Due Diligence Answers from TSI (#2)

1. Please breakdown the AxN revenue by Year and by Customer for 2004-2009 & Ytd. 2010, as you did with AdDept please list largest revenue customer first.
I have attached a Word document that contains the lists. The 2010 listing does not include the June 1 billing, which is a very large one. Note that in quite a few cases a newspaper has recently taken over the handling of its sister papers. So, the year-to-year comparisons may not be meaningful.

2. Please list all newspaper customers that use AxN, as well as large newspaper potential customers who should be using AxN
I have attached a spreadsheet that lists newspapers currently using AxN. There are more papers on this list than on the 2010 billings list for three reasons: 1) Belk pays for some of its "occasional use" papers; 2) In many cases the ordering for several papers are handled by one; 3) A few papers are still "testing" for Saks.

I have attached a separate spreadsheet that lists newspapers that are used (to the best of our knowledge) by Belk, Dick's, Lord & Taylor, and/or Saks that do not currently subscribe to AxN. I did not include Macy's in this list for reasons that are detailed in #19 below.

3. Do you re-sell IBM hardware? If so what is the margin?
No. We were a VAR for IBM in the eighties and again in the nineties. We were eliminated from the program when IBM raised the required quotas. We worked with a large VAR in Texas to sell quite a few systems in the late nineties. Subsequently we were required by that VAR to work through another middleman. This arrangement proved unsatisfactory both to ourselves and our clients.

4. Enclose or attach a copy of your sales or marketing letter you would send a potential customer, as well as any sales or marketing brochure showing your products.
I have enclosed a Word document that contains letters that we have sent for AxN and AdDept. I also included the materials that we send with them. We have mailed to several different people at retail establishments in the marketing, accounting, and IT departments.

We do not really have brochures for AdDept. We have a couple of short documents, and they are attached. We also have a dozen or so books that contain samples of screens and reports for each area of AdDept. These books are up to 100 pages in length. Some of them doubtless need updating. I did not attach any of those.

5. What are the Ad industry largest circulation trade journals?
The only one that I know of and subscribe to is Ad Age. I am not sure if there is one that is just for retail advertisers.

6. Have you ever attended any of the big Advertising trade shows?
We attended the annual conference of the Retail Advertising and Marketing Federation once in the mid-1990's. The people who attended were not there to see systems like ours. I do not know of any trade show *per se* that caters to retailers.

7. What customers would you use for references? Who is your biggest advocate for TSI?
Belk, Stage, Saks, and Dick's would all give us very good references. We would not hesitate for a second to use any of them.

8. What are the specific modules for AdDept? AxN?
AdDept programs are very closely integrated. It is hard to delineate boundary lines between the modules. The attached pdf file named Features4 lists the areas covered by AdDept. Sometimes we charge extra for a portion of the code in an area. For example, we would charge anyone who wanted to use the use tax module. We always charge extra for interfaces and for the cost accounting modules described in #20a below.

A few AxN customers pay extra for the ability to download their orders to Excel files.

9. Describe each employee by the following:
   a. Specific job and skill set
   b. strengths and weaknesses
   c. long term potential
   d. daily tasks
Ashley Elliott: The administrative position requires a very responsible individual who can follow instructions, is capable of learning the bookkeeping system, has very good telephone manners, and is comfortable with Word and Excel. The most important attributes are reliability and the ability to get along with the rest of the staff. Ashley does not have much experience, but she seems to fit into the office environment very well and she has performed her job quite well. It is too soon to tell about her long-term potential. I have attached a document that documents her daily tasks.

The programmer analyst positions require persons with excellent analytical and problem solving skills, a strong attention to detail, an acumen for technical support, strong programming skills, the ability to accurately program to design specifications using established standards and apply robust testing procedures to confirm design specification objectives have been met. Good organizational skills and self-motivation are important attributes.

Jason Dean is our lead programmer analyst. Jason started with the company in 2007 and has successfully achieved every challenge provided. He is an outstanding quality assurance tester, programmer and technical support person. He is an excellent employee who has shown strong group leadership, respect for

co-workers, very good organizational abilities, and reliability. He tackles all projects with enthusiasm. There have been no noticeable weaknesses exhibited in his current capacity. His long-term potential is very good. Daily tasks vary depending on the project assigned. Tasks include new program development or modification of existing modules, writing report documentation, and technical support for both AxN and AdDept. He is also responsible for monitoring daily backups and other automated processes, and answering the support lines.

Sean Finnegan joined the company March 2010 as an entry-level programmer, and for all intents and purposes, right out of college. He has quickly become adept at handling AxN support and routine maintenance programming. He picks up new concepts easily, and can apply them with minimal direction. He has shown a very strong attention to detail and good analytical skills. Sean occasionally speaks very quickly when he gets nervous, which can occasionally make his speech difficult to understand. He has made a strong effort to correct this issue with good results. It is too early to determine his long-term potential, but thus far his programming skills are advancing rapidly. Daily tasks vary on the project assigned. Tasks include modification of existing modules, writing report documentation, performing network PC server backups, answering the technical support lines and providing technical assistance for AxN and routine AdDept questions.

10. Based on payroll records, it appears there has been turnover with the Technical staff? Please explain
Our contract programmer in Pittsburgh (see #14 below) took a local job. Although he did good work for us, we had been planning to replace him with someone who could help with telephone support. The timing of his departure coincided with our plans.

11. Do you have a proprietary training manual in place for a new owner?
Nearly everything is documented, but not in one manual.

12. Do you have a training manual for new staff in the programming side?
Nearly everything is documented, but not in one manual.

13. Having 30 years of coding/programming language, how will you train a new owner to take over in a 2-4 year time period?
The mechanics of running our business are not very challenging. The greater challenge will be to train a new director of application development. The thousands of programs that comprise the AdDept system and the intricacies of AxN will require a great deal of hands-on training. Explaining how to get accurate and complete specs from a client or a prospect is not easy to do. Mistakes in the process can be very costly both in terms of time and good will.

I have not formulated a specific plan yet. A lot will depend upon which direction the new owner chooses to move the company.

14. For the Tax year ending 11/30/09 you show $59,246 in contract labor? What is that for?
    Michael Davis worked for TSI as a programmer for several years. He got married and moved to Pittsburgh in 2008. We engaged him as a contract programmer for more than a year. In early 2010 he took a job at a business in Pittsburgh.

15. Your Tax returns show commission expense? What is that for? Who is getting paid commission?
    From the beginning of AxN in 2002 a man named Bob Wroblewski in Rhode Island has worked for us in marketing AxN to newspapers. He has called the newspapers after we wrote to them and has been instrumental in getting them to participate in testing and in signing the final contracts. For this we have paid him commissions on the fees that we receive for the first two years for each paper.

16. Please detail your Telephone/Internet expense? What is included in this expense?
    We receive three bills from AT&T. The one in account #721000 is for our ten phone lines. The rate for this has recently been reduced. We pay $76 per month for management of our e-mail accounts and $692.30 per month for our T-1 line. We are also billed $100 per month by Cox for our cable line, which we use as a backup in case there is a problem with the T-1 line.

17. For Tax year ending 11/30/08 you paid $58,806 for subcontract, what is this for?
    Same as #14.

18. Why have you not increased your prices for AxN?
    1) From the beginning AxN pricing has been based on the rates used for ROP (display ads) for newspaper. Since newspaper circulations have been declining precipitously, the papers have not been able to raise their ROP rates, which are per column inch. 2) Retailers have decreased their reliance on newspaper advertising, especially ROP. AxN works well for inserts, but it really shines when used for ROP. 3) Newspapers have become much more budget-conscious in the last year. A very large number of them are just emerging from bankruptcy.

19. Why hasn't the New York division of Macy's used AxN?
    That division of Macy's was the first AdDept customer in 1988. At the time they divided their newspapers among several coordinators and did all of their ordering over the telephone. They did not send orders at all and were not interested in doing so. As they got more papers, they allowed the coordinators to place orders in any way that they wanted. Over the years we tried several times to interest them in the using AdDept to produce orders. I took two trips to New York to show AxN to them. The last one, which was several years ago, was attended by everyone important in the scheduling department, two people from IT, and the head of the business office. They seemed very interested in it, and they had nothing but praise for my presentations, but they never acted.

A few years ago Macy's began installing a home-grown advertising system that performed some of the features that AdDept provides. They asked us to quote providing an interface for that system, which lacked a component for insertion orders, to AxN. We spent hours working on the specs, and we did provide a quote, but we never heard from them again. Our contact with Macy's resigned just as the quote was being finalized.

It is our understanding that Macy's, which now places all of its advertising from its New York office, is now using that home-grown system for scheduling. We would be willing to construct an interface for them, but it would be a lot of work. The layout of the file that they said that they could provide us was extremely difficult to work with because it had a large number of records for each ad. In some cases we had to aggregate them to get what we needed, and in others we had to skip records that repeated information from previous ones.

20. Please <u>explain in detail</u> the following 2 items
    a. What do you mean by AdDept provides the tools for accurate and verifiable allocation of expenses to stores and/or merchandise (actually merchant or merchandise group, not merchandise)?

AdDept has two built-in "Business Intelligence" modules. One is for stores and one is for merchants (department level or higher). Each creates very large detailed "de-normalized" files at up to three levels: plan, latest projection, and actual. So, if an AdDept client wanted to know the details of the spending for a particular store in comparison with the budget, that information is available at virtually any imaginable level. Similarly, if an AdDept customer wanted to know the spending of a particular department in comparison with the budget, that information is available. Essentially, whether the company budgets by store, by department (or some other merchandise grouping), or both, the system provides accurate and verifiable detailed backup.

The rules for the allocations are determined by the user, but we provide a lot of assistance. For example, if there are four stores served by one media outlet, the costs can be split by planned sales or by actual sales. The company can even invent its own percentages. Ads that target specific stores can be flagged, and the costs can be assigned to that store.

AdDept also allocates other things. Co-op income can be allocated to stores in a number of different ways. Expenses that are associated with a media but not with an ad can be allocated. Even overhead expenses can be allocated. Use tax can be allocated in a number of ways. We spend a good deal of time making sure that the allocation process works efficiently and correctly.

    b. AdDept facilitates the collection of co-op?

Co-op is the amount of money billed to a supplier in exchange for the advertising space devoted to the supplier's products. A large portion of retail advertising is funded by co-op billings.

Generally, when a piece (say a direct mail catalog or an insert) is planned, each merchant is expected to collect co-op to pay for some or all of his/her space. Getting them to make good on the promises is easier said than done. They turn in the co-op at various times (usually just before the month closes), and sometimes it does not match up very closely with the commitment. It is important to have a good record-keeping tool to assess how well each merchant is doing in this regard.

21. Have you considered upgrading AdDept text-based front end to graphical
Or web-based?
Denise and Mike have spent a great deal of time thinking about, researching, and discussing this subject. There are many ways to go about this, but each has severe disadvantages, and most approaches either provide no substantive benefit (i.e., they disguise but do not eliminate the disadvantages of the text-based interface) or they would require man-years of effort.

A few AdDept programs, particularly the crucial ones for recording and editing expense invoices, involve many very large multi-dimensional arrays used as parameters passed between programs. It would be impossible to emulate them using a web-based interface without totally rewriting them to use files instead of parameters.

We have informally polled our customers as to what their interest would be. A few said that they would like a better-looking interface, but no one has offered to help pay for it. A few have told us to concentrate on providing enhancements needed for day-to-day operations.

IBM has tried at least three or four times to come up with a process for automating the "modernization" of programs. We have investigated them and found them all fatally flawed. The fact that IBM keeps scrapping ideas and coming up with new ones makes it hard to take them seriously.

Zenn has recently announced a more sophisticated method of translating 5250 screens to a web-based substitute that uses PHP for the front end. Denise and Mike have discussed looking at this as a possible tool for bridging to a more modern-looking front end.

What would this cost and could it bring you new business?
The cost is time, and there would be plenty of it required. There may also be costs in terms of support if objects outside of the iSeries native structure are required, as they almost certainly would be.

A flashy new interface could certainly eliminate one of the potential objections to AdDept, and, depending upon how it was implemented, could possibly help make the system more portable to other operating systems. That would eliminate another common objection.

22. I received a new lease agreement from the landlord. I have attached it to this document.