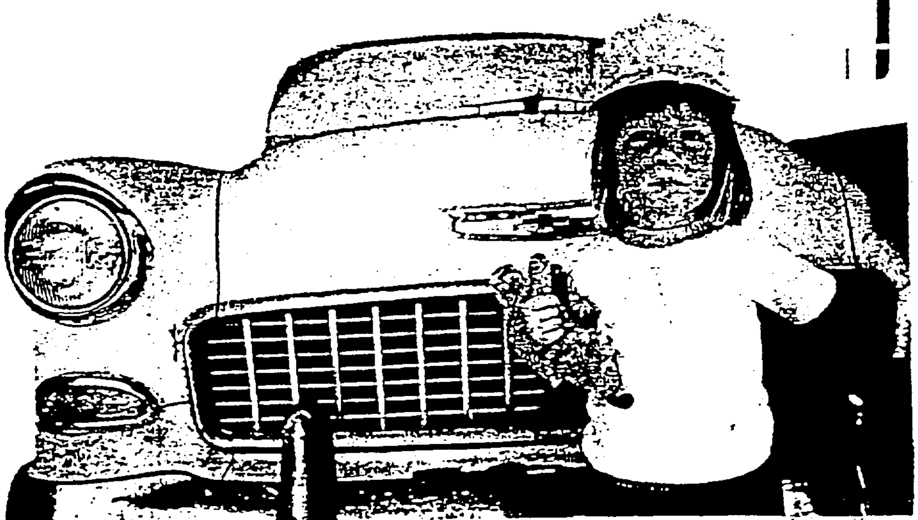
Lotus

1994
Report
to
Shareholders

21-010088

Are we there yet?



R-#27

Lotus

March 20, 1995

Dear Shareholder:

You are cordially invited to attend the 1995 Annual Meeting of Shareholders of Lotus Development Corporation, which will be held at the Museum of Transportation, Larz Anderson Park, 15 Newton Street, Brookline, Massachusetts, on Tuesday, May 2, 1995 at 10:00 a.m., local time.

Information about the Annual Meeting, including a listing and discussion of the matters on which the shareholders of the Company will act, may be found in the enclosed formal Notice of Annual Meeting and Proxy Statement. The Annual Report to Shareholders for the fiscal year ended December 31, 1994 has also been enclosed if it was not previously furnished to you.

We hope that you will be able to attend the Annual Meeting. However, whether or not you anticipate attending in person, I urge you to complete, sign and return the enclosed proxy card promptly to ensure that your shares will be represented at the Annual Meeting. If you do attend, you, of course, will be entitled to vote in person, and such vote will revoke your proxy.

Sincerely,

Jim P. Manzi
Chairman of the Board and President

Lotus Development Corporation, 55 Cambridge Parkway, Cambridge, Massachusetts 02142 617 577-8500

IBM 7510297407

LOTUS DEVELOPMENT CORPORATION
55 Cambridge Parkway
Cambridge, Massachusetts 02142

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

TO OUR SHAREHOLDERS:

The Annual Meeting of Shareholders (the "Meeting") of Lotus Development Corporation, a Delaware corporation (the "Company"), will be held on Tuesday, May 2, 1995 at 10:00 a.m., local time, at the Museum of Transportation, Larz Anderson Park, 15 Newton Street, Brookline, Massachusetts. The purpose of the Meeting shall be:

1. To elect directors of the Company to serve until the next Annual Meeting of Shareholders and until their respective successors have been duly elected and qualified.

2. To approve the amendment of the Company's 1992 Stock Option Plan to increase the number of shares of the Company's Common Stock that may be offered pursuant to such plan.

3. To ratify the selection of the firm of Coopers & Lybrand L.L.P., as auditors for the Company for the fiscal year ending December 31, 1995.

4. To transact such other business as may properly come before the Meeting or any adjournments thereof.

Only shareholders of record on the books of the Company at the close of business on March 10, 1995 will be entitled to notice of and to vote at the Meeting.

Please sign, date and return the enclosed proxy card in the enclosed envelope at your earliest convenience. If you return your proxy, you may nevertheless attend the Meeting and vote your shares in person.

All shareholders of the Company are cordially invited to attend the Meeting.

By Order of the Board of Directors

Thomas M. Lemberg
Secretary

Cambridge, Massachusetts
March 20, 1995

IT IS IMPORTANT THAT YOUR SHARES BE REPRESENTED AT THE MEETING. WHETHER OR NOT YOU PLAN TO ATTEND THE MEETING, PLEASE SIGN, DATE AND MAIL THE ENCLOSED PROXY IN THE ENCLOSED ENVELOPE, WHICH REQUIRES NO POSTAGE IF MAILED FROM WITHIN THE UNITED STATES.

LOTUS DEVELOPMENT CORPORATION
55 Cambridge Parkway
Cambridge, Massachusetts 02142

PROXY STATEMENT

Annual Meeting of Shareholders To Be Held on May 2, 1995

Proxies enclosed with this Proxy Statement are solicited by the Board of Directors of Lotus Development Corporation, a Delaware corporation (the "Company"), for use at the Annual Meeting of Shareholders (the "Meeting") to be held on Tuesday, May 2, 1995 at 10:00 a.m., local time, at the Museum of Transportation, Larz Anderson Park, 15 Newton Street, Brookline, Massachusetts, and any adjournments thereof.

Shares represented by duly executed proxies in the form enclosed herewith received by the Company prior to the Meeting will be voted at the Meeting FOR the election of the nominees for director named below (except to the extent that authority therefor is withheld) and FOR each proposal described in this Proxy Statement. Where no choice has been specified on a proxy with respect to a particular matter, the shares represented by that proxy will be voted FOR the particular matter.

Any shareholder may revoke a proxy at any time prior to its exercise by delivering a later-dated proxy or a written notice of revocation to the Secretary of the Company at the address of the Company set forth above, or by voting in person at the Meeting. If a shareholder does not intend to attend the Meeting, any proxy or notice should be returned for receipt by the Company not later than the close of business on Monday, May 1, 1995. The persons named in the proxies are officers of the Company. The Company will bear the cost of solicitation of proxies relating to the Meeting.

Only shareholders of record as of the close of business on March 10, 1995 (the "Record Date") will be entitled to notice of and to vote at the Meeting and any adjournments thereof.

As of the Record Date there were 48,257,996 shares (excluding treasury shares) of the Company's Common Stock, $.01 par value (the "Common Stock"), issued and outstanding. Such shares of Common Stock are the only voting securities of the Company. Shareholders are entitled to cast one vote for each share of Common Stock held of record on the Record Date.

The Board of Directors of the Company (the "Board of Directors") is not aware of any other matters to be presented at the Meeting. If any other matter should be presented at the Meeting upon which a vote properly may be taken, shares represented by all duly executed proxies received by the Company will be voted with respect thereto in accordance with the best judgment of the persons named in the proxies. An Annual Report to Shareholders, containing financial statements for the fiscal year ended December 31, 1994, preceded or accompanies this Proxy Statement. This Proxy Statement and the proxy enclosed herewith were first mailed to shareholders on or about March 20, 1995.

The mailing address of the Company's principal executive offices is 55 Cambridge Parkway, Cambridge, Massachusetts 02142.

PRINCIPAL HOLDERS OF VOTING SECURITIES

Security Ownership of Certain Beneficial Owners

The following table sets forth as of December 31, 1994 the name of each person who, to the knowledge of the Company, owned beneficially more than five percent (5%) of the shares of Common Stock of the Company outstanding at such date, the number of shares owned by each such person and the percentage of the outstanding shares represented thereby. The information below with respect to beneficial ownership is based upon information filed with the Securities and Exchange Commission ("SEC") pursuant to Sections 13(d) or 13(g) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and furnished to the Company by the respective shareholders.

Name and Address of Beneficial Owner	Amount and Nature of Beneficial Ownership	Percent of Class
The Capital Group Companies, Inc. 333 South Hope Street Los Angeles, CA 90071	2,630,000(1)	5.51%
FMR Corp. 82 Devonshire Street Boston, MA 02109	6,793,974(2)	14.23%
Manning and Napier Advisors, Inc. 1100 Chase Square Rochester, NY 14604	3,241,506(3)	6.80%
Metropolitan Life Insurance Company One Madison Avenue New York, NY 10010	3,561,300(4)	7.46%
State Street Research & Management Company One Financial Center Boston, MA 02111	3,537,500(5)	7.41%

(1) Represents shares held by Capital Research and Management Company, a registered investment adviser ("CRMC") and an operating subsidiary of The Capital Group Companies, Inc. As of the date set forth above, CRMC exercised sole investment discretion with respect to all of such shares, all of which were owned by various institutional investors. CRMC had no voting power with respect to such shares and disclaims beneficial ownership of such shares.

(2) Represents shares beneficially owned by (i) FMR Corp. through its wholly owned subsidiaries, Fidelity Management & Research Company, a registered investment adviser ("Fidelity"), and Fidelity Management Trust Company, a bank ("FMTC"), (ii) by certain investment companies (including the Fidelity Magellan Fund) for which Fidelity serves as investment adviser (the "Fidelity Funds"), and (iii) by Edward C. Johnson 3d, as Chairman of FMR Corp., and through certain members of his family and family trusts by virtue of their controlling interest as a group in the voting stock of FMR Corp. The Fidelity Magellan Fund beneficially owned 4,757,890 shares or 9.97% of the Common Stock outstanding as of the date set forth above. FMTC is the beneficial owner of 109,190 shares or .23% of the Common Stock outstanding of the Company as a result of its serving as investment manager of institutional account(s). Mr. Johnson and FMR Corp., through its control of Fidelity, and the Fidelity Funds each had sole dispositive power with respect to the 6,684,784 shares owned by the Fidelity Funds. Mr. Johnson and FMR Corp., through its control of FMTC, had sole dispositive power over 109,190 shares and sole voting power with respect to 7,990 of these shares and no voting power with respect to 101,200 shares owned by institutional accounts managed by FMTC. Neither FMC Corp. nor Mr. Johnson has the sole power to vote or direct the voting of the shares owned directly by the Fidelity Funds, which power resides with the Funds' Board of Trustees.

(3) The beneficial owner, a registered investment adviser, possessed sole voting with respect to 3,170,281 of such shares and sole dispositive power with respect to all such shares as of the date stated above.

(4) The beneficial owner, a registered investment adviser and insurance company, possessed sole voting with respect to 3,430,700 of such shares and sole dispositive power with respect to all such shares as of the date stated above.

(5) The beneficial owner, a registered investment adviser, possessed sole voting power with respect to 3,407,100 of such shares and sole dispositive power with respect to all such shares as of the date stated above.

Security Ownership of Directors and Executive Officers

The following table sets forth for each member of the Board of Directors, the Company's Chief Executive Officer ("CEO"), and each of the next four most highly compensated executive officers of the Company, the position presently held by such person and the number of shares and percentage of outstanding Common Stock of the Company beneficially owned by each and by all directors and executive officers as a group, as of February 1, 1995.

Name	Positions and Offices with the Company	Amount and Nature of Beneficial Ownership(1)	Percent of Class
Jim P. Manzi	Chairman of the Board, President and Chief Executive Officer	1,217,072(2)	2.54%
Richard S. Braddock	Director	8,000(3)	*
Elaine L. Chao	Director	0	*
William H. Gray III	Director	0	*
Michael E. Porter	Director	11,083(4)	*
Henri A. Termeer	Director	7,083(5)	*
Edwin J. Gillis	Senior Vice President— Finance and Operations and Chief Financial Officer	101,759(6)	*
John B. Landry	Senior Vice President— Communications, Development and Chief Technology Officer	42,556(7)	*
June L. Rokoff	Senior Vice President— Worldwide Services Group	65,471(8)	*
Robert K. Weiler	Senior Vice President— Worldwide Sales and Marketing	83,248(9)	*
All directors and executive officers as a group (14 persons)		1,594,572(10)	3.30%

* less than 1%

(1) Except where expressly stated otherwise, each named person possesses sole voting and investment power with respect to the shares.

(2) Includes 26,201 shares held in the Jim P. Manzi 1993 Irrevocable Trust for the benefit of Mr. Manzi's children. Includes 46,666 shares that Mr. Manzi has the right to acquire within 60 days of February 1, 1995 by the exercise of stock options.

(3) Includes 7,500 shares that Mr. Braddock has the right to acquire within 60 days of February 1, 1995 by the exercise of stock options.

(4) Includes 7,083 shares that Mr. Porter has the right to acquire within 60 days of February 1, 1995 by the exercise of stock options.

(5) Includes 7,083 shares that Mr. Termeer has the right to acquire within 60 days of February 1, 1995 by the exercise of stock options.

(6) Includes 99,479 shares that Mr. Gillis has the right to acquire within 60 days of February 1, 1995 by the exercise of stock options. Includes 780 shares held in trust for the benefit of Mr. Gillis under the Company's 401k and Profit Sharing Plan.

(7) Includes 31,270 shares that Mr. Landry has the right to acquire within 60 days of February 1, 1995 by the exercise of stock options. Includes 112 shares held in trust for the benefit of Mr. Landry under the Company's 401k and Profit Sharing Plan and 1,200 shares over which Mr. Landry exercises investment discretion as custodian of such shares held for the benefit of his minor children.

(8) Includes 48,541 shares that Ms. Rokoff has the right to acquire within 60 days of February 1, 1995 by the exercise of stock options. Includes 7,430 shares held in trust for the benefit of Ms. Rokoff under the Company's 401k and Profit Sharing Plan.

(9) Includes 81,979 shares that Mr. Weiler has the right to acquire within 60 days of February 1, 1995 by the exercise of stock options.

(10) Includes 387,760 shares that directors and executive officers of the Company have the right to acquire within 60 days of February 1, 1995 by the exercise of stock options and 8,463 shares of Common Stock held in trust by the Company's Profit Sharing and 401k Plan as described above.

EXECUTIVE COMPENSATION AND OTHER INFORMATION CONCERNING DIRECTORS AND EXECUTIVE OFFICERS

Summary Compensation

The following table sets forth information concerning the cash and noncash compensation in each of the last three fiscal years for the Company's CEO and the next four most highly compensated executive officers.

		Annual Compensation(1)		Long Term Compensation	All Other Compensation
Name and Principal Position	Year	Salary ($)	Bonus ($)	Options (#)	($)(2)
Jim P. Manzi	1994	650,000	227,500	200,000	31,800
Chairman of the Board and	1993	650,000	650,000	40,000	35,046
President	1992	650,000	0	0	34,214
Edwin J. Gillis	1994	325,000	113,750	100,000	17,100
Chief Financial Officer and	1993	275,000	275,000	17,500	18,597
Senior Vice President—Finance and Operations	1992	275,000	0	50,000	23,805
John B. Landry	1994	325,000	113,750	100,000	18,150
Senior Vice President—	1993	325,000	325,000	12,500	28,325
Communications Development and Chief Technology Officer	1992	325,000	182,000(3)	0	26,889
June L. Rokoff	1994	325,000	113,750	100,000	18,150
Senior Vice President—	1993	325,000	325,000	25,000	19,771
Worldwide Services Group	1992	307,400	0	65,000	19,945
Robert K. Weiler	1994	350,963	120,313	100,000	18,695
Senior Vice President—	1993	325,000	325,000	17,500	19,771
Worldwide Sales and Marketing	1992	325,000	0	0	24,688

(1) Does not include perquisites or other personal benefits in any year for which the aggregate amount was less than the lesser of either $50,000 or 10 percent of the total annual salary and bonus for the executive officer in that year.

(2) Includes amounts credited to the account of the executive officer for those years in which he or she served in such capacity in connection with (i) the profit sharing feature of the Company's Profit Sharing and 401k Plan, (ii) the Company's Defined Contribution Restoration Plan and

(iii) the Company matching contribution under the savings feature of the Profit Sharing and 401k Plan as follows:

Name	Year	Profit Sharing Amount ($)	Defined Contribution Restoration Plan ($)	401k Matching Contribution ($)
Manzi	1994	3,150	24,150	4,500
	1993	11,084	19,465	4,497
	1992	7,781	22,069	4,364
Gillis	1994	3,150	9,450	4,500
	1993	11,084	3,016	4,497
	1992	7,781	11,660	4,364
Landry	1994	3,150	10,500	4,500
	1993	11,084	12,744	4,497
	1992	7,781	14,744	4,364
Rokoff	1994	3,150	10,500	4,500
	1993	11,084	4,190	4,497
	1992	7,781	7,800	4,364
Weiler	1994	3,150	11,045	4,500
	1993	11,084	4,190	4,497
	1992	7,781	12,543	4,364

(3) Represents payment by the Company related to Mr. Landry's prior employment for cash and other compensation that he had foregone by joining the Company.

Option Grants in Last Fiscal Year

The following table sets forth information concerning individual stock option grants made to the Company's CEO and each of the Company's next four most highly compensated executive officers during fiscal 1994.

	Individual Grants(1)				Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term(2)	
Name	Options Granted (#)	Percent of Total Options Granted to Employees in Fiscal Year (%)	Exercise Price ($/Sh)	Expiration Date	5% ($)	10% ($)
Jim P. Manzi	200,000	5.06	64.50	January 25, 2001	2,226,330	8,048,709
Edwin J. Gillis	100,000	2.53	64.50	January 25, 2001	1,113,165	4,024,354
John B. Landry	100,000	2.53	64.50	January 25, 2001	1,113,165	4,024,354
June L. Rokoff	100,000	2.53	64.50	January 25, 2001	1,113,165	4,024,354
Robert K. Weiler	100,000	2.53	64.50	January 25, 2001	1,113,165	4,024,354

(1) All options described above are "premium" options granted at a per share exercise price 20% above the fair market value of a share of Common Stock on the date of grant. The options are non-qualified stock options, have a seven year term and vest over three years beginning on the 25th month following the date of grant and thereafter in equal monthly installments over the succeeding 35 months.

(2) Calculation of potential realizable values are based on theoretical rates of return required to be disclosed by the SEC and may or may not accurately reflect or predict the actual value of the stock options.

Aggregated Option Exercises In Last Fiscal Year And Fiscal Year-End Option Values

The following table sets forth information concerning each exercise of stock options by the CEO and each of the Company's next four most highly compensated executive officers during fiscal 1994 and the value of unexercised options at the end of that fiscal year.

Name	Shares Acquired on Exercise (#)	Value Realized ($)	Number of Unexercised Options at Fiscal Year-End Exercisable/ Unexercisable (#)	Value of Unexercised in-the-Money Options at Fiscal Year-End(1) Exercisable/ Unexercisable ($)
Jim P. Manzi	21,250	674,688	44,166/233,333	914,883/ 669,755
Edwin J. Gillis	10,000	421,563	98,385/165,364	961,704/1,047,808
John B. Landry	40,500	1,522,063	40,489/144,010	848,605/ 915,064
June L. Rokoff	21,250	772,188	46,979/164,270	675,635/ 925,284
Robert K. Weiler	15,000	643,125	43,385/152,864	949,517/1,168,121

(1) Based on the closing price on the NASDAQ National Market System for a share of Common Stock on December 31, 1994 of $41.00.

Pension Plan

In 1985, the Company established the Lotus Development Corporation Pension Plan (the "Pension Plan") for the purpose of assisting its employees in meeting the needs of retirement. In 1992, the Company determined that its Profit Sharing and 401k Plan could provide adequate retirement assistance to employees and, effective June 1, 1992, suspended the Pension Plan. While all benefits accrued under the Pension Plan through May 31, 1992 have become fully vested, no further benefits have accrued to employees after that date.

Benefits under the Pension Plan are based on an average of the participant's highest consecutive 36 months of total annual compensation during the last 72 months of service ("Final Average Compensation"). The monthly benefit payable upon normal retirement in the form of a single life annuity is computed as follows: 1/12th of 1.5% of Final Average Compensation is multiplied by the participant's total number of years of service at June 1, 1992 up to no more than 35 years. From that result is subtracted the monthly value of the annuity that could be acquired (on specified actuarial assumptions) with the amount of Company profit sharing contributions for the participant's account for 1990 and subsequent years accumulated with a deemed interest return.

The table below sets forth the estimated annual benefits payable upon normal retirement under the Pension Plan formula to employees in the specified average salary and years of service classifications:

Remuneration	Years of Service 5	Years of Service 10
$ 25,000	$ 1,875	$ 3,750
50,000	3,750	7,500
75,000	5,625	11,250
100,000	7,500	15,000
125,000	9,375	18,750
150,000	11,250	22,500
175,000	13,125	26,250
200,000	15,000	30,000
228,886*	17,165	34,330

* The maximum permitted salary recognized under the Internal Revenue Code of 1986, as amended (the "Code") as in effect in 1992.

As of June 1, 1992, the date on which the accrual of future benefits was suspended, Mr. Manzi had eight years, Mr. Landry had less than one year, Ms. Rokoff had seven years, Mr. Gillis had less than one year and Mr. Weiler had one year of service under the Pension Plan.

Other Benefit Plans

The Company currently provides certain benefits to its eligible employees (including its executive officers) through the benefit plans described below:

1992 Stock Option Plan. The Company maintains the Lotus Development Corporation 1992 Stock Option Plan (the "1992 Stock Option Plan") to attract and retain the best available personnel for positions of substantial responsibility and to provide additional incentives to certain employees and consultants to contribute to the success of the Company. The 1992 Stock Option Plan is administered by a committee of the Board of Directors that consists of independent directors. Stock options granted under the plan may not be granted at less than fair market value on the date of grant. See "Proposal No. 2—Approval of Amendment to the 1992 Stock Option Plan" below.

Employee Stock Purchase Plan. The Company maintains the Employee Stock Purchase Plan (the "Employee Plan") to provide incentive and to encourage ownership of Common Stock by all eligible employees of the Company and its subsidiaries. Employees of the Company may participate in the Employee Plan by authorizing payroll deductions over a six month period, with the proceeds being used to purchase shares of Common Stock for the participant at a discounted price. The Employee Plan is intended to be an "employee stock purchase plan" under Section 423 of the Code.

Profit Sharing Plan and 401k Plan. The Company's Profit Sharing and 401k Plan (the "Plan") provides savings options to eligible U.S. employees of the Company through deferment of a portion of their compensation. Participants may elect to defer 2% to 12% of their compensation into the Plan and may also elect to contribute up to an additional 10% of their compensation on a non-deferred basis; provided that the combination of deferred and non-deferred contributions cannot exceed 12% of annual compensation. The Company also makes matching contributions equal to a percentage of the participant's biweekly deferred contributions.

Under the Plan, an annual discretionary profit sharing contribution by the Company based on a percentage of operating profit is allocated to the accounts of all participants, who do not themselves make any profit sharing contribution. The level of Company profit sharing and matching contributions is set annually by the Board of Directors.

The Plan is administered by a committee appointed by the Board of Directors. Each participant's contributions to the Plan are held in trust by a bank trustee and are invested in certain investment funds in accordance with the participant's instructions. The Plan is intended to be a qualified plan under Section 401(k) of the Code.

Defined Restoration Plan. The Company adopted the Defined Contribution Restoration Plan to provide supplemental retirement benefits to employees, who because of limitations imposed by the law on benefits under tax qualified plans, would receive less than the full benefits to which they would have otherwise been entitled under the Company's qualified retirement plan. Under the Defined Contribution Restoration Plan, a participant's account is credited each year with the amount by which his or her profit sharing allocation under the Company's Profit Sharing and 401k Plan, calculated without consideration of the limitations imposed under the Code, exceeds the amounts permitted under the Code. The Company's funding policy is to pay these supplemental benefits directly to participants as they become due.

Compensation Committee Report on Executive Compensation

The Company's executive compensation program is administered by the Compensation Committee of the Board of Directors (the "Committee"). The Committee, which is composed of two independent directors, makes recommendations to the Board of Directors on the three key components of the Company's executive compensation program, base salary, annual incentive awards and long term incentives.

Compensation Policies for Executive Officers.

The Company's executive compensation program is designed to attract and retain fully qualified executives in the highly competitive high technology marketplace. The levels of executive compensation established by the Committee are designed to be consistent with those available to other executives in similarly sized corporations.

The Committee establishes individual compensation awards based on the contribution the executive has made in attaining the Company's short term and strategic performance objectives as well as the executive's anticipated future contribution. The Company's executive compensation program consists primarily of the following integrated components:

1. *Base Salary*—which is designed to compensate executives competitively within the industry and marketplace.

2. *Annual Incentives*—which provide a direct link between executive compensation and annual Company performance against predetermined measures.

3. *Long Term Incentives*—which consist of stock options that link management decision making with long-term Company performance and shareholder interests.

Base Salary. Base salary levels for executive officers of the Company are reviewed annually by the Compensation Committee. The Committee's current policy is to target base salaries at the mid-range of the market and to maintain the combined amount of base salary and annual incentives within the upper quartile of the market based on independent nationally-recognized surveys and competitive analyses of companies whose gross revenues fall within the same range as those of the Company. The surveys from which this market comparison is drawn include data from over 400 major manufacturing and service companies and from over 300 high technology companies of various sizes. The surveys include, but are not limited to, data from all industries represented in the Standard and Poor's 500 High Technology Composite Index, i.e., Computer Software & Services, Communication Equipment/Manufacturers, Computer Systems, Aerospace/Defense, Electronics (Instrumentation, Defense and Semiconductors) and Office Equipment and Supplies. The High Technology Composite Index is the "line of business index" used in the stock performance graph set forth below. See "Performance Graph—Cumulative Five-Year Return" below.

Annual Incentives. All executive officers participate in an Executive Incentive Program, which compensates officers in the form of annual cash bonuses. Awards under this program are based on the attainment of four specific Company performance measures established by the Compensation Committee at the beginning of the fiscal year. These performance measurements are keyed to management's annual operating plan and are based on the achievement of targeted (i) operating profit, (ii) revenue growth, (iii) revenue per employee and (iv) expense per employee. As Company performance for fiscal 1994 did not meet the targeted measures, the Executive Incentive bonuses actually paid were below targeted amounts.

Long Term Incentives. The Company provides long term incentives through its Amended and Restated 1983 Nonqualified Stock Option Plan and its 1992 Stock Option Plan. The purpose of these plans is to create a direct link between compensation and the long-term performance of the Company. Stock options under these plans are granted at or above fair market value and vest in installments, generally over four years. Options granted before January 1, 1993 have a five year term and options granted on or after that date have a seven year term. The Company makes its annual grant of options to its employees, including its executive officers, in January, to enable the Company to more closely link option grants to individual contribution and Company performance.

When recommending option awards for an executive officer, the Committee considers (i) the executive's current contribution to Company performance, (ii) the anticipated contribution in meeting the Company's long-term strategic performance goals and (iii) industry practices and norms. Because the receipt of value by an executive officer under a stock option is dependent upon an increase in the price of the Company's Common Stock, this portion of the executives' compensation is directly aligned with an increase in shareholder value.

In 1994, the Company adopted a "premium" stock option program for the CEO, the executive officers and certain other officers of the Company. The program is designed to enhance the link between the participant's compensation and the long-term performance of the Company and assist in the retention of each participant. Under this program participants receive options to purchase Common Stock under the 1992 Stock Option Plan at 20% above fair market value. Options granted under this program have a seven year term and vest over three years beginning in the 25th month following the date of grant and thereafter in equal monthly installments over the succeeding 35 months.

In January 1995, the Company granted "premium" options to purchase the following number of shares of Common Stock to the CEO and the next four most highly compensated executive officers at an exercise price of $48.60 per share: Mr. Manzi—100,000; Mr. Landry—50,000; Ms. Rokoff—50,000; Mr. Gillis—50,000; and Mr. Weiler—50,000.

CEO Compensation.

Base Salary. The CEO's salary is positioned competitively to the mid-range of the marketplace, as determined through comparison of surveys and competitive analyses in the manner described above. The CEO has not received a base salary increase since January 1990.

Incentive Compensation. The annual Executive Incentive Program is designed to reward the CEO based on the Company's performance. The CEO's annual bonus payable under this Program is determined using the same four measurements employed in determining the annual incentive awards for executive officers described above. These performance measurement targets are set and approved by the Committee annually. The CEO's maximum potential annual incentive award under this program is 150% of base salary. As Company performance for fiscal 1994 did not meet three of the four measurement targets, the CEO's Executive Incentive bonus for 1994 was below the targeted amount.

Long Term Incentive. In January 1995, the CEO received a "premium" option grant as described above. Consistent with the Committee's considerations for awards under this plan, the award was based on the anticipated contribution of the CEO to the attainment of the Company's long-term strategic performance. Based upon its assessment of the industry surveys described above, the Committee believes that the awarding of this grant is within the scope of the marketplace for executives of similarly sized companies.

Respectfully submitted by the Compensation Committee,

Richard S. Braddock, Chairman
Henri Termeer

Compensation of Directors

All Directors, with the exception of Mr. Manzi, received an annual retainer of $24,000 for the fiscal year ended December 31, 1994, together with reimbursement of expenses incurred in attending meetings of the Board of Directors.

On January 1, 1995, Mr. Braddock, Ms. Chao, Mr. Gray, Mr. Porter and Mr. Termeer were each granted an option to acquire 10,000 shares of Common Stock at an exercise price of $40.50 per share, which price was equal to the market value of the Company's Common Stock on the first business day following that date, pursuant to the Company's 1986 Stock Option Plan for Non-Employee Directors. In addition, in accordance with such plan, Mr. Cray and Ms. Chao were each granted options to purchase 10,000 shares of Common Stock at an exercise price of $55.625 and $31.00, respectively, (the market value of such shares on the date of grant) in connection with their election to the Board of Directors.

Compensation Committee Interlocks and Insider Participation

During 1994, Messrs. Aldo Papone, Chester A. Siuda, Richard S. Braddock and Henri A. Termeer each served on the Compensation Committee of the Board. Messrs. Papone and Siuda each declined to stand for re-election to the Board of Directors at the Company's 1994 Annual Meeting of Shareholders in May 1994.

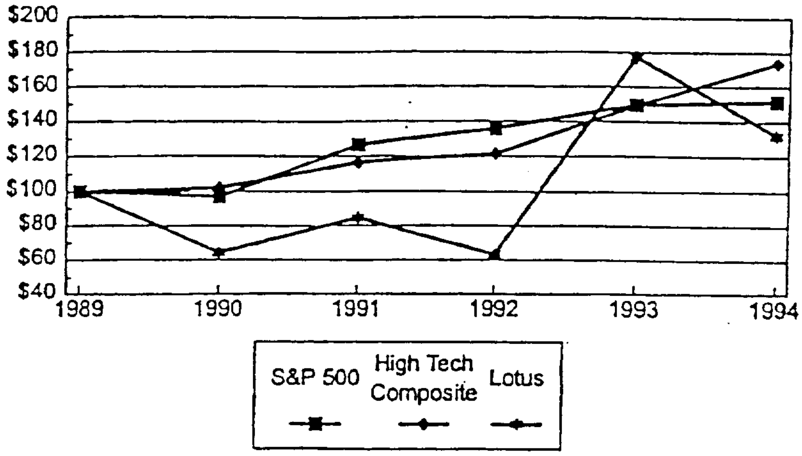
Compliance with Section 16(a) of the Exchange Act

Michael E. Porter, a Director of the Company, made one late filing reporting the purchase of 500 shares of Common Stock that was required to be filed in 1994 on Form 4 under Section 16(a) of the Exchange Act. Mr. Porter subsequently reported this transaction.

Performance Graph

The following indexed graph indicates the Company's total return to its shareholders for the past five year period ended December 31, 1994 as compared to the total return over such period for the Standard & Poor's 500 Composite Index and the Standard & Poor's High Tech Composite Index. This graph assumes a $100 investment at the beginning of the five-year period and the reinvestment of all dividends.

CUMULATIVE FIVE-YEAR TOTAL RETURN



PROPOSAL NO. 1—ELECTION OF DIRECTORS

Each of the persons named below has been nominated for election as a director of the Company until the 1996 Annual Meeting of Shareholders and until his successor has been duly elected and qualified. No proxy may be voted for more persons than the number of nominees listed below. Shares represented by all duly executed proxies received by the Company and not marked to withhold authority to vote for any individual director or for all directors will be voted FOR the election of all the nominees named below. The Board of Directors knows of no reason why any such nominee should be unable or unwilling to serve, but if such should be the case, the shares represented by duly executed proxies received by the Company will be voted for the election of a substitute nominee selected by the Board of Directors. The nominees receiving a plurality of the votes cast at the Meeting will be elected as directors.

Information Pertaining to Nominees

The following table sets forth the name and address of each nominee, the age of each nominee, the year in which each nominee first became a director of the Company, the principal occupation of each nominee during the past five years and any other directorships held, as of February 1, 1995, by each nominee in any company subject to the reporting requirements of the Exchange Act or in any company registered as an investment company under the Investment Company Act of 1940, as amended.

Name and Address	Age	Year in Which Nominee First Became Director	Principal Occupation During Past 5 Years	Directorships
Jim P. Manzi .... c/o Lotus Development Corporation 55 Cambridge Parkway Cambridge, MA 02142	43	1984	Chairman of the Board of the Company (1986 to present); President and Director of the Company (1984 to present)	None
Richard S. Braddock ..... c/o Clayton, Dubilier & Rice, Inc. 126 East 56th Street New York, NY 10022	53	1992	Partner (1994 to present), Clayton, Dubilier & Rice, Inc.; Chief Executive Officer (1993), Medco Containment Services, Inc. (health care related services company); President and Chief Operating Officer (1990-1992), Citicorp and Citibank, N.A. (bank and financial services companies).	Eastman Kodak Company; True North Communications Inc.
Elaine L. Chao .... c/o United Way of America 701 North Fairfax Street Alexandria, VA 22314	42	1994	President and Chief Executive Officer (1992 to present), United Way of America; Director (1991-1992), Peace Corps; Deputy Secretary (1989-1991), United States Department of Transportation.	Dole Food Company
William H. Gray III ...... c/o United Negro College Fund 700 13th Street, N.W. Suite 1180 Washington, D.C. 20005	53	1994	President and Chief Executive Officer (1991 to present), United Negro College Fund; Congressman 2nd District Pennsylvania (1979-1991), U.S. House of Representatives.	Chase Manhattan Corp.; MBIA Corp.; Prudential Insurance Corp. of America; Rockwell Int'l Corp.; Union Pacific Corp.; Warner Lambert Corp.; and Westinghouse Corp.

Name and Address	Age	Year in Which Nominee First Became Director	Principal Occupation During Past 5 Years	Directorships
Michael E. Porter .... c/o Harvard Business School Aldrich Building, Room 200 Soldiers Field Road Boston, MA 02163	47	1993	Professor (1973 to present), Harvard Business School.	Alpha Beta Technologies, Inc.
Henri A. Termeer .... c/o Genzyme Corporation One Kendall Square Cambridge, MA 02139	48	1993	Chairman, President and Chief Executive Officer (1988 to present), Genzyme Corporation.	Abiomed Inc.; AutoImmune Inc.; Hambrecht & Quist Health Care Investors, Inc.; Hambrecht & Quist Life Sciences; IG Laboratories, Inc.; Xenova Corp.; Genzyme Corp.; Genzyme Transgenics; and Neozyme II Corp.

Board Meetings and Committees

The Board of Directors is comprised of Jim P. Manzi, Richard S. Braddock, Elaine L. Chao, William H. Gray III, Michael E. Porter and Henri A. Termeer. The Board of Directors met six times during the year ended December 31, 1994. The Board of Directors has a Compensation Committee, which establishes and reviews compensation of senior management and which consists of Messrs. Braddock and Gray. The Compensation Committee met once during 1994. The Board of Directors also has an Audit Committee which oversees actions taken by the Company's independent auditors and reviews the Company's internal controls, consisting of Mr. Porter and Ms. Chao. The Audit Committee met twice during 1994.

Pursuant to the Company's By-laws, the Board of Directors has set the number of directors of the Company to be elected at the Meeting at six. All nominees are currently members of the Board of Directors.

Certain Transactions

In 1994, the Company paid fees for legal services of approximately $2,790,188 to O'Sullivan Graev & Karabell, the law firm of which Lawrence G. Graev is a member. Mr. Graev served as a member of the Board of Directors until May 1994.

The Company's Profit Sharing and 401k Plan invests in a number of investment funds at the direction of its participants. During 1994, the Profit Sharing and 401k Plan invested in the Fixed Income Fund, which is managed by Fidelity Management Trust Company, and in the Fidelity Magellan Fund and the Fidelity Equity Income Funds, which are managed by Fidelity Management & Research Company. Both Fidelity Management Trust Company and Fidelity Management & Research Company are wholly owned subsidiaries of FMR Corp., which, as of December 31, 1994, beneficially owned greater than 5% of the outstanding Common Stock of the Company. See "Principal Holders of Voting Securities" above and "Other Benefit Plans—Profit Sharing and 401k Plan" above.

The Board of Directors unanimously recommends that shareholders vote FOR the election of each of the nominees listed above.

PROPOSAL NO. 2—APPROVAL OF AMENDMENT
TO THE 1992 STOCK OPTION PLAN

Description of the 1992 Stock Option Plan

Purpose. The purpose of the Lotus Development Corporation 1992 Stock Option Plan is to further the growth and success of the Company and its Subsidiaries (as defined in such plan) by enabling officers, employees and consultants of the Company and its Subsidiaries to acquire shares of Common Stock, thereby increasing their personal interest in such growth and success and to provide a means of rewarding outstanding performance by such persons to the Company or its Subsidiaries. Options granted under the 1992 Stock Option Plan ("Options") may be either "incentive stock options" ("ISOs"), intended to qualify as such under the provisions of Section 422 of the Code, or non-qualified stock options ("NSOs").

Shares to be Optioned. The number of shares eligible for the granting of Options under the 1992 Stock Option Plan is 6,000,000, subject to adjustment as described below. No Option may be granted after April 21, 2002, the tenth anniversary of the date on which the 1992 Stock Option Plan was adopted by the Board of Directors. Common Stock issuable upon exercise of an Option granted under the 1992 Stock Option Plan may be authorized but unissued shares of Common Stock and/or shares of Common Stock held in the Company's treasury. If and to the extent that Options granted under the 1992 Stock Option Plan terminate, expire or are canceled without having been fully exercised, new Options may be granted under the 1992 Stock Option Plan with respect to the shares of Common Stock covered by the unexercised portion of such terminated, expired or canceled Options.

Administration of the Plan. The 1992 Stock Option Plan shall be administered by a Stock Option Committee (the "Committee") consisting of two or more non-employee Directors who are ineligible to participate in such plan and who shall be appointed to such Committee by the Board of Directors from time to time. In addition, so long as the 1992 Stock Option Plan shall be required to comply with Rule 16b-3 under the Exchange Act, each member of the Committee shall be a "disinterested person" within the meaning of Rule 16b-3. The Committee shall have sole discretion (subject to the limits of the 1992 Stock Option Plan) to determine the persons to whom Options shall be granted ("Optionees"), the time of such grants, the number of shares subject to each Option, the Option exercise price, the time or times when each Option shall become exercisable and the duration of the exercise period. Except as otherwise expressly provided in the 1992 Stock Option Plan, the Committee shall have all powers with respect to the administration and interpretation of the Plan and any Option agreement issued thereunder.

Eligible Persons. Options granted under the 1992 Stock Option Plan shall be, at the discretion of the Board of Directors (or the Committee), either ISOs or NSOs. ISOs may be granted only to persons who are officers or employees (including directors who are officers or employees) of the Company or its Subsidiaries. NSOs may be granted to officers, employees and consultants of the Company and its Subsidiaries (including directors who are officers, employees or consultants). No individual participant under the 1992 Stock Option Plan may be granted Options to purchase more than 250,000 shares of Common Stock in the aggregate during any calendar year. No ISO may be granted to an officer or employee who owns stock possessing more than 10% of the total voting power of all classes of stock of the Company (a "10% Person") unless the option price of the shares subject to such ISO is fixed at not less than 110% of Fair Market Value (as defined in the 1992 Stock Option Plan) on the date of grant and such ISO is not exercisable more than five years after its date of grant. As of December 31, 1994, approximately 5,665 persons would have been eligible to receive Options under such plan.

Option Price. Options granted under the 1992 Stock Option Plan may not be granted at less than Fair Market Value on the date of grant. At March 1, 1995, the Fair Market Value of a share of Common Stock computed in accordance with the 1992 Stock Option Plan was $41.25.

Exercise of Option. The terms of each Option granted under the 1992 Stock Option Plan shall be set forth in the Option Agreement evidencing the Option. Upon the exercise of an Option, an Optionee may pay the Company the amount of the aggregate Option exercise price with cash or a personal or certified check and/or, at the discretion of the Committee at the time of grant, with shares of Common Stock. Anything contained in the 1992 Stock Option Plan to the contrary notwithstanding, an ISO granted under the 1992 Stock Option Plan to an Optionee shall not be exercisable to the extent that the aggregate Fair Market Value of all stock with respect to which incentive stock options are exercisable for the first time by such Optionee during such calendar year (under all plans of the Company and its Subsidiaries) exceeds $100,000 (Fair Market Value being determined for such purpose for all such stock as of the date of grant of such ISO).

Changes in Capital Structure. If the Common Stock is changed by reason of a stock split, reverse split, stock dividend or recapitalization, or converted into or exchanged for other securities as a result of a merger, consolidation or reorganization, the Committee shall make such adjustments in the number and class of shares of stock with respect to which Options may be granted under the 1992 Stock Option Plan as shall be equitable and appropriate in order to make such Options immediately after such change, as nearly as may be practicable, equivalent to such Options immediately prior to such change. A corresponding adjustment shall be made to each Option outstanding at the time such change is made. No such adjustment will be made in the case of ISOs, however, if such adjustment would constitute a modification, extension or renewal of such ISOs within the meaning of Section 422 and 425 of the Code and the regulations promulgated thereunder or would be considered, under Section 422 of the Code, the adoption of a new plan requiring shareholder approval.

In addition, no adjustment to options shall be made in connection with the dissolution or liquidation of the Company, a reorganization, merger or consolidation in which the Company is not the surviving corporation, or a sale of all or substantially all of the assets of the Company (a "Corporate Transaction"), if provision is made in connection with such transaction for the assumption of outstanding Options by, or the substitution for such Options of new options covering the stock of, the surviving, successor or purchasing corporation, or a parent or subsidiary thereof, with appropriate adjustments as to the number, kind and option prices of shares subject to such new options; *provided, however*, that in the case of ISOs, the Committee shall, to the extent not inconsistent with the best interests of the Company or its Subsidiaries, use its best efforts to ensure that any adjustment or substitution will not constitute a modification, extension or renewal of such ISOs within the meaning of Section 425(h) of the Code or regulations promulgated thereunder.

Restrictions on Options. No Options shall be granted under the 1992 Stock Option Plan, and no shares of Common Stock shall be issued upon the exercise of Options, unless and until the Company and/or the Optionee shall have complied with all laws and regulations relating thereto, including but not limited to federal and state securities laws. Options granted under the 1992 Stock Option Plan are nonassignable and nontransferable by the Optionee except by will or by the laws of descent and distribution.

Amendment. The Board may at any time modify and amend the 1992 Stock Option Plan in any respect; *provided, however*, that the approval of holders of a majority of the voting capital stock of the Company (voting as a single class) shall be obtained prior to any such amendment becoming effective if such approval is required by law or is necessary to comply with regulations promulgated under Section 16(b) of the Exchange Act or with Section 422 of the Code or the regulations promulgated thereunder.

Termination of Options. Options granted under the 1992 Stock Option Plan and not theretofore exercised shall automatically terminate 90 days following any Termination for Cause (as defined in the 1992 Stock Option Plan), 12 months after the date on which the Optionee ceases to serve the Company by reason of death or total disability and six months after the Optionee ceases to serve the Company for any other reason; provided that the Option Agreement may provide for termination at such earlier times upon the occurrence of these and other events as the Committee determines in its discretion at the time of grant. In addition, Options will terminate automatically upon the occurrence of a Corporate Transaction if no provision is made for the assumption of outstanding Options or substitution of new options for such Options. An Option shall terminate automatically upon the tenth anniversary of its date of grant (or in the case of an ISO granted to a 10% Person, upon the fifth anniversary of the date of grant) and upon any transfer of a right or privilege relating thereto (other than by will or the laws of descent and distribution).

Federal Income Tax Consequences. An NSO granted under the Plan will be treated for U.S. Federal income tax purposes pursuant to Section 83 of the Code and the Treasury Regulations promulgated thereunder. The following general rules are applicable to Optionees who are holders of such "non-statutory" options and to the Company for Federal income tax purposes, based upon the assumption that such options under the Plan do not have a "readily ascertainable fair market value" at the time of grant, as defined in the Treasury Regulations promulgated under Section 83 of the Code.

1. The Optionee will not recognize any income on the grant of an NSO under the Plan.

2. The Optionee will recognize ordinary compensation income on the date of exercise of an NSO in an amount equal to the excess, if any, of the fair market value of the shares acquired on the date of exercise over the exercise price paid therefor.

3. When an Optionee sells shares acquired through the exercise of an NSO, he or she will recognize gain or loss in an amount equal to the difference between the fair market value of the shares on the date of exercise and his or her selling price. Such gain or loss will be characterized as capital gain or loss if the shares are held as a capital asset immediately before their sale. If the Optionee holds the shares for the requisite one-year statutory holding period, this gain or loss will be treated as long-term capital gain or loss.

4. In general, the Company will be entitled to a tax deduction in the year in which compensation income is recognized by the Optionee. The amount of the Company's allowable deduction will be equal to the compensation income recognized by the Optionee.

The following Federal income tax consequences are applicable to ISOs granted and exercised pursuant to the Plan.

1. If the Optionee is not a 10% Person (or if the Optionee is a 10% Person and the Option price is at least 110% of the fair market value of the shares at the date of grant), no taxable income results to the Optionee upon the grant of an ISO or upon the issuance of shares to him or her upon exercise of such option.

2. No tax deduction is allowed to the Company upon either grant or exercise of an ISO pursuant to the Plan.

3. If shares acquired upon exercise of an ISO are not disposed of (i) within the two years following the date the ISO was granted or (ii) within one year following the date the shares are transferred to him or her pursuant to the Option exercise, the difference between the amount realized on any disposition of the shares thereafter and the Option price will be treated as long-term capital gain or loss to the Optionee.

4. If shares acquired upon exercise of an ISO are disposed of before the expiration of either of the requisite holding periods, then the lower of (i) any excess of the fair market value of the shares at the time of exercise of the ISO over the Option price or (ii) the actual gain on disposition, will be treated as compensation to the Optionee and will be taxed as ordinary income.

5. In any year that an Optionee recognizes ordinary compensation income on the disposition of an ISO, the Company will generally be entitled to a corresponding tax deduction, in the same amount.

6. Any excess of the amount realized by the Optionee on disposition over the sum of (i) the exercise price, and (ii) the amount of ordinary income recognized under the above rules will

be treated as either long-term or short-term capital gain, depending upon the time elapsed between receipt and disposition of such shares.

In addition to the tax consequences described above, ISOs granted pursuant to the Plan may result in a further "alternative minimum tax" to the Optionee under the Code. In such case, an amount equal to the excess, if any of the fair market value of the shares acquired on the date of exercise over the exercise price will be included as a positive adjustment to income in determining the alternative minimum taxable income of the Optionee as of the date of exercise.

The 1992 Stock Option Plan is not an employee benefit plan which is subject to the provisions of the Employee Retirement Income Security Act of 1974. The provisions of Section 401(a) of the Code are therefore not applicable to the 1992 Stock Option Plan.

Proposed Action

It is proposed that the Shareholders approve the amendment of the 1992 Stock Option Plan to increase the authorized number of shares of Common Stock that may be offered under the plan from 6,000,000 to 12,000,000 shares.

As of February 1, 1995, approximately 295,000 shares of Common Stock remained available for grant pursuant to the 1992 Stock Option Plan. The adoption of the amendment to the 1992 Stock Option Plan will provide additional shares for grant after the currently remaining shares in the plan have been granted in order that the Company may continue to attract and retain the best available personnel for positions of substantial responsibility and provide certain directors, employees and consultants with an additional incentive to contribute to the success of the Company. Additional authorized shares under the 1992 Stock Option Plan may also be used to provide incentives to senior management of the Company in the form of "premium options", which are priced above fair market value on the date of grant. See "Executive Compensation and Other Information Concerning Directors and Executive Officers—Option Grants in Last Fiscal Year" above. It is therefore proposed that the Company's shareholders approve the amendment of the 1992 Stock Option Plan.

Approval of the amendment of the 1992 Stock Option Plan will require the affirmative vote of a majority of the shares of Common Stock present or represented, and entitled to vote at the Meeting.

The Board of Directors unanimously recommends that shareholders vote FOR approval of the amendment of the 1992 Stock Option Plan.

PROPOSAL NO. 3—RATIFICATION OF SELECTION OF AUDITORS

The Board of Directors has selected the firm of Coopers & Lybrand L.L.P. ("Coopers & Lybrand") independent certified public accountants, to serve as auditors for the fiscal year ending December 31, 1995. Coopers & Lybrand has served as the Company's auditors since 1982. It is expected that a member of the firm of Coopers & Lybrand will be present at the Meeting and will be available to make a statement and to respond to appropriate questions. If the shareholders do not ratify the selection of Coopers & Lybrand, the Board of Directors may consider selection of other independent certified public accountants to serve as independent auditors, but no assurances can be made that the Board of Directors will do so or that any other independent certified public accountants would be willing to serve.

The Board of Directors unanimously recommends a vote FOR the ratification of this selection.

VOTING PROCEDURES

For purposes of determining whether a proposal has received a majority vote, abstentions will be included in the vote totals, with the result that an abstention will have the same effect as a negative vote. In instances where brokers are prohibited from exercising discretionary authority for beneficial holders who have not returned a proxy (so-called "broker non-votes"), those shares will not be included in the vote totals and, therefore, will have no effect on the outcome of the vote. Shares that abstain or for which the authority to vote is withheld on certain matters will, however, be treated as present for quorum purposes on all matters.

OTHER BUSINESS

The Board of Directors knows of no business which will be presented for consideration at the Meeting other than that stated above. If other business should come before the Meeting, the persons named in the proxies solicited hereby, each of whom is an officer of the Company, may vote all shares subject to such proxies with respect to any such business in the best judgment of such persons.

SHAREHOLDER PROPOSALS

It is currently contemplated that the 1996 Annual Meeting of Shareholders will be held on or about May 9, 1996. Proposals of shareholders intended for inclusion in the proxy statement to be furnished to all shareholders entitled to vote at the next annual meeting of the Company must be received at the Company's principal executive offices not later than December 18, 1995. It is suggested that proponents submit their proposals by certified mail, return receipt requested.

EXPENSES AND SOLICITATION

The cost of solicitation of proxies will be borne by the Company. Proxies will be solicited principally by the Company by use of the mails. The Company has also engaged the services of Georgeson & Company Inc., a professional proxy solicitation firm, to assist in the solicitation of proxies for a fee of $7,500 plus expenses. Further solicitation of proxies from some shareholders may be made by directors, officers and regular employees of the Company personally or by telephone, telegraph or letter. No additional compensation, except for reimbursement of reasonable out-of-pocket expenses, will be paid for any such further solicitation. In addition, the Company may request banks, brokers and other custodians, nominees and fiduciaries to solicit customers of theirs who have shares of Common Stock registered in the name of a nominee. The Company will reimburse any such persons for their reasonable out-of-pocket expenses.

Dated: March 20, 1995

Financial Highlights

(In thousands, except per share data)	1994	1993	1992	1991	1990
Net sales	$970,723	$981,168	$900,149	$828,895	$692,242
Net income (loss)	(20,879) (1)	55,535 (2)	80,403 (3)	33,116 (4)	23,254 (5)
Net income (loss) per share	(0.44) (1)	1.24 (2)	1.87 (3)	0.75 (4)	0.54 (5)
Total assets	904,079	905,345	763,444	725,537	656,807
Stockholders' equity	554,130	528,391	399,438	323,113	309,439

Notes: (1) *1994 amounts include a non-tax deductible charge to operations of $67.9 million, or $1.40 per share, for purchased research and development related to the acquisitions of Soft*Switch, Inc. and Edge Research, Inc. 1994 amounts also include a restructuring charge of $9 million on a pre-tax basis and $5.8 million, or $0.12 per share, on an after-tax basis.*

(2) *1993 amounts include a non-tax deductible charge to operations of $19.9 million, or $0.45 per share, for purchased research and development related to the acquisition of Approach Software Corporation.*

(3) *1992 amounts include gains on the sale of the Company's investment in Sybase, Inc., of $49.7 million on a pre-tax basis and $33.3 million, or $0.77 per share, on an after-tax basis. 1992 amounts also include a restructuring charge of $15 million on a pre-tax basis and $10.1 million, or $0.23 per share, on an after-tax basis.*

(4) *1991 amounts include a restructuring charge of $23 million on a pre-tax basis and $18.6 million, or $0.42 per share, on an after-tax basis.*

(5) *1990 amounts include a non-tax deductible charge to operations of $53 million, or $1.23 per share, for purchased research and development related to the acquisition of Samna Corporation.*

1994 was the year of the information superhighway — in the media, countless conference speeches, and almost anything associated with information technology. We've been unable to escape from the metaphor. So we've made it the theme for this year's annual report.

But we've got our own take on it. For us, it's as much a continuing journey as an ultimate destination. Last year I vowed to never again mention the word "transition," but in retrospect, that was unrealistic. Transition is another word for change, and in our business, change is inevitable. In fact, our company is all about creating and exploiting change.

Lotus began an important journey back in 1985 with the start of development for Notes. Back then, all the focus was on the individual desktop, which was perhaps not inappropriate for the flood tide of the PC Revolution. The idea of personal computers that would reach beyond the individual desktop and allow people to communicate and share information had fewer adherents.

With Notes, we soon blazed a rather substantial road. Today, we have more than 5,000 customers and 1.35 million users. An entire industry has built up around Notes, with more than 8,000 business partners offering new products and services. cc:Mail, the industry's leading mail product, now has 6.5 million users.

For Lotus, the information superhighway is not something on the drawing boards, or under construction. We have ten years of development experience and five years of in-market experience with our communications products, and people are using it to get places. In early 1994, IDC announced the results of a study showing that companies deploying Notes are realizing returns on investment averaging 179 percent.

This past year, we've been joined by several partners in broadening the scope of Notes in the marketplace, including AT&T, Hewlett-Packard, and IBM.

Our communications strategy has clearly given us a fast lane for growth — with revenues increasing 94 percent this past year. In the fourth quarter, communications revenues exceeded desktop revenues for the first time.

We now have three major businesses. The first two, communications and desktop applications, are well established. As the transition toward communications continues, the desktop business remains substantial, generating revenues and profits that enable us to invest in growth. Our third business, public networks and inter-enterprise computing, is just getting started and has vast potential.

Our commitment to the desktop remains strong. We continued to move ahead with our desktop applications in 1994, with 1-2-3 Release 5, a new SmartSuite, and new releases of Approach, Organizer, Freelance Graphics and Ami Pro. But this is no longer an easy business. There are factors, such as the maturity of the business and the unrelenting competition, that have changed this business forever. We also made our own mistakes — a series of product slips at mid-year and poor performance in Europe — but we've taken steps to correct them.

The pace of growth for each of our businesses is clearly quite different. The desktop business has become mature, with marginal growth. Renewed growth will depend on our ability to reinvent it through team computing. Our communications business, on the other hand, has established considerable momentum. And our public network inter-enterprise business is a classic start-up, with no profits now, but enormous growth potential.

Given this mix and range in our businesses, it is not surprising that our stock price was volatile this past year. The market had a wide range of views on the size and timing of future profits. For our part, we are quite happy with our mix. It provides a good balance of steady revenues and substantial growth opportunities.

The question we must always ask is: Are we there yet?

Part of the answer, obviously, is yes. We have built a great road. We are out in front with Notes. No competitor has anything like it. Our customers are reaching destinations in terms of return on investment and achieving business goals.

But in another sense, we are still on our way. Our customers continue to face difficult technology and investment choices, and no one is going to get there all at once. Our job is to help them manage the journey. As Jack Kerouac said in ON THE ROAD: "There's always more, a little further — it never ends." That's fine with us. There are many opportunities still ahead — for Lotus, our shareholders, and our customers.

Jim Manzi

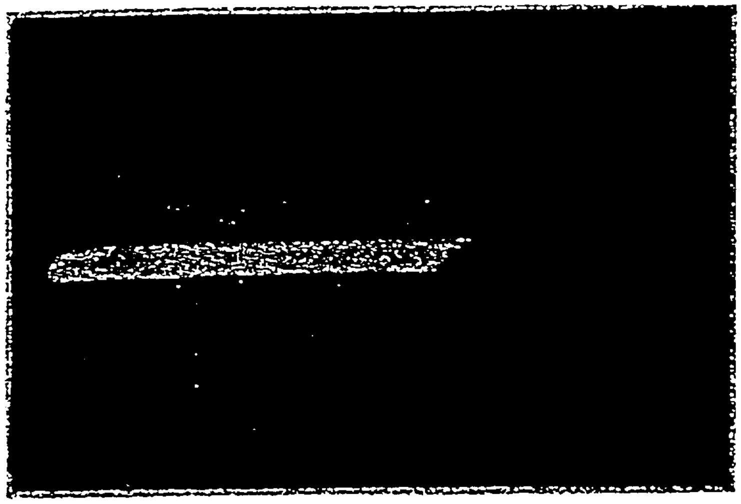
President and CEO

1994

Report

to

Shareholders



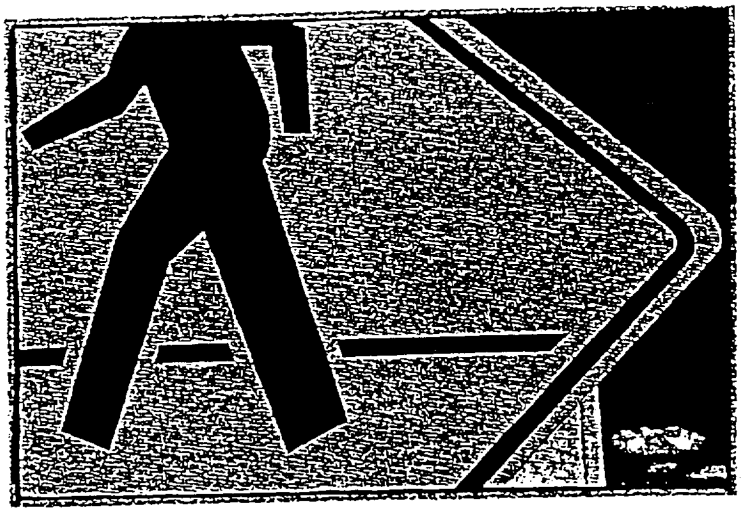
STARTING OUT

There is such a thing as vision in the world of business. It is never as dramatic or far-reaching as what happened to Saul on the road to Damascus, but it does occur, and when it does, it can have a major impact on a company and its customers, even on the way that all companies do business.

The vision that now guides Lotus began back in 1985, when Ray Ozzie and a small team of developers started work on the software that became Lotus Notes®. It began with an idea that was different — at the time.

In 1985, the PC Revolution was in full flower, and all the attention was on the possibilities of individual empowerment and, it was assumed, individual productivity.

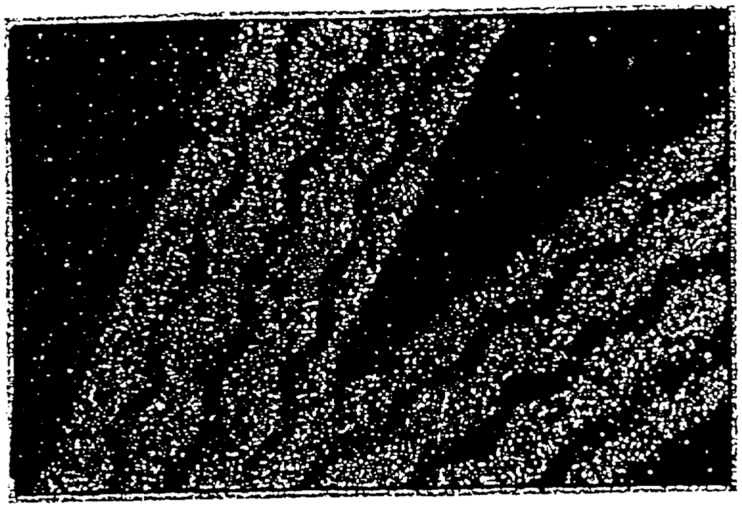
The different view — or vision — of the Notes™ developers was that personal computers were more interesting, and quite possibly more valuable, if people could use them, not just to work in isolation, but to communicate and share



information with other people. Work in any organization is, after all, as much collaborative as personal. In fact, work always involves other people, and in business, products are rarely developed or sold, and revenues are rarely generated, by people acting alone.

The insight seems obvious today, when everyone is clamoring to engineer their way onto the information superhighway. But back in 1985, developing Notes was an errand into the wilderness, an errand that took five years of development, followed by five years of in-market and further development to reach what it's become today. But our foresight has paid off with annual growth rates of nearly 100 percent for Lotus communications products, and we are ahead of the rush to the highway. We have been on it, with our customers, for some time. As Old Bull Lee says in ON THE ROAD: "Only damn fools pay no attention to visions."

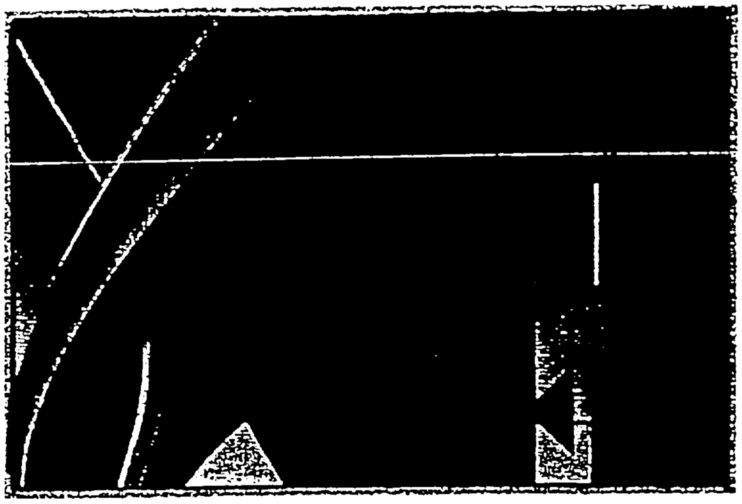
ROADS PRECEDE MAPS



If you are making a map, it helps if you've been there. Otherwise you are like those mapmakers before Columbus who drew wild beasts at the edge of the world. Or those real estate boosters in early 19th century America who created maps of imaginary roads to imaginary cities in order to sell land on the frontier.

For Lotus, there is nothing new about groupware, communications software, or helping people use computer networks to share information and achieve organizational goals. We've been exploring this territory with our customers for some time.

Roads have been built, and people are using them to get where they want to go. There are now 1.35 million users of Notes, and 6.5 million users of cc:Mail™, and thousands more are being added every month. Lotus has more than 5,000 customers and 8,000 business partners developing applications for Notes and cc:Mail.

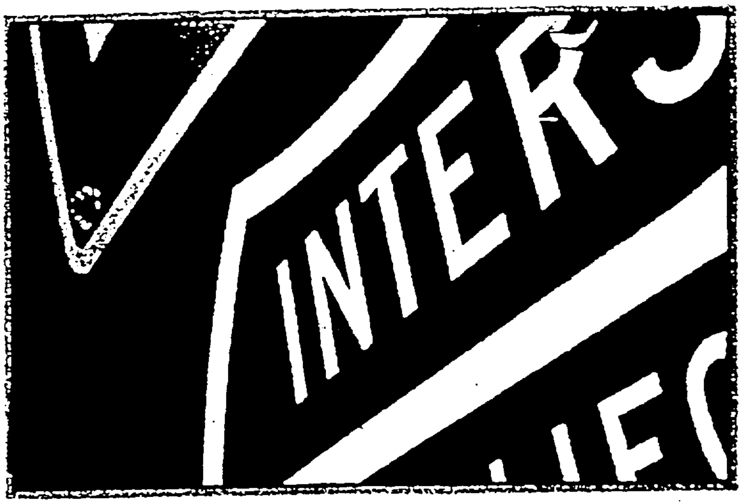


Other substantial roads built by Lotus preceded these newer ones. They are our desktop applications. One of them, 1-2-3®, pretty much blazed the way for a whole new industry. When we began building communications software, at first it appeared to diverge from traditional desktop applications. But we always believed that all of our products are more useful if they work together, if you can readily get from one to the other, if the roads converge.

Today, many customers use our desktop suite because it works so well with our communications applications, and vice versa.

In discussions of computer systems and software, you often hear the term "architecture." It is like a map, and some say that when you don't have products in the marketplace, an architecture is the next best thing. But Lotus' communications architecture is real, something on which real products, tools, services, and thousands of applications are being built. It is a map being drawn from ever-widening experience and knowledge.

ROADS ARE FOR COMMERCE



The Romans built roads to administer their empire, and one rationale for the interstate highway system in the United States was civil defense. But the main purpose of roads has always been commerce: getting goods and services to market, connecting business with customers, producers with suppliers.

The same is true of today's electronic highways. The main purpose is not home entertainment, but work and commerce.

Eventually there may be movies on demand and a marketplace for home shopping that goes beyond ordering pizza or floral arrangements. But in the meantime, there's already substantial and rapidly growing traffic that serves the business (as distinct from the consumer) marketplace. Companies invest in Notes applications because they can reduce the

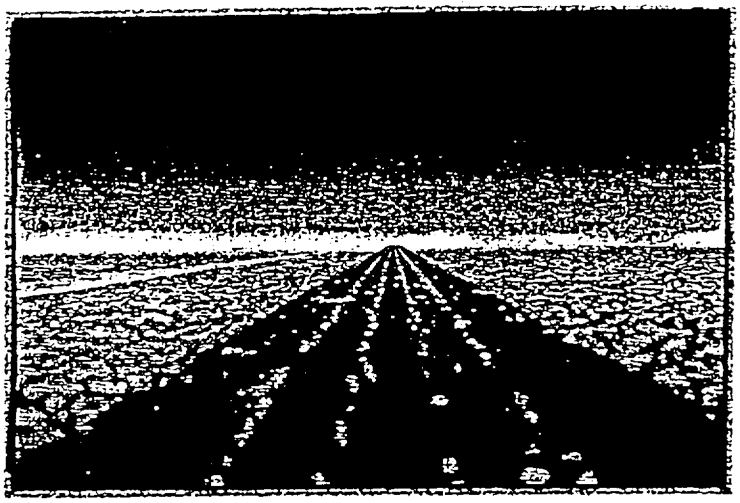
time and enhance the quality of such basic business processes as product development and customer service. The growth of the business market is driven by the tangible returns companies receive on their investment.

The first electronic links are internal, connecting groups within the enterprise, but soon reach outward to connect the enterprise with customers and suppliers. As a result of this electronic web, the structure of business organizations, and the nature of commerce itself, is changing. Businesses are able to focus on what they do best, and "outsource" other functions. The lines between companies, even industries, become blurred, and new configurations and new opportunities for commerce become possible. One road leads to another.

There is no standing still — we know we can't be complacent.

Lotus' communications strategy rests on the premise that our customers have little interest in open-ended questions. Companies are more concerned with achieving specific goals, such as profitability and market share. "Are we there yet?" is about as general as any business question gets, and it implies a destination.

Surfing on a sea of information is not a business goal. Nor is the accumulation of information. Since economic value is based on scarcity, and since the amount of information in the world is infinite, information has no value by itself. It is valuable when it is used, when it leads to the production of goods and services.



The information economy is nothing new. Every economy — from the hunter-gatherer clans to market economies and even planned economies — depends on information. What has changed is the velocity of information and the potential access to it — both the result of today's information and communications technology. This places a premium on getting the right information and getting it fast, and on marshalling information in order to decide and act. Businesses are attempting to transform themselves with information technology ("reengineering" has become well established in business parlance).

Lotus' business lies at the heart of a major intersection where technology, organizational change, and the impact on people at work all converge. Our purpose is to provide not just great products — Notes, cc:Mail and desktop applications for team computing — but also the benefit of our experience and knowledge, so that our customers can get where they want to go.

Lotus Backgrounder

Lotus Development Corporation
Highlights: 1982 - 1992

1982

April

Lotus Development Corporation opens with $1 million in venture capital and eight employees.

October

Lotus 1-2-3, business software integrating spreadsheet, database and graphics, announced.

December

Second-round financing raises $3.8 million - a record for personal computer software firms; 50 employees.

1983

January

1-2-3 ships.

April

1-2-3 leads the Softsel best-seller list for the first time.

June

Lotus moves to new headquarters in east Cambridge, Mass.; 150 employees.

September

Lotus announces international distribution and first European subsidiary.

October

$41 million raised in first public offering.

December

Year ends with $53 million in revenues; 300 employees.

1984

January

United Kingdom subsidiary opens in Windsor, England.

February

Symphony, business software integrating spreadsheet, word processing, graphics, database, and communications announced.

April

Lotus leads Softsel best-seller list for 12 consecutive months.

July

Symphony ships.

October

Mitchell D. Kapor named chairman and chief executive officer of Lotus; Jim P. Manzi named president and chief operating officer.

November

Jazz for the Apple Macintosh introduced.
Spelling Checker and Text Outliner, the first add-in products for Symphony announced.
LOTUS Magazine announced.

December

Year ends with annual revenues of $156.9 million: 741 employees.

1985

February

Symphony Spelling Checker and Text Outliner ship.

April

1-2-3 leads Softsel Hot List for 24 consecutive months.
Lotus announces 1-2-3 Release 2, and Symphony 1.1.
Partial assets of Software Arts, creators of Visicalc, acquired.

May

First issue of LOTUS magazine published.
Lotus Jazz ships.

June

Manufacturing facility opens in Dublin, Ireland.

July

Lotus announces plans to establish Lotus Japan, a wholly-owned subsidiary.
Symphony Release 1.1 and Symphony Link ship.
Company acquires Dataspeed, Inc. of San Mateo, Calif., which leads to development of Signal.

September

1-2-3 Release 2 ships.
Signal, a real-time market data system delivering stock market quotations, announced.
Lotus Philanthropy program introduced.

October

Signal ships.

December

Manufacturing facility opens in Caguas, Puerto Rico
Company reports annual revenues of $225.5 million: 1.068 employees.

1986

February

Company acquires ISYS Corporation, of Acton, Mass., which leads to development of Lotus One Source.
Assets acquired from InfoCenter of New Paltz, N.Y., which leads to development of The Application Connection (T-A-C).
GNP Development of Pasadena, Calif. acquired, providing technology for Lotus HAL.
Lotus hosts first full-scale Developer Conference.

April

Jazz Release 1A ships.
Jim P. Manzi named chief executive officer.

June

Company acquires Graphics Communications, Inc. of Waltham, Mass., which becomes Lotus' Graphic Products Group, responsible for Freelance and Graphwriter.

July

Mitchell D. Kapor resigns as Lotus chairman.
Jim P. Manzi named chairman of Lotus Development Corporation.
1-2-3 Release 2.01 ships.
T-A-C, software that provides connections between mainframes computers and applications on personal computers.

August

Lotus announces MultiValue Plan for customer service and support.
1-2-3 Government Edition announced.

September

T-A-C ships.
1-2-3 J. Japanese version ships.
Lotus One Source, a family of business and financial information products delivered on compact disk, announced.

October

Lotus ships two-millionth copy of 1-2-3.
Lotus HAL announced.
Lotus Manuscript, an advanced word and document processor, announced.

November

Lotus HAL ships.
Lotus announces and ships Freelance Plus and Freelance Maps, companion map sets for Freelance Plus.

December

Lotus Manuscript ships.
Lotus Express for MCI Mail announced.
Lotus Philanthropy Program donates more than $785,000 in 1986.
Year ends with $283 million in revenues; 1,421 employees.
Certain assets of Future Software acquired.

1987

January

Two-for-one stock dividend announced.
Lotus Developer Tools ship.
Metro, a desktop management program, simultaneously announced and shipped.

February

1-2-3/J is Japan's best-selling business software package for four consecutive months; receives the Nikkei Award for Creative Excellence.

March

Mainframe Software Division forms.
Lotus One Source ships.
Lotus Express ships.
Lotus signs letter of intent to acquire Computer Access Corporation of Belmont, Mass.

April

Company announces 3.5-inch versions of 1-2-3, Symphony, Freelance Plus and Lotus Express for IBM Personal System/2 machines.
Lotus celebrates its fifth anniversary with Lotus Week and announces future product directions, including 1-2-3 Release 3, 1-2-3/G,
Lotus/DBMS, and 1-2-3/M.

June

Lotus and Telerate announce joint marketing and development agreement.

July

Enhanced version of T-A-C announced.
Agreement to acquire Datext, Inc. of Woburn, Mass., announced. Datext markets financial databases on CD ROM.

August

Lotus, Intel and Microsoft announce major upgrade to expanded memory specification.
Lotus HAL for the IBM Personal System/2 announced.
Lotus ships three-millionth spreadsheet product.
Lotus Japan announces two new products and developer marketing program: 1-2-3 Release 2.1J; an add-in word processing program that works with Release 2.1J; and developer tools for 2.1J.

September

Lotus Graphwriter II announced.
Lotus Publishing announces Lotus Selects, a catalog of products for users of 1-2-3 and Symphony.
Speedup and Learn, add-ins for 1-2-3, ship.

October

Plans to develop 1-2-3 for Apple Macintosh Computers announced.
1-2-3 Small Business Kit announced.
Graphwriter II ships.
Acquisition of Datext, Inc. completed.

November

Lotus Agenda, the personal information manager, announced.
Canadian headquarters opens; French Canadian versions of Lotus HAL and Freelance Plus to be shipped.
Availability of Lotus 1-2-3 Networker announced.
Lotus conducts nationwide forums to assist corporate customers with planning process.
1-2-3 Small Business Kit ships.

December

Lotus announces immediate availability of CD/International, which brings global financial information together with Lotus screening and analysis software.
Australian subsidiary opens.
Year ends with $395.6 million in revenues; 2,100 employees.

1988

January

Lotus and Charles Schwab announce joint agreement to market Signal.
Symphony 2.0 announced.
Manuscript 2.0 announced.

February

Symphony 2.0 ships.

March

Lotus announces immediate availability of Metro 1.1.Lotus announces Blueprint, a new data access architecture linking Lotus applications to external data sources.

April

Lotus and Radio Shack announce a joint agreement to market 1-2-3 Small Business Kit.
UNIX version of 1-2-3 announced.
Lotus announces new version of CD/Corporate, an information product delivered on CD ROM.

November

Lotus announces Prompt CD, a customer support database delivered on compact disk.
Lotus ships Agenda for OS/2.
Lotus announces agreement with Digital Equipment Corporation to develop and market products for Digital's VAX/VMS computing environment.

December

Lotus Freelance Plus 3.0 ships
Lotus Agenda wins 1988 Year-End Awards from PC Computing, PC Magazine, and Home Office Computing.
Year Ends with $468.5 million in revenues, 2,500 employees.

1989

January

Lotus announces Magellan, a hard disk management utility for IBM and compatible personal computers.

March

Lotus announces the expansion of its Information Services business to the Far East.
Lotus announces 1-2-3 Release 2.2.
Lotus acquires the rights to Allways, The Spreadsheet Publisher from Funk Software, Inc.

April
Lotus ships Magellan.

May

Lotus announces network versions of 1-2-3, Manuscript and Symphony.
Lotus announces Freelance Release 3J, the first integrated business-graphics package for the Japanese Market.

May

Lotus announces new add-ins for 1-2-3 Release 3 to be created by independent software vendors using the Lotus Extended Application
Facility.
Lotus serves as technology partner with Ziff Communications Company in development of Computer Library, a PC-based information product.
Lotus announces Value Pack, a set of enhancements for 1-2-3 Release 2.01.
Lotus Week '88 begins, a five-day series of events for shareholders, corporate customers, third-party developers, user groups and resellers.
Lotus announces shipment of 4 millionth spreadsheet.

June

Manuscript 2.0 ships.
Lotus announces the expansion of its distribution channel.
Lotus announces the construction of a new corporate facility in Cambridge, Massachusetts.

July

Agenda ships.
1-2-3 Release 2.01 receives highest overall rating by Software Digest for the fifth consecutive year.

August

Lotus announces T-A-C Release 5.0.

September

Readers of PC World magazine vote Lotus 1-2-3 and Symphony as the preferred applications in their respective spreadsheet and integrated categories.

October

Lotus announces Freelance Plus 3.0, a comprehensive business graphics program.
Computer Library Ships.
Lotus announces CD/Networker, a local area network implementation of One Source.

June

Lotus ships 1-2-3 Release 3.
Lotus announces agreement for NEC to manufacture and distribute Lotus software on ROM card for NEC's Ultralite laptop computer.
Lotus ships network versions of Symphony and Manuscript.

July

Lotus announces the Magellan Viewer Toolkit for third-party developers.
Lotus announces joint development and marketing agreement with Sun Microsystems.
Lotus ships CD/Networker, a network implementation of Lotus One Source.
Lotus ships 1-2-3 Release 2.2.

August

Lotus announces the Lotus Spreadsheet for DeskMate.

September

Lotus and IDD Information Services, announce availability of CD/Mergers and Acquisitions.
Lotus announces agreement with Poqet Computer Corp. to manufacture and distribute ROM card versions of Lotus software for the Poqet PC.
Lotus announces shipment of Add-in Toolkit for 1-2-3 Release 3.
Lotus announces availability of Symphony 2.0 Plus, integrating Allways.
Lotus acquires minority equity interest in Sybase, Inc.
Lotus ships DataLens Developer Toolkit.

October

Lotus announces CD/Investment: U.S. Equities.
Lotus ships 1-2-3 Release 3 network editions.

November

Lotus Development Japan ships Freelance Release 3J.
Lotus announces Lotus @FACTORY.

December

Lotus ships 1-2-3 Release 2.2 network versions.
Lotus ships Lotus Notes.
Lotus ships CD/Investment: U.S. Equities
Financial News Network Acquires LINC from Lotus.
Lotus ends 1989 with $556 million in revenues and 2,700 employees.

1990

January

Lotus announces Lotus 1-2-3 for Sun Microsystems workstations.

February

Lotus introduces Lotus Realtime.
Lotus introduces three International One Source products: CD/Private+:UK, CD/Corporate:UK and CD/M&A:Europe.
Lotus and IBM announce Lotus 1-2-3/M.

March

Lotus announces 1-2-3 for Digital's VAX/VMS family of computers.
Lotus ships 1-2-3/G for OS/2
Lotus ships Symphony 2.2.
Lotus ships 1-2-3 for Sun
Lotus announces establishment of Consulting Services Group.
Lotus announces Magellan 2.0.

April

Lotus introduces Lotus MarketPlace, CD-ROM Databases for the Apple Macintosh.
Lotus ships 1-2-3 for VAX/VMS for Digital's VAX/VMS family of computers.
Lotus ships @Factory

May

Lotus acquires Aleph 2, developer of Impress.
Lotus announces 1-2-3 Release 3.1.
Lotus acquires Alpha Software's AlphaWorks.

June

Lotus announces Lotus 1-2-3 for UNIX System V.
Lotus announces opening of Lotus Children's Center.
Lotus ships Lotus 1-2-3 for Digital's ALL-IN-1.

September

Lotus announces immediate availability of 1-2-3 Release 3.1.
Lotus announces Freelance Graphics for OS/2.
Lotus announces Lotus Improv for the NeXT Machine
Lotus announces new versions of 1-2-3 with character sets for Eastern Europe

October

Lotus ships Lotus Marketplace

November

Lotus signs Definitive Merger Agreement with Samna Corp., developer of Ami and Ami Pro word processors.

December

Lotus ships Russian version of 1-2-3.
Lotus completes Acquisition of Samna Corp.

1991

January

Lotus ships Freelance Graphics for OS/2.
IDG purchases Lotus Publishing Corporation.
Lotus cancels shipment of Lotus MarketPlace: Households.
Lotus announces 1990 sales of $684 million.

February

Lotus ships Lotus Improv.
Lotus acquires cc:Mail Inc.
MCI acquires rights to develop Lotus Express.

March

Lotus announces new Freelance Graphics for DOS.
Lotus completes acquisition of cc:Mail Inc..
Lotus ships 1-2-3/Notebook in Japan.
Lotus announces Freelance Graphics for DOS.

April

Lotus and Hewlett-Packard announce Lotus 1-2-3 for 95LX Palmtop computer.

May

Lotus ships 1-2-3 for DOS Release 2.3.
Lotus ships Lotus Notes Version 2.0.

June

Lotus announces 1-2-3 for Windows.
Lotus announces 1-2-3 for Macintosh.
Lotus announces enhanced 1-2-3 and Lotus Realtime for SUN Sparc Systems.

August

Lotus ships 1-2-3 for Windows.

5/90 - W ship NS 1.25
See Ex 30 clean up
cuts -
9/90 / 9/91

September

Lotus announces Open Messaging Interface.
Lotus announces CD/Insurance.

October

Lotus announces Freelance Graphics for Windows.

December

Lotus ships 1-2-3 for Macintosh.

1992

March

Lotus Customer Service and Support receives certificate of merit from Service News.
Lotus ships SmartPics for Windows Applications.

April

Lotus announces SmartSuite OS/2 Suite of Applications.
Lotus ships 1-2-3 for Home.
Lotus acquires The Organizer from Threadz.

May

Lotus ships Lotus Sound.

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1994

Report

to

Shareholders

IBM 7510297454

Management's Discussion and Analysis

As an aid to understanding the Company's operating results, the table below indicates the percentage relationships of income and expense items included in the Consolidated Statements of Operations for each of the three years ended December 31, 1994 and the percentage changes in those items for each of the two years ended December 31, 1994.

Percent changes year to year			*Items as a percentage of net sales*		
1994-93	1993-92	Income and expense items	1994	1993	1992
(1%)	9%	Net sales	100.0%	100.0%	100.0%
(15%)	1%	Cost of sales	17.8%	20.6%	22.2%
3%	11%	Gross margin	82.2%	79.4%	77.8%
		Expenses:			
25%	7%	Research and development	16.3%	12.9%	13.1%
8%	9%	Sales and marketing	51.2%	47.2%	47.1%
(2%)	1%	General and administrative	7.1%	7.1%	7.7%
–	–	Other (income)/expense, net (A)	7.0%	1.8%	(3.4%)
17%	17%	Total expenses	81.6%	69.0%	64.5%
(94%)	(15%)	Income before provision for income taxes	0.6%	10.4%	13.3%
(43%)	17%	Provision for income taxes	2.7%	4.7%	4.4%
(138%)	(31%)	Net income (loss)	(2.1%)	5.7%	8.9%
(135%)	(34%)	Net income (loss) per share	($0.44)	$1.24	$1.87

Note (A): 1994, 1993 and 1992 amounts include significant non-recurring income and expense items which are set forth in Footnote J to the financial statements.

Results of Operations

1994 compared to 1993

Revenue

The Company's revenue is derived from desktop applications products and communications products and services. Desktop applications products include SmartSuite (an integrated applications suite), 1-2-3 (spreadsheets), Ami Pro (word processing), Freelance Graphics (presentation graphics), Lotus Approach (end-user database) and Lotus Organizer (personal information management). Communications products and services include Lotus Notes (workgroup computing), cc:Mail (electronic mail), Soft*Switch (electronic mail switching) and consulting services.

The Company's worldwide revenue decreased 1% to $971 million in 1994. Revenue from desktop applications declined by 20%, while revenue from communications products and services grew by 94%. This performance generally reflects competition for the Company's products in the maturing desktop applications market, growing momentum for the Company's products in the expanding client-server communications market and an initial adverse effect from the implementation of the Company's Passport program.

Desktop Applications Revenue

Revenue from desktop applications represented 64% of total revenue in 1994, as compared to 79% in 1993. DOS desktop applications revenue, primarily from 1-2-3 for DOS, declined approximately $135 million in 1994. Windows desktop applications revenue remained relatively unchanged in 1994, as an increase in revenue from SmartSuite was offset by a decline in revenue from standalone applications. SmartSuite represented 46% of Windows desktop applications revenue in 1994 compared to 30% in 1993.

The 20% decline in desktop applications revenue in 1994 is primarily attributable to severe competition, as well as downward pricing pressure and the continuing migration of users from DOS-based to Windows-based applications.

The Company believes that intense competition, particularly from its largest competitor, Microsoft Corporation ("Microsoft"), resulted in a reduction in Windows desktop applications revenue and market share. The Company believes that mid-year delays in the shipment of certain Windows desktop products also contributed to a decrease in revenue and market share as certain end-users may have purchased competitive products rather than waiting for the Company's new product offerings. Windows market share losses were particularly pronounced in the Company's European business, where weaker-than-expected end-user demand, higher-than-desired distribution channel inventories in certain markets and severe competition contributed to the decline in desktop applications revenue.

On a worldwide basis, pricing for Windows desktop applications products declined in 1994 compared to 1993 due to competitive factors and an increase in the number of volume sales contracts with large corporate customers. The Company anticipates that downward pressure on pricing will continue.

The marketplace migration from DOS to Windows adversely affected and will continue to affect the Company's results, as its current market share for Windows spreadsheets is lower than that for DOS spreadsheets. However, the Company believes that the magnitude of the decline in DOS-based revenue in 1995 should not be as dramatic as that experienced in recent years, as DOS-based revenue continues to represent a smaller share of overall revenue.

Other factors that could affect the Company's desktop applications revenue over its next fiscal year include the rate of growth of the Windows market, the market shift from standalone applications to integrated suites, the impact of "Windows 95", a new operating system that Microsoft has announced it will release in 1995, and the sales and marketing efforts of Microsoft and Novell, Inc. ("Novell") relative to those of the Company. See "Issues and Risks".

Significant new desktop products released in the third quarter of 1994 included 1-2-3 for Windows Release 5.0, 1-2-3 for DOS Release 4.0, SmartSuite for Windows Release 3.0, Ami Pro for Windows Release 3.1, Freelance Graphics for Windows Release 2.1 and Lotus Approach for Windows Release 3.0. In the fourth quarter of 1994, the Company released Lotus Organizer for Windows Release 2.0.

Communications Products and Services Revenue

Revenue from communications products and services represented 36% of total revenue in 1994 as compared to 19% in 1993. The primary component of the communications revenue growth was a substantial increase in Lotus Notes revenue. Notes revenue increased more than 100% during the year, and the number of Notes users more than doubled. As of December 31, 1994, there were approximately 1.35 million users of Notes worldwide.

The Company believes that its Notes revenue performance was driven by several elements. As the client-server market expands and there is a greater availability of networked personal computers, demand for networked applications, such as Notes, has increased. In addition, end-user demand for Notes has grown dramatically as customers have begun to understand how the product's workgroup computing capabilities can enable them to become more productive. The Company has further enhanced the product's value to customers by expanding the number of third parties, or business partners, who are capable of developing applications for Notes. As of December 31, 1994, the number of business partners offering products and services for Notes had increased to more than 8,000. Also contributing to the growth in Notes revenue is the greater availability of Notes on different operating system platforms. As of December 31, 1994, Notes was available on the Windows, Windows NT, OS/2, Macintosh, UNIX SCO, UNIX AIX, UNIX HP-UX and Sun Solaris operating system platforms.

The Company announced that it will lower its pricing for Notes in 1995 in an effort to accelerate growth in the number of end-users. While the Company does not believe that competition is currently a significant factor in the workgroup computing market, several competitors with greater resources than those of the Company have announced their intentions to enter into this market. In addition, the Company expects that continued growth in this market will attract other competitors. The latest commercially available version of Notes, Release 3.2, was last updated in the third quarter of 1994.

Also contributing to the communications revenue growth were increases in product and service revenue from cc:Mail, consulting services and customer support. In addition, communications revenue in 1994 included five months of revenue from newly acquired Soft*Switch, Inc. ("Soft*Switch"). While cc:Mail revenue continues to grow, its rate of growth is lower than that of the prior year. The Company believes that the decline in the rate of growth of cc:Mail revenue is attributable to a decline in the growth rate of the LAN-based electronic mail market and to increased competition. As of December 31, 1994, there were approximately 6.5 million cc:Mail users worldwide. The Company anticipates that customer support revenue from communications products will continue to represent a growing component of communications revenue as the installed base of Notes, cc:Mail and Soft*Switch customers grows.

Passport Program

In May 1994, the Company launched Passport, a new sales program intended to facilitate and simplify volume purchases by corporate customers on a worldwide basis. Under the Passport program, the Company's resellers offer discounted worldwide pricing to end-user customers based on customers' cumulative program purchases or their non-binding commitments to purchase certain volumes of Lotus products in the future. Customers can select options that may or may not require an initial purchase. However, if an initial purchase is not required, customers can maintain their program pricing by purchasing against their commitments in a specified period of time and by purchasing a certain percentage of their total commitment within the first six months. The Company believes that the transition to Passport resulted in a slower-than-expected conversion of customer purchase commitments into actual sales in the second and third quarters of 1994. However, the Company believes that over time Passport will strengthen its competitive position and will result in increased sales.

International Revenue

Revenue outside the United States declined to 48% of the Company's worldwide revenue in 1994 from 51% in 1993, primarily due to the decline in desktop revenue in Europe. This decline was partially offset by sales gains in the Asia Pacific region, particularly in communications revenue in Japan. The impact of foreign currency fluctuations on international revenue was insignificant.

Expenses and Profit Margins

Cross margin as a percentage of sales increased to 82% in 1994 compared with 79% in 1993. The gross margin improvement is primarily attributable to reduced manufacturing and delivery costs resulting from an increase in the percentage of sales in the form of non-physical license rights, a corresponding decrease in the percentage of sales in the form of physical units ("shrinkwrap product") and material cost reductions. Gross profit margins in the United States were approximately 85% in 1994 as compared to approximately 80% in 1993. International gross profit margins were approximately 77% in 1994 as compared to approximately 78% in 1993. The difference in geographic margins in 1994 was primarily due to a more rapid shift in the United States of sales from physical units to non-physical license rights.

The Company continues to make investments in research and development to maintain a competitive position in the desktop market and to add to and improve its communications products. Research and development expenses increased 25% to $159 million in 1994, reflecting a constant level of desktop development spending year over year and significantly higher spending associated with the Company's communications products. Additionally, the acquisition of Soft*Switch and an increase in international product development spending contributed to higher research and development expenses. Capitalized software development costs during 1994 were $36 million compared with $25 million for 1993. The increase reflects the growth in research and development spending on communications products.

Sales and marketing expenses increased 8% to $497 million in 1994. The increase consists of significantly higher spending for marketing, sales and support of communications products and a slight decrease in marketing spending for desktop products. The Company's expansion of its communications support capability and growth in the consulting services business also drove higher sales and marketing spending in 1994.

General and administrative expenses decreased 2% to $69 million in 1994 as the Company continued efforts to control infrastructure and fixed costs.

In May 1994, the Company acquired all of the outstanding shares of Iris Associates, Inc. ("Iris") in a transaction that was accounted for as a pooling of interests. The acquisition had an immaterial impact on the results of operations in 1994.

In July 1994, the Company acquired Soft*Switch, Inc. The purchase price consisted of approximately $64.3 million of cash consideration, $8 million of assumed liabilities and $5.2 million of deferred tax liabilities. A significant portion of the purchase price was allocated to purchased research and development, resulting in a $62.5 million charge to the Company's 1994 operations. See Note K of Notes to Consolidated Financial Statements. This charge, which is included in other income and expense, is not deductible for tax purposes. Subsequent to the acquisition, the Company initiated substantial development efforts to make Soft*Switch's EMX products more competitive in a rapidly changing environment. These efforts are focused on the development of the ultimate standalone EMX product and the integration of the underlying EMX technology with the Company's other communications products. Development efforts will be concentrated on improving performance, cross-platform functionality, usability, connectivity, systems management and communication protocol layers and are expected to involve extensive rewriting of the code. The Company expects to invest considerable amounts through 1997 to complete and continue development of the ultimate technologies using the purchased research and development.

In September 1994, the Company acquired Edge Research, Inc. ("Edge"). The purchase price was allocated to purchased research and development resulting in a $5.4 million non-tax deductible charge to other income and expense in 1994. See Note K of Notes to Consolidated Financial Statements.

IBM 7510297458

In the third quarter of 1994, the Company recorded a $9 million restructuring charge to other income and expense related to the Company's European operations and to the discontinuation of a product. European restructuring activities include the streamlining of the marketing organization from a product focus to a market segment focus, the centralization of certain finance and administration functions and a reduction in desktop applications support staff. The restructuring activities in 1994 resulted in a reduction in force of approximately 130 positions, primarily in the United Kingdom and Germany. The associated charge reflects severance and related costs, of which $5.8 million was paid in 1994. The charge related to the discontinued product reflects a $1.1 million non-cash write-off of capitalized software due to the decision to discontinue further development and marketing. The Company anticipates that these restructuring activities will be essentially completed within the next six months and that the likely effects on future operating results will principally consist of a reduction in compensation and amortization expenses. The Company expects to save approximately $8 million annually over the next several years as a result of the restructuring. The Company does not believe that the restructuring will have a material impact on future liquidity.

Other income and expense also includes interest income and expense and the effect of currency transaction gains and losses. Interest income was higher in 1994 than in 1993 because of higher average cash and short-term investment balances and higher interest rates. Interest expense declined primarily due to scheduled debt repayments.

In June 1993, the Company acquired Approach Software Corporation ("Approach"). The purchase price consisted of approximately $23 million of cash consideration and assumed liabilities. A significant portion of the purchase price was allocated to purchased research and development, resulting in a $19.9 million charge to the Company's 1993 operations. See Note K of Notes to Consolidated Financial Statements. This charge, which is included in other income and expense, is not deductible for tax purposes. Subsequent to the acquisition, the Company initiated substantial development efforts focused on improving the user interface, conforming the technology to the Company's cross-product standards and integrating the technology into the Company's suite of desktop applications. These efforts are expected to involve extensive rewriting of the code and the addition of significant new product features. At the time of the acquisition, the Company expected to invest approximately $20 million through 1996 to complete and continue the development of the ultimate technology using the purchased research and development.

Earnings for 1994, excluding the restructuring and purchased research and development charges, were $52.8 million, or $1.08 per share. Earnings for 1993, excluding the charge for purchased research and development, were $75.4 million, or $1.69 per share.

The effective tax rate for 1994 of 36%, excluding the effect of non-tax deductible charges for purchased research and development related to the acquisitions of Soft*Switch and Edge, compares with 38% for 1993, excluding the effect of a non-tax deductible charge for purchased research and development related to the acquisition of Approach. The decrease in the rate reflects benefits derived from the Company's international manufacturing operations.

Issues and Risks

There are a number of business factors, which singularly or combined, may affect the future results of the Company. The following issues and risks, among others, should be considered when evaluating the future outlook of the Company.

Competition, generally. The applications software business is highly competitive. The Company's products compete with software products offered by larger independent software companies, such as Microsoft and Novell. Certain products offered by the Company are directed at operating environments or business applications in which one or more companies were early entrants and enjoy significant product and market share.

Rapid technological change. The personal computer and software industries are characterized by rapid technological change, such as changes in operating systems, and uncertainties as to widespread acceptance of new products. The Company's success in the future will depend in part on its ability to anticipate and respond to these changes on a timely basis.

Changes in the personal computer industry. The Company believes that demand for the Company's products is indirectly linked to the demand for new personal computers for business use, particularly in the case of desktop applications. Historically, the industry has been characterized by sustained growth in unit sales of personal computers, but no assurance can be given that this trend will continue. Accordingly, the level of demand for personal computers for business use may be viewed by certain investors as potentially predictive of future demands for the Company's products.

Long-term investment cycle. Developing, manufacturing and licensing software is expensive and the investment in product development often involves a long pay-back cycle. The Company's future plans include significant investments in software research and development, from which significant revenues may not be realized for a number of years.

Historical significance of desktop revenue. Historically, the Company has used profits from desktop revenue to make substantial investments in the Company's communications products. Although revenue from communications products has grown significantly over the last few years, revenue from desktop applications is important to the continued funding of the communications business. There can be no assurance that desktop revenue will continue at historical levels.

Windows desktop applications competition. The Company believes that its share of the Windows desktop applications market will be an important factor in its future success. Although the Company's share of this market fluctuates from quarter to quarter, management believes that the Company is second in market share to Microsoft, the developer of the MS-DOS and Microsoft Windows operating environments, in the spreadsheet and desktop suite product categories, and third behind Microsoft and WordPerfect, a unit of Novell, in the word processing product category. Furthermore, the Company believes that Microsoft has and will continue to use its position in operating systems to leverage its lead in the Windows desktop applications market.

The market for Windows desktop applications is highly competitive and attempts by these larger competitors to maintain or increase market share may lead to product price reductions and increased marketing efforts aimed at sales of bundled desktop applications sold as suites.

Desktop suites competition. Competition in the Windows applications market has been intensified by the emergence of desktop "suites", in which software publishers combine and integrate standalone applications for sale as a unit. The desktop suite magnifies the effects of competition in the desktop applications market, since the popularity of one major product in a suite may drive the sale of the entire suite and may enable the software publisher to occupy the buyer's entire personal computer "desktop". Generally, the sales price of a suite is greater than the price of any single application included in the suite, but is significantly less than the aggregate price of all the applications included in the suite, if purchased separately. The Company believes that sales of SmartSuite generate greater revenue per user desktop and do not significantly reduce gross margins, despite imputed lower sales prices per application, because users of the suite purchase applications that they would not otherwise purchase on a standalone basis. The Company expects that sales of desktop suites will continue to account for a growing percentage of all Windows desktop sales and will eventually surpass aggregate sales of individual desktop applications as a percentage of all Windows desktop sales.

The Company, Microsoft and Novell each market applications suites for the Windows operating environment. The Company believes that SmartSuite revenue has been driven by growing demand for desktop suites, the Company's highly rated individual applications, particularly 1-2-3 for Windows, and the high degree of integration among the products in its suite. However, no assurance can be given that sales of SmartSuite will grow.

Communications products competition. The Company was an early entrant into the market for software designed to facilitate workgroup computing and believes that its offering, Lotus Notes, is the leading product in this category. Workgroup computing is an emerging technology and, as such, is subject to rapid changes. There can be no assurance that Notes will continue to gain market acceptance as increased competition brings new products and new technology to the marketplace for workgroup computing.

Like the market for desktop applications generally, the market for local area network-based e-mail products is also highly competitive. The Company's largest competitor in this market is Microsoft, which has announced its intention to include certain e-mail functions in future versions of its operating systems software. There can be no assurance that such development will not have an adverse effect on the Company's market share for communications products.

Possibility of new product delays. As is common in the computer software industry, the Company has from time to time experienced delays in its product development and "debugging" efforts, and may experience similar delays from time to time in the future. Significant delays in developing, completing or shipping new or enhanced products could adversely affect the Company.

Historical patterns of revenue flow. The Company's sales revenue typically fluctuates from quarter to quarter, with sales being relatively higher in the fourth quarter and in quarters in which new versions of established products are introduced. In addition, a high percentage of the Company's revenues are expected to be realized in the third month of each fiscal quarter and tend to be concentrated in the latter half of that month. The Company's backlog early in a quarter will not generally be large enough to assure that it will meet its revenue targets for any particular quarter. Accordingly, the Company's quarterly results may be difficult to predict until the end of the quarter, and a shortfall in shipments or contract orders at the end of any particular quarter may cause the results of that quarter to fall short of anticipated levels.

Reserves for sales returns. The Company engages channel partners to sell products to end-users. Channel partners buy significant quantities of products from the Company in anticipation of sales of such products. In certain circumstances, channel partners may be unable to sell their inventories to end-users and thus may return inventory to the Company. Consequently, the Company maintains reserves for product returns in accordance with historical experience and by making judgments about future competitive conditions and product life cycles. There can be no assurance that historical experience will be an accurate guide for the future, because the rate of product returns is primarily a function of the competitive state of the market in the future, and thus, in large part, is a function of the actions of the Company's competitors, which the Company cannot anticipate.

Protection of intellectual property and other proprietary rights. The Company regards its applications as proprietary and attempts to protect its intellectual property rights by relying on copyrights, trademarks, patents, and common law safeguards, including trade secret protection, as well as restrictions on disclosure and transferability in its agreements with other parties. Although the Company intends to protect its intellectual property rights vigorously, there can be no assurance that the laws of all jurisdictions in which the Company's products are or may be developed, manufactured or sold will afford the same protection to its products and intellectual property, or will be enforced or enforceable by the Company, to the same extent as under the laws of the United States.

The software industry is characterized by frequent litigation regarding copyright, patent and other intellectual property rights. The Company has from time to time had infringement claims asserted by third parties against it and its products. There can be no assurance that such third party claims will be resolved in a satisfactory manner, that third parties will not assert other claims against the Company with respect to existing or future products or that licenses will be available on reasonable terms, or at all, with respect to any third party technology underlying any such claims. In the event of litigation to determine the validity of any third party claims, such litigation could result in significant expense to the Company and divert the efforts of the Company's technical and management personnel, whether or not such litigation is determined in favor of the Company.

Volatility of the Company's Common Stock. Market prices for securities of software companies have generally been volatile. In particular, the market price of the Company's Common Stock has been and may continue to be subject to significant fluctuations. These fluctuations may be due to factors specific to the Company (including those described above) or to factors affecting the computer industry or the securities markets in general.

1993 compared to 1992

Worldwide revenue increased 9% in 1993 as compared to 1992. Desktop revenue was essentially unchanged in 1993, while communications-related revenue grew approximately 55%.

Revenue from desktop applications was 79% of total revenue in 1993 and 84% of total revenue in 1992. In 1993, users continued to migrate from DOS-based applications to Windows-based applications. As a result, Windows revenue more than doubled as compared to 1992, while DOS-based revenue, particularly spreadsheets, declined approximately $215 million. Due to the full-fledged emergence of desktop "suites" in 1993, the Company's suite offering, SmartSuite, grew to represent approximately one-third of total 1993 Windows desktop applications revenue. Pricing declined during the first half of 1993, but remained relatively stable during the second half of 1993.

Significant new Windows desktop products released in 1993 included 1-2-3 for Windows Release 4.0, Improv for Windows Release 2.0, Freelance Graphics for Windows Release 2.0, Lotus Organizer for Windows Release 1.1 and SmartSuite for Windows Release 2.0. Also released in 1993 were 1-2-3 for OS/2 Release 2.0, Freelance Graphics for OS/2 Release 1.0, Ami Pro for OS/2 Release 3.0 and an OS/2 SmartSuite.

Communications products and services represented 19% of total revenue in 1993 as compared to 13% in 1992. Notes revenue more than doubled over 1992 and cc:Mail revenue grew considerably in 1993 as well. Consulting services revenue also increased significantly, resulting from internal growth and from the acquisition of several consulting businesses. New versions of Notes 3.0 were shipped for the Windows, Macintosh and OS/2 operating platforms in May 1993.

Revenue outside the United States grew by 12% during 1993 and accounted for 51% of worldwide revenue in 1993 as compared to 49% in 1992. The impact of foreign currency fluctuations on international revenue was insignificant in 1993 and in 1992.

Gross margin as a percentage of sales increased to 79% in 1993 compared with 78% in 1992. The rate was favorably affected by the achievement of manufacturing efficiencies resulting from higher production volumes, the closing of the Company's Puerto Rican manufacturing plant and material cost reductions.

The increase in operating expenses in 1993 reflected higher spending associated with the development and enhancement of the communications products as well as a substantial investment in the sales and marketing of the communications business and SmartSuite. During 1993, research and development expenses increased 7% compared with 1992, and sales and marketing expenses increased 9% compared with 1992. General and administrative expenses increased only 1% and reflected the Company's continued efforts to control infrastructure and fixed costs.

Interest income was higher in 1993 than 1992 because of higher average cash and short-term investment balances. Interest expense declined primarily due to scheduled repayments of long-term debt obligations.

In June 1993, the Company acquired Approach Software Corporation. The purchase price consisted of approximately $23 million of cash consideration and assumed liabilities. A significant portion of the purchase price was allocated to purchased research and development, resulting in a $19.9 million non-tax deductible charge to the Company's 1993 operations. Earnings for 1993, excluding the charge for purchased research and development, were $75.4 million or $1.69 per share.

Other income and expense in 1992 included a pre-tax gain of $49.7 million from the sale of the Company's investment in Sybase, Inc., offset by a restructuring charge of $15 million. The restructuring charge related principally to plans initiated by the Company in the fourth quarter of 1992 to close its Puerto Rican manufacturing subsidiary and to reorganize and centralize its North American and European operations related to logistics, distribution and support. Earnings for 1992, excluding the gain and the restructuring charge, were $57.2 million or $1.33 per share.

The effective tax rate for 1993 was 38% compared with 33% in 1992. The increase in the tax rate reflected the effect of the loss of tax benefits associated with the closing of the Company's Puerto Rican manufacturing plant, a one percentage point increase in the U.S. federal statutory tax rate, and the impact of the statutory rate change on deferred taxes in accordance with FAS 109

Liquidity and Capital Resources

Cash and short-term investments decreased $40 million to $376 million at December 31, 1994. The two primary sources of cash flow in 1994 were $97 million of cash generated by operations and $56 million in proceeds from the issuance of common stock under the Company's employee stock plans. The primary uses of cash flow for investing and financing activities were $44 million for the purchase of property and equipment, $39 million for payments for software and other intangibles, $66 million for acquisition payments, $28 million for the scheduled repayment of debt and $13 million to repurchase the Company's common stock under a previously announced buyback program.

A substantial portion of the Company's cash and short-term investments are either deposited in financial institutions located in Puerto Rico or held by subsidiaries outside the United States. These investments can be readily transferred to the United States as required, subject to income and/or withholding taxes upon repatriation, for which taxes have been provided.

The Company's financial resources are represented by cash, short-term investments and unused portions of credit facilities. The Company believes its financial resources and funds provided by ongoing operations are adequate to meet future liquidity requirements.

Lotus Development Corporation

Consolidated Statements of Operations

(In thousands, except per share data)	1994	1993	1992
	Years ended December 31,		
Net sales	$970,723	$981,168	$900,149
Cost of sales	172,325	202,443	200,103
Gross margin	798,398	778,725	700,046
Expenses:			
Research and development	158,669	126,884	118,308
Sales and marketing	497,396	462,658	423,813
General and administrative	68,520	70,057	69,103
Other (income)/expense, net (Note I)	68,214	17,357	(31,183)
Total expenses	792,799	676,956	580,041
Income before provision for income taxes	5,599	101,769	120,005
Provision for income taxes (Note H)	26,478	46,234	39,602
Net income (loss)	($20,879)	$55,535	$80,403
Net income (loss) per share	($0.44)	$1.24	$1.87
Shares used in calculation of net income (loss) per share	47,013	44,721	42,994

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

Lotus Development Corporation

Consolidated Balance Sheets

(In thousands)	December 31, 1994	1993
Assets		
Current assets:		
Cash and short-term investments (Note B)	$376,218	$416,693
Accounts receivable, net of allowances of $37,971 and $30,002	230,977	217,336
Inventory (Note C)	20,711	21,220
Other current assets	24,452	20,817
Total current assets	652,358	676,066
Property and equipment, net of accumulated depreciation and amortization of $185,286 and $153,768 (Note D)	138,664	127,437
Software and other intangibles, net of accumulated amortization of $128,140 and $123,016 (Note B)	96,228	88,625
Other assets (Note E)	16,829	13,217
Total assets	$904,079	$905,345

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

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(In thousands, except per share data)	December 31, 1994	1993
Liabilities and Stockholders' Equity		
Current liabilities:		
Current portion of long-term debt (Note I)	$ –	$28,480
Accounts payable	44,815	45,914
Accrued compensation and benefits	35,674	36,368
Accrued and deferred income taxes (Note H)	35,219	49,017
Other accrued expenses	74,516	77,648
Deferred revenue	70,130	39,996
Total current liabilities	260,354	277,423
Deferred income taxes (Note H)	39,595	49,531
Long-term debt (Note I)	50,000	50,000
Commitments and contingencies (Note F)		
Stockholders' equity (Note G):		
Preferred stock, $1.00 par value, 5,000 shares authorized, none issued	–	–
Common stock, $.01 par value, 200,000 and 100,000 shares authorized: 63,575 and 62,152 issued; and 47,849 and 44,928 outstanding	636	622
Additional paid-in capital	280,815	251,414
Retained earnings	507,380	526,554
Treasury stock, 15,726 and 17,224 shares at an average cost of $14.95 and $14.44 per share	(235,047)	(248,728)
Translation adjustment	346	(1,471)
Total stockholders' equity	554,130	528,391
Total liabilities and stockholders' equity	$904,079	$905,345

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

Lotus Development Corporation

Consolidated Statements of Cash Flows

(In thousands)	Years ended December 31 1994	1993	1[illegible]
Cash flows from operating activities:			
Net income (loss)	($20,879)	$55,535	$80,4
Gain on sale of investment in Sybase, Inc.	–	–	(49,7
Charge for purchased research and development	67,944	19,900	
Depreciation and amortization	87,392	86,973	84,3
Change in assets and liabilities, net of effects from acquisitions:			
(Increase) decrease in accounts receivable	1,031	(42,000)	(11,0
Decrease in inventory	3,237	3,207	7,6
Increase (decrease) in accounts payable and accrued expenses	(24,986)	10,832	(1,2
Increase (decrease) in accrued and deferred income taxes	(30,075)	11,892	20,6
Increase in deferred revenue	20,263	15,601	5
Net change in other working capital items	(6,532)	259	(3,1
Net cash provided by operating activities	97,395	162,199	128,3
Cash flows from investing activities:			
Purchases of property and equipment	(44,413)	(30,587)	(34,0
Payments for software and other intangibles	(39,265)	(36,771)	(39,31
Proceeds from sale of investment in Sybase, Inc.	–	–	77,71
Proceeds from sales (purchases) of short-term investments, net	84,702	(79,883)	(31,55
Payments for acquisitions, net of cash received	(66,345)	(15,455)	(8,72
Other, net	(2,449)	2,002	1,36
Net cash used for investing activities	(67,770)	(160,694)	(34,55
Cash flows from financing activities:			
Repayment of long-term debt	(28,480)	(30,260)	(30,26
Purchase of common stock for treasury	(12,625)	(8,107)	(35,87
Issuance of common stock, including tax benefit thereon	55,707	81,708	32,24
Decrease in short-term borrowings	–	(1,130)	(23,16
Net cash provided by (used for) financing activities	14,602	42,211	(57,05
Net increase in cash and cash equivalents	44,227	43,716	36,73
Cash and cash equivalents, beginning of year	164,849	121,133	84,40
Cash and cash equivalents, end of year	209,076	164,849	121,13
Short-term investments	167,142	251,844	171,961
Cash and short-term investments	$376,218	$416,693	$293,094

Supplemental Cash Flow Information

(In thousands)	1994	1993	1992
Interest received	$17,062	$9,971	$10,952
Interest paid	$5,765	$8,702	$13,970
Income taxes paid	$56,238	$24,698	$18,982

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

Lotus Development Corporation

Consolidated Statements of Stockholders' Equity

Years ended December 31, 1992, 1993, and 1994 *(In thousands)*	Common Stock	Additional Paid-In Capital	Retained Earnings	Treasury Stock	Translation Adjustment	Total
Balance, December 31, 1991	$613	$194,710	$390,615	($261,984)	($842)	$323,113
Net Income	–	–	80,403	–	–	80,403
Acquisition of 1,968 shares of common stock	–	–	–	(35,876)	–	(35,876)
Issuance of 395 shares of common stock under employee stock purchase plan	–	1,308	–	5,518	–	6,826
Exercise of 1,229 non-qualified stock options	9	20,722	–	4,687	–	25,418
Currency translation effect	–	–	–	–	(446)	(446)
Balance, December 31, 1992	622	216,740	471,019	(287,655)	(1,288)	399,438
Net income	–	–	55,535	–	–	55,535
Acquisition of 250 shares of common stock	–	–	–	(8,107)	–	(8,107)
Issuance of 360 shares of common stock under employee stock purchase plan	–	2,894	–	5,139	–	8,033
Exercise of 2,937 non-qualified stock options	–	22,604	–	41,895	–	64,499
Income tax benefit related to exercise of stock options	–	9,176	–	–	–	9,176
Currency translation effect	–	–	–	–	(183)	(183)
Balance, December 31, 1993	622	251,414	526,554	(248,728)	(1,471)	528,391
Net loss	–	–	(20,879)	–	–	(20,879)
Pooling of interests with Iris Associates, Inc. (Note K)	14	–	1,705	–	–	1,719
Acquisition of 323 shares of common stock	–	–	–	(12,625)	–	(12,625)
Issuance of 286 shares of common stock under employee stock purchase plan	–	6,807	–	4,135	–	10,942
Exercise of 1,535 non-qualified stock options	–	13,270	–	22,171	–	35,441
Income tax benefit related to exercise of stock options	–	9,324	–	–	–	9,324
Currency translation effect	–	–	–	–	1,817	1,817
Balance, December 31, 1994	$636	$280,815	$507,380	($235,847)	$346	$554,130

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

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Lotus Development Corporation

Notes to Consolidated Financial Statements

A Business

The Company and its subsidiaries are engaged in the development, manufacturing, marketing and support of applications software. The Company sells its products primarily through distributors and resellers.

B Summary of Significant Accounting Policies

Basis of Presentation

The consolidated financial statements comprise those of the Company and its wholly owned domestic and foreign subsidiaries. All significant intercompany accounts and transactions have been eliminated. Certain amounts in the financial statements of prior years have been reclassified to conform with the current year presentation.

Revenue Recognition

Revenue from the sale of software products to distributors, resellers and original equipment manufacturers is recognized when the products are shipped. Revenue is recognized from the sale of software products under installation agreements with end-users based upon the expected installation period, provided that payment is due currently. Maintenance, service and subscription revenue are recognized ratably over the term of the related sales contract or as services are performed. Allowances for estimated future product returns under the Company's agreements with its distributors and resellers for stock balancing and upgrade swaps are provided in the same period as the related revenue. Allowances for bad debts, which have not been material, are also provided.

At the time the Company recognizes revenue from the sale of software products, no significant vendor and postcontract support obligations remain, and the costs of insignificant support obligations are accrued.

Cash and Short-term Investments

All highly liquid investments with a maturity of three months or less at the date of purchase are considered to be cash equivalents, and those with maturities greater than three months are considered to be short-term investments. Short-term investments are stated at cost or amortized cost, which approximates market. Cash equivalents and short-term investments consist primarily of certificates of deposit, repurchase agreements, commercial paper, corporate bonds, Eurobonds, collateralized mortgage obligations and other money market instruments.

In the first quarter of 1994, the Company adopted Statement of Financial Accounting Standard No. 115, "Accounting for Certain Investments in Debt and Equity Securities" ("FAS 115"). The Company has the intent and ability to hold to maturity all securities that mature in less than one year. Accordingly, these "held-to-maturity" securities have been recorded at amortized cost. The Company has categorized all other securities as "available-for-sale," since the Company may liquidate these investments currently. FAS 115 requires that unrealized gains and losses on available-for-sale securities be excluded from earnings and reported in a separate component of stockholder equity. At December 31, 1994, the unrealized loss was immaterial.

The amortized cost of securities, which approximates fair value, consists of the following at December 31, 1994:

(In thousands)	Maturity		
Type of security	Less than one year	One to five years	Total
Corporate bonds and Eurobonds	$18,441	$51,058	$69,49
Commercial paper	17,704	199	17,90
Collateralized mortgage obligations	4,145	12,640	16,78
	40,290	63,897	104,18
Cash, other cash equivalents and other short-term investments			272,03
Total cash and short-term investments			$376,21

Inventory

Inventory is stated at cost, using the first-in, first-out (FIFO) method, but not in excess of net realizable value.

Property, Equipment and Depreciation

Property and equipment are stated at cost. Depreciation and amortization of property and equipment are computed using the straight-line method over the estimated useful lives of the asset as follows:

Buildings	30 year
Computer equipment	3–5 year
Manufacturing and other equipment	3–5 year
Furniture and fixtures	5 year
Leasehold improvements	Shorter of lease term or life of asse
Building improvements	Shorter of 10 years or life of asse

Maintenance and repairs are expensed as incurred. The costs of retired assets are removed from asset accounts and related depreciation is removed from accumulated depreciation.

Software and Other Intangibles

Costs related to research, design and development of computer software are charged to research and development expense as incurred. The Company capitalizes eligible software costs upon establishing product technological feasibility and amortizes these costs on a product-by-product basis commencing upon general release of the products to customers. Capitalized software costs are amortized on a straight-line basis over the economic life of the product, generally three years. The straight-line method of amortization generally results in approximately the same amount of expense as that calculated using the ratio that current period gross product revenues bear to the total of current and anticipated future gross product revenues. Internal software costs of $36.0 million, $25.0 million and $26.0 million were capitalized in 1994, 1993 and 1992. Related amortization charges of $29.1 million for 1994, $25.2 million for 1993 and $22.2 million for 1992 are reflected in cost of sales. The net amount of capitalized software was $53.6 million and $47.8 million as of December 31, 1994 and 1993.

Intangible assets of $21.8 million capitalized in 1994 were largely attributable to the acquisitions of Soft*Switch, Inc. and a consulting services business. Intangible assets of $15.2 million and $22.1 million capitalized in 1993 and 1992 were primarily related to other acquisitions. These assets are amortized on a straight-line basis, generally over a three to five year period. Related amortization charges, the majority of which were reflected in cost of sales, totaled $20.2 million in 1994, $22.5 million in 1993 and $19.2 million in 1992.

The Company evaluates the net realizable value of capitalized software and other intangibles on an ongoing basis relying on a number of factors including operating results, business plans, budgets and economic projections. In addition, the Company's evaluation considers non-financial data such as market trends, product development cycles and changes in management's market emphasis.

Income Taxes

Deferred tax liabilities and assets are determined based on the difference between the financial statement and tax basis carrying amounts of assets and liabilities using current statutory tax rates. A valuation reserve against deferred tax assets is recorded if, based upon weighted available evidence, it is more likely than not that some or all of the deferred tax assets will not be realized.

U.S. Federal income taxes, net of applicable foreign tax credits, are provided on the portion of foreign earnings which may be remitted to the Company's parent corporation in future years. Undistributed earnings of foreign affiliates reinvested in those operations indefinitely, and for which no U.S. taxes are provided, aggregated approximately $60 million and $40 million at December 31, 1994 and 1993.

Net Income (Loss) per Share

Per share amounts are calculated using the weighted average number of common shares and common share equivalents outstanding during periods of net income. Common share equivalents are attributable to unexercised stock options and are computed using the treasury stock method. Per share amounts are calculated using only the weighted average number of common shares outstanding during periods of net loss. Fully diluted net income per share is not materially different from reported primary net income per share.

Foreign Currency Translation

Assets and liabilities of foreign subsidiaries are translated to U.S. dollars at year-end exchange rates. Income and expense items are translated at average rates of exchange during the year. Resulting translation adjustments are accumulated in a separate component of stockholders' equity. The effect of exchange rate changes on cash and cash equivalents was immaterial in 1994, 1993 and 1992.

In an effort to minimize the effect of exchange rate fluctuations on the results of its operations and the asset and liability positions of foreign subsidiaries, the Company hedges certain portions of its foreign currency exposure through the use of forward exchange contracts and options on foreign currencies. The Company does not engage in foreign currency speculation. The cash flows related to the gains and losses on foreign currency hedges are classified in the statements of cash flows as part of cash flows from operating activities.

Forward exchange contracts totaling $55 million, primarily to exchange foreign currencies for U.S. dollars, were outstanding at December 31, 1994. These contracts are used to hedge asset and liability positions of foreign subsidiaries. Gains and losses associated with currency rate changes on these contracts are recorded currently in income, offsetting losses and gains on the related assets and liabilities. All contracts, which primarily hedge European currencies and Japanese yen, mature during 1995. Forward exchange contracts outstanding at December 31, 1993, totaling $50 million, matured during 1994.

Foreign currency options are used to hedge certain anticipated transactions denominated primarily in European currencies and Japanese yen. Potential losses on such contracts are limited to the cost of the options. Gains on such options are recorded in income only when realized, offsetting foreign exchange losses of the related transactions. There were no option contracts outstanding at December 31, 1994, and at December 31, 1993, the amount of option contracts outstanding was $96 million.

The market risk exposure from currency options is limited to the cost of such instruments. The market risk exposure from forward contracts is assessed in light of the underlying currency exposures and is controlled by the initiation of additional or offsetting foreign currency contracts. Credit risk exposure from currency options and forward contracts is minimized as these instruments are contracted with multiple financial institutions.

The fair value of currency options is established by obtaining bids, based upon a hypothetical sale of the options, from banks that are authorized currency traders. Forward contracts are revalued monthly by comparing contract rates to month-end exchange rates. The Company's currency options and forward contracts are over-the-counter instruments.

Financial Instruments

The fair values of financial instruments, including cash equivalents, short-term investments, marketable securities, debt, options on foreign currencies and forward exchange contracts, approximated their carrying values at December 31, 1994 and 1993. Fair values have been determined through information obtained from market sources and management estimates.

Diversification of Credit Risk

The Company's investment portfolio is diversified and consists of cash equivalents and short-term investments placed with high credit qualified institutions. At December 31, 1994 and 1993, approximately 40% and 41% of accounts receivable represented amounts due from ten customers. The credit risk in the Company's trade accounts receivable is substantially mitigated by the Company's credit evaluation process, reasonably short collection terms and the geographical dispersion of sales transactions.

C Inventory

Inventory consists of the following:

(In thousands)	December 31, 1994	1993
Finished goods	$13,041	$13,962
Raw materials	7,670	7,258
Total	$20,711	$21,220

D Property and Equipment

Property and equipment consists of the following:

(In thousands)	December 31, 1994	1993
Land	$5,800	$7,395
Buildings and building improvements	58,185	55,463
Leasehold improvements	38,891	36,699
Computer equipment	139,964	111,045
Manufacturing and other equipment	49,841	44,191
Furniture and fixtures	31,269	26,412
	323,950	281,205
Less accumulated depreciation and amortization	185,286	153,768
Property and equipment, net	$138,664	$127,437

E Other Assets

Other assets consist of the following:

(In thousands)	December 31, 1994	1993
Marketable securities	$3,004	$3,004
Deposits and other	13,825	10,213
Total	$16,829	$13,217

Marketable securities represent investments in interest bearing securities held at a custodial institution in Puerto Rico. These securities are carried at cost, which approximates market.

F Commitments and Contingencies

Lease Commitments

The Company leases certain facilities and equipment under various operating leases. At December 31, 1994, future minimum lease payments under operating leases with terms in excess of one year were as follows:

Year	(In thousands)
1995	$37,027
1996	32,171
1997	21,287
1998	17,003
1999	12,931
Future years	42,795
Total	$163,214

Total rental expense was approximately $43.7 million, $41.7 million and $40.2 million for the years ended December 31, 1994, 1993 and 1992.

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G Stock Plans

Stock Option Plans

The Company has stock option plans for employees and consultants which provide for non-qualified and incentive stock options. Options are granted at a price not less than the fair market value on the date of grant. The options generally become exercisable over a four-year period and expire over a period not exceeding ten years. At December 31, 1994, 2.6 million shares were available for grant.

The Company also has a stock option plan for non-employee directors which provides that each independent director of the Company be granted annually an option to acquire 10,000 shares of common stock at a price equal to the fair market value on the date of grant. The options become exercisable over a four year period and expire over a period not exceeding ten years. At December 31, 1994, 170,000 shares were available for grant.

Activity in these plans was as follows:

(In thousands, except option prices)	Years ended December 31, 1994	1993	1992
Shares under option, beginning of year	5,814	7,154	8,782
Options granted (at option prices of $30.50 to $64.50 in 1994, $19.63 to $47.38 in 1993, and $17.38 to $33.88 in 1992)	3,955(B)	2,453	788(A)
Options exercised	(1,535)	(2,937)	(1,229)
Options cancelled	(628)	(856)	(1,187)
Shares under option, end of year (at exercise prices of $16.00 to $64.50 in 1994, $16.00 to $47.38 in 1993, and $6.25 to $37.88 in 1992)	7,606	5,814	7,154
Average price of options exercised	$23.09	$22.09	$20.74
Shares exercisable	1,936	1,412	2,919
Average option price of shares exercisable	$23.16	$23.71	$22.49

(A) The Company's annual grant to employees, historically made in December, was moved to January 1993 to more closely link option grants to performance. In January 1993, the Company granted 1.8 million options at fair market value on the date of grant.

(B) In January 1994, the Company granted a total of 2.6 million options to its employees. Of the total grant, 1.6 million options were granted at fair market value at the date of the grant. The remaining 1.0 million options were granted at 120% of fair market value on the date of grant.

Employee Stock Purchase Plan

The Employee Stock Purchase Plan authorizes the Company to sell up to 4.1 million shares of common stock to employees through voluntary payroll withholdings. The stock price to employees is equal to 85% of the market price on the first or last day of each six-month withholding period, whichever is lower. Purchases are limited to ten percent of an employee's eligible compensation, subject to an annual maximum as defined in the plan. Through December 31, 1994, approximately 2.5 million shares were purchased by employees pursuant to the plan.

Shares issued to employees during the past three years are summarized in the table below.

(In thousands, except per share data)	Years ended December 31, 1994	1993	1992
Number of shares	286	360	395
Proceeds	$10,942	$8,033	$6,826
Average price per share	$38.21	$22.34	$17.29

H Income Taxes

The components of the provision for income taxes were as follows:

(In thousands)	Years ended December 31, 1994	1993	1992
Domestic:			
Current	$22,450	$18,437	$7,970
Deferred	(9,119)	7,581	17,902
	13,331	26,018	25,872
Foreign:			
Current	13,862	19,763	9,470
Deferred	(2,215)	(347)	3,460
	11,647	19,416	12,930
State:			
Current	1,500	800	800
Deferred	–	–	–
	1,500	800	800
Total:			
Current	37,812	39,000	18,240
Deferred	(11,334)	7,234	21,362
Total income taxes	$26,478	$46,234	$39,602

Income before provision for income taxes from domestic and foreign operations was as follows:

(In thousands)	Years ended December 31, 1994	1993	1992
Domestic	$37,080	$37,337	$72,622
Foreign	(31,481)	64,432	47,383
Total	$5,599	$101,769	$120,005

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Provisions for income taxes were at rates other than the U.S. Federal statutory tax rate for the following reasons:

	Years ended December 31,		
	1994	1993	1992
U.S. Federal statutory tax rate	35.0%	35.0%	34.0%
Foreign operations	1.3	4.4	(0.8)
Research and development credit	(5.0)	(4.5)	(4.0)
Impact of U.S. Federal statutory rate increase on beginning deferred taxes	–	2.0	–
Tax exempt Interest Income	–	(0.6)	(0.9)
Non-deductible amortization	2.2	2.0	3.7
State taxes	1.6	0.8	0.7
Other, net	0.9	(1.1)	0.3
Subtotal	36.0	38.0	33.0
Non-deductible charges for purchased research and development	436.9	7.4	–
Effective tax rate	472.9%	45.4%	33.0%

Consolidated results of operations in 1994 include results of manufacturing operations in Ireland and Singapore. In 1993 and 1992, net income also included income from the Company's Puerto Rican manufacturing subsidiary. Income from the sale and licensing of products manufactured or developed in Ireland is subject to a 10% tax rate through the year 2010. Income from Singapore operations is taxed at favorable rates, relative to U.S. statutory rates, until 1997 under a grant issued by the Singapore government. 1993 and 1992 income from products manufactured in Puerto Rico, which was not subject to U.S. Federal income tax, was subject to a local tax rate of approximately 5%. In addition, remitted Puerto Rico earnings may be subject to Puerto Rico withholding taxes at rates not in excess of 10%. The aggregate dollar and per share tax benefits from tax holidays were immaterial to the results of operations in 1994, 1993 and 1992.

For U.S. Federal income tax purposes, at December 31, 1994, the Company has tax credit carryforwards of approximately $41 million and a net operating loss carryforward of $16 million, which expire between 1996 and 2009. The net operating loss carryforward and approximately $1 million of tax credit carryforwards represent tax benefits resulting from the acquisition of Soft*Switch, Inc.

The Internal Revenue Service ("IRS") has proposed adjustments to the Company's U.S. income tax returns for the years 1985 through 1989. The Company will appeal these adjustments and believes that any sustained adjustments will not be material to the financial statements. The IRS has commenced its examination of the Company's U.S. income tax returns for the years 1990 through 1992. The Company believes that sustained adjustments, if any, from the examination will not be material to the financial statements.

Deferred taxes result from temporary differences in the recognition of revenues and expenses for tax and financial reporting purposes. The sources of these temporary differences for 1994, 1993 and 1992, and the effect of each on the tax provision, were as follows:

	Years ended December 31,		
(In thousands)	1994	1993	1992
Unrepatriated foreign earnings, net	($8,101)	$14,110	$11,911
Depreciation	(980)	(1,130)	(1,769)
Compensation	(1,048)	(1,423)	4,338
Capitalized software costs	566	1,590	557
Charges to (provision for) reserves	(268)	(1,654)	2,031
Deferred revenue	–	(2,171)	3,628
Other, net	(1,503)	(2,088)	666
Total	($11,334)	$7,234	$21,362

The components of the net deferred tax liability are as follows.

	December 31,	
(In thousands)	1994	1993
Deferred tax assets:		
Reserves	$13,587	$16,352
Depreciation	5,072	5,871
Tax credits against unrepatriated foreign earnings	85,045	77,363
Tax return carryforwards	47,131	48,233
Deferred revenue	2,770	2,574
Other	12,458	11,934
Total	166,063	162,327
Valuation allowances (A)	49,162	35,794
Net deferred tax assets	116,901	126,533
Deferred tax liabilities:		
Capitalized software costs	10,947	10,381
Unrepatriated foreign earnings	114,832	130,417
Compensation	99	2,972
Other	4,601	6,389
Total	130,479	150,159
Net deferred tax liability	$13,578	$23,626

(A) The valuation allowance at December 31, 1994 and 1993 includes $10 million for foreign tax benefits. During 1994, a $7 million valuation allowance was established for tax benefits resulting from the acquisition of Soft*Switch, Inc. due to the limitations imposed by U.S. tax rules on the use of tax benefits following certain changes in ownership. In addition, valuation allowances of $32.2 million and $25.8 million at December 31, 1994 and 1993 have been established for tax return carryforwards resulting from stock option compensation deductions. The tax benefit associated with the stock option compensation deductions will be credited to equity when realized.

I Debt

Long-term Debt

Long-term debt consists of the following:

(In thousands)	December 31, 1994	1993
Notes payable to banks, bearing interest at LIBOR plus 0.45% per annum	$50,000	$50,000
Notes payable to insurance companies, bearing interest at 10.57% per annum	–	28,480
Total debt	50,000	78,480
Less current portion	–	28,480
Long-term debt	$50,000	$50,000

In July 1990, the Company completed a $50 million floating rate financing with a group of banks collateralized by its office facility in Cambridge, Massachusetts. Principal payment of the notes is due in 1997.

In May 1989, the Company arranged a $100 million private debt placement with a group of insurance companies. The final principal payment of $28 million was paid in June 1994.

The Company renegotiated its revolving credit agreements during 1994 and now maintains one multi-currency revolving credit agreement with a group of domestic and international banks. The agreement, which expires June 1997, commits the participating banks, subject to certain terms and conditions, to lend an aggregate of $150 million. There were no borrowings under this credit agreement as of December 31, 1994. Interest rates on borrowings are set under a number of bid options not exceeding .425% over LIBOR. Commitment fees are payable on unborrowed amounts at a maximum rate of 1/8% per annum. The Company is required to maintain a minimum level of net worth as well as a maximum debt to net worth ratio, among other things specified in the revolving credit agreement. The Company was in compliance with the covenants of its credit agreement at December 31, 1994.

Short-term Debt

The Company occasionally borrows under unsecured credit facilities with several domestic and international banks in order to meet short-term domestic and international cash requirements. There were no such borrowings at December 31, 1994 and 1993. As of December 31, 1994, the Company had unused short-term credit facilities of $29 million.

J Other (Income)/Expense, Net

Other (income)/expense consists of the following:

(In thousands)	Years ended December 31, 1994	1993	1992
Charges for purchased research and development (Note K)	$67,944	$19,900	$ –
Restructuring charges	9,000	–	15,000
Gain on sale of investment in Sybase, Inc.	–	–	(49,706)
Interest income	(16,442)	(11,890)	(10,679)
Interest expense	5,295	8,525	13,547
Other, net	2,417	822	655
Total other (income)/expense, net	$68,214	$17,357	($31,183)

In the third quarter of 1994, the Company acquired all outstanding shares of Soft•Switch, Inc. and Edge Research, Inc. A significant portion of the purchase price of these acquisitions, $67.9 million, was allocated to purchased research and development. This amount, which is not deductible for tax purposes, was charged to operations in the third quarter of 1994.

In the third quarter of 1994, the Company recorded a $9 million restructuring charge related to its European operations and the discontinuation of a product. European restructuring activities include the streamlining of the marketing organization from a product focus to a market segment focus, the centralization of certain finance and administration functions, and a reduction in desktop applications support staff. The charge related to the discontinued product reflects a $1.1 million write-off of capitalized software due to the decision in the third quarter of 1994 to discontinue further development and marketing.

In June 1993, the Company acquired all outstanding shares of Approach Software Corporation. A significant portion of the purchase price, $19.9 million, was allocated to purchased research and development. This amount, which is not deductible for tax purposes, was charged to operations at the acquisition date.

In December 1992, the Company recorded a restructuring charge of $15 million for employee separations and related facilities consolidations and equipment write-downs associated with the closing of its Puerto Rican manufacturing facility and the restructuring of operations in North America and Europe.

In 1992, the Company sold its investment in Sybase, Inc., for cash consideration of $77.7 million, resulting in a pre-tax gain of $49.7 million. The investment of $28.0 million consisted of 2.5 million common shares and was accounted for at cost.

K Acquisitions and Dispositions

Iris Associates, Inc.

In May 1994, the Company acquired all outstanding shares of Iris Associates, Inc. ("Iris"), the privately held developer of Lotus Notes ("Notes"), in exchange for approximately 1.4 million shares of Lotus common stock. The transaction was accounted for as a pooling of interests. Acquired net assets of approximately $1.7 million have been recorded at historical amounts. Prior periods were not restated due to immateriality, and, accordingly, results of operations have been included since the date of acquisition. Prior to the combination, the Company funded the development of Notes and paid royalties to Iris based upon product sales.

Soft*Switch, Inc.

In July 1994, the Company acquired all outstanding shares of Soft*Switch, Inc. ("Soft*Switch"), a privately held developer of electronic mail message switches that link disparate electronic messaging systems. The two principal products sold by Soft*Switch at the acquisition date were Soft*Switch Central, a mainframe-based message switch, and EMX, a LAN-based message switch. The total purchase price of $77.5 million consisted of approximately $64.3 million of cash consideration, $8 million of assumed liabilities and $5.2 million of deferred tax liabilities. The acquisition was accounted for using the purchase method.

The purchase price was allocated among the identifiable tangible and intangible assets based on the fair market value of those assets. Purchased software that had reached technological feasibility, and was principally represented by the technology comprising the Central product, was valued using a risk adjusted cash flow model, under which future cash flows were discounted taking into account risks related to existing and future markets and an assessment of the life expectancy of the purchased software. This analysis resulted in an allocation of $15 million to purchased software, which was capitalized and is being amortized over five years.

Purchased research and development that had not reached technological feasibility and that had no alternative future use was valued using the same methodology. Purchased research and development that had not reached technological feasibility is represented by the EMX technology. Expected future cash flows associated with in-process research and development were discounted considering risks and uncertainties related to the viability of and potential changes in future target markets and to the completion of the products that will ultimately be marketed by the Company. This analysis resulted in an allocation of $62.5 million to purchased research and development expense. This amount, which is not deductible for tax purposes, was charged to operations at the acquisition date.

Soft*Switch's operating results have been included in the consolidated financial statements from the date of acquisition. Pro forma statements of operations would not differ materially from reported results.

Edge Research, Inc.

In September 1994, the Company acquired all the outstanding shares of Edge Research, Inc. ("Edge"), a privately held developer of applications development tools for Lotus Notes, for approximately $5.4 million of cash consideration. The acquisition was accounted for using the purchase method. Using methodology consistent with that used to account for the Soft*Switch acquisition, the Company identified no tangible or intangible assets, other than research and development that had not reached technological feasibility and had no alternative future use. This analysis resulted in the allocation of $5.4 million to purchased research and development expense. This amount, which is not deductible for tax purposes, was charged to operations at the acquisition date.

Edge's operating results have been included in the consolidated financial statements from the date of acquisition. Pro forma statements of operations would not differ materially from reported results.

Approach Software Corporation

In June 1993, the Company acquired all outstanding shares of Approach Software Corporation ("Approach"), a privately held developer of end-user relational database applications for the Windows environment. The purchase price consisted of approximately $23 million of cash consideration and assumed liabilities. The acquisition has been accounted for using the purchase method.

The purchase price was allocated among the identifiable tangible and intangible assets based on the fair market value of those assets. After allocating the purchase price to net tangible assets, purchased software that had reached technological feasibility, and was principally represented by the technology comprising the database products being sold by Approach at the date of the acquisition, was valued using a risk adjusted cash flow model, under which future cash flows were discounted taking into account risks related to existing and future markets and an assessment of the life expectancy of the purchased software. This analysis resulted in an allocation of $3.4 million to purchased software, which was capitalized and is being amortized over three years.

Purchased research and development that had not reached technological feasibility and which had no alternative future use was valued using the same methodology. Expected future cash flows associated with in-process research and development were discounted considering risks and uncertainties related to the viability of and potential changes in future target markets and to the completion of the products that will ultimately be marketed by the Company. This analysis resulted in an allocation of $19.9 million to purchased research and development expense. This amount, which is not deductible for tax purposes, was charged to operations at the acquisition date.

Approach's operating results have been included in the consolidated financial statements from the date of acquisition. Pro forma statements of operations would not differ materially from reported results.

One Source

Effective August 28, 1993, the Company sold its One Source business, a developer and marketer of CD-ROM information products. Total consideration received was immaterial and no gain or loss was recognized on the sale. The financial statements reflect the operations of One Source through the effective date.

L Employee Benefit Plans

The Company maintains a discretionary, non-contributory profit sharing plan for its employees. Contributions are based on a percentage of consolidated operating profit and are allocated among employees on the basis of compensation received during the plan year. Profit sharing expense was $6.9 million, $11.1 million and $7.1 million in 1994, 1993 and 1992.

In the U.S., the profit sharing plan was integrated with a pension plan which provided a minimum guaranteed defined benefit based on the employee's years of service and final average compensation. In June 1992, the Company elected to suspend the pension plan with the intent to terminate at a future date. The curtailment did not have a material impact on the Company's financial statements, nor will the expected termination. The actuarially determined pension cost related to the minimum guaranteed retirement benefit under the pension plan was not significant in 1994, 1993 and 1992.

Additionally, the Company offers a savings plan which allows eligible U.S. employees to make tax-deferred contributions, a portion of which are matched by the Company. Company contributions under the savings plan were $4.3 million in 1994, $3.8 million in 1993 and $3.2 million in 1992.

The Company also maintains retirement plans, principally defined contribution plans, covering substantially all of its international employees. Costs related to these plans amounted to approximately $4.0 million in 1994, $3.4 million in 1993 and $3.2 million in 1992.

The Company does not offer postretirement benefits other than those described above.

M International Operations

Sales and marketing operations outside the United States are conducted principally through foreign sales subsidiaries and through various representative and distributorship arrangements.

The Company's international manufacturing operations are located in Ireland and Singapore. The products of these manufacturing facilities are sold through the Company's foreign sales subsidiaries and, where the Company has not established a presence of its own, direct to distributors in those countries. Other financial information by geographical area is summarized below:

(In thousands)	North America	Asia Pacific	Europe/Other	Eliminations	Consolidated
1994:					
Net sales	$544,486	$173,026	$258,461	($5,250)	$970,723
Operating income (loss):					
By area	55,453	45,162	(24,796)	1,803	77,622
Corporate expenses					(80,753)
Other Income/(expense)					8,730
Income before provision for income taxes					5,599
Total assets	$526,525	$179,097	$213,670	($15,213)	$904,079
1993:					
Net sales	$531,536	$149,700	$308,938	($9,006)	$981,168
Operating income:					
By area	51,151	34,085	46,659	(441)	131,454
Corporate expenses					(32,228)
Other income/(expense)					2,543
Income before provision for income taxes					101,769
Total assets	$489,419	$130,869	$299,577	($14,520)	$905,345
1992:					
Net sales	$494,592	$116,199	$300,049	($10,691)	$900,149
Operating income:					
By area	34,972	25,066	26,019	(567)	85,490
Corporate expenses					(11,668)
Other income/(expense)					46,183
Income before provision for income taxes					120,005
Total assets	$431,487	$78,545	$266,017	($12,605)	$763,444

Sales between geographic areas presented are insignificant. For this presentation, corporate expenses includes certain expenses incurred at the Company's corporate offices and charges for purchased research and development. U.S. research and development expenses were allocated to geographic areas on the basis of sales. Other income/(expense) includes interest income, interest expense, other expense, net, and in 1992, the $49.7 million gain on the sale of investment in Sybase, Inc.

The decrease in operating income in the Europe/Other region in 1994 as compared to 1993 and 1992 was attributable to a decline in desktop applications revenue, which resulted from severe competition in Europe. The decrease in assets in the Europe/Other region in 1994 as compared to 1993 was due to lower cash and receivable balances, which resulted from the decline in revenue and the operating loss in Europe. The increase of assets in the Asia Pacific region is due to the accumulation of unremitted earnings of the region.

Sales to unaffiliated customers outside the United States, including U.S. export sales, were $470.2 million for 1994, $485.9 million for the year 1993 and $434.9 million for the year 1992. In 1994, one customer accounted for 13% of worldwide sales. In 1993, one customer accounted for 12% of worldwide sales and a second customer accounted for 11% of such sales. No one customer accounted for more than 10% of worldwide sales in 1992.

N Shareholder Rights Plan

The Company has a shareholder rights plan which grants to holders of record one stock purchase right per share of common stock upon the occurrence of certain triggering events. Such events would include the acquisition of Lotus shares through open market purchases or a tender offer that, in the aggregate, equal or exceed 15% of outstanding shares.

Should a triggering event occur, holders of such rights would be entitled to purchase Lotus common stock (or stock of the acquiring entity, as the case may be) at a 50% discount from its then current market value. Each right entitles the holder to purchase shares with a market value aggregating $150 for a price of $75. Such rights do not extend to any holder whose action triggered the rights.

The rights expire in November 1998 and may be redeemed prior to that time at the option of the Board of Directors for nominal consideration. Until a triggering event occurs, the rights will not trade separately from the related Lotus common stock.

Report of Independent Accountants

To the Stockholders and Board of Directors of
Lotus Development Corporation

We have audited the accompanying consolidated balance sheets of Lotus Development Corporation as of December 31, 1994 and 1993, and the related consolidated statements of operations, cash flows, and stockholders' equity for each of the three years in the period ended December 31, 1994. 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 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. 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 consolidated financial position of Lotus Development Corporation as of December 31, 1994 and 1993, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1994, in conformity with generally accepted accounting principles.

Coopers + Lybrand L.L.P.

Coopers & Lybrand L.L.P

Boston, Massachusetts
January 24, 1995

Lotus Supplemental Financial Information

Five-Year Summary of Selected Financial Data

(In thousands, except per share data)	1994	1993	1992	1991	1990
Net sales	$970,723	$981,168	$900,149	$828,895	$692,242
Income before provision for income taxes	5,599	101,769	120,005	67,686	52,826
Net income (loss)	(20,879)	55,535	80,403	33,116	23,254
Net income (loss) per share	(0.44)	1.24	1.87	0.75	0.54
Total assets	904,079	905,345	763,444	725,537	656,807
Cash and short-term investments	376,218	416,693	293,094	224,810	245,386
Working capital	392,004	398,643	296,166	207,670	226,961
Long-term debt	50,000	50,000	108,740	139,000	160,000
Stockholders' equity	554,130	528,391	399,438	323,113	309,439

Quarterly Results of Operations
(Unaudited)

(In thousands, except per share data)	1994, Three Months Ended April 2	July 2	Oct 1	Dec 31	Year
Net sales	$246,992	$224,009	$235,246	$264,476	$970,723
Gross margin	200,584	185,141	192,516	220,157	798,398
Income (loss) before provision for income taxes	33,346	15,186	(65,504)	22,571	5,599
Net income (loss)	21,341	9,719	(66,385)	14,446	(20,879)
Net income (loss) per share	$0.45	$0.20	($1.39)	$0.30	($0.44)
Common stock prices					
High	86½	73½	46½	46¼	86½
Low	51¾	33	29¼	34	29¼

(In thousands, except per share data)	1993, Three Months Ended April 3	July 3	Oct 2	Dec 31	Year
Net sales	$227,004	$235,785	$240,104	$278,275	$981,168
Gross margin	176,625	184,751	193,295	224,054	778,725
Income before provision for income taxes	20,791	5,949	28,600	46,429	101,769
Net income (loss)	12,267	(4,649)	18,304	29,613	55,535
Net income (loss) per share	$0.29	($0.11)	$0.41	$0.64	$1.24
Common stock prices					
High	28½	37	48¼	58¼	58¼
Low	18¼	23½	30¼	41¼	18¼

The Company has historically not paid cash dividends on its common stock and has retained earnings for use in its business.

At the end of 1994, the number of shareholders of the Company's common stock was approximately 46,000.

Notes to Supplemental Financial Information and Quarterly Results of Operations:

(1) 1994 amounts include a charge to operations of $67.9 million, or $1.40 per share, in the third quarter for purchased research and development related to the acquisitions of Soft*Switch, Inc. and Edge Research, Inc. 1994 amounts also include a restructuring charge in the third quarter of $9 million on a pre-tax basis and $5.8 million, or $0.12 per share, on an after-tax basis.

(2) 1993 amounts include a charge to operations of $19.9 million, or $0.45 per share, in the second quarter for purchased research and development related to the acquisition of Approach Software Corporation.

(3) 1992 amounts include gains on the sale of the Company's investment in Sybase, Inc. of $34.6 million in the third quarter and $15.1 million in the fourth quarter resulting in a total gain for the year of $49.7 million on a pre-tax basis and $33.3 million, or $0.77 per share, on an after-tax basis. 1992 amounts also include a restructuring charge in the fourth quarter of $15 million on a pre-tax basis and $10.1 million, or $0.23 per share, on an after-tax basis.

(4) 1991 amounts include a fourth quarter restructuring charge of $23 million on a pre-tax basis and $18.6 million, or $0.42 per share, on an after-tax basis.

(5) 1990 amounts include a charge to operations of $53 million, or $1.23 per share, in the fourth quarter for purchased research and development related to the acquisition of Samna Corporation.

(6) The Company's common stock is traded on the over-the-counter market and is quoted on the NASDAQ National Market System under the symbol LOTS.

Board of Directors

Jim Manzi
President, CEO and Chairman of the Board
Lotus Development Corporation

Richard S. Braddock
Partner
Clayton, Dubilier, and Rice

Elaine L. Chao
President and CEO
United Way of America

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President and CEO
United Negro College Fund

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Genzyme Corporation

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Communications Business Group
Chief Technology Officer

Ilene H. Lang
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Desktop Business Group

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Senior Vice President
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Vice Presidents

Jeffrey Beir
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Desktop Product Line

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Vice President
Worldwide Operations and Information Systems

Saburo Kikuchi
President
Lotus Development Japan

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Communications Products Group
Finance and Business Development

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Inter-enterprise Communications Division

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Iris Associates

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Vice President
Lotus Consulting

Eileen Rudden
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Inter-enterprise Communications Division

John C. Throckmorton
Vice President
Word Processing Division

Michael Wyzga
Vice President
Worldwide Sales and Marketing
Plans and Controls

Michael Zisman
Vice President
Communications Products Group

Shareholder Information

Annual Meeting
The Annual Meeting of Shareholders will be held on Tuesday, May 2, 1995 at 10:00 a.m. at the following location:

Museum of Transportation
Larz Anderson Park
15 Newton Street
Brookline, Massachusetts

Copies of Lotus' Annual Report on Form 10-K are available, without charge, upon request from:

Kay Waxman
Director of Investor Relations
Lotus Development Corporation
55 Cambridge Parkway
Cambridge, Massachusetts 02142

To request further information about Lotus Development Corporation, please contact the Investor Relations Information Line at (617) 693-1900.

Common Stock
Lotus' common stock is traded over the counter on the NASDAQ National Market System — symbol LOTS.

Auditors
Coopers & Lybrand L.L.P.
Boston, Massachusetts

Legal Counsel
Baker & Botts, L.L.P.
New York, New York

Transfer Agent
Bank of Boston
Boston, Massachusetts
(617) 575-2900

Corporate Directory

Corporate Headquarters
55 Cambridge Parkway
Cambridge, Massachusetts 02142
(617) 577-8500

Lotus North American Offices
Phoenix, Arizona
Irvine, California
Los Angeles, California
Mountain View, California
San Francisco, California
Denver, Colorado
Farmington, Connecticut
Del Ray Beach, Florida
Key Largo, Florida
Miami, Florida
Orlando, Florida
Atlanta, Georgia
Chicago, Illinois
Overland Park, Kansas
Boston, Massachusetts
Detroit, Michigan
Grand Rapids, Michigan
Minneapolis, Minnesota
St. Louis, Missouri
Edison, New Jersey
Clifton Park, New York
New York, New York
Rochester, New York
Clemmons, North Carolina
Durham, North Carolina
Cincinnati, Ohio
Cleveland, Ohio
Columbus, Ohio
Bala Cynwyd, Pennsylvania
Pittsburgh, Pennsylvania
Wayne, Pennsylvania
Newport, Rhode Island
Chattanooga, Tennesee
Austin, Texas
Dallas, Texas
Houston, Texas
Arlington, Virginia
Seattle, Washington
Calgary, Alberta
Vancouver, B.C.
Ottawa, Ontario
Toronto, Ontario
Montreal, Quebec

Manufacturing and Distribution
Lotus Development Corporation
North Reading, Massachusetts

Lotus Development B.V.
Dublin, Ireland

Lotus Development Distribution Ltd.
Dublin, Ireland

Lotus Development B.V.
Singapore, Republic of Singapore

International Locations
Lotus Development Pty. Ltd.
Sydney, Melbourne, Canberra, Brisbane and Perth, Australia

Lotus Development GmbH
Vienna, Austria

Lotus Development Benelux BV
Brussels, Belgium

Lotus Desenvolvimento de Software Ltda.
São Paulo and Rio de Janeiro, Brazil

Lotus Development SOLA
(Argentina, Bolivia, Chile, Paraguay, Peru, Uruguay)
Santiago, Chile

Lotus Development Czech Republic
Prague, Czech Republic

Lotus Development Denmark A/S
Horsholm, Denmark

Lotus Development Finland
Helsinki, Finland

Lotus Development SA
Paris, France

Lotus Development GmbH
Berlin, Düsseldorf, Frankfurt, Hamburg Stuttgart and Munich, Germany

Lotus Development Software (Hong Kong) Ltd.
Hong Kong

Lotus Development Hungary
Budapest, Hungary

Lotus Development India
New Delhi, India

Lotus Development European Corporation
Jakarta, Indonesia

Lotus Development Ireland
Dublin, Ireland

Lotus Development Italia SPA
Milan and Rome, Italy

International Locations (continued)

Lotus Development Software, Ltd.
Tel Aviv, Israel

Lotus Development Japan, Ltd.
Tokyo, Japan

Lotus Sales and Services Sdn Bhd
Kuala Lumpur, Malaysia

Lotus Development Corporation de Mexico, S.A. de C.V.
Mexico City, Mexico

Lotus Development Benelux BV
Diemen, The Netherlands

Lotus Development B.V.
Curaçao, Netherlands Antilles

Lotus Development Pty. Ltd.
Auckland and Wellington, New Zealand

Lotus Development Norway
Oslo, Norway

Lotus Development Pte. Ltd.
Beijing, People's Republic of China

Lotus Development Poland
Warsaw, Poland

Lotus Development European Corporation
Lisbon, Portugal

Lotus Development Russia
Moscow, Russia

Lotus Development B.V.
Singapore, Republic of Singapore

Lotus Development SA Pty. Ltd.
Johannesburg, South Africa

Lotus Development Korea Ltd.
Seoul, South Korea

Lotus Development Iberica S.A.
Barcelona and Madrid, Spain

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Stockholm, Sweden

Lotus Development (Schweiz) AG
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Taipei, Taiwan

Lotus Development Middle East Office
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Lotus Development U.K. Ltd.
Staines, Slough, Manchester and Edinburgh, U.K.

Lotus Development Corporation
Caracas, Venezuela

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