

## **Index To Financial Information**

**SolarAttic, Inc.** **Page**

**AUDITED FINANCIAL STATEMENTS**

Independent Auditors' Report on the Financial Statements.....	F-2
Balance sheets.....	F-3
Statements of operations.....	F-4
Statements of stockholders' equity.....	F-5
Statements of cash flows.....	F-6
Notes to financial statements.....	F-8



## Independent Auditor's Report

To the Board of Directors and Stockholders  
SolarAttic, Inc.  
Elk River, Minnesota

We have audited the accompanying balance sheets of **SolarAttic, Inc.** as of December 31, 1996 and 1997, and the related statements of operations, stockholders' equity, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of SolarAttic, Inc. as of December 31, 1996 and 1997, and the results of its operations and its cash flows for the years then ended, in conformity with generally accepted accounting principles.

Plymouth, Minnesota  
January 15, 1998

*Leininger & Leininger, Ltd.*

**SOLARATTIC, INC.**  
**BALANCE SHEETS**

At December 31	1996	1997
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash	\$ 29,698	\$ 14,148
Accounts receivable	430	8,236
Inventories	40,927	34,995
Prepaid expenses	3,025	8,525
Prepaid rent	—	24,822
Prepaid stock issuance costs	—	5,694
Total current assets	74,080	96,420
<b>Furniture and Equipment</b>		
Less accumulated depreciation	45,873	66,268
	25,692	34,064
Net furniture and equipment	20,181	32,204
<b>Other Assets</b>		
Prepaid rent	—	6,205
Due from officer	43,206	56,198
Patent, net of amortization of \$27,647 and \$34,089	33,553	27,111
Customer list, net of amortization of \$2,357 and \$7,071	30,643	25,929
Total other assets	107,402	115,443
<b>Total assets</b>	<b>\$ 201,663</b>	<b>\$ 244,067</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accrued liabilities	\$ 409	\$ 2,009
Current maturities of note payable to officer	647	788
Other liabilities	—	42,400
Total current liabilities	1,056	45,197
<b>Note Payable to Officer, Net of Current Portion</b>	89,353	100,462
<b>Stockholders' Equity</b>		
Common stock, no par value; authorized 100,000,000 shares; issued and outstanding 8,977,216 and 9,385,752 shares	544,353	691,067
Retained earnings (deficit)	(433,099)	(592,659)
Total stockholders' equity	111,254	98,408
<b>Total liabilities and stockholders' equity</b>	<b>\$ 201,663</b>	<b>\$ 244,067</b>

See Notes to Financial Statements.

**SOLARATTIC, INC.**  
**STATEMENTS OF OPERATIONS**

Year Ended December 31	<b>1996</b>	<b>1997</b>
<b>Revenues</b>	\$ 46,967	\$ 61,853
<b>Cost of Goods Sold</b>	24,168	28,857
Gross profit	22,799	32,996
<b>Operating Expenses</b>	95,139	180,897
Operating loss	(72,340)	(147,901)
<b>Interest Expense</b>	6,073	11,659
<b>Net loss</b>	\$ (78,413)	\$ (159,560)
<b>Weighted Average Common Shares Outstanding</b>	8,947,695	9,247,613

See Notes to Financial Statements.

**SOLARATTIC, INC.**  
**STATEMENTS OF STOCKHOLDERS' EQUITY**

Year Ended December 31, 1996 and 1997

	Common Stock		Deficit Accumulated	Total Stockholders' Equity
	Shares	Amount		
<b>Balance December 31, 1995</b>	8,767,506	\$ 466,911	\$ (354,686)	\$ 112,225
Sale of stock	112,210	38,442	-	38,442
Stock issued for services	15,000	6,000	-	6,000
Stock issued for customer list	82,500	33,000	-	33,000
Net loss	-	-	(78,413)	(78,413)
<b>Balance December 31, 1996</b>	8,977,216	544,353	(433,099)	111,254
Sale of stock	279,426	92,070	-	92,070
Stock issued for rent	124,110	49,644	-	49,644
Stock issued for services	5,000	5,000	-	5,000
Net loss	-	-	(159,560)	(159,560)
<b>Balance December 31, 1997</b>	9,385,752	\$ 691,067	\$ (592,659)	\$ 98,408

See Notes to Financial Statements

**SOLARATTIC, INC.**  
**STATEMENTS OF CASH FLOWS**

Year Ended December 31	1996	1997
<b>Cash Flows From Operating Activities</b>		
Net loss	\$ (78,413)	\$ (159,560)
Adjustments to reconcile net loss to net cash flows from operating activities:		
Depreciation	4,972	8,372
Amortization	8,799	11,156
Amortization of prepaid rent from stock	-	18,617
Issuance of common stock for services	6,000	5,000
(Increase) decrease in operating assets:		
Accounts receivable	(430)	(7,806)
Inventory	(6,627)	5,932
Prepaid expenses	(3,025)	(5,500)
Prepaid stock issuance costs	-	(5,694)
Increase (decrease) in operating liabilities:		
Accrued liabilities	(2,984)	1,600
Other liabilities	-	42,400
Net cash flows from operating activities	(71,708)	(85,483)
<b>Cash Flows From Investing Activities</b>		
Increase in due from officers, net	(9,704)	(12,992)
Purchase of equipment	(13,069)	(20,395)
Net cash flows from investing activities	(22,773)	(33,387)
<b>Cash Flows From Financing Activities</b>		
Proceeds from issuance of common stock	38,442	92,070
Proceeds from note payable to officer	65,430	11,718
Payments on note payable to officer	(2,451)	(468)
Net cash flows from financing activities	101,421	103,320
<b>Change in cash and equivalents</b>	6,940	(15,550)
<b>Cash and Equivalents</b>		
Beginning of year	22,758	29,698
End of year	\$ 29,698	\$ 14,148

See Notes to Financial Statements.

**SOLARATTIC, INC.**  
**STATEMENTS OF CASH FLOWS (Continued)**

Year Ended December 31	1996	1997
<b>Supplemental Disclosures of Cash Flow Information</b>		
Cash payments for interest	\$ 6,073	\$ 11,659
Income taxes paid	\$ -	\$ -

**Supplemental Schedule of Noncash Investing and Financing Activities**

Issuance of common stock for services	\$ 6,000	\$ 5,000
Issuance of common stock for prepaid rent	-	49,644
Issuance of common stock for customer list	33,000	-

See Notes to Financial Statements.

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## NOTES TO FINANCIAL STATEMENTS

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### **Note 1 *Nature of Business and Significant Accounting Principles***

#### **Nature of operations:**

SolarAttic, Inc. (the Company), a Minnesota corporation, was formed on August 11, 1986 and was in the development stage through December 31, 1996. The year 1997 is the first year during which it is considered an operating company. Sales are currently throughout the continental United States. However, markets for the Company's technology and products are international in nature.

#### **Basis of financial statement presentation and accounting estimates:**

The accompanying financial statements are presented in accordance with generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could vary from those estimates.

#### **Cash equivalent policy and cash flows:**

For purposes of reporting cash flows, cash and equivalents is comprised of bank checking accounts.

#### **Inventories:**

Inventories are valued at the lower of cost (first-in, first-out method) or market. Inventory is comprised primarily of raw materials.

#### **Furniture and equipment:**

Furniture and equipment is recorded at cost, less accumulated depreciation. Depreciation is provided on a straight-line basis over the estimated useful life of three to seven years.

#### **Patent:**

The Company has capitalized costs related to acquiring a patent, which are being amortized using the straight-line method over 9.5 years. All other patent costs are expensed as incurred.

#### **Customer list:**

The Company has capitalized costs related to acquiring a customer list which are being amortized using the straight-line method over 7 years.

#### **Other liabilities:**

The Company has credit cards payable which are backed by the personal guarantee of an officer.

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## NOTES TO FINANCIAL STATEMENTS (CON'T)

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### **Note 1** *Nature of Business and Significant Accounting Principles (CON'T)*

#### **Research and development:**

Research and development costs are charged to operations as incurred and totaled \$7,817 and \$1,853 for 1996 and 1997, respectively.

#### **Stock based compensation:**

In 1995, the Financial Accounting Standards Board issued SFAS No. 123, *Accounting for Stock-Based Compensation*. As permitted by this Standard, the Company will continue to measure compensation cost using the intrinsic value-based method of accounting prescribed by the Accounting Principles Board (APB) Opinion No. 25, *Accounting for Stock Issued to Employees*.

#### **Prepaid stock issuance costs:**

The Company has recorded prepaid stock issuance costs for legal and other expenses incurred in connection with its SCOR (small corporate offering registration) stock offering. These SCOR costs will be deducted from the proceeds of the SCOR stock issuance.

#### **Income taxes:**

The Company has adopted FASB Statement No. 109, *Accounting for Income Taxes*, which requires an asset and liability approach to financial accounting and reporting for income taxes. Under the asset and liability method, deferred tax assets are recognized for deductible temporary differences and operating loss or tax credit carry forwards and deferred tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the amounts of assets and liabilities recorded for income tax and financial reporting purposes. Deferred tax assets are reduced by a valuation allowance when management determines that it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

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**NOTES TO FINANCIAL STATEMENTS (CON'T)**

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**Note 2 *Related Party Transactions***

Note payable to officer at December 31, 1996 and 1997, consist of the following:

	<u>1996</u>	<u>1997</u>
Unsecured note payable, maturing January 1, 2027, monthly installments of \$708 including interest at 8.75%. The rate adjusts every six months, based on the 6 month LIBOR rate plus 6%.	\$ 90,000	\$ —
Unsecured note payable, maturing January 1, 2028, monthly installments of \$735 including interest at 7.90%. The rate adjusts every six months, based on the 6 month LIBOR rate plus 6.25%.		101,250
Less current maturities	<u>647</u>	<u>788</u>
	\$ <u><u>89,353</u></u>	\$ <u><u>100,462</u></u>
Future maturities are as follows:		
1998		\$ 788
1999		927
2000		1,003
2001		1,085
2002		1,174
Thereafter		<u>96,273</u>
		\$ <u><u>101,250</u></u>

Interest expense for related parties was \$4,939 in 1996 and \$11,659 in 1997.

Amounts due from officer are unsecured, non interest bearing and mature December 31, 1999. Due from officer is scheduled for monthly repayment at the rate of 1/20th of Mr. Palmer's salary when Mr. Palmer starts to receive a salary.

The Company rented office and warehouse facilities from an officer of the Company on a month-to-month basis in 1996 and the first four months in 1997. In addition, the Company paid certain real estate taxes and repairs. Total occupancy related expense was \$10,432 in 1996 and \$2,354 in 1997.

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## NOTES TO FINANCIAL STATEMENTS (CON'T)

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### **Note 3** *Stockholders' Equity*

#### **Stock option plan:**

The Company has reserved 1,000,000 shares of common stock for issuance under an incentive stock option plan established in 1986. Under the plan, options are granted at prices determined by the Board of Directors. It is the Company's policy to not grant any options at a price less than the current market or sales price. No options have been granted as of December 31, 1997. The incentive stock option plan matures in 2001.

#### **Stock options:**

Certain stockholders are able to purchase additional stock with stock options from options granted which are considered associated with compensation issues under reporting requirements. At December 31, 1997, there were 950,000 options outstanding and exercisable. Of this total, 200,000 options are exercisable at 20¢ per share expiring December 31, 1998; 250,000 options are exercisable at 30¢ per share expiring December 31, 1998; 400,000 shares are exercisable at 40¢ per share expiring December 31, 2000; and, 100,000 options are exercisable at \$1.00 per share expiring December 31, 2003. These options were granted outside of the stock option plan. During 1996, options to purchase 400,000 shares were granted at an exercise price of 40¢ per share. During 1997, options to purchase 100,000 shares were granted at an exercise price of \$1.00 per share. No option shares expired, were canceled or exercised in 1996 and 1997.

#### **Stock warrants:**

Certain stockholders are able to purchase additional stock with stock warrants attached to common stock issued. At December 31, 1997, there were 685,993 warrants outstanding and exercisable. Of this total, 645,993 warrants are exercisable at 20¢ per share expiring December 31, 1998. The remaining 40,000 warrants are exercisable at 30¢ per share expiring December 31, 1998. No warrants were granted in 1996 and 1997. 32,210 shares were exercised in 1996 at 20¢ per share and 130,000 shares were exercised in 1997 at 20¢ per share.

#### **Common shares issued as consideration:**

Common shares have been issued periodically for patents, inventory, consulting services, rent and customer lists. The amount assigned to each transaction is based upon contractual agreements.

#### **Stock based compensation:**

The Company applies APB Opinion No. 25 in accounting for its stock incentive plans. Accordingly, no compensation cost has been recognized for options granted. There are no charges or credits to expense with respect to the granting or exercise of options since the options were issued with exercise prices at or exceeding fair market value on their respective dates of grant. However, using an option pricing model to determine the fair value of the options and considering the expected option life, anticipation of no dividends, and the risk-free interest rate, determining compensation cost for stock-based compensation plans consistent with SFAS 123 would not have had a material impact on reported net income of the Company.

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## NOTES TO FINANCIAL STATEMENTS (CON'T)

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### **Note 4 *Income Taxes***

The Company recorded no provision for income tax expense for the periods ended December 31, 1996 and 1997.

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Deferred tax assets and liabilities were comprised of the following at December 31

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	<u>1996</u>	<u>1997</u>
Deferred tax asset - net operating losses	\$ 172,000	\$ 235,800
Less valuation allowance	<u>172,000</u>	<u>235,800</u>
Net deferred tax assets	-	-
Deferred tax liabilities	-	-
Total deferred income taxes	<u>\$ -</u>	<u>\$ -</u>

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A valuation allowance has been established for the deferred tax asset because management determined it is more likely than not that the deferred tax asset will not be realized. The Company's valuation allowance increased \$63,800 from December 31, 1996 to December 31, 1997, due to net operating losses incurred during 1997. At December 31, 1997, for income tax purposes, the Company had federal and state net operating loss carry forwards of approximately \$592,000 available that expire through the year 2012.

### **Note 5 *Commitments and Contingencies***

#### **Warranty:**

The materials assembled by the Company generally carry warranties provided by the manufacturers against product failure. In addition, the Company provides a warranty of its assembled product workmanship. Management has determined that no warranty reserve was necessary as of December 31, 1996 and 1997.

### **Note 6 *Performance Stock Option Agreement***

On June 25, 1997, the Company signed a distribution agreement for the exclusive distribution of the Company's pool heater. As part of the agreement, the Company granted the distributor a performance option clause with the following terms: If, prior to September 30, 1998, the distributor sells 100 of the Company's swimming pool heaters, SolarAttic will grant an option in the Company's common stock of 300,000 shares exercisable at \$1.65 per share through September 30, 2003. If the distributor sells 500 swimming pool heaters prior to this same date, the option shall be for a total of 600,000 shares exercisable at \$1.65 per share and expiring on September 30, 2003. If the distributor fails to sell 100 units, there shall be no options. There are no extensions or other provisions to this agreement. Prior to this time there was no affiliation between the distributor, its principals and the Company or the Company's employees, officers or directors.

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**NOTES TO FINANCIAL STATEMENTS (CON'T)**

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**Note 7 *Operating Leases***

In April of 1997, the Company began leasing space under a non-cancelable operating lease expiring April 15, 1999. Under this agreement, the Company issued 124,110 shares of common stock totaling \$49,644. This was recorded as prepaid rent expense and is being amortized to rent expense over the lease term. In addition to the common stock, the Company makes a monthly cash payment for rent.

Rent expense totaled \$0 and \$23,852 for the years ended December 31, 1996 and 1997.

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Future minimum cash lease payments as of December 31, 1997 were as follows:

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1998	\$	6,337
1999		<u>2,069</u>
	\$	<u><u>8,406</u></u>

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