VALUE LINE FUND INC
Form N-CSRS
September 09, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM N-CSR

CERTIFIED SHAREHOLDER REPORT OF REGISTERED
MANAGEMENT INVESTMENT COMPANIES

Investment Company Act file Number 811-02265

Value Line Fund, Inc.
(Exact name of registrant as specified in charter)

7 Times Square, New York, N.Y. 10036
(Address of principal executive offices) (Zip Code)

Registrant’s telephone number, including area code: 212-907-1900

Date of fiscal year end: December 31

Date of reporting period: June 30, 2014

Item I. Reports to Stockholders.

A copy of the Semi-Annual Report to Stockholders for the period ended 6/30/14 is included with this Form.

Semi - Annual Report
June 30, 2014

Value Line Premier Growth Fund, Inc.
(VALSX)

The Value Line Fund, Inc.
(VLIFX)

Value Line Income and Growth Fund, Inc.
(VALIX)

Value Line Larger Companies Fund, Inc.
(VALLX)

Value Line Core Bond Fund
(VAGIX)

This audited report is issued for information to shareholders. It is not authorized for distribution to prospective investors
unless preceded or accompanied by a currently effective prospectus of the Fund (obtainable from the Distributor).

#00116881

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President's Letter (unaudited)

Dear Fellow Shareholders:

We are pleased to present you with this semi-annual report for Value Line Premier Growth Fund, Inc., The Value Line Fund, Inc., Value Line Income and Growth Fund, Inc., Value Line Larger Companies Fund, Inc. and Value Line Core Bond Fund (individually, a "Fund" and collectively, the "Funds") for the six months ended June 30, 2014.

The six months ended June 30, 2014 were rewarding ones for the equity, hybrid and fixed income Value Line Funds, as both equities and fixed income generated positive returns. Generally low market volatility and recovery in U.S. economic growth in the second quarter of 2014, following severe winter weather that dampened growth in the first calendar quarter, helped support market gains. The semi-annual period was also highlighted by several of the Funds being recognized for their long-term performance and attractive risk profiles.

Value Line Premier Growth Fund, Inc. outpaced its peers for the five- and ten-year periods ended June 30, 2014, as noted by leading independent mutual fund advisory service Lipper Inc.1 (multi-cap growth category). Lipper also awarded its top Lipper Leader rating of 5 to the Fund for Preservationi versus its peers as of June 30, 2014. Additionally, the Fund earned an Overall four-star rating from Morningstar2 in the mid-cap growth category among 635 funds as of June 30, 2014 based on risk-adjusted returns. Morningstar gave the Fund a Risk rating of Low.ii

The Value Line Fund, Inc. was given a Risk rating of Lowiv by Morningstar as of June 30, 2014.

Value Line Income and Growth Fund, Inc. outpaced its peers for the six-month and one-, three-, five- and ten-year periods ended June 30, 2014, as noted by Lipper Inc.1 (mixed-asset target allocation moderate category). Lipper also awarded its top Lipper Leader rating of 5 to the Fund for Consistent Returniii versus its peers as of June 30, 2014. Additionally, the Fund earned an Overall four-star rating from Morningstar2 in the moderate allocation category among 730 funds as of June 30, 2014 based on risk-adjusted returns. Morningstar gave the Fund a Risk rating of Below Average.vi

Value Line Larger Companies Fund, Inc. was given a Risk rating of Below Averagevii by Morningstar as of June 30, 2014.

Value Line Core Bond Fund outpaced its peers for the three-, five- and ten-year periods ended June 30, 2014, as noted by Lipper Inc.1 (investment grade debt category). Lipper also awarded its top Lipper Leader rating of 5 to the Fund for Total Returnv versus its peers as of June 30, 2014.

Also a highlight of the semi-annual period was welcoming Cindy Starke to our portfolio management team after Mark Spellman left the firm in February 2014 to pursue other opportunities. Prior to joining us in June 2014, Cindy was a portfolio manager and equity analyst at Spears Abacus Advisors from 2012 to 2014. From 2010 to 2012, she was an equity analyst with Conative Capital Management, and from 2007 to 2009, a managing director, portfolio manager and equity analyst at Barrett Associates. From 1999 to 2007, she was managing director, portfolio manager and equity analyst at NewBridge Partners and Victory NewBridge. Cindy currently serves as portfolio manager of Value Line Larger Companies Fund, Inc. and as a co-portfolio manager of Value Line Income and Growth Fund, Inc.

On the following pages, the Funds' portfolio managers discuss the management of their respective Funds during the semi-annual period. The discussions highlight key factors influencing recent performance of the Funds. You will also find a schedule of investments and financial statements for each of the Funds.

Before reviewing the performance of your individual mutual fund investment(s), we encourage you to take a brief look at the major factors affecting the financial markets over the six months ended June 30, 2014, especially given the newsworthy events of the semi-annual period. With the positive performance results of the Funds during the first half of 2014, we also invite you to take this time to consider a broader diversification strategy by including additional Value Line Funds, which you can read about on the following pages, in your investment portfolio. You can also find out more about the entire family of Value Line Funds at our website, www.vlfunds.com, newly redesigned to be even more informative, user-friendly and comprehensive.

Economic Review

U.S. real Gross Domestic Product (GDP) got off to a slow start in 2014, contracting at a 2.9% annualized rate from January through March. This was the biggest decline in the pace of U.S. economic growth since the first quarter of 2009. Part of the decline was due to the unusually harsh winter weather conditions throughout much of the nation. In turn, consumer spending grew at the weakest pace in five years, restrained further by a drop in health care outlays. Such low health care spending was largely unexpected, as the U.S. Bureau of Economic Analysis had earlier estimated that major provisions of President Obama's signature health care law would result in increased medical spending by consumers. Second quarter GDP numbers are widely expected to show a significant increase over those of the first quarter, supported by what many anticipate to be some upside surprises in the labor and housing markets as well as in consumer confidence.

Inflation remained modest through the semi-annual period though inching up to hover around the Federal Reserve's (the Fed's) target of 2.0%. The headline Consumer Price Index (CPI) rose 2.1% over the 12 months ended June 30, 2014 before seasonal adjustment. Core inflation, which excludes food and energy and which is the price measure tied to consumer spending watched most closely by the Fed, was up 1.9% in June 2014 from a year earlier. Limited wage growth was a key contributor to the relatively benign inflation scenario.

(continued)

The U.S. saw moderate but unspectacular job growth. While the unemployment rate declined from 6.7% at the close of 2013 to 6.1% at the end of June 2014, job creation was lackluster, with hiring generally concentrated in sectors representative of low-wage jobs. Still, the consumer looked more positively on the U.S. economy overall, with the Consumer Confidence Index rising from 78.1 in December 2013 to 85.2 in June 2014, its highest level since January 2008. Consumers indicated that they expect business conditions to improve, and their assessment of the job market also grew more favorable.

Against this backdrop of disappointing economic growth but declining unemployment and still modest inflation, the Fed left the targeted federal funds rate unchanged throughout the semi-annual period. By the end of June 2014, the majority of Fed governors saw the first interest rate hike likely to occur in 2015. Despite expectations for improved economic activity in the second half of 2014, Fed Chair Janet Yellen reaffirmed the Fed's commitment to maintaining accommodative monetary policy until a more robust recovery can be sustained. While there were pockets of economic strength and lower unemployment, these trends were not as strong as the Fed had hoped. Meanwhile, the Fed's bond-buying program was tapered by $10 billion per month each month since January 2014, with the wind-down targeted for completion in October 2014.

Equity Market Review

U.S. equities, as measured by the S&P 500® Index3, posted a solid gain of 7.14% during the six months ended June 30, 2014, despite the weak U.S. economic data early in the calendar year. Indeed, even with a weak January 2014, the S&P 500® Index experienced a sixth consecutive quarterly gain, a record not matched since 1998. The U.S. equity market's climb to new highs through the end of June 2014, amidst low volatility and improved economic data in the second calendar quarter, was supported by many U.S. corporate earnings announcements reflecting top-line growth, even as overall management guidance for 2014 was less optimistic than consensus.

All ten sectors of the S&P 500® Index posted positive absolute performance for the semi-annual period, with the utilities, energy and health care sectors leading the way. Consumer discretionary, industrials, telecommunication services and financials were the weakest sectors during the semi-annual period.

Fixed Income Market Review

In contrast to a challenging 2013, the broad U.S. fixed income market, as measured by the Barclays U.S. Aggregate Bond Index4, posted a solid positive return of 3.93% during the semi-annual period. The yield curve flattened, as intermediate-term and longer-term yields declined and shorter-term maturities edged up. The yield on the bellwether 10-year U.S. Treasury note fell approximately 51 basis points during the semi-annual period, while the yield on the 30-year U.S. Treasury declined approximately 62 basis points. (A basis point is 1/100th of a percentage point.) The 30-year U.S. Treasury bond's especially strong performance stemmed both from low inflation and from a flood of buyers looking for relative safety away from the comparatively slower economic growth seen in the European Union and the BRIC nations (Brazil, Russia, India and China).

Weak first quarter GDP, lackluster job growth and inflation hovering around the Fed's target level of 2% kept interest rates low during the semi-annual period. A combination of low interest rates and low market volatility led many investors on a search for yield, benefiting the performance of spread, or non-U.S. Treasury, sectors, particularly in the middle and lower credit rating bands, and causing U.S. Treasuries to lag in comparison. Corporate bonds, both investment grade and high yield, and securitized debt most significantly outperformed U.S. Treasuries during the semi-annual period. Another factor supporting investors' heightened risk tolerance was the progress made in several European countries toward better economic conditions.

* * *

We thank you for trusting us to be a part of your long-term, comprehensive investment strategy. We appreciate your confidence in the Value Line Funds and look forward to serving your investment needs in the years ahead just as we have been helping to secure generations' financial futures for more than 60 years—based on solid fundamentals, sound investment principles and the power of disciplined and rigorous analytics. If you have any questions or would like additional information on these or other Value Line Funds, we invite you to contact your investment representative or visit us at www.vlfunds.com.

Sincerely,

/s/ Mitchell Appel
Mitchell Appel
President of the Value Line
Funds

(continued)

Past performance does not guarantee future results. Investment return and principal value of an investment can fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost; and that current performance may be lower or higher than the performance data quoted. Investors should carefully consider the investment objective, risks, charges and expense of a fund. This and other important information about a fund is contained in the fund's prospectus. A copy of our funds' prospectuses can be obtained free of charge by going to our website at www.vlfunds.com or calling 800.243.2729.

1 Lipper Leader ratings are derived from highly sophisticated formulas that analyze funds against clearly defined criteria. Funds are compared to similar funds, and only those that trust stand out are awarded Lipper Leader status. Funds are ranked against their peers on each of four measures: Total Return, Consistent Return, Preservation and Expense. A fifth measure, Tax Efficiency, applies in the United States. Scores are subject to change every month and are calculated for the following periods: 3-year, 5-year, 10-year and overall. The overall calculation is based on an equal-weighted average of percentile ranks for each measure over 3-year, 5-year and 10-year periods (if applicable). For each measure, the highest 20% of funds in each peer group are named Lipper Leaders. The next 20% receive a rating of 4: the middle 20% are rated 3: the next 20% are rated 2; and the lowest 20% are rated 1.

i For Value Line Premier Growth Fund, Inc.: Preservation 5 rating for 3-year (10,893 funds), 5-year (9,123 funds) and overall (10,893 funds) periods ended June 30, 2014; 4 rating for 10-year (5,423 funds) period ended June 30, 2014.

iii For Value Line Income and Growth Fund, Inc.: Consistent 5 rating for 10-year (254 funds) and overall (445 funds) periods ended June 30, 2014; 4 rating for 3-year (445 funds) and five-year (385 funds) periods ended June 30, 2014.

v For Value Line Core Bond Fund: Total Return 5 rating for 5-year (400 funds), 10-year (288 funds) and overall (466 funds) periods ended June 30, 2014; 3 rating for 3-year (466 funds) period ended June 30, 2014.

2 The Morningstar RatingTM for funds methodology rates funds based on an enhanced Morningstar Risk-Adjusted Return measure, which also accounts for the effects of all sales charges, loads, or redemption fees. Funds are ranked by their Morningstar Risk-Adjusted Return scores and stars are assigned using the following scale: 5 stars for top 10%; 4 starts next 22.5%; 3 stars next 35%; 2 stars next 22.5%; 1 star for bottom 10%. Funds are rated for up to three periods: the trailing three-, five- and 10-years. For a fund that does not change categories during the evaluation period, the overall rating is calculated using the following weights: At least 3 years, but less than 5 years uses 100% three-year rating. At least 5 years but less than 10 years uses 60% five-year ratings/40% three-year rating. At least 10 years uses 50% ten-year rating/30% five-year rating/20% three-year rating.

ii For Value Line Premier Growth Fund, Inc.: Four-star rating for 3-year (635 funds), 5-year (574 funds), 10-year (417 funds) and Overall (635 funds) periods ended June 30, 2014. All in the mid-cap growth category. Morningstar Risk: Low for the 3-year and 5-year periods ended June 30, 2014; Below Average for the 10-year and Overall periods ended June 30, 2014.

iv For The Value Line Fund, Inc.: Morningstar Risk: Low for the 3-year, 5-year and Overall periods ended June 30, 2014; Below Average for the 10-year period ended June 30, 2014.

vi For Value Line Income and Growth Fund: Four-star rating for 10-year (423 funds) and Overall (730 funds) periods ended June 30, 2014; 3-star rating for 3-year (730 funds) and 5-year (649 funds) periods ended June 30, 2014. All in the moderate allocation category. Morningstar Risk: Below Average for the 3-year, 5-year, 10-year and Overall periods ended June 30, 2014.

vii For Value Line Larger Companies Fund, Inc.: Morningstar Risk: Below Average for the 3-year, 5-year, 10-year and Overall periods ended June 30, 2014.

3 The S&P 500® Index consists of 500 stocks that are traded on the New York Stock Exchange, American Stock Exchange and the NASDAQ national Market System and is representative of the broad stock market. This is an unmanaged index and does not reflect charges, expenses or taxes, and it is not possible to directly invest in this index.

4 The Barclays U.S. Aggregate Bond Index is a broad-based benchmark that measures the investment grade, U.S. dollar-denominated, fixed-rate taxable bond market, including U.S. Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS. This is an unmanaged index and does not reflect charges, expenses or taxes, which are deducted from the Fund’s return. It is not possible to directly invest in this index.

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VALUE LINE PREMIER GROWTH FUND, INC.

INVESTMENT OBJECTIVE AND STRATEGY

The Fund primarily seeks long-term growth of capital.

To achieve the Fund's goal, the Fund's investment adviser invests at least 80% of the Fund's net assets in a diversified portfolio of U.S. equity securities with favorable growth prospects. In selecting securities for purchase or sale, the Adviser generally analyzes the issuer of a security using fundamental factors such as growth potential and earnings estimates and quantitative factors such as historical earnings, earnings momentum and price momentum. The Fund may invest in small, mid or large capitalization companies, including foreign companies. There are no set limitations of investments according to a company's size, or to a sector weighting.

Manager Discussion of Fund Performance

Below, Value Line Premier Growth Fund, Inc. portfolio manager Stephen E. Grant discusses the Fund's performance and positioning for the six months ended June 30, 2014.

How did the Fund perform during the semi-annual period?

The Fund generated a cumulative total return of 4.35% during the six months ended June 30, 2014. This compares to the 7.14% return of the Fund's benchmark, the S&P 500® Index, during the same annual period.

What key factors were responsible for the Fund's performance during the six-month reporting period?

The Fund generated solid absolute gains but underperformed the S&P 500® Index during the six-month reporting period due to both stock selection and sector allocation decisions overall.

Also, while the semi-annual period ended June 30, 2014 saw gains for the equity market, value stocks outperformed growth stocks, and large-cap stocks outperformed small-cap stocks. Relative to the benchmark, both of these factors acted as headwinds to Fund results, as the Fund concentrates its holdings on growth-oriented stocks and on stocks with an average market capitalization well below that of the S&P 500® Index.

Which equity market sectors most significantly affected Fund performance?

Stock selection in information technology, industrials and energy detracted from the Fund's performance most during the semi-annual period. Having underweighted allocations to the strongly performing information technology and energy sectors and having an overweighted exposure to the weaker industrials sector also hurt. In information technology, the Fund held no positions in the strongly performing large-cap stocks in the sector, including Apple, Microsoft, Intel and Facebook, each of which saw their shares climb double-digits during the semi-annual period. The Fund was overweighted, however, in global payment solutions company MasterCard, whose shares declined on profit-taking after being one of the Fund's best performers in 2013. We trimmed the Fund's position in MasterCard during the semi-annual period because it had grown into a larger holding than we were comfortable with after its prior year's growth. A sizable position in application software developer Ansys also hurt, as its shares fell. In industrials, positions in engineering and constructing firm Chicago Bridge & Iron, electronic instruments manufacturer Ametek, aerospace and defense parts manufacturer Precision Castparts and human resources and financial consulting services provider Towers Watson each dampened results, as each saw share price declines during the semi-annual period. We trimmed the Fund's position in Towers Watson during the semi-annual period because of signs that its long-term earnings and stock price growth may be slowing. In energy, an underweighted exposure to the oil services industry particularly hurt, as the Fund held no positions in either Schlumberger or Halliburton, both of which saw robust gains during the semi-annual period.

Partially offsetting these detractors were the positive contributions made by effective stock selection in the financials and telecommunication services sectors. Having an underweighted allocation to the weakly-performing financials sector also helped. In financials, a position in India's HDFC Bank, whose shares rallied strongly, boosted the Fund's relative results. Not holding positions in laggards Citigroup and JPMorgan Chase also buoyed Fund performance. In telecommunication services, a position in wireless communications infrastructure owner and operator SBA Communications was a particularly strong performer.

Which stocks detracted significantly from the Fund's performance during the semi-annual period?

During the semi-annual period, among the stocks that detracted most from the Fund's relative performance was MasterCard, already mentioned. Positions in TJX Companies, a discount apparel and home fashion retailer, and LKQ, an automotive products and services wholesaler, also detracted significantly, each suffering from quarterly earnings reports that were weaker than forecast.

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What were some of the Fund's best-performing individual stocks?

Among the individual stocks that contributed most to the Fund's relative results were pharmaceuticals company Novo Nordisk, Indian bank HDFC Bank and life science equipment firm Idexx Laboratories.

Novo Nordisk performed well on continued strong earnings results that drove a quadrupling of its stock price since the Fund established a position in its shares five years ago. HDFC Bank, mentioned earlier as an outstanding performer in the financials sector, had been one of the Fund's weakest performers in 2013. Its shares rebounded during the semi-annual period as investors regained confidence in India and its improving economy. Shares of Idexx Laboratories rose on continued strong earnings results that drove an 800%-plus gain in its stock price since we established a Fund position in its shares more than a decade ago.

Avoiding a position in diversified industrials and financial services conglomerate General Electric, whose shares fell during the semi-annual period, further boosted the Fund's relative results.

How did the Fund use derivatives and similar instruments during the reporting period?

The Fund did not use derivatives during the reporting period.

Did the Fund make any significant purchases or sales during the semi-annual period?

During the semi-annual period, we initiated a Fund position in consumer products manufacturing giant Procter & Gamble in recognition of its consistent long-term growth record in earnings and stock price, generated by its powerful product portfolio. We added to the Fund's positions in diversified defense company General Dynamics and information services provider IHS, as each continued to deliver good earnings and stock price growth.

We sold the Fund's position in natural food supermarket owner and operator Whole Foods Market because its quarterly earnings reports began to disappoint. We also exited the Fund's position in Internet exchange services provider Equinix because of reduced consistency and predictability in its earnings and stock price.

Were there any notable changes in the Fund's weightings during the six-month period?

There were no material changes in the Fund's sector weightings during the six-month period ended June 30, 2014.

How was the Fund positioned relative to its benchmark index at the end of June 2014?

As of June 30, 2014, the Fund was overweighted relative to the S&P 500® Index in the industrials and materials sectors. The Fund was underweighted relative to the S&P 500® Index in the energy, financials and information technology sectors and rather neutrally weighted relative to the Index in the consumer discretionary, consumer staples, health care, utilities, telecommunication services sectors on the same date.

What is your tactical view and strategy for the months ahead?

Regardless of market conditions, we intend to stay true to our time-tested investment discipline going forward, seeking to invest in companies that have demonstrated a solid history of consistent growth in both their earnings and stock price. In our view, these companies possess attractive portfolios of proprietary products and services that give them strong market positions and make them less vulnerable to swings in national and international economic conditions. At the same time, we believe the underlying stocks of these companies tend to be less volatile than the average stock in the S&P 500® Index. By maintaining our investment discipline, the Fund has historically provided a smoother ride to investors than its peer group averages. Putting aside short-term ebbs and flows in the equity market, we believe the Fund's investments are likely to continue to provide superior returns to our shareholders over the long term.

Value Line Premier Growth Fund, Inc.
Portfolio Highlights at June 30, 2014 (unaudited)

Ten Largest Holdings

Issue	Shares		Value	Percentage of Net Assets
Alexion Pharmaceuticals, Inc.	37,800	$	5,906,250	1.5%
Alliance Data Systems Corp.	19,400		5,456,250	1.4%
Roper Industries, Inc.	36,000		5,256,360	1.3%
AMETEK, Inc.	96,750		5,058,090	1.3%
Danaher Corp.	61,000		4,802,530	1.2%
Ecolab, Inc.	43,000		4,787,620	1.2%
MasterCard, Inc. Class A	63,000		4,628,610	1.2%
Henry Schein, Inc.	38,800		4,604,396	1.2%
AMBEV S.A. ADR	650,000		4,576,000	1.2%
Kirby Corp.	39,000		4,568,460	1.2%

Asset Allocation – Percentage of Net Assets

Sector Weightings – Percentage of Total Investment Securities*

*Sector weightings exclude short-term investments.

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Value Line Premier Growth Fund, Inc.
Schedule of Investments (unaudited)

Shares		Value
COMMON STOCKS (98.3%)		
	CONSUMER DISCRETIONARY (9.3%)	
8,400	AutoZone, Inc. *	$ 4,504,416
56,000	BorgWarner, Inc.	3,650,640
44,000	Brinker International, Inc.	2,140,600
10,500	Buckle, Inc. (The) (1)	465,780
2,000	Buffalo Wild Wings, Inc. *	331,420
51,000	Dick's Sporting Goods, Inc.	2,374,560
10,000	Domino's Pizza, Inc.	730,900
23,000	Genuine Parts Co.	2,019,400
11,200	Gildan Activewear, Inc.	659,456
27,000	Johnson Controls, Inc.	1,348,110
112,000	LKQ Corp. *	2,989,280
18,000	O'Reilly Automotive, Inc. *	2,710,800
40,000	Starbucks Corp.	3,095,200
68,600	TJX Companies, Inc. (The)	3,646,090
21,600	VF Corp.	1,360,800
33,600	Wolverine World Wide, Inc. (1)	875,616
44,000	Yum! Brands, Inc.	3,572,800
		36,475,868
	CONSUMER STAPLES (9.3%)	
650,000	AMBEV S.A. ADR	4,576,000
81,000	BRF S.A. ADR	1,969,110
17,000	British American Tobacco PLC ADR	2,024,360
21,300	Brown-Forman Corp. Class B	2,005,821
17,600	Bunge Ltd.	1,331,264
48,400	Church & Dwight Co., Inc.	3,385,580
16,800	Coca-Cola Femsa, S.A.B. de C.V. ADR (1)	1,908,816
18,000	Costco Wholesale Corp.	2,072,880
23,400	Energizer Holdings, Inc.	2,855,502
89,812	Flowers Foods, Inc.	1,893,237
20,000	Fomento Economico Mexicano S.A.B. de C.V. ADR	1,873,000
64,000	General Mills, Inc.	3,362,560
43,000	Hormel Foods Corp.	2,122,050
3,000	McCormick & Co., Inc.	214,770
29,000	PepsiCo, Inc.	2,590,860
14,000	Procter & Gamble Co. (The)	1,100,260
22,000	Reynolds American, Inc.	1,327,700
		36,613,770
	ENERGY (5.7%)	

Shares		Value
4,400	CNOOC Ltd. ADR	788,876
14,600	Core Laboratories N.V.	2,439,076
22,000	Enbridge, Inc.	1,044,340

Shares		Value
	ENERGY (5.7%) (continued)	
29,873	EQT Corp.	$ 3,193,424
70,000	FMC Technologies, Inc.*	4,274,900
51,400	Noble Energy, Inc.	3,981,444
12,000	Oceaneering International, Inc.	937,560
5,000	Oil States International, Inc. *	320,450
32,000	ONEOK, Inc.	2,178,560
5,346	Pioneer Natural Resources Co.	1,228,564
26,000	TransCanada Corp.	1,240,720
24,600	Ultrapar Participacoes S.A. ADR	580,560
		22,208,474
	FINANCIALS (11.0%)	
8,000	ACE Ltd.	829,600
21,000	Affiliated Managers Group, Inc. *	4,313,400
52,600	AFLAC, Inc.	3,274,350
3,000	Alleghany Corp. *	1,314,360
36,000	American Tower Corp. REIT	3,239,280
45,000	Arch Capital Group Ltd. *	2,584,800
8,316	Banco de Chile ADR (1)	666,195
1,300	Bank of Montreal	95,667
22,100	Bank of Nova Scotia	1,471,860
4,700	BlackRock, Inc.	1,502,120
9,400	Brown & Brown, Inc.	288,674
9,400	Camden Property Trust REIT	668,810
3,200	Canadian Imperial Bank of Commerce (1)	291,136
23,200	Equity Lifestyle Properties, Inc. REIT	1,024,512
14,153	Essex Property Trust, Inc. REIT	2,617,031
1,400	Everest Re Group Ltd.	224,686
1	Gaming and Leisure Properties, Inc. REIT	34
75,500	HDFC Bank Ltd. ADR	3,534,910
22,000	M&T Bank Corp.	2,729,100
8,000	PartnerRe Ltd.	873,680
27,000	Portfolio Recovery Associates, Inc. *	1,607,310
5,000	Principal Financial Group, Inc.	252,400
29,000	ProAssurance Corp.	1,287,600
21,500	Prudential Financial, Inc.	1,908,555
26,000	Royal Bank of Canada	1,857,180
10,000	Stifel Financial Corp. *	473,500
17,000	T. Rowe Price Group, Inc.	1,434,970
8,000	Taubman Centers, Inc. REIT	606,480
14,800	Toronto-Dominion Bank (The)	760,868
30,000	Wells Fargo & Co.	1,576,800
		43,309,868

Shares Value

	HEALTH CARE (12.9%)		
37,800	Alexion Pharmaceuticals, Inc. *	$	5,906,250
17,200	Allergan, Inc.		2,910,584
15,200	Bayer AG ADR		2,147,304
14,500	Becton, Dickinson & Co.		1,715,350
1,100	Bio-Rad Laboratories, Inc. Class A *		131,681
11,800	Bio-Reference Laboratories, Inc. *		356,596
17,000	C.R. Bard, Inc.		2,431,170
16,000	Catamaran Corp. *		706,560
54,000	Cerner Corp. *		2,785,320
5,400	Cooper Cos., Inc. (The)		731,862
4,000	DaVita HealthCare Partners, Inc. *		289,280
10,000	DENTSPLY International, Inc.		473,500
46,000	Express Scripts Holding Co. *		3,189,180
38,800	Henry Schein, Inc. *		4,604,396
24,000	IDEXX Laboratories, Inc. *		3,205,680
15,000	McKesson Corp.		2,793,150
20,400	Mednax, Inc. *		1,186,260
15,300	Mettler-Toledo International, Inc. *		3,873,654
6,500	MWI Veterinary Supply, Inc. *		922,935
89,000	Novo Nordisk A/S ADR		4,110,910
4,000	ResMed, Inc. (1)		202,520
23,000	Teva Pharmaceutical Industries Ltd. ADR		1,205,660
29,000	Thermo Fisher Scientific, Inc.		3,422,000
8,000	Universal Health Services, Inc. Class B		766,080
7,000	WellPoint, Inc.		753,270
			50,821,152
	INDUSTRIALS (28.9%)		
25,300	Acuity Brands, Inc.		3,497,725
96,750	AMETEK, Inc.		5,058,090
39,200	AZZ, Inc.		1,806,336
59,800	Canadian National Railway Co.		3,888,196
1,000	Canadian Pacific Railway Ltd.		181,140
31,000	Chicago Bridge & Iron Co. N.V.		2,114,200
5,000	Civeo Corp. *		125,150
35,000	CLARCOR, Inc.		2,164,750
10,000	Clean Harbors, Inc. *		642,500
61,000	Danaher Corp.		4,802,530
56,000	Donaldson Co., Inc.		2,369,920
26,000	EnerSys		1,788,540
14,800	Equifax, Inc.		1,073,592
18,000	Esterline Technologies Corp. *		2,072,160
30,000	Fastenal Co. (1)		1,484,700
10,000	FedEx Corp.		1,513,800

See Notes to Financial Statements.

June 30, 2014

Shares			Value
COMMON STOCKS (continued) (98.3%)			
	INDUSTRIALS (28.9%) (continued)		
8,000	Flowserve Corp.	$	594,800
27,000	General Dynamics Corp.		3,146,850
6,000	Graco, Inc.		468,480
29,062	HEICO Corp.		1,509,480
48,850	IDEX Corp.		3,944,149
18,600	IHS, Inc. Class A *		2,523,462
19,000	ITT Corp.		913,900
33,000	J.B. Hunt Transport Services, Inc.		2,434,740
21,000	Kansas City Southern		2,257,710
39,000	Kirby Corp. *		4,568,460
7,000	L-3 Communications Holdings, Inc.		845,250
26,000	Lincoln Electric Holdings, Inc.		1,816,880
8,000	Oshkosh Corp.		444,240
33,000	Parker Hannifin Corp.		4,149,090
17,800	Precision Castparts Corp.		4,492,720
66,500	Republic Services, Inc.		2,525,005
9,000	Rockwell Automation, Inc.		1,126,440
54,000	Rollins, Inc.		1,620,000
36,000	Roper Industries, Inc.		5,256,360
50,700	Rush Enterprises, Inc. Class A *		1,757,769
4,000	Snap-on, Inc.		474,080
37,600	Stericycle, Inc. *		4,452,592
23,000	Teledyne Technologies, Inc. *		2,234,910
66,000	Toro Co. (The)		4,197,600
8,900	Towers Watson & Co. Class A		927,647
40,000	Union Pacific Corp.		3,990,000
36,000	United Technologies Corp.		4,156,200
12,700	Valmont Industries, Inc. (1)		1,929,765
12,600	W.W. Grainger, Inc.		3,203,802
42,800	Wabtec Corp.		3,534,852
67,600	Waste Connections, Inc.		3,281,980
			113,362,542
	INFORMATION TECHNOLOGY (9.5%)		
25,000	Accenture PLC Class A		2,021,000
19,400	Alliance Data Systems Corp. *		5,456,250

Shares			Value
	INFORMATION TECHNOLOGY (9.5%) (continued)		
30,800	Amphenol Corp. Class A	$	2,967,272
9,700	Anixter International, Inc.		970,679
60,000	ANSYS, Inc. *		4,549,200

17,000	Automatic Data Processing, Inc.		1,347,760
76,000	Cognizant Technology Solutions Corp. Class A *		3,717,160
24,400	Fiserv, Inc. *		1,471,808
63,000	MasterCard, Inc. Class A		4,628,610
11,200	MICROS Systems, Inc. *		760,480
75,000	Salesforce.com, Inc. *		4,356,000
51,000	Trimble Navigation Ltd. *		1,884,450
6,800	Ultimate Software Group, Inc. (The) *		939,556
20,300	WEX, Inc. *		2,130,891
			37,201,116
	MATERIALS (8.3%)		
15,000	Air Products & Chemicals, Inc.		1,929,300
8,000	Airgas, Inc.		871,280
3,600	Albemarle Corp.		257,400
26,700	AptarGroup, Inc.		1,789,167
20,000	Ball Corp.		1,253,600
11,800	BASF SE ADR		1,374,700
29,000	Crown Holdings, Inc. *		1,443,040
43,000	Ecolab, Inc.		4,787,620
40,000	FMC Corp.		2,847,600
5,400	NewMarket Corp.		2,117,394
31,000	Praxair, Inc.		4,118,040
24,000	Rockwood Holdings, Inc.		1,823,760
20,200	Scotts Miracle-Gro Co. (The) Class A		1,148,572
30,000	Sigma-Aldrich Corp.		3,044,400
12,800	Syngenta AG ADR		957,440
39,000	Valspar Corp. (The)		2,971,410
			32,734,723
	TELECOMMUNICATION SERVICES (1.0%)		
40,000	SBA Communications Corp. Class A *		4,092,000

Shares		Value	
	UTILITIES (2.4%) (continued)		
165,600	Cia de Saneamento Basico do Estado de Sao Paulo ADR	$	1,775,232
60,000	ITC Holdings Corp.		2,188,800
17,400	MDU Resources Group, Inc.		610,740
8,000	NextEra Energy, Inc.		819,840
52,000	Questar Corp.		1,289,600
14,000	Sempra Energy		1,465,940
26,800	Wisconsin Energy Corp.		1,257,456
			9,407,608
	TOTAL COMMON STOCKS (Cost $177,257,743) (98.3%)		386,227,121
SHORT-TERM INVESTMENTS (1.6%)			
	MONEY MARKET FUNDS (1.6%)		
6,285,972	State Street Institutional Liquid Reserves Fund		6,285,972
	TOTAL SHORT-TERM INVESTMENTS (Cost $6,285,972) (1.6%)		6,285,972
	TOTAL INVESTMENT SECURITIES (99.9%) (Cost $183,543,715)		$392,513,093

CASH AND OTHER ASSETS IN EXCESS OF LIABILITIES (0.1%)	450,401
NET ASSETS (100%)	$392,963,494
NET ASSET VALUE OFFERING AND REDEMPTION PRICE, PER OUTSTANDING SHARE	
($392,963,494 ÷ 11,079,978 shares outstanding)	$35.47

* Non-income producing.
(1) A portion or all of the security was held on loan. As of June 30, 2014, the market value of the securities on loan was $6,545,741.
ADR American Depositary Receipt.
REIT Real Estate Investment Trust.

The following table summarizes the inputs used to value the Fund's investments in securities as of June 30, 2014 (See Note 1B):

Investments in Securities:	Level 1	Level 2	Level 3	Total
Assets:				
Common Stocks*	$386,227,121	$—	$—	$386,227,121
Short-Term Investments	—	6,285,972	—	6,285,972
Total Investments in Securities	$386,227,121	$6,285,972	$—	$392,513,093

* See Schedule of Investments for further classification.

See Notes to Financial Statements.

THE VALUE LINE FUND, INC.

INVESTMENT OBJECTIVE AND STRATEGY

The Fund's primary investment objective is long-term growth of capital. Current income is a secondary investment objective.

To achieve the Fund's investment objectives the Advisor invests substantially all of the Fund's net assets in common stocks. While the Fund is actively managed by the Adviser, the Adviser relies primarily on the rankings of companies by the Value Line Timeliness™ Ranking System (the "Ranking System") in selecting securities for purchase or sale. The Fund's investments principally are selected from common stocks ranked 1, 2 or 3 by the Ranking System at the time of purchase. The Adviser will determine the percentage of the Fund's assets invested in each stock based on the stock's relative attractiveness.

Manager Discussion of Fund Performance

Below, The Value Line Fund, Inc. portfolio manager Stephen E. Grant discusses the Fund's performance and positioning for the six months ended June 30, 2014.

How did the Fund perform during the semi-annual period?

The Fund generated a cumulative total return of 4.15% during the six months ended June 30, 2014. This compares to the 7.14% return of the Fund's benchmark, the S&P 500® Index, during the same annual period.

What key factors were responsible for the Fund's performance during the six-month reporting period?

The Fund generated solid absolute gains but underperformed the S&P 500® Index during the six-month reporting period due to both stock selection and sector allocation decisions overall.

Also, while the semi-annual period ended June 30, 2014 saw gains for the equity market, value stocks outperformed growth stocks, and large-cap stocks outperformed small-cap stocks. Relative to the benchmark, both of these factors acted as headwinds to Fund results, as the Fund concentrates its holdings on growth-oriented stocks and on stocks with an average market capitalization well below that of the S&P 500® Index.

Which equity market sectors most significantly affected Fund performance?

Stock selection in information technology, industrials and energy detracted from the Fund's performance most during the semi-annual period. Having underweighted allocations to the strongly performing information technology and energy sectors and having an overweighted exposure to the weaker industrials sector also hurt. In information technology, the Fund held no positions in the strongly performing large-cap stocks in the sector, including Apple, Microsoft, Intel and Facebook, each of which saw their shares climb double-digits during the semi-annual period. The Fund was overweighted, however, in global payment solutions company MasterCard, whose shares declined on profit-taking after being one of the Fund's best performers in 2013. A sizable position in application software developer Ansys also hurt, as its shares fell. In industrials, positions in engineering and constructing firm Chicago Bridge & Iron, pest control services provider Rollins and railroad systems operator Kansas City Southern each dampened results, as each saw share price declines during the semi-annual period. In energy, an underweighted exposure to the oil services industry particularly hurt, as the Fund held no positions in either Schlumberger or Halliburton, both of which saw robust gains during the semi-annual period.

Partially offsetting these detractors were the positive contributions made by effective stock selection in the financials and telecommunication services sectors. Having an underweighted allocation to the weakly-performing financials sector also helped. In financials, not holding positions in laggards Citigroup and JPMorgan Chase buoyed Fund performance most. In telecommunication services, a position in wireless communications infrastructure owner and operator SBA Communications was a particularly strong performer.

Which stocks detracted significantly from the Fund’s performance during the semi-annual period?

During the semi-annual period, among the stocks that detracted most from the Fund’s relative performance were TJX Companies, a discount apparel and home fashion retailer; LKQ, an automotive products and services wholesaler; and Dicks Sporting Goods, a sporting goods retailer. Each suffered during the semi-annual period from quarterly earnings reports that were weaker than forecast.

What were some of the Fund’s best-performing individual stocks?

Among the individual stocks that contributed most to the Fund’s relative results were specialty pharmaceuticals firm Allergan, pharmaceuticals company Novo Nordisk and diversified energy company ONEOK.

(continued)

Allergan benefited from a takeover bid from Valeant Pharmaceuticals International. Novo Nordisk performed well on continued strong earnings results that drove a quadrupling of its stock price since the Fund established a position in its shares five years ago. ONEOK benefited from ongoing strong operating performance.

How did the Fund use derivatives and similar instruments during the reporting period?

The Fund did not use derivatives during the reporting period.

Did the Fund make any significant purchases or sales during the semi-annual period?

During the semi-annual period, we initiated a Fund position in consumer products manufacturing giant Procter & Gamble in recognition of its consistent long-term growth record in earnings and stock price, generated by its powerful product portfolio. We established a Fund position in application software developer Ultimate Software Group for similar reasons, seeking to take advantage of what we believed to be a short-term drop in its stock price during the spring 2014 sell-off of high growth stocks. We added to the Fund's position in information services provider IHS, as it continued to deliver good earnings and stock price growth.

We sold the Fund's position in natural food supermarket owner and operator Whole Foods Market because its quarterly earnings reports began to disappoint. We also exited the Fund's position in Internet exchange services provider Equinix because of reduced consistency and predictability in its earnings and stock price.

Were there any notable changes in the Fund's weightings during the six-month period?

There were no material changes in the Fund's sector weightings during the six-month period ended June 30, 2014.

How was the Fund positioned relative to its benchmark index at the end of June 2014?

As of June 30, 2014, the Fund was overweighted relative to the S&P 500® Index in the industrials and materials sectors. The Fund was underweighted relative to the S&P 500® Index in the energy, financials and information technology sectors and rather neutrally weighted relative to the Index in the consumer discretionary, health care, consumer staples, utilities and telecommunication services sectors on the same date.

What is your tactical view and strategy for the months ahead?

Regardless of market conditions, we intend to stay true to our time-tested investment discipline going forward, seeking to invest in companies that have demonstrated a solid history of consistent growth in both their earnings and stock price. In our view, these companies possess attractive portfolios of proprietary products and services that give them strong market positions and make them less vulnerable to swings in national and international economic conditions. At the same time, we believe the underlying stocks of these companies tend to be less volatile than the average stock in the S&P 500® Index. By maintaining our investment discipline, the Fund has historically provided a smoother ride to investors than its peer group averages. Putting aside short-term ebbs and flows in the equity market, we believe the Fund's investments are likely to continue to provide superior returns to our shareholders over the long term.

The Value Line Fund, Inc.
Portfolio Highlights at June 30, 2014 (unaudited)

Ten Largest Holdings

Issue	Shares	Value	Percentage of Net Assets
Alliance Data Systems Corp.	8,300	$ 2,334,375	1.9 %
Rollins, Inc.	75,600	2,268,000	1.8 %
AutoZone, Inc.	4,000	2,144,960	1.7 %
Novo Nordisk A/S ADR	45,500	2,101,645	1.7 %
Yum! Brands, Inc.	24,800	2,013,760	1.6 %
AMETEK, Inc.	36,750	1,921,290	1.5 %
Church & Dwight Co., Inc.	26,000	1,818,700	1.4 %
Alexion Pharmaceuticals, Inc.	11,600	1,812,500	1.4 %
Roper Industries, Inc.	12,400	1,810,524	1.4 %
Kirby Corp.	14,700	1,721,958	1.4 %

Asset Allocation – Percentage of Net Assets

Sector Weightings – Percentage of Total Investment Securities*

*Sector weightings exclude short-term investments.

The Value Line Fund, Inc.
Schedule of Investments (unaudited)

Shares		Value
COMMON STOCKS (97.6%)		
	CONSUMER DISCRETIONARY (10.9%)	
4,000	AutoZone, Inc. *	$ 2,144,960
13,600	BorgWarner, Inc.	886,584
17,400	Brinker International, Inc.	846,510
6,000	Buckle, Inc. (The) (1)	266,160
7,600	Buffalo Wild Wings, Inc. *	1,259,396
16,800	Dick’s Sporting Goods, Inc.	782,208
3,800	Domino’s Pizza, Inc.	277,742
5,700	Gildan Activewear, Inc.	335,616
33,000	LKQ Corp. *	880,770
3,200	O’Reilly Automotive, Inc. *	481,920
7,400	Penn National Gaming, Inc. *	89,836
9,300	Starbucks Corp.	719,634
32,000	TJX Companies, Inc. (The)	1,700,800
10,400	VF Corp.	655,200
16,800	Wolverine World Wide, Inc.	437,808
24,800	Yum! Brands, Inc.	2,013,760
		13,778,904
	CONSUMER STAPLES (11.4%)	
3,100	Boston Beer Co., Inc. (The) Class A *	692,912
4,900	British American Tobacco PLC ADR	583,492
4,000	Bunge Ltd.	302,560
11,400	Casey’s General Stores, Inc.	801,306
26,000	Church & Dwight Co., Inc.	1,818,700
9,000	Costco Wholesale Corp.	1,036,440
7,500	Energizer Holdings, Inc.	915,225
40,500	Flowers Foods, Inc.	853,740
19,000	General Mills, Inc.	998,260
33,000	Hormel Foods Corp.	1,628,550
15,700	Ingredion, Inc.	1,178,128
18,100	J&J Snack Foods Corp.	1,703,572
9,000	PepsiCo, Inc.	804,060
8,000	Procter & Gamble Co. (The)	628,720
6,000	Reynolds American, Inc.	362,100
		14,307,765
	ENERGY (3.8%)	
2,000	Core Laboratories N.V.	334,120
14,000	Enbridge, Inc.	664,580
10,000	EQT Corp.	1,069,000

5,600	FMC Technologies, Inc.*	341,992
13,400	Noble Energy, Inc.	1,037,964
3,600	Oceaneering International, Inc.	281,268
15,000	ONEOK, Inc.	1,021,200
		4,750,124
	FINANCIALS (5.5%)	
8,000	Affiliated Managers Group, Inc.*	1,643,200
12,000	AFLAC, Inc.	747,000

Shares		Value
	FINANCIALS (5.5%) (continued)	
9,000	American Tower Corp. REIT	$ 809,820
2,000	BlackRock, Inc.	639,200
3,500	Crown Castle International Corp. REIT	259,910
6,300	M&T Bank Corp.	781,515
4,400	MetLife, Inc.	244,464
5,000	Prudential Financial, Inc.	443,850
8,000	Royal Bank of Canada	571,440
4,900	Stifel Financial Corp. *	232,015
6,600	T. Rowe Price Group, Inc.	557,106
		6,929,520
	HEALTH CARE (13.0%)	
11,600	Alexion Pharmaceuticals, Inc. *	1,812,500
9,600	Allergan, Inc.	1,624,512
5,800	C.R. Bard, Inc.	829,458
8,740	Catamaran Corp. *	385,959
17,400	Cerner Corp. *	897,492
800	Cooper Cos., Inc. (The)	108,424
1,500	DaVita HealthCare Partners, Inc. *	108,480
3,900	DENTSPLY International, Inc.	184,665
15,340	Express Scripts Holding Co. *	1,063,522
12,700	Henry Schein, Inc. *	1,507,109
6,400	IDEXX Laboratories, Inc. *	854,848
5,600	McKesson Corp.	1,042,776
16,800	Mednax, Inc. *	976,920
4,700	Mettler-Toledo International, Inc.*	1,189,946
45,500	Novo Nordisk A/S ADR	2,101,645
10,000	Teva Pharmaceutical Industries Ltd. ADR	524,200
10,200	Thermo Fisher Scientific, Inc.	1,203,600
		16,416,056
	INDUSTRIALS (30.7%)	
7,800	Acuity Brands, Inc.	1,078,350
36,750	AMETEK, Inc.	1,921,290
22,200	Canadian National Railway Co.	1,443,444
800	Canadian Pacific Railway Ltd.	144,912
4,400	Carlisle Companies, Inc.	381,128
10,000	Chicago Bridge & Iron Co. N.V.	682,000

15,000	CLARCOR, Inc.	927,750
6,000	Clean Harbors, Inc.*	385,500
20,700	Danaher Corp.	1,629,711
31,000	Donaldson Co., Inc.	1,311,920
4,800	Equifax, Inc.	348,192
2,400	Esterline Technologies Corp.*	276,288
8,000	Fastenal Co. (1)	395,920
5,000	FedEx Corp.	756,900
9,900	General Dynamics Corp.	1,153,845

Shares		Value
	INDUSTRIALS (30.7%) (continued)	
7,300	Graco, Inc.	$ 569,984
13,983	HEICO Corp.	726,277
16,200	IDEX Corp.	1,307,988
6,000	IHS, Inc. Class A *	814,020
5,850	ITT Corp.	281,385
6,800	J.B. Hunt Transport Services, Inc.	501,704
8,200	Kansas City Southern	881,582
14,700	Kirby Corp.*	1,721,958
5,400	L-3 Communications Holdings, Inc.	652,050
4,000	Lincoln Electric Holdings, Inc.	279,520
6,900	Middleby Corp. (The) *	570,768
3,500	Oshkosh Corp.	194,355
10,400	Parker Hannifin Corp.	1,307,592
5,700	Precision Castparts Corp.	1,438,680
21,300	Republic Services, Inc.	808,761
2,800	Rockwell Automation, Inc.	350,448
75,600	Rollins, Inc.	2,268,000
12,400	Roper Industries, Inc.	1,810,524
12,000	Stericycle, Inc. *	1,421,040
6,000	Teledyne Technologies, Inc.*	583,020
15,600	Toro Co. (The)	992,160
9,600	Union Pacific Corp.	957,600
11,400	United Technologies Corp.	1,316,130
4,200	Valmont Industries, Inc. (1)	638,190
4,900	W.W. Grainger, Inc.	1,245,923
11,500	Wabtec Corp.	949,785
25,300	Waste Connections, Inc.	1,228,315
		38,654,909
	INFORMATION TECHNOLOGY (10.7%)	
17,800	Accenture PLC Class A	1,438,952
8,300	Alliance Data Systems Corp.*	2,334,375
7,000	Amphenol Corp. Class A	674,380
2,700	Anixter International, Inc.	270,189
13,500	ANSYS, Inc.*	1,023,570
8,000	Automatic Data Processing, Inc.	634,240
28,000	Cognizant Technology Solutions Corp. Class A *	1,369,480
3,200	Fidelity National Information Services, Inc.	175,168

6,400	Fiserv, Inc. *	386,048
23,000	MasterCard, Inc. Class A	1,689,810
2,800	MICROS Systems, Inc. *	190,120
17,600	Open Text Corp.	843,744
24,000	Salesforce.com, Inc. *	1,393,920
3,000	Ultimate Software Group, Inc. (The) *	414,510
6,100	WEX, Inc. *	640,317
		13,478,823

See Notes to Financial Statements.

June 30, 2014

Shares		Value
COMMON STOCKS (97.6%) (continued)		
	MATERIALS (9.6%)	
3,000	Airgas, Inc.	$ 326,730
12,000	Ball Corp.	752,160
25,600	Crown Holdings, Inc.*	1,273,856
12,000	Ecolab, Inc.	1,336,080
22,400	FMC Corp.	1,594,656
1,800	NewMarket Corp.	705,798
10,000	Packaging Corp. of America	714,900
10,300	Praxair, Inc.	1,368,252
11,000	Scotts Miracle-Gro Co. (The) Class A	625,460
11,400	Sigma-Aldrich Corp.	1,156,872
25,900	Silgan Holdings, Inc.	1,316,238
12,400	Valspar Corp. (The)	944,756
		12,115,758
	UTILITIES (2.0%)	
30,000	ITC Holdings Corp.	1,094,400
4,000	NextEra Energy, Inc.	409,920
23,000	Questar Corp.	570,400
10,900	Wisconsin Energy Corp.	511,428
		2,586,148
	TOTAL COMMON STOCKS (Cost $64,432,786) (97.6%)	123,018,007

Shares		Value
SHORT-TERM INVESTMENTS (2.4%)		
	MONEY MARKET FUNDS (2.4%)	
3,025,809	State Street Institutional Liquid Reserves Fund	$ 3,025,809
	TOTAL SHORT-TERM INVESTMENTS (Cost $3,025,809) (2.4%)	3,025,809
	TOTAL INVESTMENT SECURITIES (100.0%) (Cost $67,458,595)	$ 126,043,816

EXCESS OF LIABILITIES OVER CASH AND OTHER ASSETS (0.0%)	(52,340)
NET ASSETS (100%)	$ 125,991,476
NET ASSET VALUE OFFERING AND REDEMPTION PRICE, PER OUTSTANDING SHARE ($125,991,476 ÷ 8,962,383 shares outstanding)	$ 14.06

* Non-income producing.

(1) A portion or all of the security was held on loan. As of June 30, 2014, the market value of the securities on loan was $1,300,270.
ADR American Depositary Receipt.
REIT Real Estate Investment Trust.

The following table summarizes the inputs used to value the Fund's investments in securities as of June 30, 2014 (See Note 1B):

Investments in Securities:	Level 1	Level 2	Level 3	Total
Assets:				
Common Stocks*	$123,018,007	$—	$—	$123,018,007
Short-Term Investments	—	3,025,809	—	3,025,809
Total Investments in Securities	$123,018,007	$3,025,809	$—	$126,043,816

* See Schedule of Investments for further classification.

See Notes to Financial Statements.

VALUE LINE INCOME AND GROWTH FUND, INC.

INVESTMENT OBJECTIVE AND STRATEGY

The Fund’s primary investment objective is income, as high and dependable as is consistent with reasonable risk. Capital growth to increase total return is a secondary objective.

To achieve the Fund’s goals, the Adviser invests not less than 50% of the Fund’s net assets in common or preferred stocks or securities convertible into common stock which may or may not pay dividends. The balance of the Fund’s net assets are primarily invested in U.S. government securities, money market securities and investment grade debt securities rated at the time of purchase from the highest (AAA) to medium (BBB) quality. Although the Fund can invest in companies of any size, it generally invests in U.S. securities issued by larger, more established companies (those with a market capitalization of more than $5 billion).

Manager Discussion of Fund Performance

Effective February 2014, Stephen E. Grant replaced Mark T. Spellman as portfolio manager responsible for the equity portion of the Fund. Effective June 2014, Cindy Starke joined Mr. Grant in sharing that equity portfolio management responsibility. Below, Value Line Income and Growth Fund, Inc. portfolio managers Cindy Starke, Stephen E. Grant and Liane Rosenberg discuss the Fund’s performance and positioning for the six months ended June 30, 2014.

How did the Fund perform during the semi-annual period?

The Fund generated a cumulative total return of 5.53% during the six months ended June 30, 2014. This compares to the 6.04% return of the Fund’s blended benchmark, comprised 60% of the S&P 500® Index and 40% of the Barclays U.S. Aggregate Bond Index (the Barclays Index), during the same semi-annual period.

What key factors were responsible for the Fund’s performance during the six-month reporting period?

The Fund benefited from effective asset allocation. Throughout the six-month reporting period, the Fund was overweighted equities and underweighted fixed income. With U.S. equities, as measured by the S&P 500® Index, up 7.14% during the semi-annual period, and bonds, as measured by the Barclays Index, posting a return of 3.93%, this asset allocation clearly added value.

Security selection overall within the equity and fixed income portions of the Fund also proved beneficial. However, the Fund’s allocation to cash during a period of rallying markets and a small weighting in convertible equities were a drag on the Fund’s relative performance.

Which equity market sectors most significantly affected Fund performance?

Stock selection in the consumer staples, health care and industrials sectors contributed most positively to the Fund’s results. Only partially offsetting these positive contributors was stock selection in the information technology, materials, energy and utilities sectors, which detracted.

What were some of the Fund's best-performing individual stocks?

Contributing most to the Fund's relative results were two pharmaceuticals companies—Actavis and Teva Pharmaceuticals—and semiconductor company Avago Technologies, each of which generated robust double-digit gains during the semi-annual period. Actavis' shares were up on the news of its accretive acquisition of Forest Laboratories. In addition to anticipated cost savings, we believe the combined company should result in greater product diversification and higher sales growth. Shares of Teva Pharmaceuticals rose after receiving FDA approval for a three-times-a-week version of its leading multiple sclerosis treatment, Copaxone. This approval was an important catalyst, as it gave the company time to convert existing patients on their daily Copaxone treatment before a generic version is approved. Avago Technologies' shares rose sharply based on good results and the accretive benefits and diversification gains from its acquisition of LSI.

Which stocks detracted significantly from the Fund's performance during the semi-annual period?

During the semi-annual period, the stocks that detracted most from the Fund's performance were office products superstore Staples, construction and engineering firm Chicago Bridge & Iron and master limited partnership engaged in natural gas transportation and storage Boardwalk Pipeline Partners LP, each of which experienced double-digit share price declines. Shares of Staples dropped, as the company's same-store sales and gross margins fell short of expectations. In our view, Staples' business appears to be in a secular decline. Seeing further downside risk, we sold the Fund's position in Staples by the end of the semi-annual period. Chicago Bridge & Iron's shares sold off following a weaker than expected first quarter 2014 earnings report. We maintained the Fund's position in the firm, however, as the shortfall appeared to us to be timing-related rather than any fundamental problem with the company's business. Boardwalk Pipeline Partners LP saw its shares decline after announcing disappointing earnings results and guidance that fell short of expectations. We sold the Fund's position in Boardwalk Pipeline Partners LP by the end of the semi-annual period.

(continued)

Did the equity portion of the Fund make any significant purchases or sales?

During the semi-annual period, we initiated positions in Starbucks, Estee Lauder Companies and Visa. Starbucks is the world's leading coffee retailer with more than 20,000 locations around the globe. The company generates revenues from its company-owned stores, licensed stores, consumer packaged goods business and food service operations. With a loyal and expanding global customer base, we believe the company is well positioned to grow both its sales and earnings during the coming years. We established a Fund position in Estee Lauder Companies, a leading company in the global prestige beauty product market. Estee Lauder Companies owns a diversified portfolio of well-known beauty brands that, in our view, stand to benefit from growing global disposable incomes and an aging global population. The Fund purchased shares of Visa, a leading global payments technology company. Visa is well positioned, in our view, to be one of the winners in the secular transition to digital payments from checks and cash. Some analysts estimate that the digital payments opportunity is only 15% penetrated globally.

In addition to those sales already mentioned, we sold the Fund's position in discount retailer Target, as the company's sales growth remained challenged, and it appeared that e-commerce competition continued to impact its in-store customer traffic. We eliminated the Fund's position in consumer foods manufacturer General Mills, as we felt its shares were fully valued, and we had grown concerned about slowing U.S. sales. We exited the Fund's position in global logistics company Expeditors International of Washington, as we saw what we considered to be downside risk in its margins and earnings.

Were there any notable changes in the equity portion of the Fund's weightings during the six-month period?

During the semi-annual period, we decreased weightings in the financials and materials sectors, and we increased positions in the consumer discretionary and information technology sectors.

How was the equity portion of the Fund positioned relative to its benchmark index at the end of June 2014?

As of June 30, 2014, the Fund was overweighted relative to the S&P 500® Index in the telecommunication services and utilities sectors. The Fund was underweighted relative to the S&P 500® Index in the materials sector and was rather neutrally weighted to the S&P 500® Index in the consumer discretionary, consumer staples, energy, financials, health care, industrials and information technology sectors on the same date.

What was the duration strategy of the fixed income portion of the Fund?

Given the market's low volatility and the 10-year U.S. Treasury's narrow trading range, especially during the second calendar quarter, we kept the Fund's duration in a relatively tight band of 1/4 year either longer or shorter than that of the Barclays Index. Duration is a measure of the Fund's sensitivity to changes in interest rates.

While duration positioning had an overall neutral impact on results during the semi-annual period, yield curve positioning detracted. Longer duration assets were the best performers during the semi-annual period, and the fixed income portion of the Fund had an underweighted exposure to the long-term end of the yield curve. Yield curve indicates the spectrum of maturities within a particular sector.

Which fixed income market segments most significantly affected Fund performance?

Overall, the fixed income portion of the Fund outperformed its benchmark, the Barclays Index. The biggest positive contributors to performance were investment grade and high yield corporate bonds. During the semi-annual period, higher risk assets outperformed lower risk assets, and the fixed income portion of the Fund was significantly overweight investment grade corporate bonds relative to the Barclays Index, while maintaining a significant underweight to U.S. Treasuries. Investment grade corporate bonds outperformed U.S. Treasuries by approximately 300 basis points during the semi-annual period. (A basis point is 1/100th of a percentage point.) Within corporate credit, we also maintained an out-of-benchmark exposure to high yield corporate bonds. This high yield corporate bond exposure had a positive impact on relative results, as high yield corporate bonds outperformed the Barclays Index by approximately 150 basis points during the semi-annual period. U.S. Treasuries, particularly those on the short-term end of the yield curve, were the weakest performers during the semi-annual period, and so the fixed income portion of the Fund's underweight to these holdings proved prudent as well.

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(continued)

Were there any notable changes in the fixed income portion of the Fund's weightings during the six-month period?

The most significant sector shifts in the fixed income portion of the Fund encompassed a reduction in U.S. Treasuries with a similar incremental increase in corporate bonds, both investment grade and high yield. To a more modest degree, exposure to securitized assets edged up, with the increased exposure coming from commercial mortgage-backed securities. We also modestly increased the fixed income portion of the Fund's exposures to sovereign debt and taxable municipal bonds during the six-month period.

How was the fixed income portion of the Fund positioned relative to its benchmark index at the end of June 2014?

As of June 30, 2014, the fixed income portion of the Fund was overweight relative to the Barclays Index in investment grade corporate bonds and in securitized debt. It also maintained its out-of-benchmark exposure to high yield corporate bonds. The fixed income portion of the Fund was underweight relative to the Barclays Index in U.S. Treasuries and supranational agency debt and was rather neutrally weighted to the benchmark index in asset-backed securities, sovereign debt and taxable municipal bonds on the same date.

How did the Fund's overall asset allocation shift from beginning to end of the semi-annual period?

At the end of December 2013, the Fund had a weighting of 66% in stocks, 4% in bonds convertible into common stocks, 22% in fixed income securities and 8% in cash equivalents. By the end of June 2014, allocation had changed little. At June 30, 2014, the Fund had a weighting of 69% in stocks, 3% in bonds convertible into common stocks, 22% in fixed income securities and 6% in cash equivalents.

How did the Fund use derivatives and similar instruments during the reporting period?

The Fund did not use derivatives during the reporting period.

What is your tactical view and strategy for the months ahead?

With short-term interest rates and inflation still low, we believe there are many stocks that offer attractive dividend income and capital appreciation potential. We intend to continue to build a diversified equity portfolio of high quality companies with good balance sheets and cash flow generation led by vetted management teams. We also intend to continue to monitor the pace of economic growth, the job market and the inflation rate, as these factors, along with potential changes to the Fed's stance on the economy and its timeline on raising interest rates, are likely to impact the Fund's equity holdings. We remained comfortable at the end of the semi-annual period with the Fund's underweighted allocation to fixed income, as we saw better return potential in other asset classes.

As always, our goal is to preserve capital in the near term while generating solid total return (i.e., income plus capital appreciation) over the long term and across economic cycles.

Value Line Income and Growth Fund, Inc.
Portfolio Highlights at June 30, 2014 (unaudited)

Ten Largest Holdings

Issue	Shares		Value	Percentage of Net Assets	
Intel Corp.	129,000	$	3,986,100	1.2	%
Johnson & Johnson	36,100		3,776,782	1.1	%
Schlumberger Ltd.	31,200		3,680,040	1.1	%
Raytheon Co.	38,900		3,588,525	1.0	%
Microsoft Corp.	84,800		3,536,160	1.0	%
Starbucks Corp.	45,000		3,482,100	1.0	%
Exxon Mobil Corp.	33,000		3,322,440	1.0	%
Charles Schwab Corp. (The)	120,000		3,231,600	0.9	%
JPMorgan Chase & Co.	55,600		3,203,672	0.9	%
Discover Financial Services	51,000		3,160,980	0.9	%

Asset Allocation – Percentage of Net Assets

Sector Weightings – Percentage of Total Investment Securities*

*Sector weightings exclude short-term investments.

Value Line Income and Growth Fund, Inc.
Schedule of Investments (unaudited)

Shares			Value
COMMON STOCKS (68.9%)			
	CONSUMER DISCRETIONARY (8.8%)		
25,300	Brinker International, Inc.	$	1,230,845
40,000	Comcast Corp. Class A		2,133,200
30,200	DIRECTV *		2,567,302
20,000	Discovery Communications, Inc. Class A *		1,485,600
30,000	Harley-Davidson, Inc.		2,095,500
15,000	Harman International Industries, Inc.		1,611,450
13,600	Home Depot, Inc.		1,101,056
27,000	Las Vegas Sands Corp.		2,057,940
35,000	Lowe’s Cos., Inc.		1,679,650
32,000	Macy’s, Inc.		1,856,640
28,300	McDonald’s Corp.		2,850,942
45,000	Starbucks Corp.		3,482,100
12,700	Time Warner Cable, Inc.		1,870,710
44,000	TJX Companies, Inc. (The)		2,338,600
24,400	Walt Disney Co. (The)		2,092,056
			30,453,591
	CONSUMER STAPLES (7.1%)		
41,200	Coca-Cola Co. (The)		1,745,232
33,400	CVS Caremark Corp.		2,517,358
35,400	Dr. Pepper Snapple Group, Inc.		2,073,732
28,000	Estee Lauder Companies, Inc. (The) Class A		2,079,280
29,600	Ingredion, Inc.		2,221,184
42,900	Kroger Co. (The)		2,120,547
26,300	PepsiCo, Inc.		2,349,642
33,000	Procter & Gamble Co. (The)		2,593,470
27,300	Wal-Mart Stores, Inc.		2,049,411
39,000	Walgreen Co.		2,891,070
46,000	Whole Foods Market, Inc.		1,776,980
			24,417,906
	ENERGY (7.5%)		
21,500	Chevron Corp.		2,806,825
27,300	ConocoPhillips		2,340,429
24,000	Diamond Offshore Drilling, Inc.(1)		1,191,120
45,455	Ensco PLC Class A		2,525,934
21,000	Enterprise Products Partners L.P.		1,644,090
33,000	Exxon Mobil Corp.		3,322,440
16,100	Hess Corp.		1,592,129
25,600	Royal Dutch Shell PLC ADR (1)		2,227,456

31,200	Schlumberger Ltd.		3,680,040
29,500	Total S.A. ADR		2,129,900
27,400	TransCanada Corp.		1,307,528
24,000	Transocean Ltd. (1)		1,080,720
			25,848,611
	FINANCIALS (10.3%)		
9,700	Ameriprise Financial, Inc.		1,164,000
27,300	Bank of Montreal		2,009,007

Shares			Value
	FINANCIALS (10.3%) (continued)		
6,800	BlackRock, Inc.	$	2,173,280
23,000	Canadian Imperial Bank of Commerce (1)		2,092,540
24,400	Capital One Financial Corp.		2,015,440
120,000	Charles Schwab Corp. (The)		3,231,600
51,000	Discover Financial Services		3,160,980
53,760	Hartford Financial Services Group, Inc.		1,925,146
25,400	Health Care REIT, Inc.		1,591,818
55,600	JPMorgan Chase & Co.		3,203,672
16,600	PartnerRe Ltd.		1,812,886
114,000	People’s United Financial, Inc.		1,729,380
29,200	Prudential Financial, Inc.		2,592,084
33,100	State Street Corp.		2,226,306
71,200	U.S. Bancorp		3,084,384
31,200	Wells Fargo & Co.		1,639,872
			35,652,395
	HEALTH CARE (9.2%)		
35,000	AbbVie, Inc.		1,975,400
13,700	Actavis PLC *		3,055,785
10,000	Allergan, Inc.		1,692,200
17,700	Amgen, Inc.		2,095,149
22,400	Bristol-Myers Squibb Co.		1,086,624
18,000	Edwards Lifesciences Corp. *		1,545,120
30,000	Gilead Sciences, Inc.*		2,487,300
36,100	Johnson & Johnson		3,776,782
28,000	Medtronic, Inc.		1,787,167
47,800	Merck & Co., Inc.		2,765,230
93,388	Pfizer, Inc.		2,771,756
33,200	Sanofi-Aventis ADR		1,765,244
37,237	Teva Pharmaceutical Industries Ltd. ADR		1,951,964
10,000	Thermo Fisher Scientific, Inc.		1,180,000
24,000	UnitedHealth Group, Inc.		1,962,000
			31,897,721
	INDUSTRIALS (7.7%)		
49,100	ADT Corp. (The) (1)		1,715,554
19,400	Canadian National Railway Co.		1,261,388
35,000	Chicago Bridge & Iron Co. N.V.		2,387,000
23,400	Cintas Corp.		1,486,836

13,000	FedEx Corp.		1,967,940
10,600	General Dynamics Corp.		1,235,430
10,700	Lockheed Martin Corp.		1,719,811
15,600	MSC Industrial Direct Co., Inc. Class A		1,491,984
9,600	Northrop Grumman Corp.		1,148,448
38,900	Raytheon Co.		3,588,525
52,100	Republic Services, Inc.		1,978,237
25,300	Tyco International Ltd.		1,153,680
25,400	Union Pacific Corp.		2,533,650
24,000	United Technologies Corp.		2,770,800
			26,439,283

Shares			Value
	INFORMATION TECHNOLOGY (13.3%)		
105,000	Activision Blizzard, Inc.	$	2,341,500
32,000	Apple, Inc.		2,973,760
32,000	Avago Technologies Ltd.		2,306,240
34,000	Cognizant Technology Solutions Corp. Class A *		1,662,940
47,300	eBay, Inc. *		2,367,838
93,442	EMC Corp.		2,461,262
40,000	Facebook, Inc. Class A *		2,691,600
5,400	Google, Inc. Class A *		3,157,218
3,900	Google, Inc. Class C *		2,243,592
30,000	Harris Corp.		2,272,500
129,000	Intel Corp.		3,986,100
15,000	International Business Machines Corp.		2,719,050
84,800	Microsoft Corp.		3,536,160
45,500	Oracle Corp.		1,844,115
34,300	QUALCOMM, Inc.		2,716,560
30,000	SAP AG ADR (1)		2,310,000
19,400	TE Connectivity Ltd.		1,199,696
14,000	Visa, Inc. Class A		2,949,940
			45,740,071
	MATERIALS (0.7%)		
28,000	E.I. du Pont de Nemours & Co.		1,832,320
34,600	OCI Partners L.P.		735,250
			2,567,570
	TELECOMMUNICATION SERVICES (2.1%)		
88,000	AT&T, Inc.		3,111,680
55,000	BCE, Inc.		2,494,800
36,100	Verizon Communications, Inc.		1,766,373
			7,372,853
	UTILITIES (2.2%)		
24,900	AGL Resources, Inc.		1,370,247
25,400	American Electric Power Company, Inc.		1,416,558
53,000	American States Water Co.		1,761,190
36,300	Wisconsin Energy Corp.		1,703,196
39,100	Xcel Energy, Inc.		1,260,193

		7,511,384
	TOTAL COMMON STOCKS (Cost $159,744,165) (68.9%)	237,901,385

PREFERRED STOCKS (0.0%)

	FINANCIALS (0.0%)	
5,000	MetLife, Inc., Series B, 6.50% (1)	127,700
	TOTAL PREFERRED STOCKS (Cost $125,000) (0.0%)	127,700

See Notes to Financial Statements.

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June 30, 2014

Shares			Value
CONVERTIBLE PREFERRED STOCKS (0.7%)			
	CONSUMER STAPLES (0.2%)		
4,000	Bunge Ltd., 4.88%	$	415,800
2,500	Post Holdings, Inc., 3.75% (1) (2)		295,368
			711,168
	FINANCIALS (0.5%)		
6,000	AMG Capital Trust II, Convertible Fixed, 5.15%		376,875
250	Huntington Bancshares, Inc., Series A, 8.50% (1)		333,117
1,000	KeyCorp, Series A, 7.75%		131,050
16,000	MetLife, Inc., 5.00% (1)		511,360
250	Wells Fargo & Co., Series L, 7.50%		303,500
2,000	Weyerhaeuser Co., Series A, 6.38% (1)		113,500
			1,769,402
	HEALTH CARE (0.0%)		
1,800	National Healthcare Corp., Series A, 0.80%		26,910
	TOTAL CONVERTIBLE PREFERRED STOCKS (Cost $1,797,801) (0.7%)		2,507,480

Principal Amount			Value
ASSET-BACKED SECURITIES (0.2%)			
$243,706	Ford Credit Auto Lease Trust, Series 2013-B, Class A2B, 0.42%, 1/15/16 (3)		243,791
250,000	Honda Auto Receivables Owner Trust, Series 2013-4, Class A3, 0.69%, 9/18/17		250,453
	TOTAL ASSET-BACKED SECURITIES (Cost $494,185) (0.2%)		494,244
COMMERCIAL MORTGAGE-BACKED SECURITIES (1.5%)			
300,000	Banc of America Commercial Mortgage Trust, Series 2006-2, Class A4, 5.92%, 5/10/45 (3)		321,500
100,000	Bear Stearns Commercial Mortgage Securities Trust, Series 2007-T26, Class A4, 5.47%, 1/12/45 (3)		110,134
250,000	Citigroup Commercial Mortgage Trust, Series 2006-C5, Class A4, 5.43%, 10/15/49		271,169

Principal Amount			Value
COMMERCIAL MORTGAGE-BACKED SECURITIES (1.5%) (continued)			
$ 500,000	Commercial Mortgage Trust, Series 2007-GG9, Class A4,5.44%, 3/10/39	$	545,583
500,000	FHLMC Multifamily Structured Pass-Through Certificates, Series K710, Class A2, 1.88%, 5/25/19		500,471
200,000	FREMF Mortgage Trust, Series 2012-K711, Class B, 3.68%, 8/25/45 (2) (3)		207,373
250,000	FREMF Mortgage Trust, Series 2014-K715, Class B, 4.12%, 2/25/46 (2) (3)		261,658

120,000	FREMF Mortgage Trust, Series 2013-K713, Class B, 3.27%, 4/25/46 (2) (3)	121,130
244,483	GNMA, Series 2013-12, Class AB, 1.83%, 11/16/52	236,443
250,000	GNMA, Series 2013-12, Class B, 2.45%, 11/16/52 (3)	236,618
350,000	GS Mortgage Securities Trust, Series 2006-GG6, Class A4, 5.55%, 4/10/38 (3)	369,785
228,775	JP Morgan Chase Commercial Mortgage Securities Trust, Series 2005-CB12, Class A3A2,4.93%, 9/12/37	228,742
191,562	JP Morgan Chase Commercial Mortgage Securities Trust, Series 2007-CB20, Class A1A, 5.75%, 2/12/51 (3)	213,905
273,075	ML-CFC Commercial Mortgage Trust, Series 2006-4, Class A1A, 5.17%, 12/12/49	294,877
250,000	ML-CFC Commercial Mortgage Trust, Series 2006-4, Class A3, 5.17%, 12/12/49	269,033
250,000	ML-CFC Commercial Mortgage Trust, Series 2007-6, Class A4, 5.49%, 3/12/51 (3)	274,590
246,355	Thornburg Mortgage Securities Trust,Series 2005-1, Class A3, 2.24%, 4/25/45 (3)	249,991

Principal Amount		Value
COMMERCIAL MORTGAGE-BACKED SECURITIES (1.5%) (continued)		
$250,000	UBS-Barclays Commercial Mortgage Trust, Series 2012-C4, Class A5, 2.85%, 12/10/45	$ 245,511
250,000	Wells Fargo Commercial Mortgage Trust, Series 2013-LC12, Class B, 4.44%, 7/15/46 (3)	261,418
	TOTAL COMMERCIAL MORTGAGE-BACKED SECURITIES (Cost $5,297,457) (1.5%)	5,219,931
CORPORATE BONDS & NOTES (9.0%)		
	BASIC MATERIALS (0.9%)	
200,000	ArcelorMittal, Senior Unsecured Notes, 5.00%, 2/25/17	211,500
250,000	Celanese U.S. Holdings LLC, Guaranteed Notes, 4.63%, 11/15/22	251,250
250,000	Glencore Funding LLC, Guaranteed Notes, 4.13%, 5/30/23 (2)	251,085
250,000	LYB International Finance B.V., Guaranteed Notes, 4.00%, 7/15/23	262,454
250,000	Mosaic Co. (The), Senior Unsecured Notes, 5.45%, 11/15/33	280,134
375,000	PPG Industries, Inc., Senior Unsecured Notes, 3.60%, 11/15/20	393,955
560,000	Southern Copper Corp., Senior Unsecured Notes, 6.38%, 7/27/15	590,128
150,000	Southern Copper Corp., Senior Unsecured Notes, 7.50%, 7/27/35	174,619
250,000	Steel Dynamics, Inc., Guaranteed Notes, 6.13%, 8/15/19	271,875
250,000	Vale Overseas Ltd., Guaranteed Notes, 5.63%, 9/15/19	281,176
100,000	Vale S.A., Senior Unsecured Notes, 5.63%, 9/11/42	97,970
		3,066,146
	COMMUNICATIONS (0.9%)	
250,000	America Movil S.A.B. de C.V., Senior Unsecured Notes, 3.13%, 7/16/22	246,000
100,000	CenturyLink, Inc., Series P, Senior Unsecured Notes, 7.60%, 9/15/39	100,375

See Notes to Financial Statements.

Schedule of Investments (unaudited) (continued)

Principal Amount			Value
CORPORATE BONDS & NOTES (9.0%) (continued)			
		COMMUNICATIONS (0.9%) (continued)	
$	150,000	Comcast Corp., Guaranteed Notes, 6.40%, 3/1/40	$ 192,300
	250,000	DIRECTV Holdings LLC/ DIRECTV Financing Co., Inc., Guaranteed Notes, 3.80%, 3/15/22	258,154
	250,000	Harris Corp., Senior Unsecured Notes, 4.40%, 12/15/20	268,725
	200,000	MetroPCS Wireless, Inc., Guaranteed Notes, 6.63%, 11/15/20	213,500
	200,000	Motorola Solutions, Inc., Senior Unsecured Notes, 6.00%, 11/15/17	227,092
	250,000	Netflix, Inc., Senior Unsecured Notes, 5.75%, 3/1/24 (2)	261,250
	150,000	Rogers Communications, Inc., Guaranteed Notes, 5.00%, 3/15/44	156,422
	250,000	Telefonica Emisiones SAU, Guaranteed Notes, 5.88%, 7/15/19	289,847
	250,000	Time Warner, Inc., Guaranteed Notes, 3.15%, 7/15/15	256,895
	150,000	Verizon Communications, Inc., Senior Unsecured Notes, 1.25%, 11/3/14	150,455
	300,000	Verizon Communications, Inc., Senior Unsecured Notes, 2.50%, 9/15/16	309,223
	250,000	Viacom, Inc., Senior Unsecured Notes, 3.88%, 4/1/24	254,049
			3,184,287
		CONSUMER, CYCLICAL (1.0%)	
	250,000	CVS Caremark Corp., Senior Unsecured Notes, 6.60%, 3/15/19	294,353
	275,000	D.R. Horton, Inc., Guaranteed Notes, 6.50%, 4/15/16	297,688
	250,000	Delphi Corp., Guaranteed Notes, 6.13%, 5/15/21	279,400
	99,000	Kia Motors Corp., Senior Unsecured Notes, 3.63%, 6/14/16 (2)	103,663

Principal Amount			Value
		CONSUMER, CYCLICAL (1.0%) (continued)	
$	205,000	Lennar Corp., Series B, Guaranteed Notes, 5.60%, 5/31/15	$ 212,175
	500,000	Lowe's Cos., Inc., Senior Unsecured Notes, 2.13%, 4/15/16	513,485
	150,000	Macy's Retail Holdings, Inc., Guaranteed Notes, 4.38%, 9/1/23	158,958
	100,000		100,707

		Nissan Motor Acceptance Corp., Senior Unsecured Notes, 2.35%, 3/4/19 (2)	
	500,000	Nordstrom, Inc., Senior Unsecured Notes, 4.75%, 5/1/20	553,240
	250,000	Wyndham Worldwide Corp., Senior Unsecured Notes, 3.90%, 3/1/23	251,139
	500,000	Wynn Las Vegas LLC/Wynn Las Vegas Capital Corp., Senior Unsecured Notes, 5.38%, 3/15/22	520,625
			3,285,433
		CONSUMER, NON-CYCLICAL (1.0%)	
	150,000	ADT Corp. (The), Senior Unsecured Notes, 2.25%, 7/15/17	148,125
	250,000	Amgen, Inc., Senior Unsecured Notes, 2.13%, 5/15/17	256,235
	250,000	Boston Scientific Corp., Senior Unsecured Notes, 2.65%, 10/1/18	255,558
	250,000	Celgene Corp., Senior Unsecured Notes, 2.30%, 8/15/18	254,045
	250,000	Cigna Corp., Senior Unsecured Notes, 2.75%, 11/15/16	259,628
	150,000	Constellation Brands, Inc., Guaranteed Notes, 3.75%, 5/1/21	149,063
	150,000	Edwards Lifesciences Corp., Senior Unsecured Notes, 2.88%, 10/15/18	153,285
	250,000	Express Scripts Holding Co., Guaranteed Notes, 3.50%, 11/15/16	265,447
	200,000	HCA, Inc., Senior Secured Notes, 6.50%, 2/15/20	225,000
	250,000	HJ Heinz Co., Secured Notes, 4.25%, 10/15/20	251,562
	500,000	Humana, Inc., Senior Notes, 6.45%, 6/1/16	550,725

Principal Amount			Value
		CONSUMER, NON-CYCLICAL (1.0%) (countinued)	
$	250,000	Kroger Co. (The), Senior Unsecured Notes, 3.40%, 4/15/22	$ 253,389
	250,000	Kroger Co. (The), Senior Unsecured Notes, 5.15%, 8/1/43	270,072
	300,000	Mylan, Inc., Senior Unsecured Notes, 1.35%, 11/29/16	300,500
			3,592,634
		ENERGY (1.0%)	
	150,000	Anadarko Petroleum Corp., Senior Unsecured Notes, 6.38%, 9/15/17	172,701
	150,000	DCP Midstream Operating L.P., Guaranteed Notes, 2.50%, 12/1/17	154,304
	150,000	Devon Energy Corp., Senior Unsecured Notes, 2.40%, 7/15/16	154,717
	350,000	Devon Energy Corp., Senior Unsecured Notes, 1.88%, 5/15/17	356,046
	150,000	Energy Transfer Partners L.P., Senior Unsecured Notes, 9.00%, 4/15/19	191,688
	200,000	Ensco PLC, Senior Unsecured Notes, 4.70%, 3/15/21	217,878

500,000	Enterprise Products Operating LLC, Guaranteed Notes, 4.85%, 8/15/42	517,044
100,000	Hess Corp., Senior Unsecured Notes, 5.60%, 2/15/41	116,279
250,000	Marathon Oil Corp., Senior Unsecured Notes, 2.80%, 11/1/22	242,984
100,000	Petrobras Global Finance B.V., Guaranteed Notes, 3.11%, 3/17/20 (1) (3)	102,745
250,000	Petrobras Global Finance B.V., Guaranteed Notes, 6.25%, 3/17/24	266,100
97,000	Plains Exploration & Production Co., Guaranteed Notes, 6.88%, 2/15/23	113,490
100,000	Rowan Companies, Inc., Guaranteed Notes, 7.88%, 8/1/19	122,127
250,000	Spectra Energy Partners L.P., Senior Unsecured Notes, 4.75%, 3/15/24	270,853

See Notes to Financial Statements.

June 30, 2014

Principal Amount		Value			
CORPORATE BONDS & NOTES (9.0%) (continued)					
	ENERGY (1.0%) (continued)				
$ 200,000	Tesoro Corp., Guaranteed Notes, 4.25%, 10/1/17	$ 209,000	Subscriptions receivable	(299,923)	—

Scientific development tax credits receivable	90,433	139,483
Prepaid expenses	(98,476)	6,193
Convertible note payable net	(70,420)	—
Accounts payable	110,742	6,781
Redeemable preferred stock	(280,000)	130,000
Accrued liabilities	143,320	120,136
Deferred revenue	51,374	—
Accrued payroll taxes	98,846	—
Net cash provided by (used in) operating activities	$ (1,833,579)	$ 285,608
Investing activities		
Fixed assets	(41,131)	(17,688)
Net cash provided by (used in) investing activities	$ (41,131)	$ (17,688)
Financing activities		
Other comprehensive income	63,308	(26,738)
Proceeds from the sale of common stock	683,707	130,460
Proceeds from the issuance of Series A Preferred Stock	1,358,399	—
Proceeds from the issuance of Series B Preferred Stock and Warrants	4,516,801	—
Proceeds from the issuance of common stock purchase warrants	498,407	—
Repayment of note payable and other loans	(44,545)	(364,368)

Payments to stockholders	(209,651)	—
Net cash provided by financing activities	$ 6,866,426	$ (260,646)
Change in cash during the period	4,991,716	7,274
Cash, beginning of period	113,629	212
Cash, end of period	$ 5,105,345	$ 7,486

See accompanying notes to consolidated financial statements.

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PerfectData Corporation and Subsidiary
Notes to Consolidated Financial Statements (unaudited)

Note 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of PerfectData Corporation ("Company"), included herein have been prepared by the Company in accordance with generally accepted accounting principles for interim financial information and with instructions to Form 10-QSB. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. However, in the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. The unaudited condensed consolidated financial statements herein include the accounts of the Company and its wholly owned subsidiary, Sona Mobile, Inc. ("Sona Mobile") and Sona Mobile's wholly owned subsidiary, Sona Innovations, Inc. ("Innovations"), a Canadian company. All material inter-company accounts and transactions have been eliminated. The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the Sona Mobile's audited consolidated financial statements for the year ended December 31, 2004 and the notes thereto included in Form 8-K/A filed with the United States Securities and Exchange Commission on July 5, 2005. (See note 2.) Results of consolidated operations for the interim periods are not necessarily indicative of the operating results to be attained for the entire fiscal year.

Note 2. Company Background and Description of Business

The Company was incorporated in the State of California on June 8, 1976. On November 29, 2004, after obtaining the requisite shareholder approval, the Company reincorporated in the State of Delaware.

Initially the Company's business involved designing and manufacturing a proprietary line of magnetic media maintenance equipment - disk pack cleaners and inspectors. The Company's cleaning and maintenance products were designed to address the needs of the end users of computers and office automation equipment and by maintenance organizations as part of preventative maintenance programs to reduce equipment "down time" and service costs and to increase product life. Beginning in March 2000, the Company began seeking acquisitions that were not related to its historical business. The Company's board of directors (the "Board") determined that profitability on a continuous basis would not be achieved absent an acquisition of a new business or businesses and/or a new product. On November 30, 2004, the Company sold its entire business operations, consisting of inventories of finished goods, raw materials and work in progress; books and records, including customer and supplier lists and other data relating to the operating business; the trade name "PerfectData Corporation" and all other names used in the business; the goodwill relating to the business; certain accounts receivable; machinery and equipment, office furniture, computer equipment and supplies; and intellectual property rights to Spray Products Corporation ("Spray"). Cash and cash equivalents were not included in the sale.

With the completion of the sale to Spray, the Company increased its efforts to find a new business opportunity. On April 19, 2005 (the "Effective Date"), pursuant to an Agreement and Plan of Merger dated as of March 7, 2005 (the "Merger Agreement"), Sona Mobile, Inc., a state of Washington corporation, was merged with and into PerfectData Acquisition Corporation, a state of Delaware corporation ("Merger Sub") and a wholly-owned subsidiary of the Company (the "Merger"). Merger Sub simultaneously changed its named to Sona Mobile, Inc.

As contemplated by the Merger Agreement, on the Effective Date, four of the Company's five directors resigned, including the Chairman of the Board, and the remaining director appointed three designees of Sona Mobile to fill those vacancies. Also, on the Effective Date the Company's chief executive officer resigned and the reconstituted board appointed designees of Sona Mobile as the Company's new executive officers.

In the Merger, the Sona Mobile shareholders received an aggregate of 539,733 shares of the Company's Series A Convertible Preferred Stock (the "Series A Stock"). The conversion ratio for the

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Note 2. Company Background and Description of Business (Continued)

Series A Stock is 48.11159 to one – meaning each share of Series A Stock converts into 48.11159 shares of the Company's common stock, par value $.01 per share (the "Common Stock"), or a total of 25,967,413 shares of Common Stock. Sona Mobile's financial advisor in connection with the Merger (the "Advisor") received 28,407 shares of the Series A Stock, convertible into 1,366,706 shares of Common Stock. The holders of the Series A Stock vote together with the holders of our Common Stock on all matters submitted for vote to the Company's shareholders on an as converted basis. As a result, the holders of the Series A Stock had 80% voting control of the Company on the Effective Date. The interests of the holders of the Series A Stock will increase to 85% voting control (based on the Company's capitalization on the Effective Date) if either of the following two conditions are satisfied: (1) if the Company, on a consolidated basis, has revenues of at least $3,000,000 and a gross profit margin of at least 50% for its fiscal year ending December 31, 2005 or (2) if the Company's aggregate revenues for 2005 and 2006 are at least $12,000,000 and our gross profit margin, combined aggregate revenues and aggregate cost of revenues, for 2005 and 2006 are at least 50%.

The Series A Preferred Stock converts automatically into Common Stock at such time as our stockholders approve an amendment to our Certificate of Incorporation that increases the number of authorized shares of Common Stock to an amount that would permit the conversion of the Series A Preferred Stock. The Series A Preferred Stock votes with the Common Stock on all matters presented to stockholders for vote on an as converted basis.

Upon completion of the Merger, the Company's only business was the historical business of Sona Mobile. The Merger was accounted for as a reverse acquisition into a public shell. No goodwill was recorded in connection with the Merger and the costs were accounted for as a reduction of additional paid-in-capital. The pre-Merger financial statements of Sona Mobile are treated as the historical financial statements of the combined companies. The historical financial statements of the Company prior to the Merger are not presented. Furthermore, because Sona Mobile is deemed the accounting acquiror, the Company's historical stockholders' equity is not carried forward to the merged entity as of June 30, 2005. Immediately prior to the Merger the Company had a net asset value of $1,145,962 consisting of cash and prepaid expenses of $1,232,612 and liabilities of $86,650.

Sona Mobile was organized in November 2003 in the State of Washington for the purpose of acquiring all of the stock of Sona Innovations, Inc., a Canadian company ("Innovations"). The acquisition was completed in December 2003. Sona Mobile operates as one business segment.

Sona Mobile develops and markets wireless data applications for mobile devices in the rapidly growing wireless data marketplace. Sona Mobile is a Vertical Wireless Software and Service Provider specializing in value-added services to data-intensive vertical market segments. Sona Mobile's revenues consist primarily of licensing and support fees relating to the Sona Wireless Development Platform and related end-user wireless applications to enterprises and cellular operators.

Sona Mobile markets its products and services principally to two large vertical markets and one broad horizontal market.

- Financial services. One of Sona Mobile's primary focuses is to develop solutions for the data-intensive investment banking community and client-facing applications for the retail banking industry.
- Media and entertainment. Sona Mobile delivers content via significant channel partners and content partners, including live streaming television, digital radio, specific theme phones, and gaming applications.
- Enterprise solutions. Sona Mobile's products and services extend enterprise applications to the wireless arena, such as CRM, SFA, IT service desk, Business Continuity Protocol, all of which are delivered in compliance with the current regulatory environment.

Note 3. Summary of Significant Accounting Policies

These consolidated financial statements are presented in United States dollars and have been prepared in accordance with U.S. generally accepted accounting principles and reflect the following policies:

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Sona Mobile and the accounts of Sona Mobile's wholly-owned subsidiary, Innovations. All intercompany accounts and transactions have been eliminated in consolidation.

(b) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and term deposits with original maturity dates of less than 90 days. Cash and cash equivalents are stated at cost which approximates market value, and are concentrated in two major financial institutions.

(c) Foreign currency translation

In accordance with the provisions of SFAS No. 52 "Foreign Currency Translation," assets and liabilities denominated in a foreign currency have been translated at the period end rate of exchange. Revenue and expense items have been translated at the transaction date rate. For Sona Mobile, which utilizes its local currency as its functional currency, the resulting translation gains and losses are included in other comprehensive income. Gains or losses resulting from foreign exchange transactions are reflected in earnings.

(d) Fixed assets

Fixed assets are stated at cost. Depreciation is provided on a straight line basis over the estimated useful lives of three to five years.

(e) Use of estimates

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

(f) Software rights

Software rights were recorded at the excess of the purchase price for Innovations, purchased in 2003, over the fair value of that company's identifiable net tangible assets. As at June 30, 2005 the software rights have been written off.

The Company tests for recoverability of software rights when events or changes in circumstance indicate that their carrying amount may not be recoverable. Circumstances which could trigger a review include, but are not limited to significant decreases in the market price of the assets; significant adverse changes in the business climate or legal factors; accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the asset; current period cash flow or operating losses combined with a history of losses or a forecast of continuing losses associated with the use of the asset; and current expectation that the asset will more likely than not be sold or

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Note 3. Summary of Significant Accounting Policies (Continued) disposed of significantly before the end of its estimated useful life. Recoverability is assessed based on the carrying amount of the asset and its fair value which is generally determined based on the sum of the undiscounted cash flows expected to result from the use and the eventual disposal of the asset, as well as specific appraisal in certain instances. An impairment loss is recognized when the carrying amount is not recoverable and exceeds fair value.

(g) Income taxes

The Company accounts for income taxes in accordance with SFAS No. 109 "Accounting for Income Taxes," which requires an asset and liability approach to financial accounting and reporting for income taxes. Deferred income tax assets and liabilities are computed periodically for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. The income tax provision is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

(h) Revenue recognition

The Company derives revenue from license and service fees related to customization and implementation of the software being licensed. License fees are recognized in accordance with Statement of Position (SOP) 97-2, "Software Revenue Recognition," as amended by SOP 98-4 and SOP 98-9, and in certain instances in accordance with SOP 81-1, "Accounting for Performance of Construction-Type and Certain Production-Type Contracts." Service fees are recorded on a percentage of completion or completed-contract basis depending on whether or not reliable estimates of the costs to complete the work can be obtained. License fees are recognized over the service period when there is persuasive evidence of an arrangement, the fee is fixed or determinable and collection of the receivable is probable. The deferred revenues are amounts received prior to completion of service.

(i) Research and development

The Company incurs costs on activities that related to research and the development of new products. Research costs are expensed as they are incurred. Costs are reduced by tax credits where applicable.

Note 4. Note Payable

	As at June 30, 2005 (unaudited)
Amounts owed to the former shareholder of Sona Innovations Inc. – non interest bearing with no specific terms of repayment	$ 10,780

Note 5. Schedule of Stockholders' Equity

The schedule of stockholders' equity reflects the Merger, which was treated as a reverse acquisition with Sona Mobile as the accounting acquiror. The beginning equity is that of Sona Mobile as of December 31, 2004 and the schedule reflects the exchange of Sona Mobile's capital stock for shares of the Company's Series A Stock. The schedule also reflects the Series B Financing described below.

PerfectData Corporation and Subsidiary
Notes to Consolidated Financial Statements (unaudited)

Note 5. Schedule of Stockholders' Equity (Continued)

Series B Financing

In June 2005, the Company sold or received subscriptions for 3,848.7 shares of our Series B Convertible Preferred Stock, $.01 per share (the "Series B Preferred Stock") and warrants to purchase 962,175 shares of Common Stock (the "Warrants"). The gross proceeds from the sale of the Series B Preferred Stock and the Warrants were approximately $5.05 million. The Series B Stock ranks pari passu with the Series A Preferred Stock and is identical in all material respects to the Series A Preferred Stock except that each share of Series B Preferred Stock converts into 1,000 shares of Common Stock, or 3,848,700 in the aggregate.

	Common Stock		Sona Series A redeemable preferred stock		Warrants on Common Stock		Series A & Series B Convertible Preferred Stock		Additio paid-i
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount	Capit
Balance at December 31, 2004	1,558,177	$ 450,459							$ 205,5
Sona common stock issued prior to reverse merger	2,014,849	683,707							
Convertible note Conversion	158,730	70,420							(70,4
Common stock acquired in the reverse merger	6,584,530	65,845	2,372,779	$ 280,000					1,080,1
Exchange of stock pursuant to merger	(3,715,256)	(1,204,586)	(2,327,779)	$ (280,000)					1,478,9
Issuance of Series A Convertible Preferred Stock							568,140	$5,681	
Redemption/Cancellation of shares	(16,500)								
Cost of financing reverse merger									(67,5

Issuance of Series B Convertible Preferred Stock								3,849	38	4,551,0
Common stock purchase warrants issued pursuant to Series B Financing						962,175	498,407			
Costs of Series B Financing										(34,2
Other comprehensive income										
Net loss										
Balance at June 30, 2005	6,584,530	$	65,845	0	0	962,175	$498,407	571,989	$5,719	$7,143,3

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PerfectData Corporation and Subsidiary
Notes to Consolidated Financial Statements (unaudited)

Note 6. Convertible Note Payable

On March 2, 2005, the holder of a $100,000 convertible promissory note issued by Sona Mobile in 2004 exercised his right to convert the note into 158,730 shares of Sona Mobile's common stock. Such shares were ultimately converted into 15,873 shares of the Company's Series A Stock.

Note 7. Share Capital

On the Effective Date, the Company issued 568,140 shares of its Series A Stock in connection with the Merger.

In June 2005 the Company sold or had received subscriptions for 3,849 shares of its Series B Stock and 962,175 common stock purchase warrants (the "Warrants"). The total proceeds from this financing were $5,049,466. The Warrants were valued at $498,407 using the Black-Scholes option pricing formula and the closing stock price on June 20, 2005, the date of the Series B Financing.

The Company had 6,359,530 shares of its Common Stock outstanding as of December 31, 2004. Between January 1, 2005 and the Effective Date, the Company issued an additional 225,000 shares of Common Stock—150,000 shares in payment of legal fees and 75,000 upon exercise of stock options.

Note 8. Financial Instruments

The Company's financial instruments consist of cash, accounts receivable, accounts payable, share subscription receivable and notes payable. The Company is subject to credit risk with respect to its accounts receivable to the extent that debtors do not meet their obligations. The Company monitors the age of its accounts receivables and may delay development or terminate information fees if debtors do not meet payment terms. A reasonable estimate of the fair value of the note payable could not be made as the timing of payments, if any, is not known.

The Company is subject to foreign currency risk with respect to financial instruments denominated in a foreign currency.

Note 9. Income Taxes

Deferred tax benefits arising from net operating loss and scientific research and experimental development expenditure carryforwards were determined using the applicable statutory rates. The net operating loss carry forward balances vary from the applicable percentages of net loss due to expenses, primarily amortization of software rights, recognized under generally accepted accounting principles, but not deductible for tax purposes.

At June 30, 2005 the Company had net deferred tax assets of approximately $870,000 arising from the net operating loss carryforwards. These deferred tax assets are fully offset by valuation allowances. Due to the change in control provisions under U.S. tax laws, which may apply to the Company as a result of the Merger, the utilization of net operating losses to offset future taxable income may be limited under U.S. tax laws.

Note 10. Commitments

On December 29, 2004, Innovations signed a letter of intent to acquire the assets and employee contracts of Smart Video Canada Inc. for $83,195 ($100,000 Canadian). An initial deposit of $4,160 ($5,000 Canadian) was paid as at December 31, 2004 and remainder to be paid throughout the second half of 2005. The initial deposit is carried as a prepaid expense on the Company's June 30, 2005 balance sheet.

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders of Sona Mobile, Inc. and Subsidiary

We have audited the accompanying consolidated balance sheets of Sona Mobile, Inc. and Subsidiary (the "Company") as of December 31, 2004 and 2003, and the related consolidated statements of operations and comprehensive loss, shareholders' deficiency, and cash flows for the year ended December 31, 2004 and for the period from November 12, 2003 (date of inception) to December 31, 2003. 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 audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Sona Mobile, Inc. and its Subsidiary as at December 31, 2004 and 2003, and the results of their operations and their cash flows for the year ended December 31, 2004 and for the period from November 12, 2003 (date of inception) to December 31, 2003, in conformity with accounting principals generally accepted in the United States of America.

Toronto, Canada

March 18, 2005 Chartered Accountants

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Sona Mobile, Inc. and Subsidiary

Consolidated Balance Sheets (audited)

	As at December 31, 2004	2003
Assets		
Current		
Cash	$ 113,629	$ 213
Accounts receivable	131,630	9,059
Scientific development tax credits receivable	90,433	159,617
Prepaid expenses	17,852	6,193
Total current assets	353,544	175,082
Software rights, net (notes 2 and 3)	415,936	554,583
Equipment, net (note 4)	11,294	13,079
	$ 780,774	$ 742,744
Liabilities and Shareholders' Deficiency		
Current		
Accounts payable	$ 207,163	$ 200,104
Accrued liabilities	52,190	18,546
Deferred revenue	1,432	—
Note payable and other short term loans (note 5)	55,325	377,599
Redeemable preference shares (note 8)	280,000	150,000
Due to shareholder (note 6)	209,651	74,018
Total current liabilities	805,761	820,267
Convertible note payable (note 7)	85,630	—
Total liabilities	891,391	820,267
Shareholders' deficiency		
Share capital (note 8)		
Authorized – 7,000,000 preference shares, no par value;		
3,000,000 Series A preference shares;		
10,000,000 common shares, no par value		
Issued and outstanding		
1,558,177 and 930,001 common shares	450,459	35,000
Other paid-in capital (notes 7 and 8)	205,555	—

Accumulated other comprehensive income (loss)	(25,651)	2,301
Accumulated deficit	(740,980)	(114,824)
Total shareholders' deficiency	(110,617)	(77,523)
	$ 780,774	$ 742,744

See accompanying notes to consolidated financial statements.

Sona Mobile, Inc. and Subsidiary
Consolidated Statements of Operations and Comprehensive Loss (audited)

	Year ended December 31, 2004	Period beginning November 12, 2003 (inception) and ending December 31, 2003
Revenue		
Application licenses	$ 401,536	$ —
Operating expense		
Depreciation – equipment	3,941	—
Amortization – software rights	138,647	—
Bad debt expense	15,568	—
Consulting (note 6)	248,580	48,000
Insurance	3,235	—
Scientific development tax credits	(7,683)	—
Office	48,214	—
Professional fees	93,859	64,137
Rent (note 6)	29,083	—
Telephone and telecommunications	75,718	—
Travel	44,600	2,687
Wages and benefits	260,290	—
Stock based compensation (note 8)	46,463	—
Total operating expense	1,000,515	114,824
Operating loss	(598,979)	(114,824)
Other income (expense)		
Interest expense (note 7)	(27,177)	—
Net Loss	(626,156)	(114,824)
Other comprehensive income (loss) – Translation adjustment	(27,952)	2,301
Comprehensive loss	$ (654,108)	$ (112,523)

See accompanying notes to consolidated financial statements.

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Sona Mobile, Inc. and Subsidiary
Consolidated Statements of Cash Flows (audited)

	Year ended December 31, 2004	Period beginning November 12, 2003 (inception) and ending December 31, 2003
Cash provided by (used in):		
Operating activities		
Net loss	$ (626,156)	$ (114,824)
Adjustments for:		
Amortization of equipment	3,941	—
Amortization of software rights	138,647	—
Amortization of deferred interest	16,185	—
Changes in non-cash working capital assets and liabilities net of acquired assets and liabilities due to acquisitions:		
Accounts receivable	(122,571)	—
Scientific development tax credits receivable	69,184	—
Prepaid expenses	(11,659)	—
Accounts payable	7,058	114,824
Accrued liabilities	33,644	—
Deferred revenue	1,432	—
Net cash provided by (used in) operating activities	(490,295)	—
Investing		
Furniture and equipment	(2,156)	—
Cash balance from acquisition of subsidiary	—	208
Net cash provided by (used in) investing activities	(2,156)	208
Financing		
Proceeds from deposits on share subscriptions	175,000	—
Proceeds from the sale of preference shares	130,000	—
Proceeds from the sale of common shares	368,997	—
Net proceeds from (repayment of) note payable and other loans	(275,811)	—
Proceeds from shareholder (note 6)	135,633	5
Proceeds from convertible note payable	100,000	—
Net cash provided by financing activities	633,819	5
Effect of exchange rate changes on cash	(27,952)	—
Change in cash during the year	113,416	213
Cash, beginning of year	213	—
Cash, end of year	$ 113,629	$ 213
Supplemental schedule of non-cash investing and financing activities:		

Redeemable preference shares issued in exchange for payment of deposit for acquisition of subsidiary	$ —	$ 150,000
Common shares issued in exchange for payment of deposit for acquisition of subsidiary	$ —	$ 35,000

See accompanying notes to consolidated financial statements.

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Sona Mobile, Inc. and Subsidiary
Consolidated Statements of Shareholders' Deficiency (audited)
For the year ended December 31, 2004 and the period from November 12, 2003, the date of incorporation, to December 31, 2003

	Common Stock		Additional Paid-in Capital	Accumulated Other Comprehensive Income	Accumulated Deficit	Shareholder's Equity (Deficiency)
Balance, November 12, 2003 (inception)	$ —	$ —	$ —	$ —	$ —	$ —
Issuance of shares on incorporation	496,667	—	—	—	—	—
Issuance of shares in exchange for payment of deposit for acquisition of subsidiary	183,334	35,000	—	—	—	35,000
Issuance of shares as compensation for delays in the acquisition of subsidiary	250,000	—	—	—	—	—
Foreign exchange translation	—	—	—	2,301	—	2,301
Net loss	—	—	—	—	(114,824)	(114,824)
Balance, December 31, 2003	930,001	35,000	—	2,301	(114,824)	(77,523)
Issuance of shares for cash	628,176	368,996	—	—	—	368,996
Common stock committed for repayment of note payable (note 7)	—	—	30,555	—	—	30,555
Common stock committed for cash (note 8)	—	—	175,000	—	—	175,000
Stock based compensation	—	371,700	—	—	—	371,700

Deferred stock based compensation (note 8)	—	(325,237)	—	—	—	(325,237)
Foreign exchange translation	—	—	—	(27,952)	—	(27,952)
Net loss	—	—	—	—	(626,156)	(626,156)
Balance, December 31, 2004	$1,558,177	$ 450,459	$ 205,555	$ (25,651)	$ (740,980)	$ (110,617)

See accompanying notes to consolidated financial statements.

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Sona Mobile, Inc. and Subsidiary
Notes to Consolidated Financial Statements
December 31, 2004 and 2003

1. Company background

Sona Mobile, Inc. (the Company) was incorporated on November 12, 2003 in the state of Washington. The Company is a provider of wireless solutions that bring mobility to businesses in the wireless data marketplace. The Company has customers in the banking, manufacturing, entertainment, and utilities/energy industries.

2. Summary of significant accounting policies

These consolidated financial statements are presented in United States dollars and have been prepared in accordance with U.S. generally accepted accounting principles and reflect the following policies:

(a) Principles of consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiary, Sona Innovations Inc. The subsidiary was acquired December 23, 2003 and the assets and liabilities are included in the 2003 and 2004 consolidated balance sheet. The results of the subsidiary's operations are recorded from the date of acquisition. All intercompany accounts and transactions have been eliminated in consolidation.

(b) Cash and cash equivalents

Cash and cash equivalents are comprised of cash and term deposits with original maturity dates of less than 90 days. Cash and cash equivalents are stated at cost which approximates market value, and are concentrated in two major financial institutions.

(c) Foreign currency translation

In accordance with the provisions of SFAS No. 52 "Foreign Currency Translation", assets and liabilities denominated in a foreign currency have been translated at the year end rate of exchange. Revenue and expense items have been translated at the transaction date rate. For the foreign subsidiary which utilizes its local currency as its functional currency, the resulting translation gains and losses are included in other comprehensive income. Gains or losses resulting from foreign exchange transactions are reflected in earnings.

(d) Long term investments

Equipment is stated at cost. Depreciation is provided on a straight line basis over the estimated useful lives of three to five years.

(e) Measurement uncertainty

The preparation of consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities, at the date of the financial statements, and the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from these estimates.

(f) Software rights

Software rights are recorded at the excess of the purchase price of the subsidiary over the fair value of the subsidiary's identifiable net tangible assets. The carrying value of the rights is being amortized over the program application's estimated useful life of four years.

The Company tests for recoverability of software rights when events or changes in circumstance indicate that their carrying amount may not be recoverable. Circumstances which could trigger

2. Summary of significant accounting policies (continued)

a review include, but are not limited to significant decreases in the market price of the assets; significant adverse changes in the business climate or legal factors; accumulation of costs significantly in excess of the amount originally expected for the acquisition or construction of the asset; current period cash flow or operating losses combined with a history of losses or a forecast of continuing losses associated with the use of the asset; and current expectation that the asset will more likely than not be sold or disposed of significantly before the end of its estimated useful life.

Recoverability is assessed based on the carrying amount of the asset and its fair value which is generally determined based on the sum of the undiscounted cash flows expected to result from the use and the eventual disposal of the asset, as well as specific appraisal in certain instances. An impairment loss is recognized when the carrying amount is not recoverable and exceeds fair value.

As at December 31, 2004 and 2003 there were no circumstances or events which had occurred which might indicate that the carrying value of the rights may not be recoverable and therefore no test of the recoverability has been made.

(g) Income taxes

The Company accounts for income taxes in accordance with SFAS No. 109 "Accounting for Income Taxes" which requires an asset and liability approach to financial accounting and reporting for income taxes. Deferred income tax assets and liabilities are computed periodically for differences between the financial statement and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized. The income tax provision is the tax payable or refundable for the period plus or minus the change during the period in deferred tax assets and liabilities.

(h) Revenue recognition

The Company derives revenue from license and service fees related to customization and implementation of the software being licensed. Service fees are recorded on a percentage of completion or completed-contract basis depending on whether or not reliable estimates of the costs to complete the work can be obtained. License fees are recognized over the service period when there is persuasive evidence of an arrangement, the fee is fixed or determinable and collection of the receivable is probable. The deferred revenues are amounts received prior to completion of service.

(i) Research and development

The Company annually incurs costs on activities that related to research and the development of new products. Research costs are expenses as they are incurred. Costs are reduced by investment tax credits where applicable.

(j) Use of estimates

The preparation of consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amount of revenues and expenses during the reported period. Actual results could differ from those estimates. These estimates are reviewed periodically and, as adjustments become necessary, they are reported in earnings in the period in which they become known.

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3. Business acquisition

On December 23, 2003 the Company acquired 100% of the outstanding voting shares of Sona Innovations Inc., a Canadian company that developed the wireless platform upon which the Company's products are based. Prior to the acquisition the two companies were at arm's length. The consideration for the shares was $132,175 ($175,000 Canadian) in cash and short term notes as well as assumption of $377,644 ($500,000 Canadian) of current debt owed to the majority shareholder of the investee prior to the acquisition (note 5).

The allocation of the purchase price is as follows:

Cash	$	208
Accounts receivable		9,059
Scientific tax credits receivable		159,616
Prepaid expenses		6,193
Equipment		13,078
Software rights		554,583
		742,737
Accounts payable		(85,279)

Accrued liabilities		(18,546)
Short term loans		(55,079)
Due to shareholder		(74,013)
Total purchase price	$	509,820

4. Long term investments

		2004		2003
Furniture and office equipment	$	5,293	$	2,915
Computer and telephone equipment		9,942		10,164
		15,235		13,079
Accumulated amortization		(3,941)		—
	$	11,294	$	13,079

5. Note payable and other short term loans

		2004		2003
Amounts owed to former shareholders of Sona Innovations Inc. - non interest bearing with no specific terms of repayment (note 3)	$	55,325	$	55,079
Debt assumed on acquisition of subsidiary bearing interest at 3.5% per annum, payable June 23, 2004 (note 3)		—		322,520
	$	55,325	$	377,599

6. Related party transactions

During the year, the Company paid consulting fees to shareholders and directors of the company in the amount of $215,000 and $48,000 in 2004 and 2003, respectively. The balance due to shareholder of $209,651 is non-interest bearing, unsecured with no specific terms of repayment.

The Company's subsidiary shares premises with the former majority shareholder of the subsidiary who also owns 250,000 common shares of Sona Mobile, Inc. During 2004 the Company paid rent to the former majority shareholder in the amount of $22,590 on a month to month basis with no commitment.

7. Convertible note payable

In July 2004 the Company issued a note for proceeds for $100,000, its face value. The note is due January 2006 and bears interest at 12% per annum, payable upon maturity. On the note's due date, 48,500 common shares are to be issued to the note holder. The note is convertible to 158,730 common shares or $.63 per share, at any time before the due date.

In accordance with EITF 98-5 the fair value of the conversion option on the date of issuance was nil as the conversion price was equal to the current issue price for the shares. The obligation to issue common shares has been valued at the market price at the time of issue in the amount of $30,555 and is reflected as part of "Other paid-in capital" in shareholder's equity and the related note discount, netted against the note payable. Interest and amortization of the discount are charged to income over the term of the note.

On March 2, 2005 the holder of the note exercised the conversion. The other paid-in capital and the carrying value of the note payable including accrued interest and unamortized discount of $21,580 have been recorded as proceeds for the issue of the 158,730 shares.

8. Share capital

Redeemable Preference shares

The board of directors has designated 3 million of the 10 million preference shares authorized as Series A preference shares. The shares are voting, have a non-cumulative dividend rate of 6% and are convertible to common shares on a one to one basis, subject to certain anti-dilutive provisions. The shares are redeemable at the option of the holder, if the Company is not sold, merged or subject to a public offering within 5 years of issue. The redemption amount is equal to their paid up amount plus an additional 6% compounded annually. Should the Company be subject to a public offering where the offering price is 33 times the issue price and in aggregate greater than $10 million or a majority of the Series A preferred shareholders provide consent, the shares are subject to a mandatory conversion to common shares. The holders of the Series A preferred shares have the right to purchase shares offered for sale by the Company in a number of shares necessary to maintain the holder's pro rata ownership on the basis of common share equivalents outstanding. Due to the redeemable feature of these shares they have been classified as a liability in the balance sheet.

In December, 2003 1,686,667 Series A preference shares were issued to the Company's founders for nominal consideration and 500,000 Series A preference shares were issued at $150,000 in repayment of deposits made on the acquisition of Sona Innovations Inc. as described in note 3. In January and May, 2004 141,112 Series A preference shares were issued for $130,000 to finance the remainder of the acquisition.

Common shares

In December, 2003 496,667 common shares were issued to the Company's founders for nominal consideration, 183,334 shares were issued for $35,000 in repayment of deposits made on the acquisition of Sona Innovations Inc. as described in note 3 and 250,000 shares were issued for nominal consideration to the former majority shareholder of the subsidiary as compensation for delays in closing the acquisition. In January and June, 2004 and during August to October, 2004 an aggregate of 628,176 shares were issued for $368,997. The proceeds of these issues were used to pay the remaining notes payable and debt assumed in the acquisition of the subsidiary as described in note 3, as well as to finance current operations.

In December 2004 the Company received $175,000 for 101,157 shares issued January 3, 2005. This amount is reflected as "Other paid-in capital" in the balance sheet.

Sona Mobile, Inc. and Subsidiary
Notes to Consolidated Financial Statements

December 31, 2004 and 2003

8. Share capital (continued)

On November 18, 2004 the board authorized 590,000 shares to be issued to various employees and a consultant for no consideration. These shares were issued January 3, 2005. The value of these shares is $371,700, of which $46,463 has been recorded as expense in the current period and $325,237 has been recorded as deferred stock based compensation in the statement of shareholders' deficiency.

9. Financial instruments

The Company's financial instruments consist of cash, accounts receivable, accounts payable, deposits on share subscriptions, notes payable, other short term loans and amount due to shareholder.

The Company is subject to credit risk with respect to its accounts receivable to the extent that debtors do not meet their obligations. The Company monitors the age of its accounts receivables and may delay development or terminate information fees if debtors do not meet payment terms.

The Company is subject to foreign currency risk with respect to financial instruments denominated in a foreign currency.

A reasonable estimate of fair value of the amount due to shareholder and other short term loans could not be made as the timing of payments, if any, is not known.

Due to the short period to maturity, the book value of the remaining financial instruments approximates their fair value.

10. Income taxes

Deferred tax benefits arising from net operating loss and scientific research and experimental development expenditure carryforwards were determined using the applicable statutory rates. The net operating loss carry forward balances vary from the applicable percentages of net loss due to expenses, primarily amortization of software rights, recognized under generally accepted accounting principles, but not deductible for tax purposes.

The Company has Canadian scientific research and experimental development expenditures of approximately $815,000 that may be carried forward indefinitely and applied to reduce taxable income in future years. In addition, the Company has losses carried forward for Canadian tax purposes which may be applied to reduce taxable income in the amount of approximately $240,000. Losses in the amount of $52,000 expire in 2009 and the remaining $188,000 expire in 2014.

Net operating loss carryforwards available for U.S. federal and state tax purposes of approximately $287,000. Of these losses $115,000 expires in 2023 and 2013 for federal and state purposes, respectively, and $172,000 expires in 2024 and 2014 for federal and state purposes, respectively.

The utilization of the net operating losses to offset future taxable income may be limited under U.S. tax laws.

At December 31, 2004 and 2003 the Company had net deferred tax assets of approximately $447,000 and $336,000 arising from the net operating loss and scientific research and experimental development expenditure carryforwards. These deferred tax assets are fully offset by deferred tax liability arising from the software rights, the amortization of which is not deductible for tax purposes and the remainder by valuation allowances.

The deferred tax liability related to the software is $145,000 and $194,000 at December 31, 2004 and 2003. The Company has established a valuation allowance of 100% to the extent of the deferred net tax assets since it is more likely than not that the benefit will not be realized. During 2004 and 2003 the valuation allowance increased by $160,000 and $142,000.

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Sona Mobile, Inc. and Subsidiary
Notes to Consolidated Financial Statements
December 31, 2004 and 2003

11. Commitment

On December 29, 2004, Sona Innovations Inc. signed a letter of intent to acquire the assets and employees contracts of Smart Video Canada Inc. for $83,195 ($100,000 Canadian). An initial deposit of $4,160 ($5,000 Canadian) was paid as at December 31, 2004 and remainder to be paid throughout 2005.

12. Subsequent events

On January 12, 2005 Sona Mobile, Inc. signed a non-binding Letter of Intent to merge with Perfectdata Corporation. Under the terms of the letter of intent, the shareholders of Sona Mobile, Inc. initially will own 80% of the merged entity and could own an additional 5% pursuant to a formula to be set forth in the merger agreement. The transaction is subject to completion of due diligence, execution of a definitive merger agreement, and satisfying other material conditions. On March 10, 2005, the parties executed a definitive agreement.

In addition, on March 7, 2005 the Company issued 250,000 common shares to accredited investors for proceeds of $475,000 to finance current operations.

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APPENDIX I (AUDIT COMMITTEE CHARTER)

PERFECTDATA CORPORATION

AUDIT COMMITTEE CHARTER
(As amended on October 15, 2002)

Organization

This Charter governs the operations of the Audit Committee (the "Committee") of PerfectData Corporation (the "Company"). The Committee shall review and reassess this Charter at least annually and obtain the approval of the Board of Directors of the Company (the "Board") of its recommendations as to proposed changes or additions to this

Charter. The Committee shall be appointed by the Board and shall consist of at least three directors appointed annually and serving at the pleasure of the Board, each of whom is independent of management and the Company.

A member of the Committee shall be considered "independent" if he or she has no relationship that may interfere with the exercise of his or her judgment, independent from management and the Company. So long as the Company's Common Stock shall be traded on The Nasdaq Stock Market, Inc. ("Nasdaq"), or, if in the future the Common Stock shall be listed on the American Stock Exchange LLC, the Board shall interpret "independence" as defined in the rules of the National Association of Securities Dealers, Inc. (the "NASD"). If the Common Stock should ever be listed on the New York Stock Exchange, Inc., the Board shall interpret "independence" as defined by such Exchange or, if appropriate, continue to use the definition in the NASD rules. In addition, the Board shall interpret "independence" pursuant to any rules adopted by the Securities and Exchange Commission (the "Commission"). Subject to such regulations as the Commission may hereafter adopt, for a member of the Committee to be independent, he or she shall not, other than in his or her capacity as a member of the Committee, the Board or any other Board committee, (a) accept any consulting, advisory or other compensatory fee from the Company or (b) be an affiliated person of the Company or any subsidiary thereof.

All Committee members shall, at the time of appointment, be able to read and understand fundamental financial statements, including the Company's balance sheet, income statement and cash flow statement. At least one member shall have past employment experience in finance or accounting, requisite professional certification in accounting, or any other comparable experience or background which results in the individual's financial sophistication, including being or having been a chief executive officer, chief financial officer or other senior officer with financial oversight responsibilities. At least one member shall qualify as a "financial expert" under the rules of the Commission.

For meetings of the Committee two members (a majority if there are more than three members of the Committee) of the Committee shall constitute a quorum. No action may be taken except by the affirmative vote of at least two members (a majority if there are more than three members of the Committee) of the Committee. In the absence or disqualification of a member of the Committee, the member or members present at any meeting and not disqualified from voting, whether or not he, she or they constitute a quorum, may unanimously appoint another member of the Board to act at the meeting in place of any such absent or disqualified member, provided that a majority of the persons acting at the meeting is independent of management and the Company.

Statement of Policy

The Committee shall provide assistance to the Board in fulfilling its oversight responsibility to the shareholders, potential shareholders, the investment community and others relating to the Company's financial statements and the financial reporting process, the systems of internal accounting and financial controls, the internal audit function (when established), the annual independent audit of the Company's financial statements and the legal compliance and ethics programs as established by management and the Board. In so doing, it is the responsibility of the Committee to maintain free and open communication between the Committee, the independent auditors, the internal auditors (when engaged) and management of the Company. In discharging its oversight role, the Committee is empowered to investigate any

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matter brought to its attention with full access to all books, records, facilities and personnel of the Company and the power to retain outside counsel, including, but not limited to, outside counsel to the Company, or other advisors for this purpose and to consult such other entities having a relationship with the Company, including, without limitation, the Company's investment bankers or financial analysts who follow the Company, as the Committee deems appropriate. The Committee shall determine the compensation for such counsel or other advisors and the Company shall make appropriate funds available to the Committee for such purpose.

Responsibilities and Processes

The primary responsibility of the Committee is to oversee the Company's financial reporting process on behalf of the Board and report the results of its activities to the Board and, where required or deemed appropriate, to the shareholders of the Company. Not in limitation of the foregoing, the Committee shall prepare annually the Audit Committee Report as required by Item 306 of the Commission's Regulation S-K and Regulation S-B, whichever is applicable to the Company, for inclusion in the Company's proxy statement for its Annual Meeting of Shareholders. Management is responsible for preparing the Company's financial statements, and the independent auditors are responsible for auditing those financial statements. The Committee, in carrying out its responsibilities, believes its policies and procedures should remain flexible, in order to best react to changing conditions and circumstances. The Committee should take the appropriate actions to set the overall corporate "tone" for quality financial reporting, sound business risk practices and ethical behavior.

The following shall be the principal recurring processes of the Committee in carrying out its oversight responsibilities. The processes are set forth as a guide with the understanding that the Committee may supplement them as appropriate.

- Annually, the Committee shall review and select the Company's independent auditors, subject to shareholders' approval. The Committee shall have the sole authority to determine the compensation to be paid to the independent auditors for its services in preparing an audit report and in reviewing the financial statements of the Company and the Company shall make appropriate funds available for such purpose and for the services provided in the succeeding sentence. The Audit Committee shall approve in advance the retention of the independent auditors for any non-audit service and the fee for such service. The term "non-audit service" shall mean any professional service provided to the Company other than those provided in connection with an audit or a review of the financial statements of the Company. The Committee's approval in advance may be waived with respect to a non-audit service only if (a) the service was not recognized by the Company at the time of the audit engagement to be a non-audit service; (b) the aggregate amount paid for all non-audit services is not more than five percent of the total amount of revenues paid by the Company to the independent auditor during the fiscal year when the non-audit services were performed; (c) the service is promptly brought to the attention of the Committee; (d) the Committee approves the activity prior to the conclusion of the audit; and (e) the Commission by regulation otherwise permits a waiver.

- The Committee shall have a clear understanding with management and the independent auditors that the independent auditors are accountable to the Audit Committee directly and the Board indirectly as the representatives of the Company's shareholders. The Committee shall have the ultimate authority and responsibility to evaluate, and the sole authority, where appropriate, to replace, the independent auditors. The Committee shall discuss with the auditors their independence from management and the Company and the matters included in the written disclosures required by the Independence Standards Board. At least annually the Committee shall (1) review resumes of key partners and managers of the independent auditors in order to evaluate the experience and qualifications of those who perform services for the Company and (2) review a report by the independent auditors describing (a) the firm's internal quality control procedures, (b) any material issues raised by the most recent internal quality control review or peer review, or by any inquiry or investigation by governmental or professional authorities within the preceding five years, respecting one or more independent audits carried out by the firm, and any steps taken to deal with any such issues, and (c) all relationships between the independent auditors and the Company.

- The Committee shall approve the scope of the annual audit by the independent auditors and authorize any supplementary reviews, investigations or audits as it shall deem advisable. The independent auditors shall timely report to the Committee all critical accounting policies and practices to be used and all alternative treatments of financial information within generally accepted accounting principles (GAAP) that have been discussed with management, the ramifications of the use of such alternative disclosures and the treatment preferred by the independent auditors. The independent auditors shall also timely report to the Committee any accounting disagreements between the independent auditors and management and any other material written communications between the independent auditors and management. Also, the Committee shall discuss with management, the internal auditors (when engaged) and the independent auditors the adequacy and effectiveness of the accounting and financial controls, including the Company's system to monitor and manage business risk, and legal and ethical compliance programs. Further, the Committee shall meet separately with the internal auditors (when engaged) and the independent auditors, with and without management present, to discuss the results of their examinations and any problems or difficulties encountered by the independent auditors and management's response thereto. The Committee shall also review in connection with its annual review of the audited financial statements all non-audited services performed by the independent auditor to confirm that each is permitted by law or regulation and was previously approved by the Committee or such pre-approval was not required as provided above.

- The Committee shall review the interim financial statements with management and the independent auditors prior to the filing of the Company's Quarterly Report on Form 10-Q or Form 10-QSB. Also, the Committee shall discuss the results of the quarterly review, including, without limitation, the Company's disclosures in the Quarterly Report under "Management's Discussion and Analysis of Financial Condition and Results of Operations," and any other matters required to be communicated to the Committee by the independent auditors under generally accepted auditing standards. The Chairperson of the Committee (or, in the event of his or her unavailability, a member) may represent the entire Committee for the purposes of this review.

- The Committee shall review with management and the independent auditors the financial statements to be included in the Company's Annual Report on Form 10-K or Form 10-KSB (or the annual report to shareholders if distributed prior to the filing of the Form 10-K or Form 10-KSB), including (a) the Company's disclosures under "Management's Discussion and Analysis of Financial Condition and Results of Operations" and (b) their judgment about the quality, not just acceptability, of accounting principles, the reasonableness of significant judgments, particularly insofar as they relate to critical accounting estimates, and the clarity of the disclosures in the financial statements. Also, the Committee shall discuss the results of the annual audit and any other matters required to be communicated to the Committee by the independent auditors under generally accepted auditing standards. Without limiting any of the foregoing, the Committee shall (x) review with management and the independent auditors the effect of regulatory and accounting initiatives on the Company's financial statements, including, without limitation, the adoption of material accounting policies, and (y), where deemed necessary or appropriate, discuss with the national office of the independent auditors issues on which it was consulted by the audit team assigned to the Company and matters of audit quality and consistency.

- The Committee shall review the independent auditors' management letters and other material written communications between the independent auditors and the Company with the independent auditors and with the corporate staff and engage in the appropriate follow-up of a recommendation in any such management letter or other communication. The Committee shall also review with management and the independent auditors any correspondence with regulators or governmental agencies, and any employee complaints or published reports, which raise material issues regarding the Company's financial statements and/or accounting policies.

- The Committee shall determine the appropriate actions that should be taken regarding all irregularities uncovered.

• The Committee shall establish procedures for (a) the receipt, retention and treatment of complaints received by the Company regarding accounting, internal accounting controls, or auditing matters and (b) the confidential, anonymous submission by employees of the Company of concerns regarding questionable accounting or auditing matters.

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• The Committee shall perform such other functions as may be required or deemed appropriate by the Commission or by the national securities exchange or national securities association on which the securities of the Company are publicly traded (currently the NASD for Nasdaq) for an audit committee to perform.

• The Committee shall report to the Board on the activities and findings of the Committee and, when appropriate, make recommendations to the Board based on these findings.

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APPENDIX II (COMPENSATION AND NOMINATING COMMITTEE CHARTER)

Charter for the Compensation and Nominating Committee
Of
PerfectData Corporation

Purpose

The Compensation and Nominating Committee (the "Committee") is appointed by the Board of Directors (the "Board") of PerfectData Corporation (the "Company") to:

- Select or recommend to the Board director nominees for the next annual meeting of shareholders; and
- Determine, or recommend to the Board for determination, the compensation of the Chief Executive Officer.

Committee Membership

The Committee will be composed of three directors who satisfy the definition of "independent" under the listing standards of the American Stock Exchange (AMEX) and the Nasdaq Stock Market, Inc. The Committee members will be appointed by the Board and may be removed by the Board in its discretion. The Committee shall have the authority to delegate any of its responsibilities to subcommittees as the Committee may deem appropriate, provided the subcommittees are composed entirely of independent directors.

Meetings

The Committee shall meet as often as its members deem necessary to perform the Committee's responsibilities.

Committee Authority and Responsibilities

The Committee, to the extent it deems necessary or appropriate, will:

- Identify individuals qualified to become members of the Board.
- Select[1], or recommend to the Board, director nominees to be presented for shareholder approval at the annual meeting.
- Select, or recommend to the Board, director nominees to fill vacancies on the Board as necessary.
- Review the individual goals and objectives, and evaluate the performance of the Chief Executive Officer, and set the Chief Executive Officer's compensation based on this evaluation.

At the Company's expense, the Committee will have the authority, to the extent it deems necessary or appropriate, to retain a firm to be used to identify director candidates and/or to assist in determining the compensation of the Chief Executive Officer. The Committee shall have sole authority to retain and terminate any such firm, including sole authority to approve the firm's fees and other retention terms. The Committee shall also have authority, to the extent it deems necessary or appropriate, to retain other advisors. The Committee will review and reassess the adequacy of this charter annually and recommend any proposed changes to the Board for approval. The Committee will annually evaluate the Committee's own performance.

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[1]Subject to the contractual or other commitments of the Company to provide third parties with the ability to nominate and/ or appoint directors, the selection and nomination of such directors is not subject to approval by the Nominating Committee.

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APPENDIX III

AMENDED AND RESTATED STOCK OPTION PLAN OF 2000
OF
PERFECTDATA CORPORATION

1. Purpose. The purpose of this Amended and Restated Stock Option Plan of 2000 of PerfectData Corporation (the "Plan") is to aid PerfectData Corporation, a Delaware corporation (the "Company"), in attracting, retaining, motivating and rewarding employees, non-employee directors, and other persons who provide substantial services to the Company or its subsidiaries or affiliates, to provide for equitable and competitive compensation opportunities, to recognize individual contributions and reward achievement of Company goals, and promote the creation of long-term value for stockholders by closely aligning the interests of Participants with those of stockholders. The Plan authorizes stock-based and cash-based incentives for Participants. The Plan amends and restates the Stock Option Plan of 2000 of PerfectData Corporation (the "Original Plan") approved by the Board on May 22, 2000 and ratified by the Company's shareholders on October 19, 2000.

2. Definitions. In addition to the terms defined in Section 1 above and elsewhere in the Plan, the following capitalized terms used in the Plan have the respective meanings set forth in this Section:

"Annual Incentive Award" means a type of Performance Award granted to a Participant under Section 7(c) representing a conditional right to receive cash, Stock or other Awards or payments, as determined by the Committee, based on performance in a performance period of one fiscal year or a portion thereof.

"Award" means any Option, SAR, Restricted Stock, Deferred Stock, Stock granted as a bonus or in lieu of another award, Dividend Equivalent, Other Stock-Based Award, Performance Award or Annual Incentive Award, together with any related right or interest, granted to a Participant under the Plan.

"Beneficiary" means the legal representatives of the Participant's estate entitled by will or the laws of descent and distribution to receive the benefits under a Participant's Award upon a Participant's death, provided that, if and to the extent authorized by the Committee, a Participant may be permitted to designate a Beneficiary, in which case the "Beneficiary" instead will be the person, persons, trust or trusts (if any are then surviving) which have been designated by the Participant in his or her most recent written beneficiary designation filed with the Committee to receive the benefits specified under the Participant's Award upon such Participant's death. Unless otherwise determined by the Committee, any designation of a Beneficiary other than a Participant's spouse shall be subject to the written consent of such spouse.

"Board" means the Company's Board of Directors.

"Cause" shall mean "Cause" as such term is defined in the Participant's employment agreement, or if none shall exist, as any of the following: (a) the Participant's conviction of any crime (whether or not involving the Company) constituting a felony in the jurisdiction involved; (b) conduct of the Participant related to the Participant's employment for which either criminal or civil penalties against the Participant or the Company may be sought; (c) material violation of the Company's policies, including, but not limited to those relating to sexual harassment, the disclosure or misuse of confidential information, or those set forth in Company manuals or statements of policy; or (d) serious neglect or misconduct in the performance of the Participant's duties for the Company or willful or repeated failure or refusal to perform such duties.

"Change in Control" and related terms have the meanings specified in Section 9.

"Code" means the Internal Revenue Code of 1986, as amended. References to any provision of the Code or regulation (including a proposed regulation) thereunder shall include any successor provisions and regulations.

"Committee" means the Compensation and Nominating Committee of the Board, the composition and governance of which is established in the Committee's Charter as approved from time to time by the Board and subject to any corporate governance documents of the Company, including the rules and regulations of any exchange or market on which the Company's securities are then listed and/or traded.

No action of the Committee shall be void or deemed to be without authority due to the failure of any member, at the time the action was taken, to meet any qualification standard set forth in the Committee Charter or this Plan. The full Board may perform any function of the Committee hereunder, in which case the term "Committee" shall refer to the Board.

"Covered Employee" means an Eligible Person who is a Covered Employee as specified in Section 12(j).

"Deferred Stock" means a right, granted to a Participant under Section 6(e), to receive Stock or other Awards or a combination thereof at the end of a specified deferral period. Deferred Stock may be denominated as "stock units," "restricted stock units," "phantom shares," "performance shares," or other appellations.

"Disability" shall mean a disability described in Section 422(c) (6) of the Code. The existence of a Disability shall be determined by the Committee in its absolute discretion.

"Dividend Equivalent" means a right, granted to a Participant under Section 6(g), to receive cash, Stock, other Awards or other property equal in value to all or a specified portion of the dividends paid with respect to a specified number of shares of Stock.

"Effective Date" means the effective date specified in Section 12(p).

"Eligible Person" has the meaning specified in Section 5.

"Employee Stock Purchase Plan" has the meaning specified in Section 11.

"Exchange Act" means the Securities Exchange Act of 1934, as amended. References to any provision of the Exchange Act or rule (including a proposed rule) thereunder shall include any successor provisions and rules.

"Fair Market Value" means, with respect to a share of Stock on an applicable date:

i. If the principal market for the Stock (the "Market") is a national securities exchange or the National Association of Securities Dealers Automated Quotation System ("NASDAQ") National Market or SmallCap Market, the last sale price or, if no reported sales take place on the applicable date, the average of the high bid and low asked price of Stock as reported for such Market on such date or, if no such quotation is made on such date, on the next preceding day on which there were quotations, provided that such quotations shall have been made within the ten (10) business days preceding the applicable date;
ii. If the Market is the NASDAQ National List, the NASDAQ Supplemental List or another market, the average of the high bid and low asked price for Stock on the applicable date, or, if no such quotations shall have been made on such date, on the next preceding day on which there were quotations, provided that such quotations shall have been made within the ten (10) business days preceding the applicable date; or,
iii. In the event that neither paragraph i. nor ii. shall apply, the Fair Market Value of a share of Stock on any day shall be determined in good faith by the Committee in a manner consistently applied.

"Incentive Stock Option" or "ISO" means any Option designated as an incentive stock option within the meaning of Code Section 422 or any successor provision thereto and qualifying thereunder.

"Option" means a right, granted to a Participant under Section 6(b) or 11, to purchase Stock or other Awards at a specified price during specified time periods.

"Other Stock-Based Awards" means Awards granted to a Participant under Section 6(h).

"Participant" means a person who has been granted an Award under the Plan that remains outstanding, including a person who is no longer an Eligible Person.

"Performance Award" means a conditional right, granted to a Participant under Sections 6(i) and 7, to receive cash, Stock or other Awards or payments, as determined by the Committee, based upon performance criteria specified by the Committee.

"Qualified Member" means a member of the Committee who is a "Non-Employee Director" within the meaning of Rule 16b-3 (b) (3) and an "outside director" within the meaning of Regulation 1.162-27 under Code Section 162(m).

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"Restricted Stock" means Stock granted to a Participant under Section 6(d) which is subject to certain restrictions and to a risk of forfeiture.

"Retirement" means termination of employment from the Company by a Participant whose age and years of service together equal 65.

"Rule 16b-3" means Rule 16b-3, as from time to time in effect and applicable to Participants, promulgated by the Securities and Exchange Commission under Section 16 of the Exchange Act.

"Stock" means the Company's Common Stock, and any other equity securities of the Company that may be substituted or resubstituted for Stock pursuant to Section 12 (c) .

"Stock Appreciation Rights" or "SAR" means a right granted to a Participant under Section 6(c).

3. Administration.

(a) Authority of the Committee. The Plan shall be administered by the Committee, which shall have full and final authority, in each case subject to and consistent with the provisions of the Plan, to select Eligible Persons to become Participants; to grant Awards; to determine the type and number of Awards, the dates on which Awards may be exercised and on which the risk of forfeiture or deferral period relating to Awards shall lapse or terminate, the acceleration of any such dates, the expiration date of any Award, whether, to what extent, and under what circumstances an Award may be settled, or the exercise price of an Award may be paid, in cash, Stock, other Awards, or other property, and other terms and conditions of, and all other matters relating to, Awards; to prescribe documents evidencing or setting terms of Awards (such Award documents need not be identical for each Participant), amendments thereto, and rules and regulations for the administration of the Plan and amendments thereto; to construe and interpret the Plan and Award documents and correct defects, supply omissions or reconcile inconsistencies therein; and to make all other decisions and determinations as the Committee may deem necessary or advisable for the administration of the Plan. Decisions of the Committee with respect to the administration and interpretation of the Plan shall be final, conclusive, and binding upon all persons interested in the Plan, including Participants, Beneficiaries, transferees under Section 12(b) and other persons claiming rights from or through a Participant, and stockholders. The foregoing notwithstanding, the Board shall perform the functions of the Committee for purposes of granting Awards under the Plan to non-employee directors (authority with respect to other aspects of non-employee director awards is not exclusive to the Board, however).

(b) Manner of Exercise of Committee Authority. At anytime that a member of the Committee is not a Qualified Member, any action of the Committee relating to an Award intended by the Committee to qualify as "performance-based compensation" within the meaning of Code Section 162(m) and regulations thereunder or intended to be covered by an exemption under Rule 16b-3 under the Exchange Act may be taken by a subcommittee, designated by the Committee or the Board, composed solely of two or more Qualified Members or may be taken by the Committee but with each such member who is not a Qualified Member abstaining or recusing himself or herself from such action, provided that, upon such abstention or recusal, the Committee remains composed of two or more Qualified Members. Such action, authorized by such a subcommittee or by the Committee upon the abstention or recusal of such non-Qualified Member(s), shall be the action of the Committee for purposes of the Plan. The express grant of any specific power to the Committee, and the taking of any action by the Committee, shall not be construed as limiting any power or authority of the Committee. To the fullest extent authorized under Section 157(c) and other applicable provisions of the Delaware General Corporation Law, the Committee may delegate to officers or managers of the Company or any subsidiary or affiliate, or committees thereof, the authority, subject to such terms as the Committee shall determine, to perform such functions, including administrative functions, as the Committee may determine, to the extent that such delegation will not cause Awards intended to qualify as "performance-based compensation" under Code Section 162(m) to fail to so qualify.

(c) Limitation of Liability. The Committee and each member thereof, and any person acting pursuant to authority delegated by the Committee, shall be entitled, in good faith, to rely or act upon any report or other information furnished by any executive officer, other officer or employee of the Company or a subsidiary or affiliate, the Company's independent auditors, consultants or any other agents assisting

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in the administration of the Plan. Members of the Committee, any person acting pursuant to authority delegated by the Committee, and any officer or employee of the Company or a subsidiary or affiliate acting at the direction or on behalf of the Committee or a delegee shall not be personally liable for any action or determination taken or made in good faith with respect to the Plan, and shall, to the extent permitted by law, be fully indemnified and protected by the Company with respect to any such action or determination.

4. Stock Subject to Plan.

(a) Overall Number of Shares Available for Delivery. Subject to adjustment as provided in Section 12(c), the shares of Stock reserved and available for delivery in connection with Awards under the Plan shall be (i) 5,000,000 shares and (ii) the number of shares which become available in accordance with Section 4(b) after the Effective Date. In order that applicable regulations under the Code relating to ISOs shall be satisfied, the maximum number of shares of Stock that may be delivered upon exercise of ISOs shall be the number specified in clause (i) of the first sentence of this Section 4(a), and, if necessary to satisfy such regulations, that same maximum limit shall apply to the number of shares of Stock that may be delivered in connection with each other type of Award under the Plan (applicable separately to each type of Award). Any shares of Stock delivered under the Plan shall consist of authorized and unissued shares or treasury shares.

(b) Share Counting Rules. The Committee may adopt reasonable counting procedures to ensure appropriate counting, avoid double counting (as, for example, in the case of tandem or substitute awards) and make adjustments if the number of shares of Stock actually delivered differs from the number of shares previously counted in connection with an Award. Shares that are potentially deliverable under an Award under the Plan that are canceled, expired, forfeited, settled in cash or otherwise terminated without a delivery of such shares to the Participant will not be counted as delivered under the Plan. Shares that have been issued in connection with an Award (e.g., Restricted Stock) that is canceled, forfeited, or settled in cash such that those shares are returned to the Company will again be available for Awards. Shares withheld in payment of the exercise price or taxes relating to an Award and shares equal to the number surrendered in payment of any exercise price or taxes relating to an Award shall be deemed to constitute shares not delivered to the Participant and shall be deemed to be available for Awards under the Plan. The foregoing notwithstanding, if issued shares are returned to the Company, including upon a cash out of Restricted Stock, surrender of shares in payment of an exercise price or taxes relating to an Award, or withholding of shares in payment of taxes upon vesting of Restricted Stock, such shares shall not become available again under the Plan if the transaction resulting in the return of shares occurs more than ten years after the date of the most recent shareholder approval of the Plan, and otherwise shares shall not become available under this Section 4(b) in an event that would constitute a "material revision" of the Plan subject to shareholder approval under then applicable rules of the

NASDAQ. In addition, in the case of any Award granted in substitution for an award of a company or business acquired by the Company or a subsidiary or affiliate, shares issued or issuable in connection with such substitute Award shall not be counted against the number of shares reserved under the Plan, but shall be available under the Plan by virtue of the Company's assumption of the plan or arrangement of the acquired company or business. This Section 4(b) shall apply to the share limit imposed to conform to the Treasury regulations governing ISOs only to the extent consistent with applicable regulations relating to ISOs under the Code. Because shares will count against the number reserved in Section 4(a) upon delivery, and subject to the share counting rules under this Section 4(b), the Committee may determine that Awards may be outstanding that relate to a greater number of shares than the aggregate remaining available under the Plan, so long as Awards will not result in delivery and vesting of shares in excess of the number then available under the Plan.

5. Eligibility and Certain Award Limitations.

(a) Eligibility. Awards may be granted under the Plan only to Eligible Persons. For purposes of the Plan, an "Eligible Person" means an employee of the Company or any subsidiary or affiliate, including any executive officer, a non-employee director of the Company, a consultant or other person who provides substantial services to the Company or a subsidiary or affiliate, and any person who has been offered employment by the Company or a subsidiary or affiliate, provided that such prospective employee may

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not receive any payment or exercise any right relating to an Award until such person has commenced employment with the Company or a subsidiary or affiliate. An employee on leave of absence may be considered as still in the employ of the Company or a subsidiary or affiliate for purposes of eligibility for participation in the Plan. For purposes of the Plan, a joint venture in which the Company or a subsidiary has a substantial direct or indirect equity investment shall be deemed an affiliate, if so determined by the Committee.

(b) Per-Person Award Limitations. In each calendar year during any part of which the Plan is in effect, an Eligible Person may be granted Awards intended to qualify as "performance-based compensation" under Code Section 162(m) under each of Section 6(b), 6(c), 6(d), 6(e), 6(f), 6(g) or 6(h) relating to up to his or her Annual Limit (such Annual Limit to apply separately to the type of Award authorized under each specified subsection, except that the limitation applies to Dividend Equivalents under Section 6(g) only if such Dividend Equivalents are granted separately from and not as a feature of another Award). Subject to Section 4(a), a Participant's Annual Limit, in any year during any part of which the Participant is then eligible under the Plan, shall equal 500,000 shares plus the amount of the Participant's unused Annual Limit relating to the same type of Award as of the close of the previous year, subject to adjustment as provided in Section 12(c). In the case of an Award which is not valued in a way in which the limitation set forth in the preceding sentence would operate as an effective limitation satisfying Treasury Regulation 1.162-27(e)(4) (including a Performance Award under Section 7 not related to an Award specified in Section 6), an Eligible Person may not be granted Awards authorizing the earning during any calendar year of an amount that exceeds the Participant's Annual Limit, which for this purpose shall equal $500,000 plus the amount of the Participant's unused cash Annual Limit as of the close of the previous year (this limitation is separate and not affected by the number of Awards granted during such calendar year subject to the limitation in the preceding sentence). For this purpose, (i) "earning" means satisfying performance conditions so that an amount becomes payable, without regard to whether it is to be paid currently or on a deferred basis or continues to be subject to any service requirement or other non-performance condition, and (ii) a Participant's Annual Limit is used to the extent an amount or number of shares may be potentially earned or paid under an Award, regardless of whether such amount or shares are in fact earned or paid.

6. Specific Terms of Awards.

(a) General. Awards may be granted on the terms and conditions set forth in this Section 6. In addition, the Committee may impose on any Award or the exercise thereof, at the date of grant or thereafter (subject to Section 12(e)), such additional terms and conditions, not inconsistent with the provisions of the Plan, as the Committee shall determine, including terms requiring forfeiture of Awards in the event of termination of employment or service by the Participant and terms permitting a Participant to make elections relating to his or her Award. The Committee shall retain full power and discretion with respect to any term or condition of an Award that is not mandatory under the Plan. The Committee shall require the payment of lawful consideration for an Award to the extent necessary to satisfy the requirements of the Delaware General Corporation Law, and may otherwise require payment of consideration for an Award except as limited by the Plan.

(b) Options. The Committee is authorized to grant Options to Participants on the following terms and conditions:

(i) Exercise Price. The exercise price per share of Stock purchasable under an Option (including both ISOs and non-qualified Options) shall be determined by the Committee, provided that such exercise price shall be not less than the Fair Market Value of a share of Stock on the date of grant of such Option, subject to Section 8(a).

(ii) Option Term; Time and Method of Exercise. The Committee shall determine the term of each Option, provided that in no event shall the term of any ISO or SAR in tandem therewith exceed a period of ten years from the date of grant. The Committee shall determine the time or times at which or the circumstances under which an Option may be exercised in whole or in part (including based on achievement of performance goals and/or future service requirements), the methods by which such exercise price may be paid or deemed to be paid and the form of such payment (subject to Section 12(k)), including, without limitation, cash, Stock (including through withholding of Stock

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deliverable upon exercise, if such withholding will not result in additional accounting expense to the Company), other Awards or awards granted under other plans of the Company or any subsidiary or affiliate, or other property (including through "cashless exercise" arrangements, to the extent permitted by applicable law), and the methods by or forms in which Stock will be delivered or deemed to be delivered in satisfaction of Options to Participants (including deferred delivery of shares representing the Option "profit," at the election of the Participant or as mandated by the Committee, with such deferred shares subject to any vesting, forfeiture or other terms as the Committee may specify).

(iii) ISOs. The terms of any ISO granted under the Plan shall comply in all respects with the provisions of Code Section 422, including but not limited to the requirement that no ISO shall be granted more than ten years after the adoption of the Original Plan.

(c) Stock Appreciation Rights. The Committee is authorized to grant SARs to Participants on the following terms and conditions:

(i) Right to Payment. A SAR shall confer on the Participant to whom it is granted a right to receive, upon exercise thereof, the excess of (A) the Fair Market Value of one share of Stock on the date of exercise (or, in the case of a "Limited SAR," the Fair Market Value determined by reference to the Change in Control Price, as defined under Section 9(c) hereof) over (B) the grant price of the SAR as determined by the Committee, which grant price shall be not less than the Fair Market Value of a share of Stock on the date of grant of such SAR.

(ii) Other Terms. The Committee shall determine at the date of grant or thereafter, the time or times at which and the circumstances under which a SAR may be exercised in whole or in part (including based on achievement of performance goals and/or future service requirements), the method of exercise, method of settlement, form of consideration payable in settlement, method by or forms in which Stock will be delivered or deemed to be delivered to Participants, whether or not a SAR shall be free-standing or in tandem or combination with any other Award, and the maximum term of an SAR, which in no event shall exceed a period of ten years from the date of grant. Limited SARs that may only be exercised in connection with a Change in Control or other event as specified by the Committee may be granted on such terms, not inconsistent with this Section 6(c), as the Committee may determine. The Committee may require that an outstanding Option be exchanged for an SAR exercisable for Stock having vesting, expiration, and other terms substantially the same as the Option, so long as such exchange will not result in additional accounting expense to the Company.

(d) Restricted Stock. The Committee is authorized to grant Restricted Stock to Participants on the following terms and conditions:

(i) Grant and Restrictions. Restricted Stock shall be subject to such restrictions on transferability, risk of forfeiture and other restrictions, if any, as the Committee may impose, which restrictions may lapse separately or in combination at such times, under such circumstances (including based on achievement of performance goals and/or future service requirements), in such installments or otherwise and under such other circumstances as the Committee may determine at the date of grant or thereafter. Except to the extent restricted under the terms of the Plan and any Award document relating to the Restricted Stock, a Participant granted Restricted Stock shall have all of the rights of a stockholder, including the right to vote the Restricted Stock and the right to receive dividends thereon (subject to any mandatory reinvestment or other requirement imposed by the Committee).

(ii) Forfeiture. Except as otherwise determined by the Committee, upon termination of employment or service during the applicable restriction period, Restricted Stock that is at that time subject to restrictions shall be forfeited and reacquired by the Company; provided that the Committee may provide, by rule or regulation or in any Award document, or may determine in any individual case, that restrictions or forfeiture conditions relating to Restricted Stock will lapse in whole or in part, including in the event of terminations resulting from specified causes.

(iii) Certificates for Stock. Restricted Stock granted under the Plan may be evidenced in such manner as the Committee shall determine. If certificates representing Restricted Stock are registered

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in the name of the participant, the Committee may require that such certificates bear an appropriate legend referring to the terms, conditions and restrictions applicable to such Restricted Stock, that the Company retain physical possession of the certificates, and that the participant deliver a stock power to the Company, endorsed in blank, relating to the Restricted Stock.

(iv) Dividends and Splits. As a condition to the grant of an Award of Restricted Stock, the Committee may require that any dividends paid on a share of Restricted Stock shall be either (A) paid with respect to such Restricted Stock at the dividend payment date in cash, in kind, or in a number of shares of unrestricted Stock having a Fair Market Value equal to the amount of such dividends, or (B) automatically reinvested in additional Restricted Stock or held in kind, which shall be subject to the same terms as applied to the original Restricted Stock to which it relates, or (C) deferred as to payment, either as a cash deferral or with the amount or value thereof automatically deemed reinvested in shares of Deferred Stock, other Awards or other investment vehicles, subject to such terms as the Committee shall determine or permit a Participant to elect. Unless otherwise determined by the Committee, Stock distributed in connection with a Stock split or Stock dividend, and other property distributed as a dividend, shall be subject to restrictions and a risk of forfeiture to the same extent as the Restricted Stock with respect to which such Stock or other property has been distributed.

(e) Deferred Stock. The Committee is authorized to grant Deferred Stock to Participants, which are rights to receive Stock, other Awards, or a combination thereof at the end of a specified deferral period, subject to the following terms and conditions:

(i) Award and Restrictions. Issuance of Stock will occur upon expiration of the deferral period specified for an Award of Deferred Stock by the Committee (or, if permitted by the Committee, as elected by the Participant). In addition, Deferred Stock shall be subject to such restrictions on transferability, risk of forfeiture and other restrictions, if any, as the Committee may impose, which restrictions may lapse at the expiration of the deferral period or at earlier specified times (including based on achievement of performance goals and/or future service requirements), separately or in combination, in installments or otherwise, and under such other circumstances as the Committee may determine at the date of grant or thereafter. Deferred Stock may be satisfied by delivery of Stock, other Awards, or a combination thereof (subject to Section 12(k)), as determined by the Committee at the date of grant or thereafter.

(ii) Forfeiture. Except as otherwise determined by the Committee, upon termination of employment or service during the applicable deferral period or portion thereof to which forfeiture conditions apply (as provided in the Award document evidencing the Deferred Stock), all Deferred Stock that is at that time subject to such forfeiture conditions shall be forfeited; provided that the Committee may provide, by rule or regulation or in any Award document, or may determine in any individual case, that restrictions or forfeiture conditions relating to Deferred Stock will lapse in whole or in part, including in the event of terminations resulting from specified causes.

(iii) Dividend Equivalents. Unless otherwise determined by the Committee, Dividend Equivalents on the specified number of shares of Stock covered by an Award of Deferred Stock shall be either (A) paid with respect to such Deferred Stock at the dividend payment date in cash or in shares of unrestricted Stock having a Fair Market Value equal to the amount of such dividends, or (B) deferred with respect to such Deferred Stock, either as a cash deferral or with the amount or value thereof automatically deemed reinvested in additional Deferred Stock, other Awards or other investment vehicles having a Fair Market Value equal to the amount of such dividends, as the Committee shall determine or permit a participant to elect.

(f) Bonus Stock and Awards in Lieu of Obligations. The Committee is authorized to grant Stock as a bonus, or to grant Stock or other Awards in lieu of obligations of the Company or a subsidiary or affiliate to pay cash or deliver other property under the Plan or under other plans or compensatory arrangements, subject to such terms as shall be determined by the Committee.

(g) Dividend Equivalents. The Committee is authorized to grant Dividend Equivalents to a Participant, entitling the Participant to receive cash, Stock, other Awards, or other property equivalent to

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all or a portion of the dividends paid with respect to a specified number of shares of Stock. Dividend Equivalents may be awarded on a free-standing basis or in connection with another Award. The Committee may provide that Dividend Equivalents shall be paid or distributed when accrued or shall be deemed to have been reinvested in additional Stock, Awards, or other investment vehicles, and subject to restrictions on transferability, risks of forfeiture and such other terms as the Committee may specify.

(h) Other Stock-Based Awards. The Committee is authorized, subject to limitations under applicable law, to grant to Participants such other Awards that may be denominated or payable in, valued in whole or in part by reference to, or otherwise based on, or related to, Stock or factors that may influence the value of Stock, including, without limitation, convertible or exchangeable debt securities, other rights convertible or exchangeable into Stock, purchase rights for Stock, Awards with value and payment contingent upon performance of the Company or business units thereof or any other factors designated by the Committee, and Awards valued by reference to the book value of Stock or the value of securities of or the performance of specified subsidiaries or affiliates or other business units. The Committee shall determine the terms and conditions of such Awards. Stock delivered pursuant to an Award in the nature of a purchase right granted under this Section 6(h) shall be purchased for such consideration, paid for at such times, by such methods, and in such forms, including, without limitation, cash, Stock, other Awards, notes, or other property, as the committee shall determine. Cash awards, as an element of or supplement to any other Award under the Plan, may also be granted pursuant to this Section 6(h).

(i) Performance Awards. Performance Awards, denominated in cash or in Stock or other Awards, may be granted by the Committee in accordance with Section 7.

7. Performance Awards, Including Annual Incentive Awards.

(a) Performance Awards Generally. The Committee is authorized to grant Performance Awards on the terms and conditions specified in this Section 7. Performance Awards may be denominated as a cash amount, number of shares of Stock, or specified number of other Awards (or a combination) which may be earned upon achievement or satisfaction of performance conditions specified by the Committee. In addition, the Committee may specify that any other Award shall constitute a Performance Award by conditioning the right of a Participant to exercise the Award or have it settled, and the timing thereof, upon achievement or satisfaction of such performance conditions as may be specified by the Committee. The Committee may use such business criteria and other measures of performance as it may deem appropriate in establishing any performance conditions, and may exercise its discretion to reduce or increase the amounts payable under any Award subject to performance conditions, except as limited under Sections 7(b) and 7(c) in the case of a Performance Award intended to qualify as "performance-based compensation" under Code Section 162(m).

(b) Performance Awards Granted to Covered Employees. If the Committee determines that a Performance Award to be granted to an Eligible Person who is designated by the Committee as likely to be a Covered Employee should qualify as "performance-based compensation" for purposes of Code Section 162(m), the grant, exercise and/or settlement of such Performance Award shall be contingent upon achievement of a preestablished performance goal and other terms set forth in this Section 7(b).

(i) Performance Goal Generally. The performance goal for such Performance Awards shall consist of one or more business criteria and a targeted level or levels of performance with respect to each of such criteria, as specified by the Committee consistent with this Section 7(b). The performance goal shall be objective and shall otherwise meet the requirements of Code Section 162(m) and regulations thereunder (including Regulation 1.162-27 and successor regulations thereto), including the requirement that the level or levels of performance targeted by the Committee result in the achievement of performance goals being "substantially uncertain." The Committee may determine that such Performance Awards shall be granted, exercised and/or settled upon achievement of anyone performance goal or that two or more of the performance goals must be achieved as a condition to grant, exercise and/or settlement of such Performance Awards. Performance goals may differ for Performance Awards granted to anyone Participant or to different Participants.

(ii) Business Criteria. One or more of the following business criteria for the Company, on a consolidated basis, and/or for specified subsidiaries or affiliates or other business units of the

Company, shall he used by the Committee in establishing performance goals for such Performance Awards: (1) revenues; (2) earnings from operations, earnings before or after taxes, earnings before or after interest, depreciation, amortization, incentives, service fees or extraordinary or special items; (3) net income or net income per common share (basic or diluted); (4) return on assets, return on investment, return on capital, or return on equity; (5) cash flow, free cash flow, cash flow return on investment, or net cash provided by operations; (6) economic value created or added; (7) operating margin or profit margin; (8) stock price or total stockholder return; and (9) strategic business criteria, consisting of one or more objectives based on meeting specified market penetration or value added, geographic business expansion goals, cost targets, customer satisfaction, employee satisfaction, management of employment practices and employee benefits, supervision of litigation and information technology, and goals relating to acquisitions or divestitures of subsidiaries, affiliates or joint ventures. The targeted level or levels of performance with respect to such business criteria may be established at such levels and in such terms as the Committee may determine, in its discretion, including in absolute terms, as a goal relative to performance in prior periods, or as a goal compared to the performance of one or more comparable companies or an index covering multiple companies.

(iii) Performance Period; Timing for Establishing Performance Goals. Achievement of performance goals in respect of such Performance Awards shall be measured over a performance period of up to one year or more than one year, as specified by the Committee. A performance goal shall be established not later than the earlier of (A) 90 days after the beginning of any performance period applicable to such Performance Award or (B) the time 25% of such performance period has elapsed.

(iv) Performance Award Pool. The Committee may establish a Performance Award pool, which shall be an unfunded pool, for purposes of measuring performance of the Company in connection with Performance Awards. The amount of such Performance Award pool shall be based upon the achievement of a performance goal or goals based on one or more of the business criteria set forth in Section 7(b) (ii) during the given performance period, as specified by the Committee in accordance with Section 7(b) (iv). The Committee may specify the amount of the Performance Award pool as a percentage of any of such business criteria, a percentage thereof in excess of a threshold amount, or as another amount which need not bear a strictly mathematical relationship to such business criteria.

(v) Settlement of Performance Awards; Other Terms. Settlement of such Performance Awards shall be in cash, Stock, other Awards or other property, in the discretion of the Committee. The Committee may, in its discretion, increase or reduce the amount of a settlement otherwise to be made in connection with such Performance Awards, but may not exercise discretion to increase any such amount payable to a Covered Employee in respect of a Performance Award subject to this Section 7(b). Any settlement which changes the form of payment from that originally specified shall be implemented in a manner such that the Performance Award and other related Awards do not, solely for that reason, fail to qualify as "performance-based compensation" for purposes of Code Section 162(m). The Committee shall specify the circumstances in which such Performance Awards shall be paid or forfeited in the event of termination of employment by the Participant or other event (including a Change in Control) prior to the end of a performance period or settlement of such Performance Awards.

(c) Annual Incentive Awards Granted to Designated Covered Employees. The Committee may grant an Annual Incentive Award to an Eligible Person who is designated by the Committee as likely to be a Covered Employee. Such Annual Incentive Award will be intended to qualify as "performance-based compensation" for purposes of Code Section 162(m), and therefore its grant, exercise and/or settlement shall be contingent upon achievement of preestablished performance goals and other terms set forth in this Section 7(c).

(i) Grant of Annual Incentive Awards. Not later than the earlier of 90 days after the beginning of any performance period applicable to such Annual Incentive Award or the time 25% of such performance period has elapsed, the Committee shall determine the Covered Employees who will potentially receive Annual Incentive Awards, and the amount(s) potentially payable thereunder,

for that performance period. The amount(s) potentially payable shall be based upon the achievement of a performance goal or goals based on one or more of the business criteria set forth in Section 7(b) (ii) in the given performance period, as specified by the Committee. The Committee may designate an annual incentive award pool as the means by which Annual Incentive Awards will be measured, which pool shall conform to the provisions of Section 7(b) (iv). In such case, the portion of the Annual Incentive Award pool potentially payable to each Covered Employee shall be preestablished by the Committee. In all cases, the maximum Annual Incentive Award of any Participant shall be subject to the limitation set forth in Section 5.

(ii) Payout of Annual Incentive Awards. After the end of each performance period, the Committee shall determine the amount, if any, of the Annual Incentive Award for that performance period payable to each Participant. The Committee may, in its discretion, determine that the amount payable to any Participant as a final Annual Incentive Award shall be reduced from the amount of his or her potential Annual Incentive Award, including a determination to make no final Award whatsoever, but may not exercise discretion to increase any such amount. The Committee shall specify the circumstances in which an Annual Incentive Award shall be paid or forfeited in the event of termination of employment by the Participant or other event (including a Change in Control) prior to the end of a performance period or settlement of such Annual Incentive Award.

(d) Written Determinations. Determinations by the Committee as to the establishment of performance goals, the amount potentially payable in respect of Performance Awards and Annual Incentive Awards, the level of actual achievement of the specified performance goals relating to Performance Awards and Annual Incentive Awards, and the amount of any final Performance Award and Annual Incentive Award shall be recorded in writing in the case of Performance Awards intended to qualify under Section 162(m). Specifically, the Committee shall certify in writing, in a manner conforming to applicable regulations under Section 162(m), prior to settlement of each such Award granted to a Covered Employee, that the performance objective relating to the Performance Award and other material terms of the Award upon which settlement of the Award was conditioned have been satisfied.

8. Certain provisions Applicable to Awards.

(a) Stand-Alone, Additional, Tandem, and Substitute Awards. Awards granted under the Plan may, in the discretion of the Committee, be granted either alone or in addition to, in tandem with, or in substitution or exchange for, any other Award or any award granted under another plan of the Company, any subsidiary or affiliate, or any business entity to be acquired by the Company or a subsidiary or affiliate, or any other right of a Participant to receive payment from the Company or any subsidiary or affiliate. Awards granted in addition to or in tandem with other Awards or awards may be granted either as of the same time as or a different time from the grant of such other Awards or awards. Subject to Section 12(k), the Committee may determine that, in granting a new Award, the in-the-money value or fair value of any surrendered Award or award may be applied to reduce the exercise price of any Option, grant price of any SAR, or purchase price of any other Award.

(b) Term of Awards. The term of each Award shall be for such period as may be determined by the Committee, subject to the express limitations set forth in Section 6 (b) (ii).

(c) Form and Timing of Payment under Awards; Deferrals. Subject to the terms of the Plan (including Section 12(k)) and any applicable Award document, payments to be made by the Company or a subsidiary or affiliate upon the exercise of an Option or other Award or settlement of an Award may be made in such forms as the Committee shall determine, including, without limitation, cash, Stock, other Awards or other property, and may be made in a single payment or transfer, in installments, or on a deferred basis. The settlement of any Award may be accelerated, and cash paid in lieu of Stock in connection with such settlement, in the discretion of the Committee or upon occurrence of one or more specified events (subject to Section 12(k)). Installment or deferred payments may be required by the Committee (subject to Section 12(e)) or permitted at the election of the Participant on terms and conditions established by the Committee. Payments may include, without limitation, provisions for the payment or crediting of reasonable interest on installment or deferred payments or the grant or crediting of Dividend Equivalents or other amounts in respect of installment or deferred payments denominated in Stock.

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(d) Exemptions from Section 16(b) Liability. With respect to a Participant who is then subject to the reporting requirements of Section 16(a) of the Exchange Act in respect of the Company, the Committee shall implement transactions under the Plan and administer the Plan in a manner that will ensure that each transaction with respect to such a Participant is exempt from liability under Rule 16b-3 or otherwise not subject to liability under Section 16(b)), except that this provision shall not limit sales by such a Participant, and such a Participant may engage in other non-exempt transactions under the Plan. The Committee may authorize the Company to repurchase any Award or shares of Stock deliverable or delivered in connection with any Award (subject to Section 12(k)) in order to avoid a Participant who is subject to Section 16 of the Exchange Act incurring liability under Section 16(b). Unless otherwise specified by the Participant, equity securities or derivative securities acquired under the Plan which are disposed of by a Participant shall be deemed to be disposed of in the order acquired by the Participant.

9. Change in Control.

(a) Effect of "Change in Control" on Non-Performance Based Awards. In the event of a "Change in Control," the following provisions shall apply to non-performance based Awards, including Awards as to which performance conditions previously have been satisfied or are deemed satisfied under Section 9(b), unless otherwise provided by the Committee in the Award document:

(i) All deferral of settlement, forfeiture conditions and other restrictions applicable to Awards granted under the Plan shall lapse and such Awards shall be fully payable as of the time of the Change in Control without regard to deferral and vesting conditions, except to the extent of any waiver by the Participant or other express election to defer beyond the Change in Control and subject to applicable restrictions set forth in Section 12(a);

(ii) Any Award carrying a right to exercise that was not previously exercisable and vested shall become fully exercisable and vested as of the time of the Change in Control and shall remain exercisable and vested for the balance of the stated term of such Award without regard to any termination of employment or service by the Participant other than a termination for "cause" (as defined in any employment or severance agreement between the Company or it subsidiary or affiliate and the Participant then in effect or, if none, as defined by the Committee and in effect at the time of the Change in Control), subject only to applicable restrictions set forth in Section 12(a); and

(iii) The Committee may, in its discretion, determine to extend to any Participant who holds an Option the right to elect, during the 50-day period immediately following the Change in Control, in lieu of acquiring the shares of Stock covered by such Option, to receive in cash the excess of the Change in Control Price over the exercise price of such

Option, multiplied by the number of shares of Stock covered by such Option, and to extend to any Participant who holds other types of Awards denominated in shares the right to elect, during the 50-day period immediately following the Change in Control, in lieu of receiving the shares of Stock covered by such Award, to receive in cash the Change in Control Price multiplied by the number of shares of Stock covered by such Award. In addition, the Committee may provide that Options and SARs shall be subject to a mandatory cash-out in lieu of accelerated vesting, in order to limit the extent of "parachute payments" under Sections 280G and 4999 of the Code.

(b) Effect of "Change in Control" on Performance-Based Awards. In the event of a "Change in Control," with respect to an outstanding Award subject to achievement of performance goals and conditions, such performance goals and conditions shall be deemed to be met or exceeded if and to the extent so provided by the Committee in the Award document governing such Award or other agreement with the Participant.

(c) Definition of "Change in Control." A "Change in Control" shall be deemed to have occurred if, after the Effective Date, there shall have occurred any of the following (whether as a result of a series of transactions or an isolated event): (1) the consummation of any merger by the Company into another corporation or corporations which results in the stockholders of the Company immediately prior to such transaction owning less than 50% of the surviving Corporation; (2) the consummation of any acquisition (by purchase, lease or otherwise) of all or substantially all of the assets of the Company by any person, corporation or other entity or group thereof acting jointly; (3) the acquisition of beneficial ownership,

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directly or indirectly, of voting securities of the Company (defined as Stock of the Company or any securities having voting rights that the Company may issue in the future) and rights to acquire voting securities of the Company (defined as including, without limitation, securities that are convertible into voting securities of the Company (as defined above) and rights, options warrants and other agreements or arrangements to acquire such voting securities) by any person, corporation or other entity or group thereof acting jointly, in such amount or amounts as would permit such person, corporation or other entity or group thereof acting jointly to elect a majority of the members of the Board of the Company, as then constituted; or (4) the acquisition of beneficial ownership, directly or indirectly, of voting securities and rights to acquire voting securities having voting power equal to 25% or more of the combined voting power of the Company's then outstanding voting securities by any person, corporation or other entity or group thereof acting jointly unless such acquisition as is described in this part (4) is expressly approved by resolution of the Board of the Company passed upon affirmative vote of not less than a majority of the Board and adopted at a meeting of the Board held not later than the date of the next regularly scheduled or special meeting held following the date the Company obtains actual knowledge of such acquisition (which approval may be limited in purpose and effect solely to affecting the rights of a Participant under this Plan). Notwithstanding the preceding sentence, (i) any transaction that involves a mere change in identity form or place of organization within the meaning of Section 368 (a) (1) (F) of the Code, or a transaction of similar effect, shall not constitute a Change in Control.

(d) Definition of "Change in Control Price." The "Change in Control Price" means an amount in cash equal to the higher of (i) the amount of cash and fair market value of property that is the highest price per share paid (including extraordinary dividends) in any transaction triggering the Change in Control or any liquidation of shares following a sale of substantially all assets of the Company, or (ii) the highest Fair Market Value per share at any time during the 60-day period preceding and 60-day period following the Change in Control.

10. Additional Award Forfeiture Provisions.

(a) Forfeiture of Options and Other Awards and Gains Realized Upon Prior Option Exercises or Award Settlements. Unless otherwise determined by the Committee, each Award granted hereunder shall be subject to the following additional forfeiture conditions, to which the Participant, by accepting an Award hereunder, agrees. If any of the events specified in Section 10(b)(i), (ii), or (iii) occurs (a "Forfeiture Event"), all of the following forfeitures will result, such forfeitures to be effective at the later of the occurrence of the Forfeiture Event or the Participant's termination of employment:

(i) The unexercised portion of the Option, whether or not vested, and any other Award not then settled (except for an Award that has not been settled solely due to an elective deferral by the Participant and otherwise is not forfeitable in the event of any termination of service of the Participant) will be immediately forfeited and canceled upon the occurrence of the Forfeiture Event; and

(ii) The Participant will be obligated to repay to the Company, in cash, within five business days after demand is made therefore by the Company, the total amount of Award Gain (as defined herein) realized by the Participant upon each exercise of an Option or settlement of an Award (regardless of any elective deferral) that occurred on or after (A) the date that is six months prior to the occurrence of the Forfeiture Event, if the Forfeiture Event occurred while the Participant was employed by the Company or a subsidiary or affiliate, or (B) the date that is six months prior to the date the participant's employment by the Company or a subsidiary or affiliate terminated, if the Forfeiture Event occurred after the Participant ceased to be so employed. For purposes of this Section, the term "Award Gain" shall mean (i) in respect of a given Option exercise, the product of (X) the Fair Market Value per share of Stock at the date of such exercise (without regard to any subsequent change in the market price of shares) minus the exercise price times (Y) the number of shares as to which the Option was exercised at that date, and (ii) in respect of any other settlement of an Award granted to the participant, the Fair Market Value of the cash or Stock paid or payable to Participant (regardless of any elective deferral) less any cash or the Fair Market Value of any Stock or property (other than an Award or award which would have itself then been forfeitable hereunder and excluding any payment of tax withholding) paid by the Participant to the Company as a condition of or in connection with such settlement.

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(b) Events Triggering Forfeiture. The forfeitures specified in Section 10(a) will be triggered upon the occurrence of anyone of the following Forfeiture Events at any time during the Participant's employment by the Company or a subsidiary or affiliate or during the one-year period following termination of such employment:

(i) The Participant, acting alone or with others, directly or indirectly, prior to a Change in Control, (A) engages, either as employee, employer, consultant, advisor, or director, or as an owner, investor, partner, or stockholder unless the Participant's interest is insubstantial, in any business in an area or region in which the Company conducts business at the date the event occurs, which is directly in competition with a business then conducted by the Company or a subsidiary or affiliate; (B) induces any customer or supplier of the Company or a subsidiary or affiliate, or other company with which the Company or a subsidiary or affiliate has a business relationship, to curtail, cancel, not renew, or not continue his or her or its business with the Company or any subsidiary or affiliate; or (C) induces, or attempts to influence, any employee of or service provider to the Company or a subsidiary or affiliate to terminate such employment or service. The Committee shall, in its discretion, determine which lines of business the Company conducts on any particular date and which third parties may reasonably be deemed to be in competition with the Company. For purposes of this Section 10(b) (i), a Participant's interest as a stockholder is insubstantial if it represents beneficial ownership of less than five percent of the outstanding class of stock, and a Participant's interest as an owner, investor, or partner is insubstantial if it represents ownership, as determined by the Committee in its discretion, of less than five percent of the outstanding equity of the entity;

(ii) The Participant discloses, uses, sells, or otherwise transfers, except in the course of employment with or other service to the Company or any subsidiary or affiliate, any confidential or proprietary information of the Company or any subsidiary or affiliate, including but not limited to information regarding the Company's current and potential customers, organization, employees, finances, and methods of operations and investments, so long as such information has not otherwise been disclosed to the public or is not otherwise in the public domain, except as required by law or pursuant to legal process, or the Participant makes statements or representations, or otherwise communicates, directly or indirectly, in writing, orally, or otherwise, or takes any other action which may, directly or indirectly, disparage or be damaging to the Company or any of its subsidiaries or affiliates or their respective officers, directors, employees, advisors, businesses or reputations, except as required by law or pursuant to legal process;

(iii) The Participant fails to cooperate with the Company or any subsidiary or affiliate by making himself or herself available to testify on behalf of the Company or such subsidiary or affiliate in any action, suit, or proceeding, whether civil, criminal, administrative, or investigative, or otherwise fails to assist the Company or any subsidiary or affiliate in any such action, suit, or proceeding by providing information and meeting and consulting with members of management of, other representatives of, or counsel to, the Company or such subsidiary or affiliate, as reasonably requested; or

(iv) The Participant is terminated for Cause.

(c) Agreement Does Not Prohibit Competition or Other Participant Activities. Although the conditions set forth in this Section 10 shall be deemed to be incorporated into an Award, a Participant is not thereby prohibited from engaging in any activity, including but not limited to competition with the Company and its subsidiaries and affiliates. Rather, the non-occurrence of the Forfeiture Events set forth in Section 10(b) is a condition to the Participant's right to realize and retain value from his or her compensatory Options and Awards, and the consequence under the Plan if the Participant engages in an activity giving rise to any such Forfeiture Event are the forfeitures specified herein. The Company and the Participant shall not be precluded by this provision or otherwise from entering into other agreements concerning the subject matter of Section 10(a) and 10(b).

(d) Committee Discretion. The Committee may, in its discretion, waive in whole or in part the Company's right to forfeiture under this Section, but no such waiver shall be effective unless evidenced

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by a writing signed by a duly authorized officer of the Company. In addition, the Committee may impose additional conditions on Awards, by inclusion of appropriate provisions in the document evidencing or governing any such Award.

11. Employee Stock Purchase Program.

(a) Stock Available for Awards. The aggregate number of shares of Stock that may be granted as Options under the Employee Stock Purchase Plan ("ESPP") shall be determined on an annual basis by the Committee. Shares shall be deemed to have been granted under the ESPP only to the extent actually issued and delivered pursuant to the Award. To the extent that an Award lapses or the rights of the Participant terminate, any shares of Stock subject to such Award shall again be available for the grant of future Stock Awards.

(b) Eligibility. An Award made pursuant to the ESPP may be granted to an individual who, at the time of grant, is an employee of the Company or a subsidiary and has been determined to be eligible for participation. An Award made pursuant to the ESPP may be granted on more than one occasion to the same person; each Award shall be evidenced by a written instrument duly executed by or on behalf of the Company. Notwithstanding the foregoing, no employee of the Company or a subsidiary shall be granted an Option if such employee, immediately after the Option is granted, owns stock possessing five percent (5%) or more of the total combined voting power or five percent (5%) or more of the value of all classes of stock of the Company or any subsidiary. For the purpose of determining stock ownership, the rules of Section 424(d) of the Code shall apply. In addition, the Stock which the Participant may purchase under any outstanding Options shall be treated as stock owned by the Participant. The Committee may exclude the following employees from receiving Options under the ESPP:

(1) Employees who have been employed by the Company or a subsidiary less than two (2) years;
(2) Employees whose customary employment with the Company or a subsidiary is twenty (20) hours or less per week;
(3) Employees whose customary employment with the Company or a subsidiary is not for more than five (5) months in any calendar year; and
(4) Highly compensated employees within the meaning of Section 414(q) of the Code.

(c) Employee Stock Purchase Plan Stock Option Agreement. Each Option shall be evidenced by an Option Agreement between the Company and the Participant which shall contain such terms and conditions as may be approved by the Committee and are consistent with Section 423 of the Code. The terms and conditions of the respective Option Agreements need not be identical. Each Option Agreement shall specify the effect of termination of employment, total and permanent Disability, Retirement or death on the exercisability of the Option. Under each Option Agreement, a Participant shall have the right to appoint any individual or legal entity in writing as his or her Beneficiary in the event of his or her death. Such designation may be revoked in writing by the Participant at any time and a new Beneficiary may be appointed in writing on the form provided by the Committee for such purpose. In the absence of such appointment, the Beneficiary shall be the legal representative of the Participant's estate.

(d) Option Period. The term of each Option shall be as specified by the Committee at the date of grant and shall be stated in the Option Agreement; provided, however, that an Option may not be exercised after the expiration of:

(1) Five (5) years from the date such Option is granted if the ESPP requires that the Option price must be not less than eighty-five percent (85%) of the Fair Market Value of the Stock at the time the Option is exercised; or
(2) Twenty-Seven (27) months from the date such Option is granted if the Option provides for an Option Price in some other permissible manner under Section 423 of the Code (such as a flat dollar amount) .

(e) Limitation on Exercise of Option. An Option may be exercisable in whole or in such installments and at such times as determined by the Committee and the applicable term relating to the exercise of the option shall be stated in the Option Agreement and must be uniform for all employees

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with the following exceptions: (1) the Committee may limit the maximum number of Options that can be exercised under the ESPP, and (2) the Committee may limit the amount of Options that all employees may be granted to a specified relationship to total compensation or the base or regular rate of compensation; and provided, however, that an Option may be exercised at the rate of at least twenty percent (20%) per year over five (5) years from the date it is granted.

(f) Special Limitation Regarding Exercise of Option. No employee may be granted an Option which permits his or her rights to exercise Options under the ESPP of the Company and subsidiaries to accrue at a rate that exceeds $25,000 of the Fair Market Value of such stock (determined at the time of grant) for each calendar year in which such Option is outstanding at any time. For the purpose of this rule:

(1) The right to purchase Stock under an Option accrues when the Option (or any portion thereof) first becomes exercisable during the calendar year;
(2) The right to purchase Stock under an Option accrues at the rate provided in the Option, but in no case shall such rate exceed $25,000 of Fair Market Value of such stock (determined at the time of grant) for anyone calendar year; and
(3) A right to purchase Stock which has accrued under one Option granted pursuant to the Plan may not be carried over to any other Option.

The Committee shall determine, in accordance with applicable provisions of the Code, Treasury Regulations, and other administrative pronouncements which Options will not constitute Options under Section 423 of the Code because of such limitation and shall notify the Participant of such determination as soon as practicable after such determination.

(g) Option Price. The purchase price of Stock issued under each Option shall be determined by the Committee and shall be stated in the Option Agreement, but such purchase price shall not be less than the lesser of:

(1) An amount equal to eighty-five percent (85%) of the Fair Market Value of the Stock at the time the Option is granted; or
(2) An amount which under the terms of the Option may not be less than eight-five percent (85%) of the Fair Market Value of such Stock at the time of the exercise of the Option.

(h) Options and Rights in substitution for Stock Options Granted by Other Companies. Options may be granted under the Plan from time to time in substitution for stock options held by employees of companies who become, or who became prior to the Effective Date of the Plan, employees of the Company or of any Subsidiary as a result of a merger or consolidation of the employing company with the Company, or such subsidiary, or the acquisition by the Company or a subsidiary of all or a portion of the assets of the employing company with the result that such employing company becomes a subsidiary.

12. General Provisions.

(a) Compliance with Legal and Other Requirements. The Company may, to the extent deemed necessary or advisable by the Committee, postpone the issuance or delivery of Stock or payment of other benefits under any Award until completion of such registration or qualification of such Stock or other required action under any federal or state law, rule or regulation, listing or other required action with respect to any stock exchange or automated quotation system upon which the Stock or other securities of the Company are listed or quoted, or compliance with any other obligation of the Company, as the Committee may consider appropriate, and may require any Participant to make such representations, furnish such information and comply with or be subject to such other conditions as it may consider appropriate in connection with the issuance or delivery of Stock or payment of other benefits in compliance with applicable laws, rules, and regulations, listing requirements, or other obligations. The foregoing notwithstanding, in connection with a Change in Control, the Company shall take or cause to be taken no action, and shall undertake or permit to arise no legal or contractual obligation, that results or would result in any postponement of the issuance or delivery of Stock or payment of benefits under any Award or the imposition of any other conditions on such issuance, delivery or payment, to the extent that such postponement or other condition would represent a greater burden on a Participant than existed on the 90th day preceding the Change in Control.

(b) Limits on Transferability; Beneficiaries. No Award or other right or interest of a Participant under the Plan shall be pledged, hypothecated or otherwise encumbered or subject to any lien, obligation or liability of such Participant to any party (other than the Company or a subsidiary or affiliate thereof), or assigned or transferred by such Participant otherwise than by will or the laws of descent and distribution or to a Beneficiary upon the death of a Participant, and such Awards or rights that may be exercisable shall be exercised during the lifetime of the Participant only by the Participant or his or her guardian or legal representative, except that Awards and other rights (other than ISOs and SARs in tandem therewith) may be transferred to one or more transferees during the lifetime of the Participant, and may be exercised by such transferees in accordance with the terms of such Award, but only if and to the extent such transfers are permitted by the Committee, subject to any terms and conditions which the Committee may impose thereon (including limitations the Committee may deem appropriate in order that offers and sales under the Plan will meet applicable requirements of registration forms under the Securities Act of 1933 specified by the Securities and Exchange Commission). A Beneficiary, transferee, or other person claiming any rights under the Plan from or through any Participant shall be subject to all terms and conditions of the Plan and any Award document applicable to such Participant, except as otherwise determined by the Committee, and to any additional terms and conditions deemed necessary or appropriate by the Committee.

(c) Adjustments. In the event that any large, special and non-recurring dividend or other distribution (whether in the form of cash or property other than Stock), recapitalization, forward or reverse split, Stock dividend, reorganization, merger, consolidation, spin-off, combination, repurchase, share exchange, liquidation, dissolution or other similar corporate transaction or event affects the Stock such that an adjustment is determined by the Committee to be appropriate under the Plan, then the Committee shall, in such manner as it may deem equitable, adjust any or all of (i) the number and kind of shares of Stock which may be delivered in connection with Awards granted thereafter, (ii) the number and kind of shares of Stock by which annual per-person Award limitations are measured under Section 5(b) (iii) the number and kind of shares of Stock subject to or deliverable in respect of outstanding Awards, and (iv) the exercise price, grant price or purchase price relating to any Award or, if deemed appropriate, the Committee may make provision for a payment of cash or property to the holder of an outstanding Option (subject to Section 12(k)). In addition, the Committee is authorized to make adjustments in the terms and conditions of, and the criteria included in, Awards (including Performance Awards and performance goals and any hypothetical funding pool relating thereto) in recognition of unusual or nonrecurring events (including, without limitation, events described in the preceding sentence, as well as acquisitions and dispositions of businesses and assets) affecting the Company, any subsidiary or affiliate or other business unit, or the financial statements of the Company or any subsidiary or affiliate, or in response to changes in applicable laws, regulations, accounting principles, tax rates and regulations or business conditions or in view of the Committee's assessment of the business strategy of the Company, any subsidiary or affiliate or business unit thereof, performance of comparable organizations, economic and business conditions, personal performance of a Participant, and any other circumstances deemed relevant; provided that no such adjustment shall be authorized or made if and to the extent that the existence of such authority (i) would cause Options, SARs, or Performance Awards granted under Section 8 to Participants designated by the Committee as Covered Employees and intended to qualify as "performance-based compensation" under Code Section 162(m) and regulations thereunder to otherwise fail to qualify as "performance-based compensation" under Code Section 162(m) and regulations thereunder, or (ii) would cause the Committee to be deemed to have authority to change the targets, within the meaning of Treasury Regulation 1.162-27(e)(4)(vi), under the performance goals relating to Options or SARs granted to Covered Employees and intended to qualify as "performance-based compensation" under Code Section 162(m) and regulations thereunder.

(d) Tax Provisions.

(i) Withholding. The Company and any subsidiary or affiliate is authorized to withhold from any Award granted, any payment relating to an Award under the Plan, including from a distribution of Stock, or any payroll or other payment to a Participant, amounts of withholding and other taxes due or potentially payable in connection with any transaction involving an Award, and to take such other action as the Committee may deem advisable to enable the Company and Participants to satisfy

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obligations for the payment of withholding taxes and other tax obligations relating to any Award. This authority shall include authority to withhold or receive Stock or other property and to make cash payments in respect thereof in satisfaction of a Participant's withholding obligations, either on a mandatory or elective basis in the discretion of the Committee. Other provisions of the Plan notwithstanding, only the minimum amount of Stock deliverable in connection with an Award necessary to satisfy statutory withholding requirements will be withheld, except a greater amount of Stock may be withheld if such withholding would not result in additional accounting expense to the Company.

(ii) Required Consent to and Notification of Code Section 83(b) Election. No election under Section 83(b) of the Code (to include in gross income in the year of transfer the amounts specified in Code Section 83(b)) or under a similar provision of the laws of a jurisdiction outside the United States may be made unless expressly permitted by the terms of the Award document or by action of the Committee in writing prior to the making of such election. In any case in which a Participant is permitted to make such an election in connection with an Award, the Participant shall notify the Company of such election within ten days of filing notice of the election with the Internal Revenue Service or other governmental authority, in addition to any filing and notification required pursuant to regulations issued under Code Section 83(b) or other applicable provision.

(iii) Requirement of Notification Upon Disqualifying Disposition Under Code Section 421(b). If any Participant shall make any disposition of shares of Stock delivered pursuant to the exercise of an Incentive Stock Option under the circumstances described in Code Section 421(b) (relating to certain disqualifying dispositions), such Participant shall notify the Company of such disposition within ten days thereof.

(e) Changes to the Plan. The Board may amend, suspend or terminate the Plan or the Committee's authority to grant Awards under the Plan without the consent of stockholders or Participants; provided, however, that any amendment to the Plan shall be submitted to the Company's stockholders for approval not later than the earliest annual meeting for which the record date is after the date of such Board action if such stockholder approval is required by any federal or state law or regulation or the rules of any stock exchange or automated quotation system on which the Stock may then be listed or quoted, and the Board may otherwise, in its discretion, determine to submit other amendments to the Plan to stockholders for approval and provided further, that, without the consent of an affected Participant, no such Board action may materially and adversely affect the rights of such Participant under any outstanding Award.

(f) Right of Setoff. The Company or any subsidiary or affiliate may, to the extent permitted by applicable law, deduct from and set off against any amounts the Company or it subsidiary or affiliate may owe to the Participant from time to time, including amounts payable in connection with any Award, owed as wages, fringe benefits, or other compensation owed to the Participant. Such amounts as may be owed by the Participant to the Company, including but not limited to amounts owed under Section 10(a), although the Participant shall remain liable for any part of the Participant's payment obligation not satisfied through such deduction and setoff. By accepting any Award granted hereunder, the Participant agrees to any deduction or setoff under this Section 12(f).

(g) Unfunded Status of Awards; Creation of Trusts. The Plan is intended to constitute an "unfunded" plan for incentive and deferred compensation. with respect to any payments not yet made to a Participant or obligation to deliver Stock pursuant to an Award, nothing contained in the Plan or any Award shall give any such Participant any rights that are greater than those of a general creditor of the Company; provided that the Committee may authorize the creation of trusts and deposit therein cash, Stock, other Awards or other property, or make other arrangements to meet the Company's obligations under the Plan. Such trusts or other arrangements shall be consistent with the "unfunded" status of the Plan unless the Committee otherwise determines with the consent of each affected Participant.

(h) Nonexclusivity of the Plan. Neither the adoption of the Plan by the Board nor its submission to the stockholders of the Company for approval shall be construed as creating any limitations on the power of the Board or a committee thereof to adopt such other incentive arrangements, apart from the

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Plan, as it may deem desirable, including incentive arrangements and awards which do not qualify under Code Section 162(m), and such other arrangements may be either applicable generally or only in specific cases.

(i) Payments in the Event of Forfeitures; Fractional Shares. Unless otherwise determined by the Committee, in the event of a forfeiture of an Award with respect to which a Participant paid cash consideration, the Participant shall be repaid the amount of such cash consideration. No fractional shares of Stock shall be issued or delivered pursuant to the Plan or any Award. The Committee shall determine whether cash, other Awards or other property shall be issued or paid in lieu of such fractional shares or whether such fractional shares or any rights thereto shall be forfeited or otherwise eliminated.

(j) Compliance with Code Section 162(m). It is the intent of the Company that Options and SARs granted to Covered Employees and other Awards designated as Awards to Covered Employees subject to Section 7 shall constitute qualified "performance-based compensation" within the meaning of Code Section 162(m) and regulations thereunder, unless otherwise determined by the Committee at the time of allocation of an Award. Accordingly, the terms of Sections 7(b), (c), and (d), including the definitions of Covered Employee and other terms used therein, shall be interpreted in a manner consistent with Code Section 162(m) and regulations thereunder. The foregoing notwithstanding, because the Committee cannot determine with certainty whether a given Participant will be a Covered Employee with respect to a fiscal year that has not yet been completed, the term Covered Employee as used herein shall mean only a person designated by the Committee as likely to be a Covered Employee with respect to a specified fiscal year. If any provision of the Plan or any Award document relating to a Performance Award that is designated as intended to comply with Code Section 162(m) does not comply or is inconsistent with the requirements of Code Section 162(m) or regulations thereunder, such provision shall be construed or deemed amended to the extent necessary to conform to such requirements, and no provision shall be deemed to confer upon the Committee or any other person discretion to increase the amount of compensation otherwise payable in connection with any such Award upon attainment of the applicable performance objectives.

(k) Certain Limitations Relating to Accounting Treatment of Awards. At any time that the Company is accounting for stock-denominated Awards under Accounting Principles Board Opinion 25 ("APB 25"), the Company intends that, with respect to such Awards, the compensation measurement date for accounting purposes shall occur at the date of grant or the date performance conditions are met if an Award is fully contingent on achievement of performance goals, unless the Committee specifically determines otherwise. Therefore, other provisions of the Plan notwithstanding, in order to preserve this fundamental objective of the Plan, if any authority granted to the Committee hereunder or any provision of the Plan or an Award agreement would result, under APB 25, in "variable" accounting or a measurement date other than the date of grant or the date such performance conditions are met with respect to such Awards, if the Committee was not specifically aware of such accounting consequence at the time such Award was granted or provision otherwise became effective, such authority shall be limited and such provision shall be automatically modified and reformed to the extent necessary to preserve the accounting treatment of the award intended by the Committee. This provision shall cease to be effective if and at such time as the Company no longer accounts for equity compensation under APB 25.

(l) Governing Law. The validity, construction, and effect of the Plan, any rules and regulations relating to the Plan and any Award document shall be determined in accordance with the laws of the State of Delaware, without giving effect to principles of conflicts of laws, and applicable provisions of federal law.

(m) Awards to Participants Outside the United States. The Committee may modify the terms of any Award under the Plan made to or held by a Participant who is then resident or primarily employed outside of the United States in any manner deemed by the Committee to be necessary or appropriate in order that such Award shall conform to laws, regulations, and customs of the country in which the Participant is then resident or primarily employed, or so that the value and other benefits of the Award to the Participant, as affected by foreign tax laws and other restrictions applicable as a result of the Participant's residence or employment abroad shall be comparable to the value of such an Award to a Participant who is resident or primarily employed in the United States. An Award may be modified under

this Section 12(m) in a manner that is inconsistent with the express terms of the Plan, so long as such modifications will not contravene any applicable law or regulation or result in actual liability under Section 16(b) for the Participant whose Award is modified.

(n) Limitation on Rights Conferred under Plan. Neither the Plan nor any action taken hereunder shall be construed as (i) giving any Eligible Person or Participant the right to continue as an Eligible Person or Participant or in the employ or service of the Company or a subsidiary or affiliate, (ii) interfering in any way with the right of the Company or a subsidiary or affiliate to terminate any Eligible Person's or Participant's employment or service at any time, (iii) giving an Eligible Person or Participant any claim to be granted any Award under the Plan or to be treated uniformly with other Participants and employees, or (iv) conferring on a Participant any of the rights of a stockholder of the Company unless and until the Participant is duly issued or transferred shares of Stock in accordance with the terms of an Award or an Option is duly exercised. Except as expressly provided in the Plan and an Award document, neither the Plan nor any Award document shall confer on any person other than the Company and the Participant any rights or remedies thereunder.

(o) Severability; Entire Agreement. If any of the provisions of this Plan or any Award document is finally held to be invalid, illegal or unenforceable (whether in whole or in part), such provision shall be deemed modified to the extent, but only to the extent, of such invalidity, illegality or unenforceability, and the remaining provisions shall not be affected thereby; provided, that, if any of such provisions is finally held to be invalid, illegal, or unenforceable because it exceeds the maximum scope determined to be acceptable to permit such provision to be enforceable, such provision shall be deemed to be modified to the minimum extent necessary to modify such scope in order to make such provision enforceable hereunder. The Plan and any Award documents contain the entire agreement of the parties with respect to the subject matter thereof and supersede all prior agreements (unless an employment agreement entered into between the Company and the Participant specifically provides contradictory terms, in which case the terms of the employment agreement shall govern), promises, covenants, arrangements, communications, representations and warranties between them, whether written or oral with respect to the subject matter thereof.

(p) Plan Effective Date and Termination. The Plan shall become effective if, and at such time as, the stockholders of the Company have approved it by the affirmative votes of the holders of a majority of the voting securities of the Company present in person or by proxy and entitled to vote on the subject matter at a duly held meeting of stockholders at which a quorum is present. Unless earlier terminated by action of the Board, the Plan will remain in effect until such time as no Stock remains available for delivery under the Plan and the Company has no further rights or obligations under the Plan with respect to outstanding Awards under the Plan.

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APPENDIX IV (CHARTER AMENDMENTS)

CERTIFICATE OF AMENDMENT
OF CERTIFICATE OF INCORPORATION
OF
PERFECTDATA CORPORATION

(Pursuant to Section 242 of
the Delaware General Corporation Law)

PerfectData Corporation (the "Corporation"), a corporation organized and existing under and by virtue of the Delaware General Corporation Law (the "DGCL") does hereby certify that:

1. The name of the Corporation is PerfectData Corporation.

2. The Board of Directors of the Corporation unanimously duly adopted resolutions setting forth two (2) proposed amendments (the "Amendments") to the Certificate of Incorporation of the Corporation, as amended (the "Certificate of Incorporation"), declaring the Amendments advisability to its stockholders, and directing that the Amendments be considered at the 2005 annual meeting of the stockholders of the Corporation followed by a majority vote in favor of the Amendments by the stockholders at such annual meeting. The Amendments adopted provide as follows:

(i) That Article First of the Certificate of Incorporation shall be amended to read in its entirety as follows:

"FIRST: The name of the corporation is Sona Mobile Holdings Corp. (hereinafter called the "Corporation").";

and

(ii) That the first sentence of Article Fourth of the Certificate of Incorporation would be amended in its entirety to read as follows:

"FOURTH: The total number of shares of all classes of stock which the Corporation shall have authority to issue is 92,000,000 shares, consisting of 90,000,000 shares of common stock, $.01 par value per share (the "Common Stock"), and 2,000,000 shares of preferred stock, $.01 par value per share (the "Preferred Stock")."

3. That the Amendments herein certified have been duly adopted in accordance with the provisions of Section 242 of the DGCL by the Board of Directors.

4. This Certificate of Amendment shall become effective upon the filing hereof in the Office of the Secretary of State of the State of Delaware.

Executed on this ____ day of ____, 2005.

PerfectData Corporation
By: ______________________________
John Bush
President and Chief Executive Officer

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APPENDIX V (REVERSE SPLIT CHARTER AMENDMENT)

CERTIFICATE OF AMENDMENT
OF CERTIFICATE OF INCORPORATION
OF
[PERFECTDATA CORPORATION]*
(Pursuant to Section 242 of
the Delaware General Corporation Law)

[PerfectData Corporation]* (the "Corporation"), a corporation organized and existing under and by virtue of the Delaware General Corporation Law (the "DGCL") does hereby certify that:

1. The name of the Corporation is [PerfectData Corporation].*

2. The Board of Directors of the Corporation, by [unanimous written consent pursuant to Section 141(f) of the DGCL] [majority vote at a duly called meeting], duly adopted resolutions setting forth an amendment to the Corporation's Certificate of Incorporation, as amended (the "Certificate of Incorporation"), declaring such amendment to be advisable and recommended that the amendment be put to a vote of the Corporation's stockholders, that the issued shares of the Corporation's Common Stock on the date hereof shall be immediately, upon the filing of this Certificate of Amendment, combined into a smaller number of shares of Common Stock in the ratio of new shares for one old share.

3. To accomplish the foregoing, Article Fourth of the Certificate of Incorporation is hereby amended by inserting the following paragraph at the end of Section A thereof:

"5. Reverse Split. Each share of the Corporation's Common Stock issued prior to the date hereof (the "Old Common Stock"), will be automatically reclassified as and converted into new shares of Common Stock (the "New Common Stock"). No fractional shares of New Common Stock shall be issued to the holders of record of Old Common Stock in connection with the foregoing reclassification of shares of Old Common Stock. In lieu thereof, the aggregate of all fractional shares otherwise issuable to the holders of record of Old Common Stock shall be issued to the Corporation's transfer agent, as agent for, the accounts of all holders of record of Old Common Stock otherwise entitled to have a fraction of a share issued to them. The sale of all of the fractional interests will be effected by the transfer agent as soon as practicable after the date hereof on the basis of prevailing market prices of the New Common Stock at the time of sale. After such sale and upon the surrender of the stockholders' stock certificates, the transfer agent will pay to such holders of record their pro rata share of the net proceeds derived from the sale of the fractional interests. Each stock certificate that, immediately prior to the date hereof, represented shares of Old Common Stock shall, from and after the date hereof, automatically and without the necessity of presenting the same for exchange, represent that number of whole shares of New Common Stock into which the shares of Old Common Stock represented by such certificate shall have been reclassified (as well as the right to receive cash in lieu of any fractional shares of New Common Stock as set forth above); provided, however, that each holder of record of a certificate that represented shares of Old Common Stock shall receive, upon surrender of such certificate, a new certificate representing the number of whole shares of New Common Stock into which the shares of Old Common Stock represented by such certificate shall have been reclassified, as well as any cash in lieu of fractional shares of New Common Stock to which such holder may be entitled as set forth above."

4. That this Certificate of Amendment was duly adopted in accordance with the provisions of Section 242 of the DGCL.

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* Subject to name change.

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5. This Certificate of Amendment shall become effective upon the filing hereof in the Office of the Secretary of State of the State of Delaware.

Executed on this day of , 200 .

[PerfectData Corporation]
By: ____________________

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(FORM OF PROXY)

PERFECTDATA CORPORATION
P R O X Y
FOR ANNUAL MEETING OF THE STOCKHOLDERS
THURSDAY, NOVEMBER 17, 2005
THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS

The undersigned hereby appoints Shawn Kreloff and John Bush, and each of them, with full power of substitution, as proxies to vote the shares which the undersigned is entitled to vote at the Annual Meeting of the Stockholders of PerfectData Corporation ("PerfectData") to be held at 825 Third Avenue, 32nd Floor, New York, New York, on Thursday, November 17, 2005 at 10:00 A.M., Eastern Time and at any adjournments thereof, hereby revoking any proxies heretofore given, to vote all shares of common stock of PerfectData held or owned by the undersigned as indicated on the proposals as more fully set forth in the Proxy Statement, and in their discretion upon such other matters as may come before the meeting.

Please mark **"X"** your votes as indicated :
1. ELECTION OF DIRECTORS: Shawn Kreloff, John Bush, Nicholas H. Glinsman. Bryan Maizlish, Frank J. Fanzilli, Jr., Paul A McAleese, Michael P. Castellano and Joseph V. Vittoria

FOR election of all nominees

WITHHOLD vote from all nominees

FOR all nominees,

EXCEPT for nominee(s) listed below from whom vote is withheld.

____

2. Approval the Amended and Restated Stock Option Plan of 2000 of PerfectData Corporation.

FOR AGAINST ABSTAIN

3. To approve an amendment to our Certificate of Incorporation that would change our name to "Sona Mobile Holdings Corp."

FOR AGAINST ABSTAIN

4. To approve an amendment to our Certificate of Incorporation that would increase the number of shares of our authorized shares of common stock to 90,000,000.

FOR AGAINST ABSTAIN

5. To grant to our board of directors discretionary authority to amend our Certificate of Incorporation to effect a reverse stock split of our common stock at a ratio within the range from one-for-three to one-for-five at any time prior to December 31, 2006.

FOR AGAINST ABSTAIN

(Continued, and to be signed, on the Reverse Side)

FOLD HERE

THIS PROXY WHEN PROPERLY SIGNED WILL BE VOTED IN THE MANNER DIRECTED HEREIN BY THE UNDERSIGNED STOCKHOLDER. IF NO DIRECTION IS MADE, THIS PROXY WILL BE VOTED FOR PROPOSALS 1 THROUGH 5.

The undersigned hereby acknowledges receipt of the Notice of, and Proxy Statement for, the aforesaid Annual Meeting.

Dated: , 2005

Signature of Stockholder

Signature of Stockholder

NOTE: When shares are held by joint tenants, both should sign. When signing as attorney, executor, administrator, trustee, or guardian, please give full title as such. If a corporation, please sign in full corporate name by President or other authorized officer. If a partnership, please sign in partnership name by an authorized person.

IMPORTANT - PLEASE FILL IN, SIGN AND RETURN PROMPTLY USING THE ENCLOSED ENVELOPE.