

AGS COMPUTERS, INC.

ANNUAL REPORT
1970

TO OUR SHAREHOLDERS

AGS has continued to make gains in gross revenues and to expand the scope of its operations during the year 1970. On July 28, 1970 substantially all of the assets of Duo Computer Corporation were acquired for cash. This firm is a data input service bureau utilizing optical scanning equipment. Considerable time and money has been spent to effect a turn-around in Duo's operations. We have changed the thrust of its activities to encompass a wider spectrum of the services required in the data input area. AGS is currently in various stages of negotiation to acquire several firms to further complement the range of services offered by your company. Due to a lack of market acceptance of AGS' proprietary package, EX*PRESS, all costs associated with its development were written off during the

year. However, subsequent to the certification of our annual report we entered negotiations with a major CPA firm to market EX*PRESS through their Management Services Division.

While your company has experienced an improvement in operations during the first quarter of 1971, we are still experiencing a slow rate of new account assignments and Duo has continued to operate at a loss. AGS' current projects have an expected life-time much greater than at any previous point in the company's history and its current accounts are expanding their use of AGS' services. On balance, the year 1971 should see the company continue to show substantial revenue gains and return to a profitable status.



Lawrence J. Schoenberg
President

OFFICERS AND DIRECTORS

Lawrence J. Schoenberg	<i>President & Director</i>
Joseph Abrams	<i>Executive-Vice President, Secretary & Director</i>
Peter G. Graf	<i>Vice-President, Treasurer & Director</i>
Anthony F. Stepanski	<i>Vice-President</i>
Marcia A. Lampe	<i>Vice-President</i>
David B. Levine	<i>Vice-President</i>

COUNSEL

Greenbaum, Wolff & Ernst

ACCOUNTANTS

Lybrand, Ross Bros. & Montgomery

REGISTRAR & TRANSFER AGENT

Registrar & Transfer Company

AGS COMPUTERS, INC. and SUBSIDIARY CONSOLIDATED BALANCE SHEETS (Note 1) December 31, 1970 and 1969

ASSETS:

	1970	1969
Current assets:		
Cash	\$ 46,634	\$ 35,671
Marketable securities, at cost		194,193
Other investments, at cost (Note 2)		120,000
Accounts receivable	212,116	210,765
Due from officers (Note 2)	100,000	
Prepaid expenses	13,360	3,662
Total current assets	372,110	564,291
Furniture and equipment and leasehold improvements, at cost less accumulated depreciation and amortization (1970, \$6,770; 1969, \$1,666)	57,807	17,855
Deferred proprietary program costs (Note 3)		14,188
Other investments, at cost, less, in 1970, provision for loss of \$63,000 (Note 2)	16,000	29,000
Other assets	9,996	9,833
	\$455,913	\$635,167

LIABILITIES:

Current liabilities:		
Note payable to bank	\$ 20,000	\$ 50,000
Accounts payable and accrued expenses	84,194	40,636
Accrued income taxes	3,021	77,155
Total current liabilities	107,215	167,791
Deferred income taxes		7,500
Commitments and contingencies (Note 4).		

CAPITAL:

Common stock, par value \$.10 per share, authorized 1,000,000 shares; issued and outstanding 439,500 shares (Notes 2 and 5)	435,150	379,150
Retained earnings (deficit)	(86,452)	80,726
	348,698	459,876
	\$455,913	\$635,167

See notes to financial statements.

CONSOLIDATED STATEMENTS OF INCOME (LOSS) AND DEFICIT (Note 1)

For the years ended December 31, 1970 and 1969

	<u>1970</u>	<u>1969</u>
Income from services	\$1,152,736	\$808,648
Investment income	5,693	31,328
	<u>1,158,429</u>	<u>839,976</u>
Cost and expenses:		
Cost of services	758,216	444,371
Selling, general and administrative	422,063	233,060
Proprietary program costs (Note 3)	76,328	
	<u>1,256,607</u>	<u>677,431</u>
Income (loss) before provision for income taxes and extraordinary charge	(98,178)	162,545
Provision for income taxes:		
Current		81,500
Deferred	-	7,500
Benefit attributable to operating loss carry-back (Note 6)	(32,000)	
	<u>(32,000)</u>	<u>89,000</u>
Income (loss) before extraordinary charge	(66,178)	73,545
Provision for loss on investments and loans, net of related income tax benefit (\$62,000) (Notes 2 and 6)	101,000	
Net income (loss)	(167,178)	73,545
Retained earnings, beginning of period	80,726	7,181
Retained earnings (deficit) end of period	<u>(\$ 86,452)</u>	<u>\$ 80,726</u>
Per average share of common stock:		
Income (loss) before extraordinary charge	(\$.15)	\$.19
Extraordinary charge	(.23)	
Net income (loss)	<u>(\$.38)</u>	<u>\$.19</u>

CONSOLIDATED STATEMENTS of SOURCE and APPLICATION of FUNDS (Note 1)

For the years ended December 31, 1970 and 1969

	<u>1970</u>	<u>1969</u>
Source of funds:		
Net income		\$ 73,545
Depreciation (straight-line) charged to operations	\$ 5,636	1,379
Decrease (increase) in other investments	13,000	(29,000)
Decrease (increase) in deferred proprietary costs	14,188	(14,188)
Capital contribution by officers	56,000	
Sale of common stock		290,075
Other, net	(163)	5,834
Total funds provided	<u>88,661</u>	<u>327,645</u>
Application of funds:		
Net loss	167,178	
Additions to fixed assets, net of dispositions (1970, \$5,672; 1969, \$532)	45,588	11,587
Decrease in deferred income taxes	7,500	
Total funds applied	<u>220,266</u>	<u>11,587</u>
Increase (decrease) in working capital	<u>(\$131,605)</u>	<u>\$316,058</u>

See notes to financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Duo Computer Corp., which was purchased in July, 1970 for cash. The results of operations of Duo are included in the consolidated statement of income since the date of acquisition.
2. At December 31, 1969, other investments included a \$50,000 participation in a \$1,000,000 note issued by Rapp Oil Corporation (Rapp), due on December 10, 1970, secured by a mortgage on certain oil leases, and a \$29,000 investment in securities (5% debentures and stock) of Shannon Properties, Inc. (Shannon). During 1970, both Rapp and Shannon ceased paying interest on their obligations to the Company and Rapp defaulted on the \$1,000,000 note.
In April, 1970, the Company loaned \$100,000 to Rapp and received a non-interest bearing note due in May, 1970. Rapp defaulted on the note, and subsequently failed to pay under renegotiated terms. The Company has obtained a confession of judgment, in connection with the note, against Rapp and against Mr. Robert Rapp, the President and principal stockholder.
The Company has written off the \$100,000 note receivable and has provided a reserve of \$63,000 against the remaining \$79,000.
Three officers of the Company (who are also directors and majority stockholders) guaranteed to hold the Company harmless from any loss resulting from the aforementioned loans and investments and, in this connection, have agreed to reimburse the Company for their loss on the \$100,000 note. The reimbursement, net of applicable income tax effect, has been accounted for as a capital contribution.
On March 29, 1971, the officers paid \$100,000 to the Company.
It is not possible at this time to determine what action the officers will take to satisfy their guarantee of the remaining investments should they prove to be worthless. The net effect of any payment thereunder will be accounted for as a capital contribution.
3. The Company follows the policy of deferring the cost of developing proprietary programs, writing off such costs over a two-year period commencing from the time the programs are completed and offered for sale, and writing off immediately any costs related to programs which do not appear to be marketable. During 1970, costs related to a nonmarketable program were written off to expense.
4. The Company and its subsidiary lease premises which they occupy under agreements which provide for the payment of minimum annual rentals aggregating approximately \$40,000 through June 30, 1972 and \$33,000 thereafter through June 30, 1979.
The New York State Sales Tax Bureau of the Department of Taxation and Finance has sought to impose liability on the Company in the amount of \$46,814.72 for sales taxes, interest and penalties in respect of services furnished by Duo, prior to acquisition by the Company. The claim is being contested and, in the opinion of counsel, is without merit.
5. The Company has a qualified stock option plan under which 20,000 shares of common stock are reserved for issuance to officers and employees at prices not lower than the fair market value at dates options are granted. Options are exercisable after one year in accordance with terms fixed by the Board of Directors, but in all cases expire five years from date of grant.
During 1970, options were granted to purchase 7,050 shares at prices ranging from \$2.00 to \$3.50 per share, and options to purchase 4,600 shares at prices ranging from \$2.50 to \$5.00 per share were terminated. At December 31, 1970, options to purchase 15,850 shares at prices ranging from \$2.00 to \$4.50 per share were outstanding, of which options to purchase 9,000 shares were exercisable, and 4,150 shares were reserved for the granting of future operations.
In January, 1971, the Board of Directors authorized and approved a non-qualified stock option plan under which 30,000 shares of common stock are to be reserved for issuance to Company officers and employees at prices not less than 75% of the fair market value on date of grant. The plan was approved by the stockholders on March 9, 1971.
In connection with a public offering in 1969, warrants to purchase 15,000 shares at a price of \$3.85 per share were issued to the underwriters and others. The warrants expire the earlier of May 21, 1974 or nine months after the effective date of an appropriate filing under the Securities Act of 1933 permitting the public offering of the warrants. The warrants became exercisable on May 21, 1970.
6. Based upon the loss sustained in 1970, a benefit, in the approximate amount of total income taxes provided in 1968 and 1969 less state taxes that would have been due under alternate methods of computation, has been reflected in the 1970 income statement.
The Company's subsidiary has an operating loss carry-forward of approximately \$35,000, which may be applied against future income, if earned. The carry-forward expires in 1975.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors and Stockholders of
AGS Computers, Inc.:

We have examined the consolidated balance sheet of AGS COMPUTERS, INC. and SUBSIDIARY as of December 31, 1970 and the related consolidated statements of income (loss) and deficit and source and application of funds for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined the financial statements of AGS Computers, Inc. for the year 1969.

In our opinion, subject to any adjustment which would result from the satisfaction by officers of the Company of their guarantee of certain assets as discussed in Note 2, the aforementioned financial statements present fairly the consolidated financial position of AGS Computers, Inc. and Subsidiary at December 31, 1970 and 1969 and the consolidated results of operations and source and application of funds for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

LYBRAND, ROSS BROS. & MONTGOMERY

New York, February 26, 1971,
except as to Notes 2 and 5, for
which the date is March 29, 1971.

SUMMARY OF OPERATIONS

	January 4, 1967 (inception) to December 31, 1967	Year Ended December 31,		
	<u>1968</u>	<u>1969</u>	<u>1970</u>	
Income from services	\$ 51,101	\$349,733	\$808,648	\$1,152,736
Income (loss) from continuing operations	\$(13,311)	\$ 29,326	\$ 73,545	\$ (66,178)
Income (loss) before extraordinary item	\$(13,311)	\$ 16,092	\$ 73,545	\$ (66,178)
Net income (loss)	<u>\$(13,311)</u>	<u>\$ 20,492</u>	<u>\$ 73,545</u>	<u>\$ (167,178)</u>
Per share of common stock:				
Average number of common shares outstanding.....	<u>297,000</u>	<u>301,250</u>	<u>394,987</u>	<u>439,500</u>
Income (loss) from continuing operations	\$ (.04)	\$.10	\$.19	\$ (.15)
Income (loss) before extraordinary item	(.04)	.06	.19	(.15)
Extraordinary item01		(.23)
Net income (loss)	<u>\$ (.04)</u>	<u>\$.07</u>	<u>\$.19</u>	<u>\$ (.38)</u>