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PART I

ITEM 1. BUSINESS

INTRODUCTION

The Company was formed to design, develop and market high performance general purpose parallel computer systems. Tera's Multithreaded Architecture System ("MTA") system is designed to address a wide range of scientific and engineering applications, such as simulation and visualization of complex mechanical and biochemical systems, as well as emerging commercial applications, such as computer-aided design and visualization, information-on-demand and database mining. The Company believes that its MTA system architecture represents a significant breakthrough in high performance computing that will enable the Company to offer systems with several times the price/performance of currently available commercial high performance computer systems. Typical MTA system configurations are expected to sell for between \$5 million and \$40 million. The Company installed a single processor MTA system at the San Diego Supercomputer Center in December 1997, which it plans to upgrade in stages to larger configurations as it receives production printed circuit boards and other components from its vendors which are then integrated into a commercially acceptable system. See "--Risk Factors - Manufacturing Risks; Reliance On and Capacity Of Third Party Sole Source Suppliers."

HIGH PERFORMANCE COMPUTER INDUSTRY

Historically the need for greater computing power for scientific, engineering and commercial applications has increased significantly. This need typically has been met by high performance computer systems for scientific and engineering applications and by mainframes for commercial applications, with millions of dollars invested per system.

For scientific and engineering applications, the increased need for computing power has been driven by greater emphasis on computational modeling to develop and verify engineering solutions across a broad range of industries and an increased focus on highly challenging basic and applied scientific problems that can be met only through numerically intensive computation. The U.S. government has recognized that the continued development and use of high performance computer systems for these technical applications is of critical importance to the economic competitiveness of the United States.

For commercial applications, pressures resulting from global competition, reduced cost of communication and the proliferation of data from the enormous number of workstations and personal computers also have increased the need for high performance computing. For competitive reasons, many large commercial users have concluded that enterprise-wide computing applications require immediate interactive processing of available data. In order to process data in such a manner, such users must move away from batch processing but cannot do so because of the limited computational capacities of their existing systems.

Computer designers have taken a variety of approaches in their efforts to achieve higher levels of performance. Traditionally, high performance computer systems employed one or a small number of the fastest available single processors. Improvements in performance have been achieved by designing processors having faster switching times and greater densities and, in the case of numerically intensive applications, by employing vector multiprocessing. This approach, employed most notably by Cray Research and NEC Corporation, repeatedly

applies the same operation to each of a sequence of data elements. Vector multiprocessing has proven to be highly effective for many scientific and engineering applications, but not for most commercial applications. Moreover, these systems are limited in performance and have a high cost of computation.

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A number of computer companies, including IBM, Silicon Graphics, Inc., Hitachi, Ltd., Fujitsu, Ltd., Sun Microsystems, Inc. and Hewlett-Packard Corporation, have turned to massively parallel processing as a way to achieve greater computational power and improved price/performance levels. Massively parallel processing enables large numbers of processors to act concurrently on multiple tasks or in concert on a single computationally-intensive task. In these systems, each processor is directly connected to its own private memory, so that the programmer must manage the movement of data among memory units. As a result, computer systems relying on this architecture are difficult to program and have limited applicability.

While some users have developed scientific and engineering software for certain of their applications on massively parallel systems, it has not been practical for them to port a large number of third-party software applications to these computer systems. The Company believes that the absence of a standard software development environment has inhibited third-party application programs which in turn has severely restricted market acceptance of massively parallel processing systems.

Users of high performance computer systems therefore face a limited choice. Mainframes and vector multiprocessing systems permit a conventional programming environment, but are subject to inherent performance limitations and are limited in the number of processors in a system, while massively parallel processing systems are difficult or impractical to program and perform poorly for most applications.

THE TERA SOLUTION

The Company believes that its MTA system architecture represents a significant breakthrough in high performance computing. The key to this breakthrough is its scalable shared memory, which the Company believes will enable the MTA system to overcome limitations of currently available commercial high performance computer systems. The MTA system is designed to have all of the following key attributes to serve the evolving needs of the high performance computer market effectively: (i) sustainable high speed, (ii) broad applicability, (iii) ease of software programmability and portability, (iv) scalability, (v) balanced input/output capability and (vi) a future product migration path. See " -- Technology " and " -- Products."

Scalable shared memory provides every processor with equal access to every memory location. This greatly simplifies programming because it eliminates concerns about the layout of data in memory. It also provides a very flexible and efficient approach to parallelism since any available processor can operate on any data no matter where the data are located. Applications with irregular or unpredictable internal data flow patterns are facilitated by this capability.

The historical drawback of shared memory has been its slowness due to some processors being physically distant from some areas of memory and the likelihood of conflicts when two or more processors attempt to access the same memory location. Both factors increase the latency, or delay, experienced when a processor attempts to access a memory location. The MTA system's architecture is designed to be latency tolerant: a processor never wastes time waiting to access memory. Tera's design accomplishes this by using a combination of multithreaded architecture and a high bandwidth interconnection network.

The MTA system software is designed to support and leverage the scalable shared memory that the architecture provides. Programs are analyzed and parallelism is extracted automatically, greatly simplifying the implementation of new applications. In addition, most programs written for Cray Research vector multiprocessing systems are designed to be automatically translated by Tera's system software to run at high speed on the MTA system. The Company intends to further extend its compatibility with competitors' systems to increase the

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attractiveness of the MTA system to both potential customers and independent software vendors ("ISV's").

STRATEGY

Tera's objective is to be the leading provider of high performance computer systems to the scientific, engineering and emerging commercial markets. Key elements of the Company's strategy include:

- - Establish and Leverage Dominant Position in the Very High Performance Scientific Computer Market.

Initially the Company intends to target the very high performance scientific computer market. Sales targets in this market include government agencies, supercomputer centers and research laboratories in the United States and Western Europe. These users generally are easily identifiable and well established, possess significant resources, develop their own application software, and are reliant upon, and are early customers for, innovative high performance computer systems.

The Company believes that establishing a dominant position in the very high performance scientific market should provide it with the necessary foundation and credibility, financial and otherwise, to attract ISV's to port their application software to the MTA system. The Company believes that the availability of such third-party software should enable it to address effectively the worldwide high performance engineering computer market for applications such as computational fluid dynamics and molecular modeling. The Company's delivery of its MTA system to the San Diego Supercomputer Center is in furtherance of this strategy.

In addition, the Company intends to develop and support, both internally and in cooperation with ISV's, application software to enable the Company to address effectively certain segments of the emerging commercial computer market. See "-- Risk Factors -- Marketing Risks; Government Funding and Regulation."

- - Establish and Leverage Strategic Relationships.

The Company intends to establish strategic relationships with leading participants in various segments of the high performance computer market. The Company believes these relationships should enable it to take advantage of the superior resources, technological capabilities and proprietary positions of these entities in advancing Tera's position in the high performance computer market.

The Company has received approximately \$19 million from the Department of Defense Advanced Research Projects Agency ("DARPA") to assist in funding the development of the MTA system. The Company currently has one contract with DARPA and has begun work under it to develop certain components of its next generation MTA system, and is also engaged as a subcontractor to the University of California, San Diego, which is the prime contractor under a contract with DARPA to evaluate certain defense-related software programs on multithreaded architecture. See " -- Risk Factors -- Marketing Risks; Government Funding and Regulation."

The Company intends to emphasize the development of relationships with large scale high performance computer users, such as Fortune 100 companies and major financial institutions, in tandem with the ISV's supplying software to these organizations, to port that software to the MTA system.

TECHNOLOGY

The MTA system is designed to incorporate the following technological characteristics:

Sustained High Speed. The MTA system's anticipated high speed is due to a combination of a high clock rate and multithreaded scalar pipelines. Each processor is expected to have an execution rate of about one billion operations per second with peak 64-bit floating point performance also about one billion floating point operations per second. Each input/output processor will have a peak transfer rate of up to four hundred million bytes per second. Sustained performance is expected to be approximately 50% of these figures.

Scalability. The MTA system is designed to use a large number of processors in a single system effectively. The current design supports systems of up to 256 processors, although at this time the Company does not plan on building a system in the current implementation larger than with 64 processors. The next generation MTA system is expected to accommodate 1,024 or more processors. A 256-processor configuration is expected to have peak performance of about 230 billion instructions per second, 230 billion 64-bit floating point operations per second, and 100 billion bytes per second of input/output performance.

Multithreaded Architecture. The MTA system architecture is designed to support up to 128 separate threads of execution per processor (over 32,000 threads in a 256-processor system). When a processor dispatches an instruction for the current thread, it instantly switches to the next thread which is ready to continue. The hardware is designed to handle this switching automatically, with no intervening machine cycles, resulting in zero switching overhead.

Threads may come from totally separate programs or from a single program. Tera's compilers automatically extract parallelism from user programs and create multiple threads to maximize performance. The MTA operating system is designed to execute multiple user programs simultaneously, even within a single processor. The input/output processors are designed to be latency tolerant and to address data anywhere in the system.

High Bandwidth Interconnection Network. All hardware resources in the MTA system, namely computational processors, input/output processors and memory units, will be interconnected via a three-dimensional pipelined network. This network is expected to provide substantially greater capacity, or bandwidth, than found in current commercially available computer systems, and is expected to be a key factor in the ability of MTA systems to scale up to hundreds of processors without compromising system performance or programmability.

Compilers and Runtime System. The MTA system software is designed to exploit the speed potential of the hardware without burdening the programmer with the details of how this is accomplished. The MTA system's parallelizing compilers analyze programs written in conventional languages, such as FORTRAN, C or C++, and determine the parts of a program's computations that can be executed simultaneously. The compiler then generates the machine instructions to create separate execution threads for these parallel parts.

It is expected that Tera's runtime system, in conjunction with its compilers, will automatically distribute and balance the threads in a parallel program to the available processors, and be able to adapt to changing parallelism as the application runs by acquiring and releasing processors.

The Tera debugger allows programmers to find mistakes in their applications by displaying and monitoring the instructions and variables in an application program. The debugger is tightly integrated with the compiler and runtime system to allow users to debug parallel programs.

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Software Portability. Tera's compilers are designed to compile most programs written for Cray Research vector multiprocessing systems into parallel programs automatically. Typical scientific applications contain between 10,000 and 1,000,000 lines of source code. It can take months to rewrite a program to run on new hardware, and additional months or years of testing and use before the code is considered trustworthy enough for actual production work. This portability problem is a major deterrent to the acceptance of any new computer system. To overcome this problem, Tera has designed its language compilers and libraries to be compatible with those from Cray Research, with the goal that most Cray Research applications can be simply recompiled on a MTA system and be ready for immediate production use with no loss of speed.

Operating System. The dominant operating system in high performance computing is UNIX. The Tera operating system is designed to be a fully distributed and symmetric implementation of UNIX, providing high performance network connections and a highly concurrent file system. Both batch processing and interactive processing are supported.

PRODUCTS

The Company has designed a number of configurations of the MTA system. Each

system will be constructed from resource modules with the model number indicating the number of these resource modules, e.g., the MTA 16 model has 16 resource modules. Each resource module contains:

- a computational processor ("CP")
- an input/output processor ("IOP") and
- either two or four memory units.

Each resource module will be individually connected to a separate routing node in the MTA system's three-dimensional toroidal interconnection network. Each resource connection is designed to be capable of supporting data transfers to and from memory at full processor rate in both directions, as are all of the connections between the network routing nodes themselves.

The Company built a prototype from production components in late 1996. The prototype was used to verify and debug mechanical components and assembly procedures developed during the design process. In 1997, the Company began construction of its initial production MTA system. In December 1997, the Company installed a single processor MTA system at the San Diego Supercomputer Center, affiliated with the University of California, San Diego, which it plans to upgrade in stages to larger configurations as it receives production printed circuit boards and other components from its vendors which are then integrated into a commercially acceptable system.

The Company has begun planning for successive product generations. By improving system peak and price/performance levels and lowering the cost of entry level systems, these future products will be designed to enhance the Company's technological position while potentially broadening its market acceptance. The Company believes that denser integrated circuit technology should enable the scaling up of systems to 1,024 processors and beyond while preserving Tera's uniform slowed memory programming model. Finally, the Company may take advantage of the ability of the MTA system to scale down to compete with workstation and other microprocessor-based products.

MARKETS AND APPLICATIONS

The MTA system has been designed for prospective customers with demanding science, engineering and commercial applications. Because of its general purpose characteristics, the Company believes that the MTA system may be employed across a broad range of mainstream and emerging high performance computer applications.

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While funding for certain defense programs has decreased in recent years, total U.S. government expenditures for high performance computer systems have been augmented by funding under various high performance computing programs. In addition, important areas of civilian research, such as energy and environmental studies, weather modeling and toxic mitigation, are receiving federal funding, and the formerly defense-oriented national research laboratories are in many cases reorganizing for non-military projects. See " -- Risk Factors -- Marketing Risks; Government Funding and Regulation."

Government agencies, supercomputer centers and research laboratories are particularly attractive prospective customers for Tera because they generally have a higher tolerance for risks inherent in a complex, innovative product. This market has, at most, several hundred sites and a limited number of customers that are well-known to each other and to their existing and potential suppliers, including Tera. The Company maintains relationships with many of the management and staff of these potential customers. Addressing this market initially will help the Company avoid the costs of assembling a large sales organization and developing a broad range of application software. With a sales cycle for its intended products of two years or longer, the Company will add sales, service, training and support personnel as needs arise.

If and when third-party application software becomes available on the MTA system, the Company intends to increase its marketing efforts to the high performance commercial computer market, where it believes major growth opportunities may exist. This market is far more risk-averse, and the Company does not expect significant sales in this market until the MTA system is well established. At such time, the Company will need to increase its marketing and selling efforts considerably and may enter into relationships with major

hardware and software suppliers.

Scientific and Engineering Applications. The Company expects that its prospective customers running scientific and engineering applications will purchase MTA systems largely for numerically intensive computations and will increasingly make use of the MTA system's input/output capabilities to handle the large amounts of data associated with such computations. The Company's prospective customers include government agencies, supercomputer centers and research laboratories that are expected to use the MTA system for a variety of applications, including basic research in the fields of biology, chemistry, environmental science, materials science and physics.

Prospective customers within the United States government include such organizations as the National Science Foundation, the Department of Defense, the National Security Agency, the Department of Energy, the National Aeronautics and Space Administration and the National Institutes of Health. These prospective customers have a number of computationally-intensive applications, including the following:

- National security
- Severe storm modeling
- Earth observation
- Climate modeling
- Computational fluid dynamics
- Human genome sequencing
- Military battlefield simulation
- Groundwater pollutant transport
- Computational biology
- Computational chemistry

The Company intends to market its MTA systems to a wide range of prospective industrial customers with major computationally-intensive, technical computing requirements, including the following:

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- Automobile crash simulation
- Combustion simulation
- Nuclear reactor design
- Drug and chemical design
- Petroleum reservoir modeling
- Electromagnetic simulation
- Multidisciplinary optimization
- Animations, computer graphics

Emerging Commercial Applications. The Company expects that prospective commercial customers may purchase MTA systems either to implement strategic new applications or to improve their processing capabilities for traditional commercial applications. These applications include:

- Interactive Simulation and Visualization -- allowing users the ability to design and develop products such as automobiles, aircraft and buildings.
- Information-on-Demand -- the management, storage and distribution of multimedia data for instantaneous access by thousands of interactive, simultaneous users.
- Database Mining -- access and examination of databases to identify significant data patterns relevant to consumer preferences, insurance claims and fraud.

RESEARCH AND DEVELOPMENT

The Company's primary implementation task has been the design of the hardware components and software required for its MTA system. The Company's research and development expenses for the years ending December 31, 1995, 1996 and 1997 were approximately \$6.7 million, \$10.5 million and \$13.5 million, respectively. The Company believes that its future performance will depend in large part on its ability to design, develop, contract for the manufacture of, and market its MTA system. Additionally, the Company must develop ongoing enhancements to its MTA system and develop new product generations. Consequently, the Company will be required to continue to devote a substantial portion of its resources to research and development.

MANUFACTURING

While the Company has designed all of the MTA system hardware components, it subcontracts the manufacture of such components, including integrated circuits, printed circuit boards, flex circuits and power supplies, on a sole or limited source basis to third-party suppliers. The Company has contracted with Unisys

Corporation to provide semiconductor test and packaging services through June 1998. The Company currently is negotiating an extension of this agreement with Unisys, which is expected to be completed shortly. The Company will perform final system integration and test and design and maintain its MTA system software internally.

Hardware. The Company's general strategy is to capitalize on state-of-the-art commercial technology available from third-party suppliers. The Company contracts with Vitesse for the supply of GaAs wafers and with a limited number of vendors for various printed circuit boards, and purchases other components on an as-needed basis. In general, the Company has designed hardware components using such suppliers' tools and procedures. The Company has designed at-speed testers to be used for diagnosis and repair both in manufacturing and in the field. Component failures will be analyzed in cooperation with the supplier of the component to determine the cause and to take corrective action. See " -- Risk Factors -- Manufacturing Risks; Reliance On and Capacity Of Third Party Sole Source Suppliers."

Quality Assurance. The Company has designed the MTA system to use the test and simulation programs developed during product design for both manufacturing testing and field maintenance. A large amount of built-in test support has been incorporated in the design of the MTA system to minimize both the time and effort required to integrate a complete system and the time needed to

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diagnose and repair it on-site. Quality assurance will be performed at the component, board, modular subsystem and complete system level. The Company has designed the MTA system to incorporate a high degree of manufacturability and serviceability, including completely scannable logic and lithographic interconnection techniques.

Software. Most of the MTA system software has been designed, and all of it will be maintained, by the Company. Although the operating system is based on UNIX, the kernel and the file system are being implemented by the Company to allow much greater parallelism. UNIX utilities are being ported to the MTA system. The Company has licensed certain mathematical library routines from IBM.

COMPETITION

The high performance computer market is intensely competitive. The barriers to entry and the cost of remaining competitive are high. The Company's competitors can be divided into two general categories: established companies that are well-known in the high performance computer market and new entrants capitalizing on developments in massively parallel processing and increased computer performance through clusters or networks of workstations.

The high performance computer market is currently dominated by Cray Research (now owned by Silicon Graphics, Inc.). Cray Research's large installed base, user loyalty, and application software, coupled with Silicon Graphic's financial resources, will continue to make it a formidable force in the marketplace. Tera intends to compete with Cray Research by offering MTA systems with superior performance, together with software compatibility. See " -- Technology -- Software Portability." Other participants in the market include IBM and Japanese companies such as Fujitsu, Ltd., Hitachi, Ltd., and NEC Corporation. To date, the Japanese suppliers, as a group, have been largely unsuccessful in the U.S. high performance computer market but have been enjoying increasing success in foreign markets. To the extent that all of these companies continue to use vector multiprocessing systems, they remain subject to inherent limitations of vector multiprocessing system performance and on system scalability. See " -- High Performance Computer Industry." Each of these competitors, however, has broader product lines and substantially greater engineering, manufacturing, marketing and financial resources than the Company.

A number of companies, including IBM, Silicon Graphics, Inc., Hitachi, Ltd., Fujitsu, Ltd., Sun Microsystems, Inc., and Hewlett-Packard Corporation, through its subsidiary, Convex Computer, have developed or plan to develop massively parallel systems for the high performance market. Massively parallel systems have been limited in applicability and difficult to program, although a breakthrough in architecture or software technology could change this situation. See " -- High Performance Computer Industry" and " -- Risk Factors -- Competition."

INTELLECTUAL PROPERTY

The Company attempts to protect its trade secrets and other proprietary rights through formal agreements with employees, customers, suppliers and consultants. Although the Company intends to protect its rights vigorously, there can be no assurance that its contractual and other security arrangements will be successful. Such arrangements are common in the high performance computer industry, and the Company anticipates entering into similar arrangements in the future. There can be no assurance that such arrangements will not be terminated or that the Company will be able to enter into similar arrangements on favorable terms if required in the future. Although the Company has not been a party to any material intellectual property litigation, third parties may assert proprietary rights claims covering certain of the Company's products and technologies. See " -- Risk Factors -- Proprietary Rights."

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Due to the abundance of prior art in the computer sciences, Tera does not expect to acquire broad-based patent protection of its MTA system architecture, although in due course the Company will attempt to obtain patent protection for significant aspects of its MTA system architecture. In 1997, the Company was awarded a software patent covering certain aspects of compiler optimization. There can be no assurance that this patent will provide any meaningful protection.

EMPLOYEES

As of December 31, 1997, the Company employed 84 employees on a full-time basis, of whom 54 were in engineering, 13 were in manufacturing, seven were in sales and marketing, and 10 were in administration. The Company also employs six individuals on a part-time or temporary basis. The Company has no collective bargaining agreement with its employees. The Company has never experienced a work stoppage and believes that its employee relations are excellent.

RISK FACTORS

The following factors should be considered in evaluating the Company's business, operations and prospects and ownership of the Company's securities:

DEVELOPMENT STAGE STATUS; HISTORY OF LOSSES. The Company had an accumulated loss from operations of approximately \$42.8 million as of December 31, 1997 and is in transition from a development stage enterprise to a production company. The Company has experienced net losses in each year of operations and expects to incur substantial further losses as it commences production, and possibly thereafter. Through December 31, 1997, the Company has had no revenue from sales of MTA systems, nor earnings. The Company will recognize system revenue only as resource modules are accepted by customers. Although the Company has installed a single processor MTA system at the San Diego Supercomputer Center, it has not yet delivered a multi-processor MTA system, and is dependent on third-party vendors to provide production printed circuit boards and other necessary components. Whether the Company will achieve revenue or earnings will depend upon a number of factors, including its ability to design, develop, manufacture and market the MTA system and to achieve broad market acceptance thereof. In addition, profitability will depend on, among other things, the level of revenue in any given period, the terms and conditions of sale or lease for an MTA system, the system model or models sold, and the Company's expense levels and manufacturing costs. There can be no assurance that the Company will be successful in delivering and receiving payments for, production MTA systems, or that it will be able to generate sales or achieve a profitable level of operations in the future. See " -- Markets and Applications" and "Management's Discussion and Analysis of Financial Condition and Results of Operations."

DEVELOPMENT STATUS OF THE MTA SYSTEM. The development of a new very high performance computer system is a lengthy and technically challenging process and requires a significant investment of capital and other resources. Several companies in this market have experienced extreme financial difficulty in the 1990s, including Thinking Machines Corporation, Cray Computer Corporation, Kendall Square Research Corporation and Supercomputer Systems, Inc. Since its inception through December 31, 1997, the Company has expended approximately \$52.2 million to design and develop the MTA system. The hardware development effort has included design of integrated circuits, packaging and cooling systems

and at-speed testing equipment. The software development effort has included design of compilers, an operating system and input-output software technology. Until November 1996, when the Company announced that its initial prototype was undergoing testing and had run its first programs, the MTA system had been subject only to computer simulation. While the initial testing and evaluation of the prototype system has been successful, the Company only recently has begun to integrate multiple modules into commercially configured systems.

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Modifications to the hardware components, software and the integrated system still may be required. Development of system software is a difficult process, and there can be no assurance that the Company will be able to meet all of the technical challenges required to integrate and complete MTA systems that satisfy both internal and commercially acceptable performance specifications. Additional delays in completing the various hardware components or software, or in integrating the full system, would materially and adversely affect the Company's business and results of operations. Even if the Company is successful in completing a commercially configured MTA system, there can be no assurance that the Company's products will be commercially successful. See " -- Markets and Applications" and " -- Competition."

MANUFACTURING RISKS; RELIANCE ON AND CAPACITY OF THIRD PARTY SOLE SOURCE SUPPLIERS. The Company has subcontracted the manufacture of substantially all of its hardware components, including integrated circuits, printed circuit boards, flex circuits and power supplies, on a sole or limited source basis to third party suppliers, and there can be no assurance that such suppliers will be able to manufacture the components to the Company's design specifications. Manufacturing difficulties and limited yields, particularly of gallium arsenide ("GaAs") integrated circuits and advanced printed circuit boards and flex circuits, could materially and adversely affect the Company's ability to complete and deliver production models of the MTA system. The manufacture of integrated circuits, and in particular the manufacture of GaAs integrated circuits, is a difficult and complex process. Minute impurities, difficulties in the fabrication process, defects in the masks used to print circuits on wafers or other factors can cause a substantial percentage of wafers to be rejected or numerous die on each wafer to be non-functional. The Company's suppliers may experience problems in achieving acceptable manufacturing yields for these or other reasons, resulting in substantial delays in the delivery of necessary hardware components to the Company and unacceptably high prices for those components, with a resulting loss of profitability or loss of competitiveness for the Company's products. The Company has experienced such yield problems already and these failures forced the Company to redesign certain components for manufacture by alternative suppliers which caused delays in the fabrication of the Company's prototype and increased demands upon the Company's financial resources. The Company also has experienced delays in receiving integrated circuits and printed circuit boards from its suppliers which meet its design specifications. There can be no assurance that the Company's efforts to obtain components in a timely manner that meet its design specifications will be successful. Delays in obtaining such components have adversely affected the Company's ability to deliver its first multi-processor MTA system to the San Diego Supercomputer Center on schedule and may continue to hinder its ability to satisfy future delivery schedules with the San Diego Supercomputer Center and other potential customers.

Moreover, the production capacity of the Company's integrated circuit and printed circuit board suppliers is very limited and the availability of these and other components will be a limiting factor on the number and size of the MTA systems that may be sold in 1998, and thereafter, assuming the receipt of additional purchase orders. Absent improved yields, increased production capacity or a reallocation of such suppliers' output to meet the Company's needs, the Company may be unable to obtain a sufficient quantity of suitable components to meet future production and delivery schedules. In addition, some of the Company's key suppliers are small companies with limited financial and other resources, and consequently may be more likely to experience financial difficulties than larger, well established companies. Any or all of the Company's suppliers may make strategic changes in their product lines, which may result in the delay or suspension of manufacture of the Company's components or systems. In the event of a reduction or interruption of supply of the Company's components, it could take the Company a considerable period of time to identify and qualify alternative suppliers to redesign its products as necessary and recommence manufacture. The Company's inability to obtain sufficient sole or

limited source components as required, or to develop alternative sources if and as required in the future, could result in the Company finding itself without a source of supply for its components;

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this could materially impair the Company's ability to deliver its products, which would materially and adversely affect the Company's business and results of operations.

The Company's current contract with Unisys Corporation provides for integrated circuit test and packaging services through June 1998. The Company expects that it will be able to extend this agreement on mutually agreeable terms. If this agreement is not extended, however, the Company would contract with another vendor for such packaging services or perform such work internally. The inability of the Company to subcontract for these services after its agreement with Unisys expires, or the Company's inability to perform such services internally, would materially and adversely affect the Company's business and results of operations.

FUTURE CAPITAL NEEDS. During 1998, the Company's working capital needs will depend primarily upon its personnel costs and the cost of inventory, as well as manufacturing startup costs, inventory and receivable financing associated with the production of MTA systems and research and development expenses related to future implementations of the MTA systems. The Company has experienced delays in the development of particular components of the MTA system that have increased the need for working capital, and the Company could experience significant additional delays in the manufacturing process that could further substantially increase the Company's need for working capital. Personnel and operating costs will be required to support ongoing research, development and engineering efforts, development of a customer service organization, increases in its sales and marketing efforts, and capital expenditures in lease of goods. Additionally, the Company's administrative functions will increase in order to support its engineering and sales efforts. If the Company were not to receive revenue from the sale of MTA systems, it likely would be required to engage in additional financings in order to continue current levels of business operations. The Company may raise additional equity capital in 1998, even if revenues are received from the sale of MTA systems when anticipated, in order to enhance its financial position for future operations. There can be no assurance that any additional financings will be available to the Company when needed or, if available, will be available on satisfactory terms or that any such financings will not be dilutive to the Company's shareholders. See "Management's Discussion and Analysis of Financial Condition and Results of Operations -- Liquidity and Capital Resources."

MARKETING RISKS; GOVERNMENT FUNDING AND REGULATION. The Company's first sales targets will be U.S. and foreign government agencies and research laboratories, which constitute more than one-half of the market for very high performance computer systems. The U.S. government historically has facilitated the development of, and has constituted a market for, new and enhanced very high performance computer systems. A change of policy by the U.S. government or foreign governments that results in a reduction of, or delays in, funding of certain high technology programs employing high performance computing could have a major impact on the market for very high performance computer systems, and would materially and adversely affect the Company's business, results of operations and need for capital.

Most of the Company's potential customers already own or lease very high performance computer systems. Some of the Company's competitors may offer trade-in allowances or substantial discounts to potential customers, and the Company may not be able to match such sales incentives. The Company may be required to provide discounts in order to make sales or be required to finance the leasing of its products, which would result in a deferral of the Company's receipt of cash for such systems. These developments could materially and adversely affect the Company's business and results of operations.

The U.S. government regulates the export of high performance computing systems such as the anticipated MTA system. There can be no assurance that the U.S. government will grant any necessary export licenses for the sale of MTA systems to foreign buyers. The Company's prospects for growth will depend in part on its ability to obtain export licenses for foreign sales, the delay

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or denial of which could materially and adversely affect the Company's business and results of operations.

In order to expand its market beyond the very high performance scientific market, and particularly beyond government agencies and research laboratories, to engineering and other commercial markets, the Company must be able to attract independent software vendors to port their software application programs so that they will run on the MTA system. There can be no assurance that the Company will be able to induce independent software vendors to port their applications, and the failure to do so could materially and adversely affect the Company's business and results of operations.

MANAGEMENT OF GROWTH; DEPENDENCE ON KEY PERSONNEL. If the Company is successful in developing and marketing the MTA system, the Company believes it could undergo a period of rapid growth which could place a significant strain on its management, financial and other resources. The Company's ability to manage its growth will require it to continue to improve its operational and financial systems and to motivate and effectively manage its employees. If the Company grows, it will have to implement new financial, budgeting, management information and internal control systems. The success of the Company will depend on the ability of management to implement effectively these changes and to manage the Company's operations over the long term. The Company's success also will depend in large part upon its ability to attract and retain highly skilled technical personnel to provide technological depth and support, to complete and enhance its first products and to develop new products. In addition, marketing and sales personnel will be needed. Competition for highly skilled management, technical, marketing and sales personnel is intense. There can be no assurance that the Company will be successful in attracting and retaining such personnel, and its failure to do so would materially and adversely affect the Company's business and results of operations.

The Company is dependent on Burton J. Smith, the Company's Chairman of the Board and Chief Scientist, and James E. Rottsolk, the Company's Chief Executive Officer, and the loss of services of either could have a material impact on the ability of the Company to achieve its business objectives. The Company has key man life insurance policies on the lives of Messrs. Smith and Rottsolk in the amount of \$2 million and \$1 million, respectively. The Company has no employment contracts with either Mr. Smith or Mr. Rottsolk or with any other employee.

QUARTERLY PERFORMANCE MAY VARY SIGNIFICANTLY. In the event that the Company is able to attain broad market acceptance of the MTA system, one or a few system sales may account for a substantial percentage of the Company's quarterly and annual revenue because of the anticipated high average sales price of the MTA system models and the timing of purchase orders and product acceptances. Because a number of the Company's prospective customers receive funding from the U.S. or foreign governments, the timing of orders from such customers may be subject to the appropriation and funding schedules of the relevant government agencies. The timing of orders and shipments also could be affected by other events outside the control of the Company, such as changes in levels of customer capital spending, the introduction or announcement of competitive products, the availability of components, currency fluctuations and international conflicts or economic crises. Because of these factors, revenue, expenses, net income or loss and cash flow are likely to fluctuate significantly from quarter to quarter.

RAPID TECHNOLOGICAL CHANGE AND NEW PRODUCTS. The market for the Company's products is characterized by rapidly changing technology, accelerated product obsolescence and rapidly changing industry standards. The Company's success will depend upon its ability to complete development of the MTA system and to introduce new products and features in a timely manner to meet evolving customer requirements. There can be no assurance that the Company will be successful in these efforts. The Company's business and results of operations will be materially and adversely affected if the Company incurs delays in developing its products or if such products

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do not gain broad market acceptance. In addition, there can be no assurance that

products or technologies developed by others will not render the Company's products or technologies noncompetitive or obsolete. See " --High Performance Computer Industry" and " -- Competition."

COMPETITION. The Company's competitors can be divided into two general categories: established companies that are well-known in the high performance computer market and new entrants capitalizing on developments in parallel processing and increased computer performance through networking.

The high performance computer market is highly competitive and has been dominated by Cray Research. Other participants in the market include IBM Corporation and Japanese companies such as Fujitsu, Ltd., Hitachi, Ltd., and NEC Corporation. Each of these competitors has broader product lines and substantially greater research, engineering, manufacturing, marketing and financial resources than the Company.

A number of companies, including IBM, Silicon Graphics, Inc., Hitachi, Ltd., Fujitsu Ltd., Sun Microsystems, Inc., and Hewlett-Packard Corporation, through its subsidiary, Convex Computer, have developed or plan to develop massively parallel systems for the high performance computer market. Although to date this kind of system architecture has been limited in applicability and difficult to program, a breakthrough in architecture or software technology could change this situation. There can be no assurance that such a breakthrough will not occur, and such an advance would materially and adversely affect the Company's business and results of operations.

There can be no assurance that the performance of the MTA system will be competitive with the computer systems offered by the Company's competitors or that the Company will be able to compete successfully over time against new entrants or innovative competitors at the lower end of the market. Furthermore, periodic announcements by the Company's competitors of new high performance computer systems and price adjustments may materially and adversely affect the Company's business and results of operations. See " -- Technology" and " -- Competition."

PROPRIETARY RIGHTS. The Company relies on a combination of copyright and trade secret protection, non-disclosure agreements and licensing arrangements to establish, protect and enforce its proprietary rights. Despite the Company's efforts to safeguard and maintain its proprietary rights, there can be no assurance that the Company will be successful in doing so or that the Company's competitors will not independently develop or patent technologies that are substantially equivalent or superior to the Company's technologies.

Although the Company is not a party to any present litigation regarding proprietary rights, there can be no assurance that third parties will not assert intellectual property claims against the Company in the future. Such claims, if proved, could materially and adversely affect the Company's business and results of operations. In addition, although any such claims may ultimately prove to be without merit, the necessary management attention to and legal costs associated with litigation or other resolution of such claims could materially and adversely affect the Company's business and results of operations. See " -- Intellectual Property."

The laws of certain foreign countries do not protect intellectual property rights to the same extent or in the same manner as do the laws of the United States. Although the Company continues to implement protective measures and intends to defend its proprietary rights vigorously, there can be no assurance that these efforts will be successful.

SHARES ELIGIBLE FOR FUTURE SALE. Sale of substantial amounts of the Company's Common Stock in the public market or the prospect of such sales could materially and adversely affect the market price of the Common Stock. As of March 9, 1998, the Company had outstanding 11,459,736 shares

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of Common Stock; 8,578 shares of Series A Convertible Preferred Stock convertible into shares of Common Stock, and privately placed warrants to purchase another 1,117,642 shares of Common Stock. Almost all of the Company's outstanding shares of Common Stock may be sold without substantial restrictions. In addition, as of such date, the Company had granted options under its option

plans to purchase an aggregate of 2,047,208 shares of Common Stock. All of the shares purchased under the option plans are available for sale in the public market, subject in some cases to volume and other limitations.

Sales in the public market of substantial amounts of Common Stock, including sales of Common Stock issuable upon conversion of the Series A Convertible Preferred Stock and issuable upon exercise of the privately placed warrants, or the perception that such sales could occur could depress prevailing market prices for the Common Stock. The existence of the Series A Convertible Preferred Stock and warrants may prove to be a hindrance to future equity financing by the Company. Further, the holders of such warrants and options may exercise them at a time when the Company would otherwise be able to obtain additional equity capital on terms more favorable to the Company.

POSSIBLE VOLATILITY OF STOCK PRICE. The trading price of the Company's Common Stock could be subject to significant fluctuations in response to variations in quarterly operating results, changes in analysts' estimates, announcements of technological innovations by the Company or its competitors, general conditions in the very high performance computer industry and other factors. In addition, the stock market is subject to price and volume fluctuations that affect the market prices for companies in general, and small capitalization, high technology companies in particular, and are often unrelated to their operating performance.

POSSIBLE ILLIQUIDITY OF TRADING MARKET. The Common Stock is quoted on the Nasdaq National Market (the "Market"). Nasdaq has proposed more stringent listing and maintenance requirements and significantly increased its compliance enforcement efforts. If the Company should continue to experience losses from operations, it may be unable to maintain the standards for continued quotation on the Market, and the Common Stock could be subject to removal therefrom. If such removal were to occur, trading, if any, in the Common Stock would be conducted in the over-the-counter market on an electronic bulletin board established for securities that do not meet the listing requirements for the Market, or in what are commonly referred to as the "pink sheets." As a result, an investor would find it more difficult to dispose of, or to obtain accurate quotations for the price of, the Company's securities. In addition, such removal would subject the Company's securities to so-called "penny stock" rules that impose additional sales practice and market-making requirements on broker-dealers who sell and/or make a market in such securities. Consequently, removal from the Market could affect the ability or willingness of broker-dealers to sell and/or make a market in the Company's securities and the ability of purchasers of the Company's securities to sell their securities in the secondary market. In addition, if the market price of the Company's Common Stock falls to below \$5.00 per share, the Company may become subject to certain penny stock rules even if still quoted on the Market. While such penny stock rules should not affect the quotation of the Company's Common Stock on the Market, such rules may further limit the market liquidity of the Common Stock and Warrants and the ability of investors to sell securities in the secondary market.

NO ANTICIPATED DIVIDENDS. The Company has not previously paid any dividends on its Common Stock and for the foreseeable future intends to continue its policy of retaining any earnings to finance the development and expansion of its business.

EFFECT OF ANTITAKEOVER PROVISIONS. Certain provisions of the Company's Restated Articles of Incorporation and Restated Bylaws and the laws of the State of Washington could have the effect of making it more difficult for a third party to acquire, or of discouraging a third party from attempting to acquire, control of the Company. Such provisions could limit the price that certain

investors might be willing to pay in the future for shares of Common Stock. The Company is authorized to issue Preferred Stock, without shareholder approval, with rights senior to those of the Common Stock and to impose various procedural and other requirements that could make it more difficult for shareholders to effect certain corporate actions.

LIMITATIONS ON LIABILITY AND INDEMNIFICATION MATTERS. As permitted by the Washington Business Corporation Act, the Company has included in its Restated Articles of Incorporation a provision to eliminate the personal liability of its directors for monetary damages for breach or alleged breach of their fiduciary

duties as directors, subject to certain exceptions. In addition, the Bylaws of the Company provide that the Company is required to indemnify its directors under certain circumstances, including those in which indemnification would otherwise be discretionary, and the Company is required to advance expenses to its officers and directors as incurred in connection with proceedings against them for which they may be indemnified.

ITEM 2. PROPERTIES

The Company entered into a five year lease in April 1994 and occupies 42,000 square feet of a commercial building in Seattle with a monthly rental, including expenses and parking, of approximately \$72,000. The Company has executed a ten-year lease beginning on November 1, 1998, for a new facility to house all its operations in Seattle. Under the lease, the Company initially will occupy approximately 85,000 square feet and in three years is committed to occupy approximately 132,000 square feet. The initial base rental, excluding parking, will be approximately \$145,000 per month. The Company will have an option to extend the lease for another five years after the initial ten-year term. The Company expects this space to be adequate for its needs for the foreseeable future.

ITEM 3. LEGAL PROCEEDINGS

The Company is not a party to any legal proceedings.

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

No matters were submitted to a vote of security holders during the fourth quarter of 1997.

ITEM E.O. EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of the Company as of March 20, 1998 were as follows:

NAME ----	AGE ---	POSITION -----
Burton J. Smith	57	Chairman of the Board and Chief Scientist
James E. Rottsolk	53	Chief Executive Officer and President
Kenneth W. Johnson	55	Vice President - Finance, Chief Financial Officer, and Secretary
Brian D. Koblenz	37	Vice President - Software
Gerald E. Loe	48	Vice President - Hardware Engineering and Manufacturing
Richard M. Russell	53	Vice President - Marketing

Burton J. Smith has been the Chairman of the Board and Chief Scientist since the Company's inception. He is a recognized authority on high performance computer architecture and programming languages for parallel computers, and is the principal architect of the MTA system. Prior to co-founding Tera, Mr. Smith was a Fellow of the Supercomputing Research Center (now Center for Computing Sciences), a division of the Institute for Defense Analyses, from 1985 to 1988. Mr. Smith was a member of the National Science Foundation Advisory Committee on Computer Research from 1983 to 1987, a member of the National Science Foundation Blue Ribbon Panel on High Performance Computing in 1993, and a member of the Universities Space Research Association Science Council from 1987 to 1991. He was honored in 1990 with the Eckert-Mauchly Award given jointly by the Institute for Electrical and Electronic Engineers and the Association for Computing Machinery, and was elected a Fellow of both organizations in 1994. Mr. Smith received his S.M., E.E. and Sc.D. degrees from the Massachusetts Institute of Technology.

James E. Rottsolk is a co-founder of the Company and has served as its Chief Executive Officer and President since its inception. Prior to co-founding Tera

in 1987, Mr. Rottsolk served as an executive officer with several high technology start-up companies. Mr. Rottsolk received his A.M. and J.D. degrees from the University of Chicago.

Kenneth W. Johnson joined the Company in September 1997 as Vice President - Finance, Chief Financial Officer and Secretary. Prior to joining the Company, Mr. Johnson practiced law in Seattle for twenty years with Stoel Rives LLP and predecessor firms, where his practice emphasized corporate finance. Mr. Johnson received his A.B. degree from Stanford University and his J.D. degree from Columbia University Law School.

Brian D. Koblenz served as Tera's Group Leader, Languages and Compilers, from 1990 until May 1994, when he assumed his present position as Vice President - Software. Prior to joining the Company, Mr. Koblenz was Principal Software Engineer at Digital Equipment Corporation ("Digital"), from 1986 to 1989. He was lead designer of Digital's high performance FORTRAN compiler and participated in the Alpha architecture and VAX vectorization efforts. He received his B.S. from the University of Vermont and his M.S. from the University of Washington.

Gerald E. Loe joined the Company in 1992 as Vice President - Hardware Engineering and Manufacturing. He was named Vice President - Hardware in 1996 and resumed his former position in March 1998. Prior to joining Tera he was Vice President of Operations at Siemens Quantum Inc., a high-end radiology ultrasound company, from 1989 to 1992. Mr. Loe received his B.S.M.E. from the Massachusetts Institute of Technology and his M.B.A. from Harvard Business School.

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Richard M. Russell joined the Company as Director of New Business Development in 1995 and was named Vice President, Marketing in March 1998. Prior to joining the Company, he worked in a variety of sales and marketing positions at several high technology companies, including Cray Research from 1976 through 1990 and Kendall Square Research from 1991 through 1994. Mr. Russell was educated in England.

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PART II

ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

The Company's Common Stock is traded on the Nasdaq National Market under the symbol TERA; prior to January 20, 1998, the Company's stock was traded on the Nasdaq SmallCap Market. On March 9, 1998, there were 326 holders of record of the Common Stock. The Company has not paid cash dividends on its Common Stock. The Company currently anticipates that it will retain all available funds for use in its business and does not anticipate paying any cash dividends on its Common Stock in the foreseeable future.

The quarterly high, low and closing sales prices of the Common Stock for the periods indicated are as follows:

	1996			1997		
	High	Low	Close	High	Low	Close
First Quarter	6 1/8	3 3/4	5 1/4	6 1/4	3 5/16	5 5/8
Second Quarter	7 1/8	4 1/8	5 1/2	6 3/8	3 7/8	5 1/2
Third Quarter	5 7/8	3 5/8	4 3/4	18 3/16	4 7/16	12 7/8
Fourth Quarter	7	3 1/4	3 7/8	17 3/4	9 3/4	15 1/4

On March 9, 1998, the closing sale price for the Common Stock was \$12.75.

These quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission, and may not represent actual transactions.

SALES OF UNREGISTERED SECURITIES

On August 6, 1997, the Company issued 4,000 shares of Common Stock to a consultant, Alan Honick, as payment for services rendered in a private placement exempt from the registration provisions of the Securities Act of 1933 under Section 4(2) thereof, based on the nature of the offering and the status of the recipient.

On December 23, 1997, the Company raised \$9,500,000 in cash through the negotiated private sale of 10,000 shares of its Series A Convertible Preferred Stock (the "Series A Stock") and 125,000 common stock purchase warrants to two accredited investors, Advantage Fund II Ltd. and Genesee Fund Limited - Portfolio B. The Series A Stock is convertible from time to time into shares of Common Stock at a conversion price equal to the lower of \$19.185 per share or the lowest sale (regular way) price during the five consecutive trading days ending one day prior to the date on which a notice of conversion is delivered to the Company, with the conversion price subject to adjustment in certain conditions. The warrants are exercisable at a price of \$19.185 per share, subject to adjustment in certain conditions. Further information regarding these securities is contained in Note 9 of the Notes to Financial Statements. There were no sales agents or underwriters involved in this placement. The sale was exempt from the registration provisions of the Securities Act of 1933 under Section 4(2) thereof, based on the nature of the offering and status of the offerees.

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ITEM 6. SELECTED FINANCIAL DATA

(In thousands, except per share amounts and Statistical Data)

Years Ended December 31,	1993	1994	1995	1996	1997
	----	----	----	----	----
Operating Data:					
Revenue	\$ -	\$ -	\$ -	\$ -	\$ 74
Research and Development	5,124	5,575	6,679	10,504	13,547
Research Funding	3,172	4,410	2,196	185	349
Loss for Common Stock	2,789	2,123	5,646	12,077	17,864
Loss per Common Share	\$ 1.40	\$ 1.00	\$ 2.13	\$ 2.27	\$ 2.03
Weighted Average Shares Outstanding	1,986	2,119	2,646	5,321	8,785
Balance Sheet Data:					
Cash and Cash Equivalents	\$ 85	\$ 21	\$ 4,285	\$ 929	\$ 13,329
Working Capital	(4,002)	(3,850)	2,642	(22)	14,342
Capital leases, long-term portion	271	168	419	114	532
Total Assets	841	1,168	7,269	4,617	20,859
Shareholders' Equity	(3,523)	(3,219)	4,092	1,128	15,846
Statistical Data:					
Number of Full-Time Employees	43	56	66	61	84

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ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

PRELIMINARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

The information set forth in "Management's Discussion and Analysis of Financial Condition and Results of Operations" below includes "forward- looking statements" within the meaning of Section 21E of the Securities Exchange Act of 1934, and is subject to the safe harbor created by that Section. Factors that realistically could cause results to differ materially from those projected in the forward looking statements are set forth in this section and under "Business - -- Risk Factors." The following discussion should also be read in conjunction

with the Financial Statements and Notes thereto.

OVERVIEW

The Company is a development stage enterprise that had an accumulated net loss of approximately \$42.8 million as of December 31, 1997. Approximately 76% of the Company's funding to date has been from the sale of equity, with the remaining 24% provided from DARPA research funding.

The Company has experienced net losses in each year of operations and expects to incur substantial further losses as it commences production, and possibly thereafter. Through December 31, 1997, the Company had no revenue from the sale of MTA systems, nor earnings. In November 1996 the Company announced that the University of California at San Diego had ordered the first MTA system production model for installation and evaluation at the San Diego Supercomputer Center ("SDSC"), utilizing a grant from the National Science Foundation. The agreement calls for the phased-in delivery of an MTA system which the Company of up to eight resource modules, for a total consideration to the Company of \$4 million. At the end of December 1997, the Company delivered a single-processor MTA system to SDSC, which the Company plans to upgrade in stages to larger configurations as it receives production printed circuit boards and other components which are integrated into a commercially acceptable system. See "Business -- Risk Factors -- Development Status of the MTA System" and "Business -- Strategy."

RESULTS OF OPERATIONS

YEARS ENDED DECEMBER 31, 1995, 1996 AND 1997

REVENUE. The Company received revenue in 1997 of approximately \$73,500 pursuant to a subcontract with SDSC to evaluate multithreaded architecture for certain defense applications. The Company expects to complete its portion of this subcontract in 1998 for approximately \$490,000. The Company also anticipates receiving revenue in 1998 from the sale of its initial MTA system, including larger configurations to SDSC and from other sales to potential customers in 1998, although it currently has no contracts or purchase orders for such other sales. See "Business--Risk Factors."

OPERATING EXPENSES. Research and development expenses include costs associated with the development of the MTA system, including personnel expense, depreciation and lease expense on facilities and equipment, nonrecurring engineering, software and hardware costs and preproduction expenses. Research and development expenses increased from \$6.7 million in 1995 to \$10.5 million in 1996 to \$13.5 million in 1997, representing approximately 86% of total operating expenses in 1995 and 1996, and decreasing slightly to just under 84% in 1997. Research and development expenditures for 1997 included an \$832,000 charge as compensation expense related to certain performance-based stock options; without that charge, 1997 research and development expenditures would have been approximately \$12.7 million, or about 83% of total operating expenditures. The 1996 increase over 1995 primarily reflected increased prototype costs. Prototype expenditures declined by \$938,000 to \$402,000 in 1997, and essentially ceased after the third quarter of 1997. This decrease only partially offset increases in manufacturing costs and wages and benefits due to increased staff (even after excluding the compensation charge for certain performance-based stock options), plus almost \$2.3 million in preproduction costs and expenses relating to inventory obsolescence,

expensed parts and inventory revaluation. A decline of approximately \$1.6 million in nonrecurring engineering expenses pertaining to the MTA system in 1997 over 1996 was offset almost entirely by increased nonrecurring engineering expenditures on the next generation MTA system.

While the Company expects that research and development will continue to be a major expense, these expenses are expected to decrease as a percentage of total operating expenses and will generally include expenditures related to continuing engineering of the MTA system, research and development related to the next generation MTA system and related software development.

Marketing and sales expenses have increased from \$281,000 in 1995 to nearly \$1,120,000 in 1997, as the Company has continued to increase sales and customer

support staff and expenditures in connection with sales and marketing, benchmarks and development of third party applications software. In 1997, marketing and sales expenses increased to 6.9% of total operating expenses, with a significant increase in the fourth quarter as the Company then opened a two-person, branch sales office in Japan and added a third U.S. salesperson. These expenses are expected to continue to grow as the Company increases its marketing and sales activities.

The Company's general and administrative expenses have increased each year consistent with expansion of the Company's infrastructure. In 1995, 1996 and 1997 these expenses were \$749,000, \$1,057,000 and \$1,561,000, respectively, an increase of 41% in 1996 over 1995 and a further 48% increase in 1997 over 1996. The increase in amount of expenditures in 1996 over 1995 was due primarily to the first full year's cost of liability insurance and professional services associated with becoming a publicly owned company, while the 1997 increase was primarily due to additional staff and further increases in legal, investor relations, stock transfer and other costs associated with being a publicly owned company. General and administrative expenses are expected to increase commensurate with any growth in the Company's operations.

RESEARCH FUNDING. The Company has been billing DARPA under an approximately \$1 million research contract awarded in September 1995. Billings increased in 1997 to \$349,000 over \$185,000 in 1996. The Company expects to bill approximately \$400,000 under this contract in 1998.

OTHER INCOME (EXPENSE). Other expense decreased from \$133,000 in 1995 to \$37,000 in 1996 as a result of an increase in interest income and a decrease in interest expense as lease obligations were fulfilled. Other income increased in 1997 to \$101,000 as interest income increased to \$140,000 while interest expense declined to \$27,000, reflecting the Company's increased cash position due to the sales of equity securities throughout the year.

TAXES. There was no provision for federal income taxes in 1995, 1996, or 1997 as the Company has continued to incur net operating losses. As of December 31, 1997, the Company had net operating loss carryforwards of approximately \$39,153,000, which expire in years 2003 through 2012, if not utilized. The Company's net operating loss carryforwards and certain other tax attributes (including its research credit of approximately \$1,825,000 at December 31, 1997) would be limited to an annual utilization for losses and credits for periods prior to 1996 of approximately \$700,000. This limitation may result in the expiration of net operating losses and credits before utilization.

PREFERRED STOCK. In 1997, the Company amortized a total of \$2,019,000 related to the conversions of its Series B and Series C Convertible Preferred Stock during the year into Common Stock at a discount from the fair market value of the Common Stock, and recorded dividends of \$90,000 on these securities. In December 1997, the Company issued \$10,000,000 of its Series A Convertible Preferred Stock; while the Company will not recognize a conversion discount with respect to the Series A Convertible Preferred Stock, it will pay a 5% cumulative dividend on these shares while they remain outstanding in cash or, at the Company's option, in shares of Common Stock.

YEAR 2000. The Company does not expect that issues relating to the Year 2000 problem will be significant to its financial condition or results of operations. No significant modifications to its computer system are necessary to address Year 2000 issues, and it does not anticipate that any issues affecting its suppliers and customer will affect the Company's operations.

LIQUIDITY AND CAPITAL RESOURCES

Since its inception through December 31, 1997, the Company's principal sources of liquidity have been net proceeds from the sale of equity totaling \$58.7 million and DARPA research funding and subcontracts totaling \$19 million. Billings under the current contracts and subcontracts with DARPA are expected to approximate \$900,000 in 1998. At December 31, 1997, the Company had \$13.3 million in cash and had no bank line of credit.

During 1998, the Company's working capital needs will depend primarily upon personnel costs and the cost of inventory, as well as manufacturing startup costs, inventory and receivable financing associated with the production and

sale of MTA systems and research and development expenses related to future implementations of the MTA system. In 1997, overall wages and benefits increased by about 21% over 1996 to \$6.2 million, while total expenses related to inventory increased in 1997 to approximately \$5.7 million, a \$4.8 million increase over 1996; these expenses are expected to increase in 1998. The Company has experienced delays in the development of particular components of the MTA system which have increased the need for working capital, and the Company could experience significant additional delays in the manufacturing process that could further substantially increase the Company's need for working capital. Personnel and operating costs will be required to support ongoing research, development and engineering efforts, development of a customer service organization, increases in sales and marketing efforts, and capital expenditures for leased equipment.

Although the Company believes that its current funds, together with revenue from anticipated sales of MTA systems, may be adequate to continue current levels of business operations through 1998, the Company may require further additional working capital if the sales of the MTA system are substantially delayed. The Company may raise additional equity capital in 1998, even if revenues are received from the sale of MTA systems when anticipated, in order to enhance its financial position for future operations. There can be no assurance that any additional financing will be available on acceptable terms when needed or, if available, will be available on satisfactory terms or that such financings will not be dilutive to the Company's shareholders.

ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is a "small business issuer," as defined under the applicable rules under the Securities Exchange Act of 1934, and is not required to provide the information set forth in Item 305 of Regulation S-K.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

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Balance Sheets at December 31, 1996 and December 31, 1997.....F1
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 Statements of Shareholders' Equity from inception through December 31, 1997.....F3
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QUARTERLY FINANCIAL DATA

(in thousands, except per share data)

The following table presents unaudited quarterly financial information for the two years ended December 31, 1997. In the opinion of management, this information contains all adjustments, consisting only of normal recurring adjustments, necessary for a fair presentation thereof. The operating results are not necessarily indicative of results for any future periods.

For quarter ended:	1996				1997			
	3/31	6/30	9/30	12/31	3/31	6/30	9/30	12/31
Revenue	----	----	----	-----	----	----	----	-----

Gross Profit									\$	21					
Net Operating Expense	\$	3,527	\$	3,721	\$	2,586	\$	2,206	\$	2,401	\$	3,555	\$	4,380	\$5,520
Loss for Common Stock	\$	(3,551)	\$	(3,737)	\$	(2,574)	\$	(2,215)	\$	(2,415)	\$	(3,940)	\$	(4,775)	\$ (6,734)
Loss Per Common Share	\$	(0.90)	\$	(0.79)	\$	(0.41)	\$	(0.35)	\$	(0.36)	\$	(0.55)	\$	(0.46)	\$ (0.61)

The Company's future operating results may be subject to quarterly fluctuations as a result of a number of factors, including the timing of deliveries of the Company's products. See "Business - Risk Factors." Quarter-to-quarter comparisons should not be relied upon as indicators of future performance.

ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

None.

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TERA COMPUTER COMPANY
(a development stage company)
BALANCE SHEETS
DECEMBER 31, 1996 AND 1997

	1996	1997
	-----	-----
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents	\$ 928,760	\$ 13,329,115
Accounts receivable	40,045	99,696
Related party receivable		368,008
Inventory	851,960	4,290,873
Advances to suppliers	310,077	325,385
Other assets	146,350	410,754
Stock subscriptions receivable	1,074,997	
	-----	-----
Total current assets	3,352,189	18,823,831
PROPERTY AND EQUIPMENT, NET	1,182,422	1,914,925
LEASE DEPOSITS	81,902	120,629
	-----	-----
TOTAL	\$ 4,616,513	\$ 20,859,385
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable	\$ 1,070,242	\$ 2,138,343
Accrued payroll and related expenses	1,712,971	1,713,553
Potential contract adjustments	250,000	250,000
Current portion of obligations under capital leases	340,765	379,597
	-----	-----
Total current liabilities	3,373,978	4,481,493
OBLIGATIONS UNDER CAPITAL LEASES, Less current portion	114,474	532,321
SHAREHOLDERS' EQUITY:		
Preferred stock, par \$.01 -- Authorized, 5,000,000 shares; 10,000 shares issued and outstanding of Series A convertible Liquidity preference -- \$11,512,777		8,545,709
Common Stock, par \$.01 -- Authorized, 25,000,000 shares; issued and outstanding,		

6,496,815 and 11,248,096 shares Common Stock subscribed	27,098,153 1,074,997	52,208,938
Accumulated deficit	(27,045,089)	(44,909,076)
Total shareholders' equity	1,128,061	15,845,571
TOTAL	\$ 4,616,513	\$ 20,859,385

See notes to financial statements.

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TERA COMPUTER COMPANY
(a development stage company)

STATEMENTS OF OPERATIONS
YEARS ENDED DECEMBER 31, 1995, 1996 AND 1997, AND
PERIOD FROM DECEMBER 7, 1987 (inception) THROUGH DECEMBER 31, 1997

	1995	1996	1997	INCEPTION THROUGH DECEMBER 31, 1997
REVENUE				
Service revenue	\$	\$	\$ 73,531	\$ 73,531
OPERATING EXPENSES:				
Cost of sales			(51,891)	(51,891)
Research and development	(6,679,492)	(10,503,747)	(13,546,785)	(52,179,985)
Marketing and sales	(281,113)	(664,911)	(1,119,431)	(2,950,300)
General and administrative	(748,569)	(1,057,168)	(1,561,145)	(6,373,612)
	(7,709,174)	(12,225,826)	(16,205,721)	(61,482,257)
RESEARCH FUNDING	2,196,288	185,236	349,407	19,004,252
Net operating expenses	(5,512,886)	(12,040,590)	(15,856,314)	(42,478,005)
OTHER INCOME (EXPENSE)	(133,445)	(36,748)	101,085	(322,313)
NET LOSS	(5,646,331)	(12,077,338)	\$15,755,229)	(42,800,318)
PREFERRED STOCK DIVIDEND			(89,964)	(89,964)
AMORTIZATION OF PREFERRED STOCK DISCOUNT			(2,018,794)	(2,018,794)
LOSS FOR COMMON STOCK	(5,646,331)	\$ (12,077,338)	\$ (17,863,987)	\$ (44,909,076)
LOSS PER COMMON SHARE	\$ (2.13)	\$ (2.27)	\$ (2.03)	\$ (20.47)
WEIGHTED AVERAGE SHARES OUTSTANDING	2,646,243	5,320,785	8,784,943	2,193,839

See notes to financial statements.

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TERA COMPUTER COMPANY
(a development stage company)
STATEMENTS OF SHAREHOLDERS' EQUITY
PERIOD FROM DECEMBER 7, 1987 (inception) THROUGH DECEMBER 31, 1997

Convertible preferred stock

	Series A	Series B	Series C	Series D	Series E
BALANCE, December 7, 1987 Common Stock(1)	\$ --	\$ --	\$ --	\$ --	\$ --
BALANCE, December 31, 1987 Series A preferred stock(2)	215,000				
Common stock(3)					
Series B preferred stock(4)		486,240			
Net loss					
BALANCE, December 31, 1988 Common stock(5)	215,000	486,240			
Series B preferred stock(6)		54,760			
Net loss					
BALANCE, December 31, 1989 Common stock(7)	215,000	541,000			
Series B preferred stock(8)		948			
Series C preferred stock(9)			460,000		
Net loss					
BALANCE, December 31, 1990 Common stock(10)	215,000	541,948	460,000		
Series A preferred stock(11)	35,000				
Series C preferred stock(12)			430,453		
Series D preferred stock(13)				260,000	
Net loss					
BALANCE, December 31, 1991 Common stock(14)	250,000	541,948	890,453	260,000	
Series D preferred stock(15)				521,498	
Net loss					
BALANCE, December 31, 1992 Common stock(16)	250,000	541,948	890,453	781,498	
Series D preferred stock(17)				30,000	
Series E preferred stock(18)					893,876
Net loss					
BALANCE, December 31, 1993 Additional paid-in capital(19)	250,000	541,948	890,453	811,498	893,876
Common stock(20)					
Series E preferred stock(21)					1,669,994
Net loss					
BALANCE, December 31, 1994 Common stock(22)	250,000	541,948	890,453	811,498	2,563,870
Series E preferred stock(23)				402,340	
Common stock(24)					
Common stock(25)					
Common stock(26)	(250,000)	(541,948)	(890,453)	(811,498)	(2,966,210)
Common stock(27)					
Common stock(28)					
Net loss					
BALANCE, December 31, 1995 Common stock(29)					
Common stock(30)					
Series A preferred stock(31)	6,888,194				
Common stock(32)					
Common stock(33)					
Common stock(34)	(6,888,194)				
Net loss					
BALANCE, December 31, 1996 Common stock(35)					
Common stock(36)					
Series B preferred stock(37)		2,829,102			
Common stock(38)					
Common stock(39)					
Common stock(40)		(2,829,102)			
Common stock(41)					
Series C preferred stock(42)			4,962,171		
Common stock(43)					
Common stock(44)			(4,962,171)		

Common stock(35)	1,244,136		1,244,136
Common stock(36)	1,060,405		1,060,405
Series B preferred stock(37)			2,829,102
Common stock(38)	105,296		105,296
Common stock(39)	10,585,646		10,585,646
Common stock(40)	3,625,975	(811,589)	(14,716)
Common stock(41)	17,500		17,500
Series C preferred stock(42)			4,962,171
Common stock(43)	87,365		87,365
Common stock(44)	6,259,340	(1,297,169)	
Common stock(45)	118,125		118,125
Series A preferred stock(46)	932,000		9,477,709
Net loss		(15,755,229)	(15,755,229)
BALANCE, December 31, 1997	52,208,938	\$(44,909,076)	\$15,845,571

See notes to financial statements.

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TERA COMPUTER COMPANY
(a development stage company)

STATEMENTS OF SHAREHOLDERS' EQUITY (continued)
PERIOD FROM DECEMBER 7, 1987 (inception) THROUGH DECEMBER 31, 1997

-
- (1) Issued 319,321 shares of common stock for cash at \$0.001 per share on December 9, 1987.
 - (2) Issued 87,162 shares of Series A preferred stock for cash at \$2.46 per share on January 1, 1988.
 - (3) Issued 319,321 shares of common stock for cash at \$0.001 per share on February 8, 1988, and 42,576 shares of common stock for cash at \$0.18 per share on October 30, 1988.
 - (4) Issued 92,009 shares of Series B preferred stock for cash at \$5.28 per share between September 1 and December 30, 1988.
 - (5) Options issued under the 1988 stock plan were exercised for 709, 709, and 3,548 shares of common stock at the option price of \$0.35 per share on January 2, March 10, and August 7, 1989, respectively.
 - (6) Issued 10,362 shares of Series B preferred stock for cash at \$5.28 per share between March 31 and August 15, 1989.
 - (7) Options issued under the 1988 stock plan were exercised for 4,399 shares of common stock at the option price of \$0.35 per share on December 31, 1990.
 - (8) Issued 160 shares of Series B preferred stock for cash at \$5.92 per share on April 30, 1990.
 - (9) Issued 65,283 shares of Series C preferred stock for cash at \$7.05 per share between April 25 and December 21, 1990.
 - (10) Options issued under the 1988 stock plan were exercised in lieu of directors' fees and travel expenses for 1,464, 4,612, and 2,128 shares of common stock at the option price of \$0.35, \$0.35, and \$0.88 per share on May 10, 1991, December 31, 1991, and December 31, 1991, respectively.
 - (11) Issued 7,450 shares of Series A preferred stock for cash at \$4.70 per share on May 16, 1991.
 - (12) Issued 41,866 shares of Series C preferred stock for cash and 19,223 shares in lieu of convertible debt at \$7.05 per share between April 8 and May 29, 1991, and February 25 and May 29, 1991, respectively.
 - (13) Issued 24,599 shares of Series D preferred stock for cash at \$10.57 per share between December 3 and December 18, 1991.

(14) Options issued under the 1988 stock plan were exercised in lieu of directors' fees and travel expenses for 1,419 and 4,257 shares of common stock at the option price of \$0.35 per share on December 31, 1992; and for 2,270 shares of common stock at the exercise price of \$0.88 per share on December 31, 1992. TERA COMPUTER COMPANY (a development stage company)

See notes to financial statements.

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STATEMENTS OF SHAREHOLDERS' EQUITY (continued)
PERIOD FROM DECEMBER 7, 1987 (inception) THROUGH DECEMBER 31, 1997

- (15) Issued 49,340 shares of Series D preferred stock for cash at \$10.57 per share between February 13 and August 17, 1992.
- (16) Options issued under the 1988 stock plan were exercised for 6,918 and 31,222 shares of common stock for cash and in lieu of compensation at the option price of \$0.35 per share on January 19, 1993, and between January 29 and December 22, 1993, respectively; and for 56 and 15,327 shares of common stock for cash and in lieu of compensation at the option price of \$1.76 per share on November 1, 1993, and on December 22, 1993, respectively; and for 9,440 shares of common stock in lieu of compensation at the option price of \$0.88 per share between September 1 and December 22, 1993; and for 283 shares of common stock in exchange for third-party fees at the option price of \$3.52 per share on December 4, 1993.
- Warrants were also exercised for 27,532 and 2,270 shares of common stock for cash at the exercise price of \$7.05 and \$10.57 per share between January 20 and March 30, 1993, and September 13, 1993, respectively.
- (17) Issued 2,838 shares of Series D preferred stock for cash at \$10.57 per share on January 14, 1993.
- (18) Issued 67,658 shares of Series E preferred stock for cash at \$13.21 per share between November 10 and December 28, 1993.
- (19) Issued stock options of 112, 911, 887, and 13,718 under the 1993 stock plan at an option price of \$0.35 per share in lieu of deferred pay, directors' fees, and bonuses for \$556,921, \$43,750, and \$67,666, respectively, on March 15, 1994.
- (20) Warrants were exercised for 6,149 shares of common stock at the exercise price of \$14.09 per share between March 31 and April 4, 1994, and options issued under the 1988 stock plan were exercised for 4,652 shares of common stock at the option price of \$0.35 per share between March 10 and July 19, 1994.
- (21) Issued 3,358, 3,784, and 19,017 shares of Series E preferred stock for cash at \$13.21 per share between March 17 and September 2, on September 7, and between June 21 and July 1, 1994, respectively; 2,483, 15,966, 58,542, and 17,740 shares of Series E preferred stock for cash at \$14.09 per share between September 8 and October 31, June 30 and July 27, August 2 and December 20, and on October 31, 1994, respectively; and 7,130 shares of Series E preferred stock in lieu of conversion of debt at \$14.09 per share on November 10, 1994. Issuance costs related to these transactions amounted to \$111,363.
- (22) Options issued under the 1988 stock plan were exercised for 4,030, 6,954, and 851 shares of common stock for cash at \$0.35, \$0.88, and \$1.76, respectively, on January 1, 1995; options were exercised for 1,419 shares of common stock for cash at \$1.76 per share on January 17, 1995; and options were exercised for 2,270 shares of common stock in lieu of deferred compensation at \$0.88 per share on March 7, 1995.

See notes to financial statements

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TERA COMPUTER COMPANY
(a development stage company)

STATEMENTS OF SHAREHOLDERS' EQUITY (continued)
PERIOD FROM DECEMBER 7, 1987 (inception) THROUGH DECEMBER 31, 1997

- (23) Issued 17,385 shares of Series E preferred stock for cash at \$14.09 per share between January 25 and June 19, 1995 (net of \$17,150 in total issuance costs); and 4,967 and 11,353 shares of Series E preferred stock in lieu of conversion of debt at \$14.09 and \$9.19 per share on March 6 and April 10, 1995, respectively.
- (24) Convertible notes in the amount of \$3,629,400 were converted into 617,546 shares of common stock on September 29, 1995.
- (25) Issued 1,700,000 shares of common stock and 850,000 securityholder warrants for cash at \$6.00 per share for \$8,409,606 (net of \$1,790,394 in total issuance costs) on September 28, 1995. The securityholder warrants are exercisable at \$7.20.
- (26) On September 29, 1995, 94,612, 102,531, 126,372, 76,777, and 229,383 shares of Series A, B, C, D and E preferred stock were converted into common stock.
- (27) Options under the 1988 and 1993 stock plan were exercised for 4,186 and 12,025 shares of common stock for cash at \$1.76 and \$0.35, respectively, on October 1, 1995.
- (28) Issued 100,000 shares of common stock and 50,000 securityholder warrants for cash at \$6.00 per share for \$491,240 (net \$108,760 in total issuance costs) on October 23, 1995. The securityholder warrants are exercisable at \$7.20.
- (29) Options issued under the 1988 stock plan were exercised for 5,677, 23,992 and 2,838 shares of common stock for cash at \$0.35, \$1.76 and \$5.29 per share, respectively, between January 17 and December 23, 1996.
- (30) Options issued under the 1988 stock plan were exercised for 6,007 and 24,126 shares of common stock at \$1.02 and \$0.35 per share, respectively, for shareholder notes which are due and payable in 1997 and 1999, respectively.
- (31) Issued 2,360,000 shares of Series A convertible preferred stock and 1,180,000 warrants for cash at \$3.40 per share for \$8,024,000 (net \$1,135,806 in total issuance costs) between May and July 1996.
- (32) Options issued under the 1993 stock plan were exercised for 999 and 2,745 shares of common stock on May 28 and December 26, 1996, respectively, for cash at \$0.35 per share.
- (33) Warrants were exercised for 361,952 shares of common stock at \$5.94 per share, of which 180,976 were exercised for cash and 180,976 for shareholder notes which were paid by February 1997. In connection with the exercise of these warrants, the Company issued additional warrants to purchase 90,488 shares of common stock at \$6.00 per share.
- (34) On December 11, 1996, 2,360,000 shares of Series A preferred stock were converted into the same number of shares of common stock. TERA COMPUTER COMPANY (a development stage company)

See notes to financial statements.

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TERA COMPUTER COMPANY
(a development stage company)

STATEMENTS OF SHAREHOLDERS' EQUITY (continued)
PERIOD FROM DECEMBER 7, 1987 (inception) THROUGH DECEMBER 31, 1997

- (35) Options were exercised under the 1988 stock option plan between March 12, 1997 and December 29, 1997, for cash, as follows: 7,827 shares at \$0.35 per share, 6,244 shares at \$0.88 per share, 96,299 shares at \$1.76 per share net of 30,655 shares at \$1.76 per share for shares exercised against notes receivable, and 1,960 shares at \$5.28 per share; options were exercised under the 1993 stock option plan between March 12, 1997 and September 17, 1997, for cash, for 19,201 shares at \$0.35 per share; and options were exercised under the 1995 stock option plan between May 15, 1997 and December 15, 1997, for cash, as follows: 500 shares at \$4.00 per share, 1,250 shares at \$4.125 per share, 1,000 shares at \$4.813 per share, 989 shares at \$4.87 per share, 5,998 shares at \$5.00 per share, 3,166 shares at \$5.25 per share, and 25,000 shares at \$5.50 per share. A \$902,402 compensation expense was recognized for performance-based options.
- (36) The Company issued 299,332 shares of common stock, 6,666 redeemable stock purchase warrants and 68,167 private warrants exercisable at \$6.00 per share for a total of \$1,122,540, in a private placement completed on March 21, 1997, less issuance costs of \$62,135. In connection with this offering, the Company issued 29,041 warrants exercisable at \$6.00 per share to a sales agent.
- (37) The Company issued 3,000 shares of Series B preferred stock at \$1,000 per share on March 24, 1997, for \$3,000,000, less issuance costs of \$170,898.
- (38) The Company issued 21,577 shares at a purchase price of \$4.88 per share pursuant to the 1996 Employee Stock Purchase Plan on May 7, 1997.
- (39) The Company issued 2,838,665 shares of common stock in connection with the exercise of its redeemable stock purchase warrants for an aggregate sum of \$10,652,635 or \$4.00 per share, less transaction costs of \$66,989, on June 25, 1997. All remaining redeemable stock purchase warrants were redeemed at \$.05 per warrant.
- (40) The Company issued an aggregate of 740,266 shares of common stock in connection with the conversion of all of the Series B preferred shares issued in March 1997, including in payment of accrued dividends thereon, from July 1, 1997 through August 8, 1997. The Company also paid cash dividends of \$14,716 on these shares.
- (41) The Company issued 4,000 shares at \$4.38 per share, for services rendered by an independent consultant on August 6, 1997.
- (42) The Company issued 5,000 shares of Series C preferred stock at \$1,000 per share on September 26, 1997, for \$5,000,000, less issuance costs of \$37,829.
- (43) The Company issued 19,159 shares of common stock at a purchase price of \$4.56 per share pursuant to the 1996 Employee Stock Purchase Plan on September 30, 1997.
- (44) The Company issued an aggregate of 478,526 shares of common stock in connection with the conversion of all of the Series C preferred shares issued in September 1997, including in payment of accrued dividends thereon, from November 5 through December 9, 1997. TERA COMPUTER COMPANY (a development stage company)

See notes to financial statements.

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TERA COMPUTER COMPANY
(a development stage company)

STATEMENTS OF SHAREHOLDERS' EQUITY (continued)
PERIOD FROM DECEMBER 7, 1987 (inception) THROUGH DECEMBER 31, 1997

- (45) The Company issued 30,000 shares of common stock pursuant to the exercise of warrants for cash at an exercise price of \$3.9375 per share on December 9, 1997.
- (46) The Company issued 10,000 shares of its Series A preferred stock and 125,000 common stock purchase warrants exercisable at \$19.185 per share,

for a total consideration of \$9,500,000, less issuance costs of \$22,291, on December 23, 1997. The value of the warrants has been calculated at \$932,000.

See notes to financial statements.

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TERA COMPUTER COMPANY
(a development stage company)

STATEMENTS OF CASH FLOWS
YEARS ENDED DECEMBER 31, 1995 AND 1996 AND 1997, AND
PERIOD FROM DECEMBER 7, 1987 (inception) THROUGH DECEMBER 31, 1997

	1995	1996	1997	INCEPTION THROUGH DECEMBER 31, 1997
OPERATING ACTIVITIES:				
Net loss	\$ (5,646,331)	\$ (12,077,338)	\$ (15,755,229)	\$ (42,800,318)
Adjustments to reconcile net loss to net cash used by operating activities:				
Depreciation and amortization	414,953	836,964	801,753	2,703,300
Loss on disposal of assets		20,616	8,087	30,270
Cash provided (used) by changes in operating assets and liabilities:				
Accounts receivable	272,572	2,020	(59,651)	(99,696)
Inventory		(851,960)	(3,438,913)	(4,290,873)
Other assets	(192,995)	89,772	(303,131)	(531,383)
Accounts payable and other accrued liabilities	(793,869)	384,127	1,068,100	2,388,343
Accrued payroll and related expenses	(241,501)	420,345	582	1,713,553
Deferred research funding	(115,177)			
Advances to suppliers	(982,972)	672,895	(15,308)	(325,385)
Net cash used by operating activities	(7,285,320)	(10,502,559)	(17,693,709)	(41,212,188)
INVESTING ACTIVITIES:				
Purchase of property and equipment	(1,348,809)	(423,151)	(1,542,344)	(4,201,023)
Proceeds from disposal of assets		24,500		83,226
Net cash used by investing activities	(1,348,809)	(398,651)	(1,542,344)	(4,117,797)
FINANCING ACTIVITIES:				
Bank borrowings				800,000
Bank repayment				(800,000)
Related party receivable			(368,008)	(368,008)
Shareholder receivable		(1,074,997)	1,074,997	
Issuance of notes payable				1,004,726
Repayment of notes payable	(621,230)			(1,079,726)
Sale of common stock	18,015,512	2,226,407	21,927,031	50,100,181
Sale (conversion) of preferred stock	(5,057,769)	6,886,925	8,545,709	8,545,709
Capital leases, net	561,552	(493,085)	456,679	456,218
Net cash provided by financing activities	12,898,065	7,545,250	31,636,408	58,659,100
NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	4,263,936	(3,355,960)	12,400,355	13,329,115
CASH AND CASH EQUIVALENTS:				
Beginning of period	20,784	4,284,720	928,760	
End of period	\$4,284,720	\$928,760	\$13,329,115	\$13,329,115
SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION:				
Cash paid for interest	\$205,197	\$117,732	\$97,598	\$596,281

Notes payable of \$1,249,400 were converted into 88,657 shares of common stock on September 29, 1995.

The Company issued convertible notes in the amount of \$2,380,000 during July 1995 which were converted into 528,889 shares of common stock on September 29, 1995.

See notes to financial statements.

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TERA COMPUTER COMPANY
(a development stage company)

NOTES TO FINANCIAL STATEMENTS
YEARS ENDED DECEMBER 31, 1995, 1996 AND 1997 AND
PERIOD FROM DECEMBER 7, 1987 (inception) THROUGH DECEMBER 31, 1997

NOTE 1: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

GENERAL: Tera Computer Company (the Company) was incorporated in December 1987 for the purpose of designing, developing, and marketing high performance general purpose parallel computer systems. In 1997, the Company completed development work on its initial prototype hardware and commenced production of its initial production system. The Company currently is in transition from a development stage enterprise to a production company.

Through 1997, no revenue had been generated from product sales. The Company intends to fund its ongoing expenses, including personnel costs, cost of inventory, manufacturing start-up costs and research, development and engineering costs, primarily through use of current cash resources and anticipated revenues from sales of MTA systems. If such sales do not occur or are delayed, then management plans to obtain funding through additional equity and/or debt financings. If the Company does not receive adequate funds, then it would be required to reduce current expenditures, including funds spent on personnel and research and development.

REVENUE RECOGNITION: The Company will recognize revenue from sales of MTA systems as such systems, including resource modules, are accepted by customers. Maintenance revenues generally will be recognized ratably over the term of the maintenance contract. Service revenues are generally recognized as services are performed.

The Company's revenues in 1997 were for services performed under an evaluation subcontract with the San Diego Supercomputer Center, which is the prime contractor with the Defense Advanced Research Projects Agency ("DARPA"). This subcontract expires at the end of 1998.

RESEARCH FUNDING: Research funding is recorded upon submission of vouchers for payment pursuant to government contracts. In July 1991, the Company entered into a three-year, cost-sharing contract with DARPA, which expired in December 1996. The Company billed the entire \$15.5 million committed under this contract by the end of 1995. In September 1995, the Company entered into a \$1 million, three-year, cost-sharing contract with DARPA. As of December 31, 1997, the Company had billed \$542,000 under this contract.

RESEARCH AND DEVELOPMENT: Research and development costs include costs incurred in the development and production of the Company's initial prototype system, hardware and software development expenses, costs incurred to enhance and support existing software features and expenses related to future implementations of the MTA system. Research and development costs are expensed as incurred.

CASH AND CASH EQUIVALENTS: Cash and cash equivalents consist of highly liquid financial instruments that are readily convertible to cash and have original maturities of three months or less at the time of acquisition.

INVENTORY: Inventory is valued at standard costs that approximate actual costs, computed on a first-in, first-out basis, not in excess of market values.

PROPERTY AND EQUIPMENT: Property and equipment consist of office furniture, equipment, software, and computer equipment and are recorded at cost. Depreciation is provided using the straight-line method over the estimated useful lives of the classes of assets, which generally range from three to seven years. Equipment under capital leases is depreciated over the lease term. Maintenance and repairs which do not increase the value of an asset nor extend its useful life are charged to expense as incurred.

INCOME TAXES: Effective January 1, 1993, the Company has accounted for taxes under Statement of Financial Accounting Standards (SFAS) No. 109, Accounting for Income Taxes. Under SFAS No. 109, the liability method is used in accounting for income taxes. Its adoption had no impact on previous periods.

LOSS PER SHARE: Loss per share is computed on the basis of the weighted average number of common shares outstanding during the period after giving effect for any dilutive stock options, warrants and convertible preferred stock. For the years ended December 31, 1995, 1996 and 1997, options, warrants and convertible preferred stock outstanding that would otherwise qualify as common stock equivalents are excluded because their inclusion would have the effect of decreasing the loss per share.

STOCK SPLIT: Share and per share amounts have been restated to reflect a reverse stock split of approximately one-for-3.5231 in September 1995.

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

NOTE 2: SIGNIFICANT RISKS AND UNCERTAINTIES

MANUFACTURING RISKS AND RELIANCE ON THIRD-PARTY SOLE SOURCE SUPPLIERS: The Company's ability to build its computer systems is dependent upon several third-party sole or limited source suppliers. The failure of any of these suppliers to deliver components that meet the Company's specifications would cause delays which would severely affect the Company's business. The Company has experienced such problems already, resulting in delays in the fabrication of the Company's initial prototype and the delivery of its MTA system to the San Diego Supercomputer Center and increasing the demands upon the Company's financial resources.

MARKETING RISKS: The Company's initial market will be U.S. and foreign government agencies and research laboratories, which constitute more than one-half of the market for very high performance computer systems. The U.S. Government historically has facilitated the development of, and has constituted a market for, new and enhanced very high performance computer systems. A change of policy or funding by the U.S. Government or foreign governments that results in a reduction of, or delays in, funding of certain high technology programs employing high performance computing could have a major impact on the market for very high performance computer systems, and would materially and adversely affect the Company's business and results of operations. In addition, the Company's ability to export their products could depend on U.S. Government policy related to high technology exports.

RAPID TECHNOLOGICAL CHANGE: The computer industry is characterized by rapid changes in technology and uncertainty over the impact of emerging technologies. The Company's business would be adversely affected by delays in product development, the failure to gain market acceptance, or products or technologies developed by others which could render the Company's products or technologies noncompetitive or obsolete.

NOTE 3: RELATED PARTY RECEIVABLE

The Company received promissory notes in the aggregate principal amount of \$317,716 and other commitments which net to \$50,292 from certain of its employees in connection with the exercise of stock options in 1997. The notes generally are payable in twelve months or less, bear interest at the rate of 5.68% and 5.84% per year, and are secured by pledges of the stock received upon such exercises.

NOTE 4: INVENTORY

As of December 31, 1996 and 1997, the Company's inventory consisted of components, subassemblies, and work in process, as follows:

	1996 ----	1997 ----
Components and subassemblies	\$851,960	\$3,405,120
Work in process		885,753
	----- \$851,960 =====	----- \$4,290,873 =====

NOTE 5: PROPERTY AND EQUIPMENT

Property and equipment consist of the following at December 31:

	1996 ----	1997 ----
Computer and electronic equipment	\$ 2,247,011	\$3,337,827
Computer software	527,650	886,030
Furniture, fixtures and equipment	279,944	347,117
	----- 3,054,605	----- 4,570,974
Less accumulated depreciation and amortization	(1,872,183)	(2,656,049)
	----- \$ 1,182,422 =====	----- \$1,914,925 =====

Depreciation and amortization expense was \$414,953, \$836,964 and \$801,753 for 1995, 1996 and 1997, respectively.

NOTE 6: LEASES

The Company has acquired computer and other equipment under capital lease lines of credit in the amount of \$406,927 and \$890,785, net of accumulated amortization of \$394,018 and \$804,526 in 1996 and 1997. See Note 5 above. The capital lease line of credit for \$800,000, of which \$500,000 had been expended as of December 31, 1997, expired on that date. An interim lease line of credit for \$425,000 was granted on January 9, 1998 which will expire on April 30, 1998; the Company expects to enter into another lease line of credit at that time.

The Company leases its office space in Seattle under an operating lease. Sales offices are rented pursuant to month-to-month or similar arrangements. The Company has executed a ten-year lease beginning on November 1, 1998 for a new facility to house all of its Seattle operations. Under this lease the Company initially will occupy approximately 85,000 square feet and in three years will occupy approximately 132,000 square feet.

Minimum lease commitments are:

	Capital leases	Operating leases
	-----	-----
1998	\$ 476,908	\$ 1,040,000
1999	375,570	2,032,000
2000	226,448	2,003,000
2001		2,228,000
2002		3,015,000
Later years		18,204,000
	-----	-----
	1,078,926	28,522,000
Less amounts representing interest	167,009	
	-----	-----
	\$ 911,917	\$28,522,000
	=====	=====

Minimum operating lease expenses for 1995, 1996 and 1997 were \$524,442, \$585,017 and \$601,215, respectively.

NOTE 7: COMMITMENTS

The Company is contractually committed to acquire components, and manufacturing and engineering services totaling \$3,450,000 and \$1,692,000, of which \$310,000 and \$325,000 had been advanced to suppliers as of December 31, 1996 and December 31, 1997, respectively.

NOTE 8: FEDERAL INCOME TAXES

Due to the Company's loss position, there was no provision for income taxes for the period from December 7, 1987 (inception) through December 31, 1997.

As of December 31, 1995, 1996 and 1997, the Company had federal net operating loss carryforwards of approximately \$11,930,000, \$24,063,000 and \$39,153,000, respectively. The Company also had federal research and experimentation tax credit carryforwards of approximately \$1,106,000, \$1,283,000 and \$1,825,000, respectively. The net operating loss credit carryforwards will expire at various dates beginning in 2003 through 2012 if not utilized.

The Company's September 1995 initial public offering resulted in a change in stock ownership of the Company as defined by Section 382 of the Internal Revenue Code of 1986, as amended. The net operating loss carryforwards incurred prior to the public offering are limited to an annual utilization of approximately \$700,000. The research and experimentation credit is similarly limited. The annual limitations may result in the expiration of net operating losses and credits before utilization.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amount used for income tax purposes. Significant components of deferred tax assets are as follows at December 31:

	1995	1996	1997
	----	----	----
Warranty reserve	\$ 85,000	\$ 85,000	\$ 85,000
Accrued compensation	291,000	419,000	236,000
Other	31,000	32,000	6,000
Research and experimentation	1,106,000	1,283,000	1,825,000
Net operating loss carryforwards	3,919,000	8,181,000	13,312,000
	-----	-----	-----
Total deferred tax assets	5,432,000	10,000,000	15,464,000
	-----	-----	-----

Valuation allowance for deferred tax assets	\$ (5,432,000)	\$ (10,000,000)	\$ (15,464,000)
	=====	=====	=====

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NOTE 9: SHAREHOLDERS' EQUITY

PREFERRED STOCK: In 1997, the Company issued 3,000 shares of Series B convertible preferred stock for \$3,000,000, less issuance costs, and 5,000 shares of Series C convertible preferred stock for \$5,000,000, less issuance costs, in two private placements. All shares of the Series B and Series C convertible preferred stock were converted into shares of common stock during 1997 at a discount from the market price of the underlying shares of common stock, measured over a specified period immediately prior to each conversion date. In accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 68, "Increasing Rate Preferred Stock," the Company calculated the amount of the discount during 1997 by dividing the proceeds from the private placements by the amount of the conversion feature. With respect to the Series B and Series C preferred stock, the conversion feature was 80%, which was divided into the \$8,000,000 total proceeds, resulting in an aggregate \$2,000,000 discount which was amortized fully in 1997. The Series B and Series C convertible preferred stock each bore a 5% cumulative annual dividend payable in cash or, at the Company's option, in shares of common stock at the same discount from the market price of the common stock. The Company also amortized an aggregate discount of \$18,794 during 1997 for dividends paid in shares of common stock.

In December 1997, the Company issued 10,000 shares of Series A convertible preferred stock with a stated value of \$1,000 per share, all of which were outstanding at December 31, 1997. The Series A preferred shares may be converted into shares of common stock at any time at a conversion price equal to the lesser of \$19.185 per share or the lowest sale price of the common stock during the five trading days immediately prior to the conversion.

The Company may redeem any or all of the Series A preferred shares at any time upon a minimum of 20 days notice at a redemption price equal to the greater of (i) the sum of the stated value of the shares being redeemed and the accrued and unpaid dividends thereon times 115% plus any dividends in arrears, or (ii) the result of multiplying the number of shares issuable upon conversion of the shares being redeemed, including any accrued and unpaid dividends thereon and any dividends in arrears, times the arithmetic average of the closing prices of the common stock during the five trading days immediately prior to the redemption date.

The preferred stockholders are entitled to receive quarterly cash dividends at the rate of 5% of the stated value per annum. Dividends accrue from the date of issuance through and including the date that the shares are converted or redeemed. Dividends may be paid in cash or, at the Company's option, in common stock based on the lowest sale price during the five trading days preceding the date of payment.

Holder of Series A preferred shares have no voting rights. In the event of voluntary or involuntary liquidation, the holders of the Series A preferred shares are entitled to receive in cash, before any amount is paid to holders of common stock, an amount equal to the stated value of Series A preferred shares plus any accrued and unpaid dividends.

SECURITYHOLDER WARRANTS: At December 31, 1997, the Company had outstanding private warrants to purchase an aggregate of 214,342 shares of common stock, as follows: warrants covering 20,321 shares exercisable at \$14.09 per share through September 24, 2000; warrants covering 90,488 shares exercisable at \$6.00 per share through February 28, 2002; warrants covering 5,801 shares exercisable at \$6.00 per share through November 7, 2005; and warrants covering 524 shares exercisable at \$6.00 per share through May 21, 2006.

As part of the December 1997 issuance of its Series A convertible preferred stock, the Company also issued warrants to the holders of the Series A preferred shares to purchase 125,000 shares of common stock. The warrants are exercisable through December 23, 2002, at an exercise price of \$19.185 per share.

REPRESENTATIVE WARRANTS: In 1997, The Company issued warrants to purchase 700,000 shares of common stock at an exercise price of \$3.9375 per share, expiring on April 21, 2002, and warrants to purchase 300,000 shares of common stock at an exercise price of \$4.50 per share, expiring on June 25, 2002 in exchange for certain financial advisory services and the cancellation of earlier warrants issued as representative warrants in connection with the Company's 1995 initial public offering and sales agent's warrants issued in connection with a 1996 private placement. At December 31, 1997, warrants to purchase 670,000 shares of common stock at \$3.9375 per share and warrants to purchase 300,000 shares of common stock at \$4.50 per share were outstanding.

STOCK OPTIONS: The Company's 1988 Employee Stock Option Plan ("1988 Plan") provided for issuance to eligible employees and advisors of incentive stock options and nonstatutory stock options to purchase common stock at or below fair market value at the date of grant. Outstanding options expire ten years from the date of grant and are generally exercisable in full upon grant, but are subject to repurchase rights based on a four-year vesting schedule and rights of first refusal. The 1988 Plan was terminated by the Board of Directors in 1995. Options for 453,107 shares remain outstanding under the 1988 Plan as of December 31, 1997.

Options for 58,301 shares granted under the 1988 Plan to certain employees, including executive officers, contained performance conditions for exercise, permitting one-half of the options to be exercised when the Company's MTA system exceeded certain benchmark tests and upon initial shipment of the MTA system to a customer. In addition, Burton J. Smith and James E. Rottsolk, the respective Chairman and President of the Company, together matched the Company's options with options covering the same number of shares and containing the same terms on shares of the Company's common stock which they owned. The performance criteria were satisfied in 1997, and all such options were exercised. In connection with these exercises, the Company recognized as compensation expense the aggregate amount of \$902,402, measured as the difference between the fair market value of the Company's common stock on the day the performance criteria were satisfied and the \$1.76 per share exercise price. The Company also accepted notes as payment for the exercise price and related payroll taxes from certain employees, including two executive officers. See Note 3, above.

In 1993, the Company established the 1993 Employee Stock Option Plan ("1993 Plan"). The 1993 Plan made available options for 283,840 shares to be issued to eligible employees and advisors. Outstanding options expire five years from the date of grant, with vesting provisions to be specified upon grant, although options generally vest over four or five year periods. The 1993 Plan was terminated by the Board of Directors in 1995. Options for 98,781 shares remain outstanding under the 1993 Plan as of December 31, 1997.

In 1995, the Company established the 1995 Employee Stock Option Plan ("1995 Plan"). As amended, the 1995 Plan permits options for 2,000,000 shares to be issued to eligible employees, officers, or agents of the Company. Outstanding options expire ten years from the date of grant, with vesting provisions to be specified upon grant, although options generally vest over four or five year periods. As of December 31, 1997, options covering 532,483 shares of common stock remained available for grant under the 1995 Plan.

In 1995, the Company established the 1995 Independent Directors Stock Option Plan ("1995 Directors Plan"). The 1995 Directors Plan makes available 100,000 shares to be issued to independent directors only, with options covering 1,500 shares of common stock awarded for each year of the term for which each director is elected or re-elected at an exercise price equal to the fair market value of the common stock on the date of award. Outstanding options expire ten years from the date of grant. Options vest cumulatively, with 1,500 shares becoming exercisable for each year that the optionee remains a director. As of December 31, 1997, 83,500 shares remained available for grant under the 1995 Directors Plan.

The following table summarizes plan activity under the Company's Stock Option Plans for the three years ended December 31, 1997:

Options	Number of Shares							
	1988 Plan	Wgdt. avg. exer. price	1993 Plan	Wgdt. avg. exer. price	1995 Plan	Wgdt. avg. exer. price	1995 Directors Plan	Wgdt. avg. exer. price
Outstanding at December 31, 1994	625,884	\$1.96	133,746	\$0.35				
Granted	56,386	5.28			255,450	\$5.00		
Exercised	(19,710)	1.97	(12,020)	0.33				
Canceled	(42,884)	2.65			(1,000)	5.00		
Outstanding at December 31, 1995	619,676	\$2.24	121,726	\$0.35	254,450	\$5.00		
Exercisable at December 31, 1995	445,616	\$1.71	121,726	\$0.35				
Granted					878,650	5.21	12,000	\$5.50
Exercised	(29,670)	1.49	(3,744)	0.35				
Canceled	(20,053)	4.85			(19,467)	4.92		
Outstanding at December 31, 1996	569,953	\$2.21	117,982	\$0.35	1,111,133	\$5.16	12,000	\$5.50
Exercisable at December 31, 1996	460,181	\$1.97	117,982	\$0.35	82,595	\$4.99		
Granted					412,357	6.43	4,500	
Exercised	(112,330)	1.67	(19,201)	0.35	(37,903)	5.30		
Canceled	(4,516)	4.48			(18,020)	4.51		
Outstanding at December 31, 1997	453,107	\$2.32	98,781	\$0.35	1,467,517	\$5.52	16,500	\$5.16
Exercisable at December 31, 1997	435,376	\$2.20	98,781	\$0.35	391,152	\$5.11	6,000	\$5.50

The following table summarizes information about stock options outstanding at December 31, 1997:

Range of exercise prices	Options Outstanding			Options Exercisable	
	Outstanding as of December 31, 1997	Weighted-average remaining contractual life	Weighted-average exercise price	Exercisable as of December 31, 1997	Weighted average exercise price
\$ 0.00 - \$ 2.00	413,714	2.6	\$ 0.93	413,634	\$0.93
\$ 2.01 - \$ 4.00	44,237	7.9	3.78	17,591	3.56
\$ 4.01 - \$ 6.00	1,528,154	8.4	5.23	434,090	5.1
\$ 6.01 - \$10.00					
\$10.01 - \$12.00	5,000	9.8	11.50		
\$12.01 - \$14.00	28,500	9.7	13.30		
\$14.01 - \$16.00	2,000	9.6	16.00		
\$16.01 - \$18.00	14,300	9.6	17.70		
	2,035,905	7.2	\$ 4.56	865,315	\$3.08

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In 1996, the Company established an Employee Stock Purchase Plan ("1996 ESPP"). The maximum number of shares of the Company's common stock that employees may acquire under the 1996 ESPP is 1,000,000 shares. Eligible employees are permitted to acquire shares of the Company's common stock through payroll deductions not exceeding 15% of base wages. The purchase price per share under the 1996 ESPP is the lower of (a) 85% of the fair market value of the Company's Common Stock at the beginning of each six month offering period or (b) the fair market value of the Common Stock at the end of each six month offering period.

FAIR VALUE INFORMATION: The Company applies Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees and related Interpretations in accounting for its stock option and purchase plans. Had compensation cost for the Company's stock option plans and its stock purchase plan been determined based on the fair value at the grant dates for awards under those plans consistent with the method of Statement of Financial Accounting Standards (SFAS) No. 123, Accounting for Stock-Based Compensation, the Company's loss for common stock and loss per common share for the years ended December 31, 1995, 1996 and 1997 would have been increased to the pro forma amounts indicated below:

Loss for common stock --

	1995 ----	1996 ----	1997 ----	Inception to Date -----
As reported	\$ (5,646,243)	\$ (12,077,338)	\$ (17,863,987)	\$ (44,909,076)
Pro forma	\$ (5,901,930)	\$ (12,893,740)	\$ (19,359,707)	\$ (47,476,885)

Loss per common and common equivalent share --

	1995 ----	1996 ----	1997 ----	Inception to Date -----
As reported	\$ (2.13)	\$ (2.27)	(2.03)	\$ (20.47)
Pro forma	\$ (2.23)	\$ (2.42)	(2.20)	\$ (21.64)

The estimated fair values of options granted during 1995, 1996 and 1997 were \$4.62, \$4.76 and \$5.85 per share, respectively; these fair values were estimated as of the dates of grant using the Black-Scholes option-pricing model with the following weighted-average assumptions: no dividend yield, expected volatility of 101%, risk-free interest rate of 5.58%, 6.50% and 5.74% for 1995, 1996 and 1997, respectively, and an expected term of 9.75 years. Pro forma compensation cost of options granted under the 1996 ESPP is measured based on the discount from market value.

The pro forma disclosure above includes the amortization of the fair value of all options granted during 1995, 1996 and 1997. If only options granted during 1996 and 1997 were valued, as prescribed by SFAS No. 123, pro forma loss for common stock would have been \$12,666,857 and \$18,994,325, and loss per common share would have been \$2.38 and \$2.16 for 1996 and 1997.

Because SFAS No. 123 does not apply to awards granted prior to 1995, the resulting compensation expense reflected in the pro forma disclosure above may not be indicative of future amounts.

NOTE 10: LOSS PER COMMON SHARE

The Company adopted SFAS No. 128, Earnings Per Share, for the year ended December 31, 1997, as required. On February 3, 1998, the SEC released Staff Accounting Bulletin (SAB) No. 98, which

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requires companies to restate all prior periods presented in accordance with the provisions of SFAS No. 128, including those periods prior to an initial public offering.

The weighted average number of shares outstanding used to compute basic loss per share were 2,646,243, 5,320,785 and 8,784,943 for the years ended December 31, 1995, 1996 and 1997, respectively. Because the results from operations reflect a net loss for all years presented, basic and diluted loss per share are calculated based on the same weighted average number of shares outstanding.

The following outstanding warrants, options and preferred stock were not included in the computation of diluted loss per share, as of December 31, because the effect was antidilutive:

	1995		1996		1997	
	Number	Exercise Price	Number	Exercise Price	Number	Exercise Price
Stock warrants	1,364,199	\$6.00-\$8.40	2,440,473	\$5.94-\$14.09	1,309,342	\$3.94-\$19.19
Common stock options	995,852	\$0.35-\$5.28	1,811,068	\$0.35-\$ 5.75	2,035,905	\$0.35-\$17.75
Convertible preferred stock					10,000	\$14.44

NOTE 11: RETIREMENT PLAN

In 1989, the Company adopted a tax-qualified savings plan and trust, which was amended and restated as of April 1, 1994, under Section 401(k) of the Internal Revenue Code of 1986 (the "Plan"). All employees are eligible to participate as of the first day of the fiscal quarter following employment. The Plan is funded by voluntary employee salary contributions from 1% to 15% of annual compensation. The Company may make voluntary matching contributions in amounts determined annually by the Board of Directors. As of December 31, 1997, the Company had contributed \$219,133 to the Plan, and has accrued \$102,158 as a contribution to the Plan for 1997.

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[DELOITTE & TOUCHE LLP LOGO]

INDEPENDENT AUDITORS' REPORT

Board of Directors and Stockholders of
Tera Computer Company
Seattle, Washington

We have audited the accompanying balance sheets of Tera Computer Company (a development stage company) as of December 31, 1996 and 1997, and the related statements of operations, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1997 and the period from December 7, 1987 (inception) through December 31, 1997. 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, such financial statements present fairly, in all material respects, the financial position of Tera Computer Company as of December 31, 1996 and 1997, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1997, and the period from December 7, 1987 (inception) to December 31, 1997, in conformity with generally accepted accounting principles.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
January 21, 1998

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PART III

Certain information required by Part III is omitted from this Report as the Company will file a definitive proxy statement for the Annual Meeting of Shareholders to be held on May 6, 1998 pursuant to Regulation 14A (the "Proxy Statement") not later than 120 days after the end of the fiscal year covered by this Report, and certain information included therein is incorporated herein by reference. Only those sections of the Proxy Statement which specifically address the items set forth herein are incorporated by reference.

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to Directors may be found under the caption "Election of Directors" in the Company's Proxy Statement. Such information is incorporated herein by reference. Information with respect to Executive Officers may be found on pages 18 and 19 hereof, under the caption "Executive Officers of the Registrant." Information with respect to compliance with Section 16(a) of the Exchange Act by the persons subject thereto may be found under the caption "Compliance With Section 16(a) of the Securities Exchange Act of 1934" in the Proxy Statement and is incorporated herein by reference.

ITEM 11. EXECUTIVE COMPENSATION

The information in the Proxy Statement set forth under the captions "Information Regarding Executive Officer Compensation" and "Board of Directors and Committee Meetings" is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

The information in the Proxy Statement set forth under the caption "Security Ownership of Certain Beneficial Holders and Management" is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

The information set forth in the last paragraph under the caption "Stock Options" in the Proxy Statement is incorporated herein by reference.

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ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K

(a) EXHIBIT LISTING

- 3.1 Restated Articles of Incorporation (1)
- 3.2 Restated Bylaws (1)
- 4.1 Statement of Rights and Preferences of the Series A Convertible Preferred Stock of the Registrant, as filed with the Secretary of State of the State of Washington on December 23, 1997 (7)
- 10.1 1988 Stock Option Plan (2)
- 10.2 1993 Stock Option Plan (2)
- 10.3 1995 Stock Option Plan (2)
- 10.4 1995 Independent Director Stock Option Plan (2)
- 10.5 Agreement between the Defense Advanced Research Projects Agency and the Registrant, Contract No. MDA972-91-C-0021, dated July 1, 1991 (2)
- 10.6 Agreement between the Defense Advanced Research Projects Agency and the Registrant, Contract No. MDA972-95-C-0003, dated February 23,

1995 (3)

- 10.7 Cooperative Research and Development Agreement No. SC94/01282 between Sandia Corporation and the Registrant, dated July 26, 1994 (2)
- 10.8 Cooperative Research and Development Agreement No. TC-695-93 between Regents of the University of California and the Registrant, dated July 15, 1994 (2)
- 10.9 Agreement between Cadence Design Systems, Inc. and the Registrant entitled "Statement of Work for Gate Array and Standard Cell Place and Route," dated May 30, 1995 (3)
- 10.11 Office Lease Agreement between Blume Eastlake Limited Partnership and the Registrant, dated January 24, 1994 (2)
- 10.12 Agreement between the Advanced Research Projects Agency and the Registrant, Contract No. DABT63-95-C-0096, dated September 27, 1995 (5)
- 10.13 Agreement between Unisys Corporation and the Registrant, dated December 5, 1995 (5)
- 10.14 Agreement between Unisys Corporation and the Registrant, dated August 16, 1996 (4)
- 10.15 Cooperative Agreement between The Regents of the University of California, University of California, San Diego and the Registrant, dated November 11, 1996 (6)
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- 10.17 Subcontract Agreement Between the Regents of the University of California and the Registrant, effective July 1, 1997
- 10.18 Lease Agreement between Merrill Place, LLC and the Registrant, dated November 21, 1997.
- 11.1 Computation of Earnings Per Share
- 23.1 Independent Auditors' Consent
- 27.1 Financial Data Schedule

(1) Incorporated by reference to Amendment No. 3 to Form SB-2 Registration Statement, Registration No. 33-95460-LA, as filed with the Commission on September 22, 1995.

(2) Incorporated by reference to Form SB-2 Registration Statement, Registration No. 33-95460-LA, as filed with the Commission on August 3, 1995.

(3) Incorporated by reference to Form SB-2 Registration Statement, Registration No. 33-95460-LA, as filed with the Commission on August 3, 1995, and to the Order granting the Company's application respecting Confidential Treatment.

(4) Incorporated by reference to Post-Effective Amendment No. 3 on Form S-3 to Form SB-2 Registration Statement, Registration Statement No. 33-95460-LA, as filed with the Commission on December 6, 1996, and to the Order granting the Company's application respecting Confidential Treatment.

(5) Incorporated by reference to Form 10K-SB as filed with the Commission for fiscal year ended December 31, 1995, and to the Order granting the Company's application respecting Confidential Treatment.

(6) Incorporated by reference to Form 10-QSB as filed with the Commission for the quarterly period ended September 30, 1996, and to the Order granting the Company's application respecting Confidential Treatment.

(7) Incorporated by reference to Form S-3 Registration Statement, Registration No. 333-44137, as filed with the Commission on January 12, 1998.

(8) Incorporated by reference to Form 10-QSB, as filed with the Commission for the quarterly period ended September 30, 1997.

(b) REPORTS ON FORM 8-K

One Form 8-K, dated and filed on October 1, 1997, reported the raising of \$5,000,000 through a private placement of preferred stock under Item 5.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act , the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized in the City of Seattle, State of Washington, on March 30, 1998.

TERA COMPUTER COMPANY

By JAMES E. ROTTSOLK

James E. Rottsolk
Chief Executive Officer
and President

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of Registrant and in the capacities indicated on March 30, 1998.

Signature -----	Title -----
By JAMES E. ROTTSOLK ----- James E. Rottsolk	Chief Executive Officer, President and Director
By BURTON J. SMITH ----- Burton J. Smith	Chairman of the Board of Directors and Chief Scientist
By KENNETH W. JOHNSON ----- Kenneth W. Johnson	Chief Financial Officer
By DAVID N. CUTLER ----- David N. Cutler	Director
By DANIEL J. EVANS ----- Daniel J. Evans	Director
By KENNETH W. KENNEDY ----- Kenneth W. Kennedy	Director
By JOHN W. TITCOMB, JR. ----- John W. Titcomb, Jr.	Director

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Purchase Order# 10147520-001 Schedule
(2/6/98)

SUBCONTRACT AGREEMENT BETWEEN

THE REGENTS OF THE UNIVERSITY OF CALIFORNIA
UNIVERSITY OF CALIFORNIA, SAN DIEGO, PURCHASING SUBCONTRACTS
9500 GILMAN DRIVE
LA JOLLA CA 92093-0914

AND

TERA COMPUTER COMPANY
2815 EASTLAKE AVENUE EAST
SEATTLE, WA 98102-3007

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This Agreement is executed by and between The Regents of the University of California, University of California, San Diego, a corporation of the State of California (hereinafter referred to as "the University"), and Tera Computer Company, A WASHINGTON CORPORATION, (hereinafter referred to as "Subcontractor").

WHEREAS, the University is the recipient of Contract No. DABT63-97-CA-0028 ("Prime Award") issued by the Defense Advanced Research Projects Agency (DARPA) ("Prime Sponsor") for the conduct of a project entitled: "Evaluation of a Multithreaded Architecture for Defense Applications" ("Project") which is attached hereto, identified as Attachment A, Prime Award and incorporated herein by references as an integral part of this Agreement; and

WHEREAS, it is considered in the best interest of the United States Government and the University for the Subcontractor to participate in this Project;

NOW, THEREFORE, in consideration of the mutual promises and covenants contained herein, the University and the Subcontractor agree to a cost-reimbursement subcontract ("Agreement") under said Prime Award.

1 SUPPLIES OR SERVICES

1.1 Scope of Work

Subcontractor shall furnish the necessary materials, facilities, equipment, and services for performance of Subcontractor's performance as detailed in Attachment B, Statement of Work, and if and to the extent updated by a Supplemental Statement of Work, all incorporated herein by reference as an integral part of this Agreement.

1.2 Contract Type: Cost Plus Fixed Fee

This Agreement is a cost reimbursement, fixed fee, subcontract for research and development work.

2 PERIOD OF PERFORMANCE

This Agreement Project Period shall begin on 7/1/97 and shall terminate on 12/31/98 subject to continuation and prime funding of the Project. For purposes of allowable expenditures of funds allocated hereunder, the funding period ("Budget Period") is from

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7/1/97 through 12/31/98 . Services to be furnished hereunder shall be performed and completed within the Project Period unless this Agreement is extended or terminated as provided herein. Unless otherwise approved when/if additional funds are allocated, funds not expended in one Budget Period may not be carried forward into subsequent Budget Periods.

3 COST, FUNDING AND PAYMENT

3.1 Cost

In consideration of the services rendered and items delivered or reported by the Subcontractor in accordance with Article 1 above and revisions thereto, the University will provide compensation to the Subcontractor for any work on a cost reimbursement basis. The Subcontractor agrees to use its best efforts to perform all work and obligations under this Agreement within the estimated cost in the period of performance set forth above. The amount allotted for the first Budget Period shall not exceed the amount of One million, eighty thousand dollars (\$1,080,000.00) as detailed in the budget included in Attachment B. Regardless of the cumulative amount of funds allotted under this Agreement, Subcontractor may not expend funds except in accordance with Statement of Work which has been approved by the University's Principal Investigator and, if necessary, by the Prime Sponsor's Project Director and/or Contracts Officer.

3.2 Allowable Costs

Allowable costs are those as itemized on the budget included in Attachment B. Notwithstanding the above, the Subcontractor shall be reimbursed for cost incurred in accordance with Prime Award and FAR 52.216-7 "Allowable Cost and Adjustment" (MAR 97), as limited by Article 3.5 below, and with procedures and practices as approved by the University and the Subcontractor's cognizant government audit agencies. At the University's sole discretion, the University may request audit or examination by the cognizant government agencies or Contract Office, to the extent permitted by law and provisions of this Agreement, of all books, records, invoices and other materials of the Subcontractor. In the event the Subcontractor's cognizant government audit agencies or Contract Office refuse to audit, the University shall have the right to audit. Subcontractors shall not purchase any materials, supplies, or equipment unless they are necessary to the performance of the requirements of the subcontract and/or authorized under the terms of the subcontract or approved or directed by the University's ACO.

3.3 Travel

All travel costs, including per diem rates, must be approved in writing in advance, regardless of whether costs are included on budget included in Attachment B. (Prime H.3)

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3.4 Subcontracts

Subcontractor is authorized to issue the subcontracts (third-tier) to the vendors and in the amounts as indicated on the budget included in Attachment B, provided however that such third tier subcontracts include all applicable terms of prime award Attachment A, as well as this Purchase Order Subcontract, and provided further that Subcontractor complies with all applicable procurement regulations with regard to determining, applying and documenting appropriate source selection and price reasonableness procedures.

3.5 Limitation of Funds

The amount currently available for payment hereunder is limited to the Cumulative Allotted Funds noted on the face page of above-referenced Purchase Order and any modifications or Change Orders subsequently issued thereto. It is estimated that the Cumulative Allotted Funds will cover the cost of performance through the Budget Period specified in Article 2, above, as noted on the face page of the PO or Change Order. Allowable costs constitute those costs incurred by Subcontractor in the performance of this Agreement in accordance with Article 3.2 above, and as limited by FAR 52.232-20 entitled "Limitation of Cost" (APR 1984). Accordingly, no legal liability on the part of the Prime Sponsor or the University for payment in excess of the cumulative amount allotted shall arise unless additional funds are made available and are incorporated/allocated as a modification to this Agreement. Subcontractor agrees to give timely written notification to the University Subcontract Officer at any time Subcontractor has reason to believe the total cost to the University will be GREATER or LESS than the estimated costs set forth in the approved budget (Attachment B) and allocated hereunder. Subcontractor will comply with the provisions of Article H.10 of the Prime Award (Attachment A) in giving such notice.

3.6 Estimated Funding for Project Period

A total amount of funding for the entire Project Period may be estimated in Subcontractor's budget included in Attachment B, and as modified from time to time. While the parties may estimate or project future funding for the entire Project Period, in no event is the University or the Prime Sponsor liable to reimburse Subcontractor for expenses incurred, whether or not projected in Subcontractor's Statement of Work or budget, in excess of the Cumulative Allotted Funds under above-referenced Purchase Order. Allocation of additional incremental funding to Subcontractor is dependent upon satisfactory progress, the proposed Statement of Work, and the availability of funds.

3.7 Invoicing and Payment

The Subcontractor shall submit invoices not more frequently than monthly for the allowable costs incurred in the performance of the work hereunder to the University. Costs

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must be identified on each invoice by line item similar to the budget in Attachment B. Invoices in triplicate shall be submitted to:

DISBURSEMENTS OFFICE, 0955
UNIVERSITY OF CALIFORNIA, SAN DEF-GO
LA JOLLA, CALIFORNIA 92093-0954

To expedite approval and payment of Subcontractor invoices, Subcontractor may submit a courtesy copy of all invoices to the University's Project Director. For coordination of invoices telephone R. Mercardo at (619) 534-0907. The University will make provisional payment on all invoices submitted in accordance with the terms of this Agreement.

4 PACKAGING AND MARKING OF REPORTS AND DELIVERABLES

All deliverable reports required hereunder shall be marked with the following information:

UCSD PO number: 10147520
Prime Contract Number: DABT63-97-C-0028
Prime Contract Requisition/Purchase Request and commitment Number (PR&C):
HJ1500-7074 0297
Prime AAP Number: DAR7-F188/00
Project Title: Evaluation of a Multithreaded Architecture for Defense Applications

5 REPORTS AND DELIVERABLES

5.1 Deliverables

Deliverables under this Agreement are the reports as specified in Article 5.3 below. No other tangible personal property is deliverable hereunder.

5.2 Delivery of Reports

Unless otherwise directed, reports are to be transmitted electronically to the University's Principal Investigator and Project Manager at the e-mail addresses in Article 6.2 below. The University Project Manager will provide electronic report templates based on MS Word 6.0 and MS Excel 5.0.

5.3 Contract Data Requirements List

Attachment A, Prime Award, includes "Exhibit A" which is DD Form 1423, Contract Data Requirement List (CDRL), A001 through A003, and Data Item Description

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(DID) forms. Subcontractor is required to submit reports in accordance with CDRL and DID information in Attachment A, Exhibit A, and summarized below:

Table with 4 columns: CDRL Data Item, Title of Data Item, DID number (form number), Due Date - to UCSC. Rows include A001 (Scientific and Technical Report), A002 (R&D Status Report), and A003 (Funds and Man-hour Expenditure Report).

*Notwithstanding the information required for Data Item A003, Subcontractor shall not be required to submit Funds Expenditure and Work Completed Graphs. In satisfaction of this reporting requirement, Subcontractor shall be required to report the percentage of work planned and work actually completed during the reporting period.

5.4 Articles

One copy of each paper planned for publication in appropriate professional journals shall be submitted to the Prime Contractor via the Principal Investigator, both before proposed publication and after publication. Proposed publications may be submitted electronically or hard copies may be mailed to the address specified in Article 6.2. (Prime, Article H.5).

5.5 Closeout Reports

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In addition to reports as required above, upon termination or expiration of this Agreement Subcontractor agrees to comply with the closeout guidance set forth in the Prime Award, and to submit final reports as provided in Article 17, Closeout, below.

6 CONTRACT ADMINISTRATION DATA

6.1 Prime Sponsor's Key Personnel and Responsibility

6.1.1 Government Contract Administrator

The Government Contract Administrator will act as the Prime Sponsor's representative for administrative matters pertaining to changes/increases in the scope of work, technical oversight, or funding.

The contract administrator is:

Barbara VanDoren phone: 520 538-0423
Directorate of Contracting fax: 520 533-1600
Attn.: ATZS-DKO-I

Post Office Box 12748
Fort Huachuca, AZ 85670-2748

6.2 University's Key Personnel and Responsibility

6.2.1 Principal Investigator

The University's Principal Investigator (Technical Representative) of the Prime Award is Dr. Wayne Pfeiffer who shall coordinate the performance of the various investigators and all subcontractors under the Prime Award, and under this Agreement, and who is responsible for the overall management of the effort necessary for the timely and professional execution of the project and for attaining the project goals. The University's PI does not have authority to issue contractual modifications or changes to the terms and conditions of this Agreement.

Dr. Wayne Pfeiffer Phone: (619) 534-5120
Principal Investigator Fax: (619) 534-5056
University of California, San Diego E-mail: wpfeiffer@usc.edu
9500 Gilman Drive
La Jolla CA 92093-0407

6.2.2 Project Director

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The University's Project Director is Mr. Jim D'Aoust who is designated the University's (UCSD) Project Management Representative(s) and who is responsible for day-to-day management and project direction for the University, and for coordination of the work with the Subcontractor's project director(s) and investigator(s). The Project Director is delegated by the Principal Investigators to give direction, clarification and approval which lies within the scope of the Agreement.

Project Director
Tera Computer Corporation
2815 Eastlake Ave, East
Seattle WA 98102-3027

Fax: (206) 490-
E-mail: russell@tera.com

6.4.3 Contracts Officer

Subcontractor's Contracts Officer is Kenneth Johnson, who, together with Subcontractor's Project Director, has the authority to issue contractual modifications or changes to the terms of this Agreement. In the event that the Subcontractor effects any change at the direction of any person other than the Project Director or Contracts Officer, the change will be considered to have been made without authority.

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Mr. Kenneth Johnson
Contracts Officer
Tera Computer Corporation
2815 Eastlake Ave, East
Seattle WA 98102-3027

Phone: (206) 490-2091
Fax: (206) 323-1318
E-mail: ken@tera.com

7 CHANGES AND MODIFICATIONS

All substantive changes and modifications to this Agreement must be approved by both parties by means of a written modification to this Agreement, signed by individuals with authority to enter into such agreements at a level equal to the authority to enter into the original Agreement. Depending upon the terms and conditions of the Prime Award, changes and modifications to this Agreement may require approval of the Prime Sponsor. Substantive modifications in any of the terms of this Agreement which require a specific written approval by the Prime Sponsor shall not be effective prior to receipt of the written acceptance or ratification by the Prime Sponsor to the change, modification, or amendment. Neither the University nor the Prime Sponsor is obligated to pay for additional costs authorized by formal change or modification until such change or modification is approved by both parties hereunder.

8 DISPUTES

If either party believes there is a dispute either of fact or of interpretation arising from the performance or administration of this Agreement, they will promptly notify the other party, and the parties agree to exercise their best efforts to reach a fair and equitable resolution of the dispute. The parties involved in the dispute, including any subcontractors engaged by the Subcontractor, shall proceed diligently with performance of this Agreement including any subcontracts issued by Subcontractor hereunder, as directed by University, pending final resolution of any request for relief, claim, appeal or action related to this Agreement. If the dispute cannot be resolved by the parties involved, the complainant may file a protest or notice of other controversy with the University's Contractual Officer, at the address in Article 6.2.2. All protests or notices must be in writing. The parties' respective Contractual Officers shall be delegated with the authority to investigate the issues involved in the dispute, analyze the findings, consult with the parties' respective legal counsel where appropriate, and attempt to mediate a resolution to the dispute. The University's Contractual Officer shall hand down a written decision which shall be final and conclusive upon the parties as to questions of fact. Compliance with this Article does not preclude use of any other legal remedies by the parties.

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9. PUBLICATIONS ACKNOWLEDGMENT AND DISCLAIMER

9.1 Publications

All news releases, public information brochures, publications, and other similar items (not limited to printed media, and including video, etc.) prepared by the either party and/or it's employees or contractors, which describe activities or results under this Agreement ("Publications") shall be coordinated with the other party and the Prime Sponsor Responsible Official before release. The publishing party will provide advance copies of all proposed technical articles to the other party sufficiently in advance of proposed publication to permit the other party to comment.

9.2 Acknowledgment

It is the intent of this article that presentations, publications (e.g.) pamphlets, journal articles, reports, books, teaching guides, software), audiovisuals (e.g. posters, slides, videotapes, film), or other materials that result from activities of this Project should indicated or show program attribution. All Publications shall acknowledge the sponsorship of the Prime Sponsor in substantially the following terms: "This material is (partially) based on work sponsored by Contract #N00164-96-C-0022. The Government has certain rights to this material."

9.3 Disclaimer

All materials, except scientific articles or papers published in scientific journals, must also contain the following: "Any opinions, findings, and conclusions or recommendations expressed in this publication are solely the responsibility of the author(s) and do not necessarily represent or reflect the official views of the Government or the Regents of the University of California."

10 EQUIPMENT AND REAL PROPERTY

No equipment or real property may be acquired by Subcontractor hereunder.

11 PATENTS AND INVENTIONS

11.1 Applicable Law

Patents and inventions arising under this Agreement shall be subject to the provisions of Far 52.227-11, Patent Rights -- Retention by the Contractor (Short Form) (Jun 1989).

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11.2 Invention Disclosure

Any invention or patentable idea developed, made or conceived by employees of the Subcontractor, in the course of research performed under this Agreement, and upon disclosure to the Subcontractor, shall be reported to the Prime Sponsor with a copy of the report provided to the University. Upon request, Subcontractor agrees to provide an annual and final report of inventions to the University.

11.3 Joint Inventions

For inventions made jointly by University and Subcontractor employees, the University and Subcontractor will reach agreement through good faith discussions as to which party shall handle the reporting and other administrative matters pertaining to inventions made with Government support under this Cooperative Agreement, and to negotiate in good faith regarding the disposition of rights, including copyright, patent and license of joint inventions, such disposition taking into consideration the relative contributions of the inventors.

12 RIGHTS IN DATA

The Government shall have unlimited rights in Technical Data provided hereunder by subcontractor, including all reports and other deliverables. (Prime H.11).

13 UNIVERSITY ACCESS TO PROJECT INFORMATION

In order for University to perform as required under the Prime Award and to coordinate collaborative work among Subcontractor and other parties contracting with University for this Project, University must have access to some existing data and proprietary software (including source code kernels), as well as data and software which may be developed by contractors during the course of the Project, including Project-related Inventions, Technical Data, software and source code kernels ("Project Information"). Subcontractor agrees to grant University access to all of Subcontractor's Project Information upon request. Where appropriate, Subcontractor will mark all Project Information which Subcontractor 'deems to be confidential or proprietary as "Confidential or Proprietary Project Information". University will use any such Confidential or Proprietary Project Information only for the purposes of the Project, will treat it with the same degree of care University treats its own confidential information, will not disclose or transfer it to other parties and will return or destroy it when the Project is concluded. Subcontractor will include this requirement for University access to Project Information in any subcontracts issued by Subcontractor to third-tier subcontractors, unless University has entered into separate agreement(s) with such third-tier subcontractor(s) to receive access to Project Information

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directly. This limited right to use Project Information is granted to the University, not as consideration for this award, but in order to support the research and educational mission of the University of California and to enable University to perform its obligations in the Project.

14 INDEMNIFICATION

Each party shall be solely responsible for the performance of the work hereunder. Each party, shall reimburse the other party for and defend, indemnify and hold the other party harmless from and against any and all liability, loss, expenses, attorneys' fees, or claims for injury or damages arising out of the performance of this Agreement but only in proportion to and to the extent such liability, loss, expense, attorney's fees, or claims for injury or damages are caused by or result from the negligent or intentional acts or omissions of the indemnifying party, its, officers, agents, or employees. Notwithstanding any other provision of this Agreement, neither party shall be liable to the to the other party for consequential, incidental, special, indirect, exemplary or punitive damages arising from or related to the indemnifying party's performance under this Agreement.

15 EXCUSABLE DELAYS

In the event of a delay caused by inclement weather, fire, flood, strike or other labor dispute, acts of God, acts of Governmental officials or agencies, or any other cause beyond the control of the Subcontractor, the time for performance shall be extended hereunder for the periods of time attributable to such a delay, which may extend beyond the time lost due to one or more of the causes mentioned above. In the event of any such delay, subject to prior approval by the Prime Sponsor and by mutual agreement between the University and the Subcontractor, this Agreement may be revised by changing the maximum amount, performance period, and other provisions, as appropriate.

16 FAR CLAUSES INCORPORATED BY REFERENCE

16.1 Prime Award Clauses

All Contract Clauses incorporated by reference into Attachment A, Prime Award, Section "I", Contract Clauses, are incorporated by reference into this Agreement, with the same force and effect as if they were given in full text. In all such clauses, to the extent applicable, the word "Government" applies to the Prime Sponsor and the University, and references to "Contractor" apply to Subcontractor.

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16.2 Supplement 5

University of California, Special Terms and Conditions for Federal Government Contracts ("Supplement 5") is also incorporated by reference into this Agreement..

17 SUSPENSION OR TERMINATION

17.1 Suspension

The University may suspend this Agreement in whole or in part, (1) when the University believes that the Subcontractor has materially failed to comply with the terms and conditions of this Agreement (2) for any reason by mutual agreement between the University and the Subcontractor upon the request of either party, or (3) when the parties cannot agree to the extent of a termination.

17.2 Termination

This Agreement may be terminated by either party at any time upon the issuing of notice sixty (60) days prior to effective date of termination. In such event, the Subcontractor shall exert its best efforts and will proceed in an orderly fashion to limit or to terminate any outstanding commitments and to conclude the work. All costs, up to the amount of the Cumulative Allotted Funds specified on the Purchase Order or Change Order issued hereunder by University, associated with the termination (including indirect costs) shall be allowable, including without limitation, uncancellable costs incurred prior to the effective date of termination, which have not been reimbursed to the Subcontractor. In the event of termination, the Subcontractor shall submit a final report of expenditures (within 90 days after the 60 day termination period) of all costs incurred and all funds received.

17.3 No-Cost Settlement

Article H.6 of the Prime Award, Attachment A, is specifically incorporated herein.

18 CLOSEOUT

18.1 Post-Closeout Audit

This Agreement may be closed out without a specific (transactional) audit or without an organization-wide or single audit covering the entire period of Federal or University support. The closeout of this Agreement shall not affect the retention period for, or University or Federal right of access to, Project records. After closeout, the University may nevertheless disallow and recover from the Subcontractor an appropriate amount, on the basis of a subsequently received audit report of any other available information.

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18.2 Required Reports and Documents

Subcontractor agrees to provide the following reports and documents at closeout, whether for termination or expiration of this Purchase Order Subcontract:

18.2.1 Final Invoice - a final request for reimbursement for all expenses during final billing period, as well as a summary of all expenses billed and reimbursed through end date, and such final billing shall be marked "FINAL";

18.2.2 Release and Assignment Forms - Upon closeout, University will provide certificates for Subcontractor's Release and Subcontractor's Assignment of Refunds, Rebates Credits, and Other Amounts which will be executed and returned to University;

18.2.3 Certification of Final Indirect Costs, if applicable to Subcontractor's type of organization, as required under FAR 52.242-4;

18.2.4 Other Reports and Documents - any other reports, documents or deliverables, if specified or required on the face of the Purchase Order Subcontract; and

18.2.5 A Final Report of Inventions shall be submitted within 90 days of the end of the year or final termination of this Project.

19 ATTACHMENTS, ORDER OF PRIORITY

This Agreement consists of the Purchase Order referenced above, this Subcontract Schedule, and the attachments listed below. In the event of a conflict or inconsistency in the terms of these documents, the terms of the PO and this Subcontract Schedule shall control, and the attachments shall be applied in the order of priority listed below. Attachments:

Attachment A	Prime Award (including all attachments and exhibits)
Attachment B	Subcontractor's Statement of Work (including approved Budget)
Supplement 5	University of California, Special Terms and Conditions for Federal Government Contracts

MERRILL PLACE OFFICE BUILDING
411 FIRST AVENUE SOUTH
SEATTLE, WASHINGTON 98104

LEASE AGREEMENT

MERRILL PLACE, LLC

LANDLORD

AND

TERA COMPUTER COMPANY

TENANT

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LEASE AGREEMENT

THIS LEASE ("Lease") made this ____ day of _____, 1997, between MERRILL PLACE LLC, a Washington limited liability company ("Landlord"), and TERA COMPUTER COMPANY, a Washington corporation ("Tenant").

In consideration of the mutual promises, covenants and conditions contained herein, the parties hereto agree as follows:

1. LEASE DATA AND EXHIBITS. The following terms as used herein shall have the meanings provided in this Section 1, unless otherwise specifically modified by provisions of this Lease.

(a) BUILDINGS. Certain structures situated on a portion of the real property more particularly described on Exhibit A attached hereto and incorporated herein by reference (the "Property"), with a postal address of 411 First Avenue South, Seattle, Washington 98104. The structures on the Property are shown on the site plan attached hereto as Exhibit A-1 and are referred to herein as the "Sellar Hambach Building", the "Schwabacher Building" and the "Warehouse Building" (individually a "Building" and collectively, the "Buildings").

(b) PREMISES. The leased premises (the "Premises") shall include approximately 95,938 square feet of office space as hereafter designated by Tenant from the space in the Sellar Hambach Building described as follows:

Floor 1	Sellar Hambach Building	3,321 Sq. Ft.
Floor 2	Sellar Hambach Building	19,814 Sq. Ft.
Floor 3	Sellar Hambach Building	19,048 Sq. Ft.
Floor 4	Sellar Hambach Building	18,868 Sq. Ft.
Floor 5	Sellar Hambach Building	18,382 Sq. Ft.
Floor 6	Sellar Hambach Building	18,096 Sq. Ft.
Floor 7	Sellar Hambach Building	17,457 Sq. Ft.

Said areas are outlined on the floor plan(s) attached hereto as Exhibit B and incorporated herein by this reference. The Premises also include tenant improvements, as described in Exhibit C attached hereto and incorporated herein by this reference. Not later than December 31, 1997, Tenant shall notify Landlord which portions of the above described space in the Sellar Hambach Building will be included in the approximately 95,938 square feet of the initial

Premises. Once Tenant has so notified Landlord, Exhibit B shall be amended to show the portion included as the initial Premises and the portion included as Additional Pocket Space (as defined below).

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(c) POCKET SPACE. Not later than the Commencement Date, Tenant shall designate up to approximately 10,938 square feet of the initial Premises as the "Initial Pocket Space" and such Initial Pocket Space will be shown on an attachment to Exhibit B. In addition, the portions of the Sellar Hambach Building described above which are not included in the initial Premises and the following spaces shown on Exhibit B-1 are hereby designated as the "Additional Pocket Space":

Floor 2	Schwabacher Building	8,400 Sq. Ft.
Floor 3	Schwabacher Building	8,400 Sq. Ft.

The Initial Pocket Space shall become part of the Premises on the earlier of eighteen (18) months after the Commencement Date or the date Tenant occupies such space for other than the storage of furniture or supplies. The Additional Pocket Space shall become part of the Premises thirty-six (36) months after the Commencement Date. Until such date, Landlord may lease any of the Additional Pocket Space to third parties. The parties agree there will be a new lease executed by Tenant and the Merrill Place Building Condominium Association on terms identical to this Lease for Tenant's lease of Additional Pocket Space in the Schwabacher Building. The Initial Pocket Space and the Additional Pocket Space are referred to herein collectively as the "Pocket Space."

(d) TENANT'S PERCENTAGE OF THE BUILDING. The initial Premises constitute 74.96% of the non-retail space in the Sellar Hambach Building and will, when fully occupied (including the Pocket Space), constitute 89.84% of the non-retail space in the Sellar Hambach Building ("Tenant's Percentage of the Building(s)") calculated by dividing the net rentable area of the Premises from time to time, by the area of the non-retail space on floors 1 through 7 of the Sellar Hambach Building (127,992 net rentable square feet). The rentable area of the Premises as expanded from time to time and the rentable area of the Buildings shall be determined by the architectural firm of JPC utilizing BOMA standards. Based upon such calculations, "Tenant's Percentage of the Building(s)," the Rent deposit described in Section 1(h), and the Security Deposit described in Section 1(i) will be adjusted to reflect such measurements.

(e) BASIC PLANS DELIVERY DATE. February 1, 1998.

FINAL PLANS DELIVERY DATE. April 1, 1998.

(f) COMMENCEMENT DATE. November 1, 1998 or such earlier date as provided in Section 3 hereof.

(g) EXPIRATION DATE. 120 months following the Commencement Date.

(h) RENT. Monthly rent (the "Rent") in the following amounts:

Months	1 - 36:	\$1.70 per rentable square foot
Months	37 - 60:	\$1.833 per rentable square foot

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Months	61 - 84:	\$1.933 per rentable square foot
Months	85 - 120:	\$2.033 per rentable square foot

The Rent shall be payable without offset or deduction on or before the first day of each month. Additional rent "Additional Rent" shall be calculated and paid from time to time as provided in Section 7 and Section 8 hereof. Tenant shall deposit with Landlord within three (3) days of the execution of this Lease \$144,500.00 to be applied to the first Rent payment due hereunder.

(i) SECURITY DEPOSIT. \$267,920.94.

(j) OPTION TO RENEW. One (1) period of five (5) years.

(k) OPTION RENT. A monthly rental of 95% of Market Rent for similar office space in the Pioneer Square area, but not less than \$2.033 per rentable square foot.

(l) EXPANSION OPTION. Continuing right of first right of refusal on all non-retail space in the Buildings other than Additional Pocket Space.

(m) NOTICE ADDRESSES.

Landlord: 2401 Utah Avenue South
Suite 305
Seattle, WA 98134

Tenant: 411 First Avenue South
Suite 600
Seattle, WA 98104

(n) EXHIBITS. The following exhibits or riders are made a part of this Lease:

Exhibit A	Legal Description of the Property
Exhibit A-1	Site Plan of Property
Exhibit B	Floor Plan of Premises
Exhibit B-1	Floor Plan of Additional Pocket Space in Schwabacher Building
Exhibit C	Tenant Improvements
Exhibit D	Memorandum of Lease
Exhibit E	Building Rules and Regulations
Exhibit F	Janitorial Services

2. PREMISES. Landlord does hereby lease to Tenant, and Tenant does hereby lease from Landlord, upon the terms and conditions herein set forth, the Premises described in Section 1(b) hereof as shown on Exhibits B and B-1, together with the appurtenances, including without limitation the right to use, in common with others, the lobbies, elevators and other common areas located on the Property.

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3. COMMENCEMENT AND EXPIRATION DATES.

(a) COMMENCEMENT DATE. The Commencement Date shall be the earlier of the date specified in Section 1(f) or the date Tenant occupies the Premises.

(b) TENANT OBLIGATIONS. If Tenant's tenant improvements are not completed on the Commencement Date due to the failure of Tenant to fulfill any obligation pursuant to the terms of this Lease or any exhibit hereto including, without limitation, Tenant's failure to deliver documents necessary to comply with the Plan Delivery Dates described in Section 1(e) and Exhibit C, the Lease shall be deemed to have commenced upon the Commencement Date.

(c) CONFIRMATION OF COMMENCEMENT DATE. In the event the Commencement Date is established as a date other than November 1, 1998, Landlord shall confirm the same to Tenant in writing. At Landlord's request, once the Commencement Date is known, the parties will execute a Memorandum of Lease in the form attached hereto as Exhibit D.

(d) EXPIRATION DATE. The Lease shall expire on the date specified in Section 1(g).

(e) EARLY TERMINATION. Tenant shall have the right to terminate this Lease in the event Landlord cannot provide adequate office space to meet Tenant's expansion needs in the Buildings or in any other buildings owned by Landlord or an affiliate of Landlord within one block of the Buildings (provided rent in the other building is 95% of Market Rent (calculated as provided below) and has similar parking to the Property). Tenant may exercise this early termination any time between the 60th and 72nd months of the Lease term provided Tenant gives Landlord written notice of Tenant's intent to terminate not later than the 42nd month of the Lease term and pays Landlord a termination fee equal to the unamortized portion of the tenant improvements as shown on Exhibit C, and leasing costs associated with Tenant's occupancy of the

Building, provided, however, that Tenant shall not be required to pay any termination fee if it moves to another building owned by Landlord or the same parties which comprise Landlord. As of the time Tenant intends to vacate the Premises pursuant to its early termination right, Tenant must provide Landlord with satisfactory evidence that Tenant has leased, from a third party, new space containing at the minimum one hundred and ten percent (110%) the then Premises, or this Lease shall not be deemed terminated.

(f) OPTION TO EXTEND TERM. Provided Tenant is not in default, beyond any applicable cure period, at the time of exercise or commencement of the option, Tenant shall have the right to extend the term of this Lease for one (1) additional period of five (5) years. Tenant shall notify Landlord no later than one (1) year prior to expiration of the initial ten year term of this Lease of Tenant's intention to exercise this option to extend the Lease term. If Tenant so exercises the option to extend the term of this Lease, such extension shall be on all terms, conditions and provisions contained in this Lease, except that the Rent shall be equal to 95% of the then market rent (the "Market Rent") for comparable space at the time such option period commences; provided, however, in no event shall the Rent during such option period be less than \$2.033 per rentable square foot.

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(g) MARKET RENT. If Landlord and Tenant are unable to agree on Market Rent within thirty (30) days following Tenant's exercise of the extension option (the "Exercise Date"), both Landlord and Tenant shall submit their final estimate of the Market Rent to the other in writing within ten (10) days thereafter, and the Market Rent shall be determined by arbitration as follows:

(i) The arbitration will be by three arbitrators, all of whom must be (1) neutral parties and (2) either MAI appraisers or licensed real estate brokers who have been active over the five (5) years ending on the date of appointment in the brokering or appraisal of office space in the greater Seattle Central Business District. Landlord and Tenant shall each select one of the arbitrators and such selection shall be accomplished within thirty (30) days after the Exercise Date. The third arbitrator will be selected by the two arbitrators so chosen by Landlord and Tenant. If the two arbitrators cannot agree upon the third arbitrator within sixty (60) days following the Exercise Date, the third arbitrator will be selected by application by either party to the American Arbitration Association.

(ii) Within one hundred twenty (120) days following the Exercise Date, (the "Decision Date"), the arbitrators shall decide on the Market Rent for the Premises for a five (5) year term. The decision of the majority of the arbitrators shall control. If a majority of the arbitrators do not agree within the stipulated time period, then each arbitrator shall render his or her separate determination of the Market Rent on or before the Decision Date. In such case, the three determinations shall be averaged to determine the Market Rent. However, if the lowest Market Rent and/or the highest Market Rent is more than ten percent (10%) lower or higher than the middle Market Rent, the low market Rent and/or high Market Rent shall be disregarded. If only one Market Rent is disregarded, the remaining two Market Rents will be averaged in order to establish the Market Rent.

(iii) Both parties may submit any information to the arbitrators for their consideration with copies to the other party. In using comparable lease rates to aid in the determination the rates must be for comparable space within a two (2) mile radius of the Building. A copy of the arbitrators' written decision will be given to both parties when the Market Rent has been determined. The determination of the Market Rent will be final and binding upon Landlord and Tenant. The cost of the arbitration will be paid by Tenant if the Market Rent is one hundred ten percent (110%) or more of the Market Rent specified in the notice given by Tenant to Landlord, and shall be paid by Landlord if the Market Rent is less than ninety percent (90%) of the Market Rent specified in the notice given by Landlord to Tenant, and otherwise shall be paid equally by Landlord and Tenant.

(h) EXPANSION OPTION. Provided Tenant is not then in default, beyond the applicable cure period, under this Lease, Tenant shall have the ongoing right of first offer on all non-retail space in the Buildings, other than Pocket Space, as such space becomes available. Prior to entering into negotiations with other prospective tenants for space on which Tenant has a right of first offer, Landlord shall provide Tenant with written notice (an

"Offer Notice") specifying the amount of space available and the date of availability. Tenant shall notify Landlord in writing within ten (10) days after receipt of any Offer Notice of Tenant's desire to

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lease such space, and if Tenant has not given such notice Tenant shall be deemed to have waived any right to lease such space which space may thereafter be leased to any other party. Any space in the Buildings leased by Tenant pursuant to the right of first offer contained in this paragraph shall be added to the Premises and all other conditions of this Lease including, but not limited to, the Lease term, Rent and Option to Extend Term shall apply to such added space.

4. RENT. Tenant shall pay Landlord without notice the Rent stated in Section 1(h) hereof and Additional Rent as provided in Section 7 and Section 8 and any other additional payments due under this Lease without deduction or offset in lawful money of the United States in advance on or before the first day of each month at Landlord's Notice Address set forth in Section 1(m) hereof, or to such other party or at such other place as Landlord may hereafter from time to time designate in writing. Rent and Additional Rent for any partial month at the beginning or end of the Lease term shall be prorated in proportion to the number of days in such month falling within the Lease term.

5. SECURITY DEPOSIT. As security for the full and faithful performance of every covenant and condition of this Lease to be performed by Tenant, Tenant shall, not later than the Commencement Date, pay to Landlord the Security Deposit as specified in Section 1(i) hereof. If Tenant shall default with respect to any covenant or condition of this Lease, including but not limited to the payment of Rent, Additional Rent or any other payment due under this Lease, Landlord may apply all or any part of the Security Deposit to the payment of any sum in default or any other sum which may be required or which Landlord may, in its reasonable discretion, deem necessary to spend or incur by reason of Tenant's default. In such event, Tenant shall, within five (5) days of written demand therefor by Landlord, deposit with Landlord the amount so applied. If Tenant shall have fully complied with all of the covenants and conditions of this Lease, but not otherwise, the amount of the Security Deposit then held by Landlord shall be retained by Landlord and applied against the Rent for the last month of the Lease term. In the event of Tenant's default under this Lease, Landlord's right to retain the Security Deposit shall be deemed to be in addition to any and all other rights and remedies at law or in equity available to Landlord. Landlord shall not be required to keep any Security Deposit separate from its general funds and Tenant shall not be entitled to any interest thereon.

6. USES. The Premises are to be used only for general office purposes and for assembling computers and packaging computer components ("Permitted Uses"), and for no other business or purpose without the prior written consent of Landlord, which consent may be withheld if Landlord, in its sole discretion, determines that any proposed use is inconsistent with or detrimental to the maintenance and operation of the Buildings as first-class office buildings in Seattle, Washington or is inconsistent with any restriction on use of the Premises, the Buildings or the Property contained in any lease, mortgage or other agreement or instrument by which the Landlord is bound or to which any of such property is subject. Tenant shall not commit any act that will increase the then existing rate of insurance on the Buildings without Landlord's consent. Tenant shall promptly pay upon demand the amount of any increase in insurance rates caused by any act or acts of Tenant. Tenant shall not commit or allow to be committed any waste upon the Premises, or any public or private nuisance or other act which disturbs the quiet enjoyment of any other tenant in the Buildings or which is

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unlawful. Tenant shall not, without the written consent of Landlord, use any apparatus, machinery or device in or about the Premises which will cause any substantial noise, vibration or fumes. If any of Tenant's office machines or equipment should disturb the quiet enjoyment of any other tenant in the Buildings, then Tenant shall, at its expense, provide adequate insulation or take other action as may be necessary to eliminate the disturbance. Tenant shall comply with all laws relating to its use or occupancy of the Premises and shall observe such reasonable rules and regulations (including, but not limited to,

the rules and regulations attached hereto as Exhibit E) as may be adopted and made available to Tenant by Landlord from time to time for the safety, care and cleanliness of the Premises, the Buildings, or the Property and for the preservation of good order therein.

7. SERVICES AND UTILITIES.

(a) STANDARD SERVICES. Landlord shall cause the Premises and the public and common areas of the Buildings and the Property, such as lobbies, elevators, stairs, corridors and restrooms, to be maintained in reasonably good order and condition consistent with the operation and maintenance of the Buildings as first-class office buildings in Seattle, Washington, except for damage occasioned by any act or omission of Tenant or Tenant's officers, contractors, agents, invitees, licensees or employees, the repair of which damage shall be paid by Tenant. Landlord shall furnish the Premises with electricity for normal office use, including lighting and operation of low power usage office machines, water and elevator service at all times during the term of the Lease. Landlord shall also provide lamp replacement service for building standard light fixtures, toilet room supplies, window washing at reasonable intervals and customary building janitorial service as shown on Exhibit F. No janitorial service shall be provided Saturdays, Sundays or legal holidays. The Rent stated in Section 1(h) hereof does not include the costs of any janitorial or other service provided or caused to be provided by Landlord to Tenant which are in addition to the services ordinarily provided Building tenants and such costs shall be paid by Tenant as Additional Rent on the first day of the month following the month in which such additional services are provided.

From 7:00 a.m. to 6:00 p.m. on weekdays and from 8:00 a.m. to 1:00 p.m. on Saturdays, excluding legal holidays ("Normal Business Hours"), Landlord shall furnish to the Premises heat and air conditioning. The tenant improvements described in Exhibit C include upgrades to allow Landlord to furnish, at Tenant's direction, heat and air conditioning at times other than Normal Business Hours. The reasonable cost of such services as established by Landlord shall be paid by Tenant as Additional Rent. During other than Normal Business Hours, Landlord may restrict access to the Building in accordance with the Building's security system, provided that Tenant shall at all times during the term of this Lease (24 hours of all days) have reasonable access to the Premises.

(b) INTERRUPTION OF SERVICES. Landlord shall not be liable for any loss, injury or damage to person or property caused by or resulting from any variation, interruption, or failure of such service due to any cause whatsoever, or from failure to make any repairs or perform any maintenance unless caused by the negligence or willful misconduct of Landlord. No temporary interruption or failure of such services incident to the making of repair, alterations or improvements, or due to accident, strike or conditions or events beyond

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Landlord's reasonable control shall be deemed an eviction of Tenant or relieve Tenant from any of Tenant's obligations hereunder.

(c) ADDITIONAL SERVICES. The Building Standard mechanical system is designed to accommodate heating loads generated by lights and equipment using up to 3.0 watts per square foot. Before installing lights and equipment in the Premises which in the aggregate exceed such amount, Tenant shall obtain the written permission of Landlord. Landlord may refuse to grant such permission unless Tenant shall agree to pay the costs of Landlord for installation of supplementary air conditioning capacity or electrical systems as necessitated by such equipment or lights. If Landlord's approval has been given, Tenant shall in advance, on the first day of each month during the Lease term, pay Landlord the reasonable amount estimated by Landlord as the cost of furnishing electricity for the operation of such equipment or lights and the reasonable amount estimated by Landlord as the cost of operation and maintenance of supplementary air conditioning units necessitated by Tenant's use of such equipment or lights. The Rent stated in Section 1(h) hereof does not include any amount to cover the cost of furnishing electricity or such additional air conditioning for such purposes and such costs shall be paid by Tenant as Additional Rent. Landlord shall be entitled to install and operate at Tenant's cost a monitoring/metering system in the Premises to measure the added demands on electrical, heating, ventilation and air conditioning systems resulting from such equipment and lights and from Tenant's after-hours heating, ventilation and air conditioning service requirements. Tenant shall comply with Landlord's

instructions for the use of drapes and thermostats in the Building. In addition, Landlord shall provide the Buildings with security guards who will patrol the Buildings and the parking garage twenty-four (24) hours per day and who will be available, upon request, to escort Tenant's personnel to and from the parking garage and the Premises at any time, day or night.

8. COSTS OF OPERATIONS AND REAL ESTATE TAXES.

(a) DEFINITIONS. In addition to the Rent provided in Section 1(h) of this Lease, Tenant shall pay to Landlord increases in Operating Costs under this Section 8 as Additional Rent, utilizing the following definitions:

(i) "OPERATING COSTS" shall include Real Property Taxes, Services and Utility Costs.

(1) "REAL PROPERTY TAXES" shall mean taxes on real property and personal property; charges and assessments (or any installments thereof due during the Lease Year) levied with respect to the Property, the Buildings, any improvements, fixtures and equipment, and all other property of Landlord, real or personal, used directly in the operation of the Buildings and located in or on the Buildings; and any taxes levied or assessed (or any installment thereof due during the Lease Year) in addition to or in lieu of, in whole or in part, such real property or personal property taxes, or any other tax upon leasing of the Buildings or rents collected, but not including any federal or state income, estate, inheritance, franchise or business and occupation tax.

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(2) "SERVICE AND UTILITY COSTS" shall mean all other expenses paid or incurred by Landlord for obtaining services and products for maintaining, operating and repairing the Buildings and the common areas of the Property outside of the Buildings and the parking garage, and the personal property used in conjunction therewith, including, without limitation, the costs of refuse collection, water, sewer and other utilities services, electricity, gas and other similar energy sources, supplies, janitorial and cleaning services, window washing, landscape maintenance, services of independent contractors, compensation (including employment taxes and fringe benefits) of all persons who perform duties in connection with the operation, maintenance and repair of the Buildings, its equipment and the Property upon which they are situated, insurance premiums, licenses, permits, and inspection fees, customary management fees, legal and accounting expenses and any other expenses or charges whether or not hereinabove described, which in accordance with generally accepted accounting and management practices would be considered an expense of maintaining, operating or repairing the Buildings, excluding or deducting, as appropriate:

(3) The following items shall not be included in the Service and Utility Costs:

(A) Costs of any special services rendered to individual tenants (including Tenant) for which a special charge is collected;

(B) Depreciation or amortization of costs required to be capitalized in accordance with generally accepted accounting practices (except other Operating Costs shall include amortization of capital improvements made subsequent to the initial development of the Buildings which are designed with a reasonable probability of improving the operating efficiency of the Buildings, provided that such amortization expense shall not exceed reasonably expected savings in operating costs resulting from such capital improvements);

(C) Legal fees, brokerage commissions, advertising costs, or other related expenses incurred by Landlord in an effort to generate rental income;

(D) Repairs, alterations, additions, improvements, or replacements made to rectify or correct any defect in the original design, materials or workmanship of Buildings or common areas (but not including repairs, alterations, additions, improvements or replacements made as a result of ordinary wear and tear);

(E) Damage and repairs attributable to fire or other casualty;

(F) Damage and repairs necessitated by the negligence or willful misconduct of Landlord, Landlord's employees, contractors or agents;

(G) Executive salaries or salaries of service personnel to the extent that such personnel perform services not solely in connection with the management, operations, repair or maintenance of the Buildings;

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(H) Landlord's general overhead expenses not related to the Buildings (if Landlord or a Landlord-related entity is the Building manager and receives a fee for its management services, which fee would be subject to the terms of paragraph K below, the only overhead expenses of Landlord that shall be included is the value of any rent-free or rent-reduced occupancy in the Building if such is given to the managing entity in lieu of a higher management fee);

(I) Legal fees, accountants' fees and other expenses incurred in connection with disputes with tenants or other occupants of the Buildings or associated with the enforcement of the terms of any leases with tenants or the defense of Landlord's title to or interest in the Buildings or any part thereof;

(J) Costs incurred due to a violation by Landlord or any other tenant of the Buildings of the terms and conditions of a lease;

(K) Building management fees in excess of management fees charged by independent property managers, and the cost of any service that would typically be supplied by the building manager at no additional charge.

(L) Costs and expenses incurred in complying with hazardous waste and environmental laws, including, but not limited to, the cost of removing or encapsulating asbestos, excluding those costs related to the disposal of waste products generated by Tenant;

(M) Fees paid to Landlord or any affiliate of Landlord for goods or services in excess of the fees that would typically be charged by unrelated, independent persons or entities for similar goods and services;

(N) Cost incurred with owning and/or operating any parking garage or parking lot serving the Buildings;

(O) Rent called for under any ground lease or master lease;

(P) Principal and/or interest payments called for under any debt secured by a mortgage or deed of trust on the Buildings; and

(Q) Costs (including permit, license and inspection fees) incurred in renovating or otherwise improving, decorating, painting or altering (1) vacant space (excluding common areas) in the Building(s) or (2) space for tenants or other occupants in the Building(s) and costs incurred in supplying any item or service to less than all of the tenants in the Building(s);

(R) Costs of any service provided to Tenant or other occupants of the Building(s) for which Landlord is reimbursed, or any other expense for which

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Landlord is or will be reimbursed by another source (i.e. expenses covered by

insurance or warranties);

(S) Costs and expenses which would be capitalized under generally accepted accounting principles, with the exception that cost-saving capital improvements may be included if, but only if, the savings reasonably expected to be generated by the improvement will exceed, during each year of the Lease term, the cost of the improvement divided by the number of years in the useful life of the improvements (in which case no more than the cost of the improvement divided by the number of years in its useful life shall be included in operating expenses in any given year);

(T) Any condominium dues which are not herein specifically included as Service and Utility Costs.

(U) Any other expense which, under generally accepted accounting principles applicable to real estate operations, would not be considered a reasonable maintenance and operating expense. Landlord shall not collect in excess of one hundred percent (100%) of the operating expenses and shall not recover any item of cost more than once.

(ii) "LEASE YEAR" shall mean the twelve month period commencing January 1 and ending December 31.

(iii) ACTUAL OPERATING COSTS.

(A) "ACTUAL SERVICE AND UTILITY COSTS" shall mean the actual expenses paid or incurred by Landlord for Service and Utility Costs during any Lease Year of the term hereof.

(B) "ACTUAL REAL PROPERTY TAXES" shall mean the amount of Real Property Taxes paid or incurred by Landlord during any Lease Year of the term hereof.

(iv) ACTUAL OPERATING COSTS ALLOCABLE TO THE PREMISES.

(A) "ACTUAL SERVICE AND UTILITY COSTS ALLOCABLE TO THE PREMISES" shall mean the Tenant's share of the Actual Service and Utility Costs determined by multiplying Tenant's Percentage of the Buildings described in Section 1(d) by the Actual Service and Utility Costs except that, to the extent such costs vary depending upon occupancy of the areas served, the variable portion shall be allocated in accordance with Tenant's share of the weighted average occupied area of the Building or Buildings during the Lease Year.

(B) "ACTUAL REAL PROPERTY TAXES ALLOCABLE TO THE PREMISES" shall mean the Tenant's share of the Actual Real Property Taxes determined by multiplying Tenant's Percentage of the Buildings described in Section 1(d) by the Actual Real Property Taxes.

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(v) ESTIMATED OPERATING COSTS ALLOCABLE TO THE PREMISES.

(A) "ESTIMATED SERVICE AND UTILITY COSTS ALLOCABLE TO THE PREMISES" shall mean Landlord's estimate of Actual Service and Utility Costs Allocable to the Premises for the following Lease Year to be given by Landlord to Tenant pursuant to Section 8(c) (i) below.

(B) "ESTIMATED REAL PROPERTY TAXES ALLOCABLE TO THE PREMISES" shall mean Landlord's estimate of Real Property Taxes Allocable to the Premises for the following Lease Year to be given by Landlord to Tenant pursuant to Section 8(d) (i) below.

(vi) "BASE SERVICE YEAR" shall mean calendar 1998.

(b) BASE AMOUNTS.

(i) SERVICE AND UTILITY COSTS BASE AMOUNT.

For purposes of this Section 8, the Service and Utility Costs Base Amount shall be an amount equal to the Actual Service and Utility Costs Allocable to the

Premises for the Base Service Year.

(ii) REAL PROPERTY TAXES BASE AMOUNT. For purposes of this Section 8, the Real Property Taxes Base Amount shall be an amount equal to the Actual Real Property Taxes Allocable to the Premises for the Base Service Year.

(c) ADDITIONAL RENT FOR SERVICE AND UTILITY COSTS.

(i) ADDITIONAL RENT FOR ESTIMATED INCREASES IN SERVICE AND UTILITY COSTS. At the beginning of each Lease Year after the Base Service Year, during the term hereof, Landlord shall furnish Tenant a written statement of the Estimated Service and Utility Costs Allocable to the Premises, for such Lease Year, and a calculation of the Additional Rent as follows: One-twelfth (1/12) of the amount, if any, by which such amount exceeds the Service and Utility Costs Base Amount shall be Additional Rent payable by Tenant as provided in Section 4 for each month during such Lease Year. If at any time or times during such Lease Year, it appears to Landlord that the Actual Service and Utility Costs Allocable to the Premises will vary from the Estimated Service and Utility Costs Allocable to the Premises by more than five percent (5%) on an annual basis, Landlord may, by written notice to Tenant, revise its estimate for such Lease Year and Additional Rent payments by Tenant for the remainder of such Lease Year shall be based on such revised estimate.

(ii) ACTUAL SERVICE AND UTILITY COSTS.

Within ninety (90) days after the close of each Lease Year during the term hereof for which an estimated statement was delivered to Tenant pursuant to subsection (c)(i) above, or as soon thereafter as practicable, Landlord shall deliver to Tenant a written statement setting forth the Actual Service and Utility Costs Allocable to the Premises during the preceding Lease Year or such prorated portion thereof if this Lease commences or terminates on a day other than the first or last day of a

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Lease Year (based on a 365-day Lease Year). If such costs for any Lease Year exceed Estimated Service and Utility Costs Allocable to the Premises paid by Tenant to Landlord pursuant to subsection (c)(i), Tenant shall pay the amount of such excess to Landlord as Additional Rent within thirty (30) days after receipt of such statement by Tenant. If such statement shows such costs to be less than the amount paid by Tenant to Landlord pursuant to subsection (c)(i), then the amount of such overpayment by Tenant shall be credited by Landlord to the next Rent payable by Tenant or, if the Lease has terminated, will be paid to Tenant.

(d) ADDITIONAL RENT FOR REAL PROPERTY TAXES.

(i) ADDITIONAL RENT FOR ESTIMATED INCREASES IN REAL PROPERTY TAXES. At the beginning of each Lease Year during the term hereof, Landlord shall furnish Tenant a written statement of the Estimated Real Property Taxes Allocable to the Premises, for such Lease Year, and a calculation of the Additional Rent as follows: One twelfth (1/12) of the amount, if any, by which such amount exceeds the Real Property Taxes Base Amount shall be Additional Rent payable by Tenant as provided in Section 4 for each month during such Lease Year. If at any time or times during such Lease Year it appears to Landlord that the Actual Real Property Taxes Allocable to the Premises will vary from the Estimated Real Property Taxes Allocable to the Premises by more than five percent (5%) on an annual basis, Landlord shall, by written notice to Tenant, revise its estimate for such Lease Year and Additional Rent payments by Tenant for the remainder of such Lease Year shall be based on such revised estimate.

(ii) ACTUAL REAL PROPERTY TAXES. Within

ninety (90) days after the close of each Lease Year during the term hereof for which an estimated statement was delivered to Tenant pursuant to subsection (d)(i) above, or as soon thereafter as practicable, Landlord shall deliver to Tenant a written statement setting forth the Actual Real Property Taxes Allocable to the Premises during the preceding Lease Year or such prorated portion thereof if this Lease commences or terminates on a day other than the first or last day of a Lease Year (based on a 365-day Lease Year). If such taxes for any Lease Year exceed Estimated Real Property Taxes Allocable to the Premises paid by Tenant to Landlord pursuant to subsection (d)(i), Tenant shall pay the amount of such excess to Landlord as Additional Rent within thirty (30) days after receipt of such statement by Tenant. If such statement shows such

cost to be less than the amount paid by Tenant to Landlord pursuant to subsection (d)(i), then the amount of such overpayment by Tenant shall be credited by Landlord to the next Rent payable by Tenant or, if the Lease has terminated, will be paid to Tenant.

(e) DETERMINATIONS. The determination of Actual Service and Utility Costs and Taxes and Estimated Service and Utility Costs and Taxes Allocable to the Premises shall be made by Landlord. The Service and Utility Costs, other than for the common areas of the Property outside the Buildings and the parking garage, shall only include those costs for the Buildings in which the Premises are located from time to time; and the new lease for any of the Premises in the Schwabacher Building will only include those Service and Utility Costs which are included as Service and Utility Costs in the Sellar Hambach Building. Landlord or its agent shall keep records in reasonable detail showing all expenditures made for the items

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enumerated above, which records shall be available for inspection and audit by Tenant at any reasonable time.

(f) FURTHER ADJUSTMENT. In the event the Sellar Hambach Building is not at least ninety-five percent (95%) fully occupied during the Base Year, the Actual Costs for such year shall be proportionately adjusted by Landlord to reflect those costs which would have occurred had the Sellar Hambach Building been ninety-five percent (95%) occupied during such year, based on the average weighted occupancy during such Lease Year.

(g) ADDITIONAL RENT NOT DUE. Notwithstanding anything to the contrary contained herein, Tenant shall not be obligated to pay any Additional Rent for Service and Utility Costs or any Additional Rent for Real Estate Taxes for a period of one (1) year following the Commencement Date.

(h) PERSONAL PROPERTY TAXES. Tenant shall pay, prior to delinquency, all Personal Property Taxes payable with respect to all Property of Tenant located on the Premises or the Building and promptly, upon request of Landlord, shall provide written proof of such payment. As used herein, "Property of Tenant" shall include all personal property located on the Premises and all improvements to the Premises which have been paid for by Tenant. "Personal Property Taxes" shall include all property taxes assessed against the Property of Tenant, whether assessed as real or personal property.

9. IMPROVEMENTS. Landlord and Tenant agree to make certain improvements to the Premises ("tenant improvements") and to the Buildings as set forth in Exhibit C following the procedure and with the allowances set forth therein. Upon expiration or sooner termination of this Lease, all improvements and additions to the Premises, except Tenant's trade fixtures, shall be deemed the property of Landlord.

10. CARE OF PREMISES.

(a) TENANT'S MAINTENANCE. Tenant shall take good care of the Premises. Tenant shall not make any alterations, additions or improvements ("Alterations") in or to the Premises, or make changes to locks on doors, or add, disturb or in any way change any plumbing or wiring ("Changes") without first obtaining the written consent of Landlord and, where appropriate, in accordance, with plans and specifications approved by Landlord. Any such Alterations or Changes shall not adversely affect either the strength or exterior appearance, or the mechanical, electric or plumbing services of the Buildings. Tenant shall reimburse Landlord for any sums expended for examination and approval of architectural or mechanical plans and specifications of the Alterations and Changes. Tenant shall also pay Landlord a sum equal to the direct costs incurred during any inspection or supervision of the Alterations or Changes. All damages or injury done to the Premises or Buildings by Tenant or by any persons who may be in or upon the Premises or Buildings with the express or implied consent of Tenant, including but not limited to the cracking or breaking of any glass of windows and doors, shall be paid for by Tenant. In addition, subject to the provisions of Section 14, Tenant shall pay for all damage to the Buildings caused by acts or omissions of Tenant or Tenant's officers, contractors, agents, invitees, licensees, or employees.

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(b) LANDLORD'S MAINTENANCE. Landlord shall, at its sole cost and expense, make all repairs and replacements and perform all maintenance necessary to keep the Premises, the Buildings and the common areas of the Buildings and the Property in good working order and repair and to maintain the Buildings and Premises in a clean, safe and tenantable condition comparable to other first class office buildings in Seattle, Washington. This maintenance and repair shall include without limitation the roof, foundation, exterior walls, interior structural walls, all structural components, utility lines, all systems, equipment and facilities serving the Premises and the Buildings, such as mechanical, electrical, HVAC, plumbing and sewer, replacement of lighting tubes, lamp ballasts and bulbs, and extermination and pest control when necessary, and snow and ice removal, unless such repair is Tenant's responsibility pursuant to Section 10(a). Landlord's work under this Section 10(b) shall be accomplished with the least possible amount of interference with the conduct of Tenant's business and, to the extent practicable, shall be done after Normal Business Hours.

11. ACCEPTANCE OF PREMISES. If this Lease shall be entered into prior to the completion of tenant improvements in the Premises, the acceptance of the Premises by Tenant shall be deferred until Landlord informs Tenant of the completion of such construction. Within five (5) days ("Inspection Period") after Landlord provides Tenant with written notice of such completion, Tenant shall make such inspection of the Premises as Tenant deems appropriate. Except as otherwise specified by Tenant in writing to Landlord within the Inspection Period, Tenant shall be deemed to have accepted the Premises in their then condition except for latent defects. If, as a result of such inspection, Tenant discovers minor deviations or variations from the plans and specifications for Tenant's improvements of a nature commonly found on a "punch list" (as the term is used in the construction industry), Tenant shall, during the Inspection Period, notify Landlord of such deviations. Landlord shall promptly repair all punch list items. The existence of such punch list items shall not postpone the Commencement Date of this Lease or the obligation of Tenant to pay Rent. Any tenant improvements made by Landlord shall include a one (1) year warranty for materials and workmanship.

12. ACCESS. Subject to Landlord's execution of Tenant's standard nondisclosure agreement, Tenant shall permit Landlord and its agents to enter into and upon the Premises at all reasonable times for the purpose of inspecting the same or for the purpose of cleaning, repairing, altering or improving the Premises or the Buildings provided Landlord gives Tenant reasonable advance notice, except in emergencies, and Tenant has the right to accompany Landlord or its agents. Nothing contained in this Section 12 shall be deemed to impose any obligation upon Landlord not expressly stated elsewhere in this Lease. When reasonably necessary Landlord may temporarily close entrances, doors, corridors, elevators or other facilities without liability to Tenant by reason of such closure and without such action by Landlord being construed as an eviction of Tenant or release of Tenant from the duty of observing and performing any of the provisions of this Lease. Landlord shall have the right to enter the Premises for the purpose of showing the Premises to prospective tenants within the period of one hundred eighty (180) days prior to the expiration or sooner termination of the Lease term.

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13. DAMAGE OR DESTRUCTION.

(a) DAMAGE AND REPAIR. If any of the Buildings containing the Premises is damaged by fire or any other cause to such extent that the cost of restoration, as reasonably estimated by Landlord, will equal or exceed thirty percent (30%) of the replacement value of the Building (exclusive of foundations) just prior to the occurrence of the damage, or if insurance proceeds sufficient for restoration are for any reason unavailable, then Landlord may no later than the thirtieth day following the damage, give Tenant a notice of Landlord's election to terminate this Lease. In the event of such election, this Lease shall be deemed to terminate on the third day after the giving of such notice, and Tenant shall surrender possession of the Premises within a reasonable time thereafter, and the Rent and Additional Rent shall be apportioned as of the date of Tenant's surrender and any Rent paid for any period beyond such date shall be repaid to Tenant. If the cost of restoration as estimated by Landlord shall amount to less than thirty percent (30%) of said replacement value of the Building and insurance proceeds sufficient for restoration are available, or if Landlord does not elect to terminate this

Lease, Landlord shall restore the Building and the Premises (to the extent of the improvements to the Premises originally provided by Landlord hereunder) with reasonable promptness, subject to delays beyond Landlord's control and delays in the making of insurance adjustments by Landlord, and Tenant shall have no right to terminate this Lease except as provided in this Section 13. To the extent that any portion of the Premises are rendered untenable, the Rent and Additional Rent shall proportionately abate, except in the event such damage resulted from or was caused, directly or indirectly, by the willful misconduct of Tenant, Tenant's officers, agents, or employees, in which event Rent shall abate only to the extent Landlord receives proceeds from any rental income insurance policy to compensate Landlord for loss of Rent hereunder. In the event Landlord intends to restore the Building and the Premises, as provided herein, it will provide Tenant with a schedule for such restoration. If the restoration is scheduled to take more than ninety (90) days to complete, Tenant, at its option, may terminate the Lease.

(b) DESTRUCTION DURING LAST YEAR OF TERM. In case any of the Buildings containing the Premises shall be destroyed by fire or other cause to the extent that the cost of restoration estimated by Landlord will equal or exceed thirty percent (30%) of the replacement value of the Building at any time during the last Lease Year of this Lease, either Landlord or Tenant may terminate this Lease upon written notice to the other given within sixty (60) days of the date of such destruction.

(c) BUSINESS INTERRUPTION. No damages, compensation or claim shall be payable by Landlord for inconvenience, loss of business or annoyance arising from any repair or restoration of any portion of the Premises or the Buildings. Landlord shall use its best efforts to effect such repairs promptly.

(d) TENANT IMPROVEMENTS. Landlord will not carry insurance of any kind on Tenant's furniture, furnishings, fixtures, equipment or appurtenances of Tenant under this Lease and Landlord shall not be obligated to repair any damage thereto or replace the same.

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(e) EXPRESS AGREEMENT. The provisions of this Section 13 shall be considered an express agreement governing any case of damage or destruction of the Buildings or Premises by fire or other casualty.

14. WAIVER OF SUBROGATION. Whether any loss or damage to the Premises, the Buildings, or any property therein, is due to the negligence of either Landlord or Tenant, their agents or employees, or any other cause, Landlord and Tenant do each hereby release and relieve the other, their agents or employees, from responsibility for, and waive their entire claim of recovery for any loss or damage to the real or personal property of either located anywhere in the Buildings, including the Buildings themselves, arising out of or incident to the occurrence of any of the perils which are covered by their respective property and related insurance policies. Each party shall use best efforts to cause its insurance carriers to consent to the foregoing waiver of rights of subrogation against the other party. Notwithstanding the foregoing, no such release shall be effective unless and to the extent the aforesaid insurance policy or policies shall expressly permit such a release or contain a waiver of the carrier's right to be subrogated.

15. INDEMNIFICATION.

(a) TENANT'S INDEMNIFICATION. Subject to the provisions of Section 14, Tenant shall indemnify and hold Landlord harmless from and against all common law or statutory liabilities, damages, obligations, losses, claims, civil actions, costs, or expenses, including attorneys fees, arising from any act, omission, or negligence of Tenant or its officers, contractors, licensees, agents, servants, employees, guests, invitees, or visitors in or about the Buildings or the Premises, or arising from any injury or damage to any person or property, occurring in or about the Buildings or the Premises as a result of any act, omission or negligence of Tenant, or its officers, contractors, licensees, agents, employees, guests, or visitors or arising from any breach or default under this Lease by Tenant. As part of such indemnity, Tenant waives its immunity from suit under the provisions of RCW 51, et seq. The foregoing provisions shall not be construed to make Tenant responsible for loss, damage, liability or expense resulting from injuries to third parties caused by the negligence of Landlord, or its officers, contractors, licensees, agents, employees, invitees or other tenants of the Buildings.

(b) LANDLORD'S INDEMNIFICATION. Subject to the provisions of Section 14, Landlord shall indemnify, defend and hold Tenant, its officers, agents, employees and contractors harmless from all losses, damages, fines, penalties, liability and expenses (including reasonable attorneys' fees and costs) resulting from any actual injury to any person or from any actual loss of or damage to any property attributable to Landlord's operation of the Buildings or caused by or resulting from any negligent or intentional act or omission of Landlord or any employee, agent, contractor, guest or invitee of Landlord. The foregoing indemnities specifically cover actions brought by each party's own employees and shall survive the expiration or earlier termination of this Lease. Landlord shall not be liable for interference with Tenant's light, air or view in or from the Premises.

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LANDLORD AND TENANT ACKNOWLEDGE THE FOREGOING INDEMNIFICATION PROVISIONS WERE SPECIFICALLY NEGOTIATED AND AGREED UPON BY THEM.

Further, Landlord shall not be liable for any loss or damage to persons or property sustained by Tenant or other persons, which may be caused by theft, or by any act or neglect of any tenant or occupant of the Buildings or any other third parties.

16. INSURANCE.

(a) TENANT'S INSURANCE.

(1) LIABILITY INSURANCE. Tenant shall, throughout the term of this Lease and any renewal hereof, at its own expense, keep and maintain in full force and effect, a policy of comprehensive general liability insurance including a contractual liability endorsement covering Tenant's obligations under Section 15, insuring Tenant's activities upon, in or about the Premises, the Buildings in which the Premises are located, or the Property, and against claims of bodily injury or death or property damage or loss with a limit of not less than Two Million Dollars (\$2,000,000) per occurrence and Three Million Dollars (\$3,000,000) in the aggregate combined single limit.

(2) PROPERTY INSURANCE. Tenant shall throughout the term of this Lease and any renewal hereof at its own expense, keep and maintain in full force and effect, what is commonly referred to as "all risk" coverage insurance (but excluding earthquake and flood) on Tenant's leasehold improvements in an amount not less than the current One Hundred percent (100%) replacement value thereof with commercially reasonable deductibles.

(3) INSURANCE POLICY REQUIREMENTS. All insurance required under this Section 16 shall be with companies reasonably approved by Landlord. No insurance policy required under this Section 16 shall be cancelled or reduced in coverage and each insurance policy shall provide that it is not subject to cancellation or a reduction in coverage except after thirty (30) days prior written notice to Landlord.

(4) DELIVERY OF POLICIES. Tenant shall deliver to Landlord on or before the Commencement Date and from time to time thereafter, copies of policies of such insurance or certificates evidencing the existence and amounts of same and naming Landlord and, if requested by Landlord, Landlord's mortgagee, as additional insured thereunder. In no event shall the limits of any insurance policy required under Section 16 be considered as limiting the liability of Tenant under this Lease.

(b) LANDLORD'S INSURANCE. Landlord shall maintain at all times during the Lease term a policy or policies of property insurance with extended coverage endorsement covering the Buildings in an amount equal to the full replacement cost of the Buildings. Further, Landlord shall maintain at all times during the Lease term a policy or policies of commercial general liability, or a combination of commercial general liability and umbrella or excess liability insurance, with combined limits as determined to be appropriate by Landlord,

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but in no event less than Three Million Dollars (\$3,000,000). The liability

insurance required hereunder shall cover all of Landlord's operations and activities and all contingent liability of Landlord for all operations performed at the Buildings on Landlord's behalf by Landlord's contractors or subcontractors. The liability coverage required hereunder shall provide that Landlord's insurance applies separately to each named insured or additional insured against whom a claim is made or suit is brought, except with respect to the limits of the insurer's liability.

17. ASSIGNMENT AND SUBLETTING.

(a) ASSIGNMENT OR SUBLEASE. Tenant shall not assign, mortgage, encumber or otherwise transfer this Lease or sublet the whole or any part of the Premises without in each case first obtaining Landlord's prior written consent. Such consent shall not be unreasonably withheld except, (1) Landlord may withhold its consent if in Landlord's reasonable judgment occupancy by any proposed assignee, subtenant or other transferee: (i) is not consistent with the maintenance and operation of a first-class office building due to the proposed occupant's nature or manner of conducting business, or (ii) is likely to cause disturbance to the normal use and occupancy of the Buildings by other tenants, their employees, customers, clients or other guests or visitors; (2) Landlord may, in its absolute and sole discretion, withhold consent to any mortgage, hypothecation, pledge or other encumbrance of any interest in this Lease by Tenant or any subtenant, whereby this Lease or any interest therein becomes collateral for any obligation of Tenant or any other person; and (3) Landlord may withhold its consent to the extent Landlord reasonably determines necessary to comply with a restriction on use of the Premises, the Buildings or the Property contained in any lease, mortgage, or other agreement or instrument by which the Landlord is bound or to which any of such property is subject. No such assignment, subletting or other transfer shall relieve Tenant of any liability under this Lease. Consent to any such assignment, subletting or transfer shall not operate as a waiver of the necessity for consent to any subsequent assignment, subletting or transfer. In the event Tenant intends to sublease space Tenant does not intend to use in the future, Tenant may so notify Landlord which may, at its option, terminate the Lease as to such space, in which event Landlord shall enter into the relationship of landlord and tenant with any such subtenant or assignee, based on the rent (and/or other compensation) and the term agreed to by such subtenant or assignee and otherwise upon the terms and conditions of this Lease. In connection with each request for an assignment or subletting, Tenant shall pay the reasonable cost of processing such assignment or subletting, including attorneys fees, upon demand of Landlord. Tenant shall provide Landlord with copies of all assignments, subleases and assumption instruments.

Any transfer of this Lease by acquisition, merger, consolidation or liquidation, or any change in the ownership of, or power to vote, a majority of Tenant's outstanding voting stock during any three (3) month period shall constitute an assignment for the purpose of this Section 17, provided Landlord must consent to such an assignment if Landlord is given prior written notice of the event and if the successor Tenant has a net worth equal to or greater than the net worth of Tenant on the execution of this Lease.

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(b) ASSIGNEE OBLIGATIONS. As a condition to Landlord's approval of any assignment, any potential assignee otherwise approved by Landlord shall assume in writing all obligations of Tenant under this Lease and shall be jointly and severally liable with Tenant for the payment of Rent and performance of all terms, covenants and conditions of this Lease.

(c) SUBLESSEE OBLIGATIONS. Any sublessee shall assume all obligations of Tenant as to the portion of the Premises which is subleased to such sublessee and shall be jointly and severally liable with Tenant for rental and other payments and performance of all terms, covenants and conditions of such approved sublease.

18. SIGNS. Except for Tenant's business sign which Tenant may, at Tenant's sole cost and expense, install on the east exterior wall of the Sellar Hambach Building near the main Sellar Hambach Building entrance (the exact location, size and design of such sign are subject to the approval of Landlord and the Pioneer Square Review Board, and subject to any requirements of the City of Seattle), Tenant shall not inscribe any inscription, or post, place, or in any manner display any sign, graphics, notice, picture, placard or poster, or any advertising matter whatsoever anywhere in or about the Premises, the

Buildings or the Property at places visible (either directly or indirectly as an outline or shadow on a glass pane) from anywhere outside the Premises without first obtaining Landlord's written consent thereto, such consent to be at Landlord's sole discretion. Any such consent by Landlord shall be upon the understanding and condition that Tenant shall remove the signs at the expiration or sooner termination of this Lease and Tenant shall repair any damage to the Premises or the Buildings caused thereby.

19. LIENS AND INSOLVENCY.

(a) LIENS. Tenant shall keep its interest in this Lease and any property of Tenant (other than unattached personal property) and the Premises, the Property and the Buildings free from all liens arising out of any work performed or materials ordered or obligations incurred or on behalf of Tenant and Tenant hereby indemnifies and holds Landlord harmless from any liability from any such lien, including without limitation, liens arising from any work performed pursuant to Exhibit C hereto. In the event any lien is filed against the Buildings, the Property or the Premises by any person claiming by, through or under Tenant, Tenant shall, upon request of Landlord, at Tenant's expense, immediately either cause such lien to be released of record or furnish to Landlord a bond in form and amount and issued by a surety satisfactory to Landlord, indemnifying Landlord, the Property and the Buildings against all liability, costs and expenses, including attorneys fees, which Landlord may incur as a result thereof. Provided that such bond has been furnished to Landlord, Tenant, at its sole cost and expense and after written notice to Landlord, may contest, by appropriate proceedings conducted in good faith and with due diligence, any lien, encumbrance or charge against the Premises, the Property or the Buildings arising from work done or materials provided to and for Tenant, if, and only if, such proceedings suspend the collection thereof against Landlord, and the Premises, Buildings and Property, and neither the Premises, the Buildings, the Property nor any part thereof or interest therein is or will be in any danger of being sold, forfeited or lost.

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(b) INSOLVENCY. If Tenant becomes insolvent or voluntarily or involuntarily bankrupt, or if a receiver, assignee or other liquidating officer is appointed for the business of Tenant, Landlord at its option may terminate this Lease and Tenant's right of possession under this Lease and in no event shall this Lease or any rights or privileges hereunder be an asset of Tenant in any bankruptcy, insolvency or reorganization proceeding.

20. DEFAULT.

(a) TENANT'S DEFAULT. Any payment due under this Lease by Tenant which is more than five (5) business days late shall incur a late charge equal to five percent (5%) of the amount of the late payment. Thereafter, Tenant shall have a period of ten (10) business days from the day of written notice from Landlord to Tenant within which to cure any default in the payment of Rent, Additional Rent or other sums due hereunder. Tenant shall have a period of fifteen (15) days from the date of written notice from Landlord to Tenant within which to cure any other default hereunder; provided, however, that with respect to any such default which cannot be cured within fifteen (15) days, the default shall not be deemed to be uncured if Tenant commences to cure within fifteen (15) days and for so long as Tenant is diligently prosecuting the cure thereof.

(1) VACATION AND ABANDONMENT. Any vacation or abandonment by Tenant shall be considered a default with no right to cure, allowing Landlord to re-enter the Premises under Section 20(c). Vacation shall be defined as being out of the Premises for thirty (30) consecutive days, except as a result of casualty damage or similar occurrence. Abandonment shall be defined as an absence from the Premises of five (5) days or more while Tenant is in default.

(2) LANDLORDS RE-ENTRY. Upon an uncured default of this Lease by Tenant, Landlord, besides other rights or remedies it may have, at its option, may enter the Premises or any part thereof, either with or without process of law, and expel, remove or put out Tenant or any other persons who may be therein, together with all personal property found therein; and Landlord may terminate this Lease, or it may from time to time, without terminating this Lease and as agent of Tenant, rent the Premises or any part thereof for such term or terms (which may be for a term less than or extending beyond the term hereof), and at such rental or rentals and upon such other terms and conditions

as Landlord in its sole, reasonable discretion may deem advisable, (with the right to repair, renovate, remodel, redecorate, alter and change the Premises) and Tenant shall remain liable for any deficiency computed as set forth in Section 20(a)(3). In the case of any default, re-entry and/or dispossession, by summary proceedings or otherwise, all Rent and Additional Rent shall become due thereupon and be paid up to the time of such reentry or dispossession together with such expenses as Landlord may reasonably incur for attorneys fees, advertising expenses, brokerage fees and/or putting the Premises in good order or preparing the same for re-rental together with interest thereon as provided in Section 38(f) hereof, accruing from the date of any such expenditure by Landlord.

(3) RELETTING THE PREMISES. At the option of Landlord, rents received by Landlord from such reletting shall be applied first to the payment of any

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indebtedness from Tenant to Landlord other than Rent and Additional Rent due hereunder; second, to the payment of any costs and expenses of such reletting and including, but not limited to, attorneys fees, advertising fees and brokerage fees, and to the payment of any repairs, renovations, remodeling, redecoration, alterations and changes in the Premises; third, to the payment of Rent and Additional Rent due and to become due hereunder, and if after so applying said rents there is any deficiency in the Rent or Additional Rent to be part by Tenant under this Lease, Tenant shall pay any deficiency to Landlord monthly on the dates specified herein and any payment made or suits brought to collect the amount of the deficiency for any month shall not prejudice in any way the right of Landlord to collect the deficiency for any subsequent month. The failure or refusal of Landlord to relet the Premises or any part or parts thereof shall not release or affect Tenant's liability hereunder, nor shall Landlord be liable for failure to relet, or in the event of reletting, for failure to collect the rent thereof, and in no event shall Tenant be entitled to receive any excess of net rents collected over sums payable by Tenant to Landlord hereunder. No such re-entry or taking possession of the Premises shall be construed as an election on Landlord's part to terminate this Lease unless a written notice of such intention be given to Tenant. Notwithstanding any such reletting without termination, Landlord may at any time thereafter elect to terminate this Lease for Tenant's previous breach and default. Should Landlord at any time terminate this Lease by reason of any default, in addition to any other remedy it may have, it may recover from Tenant the present value at a discount rate of nine percent (9%) of the amount of Rent and Additional Rent reserved in this Lease for the balance of the term, as it may have been extended, over the then fair market rental value of the Premises for the same period, plus all court costs and attorneys fees incurred by Landlord in the collection of the same.

(4) WAIVER OF REDEMPTION RIGHTS. Tenant, for itself, and on behalf of any and all persons claiming through or under it, including creditors of all kinds, does hereby waive and surrender all right and privilege which they or any of them might have under or by reason of any present or future law, to redeem the Premises or to have a continuance of this Lease for the term hereof, as it may have been extended, after having been dispossessed or ejected therefrom by process of law or under the terms of this Lease or after the termination of this Lease as herein provided.

(5) NONPAYMENT OF ADDITIONAL RENT. All costs and expenses which Tenant assumes or agrees to pay to Landlord pursuant to this Lease shall be deemed Additional Rent and, in the event of nonpayment thereof, Landlord shall have all the rights and remedies herein provided for in case of nonpayment of Rent.

(6) CUMULATIVE REMEDIES. All rights of Landlord herein enumerated shall be cumulative, and none shall exclude any other right or remedy allowed by law. In addition to the other remedies in this Lease provided, Landlord shall be entitled to restrain by injunction the violation or attempted violation by Tenant of any of the covenants, agreements or conditions of this Lease.

(b) LANDLORD'S DEFAULT. If Landlord fails to perform any covenant or condition of this Lease, requiring the payment of money on the part of Landlord and such failure is not cured within ten (10) days after written notice from Tenant to Landlord, or if

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Landlord shall fail to keep or perform any of the covenants or conditions of this Lease other than a covenant or condition requiring payment of money by Landlord and such failure is not cured within thirty (30) days after written notice of the failure from Tenant to Landlord, then, in addition to all other rights or remedies available to Tenant under this Lease, at law or in equity, Tenant may perform the covenant or condition which Landlord failed to perform and Landlord shall, upon receipt of an invoice from Tenant, pay Tenant the actual costs incurred by Tenant in so doing, together with interest thereon at an interest rate provided in paragraph 38(f), provided, however, if Landlord commences curative efforts of a nonmonetary failure within the thirty (30) day cure period and is diligently prosecuting the cure in good faith, then the thirty (30) day period shall be extended so long as Landlord is diligently prosecuting the cure to completion. In addition to the foregoing rights and remedies of Tenant, if Tenant has also given notice of the failure to Landlord's lender as provided in the SND Agreement (defined below), and the default is not cured within the applicable time periods, Tenant shall, in addition to all other rights and remedies at law or in equity, also have the right to terminate the Lease on written notice to Landlord and its lender.

21. SUBORDINATION. Landlord represents and warrants to Tenant that Landlord is the fee owner of the Building and the Property, subject only to the covenants, easements and restrictions of record, including that certain Deed of Trust dated and recorded in the records of King County, Washington under Recording No. 9701021191, in which Bank of America National Trust and Savings Association doing business as Seafirst Bank ("Lender") is the beneficiary, Rainier Credit Company is the trustee and Landlord is the grantor. Upon the execution of this Lease by Tenant, Landlord shall cause Lender to execute and deliver to Tenant a Subordination and Non-Disturbance Agreement (the "SND Agreement") in the form approved by the Lender. Such SND Agreement must be binding on all successors and assigns of Lender and reasonably acceptable to Tenant in form and content. In consideration for such non-disturbance agreement, Tenant will also execute the SND Agreement for Lender's benefit in which Tenant (i) confirms that this Lease is subordinate to the Deed of Trust, (ii) agrees to attorn to Lender if Lender becomes the owner of the Property or the Building, (iii) agrees to give Lender copies of whatever notices of default Tenant may give Landlord hereunder, (iv) agrees to accept a cure by Lender of any of Landlord's defaults, provided such cure is completed within the cure period set forth in the SND Agreement, and (v) agrees not to pay rent more than one (1) month in advance. Tenant agrees to subordinate its interests in this Lease to any subsequent lender having an interest in the Property if such lender executes for Tenant's benefit a non-disturbance agreement that is substantially identical to the one described above for Lender's execution.

22. SURRENDER OF POSSESSION. Subject to the terms of Section 13 relating to damage and destruction, upon expiration of the term of this Lease, whether by lapse of time or otherwise Tenant shall promptly and peacefully surrender the Premises to Landlord in as good condition as when received by Tenant from Landlord or as thereafter improved, reasonable use, wear and tear and damage by casualty, described in Section 13 excepted.

23. REMOVAL OF PROPERTY. Tenant shall remove all of its movable property and trade fixtures which can be removed without damage to the Premises at the expiration or sooner termination of this Lease, and shall pay Landlord any damages for injury

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to the Premises or Buildings resulting from such removal. If Tenant shall fail to remove any of its property of any nature whatsoever from the Premises or the Buildings at the termination of this Lease or when Landlord has the right of re-entry, Landlord may remove and store said property without liability for loss thereof or damage thereto, such storage to be for the account and at the expense of Tenant. If Tenant shall not pay the cost of storing any such property after it has been stored for a period of thirty (30) days or more, Landlord may, at its option, sell, or permit to be sold, any or all such property at public or private sale, in such manner and at such times and places as Landlord in its sole discretion may deem proper, without notice to Tenant, unless notice is required under applicable statutes, and shall apply the proceeds of such sale:

first, to the cost and expense of such sale, including reasonable attorneys fees actually incurred; second, to the payment of the costs or charges for storing any such property; third, to the payment of any other sums of money which may then be or thereafter become due Landlord from Tenant under any of the terms hereof; and, fourth, the balance, if any, to Tenant.

24. NON-WAIVER. Waiver by Landlord of any term, covenant or condition herein contained or any breach thereof shall not be deemed to be a waiver of such term, covenant, or condition or of any subsequent breach of the same or any other term, covenant, or condition herein contained. The subsequent acceptance of Rent or Additional Rent hereunder by Landlord shall not be deemed to be a waiver of any preceding breach by Tenant of any term, covenant or condition of this Lease, other than the failure of Tenant to pay the particular Rent or Additional Rent so accepted, regardless of Landlord's knowledge of such preceding breach at the time of acceptance of such Rent or Additional Rent.

25. HOLDOVER. Tenant shall not hold over after the expiration of the term of this Lease, without the written consent of Landlord. Any holdover by Tenant shall create a month-to-month tenancy which may be terminated as provided by applicable state law. During such tenancy, Tenant shall be bound by all of the terms, covenants and conditions herein so far as applicable, except rental which shall be the greater of (a) the then quoted rates for similar space in the Building, or (b) the Rent and Additional Rent stated herein.

26. CONDEMNATION.

(a) ENTIRE TAKING. If all of the Premises or such portions of the Buildings as may be required for the reasonable use of the Premises, are taken by eminent domain, this Lease shall automatically terminate as of the date title vests in the condemning authority and all Rent, Additional Rent and other payments shall be paid to that date.

(b) CONSTRUCTIVE TAKING OF ENTIRE PREMISES. In the event of a taking of a material part of but less than all of a Building, where Landlord or Tenant shall determine that the remaining portions of the Building cannot be economically and effectively used by it (whether on account of physical, economic, aesthetic or other reasons) or where Landlord determines the Building should be restored in such a way as to materially alter the Premises, the party determining to terminate the Lease shall forward a written notice to the other party of such determination not more than sixty (60) days after the date of taking. The term of this

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Lease shall expire upon such date as the party shall specify in such notice but not earlier than sixty (60) days after the date of such notice.

(c) PARTIAL TAKING. Subject to the provisions of the preceding Section 26(b), in case of taking of a part of the Premises, or a portion of a Building not required for the reasonable use of the Premises, then this Lease shall continue in full force and effect and the Rent shall be equitably reduced based on the proportion by which the floor area of the Premises is reduced, such Rent reduction to be effective as of the date title to such portion vests in the condemning authority.

(d) AWARDS AND DAMAGES. Landlord reserves all rights to damages to the Premises for any partial, constructive, or entire taking by eminent domain, and Tenant hereby assigns to Landlord any right Tenant may have to such damages or award, and Tenant shall make no claim against Landlord or the condemning authority for damages for termination of the leasehold interest or interference with Tenant's business. Tenant shall have the right, however, to claim and recover from the condemning authority compensation for any loss to which Tenant may be put for Tenant's moving expenses, business interruption or taking of Tenant's personal property (not including Tenant's leasehold interest) provided that such damages may be claimed only if they are awarded separately in the eminent domain proceedings and not out of or as part of the damages recoverable by Landlord.

27. NOTICES. All notices under this Lease shall be in writing and delivered in person or sent by registered or certified mail, postage prepaid, to Landlord and to Tenant at the Notice Addresses provided in Section 1(m) (provided that after the Commencement Date any such notice shall be mailed or delivered by hand to Tenant at the Premises) and to the holder of any Landlord's

mortgage at such place as such holder shall specify to Tenant in writing; or such other addresses as may from time to time be designated by any such party in writing. Notices mailed as aforesaid shall be deemed given on the date of such mailing.

28. COSTS AND ATTORNEYS FEES. If Tenant or Landlord shall bring any action for any relief against the other, declaratory or otherwise, arising out of this Lease, including any suit by Landlord for the recovery of Rent, Additional Rent or other payments hereunder or for possession of the Premises, each party shall, and hereby does, to the extent permitted by law, waive trial by jury and the losing party shall pay the prevailing party a reasonable sum for attorney's and paralegal's fees in such suit, at trial and on appeal, and such attorney's and paralegal's fees shall be deemed to have accrued on the commencement of such action.

29. LANDLORD'S LIABILITY. Anything in this Lease to the contrary notwithstanding, covenants, undertakings and agreements herein made on the part of Landlord are made and intended not as personal covenants, undertakings and agreements for the purpose of binding Landlord personally or the assets of Landlord except Landlord's interest in the Premises, the Buildings, and the Property but are made and intended for the purpose of binding only the Landlord's interest in the Premises, the Buildings, and the Property and their replacements, rents, sale proceeds, insurance proceeds or condemnation awards as the same may from time to time be encumbered. No personal liability or personal responsibility is

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assumed by, nor shall at any time be asserted or enforceable against Landlord or its members or their respective heirs, legal representatives, successors or assigns on account of the Lease or on account of any covenant, undertaking or agreement of Landlord in this Lease contained.

30. LANDLORD'S CONSENT. Except as specified in other provisions of this Lease, whenever Landlord's consent is required under the terms hereof, such consent shall not be unreasonably withheld, provided, the withholding of Landlord's consent due to any mortgagee's refusal to grant its consent, shall not be deemed unreasonable.

31. ESTOPPEL CERTIFICATES. Tenant shall, from time to time, upon written request of Landlord, execute, acknowledge and deliver to Landlord or its designee a written statement stating: the date this Lease was executed and the date it expires; the date the term commenced and the date Tenant accepted the Premises; the amount of minimum monthly Rent and the date to which such Rent has been paid; and certifying: that this Lease is in full force and effect and has not been assigned, ratified, supplemented or amended in any way (or specifying the date and terms of agreement so affecting this Lease); that this Lease represents the entire agreement between the parties to this Lease; that all conditions under this Lease to be performed by the Landlord have been satisfied; that all required contributions by Landlord to Tenant on account of Tenant's improvements have been received; that on this date there are no existing claims, defenses or offsets which the Tenant has against the enforcement of this Lease by the Landlord; that no Rent has been paid more than one month in advance; and that no security has been deposited with Landlord (or, if so, the amount thereof). It is intended that any such statement delivered pursuant to this paragraph may be relied upon by a prospective purchaser or mortgagee of Landlord's interest or assignee of any mortgage upon Landlord's interest in the Buildings. If Tenant shall fail to respond within ten (10) days of receipt by Tenant of a written request by Landlord as herein provided, Tenant shall be deemed to have given such certificate as above provided without modification and shall be deemed to have admitted the accuracy of any information supplied by Landlord to a prospective purchaser or mortgagee and to have certified that this Lease is in full force and effect, that there are no uncured defaults in Landlord's performance, that the security deposit is as stated in the Lease, and that not more than one month's Rent has been paid in advance.

32. TRANSFER OF LANDLORD'S INTEREST. In the event of any transfer or transfers of Landlord's interest in the Premises, the Buildings, or the Property other than a transfer for security purposes only, the transferor shall be automatically relieved of any and all obligations and liabilities on the part of Landlord accruing from and after the date of such transfer provided transferee assumes such liability, and the transferee shall have no obligation or liability with respect to any matter occurring or arising prior to the date of such

transfer. Tenant agrees to attorn to the transferee.

33. RIGHT TO PERFORM. If Tenant shall fail to pay any sum of money required to be paid by it hereunder; or shall fail to perform any other act on its part to be performed hereunder, and such failure shall continue for ten (10) days after notice thereof by Landlord, Landlord may, but shall not be obligated so to do, and without waiving or releasing Tenant from any obligations of Tenant, make such payment or perform any such other act on Tenant's part to be made or performed as provided in this Lease. In such event, the amount so

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paid by Landlord shall constitute Additional Rent and shall be paid, together with interest at the rate set forth in Section 38(f), from the date of Landlord's payment, by Tenant to Landlord within ten (10) days of Tenant's receipt of a bill from Landlord. Landlord shall have (in addition to any other right or remedy of Landlord) the same rights and remedies in the event of the nonpayment of sums due under this Section 33 as in the case of default by Tenant in the payment of Rent.

34. AUTHORITY.

(a) CORPORATE AUTHORITY. If Tenant is a corporation, each individual executing this Lease on behalf of Tenant represents and warrants that he or she is duly authorized to execute and deliver this Lease on behalf of Tenant, in accordance with a duly adopted resolution of the Board of Directors of Tenant and in accordance with the bylaws of Tenant, and that this Lease is binding upon Tenant in accordance with its terms. At Landlord's request, Tenant shall, within thirty (30) days after execution of this Lease, deliver to Landlord a certified copy of a resolution of the Board of Directors of Tenant authorizing or ratifying the execution of this Lease.

(b) PARTNERSHIP AUTHORITY. If Tenant is a partnership, each individual executing this Lease on behalf of Tenant represents and warrants that he or she is duly authorized to execute and deliver this Lease on behalf of Tenant, in accordance with the partnership agreement of Tenant, and that this Lease is binding upon Tenant in accordance with its terms.

35. HAZARDOUS SUBSTANCES. Without Landlord's consent, Tenant shall not keep, use, release or dispose of any substances designated as, or containing components now or hereafter designated as, hazardous, dangerous, toxic or harmful and/or subject to regulation under any federal, state or local law, regulation or ordinance ("Hazardous Substances") on or about the Premises, the Buildings or the Property; provided, the foregoing shall not preclude Tenant from keeping and using in or about the Premises and the Buildings, office supplies, ordinary cleaning products and the like which are normally found in business offices and computer component packaging materials, solutions and adhesives and which contain or may contain Hazardous Substances, so long as Tenant uses, stores and disposes of any such products, supplies, materials, solutions and adhesives in compliance with all applicable environmental laws. Tenant hereby agrees to defend, indemnify and hold Landlord harmless from any and all clean up costs and expenses and any and all other charges, expenses, fees, fines, penalties (both civil and criminal) and costs relating to any remedial action or clean up suffered or incurred by Landlord and caused by Tenant's use of the Premises or the Buildings.

36. PARKING. Tenant shall, throughout the term of this Lease, lease at least one hundred (100) parking stalls in the parking garage on the Property. In addition, upon sixty (60) days' prior written notice to Landlord, Tenant may, from time to time, (a) increase the number of parking stalls it will lease up to a maximum of the greater of one hundred forty (140) parking stalls or one (1) parking stall per one thousand (1,000) square feet of rentable space in the Premises up to a maximum of One Hundred Seventy-Five (175) parking stalls or (b) may decrease the number of parking stalls leased provided the number of parking stalls leased shall not be reduced below one hundred (100). Tenant may also, from time to time,

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upon thirty (30) days' prior written notice to Landlord, designate that a portion of the leased parking stalls, not to exceed fifteen (15), be classified

as "reserved". The monthly rental for the parking stalls for the first three (3) years of the Lease term will be One Hundred Ten Dollars (\$110.00) for non-reserved stalls and One Hundred Forty-Five Dollars (\$145.00) for reserved parking stalls. After the first three (3) years of the Lease term, rent for the parking stalls will be eighty-five percent (85%) of the rate for reserved and non-reserved parking in Pioneer Square. Landlord only guarantees that the reserved parking stalls will be available at all times after Normal Business Hours, including during events in the Pioneer Square area. Tenant shall have a right of first refusal to other available parking controlled by Landlord in a two block radius of the Buildings at a monthly rate of eighty-five percent (85%) of the market rate for parking in Pioneer Square. In addition, the parking stalls for automobiles described above, Landlord shall, at no cost to Tenant, provide Tenant with secured parking space for up to seventy (70) bicycles in the parking garage.

37. TENANT'S EXISTING LEASE. Tenant currently leases space under a lease with a term ending on April 30, 1999. Tenant agrees to use its best efforts to terminate its existing Lease effective as soon as possible after the Commencement Date. In the event Tenant is unable to cause the termination of its existing Lease prior to its currently scheduled expiration date, Landlord shall, upon subsatisfactory verification of payment by Tenant, reimburse Tenant for one-half of the monthly rent and other costs incurred by Tenant under its existing Lease from November 1, 1998, until April 30, 1999, or any earlier termination of the existing lease. Landlord, at its option, may reimburse Tenant by crediting Tenant's next monthly Rent under this Lease by the appropriate reimbursement amount.

38. GENERAL.

(a) HEADINGS. Titles to Sections of this Lease are not a part of this Lease and shall have no effect upon the construction or interpretation of any part hereof.

(b) HEIRS AND ASSIGNS. All of the covenants, agreements, terms and conditions contained in this Lease shall inure to and be binding upon the Landlord and Tenant and their respective heirs, executors, administrators, successors and assigns.

(c) NO BROKERS. Tenant represents and warrants to Landlord that it has not engaged any broker, finder or other person who would be entitled to any commission or fees in respect of the negotiation, execution or delivery of this Lease, other than Kidder, Mathews & Segner, Inc. ("KMS"), and shall indemnify and hold harmless Landlord against any loss, cost, liability or expense incurred by Landlord as a result of any claim asserted by any other broker, finder or other person on the basis of any arrangements or agreement made or alleged to have been made by or on behalf of Tenant. The provisions of this Section 38(c) shall not apply to brokers with whom Landlord has an express written broker agreement and Landlord agrees to pay KMS a real estate fee equal to four percent (4%) of the Rent payable hereunder for the first five (5) years of the Lease term plus two percent (2%) of the Rent for the remaining five (5) years of the initial Lease term. Thirty-five percent (35%) of the real estate fee will be paid on the execution of this Lease. The remaining sixty-five percent (65%) of the real estate fee will be paid in two parts: the sixty-five percent (65%) of the real estate fee

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based on Rent from the initial Premises (95,938 square feet) will be paid after the Commencement Date on Tenant's first occupancy of any such space, and the sixty-five percent (65%) of the real estate fee based on Rent from the Additional Pocket Space will be paid upon Tenant's occupancy of that space.

(d) ENTIRE AGREEMENT. This Lease, including all Exhibits, contains all covenants and agreements between Landlord and Tenant relating in any manner to the leasing, use and occupancy of the Premises, and to Tenant's use of the Buildings and other matters set forth in this Lease. No prior agreements or understanding pertaining to the same shall be valid or of any force or effect and the covenants and agreements of this Lease shall not be altered, modified or added to except in writing signed by Landlord and Tenant.

(e) SEVERABILITY. Any provision of this Lease which shall prove to be invalid, void or illegal shall in no way affect, impair or invalidate any other provision hereof and the remaining provisions hereof shall

nevertheless remain in full force and effect.

(f) OVERDUE PAYMENTS. Any Rent, Additional Rent or other sums payable by Tenant to Landlord under this Lease which shall not be paid upon the due date thereof, shall bear interest at a rate equal to three percentage points above the prime rate of interest stated from time to time by Seattle-First National Bank or its successor, or, in the absence of an established prime rate, five percentage points over that bank's rate for one year certificates of deposit, but not in excess of the highest lawful rate permitted under applicable laws, calculated from the original due date thereof to the date of payment.

(g) FORCE MAJEURE. Except for the payment of Rent, Additional Rent or other sums payable by Tenant to Landlord, time periods for Tenant's or Landlord's performance under any provision, of this Lease shall be extended for periods of time during which Tenant's or Landlord's performance is prevented due to circumstances beyond Tenant's or Landlord's control, including without limitation, strikes, embargoes, shortages of labor or materials, governmental regulations, acts of God, war or other strife.

(h) RIGHT TO CHANGE PUBLIC SPACES. Landlord shall have the right at any time, without thereby creating an actual or constructive eviction or incurring any liability to Tenant therefor, to change the arrangement or location of such of the following as are not contained within the Premises or any part thereof: entrances, passageways, doors and doorways, corridors, stairs, toilets and other like public service portions of the Buildings and common areas of the Property outside of the Buildings and the parking garage, provided, Landlord shall not unreasonably impair Tenant's access to the Premises. Nevertheless, in no event shall Landlord diminish any service, change the arrangement or location of the elevators serving the Premises, make any change which shall diminish the area of the Premises, or make any change which shall change the character of the Buildings from that of a first-class office building.

(i) GOVERNING LAW. This Lease shall be governed by and construed in accordance with the laws of the state of Washington.

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(j) BUILDING DIRECTORY. Landlord shall maintain in the lobby of the Sellar Hambach Building a directory which shall include the name of Tenant and any other names reasonably requested by Tenant in proportion to the number of listings given to comparable tenants of the Building.

(k) BUILDING NAME. The Buildings will be known by such name or names as Landlord may designate from time to time.

IN WITNESS WHEREOF this Lease has been executed the day and year first above set forth.

LANDLORD: MERRILL PLACE, LLC, a Washington limited liability company
By NSD, LLC, a Washington limited liability company - Manager

By: _____
Kevin Daniels - Member

TENANT: TERA COMPUTER COMPANY,
a Washington corporation

By: _____
Its: _____

By: _____
Its: _____

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STATE OF WASHINGTON)
) ss.
COUNTY OF KING)

THIS IS TO CERTIFY that on this ____ day of _____, 1997, before me, the undersigned, a notary public in and for the state of Washington, duly commissioned and sworn, personally appeared KEVIN DANIELS, to me known to be a Member of NSD, LLC, a Washington limited liability company, to me known to be the Manager of Merrill Place, LLC, the Washington limited liability company that executed the within and foregoing instrument, and acknowledged the said instrument to be the free and voluntary act and deed of each limited liability company for the uses and therein mentioned, and on oath stated that said individual was authorized to execute said instrument.

WITNESS my hand and official seal hereto affixed this _____ day of November, 1997.

(Print name)
Notary Public in and for the State of Washington.
My appointment expires_____.

STATE OF WASHINGTON)
) ss.
COUNTY OF KING)

I certify that I know or have satisfactory evidence that _____ and _____ are the persons who appeared before me and said persons acknowledged that they signed this instrument, on oath stated that they were authorized to execute the instrument as the _____ and _____ of TERA COMPUTER COMPANY, a Washington corporation, to be the free and voluntary act and deed of said corporation, for the uses and purposes mentioned in the instrument.

WITNESS my hand and official seal hereto affixed this _____ day of _____, 1997.

(Print name)
Notary Public in and for the State of Washington.
My appointment expires_____.

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EXHIBIT A

Legal Description

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EXHIBIT B

Floor Plan

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EXHIBIT C

Tenant Improvements

I. IMPROVEMENTS BY TENANT/REIMBURSEMENT BY LANDLORD

Design and construction of all improvements in the Premises beyond those existing on the date hereof and those provided by Landlord as set forth below, shall be provided at Tenant's expense. Landlord shall pay the cost of such additional tenant improvements up to an amount equal to \$15.00 per square foot of Tenant's Premises, including all Pocket Space. In addition, on or before September 1, 1998, Landlord agrees to acquire shares of Tenant's common stock for a purchase price equal to \$10.00 per square foot of Tenant's Premises, including Pocket Space (the "Additional Tenant Allowance"). Tenant agrees to deposit such funds with Landlord to be used to pay for the construction of tenant improvements to the Premises. The shares so acquired by Landlord shall be

"restricted Securities" and the number of shares to be received by Landlord shall be determined by dividing the Additional Tenant Allowance by, at Landlord's option, either the average closing price of Tenant's common stock for the fifteen (15) business days ending on the date of execution of this Lease or the fifteen (15) business days immediately prior to the Commencement Date. No fractional shares shall be issued. The cost of such tenant improvements shall include, but not be limited to: Architectural and engineering design, partitions (including one-half (1/2) the cost of any public corridor or demising partitions enclosing the Tenant's unimproved area), doors, door frames, hardware, paint, wall covering, base, ceilings, lights, mechanical distribution, diffusers, thermostats, sprinkler distribution, sprinkler heads, emergency speakers, fire extinguishers and cabinets, telephone and electrical wiring and outlets, cabling, HVAC improvements, light switches, window coverings, floor coverings, construction supervision fee, and all applicable permit fees and sales tax. Tenant may use the full amount of the allowance and the Additional Tenant Allowance for immediate tenant improvements or may reserve portions of the allowance for use for tenant improvements for the Pocket Space.

II. DESIGN OF TENANT IMPROVEMENTS

In addition to the allowances provided in paragraph I above, Landlord agrees to reimburse Tenant in an amount equal to \$.15 per square foot of the Premises for the design of the tenant improvements. Tenant shall retain the services of a qualified architect or office planner approved by Landlord, to prepare the necessary drawings for Basic Plans and supply the information necessary to complete the Working Drawings and Engineering Drawings referred to in Section II.B of this Exhibit C for construction of the tenant improvements in Tenant's unimproved area including the Pocket Space. Alternatively, at Tenant's option, Landlord will have its architect prepare one (1) set of basic plans with two (2) revisions. All Tenant's Plans shall be subject to approval of Landlord in accordance with Section II.C of this Exhibit C.

Tenant's architect or office planner shall ensure that the work shown on Tenant's Plans is compatible with the basic Building Plans and that necessary basic Building modifications are

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included in Tenant's Plans. Such modifications shall be subject to the Landlord's approval and the cost thereof shall be paid by Tenant.

On or before the indicated dates, Tenant shall supply Landlord with one (1) reproducible copy and five (5) black line prints of the following Tenant Plans:

A. BASIC PLANS DELIVERY DATE: February 1, 1998.

The Basic Plans due on this date shall be signed by Tenant and include Architectural Floor Plans. The Architectural Floor Plans shall be fully dimensioned floor plans showing partition layout and identifying each room with a number and each door with a number. The Basic Plans must clearly identify and locate equipment requiring plumbing or other special mechanical systems, area(s) subject to above-normal floor loads, special openings in the floor, and other major or special features.

B. WORKING DRAWINGS DELIVERY DATE: March 1, 1998.

On this date and at Tenant's expense, Tenant's architect shall produce four (4) sets of Full Working Drawings for construction from the Basic Plans using the Pin Bar System, which system shall be approved by Landlord for compatibility with the other Building drawings. The four (4) sets of Working Drawings due on this date shall be signed by the Tenant and include all items in the Basic Plans referenced in Section II.A above plus the following additional information:

(1) Electrical and Telephone Outlets: Locate all power and telephone requirements. Dimension the position from a corner and give height above concrete slab for all critically located outlets. Identify all dedicated circuits and identify all power outlets greater than 120 volts. For the equipment used in these outlets which require dedicated circuits and/or which require greater than 120 volts, identify the type of equipment, the manufacturer's name and the manufacturer's model number, and submit a brochure for each piece of equipment. Also identify the manufacturer's name of the phone

system to be used and the power requirements, size and location of its processing equipment.

(2) Reflected Ceiling Plan: Lighting layout showing location and type of all Building Standard and special lighting fixtures.

(3) Furniture Layout: Layout showing furniture location so that Landlord's engineer can review the location of all light fixtures.

At Tenant's expense, Landlord's engineers shall prepare plumbing, electrical, heating, air conditioning and structural plans ("Engineering Drawings") for Tenant's improvements based on the signed Working Drawings.

C. FINAL PLANS REVIEW DATE: March 15, 1998.

On this date, Tenant's architect shall deliver to Tenant and Landlord for review and approval four (4) complete sets of Final Plans which will incorporate the Working Drawings referenced in Section II.B above, plus the following additional information:

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(1) Millwork Details: These drawings shall be in final form with Tenant's architect's title block in the lower right hand corner of the drawing, and shall include construction details of all cabinets, paneling, trim, bookcases, and door and jamb details for non-Building Standard doors and jambs.

(2) Keying Schedules and Hardware Information: This information shall be in final form and include a Keying Schedule indicating which doors are locked and which key(s) open each lock, plus an "X" on the side of the door where the key will be inserted if a keyed door. Complete specifications for all non-Building Standard hardware will also be provided.

(4) Room Finish and Color Schedule: This information shall be in final form and include locations and specifications for all wall finishes, floor covering and base for each room.

(5) Construction Notes and Specifications: Complete specifications for every item included except those specified by the Landlord.

D. FINAL PLANS DELIVERY DATE: April 1, 1998.

The four (4) sets of Final Plans approved by Landlord and Tenant and due on this date shall include all the Final Plans referenced in Sections II.C above. Final Plans are to be signed by Tenant and delivered to Landlord by the Final Plans Delivery Date. Landlord shall return one (1) signed set to Tenant for Tenant's records. Landlord will incorporate Engineering Drawings with Tenant's Final Plans for transmittal to the general contractor.

Tenant shall be responsible for delays and additional costs in completion of Tenant's work caused by changes made to any of Tenant's Plans after the specified Plan Delivery Date, by inadequacies of plans and specifications, or by delay in delivery of special materials requiring long lead times. Tenant shall further be responsible for such delays as provided in Section 3(b) of the Lease.

III. CONSTRUCTION OF TENANT IMPROVEMENTS

A. AUTHORIZATION TO PROCEED. Upon completion of Tenant's Final Plans and at the request of Tenant, Landlord shall obtain bids from three (3) qualified contractors for the construction of such tenant improvements. Within five (5) days of receipt of such bids, Tenant shall give Landlord written authorization to complete the Premises in accordance with such Final Plans utilizing the lowest bidder. Tenant may in such authorization delete any or all items of extra cost; however, if Landlord deems these changes to be extensive, at its option, Landlord may refuse to accept the authorization to proceed until all changes have been incorporated in the Final Plans signed by Tenant and written acceptance of the revised price has been received by Landlord from Tenant. In the absence of such written authorization to proceed, Landlord shall not be obligated to commence work on the Premises and Tenant shall be responsible for any costs due to any resulting delay in completion of the Premises and as provided in Section 3(b) of the Lease.

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B. PAYMENTS. Landlord's contractor shall complete Tenant's improvements in accordance with Tenant's approved Final Plans. Tenant shall pay, within ten (10) days after receipt of monthly progress statements from Landlord, the full amount of such progress billing which pertains to such amounts in excess of the \$25.00 per rentable square foot allowance and Additional Tenant Allowance provided by Landlord pursuant to Section I of this Exhibit C. Tenant may retain an amount equal to five percent (5%) of the estimated cost of such improvements from the last payment due immediately prior to the credit for Landlord's reimbursement. Final billing shall be rendered and payable within ten (10) days after acceptance of the Premises by Tenant in accordance with the terms of the Lease. Retainage pursuant to the terms of this paragraph shall be payable with such final billing. In the event acceptance of the Premises is subject to punch list items as provided in the Lease, a portion of the retainage equal to the cost to complete each outstanding punch list item may be retained until such punch list item is complete.

C. FINAL PLANS AND MODIFICATIONS. If Tenant shall request any change, Tenant shall request such change in writing to Landlord and such request shall be accompanied by all plans and specifications necessary to show and explain changes from the approved Final Plans. After receiving this information, Landlord shall give Tenant a written price for the cost of engineering and design services to incorporate the changes in Tenant's Final Plans. If Tenant approves such price in writing, Landlord shall have such Final Plans changes made and Tenant shall promptly pay Landlord for this cost. Promptly upon completion of such changes in the Final Plans, Landlord shall notify Tenant in writing of the cost, if any, which shall be chargeable or credited to Tenant for such change, addition or deletion. The cost for such change, whether chargeable or credited to Tenant, shall include a Landlord coordination fee equal to fifteen percent (15%) of the amount of such change. Tenant shall within five (5) days notify Landlord in writing to proceed with such change, addition or deletion. In the absence of such notice, Landlord shall proceed in accordance with the previously approved Final Plans before such change, addition or deletion was requested. In accordance with Section 3(b) of the Lease, Tenant shall be responsible for any resulting delay in completion of the Premises due to modification of Final Plans. Tenant shall also be responsible for any demolition work required as a result of the change.

D. IMPROVEMENTS CONSTRUCTED BY TENANT. If any work is to be performed in connection with Tenant improvements on the Premises by Tenant or Tenant's contractor:

(1) Such work shall proceed upon Landlord's written approval of (i) Tenant's contractor, (ii) public liability and property damage insurance satisfactory to Landlord carried by Tenant's contractor, (iii) detailed plans and specifications for such work, and (iv) amount of general conditions to be paid by Tenant to Landlord for the services still provided by Landlord's contractor.

(2) All work shall be done in conformity with a valid building permit when required, a copy of which shall be furnished to Landlord before such work is commenced, and in any case, all such work shall be performed in accordance with all applicable governmental regulations. Notwithstanding any failure by Landlord to object to any such work, Landlord shall have no responsibility for Tenant's failure to meet all applicable regulations.

(3) All work by Tenant's contractor shall be scheduled through Landlord.

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(4) Tenant or Tenant's contractor shall arrange for necessary utility, hoisting and elevator service with Landlord's contractor and shall pay such reasonable charges for such services as may be charged by Landlord's contractor. This will be included in the general conditions of Subsection (1)(iv) above.

(5) Tenant shall promptly reimburse Landlord for costs incurred by Landlord due to faulty work done by Tenant or its contractors, or by reason of any delays caused by such work, or by reason of inadequate clean-up.

(6) Prior to commencement of any work on the Premises by Tenant or Tenant's contractor, Tenant or Tenant's contractor shall enter into an indemnity agreement and a lien priority agreement satisfactory to Landlord indemnifying and holding harmless Landlord and Landlord's contractor for any liability, losses or damages directly or indirectly from lien claims affecting the Property, the Building or the Premises arising out of Tenant's or Tenant's contractor's work or that of subcontractors or suppliers, and subordinating any such liens to the liens of construction and permanent financing for the Building.

(7) Landlord shall have the right to post a notice or notices in conspicuous place in or about the Premises announcing its non-responsibility for the work being performed therein.

E. TENANT'S ENTRY TO PREMISES. Tenant's entry to the Premises for any purpose, including without limitation, inspection or performance of Tenant Construction by Tenant's agents, prior to the Commencement Date as specified in Section 3(a) of the Lease shall be scheduled in advance with Landlord and shall be subject to all the terms and conditions of the Lease, except the payment of Rent. Tenant's entry shall mean entry by Tenant, its officers, contractors, office planner, licensees, agents, servants, employees, guests, invitees, or visitors.

F. TENANT'S TELEPHONE. Tenant is responsible for Tenant's telephone service. Tenant shall select Tenant's telephone system and shall coordinate its installation with the Landlord.

IV. IMPROVEMENTS BY THE LANDLORD

Notwithstanding anything to the contrary contained herein, Landlord shall, at Landlord's sole cost and expense, make the following modifications/refurbishments to the Building:

A. LOADING AREA/FREIGHT ELEVATOR. To be located on the west side of the Hambach Building. The alley location shall accommodate up to a 73'0" tractor trailer rig 8'6" wide and 13'6" tall.

Landlord will provide for all costs to design and construct a freight elevator to meet Tenant's equipment needs. In general, the freight elevator will move equipment to the first, second & third Floors. The elevator must accommodate a minimum of an 8,000 pound load. All transitions shall be smooth and level to and from the elevator. The dimensions, including allowances for a pallet jack and minimal clearance around the crate are approximately 102" (h) x 144" (w) x 64" (d). The freight elevator will have double doors. Each door must have a minimum clear opening width of 100".

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B. FLOOR LOAD CAPACITY. The first and second floors of the Hambach Building will be used for assembling and packaging computer components. Landlord will ensure that the building can accommodate an electric pallet jack, moving a 5,000 pound load and a stationary load of 15,500 pounds in certain locations on the second floor.

C. SUPPLEMENTAL COOLING. Landlord will provide adequate space on site for two 125 ton chillers with an approximate total dimension of 36' x 8' x 9' and a total weight of approximately 20,000 pounds, to service the assembling and packaging areas. (Tenant will pay for the cost and installation of the chillers.)

D. SECURITY SYSTEMS. Landlord will add additional security cameras to its current system at the entrances to the garage and at the loading/freight elevator area.

E. HEATING, VENTILATION & AIR CONDITIONING. Landlord, at Landlord's expense will provide improvements to the current HVAC and control system to allow Tenant to control HVAC units after normal business hours. The improvements will also include upgrading the HVAC to allow for multiple zones per floor.

V. COST SAVINGS

So long as Landlord's costs in regard to the construction of tenant

improvements are not increased, Landlord agrees to assist Tenant in working to maximize any and all funding available through any special cost savings programs, such as reduced real estate taxes, low interest rate loans, and refund of state sales taxes with respect to the construction of any tenant improvements. Any savings from these programs will accrue to Tenant.

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EXHIBIT D

Memorandum of Lease

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RETURN ADDRESS:

David H. Oswald, Esq.
Ryan, Swanson & Cleveland, PLLC
1201 Third Avenue, Suite 3400
Seattle, WA 98101-3034

MEMORANDUM OF LEASE

GRANTOR: MERRILL PLACE LLC

GRANTEE: TERA COMPUTER COMPANY

ABBREVIATED LEGAL DESCRIPTION: Portion of Block 4, D.S. Maynard's Plat of
Seattle, Vol. 1, Pg. 23
(See Page 4 for full legal description)

ASSESSOR'S TAX PARCEL NO.: 524780-0200-03

THIS MEMORANDUM OF LEASE is made this _____ day of _____,
1997, by and between MERRILL PLACE LLC, a Washington limited liability company
("Landlord"), and TERA COMPUTER COMPANY, a Washington corporation ("Tenant").

W I T N E S S E T H:

IN CONSIDERATION of the rents reserved in that certain Lease Agreement between the parties dated _____, 1997 (the "Lease"), and of the terms, covenants, conditions and agreements on the part of Tenant therein, notice is hereby given that Landlord has leased to Tenant _____ square feet of the buildings (the "Premises") located on certain real property having a postal address of 411 First Avenue South, Seattle, King County, Washington 98104, which real property is legally described on Exhibit A attached hereto and made a part hereof, together with all and singular the building or buildings, privileges and advantages, with any and all appurtenances belonging or in any way appertaining to the Premises hereby leased, including the right in Tenant, its successors, assigns, subtenants, employees, customers, licensees and invitees to use the parking areas, sidewalks, common areas and access areas to and from public streets and highways.

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TO HAVE AND TO HOLD the Premises for the initial term of one hundred twenty (120) months, ending at the time indicated in the Lease, with options to extend the term for one additional period of five (5) years, upon the terms, covenants and conditions specified in the Lease.

"LANDLORD"

MERRILL PLACE LLC,
a Washington limited liability company

By: NSD, LLC,
a Washington limited liability company,
its Manager

By: _____
Kevin Daniels, Member

"TENANT"

TERA COMPUTER COMPANY,
a Washington corporation

By: _____
Its: _____

STATE OF WASHINGTON)
) ss.
COUNTY OF KING)

I certify that I know or have satisfactory evidence that KEVIN DANIELS is the person who appeared before me, and said person acknowledged that he signed this instrument, on oath stated that he was authorized to execute the instrument and acknowledged it as the Member of NSD, LLC, in its capacity as the Manager of MERRILL PLACE LLC, to be the free and voluntary act and deed of said limited liability company, for the uses and purposes mentioned in the instrument.

WITNESS my hand and official seal hereto affixed this _____ day of _____, 1997.

(Print name)
Notary Public in and for the State of Washington.
My appointment expires _____.

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STATE OF WASHINGTON)
) ss.
COUNTY OF KING)

I certify that I know or have satisfactory evidence that _____ is the person who appeared before me, and said person acknowledged that he/she signed this instrument, on oath stated that he/she was authorized to execute the instrument and acknowledged it as the _____ of TERA COMPUTER COMPANY, to be the free and voluntary act and deed of said corporation, for the uses and purposes mentioned in the instrument.

WITNESS my hand and official seal hereto affixed this _____ day of _____, 1997.

(Print name)
Notary Public in and for the State of Washington.
My appointment expires _____.

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EXHIBIT A
(LEGAL DESCRIPTION)

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EXHIBIT E
Additional Terms of Lease

1. PARKING. Tenant shall have the right to park up to 140 automobiles and 70 bicycles in the parking garage portion of the Building, at the then prevailing parking rate in the garage, provided that there will be no charge for parking bicycles in the garage. The use of the garage shall be subject to such rules and regulations as Landlord or its parking garage operator may adopt from time to time. Tenant may, at its option, at any time during the Lease Term, on sixty (60) days' advance notice to Landlord, lease the entire garage, subject to existing contracts for space in the garage, at a net rent of \$23,000 per month [for the first year only].

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EXHIBIT F

Building Rules and Regulations

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EXHIBIT E

Rules and Regulations

1. The sidewalks, halls, passages, exits, entrances, elevators and stairways of the Building shall not be obstructed by Tenant or used by it for any purpose other than for ingress to and egress from the Premises. The halls, passages, exits, entrances, elevators and stairways are not for the use of the general public, and Landlord shall in all cases retain the right to control and prevent access thereto of all persons whose presence in the judgment of Landlord would be prejudicial to the safety, character, reputation and interests of the Building and its tenants, provided that nothing herein contained shall be construed to prevent such access to persons with whom Tenant normally deals in the ordinary course of its business, unless such persons are engaged in illegal activities. Tenant shall not go upon the roof of the Building.

2. No sign, placard, picture, name, advertisement or notice visible from the exterior of the Premises shall be inscribed, painted, affixed or otherwise displayed by Tenant on any part of the Building without the prior written consent of Landlord. Landlord will adopt and furnish to Tenant general guidelines relating to signs inside the Building on the office floors. Tenant agrees to conform to such guidelines, but may request approval of Landlord for modifications. All approved signs or lettering on doors shall be printed, painted, affixed or inscribed at the expense of Tenant by a person approved by Landlord. Materials shall not be placed on windowsills. Any materials visible from outside the Building will not be permitted.

3. The Premises shall not be used for storage of merchandise held for sale to the general public or for lodging. No cooking shall be done or permitted by Tenant on the Premises, except that use by Tenant of Underwriters' Laboratory-approved microwave oven and equipment for brewing coffee, tea, hot chocolate and similar beverages shall be permitted, provided that such use is in accordance with all applicable federal, state and city laws, codes, ordinances, rules and regulations.

4. Tenant shall not employ any person or persons other than the janitor of Landlord for the purpose of cleaning the Premises, unless otherwise agreed to by Landlord in writing. Except with the written consent of Landlord, no person or persons other than those approved by Landlord shall be permitted to enter the Building for the purpose of cleaning same. Tenant shall not cause any unnecessary labor by reason of Tenant's carelessness or indifference in the preservation of good order and cleanliness. Janitor service will not be furnished on nights when rooms are occupied after 9:30 p.m. unless, by agreement in writing, service is extended to a later hour for specifically designated rooms.

5. Landlord will furnish Tenant with an agreed number of keys to the Premises, free of charge. No additional locking devices shall be installed without the prior written consent of Landlord. Landlord may make reasonable charge for any additional lock or any bolt installed on any door of the Premises without the prior consent of Landlord. Tenant shall in each case furnish Landlord with a key for any such lock. Tenant, upon the termination of its tenancy, shall deliver to Landlord all keys to doors in the Building and the Premises that shall have been furnished to Tenant.

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6. The building freight elevator shall be available for use by Tenant, subject to such reasonable scheduling as Landlord shall deem appropriate. The persons employed by Tenant to move equipment or other items in or out of the Building must be acceptable to Landlord. Landlord shall have the right to prescribe the weight, size and position of all equipment, materials, supplies, furniture or other property brought into the Building. Heavy objects shall, if considered necessary by Landlord, stand on wood strips of such thickness as is

necessary to properly distribute the weight of such objects. Landlord will not be responsible for loss of or damage to any such property from any cause, and all damage done to the Building by moving or maintaining Tenant's property shall be repaired at the expense of Tenant.

7. Tenant shall not use or keep in the Premises or the Building any kerosene, gasoline or flammable or combustible fluid or materials or use any method of heating or air conditioning other than that supplied by Landlord. Tenant shall not use, keep or permit or suffer the Premises to be occupied or used in a manner offensive or objectionable to Landlord or other occupants of the Building by reason of noise, odors, and/or vibrations, or interfere in any way with other tenants or those having business in the Building.

8. Landlord reserves the right to exclude from the Building between the hours of 6 p.m. and 8 a.m. and at all hours on Sundays and legal holidays and after 2 p.m. on Saturdays all persons who do not present an access card for entrance. Landlord will furnish access cards to persons for whom Tenant requests same in writing. Tenant shall be responsible for all persons for whom it requests cards and shall be liable to Landlord for all acts of such persons. Landlord shall in no case be liable for damages for any error with regard to the admission to or exclusion from the Building of any person. In the case of invasion, mob, riot, public excitement or other circumstances rendering such action advisable in Landlord's opinion, Landlord reserves the right to prevent access to the Building during the continuance of same by such action as Landlord may deem appropriate, including closing doors.

9. The directory of the Building will be provided for the display of the name and location of tenants and a reasonable number of the principal officers and employees of tenants, and Landlord reserves the right to exclude any other names therefrom. Any additional name that Tenant shall desire to place upon the directory must first be approved by Landlord and, if so approved, a charge will be made therefor.

10. No curtains, draperies, blinds, shutters, shades, screens or other coverings, hangings or decorations shall be attached to, hung or placed in, or used in connection with any window of the Building without the prior written consent of Landlord. In any event, with the prior written consent of Landlord, such items shall be installed on the office side of Landlord's standard window covering and shall in no way be visible from the exterior of the Building.

11. Tenant shall see that the doors of the Premises are closed and locked and that all water faucets, water apparatus and utilities are shut off before Tenant or Tenant's employees leave the Premises, so as to prevent waste or damage, and for any default or carelessness in this regard Tenant shall make good all injuries sustained by other tenants or occupants of the Building or Landlord. On multiple-tenancy floors, all tenants shall keep the doors to the Building corridors closed at all times except for ingress and egress.

12. The toilet rooms, toilets, urinals, wash bowls and other apparatus shall not be used

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for any purpose other than that for which they were constructed, no foreign substance of any kind whatsoever shall be deposited therein, and any damage resulting to same from Tenant's misuse thereof shall be paid for by Tenant.

13. Except with the prior consent of Landlord, Tenant shall not sell, or permit the sale from the Premises of, or use or permit the use of any sidewalk or common area adjacent to the Premises for the sale of, newspapers, magazines, periodicals, theatre tickets or any other goods, merchandise or service, nor shall Tenant carry on, or permit or allow any employee or other person to carry on, business in or from the Premises for the service or accommodation of occupants of any other portion of the Building, nor shall the Premises be used for manufacturing of any kind, or for any business or activity other than that specifically provided for in Tenant's lease.

14. Tenant shall not install any radio or television antenna, satellite dish, loudspeaker, or other device on the roof or exterior walls of the Building.

15. Tenant shall not use in any space, or in the common areas of the , any handtrucks except those equipped with rubber tires and side guards or such

other material-handling equipment as Landlord may approve. No other vehicles of any kind shall be brought by Tenant into the Building or kept in or about the Premises.

16. Tenant shall store all its trash and/garbage within the Premises until removal of same to such/location in the Building as may be designated from time to time by Landlord. No material shall be placed in the Building trash boxes or receptacles if such material is of such nature that it may not be disposed of in the ordinary and customary manner of removing and disposing of trash and garbage in the City of Seattle without being in violation of any law or ordinance governing such disposal.

17. All loading and unloading of merchandise, supplies, materials, garbage and refuse shall be made only through such entryways and elevators and at such times as Landlord shall designate. In its use of the loading areas on the first basement floor, Tenant shall not obstruct or permit the obstruction of said loading areas, and at no time shall Tenant park vehicles therein except for loading and unloading.

18. Canvassing, soliciting, peddling or distribution of handbills or any other written material in the Building is prohibited, and Tenant shall cooperate to prevent same.

19. Landlord reserves the right to select the name of the Building and to make such change or changes of name as it may deem appropriate from time to time, and Tenant shall not refer to the Building by any name other than: (i) the names as selected by Landlord (as same may be changed from time to time), or (ii) the postal address, approved by the United States Post Office. Tenant shall not use the name of the Building in any respect other than as an address of its operation in the Building, without the prior written consent of Landlord.

20. The requirements of Tenant will be attended to only upon application by telephone or writing or in person at the office of the Building. Employees of Landlord shall not perform any work or do anything outside of their regular duties unless under special instructions from Landlord. If Landlord's employees are made available for the assistance of Tenant, Landlord- shall- be paid for their services by Tenant at reasonable hourly rates.

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21. Landlord may waive any one or more of these Rules and Regulations for the benefit of any particular tenant or tenants, but no such waiver by Landlord shall be construed as a waiver of these Rules and Regulations in favor of any other tenant or tenants, nor prevent Landlord from thereafter enforcing any such Rules and Regulations against any or all of the tenants of the Building.

22. Wherever the word "Tenant" occurs in these Rules and Regulations, it is understood and agreed that it shall mean Tenant's associates, agents, clerks, employees and visitors. Wherever the word "Landlord" occurs in these Rules and Regulations, it is understood and agreed that it shall mean Landlord's assigns, agents, clerks, employees and visitors.

23. These Rules and Regulations are in addition to, and shall not be construed in any way to modify, alter or amend, in whole or in part, the terms, covenants, agreements and conditions of any lease of premises in the Building.

24. Landlord reserves the right to make such other and reasonable rules and regulations as in its judgment may from time to time be needed for the safety, care and cleanliness of the Building and for the preservation of good order therein.

25. Subject to the provisions of Exhibit C to the Lease, Landlord shall have the right to limit the weight, size and to designate the locations of all safes, filerooms, libraries and other heavy property within the Building. Maximum uniform floor loading allowed is 150 pounds per square foot live load and 40 pounds per square foot dead load. Tenant warrants that under no circumstances shall it load the floor in excess of this limit. If excess floor loading is required, all costs (including engineering) to prepare the floor surface and structure to withstand excess floor loads shall be borne by Tenant.

No vending machine or machines of any description shall be installed, maintained or operated on the Premises without the prior written consent of the Landlord.

Landlord may, however, rescind such consent at any time without liability to Tenant.

TERA COMPUTER COMPANY
(a development stage company)
COMPUTATION OF NET LOSS PER SHARE

	TWELVE MONTHS ENDED DECEMBER 31,			INCEPTION THROUGH DECEMBER 31, 1997
	1995	1996	1997	
WEIGHTED AVERAGE SHARES OUTSTANDING	2,646,243	5,320,785	8,784,943	2,193,839
NET LOSS APPLICABLE TO COMMON STOCK	(\$5,646,331)	(\$12,077,338)	(\$17,863,987)	(\$44,909,076)
NET LOSS PER COMMON SHARE	(\$2.13)	(\$2.27)	(\$2.03)	(\$20.47)

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference into Registration Statement Nos. 333-1430 and 333-12747 on Form S-8, and 333-36563 and 333-44137 on Form S-3, of Tera Computer Company (a development stage company) of our report dated January 21, 1998, included in this Annual Report on Form 10-K of Tera Computer Company for the year ended December 31, 1997.

/s/ DELOITTE & TOUCHE LLP

Seattle, Washington
March 30, 1998

<ARTICLE> 5

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This schedule contains summary financial information extracted from the audited financial statements of Tera Computer Company for the year ended Dec 31, 1997 and is qualified in its entirety by reference to such financial statements.

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