Bickerstaff, Heath & Smiley

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98 San Jacinto Boulevard
Austin, Texas 78701-4039

512/472-8021
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April 22, 1991

VIA FEDERAL EXPRESS

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Mr. Steve Tribble
Director, Division of Records and Reporting
State of Florida Public Service Commission
Fletcher Building
101 East Gaines Street
Tallahassee, Florida 32399-0870

RE: Inter-Tel NetSolutions, Inc.'s Application (No. 910155-TI) for Certificate of Public Convenience and Necessity to Provide Interexchange Telecommunications Services

Dear Mr. Tribble:

Enclosed please find the original and 12 copies of Inter-Tel, Inc.'s 1990 Annual Report to be included with our application filing package (Document No. 01483).

Thank you for your assistance.

Very truly yours,

Robin A. Casey

Robin A. Casey

Enclosures

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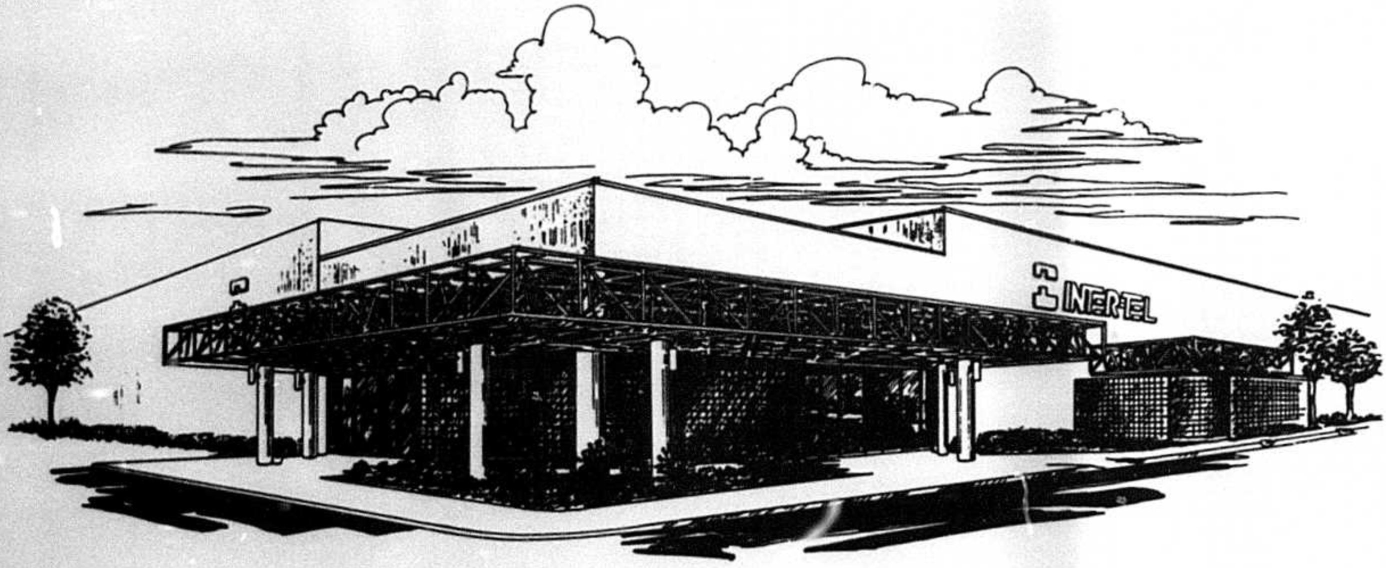
1990 ANNUAL REPORT

INTER-TEL

People and Technology Serving People™

Our Mission



Inter-Tel Corporate Headquarters in Chandler, Arizona.

Our Mission is to always keep in mind that we are in the business of SERVICE — before, during and after the sale. Every person at Inter-Tel knows that he or she works for the customer. And unless the customer receives more than just a product, the customer has received less than they deserve.

Next, we must provide PRODUCTS which are market driven. In other words, we must create technologically advanced products at competitive prices. Products which allow our customers — large or small — to function in a modern office environment at maximum efficiency.

Finally, in order for Inter-Tel to provide the best service and products, we must receive a fair PROFIT. With a fair profit, there can be peace of mind for our customers, there can be security for our people, there can be a return for our shareholders, and there can be continued growth for Inter-Tel, which ensures excellence in our service and products.

INTER-TEL INCORPORATED AND SUBSIDIARIES

FINANCIAL SUMMARY

(In thousands, except per share amounts)	For the years ended December 31, 1990	1989	1988	1987	November 30, 1986
Net Sales	$67,359	$61,588	$62,596	$49,405	$36,526
Other Income	578	511	625	733	554
Costs of Sales	42,215	37,236	38,514	30,033	22,786
Research & development expenses	3,381	3,101	2,500	1,989	1,503
Selling, general and administrative	18,415	19,358	18,310	13,754	11,374
Interest expense	1,449	1,553	900	758	649
Income taxes	1,147	330	1,245	1,661	360
Net Income before Extraordinary Item	$ 1,330	$ 521	$ 1,752	$ 1,943	$ 408
Extraordinary Item — Tax Benefit Carryforward				300	
Net Income	$ 1,330	$ 521	$ 1,752	$ 2,243	$ 408
Income per Share:					
Before Extraordinary Item	$ .16	$ .06	$ .20	$ .23	$ .05
Extraordinary Item				.04	
Net Income per Share	$ .16	$ .06	$ .20	$ .27	$ .05
Average shares outstanding	8,290	8,614	8,808	8,250	8,425
Total assets	$40,704	$45,774	$44,186	$43,936	$25,775
Working capital	9,852	8,718	8,292	9,243	10,794
Long-term debt	7,751	8,557	8,309	8,742	5,470
Shareholders' equity	20,946	20,438	20,978	18,734	14,782

STOCK DATA

Inter-Tel common stock is traded over-the-counter (symbol INTL) and since February 1983 has been included in the NASD national market system. As of February 1,1991 there were of record approximately 1,090 shareholders of the Company's common stock. The following table sets forth high and low closing prices reported by NASDAQ.

1990	High	Low
First Quarter	2½	1⅜
Second Quarter	2	1¼
Third Quarter	2¼	1¼
Fourth Quarter	2⅛	1

1989	High	Low
First Quarter	2⅝	1⅞
Second Quarter	2⅝	2½
Third Quarter	2⅜	1¾
Fourth Quarter	2	1⅛

Inter-Tel intends to retain its earnings for use in the development of its business and does not intend to pay cash dividends.

INTER-TEL

TO OUR SHAREHOLDERS:

I would like to share with you how current world conditions are affecting Inter-Tel, and what we are doing to insure our success during these uncertain times. Tough times are not new to Inter-Tel. Our Company was founded in the midst of the Vietnam War in 1969, the following year was a recession year and our industry has been in a virtual recession for the past five years. This time, however, Inter-Tel is better prepared and financially stronger.

To withstand the effects of these times, Inter-Tel is embarking on a three part strategy to further strengthen the Company and give us a competitive edge.

WORLD CLASS MANAGEMENT

The first and most important part of our strategy is World Class Management, a continuing process which takes time and dedication to implement and achieve. It involves everyone at Inter-Tel and begins with the unwavering commitment of senior management. Over time, everyone at Inter-Tel will be involved in the training necessary to learn this process. The process eliminates waste and increases everyone's awareness of the need for quality in every aspect of our business. The outcome is better service to our customers, better products and ultimately a better, more profitable company.

CONTAINMENT AND REDUCTION OF COSTS

The second part of our strategy is the continual reduction and containment of costs. Even though Inter-Tel continues to improve its position in the key system and PABX industry, we have seen a decline in demand and profit margins in the industry are the lowest in history. To maintain and continue to improve our position we are taking steps to contain dramatically rising health care costs, restrict personnel increases, control variable expenses and limit capital expenditures. In addition, as a demonstration of senior management's commitment, the senior managers and I have taken an overall 28 percent decrease in compensation.

BUSINESS OPPORTUNITIES

The third and most positive part of our strategy is to take advantage of business opportunities which exist in the market. We have formed a new subsidiary, Inter-Tel NetSolutions, Inc., to sell long-distance and network services to our large base of existing customers. In addition, we are introducing our new voice mail system, the Inter-Tel Envoy, and we are putting increased effort into our Medalist dealers, our direct offices and our sales in England and Europe. We are also taking advantage of the weakened condition of our competitors by acquiring customer bases in areas where we have direct offices. Early results suggest that these efforts will be very successful. However, it is too soon to predict with absolute certainty the eventual outcome of our endeavors.

INTER-TEL

1990 RESULTS — 1991 PROSPECTS

Despite softening demand from some wholesale customers and production shortages in the last half of 1990, net sales for the year were a record $67.4 million, up 9% over 1989. This increase was principally attributable to higher OEM sales. Our Direct Sales branches recorded a slight decrease in volume while our United Kingdom subsidiary accelerated its operations and is up and running.

Net earnings rebounded to $1,330,000 or $.16 a share from $521,000 or $.06 a share in 1989. While this result was below our plan, it marks the fifth consecutive year of profitability for Inter-Tel, a performance unique in our market niche.

The year was not without disappointment. The import penalty duty on assemblies manufactured in Korea continued to have an adverse effect. Such duties totalled $755,000 and reduced net income after taxes by $.05 a share. On the positive side, certain assemblies previously in question were declared exempt from the additional 13.4% duty.

As we announced last year, Inter-Tel has reviewed alternate sourcing opportunities to avoid duty costs entirely. We are moving production of affected assemblies to other locations, including the Philippines and the United States. Inter-Tel's smallest system, the GLX, is already in production in the Philippines, as are various other assemblies. However, the transition has been slower than expected and delays which caused product shortages had a negative impact on fourth quarter sales and expected sales during the first half of 1991.

The network services and long-distance business which Inter-Tel NetSolutions began last year is most promising. We have already filed tariffs and qualified in several states. These services will be expanded nationwide. Inter-Tel NetSolutions' ability to leverage on the existing infrastructure of the Inter-Tel Direct Sales branches and dealer network will enhance the profitability of these new services. We expect this new business to contribute to profits during the second half of 1991.

All of us at Inter-Tel are confident we will meet the challenges of the present and will seize the opportunities of the future. We appreciate the support of our dedicated employees, suppliers, customers and particularly our shareholders, as we carry out our strategies for success.

Steven G. Mihaylo
Chairman and Chief Executive Officer

ANOTHER STANDOUT YEAR . . .

Throughout Inter-Tel's history, there have been many years that stand out. One such year was 1973, when the company formed its research and development team. Another was 1975, when the first system completely designed by Inter-Tel was released. And then there was 1990, which saw the formation of Inter-Tel NetSolutions, Inc., the expansion of Inter-Tel's wholesale and retail operations and extensive enhancements to Inter-Tel's products. 1990 will be remembered as another standout year.

INTER-TEL NETSOLUTIONS, INC.

In 1990, the formation of Inter-Tel NetSolutions, Inc. opened a tremendous new market to Inter-Tel.

This new subsidiary is able to provide customers with access to shared communication network services, including long-distance, T-1 service, intra-LATA, network switching, and a diverse array of other services.

Inter-Tel sales representatives are now able to provide businesses with complete answers to their communication needs. These solutions not only include productivity-enhancing telephone systems but also hassle free shared communications.

In addition to "one-stop shopping" and controlling long distance costs, Inter-Tel NetSolutions will offer customers the convenience of having all telephone costs itemized on one easy-to-understand bill.

The response from customers thus far has been extremely positive. The concept of bundling all products into a telemanagement service sets Inter-Tel apart from the competition.

INTER-TEL COMMUNICATIONS, INC.

Inter-Tel's 17 direct sales offices are primarily involved in the sale, installation and service of Inter-Tel products to end-users.

Direct customer contact is one of the key differences between Inter-Tel and its competitors. End-user suggestions are communicated directly to Inter-Tel's Product Planning Committee for design into future products. This feedback assures that Inter-Tel will continue producing products which have applications that translate into improved productivity.

In 1990, Inter-Tel Communications' customers benefited from the release of numerous new products, including the Computer Attendant Console, the ESPMDX System, the Expanded ESPDX System and the CallMaster Accounting System.

Also in 1990, Inter-Tel Communications expanded its vital role with the acquisition of Creative TeleSystems in Riverside, California, and an equity investment in Telephone Corporation of America in Beltsville, Maryland.

INTER-TEL EQUIPMENT, INC.

Inter-Tel Equipment, Inc., is responsible for every step of product development from research and design through manufacturing, warehousing and delivery.

Inter-Tel Equipment also manages the company's wholesale distribution channel. Through a first-rate nationwide network of dealers and distributors, Inter-Tel has built a solid foundation for future product releases, thus securing the company's future.

In 1990, Inter-Tel Equipment made great strides internationally, expanding markets in the United Kingdom, western Europe, Poland and Guam.

The immediate market acceptance of the Inter-Tel/DVK Keysets in 1990 demonstrated the superiority of Inter-Tel's engineering. Other enhancements and releases that benefited dealers and distributors included software upgrades to the GMX-48 and the arrival of the GMX-152D, which completed Inter-Tel's GMX Family of Products.

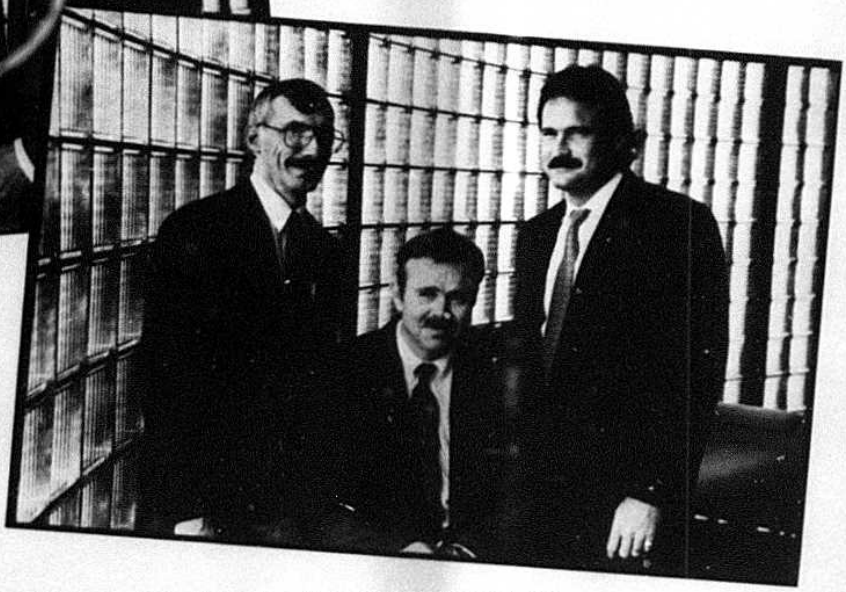
The year 1990 was indeed a standout year for Inter-Tel. The continued aggressive pursuit of excellence by Inter-Tel NetSolutions, Inter-Tel Communications and Inter-Tel Equipment will ensure that Inter-Tel has many more standout years ahead.

People and Technology Serving People™

INTER-TEL

Steve Mihaylo — *Chairman and CEO, Inter-Tel, Incorporated*
Steve Nichols — *President, Inter-Tel NetSolutions, Inc.*
Craig Rauchle — *President, Inter-Tel Communications, Inc.*
Ralph Marsh — *Chief Financial Officer, Inter-Tel, Incorporated*
Tom Parise — *President, Inter-Tel Equipment, Inc.*

Craig Rauchle — *President, Inter-Tel Communications, Inc.*
Jim Chumney — *Vice President, Engineering, Inter-Tel Equipment, Inc.*
Skip Welch — *Vice President, Systems Engineering, Inter-Tel Equipment, Inc.*



Tom Peiffer — *Vice President, Technical Services, Inter-Tel Equipment, Inc.*
Tom Hanson — *Vice President, Operations, Inter-Tel Equipment, Inc.*
Tom Parise — *President, Inter-Tel Equipment, Inc.*

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

Results of Operations
Years Ended December 31, 1990 and 1989

Net sales of $67.4 million were almost $6 million greater than those in 1989. The increase is attributable to increased shipments of private label products to Premier Telecom Products, Inc. A slight decrease in net sales through Direct Sales branches was largely offset by increased shipments through the United Kingdom subsidiary. International sales are expected to grow in 1991. However, the recessionary factors first experienced in late 1990 are expected to result in lower 1991 shipments of telecommunication hardware and software to distributors, dealers and the Company's principal private label customer, Premier Telecom Products, Inc. Inter-Tel's contract with Premier expires in April, 1991 and is presently being renegotiated.

Costs of sales increased in 1990, from 60.5% to 62.7%. About half of the increase was due to the 13.4% additional import duty imposed in late 1989 upon certain assemblies produced by Inter-Tel's Korean subcontractors. The remainder is attributable principally to the increase in private label sales which carry a lower margin. Inter-Tel is in the process of moving production of the affected assemblies to other non-duty locations, including the Philippines and the United States. As indicated in the Chairman's letter to shareholders, this transition has been slower than expected and delays which caused product shortages have had a negative impact on sales which could continue in the first half of 1991. The additional penalty duty is expected to continue to impact costs of sales during most of 1991. In late 1990 it was determined that certain other assemblies, formerly in question, were exempt from the additional duty. A contingent provision of $304,000 for possible payment of this additional duty for these assemblies, made during the first three quarters, was reversed in the fourth quarter of 1990.

Research and development expenses continued at 5% of net sales, a rate expected to continue under Inter-Tel's policy of being at the forefront of communications systems feature enhancement.

Selling and administrative expenses decreased $944,000 to 27.3% of sales from 31.4% of sales in 1989. The decrease reflected the continuation of Inter-Tel's cost and expense control program and the expiration of payments under non-competition agreements related to earlier acquisitions.

Included in selling and administrative expenses are approximately $200,000 of start-up costs of the new subsidiary Inter-Tel NetSolutions, Inc. which will provide customers with shared communication network services, including long-distance, T-1, network switching and other services. Initial minimal long-distance revenues are included in 1990 sales. Billings are expected to increase substantially in 1991 and beyond.

Operations of the Company's training center/hotel and office complex improved but continued to result in a loss ($480,000 after income tax benefits). The Company has invested approximately $9,000,000 in this facility in Central Phoenix, Arizona. Both the real estate market and the hospitality industry in Arizona have suffered recent downturns. These may have caused a decline in the value of the complex. However, management believes this is temporary and anticipates recovery of the hospitality industry and the real estate market in the future. Renovation of the complex is complete and operations are anticipated to improve slightly in 1991.

The $103,000 decrease in interest expense reflects slightly lower average borrowings and the reduction in the prime rate late in the year.

Net income in 1990 increased to $1,330,000 or $.16 a share from $521,000 or $.06 a share in 1989. With the continuation of the stock repurchase program initiated in 1989 average shares outstanding in 1990 decreased approximately 325,000 shares to 8,290,000 shares.

Years Ended December 31, 1989 and 1988

Net sales of $61.6 million in 1989 were $1 million lower than those in 1988. The decrease was almost entirely attributable to lower sales to one international customer. Sales through Direct Sales branches increased by approximately $1 million or 3%. Shipments to distributors, dealers and Inter-Tel's private label customer were about equal to 1988.

Cost of sales as a percentage of sales decreased to 60.5% from 61.5%. The improvement in this percentage occurred wholly in the Direct Sales units. The Wholesale Sales unit continued to experience highly competitive market conditions and slowing business activity. Wholesale margins were also affected by the Department of Commerce's assessment of a 13.4% additional import duty on certain assemblies produced by Inter-Tel's Korean subcontractors. Such additional duties were in force at a lower rate during the last half of 1989.

Research and development expenses were increased to 5% of sales in 1989, a full 24% greater than 1988 increasing $601,000 to $3,101,000 from 1988 to 1989.

Selling and administrative expenses increased to 31% of sales from 29% of sales in 1988, and during 1989 include the start up expenses of Inter-Tel's United Kingdom and Japanese subsidiaries. These aggregated over $250,000 in 1989. In addition, expenses of the new training center/hotel and office complex were approximately $350,000 higher in 1989 as operations expanded during the year. Initial operations of this complex resulted in a loss of $557,000 after income tax benefits.

Interest expense increases are the result of higher rates and increased borrowings made necessary by new vendor terms. Total interest expense of $1,553,000 in 1989 was $653,000 or 73% greater than the year before.

Net income in 1989 of $521,000 or $.06 a share compared to net income of $1,752,000 or $.20 a share in 1988. Average shares outstanding during 1989 decreased by approximately 200,000 shares to 8,614,000 principally as a result of the stock repurchase program which was resumed during the year.

Liquidity and Capital Resources

With the completion of the investment in the training center/hotel and office complex, additions to property and equipment are being limited to tenant improvements, production dies, and technical and marketing equipment. Additions are expected to be lower than funds provided from depreciation.

Working capital requirements for planned sales expansion are expected to be met by the Company's bank line of credit. Shortened vendor terms agreed to in 1989 in exchange for pricing concessions have resulted in substantially increased direct borrowings. To provide for this the Company in 1989 obtained an increase in its bank line of credit to $13,000,000. The line of credit expires in June 1991 but the Company believes it will be renewed. Management has also begun negotiations for extending or refunding of its long-term loans due in 1992 and 1993. Such extensions or refunding will be necessary to be sufficient, together with funds from operations to provide for anticipated liquidity needs.

Believing the Company's common stock was undervalued on the open market, the Board of Directors in 1989 approved the resumption of the stock repurchase program. Since then a total of 818,058 shares have been repurchased (400,362 in 1989 and 417,696 in 1990) at a total cost of $2,081,049. In 1989

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS — Continued

Inter-Tel obtained an additional $1,000,000 term loan to provide funds for this program, with the remainder provided from operating funds.

Impact of Inflation

Although inflation and fluctuations in international currency values always have some impact on prices and sales margins, they have not been a principal factor in Inter-Tel's business in recent years. Changes in international currency values will become more important as Inter-Tel expands its international operations. Inter-Tel believes that its position in relation to its competitors is not materially affected by these factors. However, because of the possible impact of the additional import penalty duties imposed by the Department of Commerce, Inter-Tel has reviewed subcontract sourcing alternatives and opportunities. As previously indicated some changes in subcontracting sources have been completed or are in process. The impact on future operations of sourcing changes cannot be predicted.

REPORT OF ERNST & YOUNG, INDEPENDENT AUDITORS

Board of Directors
Inter-Tel, Incorporated

We have audited the accompanying consolidated balance sheets of Inter-Tel, Incorporated and subsidiaries as of December 31, 1990 and 1989 and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended December 31, 1990. 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 Inter-Tel, Incorporated and subsidiaries at December 31, 1990 and 1989 and the consolidated results of operations and cash flows for each of the three years in the period ended December 31, 1990, in conformity with generally accepted accounting principles.

Ernst & Young

Phoenix, Arizona
January 31, 1991

INTER-TEL INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

December 31, 1990 and 1989

	1990	1989
ASSETS		
CURRENT ASSETS		
Cash	$ 674,959	$ 3,342,765
Accounts receivable, less allowances of $521,000 in 1990 and $734,000 in 1989	7,810,018	10,111,429
Inventories	11,294,254	11,363,881
Prepaid expenses and other assets	1,366,812	679,089
TOTAL CURRENT ASSETS	21,146,043	25,497,164
PROPERTY, PLANT & EQUIPMENT	17,868,989	17,979,925
OTHER ASSETS	200,384	654,209
EXCESS OF PURCHASE PRICE OVER NET ASSETS ACQUIRED	1,488,777	1,643,158
	$40,704,193	$45,774,456
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Notes payable	$ 2,850,000	$ 6,740,488
Accounts payable	2,103,960	2,864,222
Accrued expenses	4,724,934	4,847,050
Customer deposits	289,962	765,227
Income taxes payable	371,325	663,333
Current portion of long-term debt	954,191	898,653
TOTAL CURRENT LIABILITIES	11,294,372	16,778,973
LONG-TERM DEBT, less current portion	7,751,141	8,557,066
OTHER LIABILITIES	713,068	
SHAREHOLDERS' EQUITY		
Common Stock, no par value — authorized 30,000,000 shares, issued 10,941,111 shares	18,999,524	18,999,524
Additional paid-in capital	75,000	75,000
Retained earnings	9,213,442	7,883,169
Equity adjustment for foreign currency translation	158,380	
	28,446,346	26,957,693
Less cost of Common Stock in treasury — 2,990,696 shares in 1990 and 2,573,000 shares in 1989	7,500,734	6,519,276
	20,945,612	20,438,417
	$40,704,193	$45,774,456

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF INCOME

Years Ended December 31, 1990, 1989 and 1988

	1990	1989	1988
REVENUES:			
Net sales	$67,358,758	$61,588,398	$62,596,351
Other income	541,265	482,261	536,743
Interest income	36,657	28,336	87,909
	67,936,680	62,098,995	63,221,003
COSTS AND EXPENSES:			
Costs of sales	42,215,214	37,236,070	38,513,748
Research and development	3,380,400	3,100,630	2,500,505
Selling, general and administrative	18,414,451	19,358,446	18,309,882
Interest	1,449,342	1,552,546	899,600
	65,459,407	61,247,692	60,223,735
INCOME BEFORE INCOME TAXES	2,477,273	851,303	2,997,268
INCOME TAXES			
Current	1,412,000	256,000	1,638,000
Deferred (credit)	(265,000)	74,000	(393,000)
	1,147,000	330,000	1,245,000
NET INCOME	$ 1,330,273	$ 521,303	$ 1,752,268
Net income per share of common stock	$ .16	$ .06	$ .20

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

Years Ended December 31, 1990, 1989 and 1988

	Common Stock	Additional Paid-In Captial	Retained Earnings	Treasury Stock	Total
Balance at December 31, 1987	$18,465,425	$75,000	$5,448,907	$(5,255,740)	$18,733,592
Shares issued and exchanged pursuant to stock option and stock purchase plans	495,810			(163,945)	331,865
Tax benefit of stock options exercised			160,691		160,691
Net income for 1988			1,752,268		1,752,268
Balance at December 31, 1988	$18,961,235	$75,000	$7,361,866	$(5,419,685)	$20,978,416
Shares issued pursuant to stock option plans	38,289				38,289
Purchase of treasury stock				(1,099,591)	(1,099,591)
Net income for 1989			521,303		521,303
Balance at December 31, 1989	$18,999,524	$75,000	$7,883,169	$(6,519,276)	$20,438,417
Purchase of treasury stock				(981,458)	(981,458)
Net income for 1990			1,330,273		1,330,273
Equity adjustment for foreign currency translation					158,380
Balance at December 31, 1990	$18,999,524	$75,000	$9,213,442	$(7,500,734)	$20,945,612

See notes to consolidated financial statements.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended December 31, 1990, 1989 and 1988

	1990	1989	1988
OPERATING ACTIVITIES:			
Net Income	$ 1,330,273	$ 521,303	$ 1,752,268
Adjustments to reconcile net income to net cash provided by (used in) operations:			
Depreciation and amortization	2,222,386	1,963,977	1,723,875
Provision for losses on receivables	152,329	397,403	300,118
Provision for inventory valuation	(21,321)	173,297	518,984
Increase in other liabilities	337,427		
(Gain) loss on sale of equipment		101,940	(5,594)
(Increase) Decrease in deferred income tax benefit	(265,000)	74,000	(393,000)
Equity adjustment from foreign currency translation	158,380		
Changes in operating assets and liabilities	976,491	(4,162,371)	(3,673,792)
NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES	4,890,965	(930,451)	222,859
INVESTING ACTIVITIES:			
Additions to property and equipment	(1,980,607)	(1,472,780)	(4,264,216)
Proceeds from sale of property and equipment	112,085	70,151	605,634
NET CASH USED IN INVESTING ACTIVITIES	(1,868,522)	(1,402,629)	(3,658,582)
FINANCING ACTIVITIES:			
Proceeds from credit line	27,550,000	24,325,000	11,090,000
Payments on credit line	(30,950,000)	(19,825,000)	(9,840,000)
Proceeds from new term notes		1,990,488	
Payments on long-term debt	(1,308,791)	(761,167)	(960,622)
Purchase of treasury stock	(981,458)	(1,099,591)	
Proceeds from exercise of stock options		38,289	492,556
NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES	(5,690,249)	4,668,019	781,934
INCREASE (DECREASE) IN CASH	(2,667,806)	2,334,939	(2,653,789)
CASH AT BEGINNING OF YEAR	3,342,765	1,007,826	3,661,615
CASH AT END OF YEAR	$ 674,959	$ 3,342,765	$ 1,007,826

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1990, 1989 and 1988

NOTE A — SIGNIFICANT ACCOUNTING POLICIES

Principles of Consolidation: The consolidated financial statements include the accounts of Inter-Tel, Incorporated and all significant subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Inventories: Inventories, consisting principally of telephone systems and related components, are stated at the lower of cost (first-in, first-out method) or market.

Property, Plant and Equipment: Property, plant and equipment is stated at cost. Depreciation is computed using the straight-line method over the estimated useful life of the related property. Leasehold improvements are depreciated over the shorter of the related lease terms or the estimated useful lives of the improvements.

Excess of Purchase Price Over Net Assets Acquired: Purchase prices of acquired businesses have been allocated to the assets and liabilities acquired based on the estimated fair market values on the respective acquisition dates. Based on these values the excess purchase prices over the fair market value of the net assets acquired are being amortized over 40 years. Accumulated amortization through December 31, 1990 and 1989 totalled $490,000 and $334,000, respectively.

Income Taxes: Deferred income taxes result from timing differences in the recognition of revenues and expenses for financial reporting and income tax purposes.

Income Per Common Share: Income per common share is based on the weighted average number of common shares outstanding during each year and common stock equivalents consisting of dilutive stock options.

NOTE B — GEOGRAPHIC AND BUSINESS SEGMENT INFORMATION

The Company and its subsidiaries' principal activity is to design, produce, and market business telecommunication systems, including digital electronic key, hybrid, and PABX systems in the United States and Europe. The Company performs ongoing credit risk evaluations of its customers' financial condition and requires bank letters of credit in those instances it deems appropriate.

The Company had sales to one customer during 1990, 1989 and 1988 of 33%, 25% and 25% of sales, respectively. Export sales did not exceed 10% in any year.

During 1987 and 1988, the Company renovated buildings into an executive office and hotel complex for rental purposes and as a training center for Company employees and customers. Hotel and rental operations were minimal during that period. Identifiable assets for this business segment approximate $9,200,000 at December 31, 1990. Initial operations in 1990 and 1989 are as follows:

	1990	1989
Revenues	$965,000	$460,000
Loss before income taxes	827,000	911,000
Income tax benefits	347,000	354,000
Net loss	480,000	557,000
Capital expenditures	350,000	503,000
Depreciation	315,000	203,000

NOTE C — PROPERTY, PLANT AND EQUIPMENT

	December 31, 1990	December 31, 1989
Buildings	$10,465,517	$10,094,796
Machinery and equipment	6,921,684	5,589,917
Transportation equipment	1,611,754	1,647,359
Furniture and fixtures	2,277,674	2,190,582
Leasehold improvements	106,073	83,503
Land	5,837,608	5,928,386
	27,220,310	25,534,543
Less: Accumulated depreciation and amortization	9,351,321	7,554,618
	$17,868,989	$17,979,925

Interest costs totalling approximately $154,000 were capitalized in 1988 as part of the cost of construction.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — Continued

December 31, 1990, 1989 and 1988

NOTE D — LONG-TERM DEBT

A summary of long-term debt follows:

	December 31, 1990	1989
Industrial Development Authority Bonds, payable $20,619 monthly, plus interest at prime rate plus 1% until June 1, 1993, when the remainder is due; collateralized by land and a building with a carrying amount of $5,239,423 at December 31, 1990	$4,268,004	$4,515,432
Term loan notes payable $16,667 monthly, plus interest at prime rate plus 1⅛% until April 1992, when the remainder is due	3,233,329	3,433,333
Other long-term obligations	1,203,999	1,506,954
	8,705,332	9,455,719
Less current portion	954,191	898,653
	$7,751,141	$8,557,066

Principal amounts of long-term debt obligations maturing subsequent to December 31, 1990, are: 1991 — $954,191, 1992 — $3,653,567, 1993 — $4,094,905, 1994 — $2,669.

The Term Loan and IDA Bond Agreements contain certain restrictions on dividends and redemptions, other borrowings and capital expenditures and require the maintenance of specified financial ratios. The Term Loan Agreement also provides for a line of credit of $13,000,000, of which $5,589,709 was utilized at December 31, 1990. The line of credit bears interest at the prime rate and is collateralized by inventory, receivables, equipment and certain real estate and the available amount is reduced by outstanding letters of credit of $2,739,709 at December 31, 1990.

NOTE E — LEASES

Rental expense amounted to approximately $1,187,770, $1,089,000 and $1,033,000 in 1990, 1989 and 1988, respectively.

Noncancellable operating leases are primarily for buildings. Certain of the leases contain provisions for rent increases based on a specified price index per year. At December 31, 1990, future minimum commitments under noncancellable leases are: 1991 — $929,387, 1992 — $640,661, 1993 — $387,673, 1994 — $290,342, 1995 — $34,836, Thereafter — $51,145.

NOTE F — OTHER INCOME

Included in other income is $488,000, $471,000 and $431,000 received from the rental of a portion of the Company's corporate headquarters and other property during 1990, 1989 and 1988, respectively.

NOTE G — INCOME TAXES

The deferred tax effect of timing differences is as follows:

	1990	1989	1988
Inventory basis differences	$(212,265)	$ (79,702)	$(184,157)
Accelerated depreciation	(72,043)	(39,089)	13,622
Accrued vacation pay	(14,311)	(3,878)	(57,080)
State franchise tax	(2,201)	(18,565)	24,517
Bad debts	(30,606)	91,818	(143,720)
Accrued expenses		194,750	
Other	66,426	(71,334)	(46,182)
	$(265,000)	$ 74,000	$(393,000)

Federal and state income taxes consisted of the following:

	1990	1989	1988
Federal	$ 850,300	$244,600	$ 954,300
State	296,700	85,400	290,700
	$1,147,000	$330,000	$1,245,000

The Company's effective tax rate varies from the statutory rate due to nondeductible foreign operation losses ($254,735) and amortization of goodwill in 1990.

The tax provision for all years presented has been computed under the provisions of Accounting Principles Board Opinion 11. The Company expects to adopt FASB Statement 96, Accounting for Income Taxes, on a prospective basis when required. Adoption of Statement 96 is not expected to have a significant impact on the Company's financial position or results of operations. The Company does not expect to restate prior-year financial statements to reflect the new rules.

NOTE H — STOCK OPTIONS AND COMMON STOCK

Under various stock options plans, officers and key employees may purchase Common Stock of the Company at amounts not less than the fair market value at the date of grant. The options, which have a term of five years, are exercisable over four years commencing one year from the date of grant.

Option activity for the past three years is as follows:

	Shares		
	1990	1989	1988
Outstanding at beginning of year	820,550	715,575	7[illegible],925
Granted	33,500	482,500	90,[illegible]00
Exercised		25,825	131,42[illegible]
Expired or cancelled	260,050	351,700	36,825
Outstanding at end of year	594,000	820,550	715,575
Exercise price range	$1.13-$3.06	$1.13-$6.38	$1.44-$6.38
Exercisable at end of year	225,025	236,800	269,450

Prior to 1989, the Company also had a non-compensatory Employee Stock Purchase Plan which permitted employees to purchase the Company's Common Stock through payroll deductions at 85 percent of the fair market value of the Common Stock. During 1988, employees purchased 104,275 shares pursuant to this Plan.

At December 31, 1990, the Company has reserved 1,395,005 shares of Common Stock for issuance in connection with the stock option plans.

NOTE I — RETIREMENT PLAN

The Company has a 401(k) Retirement Plan for the benefit of all of its employees. Participants may contribute an amount not exceeding 10 percent of compensation received during the period of participation in the Plan. The Company makes voluntary annual contributions to the plan based on a percentage of the total contributions made by Plan participants. Contributions to the Plan totaled $103,000, $79,000 and $124,000 in 1990, 1989 and 1988, respectively.

NOTE J — SUPPLEMENTAL CASH FLOW INFORMATION

	Years Ended December 31		
	1990	1989	1988
Cash paid for:			
Interest	$1,471,462	$ 1,513,559	$ 1,068,383
Income taxes	$1,704,008	$ 220,817	$ 2,316,060
Changes in operating assets and liabilities:			
(Increase) decrease in receivables	$2,149,631	$ (26,826)	$ (159,669)
(Increase) in inventories	(169,951)	(139,599)	(1,133,630)
(Increase) in prepaid expenses	(47,082)	(36,796)	(141,518)
(Increase) decrease in other assets	325,538	(202,500)	
(Decrease) in drafts payable		(5,355,498)	(2,569,233)
Increase (Decrease) in accounts payable and accrued expenses	(514,373)	2,189,878	658,606
Increase (Decrease) in customer deposits	(475,265)	(626,214)	325,844
Increase (Decrease) in income taxes payable	(292,007)	35,184	(654,192)
	$ 976,491	$(4,162,371)	$(3,673,792)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS — Continued

December 31, 1990, 1989 and 1988

NOTE K — QUARTERLY RESULTS OF OPERATIONS (UNAUDITED)

A summary of the quarterly results of operations for the years ended December 31, 1990 and 1989, follows:

(In thousands, except per share amounts)	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
1990				
Revenues	$16,986	$18,139	$17,830	$14,982
Gross margin	6,159	6,655	6,561	5,769
Net income	331	485	328	186
Net income per common share	.04	.06	.04	.02
Average number of shares outstanding	8,489	8,401	8,357	8,008

(In thousands, except per share amounts)	1st Qtr	2nd Qtr	3rd Qtr	4th Qtr
1989				
Revenues	$15,235	$14,650	$13,466	$18,748
Gross margin	6,014	5,967	5,314	7,057
Net income (loss)	90	10	(491)	912
Net income (loss) per common share	.01	—	(.06)	.11
Average number of shares outstanding	8,796	8,645	8,481	8,445

During the fourth quarter of 1990 the Company reversed a contingent provision for anti-dumping penalty duty recorded during the first three quarters, which totalled $304,000, as a result of a favorable ruling from the U.S. Department of Commerce in December, 1990.

INTER-TEL INCORPORATED AND SUBSIDIARIES

DIRECTORS
INTER-TEL, INCORPORATED

Steven G. Mihaylo
Chairman of the Board of Directors, President and Chief Executive Officer

Jerry Chapman
President, Insight Partners Incorporated

Donald E. Cline
Director, Arizona Department of Commerce

Robert H. Craft
Chairman of the Board, A.B.S. Industries, Inc.

Karl Eller
Chairman, Red River Resources, Inc.

Maurice H. Esperseth
Retired, Executive Vice President

C. Roland Haden
Dean, College of Engineering & Applied Sciences, Arizona State University

Robert S. Ingersoll
International Industrialist and Diplomat

OFFICERS
INTER-TEL, INCORPORATED

Steven G. Mihaylo
Chairman of the Board of Directors, President and Chief Executive Officer

Thomas C. Parise
Senior Vice President

Steven P. Nichols
Senior Vice President

Craig W. Rauchle
Senior Vice President

Ralph Marsh
Vice President — Chief Financial Officer, Secretary/Treasurer

Margaret Gilley
Assistant Treasurer

Kristi S. Simon
General Counsel and Assistant Secretary

OFFICERS
INTER-TEL COMMUNICATIONS, INC.

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President

Steven P. Nichols
Senior Vice President — Eastern Region

Kris Brown
Vice President — Southeastern Region

Jack Hart
Vice President — Southern California Operations

Raymond McCloud
Vice President — Mountain Region

Joe T. Sparks
Vice President — North Texas Operations

Barry E. Wichansky
Vice President — Northeastern Region

OFFICERS
INTER-TEL EQUIPMENT, INC.

Thomas C. Parise
President

Jimmy C. Chumney
Vice President — Engineering

Thomas M. Hanson
Vice President — Operations

N. Thomas Peiffer, Jr.
Vice President — Technical Services

Louis (Skip) Welch III
Vice President — Systems Engineering

OFFICER
INTER-TEL NETSOLUTIONS, INC.

Steven P. Nichols
President

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Additional Information
A copy of Inter-Tel's Form 10-K Report filed with the Securities and Exchange Commission is available upon request without charge by writing to:

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Transfer Agent
First Interstate Bank of Arizona
First Interstate Bank Plaza
Phoenix, Arizona 85036

Annual Meeting
The annual meeting of Inter-Tel, Incorporated will be held at 10:00 a.m. on April 25, 1991 at
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