliated stockholders. Additionally, our Special Committee did not retain an unaffiliated representative to act solely on behalf of unaffiliated stockholders for purposes of negotiating the terms of the reverse stock split. Instead, the transaction was approved unanimously by our disinterested directors who are not employees of our company, and the Special Committee did an extensive financial review to confirm the fairness of the reverse stock split as discussed above under **Financial Analysis and Summary of Factors Reviewed to Determine \$0.17 Per Share Fractional Share Purchase Price** and **Financial Analysis Performed by Management**.

Our decision to not secure a third-party fairness report could result in unfairness to unaffiliated stockholders. Unaffiliated stockholders will have their shares bought out at a price that has been determined to be fair by our Special Committee and Board of Directors based upon a study prepared by our senior management whose ownership stake in the company will be increased by a minimal amount as a result of the reverse stock split.

. While all of our affiliated stockholders will remain stockholders of our company following the reverse stock split by virtue of the size of their holdings, unaffiliated stockholders will have the same opportunity if they so choose (by purchasing additional shares prior to the effective time

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

of the reverse split). In light of this equal treatment, the Special Committee and our Board of Directors concluded that the expense associated with obtaining a fairness opinion was not justified.

*As a Result of the Reverse Stock Split, Stockholders Who Own More than 150 Shares, Such as Members of the Investor Group, Will Increase Their Percentage Ownership Interest in Our Company*

Based on information and estimates of record ownership of shares of common stock as of the Approval Record Date, the beneficial ownership percentage of our executive officers and directors, including vested options, will increase from 80.75% to 80.94% as a result of the reverse stock split. The beneficial ownership percentage of the Investor Group will increase from 85.09% to 85.30%, as a result of the reduction by an estimated 139,000 pre-split whole shares in the number of shares of our common stock outstanding due to the payment of cash in lieu of issuance of fractional shares. The ownership of individual investors within the Investor Group will increase by no more than 0.2% each as a result of the Reverse Stock Split.

## **Substantive Factors Favoring the Reverse Stock Split**

### *Direct and Indirect Cost Savings*

As discussed above under *Reasons for the Reverse Stock Split - Cost Savings*, we incur direct and indirect costs associated with our status as a public company. Among the most significant are the costs associated with compliance with the public reporting imposed by the Commission. We estimate that we will save approximately \$600,000 annually in direct general and administrative costs by being a private company. We also believe that because of the Sarbanes-Oxley Act, such direct costs would increase in the future. Additionally, the indirect cost to our company in terms of senior management time spent on complying with the public reporting will also be saved.

### *The Reverse Stock Split Offers Stockholders the Opportunity to Receive Cash at a Premium In Lieu of Fractional Shares*

Our Board of Directors considered several methods for valuing our common stock to determine the \$0.17 price per share to be paid to stockholders in lieu of issuing fractional shares of our common stock as a result of the reverse stock split. The cash consideration to be paid to holders of fractional shares represents a premium of approximately 11%, 10% and 7% over the weighted average closing trading price of the common stock over the 30-, 60- and 90-day periods, respectively, prior to the announcement of the reverse stock split and a premium of 209% over the closing trading price of \$0.055 on September 23, 2005.

## **Substantive Factors Disfavoring the Reverse Stock Split**



*Cessation of Public Sale Opportunities*

We intend to apply to terminate our public reporting following the reverse stock split. As a result, stockholders may no longer have the alternative of selling their shares of our common stock in the public market, and there may be no effective trading market for our common stock. Any stockholder desiring to sell his or her shares may have a difficult time finding a buyer. This illiquidity may reduce the price a buyer is willing to pay for shares of our common stock. We anticipate that the public market for shares of our common stock will be substantially reduced or eliminated altogether. Following the reverse stock split, our common stock will not qualify to be traded on any automated quotation system operated by a national securities association and will no longer be traded on the OTC Bulletin Board. Our common stock may be eligible to trade in the Pink Sheets, however we have no present plans to apply for our common stock to be traded in the Pink Sheets. For this reason, stockholders will experience a loss of liquidity after the reverse stock split and may be required to hold their shares of common stock for an indefinite period of time. We do not have any present plans to sell our assets or enter into any other transaction that would provide liquidity for the shares. However, we may explore from time to time various methods to provide liquidity to stockholders, including a sale or merger of our company or its assets.

Because only approximately 14,000 shares per day, on average, of our common stock have been traded over the three months ended December 8, 2004, the current public market is somewhat illiquid based upon the light trading volume. Larger shareholders may be required to liquidate their positions in our common stock over a period of several trading days. Our Board of Directors believes, however that the further loss of liquidity caused by the reverse stock split will be outweighed by the benefits of terminating our public reporting.

*Cessation of Publicly Available Information*

Upon terminating our public reporting, we will no longer file, among other things, annual or quarterly reports with the Commission. Updated information regarding our business, results of operations and financial condition like the information that is currently available to the general public and our investors will not be available once we terminate our public reporting. We intend to explore methods to distribute financial information to our stockholders on a cost-effective basis. Our Board of Directors does not believe this factor makes the transaction unfair to unaffiliated stockholders because any detriment to unaffiliated stockholders that may result from the termination of our public reporting will be offset by the anticipated cost-saving benefits and competitive advantages to us of no longer publicly filing reports with the Commission.

*Inability to Participate in Any Future Increase in the Value of Our Common Stock*

Cashed-out stockholders will have no further equity interest in us with respect to their cashed out shares. Accordingly, they will no longer have the opportunity to participate in the potential upside of any increase in the value of our common stock. Our Board of Directors determined that this factor does not make the transaction unfair to unaffiliated stockholders because unaffiliated stockholders who desire to hold shares of our common stock after the reverse stock split can do so by acquiring sufficient shares so that they hold at least 150 shares in their account immediately prior to the effective time.



### **Effects of the Reverse Stock Split on Stockholders Who Hold Fewer than 150 Shares of Common stock in a Single Account**

When the reverse stock split is effected, stockholders holding fewer than 150 shares of our common stock in a single account immediately prior to the effective time will not receive a fractional share of our common stock as a result of the reverse stock split, but rather will receive cash consideration. Given the historical illiquidity of our common stock, we believe the structure of the reverse stock split benefits the cashed-out stockholders. Among the potential detriments of the reverse stock split is the fact that after the reverse stock split, cashed-out stockholders will have no further ownership interest in the company, and will no longer be entitled to vote as a stockholder or share in our future assets, earnings, or profits. The cashed-out stockholder's only right will be to receive cash in lieu of the issuance to them of fractional shares of common stock.

All cash consideration amounts owed to the cashed-out stockholders as a result of the reverse stock split will be subject to applicable federal and state income taxes and state-abandoned property, or escheat, laws. Additional details regarding the federal tax consequences are described later in this information statement under the heading **Certain Material Federal Income Tax Consequences**. Additional details regarding state-abandoned property, or escheat, laws are described later in this information statement under the heading **Escheat Laws**.

As soon as practical after the consummation of the reverse stock split, we or our exchange agent will mail a letter of transmittal to each stockholder. The letter of transmittal will contain instructions for the surrender of stock certificates to our exchange agent in exchange for the payment of the cash consideration. No cash payment will be made to any cashed-out stockholder until the stockholder has surrendered his or her outstanding certificates, together with the completed letter of transmittal, to our exchange agent. For more detailed information, see **Stock Certificates**. After the reverse stock split, stockholders will have no rights as stockholders with respect to the pre-split shares of common stock or the fractional shares that would have resulted from the reverse stock split, whether or not those stockholders have been paid cash consideration.

### **Effects of the Reverse Stock Split on Stockholders Who Hold More Than 150 Shares of our Common Stock in a Single Account**

When the reverse stock split is effected, stockholders with 150 or more shares of our common stock in a single account immediately prior to the effective time will:

as of the effective time, have their shares of common stock converted into post-split common stock and receive one new share of common stock for every 150 shares of pre-split common stock in their account; and

receive cash consideration in lieu of fractional shares that would otherwise be issued to them as a result of the reverse stock split.

The remaining stockholders will benefit from having the opportunity to share in our future successes, if any. However, the remaining stockholders will not have the option to liquidate all of their shares like the cashed-out stockholders. Further, once we are private, it will be even more difficult to value, and therefore, sell their shares of common stock if they so desire.

**Procedure for Stockholders Who Hold Shares in Street Name**



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Stockholders who hold our shares in street name will be contacted by their broker or other institutional manager and receive from them a copy of our exchange agent's transmittal letter and instructions for surrendering their stock certificates in exchange for either cash consideration (if they hold fewer than 150 shares), or cash consideration and new stock certificates (if they hold more than 150 shares). They will transmit their instructions to their representative, who in turn will electronically transmit their shares to our exchange agent.

### **General Examples of Potential Effects of the Reverse Stock Split**

In general, the results of the reverse stock split can be illustrated by the following examples:

**Hypothetical Scenario No. 1.** Stockholder A is a registered stockholder who holds 100 shares of our common stock in her record account at the effective time. Instead of receiving a fractional share of our common stock immediately after the reverse stock split, Stockholder A's 100 shares will be converted into the right to receive \$17.00 (100 x \$0.17). Alternatively, if Stockholder A wants to continue her investment in our company, she can buy at least 50 more shares of our common stock and hold the shares in her record account, so long as the purchase is complete before the effective time.

**Hypothetical Scenario No. 2.** Stockholder B has two separate record accounts. As of the effective time, he holds 100 shares of our common stock in one account and 50 shares of our common stock in the other. All of his shares are registered in his name only. Stockholder B will be entitled to receive cash payments equal to the number of shares of our common stock that he holds in each record account, instead of receiving fractional shares following the reverse stock split. Stockholder B would receive two checks totaling \$25.50 ( $100 \times \$0.17 = \$17.00$ ;  $50 \times \$0.17 = \$8.50$ ;  $\$17.00 + \$8.50 = \$25.50$ ). Alternatively, if Stockholder B wants to continue his investment in our company, he can consolidate his two accounts prior to the effective time by. In that case, his holdings will not be cashed out in connection with the reverse stock split because he will hold 150 shares of our common stock in one record account, which would convert into one post-split share of our common stock. He would have to act far enough in advance so that the consolidation is complete before the effective time.

**Hypothetical Scenario No. 3.** Stockholder C holds 330 shares of common stock prior to the effective time. After the reverse stock split, Stockholder C will hold in his record account two shares of our common stock ( $330/150 = 2.2$ ) and, instead of receiving a fractional share of our common stock in his record account immediately after the reverse stock split, Stockholder C's unconverted 30 shares will be converted into the right to receive \$5.10 ( $30 \times \$0.17$ ) of cash consideration.

#### **Effect of the Reverse Stock Split on Option Holders**

Upon effectiveness of the reverse stock split, any outstanding options under our 1993 Employee Stock Option Plan and our 1995 Non-Employee Directors Stock Option Plan will have their number of shares and exercise prices adjusted to give effect to the 1-for-150 reverse stock split, with any fractional shares resulting from such adjustment converting to a right to receive \$0.17 in cash per pre-reverse stock split share less the exercise price of such pre-reverse stock split shares subject to exercise of the option. The vesting schedule for the options will remain unchanged. Any authorized but un-issued options under our 1993 Employee Stock Option Plan and our 1995 Non-Employee Directors Stock Option Plan will have the number of shares adjusted to give effect to the 1-for-150 reverse stock split.

#### **Effects of the Reverse Stock Split on Our Company**



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

The reverse stock split is expected to reduce the number of record holders of our common stock and the number of our outstanding shares of common stock. Our Amended and Restated Certificate of Incorporation currently authorizes the issuance of 100,000,000 shares of capital stock consisting of 99,000,000 shares of common stock, \$0.01 par value per share, and 1,000,000 shares of undesignated Preferred Stock. At the effective time, our authorized shares of capital stock will be reduced to 666,667 consisting of 660,000 shares of common stock, \$0.01 par value per share, and 6,667 shares of undesignated Preferred Stock. As of the Approval Record Date, 57,847,862 shares of our common stock and no shares of our undesignated Preferred Stock were outstanding. Fractional shares of common stock that would otherwise result from the reverse stock split will instead be paid in cash. We believe that the reverse stock split will reduce the number of shares of our common stock outstanding of record from 57,847,862 to approximately 385,000, assuming approximately 139,000 shares of pre-split common stock are cashed out.

Our common stock is currently registered under the Exchange Act and, consequently, we are subject to the public reporting requirements of the Exchange Act. We believe the reverse stock split will reduce the number of record holders of common stock from approximately 577 to approximately 250, which will position us to terminate our public reporting and continue future operations as a private company, thereby relieving us of the costs, administrative burdens and competitive disadvantages associated with a operating as a public company.

Based on the aggregate number of record holders of our common stock, and the number of holders of record owning more than 150 shares of our common stock as of the Approval Record Date, we estimate that payments of cash in lieu of the issuance of fractional shares to cashed-out stockholders will total approximately \$24,000 in the aggregate. If stockholders holding less than 150 shares of our common stock purchase sufficient shares of our common stock to remain stockholders following the reverse stock split, then the number of holders of record of our common stock may not be reduced below 300 and we may be ineligible to terminate our public reporting.

We believe the completion of the reverse stock split and the subsequent termination of our public reporting will cause the market for shares of our common stock to be substantially reduced or possibly eliminated. Our common stock is currently traded in the over-the-counter market on the OTC Bulletin Board, which is a quotation service that displays real time quotes, last sales prices and volume information in over-the-counter equity securities. This source of liquidity will no longer be available to our stockholders following the reverse stock split and the termination of our Registration and Reporting Obligations.

Our common stock will continue to have the same \$0.01 par value per share following the consummation of the reverse stock split. In addition, each post-reverse stock split share of our common stock will be entitled to one vote per one whole share.

We have no current plans to issue common stock other than pursuant to our existing Restricted Stock Plan, but we reserve the right to do so at any time and from time to time at such prices and on such terms as our Board of Directors determines to be in our best interests and the best interests of our then stockholders. Our board of directors will take such action, as it deems necessary or appropriate to make equitable adjustments to any outstanding stock options, restricted stock or other rights to acquire our common stock.

We are undertaking the reverse stock split at this time because, among other reasons, we believe that we will save substantial costs associated with compliance with the public reporting. However, our cost saving estimates may be inaccurate, and the actual savings to be realized from terminating our public reporting may be higher or lower than our estimates.

*Conduct of Our Business After the Reverse Stock Split    Future Company Plans*





## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Following the reverse stock split, we will no longer be a public-reporting company, but rather will operate as a private company. We expect our business and operations to continue as they are currently being conducted and, except as disclosed in this information statement, the reverse stock split is not anticipated to materially affect the conduct of our business. We expect to be subject to substantially the same risks and uncertainties after the reverse stock split.

We have no current plans or proposals to effect any extraordinary corporate transaction such as a merger, reorganization, sale or liquidation, to change our Board of Directors or senior management, to change materially our capitalization, or otherwise to effect any material change in our corporate structure of business. Other than actions discussed in this information statement, the Investor Group has no further plans, proposals or arrangements to acquire more shares or otherwise reduce or eliminate the stockholdings of our minority stockholders. However, we may explore from time to time various methods to provide liquidity to stockholders, including a sale or merger of our company or its assets.

We are not aware of any existing voting agreements that would have an impact on our future business plans.

### *Reservation of Right to Abandon the Reverse Stock Split*



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Our Board of Directors retains the right to abandon the reverse stock split, even though approved by our stockholders, if it determines prior to the effective time that the reverse stock split is not then in our best interest or the best interest of our stockholders. Among the circumstances that might cause our Board of Directors to abandon the reverse stock split is the development of a significant risk of the reverse stock split failing to achieve the overall goal of reducing the number of record holders to fewer than 300, or where the expense of cashing out the stockholders with fewer than 150 shares becomes so high that the transaction become financially prohibitive. If the reverse stock split is not implemented, then we will be unable to terminate our public reporting until we have fewer than 300 holders of record of common stock and satisfy certain other requirements of the Commission.

### *Escheat Laws*



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

The unclaimed property and escheat laws of various states provide that under circumstances defined in those states' statutes, holders of unclaimed or abandoned property must surrender that property to the state. Persons whose shares are eliminated and whose addresses are unknown to us, or who do not return their stock certificates and request payment therefore, generally will have a fixed period of years from the effective time in which to claim the cash payment payable to them. For example, with respect to stockholders whose last known addresses are in California (as shown by our records), the period is three years. Following the expiration of that three-year period, the Unclaimed Property Law of California would likely cause the cash payments to escheat to the State of California. For stockholders who reside in other states or whose last known addresses (as shown by our records) are in states other than California, those other states may have abandoned property laws that call for the state to obtain either (i) custodial possession of property that has been unclaimed until the owner reclaims it; or (ii) escheat of such property to the state. Under the laws of those other jurisdictions, the holding period, the time period that must elapse before the property is deemed to be abandoned, may be shorter or longer than three years. If we do not have an address for the holder of record of the shares, then we would turn over unclaimed cash consideration to our state of incorporation, the state of Delaware, in accordance with its escheat laws.

*Appraisal Rights*





## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

No appraisal rights are available under the Delaware General Corporation Law to stockholders who wish to dissent from the reverse stock split. There may exist other rights or actions under state law for stockholders who are aggrieved by reverse stock splits generally. Although the nature and extent of those rights or actions are uncertain and may vary depending upon facts or circumstances, stockholder challenges to corporate actions in general are related to the fiduciary responsibilities of corporate officers and directors and to the fairness of corporate transactions. For example, stockholders could, if they deemed such to be applicable, take appropriate legal action against us and our Board of Directors, and claim that the reverse stock split was unfair to the unaffiliated stockholders, and/or that there was no justifiable or reasonable business purpose for the reverse stock split.

### **Certain Material Federal Income Tax Consequences**



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Summarized below are certain of the material federal income tax consequences to us and our stockholders resulting from the reverse stock split. This summary is based on existing U.S. federal income tax law, which may change, even retroactively. This summary also assumes that the stockholders have held and will continue to hold their shares as capital assets under the Internal Revenue Code of 1986, as amended. This summary does not discuss all aspects of federal income taxation, including certain aspects that may be important to stockholders in light of their individual circumstances. Many stockholders, such as banks, financial institutions, insurance companies, broker-dealers, tax-exempt organizations, and securities traders that elect mark-to-market tax accounting treatment, may be subject to special tax rules. Other stockholders may also be subject to special tax rules, including but not limited to: stockholders who received our common stock as compensation for services or pursuant to the exercise of an employee stock option, or stockholders who have held, or will hold, stock as part of a straddle, hedging, or conversion transaction for federal income tax purposes. In addition, this summary does not discuss any state, local, foreign, or other tax considerations.

For purposes of this discussion, U.S. person means any of the following:

- (1) a citizen or resident of the U.S.;
- (2) a corporation or other entity taxable as a corporation created or organized under U.S. law (federal or state);
- (3) an estate the income of which is subject to U.S. federal income taxation regardless of its sources;
- (4) a trust if a U.S. court is able to exercise primary supervision over administration of the trust and one or more U.S. persons have authority to control all substantial decisions of the trust, or if the trust has a valid election in effect under applicable U.S. Treasury regulations to be treated as a U.S. person; or
- (5) any other person whose worldwide income and gain is otherwise subject to U.S. federal income taxation on a net basis.

As used in this discussion, the term U.S. Holder means a beneficial owner of our common stock that is a U.S. person, and the term non-U.S. Holder means a beneficial owner of our common stock that is not a U.S. person.

We urge stockholders to consult with their own tax advisor as to the particular federal, state, local, foreign and other tax consequences, in light of their specific circumstances. If a partnership holds our common stock, the tax treatment of a partner generally will depend upon the status of the partner and upon the activities of the partnership. If the stockholder is a partner of a partnership holding our common stock, we suggest that such stockholder consult his or her tax advisor.

### *Federal Income Tax Consequences to Our Company*

We believe that the reverse stock split should be treated as a tax-free recapitalization for federal income tax purposes. This should result in no material federal income tax consequences to our company.

*Federal Income Tax Consequences to Stockholders Receiving No Cash Consideration from the Reverse Stock Split*

If a stockholder (1) continues to hold our common stock immediately after the reverse stock split, and (2) receives no cash consideration as a result of the reverse stock split, such stockholder should not recognize any gain or loss in the reverse stock split. The aggregate adjusted tax basis in shares of our common stock held immediately after the reverse stock split should be equal to the aggregate adjusted tax basis in the shares of common stock held immediately prior to the reverse stock split, and

the stockholder should have the same holding period in the common stock as it had in such stock immediately prior to the reverse stock split.

*Federal Income Tax Consequences to Stockholders Receiving Cash Consideration from the Reverse Stock Split*

If a stockholder receives cash consideration as a result of the reverse stock split, its tax consequences will depend on whether, in addition to receiving cash, it or a person or entity related to it continues to hold our common stock immediately after the reverse stock split, as explained below.

*Stockholders Who Exchange All of Their Common Stock for Cash as a Result of the Reverse Stock Split.*

If a stockholder receives cash consideration in lieu of a fractional share as a result of the reverse stock split, does not continue to hold any of our common stock immediately after the reverse stock split, and is not related to any person or entity that holds our common stock immediately after the reverse stock split, the stockholder will recognize capital gain or loss. The amount of capital gain or loss the stockholder recognizes will equal the difference between the cash received for the cashed-out stock and the aggregate adjusted tax basis in such stock.

If a stockholder is related to a person or entity who continues to hold our common stock immediately after the reverse stock split, such stockholder will recognize gain or loss in the same manner as set forth in the previous paragraph, provided that such receipt of cash either is not essentially equivalent to a dividend, or is a substantially disproportionate redemption of stock, as described below.

**Not Essentially Equivalent to a Dividend.** A stockholder will satisfy the not essentially equivalent to a dividend test if the reduction in its proportionate interest in our company resulting from the reverse stock split is considered a meaningful reduction given the particular facts and circumstances. The Internal Revenue Service ( IRS ) has ruled that a small reduction by a minority stockholder whose relative stock interest is minimal and who exercises no control over the affairs of the corporation will meet this test.

**Substantially Disproportionate Redemption of Stock.** The receipt of cash in the reverse stock split will be a substantially disproportionate redemption of stock for a stockholder if the stockholder owns less than 50% of the outstanding shares of our common stock after the reverse stock split, and the percentage of the outstanding shares of our common stock owned by the stockholder immediately after the reverse stock split is less than 80% of the percentage of shares of our common stock it owned immediately before the reverse stock split.

In applying these tests, the stockholder will be treated as owning shares actually or constructively owned by certain individuals and entities related to the stockholder. If the receipt of cash consideration in lieu of fractional shares of our common stock does not give rise to capital gain or loss under any of the tests, it will be treated first as ordinary dividend income to the extent of the stockholder's ratable share of our undistributed earnings and profits, then as a tax-free return of capital to the extent of its aggregate adjusted tax basis in the shares, and any remaining amount will be treated as capital gain.

*Stockholders Who Both Receive Cash Consideration and Continue to Hold Our Common stock Immediately After the Reverse Stock Split*

If a stockholder both receives cash consideration as a result of the reverse stock split and continues to hold our common stock immediately after the reverse stock split, it generally will recognize gain, but not loss, in an amount equal to the lesser of the excess of the sum of aggregate fair market value of its shares of our common stock plus the cash received over its adjusted tax basis in the shares, or the amount of cash received in the reverse stock split. The aggregate adjusted tax basis in the stockholder's shares of our common stock held immediately after the reverse stock split should be equal to its aggregate adjusted tax basis in the shares of our common stock held immediately prior to the reverse stock split, increased by any gain recognized in the reverse stock split, and decreased by the amount of cash received in the reverse stock split.

Any gain recognized in the reverse stock split should be treated, for federal income tax purposes, as capital gain, provided that the receipt of cash either is not essentially equivalent to a dividend with respect to the stockholder, or is a substantially disproportionate redemption of stock with respect to the stockholder as discussed above. In applying these tests, the stockholder will be treated as owning shares held by certain individuals and entities related to the stockholder, and the stockholder may take into account sales of shares of our common stock that occur substantially contemporaneously with the reverse stock split. If the gain is not treated as capital gain under any of these tests, the gain will be treated as ordinary dividend income to the stockholder to the extent of its ratable share of our undistributed earnings and profits, then as a tax-free return of capital to the extent of its aggregate adjusted tax basis in its shares, and any remaining gain will be treated as a capital gain.

*Dividend Income, Capital Gain and Capital Loss*

The U.S. federal income tax rate currently applicable to dividends received from domestic corporations by an individual taxpayer is a maximum of 15%, subject to the requirements the individual must have held the stock with respect to which a dividend is distributed for a minimum of 61 days during the 120-day period beginning 60 days before the stock becomes ex-dividend. A taxpayer's holding period for these purposes is reduced by periods during which the taxpayer's risk of loss with respect to the stock is considered diminished by reason of the existence of options, contracts to sell and similar transactions. The reduced rate of tax applies to the taxable years between 2003 and 2008. Individual stockholders should consult their own advisors as to their eligibility for the reduced rate of tax in relation to dividends on our common stock.

Federal legislation also reduced the maximum U.S. federal income tax rate applicable to net capital gain (defined generally as the total capital gains in excess of capital losses for the year) recognized upon the sale of capital assets that have been held for more than 12 months to 15%. The reduced rate of tax applies to the taxable years between 2003 and 2008. Net capital gain recognized from the sale of capital assets that have been held for 12 months or less will continue to be subject to tax at ordinary income tax rates. Capital gain recognized by a corporate taxpayer will also continue to be subject to tax at the ordinary income tax rates applicable to corporations. For both individual and corporate taxpayers, there are significant limitations on the deductibility of capital losses.

*Information Reporting and Backup Withholding*

In general, payments of dividends with respect to our common stock are subject to information reporting. Each paying agent will be required to provide the IRS with information, including the name, address, and taxpayer identification number of each U.S. Holder receiving payments, and the aggregate amount of dividends paid to such beneficial owner during the calendar year. These reporting requirements, however, do not apply to all beneficial owners. Specifically, corporations, securities broker-dealers, other financial institutions, tax-exempt organizations, qualified pension and profit sharing trusts and individual retirement accounts, and non-U.S. persons satisfying certain requirements are all excluded from reporting requirements.

U.S. Holders will be required to provide their social security or other taxpayer identification numbers, and in some instances, additional information, to our transfer agent in connection with the reverse stock split to avoid backup withholding requirements that might otherwise apply. The letter of transmittal will require each stockholder to deliver such information when the common stock certificates are surrendered following the effective date. Backup withholding will apply if a U.S. Holder fails to establish its exemption from the information reporting requirements, is subject to the reporting requirements and fails to supply its correct taxpayer identification number in the manner required by applicable law, or underreports its tax liability, or if the paying agent has been otherwise notified by the IRS to backup withhold. The backup withholding tax rate is currently 28%. This backup withholding tax is not an additional tax and may be credited against a U.S. Holder's federal income tax liability if the required information is furnished to the IRS.

*Special Rules for Non-U.S. Holders*

If a stockholder is a non-U.S. Holder, its tax consequences will depend on whether its income or gain from the reverse stock split is effectively connected with the conduct of a U.S. trade or business, or, if there is an applicable treaty, is attributable to a permanent establishment maintained in the U.S. Performance of significant personal services constitutes the conduct of a U.S. trade or business.

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

### *Income or Gain Not Effectively Connected with the Conduct of a U.S. Trade or Business.*

Except as described below under the heading *Income or Gain Effectively Connected with the Conduct of a U.S. Trade or Business*, dividends (including deemed dividends) paid on our common stock held by a non-U.S. holder will be subject to U.S. federal withholding tax (but not the federal income tax) at a rate of 30% or lower treaty rate, if applicable. In order to claim a reduction of withholding under a tax treaty, a non-U.S. holder generally will be required to file IRS Form W-8BEN upon which the non-U.S. holder certifies, under penalty of perjury, its status as a non-U.S. person and its entitlement to the lower treaty rate with respect to such payments. Further, a non-U.S. holder will generally not be subject to U.S. federal income or withholding tax on gain realized on the taxable disposition of our common stock.

### *Income or Gain Effectively Connected with the Conduct of a U.S. Trade or Business*

If dividends paid to a non-U.S. Holder are effectively connected with the conduct of a U.S. trade or business by the non-U.S. Holder or, if required by a tax treaty, the dividends are attributable to a permanent establishment maintained in the United States by the non-U.S. Holder, us and other payors generally are not required to withhold tax from the dividends, provided that the non-U.S. Holder furnishes a valid IRS Form W-8ECI certifying, under penalty of perjury, that the holder is a



non-U.S. person, and the dividends are effectively connected with the holder's conduct of a U.S. trade or business and are includible in the holder's gross income. Effectively connected dividends will be subject to U.S. federal income tax on net income that applies to U.S. persons generally (and, with respect to corporate holders under certain circumstances, the branch profits tax).

In the case of any gain that is effectively connected with the conduct of a U.S. trade or business by a non-U.S. Holder (and, if required by a tax treaty, any gain that is attributable to a permanent establishment maintained in the United States), the non-U.S. Holder will generally be taxed on its net gain derived from the disposition at the regular rates and in the manner applicable to U.S. persons and, if the non-U.S. Holder is a foreign corporation, the branch profits tax may also apply.

#### *Backup Withholding and Information Reporting*

We must report annually to the IRS and to each non-U.S. holder the amount of dividends paid to that holder and the tax withheld from such dividend payments. These reporting requirements apply regardless of whether withholding was reduced or eliminated by any applicable tax treaty. Copies of the information returns reporting dividend payments and any withholding thereof may also be made available to the tax authorities in the country in which the non-U.S. holder is a resident under the provisions of an applicable income tax treaty or agreement.

A non-U.S. holder will generally not be subject to additional information reporting or to backup withholding with respect to dividend payments on our common stock, or to information reporting or backup withholding with respect to payments of proceeds from the disposition of our common stock to or through a U.S. office of any broker, as long as the holder has furnished to the payor or broker: (i) a valid IRS Form W-8BEN certifying, under penalties of perjury, its status as a non-U.S. person; (ii) other documentation upon which it may rely to treat the payments as made to a non-U.S. person in accordance with Treasury regulations; or (iii) otherwise establishes an exemption.

Any amounts withheld under the backup withholding rules from a payment to a non-U.S. holder will be allowed as a credit against such holder's U.S. federal income tax liability, if any, or will otherwise be refundable, provided that the requisite procedures are followed and the proper information is filed with the IRS on a timely basis. Non-U.S. holders should consult their own tax advisors regarding their qualification for exemption from backup withholding and the procedure for obtaining such an exemption, if applicable.

As explained above, the amounts paid to a stockholder as a result of the reverse stock split may result in dividend income, capital gain income, or some combination of dividend and capital gain income to such stockholder depending on its individual circumstances. We urge each stockholder to consult its tax advisor as to the particular federal, state, local, foreign, and other tax consequences of the transaction, in light of the specific circumstances.

## **OTHER INFORMATION**

### **Regulatory Approvals**



We are not aware of any material governmental or regulatory approval or filing required for completion of the transaction, other than compliance with the applicable federal and state securities laws and the corporate laws of the States of Delaware and California.

**Background Information Concerning Our Directors, Executive Officers and Controlling Stockholders**



*Directors*

The name, business address and experience of each of our directors for at least the past five years and certain other information concerning each director has been furnished by the director and is set forth below.

**Richard S. Ressler, 46**, has been the Chairman of the Board and a director since 1995. He was our Chief Executive Officer from October 1994 until February 1997 and our President from October 1994 until May 1995. He has served in each of these capacities pursuant to a consulting agreement between our company and Orchard Capital Corporation. Mr. Ressler is the founder and President of Orchard Capital, a firm that provides investment capital and advice to companies (including MAI) in which Orchard Capital or its affiliates invest. He has been a principal of Orchard Capital since 1994. His present business address is 6922 Hollywood Boulevard, Suite 900, Hollywood, California 90028. Mr. Ressler is Chairman of CIM Group, Inc., which acts as an integrated real estate investment and management services firm for institutional investors. He has been a principal of CIM Group and its predecessor since 1994. Mr. Ressler has been Chairman of the Board and a director of

j2 Global Communications, Inc., a leading unified messaging service provider, since 1997, and served as Chief Executive Officer of j2 Global from March 1997 until January 2000, serving in each of these capacities pursuant to a consulting agreement between j2 Global and Orchard Capital.

*Zohar Loshützer, 47*, was appointed to our Board of Directors in January 1998. From July 1997 through December 31, 2000, he was Chief Information Officer, and in 2001 he became Executive Vice President, Corporate Strategy, for j2 Global Communications, Inc., a leading unified messaging services provider. His present business address is 6922 Hollywood Boulevard, Suite 900, Hollywood, California 90028. From July 1997 through November 29, 2000, he also served as a member of the Board of Directors of j2 Global Communications, Inc. From August 2000 through December 31, 2001 he acted as a consultant with MAI Systems Corporation. Since 1995, he has also been a Managing Director of Orchard Telecom, a telecommunications-consulting firm. From 1987 until 1995, he was the general manager and part owner of Life Alert, a nationwide emergency response service.

*Stephen Ross, 57*, was elected to our Board of Directors in May 2001. He is currently a consultant for Warner Bros. His present business address is 4000 Warner Boulevard, Building 2, Suite 208, Burbank, California 91522. From 1989 to 2001, he was employed by Warner Bros. as Executive Vice President, Special Projects. He also served from 1992 through 2001 as a director of the Sea World Property Trust (an Australian theme park company). From 1986 through 1989, he was employed by Lorimar Telepictures Corp. as Senior Vice President and General Counsel. From 1981 through 1986, he worked with Telepictures Corp. where he was Senior Vice President, General Counsel and a member of its board of directors. He also serves as a director of Grill Concepts, Inc., a restaurant company.

*Steven F. Mayer, 45*, was elected to our Board of Directors in May 2001. Since December 2002, he has been Managing Director of Cerberus Capital Management, LLC, a private investment firm that manages funds and accounts with approximately \$12.5 billion in aggregate committed capital. His present business address is 11812 San Vicente Boulevard, Suite 300, Los Angeles, California 90049. Cerberus invests primarily in businesses exhibiting the potential for business improvement and manages holdings in the United States and worldwide. From February 2002 until November 2002, Mr. Mayer was Executive Managing Director of Gores Technology Group, LLC, a private investment and management firm. From November 1996 until September 2001, he was a Managing Director and co-head of Corporate Finance of U.S. Bancorp Libra, the leveraged finance investment banking unit of U.S. Bancorp, and its predecessor company. He was also a Managing Director of Libra Capital Partners, L.P., an affiliated private equity firm that sponsors and invests in management-led buyouts, later stage growth financings, leveraged recapitalizations, corporate divestitures, and acquisitions. From June 1994 until November 1996, Mr. Mayer was a managing director of Aries Capital Group, LLC, a private investment firm that he co-founded. From April 1992 until June 1994, when he left to co-found Aries Capital Group, Mr. Mayer was a principal with Apollo Advisors, L.P. and Lion Advisors, L.P., affiliated private investment firms. Prior to that time, Mr. Mayer was an attorney with Sullivan & Cromwell specializing in mergers, acquisitions, divestitures, leveraged buyouts and corporate finance. Mr. Mayer currently serves as a director of Acterna Corporation, a leading telecommunications test and measurement company and Airway Industries, Inc., a leading luggage and travel accessories company.

*Executive Officers*

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

The name, business address and experience for at least the past five years and certain other information concerning each such executive officer has been furnished by the executive officer and is set forth below.

*W. Brian Kretzmer, 51*, has been our Chief Executive Officer since August 1999 and was appointed as our President on September 10, 2000. His present business address is 26110 Enterprise Way, Lake Forest, California 92630. He also served as our Chief Financial Officer from August 1999 until March 2000. From August 1997 until July 1999, he was Executive Vice President and Chief Financial Officer for Segue Corporation, a California-based private company focused on providing support services to computer manufacturers utilizing Internet commerce. From July 1991 until July 1997 he held various positions with us, including Vice President, Corporate Development, Controller, Vice President, Finance, Chief Financial Officer, and Chief Information Officer. From July 1995 until July 1996 he also served as the President and Chief Operating Officer of Gaming Systems International, which was at that time a wholly-owned subsidiary of ours.

*James W. Dolan, 46*, has been our Chief Financial Officer since March 2000 and our Chief Operating Officer since March 2001. His present business address is 26110 Enterprise Way, Lake Forest, California 92630. Previously, he served as our Vice President, Finance from September 1999 until March 2000. From 1985 to 1999, Mr. Dolan served in positions of increasing responsibility with the accounting firm of KPMG LLP, where he managed audit and consulting projects for companies ranging in size from start-up operations to large public multinational organizations. Mr. Dolan also served as KPMG's senior audit manager to MAI from 1994 through 1997.

*Controlling Stockholder HIS Holding, LLC*

Our controlling stockholder is HIS Holding, LLC, which we also refer to in this information statement as the Investor Group. This entity is a Delaware limited liability company that was formed on March 23, 2004 to act as a holding company for investments in hospitality companies. Voting and dispositive power over shares of our common stock held by HIS Holding, LLC is held by Richard S. Ressler as the managing member. The other members of HIS Holding, LLC are James W. Dolan, W. Brian Kretzmer and The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P. The address for HIS Holding, LLC is 6922 Hollywood Boulevard, Suite 900, Los Angeles, California 90028. See *Prior Transactions Between the Investor Group and Our Company* at page 26.

*Other Background Information*

Neither HIS Holding, LLC nor any of our executive officers or directors, has been convicted in any criminal proceeding in the past five years and was not the subject of any administrative proceeding in the past five years that resulted in judgment, decree or final order that involved any injunction or finding of any violation of federal or state securities laws. Each of our executive officers and directors is a citizen of the United States.

**Prior Transactions Between the Investor Group and Our Company**





## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

### *Investor Group Purchase of Company Shares Owned by Computer Sciences Corporation*

On April 9, 2004, the Investor Group, consisting of certain members of senior management and/or our Board of Directors (Mr. Ressler, Mr. Dolan and Mr. Kretzmer) and certain of our principal senior lenders, The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P, acquired 2,433,333 shares of our common stock and \$3,133,344 of our indebtedness (representing \$2,800,000 of principal and \$333,344 of accrued interest) that were owned by CSA Private Limited, a Singapore corporation beneficially owned by Computer Sciences Corporation (NYSE: CSC) (CSA), for a total purchase price of \$1,000,000. The purchase price was negotiated based upon arm's length discussions between members of the Investor Group and senior management of CSC. As of June 30, 2004, the total amount of indebtedness disclosed in our 2004 Proxy Statement filed on August 25, 2004 was \$3,194,156, which included an additional amount of \$60,812 of additional accrued interest for the period from April 9, 2004 to June 30, 2004. From July 1, 2004 to the conversion date of November 1, 2004, the acquired note accrued an additional \$123,055 of interest resulting in total indebtedness of \$3,317,211 as of November 1, 2004 to be converted to our common stock as described below. The 2,433,333 shares of our common stock acquired by the Investor Group were distributed on November 1, 2004 to each of the members of HIS Holding as follows: Richard S. Ressler (912,500 shares); The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P (912,500 shares); W. Brian Kretzmer (304,167 shares); James W. Dolan (304,166 shares). The distribution of shares was made for the purpose of providing each member with beneficial ownership and control of those shares.

### *September 22, 2004 Stockholder Approval of the Management Equity/Conversion Transaction that Resulted in a Change in Control of Our Company*

At our 2004 annual stockholders' meeting held September 22, 2004, our stockholders approved the Investor Group's (i) conversion of the indebtedness acquired from CSA, with accrued interest, at a conversion price of \$0.10 per share (which resulted in the issuance of 31,941,560 new shares of common stock as of the conversion date of November 1, 2004), and (ii) investment of \$1,000,000 in a private placement at \$0.10 per share (which resulted in the issuance of 10,000,000 new shares of common stock) for a total of 41,941,560 shares. The issuance of these shares occurred on November 1, 2004, together with the issuance of an additional 1,230,550 shares that we and the Investor Group had informally agreed subsequent to the annual stockholders' meeting would be issued upon conversion of the \$123,055 of interest that had accrued from July 1, 2004 through October 31, 2004 (collectively, Management Equity/Conversion Transaction). Upon the completion of the Management Equity/Conversion Transaction on November 1, 2004, there was a change in control of our company, and the Investor Group then beneficially owned approximately 84.77% of our 57,847,862 outstanding shares of common stock as of November 1, 2004. The composition and ownership position of the Investor Group is set forth in the table below under Interest of Certain Persons in or Opposition to Reverse Stock Split - Security Ownership of Certain Beneficial Owners and Management.

### **Interests of Certain Persons in or Opposition to the Reverse Stock Split - Security Ownership of Certain Beneficial Owners and Management**

As of the Approval Record Date, December 30, 2004, a total of 57,847,862 shares of common stock were outstanding. The following table sets forth information as of the Approval Record Date regarding the beneficial ownership of common stock by:

each of our directors;

each of our executive officers;

all of our directors and executive officers as a group; and

each person known by us to beneficially own 5% or more of the outstanding shares of common stock as of the Approval Record Date.

The following table also sets forth hypothetical information regarding the beneficial ownership of the persons listed above assuming the effective time of the reverse stock split occurred on the Approval Record Date and the pre-split number of shares of our common stock that were cashed out in the reverse stock split was 139,000.

None of our directors has informed us that he intends to oppose any action to be taken by us concerning the reverse stock split transaction.

(1) Beneficial ownership is determined in accordance with Rule 13d-3 promulgated by the Commission under the Exchange Act and generally includes voting or investment power with respect to securities. Except as indicated below, we believe each holder possesses sole voting and investment power with respect to all of the shares of common stock owned by that holder, subject to community property laws where applicable. In computing the number of shares beneficially owned by a holder and the percentage ownership of that holder, shares of common stock subject to options or warrants held by that holder that are currently exercisable or are exercisable within 60 days after the date of the table are deemed outstanding. Those shares, however, are not deemed outstanding for the purpose of computing the percentage ownership of any other person or group. The inclusion of shares in this table as beneficially owned is not an admission of beneficial ownership. For information regarding interests in the reverse stock split of the persons or entities listed in the table below, see Background Information Concerning Our Directors, Executive Officers and Controlling Stockholders at page 27, The Reverse Stock Split Approval of the Reverse Stock Split By Our Board of Directors and Stockholders at page 7, Interests of Certain Persons in or Opposition to the Reverse Stock Split- Security Ownership of Certain Beneficial Owners and Management at page 27, and Prior Transactions Between the Investor Group and Our Company at page 27.

Name and Address	As of the Approval Record Date		As If the Effective Time of the Reverse Stock Split Occurred on the Approval Record Date	
	Number of Shares	Percentage of Class (1)	Number of Shares	Percentage of Class (2)
Canyon Capital Advisors LLC (3)	2,515,600	4.35%	16,771	4.36%

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Richard S. Ressler (4)	44,787,897	77.42%	298,586	77.61%
W. Brian Kretzmer (5)	1,086,033	1.88%	7,240	1.88%
James W. Dolan (6)	650,000	1.12%	4,333	1.13%
Investor Group (7)	43,172,110	74.63%	287,814	74.81%

- 
- (1) For each individual and group in the table, percentage ownership is calculated by dividing the number of shares beneficially owned by such person or group, plus shares acquirable within 60 days of the Approval Record Date by such person or group, by the sum of 57,847,862 shares of common stock outstanding on the Approval Record Date, plus shares of common stock acquirable within 60 days of the Approval Record Date by such person or group.
- (2) For each individual and group in the table, percentage ownership is calculated by dividing the number of shares beneficially owned by such person, plus shares acquirable within 60 days of the Approval Record Date by such person or group, by the sum of 384,725 shares (57,847,862 shares of common stock outstanding on the Approval Record Date, minus 139,000 pre-split shares estimated to be cashed out in the reverse stock split, plus shares of common stock acquirable within 60 days of the Approval Record Date by such person or group all adjusted for the 150-to-1 reverse stock split).

- (3) Canyon Capital Advisors LLC, The Value Realization Fund L.P., The Value Realization Fund B, L.P., C.P.I. Securities, L.P., The Canyon Value Realization Fund (Cayman), Ltd., GRS Partners II, Mitchell R. Julis, Joshua S. Friedman and R. Christian B. Evensen, as a group, beneficially own 2,515,600 shares of common stock (16,771 shares of common stock after the 150-to-1 reverse stock split). Power to vote or dispose of the shares beneficially owned by Canyon Capital Advisors, LLC is held jointly by Messrs. Julis and Friedman, as managing partners. The address of all of the above-referenced entities is 9665 Wilshire Boulevard, Suite 200, Beverly Hills, California 90212.
- (4) Mr. Ressler's address is c/o Orchard Capital Corporation, 6922 Hollywood Boulevard, Suite 900, Hollywood, California 90028. Includes 14,063 shares of common stock (94 shares of common stock after the 150-to-1 reverse stock split) issuable upon exercise of options held by Mr. Ressler which are currently exercisable and exercisable within 60 days of the Approval Record Date. Also includes 43,172,110 shares of common stock (287,814 shares of common stock after the 150-to-1 reverse stock split) issued to the Investor Group over which Mr. Ressler has voting and dispositive control.
- (5) Includes 591,667 shares of common stock (3,944 shares of common stock after the 150-to-1 reverse stock split) issuable upon exercise of options or warrants held by Mr. Kretzmer that are currently exercisable and exercisable within 60 days of the Approval Record Date.
- (6) Includes 233,333 (1,556 shares of common stock after the 150-to-1 reverse stock split) shares of common stock issuable upon exercise of options held by Mr. Dolan which are currently exercisable and exercisable within 60 days of the Approval Record Date..
- (7) The Investor Group consists of certain members of senior management and/or our Board of Directors (Richard S. Ressler is the Chairman of our Board of Directors, W. Brian Kretzmer is our Chief Executive Officer and President and James W. Dolan is our Chief Financial and Operating Officer) and certain of our principal senior lenders, The Canyon Value Realization Fund (Cayman), Ltd., Canyon Value Realization Fund, L.P., and CPI Securities L.P. Mr. Ressler and senior lenders own 37.5% each, and Messrs. Kretzmer and Dolan own 12.5% each, of the shares held by HIS Holding. Messrs. Kretzmer's and Dolan's percentage ownership interest in HIS Holding may be increased to 20% each. To earn the additional percentage ownership interest in HIS Holding LLC, they must be employed by Company at the time of dissolution or distributions or they can be terminated without cause, in which case the value of the increase in ownership interest shall be determined based upon 90% of the fair value of the Company at the date of termination. Per the HIS Holding, LLC Operating Agreement: The over-rides will be applicable for the benefit of Mr. Dolan and/or Mr. Kretzmer only if, at the time of realization of profits from the LLC and the intended distribution thereof, (x) distributions have been made (or are then being made) to the Members representing the return of their capital contributions plus the compounded preferred return of 10% per annum, and (y) the person entitled to an over-ride remains as an employee of MAI, but who, if terminated without cause, shall be subject to Annex C (provided that either Mr. Dolan or Mr. Kretzmer may earn an over-ride without the other). If the conditions to the over-ride are not met, as applicable to Mr. Dolan and/or Mr. Kretzmer, then such over-ride(s) will not be applicable. The managing member of HIS Holding, LLC is Orchard Capital Corporation, a California corporation, of which Richard S. Ressler is president and the controlling shareholder.

## Market Prices of Our Common Stock and Dividend Policy



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Our common stock is traded over-the-counter on the OTC Bulletin Board under the symbol MAIY.OB. The following table sets forth the range of high and low closing prices for the calendar periods set forth below. On September 23, 2005, the high, low and closing trading prices for our common stock were \$0.055, \$0.055 and \$0.055, respectively.

Period	High	Low
Fiscal 2002		
First Quarter	\$ 0.34	\$ 0.24
Second Quarter	\$ 0.45	\$ 0.25
Third Quarter	\$ 0.34	\$ 0.16
Fourth Quarter	\$ 0.16	\$ 0.08
Fiscal 2003		
First Quarter	\$ 0.55	\$ 0.06
Second Quarter	\$ 0.28	\$ 0.05
Third Quarter	\$ 0.25	\$ 0.06
Fourth Quarter	\$ 0.15	\$ 0.08
Fiscal 2004		
First Quarter	\$ 0.26	\$ 0.14
Second Quarter	\$ 0.34	\$ 0.16
Third Quarter	\$ 0.24	\$ 0.15
Fourth Quarter	\$ 0.21	\$ 0.10
Fiscal 2005		
First Quarter	\$ 0.16	\$ 0.09
Second Quarter	\$ 0.08	\$ 0.04

There were approximately 577 stockholders of record as of the Approval Record Date. On that date, the closing sale price of our common stock on the OTC Bulletin Board was \$0.11.

We have not declared any dividends on our common stock during the past five years, and our Board of Directors does not currently intend to pay any cash dividends on our common stock in the foreseeable future. Payment of cash dividends is at the discretion of our Board of Directors and depends on our earnings, financial condition, capital requirements and other relevant factors.

#### Pro Forma Financial Data

See Pro Forma Financial Data at **Appendix B** to this information statement.

#### Financial Statements, Supplementary Financial Information, Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk

See **Appendix C** to this information statement for our audited financial statements as of December 31, 2004 and 2003 and for each of the years in the two year period ended December 31, 2003 and for the period from January 1, 2004 to October 31, 2004 and for the period from November 1, 2004 to December 31, 2004, which includes Supplementary Financial Information, Management's Discussion and Analysis of Financial



Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk and our unaudited financial statements for the interim periods ended June 30, 2005 and 2004.

### **Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

### **Forward-Looking Statements**

This information statement contains forward-looking statements with respect to the impact on our company of the reverse stock split and other matters. The forward-looking statements include statements regarding our intent, belief, or current expectations, as well as the assumptions on which those statements are based. The forward-looking statements are not guarantees of future performance and occurrences and involve risks and uncertainties. Such forward-looking statements involve known and unknown risks, uncertainties and other factors which may cause the actual results, performance or achievements of our company, to be materially different from any future results, performance, or achievements expressed or implied by such forward-looking statements. Such factors include, among others, declining economic conditions, including a slowdown or recession; future terrorist activities affecting the hospitality industry; our company's ability to retain and increase revenue from existing clients and to execute agreements with new clients; the successful implementation of strategic relationships with other vendors and service providers; the competitive nature of the market for our software products and services; rapid technological change in the software industry and possible delays in development or shipment of new versions of key product lines; our company's ability to attract and retain qualified technical and management personnel; inability to control costs; changes in our product pricing; changes in business strategy or development plans; and other factors set forth in our company's Annual Report on Form 10-K for the year ended December 31, 2003 and other interim reports filed from time to time with the Securities and Exchange Commission. Actual results, events and performance may differ materially.

**Where You Can Find More Information**

The reverse stock split will result in a going private transaction subject to Rule 13e-3 of the Exchange Act. We and the Investor Group members have filed a Rule 13e-3 Transaction Statement on Schedule 13E-3 under the Exchange Act with respect to the reverse stock split. The Schedule 13E-3 contains additional information about us. Copies of the Schedule 13E-3 are available for inspection and copying at our principal executive offices during regular business hours by any interested stockholder, or a representative who has been so designated in writing, and may be inspected and copied, or obtained by mail, by written or oral request directed to James W. Dolan, Chief Financial and Operating Officer, at the following address: MAI SYSTEMS CORPORATION, 26110 Enterprise Way, Lake Forest, California 92630, telephone number (949) 598-6181.

We are currently subject to the information requirements of the Exchange Act and file periodic reports, and other information with the Commission relating to our business, financial and other matters.

Copies of such reports, proxy statements, this information statement and other information, as well as the Schedule 13E-3, may be copied (at prescribed rates) at the public reference facilities maintained by the Commission at these facilities currently located at Room 1024, 450 Fifth Street, N.W., Judiciary Plaza, Washington, D.C. 20549 and may be relocated by the Commission in the near future. For further information concerning the Commission's public reference rooms, you may call the Commission at 1-800-SEC-0330. Some of this information may also be accessed on the World Wide Web through the Commission's Internet website at <http://www.sec.gov>.

THE BOARD OF DIRECTORS OF MAI SYSTEMS CORPORATION

Dated: September , 2005

HIS HOLDING, LLC

**APPENDIX A**

**Form of**

**Certificate of Amendment of**

**Certificate of Incorporation**

**of MAI Systems Corporation**

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

MAI Systems Corporation, a Delaware corporation organized and existing under and by virtue of the laws of the General Corporation Law of the State of Delaware (the Corporation ), does hereby certify that:

1. The name of the Corporation is MAI Systems Corporation.
  
2. The Board of Directors of the Corporation duly adopted a resolution setting forth and declaring advisable the amendment of Articles FOURTH and FIFTH of the Corporation s Certificate of Incorporation so that, as amended, said Articles shall read in their entirety as follows:

FOURTH: In accordance with the provisions of Section 303 of the General Corporation Law of the State of Delaware, the authorized capital stock of all classes of the Corporation shall consist of 666,667 shares at a par value of \$0.01 per share.

FIFTH: The shares of capital stock which the Corporation shall have authority to issue shall be divided into 6,667 shares of Preferred Stock, \$0.01 par value per share (hereinafter referred to as Preferred Stock ), and 660,000 shares of common stock, \$0.01 par value per share. Upon the amendment of this Article to read as herein set forth, each 150 shares of common stock outstanding will be converted into one share of stock, with fractional shares that would result from such conversion being converted into cash on the basis of \$0.17 for each share outstanding prior to the amendment of this Article to read as herein set forth.

Shares of Preferred Stock may be issued in one or more series from time to time by the Board of Directors, and the Board of Directors is expressly authorized to fix by resolution or resolutions the designations and the powers, preferences and rights, and the qualifications, limitations and restrictions thereof, of the shares of each series of Preferred Stock, including without limitation the following:

- (a) the distinctive serial designation of such series which shall distinguish it from other series;
- (b) the number of shares in such series;
- (c) the dividend rate (or method of determining such rate) payable to the holders of the shares of such series, any conditions upon which such dividends shall be paid and the date or dates upon which such dividends shall be payable;
- (d) whether dividends on the shares of such series shall be cumulative and, in the case of shares of any series having cumulative dividend rights, the date or dates or method of determining the date or dates from which dividends on the shares of such series shall be cumulative;
- (e) the amount or amounts which shall be payable out of the assets of the Corporation to the holders of the shares of such series upon voluntary or involuntary liquidation, dissolution or winding up the Corporation, and the relative rights of priority, if any, of payment of the shares of such series;
- (f) the price or prices at which, the period or periods within which and the terms and conditions upon which the shares of such series may be redeemed, in whole or in part, at the option of the Corporation or at the option of the holder or holders thereof or upon the happening of a specified event or events;
- (g) the obligation, if any, of the Corporation to purchase or redeem shares of such series pursuant to a sinking fund or otherwise and the price or prices at which, the period or periods within which and the terms and conditions upon which the shares of such series shall be redeemed or purchased in whole or in part, pursuant to such obligation;



(h) whether or not the shares of such series shall be convertible or exchangeable, at any time or times at the option of the holder or holders thereof or at the option of the Corporation or upon the happening of a specified event or events, into shares of any other class or classes or any other series of the same of any other or classes of stock of the Corporation, and the price or prices or rate or rates of exchange or conversion and any adjustments applicable thereto; and

3. Thereafter, pursuant to a resolution of the Board of Directors, this Certificate of Amendment was submitted to the stockholders of the Corporation for their approval, and was duly adopted in accordance with the provisions of Sections 228 and 242 of the General Corporation Law of the State of Delaware. Prompt written notice of the adoption of the amendments herein certified has been given to those stockholders who have not consented in writing thereto, as provided in Section 228 of the General Corporation Law of the State of Delaware.

4. This Certificate of Amendment will be effective at 5:00 p.m. Eastern Standard Time on \_\_\_\_\_, 2005.

IN WITNESS WHEREOF, the undersigned, W. Brian Kretzmer, has signed this Certificate of Amendment as Chief Executive Officer, President and Secretary, of the Corporation, this \_\_\_\_\_ day of \_\_\_\_\_ 2005.

W. Brian Kretzmer, Chief Executive Officer,  
President and Secretary

**APPENDIX B**

Pro Forma Financial Data

Pro Forma Financial Information

Pro Forma Consolidated Balance Sheet as of June 30, 2005

Pro Forma Consolidated Statement of Operations for the year ended December 31, 2004

Pro Forma Consolidated Statement of Operations for the three months ended June 30, 2005

Pro Forma Consolidated Statement of Operations for the six months ended June 30, 2005

Footnotes to Pro Forma Financial Statements

B-1

---

**PRO FORMA FINANCIAL INFORMATION**

*Pro Forma Financial Information Showing Effect of the Reverse Stock Split*

The unaudited pro forma consolidated balance sheet set forth below give effect to the reverse stock split as if each had occurred on June 30, 2005. The unaudited pro forma consolidated statement of operations for the period from January 1, 2004 to October 31, 2004 and for the period from November 1, 2004 to December 31, 2004 give effect to the reverse stock split as if each had occurred on January 1, 2004 and November 1, 2004, respectively. The unaudited pro forma consolidated statements of operations for the three and the six months ended June 30, 2005 give effect to the reverse stock split as if it had occurred on January 1, 2005. The pro forma financial information does not purport to represent our financial position or what the results of operations would have actually been had the reverse stock split occurred at such dates or to project our financial position or results of operations for any future date or period. In addition, it does not incorporate any benefits from the reverse stock split.

On December 1, 2004, a Special Committee of our Board of Directors unanimously approved a 1-for-150 reverse split of our common stock, with \$0.17 per share to be paid in cash in lieu of issuing fractional shares. On December 2, 2004 the Special Committee presented its findings to our Board of Directors. The Special Committee found that the purpose of the reverse stock split was to reduce the number of our stockholders below 300, thereby positioning us to terminate our public reporting and continue future operations as a private company and relieving us of the costs, administrative burdens and competitive disadvantages associated with operating as a public company. The Special Committee further reported that the advantages of the reverse stock split to the unaffiliated stockholders outweighed the disadvantages, and that it was substantively and procedurally fair, and therefore, in the best interests of our company and our stockholders. The Special Committee advised our Board of Directors that it had approved the reverse stock split, and recommended that our Board of Directors approve the reverse stock split. Our Board of Directors adopted the Special Committee's recommendations regarding the reverse stock split based on the Special Committee's determination that the reverse stock split was fair and in the best interests of the Company and our stockholders. On September 23, 2005, both our Special Committee and our Board of Directors met to receive an updated report from management on the reverse stock split. At this meeting, the Board of Directors also received the recommendation of the Special Committee reaffirming the reverse stock split and all of the prior findings and confirmed that the transaction was still substantially and procedurally fair and in the best interests of all of the shareholders. At this time, the Board of Directors voted to reaffirm the implementation of the reverse stock split.



**PRO FORMA CONSOLIDATED BALANCE SHEET**

As of June 30, 2005

**(UNAUDITED)**

	Historical	Reverse Stock Split Pro Forma Adjustments	Footnotes	Pro Forma
<b><u>ASSETS</u></b>				
Current assets:				
Cash	\$ 412	\$	\$	412
Receivables, less allowance for doubtful accounts	3,289			3,289
Inventories, net	62			62
Prepays and other assets	772			772
Total current assets	4,535			4,535
Furniture, fixtures and equipment, net	575			575
Intangibles, net	7,020			7,020
Goodwill	4,622			4,622
Other assets	14			14
Total assets	\$ 16,766	\$	\$	16,766
<b><u>LIABILITIES AND STOCKHOLDERS</u></b>				
<b><u>DEFICIENCY</u></b>				
Current liabilities:				
Current portion of long-term debt	\$ 1,200		\$	1,200
Accounts payable	907			907
Customer deposits	2,481			2,481
Accrued liabilities	2,856			2,856
Income taxes payable	95			95
Unearned revenue	5,003			5,003
Total current liabilities	12,542			12,542
Long-term debt	5,984			5,984
Other liabilities	692			692
Total liabilities	19,218			19,218
Stockholders' deficiency:				
Preferred Stock				
Common stock	584	(580)	(a)	4
Additional paid-in capital	47,856	580	(a)	48,436
Accumulated other comprehensive income:				
Minimum pension liability	(1,250)			(1,250)
Foreign currency translation	(59)			(59)

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Accumulated deficit	(49,583)	(49,583)
Total stockholders' deficiency	(2,452)	(2,452)
Total liabilities and stockholders' deficiency	\$ 16,766	\$ 16,766
Book value per share	\$ (0.04)	\$ (6.31)

B-3

---

## PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS

(UNAUDITED)

(In thousands, except per share data)

(in thousands, except per share data)	Historical Jan. 1, 2004 Oct. 31, 2004	Pro Forma Adjustments	Pro Forma	Historical Nov. 1, 2004 Dec. 31, 2004	Pro Forma Adjustments	Pro Forma	Foot- notes
Revenue:							
Software	\$ 3,223		\$ 3,223	\$ 766		\$ 766	
Network and computer equipment	386		386	87		87	
Services	12,708		12,708	2,901		2,901	
Total revenue	16,317		16,317	3,754		3,754	
Direct costs:							
Software	381		381	111		111	
Network and computer equipment	318		318	79		79	
Services	3,823		3,823	872		872	
Total direct costs	4,522		4,522	1,062		1,062	
Gross profit	11,795		11,795	2,692		2,692	
Selling, general and administrative expenses							
Research and development costs	7,656		7,656	1,771		1,771	
Amortization of intangibles	3,039		3,039	669		669	
Stock compensation charge	188		188	96		96	
Other operating expense	64		64	28		28	
Operating income	848		848	128		128	
Interest income	1		1				
Interest expense	(1,966)		(1,966)	(147)		(147)	
Other non-operating expense	(26)		(26)	(2)		(2)	
Loss before income taxes	(1,143)		(1,143)	(21)		(21)	
Income tax expense	(15)		(15)	(16)		(16)	
Net loss	\$ (1,158)		\$ (1,158)	(37)		(37)	
Net loss per share:							
Basic loss per share	\$ (0.08)	\$ (11.74)	\$ (11.82)	\$ (0.10)	\$ (0.10)	(a)	
Diluted loss per share	\$ (0.08)	\$ (11.74)	\$ (11.82)	\$ (0.10)	\$ (0.10)	(a)	
Weighted average common shares used in determining loss per share:							
Basic	14,676	14,578	98	57,848	57,462	386	(a)

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Diluted	14,676	14,578	98	57,848	57,462	386	(a)
---------	--------	--------	----	--------	--------	-----	-----

B-4

---

**PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS**

For the three months ended June 30, 2005

(UNAUDITED)

(In thousands, except per share data)

	Historical	Reverse Stock Split Pro Forma Adjustments	Footnotes	Pro Forma
<b>Revenue:</b>				
Software	\$ 1,583			\$ 1,583
Network and computer equipment	90			90
Services	4,329			4,329
Total revenue	6,002			6,002
<b>Direct costs:</b>				
Software	166			166
Network and computer equipment	64			64
Services	1,396			1,396
Total direct costs	1,626			1,626
Gross profit	4,376			4,376
Selling, general and administrative expenses	2,366			2,366
Research and development costs	1,143			1,143
Amortization of intangibles	126			126
Other operating expense	59			59
Operating income	682			682
Interest expense	(197)			(197)
Loss before income tax expense	485			485
Income tax expense	(5)			(5)
Net loss	\$ 480	\$		\$ 480
<b>Loss per share:</b>				
Basic loss per share	\$ 0.01	\$ 1.23	(a)	\$ 1.24
Diluted loss per share	\$ 0.01	\$ 1.23	(a)	\$ 1.24
<b>Weighted average common shares used in determining loss per share:</b>				
Basic	57,848	(57,462)	(a)	386

Diluted	57,848	(57,462)	(a)	386
---------	--------	----------	-----	-----

B-5

---

**PRO FORMA CONSOLIDATED STATEMENT OF OPERATIONS**

For the six months ended June 30, 2005

(UNAUDITED)

(In thousands, except per share data)

	Historical	Reverse Stock Split Pro Forma Adjustments	Footnotes	Pro Forma
<b>Revenue:</b>				
Software	\$ 2,537			\$ 2,537
Network and computer equipment	279			279
Services	7,941			7,941
Total revenue	10,757			10,757
<b>Direct costs:</b>				
Software	509			509
Network and computer equipment	243			243
Services	2,721			2,721
Total direct costs	3,473			3,473
Gross profit	7,284			7,284
Selling, general and administrative expenses	4,550			4,550
Research and development costs	2,264			2,264
Amortization of intangibles	238			238
Other operating expense	72			72
Operating income	160			160
Interest expense	(400)			(400)
Loss before income tax expense	(240)			(240)
Income tax expense	(9)			(9)
Net loss	\$ (249)	\$		\$ (249)
<b>Loss per share:</b>				
Basic loss per share	\$	\$ (0.65)	(a)	\$ (0.65)
Diluted loss per share	\$	\$ (0.65)	(a)	\$ (0.65)
<b>Weighted average common shares used in determining loss per share:</b>				
Basic	57,848	(57,462)	(a)	386

Diluted	57,848	(57,462)	(a)	386
---------	--------	----------	-----	-----

B-6

---



**Footnotes to Pro Forma Financial Statements**

---

(a) Reduction in \$0.01 par value common stock and increase in additional paid-in capital of \$580,000 as a result of reducing the number of outstanding shares to approximately 386,000 shares resulting from the 150-to-1 reverse stock split resulting in common stock of \$4,000 (386,000 shares multiplied by \$0.01 par value).

B-7

---

APPENDIX C

**Financial Statements, Supplementary Financial Information and Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosures About Market Risk Relating to the Interim Periods Ended June 30, 2005 and 2004 and the Years Ended December 31, 2004, 2003 and 2002**

Quarterly Data

Selected Financial Data

Management's Discussion and Analysis of Financial Condition and Results of Operations

Quantitative and Qualitative Disclosures about Market Risk

Financial Statements for the Years Ended December 31, 2004, 2003 and 2002:

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets

Consolidated Statements of Operations

Consolidated Statements of Stockholders' Deficiency and Comprehensive Loss

Consolidated Statements of Cash Flows

Notes to Consolidated Financial Statements

Financial Statements for the Interim Periods Ended June 30, 2005 and 2004:

Condensed Consolidated Balance Sheets

Condensed Consolidated Statements of Operations

Condensed Consolidated Statements of Cash Flows

Notes to Condensed Consolidated Financial Statements

## QUARTERLY DATA (Unaudited)

(in millions, except share data)

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

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

**SELECTED FINANCIAL INFORMATION**



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

### SELECTED FINANCIAL DATA

(in thousands, except per share data)

#### STATEMENT OF OPERATIONS DATA

	For the Years Ended December 31,				For the Periods	
	2000	2001	2002	2003	Jan. 1, 2004 Oct. 31, 2004	Nov. 1, 2004 Dec. 31, 2004
Revenue	\$ 27,321	\$ 23,768	\$ 21,937	\$ 19,346	\$ 16,317	\$ 3,754
Income (loss) from continuing operations	1,444	3,657	417	353	(1,158)	(37)
Income (loss) from discontinued operations	(627)	(1,525)	(1,767)			
Net income (loss)	817	2,132	(1,350)	353	(1,158)	(37)
Income (loss) per share from continuing operations:						
Basic income (loss) per share	\$ 0.13	\$ 0.28	\$ 0.03	\$ 0.02	\$ (0.08)	\$
Diluted income (loss) per share	\$ 0.13	\$ 0.28	\$ 0.03	\$ 0.02	\$ (0.08)	\$
Income (loss) per share from discontinued operations:						
Basic income (loss) per share	\$ (0.06)	\$ (0.12)	\$ (0.13)	\$	\$	\$
Diluted income (loss) per share	\$ (0.06)	\$ (0.12)	\$ (0.13)	\$	\$	\$
Net Income (loss) per share:						
Basic income (loss) per share	\$ 0.07	\$ 0.16	\$ (0.10)	\$ 0.02	\$ (0.08)	\$
Diluted income (loss) per share	\$ 0.07	\$ 0.16	\$ (0.10)	\$ 0.02	\$ (0.08)	\$
Weighted average common shares used in determining income (loss) per share:						
Basic	10,923	13,091	13,945	14,538	14,676	57,848
Diluted	11,206	13,263	13,945	14,838	14,676	57,848

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

BALANCE SHEET DATA

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

---

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

(2) Unaudited

C-3

---

**MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**





## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

### **Critical Accounting Policies and Estimates**

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

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

**Software Development Costs**

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

The Company capitalized \$604,000 of software development costs during the six month period ended June 30, 2004 respectively, relating to its new N-Tier, Internet-native corporate application suite of products written in java. The modules to this suite of applications became available for general release in the first quarter of 2005 at which time amortization of such costs commenced. We believe that these new products will produce new sales adequate to recover amounts capitalized.

**Revenue Recognition**

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

**Accounts Receivable**

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. The amount of our reserves is based on historical experience and our analysis of the accounts receivable

C-4

---

balances outstanding. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required which would result in an additional general and administrative expense in the period such determination was made. While such credit losses have historically been within our expectations and the provisions established, we cannot guarantee that we will continue to experience the same credit loss rates that we have in the past.

**Intangibles and Long-Lived Assets**

At December 31, 2004 and June 30, 2005, goodwill and other long-lived assets represented 80% and 73%, respectively, of the Company's total assets.

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

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

#### **Accrued Expenses**



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

**Income Taxes**

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

C-5

---

**Liquidity and Capital Resources**

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

At June 30, 2005, our working capital deficiency increased from a working capital deficiency of \$7,536,000 at December 31, 2004 to a working capital deficiency of \$8,007,000. Excluding unearned revenue of \$5,003,000, working capital deficiency at June 30, 2005 was \$3,004,000. Excluding unearned revenue of \$3,456,000, the Company's working capital deficiency at December 31, 2004 was \$4,080,000. Excluding unearned revenue, the decrease in the working capital deficiency of \$1,076,000 was primarily attributable to increases in receivables of \$1,118,000 and cash of \$217,000 and decreases in accounts payable of \$107,000 and accrued liabilities of \$45,000 offset by increases in current portion of long term debt of \$197,000 and deposits of \$300,000.

Net cash used in investing activities for the period ended June 30, 2005 totaled \$27,000, which is comprised of capital expenditures.

Net cash used in financing activities for the period ended June 30, 2005 totaled \$478,000, which represents repayments on long-term debt. On January 13, 2003, the Company converted its credit facility to a term loan which requires monthly principal and interest payments of \$58,000 and matures on February 28, 2006. In addition, the Company amended its subordinated note to require monthly interest only payments of \$52,000 through February 28, 2006, at which time it will convert to a term loan to be amortized over a three years period. The restructured debt, pursuant to the original intercreditor agreement between Canyon and Coast, which was sold to Wamco on May 15, 2003, contains various restrictions and covenants, including a minimum quick ratio of 0.20 to 1.00 and minimum debt service coverage ratio of 0.50 to 1.00. In the event that we were not in compliance with the various restrictions and covenants and were unable to receive waivers for non-compliance, the term debt would be immediately due and payable. The Company was in compliance with its covenants as of June 30, 2005. There is no guaranty that the Company will meet its debt covenants in the future.

Stockholders' deficiency increased from \$2,213,000 at December 31, 2004 to \$2,452,000 at June 30, 2005, mainly as a result of net loss during the period of \$249,000.

Although the Company has a net stockholders' deficiency of \$2,452,000 and a working capital deficit of \$8,007,000 at June 30, 2005, the Company believes it will generate sufficient funds from operations or obtain additional financing to meet its operating and capital requirements for at least the next 12 months. The Company expects to generate positive cash flow from its continuing operations during 2005 from shipping out products and services from its current backlog as of June 30, 2005 as well as new orders. In the event that the Company cannot generate positive cash flow from its continuing operations during 2005, the Company can substantially reduce its research and development efforts to mitigate cash outflow to help sustain its operations. There can be no assurance that the Company will be able to sustain profitability or generate positive cash flow from operations or obtain additional financing as necessary. These financial statements have been prepared assuming the Company will continue to operate as a going concern. If the Company is unsuccessful in the aforementioned efforts, the Company could be forced to liquidate certain of its assets, reorganize its capital structure and, if necessary, seek other remedies available to the Company.

### **Order, Shipment and Backlog**

We record and enter into backlog a purchase order for equipment and software when we receives a customer s written order requesting delivery within twelve months, and systems configuration and contract provisions are verified. Orders that are canceled by the customer and orders that are not shipped within one year are removed from backlog. Orders that are removed from backlog for non-shipment are restored if they are reinstated by the customer. We include in backlog signed government contracts which have not yet been fully funded that are expected to commence delivery within the next twelve months. As of June 2005, we have approximately \$9.7 million included in backlog relating to the Air Force, of which \$1.2 million is expected to be shipped within fiscal 2005 and the balance of the contract shipped by December 31, 2008. Our backlog as of June 30, 2004 and 2005 was \$2,400,000 and \$14,900,000, respectively.

Our backlog is not necessarily indicative of future revenues.

C-6

---

**Contractual Obligations and Commercial Commitments**

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

The following table summarizes the Company's obligations and commitments as of June 30, 2005:

Contractual Cash Obligations	Total	Payments Due by Period (in thousands)			
		Less Than 1 Year	2-3 Years	4-5 Years	After 5 Years
Long-Term Debt	\$ 7,184	\$ 1,200	\$ 3,876	\$ 1,523	\$ 585
Operating Leases	3,237	583	905	917	832
Consulting Agreements	24	24			
	<b>\$ 10,445</b>	<b>\$ 1,807</b>	<b>\$ 4,781</b>	<b>\$ 2,440</b>	<b>\$ 1,417</b>

### Factors Affecting Future Operating Results

#### Demand for the Company's Products and Operating Efficiencies

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

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

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

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

Emergence of any competing solutions as industry standards;

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

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

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

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

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

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

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

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

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

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

C-7

---



### Results of Operations

#### Three Months Ended June 30, 2004 Compared to Three Months Ended June 30, 2005

	June 30, 2004 (in thousands)	Percentage of Revenue	June 30, 2005 (in thousands)	Percentage of Revenue
Revenue	\$ 4,901	100.0%	\$ 6,002	100.0%
Gross profit	3,671	74.9%	4,376	72.9%
Selling, general and administrative expenses	2,351	48.0%	2,366	39.4%
Research and development costs	908	18.5%	1,143	19.0%
Amortization of intangibles			126	2.1%
Other operating expense	15	0.3%	59	1.0%
Interest expense, net	288	5.9%	197	3.2%
Other non-operating expense	23	0.5%		
Income tax expense	4	0.1%	5	0.1%
Net income	\$ 82	1.7%	\$ 480	8.0%

The increase in revenue in 2005 was mainly attributable to an increase in the volume of software sales, which resulted in an increase of approximately \$1,101,000. The general health of the hospitality industry continues to improve from the detrimental effects of 9/11 that severely affected the hospitality and travel industries. During the three month period ended June 30, 2005, the Company shipped certain orders it expected to ship from its backlog during the three month period ended March 31, 2005 resulting in increase in revenue from the comparable period of 2004. Revenue for 2005 was \$6,002,000 compared to \$4,901,000 in 2004 or a 23.9% increase. The increase mainly related to an increase from 2004 to 2005 in software and professional services sales in Asia of approximately \$631,000 and \$209,000, respectively, as well as an increase in professional services sales of approximately \$138,000 in the United States. Our continuing hospitality business is expected to generate sufficient cash from operations to adequately fund its ongoing operating activities.

Gross profit for 2005 increased to \$4,376,000 from \$3,671,000 in 2004. The increase in gross profit is mainly due to the increase in software sales which has a gross margin in excess of ninety percent. The increase in gross profit is also due to an increase in professional and support service sales, which have lower gross margins. The Company's professional and support services costs increased from 2004. The increase in professional and support services costs was mainly attributable to an increase in global headcount combined with salary increases from 2004 to 2005.

Selling, general and administrative expenses ( SG&A ) increased slightly from \$2,351,000 in 2004 to \$2,366,000 in 2005. The Company continues to manage these expenses through its management cost control program resulting in comparable costs in 2004 as compared to 2005.

Research and development costs increased from \$908,000 in 2004 to \$1,143,000 in 2005. The company capitalized \$283,000 of software development costs in 2004. As of January 1, 2005, the Company released its new N-Tier, Internet-native corporate application suite of products written in java and ceased capitalizing costs relating to the modules associated with this suite of applications. After considering the amount capitalized in 2004, gross research and development costs decreased from 2004 to 2005 by approximately \$48,000 due to a decrease in engineers and quality assurance personnel in the United States which were replaced with less expensive resources in the Company's Malaysia operations.

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Amortization of intangibles was \$126,000 in 2005 as a result of the Company recording approximately \$10 million of intangible assets in connection with the Management Equity/Conversion Transaction on November 1, 2004, of which approximately \$4,786,000 related to identifiable intangible assets which commenced amortization in November 2004 over their estimated useful lives of seven to fifteen years.

Net interest expense was \$288,000 in 2004 compared to \$197,000 in 2005. The decrease is due to lower balances of interest bearing debt during 2005 as compared to 2004 mainly due to the conversion of approximately \$3.3 million of indebtedness by the Investor Group to the Company's common stock on November 1, 2004.

C-8

---

Six Months Ended June 30, 2004 Compared to Six Months Ended June 30, 2005

	June 30, 2004 (in thousands)	Percentage of Revenue	June 30, 2005 (in thousands)	Percentage of Revenue
Revenue	\$ 10,074	100.0%	\$ 10,757	100.0%
Gross profit	7,394	73.4%	7,284	67.7%
Selling, general and administrative expenses	4,700	46.7%	4,550	42.3%
Research and development costs	1,800	17.9%	2,264	21.0%
Amortization of intangibles			238	2.2%
Other operating expense	18	0.2%	72	0.7%
Interest expense, net	579	5.8%	400	3.7%
Other non-operating expense	39	0.4%		
Income tax expense	10	0.1%	9	0.1%
Net income	\$ 248	2.5%	\$ (249)	(2.3)%

The increase in revenue in 2005 was mainly attributable to an increase in the volume of software sales, which resulted in an increase of approximately \$683,000. The general health of the hospitality industry continues to improve from the detrimental effects of 9/11 that severely affected the hospitality and travel industries. Revenue for 2005 was \$10,757,000 compared to \$10,074,000 in 2004 or a 6.8% increase. The increase mainly related to an increase from 2004 to 2005 in software and professional services sales in Asia of approximately \$687,000 and \$314,000, respectively. This increase in Asia revenue was offset by decreases in software sales, professional services and support revenue of approximately \$296,000, \$155,000 and \$199,000, respectively in the United States. The decrease in revenue in the United States was due to the Company not shipping certain orders it expected to ship from its backlog during the three month period ended March 31, 2005, which commenced shipment during the three month period ended June 30, 2005. Our continuing hospitality business is expected to generate sufficient cash from operations to adequately fund its ongoing operating activities.

Gross profit for 2005 decreased to \$7,284,000 from \$7,394,000 in 2004. Although revenue increased from 2004, the slight decrease in gross profit in 2005 as compared to 2004 is mainly due to an increase in professional and support service costs. The Company's professional and support services costs increased approximately \$539,000 from 2004 to 2005. The increase in professional and support services costs was mainly attributable to an increase in global headcount combined with salary increases from 2004 to 2005 resulting in an increase in costs of approximately \$403,000 and \$160,000 in the United States and Asia, respectively. Additionally, the Company amortized approximately \$211,000 of developed technology intangible assets to software cost of sales during 2005. There was no such amortization charges during 2004.

Selling, general and administrative expenses ( SG&A ) decrease from \$4,700,000 in 2004 to \$4,550,000 in 2005. The decrease is mainly due to the closing of the Company's Mexico office in January, 2004 and the ongoing effects of the management cost control program resulting in reduced, building rent and consulting services.

Research and development costs increased from \$1,800,000 in 2004 to \$2,264,000 in 2005. The company capitalized \$604,000 of software development costs in 2004. As of January 1, 2005, the Company released its new N-Tier, Internet-native corporate application suite of products written in java and ceased capitalizing costs relating to the modules associated with this suite of applications. After considering the amount capitalized in 2004, gross research and development costs decreased from 2004 to 2005 by approximately \$140,000 due to a decrease in engineers and quality assurance personnel in the United States which were replaced with less expensive resources in the Company's Malaysia operations.

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Amortization of intangibles was \$238,000 in 2005 as a result of the Company recording approximately \$10 million of intangible assets in connection with the Management Equity/Conversion Transaction on November 1, 2004, of which approximately \$4,786,000 related to identifiable intangible assets which commenced amortization in November 2004 over their estimated useful lives of seven to fifteen years.

Net interest expense was \$579,000 in 2004 compared to \$400,000 in 2005. The decrease is due to lower balances of interest bearing debt during 2005 as compared to 2004 mainly due to the conversion of approximately \$3.3 million of indebtedness by the Investor Group to the Company's common stock on November 1, 2004.

C-9

---

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

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

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

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

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

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

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

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

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

C-10

---

**Results of Operations**





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

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

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

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

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

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

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

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

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

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

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

C-11

---

## RECENT ACCOUNTING PRONOUNCEMENTS

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

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

## Quantitative And Qualitative Disclosures About Market Risk

### *Market Risk Disclosures*



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

The following discussion about our market risk disclosures contains forward-looking statements. Forward-looking statements are subject to risks and uncertainties. Actual results could differ materially from those discussed in the forward-looking statements. We are exposed to market risk related to changes in interest rates and foreign currency exchange rates. We do not have derivative financial instruments for hedging, speculative, or trading purposes.

### *Interest Rate Sensitivity*





## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Of our \$7.2 million principal amount of indebtedness at June 30, 2005, none bears interest at a variable rate. However, \$5.7 million bears interest at a fixed rate of 11%, \$0.5 million bears interest at a fixed rate of 12.5%, \$0.4 million bears interest at 9.25% and \$0.6 million bears fixed interest rates ranging from zero to 6%. Since these debt instruments bear interest at fixed rates, we have exposure to decreases in interest rates because we still are required to pay the fixed rate even if current interest rates are lower.

### *Foreign Currency Risk*



Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

We believe that our exposure to currency exchange fluctuation risk is reduced because our transactions with international vendors and customers are generally transacted in US dollars. The currency exchange impact on intercompany transactions was immaterial for the quarter ended June 30, 2005.



**Report of Independent Registered Public Accounting Firm**



Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

The Board of Directors and Stockholders of

MAI Systems Corporation

Lake Forest, California

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

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

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

/s/ BDO Seidman, LLP

Costa Mesa, California

April 25, 2005

**Consolidated Balance Sheets**





## MAI SYSTEMS CORPORATION

## CONSOLIDATED BALANCE SHEETS

	As of December 31, (in thousands, except share data)	
	2003	2004
<b>ASSETS</b>		
Current assets:		
Cash	\$ 664	\$ 195
Receivables, less allowance for doubtful accounts of \$335 in 2003 and \$321 in 2004	2,248	2,171
Inventories, net	47	71
Prepays and other assets	814	748
<b>Total current assets</b>	<b>3,773</b>	<b>3,185</b>
Furniture, fixtures and equipment, net	758	629
Intangibles, net	1,755	7,470
Goodwill	1,121	4,622
Other assets	58	15
<b>Total assets</b>	<b>\$ 7,465</b>	<b>\$ 15,921</b>
<b>LIABILITIES AND STOCKHOLDERS DEFICIENCY</b>		
Current liabilities:		
Current portion of long-term debt	\$ 3,646	\$ 1,003
Accounts payable	904	1,077
Customer deposits	3,269	2,181
Accrued liabilities	3,059	2,901
Income taxes payable	85	103
Unearned revenue	3,209	3,456
<b>Total current liabilities</b>	<b>14,172</b>	<b>10,721</b>
Long-term debt	7,135	6,649
Other liabilities	744	764
<b>Total liabilities</b>	<b>22,051</b>	<b>18,134</b>
Stockholders' deficiency:		
Preferred Stock, par value \$0.01 per share; 1,000,000 shares authorized, none issued or outstanding		
Common Stock, par value \$0.01 per share; authorized 99,000,000 shares; 14,675,752 and 57,847,862 shares issued and outstanding at December 31, 2003 and 2004, respectively	152	584
Additional paid-in capital	218,112	47,856
Accumulated other comprehensive loss:		
Minimum pension liability	(1,005)	(1,250)
Foreign currency translation	(2)	(69)
Unearned compensation	(53)	
Accumulated deficit	(231,790)	(49,334)
<b>Total stockholders' deficiency</b>	<b>(14,586)</b>	<b>(2,213)</b>
<b>Total liabilities and stockholders' deficiency</b>	<b>\$ 7,465</b>	<b>\$ 15,921</b>

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

C-14

---

**Consolidated Statements of Operations**

## MAI SYSTEMS CORPORATION

## CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)	For the Years Ended December 31,		For the Periods	
	2002	2003	Jan. 1, 2004 Oct. 31, 2004	Nov. 1, 2004 Dec. 31, 2004
<b>Revenue:</b>				
Software	\$ 4,585	\$ 3,855	\$ 3,223	\$ 766
Network and computer equipment	996	485	386	87
Services	16,356	15,006	12,708	2,901
<b>Total revenue</b>	<b>21,937</b>	<b>19,346</b>	<b>16,317</b>	<b>3,754</b>
<b>Direct costs:</b>				
Software	437	587	381	111
Network and computer equipment	770	370	318	79
Services	5,713	4,563	3,823	872
<b>Total direct costs</b>	<b>6,920</b>	<b>5,520</b>	<b>4,522</b>	<b>1,062</b>
<b>Gross profit</b>	<b>15,017</b>	<b>13,826</b>	<b>11,795</b>	<b>2,692</b>
Selling, general and administrative expenses	9,363	9,596	7,656	1,771
Research and development costs	3,307	2,828	3,039	669
Amortization of intangibles	134			96
Stock compensation charge			188	
Other operating expense	212	62	64	28
<b>Operating income</b>	<b>2,001</b>	<b>1,340</b>	<b>848</b>	<b>128</b>
Interest income	5	2	1	
Interest expense (including debt modification charge)	(1,495)	(1,219)	(1,966)	(147)
Other non-operating expense	(64)	(81)	(26)	(2)
Income (loss) from continuing operations before income taxes	447	42	(1,143)	(21)
Income tax benefit (expense)	(30)	311	(15)	(16)
Income (loss) from continuing operations	417	353	(1,158)	(37)
<b>Discontinued operations:</b>				
Loss on disposal of discontinued operations	(1,021)			
Loss from discontinued operations	(746)			
<b>Total loss from discontinued operations</b>	<b>(1,767)</b>			
<b>Net income (loss)</b>	<b>\$ (1,350)</b>	<b>\$ 353</b>	<b>\$ (1,158)</b>	<b>\$ (37)</b>
<b>Income (loss) per share:</b>				
<b>Continuing Operations:</b>				
Basic income (loss) per share	\$ 0.03	\$ 0.02	\$ (0.08)	\$
Diluted income (loss) per share	\$ 0.03	\$ 0.02	\$ (0.08)	\$
<b>Discontinued Operations:</b>				
Basic (loss) per share	\$ (0.13)	\$	\$	\$
Diluted (loss) per share	\$ (0.13)	\$	\$	\$

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Net income (loss) per share:

Basic income (loss) per share	\$	(0.10)	\$	0.02	\$	(0.08)	\$
-------------------------------	----	--------	----	------	----	--------	----

Diluted income (loss) per share	\$	(0.10)	\$	0.02	\$	(0.08)	\$
---------------------------------	----	--------	----	------	----	--------	----

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

Basic	13,945	14,538	14,676	57,848
Diluted	13,945	14,838	14,676	57,848

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

C-15

**Consolidated Statements of Stockholders Deficiency**





## MAI SYSTEMS CORPORATION

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS DEFICIENCY AND COMPREHENSIVE INCOME (LOSS)

(in thousands)

	Common Stock	Additional Paid-In Capital	Accumulated Other Comprehensive Income (Loss)	Unearned Compensation	Accumulated Deficit	Total Stockholders Deficiency	Total Comprehensive Income (Loss)
Balance at December 31, 2001	140	218,022	(361)		(230,793)	(12,992) \$	1,691
Issuance of common stock	3	74				77	
Minimum pension liability			(457)			(457)	(457)
Exercise of stock options	1	8				9	
Unearned compensation	6	147		(153)			
Amortization of unearned compensation				62		62	
Translation adjustments			(131)			(131)	(131)
Net loss					(1,350)	(1,350)	(1,350)
Balance at December 31, 2002	\$ 150	\$ 218,251	(949) \$	(91) \$	(232,143) \$	(14,782) \$	(1,938)
Issuance of common stock	2	18				20	
Issuance of warrants		42				42	
Legal settlement		(199)				(199)	
Minimum pension liability			(87)			(87)	(87)
Amortization of unearned compensation				38		38	
Translation adjustments			29			29	29
Net loss					353	353	353
Balance at December 31, 2003	\$ 152	\$ 218,112	(1,007) \$	(53) \$	(231,790) \$	(14,586) \$	295
Push down accounting adjustments		(175,324)	835	17	183,651	9,179	
Issuance of common stock for cash	100	900				1,000	
Issuance of common stock as a result of debt conversion	332	2,985				3,317	
Debt modification charge		995				995	
Stock compensation charge		188				188	
Amortization of unearned compensation				31		31	
Translation adjustments			(52)			(52)	(52)
Net loss					(1,158)	(1,158)	(1,158)
Balance at October 31, 2004	\$ 584	\$ 47,856	(224) \$	(5) \$	(49,297) \$	(1,086) \$	(1,210)
Minimum pension liability			(1,037)			(1,037)	(1,037)
Amortization of unearned compensation				5		5	
Translation adjustments			(58)			(58)	(58)
Net loss					(37)	(37)	(37)
	\$ 584	\$ 47,856	(1,319) \$		(49,334) \$	(2,213) \$	(1,132)

Balance at December 31,  
2004

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

C-16

---

**Consolidated Statements of Cash Flows**

## MAI SYSTEMS CORPORATION

## CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

	For the years ended December 31,		For the Periods	
	2002	2003	Jan. 1, 2004 Oct. 31, 2004	Nov. 1, 2004 Dec. 31, 2004
<b>Cash flows from operating activities:</b>				
Net income (loss)	\$ (1,350)	\$ 353	\$ (1,158)	\$ (37)
Loss from discontinued operations	746			
Loss (gain) on disposal of discontinued operations	1,021			
Income (loss) from continuing operations	417	353	(1,158)	(37)
Adjustments to reconcile income from continuing operations to net cash provided by (used in) operating activities, net of business acquisitions and dispositions:				
Gain on IRS settlement		(262)		
Amortization of intangibles	134	38		136
Depreciation and amortization	515	474	448	54
Amortization of debt discount	170	44	39	8
Debt modification charge			995	
Stock compensation charge	62		188	
Provision for doubtful accounts receivable and inventory	89	66	170	76
Changes in assets and liabilities:				
(Increase) decrease in receivables	592	469	(208)	(58)
(Increase) decrease in inventories	30		(31)	4
(Increase) decrease in prepaids and other asset	327	(185)	138	(114)
(Increase) decrease in other assets	68	(67)	44	(1)
(Decrease) increase in accounts payable and customer deposits	(445)	366	(799)	(116)
(Decrease) increase in accrued liabilities	(522)	1,052	363	496
(Decrease) increase in income taxes payable	(151)	(4)	17	1
(Decrease) increase in unearned revenue	1,700	(484)	367	(120)
(Decrease) increase in other liabilities	42	(421)	(286)	61
Net cash provided by (used in) continuing operations	3,028	1,439	287	390
Net cash provided by (used in) discontinued operations	(2,509)			
Net cash provided by (used in) operating activities	519	1,439	287	390
<b>Cash flows from investing activities:</b>				
Capital expenditures	(101)	(346)	(129)	(66)
Payments received on note receivable	500	250		
Software development costs	(861)	(896)	(906)	(159)
Acquisition of unconsolidated subsidiary		(79)		
Net cash used in investing activities	(462)	(1,071)	(1,035)	(225)
<b>Cash flows from financing activities:</b>				
Repayments of long-term debt	(102)	(239)	(739)	(137)

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Net decrease in line of credit	(623)				
Issuance of common stock				1,000	
Net provided by (cash used) in financing	(725)	(239)	261		(137)
Effect of exchange rate changes on cash	(11)	(10)	(4)		(6)
Net increase (decrease) in cash	(679)	119	(491)		22
Cash at beginning of period	1,224	545	664		173
Cash at end of period	\$ 545	\$ 664	\$ 173	\$	195
Cash paid during the period for:					
Interest	\$ 990	\$ 826	\$ 535	\$	20
Income taxes	\$ 176	\$ 6	\$ 35	\$	

Supplemental disclosure of non-cash investing and financing activities (see note 2)

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

C-17

**Notes to Consolidated Financial Statements**



**MAI SYSTEMS CORPORATION**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**NOTE 1 SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**





**Description of the Business**

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

**Liquidity**

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

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

**Principles of Consolidation**

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

**Use of Estimates**

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

**Revenue Recognition**

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

### **Cash Equivalents**

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

### **Allowance for Doubtful Accounts**

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

### **Inventories**

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

### **Furniture, Fixtures and Equipment**

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

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

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

## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

### **Goodwill**

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

### **Income Taxes**

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

**Comprehensive Income (Loss)**

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

**Stock Option Plans**

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

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

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

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

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

	Add: Stock-based employee compensation expense recorded					
	Less: Stock based employee compensation expense determined under fair value calculations	(0.01)				
	Pro forma	\$ (0.11)	\$ 0.02	\$ (0.08)	\$	
Diluted income (loss) per share:	As reported	\$ (0.10)	\$ 0.02	\$ (0.08)	\$	
	Add: Stock-based employee compensation expense recorded					
	Less: Stock based employee compensation expense determined under fair value calculations	(0.01)				
	Pro forma	\$ (0.11)	\$ 0.02	\$ (0.08)	\$	

**Pension Plan**

The Company established a defined benefit plan for employees that were employed by the Company's maintenance service business acquired in 1988. The plan provides benefits based upon a percentage of the participant's career income with the

Company or years of service while an employee of the Company. The funding policy is to contribute annually an amount to fund pension costs as actuarially determined by an independent pension consulting firm.

### **Foreign Currency Translation**

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

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

### **Software Development Costs**

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

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

### **Research and Development Costs**

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

### **Fair Value of Financial Instruments**



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

### **Income (Loss) per Share of Common Stock**

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

### **Recent Accounting Pronouncements**

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

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

**Reclassifications**

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

**NOTE 2 MANAGEMENT EQUITY/CONVERSION TRANSACTION AND PRIVATIZATION PLANS**



**Management Equity/Conversion Transaction**

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

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

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

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

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

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

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

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

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

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

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

	Adjusted Historical Book Value-Pre Push Down Accounting (1)	Fair Value	Excess of Fair Value Over Book Value	Investor Group's 65.52% of Excess(2)	Purchase Price Allocation
Furniture, fixtures and equipment	\$ 470	\$ 687	\$ 217	\$ 142	\$ 612

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Capitalized software development costs	2,661	2,503	(158)	(158)	2,503		
Goodwill	1,121	7,374	6,253	5,251	6,372		
Trade names		4,059	4,059	2,659	2,659		
Customer relationships		3,487	3,487	2,285	2,285		
Other net liabilities	(15,517)	(15,517)			(15,517)		
Net Book /Fair Value of Assets and Liabilities	\$	(11,265)		\$	10,179	\$	(1,086)

C-23

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

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

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

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

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

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

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

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

The unaudited pro forma information provided above has been prepared by adjusting historical amounts for the period

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

from January 1, 2004 to October 31, 2004 include the pro forma impact of the debt conversion resulting in the reduction of interest expense of \$332,000 and \$276,000, respectively.

The unaudited pro forma information provided above has been prepared by adjusting historical amounts for the per



**Privatization Plans**

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

**NOTE 3 INVENTORIES, NET**

Inventories are summarized as follows:

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

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

**NOTE 4 BUSINESSSES HELD FOR SALE**



## Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

In the fourth quarter of 2001, the Company's Board of Directors adopted a plan to sell its Process manufacturing and Legacy divisions. The Process manufacturing business division designed, sold, installed and supported total technology solutions featuring complex wide and local area networks to the process manufacturing industry. The Legacy business provided a wide array of products and services to its customers who continued to use its proprietary host-based computer systems, including field engineering services, new and replacement equipment, operating systems and software application products. These products and services upgraded, enhanced and integrated the legacy systems with currently available computer technologies.

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

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

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

	<b>2002</b>	
Revenue	\$	2,344
Loss, net of tax of zero	\$	(1,767)

### **NOTE 5 FURNITURE, FIXTURES AND EQUIPMENT**

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

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

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

**NOTE 6 ACQUISITIONS, DIVESTITURE, AGREEMENTS AND FINANCING**





**Hospitality Services & Solutions**

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

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

**Gaming Systems International**

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

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

**MAI Canada**

On December 6, 2002, the Company sold all the assets and certain liabilities of its Canadian operations, including all legacy divisions, to the management of this subsidiary pursuant to a stock purchase agreement. In connection with the sale, the Company also entered into a software

distribution agreement whereby the buyer has a non-exclusive right and license to market and install the Company's hospitality products in Canada. The sale resulted in a loss of approximately \$630,000, which is included in the loss on disposal of discontinued operations. Prior to the sale, the Canadian operations incurred a net loss of \$305,000 during 2002, which is included in loss from discontinued operations in the accompanying statements of operations.

**Process Manufacturing**

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

**NOTE 7 INTANGIBLE ASSETS AND GOODWILL**

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

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

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

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

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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



Year Ending December 31, (in thousands)		
2005	\$	861
2006		861
2007		861
2008		861
2009		861
Thereafter		3,165
	\$	7,470

C-27

---

## **NOTE 8 LONG-TERM DEBT**

**Wamco 32 Ltd.**

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

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

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

**Canyon Capital Management LP**

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

tangible and intangible assets for the Company, including intellectual property, which lien is junior to the lien granted to Wamco. The principal balance outstanding on the subordinate notes payable to Canyon was approximately \$5,662,000 and \$5,660,000 at December 31, 2003 and 2004, respectively.

### **CSA Private Limited**

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

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

On April 9, 2004, the Company successfully amended its agreement with CSA whereby the principal balance and accrued interest through March 31, 2004, totaling \$3,633,000, were converted to two new secured notes. The first note for \$500,000 accrues interest at 10% per annum and provides for monthly payments of \$10,000 until the Wamco and Canyon debt is paid in full. Thereafter, the note provides for monthly payments in an amount equal to the greater of i) \$10,000 or ii) the amount required to fully amortize all remaining principal and interest in 24 equal monthly payments. The second note for \$3,133,344 ( Other Note ) also accrues interest at 10% per annum and provides for monthly payments of \$7,500, or such other interest

amount, not to exceed \$10,000 per month, that Wamco and Canyon will allow. Under the terms of the amended subordination agreement between Wamco, Canyon and CSA, all payments under the new notes are subordinated to the payment in full of the Wamco and Canyon loan agreements. The Company has not made any payments on the \$500,000 note as of December 31, 2004 and is currently in default. The interest rate has been increased to 12.5% in line with the terms of that note until the Company becomes current on its contractual payments. As of December 31, 2004, the Company's accrued and unpaid interest relating to the \$500,000 secured note was \$49,000.

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

### **Tax Claims**

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

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

Long-term debt outstanding is as follows:

	December 31, (in thousands)	
	2003	2004
11% subordinated debt, net of discount of \$50,000 and 37,000, respectively	\$ 5,623	\$ 5,623
12.5% subordinated debt	2,800	500
9.25% debt	1,366	774

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Tax Claims	428	363
Other	575	392
	10,781	7,652
Less: current installments	(3,646)	(1,003)
Non-current portion	\$ 7,135	\$ 6,649

Aggregate maturities of long-term debt are as follows:

Year Ending December 31, (in thousands)	
2005	\$ 1,003
2006	1,557
2007	1,939
2008	2,145
2009	425
Thereafter	583
	\$ 7,652

C-29

---

## **NOTE 9 - ACCRUED LIABILITIES**

Accrued liabilities consist of the following:

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

## NOTE 10 - INCOME TAXES



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

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

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

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

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

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

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Total deferred tax assets	22,188	3,438
Deferred tax liability:		
Furniture, fixtures and equipment		(57)
Identifiable intangible assets		(3,121)
Total deferred tax liabilities		(3,178)
Net deferred tax assets	22,188	260
Less: valuation allowance	(22,188)	(260)
Net deferred tax assets	\$	\$

C-30

---

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

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

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

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

	Years Ended December 31,		For the Periods	
	2002	2003	Jan. 1, 2004 Oct. 31, 2004	Nov. 1, 2004 Dec. 31, 2004
Statutory tax at 34%	\$ 152	\$ 14	\$ (389)	\$ (7)
Change in valuation allowance	(3,036)	(187)	(395)	(18,354)
Expiration of state NOLs	22		48	
Effect of foreign operations	2,729	140	(215)	11
Adjustments of NOL carry forwards and deferred tax assets pursuant to the finalization of the IRS examination		(326)	803	18,466

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

and other analysis						
Stock compensation charge					64	
Change in estimates			48			
Other	163				99	(100)
Income tax expense (benefit)	\$	30	\$	(311)	\$	15
					\$	16

C-31

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

## **NOTE 11 - SEGMENTS**



Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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

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

\$ 2,860 \$ 3,692 \$ 13,077 \$ 12,736

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



## **Customers**

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

## **NOTE 12 - STOCKHOLDERS DEFICIENCY**

### **Stock Option Plans**

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

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

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

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

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

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

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

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

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

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

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

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

### **Restricted Stock Plan**

In May 2001, the Board of Directors adopted the 2001 Restricted Stock Plan. Under the plan, 5,500,000 authorized shares of the Company's Common Stock are reserved for issuance to officers and directors of the Company. The

shares will be issued as Restricted Stock within the meaning of Rule 144 of the Securities Act of 1933, as amended. The Compensation Committee of the Board of Directors shall have the discretion to determine what terms and conditions shall apply, including the imposition of a vesting schedule.

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

### **Preferred Stock**

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

### **Stock Warrants**

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

expire on February 1, 2010.

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

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

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

## **NOTE 13 - EMPLOYEE BENEFITS**



**Savings Plans**

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

**Defined Benefit Plans**

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

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

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

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

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

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

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

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

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

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



Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

C-36

---

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

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

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

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

## NOTE 14 - COMMITMENTS AND CONTINGENCIES



**Leases**

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

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

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

**Legal Proceedings***Hotel Information Systems, Inc.*

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

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



*Logix Development Corporation*

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

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

*Other Litigation*

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

**Related Party Transactions**

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

**NOTE 15 - INCOME (LOSS) PER SHARE**

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

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

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

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



**NOTE 16 QUARTERLY RESULTS OF OPERATIONS (Unaudited)***(in millions, except share data)*

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

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

## MAI SYSTEMS CORPORATION

## CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

	(in thousands, except share data)	
	As of December 31, 2004 (a)	As of June 30, 2005
<b><u>ASSETS</u></b>		
Current assets:		
Cash	\$ 195	\$ 412
Receivables, less allowance for doubtful accounts of \$321 in 2003 and \$300 in 2005	2,171	3,289
Inventories	71	62
Prepays and other assets	748	772
Total current assets	3,185	4,535
Furniture, fixtures and equipment, net	629	575
Intangibles, net	7,470	7,020
Goodwill	4,622	4,622
Other assets	15	14
Total assets	\$ 15,921	\$ 16,766
<b><u>LIABILITIES AND STOCKHOLDERS DEFICIENCY</u></b>		
Current liabilities:		
Current portion of long-term debt	\$ 1,003	\$ 1,200
Accounts payable	1,077	907
Customer deposits	2,181	2,481
Accrued liabilities	2,901	2,856
Income taxes payable	103	95
Unearned revenue	3,456	5,003
Total current liabilities	10,721	12,542
Long-term debt	6,649	5,984
Other liabilities	764	692
Total liabilities	18,134	19,218

## Commitments and contingencies

## Stockholders' deficiency:

Preferred Stock, par value \$0.01 per share; 1,000,000 shares authorized, none issued or outstanding

Common Stock, par value \$0.01 per share; authorized 99,000,000 shares; 57,847,862 shares issued and outstanding at December 31, 2004 and June 30, 2005

	584	584
Additional paid-in capital	47,856	47,856
Accumulated other comprehensive loss:		
Minimum pension liability	(1,250)	(1,250)
Foreign currency translation	(69)	(59)
Accumulated deficit	(49,334)	(49,583)
Total stockholders' deficiency	(2,213)	(2,452)
Total liabilities and stockholders' deficiency	\$ 15,921	\$ 16,766

(a) Derived from the December 31, 2004 audited financial statements.

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

## MAI SYSTEMS CORPORATION

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	(Unaudited) For the Three Months Ended June 30, (in thousands, except per share data)		(Unaudited) For the Six Months Ended June 30, (in thousands, except per share data)	
	2004	2005	2004	2005
<b>Revenue:</b>				
Software	\$ 814	\$ 1,583	\$ 2,103	\$ 2,537
Network and computer equipment	136	90	211	279
Services	3,951	4,329	7,760	7,941
Total revenue	4,901	6,002	10,074	10,757
<b>Direct costs:</b>				
Software	8	166	329	509
Network and computer equipment	109	64	169	243
Services	1,113	1,396	2,182	2,721
Total direct costs	1,230	1,626	2,680	3,473
Gross profit	3,671	4,376	7,394	7,284
<b>Selling, general and administrative expenses</b>				
Selling, general and administrative expenses	2,351	2,366	4,700	4,550
Research and development costs	908	1,143	1,800	2,264
Amortization of intangibles		126		238
Other operating expense	15	59	18	72
Operating income	397	682	876	160
Interest expense	(288)	(197)	(579)	(400)
Other non-operating expense	(23)		(39)	
Income (loss) before income taxes	86	485	258	(240)
Income tax expense	(4)	(5)	(10)	(9)
Net income (loss)	\$ 82	\$ 480	\$ 248	\$ (249)
<b>Income (loss) per share:</b>				
<b>Net income (loss) per share:</b>				
Basic income (loss) per share	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.00
Diluted income (loss) per share	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.00

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

Basic	14,676	57,848	14,676	57,848
Diluted	14,676	57,848	14,676	57,848

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

MAI Systems Corporation

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	For the Six Months Ended June 30, (in thousands)	
	2004	2005
Net cash provided by operating activities:	\$ 605	\$ 718
Cash flows used in investing activities:		
Capital Expenditures	(110)	(27)
Capitalized software development costs	(604)	
Net cash used in investing activities	(714)	(27)
Cash flows used in financing activities-		
Repayments on long-term debt	(425)	(478)
Net cash provided by (used in) operations	(534)	213
Effect of exchange rate changes on cash	(1)	4
Net increase (decrease) in cash	(535)	217
Cash at beginning of period	664	195
Cash at end of period	\$ 129	\$ 412

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

MAI Systems Corporation

Notes to Condensed Consolidated Financial Statements

Three and Six Months ended June 30, 2005 and 2004

(Unaudited)

#### **NOTE 1 - BASIS OF PRESENTATION**

Companies for which this report is filed are MAI Systems Corporation and its wholly-owned subsidiaries (the Company). The information contained herein is unaudited, but gives effect to all adjustments (which are normal recurring accruals) necessary, in the opinion of Company management, to present fairly the condensed consolidated financial statements for the interim period. All significant intercompany transactions and accounts have been eliminated in consolidation. The results of operations for the quarter and six month periods ended June 30, 2005 are not necessarily indicative of the results to be expected for the entire year or for any future period.

Although the Company believes that the disclosures in these financial statements are adequate to make the information presented not misleading, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC), and these financial statements should be read in conjunction with the financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2004, which is on file with the SEC.

#### **NOTE 2 - LIQUIDITY**

Although the Company has a net stockholders' deficiency of \$2,452,000 and a working capital deficit of \$8,007,000 at June 30, 2005, the Company believes it will generate sufficient funds from operations or obtain additional financing to meet its operating and capital requirements for at least the next 12 months. The Company expects to generate positive cash flow from its continuing operations during 2005 from shipping out products and services from its current backlog as of June 30, 2005 as well as new orders. In the event that the Company cannot generate positive cash flow from its continuing operations during 2005, the Company can substantially reduce its research and development

efforts to mitigate cash outflow to help sustain its operations. There can be no assurance that the Company will be able to sustain profitability or generate positive cash flow from operations or obtain additional financing as necessary. These financial statements have been prepared assuming the Company will continue to operate as a going concern. If the Company is unsuccessful in the aforementioned efforts, the Company could be forced to liquidate certain of its assets, reorganize its capital structure and, if necessary, seek other remedies available to the Company.

The restructured debt, pursuant to the original intercreditor agreement between Canyon and Coast, which was sold to Wamco on May 15, 2003, contains various restrictions and covenants, including a minimum quick ratio of 0.20 to 1.00 and minimum debt service coverage ratio of 0.50 to 1.00. In the event that we were not in compliance with the various restrictions and covenants and were unable to receive waivers for non-compliance, the term debt would be immediately due and payable (see note 5). The Company was in compliance with its covenants as of June 30, 2005. There is no guaranty that the Company will meet its debt covenants in the future.

### **NOTE 3 MANAGEMENT EQUITY/CONVERSION TRANSACTION AND PRIVATIZATION PLANS**





**Management Equity/Conversion Transaction**

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

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

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

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

---

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

The following reflects the unaudited pro forma effect of the Management Equity/Conversion Transaction on continuing operations for the three and six -month periods ended June 30, 2004 (in thousands):

For the Three - Months Ended	For the Six - Months Ended
---------------------------------	-------------------------------

	June 30, 2004		June 30, 2004	
Revenue	\$	4,901	\$	10,074
Operating income		258		597
Net income		26		135
Net income per share	\$	0.00	\$	0.01

**The unaudited pro forma information provided above has been prepared by adjusting historical amounts for the three and six month periods ended June 30, 2004 to give effect to the Management Equity/Conversion Transaction as if it had occurred on January 1, 2004. The pro forma adjustments to the historical results of operations for the three and six month periods ended June 30, 2004 include the pro forma impact of the push down accounting resulting in the reduction of depreciation expense of \$76,000 and \$152,000, respectively, and an increase of amortization of identifiable intangible assets of \$215,000 and \$431,000, respectively. The pro forma adjustments to the historical results of operations for the three month and six month periods ended June 30, 2004 include the pro forma impact of the debt conversion resulting in the reduction of interest expense of \$83,000 and \$166,000, respectively.**



**Privatization Plans**

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

**NOTE 4 - INVENTORY**

Inventories are summarized as follows:

	(dollars in thousands)	
	December 31, 2004	June 30, 2005
Finished goods	\$ 65	\$ 54
Replacement parts	6	8
	\$ 71	\$ 62

**NOTE 5 - LONG TERM DEBT****Wamco 32 Ltd.**

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

The unaudited pro forma information provided above has been prepared by adjusting historical amounts ~~254~~ the three

The loan matures on February 28, 2006, at which time all remaining principal and accrued interest is due and payable. The Company will also be required to pay Wamco additional principal payments on a quarterly basis based upon an EBITDA-based formula commencing March 31, 2003. For the years ended December 31, 2003 and 2004, there were no additional principal payments required under the EBITDA-based formula. As of December 31, 2004 and June 30, 2005, the balance of the term loan was \$774,000 and \$402,000, respectively.

The loan, pursuant to the original inter-creditor agreement between Canyon Capital and Coast, which was sold to Wamco on May 15, 2003, contains various restrictions and covenants, including a minimum quick ratio of 0.20 to 1.00 and minimum debt service coverage ratio of 0.50 to 1.00. In the event that the Company were not in compliance with the various restrictions and covenants and were unable to receive waivers for non-compliance, the term loan would be immediately due and payable. The Company was in compliance with such covenants as of June 30, 2005. There is no guaranty that the Company will meet its debt covenants in the future.

### **Canyon Capital Management LP**

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

lien is junior to the lien granted to Wamco. Accrued and unpaid interest outstanding on the subordinate notes payable to Canyon was approximately \$108,000 at June 30, 2005. The principal balance outstanding on the subordinate notes payable to Canyon was approximately \$5,660,000 at December 31, 2004 and June 30, 2005.

### **CSA Private Limited**

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

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

On April 9, 2004, the Company successfully amended its agreement with CSA whereby the principal balance and accrued interest through March 31, 2004, totaling \$3,633,000, were converted to two secured new notes. The first note for \$500,000 accrues interest at 10% per annum and provides for monthly payments of \$10,000 until the Wamco and Canyon debt is paid in full. Thereafter, the note provides for monthly payments in an amount equal to the greater of i) \$10,000 or ii) the amount required to fully amortize all remaining principal and interest in 24 equal monthly payments. The second note for \$3,133,344 ( Other Note ) also accrued interest at 10% per annum and provided for monthly payments of \$7,500, or such other interest amount, not to exceed \$10,000 per month, that Wamco and Canyon will allow. Under the terms of the amended subordination agreement between Wamco, Canyon and CSA, all payments under the new notes are subordinated to the payment in full of the Wamco and Canyon loan agreements. The Company has not made any payments on the \$500,000 note as of June 30, 2005 and is currently in default. The interest rate has been increased to 12.5% in line with the terms of that note until the Company becomes current on its contractual payments. As of June 30, 2005, the Company's accrued and unpaid interest relating to the \$500,000 secured note was \$84,000.

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

The unaudited pro forma information provided above has been prepared by adjusting historical amounts ~~256~~ the three



stock (see note 3).

### **Tax Claims**

On September 30, 2003, the Company entered into a settlement agreement with the United States Internal Revenue Service (the Service) on a tax claim which resulted from the Company's 1993 Chapter 11 proceedings whereby it agreed to pay \$489,000 in equal monthly installments of \$7,438 over a period of six (6) years at an interest rate of 6%. The \$489,000 settlement is reflected as debt in the financial statements and resulted in a one-time gain of \$262,000 which is included in income tax benefit. In the event that the Company fails to pay the Service any payment, and such payment failure continues for sixty days after written notice of such failure, \$1,832,100, plus accrued interest thereon, less any payments made by the Company will be immediately due and payable to the Service. As of June 30, 2005, the Company was current with its payments to the Service and the debt balance was \$328,000.

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

### **NOTE 6 - RESTRICTED STOCK PLAN**

In May 2001, the Board of Directors adopted the 2001 Restricted Stock Plan. Under the plan, 1,250,000 authorized shares of the Company's Common Stock are reserved for issuance to officers and directors of the Company. The shares will be issued as Restricted Stock within the meaning of Rule 144 of the Securities Act of 1933, as amended. The Compensation Committee of the Board of Directors shall have the discretion to determine what terms and conditions shall apply, including the imposition of a vesting schedule.

In May 2002, the Company issued 612,500 shares of restricted common stock to its members of the board of directors and certain of its corporate officers which vest equally over a four-year period. Recipients are not required to provide consideration to the Company other than rendering the service and have the right to vote the shares. Under APB 25, compensation cost is recognized for the fair value of the restricted stock awarded, which is its quoted market price at the date of grant, which was \$0.25 per share.

The total market value of the shares of \$153,000 was treated as unearned compensation and was amortized to expense in proportion to the vesting schedule. The balance of unearned compensation was fully amortized as of June, 2005.

#### NOTE 7 - PREFERRED STOCK

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

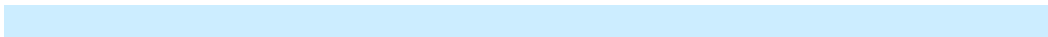
#### NOTE 8 - INTANGIBLE ASSETS

As of June, 2005, intangible assets consist of developed technology, software trade names, customer lists and goodwill (which represents the excess of the purchase price over the estimated fair value of the net assets of the acquired businesses) and capitalized software. Identifiable intangible assets other than goodwill are amortized on a straight-line basis over their estimated useful lives. Goodwill is not to be amortized until its life is determined to be finite, however, a recognized intangible asset with an indefinite useful life should be tested for impairment annually or on an interim basis if events or circumstances indicate that the fair value of the asset has decreased below its carrying value. At June 30, 2005, the Company evaluated its goodwill and determined that fair value had not decreased below carrying value and no adjustment to impair goodwill was necessary.

Intangible assets as of December 31, 2004 and June 30, 2005 are as follows (in thousands):

	December 31, 2004	June 30, 2005
Gross carrying amount of intangible assets:		
Capitalized software	\$ 2,662	\$ 2,662
Software trade names	2,659	2,659
Customer relationships	2,285	2,285
Total intangible assets	7,606	7,606
Accumulated amortization:		
Capitalized software	(39)	(250)
Software trade names	(41)	(118)
Customer relationships	(56)	(218)
Total accumulated amortization	(136)	(586)
Intangible assets, net	\$ 7,470	\$ 7,020

The unaudited pro forma information provided above has been prepared by adjusting historical amounts ~~258~~ the three



Goodwill	\$	4,622	\$	4,622
----------	----	-------	----	-------

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



Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

Goodwill at December 31, 2003	\$	1,121
Goodwill from Management Equity/Conversion Transaction		5,251
Private placement by Investor Group (note 2)		(1,000)
Year end adjustment to minimum pension liability		(750)
Impairment identified in 2004		
Goodwill at December 31, 2004 and June 30, 2005	\$	4,622

C-47

---

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

Year Ending December 31, (in thousands)	
2005	\$ 431
2006	861
2007	861
2008	861
2009	861
Thereafter	3,731
	\$ 7,606

**NOTE 9 - INCOME (LOSS) PER SHARE**

Basic and diluted income or loss per share is computed using the weighted average shares of common stock outstanding during the period. Consideration is also given in the diluted income per share calculation for the dilutive effect of stock options and warrants.

The following table illustrates the computation of basic and diluted earnings (loss) per share under the provisions of SFAS 128:

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2004	2005	2004	2005
	(in thousands except per share data)		(in thousands except per share data)	
<b>Numerator:</b>				
Numerator for basic and diluted earnings (loss) per share - net income (loss)	\$ 82	\$ 480	\$ 248	\$ (249)
<b>Denominator:</b>				
Denominator for basic income (loss) per share - weighted average number of Common shares outstanding during the period	14,676	57,848	14,676	57,848
Incremental common shares attributable to exercise of outstanding shares				
Denominator for diluted income (loss) per share	14,676	57,848	14,676	57,848
Basic earnings (loss) per share	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.00
Diluted earnings (loss) per share	\$ 0.01	\$ 0.01	\$ 0.02	\$ 0.00

The Company's amortization period for customer relationships is the greater of seven years on a straight-line basis



The number of anti-dilutive options and warrants that were excluded from the computation of incremental common shares were 3,104,000 and 2,647,750 in 2004 and 2005, respectively.

C-48

---

The Company's amortization period for customer relationships is the greater of seven years on a straight-line basis

**NOTE 10 - STOCK OPTION PLANS**

The Company accounts for stock-based compensation in accordance with Accounting Principles Board, APB, No. 25, Accounting for Stock Issued to Employees. The Company has adopted the disclosure-only provisions of FAS No. 123 Accounting for Stock-Based Compensation. Under APB No. 25, compensation expense relating to employee stock options is determined based on the excess of the market price of the Company's stock over the exercise price on the date of grant, the intrinsic value method, versus the fair value method as provided under FAS No. 123.

In December 2002, the FASB issued FAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, which amended FAS No. 123, Accounting for Stock-Based Compensation. The new standard provides alternative methods of transition for a voluntary change to the fair market value based method for accounting for stock-based employee compensation. Additionally, the statement amends the disclosure requirements of FAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. This statement is effective for financial statements for the year ended December 31, 2002. In compliance with FAS No. 148, the Company has elected to continue to follow the intrinsic value method in accounting for its stock-based employee compensation plan as defined by APB No. 25.

At June 30, 2005, the Company had two stock-based employee compensation plans. The Company accounts for these plans under the recognition and measurement principles of APB No. 25, Accounting for Stock Issued to Employees, and related interpretations. Accordingly, no stock-based employee compensation cost is reflected in net income (loss), as all options granted under the plan had an exercise price equal to the market value of the underlying common stock on the date of grant. Had compensation cost for the Company's stock option plan been determined based on the fair value at the grant date for awards for the three and six month periods ended June 30, 2004 and 2005, consistent with the provisions of FAS No. 123, the Company's net income (loss) and net income (loss) per share would have decreased. The following table represents the effect on net income and net income per share if the Company had applied the fair value based method and recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, to stock-based employee compensation.

	For the three-months ended June 30, (in thousands, except per share data)		For the six-months ended June 30, (in thousands, except per share data)	
	2004	2005	2004	2005
Net income (loss):				
As reported	\$ 82	\$ 480	\$ 248	\$ (249)
Add: Stock-based employee compensation expense recorded	10	10	20	20
Less: Stock based employee compensation expense determined under fair value	(10)	(10)	(20)	(20)

The Company's amortization period for customer relationships is the greater of seven years on a straight-line basis

Edgar Filing: MAI SYSTEMS CORP - Form PRER14C

calculations							
Pro forma	\$	82	\$	480	\$	248	\$ (249)
Basic income (loss) per share:							
As reported	\$	0.01	\$	0.01	\$	0.02	\$ 0.00
Add: Stock-based employee compensation expense recorded							
Less: Stock based employee compensation expense determined under fair value calculations							
Pro forma	\$	0.01	\$	0.01	\$	0.02	\$ 0.00
Diluted income (loss) per share:							
As reported	\$	0.01	\$	0.01	\$	0.02	\$ 0.00
Add: Stock-based employee compensation expense recorded							
Less: Stock based employee compensation expense determined under fair value calculations							
Pro forma	\$	0.01	\$	0.01	\$	0.02	\$ 0.00

C-49

**NOTE 11 - LEGAL PROCEEDINGS**

*Hotel Information Systems, Inc.*

On March 25, 2003, the Company entered into a settlement agreement with Hotel Information Systems ( HIS ) and one of its former corporate officers whereby (i) the parties dismissed all claims, known and unknown, against each other; (ii) the Company forgave and wrote off a note receivable from the former corporate officer of HIS in the amount of \$66,000 (which was expensed to other expense in the 2002 consolidated statement of operations); (iii) the Company paid \$50,000 in cash and issued a non-interest bearing unsecured promissory note which requires 35 consecutive monthly payments of \$5,000 each commencing April 1, 2003; and (iv) the remaining 374,116 shares in the escrow account will be released to the Company. If the Company is delinquent four times in any twelve-month period during the term of the unsecured promissory note in making its \$5,000 monthly payments to HIS, and HIS issues respective valid default notices, the Company will be subject to a \$225,000 penalty. As of June 30, 2005, the Company was current on its payments to HIS. The 374,116 shares have been received by MAI together with the HIS authorization to legally transfer such shares to MAI.

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



*Logix Development Corporation*

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

In December 2003, the Company entered into another settlement agreement with Logix whereby it (i) issued 200,000 free trading shares in exchange for the 200,000 restricted Common Shares from the original settlement agreement in July 2002 (ii) required the Company to make monthly payments totaling \$187,500 over a 25 month period and (iii) mutually released each other of all past, present and future claims associated with the lawsuit. As of June 30, 2005, the Company was current on its payments to Logix.

*Other Litigation*

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

**NOTE 12 COMPREHENSIVE INCOME**

The following table summarizes components of comprehensive income:

	For The Three Months Ended		For The Six Months Ended	
	June 30,		June 30,	
	2004	2005	2004	2005
Net income (loss)	\$ 82	\$ 480	\$ 248	\$ (249)
Change in cumulative translation adjustments	(37)	(5)	(57)	10
Comprehensive income (loss)	\$ 45	\$ 475	\$ 191	\$ (239)

In accordance with SFAS No. 130, Reporting Comprehensive Income, the Company reports accumulated other comprehensive income (loss) in its Consolidated Balance Sheets. Comprehensive income (loss) includes net income

(loss), minimum pension liability and other comprehensive income (loss), which includes current period foreign currency translation adjustments and amortization of unearned compensation.

C-50

---