

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-KSB

ANNUAL REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES
EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 31, 1996

Commission File Number: 0-27862

REALITY INTERACTIVE, INC.

MINNESOTA
State of Incorporation

41-1781991
I.R.S. Employer Identification Number

Suite 400
7500 Flying Cloud Drive
Eden Prairie, MN 55344
(612) 996-6777

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

COMMON STOCK, \$.01 PAR VALUE

Check whether the issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 12 months (or for such period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes X No
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Check if there is no disclosure of delinquent filers in response to Item 405 of Regulations S-B is not contained herein, and no disclosure will be contained, to the best of registrants knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB.

/ X /

The Company's revenues for the Fiscal Year Ended December 31, 1996 totaled \$484,127

As of February 28, 1997, the Company had 4,677,407 shares of Common Stock outstanding. The aggregate market value of the 2,261,881 shares of Common Stock held by non-affiliates of the Company was \$1,413,676, based on the closing bid price on February 28, 1997 on the NASDAQ Small Cap Market.

Transitional small business disclosure format: Yes No x
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DOCUMENTS INCORPORATED BY REFERENCE: Portions of the Company's Proxy Statement for the Annual Meeting of Shareholders for the year ended December 31, 1996 are incorporated by reference in Part III.

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SAFE HARBOR STATEMENT UNDER THE
PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-KSB contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements involve risks and uncertainties that may cause the Company's actual results to differ materially from the results discussed in the forward-looking statements. Factors that might cause such differences include, but are not limited to, the uncertainty in growth of a development stage company; limited growth of the market for multimedia education and training products; lack of market acceptance of the Company's products; inability of the Company to expand its marketing capability; inability of the Company to diversify its product offerings; failure of the Company to respond to evolving industry standards and technological changes; inability of the Company to meet its future additional capital requirements; inability of the Company to compete in the business education and training industry; loss of key management personnel; inability to retain subject matter experts; failure of the Company to secure adequate protection for the Company's intellectual property rights; and the Company's exposure to product liability claims. The forward-looking statements are qualified in their entirety by the cautions and risk factors set forth in Exhibit 99.1, under the caption "Cautionary Statement," to this Annual Report on Form 10-KSB for the year ended December 31, 1996.

PART I

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL

The Company was formed in May 1994 to design, develop and market interactive multimedia knowledge solutions to the industrial marketplace. The Company's business strategy is to identify industry standards and practices that affect business productivity and profitability, where the adoption of such standards and practices require enterprise-wide education and training. To address this education and training need, the Company creates products that incorporate digital multimedia elements, such as animation, video, graphics, audio and text, into a rich, interactive learning environment. Also, each of the Company's products contain productivity tools, such as word processors, budget forms and custom tailored project plans, to allow the user to organize, analyze and produce documents using company-specific information. The Company believes the interactivity of its products allows the user to control the learning environment, including the pace, sequence and level of instruction, as well as improve memory retention, compress learning time and reduce costs compared to traditional learning methods.

The Company considers itself to be a development stage company as its sales and marketing efforts have not yet generated predictable or significant revenues. The Company has a deficit accumulated during the development stage of \$9,795,144. To become profitable and to conserve capital, the Company must significantly increase revenues and manage expenses. Future operating results will depend upon many factors, including the rate at which industry adopts interactive multimedia technology for education and training, the level of product and price competition, the Company's success in maturing its direct and indirect sales channels and the ability of the company to manage its expenses in relation to sales.

PRODUCTS

The Company's product strategy has involved developing pre-packaged products that help companies comply with emerging international management standards and business practices. The Company develops products that are composed of related titles in a series that addresses a specific topic. Each series consists of four or five integrated titles and complimentary single titles, which can be sold individually or as a group. Each individual title generally sells for \$995, with discounts being offered for increasing levels of purchase commitments.

After identifying a business topic suitable for a product, the Company retains subject matter experts to provide a combination of experience, course materials, reference materials, video training, charts, diagrams and software applications. The Company's product development team works closely with the subject matter experts to transform static text and diagrams into a dynamic, interactive learning environment. The objective of the development process is to design and develop an engaging source of information that educates and trains the user. The Company's products also provide digital tools to the user to accomplish specific objectives, such as the creation of documents that provide the foundation of compliance to international management standards.

The Company has developed four products within the areas of international quality and environmental management standards, which are discussed below in more detail:

1. ISO 9000 REGISTRATION SERIES. This product is a five title series that guides a company through the entire process of complying with the ISO 9000 quality management standard. This standard, which focuses on the elements of a company's quality system, requires a company to (i) review the efficacy of its business processes and procedures, (ii) document its processes and procedures in a quality

manual and (iii) periodically audit its processes and procedures for consistent use. The product became available for sale in August 1995 and generated revenues of \$347,844 in 1996.

2. QS-9000 COMPLIANCE SERIES. This product is a four title series that helps automotive suppliers comply with the QS-9000 Supplier Quality Requirements ("QS-9000") developed by Ford Motor Company, Chrysler Corporation and General Motors Corporation (the "Big Three"). QS-9000 includes three sections: the ISO 9000 standards with enhancements and clarifications, additional quality requirements common to the Big Three and supplier specific quality requirements unique to each of the Big Three automakers. The product became available for sale in September 1996 and generated revenues of \$131,245 for the remainder of the year.
3. ISO 14000 EMS CONFORMANCE SERIES. This product is a five title series that assists companies with the design, implementation and management of an environmental management system in accordance with the ISO 14000 environmental management system standard. A key requirement of ISO 14000 is the establishment of internal pollution prevention policies. The objective is to require companies to create procedures for managing environmental affairs within their organizations in a clear and consistent manner. The Company released two of the titles to this series in October 1996, with the remaining three titles released in March 1997. The Company generated revenues of \$3,788 with the initial two titles in 1996.
4. POLLUTION PREVENTION. This is a one title product that enables companies to understand the key concepts of pollution prevention, and assists them in the preparation of a strategic plan that focuses on improving business processes and waste reduction. This product also allows users to link, via the World Wide Web, to state, regional, national and international pollution prevention resources. This product became available for sale in November 1996. No revenues were generated by this product in 1996.

Currently, the Company is in the process of translating its QS-9000 product for distribution in the German marketplace. This translation is being performed by Futuremedia PLC, the Company's distributor in the UK. Completion of the product is expected to occur in the summer of 1997, and once completed, will be distributed by Lasermedia GMBH, Futuremedia's wholly-owned subsidiary in Germany. The Company currently has no plans to translate its products into other languages, although the Company will consider such plans if the appropriate market opportunities arise.

All of the Company's products are delivered via CD-ROM, and operate on multimedia equipped, Windows-configured PCs. Because the products were developed using standard digital technology, the Company will have the ability to deliver its products over a number of platforms, including the Internet, corporate intranets, cable and satellite transmission. The Company believes its future success will depend, in part, on its ability to adapt its products to these other digital delivery platforms.

The Company has no immediate plans to develop additional off-the-shelf products. During 1997, the Company's business strategy will include developing customer relationships that result in the delivery of custom multimedia development services. The Company expects that such services will allow the Company to leverage the talent of its development staff. The Company will also begin to focus its attention towards Internet and Intranet delivery of its current products, as well as other Web development opportunities related to its core business strategy. Although these strategies represent a shift from the Company's historical focus of developing off-the-shelf products, the Company believes this change will better position the Company as a complete source for multimedia content development.

PRODUCT MARKETS

The adoption of international quality and environmental management standards has primarily occurred in manufacturing related companies, encompassing small job shops to Fortune 500 multinational companies. According to the January 1997 issue of QUALITY SYSTEMS UPDATE, which is published by McGraw-Hill, 15,475 North American locations were registered to ISO 9000 by the end of 1996. In the United States, 11,738 locations were registered to ISO 9000 by the end of 1996, a 38% increase over 1995.

For the QS-9000 market, certain representatives of the Big Three have mandated their tier 1 suppliers to comply with this quality requirement. Chrysler Corporation has mandated their suppliers to comply with QS-9000 by July 31, 1997, and General Motors Corporation has mandated compliance to QS-9000 by December 31, 1997. In total, the mandate is estimated to affect approximately 13,000 tier 1 suppliers. It is widely believed by experts in the automotive industry that QS-9000 may be adopted by companies who supply to the tier 1 suppliers, either voluntarily or as a result of a mandate by tier 1 suppliers. If this occurs, it may represent a potential market for the Company's QS-9000 product of approximately 80,000 companies. The Company is also marketing its QS-9000 product in foreign markets, such as Europe and Asia, which represents a major share of the worldwide auto market.

The ISO 14000 standard was first published in September 1996. The Company believes that ISO 14000 may appeal to a number of industries, including manufacturing, pharmaceuticals, petro-chemicals, forestry products, agriculture and service businesses, which may result in a potentially large market for the Company's ISO 14000 product. In addition, the Company believes that European and Asian industries may be potential markets for the Company's ISO 14000 product, although such markets may require that the ISO 14000 product be translated into local languages.

The market for the Company's POLLUTION PREVENTION product will be similar to that of the Company's ISO 14000 product. Although compliance to ISO 14000 is voluntary, the Pollution Prevention Act of 1990 established federal legislation that requires companies to incorporate pollution prevention planning into their business. In addition, 44 U.S. states have augmented the federal legislation by incorporating their own regulations governing pollution prevention.

The Company's future sales success will depend upon the rate at which the industrial marketplace adopts these international standards. In addition, the industrial marketplace has not widely adopted the use of interactive multimedia for education and training purposes, and many of the Company's potential customers do not own or have access to multimedia equipment compatible with the Company's products. In the event that adoption of international management standards and interactive multimedia training do not become widespread, the number of potential customers for the Company will be limited. Refer to the section "Competition" for a discussion on the Company's competitive pressures.

SALES AND MARKETING

The Company spent 1996 hiring and developing its direct sales force and developing strategic alliances with indirect channel partners. As further discussed below, the Company uses several channels of marketing and distribution, including direct sales, telesales, independent sales agents, channel resellers, international distributors and market promoters.

DIRECT SALES. The direct sales group focuses its selling efforts on Fortune 2000 companies, representing multi-site, multi-unit sales opportunities. Sales cycles for this channel generally range from six to twelve months. Currently, the Company has a direct sales office in Minneapolis, MN, Cincinnati, OH, Philadelphia, PA, Indianapolis, IN, Atlanta, GA and Los Angeles, CA. The Company believes the number of direct sales people is adequate at this stage of its sales development.

TELESALES. The telesales group, which is located at the Company's headquarters, focuses its selling efforts on small to medium-sized companies. The telesales group also qualifies sales inquiries and refers large prospects to the direct sales group.

INDEPENDENT SALES AGENTS. The Company's independent sales agent program is primarily comprised of small to medium-sized companies that specialize in selling multimedia training or technology business solutions, or have demonstrated competencies in the area of international management standards.

CHANNEL RESELLERS. Channel resellers warehouse, market and distribute the Company's products. Currently, the Company has an agreement with the American Society for Quality Control (ASQC) to warehouse, market and distribute its ISO 9000 and QS-9000 products. ASQC is the largest US organization that sells quality-related materials and holds a joint copyright to the US version of the ISO 9000 standard. Through its Automotive Division, ASQC has been involved with the QS-9000 quality requirement since its inception in 1988. The Company is actively seeking formal relationships with other channel resellers.

INTERNATIONAL DISTRIBUTORS. Currently, the Company is primarily focusing its international sales efforts on the European market. During 1996, the Company executed exclusive distribution agreements with Futuremedia PLC to market and distribute the Company's ISO 9000, QS-9000 and ISO 14000 products in the UK, and the Company's QS-9000 product in Germany through its wholly-owned subsidiary, Lasermedia GmbH. The Company is currently developing relationships with other foreign distributors.

MARKETING PARTNERS. The Company has developed relationships with certain organizations to act as promoters of the Company's products. During 1996, the Company executed agreements with the American National Standards Institute (ANSI) and the Global Environment & Technology Foundation (GETF) to market and promote the Company's ISO 14000 product. ANSI, a non-profit organization, coordinates the US voluntary standard system and is the official US representative to the International Organization for Standardization (ISO). GETF, a non-profit corporation, promotes the development and use of technology to achieve environmentally sustainable development. ANSI and GETF have agreed to allow the Company to reflect their respective business logos on the ISO 14000 product packaging.

For 1996, direct sales, telesales, independent sales agents, resellers and international distributors accounted for 52%, 21%, 5%, 12% and 10% of revenues, respectively.

COMPETITION

The market for resources that prepare companies for compliance to international management standards, such as ISO 9000, QS-9000 and ISO 14000, is highly fragmented. No single company has a dominant market share, and the Company generally competes with a variety of competitors, depending on factors such as the size of the customer, specific business requirements, geographic location and the level of anticipated investment by the customer.

The international standards market has traditionally been served by consultants, instructor-led training and companies which market publications such as books, manuals and tapes. Companies providing consulting services on ISO 9000, QS-9000 and ISO 14000, such as Andersen Consulting, Ernst & Young and Grant Thornton, enjoy a high level of customer loyalty as it relates to the implementation of enterprise-wide business practices. The Company has encountered many sales situations in which a company chose to use a consultant versus the Company's technology solution. The Company can offer no assurance that it will be ultimately successful in competing with such consultants.

In addition to competition from consultants, the Company also competes with providers of similar technology solutions for compliance to ISO 9000, QS-9000 and ISO 14000, such as Powerway, Inc. and SystemCorp. Both companies have developed and are selling technology-based solutions that assist companies with their standard compliance efforts. Because these companies are privately held, information is unavailable regarding the level of sales success these competitors may be experiencing. Although the Company believes its products permit greater interactivity between the user and the program, and include more training and education on the requirements of complying with ISO 9000, QS-9000 and ISO 14000, there can be no assurance the Company's products will achieve a greater level of market acceptance than these competing technology solutions.

INTELLECTUAL PROPERTY RIGHTS

The Company regards its multimedia products as proprietary and relies primarily on a combination of statutory and common law copyright, trademark and trade secret laws, customer licensing agreements, employee and third-party non-disclosure agreements and other methods to protect its proprietary rights.

The Company's products are licensed to end-users under a perpetual, non-transferable, non-exclusive license. The Company relies primarily on a "shrink-wrap" license for protection, which is included inside the product packaging. Such a license sets forth the terms and conditions under which the customer may use the product and binds the purchaser upon purchase and use of the product. The Company does not require its shrink wrap licenses to be signed by the licensee and therefore may be unenforceable under the laws of certain jurisdictions.

The Company has made applications for registration of certain trademarks in the United States and other parts of the world where its products are actively marketed. Currently, the Company has received registration for the mark "Reality Interactive (and Logo Design)" in the United States, Switzerland, Benelux, France and Germany. Also, the Company has received registration for the mark "Real Tools for Accelerated Learning" in the United States.

RESEARCH AND DEVELOPMENT

The Company spent most of 1996 developing its QS-9000, ISO 14000 and Pollution Prevention products. The Company's research and development expenditures are primarily comprised of direct employee costs. The Company also incurs outside product development costs related to subject matter content expertise, video and audio production and specialized computer programs.

For 1996, 1995 and 1994, the Company incurred expenditures of \$2,355,922, \$939,487 and \$200,366, respectively, developing its ISO 9000, QS-9000, ISO 14000 and Pollution Prevention products.

EMPLOYEES

As of March 15, 1997, the Company had 36 full-time employees, 1 part-time employee and 3 independent contractors, including 11 in sales and marketing, 4 in administration and finance and 25 in research and development. The Company's employees are not represented by any collective bargaining organization and the Company has never experienced a work stoppage. The Company believes its employee relations are good.

ITEM 2. DESCRIPTION OF PROPERTY

The Company's executive office is located in Eden Prairie, Minnesota, where it leases approximately 21,000 square feet under a sublease that expires in May 1999. Under the sublease, the Company is obligated to pay an annual rent of approximately \$318,900, with yearly increases in rent limited to its share of any yearly

increases in building operating expenses. There are no leases associated with the Company's direct sales offices.

The Company considers its leased real property adequate for its current and foreseeable future, and in the opinion of management, is adequately covered by insurance.

ITEM 3. LEGAL PROCEEDINGS

NONE

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

NONE

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's common stock has been quoted on the NASDAQ Small Cap Market since its initial public offering on April 10, 1996. The following table sets forth the high and low prices of the Company's common stock for the last three fiscal quarters as reported by the NASDAQ Small Cap Market.

YEAR ENDED DECEMBER 31, 1996		
QUARTER	HIGH	LOW
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Second *	\$6 1/8	\$3 3/4
Third	\$4 1/8	\$2
Fourth	\$2 1/8	\$1

* Prices shown are subsequent to April 10, 1996, the effective date of the Company's initial public offering.

As of March 24, 1997, the Company had approximately 110 shareholders of record of the Company's common stock. The Company has never paid cash dividends on its common stock and does not anticipate paying cash dividends in the foreseeable future.

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

The following presentation of management's discussion and analysis of the Company's financial condition and results of operation should be read in conjunction with the Company's financial statements and notes contained herein for the years ended December 31, 1996 and 1995.

RESULTS OF OPERATIONS

REVENUES. Revenues were \$484,127 for 1996, compared to revenues of \$54,106 for 1995. The revenue increase was due primarily to increasing sales of the Company's initial product, the ISO 9000 REGISTRATION SERIES, which generated revenues of \$347,844 during 1996. The ISO 9000 REGISTRATION SERIES was released as a complete series in August 1995 and accounted for all of the Company's 1995 revenues.

The Company also generated approximately 27%, or \$131,245 of its 1996 revenues from its second product, the QS-9000 COMPLIANCE SERIES, a four title interactive multimedia product that was released in August 1996.

The revenue results from 1996 were less than the Company's original expectations as a result of unexpected challenges associated with developing a direct sales force and longer than expected sales cycles in corporate multi-site enterprises.

COST OF REVENUES. Cost of revenues were \$107,008 for 1996, compared to \$33,464 for 1995. The increase in cost of revenues was primarily due to royalties paid to business partners as a result of an increasing level of sales. Royalties were paid to the American Society for Quality Control ("ASQC"), a sales channel for the Company's ISO 9000 REGISTRATION SERIES and QS-9000 COMPLIANCE SERIES, Process Management International,

the Company's subject matter expert for its ISO 9000 REGISTRATION SERIES and the Global Environment and Technology Foundation, a marketing partner for the Company's ISO 14000 EMS CONFORMANCE SERIES. Cost of revenues also includes the cost of media duplication and packaging materials.

OPERATING EXPENSES. The Company's operating expenses for 1996 were \$6,416,398, a 243% increase over operating expenses of \$2,642,059 for 1995. This increase in operating expenses between 1996 and 1995 was due primarily to the following:

- (a) Sales and marketing expenses were \$2,531,058 for 1996, compared to \$808,825 for 1995, a 313% increase. This increase between periods was due primarily to the addition of new direct sales, telesales and marketing positions and the expansion of direct marketing programs related to an increase in the Company's product offerings in 1996. The Company expects its sales and marketing expenses will decrease in 1997 compared to 1996 as a result of fewer direct sales personnel and marketing programs.
- (b) Research and development expenses were \$2,355,922 for 1996, compared to \$939,487 for 1995, a 251% increase. This increase was attributed to the development of three new products in 1996, the QS-9000 COMPLIANCE SERIES, a four title CD-ROM product dealing with automotive quality standards, the ISO 14000 EMS CONFORMANCE SERIES, a five title CD-ROM product dealing with environmental management standards and POLLUTION PREVENTION, a one-title product dealing with the key concepts of developing a pollution prevention program. The Company completed development of the QS-9000 COMPLIANCE SERIES in August 1996, POLLUTION PREVENTION in November 1996 and two titles of the ISO 14000 CONFORMANCE SERIES in November 1996. The remaining three titles of the ISO 14000 product were released in March 1997. Prior to 1996, the Company's development expenses primarily related to the ISO 9000 REGISTRATION SERIES, the Company's first product. The Company expects its research and development expenses to decrease in 1997 compared to 1996, as the Company shifts its attention away from the development of off-the-shelf products to a model that focuses attention on the delivery of custom and funded development services.
- (c) General and administrative expenses were \$1,529,418 for 1996, compared to \$893,747 for 1995, a 171% increase. This increase was due primarily to increased travel, office rent, depreciation expense, operating leases and professional fees. The Company expects that its general and administrative expenses for 1997 will remain consistent with 1996.

OTHER INCOME (EXPENSE). The Company's net other expense was \$92,223 for 1996, compared to net other expense of \$149,979 for 1995. For 1996, net other expense primarily consists of expenses associated with the Company's January 1996 bridge note financing, including \$282,846 of interest expense and \$113,486 related to the amortization of offering costs. During 1996, the Company also realized interest income of \$304,109 from the investment of proceeds from its bridge note financing and its April 1996 initial public offering ("IPO"). Net other expense for 1995 primarily consists of interest expense related to prior debt financings.

NET LOSS. Net loss, after deducting extraordinary losses of \$219,470 from the early retirement of debt, was \$6,350,972 for 1996, compared to a net loss of \$2,771,396 for 1995. The Company expects to continue to experience losses at least through 1997 as its projected revenues will continue to fall below its base operating expenses for most of 1997.

LIQUIDITY AND CAPITAL RESOURCES

The Company's cash and cash equivalents, and short-term investments were \$5,253,440 as of December 31, 1996, compared to \$118,916 as of December 31, 1995. The increase in cash, cash equivalents and short-term investments was primarily attributed to the Company's IPO in April 1996. Also contributing to the increase was lease financing of approximately \$266,157 obtained in a sale-leaseback of computer equipment in

May 1996. The decrease in cash and cash equivalents, and short-term investments subsequent to the Company's IPO was due primarily to the net loss from operations and repayment of Bridge Notes. See the Company's audited financial statements contained herein for further information on financing transactions.

Although the Company anticipates that it will experience operating losses and negative cash flow from operations at least through 1997, and the Company currently does not have bank financing available, the Company believes that its current cash balances will be sufficient to meet its working capital and capital expenditure needs through 1997. Thereafter, the Company may need to raise additional funds to finance its operations. To the extent the Company's revenues do not meet management's expectations, or the Company's growth exceeds management's expectations, the Company may require additional financing prior to the end of 1997. At such time, there can be no assurance that debt or equity financing would be available on favorable terms or at all.

ITEM 7. FINANCIAL STATEMENTS

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

NONE

PART III

ITEM 9. DIRECTORS, EXECUTIVE OFFICERS, PROMOTERS AND CONTROL PERSONS;
COMPLIANCE WITH SECTION 16(a) OF THE EXCHANGE ACT.

The information under the captions "Election of Directors", "Executive Officers" and "Compliance with Section 16(a) of the Securities Exchange Act of 1934", are contained in the Company's Proxy Statement relating to the Annual Meeting of Shareholders for the year ended December 31, 1996, and is incorporated herein by reference.

ITEM 10. EXECUTIVE COMPENSATION

The information contained under the caption "Executive Compensation" in the Company's Proxy Statement relating to the Annual Meeting of Shareholders for the year ended December 31, 1996 is incorporated herein by reference.

ITEM 11. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information contained under the caption "Principal Shareholders" in the Company's Proxy Statement relating to the Annual Meeting of Shareholders for the year ended December 31, 1996 is incorporated herein by reference.

ITEM 12. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information contained under the caption "Certain Relationships and Related Transactions" in the Company's Proxy Statement relating to the Annual Meeting of Shareholders for the year ended December 31, 1996 is incorporated herein by reference.

ITEM 13. EXHIBITS AND REPORTS ON FORM 8-K

(a) Index of Exhibits

Exhibit Number	Description
3.1(1)	Articles of Incorporation of the Company
3.2(1)	Amended and Restated Articles of Incorporation of the Company
3.3(1)	Bylaws of the Company
3.4(1)	Amended Bylaws of the Company
4.1(1)	Specimen form of the Company's Common Stock Certificate
4.2(1)	Warrant Agreement (including Form of Redeemable Warrant)
4.3(1)	Form of Bridge Loan Agreement, Dated January 19, 1996, between the Company and various investors (including form of Bridge Note and Bridge Warrant)
4.4(1)	Canceled Promissory Note in favor of Brightstone Fund VI in the amount of \$200,000
4.5(1)	Canceled Promissory Note in favor of Wyncrest Capital, Inc. in the amount of \$120,000
4.6(1)	Warrant in favor of Brightstone Fund VI for 43,109 shares

Exhibit Number	Description
4.7(1)	Warrant in favor of Wyncrest Capital, Inc. for 25,188 shares
10.1(1)	ISO 9000 Content Agreement between Reality Interactive, Inc. and Process Management International, dated August 4, 1994
10.2(1)	Joint Marketing and Distribution Agreement between Reality Interactive, Inc. and American Society for Quality Control, Inc., dated May 10, 1995
10.3(1)	Agreement for Consulting Services between Reality Interactive, Inc. and Steven W. McClernon, dated January 15, 1996
10.4(1)	Sublease Agreement between Reality Interactive, Inc. and Collopy Saunders Real Estate, Inc., dated December 15, 1994
10.5(1)	Subject Matter Expert Agreement between Reality Interactive, Inc. and The Third Generation, Inc., dated January 6, 1996
10.6(1)	Subject Matter Expert Agreement between Reality Interactive, Inc. and WRITAR, dated February 1, 1996
10.7(1)	Reality Systems, Inc. 1994 Stock Incentive Plan, as amended (including form of Stock Option Agreement)
10.8(1)	Form of Non-Statutory Directors' Option Agreement (issued to certain non-employee directors or affiliates of non-employee directors in 1994 and 1995)
10.9(1)	Reality Interactive, Inc. 1996 Directors Stock Option Plan (including form of Directors Stock Option Agreement)
10.10(1)	Form of Shrink-Wrap License Agreement
10.11(1)	Form of Enterprise License Agreement
10.12(1)	Form of Volume Discount Agreement
10.13(1)	ISO 9000/QS-9000 Addendum, dated March 13, 1996, between the Company and Process Management Institute, Inc., amending the agreement dated August 4, 1994
10.14(1)	Form of Lock-Up Agreement
10.15(1)	Independent Software Vendor Agreement between the Company and Hewlett Packard
10.16(1)	Master Equipment Lease Agreement, dated June 15, 1995, and Amendment No. 1 to Master Equipment Lease Agreement, dated July 1995, each between the Company and Carlton Financial Corporation
10.17(1)	Lease Agreement, dated January 30, 1996, between the Company and Lease Finance Group, Inc.
10.18(1)	Irrevocable Letters of Credit, dated June 20, 1995 and August 1, 1995, from BankWindsor in favor of Carlton Financial Corp. and Irrevocable Letter of Credit, dated December 27, 1995, in favor of Lease Finance Group, Inc.
10.19(2)	First Amendment to Joint Marketing and Distribution Agreement between Reality Interactive, Inc. and American Society for Quality Control, Inc., dated May 1, 1996
10.20(2)	Joint Marketing and Distribution Agreement between Reality Interactive, Inc. and American Society for Quality Control, Inc., dated May 17, 1996
10.21(3)	Equipment Lease between Reality Interactive, Inc. and Dexxon Capital Corporation Dated June 3, 1996
10.22(4)	Copyright License Agreement between Reality Interactive, Inc. and the American National Standards Institute dated August 30, 1996, including Modifying Agreement
10.23(4)	ISO 14000 Marketing and Promotion Agreement between Reality Interactive, Inc. and the American National Standards Institute dated September 20, 1996
10.24(4)	ISO 14000 Marketing and Promotion Agreement between Reality Interactive, Inc. and the Global Environment and Technology Foundation dated September 6, 1996
10.25(4)	Distribution Agreement between Reality Interactive, Inc. and Futuremedia PLC dated July 12, 1996
10.26	Sublease Agreement between Reality Interactive, Inc. and IVI Publishing, Inc., dated September 17, 1996

Exhibit Number	Description
10.27+	Distribution Agreement between Reality Interactive, Inc. and Lasermedia (Deutschland) GMBH, dated October 9, 1996
10.28	Amendment No. 2, dated December 9, 1996, to Master Equipment Lease Agreement, dated July 1995, each between the Reality Interactive, Inc. and Carlton Financial Corporation
10.29	Irrevocable Letter of Credit, dated December 9, 1996, from BankWindsor in favor of Carlton Financial Corp.
23.1	Consent of Price Waterhouse LLP
27.1	Financial Data Schedules
99.1	Cautionary Statement

- (1) Incorporated by reference to Amendment No. 2 to the Company's Registration Statement on Form SB-2 (File No. 0-27862), as filed with the Securities and Exchange Commission on April 9, 1996.
 - (2) Incorporated by reference to the Company's Form 10-QSB for the quarter ended March 31, 1996.
 - (3) Incorporated by reference to the Company's Form 10-QSB for the quarter ended June 30, 1996.
 - (4) Incorporated by reference to the Company's Form 10-QSB for the quarter ended September 30, 1996.
- + Pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, confidential portions of this Exhibit have been deleted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

(b) Reports on Form 8-K

No reports on Form 8-K were filed for the quarter ended December 31, 1996.

SIGNATURES

In accordance with Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

REALITY INTERACTIVE, INC.

Dated: March 28, 1997

By /S/ Wesley W. Winnekins

 Wesley W. Winnekins
 Chief Financial Officer

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

Name ----	Title -----	Date ----
/S/ Paul J. Wendorff ----- Paul J. Wendorff	Chairman, Chief Executive Officer, President and Director (Principal Executive Officer)	March 28, 1997
/S/ Wesley W. Winnekins ----- Wesley W. Winnekins	Chief Financial Officer and Secretary (Principal Financial and Accounting Officer)	March 28, 1997
/S/ Ronald E. Eibensteiner ----- Ronald E. Eibensteiner	Director	March 28, 1997
/S/ James A. Bernards ----- James A. Bernards	Director	March 28, 1997

EXHIBIT INDEX

Exhibit No.	Description	Page No.
10.26	Sublease Agreement between Reality Interactive, Inc. and IVI Publishing, Inc., dated September 17, 1996.....	17
10.27+	Distribution Agreement between Reality Interactive, Inc. and Lasermedia (Deutschland) GMBH, dated October 9, 1996.....	26
10.28	Amendment No. 2, dated December 9, 1996, to Master Equipment Lease Agreement, dated July 1995, each between Reality Interactive, Inc. and Carlton Financial Corporation.....	49
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+ Pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, confidential portions of this Exhibit have been deleted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

SUBLEASE AGREEMENT

THIS SUBLEASE AGREEMENT is entered into effective as of the 17th day of September, 1996, by and between IVI PUBLISHING, INC., a Minnesota corporation ("Sublessor") and REALITY INTERACTIVE, a Minnesota corporation ("Sublessee").

RECITALS

Sublessor is the tenant under a lease with Ryan/Wilson Limited Partnership, a Minnesota limited partnership (the "Owner") dated March 30, 1994 (the "Main Lease") for the Leased Premises as defined in the Main Lease and as shown on attached Exhibit A, (the "Main Lease Premises") located in the building at 7500 Flying Cloud Drive, Eden Prairie, Minnesota 55344 (the "Building").

The Main Lease is incorporated herein by reference as fully as if the terms and provisions were set forth in full in this Sublease Agreement, except those terms specifically excluded in or modified by this Sublease Agreement.

Sublessee desires to sublease from Sublessor that portion of the Main Lease Premises located on the fourth (4th) floor of the Building, and shown by cross-hatching on attached Exhibit A (the "Premises") and Sublessor desires to sublease the Premises to Sublessee.

THEREFORE, in consideration of the mutual promises of the parties set forth in this Sublease Agreement and other valuable consideration, the receipt and sufficiency of which are hereby acknowledged, Sublessor and Sublessee agree as follows:

ARTICLE 1. PREMISES

Sublessor hereby leases to Sublessee, and Sublessee hereby takes from Sublessor, the Premises, subject to and together with the benefit of the terms, covenants, conditions and provisions of this Sublease Agreement applicable thereto. The Premises shall be deemed to be comprised of 21,184 rentable square feet.

ARTICLE 2. TERM

The term of this Sublease Agreement (the "Term") shall be two (2) years and six (6) months commencing on December 1, 1996 (the "Commencement Date") and terminating on the day of May 31, 1999, unless sooner terminated as provided herein.

ARTICLE 3. USE

Sublessee shall use the Premises for any purpose permitted in the Main Lease.

ARTICLE 4. BASE RENT AND ADDITIONAL RENT

A. Sublessee agrees to pay Sublessor during the Term, Base Rent at the rate or rates set forth on the Addendum attached hereto as Exhibit B, payable in equal monthly installments, in advance, on the first day of each and every month during the Term. In the event the Term commences on a day other than the first day of a

calendar month, Sublessee shall pay Base Rent for said fractional month prorated on the basis of a thirty (30) day period.

B. Sublessee agrees to pay Sublessor during the Term, Additional Rent, as defined in the Main Lease, at the same rates and on the same basis as Sublessor has agreed to pay to Owner under the Main Lease. If the Premises are comprised of less than the entire Main Lease Premises, then the Additional Rent payable by Sublessee hereunder shall be calculated by multiplying the Additional Rent payable by Sublessor under the Main Lease by a fraction, the numerator of which is the rentable area of the Premises, and the denominator of which is the rentable area of the Main Lease Premises.

C. Sublessee shall also be responsible for paying a pro-rata share of the utility charges for which Sublessor is responsible under the Main Lease. This share shall be a fraction, the numerator of which is the rentable area of the Premises, and the denominator of which is the rentable area of the Main Lease Premises.

D. The parties acknowledge and agree that Sublessee shall timely pay all Base Rent, Additional Rent, and any other charges which are Sublessee's obligation hereunder.

E. All Base Rent and Additional Rent payable by Sublessee under this Sublease shall be paid, without notice or prior demand therefor and without any deduction or set-off whatsoever, to Sublessor, at the address set out in Article 14 hereof or at such place as Sublessor may designate from time to time by written notice to Sublessee given in the manner set out in Article 14 hereof.

F. The parties acknowledge that the Additional Rent currently payable by Sublessor under the Main Lease equals \$9.56 per square foot annually. The parties also acknowledge that the Additional Rent is subject to the adjustments and increases set forth in the Main Lease.

ARTICLE 5. MAIN LEASE

A. Except as may be inconsistent with the provisions of this Sublease Agreement, the terms, provisions, covenants and conditions of the Main Lease are incorporated herein by reference in like manner as though the same were specifically set forth herein. Except as may be otherwise specifically provided herein, Sublessee shall have all rights and privileges and assumes and agrees to keep and perform, as to the Premises, all of the obligations, conditions and covenants of the Tenant set forth under the Main Lease as though Sublessee were substituted as Tenant thereunder. It is agreed and understood between the parties hereto that the Sublessee obtains and is granted no more rights and privileges, as to the Premises, under this Sublease Agreement than Sublessor was granted as Tenant under the Main Lease.

B. The obligations, conditions and covenants of the Owner as the Landlord under the Main Lease shall remain the Owner's, and Sublessor shall not be required to perform the same in the event of a default by the Owner. Notwithstanding the foregoing, Sublessor shall have, with respect to the Premises, all of the rights and privileges of the Owner as Landlord under the Main Lease, except as herein otherwise specifically provided.

C. Sublessor and Sublessee each agree not to do, suffer, or permit anything to be done which would result in a default under the Main Lease, or cause the Main Lease to be terminated or forfeited.

ARTICLE 6. PAYMENT OF COSTS AND FEES

Sublessee will pay and discharge all costs, attorneys fees and expenses that may be incurred by Sublessor in enforcing the covenants and agreements of this Sublease Agreement, or which may be incurred

by Owner in enforcing the covenants and agreements of the Main Lease as a result of a default by Sublessee hereunder

ARTICLE 7. INSURANCE

Sublessee shall maintain, as to the Premises, all insurance required to be maintained, by Sublessor as Tenant, under the Main Lease, and have Sublessor and Owner named as additional insureds thereon. The insurance policies maintained by Sublessee shall provide that the same may not be canceled, terminated or altered without thirty (30) days' prior written notice sent by certified mail, return receipt requested, to Sublessor and Owner. The insurance maintained by Sublessee shall contain an express waiver of claims and subrogation in favor of Sublessor and Owner.

ARTICLE 8. INDEMNIFICATION

Sublessee agrees that it will indemnify and hold Sublessor and Owner forever harmless as provided in Article 12 of the Main Lease, which indemnification shall also include any and all responsibility or liability which Sublessor may incur by virtue of this Sublease Agreement arising out of any failure of Sublessee in any respect to comply with and perform the requirements and provisions of the Main Lease (attributable to the Premises), or this Sublease Agreement.

ARTICLE 9. ASSIGNMENT/TRANSFER

Sublessee shall not transfer, sell, assign or pledge this Sublease or further sublease the Premises, or any part thereof without (i) compliance with the requirements of the Main Lease relating thereto and (ii) obtaining the prior written consent of the Sublessor and Owner. Owner and Sublessor have legitimate concerns regarding the compatibility of new or different occupants of the Premises, including concerns based upon the use to which such occupants may make of the Premises, and may therefore withhold their consent to any such transfer based upon any concern they or either of them may have regarding the use to which the proposed transferee may put the Premises or based upon other justifiable concerns related to possible lack of harmony between the use of the proposed transferee and other uses or occupants in the Building or concerns related to the financial strength, character or reputation of the proposed transferee. No transfer of any nature shall relieve Sublessee of primary liability to Sublessor hereunder unless Sublessor agrees in writing.

ARTICLE 10. ALTERATIONS AND IMPROVEMENTS

Sublessee shall not make any alterations or improvements to the Premises without (i) complying with the terms of the Main Lease relating thereto and (ii) obtaining the prior written consent of Sublessor and Owner. Sublessor's consent may be conditioned upon Sublessor being provided with plans and specifications for the proposed alteration or improvement, information regarding the identity of the persons who will perform the work or provide the materials, security against mechanic's liens (all of which must be reasonably acceptable to Sublessor) and receipt of Owner's consent. All such work must be done in a workmanlike fashion using new, first-grade materials. Sublessee shall be responsible for the reasonable costs incurred by Sublessor and Owner in reviewing any plans and specifications to be submitted pursuant to this Article.

ARTICLE 11. SURRENDER OF THE PREMISES

Upon the expiration of the Term of this Sublease Agreement, Sublessee shall remove its equipment and trade fixtures promptly (immediately repairing any damage caused thereby) and quit and surrender the Premises in the condition existing as of the date hereof.

ARTICLE 12. DEFAULT/REMEDIES

A. If any one or more of the following events occurs, then Sublessee shall be deemed to be in default under this Sublease Agreement:

1. Sublessee fails to pay, when due, the Base Rent, Additional Rent or other charges provided for under this Sublease Agreement;

2. Sublessee fails to keep, observe or perform any of the other terms, covenants and conditions herein to be kept, observed and performed by Sublessee under this Sublease Agreement for more than (i) five (5) days after payment is due (in the case of a monetary default) or (ii) twenty (20) days after written notice is given to Sublessee specifying the nature of such default (in the case of a non-monetary default). Notwithstanding the foregoing, if the applicable grace period set forth in the Main Lease shall be shorter than that provided herein, the grace period set forth in the Main Lease shall supersede the grace period set forth in this subparagraph.

B. If a default occurs, then Sublessor shall be entitled to exercise any and all of the rights and remedies available at law or in equity, including those provided to the Owner as Landlord under the Main Lease. Any remedies under this Sublease Agreement shall not be deemed exclusive, but shall be cumulative and shall be in addition to all other remedies available to Sublessor existing at law or in equity. Owner shall be entitled to enforce the provisions of the Main Lease against Sublessee to the extent the same are violated by Sublessee.

ARTICLE 13. CONSENTS

A. Wherever the Owner's consent as Landlord is required by the provisions of the Main Lease, the Sublessee must, in addition to securing such consent, also obtain the prior written consent of the Sublessor.

B. In no event shall Sublessee be entitled to any damages for any withholding or delay in either Sublessor or Owner giving its consent and Sublessee understands and agrees that its remedies shall be limited to an action for summary judgment, an injunction or declaratory judgment.

ARTICLE 14. NOTICES

A. Sublessor shall immediately forward to Sublessee all notices of default received by Sublessor from Owner as Landlord under the Main Lease. Sublessee shall forward to Sublessor all reports and written statements concerning the Premises required of the Tenant under the Main Lease at least ten (10) days prior to the date such reports or written statements are due under the Main Lease.

B. Any notice, demand, request or other communication which may be or is required to be given to the Owner as Landlord under the Main Lease shall be effective only if a copy of the notice to the Owner is either delivered personally or sent to Sublessor as provided under subparagraph C below.

C. Any notice which one party wishes or is required to give to the other party will be regarded as given and received if in writing and either delivered personally to such party or sent certified or registered mail, return receipt requested, postage prepaid, to the addresses below, or such other addresses as either party may, from time to time, designate by written notice to the other party:

Sublessor: IVI Publishing, Inc.
7500 Flying Cloud Drive
Eden Prairie, MN 55344
Attention: CFO

Sublessee: Reality Interactive
7500 Flying Cloud Drive
Eden Prairie, MN 55344
Attention: Wes Winnekens, CFO

Owner: Ryan Properties, Inc.
700 International Centre
900 Second Avenue South
Minneapolis, Minnesota 55402

ARTICLE 15. RELATIONSHIP OF THE PARTIES

Nothing contained in this Sublease Agreement shall be deemed or construed by the parties hereto, or by a third party, to create the relationship of principal and agent or of partnership or joint venture or of any association whatsoever between Owner, Sublessor, or Sublessee. It is hereby expressly understood and agreed that no provision contained in this Sublease Agreement, nor any act or acts of the parties hereto shall be deemed to create any relationship between Sublessor and Sublessee other than the relationship of Sublessor and Sublessee.

ARTICLE 16. INVALIDITY

If any part of this Sublease Agreement or any part of any provision hereof shall be adjudicated to be void or invalid, then the remaining provisions hereof, not specifically so adjudicated to be invalid, shall be executed without reference to the part or portion so adjudicated as invalid, insofar as such remaining provisions are capable of execution.

ARTICLE 17. IMPORTANCE OF EACH COVENANT

Each covenant and agreement on the part of one party is understood and agreed to constitute an essential part of the consideration for each covenant and agreement on the part of the other party.

ARTICLE 18. CONDITIONS

This Sublease Agreement is dependent and conditioned upon the Owner executing its consent to this Sublease Agreement in the form attached hereto as EXHIBIT C.

ARTICLE 19. SUCCESSORS AND ASSIGNS

This Sublease Agreement and all covenants and agreements contained herein shall be binding upon, apply and inure to the benefit of the respective successors and assigns of the parties to this Agreement, subject to the restrictions imposed under this Sublease Agreement and the Main Lease relating to assignment or further sublease by the Sublessee.

ARTICLE 20. NON-WAIVER

Sublessor's failure to insist upon strict performance of any covenant in this Sublease Agreement or to exercise any option or right herein contained shall not be a waiver or relinquishment of such covenant, right or option, but the same shall remain in full force and effect. Sublessor is specifically authorized to accept a partial payment (no matter how such payment may be labeled or conditionally delivered) without such acceptance being deemed a waiver of the balance of the amount owed.

ARTICLE 21. APPLICABLE LAW

This Sublease Agreement shall be construed under the laws of the State of Minnesota.

ARTICLE 22. ENTIRE AGREEMENT/AMENDMENTS

This Sublease Agreement and the Exhibits attached hereto set forth all of the covenants, promises, agreements, conditions and understanding between Sublessor and Sublessee concerning the Premises and there are no other covenants, promises, agreements, conditions or understandings, either oral or written, between them other than those which are set forth in this Sublease Agreement. Except as otherwise provided herein, no subsequent alteration, amendment, change or addition to this Sublease Agreement shall be binding upon Sublessor or Sublessee unless reduced to writing and signed by both parties.

ARTICLE 23. ADDENDUM

Attached to this Sublease is an Addendum, the terms and provisions of which are hereby incorporated into this Sublease by reference.

ARTICLE 24. COUNTERPARTS

This Sublease Agreement and the Consent attached hereto may be separately executed as counterparts which shall be then read together and enforced.

IN WITNESS WHEREOF, the parties hereto have executed this Agreement effective as of the day and year first above written.

SUBLESSOR: IVI PUBLISHING, INC. SUBLESSEE: REALITY INTERACTIVE

By /S/ JOY SOLOMON By /S/ WESLEY W. WINNEKINS
Its CHIEF EXECUTIVE OFFICER Its CHIEF FINANCIAL OFFICER

EXHIBIT A

[Diagram of the Main Lease Premises and the Premises]

EXHIBIT B

Addendum to Sublease

Sublessee shall pay Base Rent in the amount of \$3.94 per square foot annually.

EXHIBIT C

ACKNOWLEDGMENT AND CONSENT

This Agreement is entered into effective as of September 19, 1996 by and between Ryan/Wilson Limited Partnership, a Minnesota limited partnership, ("Owner") and IVI Publishing, Inc., a Minnesota corporation ("Tenant").

RECITALS

Owner and Tenant are parties in the respective capacities of landlord and tenant in the Lease dated March 30, 1994 (the "Lease") for the premises described in the Lease (the "Premises") located at 7500 Flying Cloud Drive, Eden Prairie, Minnesota.

Tenant has requested that Owner grant Tenant permission to sublease a portion of the Subleased Premises to Reality Interactive, a Minnesota corporation ("Sublessee") pursuant to the terms of the attached Sublease Agreement.

Owner is willing to grant that consent subject to certain terms and conditions.

PROVISIONS

In consideration of the mutual covenants of the parties and other valuable consideration, the receipt and sufficiency is hereby acknowledged, the parties agree as follows:

1. Owner grants permission to Tenant to sublease the Subleased Premises to Sublessee for a term commencing on December 1, 1996 and terminating May 31, 1999 (the "Term") and pursuant to the terms and conditions of the attached Sublease Agreement.
2. This consent shall not be construed as a consent to any other transfer, or any further subleasing of all or any portion of the Premises.
3. Owner agrees that Sublessee's possession of the Premises pursuant to the terms of the Sublease Agreement shall not be disturbed so long as Sublessee is not in default under the terms of such Sublease Agreement and Tenant is not in default under the terms of the Main Lease.

RYAN/WILSON LIMITED PARTNERSHIP

By: /S/ JOHN P. KELLY

Its: VICE PRESIDENT

IVI PUBLISHING, INC.

By: /S/ JOY SOLOMON

Its: CHIEF EXECUTIVE OFFICER

DISTRIBUTION AGREEMENT
REALITY INTERACTIVE AND LASERMEDIA (DEUTSCHLAND) GMBH

THIS AGREEMENT is made on October 9, 1996

BETWEEN Reality Interactive, Inc. a public company, incorporated in Minnesota and having its registered office at 11200 West 78th Street, Suite 300, Eden Prairie MN USA55344 and whose principal place of business is at 11200 West 78th Street, Suite 300, Eden Prairie MN USA55344 (the "Company"), which expression where the context so requires shall include its successors and assigns,

AND LaserMedia (Deutschland) GMBH, a public company registered in Germany and having its registered office at Max-Planck-Strasse 39A, D-50858 Koln, Germany and whose principal place of business is at Max-Planck-Strasse 39A, D-50858 Koln, Germany (the "Distributor"),

WHEREBY IT IS AGREED as follows:

1 APPOINTMENT

The Company hereby appoints the Distributor (and the Distributor hereby accepts the appointment) as its exclusive distributor in the territory described in Schedule A hereto (the "Territory") for the promotion, marketing and distribution of the products more particularly described in Schedule B-1 hereto (the "Products"). Distributor shall have the right to name and license resellers to distribute the Products as long as Distributor and such reseller execute a distribution agreement in substantially the same form as this Agreement.

If Distributor meets the revenue targets more particularly described in Schedule G hereto (the Distributor Discount Schedule), Distributor can maintain its exclusive appointment beyond calendar year 1997. If such revenue targets are not met by Distributor then the appointment beyond calendar year 1997 shall convert to a nonexclusive appointment subject to termination in accordance with Clauses 2, 7 or 11.

Localization issues shall be covered in Schedule B-2.

2 PERIOD

Subject to the terms and conditions of the Agreement, this Agreement shall continue in force until December 31, 1997 from the Effective Date of this Agreement but subject to earlier termination in accordance with Clause 7 or Clause 11.

This Agreement shall automatically continue after the end of the said initial period for successive annual terms provided the parties agree to an annual revision of the Business Plan attached as Schedule C on or before December 31 preceding the renewal term, unless terminated by either party by giving to the other not less than six months prior notice to expire at the end of the said initial period or prior to the expiration of any subsequent annual renewal term.

3 DISTRIBUTOR'S OBLIGATIONS

The Distributor agrees with the Company:

(a) To use its reasonable endeavours to promote, market and distribute the Products in the Territory as part of the Distributor's range of interactive multimedia products as more particularly described in the Business Plan attached as Schedule C:

(i) To devote sufficient time, energy and expertise to market, supply, deliver, install, set-up, commission, instruct customers in the use of, provide contractual field support, warranties and help-line facilities for the Products;

(ii) To permit an audit of all records relating to revenues and collections derived from the sale of Products;

(iii) Not to undertake representation of any software system which may be competitive to or dilute efforts in the marketing etc of the Products.

(b) To give the Company, upon the signing of this Agreement and calendar monthly thereafter during the term of this Agreement, (1) a written but non-binding forecast outlining the quantities of Products that the Distributor proposes to sell during the next calendar month in the format attached as Schedule D-1; (2) a written but non-binding forecast outlining the quantities of Products that the Distributor proposes to sell during the next 6 months in the format attached as Schedule D-2; and (3) a written marketing report outlining Distributor's activities in the preceding month and proposed activities for the subsequent month as well as other relevant marketing information in the format attached as Schedule D-3. .

(c) To supply the Products at prices agreed with the Company, and to pay a royalty based on a percentage of sales revenues received by the Distributor as detailed in the Business Plan attached as Schedule C.

(d) For those Products localized into German, to be responsible for the creation of the German packaging and to be responsible for the manufacturing of the Products into final end user form; provided, however, that German versions will not be sold to end users (except for beta release purposes) until Company has been sent a full copy of the German version for review and has had a chance to review such German version. Company will review the German version within 7 business days of its receipt

(e) Not in any manner to pledge the credit of the Company or to receive any money on behalf of the Company and not to make any warranty or other representation regarding the Products other than as authorised by the Company in writing from time to time.

(f) Upon the termination of this Agreement for any reason to return to the Company and at the cost of the Distributor all materials supplied to the Distributor by the Company relating to the Products including all magnetic and optical materials embodying or containing the Products, and all documentation forming part of or relating to or concerning the Products, except that the Distributor shall be able to retail stocks of Products then held or on order together with related documentation.

(g) Not to modify, amend or in any other way interfere with the Products or any names, notices or copyright marks which may appear therein except as may be required to correct errors which may appear in the textual material associated with or forming a part of the Products from time to time, and in the event such an alteration is made to notify the Company of the alteration promptly.

(h) To co-operate with the Company or its nominees in the instruction and training of the employees of the Distributor in connection with (i) the procedures necessary to enable them to comply with the requirements of this Agreement, and (ii) the operation and use of the Products. Distributor shall be required, at its own expense, to have a person responsible for customer support attend training on Company's Products for the purposes of performing customer support. What constitutes "training" for this Clause shall be agreed to between the parties.

(i) Not without written authority from the Company to copy or reproduce the Products or any part thereof and upon the termination of this Agreement to return to the Company and at cost of the Company all brochures, pamphlets and materials supplied to the Distributor by the Company relating to the Products.

(j) Not to modify, amend or in any other way interfere with the Products or any names, notices or copyright marks which may appear thereon except as may be required to correct errors which may appear in the textual material associated with or forming a part of the Products from time to time, and in the event such alteration is made to notify the Company of the alteration promptly.

(k) To supply the Company with reseller and customer information as reasonably requested by the Company including a complete list of registered customers with all essential contact information.

(1) To be responsible for and obtain any license, permits or other such legal or regulatory requirements for importing the Products into the Territory.

4 COMPANY'S OBLIGATIONS

The Company agrees with the Distributor:

(a) To supply the Distributor with such information, know-how and technical data concerned with the Products as is reasonably necessary or appropriate, in the opinion of the Company, to the Distributor's activities in supplying the Products in the Territory and which shall come into the Company's possession or control and which the Company is free to disclose.

(b) In the Company's sole discretion, to make its sales and technical support personnel (or those of its nominees) available to the Distributor by telephone or otherwise.

(c) To give serious consideration to any modifications to the Products suggested by the Distributor without being under any obligation to incorporate any such modifications into the Products.

(d) To supply the Distributor with examples in English of publicity materials, catalogues and price lists available to the Company from time to time as the Distributor shall reasonably require and the Distributor shall be entitled to reproduce the same or parts thereof in its own publicity and other materials.

(e) Upon termination of this Agreement for any reason, the Company shall if so required by the Distributor fulfill any orders for the Product from the Distributor outstanding at the date of termination.

5 SHIPPING, CUSTOMS, TITLE, LIMITATION, WARRANTIES

(a) Risk of loss or damage to the Products shall pass to the Distributor upon delivery to the carrier as specified by Distributor. Company will not ship orders without Distributor's delivery and carrier instructions. Distributor shall be responsible for cost of shipping any ordered Products. Order procedures, payment procedures and payment terms shall be more particularly described in Schedule

(b) The Company hereby excludes to the maximum extent permitted by law any liability arising in tort, contract or otherwise for:

(i) Consequential loss or damage caused by or arising out of the use of the Products or occurring in respect of the Products;

(ii) Loss, injury or damage due to fair wear and tear, or to negligent or improper installation, use, maintenance, storage or handling of the Products on the part of any person, firm or company other than the Company and its employees.

(c) Under no circumstances shall either party be liable to the other for any damages in excess of the aggregate amount of purchases that have exchanged between the parties under this Agreement.

(d) Company authorises Distributor to pass through to its customers the standard warranties as set forth in its standard license agreement attached as Schedule E. All such warranty claims shall be made promptly in writing and shall state the nature and details of the claim, the date the cause of the claim was first observed and the registration number of the Products concerned. All such warranty claims must be received by Company not later than 15 days after the expiration of the warranty period for such customer as provided to customer in Company's standard license Agreement. Company shall have no obligations to Distributor or Distributor's resellers or customers under this Clause if (1) the Products have not been properly installed, used or maintained in accordance with Company's product documentation; (2) the Products have been modified in any manner or are used or combined with other products not supplied by Company and without the prior written consent of Company; or (3) The Products have been distributed to a customer with any warranties or representations oral or written, made by Distributor beyond those expressly set forth in Company's standard license agreement (Schedule E).

(e) THE WARRANTIES SET FORTH IN THIS CLAUSE AND IN COMPANY'S STANDARD LICENSE AGREEMENT, SCHEDULE E ARE IN LIEU OF ALL OTHER WARRANTIES, EXPRESS OR IMPLIED, WHICH ARE HEREBY DISCLAIMED AND EXCLUDED BY COMPANY, INCLUDING WITHOUT LIMITATION ANY WARRANTY OR MERCHANTABILITY OR FITNESS FOR A PARTICULAR PURPOSE OR USE AND ALL OBLIGATIONS OR LIABILITIES ON THE PART OF COMPANY ARISING OUT OF OR IN CONNECTION WITH THE DISTRIBUTION, USE, REPAIR OR PERFORMANCE OF THE PRODUCTS.

(f) THE SOLE AND EXCLUSIVE REMEDIES FOR BREACH OF ANY AND ALL WARRANTIES AND THE SOLE REMEDIES FOR COMPANY'S LIABILITY OF ANY KIND (INCLUDING LIABILITY FOR NEGLIGENCE OR PRODUCTS LIABILITY) WITH RESPECT TO THE PRODUCTS AND SERVICES COVERED BY THIS AGREEMENT AND ALL OTHER PERFORMANCE BY COMPANY UNDER THIS AGREEMENT SHALL BE LIMITED TO THE REMEDIES PROVIDED IN COMPANY'S STANDARD LICENSE AGREEMENT, ATTACHED HERETO AS SCHEDULE E.

6 INTELLECTUAL PROPERTY RIGHTS

(a) The Distributor shall have no right, title or interest in any patent related to the Products or any trade mark or name used in connection with the Products, or the copyright in the Products or in any drawing, specification or other document relating to the Products except as provided in Schedule B-2 and the Distributor agrees to enter into at the Company's expense such license agreements in respect of such rights and interest as the Company may reasonably request from time to time, and to cease any and all use of such rights upon termination of this Agreement whatever the cause or reason for such termination, except to the extent necessary to enable the Distributor to dispose of any stocks of Products then remaining or on order.

(b) The Company warrants the Company has all necessary rights to enable the Company to enter into this Agreement and to grant to the Distributor the distribution and other rights contained in this Agreement.

(c) The Company has no actual knowledge of any present claim by any third party that the Products infringe any patents, registered designs, trade marks, copyright or similar rights existing or registered in any of the countries in the Territory.

7 TERMINATION

(a) This Agreement shall terminate upon expiry of any notice given under Clause 2.

(b) Without prejudice to any other remedy that may be available for the breach or nonperformance of any of the obligations herein contained, either party shall be entitled immediately to terminate this Agreement forthwith without compensation by notice to the other if the other shall:

(i) Commit a breach of any of its obligations hereunder and shall not remedy such breach (if the same is capable of remedy) within thirty (30) days of being required to do so by notice;

(ii) Pass a resolution, or have an order made, for its winding-up (except for the purpose of and followed by an amalgamation or reconstruction).

8 FORCE MAJEURE

The Company shall not be liable to the Distributor for any loss or damage which may be suffered by the Distributor as a direct or indirect result of the supply of the Products by the Company being prevented, hindered or delayed, and the Distributor shall not be liable to the Company in respect of any delay or failure by the Distributor in carrying out any of its obligations hereunder, in either case by reason of war, riot, civil disturbance, act of God, strike, lock-out, trade dispute or labour disturbance, accident, breakdown of plant or machinery, fire, flood, difficulty in obtaining workmen, materials or transport or any other circumstances whatsoever outside the control of the party concerned.

9 MISCELLANEOUS

(a) This Agreement is personal to the Distributor who shall not assign or transfer to any other person, firm or company any of its rights or obligations hereunder.

(b) Each of the parties hereto is an independent contractor and nothing herein contained shall be deemed to create a partnership, joint venture or the relationship of principal and agent, between the parties.

10 WAIVER

The failure by either party to require strict performance by the other of any provision hereof shall not waive or diminish the right of that party to require strict performance of the provision thereafter nor shall any such failure waive or diminish the right of the party to require strict performance of any other provision hereof.

11 ALTERATIONS

If any governmental or other authority (including without limitation the Commission of the European Communities)(hereinafter together called the "Authority") requires any alteration (hereinafter called the "Alteration") to be made to this Agreement or to any agreement made under this Agreement as a condition of granting approval, clearance or exemption of this Agreement or to any agreement made under this Agreement, then the parties hereto shall within one month of both parties having notice of the Alteration confer together for the purpose of making the Alteration and any other alteration, change or other action which they consider necessary (hereinafter called the "Consequential Alterations"). In the event that either party shall not agree to the Alteration or the Consequential Alterations within two months from the date on which both parties had notice of the Alteration, then either party shall be entitled to terminate this Agreement or any agreement made under this Agreement by giving not less than one month's notice to the other party.

12 ENTIRETY OF AGREEMENT

Except as provided in this Agreement and Schedules A to G inclusive hereto embody the entire understanding between the parties with respect to the distribution of the Products in the Territory to the entire exclusion of:

(a) Any term or conditions appearing on or referred to in the Distributor's orders or the Company's acknowledgment thereof.

(b) Any prior understanding, agreement, representation, warranty or dealing by or between the parties in such respect.

The parties hereby confirm that there is no agreement, expressed or implied, which is in contradiction to this Agreement. No modification or addition to this Agreement shall be binding unless made in writing and signed on behalf of each party hereto by a duly authorised representative.

13 CONFIDENTIALITY

The Distributor shall at all times during the continuance of this Agreement and after its termination:

(a) Use its best endeavours to keep all Restricted Information confidential and accordingly not to disclose any Restricted Information to any other person.

(b) Not use any Restricted Information for any purpose other than the performance of the obligations under this Agreement.

(c) Any Restricted Information may be disclosed by the Distributor to:

- (i) Any customers or prospective customers;
- (ii) Any governmental or other authority or regulatory body;
- (iii) Any employees of the Distributor or for any aforementioned persons;

to such extent only as is necessary for the purposes contemplated by this Agreement, or as is required by law and subject in each case to the Distributor using its best endeavours to ensure that the person in question keeps the same confidentiality and does not use the same except for the purposes for which the disclosure is made.

(d) Any Restricted Information may be used by the Distributor for any purpose, or disclosed by the Distributor to any other person, to the extent only that:

(i) It is at the date hereof, or hereafter becomes public knowledge through no fault of the Distributor (provided that in doing so the Distributor shall not disclose any Restricted Information which is not public knowledge);

(ii) It can be shown by the Distributor, to the reasonable satisfaction of the Company, to have been known to it prior to its being disclosed by the Company to the Distributor.

(e) In this clause Restricted Information means any information which is disclosed to the Distributor by the Company pursuant to or in connection with this Agreement (whether orally or in writing, and whether or not such information is expressly stated to be confidential or marked as such).

14 NOTICES

(a) Any notice required or authorised to be given hereunder shall be in writing and shall be served by facsimile or first class prepaid airmail letter and shall (unless a different address is notified in writing by one party to the other by due notice under this Clause) be addressed in the case of the Company to:

REALITY INTERACTIVE, INC.
11200 West 78th Street, Suite 300
Eden Prairie, MN 55344 USA
FAX: +1 612 996 6799
TEL: +1 612 996 6777

marked for the attention of the Director of International Sales with a copy to the Chief Financial Officer

And in the case of the Distributor to:

LASERMEDIA (DEUTSCHLAND) GMBH
Max-Planck-Strasse 39A, D-50858 Koln
FAX: +44 1243 555 020 (in care of LaserMedia GMBH)
TEL: +49 2234 95518-0

marked for the attention of the Director of Sales & Marketing with a copy to the Chief Financial Officer

(b) Any such notice shall be deemed to be served, in the case of a facsimile, at the opening of office hours of the recipient party on the next working day of the recipient party after the day of dispatch and, in the case of first class prepaid letter, five days after the date of proved posting.

15 PROPER LAW

The construction, validity and performance of this Agreement shall be governed by and construed in all respects by the laws of the state of Minnesota and the parties hereby submit to the nonexclusive jurisdiction of the Minnesota state or federal courts.

SCHEDULE A
THE TERRITORY

"Territory" shall include:

Germany, German speaking portion of Switzerland and Austria

SCHEDULE B-1
THE PRODUCTS AND US RETAIL PRICE LIST

"Products" shall include the following:

ISO 9000 Registration Series (5 titles) and the QS 9000 Series (4 titles) and such versions localized into German

US RETAIL PRICE FOR THE AMERICAN VERSION OF THE PRODUCTS:

PRODUCT NAME	US PRICE
ISO 9000 Series (5 CD Set)	\$4,995.00
Title 1	\$ 99.00
Title 2	\$1,295.00
Title 3	\$1,795.00
Title 4	\$1,795.00
Title 5	\$ 895.00
QS 9000 Series (4 CD Set)	\$3,595.00
Title 1	\$ 995.00
Title 2	\$ 995.00
Title 3	\$ 995.00
Title 4	\$ 995.00

All the above US Retail Prices are in US dollars.

SCHEDULE B-2
GERMAN LOCALIZATION OF QS 9000

October 7, 1996

Mr. Philip Lingard
Operations Manager
Futuremedia
Media House, Arundel Road
Walberton, Arundel
West Sussex, BN18 0QP
UK
TEL: 44-1243-555-000
FAX: 44-1243-555-020

Re: Letter Agreement regarding German Localization of QS 9000

Dear Philip:

This letter is meant to confirm our mutual understanding concerning the development of the German version of Reality's four CD-ROM Series QS 9000 product ("QS"). Please review the letter agreement and indicate your acceptance of the letter agreement by signing the signature block at the end of the letter.

Reality Interactive ("RII") and Futuremedia PLC (FM) agree as follows:

1. LOCALIZATION RIGHTS; DISTRIBUTION RIGHTS TO BE SEPARATELY NEGOTIATED WITH LASERMEDIA.

RII hereby grants FM the right to develop a high quality German language version of QS ("German Version"). Distribution rights with respect to the German Version shall be dealt with in the International Distribution Agreement with FM'S subsidiary company, LaserMedia GmbH to be negotiated separately.

2. SCOPE OF LOCALIZATION.

FM agrees to perform all work to create the German Version including but not limited to translations of text, replacement of graphic elements, authoring, video production and editing and product management. RII understands that much of the work will actually be performed by subcontractors.

3. RII TO PROVIDE REASONABLE SUPPORT TO FM.

RII agrees to provide support for FM'S localization efforts including but not limited to providing (1) all necessary source materials to enable FM to create the German Version; and (2) reasonable access to technical personnel to help FM in dealing with source code issues. Reasonable access shall mean at least one trip to the UK by a technical person from RII for a week. All expenses for this trip shall be borne by RII.

4. MONETARY RESOURCE ALLOCATION BETWEEN RII AND FM.

The parties contemplate a combined investment of 150,000 pounds in order to develop the German Version. The attached Schedule A apportions the respective investments of the parties. The parties shall each bear one-half of the combined investment. RII shall provide its share of the investment according to Schedule A and shall front 35,000 pounds of FM's investment as also indicated in Schedule A.

FM shall repay the 35,000 pounds to RII from the initial sales of the first 11 copies of the German Version. If FM has not repaid the 35,000 pound amount in full by March 31, 1997, RII shall invoice FM for such remaining amount and FM shall pay such amount via wire transfer within 30 days of such invoice.

5. OWNERSHIP OF THE INTELLECTUAL PROPERTY RIGHTS OF THE GERMAN VERSION;
DISTRIBUTION RIGHTS.

RII shall have all right, title and interest in and to the underlying American Version of the QS 9000 product subject to each party having a joint ownership interest in the German Version. The distribution rights granted to LaserMedia in the Distribution Agreement between RII and LaserMedia to be separately negotiated.

If Futuremedia agrees to the terms of this letter agreement, please sign below and fax back a copy to Randy Boyer, Director of International Sales, at +1 612-996-6789.

Sincerely,

REALITY INTERACTIVE

BY: /S/ Wes Winnekins

Wes Winnekins, CFO

Accepted by FUTUREMEDIA PLC

/S/ Philip Lingard

(Signature)

Philip Lingard

(Name Printed)

Operations Director

(Title)

DATE: 20 October, 1996

SCHEDULE A

Pounds USDollars
 ----- -----
 Exchange Rate: 1 pound equals 1.54 USD

Total Investment	150,000	\$	231,000
External	110,000	\$	169,400
FM	28,000	\$	43,120
RII	12,000	\$	18,480
Allocation FM 50%	75,000	\$	115,500
RII 50%	75,000	\$	115,500
RII Cash Contribution	110,000	\$	169,400
FM Owes RII	35,000	\$	53,900

Pay out of the \$169,400 as follows:

		Pounds	USDollars
		-----	-----
3rd Party Translation	Week of Oct 7	26,000	\$ 40,000
3rd Party Video Production & Graphic/Text Work	Week of Oct 21	60,000	\$ 92,400
3rd Party Graphic Changes	Week of Dec 9	20,000	\$ 30,800
3rd Party Debug/Reprogram	Week of Dec 23	4,000	\$ 6,160
Total		110,000	169,400

SCHEDULE C
BUSINESS PLAN CONTAINING
DISTRIBUTOR AND ROYALTY PAYMENTS TO THE COMPANY

LaserMedia's Business Plan Outline for Reality Interactive

I. Company Information

A. Contact information (e.g. address, phone, fax, email, website)

Lasermedia GmbH, Max-Planck-Strass 39A, D-50858 Cologne, Germany
Phone: 49-2234-9-55-18-0
Fax: 49-2234-9-55-18-55
Email Address: 100436.1332@compuserve.com

1. Key contact between the company and Reality Interactive

Christiane Toffolo-Haupt: responsible for the relationship
Claus Stratmann, Christiane Toffolo-Haupt: strategic
Christiane Toffolo-Haupt: Marketing
Stefan Lemanzyk: Sales
Brigitte Frank: Administration and finance
Sabine Pergande: pre- and post-sales support

B. Company Background

1. History

1989 Founded by Claus Stratmann; GmbH in 1991
Company Launch was during launch of SPC product in February 1990
3 major projects:

\$1M DM w/Volkswagen in 1991
\$1.7M DM w/Deutsche Telekom in 1994
\$2M DM w/Post Office in 1993
Exclusive supplier relationship w/Volkswagen for multimedia

2. Structure of Organization

One legal organization: LaserMedia (Deutschland) GmbH; focussed on packaged software distribution business. The parent company is Futuremedia PLC; functionally the business runs independently from Futuremedia. LaserMedia is also able to provide customized products, using free lancers.

Management Structure:

General Management: Claus Stratmann
Marketing Manager: Christiane Toffolo-Haupt
Finance and Account Manager: Brigitte Frank

3. # of employees: 6 fulltime and 2 contractors

4. Branches

Cologne (head office)

In Cologne, in October 1995 launched, 50/50 JOINT VENTURE TRAINING CENTER (3 PRIVATE PARTIES IN THE TRAINING BUSINESS)

II. Financial Information

A. Revenue for Last 2 years

FY 95: 6.8 M DM (big deal in December 1994)

FY 96: 3.8 M DM

B. Key Changes in Financial Strategy

FY 96 was a disappointing year. In FY 97 new products contribute to make the turnaround, such as ISO 9000 new version, crane operator, Quest + Designer's Edge, Financial Planning Analysis.

C. Banking References

Commerzbank, Koln

D. Accounting Firm

Ernst & Young, Dusseldorf

E. Public or Private

LaserMedia GmbH is 100% owned by LaserMedia International which is 100% owned by Futuremedia PLC (the UK company).

III. Sales

A. Staffing

1. Head Sales Manager: Claus Stratmann
2. Organization of Sales Team
 - a. Number: 3 people actively selling
 - b. How Allocated
 - i. Direct Major Accounts (3)
 - ii. Telesales (1)
 - iii. Indirect
 - Switzerland reseller,
 - open learning center channel

3. Sales Strategies (by product) QS-9000

a. Direct.

- i. Target Customers: Automobile Manufacturers (current customers), automobile manufacturers (not current customers), automotive suppliers (current and non current customers), Quality Management Associations

Key customers: Ford, Volkswagon, Mercedes, Audi, BMW, Porsche, Lucas, Mannesman, Bosch, Siemens, ABB, Akzo, Boge (part of Mannesman), Johnson Controls, Dow Chemical, Dunlop, Eaton, Fichtel and Sachs (shock absorbers), TRW, Karman, Krupp, MAN, Philips, Skoda (Czech manufacturer), Unikellar (upholstery and interior)

The plan is for one-off sales of QS to get sales started immediately with the american version of QS-9000; larger sales and company licenses to be made as soon as the project is available in German.

Other modes of providing revenue:
rental sale

Hardware, after sales support

Sales Cycle

- i. Made contract and established need/timescale (past customer, advertising, referral, direct mail, seminar, channel partner, telemarketing)
- ii. pre-qualifying prospect (early adopter, budget, authority, urgency, management support, multimedia support, corporate vision)
- iii. sent details; give price indication
- iv. product demonstrated
- v. formal proposal submitted
- vi. budget approval confirmed
- vii. key influencers involved
- viii. LaserMedia shortlisted
- ix. spend approved
- x. verbal or written confirmation is received
- xi. purchase order received
- xii. LaserMedia accepts order

Sales process is tracked as a part of the database which shows complete history included closed sales and tracking why sales did not close.

IV. Marketing

A. Staffing

1. Marketing Manager, Christiana
2. Organization of Marketing Team

Christiana is responsible for PR, manages strategic relationships, representing the company externally at speaking engagements, success stories, writing articles, organizing exhibitions, creates and defines mail shots, product management (developing new marketing strategy for the product; product management); Sabine Pergande is responsible for telemarketing; database management; executes the mailings

- a. Leads generation (mail shots and follow ups to targeted sectors with actions)
- b. Public relations (continuous press releases and articles)
- c. Advertising (to be evaluated)
- d. Product marketing (product literature, packaging)
- e. Support for sales team
 - proposal templates, pricing
 - sales tools
 - success stories, case studies

B. Key Strategies and Goals

Database of 10,000 contacts; address, contact info and general manager; telemarketing investigates who are the key 4-6 managers for each customer (CEO, Training, Quality, etc.); "Quality" is the main focus of business, automobile suppliers.

1. Leads generation

- a. mailshot to existing customer base (quality courses)
- b. direct contact and presentation to the large automotive companies (Ford, Opel, Mercedes, Volkswagen, Audi, etc. (eventually presentation to the AKAB-CBT work group)
- c. mailshots to the non customers of LaserMedia in the automotive supplier industry
- d. generating further leads from fairs as Qualifikation (Oktober 96), Control (May 97) and eventually MTQ (November 96)

2. Public relations

- a. one initial press release for the launch of 1st modules
- b. further press releases to announce the launch of further modules
- c. case studies to leading specialized magazines for quality as QZ, Kontrolle, but also for training as Q-Magazin, etc.
- d. speaking engagements to be defined when product availability is established

3. Product Marketing

- a. Preparation (packaging, brochures, demos-CDs)
- b. Launch
 - timetable
 - event (press conference, speakers)
 - advertising
 - materials (special introductory offers)
 - press release

4. Trade Shows and Conferences

Factors that accelerate decision making cycle:

- -Multimedia training now
- -Multimedia hardware
- -Deadline/pressure
- -Good relationship (will always buy almost any products)

b. Indirect sales

Swiss Distributor-Quality Consultant-part of the Distribution agreement is to train and sell the quality products and 12 month forecasts; one day training session; support as needed and when asked; access to leads database

SCHEDULE D-1
MONTHLY SALES FORECAST TEMPLATE

See attached spreadsheet templates for ISO 9000 and QS 9000 (These forecasts are due between the 10th and 20th of every month.)

[Diagram of Excel-based Sales Forecasting Templates]

SCHEDULE D-2
6-MONTH ROLLING FORECAST

See attached spreadsheet templates for ISO 9000 and QS 9000 (These forecasts are due between the 10th and 20th of every month.)

[Diagram of Excel-based Rolling Sales Forecast]

SCHEDULE D-3
QUARTERLY MARKETING REPORT

(This report is due between the 10th and 20th of December 1996, March 1997, June 1997, September 1997 and December 1997.)

KEY MARKETING EVENTS THAT HAPPENED IN PREVIOUS QUARTER:

Trade Shows:

Press Releases:

Product Launches:

Public Relations Activities:

KEY MARKETING EVENTS FOR NEXT QUARTER:

Planned Trade Shows:

Planned Press Releases:

Planned Product Launches:

Planned Public Relations Activities:

IMPORTANT FUTURE MARKETING ACTIVITIES (MORE THAN ONE QUARTER AWAY):

Planned Trade Shows:

Planned Press Releases:

Planned Product Launches:

Planned Public Relations Activities:

Distributor Requests for Reality in the Unites States related to Marketing/Marketing Support:

SCHEDULE E
LASERMEDIA'S STANDARD LICENSE AGREEMENT

[Standard License Agreement in German Language]

SCHEDULE F

PURCHASE ORDER PROCEDURE, ROYALTY PAYMENTS PROCEDURE, PAYMENT TERMS, COMPANY CONTACT DETAILS

PRODUCT ORDER PROCEDURES:

The following procedures will apply when ordering American versions of product from Reality Interactive:

1. Product is ordered once every 30 days via fax to: SALES ADMINISTRATION MANAGER, REALITY INTERACTIVE, +1 (612) 996-6799 WITH A COPY TO RANDY BOYER, DIRECTOR OF INTERNATIONAL SALES VIA EMAIL); product is supplied at cost; invoices payable by Distributor within 30 days.

During the first week of every month, Distributor shall provide monthly royalty statements against which Company will invoice LaserMedia GMBH. LaserMedia GMBH will settle the royalty payments within seven days of Company receiving payment from its customers (average payment is 35 days) but no more than 50 days from LaserMedia GMBH invoicing its customers. Distributor will pay for shipment and insurance.

2. Reality Interactive's payment terms: wire transfers are preferred.

Wire transfers to Reality Interactive can be made as follows:

Bank: First Bank, N.A.
Eden Prairie, MN 55344 USA
(612) 942-2847

ABA #: 091000022

Account #: 173100140149

3. Orders for marketing materials should be in writing and faxed or emailed to Marketing Department (fax: +1 612 996 6799; email: andyk@ry.com)

REALITY INTERACTIVE CONTACT DETAILS:

Distributor should primarily communicate with Reality through the following person:

Randy Boyer, Director, International Sales (business issues)
Peter Kelley, International Product Manager (product issues)

Randy Boyer's Contact Details:
Internet: RandyB@ry.com (communication via internet is preferred means)
Phone: +1 612 996 6789
Fax: +1 612 996 6799

Peter Kelley's Contact Details:
Internet: peterk@ry.com
Phone: +1 612 996 6779
Fax: +1 612 996 6799

Reality's Corporate Website: <http://www.realtools.com>

SCHEDULE G
DISTRIBUTOR DISCOUNT SCHEDULE FOR AMERICAN VERSION; ROYALTY RATE FOR GERMAN
VERSION

The discount rate shall be (***)% for American versions of the products. The royalty rate payable to Reality for the German Version of QS 9000 shall be the greater of \$(***) per unit or (***)% of the German selling price.

Royalty targets to maintain exclusivity are as follows:

1. \$USD (**) in royalties paid to Reality by June 30, 1997; and
2. \$USD (**) in royalties paid to Reality by December 15, 1997 (includes \$(**) from part 1 above)

*** Pursuant to Rule 24b-2 of the Securities Exchange Act of 1934, confidential portions of this Exhibit have been deleted and filed separately with the Securities and Exchange Commission pursuant to a request for confidential treatment.

AS WITNESSED this Agreement has been signed on behalf of each of the parties the day and year first above written.

SIGNED for and on behalf of
REALITY INTERACTIVE, INC.

Signature: /S/ WESLEY W. WINNEKINS

Name (printed: WESLEY W. WINNEKINS

Title: CHIEF FINANCIAL OFFICER

Date: OCTOBER 9, 1996

SIGNED for and on behalf of
FUTUREMEDIA PLC

Signature: /S/ PHILIP LINGARD

Name (printed: PHILIP LINGARD

Title: OPERATIONS DIRECTOR

Date: OCTOBER 20, 1996

LEASE SCHEDULE

THIS LEASE SCHEDULE NO. #2 is hereby added to, incorporated into and in all respects made a part of that certain Master Equipment Lease Agreement, dated as of June 15, 1995 (the "Agreement"), between Carlton Financial Corporation, located at 7831 Glenroy Road, Suite 102, Edina, Minnesota 55439-3133, a Minnesota corporation ("Lessor"), and Reality Interactive, Inc. located at 7500 Flying Cloud Drive, Suite 400, Eden Prairie, Minnesota 55344, a Minnesota corporation ("Lessee"). Capitalized terms used herein and not otherwise defined shall have the meanings ascribed to them in the Master Equipment Lease Agreement

Lessor and Lessee agree as follows:

1. EQUIPMENT DESCRIPTION. Lessor hereby delivers and leases to Lessee, and Lessee hereby accepts and leases from Lessor, the following equipment (the "Equipment"):

See Schedule A attached hereto and made a part hereof.

2. EQUIPMENT LOCATION. The location of the Equipment shall be as follows:

same as above

3. TOTAL COST. The total cost of the Equipment shall be as follows:

System Price:	\$116,833.48
Other (specify)	\$
-----	-----
Total Cost:	\$116,833.48

4. RENTS AND PAYMENT DATES.

- A. The Rent described in Section 2 of the Master Equipment Lease Agreement shall be \$5,494.00, ("Amount of Each Payment") and the Rent Due Date shall be the 1st day of each month. The commencement date shall be January 1, 1997.
- B. The Initial Term of the Lease as described in Section 1 of the Master Equipment Lease Agreement shall be 24 months and Lessee shall make 24 rent payments ("No. of Payments").
- C. The Interim Rent payable on the Funding Date for this Schedule by Lessee to Lessor under Section 2 of the Master Equipment Lease Agreement shall be computed by multiplying the Periodic Rental amount \$5,494.00 by number of Prorata days and dividing the product thereof by 30.
- D. On Execution hereof, Lessee has paid \$10,988+ tax ("Advance Rentals").

5. REAFFIRMATION OF MASTER EQUIPMENT LEASE AGREEMENT ASSIGNMENT. All of the provisions of the Master Equipment Lease Agreement are hereby incorporated by reference in this Lease Schedule on and of the date hereof, to the same extent as if fully set forth herein. This Lease Schedule may be assigned by Lessor separately from any and all other Lease Schedules.

IN WITNESS WHEREOF, Lessor and Lessee have caused this Lease Schedule to be duly executed on the dates set forth beneath their signatures below.

LESSOR:
Carlton Financial Corporation

LESSEE:
Reality Interactive. Inc.

By: /S/ Michael J. McShane

Title: President

Date: December 9, 1996

By: /S/ Wesley W. Winnekins

Title: Chief Financial Officer

Date: December 9, 1996

MASTER EQUIPMENT LEASE AGREEMENT
DELIVERY AND ACCEPTANCE

LESSOR: CARLTON FINANCIAL CORPORATION
7831 Glenroy Road. Suite #102
Edina, MN 55439-3133
L

LEASE NO. -----
LEASE PLAN FMV

LESSEE: Reality Interactive, Inc.
7500 Flying Cloud Drive, Suite 400
Eden Prairie, MN 55344
Contact Person: Wes Wlnekins 996-6712

DESCRIPTION OF EQUIPMENT: See Schedule A attached hereto and made a part hereof.

LESSEE'S ACKNOWLEDGMENT AND CERTIFICATE OF ACCEPTANCE

- 1) Lessee hereby: (a) confirms that the equipment describe in the above Agreement(s) has been delivered to and received by the undersigned Lessee: (b) that all installation or other work necessary prior to the use of the equipment has been completed: (c) that said equipment is in good working order.
- 2) Lessee hereby: (a) confirms that the equipment is of the size, design, capacity and manufacture by it: (b) irrevocably accepts the equipment as is, where-is for all purposes of this Agreement.

Lessee hereby authorizes Lessor to pay for the leased equipment and commence said lease. This certificate shall not be considered to alter, construe, or amend the terms of the afore-said Agreements.

The undersigned affirms that he or she is a duly authorized corporate officer, partner, or proprietor of the above name.

By: /S/ Wesley W. Winnekins

Title: Wesley. W. Winnekins

Date: Chief Financial Officer

SCHEDULE "A" OF EQUIPMENT
REALITY INTERACTIVE, AS LESSEE
SCHEDULE #2

4 MOUSE TRAY
3 HANGING WORKSURFACE 36W X 24D SQUARED EDGE
4 PANEL, 48X67
1 DUPLEX RECEPTACLE. B
1 DUPLEX RECEPTACLE. D
1 TWO-WAY CONNECTOR
1 THREE-WAY CONNECTOR
1 END CAP
2 DRAW ROD, H62
17 FABRIC COVERED FA PANEL 67H x 24W Product #AN6724F
9 FABRIC COVERED FA PANEL 67Hx36W Product #AN6736F
29 FABRIC COVERED FA PANEL 67Hx48W Product #AN6748F
74 FABRIC COVERED FA PANEL 67Hx48W Cable Mngmt W/4
8 BASE POWER ENTRY KIT DIRECT
15 DUPLEX RECEPTACLE A CIRCUIT
13 DUPLEX RECEPTACLE B CIRCUIT
25 DUPLEX RECEPTACLE C CIRCUIT
27 DUPLEX RECEPTACLE D CIRCUIT
18 HANGING WORK SURFACE 36wx24D Product #ANWS3624
30 HANGING WORK SURFACE 4Swx24D Product #ANWS4824
54 HANGING CORNER WORK SURFACE 48wx24D PRODUCT #ANCWS4824
43 SHELF I6Hx48wxI3D Product#ANSH481316
27 FLIPPER D00R 16Hx48wx13D
43 TACKBOARD 16Hx48W
11 FREESTANDING LATERAL FILE W/LOCK
11 COUNTER WEIGHT FOR USE WITH 2-DRAWER FILE
28 PENCIL DRAWER
27 METAL KBD TRAY W/PALM REST
21 MOBILE PED WITH LOCK
43 TASK LIGHT FOR USE WITH 48"W
3 "C" LEG 29 HIGH PKGD ASSY
23 MOUSE TRAY
27 SERIES 2 HRD-SRFCD 2-WAY 90 CONN KIT
11 SERIES 2 HRD-SRFCD 3-WAY 90 CONN KIT
4 SERIES 2 FOUR-WAY CRNER CONNECTOR KIT
27 SERIES 2 PANEL END CAP KIT 67H
61 SERIES 1 PANEL CONNECTOR 62H
10 SERIES 1 T-CONNECTOR 62H
24 WALL STRIP 60H LIGHT GREY
1 FABRIC-COVERED FA PANEL 39Hx30W Product #AN3930F
2 FABRIC-COVERED FA PANEL 39Hx48W Product #AN3948F
7 FABRIC-COVERED FA PANEL 67Hx30W Product 4AN6730F
3 BASE POWER ENTRY KIT DIRECT CONNECT LH
1 HANGING WORK SURFACE 24wx24D Product #ANWS2424
7 HANGING WORK SURFACE 30wx24D Product #ANWS3024
1 SHELF 16Hx24wx13D Product #ANSH241316
1 FLIPPER D00R I6Hx24wx13D Product #ANFD2413
1 TACKBOARD 16Hx24W Product #ANTB1624

1 TASK LIGHT FOR USE WITH 24"W
 1 SERIES 2 PANEL END CAP KIT 39H
 2 SERIES 1 PANEL CONNECTOR 34H
 14 VARIABLE HEIGHT FILLER
 2 FABRIC-COVERED FA PANEL 53Hx24W Product #AN5324F
 9 FABRIC-COVERED FA PANEL 53Hx36W Product #AN5336F
 6 F.S. PED WITH LOCK 6/612 24D
 11 SERIES 2 PANEL END CAP KIT 53H
 9 SERIES 1 PANEL CONNECTOR 48H
 1 CEILING ENTRY KIT WITH POWER 67H
 9 CONFERENCE WORKSURFACE 50W X 25D
 1 PENINSULA DESK
 1 HALF-ROUND EXTENSION I5"Dx30"Wx29"H
 1 SINGLE PAD CREDENZA
 1 BRIDGE 22"Dx48"W
 1 OVERCABINET W/FULL TB
 1 FILENZA W/BOOKCASE
 1 BOOKCASE I2Dx42Wx47H
 1 FREESTANDING PED 6"
 1 COUNTERWEIGHT FOR 42"W FILES
 1 CENTER DRAWER METAL
 1 UNDERSHELF LIGHT USE WITH 72" OVERCABINET
 7 AS NEW, CHANGE OF HEIGHT STRIP. LIGHT GREY

4 30" HALF ROUNDS

6 30"x60" MATE TABLE
 2 30" x 60,, x 34" TRAPEZOID MATE TABLE FIXED SYMMETRICAL LEG
 10 GANGING DEVISE

Equipment transferred from Master Lease/Schedule 1

10 NO 3941 CONFERENCE CHAIRS - MIDBACK SWIVEL TILT W/MANUAL HEIGHT ADJUSTMENT
 BLACK 5 STAR BASE AND NEW ERA GR 4 NO. NE02 CLARET UPHOLSTERY
 10 AS ABOVE W/NEW ERA GR 4 NO. NE09 SPRUCE UPHOLSTERY
 2 CONFERENCE TABLES 48" X 120" RACETRACK W/NO. 735 BULL NOSE EDGE
 (NO.27 NATURAL MAPLE W/CLEAR FINISH) P.LAM. TOP NO.62 STORM GRAY MATRIX &
 TWO (2) NO. 7523-CB 23" DIA. P.LAM BASES NO.83 BLACK
 7 FDA-1 FRICTION DISPLAY ARM

IRREVOCABLE LETTER OF CREDIT

Loan/Letter of Credit No: 1114 96

Lender: BankWindsor
IDS Center
740 Marquette Avenue
Minneapolis, Minnesota 55402

Beneficiary: CARLTON FINANCIAL CORP.
7831 Glenroy Road #102
Edina, Minnesota 55439

Customer: Reality Interactive, Inc.
Flying Cloud Drive, #400
Eden Prairie, Minnesota 55344

Expiration Date: This Letter of Credit shall expire upon the earlier of: 1. the close of business on December 9, 1997 and all drafts and accompanying statements or documents must be presented to Lender on or before that time; or 2. the day that Lender honors a draw under which the full amount of this Letter of Credit is drawn.

Lender indicated above ("Lender") hereby establishes an Irrevocable Letter of Credit in favor of Beneficiary for a sum or sums not exceeding the aggregate amount of ONE HUNDRED SIXTEEN THOUSAND EIGHT HUNDRED THIRTY-THREE AND 48/100 Dollars (\$116,833.48). These funds shall be made available to Beneficiary against Lender's receipt from Beneficiary of drafts drawn at sight on Lender at its address indicated above (or such other address that Lender may provide Beneficiary with written notice of in the future) and accompanied by the signed written statements or documents indicated below.

WARNING TO BENEFICIARY: PLEASE EXAMINE THIS LETTER OF CREDIT AT ONCE. IF YOU FEEL UNABLE TO MEET ANY OF ITS REQUIREMENTS, EITHER SINGLY OR TOGETHER, YOU SHOULD CONTACT YOUR CUSTOMER IMMEDIATELY TO SEE IF THE LETTER OF CREDIT CAN BE AMENDED. OTHERWISE, YOU WILL RISK LOSING PAYMENT UNDER THIS LETTER OF CREDIT FOR FAILURE TO COMPLY STRICTLY WITH ITS TERMS AS WRITTEN.

1. DRAFT TERMS AND CONDITIONS

Lender shall honor the drafts submitted by Beneficiary under the following terms and conditions:

A STATEMENT THAT A PAYMENT DUE UNDER THE MASTER EQUIPMENT LEASE AGREEMENT DATED JANUARY 1, 1997 BETWEEN CARLTON FINANCIAL CORPORATION AND REALITY INTERACTIVE, INC. HAS NOT BEEN MADE ON THE DUE DATE AND THE DRAFT SHALL BE FOR UP TO THE TOTAL AMOUNT OF THE BALANCE DUE UNDER THE LEASE BASED UPON THE ATTACHED AMORTIZATION SCHEDULE A.

Upon Lender's honor of such drafts and payment to the Beneficiary, Lender, once the full amount of credit available under this Letter of Credit has been drawn, shall be fully discharged of its obligations under this Letter of Credit and shall not thereafter be obligated to make any further payments under this Letter of Credit in respect of such demand for payments to Beneficiary or any other person. If a non-conforming demand is made, Lender shall notify Beneficiary of its dishonor on or before the time mentioned In Section 5 below.

Beneficiary shall have no recourse against Lender for any amount paid under this Letter of Credit after Lender honors any draft or other document which complies strictly with this Letter of Credit, and which on its face appears otherwise in order but which is signed, issued, or presented by any party or under the name of any party purporting to act for Beneficiary, purporting to claim through Beneficiary, or posing as Beneficiary. By paying to Beneficiary an amount demanded in accordance with this Letter of Credit, Lender makes no representation as to the correctness of the amount demanded and Lender shall not be liable to Beneficiary or any other person for or in respect to any amount so paid or disbursed for any reason whatsoever, including, without limitation, any nonapplication or misapplication by Beneficiary of the proceeds of such payment. By presenting upon Lender or a confirming bank, Beneficiary certifies that Beneficiary has not and will not present upon the other, unless and until Beneficiary meets with dishonor. Beneficiary promises to return to Lender and confirmer any funds received by Beneficiary in excess of the Letter of Credit's maximum drawing amount.

2. USE RESTRICTIONS

All drafts must be marked "DRAWN UNDER BANK WINDSOR IRREVOCABLE LETTER OF CREDIT NO. 1114 96 DATED DECEMBER 9, 1996", and the amount of each draft shall be marked on the draft. Only Beneficiary or Beneficiary's Transferee (only if transferable) may complete a draft and accompanying statements or documents required by this Letter of Credit and make a draw under this Letter of Credit. This original Letter of Credit must accompany any draft drawn hereunder.

Partial draws are permitted under this Letter of Credit. Lender's honor of a partial draw shall correspondingly reduce the amount of credit available under this Letter of Credit. Following a partial draw, Lender shall return this original Letter of Credit to Beneficiary with the partial draw noted thereon; in the alternative, and in its sole discretion, Lender may issue a substitute Letter of Credit to Beneficiary in the amount shown above less any partial draw(s).

3. PERMITTED TRANSFEREES

The right to draw under this Letter of Credit shall be nontransferable, except for:

A. A transfer by direct operation of law to the original Beneficiary's administrator, executor, bankruptcy trustee, receiver, liquidator, successor, or other representatives at law; and

B. The first immediate transfer by such legal representative to a third party after express approval of a governmental body (judicial, administrative, or executive).

4. TRANSFEREE'S REQUIRED DOCUMENTS

When the presenter is a permitted Transferee under paragraph 3 above, the documents required for a draw shall include:

A. All documents required elsewhere in this Letter of Credit, except that such documents may be in the name of either the original Beneficiary or the presenter permitted by paragraph 3; and

B. When the presenter is a permitted Transferee under paragraph 3, A or a third party under 3.B, a certified copy of the one or more documents which show the presenter's authority to claim through or to act with authority for the original Beneficiary.

5. TIMING OF DISHONOR

Under no circumstances shall Lender be precluded from relying upon any reason for dishonor given in a communication which Beneficiary or the presenter receives within three (3) banking days after Lender has

received the last document forming part of Beneficiary's presentment (the "Three-Day Period"). Lender shall be entitled to rely upon any such reason without regard to either (i) the timing of any presentment made before the Expiration Date, or (ii) the timing inside the Three-Day Period of any preliminary communication(s) from Lender concerning the dishonor decision itself or any reason for dishonor. For any such reason so given during the Three-Day Period, Lender shall be conclusively deemed to have met the "reasonable time", "without delay", and other timing requirements as the UCP (as hereafter defined) and U.C.C. may impose. The Expiration Date shall not be extended to accommodate a presentment made with less than three (3) banking days to go before the Expiration Date, and Beneficiary shall not be entitled to submit a draw request or provide Lender with any documents in support of a draw after the Expiration Date hereof. Nor shall Lender ever be required to communicate a dishonor decision or its reasons within a time less than the Three-Day Period.

6. COMPLIANCE BURDEN

Under no circumstances shall Lender be held responsible for any impossibility or other difficulty in achieving strict compliance with the requirements of this Letter of Credit precisely as written. Beneficiary understands and acknowledges: (i) that unless and until the present wording of this Letter of Credit is amended with Lender's prior written consent, the burden of complying strictly with such wording remains solely upon Beneficiary; and (ii) that Lender is relying upon the lack of such amendment as constituting Beneficiary's initial and continued approval of such wording.

7. NON-SEVERABILITY

If any aspect of this Letter of Credit is ever declared unenforceable for any reason by any court or governmental body having jurisdiction, Lender's entire engagement under this Letter of Credit shall be deemed null and void ab initio, and both Lender and Beneficiary shall be restored to the position each would have occupied with all rights available as though this Letter of Credit had never occurred. This non-severability provision shall override all other provisions in this Letter of Credit, no matter where such provision appears within the Letter's body.

8. CHOICE OF LAW/JURISDICTION

The International Chamber of Commerce Uniform Customs and Practice for Documentary Credits, 1993 Revision, ICC Publication No. 500 (the "UCP") shall in all respects be deemed a part hereof as fully as if incorporated herein and shall apply to this Letter of Credit. This Agreement shall be governed by and construed in accordance with the laws of the State of Minnesota, United States of America, except to the extent such laws are inconsistent with the UCP. Lender and Beneficiary consent to the jurisdiction and venue of any court located in the State of Minnesota in the event of any legal proceeding under this Letter of Credit.

9. EXPIRY

Lender hereby agrees with Beneficiary that drafts drawn under and in compliance with the terms of this Letter of Credit will be duly honored if presented to the Lender on or before the Expiration Date.

Dated: DECEMBER 9, 1996

LENDER: BANK WINDSOR

BY: /S/ KEVIN R. HOWK

TITLE: ASSISTANT VICE PRESIDENT

CONSENT OF INDEPENDENT ACCOUNTANTS

We hereby consent to the incorporation by reference in the Registration Statement on Form S-8 (No. 333-05027) of Reality Interactive, Inc. of our report dated February 21, 1997 appearing in this Form 10-KSB.

/s/ Price Waterhouse LLP

Price Waterhouse LLP
Minneapolis, Minnesota
March 28, 1997

YEAR		
	DEC-31-1996	
	DEC-31-1996	
		508,728
		4,744,712
		97,396
		0
		134,853
	5,548,524	
		421,682
		229,746
	5,885,741	
	247,419	
		0
	0	
		0
		46,774
5,885,741	5,591,548	
		484,127
	788,236	
		107,008
		220,494
	6,416,398	
		0
	282,846	
	(6,131,502)	
		0
(6,131,502)		
		0
	219,470	
		0
	(6,350,972)	
	(1.68)	
		0

CAUTIONARY STATEMENT

Reality Interactive, Inc. (the "Company"), or persons acting on behalf of the Company, or outside reviewers retained by the Company making statements on behalf of the Company, or underwriters, from time to time may make, in writing or orally, "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. When used in conjunction with an identified forward-looking statement, this Cautionary Statement is for the purpose of qualifying for the "safe harbor" provisions of such sections and is intended to be a readily available written document that contains factors which could cause results to differ materially from such forward-looking statements. These factors are in addition to any other cautionary statements, written or oral, which may be made or referred to in connection with any such forward-looking statement.

The following matters, among others, may have a material adverse effect on the business, financial condition, liquidity, results of operations or prospects, financial or otherwise, of the Company. Reference to this Cautionary Statement in the context of a forward-looking statement or statements shall be deemed to be a statement that any or more of the following factors may cause actual results to differ materially from those in such forward-looking statement or statements:

DEVELOPMENT STAGE COMPANY. The Company was incorporated in May 1994, first began to ship the complete series of its initial product in August 1995, and accordingly, has only a limited history of operations. The Company's prospects for success must be considered in light of the problems, expenses, difficulties, complications and delays frequently encountered in connection with the formation and development of a new business in a competitive industry. In addition, due to the uncertainty in growth of a development stage company and the rate of change in the industry perceived by the Company, the Company is uncertain of the time frame or amount of funding required to accomplish its business objectives.

DEVELOPING MARKET; MARKET ACCEPTANCE. The market for educating and training businesses has historically been served by consultants, instructor-led training and training publications such as books, manuals and tapes. Currently, there is little use of interactive multimedia education and training products by businesses, and many of the Company's potential customers do not own or have access to multimedia compatible equipment. The Company's future success will depend upon, among other factors, the extent to which companies acquire multimedia equipment compatible with the Company's products and adopt and use interactive multimedia education and training programs. In addition, the Company's success will depend in part on its ability to market and sell multiple copies of its products to large corporate customers. In the event that adoption and use of multimedia equipment compatible with the Company's products do not become widespread, the number of potential customers of the Company will be limited. There can be no assurance that the Company's products or the prices the Company charges for its products will be acceptable to the market or that the Company will be able to sell multiple copies to large corporate customers.

LIMITED MARKETING CAPABILITY. The Company currently has a small sales and marketing staff and limited number of strategic alliances relating to distribution of its products. There can be no assurance that the Company will be able to build a suitable sales force or enter into satisfactory marketing alliances with third parties, or that its sales and marketing efforts will be successful.

DEPENDENCE ON DIVERSIFICATION OF PRODUCT OFFERINGS. The Company currently has a limited number of product offerings, and purchasers of the Company's products are not required to purchase additional products. Accordingly, the Company's products represent non-recurring revenue sources, and the success of the Company is dependent, in part, on its ability to develop sustained demand for its current products and to develop and sell additional products. There can be no assurance that the Company will be successful in developing and maintaining such demand or in developing and selling additional products.

DEPENDENCE ON EVOLVING INDUSTRY STANDARDS. The Company's initial product offerings prepare businesses for adherence to worldwide management standards. The failure of the Company to enhance its products in a timely manner to changes in the standards, the lack of public acceptance of such standards or the delay in introduction of or enhancement to such standards would materially adversely affect the Company's operations.

TECHNOLOGICAL CHANGE. The industry in which the Company competes is characterized by rapid technological change. The introduction of products embodying new technology can render existing products and product formats obsolete and unmarketable. The Company's success will depend on its ability to anticipate changes in technology and to develop and introduce new and enhanced products in a timely manner in response to technological changes, or if products or product enhancements by the Company do not achieve market acceptance, the Company's business would be materially adversely affected.

FUTURE ADDITIONAL CAPITAL REQUIREMENTS; NO ASSURANCE FUTURE CAPITAL WILL BE AVAILABLE. If the Company is unable to generate substantial revenues from its operations or if the Company's expenses exceed expectations, the Company will likely require additional funds to meet its capital requirements. The Company does not currently have available bank financing. The Company may be required to raise additional funds through public or private financings, including equity financings, or through collaborative arrangements. There can be no assurance that additional financing would be available on favorable terms, or at all. If funding is not available when needed or on acceptable terms, the Company may be forced to curtail its operations significantly or cease operations and abandon its business entirely.

COMPETITION. The business education and training industry is highly competitive. A large number of companies are currently developing interactive, multimedia-based training, educational and instructional aids. Competitors also include national, regional and local accounting firms engaged in industrial consulting and instructor-led training and companies which market training tools such as books, videos and audio tapes. Some of the Company's existing competitors, as well as a number of potential competitors, have larger technical staffs, more established marketing and sales organizations, and greater financial resources than the Company. There can be no assurance the Company will be able to compete successfully with such companies, or at all.

FLUCTUATIONS IN OPERATING RESULTS. The Company's future operating results may vary substantially from quarter to quarter. At its current stage of operations, the Company's quarterly revenues and results of operations may be materially affected by the timing of the development and market acceptance of the Company's products. Generally, operating expenses will be higher during periods in which product development costs are incurred and marketing efforts are commenced. Due to these and other factors, including the general economy, stock market conditions and announcements by the Company or its competitors, the market price of the Company's securities may be highly volatile.

DEPENDENCE ON KEY PERSONNEL; LACK OF EMPLOYMENT AND NONCOMPETITION AGREEMENTS. The success of the Company is dependent in large part upon the ability of the Company to attract and retain key management and operating personnel. Qualified individuals are in high demand and are often subject to competing offers. In the future, the Company will need to hire additional skilled personnel in the areas of research and development, sales and marketing. There can be no assurance that the Company will be able to attract and retain the qualified personnel needed for its business. The Company has no employment or noncompetition agreements with any of its management or other personnel.

DEPENDENCE ON ABILITY TO RETAIN SUBJECT MATTER EXPERTS. The Company's product development strategy requires the Company to retain third-party subject matter experts to perform research and development functions by providing accurate and informative content for the Company's products. There can be no assurance that the Company will be able to continue to attract and retain qualified subject matter experts

required to develop new products and enhance existing products. The inability of the Company to attract and retain such experts could have a material adverse effect on the Company and its prospects.

INTELLECTUAL PROPERTY. The Company regards its multimedia products as proprietary and relies primarily on a combination of statutory and common law copyright, trademark and trade secret laws, customer licensing agreements, employee and third-party nondisclosure agreements and other methods to protect its proprietary rights. Despite these precautions, it may be possible for a third party to copy or otherwise obtain or use the Company's products or technology without authorization, or to develop similar products or technology independently. If unauthorized use or copying of the Company's product were to occur to any substantial degree, the Company's business and results of operations could be materially adversely affected. There can be no assurance that the Company's means of protecting its proprietary rights will be adequate or that the Company's competitors will not independently develop similar products.

The Company believes that developers of multimedia products may increasingly be subject to such claims as the number of products and competitors in the industry grows and the functionality of such products in the industry overlaps. Any such claim, with or without merit, could result in costly litigation and could have a material adverse effect on the Company.

LACK OF PRODUCT LIABILITY INSURANCE. The Company may face a risk of exposure to product liability claims in the event that use of its products is alleged to have resulted in damage to its customers. The Company does not currently carry product liability insurance. There can be no assurance that such insurance will be available on commercially reasonable terms, or at all, or that such insurance, even if obtained, would adequately cover any product liability claim. A product liability or other claim with respect to uninsured liabilities or in excess of insured liabilities could have a material adverse effect on the business and prospects of the Company.

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REPORT OF INDEPENDENT ACCOUNTANTS

To the Board of Directors
and Stockholders of
Reality Interactive, Inc.

In our opinion, the accompanying balance sheet and the related statements of operations, of stockholders' equity (deficit) and of cash flows present fairly, in all material respects, the financial position of Reality Interactive, Inc. (a development stage company) at December 31, 1995 and 1996, and the results of its operations and its cash flows for the periods from May 24, 1994 (inception) to December 31, 1994, the years ended December 31, 1995 and 1996 and the period from May 24, 1994 (inception) to December 31, 1996, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PRICE WATERHOUSE LLP
Minneapolis, Minnesota
February 21, 1997

REALITY INTERACTIVE, INC.
(A Development Stage Company)
BALANCE SHEET

	December 31,	
	1995	1996
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 118,916	\$ 508,728
Short-term investments		4,744,712
Accounts receivable	18,237	97,396
Inventory	28,359	134,853
Prepaid expenses and other current assets	8,312	62,835
	-----	-----
Total current assets	173,824	5,548,524
	-----	-----
Fixed assets, net	269,852	191,936
Restricted cash	119,000	116,800
Other assets	14,116	28,481
	-----	-----
Total assets	\$ 576,792	\$5,885,741
	-----	-----

LIABILITIES, MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED STOCK		

AND STOCKHOLDERS' EQUITY (DEFICIT)		

Current liabilities:		
Accounts payable	\$ 188,623	\$ 116,388
Accrued liabilities	90,417	118,686
Current portion of capitalized lease obligation	14,127	
Notes payable	201,002	
Other current liabilities		12,345
	-----	-----
Total current liabilities	494,169	247,419
	-----	-----
Commitments (Note 6)		
Mandatorily redeemable convertible preferred stock, \$.01 par value, 5,000,000 shares authorized, 726,900 and 0 shares outstanding	2,125,962	
	-----	-----
Stockholders' equity (deficit):		
Common stock, \$.01 par value, 25,000,000 shares authorized, 1,643,611 and 4,677,407 shares outstanding	16,436	46,774
Additional paid-in capital	1,384,397	15,386,692
Deficit accumulated during the development stage	(3,444,172)	(9,795,144)
	-----	-----
Total stockholders' equity (deficit)	(2,043,339)	5,638,322
	-----	-----
Total liabilities, mandatorily redeemable convertible preferred stock and stockholders' equity (deficit)	\$ 576,792	\$5,885,741
	-----	-----

See accompanying notes to the financial statements.

REALITY INTERACTIVE, INC.
(A Development Stage Company)
STATEMENT OF OPERATIONS

	From May 24, 1994 (Inception) to December 31, 1994 -----	Year Ended December 31, 1995 1996 -----		From May 24, 1994 (Inception) to December 31, 1996 -----
Revenues		\$ 54,106	\$ 484,127	\$ 538,233
Cost of revenues		33,464	107,008	140,472
		-----	-----	-----
Gross profit		20,642	377,119	397,761
		-----	-----	-----
Operating expenses:				
Sales and marketing	\$ 78,754	808,825	2,531,058	3,418,637
Research and development	200,366	939,487	2,355,922	3,495,775
General and administrative	399,218	893,747	1,529,418	2,822,383
	-----	-----	-----	-----
Total operating expenses	678,338	2,642,059	6,416,398	9,736,795
	-----	-----	-----	-----
Operating loss	(678,338)	(2,621,417)	(6,039,279)	(9,339,034)
	-----	-----	-----	-----
Other income (expense):				
Interest income (expense), net	5,562	(149,979)	21,263	(123,154)
Debt offering costs			(113,486)	(113,486)
	-----	-----	-----	-----
Total other income (expense)	5,562	(149,979)	(92,223)	(236,640)
	-----	-----	-----	-----
Loss before extraordinary item	(672,776)	(2,771,396)	(6,131,502)	(9,575,674)
Extraordinary loss on early retirement of debt			(219,470)	(219,470)
	-----	-----	-----	-----
Net loss	\$ (672,776)	\$ (2,771,396)	\$ (6,350,972)	\$ (9,795,144)
	-----	-----	-----	-----
Loss before extraordinary item per common and common equivalent share	\$ (0.53)	\$ (1.69)	\$ (1.62)	
Extraordinary loss per common and common equivalent share			(0.06)	
	-----	-----	-----	
Net loss per common and common equivalent share	\$ (0.53)	\$ (1.69)	\$ (1.68)	
	-----	-----	-----	
Weighted average common shares and equivalents	1,276,254	1,643,611	3,787,893	
	-----	-----	-----	

See accompanying notes to the financial statements.

REALITY INTERACTIVE, INC.
(A DEVELOPMENT STAGE COMPANY)
STATEMENT OF STOCKHOLDERS' EQUITY (DEFICIT)
FOR THE PERIOD FROM MAY 24, 1994 (INCEPTION) TO DECEMBER 31, 1996

	Consideration	Price Per Share	Number of Shares Issued	Common Stock	Additional Paid-in Capital	Deficit Accumulated During Development Stage	Total
	-----	-----	-----	-----	-----	-----	-----
Founders shares issued - May 1994 (inception)	Cash and Intangibles	\$.06	900,000	\$ 9,000	\$ 42,750		\$ 51,750
Initial shares issued - May 1994	Cash	\$1.80	83,333	833	149,167		150,000
Shares issued - August - December 1994 (Less offering costs of \$69,839)	Cash	\$1.80	660,278	6,603	1,112,058		1,118,661
Net loss						\$(672,776)	(672,776)
Balance - December 31, 1994			1,643,611	16,436	1,303,975	(672,776)	647,635
Detachable warrants issued in connection with notes payable					80,422		80,422
Net loss						(2,771,396)	(2,771,396)
Balance - December 31, 1995			1,643,611	16,436	1,384,397	(3,444,172)	(2,043,339)
Detachable warrants issued in connection with bridge note financing - January 1996					336,000		336,000
Units issued at initial public offering - April 1996 (less offering costs of \$1,617,970)	Cash	\$5.75	2,200,000	22,000	11,010,030		11,032,030
Shares issued upon conversion of mandatorily redeemable convertible preferred stock - April 1996			726,900	7,269	2,118,693		2,125,962
Units issued to cover underwriter's overallocments - May 1996 (less offering costs of \$60,375)	Cash	\$5.75	100,000	1,000	513,625		514,625
Shares issued upon conversion of bridge notes - May 1996 (less offering costs of \$1,977)		\$3.94	6,346	63	22,963		23,026
Shares issued upon exercise of incentive stock options - June 1996	Cash	\$1.80	550	6	984		990
Net loss						(6,350,972)	(6,350,972)
Balance - December 31, 1996			4,677,407	\$46,774	\$15,386,692	\$(9,795,144)	\$5,638,322

See Accompanying Notes to the Financial Statements.

REALITY INTERACTIVE, INC.
(A Development Stage Company)
STATEMENT OF CASH FLOWS

	From May 24, 1994 (Inception) to December 31, 1994 ----	Year Ended December 31, 1995 ----	1996 ----	From May 24, 1994 (Inception) to December 31, 1996 ----
Cash Flows from Operating Activities:				
Net Loss	\$ (672,776)	\$ (2,771,396)	\$ (6,350,972)	\$ (9,795,144)
Reconciliation of Net Loss to Net Cash Used				
By Operating Activities:				
Depreciation and Amortization	16,414	103,261	120,000	239,675
Noncash Interest Expense Related to Warrants		80,422	193,979	274,401
Extraordinary Loss Related to Early Retirement of Debt (Interest Expense Related to Warrants)			142,021	142,021
Changes in Assets and Liabilities:				
Accounts Receivable		(18,237)	(79,159)	(97,396)
Inventory		(28,359)	(106,494)	(134,853)
Prepaid Expenses and Other Assets	(24,466)	2,038	(68,888)	(91,316)
Accounts Payable	69,876	118,747	(72,235)	116,388
Accrued Liabilities		90,417	28,269	118,686
Other Current Liabilities			12,345	12,345
	-----	-----	-----	-----
Net Cash Used by Operating Activities	(610,952)	(2,423,107)	(6,181,134)	(9,215,193)
	-----	-----	-----	-----
Cash Flows from Investing Activities:				
Purchases of Fixed Assets	(146,849)	(205,792)	(308,241)	(660,882)
Purchases of Short-term Investments	(30,000)		(10,244,712)	(10,274,712)
Sales of Short-term Investments		30,000	5,500,000	5,530,000
Cash Restricted for Operating Leases		(119,000)	2,200	(116,800)
	-----	-----	-----	-----
Net Cash Used by Investing Activities	(176,849)	(294,792)	(5,050,753)	(5,522,394)
	-----	-----	-----	-----
Cash Flows from Financing Activities:				
Net Proceeds from Issuance of Common Stock	1,320,411			1,320,411
Proceeds from Related Party Financing		320,000		320,000
Repayments of Capital Lease Obligation	(5,149)	(17,610)	(14,127)	(36,886)
Proceeds from Note Payable		951,002		951,002
Repayment of Notes Payable		(750,000)	(201,002)	(951,002)
Net Proceeds from Issuance of Preferred Stock		1,805,962		1,805,962
Proceeds from Convertible Notes Payable			2,800,000	2,800,000
Repayment of Convertible Notes Payable			(2,776,974)	(2,776,974)
Proceeds from Sale Leaseback of Fixed Assets			266,157	266,157
Net Proceeds from Initial Public Offering			11,546,655	11,546,655
Proceeds from Exercise of Stock Options			990	990
	-----	-----	-----	-----
Net Cash Provided by Financing Activities	1,315,262	2,309,354	11,621,699	15,246,315
	-----	-----	-----	-----
Net Cash Provided (Used) During Period	527,461	(408,545)	389,812	508,728
Cash and Cash Equivalents:				
Beginning of Period		527,461	118,916	
	-----	-----	-----	-----
End of Period	\$ 527,461	\$ 118,916	\$ 508,728	\$ 508,728
	-----	-----	-----	-----

(CONTINUED)

REALITY INTERACTIVE, INC.
(A DEVELOPMENT STAGE COMPANY)
STATEMENT OF CASH FLOWS
(CONTINUED)

	From May 24, 1994 (Inception) to December 31, 1994 ----	1995 ----	Year Ended December 31, 1996 ----	From May 24, 1994 (Inception) to December 31, 1996 ----
Supplemental disclosures of cash flow information:				
Cash paid for interest	\$ 1,100 -----	\$ 72,507 -----	\$ 92,285 -----	\$ 165,892 -----
Noncash investing and financing activities:				
Capital lease obligation incurred	\$ 36,886 -----			\$ 36,886 -----
Conversion of preferred stock from related party financing		\$ 320,000 -----		\$ 320,000 -----
Warrants issued in connection with notes payable		\$ 80,422 -----	\$ 336,000 -----	\$ 416,422 -----
Conversion of mandatorily redeemable convertible preferred stock to common stock			\$2,125,962 -----	\$2,125,962 -----
Conversion of bridge notes payable to common stock			\$ 25,003 -----	\$ 25,003 -----

SEE ACCOMPANYING NOTES TO THE FINANCIAL STATEMENTS.

REALITY INTERACTIVE, INC.
(A Development Stage Company)
NOTES TO FINANCIAL STATEMENTS
DECEMBER 31, 1996

NOTE 1 - ORGANIZATION AND STATUS

Reality Interactive, Inc. (the Company) was incorporated on May 24, 1994 for the purpose of developing interactive multimedia knowledge solutions for the industrial marketplace. Currently, the Company's product offerings consist of CD-ROM titles within the areas of international quality and environmental management standards. The first product, the ISO 9000 REGISTRATION SERIES, is a five-title series that guides a company through the process of complying with the ISO 9000 quality management standard. The second product, the QS-9000 COMPLIANCE SERIES, is a four-title series that helps automotive suppliers comply with the Big Three automakers' QS-9000 quality requirements. The third product, the ISO 14000 EMS CONFORMANCE SERIES, is a five-title series that assists companies with the design, implementation and management of an environmental management system in accordance with the ISO 14000 Environmental management systems standard. The fourth product, POLLUTION PREVENTION, enables companies to understand the key concepts of pollution prevention and waste reduction.

At December 31, 1996, the Company was in the development stage as its sales and marketing efforts have not yet generated predictable or significant revenues. The Company has a deficit accumulated during the development stage of \$0,795,144. To become profitable and to conserve capital, the Company must significantly increase revenues and control expenses. Future operating results will depend upon many factors, including the rate at which industry adopts interactive multimedia technology for education and training, the level of product and price competition, the Company's success in maturing its direct and indirect sales channels and the ability of the Company to manage its expenses in relation to sales.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

USE OF ESTIMATES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

CASH AND CASH EQUIVALENTS

Cash and cash equivalents include highly liquid investments with original maturities of less than 90 days and are generally invested in money market funds and certificates of deposit.

SHORT-TERM INVESTMENTS

Short-term investments consist of commercial paper held for periods generally less than 90 days. These investments are considered available for sale and are carried at fair value. The estimated fair value of the investments approximates the amortized cost, and therefore, there are no unrealized gains or losses as of December 31, 1996.

REVENUE RECOGNITION

Revenue is derived from product sales and licenses and is recognized upon shipment of the products. The Company has no significant obligations after shipment.

INVENTORY

Inventory consists primarily of software media, manuals and related packaging materials. Inventory is carried at the lower of cost or market using the first-in, first-out valuation method.

FIXED ASSETS

Fixed assets are stated at cost. Accelerated depreciation methods are used for both book and tax purposes over the estimated useful life of the equipment. Leasehold improvements are amortized over the lease term using the straight-line method.

INCOME TAXES

Income taxes are accounted for using the liability method under the provisions of Statement of Financial Accounting Standards (SFAS) No. 109, "Accounting for Income Taxes."

NET LOSS PER SHARE

Net loss per share is computed based on the weighted average number of common stock and common stock equivalents outstanding. Net loss per common and common equivalent share excludes stock options and warrants as common stock equivalents when the effect of their inclusion would be antidilutive.

PRODUCT DEVELOPMENT AND RESEARCH

Expenditures for software development costs and research are expensed as incurred. Such costs are required to be expensed until the point that technological feasibility and proven marketability of the product is established. Costs otherwise capitalizable after technological feasibility is achieved are also generally expensed because they are insignificant.

NOTE 3 - FIXED ASSETS

Fixed assets consist of the following:

	December 31,	
	1995	1996
	----	----
Computer equipment	\$ 288,871	\$ 297,618
Office equipment and furniture	85,574	120,064
Leasehold improvements	12,913	4,000
	-----	-----
	387,358	421,682
Less accumulated depreciation and amortization	(117,506)	(229,746)
	-----	-----
	\$ 269,852	\$ 191,936
	-----	-----

NOTE 4 - NOTES PAYABLE

In May 1995, the Company entered into a loan for up to \$1,050,000 (the Notes) from a bank. The Notes bear interest at 9%, with interest due monthly, and were payable in full on April 30, 1996. There was an outstanding balance of \$201,002 at December 31, 1995. On January 22, 1996, the Company paid off the remaining balance and retired the loan. In connection with this financing, the Company issued warrants to purchase a total of 210,000 shares of Common Stock. The estimated fair value of the warrants of \$80,422, as determined by management, was credited to additional paid-in capital and was amortized over the anticipated outstanding period of the Notes as interest expense.

In January 1996, the Company closed a \$2,800,000 convertible bridge note financing (the Bridge Notes) in a private placement, resulting in net proceeds to the Company of \$2,626,570. The Bridge Notes provided for interest at 10% per annum and matured on the earlier of July 31, 1996 or 30 days after the effective date of an initial public offering (IPO). At the option of the Bridge Note holders, up to 100% of the principal amount of the Bridge Notes was convertible into Common Stock for a period of 20 days following the effective date of the Company's IPO. In connection with this financing, the Company also issued detachable warrants to the purchasers of the Bridge Notes to purchase a total of 560,000 shares of Common Stock.

In May 1996, the Company made payments totaling \$2,861,281 to repay the Bridge Notes, including accrued interest of \$86,285. In connection with this repayment, approximately \$25,000 of the Bridge Notes were converted to 6,346 shares of Common Stock at a price equal to \$3.94. As a result of the early repayment of its bridge note financing, the Company recognized an extraordinary loss of approximately \$219,000 in 1996 related to the unamortized portion of Bridge Note offering costs and original issue discount.

NOTE 5 - INCOME TAXES

Significant components of the Company's deferred tax assets are as follows:

	December 31,	
	1995	1996
	----	----
Deferred tax assets:		
Net operating loss carryforwards	\$ 1,371,000	\$ 3,969,000
Other	50,000	50,000
	-----	-----
Total deferred tax assets	1,421,000	4,019,000
Less valuation allowance	(1,421,000)	(4,019,000)
	-----	-----
Net deferred tax assets	\$ -	\$ -
	-----	-----

At December 31, 1996, the Company had net operating loss carryforwards of approximately \$9,500,000 for income tax purposes. The net operating loss carryforwards expire in 2009 through 2011 if not previously utilized.

The Company has determined, based on the weight of available evidence at December 31, 1996, that it is more likely than not the Company's deferred tax assets will not be realized. Accordingly, a valuation allowance has been established for the tax benefits of these items. Future utilization of the available net operating loss carryforwards may be limited under Internal Revenue Code Section 382 due to future significant changes in ownership.

NOTE 6 - COMMITMENTS

LEASES

The Company leases office space, equipment and furniture under various operating lease agreements, the last of which expires in 2000.

At December 31, 1996, future minimum lease payments under noncancelable operating leases were as follows:

Year Ending December 31, -----	Operating Leases -----
1997	\$ 579,153
1998	442,754
1999	140,548
2000	655

Total future minimum lease payments	\$ 1,163,110

Rent expense was approximately \$25,000, \$150,000 and \$324,000 for the periods ended December 31, 1994, 1995 and 1996, respectively.

The Company has entered into agreements with third party content providers and marketing partners that require royalty payments to be made based upon the sales of the Company's products. The amount expensed under these agreements for 1995 and 1996, all of which was accrued at December 31, 1995 and 1996, totaled approximately \$7,200 and \$79,800, respectively.

LETTERS OF CREDIT

The Company has outstanding letters of credit from a bank as security for operating leases of certain office furniture and equipment. The Company is required to maintain the cash as collateral at the bank which issued the letters of credit. This amount is reflected as restricted cash at December 31, 1995 and 1996.

NOTE 7 - MANDATORILY REDEEMABLE CONVERTIBLE PREFERRED STOCK

From September to December 1995, the Company issued, through a private placement, 726,900 shares of Series A Mandatorily Redeemable Convertible Preferred Stock receiving net proceeds of \$1,805,962 and the conversion of a related party financing in the principal amount of \$320,000 plus accrued interest. The Company incurred issuance costs of \$54,738 in connection with the sale of this preferred stock. Further, in connection with this private placement, warrants to purchase 7,625 shares of Common Stock were granted to a selling agent.

The holders of Preferred Stock are entitled to the same number of votes they would have if such shares were converted into Common Stock. The Preferred Stock was automatically converted, on a one-to-one basis, into Common Stock in April 1996 as the Company made a registered public offering of its Common Stock.

NOTE 8 - STOCKHOLDERS' EQUITY (DEFICIT)

COMMON STOCK ISSUED

The holders of Common Stock are entitled to one vote for each share on all matters submitted to a vote of stockholders. Holders of Common Stock have no preemptive, subscription or conversion rights and there are no redemption or sinking fund provisions applicable thereto. The outstanding shares of Common Stock are fully paid and nonassessable.

In April 1996, the Company completed an IPO of 2,200,000 units at a price of \$5.75 per unit. Each unit sold consisted of one share of Common Stock and one Redeemable Common Stock Purchase Warrant to purchase one share of Common Stock. The sale of such units resulted in gross proceeds of \$12,650,000 and net proceeds of \$11,032,030. At the closing of the offering, all 726,900 shares of Mandatorily Redeemable Convertible Preferred Stock outstanding at December 31, 1995 were converted into 726,900 shares of Common Stock.

In May 1996, the Company issued an additional 100,000 units to its underwriter to cover over-allotments, resulting in gross proceeds of \$575,000 and net proceeds of \$514,625.

WARRANTS

A summary of the Company's warrant activity, all of which occurred after December 31, 1994 is as follows:

	Number -----	Exercise Price -----	Expiration -----
Warrants issued to a selling agent	7,625	\$3.00	1998
Warrants issued to note payable guarantors (Note 4)	210,000	\$3.00	2000
Warrants issued with related party financing	68,297	\$2.40	1998-2000

Outstanding at December 31, 1995	285,922	\$2.40-\$3.00	1998-2000
Warrants issued in bridge financing (Note 4)	560,000	\$4.31	1999
Warrants issued in connection with IPO	2,300,000	\$8.00	2000
Warrants issued to underwriter in connection with IPO	220,000	\$6.90	2001

Outstanding at December 31, 1996	3,365,922	\$2.40-\$8.00	1998-2001

Such warrants were issued in connection with various financing transactions by the Company. The holders of these warrants are not entitled to vote, receive dividends or exercise any other rights until such warrants have been duly exercised and payment of the purchase price has been made.

STOCK OPTIONS

Under the terms of the Company's 1994 Stock Incentive Plan, effective February 16, 1996, 700,000 shares of Common Stock have been reserved for issuance to officers, employees and independent contractors upon the exercise of stock options. Nonqualified and incentive stock options may be granted under the plan. Furthermore, the Company may grant nonqualified options outside of this plan. These stock options generally vest evenly over a three to four year period and are exercisable over periods up to five years from date of grant. Effective February 16, 1996, the Company adopted the 1996 Directors' Stock Option Plan under which 400,000 options have been reserved. This plan provides for annual grants of options to purchase 10,000 shares of Common Stock per director per year and vests six months from the date of grant.

The Board of Directors establishes all terms and conditions of each grant. Stock options are granted at or above fair market value as determined by the Board of Directors at the respective grant dates. The following summarizes stock option activity:

	Options Outstanding -----	Exercise Price Per Share -----	Weighted Average Exercise Price Per Share -----
Options outstanding at December 31, 1994	176,000	\$1.80 - \$1.98	\$1.83
Granted	216,200	\$1.80 - \$3.00	\$2.35
Canceled	(17,200)	\$1.80	\$1.80

Options outstanding at December 31, 1995	375,000	\$1.80 - \$3.00	\$2.13
Granted	181,000	\$1.00 - \$5.25	\$4.50
Canceled	(57,400)	\$1.80 - \$5.25	\$3.20
Exercised	(550)	\$1.80	\$1.80

Options outstanding at December 31, 1996	498,050	\$1.00 - \$5.25	\$2.87

Exercisable at December 31, 1996	195,950	\$1.00 - \$5.25	\$2.31

The 498,050 options outstanding at December 31, 1996 have a remaining weighted average contractual life of 3.9 years.

The Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation," in 1996. As allowed by SFAS No. 123, the Company applies APB Opinion No. 25 and related interpretations in accounting for its stock option plans and, accordingly, does not recognize compensation expense related thereto. If the Company had elected to recognize compensation expense based on the fair value of the options granted at grant date as prescribed by SFAS No. 123, net loss and net loss per share would have been increased to the pro forma amounts indicated in the following table:

	1995 ----	1996 ----
Net loss - as reported	\$ (2,771,396)	\$ (6,350,972)
Net loss - pro forma	\$ (2,788,717)	\$ (6,443,983)
Net loss per share - as reported	\$ (1.69)	\$ (1.68)
Net loss per share - pro forma	\$ (1.69)	\$ (1.70)

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following assumptions:

	1995 ----	1996 ----
Expected dividend level	0%	0%
Expected stock price volatility	70%	70%
Risk-free interest rate	6%	6%
Expected life of options	4 years	4 years