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

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934

FOR THE FISCAL YEAR ENDED DECEMBER 31, 1996

COMMISSION FILE NUMBER 000-21129

AWARE, INC.
(Exact Name of Registrant as Specified in Its Charter)

MASSACHUSETTS	04-2911026
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

ONE OAK PARK, BEDFORD, MASSACHUSETTS, 01730
(Address of Principal Executive Offices)
(Zip Code)

(617) 276-4000
(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: NONE
Securities registered pursuant to Section 12(g) of the Act:
COMMON STOCK, PAR VALUE $.01 PER SHARE
(Title of class)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. YES X NO

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the voting stock held by non-affiliates of the registrant as of February 28, 1997, based on the closing price of the Common Stock on February 28, 1997 as reported on the Nasdaq National Market, was approximately $134,917,832.

The number of shares outstanding of the registrant's common stock as of February 28, 1997 was 19,116,561.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's definitive Proxy Statement to be delivered to shareholders in connection with the registrant's Annual Meeting of Shareholders to be held on May 21, 1997 are incorporated by reference into Part III of this Annual Report on Form 10-K.

AWARE, INC.
FORM 10-K
FOR THE YEAR ENDED DECEMBER 31, 1996

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PART I

ITEM 1. BUSINESS

GENERAL

Aware, Inc. (the "Company" or "Aware") was incorporated in Massachusetts in 1986. During its first seven years, the Company was engaged primarily in research, specializing in wavelet mathematics applications, digital compression, and telecommunications and channel modulation and coding. The Company holds thirteen patents in areas related to wavelet mathematics, digital compression and similar technologies. The Company's revenue during this period consisted largely of research grants from agencies of the U.S. government and certain commercial companies. In 1993, the Company began to shift its business from contract research toward development of: (i) Asymmetric Digital Subscriber Line ("ADSL") and other broadband technologies, and (ii) image compression products. Two principal lines of business emerged as a result of the decision to commercialize the Company's core technology: telecommunications and image compression.

The Company's telecommunications products include software and hardware interfaces that integrate ADSL and Hybrid Fiber Coaxial ("HFC") chipsets into modems and other communications devices, and high speed ADSL Internet Access Modems that incorporate the Company's proprietary technology and software. The Company has co-developed chipsets incorporating the Company's technology with Analog Devices, Inc. ("ADI"), a leading supplier of integrated circuits. ADI has an exclusive license to manufacture and sell such chipsets for which the Company receives royalty payments. The Company's broadband products are designed to increase the speed of data communications over conventional copper telephone and cable television networks. The Company believes that its products will enable telephone companies ("telcos") and cable companies to utilize their installed bases of dedicated copper lines and coaxial cable to provide both residential and business customers with interactive data transmission at speeds much higher than currently available.

The Company's image compression products include WSQ by Aware, AccuPress for Radiology, AccuPress for Remote Sensing, AccuPress for Multimedia, and SeisPact. In addition, the Company's image compression organization continues to perform some contract research for the U.S. government.

The Company's executive offices are located at One Oak Park, Bedford, Massachusetts, 01730, and its telephone number is (617) 276-4000.

PRODUCTS AND MARKETS

TELECOMMUNICATIONS

TELECOMMUNICATIONS MARKET

With the rise of the Internet and World Wide Web, network service providers are experiencing a fundamental shift in the type of communications traffic transmitted over their networks. The existing network infrastructure of twisted-pair copper wiring, which was originally designed to provide analog voice service ("Plain Old Telephone Service" or "POTS"), and coaxial cable, which was designed to provide cable television service, are increasingly required to carry large amounts of data produced by computers. Service providers are faced with the challenge of providing high-speed data communications at reasonable costs, while preserving their investment in copper wire and coaxial cable networks.

Copper wire telephone networks are estimated to include over 150 million lines in the United States and over 600 million lines worldwide, according to industry sources. These networks represent an undepreciated capital investment of approximately $100 billion. Cable television service is currently available to ninety percent of the homes in the U.S. and sixty-five percent of the homes in the U.S. subscribe to the service.

To date, telcos' copper wire and cable companies' HFC infrastructures have not proven adequate for the increasing volume of traffic generated by computers remotely connected to each other and the Internet. Digital information requires more bandwidth than traditional analog voice communications if it is to be transmitted at a speed that is satisfactory to the computer user. Currently, the fastest transmission rate readily available to typical home or remote office computer users over existing copper wire is achieved through the use of a 33.6 kilobits per second ("Kbps") modem, although many users still employ modems that are slower than this. For the over 30 million and growing Internet users, these transmission rates are one of the chief frustrations of using the World Wide Web, which is the fastest growing and most data intensive segment of the Internet.

Service providers, recognizing the need for higher speed data communications, are increasingly seeking to upgrade their networks. The telcos are replacing copper wire with fiber optic cable, which permits high speed data transmissions, particularly through the backbone of the network that links their central offices to one another. However, installing fiber optic cable all the way into customers' homes or businesses is prohibitively expensive and would take decades. Similarly, cable companies are testing cable modems, which permit two-way data transmissions over their existing HFC networks.

Telcos are seeking cost-effective technologies to accommodate high speed data transmission over copper wires. Some of these technologies are described below:

> ISDN. In the early 1980's, telcos introduced Integrated Service Digital Network ("ISDN") technology, which provides digital transmission over copper wire typically at basic rates up to 144 Kbps. Although this technology is several times faster than a voiceband modem, the market penetration of existing ISDN technology is limited because its equipment and installation costs are relatively high, and it does not allow simultaneous POTS and data transmission on those wires.

> T-1. T-1 (E-1 in countries outside the U.S.) is a multiplexing format that allows digital conversion of an analog line. Once converted, a T-1 digital line can deliver data at speeds up to 1.544 megabits per second ("Mbps"). However, T-1 service cannot use the existing copper

wire networks without expensive and time-consuming modifications, including installation of repeaters every 3,000 to 5,000 feet to regenerate the signal as it passes along the line. T-1 also requires two sets of twisted-pair copper wires and does not allow simultaneous POTS and data transmission on those wires.

HDSL. In 1992, telcos introduced High bit-rate Digital Subscriber Line ("HDSL") technology, which reduces the cost of installing T-1 service. HDSL increases the distance of T-1 transmission over copper wires to approximately 12,000 feet, which reduces the need for repeaters. As a result, some telcos are deploying HDSL technology in their local access networks. However, HDSL still requires two sets of twisted-pair copper wires and does not allow simultaneous POTS and data transmission on those wires.

ADSL. Telcos are currently considering deployment of ADSL technology, which uses digital signal processing technology to expand the useable bandwidth of copper telephone wire. ADSL was initially created in the late 1980s by Bellcore, the research entity jointly created and funded by the Regional Bell Operating Companies ("RBOCs"). ADSL technology allows non-repeated transmissions of data at a distance of up to 18,000 feet over telcos' existing copper networks at a rate of up to 8 Mbps downstream to the customer and at a rate of up to 640 Kbps upstream from the customer, with the speed of transmission decreasing as distance increases. ADSL allows simultaneous POTS and high speed digital data transmission on a single set of twisted-pair copper wires.

In addition to these telco technologies, cable company suppliers are working to improve HFC technology, which would permit two-way broadband digital communications over typical cable networks. HFC technology uses digital signal processing to allow efficient sharing of upstream bandwidth so that a cable line can be used for two-way transmissions. New HFC networks are also being installed by telcos so that they can offer television service as well as telephone and data dial-tone services.

Telcos typically put new products through a rigorous approval process before deploying them on a broad basis. The approval process usually involves a number of different phases, including (i) laboratory evaluations, in which the product is tested against relevant industry standards; (ii) technical trials, in which the product is tested in the field with a small number of users; (iii) marketing trials, in which the product is tested in the field with a larger number of users and telcos begin to train their personnel to install and maintain the product; (iv) initial commercial deployment, in which telcos make the product available to selected customers for selected applications; and (v) commercial deployment, in which telcos make the product available to a substantial number of customers.

During 1996, a number of telcos performed laboratory and technical trials, in which they evaluated and tested the Company's, as well as competitors', ADSL products. The Company believes the telcos' trial experience provided them with evidence that ADSL technology is capable of delivering high-speed data transmissions rates. This knowledge coupled with rapidly dropping equipment prices may have obviated the need for many of the marketing trials the Company and others had anticipated. The Company now believes the telcos will commence commercial ADSL deployment in late 1997 and that such deployment will continue into 1998.

TELECOMMUNICATIONS PRODUCTS

The Company designs and develops products utilizing its proprietary software to implement ADSL that it believes have advantages over its competitors' ADSL products. The ASDL products developed by Aware incorporate proprietary software and algorithms based on digital signal processing technology as well as application specific integrated circuits (ASICs). In contrast to the approach taken by some competing developers of ADSL technology, Aware's approach is to maintain a high level of functionality in the software component of the product as opposed to the ASIC. The Company believes that this approach allows it to engineer improvements in its technology quickly and efficiently, rather than having to design and produce a new ASIC each time an improvement is made. The Company's ADSL technology enables data communications protocols, such as Frame Relay, TCP/IP, and ATM, to operate at higher transmission rates over copper wire. The Company has chosen to use the multi-carrier Discrete Multi-Tone ("DMT") modulation for ADSL, rather than the single-carrier Carrierless Amplitude Phase ("CAP") modulation technique. The Company believes that ADSL/DMT technology has greater potential for deployment than CAP, because (i) DMT is more flexible, (ii) the standardization process for DMT is more advanced, and (iii) there are multiple vendors who supply DMT as opposed to CAP which is offered by one vendor. (See Item 1. Business - TECHNOLOGY)

Existing Telecommunications Products

Chipsets. The Company and ADI developed a first generation ADSL chipset, which began shipping in November 1995. The chipset uses a combination of ASICs, digital signal processors, and proprietary software developed by the Company to provide all the functions necessary in a modem. The ADSL chipset meets the performance objectives of the DMT multi-carrier modulation chosen by the American National Standards Institute ("ANSI") as the standard for ADSL.

In 1993 ADI and the Company entered into an agreement, under which ADI produces and markets broadband chipsets incorporating the Company's DMT-based ADSL technology, and for which the Company receives royalties and development funding. The relationship between ADI and the Company is an exclusive arrangement, under which neither party may enter into competing agreements with third parties. The Company's ability to achieve its business objectives will depend on ADI's ability and desire to deliver chipsets to the market place. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - FACTORS THAT MAY AFFECT FUTURE RESULTS.)

In 1994 and 1995, the Company and ADI entered into additional agreements to expand their relationship to include the development and marketing of chipsets incorporating the Company's Discrete Wavelet Multi-Tone ("DWMT") technology for HFC and VDSL data communications. The Company also agreed that, if it develops and sells ADSL technology that implements DWMT technology, it would license such technology to ADI on substantially the same terms as those for the Company's ADSL technology.

Software and Hardware Interfaces. The Company develops software and hardware interfaces for its ADSL chipset which can be used to connect the chipset with PCs, network and central office equipment, and other telephony and data communications devices. The interfaces are custom developed by the Company for OEMs, who seek to incorporate the Company's ADSL technology into their systems.

Modems. The Company developed and markets an ADSL Internet Access Modem, which contains the Company's ADSL chipset and software and hardware interfaces developed by the Company. In a typical configuration, the Company's ADSL modem is designed to receive data at speeds up to 4.4 Mbps and send it at speeds of up to 440 Kbps at a distance of up to 12,000 feet over standard copper wire. This modem was designed to demonstrate technical feasibility and will not be suitable for mass production without additional redesign to reduce the power requirements, size and costs of the modem.

Products Under Development

The Company is currently engaged in the following product development and enhancement activities:

Chipsets. The Company and ADI have announced a second generation ADSL chipset, which the Company anticipates will begin shipping in production quantities in the third quarter of 1997. While maintaining the same data transmission speed, the second generation chipset contains the following enhancements as compared to the first generation chipset: (i) the number of chips in the core transceiver has been reduced from twelve to five; (ii) the power requirement has been reduced from twelve to five watts, and (iii) the dimensions of the core transceiver, DSP circuitry, and line driver circuitry have been reduced from 7" by 9" to 3" by 5".

The Company and ADI have announced that ADI expects to begin shipping an HFC chipset, which is based upon the Company's DWMT technology, in June 1997. This chipset is the first implementation of the Company's DWMT technology.

Board-Level Products. The Company plans to design, manufacture and market board-level products for installation into ADSL systems offered by OEMs. The first such board-level product that the Company has announced is an ADSL module. This module is a 3" by 5" transceiver card which will contain a second generation ADSL chipset. The Company anticipates that its module will be available in limited production quantities in the third quarter of 1997.

Modems. The Company has announced and intends to begin shipping a rate adaptive ADSL modem in the first quarter of 1997. In addition to rate adaptability, this modem will contain a single board first generation chipset design, an improved user interface, and improved diagnostic capabilities.

Advanced ADSL, SDSL, VDSL, and HFC. The Company also intends to offer new generations of advanced ADSL products, as well as chipsets, interfaces, modems, boards and systems incorporating SDSL, VDSL, and HFC technology. (See Item 1. Business - TECHNOLOGY.) The Company has not announced any such products other than those described herein.

IMAGE COMPRESSION

In 1993, the Company began an effort to produce commercially marketable wavelet image compression software products. The Company currently offers five software-based compression products and has an agreement with ADI to produce a wavelet video compression ASIC. The Company's compression products include the following: WSQ by Aware (which compresses digital fingerprint data for use by law enforcement agencies, such as the FBI); AccuPress for Radiology (which is used to compress digital radiographs and other types of medical imagery); AccuPress for Multimedia (which is a general purpose compression product); AccuPress for Remote Sensing (which is designed for compression of satellite-based remote sensing imagery); and SeisPact (which companies in the oil and gas industry can use to store and transmit large amounts of seismic data).

TECHNOLOGY

The Company's core technology is based on its research into wavelet mathematics and digital compression. From that core technology, three principal technologies have emerged, including: (i) DMT-based ADSL technology, (ii) DWMT technology, and (iii) image compression technology.

ADSL Technology

ADSL is a method for expanding the useable bandwidth of copper wire. Typically, ADSL systems divide a one megahertz (MHz) bandwidth on copper wire into three segments: (i) the 0 to 4 kilohertz (KHz) range is used for POTS, (ii) the 25 KHz to 100 KHz range is used to transmit data upstream and (iii) the 100 KHz to 1 MHz range is used to transmit information downstream. The ANSI specification for ADSL calls for operation rates of 1.5 to 8 Mbps downstream and 64 to 640 Kbps upstream when operating over existing copper wires at a distance of up to 18,000 feet.

There are two primary ADSL modulation techniques for transmitting data signals: (i) DMT, which the Company uses, and (ii) CAP. DMT is a multi-carrier modulation technique that was chosen by ANSI as the telecommunications industry standard for ADSL. CAP is a single-carrier modulation technique originally developed by AT&T Paradyne Corporation (now Globespan Technologies, Inc.). The fundamental difference between CAP and DMT is that CAP treats each of the upstream and downstream frequency ranges as a single element over which as many information bits as possible are transmitted. In contrast, DMT divides the upstream and downstream bands into groups of different smaller subchannel frequency ranges (approximately 4 KHz each) into which a much smaller number of bits are coded and transmitted simultaneously.

The Company believes that DMT technology is better able than CAP technology to address the inherent problems of the telcos' copper wire networks. Because of its multiple small frequency bands, DMT is able to adjust and adapt the movement of information to both extract more throughput from a wire and to avoid sending information into frequency ranges that are not useable. Since CAP treats the entire frequency range as a single element, it does not have the ability to balance as easily the use of the frequency spectrum to match efficiently the performance of a given wire. DMT-based systems have greater flexibility than CAP-based systems, because DMT-based modems are better able to adapt and operate to within 32 Kbps of the highest speed achievable on the link.

DWMT Technology

The Company has invented a proprietary technology based on wavelet mathematics called DWMT. The Company believes that, as a result of its research and development of DWMT technology, it is a leader in commercialization of wavelets for telecommunications.

Multi-carrier systems divide a frequency range into the desired number of subchannels by using a digital filter bank, which is a mathematical process. Because of basic limits of the form of mathematics and the limits of time and computerization speeds, the process of creating isolated subchannels is imperfect. These imperfections inhibit modems from achieving theoretical performance limits. The subchannelization method used in creating DMT modems utilized a technique called a Fourier transform. This technique has been used in the telecommunications industry since the 1960s, but has become more practical for high speed, high volume use as digital signal processors have improved. The wavelet transform yields significantly better subchannelization than the Fourier transform. Because this technique more closely approximates ideal subchannelization, the performance of a wavelet-based

DWMT system can produce performance superior to a non-wavelet DMT system operating in a noisy environment.

The Company intends to apply DWMT technology to new products using SDSL, VDSL and HFC applications. The Company is seeking to incorporate DWMT techniques into industry standards body recommendations. The following is a brief description of possible applications using SDSL, VDSL and HFC:

SDSL. Symmetric Digital Subscriber Line technology is similar to ADSL, but allows two-way data transmission at the same rates. The Company is developing an SDSL application using its DWMT technology. SDSL provides up to 2 Mbps of data in both directions on single twisted-pair copper wire at distances up to 18,000 feet while allowing simultaneous POTS. The Company expects that this SDSL application can be used for LAN interconnecting and enhanced telephony applications.

VDSL. The Company believes that Very high-speed Digital Subscriber Line technology will be the next generation of high-speed user access, critical to the implementation of fiber-to-the-neighborhood and fiber-to-the-curb architectures. These architectures involve the deployment of an access node that utilizes fiber optic cable from a telco's central office to the access node, thus bringing fiber closer to the user. The final connection to the user is new or existing copper wire or new coaxial cable. VDSL is being designed with the objective of providing performance up to six times faster than ADSL, but over a shorter distance. The goal of VDSL is to enable telcos to provide a combination of digital TV, data dial-tone and regular telephony service on a single twisted-pair of copper wire. The Company is using DWMT to develop the upstream portion of a VDSL system.

HFC. By using the frequency band from 5 to 40 MHz for upstream transmission and the frequency band from 450 to 750 MHz for downstream transmission, it is possible to provide two-way services, such as telephony and data communications, on existing HFC networks. Each of these frequency bands is typically divided into smaller bands, 1 to 2 MHz wide. The Company's HFC technology, called WaveTel HFC, is based upon DWMT and will provide up to 8 Mbps transmission over a 2 MHz band. HFC telephony and cable modem technology enables cable companies to re-use their existing network to provide two-way services.

Image Compression Technology

Since 1988, the Company has developed expertise, trade secrets, and intellectual property in the field of wavelet transform-based data compression and has obtained several patents in this area. The Company's wavelet compression technology enables digital image, video and certain types of data to be compressed to between 1% and 10% of their original size. Using wavelet compression, the decompressed data are not bit for bit identical to the original data. A risk with this technique is that, as the original data get smaller, a larger amount of error is introduced into the decompressed data. However, compressed data can be transmitted across networks faster and storage costs are reduced.

RESEARCH AND DEVELOPMENT

The Company believes that its future success depends on its ability to adapt to the rapidly changing telecommunications environment and to meet its customers' needs. The timely development and introduction of new products is essential to maintain the Company's competitive position. The Company's product development activities are focused on delivering products to its service provider customers that will enable them to make maximum use of the capabilities of their existing copper wire and coaxial cable networks. Key development objectives include enhancements to the Company's ADSL technology as well as on products incorporating DWMT technology for VDSL, SDSL, and HFC applications.

Most of the Company's products are developed internally. As of December 31, 1996, the Company had a research and development staff of 35 employees, including ten employees holding doctorate degrees related to digital signal processing and digital communications theory. The Company anticipates that its research and development organization will grow significantly in the future as the Company attempts to strengthen its technology and product position in the telecommunications marketplace.

During the years ended December 31, 1996, 1995 and 1994, research and development costs charged to operations were $3,234,799, $2,333,200, and $3,492,249, respectively. Such costs are net of software development costs capitalized in accordance with Statement of Financial Accounting Standards ("SFAS") No. 86. There were no SFAS 86 costs capitalized in 1996, 1995 or 1994.

New product development schedules are difficult to predict, because telecommunications product development, quality assurance testing and debugging are complex processes that often take longer than expected. Accordingly, although the Company estimates the shipment dates of proposed new products for internal purposes, such estimates are subject to frequent adjustment based on the Company's own periodic assessment of its progress in the development process. No assurance can be given that any of the development projects referred to in the "Products and Markets" section will be successful or that any announced shipping dates for new products will be met.

SALES AND MARKETING

To date, the Company's principal telecommunications sales and marketing strategy has been to partner with OEM equipment suppliers. These OEM customers manufacture and sell telephone network equipment, cable plant equipment, data communications equipment, and end user customer premises equipment. The Company's objective is to incorporate its technology and components into products offered by its OEM customers. Examples of companies with whom the Company has announced partnership agreements as of December 31, 1996, include DSC Communications Corporation, Teltrend, Inc., Hayes Microcomputer Products, Inc., PairGain Technologies, Inc., and RELTEC Corporation.

Due to the complexity of the Company's telecommunications technology, the Company's sales people must have a high degree of technical sophistication in order to market its products effectively. The Company believes that technology selections involving the Company's products are frequently made at senior levels within a prospective customer's organization. Consequently, the Company relies primarily on presentations by senior management to key employees of OEMs.

This type of OEM selling does not require a large sales force, therefore as of December 31, 1996, the Company had four people in its telecommunications sales and marketing organization. As ADSL technologies are more broadly adopted, the Company expects to hire additional sales and marketing

employees to support the efforts of senior management. Additional sales and marketing employees will also be required to develop new channels of distribution so that the Company may sell its products to non-OEM customers, such as telcos, cable operators, Internet service providers, and competitive access providers.

The Company sells its software-based compression products through distributors and directly to end user customers. As of December 31, 1996, there were two people in the Company's compression software sales organization.

The Company has in the past and expects in the future to derive a substantial portion of its revenues from a limited number of customers. There are relatively few OEM equipment suppliers, telcos and cable operators to whom the Company can sell its products. Consequently, the Company's future success will depend to a large extent upon: (i) the timing and size of future purchase orders for the Company's products from these customers, (ii) the financial and operating success of these customers, and (iii) the success of services offered by these customers that use the Company's products. Any attempt by such customers to seek out additional or alternative suppliers or to undertake the internal development and sale of products comparable to those of the Company could have a material adverse effect on the Company's business, financial condition and results of operations. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - FACTORS THAT MAY AFFECT FUTURE RESULTS.)

The Company derived approximately 22%, 17%, 12%, and 10% of its total revenue in 1996 from DSC Communications Corporation, ADI, the United States government, and Teltrend, Inc., respectively. The Company derived approximately 23%, 18%, 12%, and 10% of its total revenue in 1995 from ADI, General Instrument Corporation, the United States government, and GSS/Array Technology, respectively. The Company derived approximately 38% and 10% of its total revenue in 1994 from the United States government and ADI, respectively. Substantially all revenue in 1996, 1995, and 1994 was sold to unaffiliated customers in North America.

MANUFACTURING

The Company does its own final assembly and testing of its ADSL products at its Bedford, Massachusetts facility. The Company believes that its manufacturing capacity is relatively limited. A modest number of ADSL modems have been manufactured to date. As demand for ADSL and other products increases, the Company intends to rely on third party manufacturers as well as its internal manufacturing capacity to assemble and test its products. The Company obtains ADSL chipsets directly from ADI and other components needed for its ADSL products from a variety of suppliers. The Company expects that third party manufacturers will obtain product parts directly from the Company, and from suppliers chosen by the Company or the third party manufacturer. Other than the ADSL chipset, which is available through ADI, the Company believes that other components for its ADSL products are available from a large number of suppliers and that there exist many qualified manufacturers to assemble and test the Company's products. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - FACTORS THAT MAY AFFECT FUTURE RESULTS.)

COMPETITION

The markets for the Company's products are intensely competitive and the Company expects competition to increase in the immediate future, especially in the emerging ADSL market. The Company intends to compete on the basis of technology, price, the timing of product delivery, product features, quality, reliability, and customer satisfaction. The Company currently competes, or expects to compete in the future, with the following categories of companies: (i) other vendors of DMT-based ADSL technology, such as Amati Communications Corporation ("Amati"), Orckit Communications Limited ("Orckit") and Alcatel Network Systems, Inc. ("Alcatel"); (ii) vendors of alternative ADSL technologies, such as Globespan Technologies, Inc. ("Globespan"), which is currently marketing its CAP-based ADSL technology, (iii) Regional Bell Operating Companies ("RBOCs") and other telcos, who are no longer prohibited from manufacturing telecommunications equipment as a result of deregulation, and (iv) OEMs and other systems integrators, such as Pairgain Technologies, Inc., U.S. Robotics Corporation, Ericsson, Inc., and Motorola, Inc.

The Company's success will depend on telcos' willingness to invest in broadband digital services based on ADSL technology. The Company expects that its ADSL products will compete not only with other products that increase the efficiency of digital transmission technologies over copper wire, such as ISDN for Internet access, but also with other broadband transmission technologies, such as HFC, coaxial cable, fiber optic cable, digital broadcast satellite and other wireless technologies. The Company believes its current and future broadband products will permit telcos to upgrade their networks in a flexible and cost effective way, but telcos may choose to deploy products using better established technologies to upgrade their networks including fiber optic cable, which many telcos favor. To the extent that telcos choose to install fiber optic cable or other transmission media between central offices and end users, the Company's business, financial condition and results of operations will be materially adversely affected.

The Company believes that, in the ADSL market, its DMT-based products are more flexible and will enjoy greater potential for deployment than products using the CAP technique. However, CAP-based ADSL products were introduced prior to the Company's products and are more readily available than the Company's products.

To date, there has been only limited commercial deployment of the Company's competitors' DMT-based ADSL products. Therefore, the Company is uncertain how its products will compare with products sold by Amati and Orckit, each of whom manufacture DMT-based ADSL products. Amati and Orckit have each made claims in their sales literature and elsewhere suggesting that their products provide data transmission rates that are equal to or faster than that of the Company's products. However, there is no independent means by which the Company can corroborate these claims.

In the HFC market, the Company is attempting to sell its products to system integrators such as Tellabs, Inc., Northern Telecom Ltd., Scientific-Atlanta, Inc. and General Instrument Corporation. The Company believes that these companies have developed or are developing proprietary modulation schemes using in-house technology that may be competitive with the Company's technology. Although the Company believes that its DWMT technology will offer more robust communications than these proprietary modulation schemes, the Company has not manufactured any marketable products based on its DWMT technology, and there can be no assurance that the Company will be able to do so or that a market or such products will develop.

The markets for the Company's wavelet image compression technology are competitive, and are expected to become increasingly so in the near future. In addition, the Company's WSQ product is an implementation of an open standard and is therefore subject to competition.

Many of the Company's competitors and potential competitors, including the RBOCs and Alcatel, have significantly greater financial, technological, manufacturing, marketing and personnel resources than the Company. There can be no assurance that the Company will be able to compete successfully or that competition will not have a material adverse effect on the Company's business, financial condition and results of operations. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - FACTORS THAT MAY AFFECT FUTURE RESULTS.)

INTELLECTUAL PROPERTY

In the field of telecommunications technology, the Company holds three patents for applying wavelet mathematics to communications systems. The Company has five pending patent applications that pertain to the application of multi-carrier technology to broadband communications. The Company also holds six patents for image compression and processing, three patents for video compression, two patents for audio compression and one patent for certain optical applications.

Although the Company has patented certain aspects of its technology, the Company relies primarily on know-how and trade secrets to protect its intellectual property. The Company attempts to protect its trade secrets and other proprietary information through agreements with its customers, suppliers, employees and consultants, and through security measures. Each of the Company's employees is required to sign a nondisclosure and noncompetition agreement. Although the Company intends to protect its rights vigorously, there can be no assurance that these measures will be successful. In addition, the laws of certain countries in which products incorporating the Company's technology may be developed, manufactured or sold may not protect the Company's products and intellectual property rights to the same extent as the laws of the United States.

While the Company's ability to compete may be affected by its ability to protect its intellectual property, the Company believes that, because of the rapid pace of technological change in the telecommunications industry, its technical expertise and ability to introduce new products on a timely basis will be more important in maintaining its competitive position than protection of its existing intellectual property and that patent, trade secret and copyright protections are important but must be supported by other factors such as the expanding knowledge, ability and experience of the Company's personnel, new technology and products, and product enhancements. Although the Company continues to implement protective measures and intends to defend vigorously its intellectual property rights, there can be no assurance that these measures will be successful.

Many participants in the telecommunications industry have an increasing number of patents and have frequently demonstrated a readiness to commence litigation based on allegations of patent and other intellectual property infringement. Third parties may assert exclusive patent, copyright and other intellectual property rights to technologies that are important to the Company. The Company has received letters from two companies, Amati and Telebit Corporation ("Telebit"), each asserting that it owns certain U.S. and foreign patents that are necessary for products that comply with the ANSI standard for ADSL, claiming that the Company's ADSL technology would infringe such patents, and offering the Company the opportunity to enter into a license agreement with respect to such patents. The Company has been informed that ADI has received similar letters. The Company has reviewed the Amati and Telebit patents and has received an opinion of its patent counsel, based upon the Company's oral description of its technology, to the effect that the Company's ADSL modem does not infringe any valid

claim of any of the Amati and Telebit patents. Based upon this opinion, the Company believes that it does not require a license under the Amati or Telebit patents in order to conduct its business.

Despite this opinion, there can be no assurance that a court to which the issue is submitted would not find that the Company's products infringe the Amati or Telebit patents, nor that Amati or Telebit will not continue to assert infringement. If the Company is found to have infringed any of such patents, the Company could be subject to substantial damages and/or an injunction preventing it from conducting its proposed business, and the Company's business could be materially and adversely affected. The Company has also received notice from Amati of the pendency of various patent applications which Amati considers to be pertinent to the design and operation of ADSL modems. Unless and until a patent actually issues, there can be no infringement, and the Company has not examined any such patent applications or received opinion of patent counsel with respect thereto. Although Amati and Telebit have offered to license their patents and their patent applications to the Company, there can be no assurance that any license would be available on acceptable terms should the Company choose to pursue such license or be found to infringe such patents. In addition, there can be no assurance that other third parties will not assert infringement claims against the Company in the future, that these assertions or those of Amati and Telebit, will not result in protracted and costly litigation, or that the Company would prevail in any such litigation or be able to license any valid patents from third parties on commercially reasonable terms. Further, such litigation, regardless of its outcome, could result in substantial costs to and diversion of effort by the Company. Litigation may also be necessary to enforce the Company's intellectual property rights. Any infringement claim or other litigation against or by the Company could have a material adverse effect on the Company's business, financial condition and results of operations. (See Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations - FACTORS THAT MAY AFFECT FUTURE RESULTS.)

EMPLOYEES

At December 31, 1996, the Company employed 53 people, including 35 in research and development, 6 in sales and marketing, 3 in manufacturing, and 9 in finance, information systems and administration. All of these employees were based in Massachusetts. As necessary, the Company supplements its regular employees with temporary and contract personnel. The Company believes that its future success will depend in large part on the continued service of its technical and senior management personnel and upon the Company's continuing ability to attract and retain highly qualified technical, sales and marketing, and managerial personnel. Competition for highly qualified personnel is intense, and there can be no assurance that the Company will be able to retain its key managerial and technical employees or that it will be able to attract and retain additional highly qualified personnel in the future. None of the Company's employees is represented by a labor union. The Company considers its employee relations to be good.

ITEM 2. PROPERTIES

The Company has two office facilities located in Bedford and Billerica, Massachusetts. The Bedford location consists of 11,000 square feet and serves as the Company's headquarters. The Company's sales and marketing, finance and administration, manufacturing and image compression organizations are housed at this location. The Company has occupied this space since June 1995 under a lease that expires in 1998 with an option to renew for two additional one-year periods.

The Company subleases approximately 16,000 square feet of space in Billerica, which is located approximately 1.5 miles from the Bedford location. This building is occupied by the Company's telecommunications research and development organization. The Company has occupied this space since December 1996 under a lease that expires in 1997 with an option to renew for an additional three months.

The Company believes that its facilities are substantially utilized, well maintained and suitable for the products and services offered by the Company, and that suitable space will be available as needed.

ITEM 3. LEGAL PROCEEDINGS

There are no pending legal proceedings to which the Company is a party or to which any of its properties are subject which, either individually or in the aggregate, are expected by the Company to have a material adverse effect on its business, financial position or results of operations.

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

No matters were submitted to a vote of security holders during the fourth quarter of 1996.

PART II

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

The Company has one class of stock outstanding, its common stock, which has a par value of $.01 per share. The Company's common stock is traded on the Nasdaq National Market under the symbol AWRE. The following table sets forth the high and the low sales prices as reported on the Nasdaq National Market from August 9, 1996, the date of the Company's initial public offering, to December 31, 1996.

1996	HIGH	LOW
Third Quarter	19	10 1/2
Fourth Quarter	17 1/2	8 1/2

As of February 21, 1997, the Company had approximately 134 shareholders of record. This number does not include shareholders from whom shares were held in a "nominee" or "street" name. The Company has never paid cash dividends on its common stock and anticipates it will continue to reinvest earnings to finance future operations.

The Company did not sell any equity securities that were not registered under the Securities Act during the three months ended December 31, 1996.

ITEM 6. SELECTED FINANCIAL DATA

The following selected historical financial data has been derived from the Company's audited consolidated financial statements. The historical financial data should be read in conjunction with the Company's consolidated financial statements and notes thereto included in Item 8.

(in 000's, except per share data) Year Ended December 31,	1996	1995	1994	1993	1992
Statements of Operations Data					
Revenue	$ 5,301	$3,260	$ 3,827	$ 3,172	$ 1,908
Income (loss) from operations	(538)	(454)	$(1,095)	(1,028)	(3,267)
Net income (loss)	259	(343)	$(1,012)	(992)	(3,249)
Net income (loss) per share	$ 0.01	$(0.17)			
Balance Sheet Data					
Cash and short-term investments	$36,719	$2,154	$ 2,566	$ 186	$ 813
Working capital	38,280	2,516	2,877	281	1,114
Total assets	40,123	3,228	3,930	978	1,902
Total liabilities	676	309	684	493	405
Total stockholders' equity	39,446	2,920	3,246	485	1,497

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

RESULTS OF OPERATIONS

The following table sets forth, for the periods indicated, certain line items from the Company's consolidated statements of operations as a percentage of total revenue:

Year ended December 31,	1996	1995	1994
Revenue:			
Product	12.3 %	12.5 %	4.7 %
License and royalty	56.0	31.8	26.4
Research and development	31.7	55.7	68.9
Total revenue	100.0	100.0	100.0
Costs and expenses:			
Cost of product revenue	15.7	7.5	3.0
Research and development	61.0	71.6	91.3
Sales and marketing	14.5	12.6	8.6
General and administrative	18.9	22.3	25.8
Total costs and expenses	110.2	113.9	128.6
Income (loss) from operations	(10.2)	(13.9)	(28.6)
Interest income	15.0	3.4	2.2
Net income (loss)	4.9 %	(10.5)%	(26.5)%

PRODUCT REVENUE

Product revenue consists primarily of revenue from the sale of tangible products, such as ADSL modems and video editing chipset products, which are manufactured by the Company or third party suppliers. Product revenue increased by 60% from $406,000 in 1995 to $649,000 in 1996. Product revenue as a percentage of total revenue was 12.3% and 12.5% in 1996 and 1995, respectively. A year to year comparison of product revenue is not meaningful due to differences in the composition of product revenue. Product revenue in 1996 consists primarily of revenue from the sale of the Company's ADSL Internet access modems, which were introduced in early 1996. Product revenue in 1995 consists primarily of revenue from the sale of video editing chipset products, which the Company discontinued in 1995.

Product revenue increased by 124% from $181,000 in 1994 to $406,000 in 1995. Product revenue in 1995 and 1994 was comprised of sales of video editing chipset products. The increase in video editing chipset product revenue was primarily due to significant orders from a customer purchasing large quantities in 1995 before the Company discontinued that product line.

LICENSE AND ROYALTY REVENUE

License and royalty revenue consists primarily of revenue from the sale of intellectual property, such as hardware and software technology licenses, compression software licenses, and royalties from the sale of chipsets by customers who have licensed the Company's technology. As such revenue has only a

nominal cost of sale associated with it, the Company does not report a separate cost of license and royalty revenue line in its Statements of Operations.

License and royalty revenue increased by 187% from $1,037,000 in 1995 to $2,971,000 in 1996. License and royalty revenue as a percentage of total revenue was 56.0% and 31.8% in 1996 and 1995, respectively. The increase in 1996 is primarily attributable to an increase in the sale of ADSL and other broadband technology licenses to telephone company equipment suppliers. Revenue from the sale of compression software licenses also contributed to the increase in license and royalty revenue in 1996. Approximately 51% of license and royalty revenue in 1996 was received from three customers.

License and royalty revenue increased by 3% from $1,008,000 in 1994 to $1,037,000 in 1995. The increase is primarily due to increased sales of compression software licenses and royalty revenue in 1995, which was partially offset by a decline in revenue from sales of technology licenses.

RESEARCH AND DEVELOPMENT REVENUE

Research and development revenue consists primarily of revenue from commercial contract engineering and development, and government research contracts. In 1993, the Company made a decision to reduce its government research activities and focus on the commercialization of its technology. This decision has resulted in lower research and development revenue and higher product and license and royalty revenue, which explains why research and development revenue as a percentage of total revenue has declined from 68.9% in 1994 to 55.7% in 1995 to 31.7% in 1996.

Research and development revenue decreased by 8% from $1,817,000 in 1995 to $1,680,000 in 1996. The decrease is primarily due to lower revenue from commercial research and development contracts and slightly lower revenue from U.S. government research contracts. Research and development revenue decreased by 31% from $2,637,000 in 1994 to $1,817,000 in 1995. The decrease is primarily due to a significant decrease in U.S. government research revenue, which was partially offset by an increase in commercial contract engineering revenue.

COST OF PRODUCT REVENUE

Cost of product revenue consists primarily of direct material, direct labor and overhead costs to produce the Company's products, and cost of goods for purchases of finished goods inventory from third party suppliers. Cost of product revenue as a percentage of product revenue was 128% in 1996 as compared to 60% in 1995. Such percentages primarily reflect the cost of modem revenue in 1996 and the cost of video editing chipset revenue in 1995. The cost of product revenue in 1996 also includes a $365,000 provision for excess and obsolete inventory related to modems. Excluding this charge, cost of product revenue as a percentage of product revenue was 72%. Accordingly, a comparison of cost of product revenue on a year to year basis is not meaningful due to differences in the composition of product revenue.

Cost of product revenue increased by 115% from $113,000 in 1994 to $243,000 in 1995. As a percentage of product revenue, cost of product revenue decreased from 62% in 1994 to 60% in 1995. The slight improvement in cost as a percentage of product revenue is primarily due to marginally lower pricing from the third party supplier of video editing chipset products as a result of higher volumes in 1995.

RESEARCH AND DEVELOPMENT

Research and development expense consists primarily of employee and consultant costs, supplies and allocated facilities costs related to the development of the Company's products and technology. Research and development expense increased by 39% from $2,333,000 in 1995 to $3,235,000 in 1996. The increase in research and development expense is primarily attributable to higher spending on projects to

develop, enhance, and commercialize the Company's ADSL, VDSL, SDSL and HFC broadband technologies. Higher spending on these projects was partially offset by lower spending as a result of the discontinuance of research involving audio compression technology and lower facilities costs as a result of the relocation of the Company's facilities in June 1995. The Company anticipates that research and development spending will grow significantly in 1997.

Research and development expense decreased by 33% from $3,492,000 in 1994 to $2,333,000 in 1995. The decrease is primarily due to the discontinuance, in January 1995, of research and development efforts associated with audio compression technology, lower facilities costs as a result of the relocation of the Company's facilities in June 1995, and a reduction of U.S. government research activity.

SELLING AND MARKETING

Selling and marketing expense consists primarily of salaries for sales and marketing personnel, travel, product advertising, and allocated facilities expense. Selling and marketing expense increased 87% from $412,000 in 1995 to $769,000 in 1996. The increase is primarily due to the addition of sales personnel and increased product advertising related to the Company's ADSL Internet access modem. Selling and marketing expense increased 25% from $329,000 in 1994 to $412,000 in 1995. The increase is primarily due to increases in the Company's sales force and product advertising. The Company anticipates that selling and marketing expenses will increase significantly in 1997.

GENERAL AND ADMINISTRATIVE

General and administrative expense consists primarily of salaries for administrative officers and support personnel, allocated facilities costs, and professional services, such as legal and audit expenses. General and administrative expense increased by 38% from $726,000 in 1995 to $1,004,000 in 1996. The increase is primarily attributable to additions to the Company's management team and administrative infrastructure, and expenses associated with becoming a public company. General and administrative expense decreased by 27% from $988,000 in 1994 to $726,000 in 1995. The decrease is primarily due to management and support staff reductions in January 1995.

INTEREST INCOME

Interest income increased 621% from $111,000 in 1995 to $798,000 in 1996 primarily as a result of higher average cash balances due to the investment of net proceeds from the Company's initial public offering. Interest income increased 34% from $83,000 in 1994 to $111,000 in 1995 primarily due to higher average cash balances in 1995 as compared to 1994.

INCOME TAXES

The Company has made no provision for income taxes as it has a history of net losses, which has resulted in tax loss carryforwards. As of December 31, 1996, the Company had net operating loss carryforwards of approximately

$9,773,000 and approximately $493,000 of research and development tax credit carryforwards to offset future federal taxable income. To the extent not utilized, the net operating loss and tax credit carryforwards expire between 2003 and 2011.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 1996, the Company had cash, cash equivalents and short-term investments of $36.7 million, an increase of $34.5 million from the prior year. The Company has funded its operations primarily from sales of common stock, including an initial public offering in August 1996, which generated net proceeds of $35.2 million. The Company also received proceeds of $1.1 million from the issuance of common stock in connection with its stock option plans in 1996.

Cash used by operations was $586,000 in 1996. Accounts receivable and unbilled accounts receivable increased $1.1 million from December 31, 1995. The increase in total accounts receivable reflects increased revenue in 1996, as well as the achievement of significant contract milestones and the closure of several license agreements late in the year. Inventory balances increased $408,000 from December 31, 1995, which reflects the purchase of raw materials to manufacture ADSL modems in larger quantities.

Investment activities in 1996 included capital expenditures of $1.1 million. Capital investments included the purchase of engineering development equipment, manufacturing equipment, and engineering and administrative software. The Company purchased $5.6 million of short-term investments, which were placed in highly rated corporate debt and U.S. agency securities.

While there can be no assurance that the Company will not require additional financing, or that such financing will be available to the Company, the Company believes that its financial resources are adequate to meet its liquidity requirements over the next twelve months.

FACTORS THAT MAY AFFECT FUTURE RESULTS

The statements contained in this Annual Report on Form 10-K which are not historical are "forward looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements represent the Company's present expectations or beliefs concerning future events, however the Company cautions that such statements are qualified by important factors. Such factors, which are identified under the heading "Risk Factors" below, could cause actual results to differ materially from those indicated in Management's Discussion and Analysis of Financial Condition and Results of Operations.

The Company believes that the occurrence of any one or some combination of the following risk factors could have a material adverse effect on the Company's business, financial condition and results of operations.

History of Operating Losses

The Company has incurred operating losses in every fiscal year since inception. Substantial additional research and development expenses to enhance the performance and reduce the manufacturing costs of the Company's products will be required before market acceptance can be determined. Also, the Company anticipates that substantial selling and marketing expenses will be required to establish sales channels for the Company's products and technology. There can be no assurance that the Company will achieve profitable operations in any future period.

Dependence on Acceptance of ADSL Technology

The Company's future success is substantially dependent upon whether ADSL technology gains widespread commercial acceptance by the telcos ("telcos") and end users of telco services. The Company has invested substantial resources in the development of ADSL technology implemented through the Discrete Multi-Tone ("DMT") modulation technique. Telcos have only begun evaluating DMT-based ADSL technology, and there can be no assurance that the telcos will pursue the deployment of such ADSL technology.

Reliance on Telcos; Dependence on a Limited Number of Customers

Even if telcos adopt policies favoring full-scale implementation of ADSL technology, there can be no assurance that sales of the Company's ADSL products will become significant. The Company's customers, including Regional Bell Operating Companies ("RBOCs"), OEMs and other telcos, are relatively few in number and have significantly greater resources than that of the Company. The Company has limited ability to influence or control decisions made by these customers. There can be no assurance that these customers will not use their size and bargaining power to demand unfavorable terms and conditions (including price), seek alternative suppliers, or undertake internal development of products comparable to those of the Company's.

Substantial Dependence on Analog Devices, Inc.

The Company and Analog Devices, Inc. ("ADI") have entered into a series of agreements to develop integrated chipsets based on the Company's technology. The inability or refusal of ADI to manufacture, market and sell such chipsets in substantial quantities would prevent telcos from adopting the Company's technology and would have a material adverse effect on the Company's business. There can be no assurance that ADI will succeed or, in the event that ADI is not successful, that the Company would be able to find a substitute chipset manufacturer without significant delays.

Proprietary Technology; Risk of Third Party Claims of Infringement

The Company's ability to compete effectively will depend to a significant extent on its ability to protect it proprietary information and to operate without infringing the intellectual property rights of others. Despite the precautions the Company has taken to protect its intellectual property, there can be no assurance that such steps will be adequate to prevent the misappropriation of its technology. In addition, third parties may assert exclusive patent, copyright and other intellectual property rights to technologies that are important to the Company. There can be no assurance that other third parties will not assert such claims against the Company in the future.

Rapid Technological Change; Dependence on New Products

The markets for the Company's products are characterized by rapid technological advances, evolving industry standards, changes in end-user requirements, frequent new product introductions, and evolving telco offerings. The Company's business will be materially adversely affected if technologies or standards on which Company's products are based become obsolete, or if the Company is unable to develop and introduce new products in a timely manner in response to changing market conditions.

Competition

The markets for the Company's products are intensely competitive and the Company expects competition to increase in the immediate future. Many of the Company's competitors and potential competitors have significantly greater financial, technological, manufacturing, marketing and personnel resources than the Company. There can be no assurance that the Company will be able to compete successfully or that competition will not adversely affect the Company's business.

Manufacturing

The Company has limited experience in manufacturing or in supervising the manufacture of its products, including its ADSL modem. There can be no assurance that the Company will not encounter significant difficulties in manufacturing or controlling the quality of its products, or that its products will be reliable in the field.

ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

REPORT OF INDEPENDENT ACCOUNTANTS

We have audited the accompanying consolidated balance sheets of Aware, Inc. as of December 31, 1996 and 1995, and the related consolidated statements of operations, stockholders' equity, and cash flows for each of the three years in the period ended December 31, 1996. Our audits also included the financial statement schedule listed in the Index at Item 14. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements and financial statement schedule based on our audits.

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

In our opinion, the consolidated financial statements present fairly, in all material respects, the financial position of Aware, Inc. at December 31, 1996 and 1995, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1996, in conformity with generally accepted accounting principles. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, present fairly, in all material respects, the information set forth therein.

/s/ Deloitte & Touche LLP

Boston, Massachusetts
January 30, 1997

AWARE, INC.
CONSOLIDATED BALANCE SHEETS

December 31,	1996	1995
ASSETS		
Current assets:		
Cash and cash equivalents	$ 31,092,273	$ 2,153,681
Short-term investments	5,626,725	--
Accounts receivable (less allowance for doubtful accounts of $35,000 in 1996 and $5,300 in 1995)	1,654,980	500,828
Unbilled accounts receivable	110,722	116,261
Inventories	447,534	39,713
Prepaid expenses	23,426	14,471
Total current assets	38,955,660	2,824,954

Property and equipment, net of accumulated depreciation and amortization of $557,901 in 1996 and $1,480,614 in 1995	1,166,928	403,405
Total assets	$ 40,122,588	$ 3,228,359

LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 337,339	$ 111,519
Accrued expenses	60,091	65,404
Accrued compensation	173,692	67,887
Accrued professional	65,000	14,000
Deferred revenue	40,000	50,000
Total current liabilities	676,122	308,810
Stockholders' equity:		
Preferred stock, $1.00 par value; 1,000,000 shares authorized, none outstanding	--	--
Preferred stock, $1.00 par value:		
Series B convertible preferred stock, 15,875 shares authorized; issued and outstanding, none in 1996 and 15,875 in 1995	--	15,875
Series C convertible preferred stock, 13,525 shares authorized; issued and outstanding, none in 1996 and 13,525 in 1995	--	13,525
Series D convertible preferred stock, 74,800 shares authorized; issued and outstanding, none in 1996 and 69,166 in 1995	--	69,166
Series E convertible preferred stock, 45,000 shares authorized; issued and outstanding, none in 1996 and 29,432 in 1995	--	29,432
Common stock, $.01 par value; 30,000,000 shares authorized; issued and outstanding, 18,959,897 in 1996 and 1,166,960 in 1995	189,600	11,670
Additional paid-in capital	50,025,548	13,807,945
Accumulated deficit	(10,315,720)	(10,575,102)
Treasury stock	(452,962)	(452,962)
Total stockholders' equity	39,446,466	2,919,549
Total liabilities and stockholders' equity	$ 40,122,588	$ 3,228,359

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

AWARE, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

Year Ended December 31,	1996	1995	1994
Revenue:			
Product	$ 649,422	$ 406,459	$ 181,217
License and royalty	2,971,238	1,036,615	1,008,434
Research and development	1,680,449	1,816,820	2,637,199
Total revenue	5,301,109	3,259,894	3,826,850
Costs and expenses:			
Cost of product revenue	831,241	242,983	112,925
Research and development	3,234,799	2,333,200	3,492,249
Selling and marketing	769,395	411,777	329,068
General and administrative	1,003,948	725,511	987,640
Total costs and expenses	5,839,383	3,713,471	4,921,882
Income (loss) from operations	(538,274)	(453,577)	(1,095,032)
Interest income	797,656	110,615	82,683
Net income (loss) before provision for	259,382	(342,962)	(1,012,349)

income taxes			
Provision for income taxes	--	--	--
Net income (loss)	$ 259,382	$ (342,962)	$(1,012,349)

Net income (loss) per share	$ 0.01	$ (0.17)
Weighted average number of shares used in per share calculation	18,394,395	2,045,006

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

AWARE, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

Year ended December 31,	1996	1995	1994
Cash flows from operating activities:			
Net income (loss)	$ 259,382	$ (342,962)	$ (1,012,349)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:			
Depreciation and amortization	352,715	200,701	206,140
Increase (decrease) from changes in assets and liabilities:			
Accounts receivable	(1,154,152)	94,168	(326,756)
Unbilled accounts receivable	5,539	187,840	(55,603)
Inventories	(407,821)	(18,044)	25,071
Prepaid expenses	(8,955)	59,071	(49,385)
Accounts payable	225,820	14,757	(115,045)
Accrued expenses	151,492	(350,150)	314,595
Deferred revenue	(10,000)	(39,720)	(8,408)
Net cash used in operating activities	(585,980)	(194,339)	(1,021,740)
Cash flows from investing activities:			
Purchases of property and equipment	(1,116,238)	(234,131)	(371,658)
Net purchases of short-term investments	(5,626,725)	-	-
Net cash used in investing activities	(6,742,963)	(234,131)	(371,658)
Cash flows from financing activities:			
Proceeds from issuance of common stock, net of issuance costs	36,267,535	16,023	9,500
Proceeds from issuance of preferred stock, net of issuance costs	-	-	3,764,058
Proceeds from stockholders' loans	-	-	150,000
Repayment of stockholders' loans	-	-	(150,000)
Net cash provided by financing activities	36,267,535	16,023	3,773,558
Increase (decrease) in cash and cash equivalents	28,938,592	(412,447)	2,380,160
Cash and cash equivalents, beginning of period	2,153,681	2,566,128	185,968
Cash and cash equivalents, end of period	$31,092,273	$2,153,681	$ 2,566,128

SUPPLEMENTAL CASH FLOW INFORMATION:			
Cash paid for interest	$ 820	$ 877	$ 4,359
SUPPLEMENTAL NONCASH DISCLOSURES:			
Conversion of preferred stock to common stock	$ 127,998	-	-
Increase in notes receivable for accrued interest	-	-	$ 25,413
Repurchase of Series D preferred shares for cancellation of notes	-	$ 457,062	-

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

AWARE, INC.

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	Convertible Preferred Stock						
	Series B	Series C	Series D	Series E	Common Stock	Additional Paid-In Capital	Accumulated Deficit
Balance, December 31, 1993	$ 15,875	$ 13,525	$ 73,266	$	$ 11,401	$10,022,652	$ (9,219,791)
Sale of 29,432 shares of Series E convertible preferred stock, net of issuance costs of $36,689	-	-	-	29,432	-	3,760,039	-
Exercise of common stock options, 10,000 shares	-	-	-	-	100	9,400	-
Accrued interest on notes receivable for stock issuances	-	-	-	-	-	-	-
Net loss	-	-	-	-	-	-	(1,012,349)
Balance, December 31, 1994	15,875	13,525	73,266	29,432	11,501	13,792,091	(10,232,140)
Exercise of common stock options, 16,867 shares	-	-	-	-	169	15,854	-
Repurchase of Series D preferred stock, 4,100 shares	-	-	(4,100)	-	-	-	-
Net loss	-	-	-	-	-	-	(342,962)
Balance, December 31, 1995	15,875	13,525	69,166	29,432	11,670	13,807,945	(10,575,102)
Issuance of common stock in initial public offering, net of issuance costs, 3,910,000 shares	-	-	-	-	39,100	35,123,900	-
Exercise of common stock options, 1,083,162 shares	-	-	-	-	10,832	1,093,703	-
Conversion of preferred stock to common stock, 12,799,800 shares	(15,875)	(13,525)	(69,166)	(29,432)	127,998	-	-
Net income	-	-	-	-	-	-	259,382
Balance, December 31, 1996	$ -	$ -	$ -	$ -	$189,600	$50,025,548	$(10,315,720)

	Notes Receivable For Issued Stock	Treasury Stock	Total Stockholders' Equity
Balance, December 31, 1993	$(431,649)	$ -	$ 485,279

Sale of 29,432 shares of Series E convertible preferred stock, net of issuance costs of $36,689	-	-	3,789,471
Exercise of common stock options, 10,000 shares	-	-	9,500
Accrued interest on notes receivable for stock issuances	(25,413)	-	(25,413)
Net loss	-	-	(1,012,349)
Balance, December 31, 1994	(457,062)	-	3,246,488
Exercise of common stock options, 16,867 shares	-	-	16,023
Repurchase of Series D preferred stock, 4,100 shares	457,062	(452,962)	-
Net loss	-	-	(342,962)
Balance, December 31, 1995	-	(452,962)	2,919,549
Issuance of common stock in initial public offering, net of issuance costs, 3,910,000 shares	-	-	35,163,000
Exercise of common stock options, 1,083,162 shares	-	-	1,104,535
Conversion of preferred stock to common stock, 12,799,800 shares	-	-	-
Net income	-	-	259,382
Balance, December 31, 1996	$ -	$(452,962)	$39,446,466

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

AWARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. NATURE OF BUSINESS

Aware, Inc. (the "Company") designs, develops and markets telecommunications software, chipsets and modems that incorporate Asymmetric Digital Subscriber Line (ADSL), Very High Speed Digital Subscriber Line (VDSL), Symmetric Digital Subscriber Line (SDSL), and Hybrid Fiber Coaxial (HFC) technologies. Such broadband technologies are designed to increase the speed of data communications over conventional copper telephone lines and coaxial cable. The Company's products are designed to allow telephone and cable companies to utilize their installed bases of dedicated copper lines and coaxial cable to provide both residential and business customers with interactive data transmission at speeds much higher than currently available. The Company also offers image compression software products.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

BASIS OF PRESENTATION - The consolidated financial statements include the accounts of Aware, Inc. and its subsidiary. All significant intercompany transactions have been eliminated.

CASH AND CASH EQUIVALENTS - Cash and cash equivalents consist primarily of demand deposits, money market funds, commercial paper, and discount notes in highly liquid short-term instruments with original maturities of three months or less from the date of purchase and are stated at cost, which approximates market.

SHORT-TERM INVESTMENTS - The Company follows Statement of Financial Accounting Standard ("SFAS") No. 115, "Accounting for Certain Investments in Debt and Equity Securities ("SFAS 115"). The Company has the intent and the ability to hold to maturity all securities that mature in less than one year. Accordingly, these "held-to-maturity" securities have been recorded at amortized cost. The Company has categorized all other securities as "available-for-sale," since the Company may liquidate these investments currently. SFAS 115 requires that unrealized gains and losses on available-for-sale securities be excluded from earnings and reported in a separate component of stockholders' equity. As of December 31, 1996, the unrealized gain was immaterial.

The amortized cost of securities, which approximates fair value, consists of the following at December 31, 1996:

	MATURITY		
TYPE OF SECURITY	LESS THAN ONE YEAR	ONE TO FIVE YEARS	TOTAL
Corporate debt securities	$3,040,072	$1,602,023	$4,642,095
U.S. agency securities	984,630	-	984,630
Total	$4,024,702	$1,602,023	$5,626,725

ALLOWANCE FOR DOUBTFUL ACCOUNTS - Accounts are charged to the allowance for doubtful accounts as they are deemed uncollectible based on a periodic review of the accounts. Bad debt expense was approximately $20,000, $5,000, and $0 for 1996, 1995, and 1994, respectively.

INVENTORIES - Inventories are stated at the lower of cost or market with cost being determined by the first-in, first-out ("FIFO") method.

PROPERTY AND EQUIPMENT - Property and equipment are stated at cost. Depreciation and amortization of property and equipment is provided using the straight-line method over the estimated useful lives of the assets (3 to 5 years).

REVENUE RECOGNITION - Product revenue consists primarily of revenue from the sale of tangible products, such as modems and compression chipsets. Revenue is recognized upon shipment.

License and royalty revenue consists primarily of revenue from the sale of intellectual property, such as hardware and software technology licenses, compression software licenses, and royalties from the sale of chipsets by customers who have licensed the Company's technology. Revenue from the sale of technology licenses for the initial transfer of hardware and software designs is recognized when a definitive agreement is reached, the transfer has been effected, and no contingent factors are present. Revenue from the sale of compression software licenses is recognized upon shipment. Royalty revenue is recognized based upon billing schedules when no right to return exists or upon sales reports from customers.

Research and development revenue is comprised of revenue from government and commercial research and development contracts. Revenue on government contracts is generally recognized when services are performed. Certain long-term contracts are accounted for using the percentage-of-completion method, whereby revenue and profit are recognized throughout the performance period of the contract based on the ratio that incurred costs bear to established total costs to complete. Losses, if any, on contracts are provided for in the period in which the losses are first identified. Revenue on commercial contracts is generally recognized as research is performed under the terms of the respective agreements.

Unbilled accounts receivable are stated at estimated realizable value. These amounts will be billable to customers based on the terms of contracts which include achievement of milestones or completion of the contract.

INCOME TAXES - The Company accounts for income taxes under SFAS No. 109, "Accounting for Income Taxes." This Statement requires the Company to compute deferred income taxes based on the differences between the financial statement and tax basis of assets and liabilities using enacted rates in effect in the years in which the differences are expected to reverse.

CAPITALIZATION OF SOFTWARE COSTS - The Company capitalizes certain internally generated software development costs after technological feasibility of the product has been established. Capitalized software costs also include amounts paid for purchased software which has reached technological feasibility. Such costs are amortized, on a product-by-product basis, on a straight-line basis over their useful economic lives (generally two to four years), or the ratio of current gross revenues to total gross current and future revenues, whichever is greater. There were no capitalized software costs at December 31, 1995 and 1996, because such costs incurred subsequent to the establishment of technological feasibility, but prior to commercial availability, were immaterial.

CONCENTRATION OF RISK - At December 31, 1996 and 1995, the Company had bank cash balances and money market investments, in excess of federally insured deposit limits of approximately $36,619,000 and $2,079,000, respectively.

Concentration of credit risk with respect to accounts receivable is limited to $549,000, $275,000, and $155,000 with three customers at December 31, 1996 and to $250,000 with one customer at December 31, 1995.

STOCK-BASED COMPENSATION - The Company grants stock options for a fixed number of shares to employees with an exercise price equal to the fair value of the shares at the date of grant. The Company adopted SFAS No. 123, "Accounting for Stock-Based Compensation" on January 1, 1996. As permitted by SFAS No. 123, the Company accounts for stock option grants in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, the Company recognized no compensation expense for stock option grants.

NET INCOME (LOSS) PER SHARE - Net income (loss) per share (pro forma for 1995) is based on the weighted average number of common and dilutive common equivalent shares (common stock options and convertible preferred stock) outstanding. Common equivalent shares are not included in the per share calculations for the year ended December 31, 1995, because the effect of their inclusion would be antidilutive, except in accordance with Securities and Exchange Commission Staff Accounting Bulletin No. 83. The Bulletin requires all common shares issued and options to purchase shares of common stock granted by the Company during the twelve-month period prior to the filing of a proposed initial public offering to be included in the calculation as if they were outstanding for all periods. Fully diluted net income (loss) per share is not presented as the dilutive effect is immaterial.

USE OF ESTIMATES - The preparation of the Company's financial statements in conformity with generally accepted accounting principles necessarily requires management to make estimates and assumptions that effect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the balance sheet date. Significant estimates include reserves for doubtful accounts, reserves for excess and obsolete inventory, useful lives of fixed assets, valuation allowance for deferred income tax assets and accrued liabilities. Actual results may differ from these estimates.

FAIR VALUE OF FINANCIAL INSTRUMENTS - SFAS No. 107, "Disclosures About Fair Value of Financial Instruments," requires disclosure of the fair value of certain financial instruments. The carrying amounts of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued expenses approximate fair value because of their short-term nature.

ACCOUNTING FOR LONG-LIVED ASSETS - The Company adopted SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed Of", in 1996. This Statement establishes accounting standards for the impairment of long-lived assets, certain identifiable intangibles, and goodwill related to those assets to be held and used and for long-lived assets and certain identifiable intangibles to be disposed of. Adoption did not have a material effect on the Company's financial position or results of operations.

RECLASSIFICATIONS - Certain prior year amounts have been reclassified to be consistent with the current year presentation.

3. INVENTORY

Inventory consists primarily of the following at December 31:

	1996	1995
Raw materials	$408,643	$39,713
Work-in-process	38,891	-
Finished goods	-	-
Total	$447,534	$39,713

4. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following at December 31:

	1996	1995
Computer equipment	$ 983,819	$ 1,556,790
Office equipment	83,917	88,390
Furniture and fixtures	124,677	106,499
Purchased software	375,467	117,638
Manufacturing equipment	118,998	--
Leasehold improvements	37,951	14,702

Total	1,724,829	1,884,019
Less accumulated depreciation and amortization	(557,901)	(1,480,614)
Net	$1,166,928	$ 403,405

In 1996, the Company removed from the accounts approximately $1,275,000 of fully depreciated assets, which were no longer in service.

5. INCOME TAXES

Deferred income tax assets at December 31 are attributable to the following:

	1996	1995
Depreciation	$ 69,000	$ 75,000
Accrued expenses	187,000	28,000
Deferred revenue	22,000	21,000
Alternative minimum tax credit	6,000	-
Federal net operating loss carryforwards	3,367,000	3,383,000
State net operating loss carryforwards	518,000	587,000
Research and development and other tax credit carryforwards	761,000	576,000
Total	4,930,000	4,670,000
Valuation allowance	(4,930,000)	(4,670,000)
Net	$ -	$ -

A valuation allowance is provided against temporary deductible differences, net operating loss carryforwards and tax credits which are not likely to be realized. During 1996 and 1995, the net valuation allowance was changed to fully reserve gross deferred tax assets.

A reconciliation of the U.S. federal statutory rate to the effective tax rate is as follows:

	1996	1995	1994
Federal statutory rate	34 %	(34)%	(34)%
State rate, net of federal benefit	6	(6)	(6)
Operating losses with no current tax benefit	-	40	40
Tax benefit from the utilization of net operating loss carryforwards	(40)	-	-
Effective tax rate	- %	- %	- %

At December 31, 1996, the Company had available federal net operating loss carryforwards of approximately $9,773,000 which expire in 2004 through 2010, and federal research and development credit carryforwards of approximately $493,000 which expire in 2003 through 2011. The Company also had available state net operating loss carryforwards of approximately

$5,448,000 which expire in 1997 through 2000 and state research and development and investment tax credit carryforwards of approximately $268,000 which expire in 2006 through 2011.

6. STOCKHOLDERS' EQUITY

COMMON STOCK - In 1996, the Company increased the number of shares of authorized common stock from 18,650,000 to 30,000,000.

In August 1996, the Company completed an initial public offering of its common stock consisting of 3,910,000 shares at $10.00 per share. Proceeds to the Company, net of issuance costs, were approximately $35,163,000 (issuance costs were approximately $3,937,000).

In accordance with the terms of the underlying agreements, all outstanding shares of Series B, C, D, and E convertible preferred stock were automatically converted into common stock upon completion of the initial public offering.

PREFERRED STOCK - In 1996, the Company authorized 1,000,000 shares of $1.00 par value preferred stock.

NOTES RECEIVABLE FOR STOCK ISSUANCES - In December 1992, the Company issued 4,100 shares of Series D preferred stock to two officers of the Company in exchange for notes receivable totaling $410,000. Interest was payable quarterly at the applicable federal rate (approximately 5.3% at December 31, 1994). At December 31, 1994, unpaid interest on the notes amounted to $47,062. The notes were secured by the related Series D preferred stock. Upon the resignation of the two officers from the Company in March 1995, the Company accepted the Series D preferred stock in payment of the notes and unpaid interest thereon.

7. STOCK COMPENSATION PLANS

At December 31, 1996, the Company has three stock-based compensation plans, which are described below. The Company applies APB Opinion 25 and related Interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its fixed stock option plans and its employee stock purchase plan. The Company has no performance-based stock option plans. Had compensation cost for the Company's three stock-based compensation plans been determined based on the fair value at the grant dates for awards under those plans consistent with the method of SFAS 123, the Company's net income (loss) and per share amounts would have been adjusted to the pro forma amounts indicated below:

Year ended December 31,		1996	1995
Net income (loss)			
	As reported	$ 259,382	$(342,962)
	Pro forma	$(4,405,824)	$(580,611)
Primary earnings (loss) per share			
	As reported	$ 0.01	$ (0.17)
	Pro forma	$ ($0.24)	$ (0.28)
Fully diluted earnings (loss) per share			
	As reported	$ 0.01	$ (0.17)
	Pro forma	$ (0.24)	$ (0.28)

The fair value of each option grant in the pro forma presentation is estimated on the date of grant using the Black-Scholes option-pricing model. The following assumptions were used to determine the pro forma compensation cost of option grants in 1996 and 1995 for both stock option plans: dividend yield of 0%; expected volatility of 97%; risk-free interest rates of 6.25%; and expected lives of four years.

FIXED STOCK OPTION PLANS - The Company has two fixed option plans. Under the 1990 Incentive and Nonstatutory Stock Option Plan, the Company may grant incentive stock options or nonqualified stock options to its employees and directors for up to 2,873,002 shares of common stock. Under the 1996 Stock Option Plan, the Company may grant incentive stock options or nonqualified stock options to its employees and directors for up to 3,000,000 shares of common stock. Under both plans, options: are granted at an exercise price as determined by the Board of Directors; have a maximum term of ten years; and generally vest on a monthly basis over three years.

AWARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A summary of the status of the Company's two fixed stock option plans as of December 31, 1996, 1995, and 1994, and changes during the years ending on those dates is presented below:

	1996		1995		1994	
	Shares	Wgtd. Avg. Exer. Price	Shares	Wgtd. Avg. Exer. Price	Shares	Wgtd. Avg. Exer. Price
Outstanding at beginning of year	2,757,500	$ 1.21	2,481,948	1.45	1,533,448	$ .98
Granted	1,818,250	9.10	1,139,750	1.30	1,138,000	1.45
Exercised	1,083,162	1.02	16,867	.95	10,000	.95
Forfeited	96,180	14.54	847,331	1.90	179,500	1.90
Outstanding at end of year	3,396,408	7.71	2,757,500	1.21	2,481,948	1.45
Options exercisable at year end	1,343,617		1,447,474		1,378,633	
Weighted-average fair value of options granted during the year	$ 6.07		$ 0.92			

The following table summarizes information about stock options outstanding at December 31, 1996:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 2/31/96	Weighted-Avg. Remaining Contractual Life	Weighted-Avg. Exercise Price	Number Exercisable at 12/31/96	Weighted-Avg. Exercise Price
$ 0 to 1	40,400	4.85 years	$ .95	40,400	$ .95
1 to 2	1,620,258	8.07	1.30	910,173	1.30
8 to 9	1,456,000	9.39	8.25	388,671	8.25
10 to 11	279,750	9.93	$10.25	4,373	$10.25
	3,396,408	8.83	$ 7.71	1,343,617	$ 6.37

EMPLOYEE STOCK PURCHASE PLAN - In June 1996, the Company adopted an

Employee Stock Purchase Plan (the "ESPP Plan") under which eligible employees may purchase common stock at a price equal to 85% of the lower of the fair market value of the common stock at the beginning or end of each six month offering period. Participation in the ESPP Plan is limited to 6% of an employee's compensation, may be terminated at any time by the employee and automatically ends on termination of employment with the Company. A total of 100,000 shares of common stock have been reserved for issuance. During 1996, no shares of common stock were issued under this plan, as the Company had not commenced implementation of the plan.

8. COMMITMENTS

LEASE COMMITMENTS - During December 1994, management of the Company decided to relocate its office and research facilities and initiated negotiations to terminate its lease. In March 1995, the Company completed negotiations to terminate the lease effective May 31, 1995. The Company's cost to terminate the lease of approximately $180,000 was included in rent expense in 1994.

The Company entered into a three year noncancelable operating lease for its office and research facilities commencing June 1, 1995. The lease provides that the Company pay a base monthly rental of $10,500, plus, as additional rent, a proportionate annual share of the building common expenses and real estate taxes in excess of a specified amount.

In November 1996, the Company entered into a twelve month operating lease for additional space for its research facilities commencing December 1, 1996. The lease provides that the Company pay a total monthly rental of $18,600, which includes the rental of furniture from the lessor.

Rental expense approximated $143,000, $283,000, and $494,000 in 1996, 1995 and 1994, respectively.

Future annual minimum lease payments under the leases are as follows:

Year	
1997	$330,000
1998	52,000
Total	$382,000

LITIGATION - There are no material pending legal proceedings to which the Company is a party or to which any of its properties are subject which, either individually or in the aggregate, are expected by the Company to have a material adverse effect on its business, financial position or results of operations.

9. TRANSACTIONS WITH RELATED PARTIES

CONSULTING AGREEMENTS - The Company pays consulting fees for scientific research and development services provided by certain stockholders. The total charges from related parties approximated $8,000, $66,000, and $27,000 in 1996, 1995 and 1994, respectively. There were no amounts due to related parties at December 31, 1996 and 1995.

AWARE, INC.
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

10. MAJOR CUSTOMERS

The portion of total revenue that was derived from major customers was as follows:

	1996	1995	1994
Customer A	17%	23%	10%
Customer B	12%	12%	38%
Customer C	22%	-	-
Customer D	10%	-	-
Customer E	-	18%	-
Customer F	-	10%	-

11. EMPLOYEE BENEFIT PLAN

In 1994, the Company established a qualified 401(k) Retirement Plan (the "Plan") under which employees are allowed to contribute certain percentages of their pay, up to the maximum allowed under Section 401(k) of the Internal Revenue Code. Company contributions to the Plan are at the discretion of the Board of Directors. There were no Company contributions in 1996, 1995 and 1994.

12. QUARTERLY RESULTS OF OPERATIONS - UNAUDITED

The following table presents unaudited quarterly operating results for each of the Company's eight quarters in the two-year period ended December 31, 1996:

	1996			
Quarters ended	March 31,	June 30	Sept. 30	Dec. 31
Revenue	$962,003	$1,128,475	$1,505,820	$1,704,811
Income (loss) from operations	17,651	18,300	4,250	(578,475)
Net income (loss)	41,151	48,668	261,683	(92,120)
Net income (loss) per share	$ 0.00	$ 0.00	$ 0.01	$ 0.00

	1995			
Quarters ended	March 31,	June 30	Sept. 30	Dec. 31

Revenue	$ 950,376	$ 361,575	$963,498	$984,445
Income (loss) from operations	(115,837)	(562,514)	155,034	69,740
Net income (loss)	(87,213)	(530,282)	179,965	94,568
Net income (loss) per share	$ (0.04)	$ (0.26)	$ 0.01	$ 0.01

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

None.

PART III

ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT

Information with respect to Directors and Executive Officers and compliance with Section 16(a) of the Exchange Act may be found in the sections captioned "Directors and Executive Officers" and "Section 16(a) Beneficial Ownership Reporting Compliance" appearing in the Company's definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on Wednesday, May 21, 1997. Such information is incorporated herein by reference.

EXECUTIVE OFFICERS OF THE REGISTRANT

The executive officers of the Company as of February 28, 1997 are:

NAME	AGE	POSITION
James C. Bender	44	President, Chief Executive Officer, and Director
David C. Hunter	41	Senior Vice President, Product Development
Richard P. Moberg	41	Chief Financial Officer and Treasurer
Edmund C. Reiter	33	Vice President, Advanced Products
Michael A. Tzannes	35	Senior Vice President, Telecommunications

James C. Bender has been President, Chief Executive Officer and a director of the Company since October 1994. From April 1992 to February 1994, Mr. Bender served as President and Chief Executive Officer of Logicraft, Inc., a network service provider. From 1986 to April 1992, Mr. Bender serviced as Logicraft's President and Chief Operating Officer. Mr. Bender received an M.B.A. from the Harvard Graduate School of Business Administration and a B.S. from Lowell Technological Institute.

David C. Hunter joined the Company in May 1996 as Senior Vice President, Product Development. From 1982 to April 1996, Mr. Hunter served as Vice President, Research and Development of I.D.E. Corporation ("IDEA"), a manufacturer of data communications equipment. Mr. Hunter was a founder and director of IDEA. Mr. Hunter received an M.B.A. with high distinction from the Harvard Graduate School of Business Administration and a B.S. with distinction from Cornell University.

Richard P. Moberg joined the Company in June 1996 as Chief Financial Officer and Treasurer. From December 1990 to June 1996, Mr. Moberg held a number of positions at Lotus Development Corporation, a computer software developer, including Corporate Controller from June 1995 to June 1996, Assistant Corporate Controller from May 1993 to June 1995, and Director of Financial Services from December 1990 to May 1993. Mr. Moberg received an M.B.A. from Bentley College and a B.B.A. in accounting from the University of Massachusetts at Amherst.

Edmund C. Reiter has been the Company's Vice President, Advanced Products since August 1995. Prior to that, he served as the Company's Manager of Product Development for still image compression products from June 1994 to August 1995, as a Senior Member of the Company's Technical Staff from November 1993 to June 1994, and as a Member of the Technical Staff from December 1992 to November 1993. Dr. Reiter served as Senior Scientist at New England Research, Inc. from January 1991 to October 1992. Dr. Reiter received a B.S. from Boston College and a Ph.D. from the Massachusetts Institute of Technology.

Michael A. Tzannes has been the Company's Senior Vice President, Telecommunications since April 1996. Dr. Tzannes served as the Company's Vice President, Telecommunications from December 1992 to April 1996, as a Senior Member of the Company's Technical Staff from January 1991 to November 1992, and as a consultant to the Company from October 1990 to December 1990. From 1986 to 1990, he was a Staff Engineer at Signatron, Inc., a telecommunications technology and systems developer. Dr. Tzannes received a Ph.D. in electrical engineering from Tufts University, an M.S. from the University of Michigan at Ann Arbor, and a B.S. from the University of Patras, Greece.

ITEM 11. EXECUTIVE COMPENSATION

Information with respect to this item may be found in the section captioned "Compensation of Directors and Executive Officers" appearing in the Company's definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on Wednesday, May 21, 1997. Such information is incorporated herein by reference.

ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT

Information with respect to this item may be found in the section captioned "Security Ownership of Certain Beneficial Owners and Management" appearing in the Company's definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on Wednesday, May 21, 1997. Such information is incorporated herein by reference.

ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Information with respect to this item may be found in the section captioned "Certain Transactions" appearing in the Company's definitive Proxy Statement to be delivered to shareholders in connection with the Annual Meeting of Shareholders to be held on Wednesday, May 21, 1997. Such information is incorporated herein by reference.

PART IV

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

(A) (1) INDEX TO FINANCIAL STATEMENTS

The following consolidated financial statements are included in Part II, Item 8:

(2) INDEX TO FINANCIAL STATEMENT SCHEDULE

Schedules other than those listed above have been omitted since they are either not required or not applicable or the information is otherwise included.

(3) INDEX TO EXHIBITS

EXHIBIT NO.	DESCRIPTION OF EXHIBIT
3.1	Amended and Restated Articles of Organization (filed as Exhibit 3.2 to the Company's Registration Statement on Form S-1, File No. 333-6807 and incorporated herein by reference).
3.2	Amended and Restated By-Laws (filed as Exhibit 3.3 to the Company's Form 10Q for the quarter ended June 30, 1996 and incorporated herein by reference).
10.1	1990 Incentive and Non-Statutory Stock Option Plan (filed as Exhibit 10.2 to the Company's Registration Statement on Form S-1, File No. 333-6807 and incorporated herein by reference).
10.2	1996 Stock Option Plan (filed as Exhibit 10.3 to the Company's Registration Statement on Form S-1, File No. 333-6807 and incorporated herein by reference).
10.3	1996 Employee Stock Purchase Plan (filed as Exhibit 10.4 to the Company's Registration Statement on Form S-1, File No. 333-6807 and incorporated herein by reference).
10.4	License Agreement with Analog Devices, Inc., dated September 25, 1993,

	together with appendices thereto (filed as Exhibit 10.5 to the Company's Registration Statement on Form S-1, File No. 333-6807 and incorporated herein by reference).
10.5	Development Contract with Analog Devices, Inc., dated September 25, 1993, together with amendments thereto (filed as

	Exhibit 10.6 to the Company's Registration Statement on Form S-1, File No. 333-6807 and incorporated herein by reference).
10.6	Agreement with DSC Telecom L.P., dated March 6, 1996, (filed as Exhibit 10.7 to the Company's Registration Statement of Form S-1, File No. 333-6807 and incorporated herein by reference).
10.7	Lease Agreement dated April 3, 1995, with respect to real property located at One Oak Park, Bedford, Massachusetts, between R.W. Connelly as lessor and the Company as lessee (filed as Exhibit 10.11 to the Company's Registration Statement on Form S-1. File No. 333-6807 and incorporated herein by reference).
10.8*	Employment Agreement of James C. Bender, dated October 27, 1994, together with amendment thereto dated December 20, 1996.
10.9	Form of Director Indemnification Agreement (filed as Exhibit 10.13 to the Company's Registration Statement on Form S-1, File No. 333-6807 and incorporated herein by reference).
10.10*	Sublease Agreement dated November 15, 1996, with respect to real property located at 39 Manning Road, Billerica, Massachusetts, between Bay Networks, Inc. as sublandlord and the Company as sublessee.
11.1*	Computation of primary and fully diluted net income (loss) per share.
21.1*	Subsidiaries of Registrant
23.1*	Consent of Independent Accountants

* Filed herewith.

(B) Reports on Form 8-K

No reports on Form 8-K were filed during the fourth quarter of 1996.

SCHEDULE II

AWARE, INC.

VALUATION AND QUALIFYING ACCOUNTS
YEARS ENDED DECEMBER 31, 1996, 1995, 1994

COL. A	COL. B	COL. C (1)	COL. C (2)	COL. D	COL. E
		ADDITIONS			
	BALANCE AT BEGINNING OF PERIOD	CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS	DEDUCTIONS CHARGED TO RESERVES	BALANCE AT END OF PERIOD
Accounts receivable allowances:					
1996	$5,300	$ 19,698	$20,000	$ 9,998	$ 35,000
1995	-	$ 5,300	-	-	$ 5,300
1994	-	-	-	-	-
Inventory reserves:					
1996	-	$365,000	-	$65,000	$300,000
1995	-	-	-	-	-
1994	-	-	-	-	-

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

AWARE, INC.

By: /s/ James C. Bender
James C. Bender, Chief Executive Officer & President

Date: March 26, 1997

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities indicated on the 26th day of March 1997.

SIGNATURE	TITLE
/s/ James C. Bender James C. Bender	Chief Executive Officer, President, and Director (Principal Executive Officer)
/s/ Richard P. Moberg Richard P. Moberg	Chief Financial Officer, Treasurer (Principal Financial and Accounting Officer)
/s/ Charles K. Stewart Charles K. Stewart	Chairman of the Board of Directors
/s/ Jerald G. Fishman Jerald G. Fishman	Director
/s/ John K. Kerr John K. Kerr	Director
/s/ John S. Stafford, Jr. John S. Stafford, Jr.	Director

EXHIBIT 10.8

AWARE, INC.
ONE MEMORIAL DRIVE
CAMBRIDGE, MA 02142

October 27, 1994

Mr. James C. Bender
272 Farley Road
Hollis, New Hampshire 03049

Re: Employment Agreement

Dear Mr. Bender:

The purpose of this letter is to set forth our agreement with respect to your employment by Aware, Inc. (the "Company"), as follows:

1. TERM OF EMPLOYMENT. Subject to sections 5 and 6 of this agreement, the term of your employment shall begin on October 31, 1994, and end on December 31, 1997, except that the term shall be extended for up to ten one-year periods, the first to begin on January 1, 1998, unless the Company has given you written notice of non-extension at least twelve months before the date on which the one-year extension would otherwise begin.

2. SALARY AND BONUS. During the term of your employment, you shall be paid a salary at the annual rate of $180,000.00, payable monthly. The Company, at the discretion of its board of directors, may award you a bonus based upon the Company's financial results and/or achievement of corporate objectives.

3. TITLE AND LINE OF AUTHORITY. The Company agrees that during the term of your employment you shall have the title "President" and "Chief Executive Officer" and agrees to use its best efforts to cause you to be appointed to its board of directors as soon as possible after the date of this agreement and to be reelected to the board at each election for directors held during the term of your employment. You agree to resign from the board of directors upon expiration of your term of employment or its termination in accordance with this agreement. You shall report to the Company's board of directors. Presently, the Board has designated Charles Stewart to act for the Board in this reporting arrangement.

4. EMPLOYEE BENEFITS. You shall be entitled to participate in all Company sponsored insurance or other employee benefit programs, on the same basis as other employees. If you elect not to participate in the Company's health insurance program, the Company shall reimburse you for such health insurance (medical/dental) as you elect to obtain from another source, up to reimbursement of $500/month. The Company shall also pay or reimburse you for:

annual dues for your membership in the Harvard Club (Boston); access and use charges for one cellular telephone in each of two automobiles owned or leased by you; monthly and use charges for a telephone line for operation of a fax machine in your home and the cost of acquiring such machine; and other ordinary and necessary expenses incurred by you in pursuit of the Company's business for which you provide the Company with receipts appropriate to support deduction thereof by the Company for federal income tax purposes to the extent permitted by law. You shall be entitled to three (3) weeks paid vacation for each year of your employment.

5. TERMINATION:

(a) EXPIRATION OF TERM, ETC. The term of your employment shall end upon your death or your disability (as defined herein) or upon expiration of your term of employment on December 31, 1997, or as extended pursuant to #1. In the event of termination by reason of your death or disability, the Company shall continue your compensation and benefits for a period of six (6) months thereafter. All vested options may be exercised until the second anniversary of your death. All vested non-statutory options may be exercised until the third anniversary of your disability. All vested incentive options may be exercised until the first anniversary of your disability. For the purpose of the provision, "disability" shall mean your inability to perform any of the material duties of your position with the Company, continuously for a period of 90 calendar days or for 120 days in any one year period, as mutually determined by the Company and you or by a physician selected by the Company (for which purpose you agree to submit to an examination by any such physician).

(b) TERMINATION WITH CAUSE. The Company may terminate you for "cause" (as defined herein), provided that you have been given at least 10 days' prior written notice, specifying the cause in reasonable detail, and the opportunity to appear with your legal counsel at a meeting of the Company's board of directors or at a meeting of the Executive Committee of the Company's board of directors, at which at least a quorum is continuously present, to explain or refute the alleged actions or omissions specified in such notice. For the purpose of the provision, "cause" shall mean solely (i) negligent acts or omissions that have been or will be the sole or primary cause of material harm, financial or otherwise, to the Company, or (ii) conviction of a crime involving moral turpitude or conviction of a crime the principal victim of which is the Company.

6. TERMINATION WITHOUT CAUSE. The Company may terminate your employment at any time without cause, but in that event you shall be entitled to a severance payment upon such termination equal to the salary that you would have been paid pursuant to #2 of this agreement had your employment continued to the expiration of its term, but not less than $180,000.00 nor more than $270,000.00. Such payment shall be made irrespective of any other employment that you may have and any effort that you may, or may not, have made to seek or obtain other employment. For this purpose, the Company shall be deemed to have terminated your employment without cause if the Company materially changes any of your job titles or if there is a Change in Control of the Company. Change in Control means the occurrence during the Term of any of the following events:

(a) The Company is merged, consolidated or reorganized into or with another corporation (or other legal person) and as a result of such merger, consolidation or reorganization less than a majority of the combined voting power of the then-outstanding securities of such corporation (or person) immediately after such transaction are held in the aggregate by the holders of voting stock of the Company immediately prior to such transaction;

(b) The Company sells or otherwise transfers all or substantially all of its assets to another corporation (or other legal person) and as a result of such sale or transfer less than a majority of the combined voting power of the then-outstanding securities of such corporation (or person) immediately after such sale or transfer are held in the aggregate by the holders of voting stock of the Company immediately prior to such sale or transfer.

The dissolution of Novon, L.P. (or any other entity now holding stock in the Company) and the resulting distribution of the Company's stock to the holders of an interest in Novon, L.P. (or any other entity now holding stock in the Company) shall not constitute a Change in Control during the Term hereof. If the Company elects to terminate your employment without cause during the Term hereof, the effective date of termination of your employment for purposes of the exercise of your stock options shall be thirty days after written notice is given to you that the Company has elected to terminate your employment without cause, even though you are no longer receiving compensation during said thirty day period other than the severance pay referred to above.

7. STOCK OPTIONS: The Company does not currently have sufficient stock

available in its stock option plan to grant you the stock options that you desire. The Company will use its best efforts to

have the stockholders agree to increase the amount of stock available in the Company's stock option plan. If the stockholders agree to the appropriate increase in the amount of stock available in the stock option plan, the Company will use its best efforts to have the Board of Directors grant you the following stock options:

(a) FIRST OPTION. an option to purchase 230,769 shares of its common stock for $1.30/share. This option shall become exercisable cumulatively (i.e., "vest") at the rate of 6,410.25 shares at the end of each consecutive calendar month starting with November 1994, such that it shall be fully-vested and exercisable upon the last day of October 1997 and thereafter until expiration. The options to be granted pursuant to this #7(a) shall be incentive stock options as defined in Section 422 of the Internal Revenue Code of 1986 and shall be granted pursuant to the Company's Stock Option Plan.

(b) SECOND OPTION. an option to purchase 269,231 shares of its common stock for $1.30/share. This option shall become exercisable cumulatively (i.e., "vest") at the rate of 7,478.64 shares at the end of each consecutive calendar month starting with November 1994, such that it shall be fully-vested and exercisable upon the last day of October 1997 and thereafter until expiration.

(c) THIRD OPTION. an option to purchase 300,000 shares of its common stock for $1.30/share. This option shall become exercisable (i.e., "vest") at the rate of fifty (50) shares for each $1,000 of pre-tax profit realized by the Company during the period October 1, 1994 - December 31, 1997, as such profit is shown on the statements of operations prepared by the Company for each year and examined and reported upon by such independent accountants as the Company engages for such purpose. If you are still employed by the Company, on January 15, 1998 this option shall become exercisable as to 150,000 shares, even if the Company has not realized a pre-tax profit.

(d) The options to be granted pursuant to this #7(b) and (c) shall be non-statutory stock options and shall be granted pursuant to the Company's Stock Option Plan. Prior to execution of this Agreement, the Company has provided you with a copy of the forms to be used for the options to be granted to you pursuant to this Agreement. The options shall be granted as of November 1, 1994 and expire on the eighth anniversary of their date of grant.

The options shall become exercisable in full (i.e., "vest") upon any Change of Control of the Company.

8. NON-COMPETITION, ETC. You agree to execute and be bound by the Company's standard "Employee Agreement" concerning inventions, confidentiality and non-competition. A copy of this Employee Agreement is attached hereto.

9. SECURITY CLEARANCE. If requested to do so by the Company, you agree to apply for a federal security clearance and to comply with all the regulations regarding the same.

10. INDEMNIFICATION. The Company has provided you with a copy of the provision(s) of its by-laws or articles of organization providing indemnification to officers and directors of the Company in respect of their acts and omissions as such. The Company agrees that you shall be entitled to the indemnification provided thereby. A copy of such provision(s) is attached hereto and incorporated herein.

11. ARBITRATION. Any dispute arising hereunder or related hereto shall be

resolved exclusively by arbitration by a single arbitrator in Boston in accordance with the rules for commercial arbitration of the American Arbitration Association, except that the Company shall be entitled to seek injunctive relief from any Court of competent jurisdiction for any violation by you of your obligation under Sections 8 and 9. Such arbitration shall be final and binding. Judgment may be entered upon any arbitral award in any court of competent jurisdiction. No arbitrator may award punitive, multiple, statutory, or other non-compensatory damages.

12. MISCELLANEOUS. This Agreement is to be construed and enforced under the laws of Massachusetts. This Agreement expresses the complete understanding of the parties with respect to the subject matter hereto and is intended to supersede any prior or contemporaneous written or oral agreements.

AWARE, INC.

By:/s/ Charles Stewart

Charles Stewart,
Chairman of the Board

Accepted and agreed to:

/s/ James C. Bender
- -------------------------
James C. Bender

[AWARE, INC. LOGO]

A W A R E

December 20, 1996

Mr. James C. Bender
Aware, Inc.
One Oak Park
Bedford, Massachusetts 01730

RE: Amendment to Employment Agreement

Dear Mr. Bender:

The purpose of this letter is to set forth our agreement to amend the employment agreement between Aware, Inc. (the "Company") and yourself dated October 27, 1994 (the "Original Employment Agreement"), as follows:

1. TERM OF EMPLOYMENT. Section 1 of the Original Employment Agreement is hereby amended to read as follows in its entirety:

> "1. Term of Employment. Subject to Section 6 of this agreement, the term of your employment shall begin on January 1, 1997 and end on December 31, 2000, except that the term shall be extended for up to (5) one-year periods, the first to begin on January 1, 2003, unless the company or you has given the other written notice of non-extension at least six (6) months before the date on which the one-year extension would otherwise begin."

2. SALARY AND BONUS: Section 2 of the Original Employment Agreement is hereby amended by deleting the term "$180,000.00" and replacing it with the term "$200,000.00.

3. EMPLOYEE BENEFITS. Section 4 of the Original Employment Agreement is hereby amended to insert the following phrase in the third sentence: "initiation fees up to a maximum of $40,000, and annual dues up to a maximum of $6,000, at a golf or country club;"

4. TERMINATION. Section 5(a) of the Original Employment Agreement is hereby amended by deleting the date December 31, 1997" from the first sentence and replacing it with the date "December 31, 2002.

5. TERMINATION WITHOUT CAUSE. Section 6 of the Original Employment Agreement is hereby deleted in its entirety and the following new Section 6 is substituted therefor:

> 6. TERMINATION BY YOU. You may terminate your employment with the Company by providing the Company at least three (3) months' prior written notice. If such termination occurs on or before December 31, 1997 you shall forfeit thirty percent (30%) of the portion of each of the stock options described in Section 7 that is vested and unexercised on the date on which you give the Company such notice and no further vesting of any such option shall thereafter occur. If such termination occurs between January 1, 1998 and December 31, 1998 you shall forfeit twenty percent (20%) of the portion of each of the stock options described in Section 7 that is vested and unexercised on the date on which you give the Company such notice and no further vesting of any such option shall thereafter occur.

7. LIFE INSURANCE. A new Section 6A is hereby added to the Original Employment Agreement, to read as follows in its entirety:

> "6A. LIFE INSURANCE. During the term of your employment by the Company, the Company shall pay or reimburse you (as you may elect) for premiums on a term life insurance policy (renewable to age 65) on your life in the principal amount of $1 million, subject to the Company's prior approval of the insurance contract (including amount of premiums payable), which shall not be unreasonably withheld or delayed."

If this letter accurately sets forth our agreement regarding amendment of the original Employment Agreement, please sign and return to the Company the enclosed copy of this letter.

AWARE, INC.

By: /s/ Charles K. Stewart

Charles K. Stewart, Chairman of the Board

Accepted and agreed to:

/s/ James C. Bender
- -------------------
James C. Bender
President & CEO

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EXHIBIT 10.10

SUBLEASE AGREEMENT

THIS SUBLEASE AGREEMENT (the "Sublease" or "Sublease Agreement") is entered into on this 15th day of November, 1996 by and between BAY NETWORKS, INC., a Delaware corporation with its principal business address at 4401 Great America Parkway, Santa Clara, CA 95052 ("Sublandlord") and AWARE, INC., a Massachusetts corporation having an office address at One Oak Park, Bedford, MA 01730-1413 ("Subtenant").

WHEREAS, Wellfleet Communications, Inc., which was merged into Bay Networks, Inc. on October 21, 1994, entered into a Lease Agreement dated as of October 22, 1991 (the "Original Lease") which Original Lease has been amended by that certain First Amendment to Lease (the "First Amendment") dated August 31, I992 and that certain Second Amendment to Lease (the "Second.Amendment") dated October 20, 1993 and that certain Third Amendment to Lease (the "Third Amendment") dated June 30, 1995 and that certain Fourth Amendment to Lease (the "Fourth Amendment") dated September 1995 and that certain FitSh Amendment to Lease (the "Fifth Amendment") dated April 1996 (said Original Lease as amended by the First Amendment, the Second Amendment, the Third Amendment, the Fourth Amendment, the Fifth Amendment is hereinaRer collectively referred to as the "Master Lease") with respect to certain Premises located in the Building known as 39 Manning Road, Billerica, MA;), a copy of which is attached hereto as Exhibit A, under which it leases 80,000 rentable square feet of office space from WRC Properties, Inc. as assumed by Teachers Insurance Corporation, ("Landlord") in the building known as 39 Manning Road, Billerica, MA as provided in the Master Lease, together with certain appurtenant fights, the provisions of which Master Lease, portions of which are incorporated herein by reference; and

WHEREAS, Sublandlord desires to sublease to Subtenant and Subtenant desires to sublease from Sublandlord the premises leased by Sublandlord under the Master Lease on the. terms and conditions hereinafter provided,

NOW, THEREFORE, in consideration of the mutual promises herein provided, the parties agree as follows:

1. PREMISES AND TERM. Sublandlord hereby subleases to Subtenant and Subtenant hereby subleases from Sublandlord a portion of the premises consisting of approximately 15,953 rentable square feet, located and configured as shown on EXHIBIT B hereto (the "Premises"), upon and subject to the covenants, agreements, terms and conditions herein provided, for term commencing on the later to occur of: (a) Landlord's consent to this Sublease; or (b) completion of Subtenant's Work by Sublandlord (as defined on Exhibit's B & C, "Sublandlord's Work"); or (c) December 1, 1996 (the "Commencement") and terminating on November 30, 1997. Such Term may be extended under the same terms and conditions through February 28, I998, by written notice from Subtenant on or before August 31, 1997.

2. RENT. Subtenant covenants and agrees to pay net rent to Sublandlord for the Premises as follows: Annual rental of $63,812.00 in net rent plus $111,671.00 for operating expenses and real estate taxes, due and payable in advance on the first day of each month in monthly payments of $14,623.58. The parties acknowledge that the operating and real estate tax expense is a good faith estimate by Sublandlord and Subtenant agrees to pay and Sublandlord to

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receive such amount without further documentation and/or adjustments. Payments for any partial month shall be calculated on a prorated basis based on the number of days in the month.

All payments shall be made to:

Bay Networks, Inc.
8 Federal Street
Billedca, MA 01821
Attention: Real Estate Lease Administrator

3. USE. The Premises shall be used for offices and uses accessory thereto light manufacturing, research and development, and warehousing and distribution, but in no event for any uses not permitted under the Master Lease.

4. INCORPORATION OF MASTER LEASE. Except as otherwise provided herein, all of the rights, remedies, covenants, agreements, terms and conditions of the Master Lease relating to or applicable to the Sublandlord under the Master Lease with respect to the Premises are incorporated herein and made a part hereof with the same force and effect as if set forth at length herein, except to the extent the same are modified or amended by this Sublease, it being understood and agreed that said provisions shall fix the obligations, rights and remedies of the Subtenant with the same effect as if the Subtenant were the tenant named in the Master Lease. Except as otherwise provided herein, Subtenant agrees that Sublandlord shall have all of the rights and remedies of the Landlord under the Master Lease relating to the Premises with respect to Subtenant as if such rights and remedies were fully set forth herein. To the extent of a conflict between the terms of the Master Lease and this Sublease, the latter shall control.

5. CONDITION OF PREMISES. Subtenant represents that it has inspected the Premises and agrees to accept possession of the Premises in their present condition without any obligation on the part of Sublandlord to make any alterations, decorations, installations or improvements, other than the work outlined and described in Exhibit C "Sublandlord's Work", to be completed by December I, I996. Subtenant may make alterations and improvements to the Premises beyond those described in Exhibit C, in accordance with the applicable provisions of the Master Lease; provided, however, Subtenant will be required to remove such alterations and improvements and restore the Premises upon the expiration or termination of this Sublease Agreement to the extent required by the Master Lease. With respect to Sublandlord's Work, Sublandlord will notify Subtenant thirty (30) days prior to the expiration of the initial term and/or the extension term, as to the extent, if any, to which the Subtenant shall remove the Sublandlord's Work and restore the Premises to its initial condition ordinary wear and tear or casualty damage excepted.

6. ADHERENCE TO MASTER LEASE. (i) Subtenant covenants and agrees (a) to perform and observe all of the agreements, covenants, terms and conditions of the Master Lease with respect to the Premises (and the buildings and common areas, to the extent applicable) to the extent that the same are not modified or amended by this Sublease, and (b) that it shall not do or suffer or permit anything to be done which would constitute a default under the Master Lease with respect to the Premises, and (c) that notwithstanding any other provision of this Sublease to the contrary, any act or omission which constitutes a default under the Master Lease with respect to the Premises also constitutes a default hereunder.

(ii) Sublandlord covenants and agrees (a) that it shall not do (or fail to do) or suffer or permit anything to be done which would constitute a default under the Master Lease, or which would cause a termination of the Master Lease, and (b) that it shall not modify or amend the Master Lease in such a manner as to adversely affect Subtenant's use, occupancy and/or enjoyment of the Premises, without Subtenant's consent, which shall not be unreasonable withheld.

7. DEFAULT. If any default by Subtenant continues, in the case of payment

of rent or any other sum owned by Subtenant, for more than ten (10) days after written notice from Sublandlord, or in the case of any of Subtenant's other covenants, agreements or obligations under this Sublease or the Master Lease for more than thirty (30) days after notice by Sublandlord or such additional time as may be necessary if such default is not susceptible of cure within 30 days, provided Subtenant promptly commences to cure and diligently prosecutes the same until completion. Sublandlord may immediately or at any time thereatSer and without further notice terminate this Sublease and take any and all actions permitted to be taken by the Landlord under the Master Lease in respect of a default by the tenant thereunder or any termination as a result thereof.

8. PARKING. During the term of this Sublease, Subtenant shall be entitled to use a proportionate share in common with Sublandlord.

9. INDEMNITY. Subtenant and Sublandlord shall indemnify and hold harmless from and against any and all cost, expense or liability (including reasonable attorneys fees) incurred on account of either party's actions or the actions of its employees, agents, licensees or contractors on or about the Premises or on account of any breach or violation by Subtenant or Sublandlord of this Sublease, or the Master Lease, unless the same is due in substantial part to the negligence of either party's employees, agents, licensees, or contractors. Subtenant and Sublandlord hereby releases and waives any fight or claim against the other for loss of business, loss of profits, inconvenience, or for any other incidental or consequential damages.

10. ASSIGNMENT. Subtenant shall not assign this Sublease nor further sublet the Premises in whole or in part, and shall not permit Subtenant's interest in this Sublease Agreement to be vested in any third party by operation of law or otherwise. A change of control of Subtenant shall not be deemed to be an assignment for the purposes of this Section I0, except, if the acquirer of Subtenant is a direct competitor of the Sublandlord.

11. AUTHORITY. Subtenant represents and warrants that it has read and is familiar with the terms of the Master Lease. Subtenant and Sublandlord represent and warrant that each has all requisite corporate power and authority to enter into this Sublease.

12. LATE CHARGES. Other remedies for non-payment of rent notwithstanding, any rental payment not received within ten (10) days of the date it was due shall bear interest at 18% annually from the date the rent was due, which fee is a service charge intended to compensate Sublandlord for the additional administrative and other costs and expenses it incurs by reason of such late payment.

13. BROKERS. Sublandlord and Subtenant each represent to the other that they have not retained or dealt with any broker or agent in connection with this Sublease Agreement other than Avalon Partners, Inc. whose commission shall be paid entirely by Sublandlord. Each party agrees to indemnify and hold the other harmless from and against any breach of the foregoing representation.

14. INSURANCE. During the term of this Sublease Agreement, Subtenant shall maintain public liability and property damage insurance in accordance with the provisions of the Master Lease. Subtenant shall maintain fire and extended coverage insurance on its fixtures, equipment and leasehold improvements in amounts equal to the full insurable value thereof. Sublandlord and Subtenant each release the other from any liability for loss or damage sustained by it to the extent the' same would be or is covered by insurance as herein provided. Subtenant shall name Sublandlord and Landlord as an additional insured on its comprehensive liability insurance policy and shall provide Sublandlord and Landlord with a Certificate of Insurance certifying said coverage prior to taking possession of the Premises.

15. SERVICES AND REPAIRS. (i) Except as provided in subparagraph (ii) herein, it is understood that all work, services; repairs, restorations,

equipment and access which are required to be provided and made by Sublandlord hereunder or by Landlord under the Master Lease, will, in fact, be provided by the Landlord under the Master Lease, and Sublandlord shall have no obligation during the term of this Sublease Agreement to do any such work, to provide any such services, equipment or access, or to make any such repairs or restorations or otherwise perform any obligations or observe any conditions required to be observed or performed by Landlord under the Master Lease, and Subtenant agrees to look solely to the Landlord under the Master Lease for the performance and observance of the same. Sublandlord shall in no event be liable to Subtenant nor shall Subtenant's obligations hereunder be impaired or the performance thereof excused because of any failure or delay on the part of the Landlord under the Master Lease in performing or observing the obligations of the Landlord under the Master Lease, provided, however, that if a failure by the Landlord under the Master Lease materially interferes with Subtenant's use and occupancy of the Premises, and Subtenant so notifies Sublandlord in writing, Sublandlord shall use its best efforts to cause the Landlord under the Master Lease to promptly correct the failure.

Not withstanding the foregoing, if (a) Subtenant's use, occupancy and/or enjoyment of the Premises is adversely affected as a result of (1) Landlord's failure or delay to perform its obligations under the Master Lease, or (2) Sublandlord's failure or delay to perform its obligations under the Sublease, or (3) by reason of interruption, suspension or delay of work, services repairs, restorations, equipment and access, and (b) Sublandlord shall be entitled to an abatement of rent under the Master Lease as a result of the foregoing, then Subtenant shall be entitled to an equitable abatement of rent under this Sublease.

(ii) Any maintenance required of Subtenant under the Master Lease (including without limitation Section 7.2 of the Master Lease) will be performed by Sublandlord and paid by Sublandlord unless such repair or maintenance is the result of Subtenants negligence in which the cost will be billed to Subtenant.

16. ACCESS. Subtenant agrees to allow Sublandlord and its agents access to the entire Premises at any time, with reasonable advance notice to inspect Subtenant's compliance with the terms of this Sublease.

17. SURRENDER OF PREMISES. Subtenant agrees that time shall be of the essence with respect to Subtenant's obligation to surrender possession of the Premises to Sublandlord upon the termination of the term of this Sublease, and further agrees that in the event that Subtenant does not promptly surrender possession of the Premises to Sublandlord upon such termination, Sublandlord, in addition to any other rights and remedies Sublandlord may have against Subtenant for such holding over, shall be entitled to bring summary proceedings against Subtenant, and Subtenant agrees to reimburse Sublandlord for all Sublandlord's damages sustained by reason of such holding over (subject to the provisions of Paragraph 9 of this Sublease), including without limitation, Sublandlord's reasonable attorneys' fees and disbursements incurred in connection with the exercise by Sublandlord of its remedies against Subtenant.

18. NOTICES. Any notice, approval, consent or election made pursuant to this Sublease or the Master lease shall be in writing and shall be deemed duly delivered upon receipt if delivered personally or if mailed by registered or certified mail, return receipt requested, or by a reputable nationally recognized overnight carrier, addressed

if to Sublandlord: to the attention of the Real Estate Manager, Bay Networks, Inc., 8 Federal Street, Billedca, MA 01821.

if to Subtenant; to the President of Aware, Inc., One Oak Park, Bedford, MA 01730

Either party may, by notice as aforesaid, direct that future notices be sent to a different address.

19. ENTIRE AGREEMENT. All prior understandings and agreements between the parties with respect to the subject matter hereof are merged within this Sublease. The covenants and agreements herein contained shall bind and inure to the benefit of Sublandlord, Subtenant, and their respective successors and permitted assigns.

20. EFFECTIVENESS. This Sublease shall be effective only when executed by Sublandlord and Subtenant and approved by the Landlord under the Master Lease.

21. MISCELLANEOUS.

(a) If any dispute should arise between Sublandlord and Subtenant with respect to interpretation or performance of this Sublease, the non-prevailing party shall pay the prevailing party's reasonable attorneys' fees and costs.

(b) This Sublease shall be governed by and interpreted under and construed and enforced in accordance with the laws of the State Massachusetts.

(c) No modification, change or amendment of fids Sublease shall be binding upon either party unless such modification, change or amendment is in writing, duly authorized and signed by Sublandlord and Subtenant and consented in writing by Landlord.

(d) Notwithstanding anything to the contrary contained herein, the parties rights and duties herein are subject and subordinate to the requirements of the Consent To Sublease among Sublandlord, Subtenant and Landlord.

IN WITNESS WHEREOF, the parties hereto have caused this Sublease Agreement to be executed under seal by an officer duly authorized, as of the day and year first above written.

SUBLANDLORD: BAY NETWORKS, INC.

By: /s/ Berry E. Beswick

Berry E. Beswick
U.S. Real Estate Manager

SUBTENANT: Aware, Incorporated

By: /s/ Richard Moberg

Richard Moberg
Chief Financial Officer

As Landlord under the Master Lease, this Sublease Agreement is hereby consented to and approved in accardance with the applicable provisions of the Master Lease, by Landlord's duly authorized officer.

LANDLORD

By:

Its

EXHIBIT B

MAP

PROPOSED SPACE - AWARE, INC.
39 MANNING ROAD
BILLERICA, MA 1/8" = 1'0"

21 HARD WALL OFFICES
41 CUBICAL OFFICES
1 CONFERENCE
1 LAB
1 RECEPTION AREA
1 VESTIBULE

- ----------------------
15,404 SQ.FT. USEABLE SPACE
549 SQ.FT. BATHROOMS / CORE AREA

- ----------------------
15,953 SQ.FT. SPACE TO BE LEASED

EXHIBIT C
Description of Sublandlord"s Work

Sublandlord shall construct and install the items as described below on behalf of the Subtenant in accordance to the mutually agreed upon floor plan outlined on Exhibit B. All work shall be performed in good workman like manner in accordance with all applicable local, state and federal codes.

1. Construct eleven (11) 10 x 12 full height offices, framed and finished to the underside of the ceiling using existing carpet, lighting and ceiling.

2. Construct common vestibule on the southwest wall approximately 320 square feet (16 x 20) including all framing, doors & Hardware and security system.

3. Convert large conference room on the southwest wall into two private offices of equal size, framed to the underside of the ceiling using existing carpet, lighting and ceiling.

4. All necessary mechanical, electrical and plumbing for each office will be in accordance with building standards and all building codes.

5. Remove approximately 4,500 square feet of existing carpet and replace with VCT tile floor as outlined in the shaded area on Exhibit B.

Both Sublandlord and Subtenant agree the final cost for the above work will be $39,855.00 and payable by the Subtenant within thirty (30) days from the completion of such work.

The Subtenant agrees that all change orders and punch list items or any other construction issues during and after construction will be resolved between the Subtenant and Siena Construction. The Sublandlord agrees that it will use reasonable efforts to assist in the resolution of any issues between these parties.

Any change orders shall be approved by Subtenant and Sublandlord. In addition, Sublandlord shall construct the demising wall, and necessary fire exits at its own expense.

EXHIBIT 11.1

AWARE, INC.

COMPUTATION OF PRIMARY AND FULLY DILUTED
NET INCOME (LOSS) PER SHARE

	YEARS ENDED DECEMBER 31, 1996	1995
Net income (loss)	$ 259,382	($ 342,962)
Weighted average number of common and common stock equivalent shares outstanding:		
Common stock	10,841,919	1,162,717
Convertible preferred common stock equivalents	5,467,106	-
Option common stock equivalent shares	1,682,421	-
Effect of SAB 83	402,949	882,289
Common and common stock equivalent shares outstanding for purpose of calculating primary net income per share	18,394,395	2,045,006
Incremental shares to reflect full dilution	234,003	-
Total shares for purpose of calculating fully diluted net income per share	18,628,398	2,045,006
Primary net income (loss) per share	$ 0.01	($ 0.17)
Fully diluted net income (loss) per share	$ 0.01	($ 0.17)

EXHIBIT 21.1

SUBSIDIARIES OF REGISTRANT

NAME OF ORGANIZATION	JURISDICTION
Aware Security Corporation.....................	Massachusetts

<

EXHIBIT 23.1

CONSENT OF INDEPENDENT ACCOUNTANTS

We consent to the incorporation by reference in Registration Statement No. 333-15805 of Aware, Inc. on Form S-8, of our report dated January 30, 1997, appearing in this Annual Report on Form 10-K of Aware, Inc. for the year ended December 31, 1996.

/s/ Deloitte & Touche LLP

Boston, Massachusetts
March 26, 1997

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