AGS

Annual Report 1977



LAWRENCE J. SCHOENBERG

President and

Member of the Board

AGS prides itself on the quality of its' people. It is these people, working together, that produce AGS' professional and financial success. AGS' record shows consistancy of growth (44 straight quarters with a 42% compounded gain over the last 5 years) and continuity of client relationships (95% repeat business). Its current return on capital (36%) is higher than almost all labor intensive (low capital) businesses and its sales per employee (\$50,000) is higher than almost all capital intensive (low labor) businesses.

AGS significantly expanded, in 1977, its technical, marketing and administrative staff and relocated its four offices into larger quarters. These steps leave AGS well poised to continue it's rapid and profitable growth in 1978 and beyond.

MEMBERS OF THE BOARD



JOSEPH ABRAMS Executive Vice President



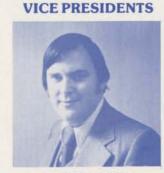
ANTHONY F. STEPANSKI Senior Vice President



PETER G. GRAF Treasurer



DAVID LEVINE Vice President



MARTIN COOK Vice President

SUBSIDIARIES



ROBERT V. TROCCHIO Vice President



JOHN KRIDEL President AGS System Forms



TERRENCE P. O'KEEFE President AGS Fundamental Systems



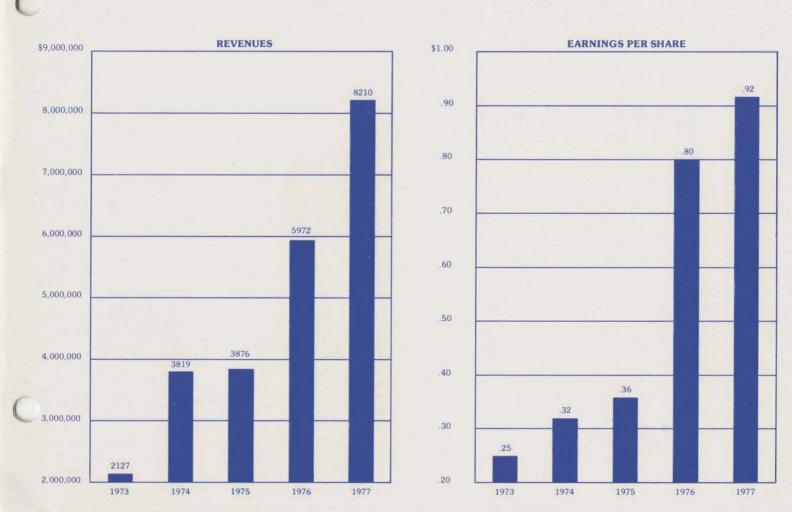
JEROLD B. LERNER General Manager AGS Information Services

AGS COMPUTERS, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME AND RETAINED EARNINGS for the years ended December 31, 1977 and 1976

	<u>1977</u>	1976
Revenues from sales and services	\$8,209,667	\$5,972,477
Cost of sales and services	5,433,700	3,795,705
Selling, general and administrative	2,122,430	1,491,956
	7,556,130	5,287,661
Income before income taxes	653,537	684,816
Income taxes: Federal, including deferred taxes of		
\$162,000 and \$49,000	198,000	256,000
State and local	73,000	88,000
	271,000	344,000
Net income	382,537	340,816
Retained earnings, beginning of year	707,885	367,069
Retained earnings, end of year	\$1,090,422	\$ 707,885
Net income per average share of common stock outstanding (common stock equivalents not		
materially dilutive)	\$.92	\$.80

See accompanying notes to consolidated financial statements.

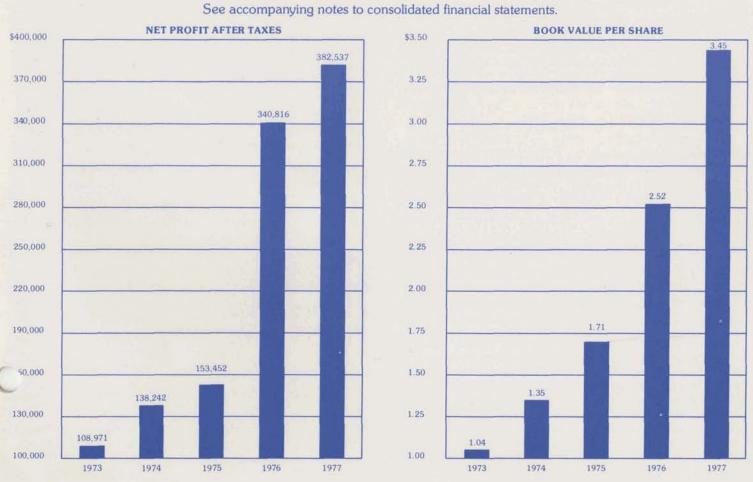


AGS COMPUTERS, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS, December 31, 1977 and 1976

ASSETS	1977	1976
Current assets:		
Cash	\$ 44,235	\$ 92,107
Temporary investments, at cost, which equals market	1,362	96,554
Accounts receivable, less allowance of \$6,100 and \$23,000	1,399,831	1,127,642
Unbilled services Refundable income taxes	290,100 92,508	31,190
Inventories	171,843	207,300
Prepaid expenses and other assets	123,959	47,736
Total current assets	2,123,838	1,602,529
Fixed assets:		
Furniture and equipment	114,710	57,218
Computer equipment	51,428	127,754
Capitalized computer lease	148,132	,
Leashold improvements	41,642	7,687
Automobiles	62,546	53,231
	418,458	245,890
Less, accumulated depreciation and amortization	94,985	60,206
In the state of th	323,473	185,684
Investment in municipal bonds, at cost	E0.0E0	50.050
(approximate market \$35,000) Other assets	50,250 38,025	50,250
Other assets	The second second	44,863
	\$2,535,586	\$1,883,326
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Note payable - bank	\$ 100,000	
Current maturities on capitalized lease obligation	15,498	
Accounts payable and accrued expenses	462,143	\$ 408,166
Income taxes payable	201 772	181,340
Deferred income taxes	391,773	229,773
Total current liabilities	969,414	819,279
Capitalized lease obligation, less current maturities	126,526	
Stockholders' equity:		
Common stock, par value \$.10 per share; authorized		
2,000,000 shares; issued 439,500 shares	43,950	43,950
Paid-in capital	341,115	341,115
Retained earnings, as annexed	1,090,422	707,885
	1,475,487	1,092,950
Less 21,715 and 18,215 shares of treasury stock, at cost	35,841	28,903
Total stockholders' equity	1,439,646	1,064,047
	\$2,535,586	\$1,883,326
	<u> </u>	

AGS COMPUTERS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION for years ended December 31, 1977 and 1976

Source of funds:	1977	1976
Net income	\$ 382,537	\$ 340,816
Depreciation and amortization	50,274	22,032
Working capital provided from operations	432,811	362,848
Stock options exercised (600 and 500 shares, respectively)	600	500
Decrease (increase) in other assets	6,838	(14,597)
Capitalized lease obligation	148,132	12.11.11
	588,381	348,751
Application of funds:	000,001	0.10,701
Purchase of treasury stock (4,100 and 9,215 shares)	7,538	16,005
Addition to fixed assets, including	1,000	20,000
capitalized computer lease, net	188,063	175,314
Current maturities of capitalized lease obligation	21,606	
	217,207	191,319
Increase in working capital	\$ 371,174	\$ 157,432
Increases (decreases) in the components of working	4 0/1,1/1	Ψ 107,102
capital are as follows:		
Cash	(\$ 47,872)	(\$ 12,641)
Temporary investments	(95,192)	(83,290)
Refundable income taxes	92,508	(00,200)
Accounts receivable, net	272,189	449,522
Unbilled services	258,910	117,000
Inventories	(35,457)	172,740
Prepaid expenses and other assets	76,223	18,037
Note payable - bank	(100,000)	
Current maturities on capitalized lease obligation	(15,498)	
Accounts payable and accrued expenses	(53,977)	(168,505)
Income taxes payable	181,340	(144, 130)
Deferred income taxes	(162,000)	(74,301)
Increase in working capital	\$ 371,174	\$ 157,432



AGS COMPUTERS, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Significant Accounting Policies

The financial statements include the accounts of the Company and its wholly-owned subsidiaries.

The company organized one new subsidiary in 1976 and one new subsidiary in 1977. The subsidiary organized in 1976 (Fundamental Systems, Inc.) purchases and reconditions used computer hardware for ultimate resale to customers. The subsidiary organized in 1977 (Information Services, Inc.) performs computer facility management services for customers.

Computer service income arising from time and material contracts is recognized on the basis of services rendered; on fixed price contracts the percentage-of-completion method is employed. Sales, costs of sales and related selling expenses, with respect to computer equipment and business forms, are recorded when the equipment or forms are delivered to the customer.

Fixed assets are recorded at cost. Depreciation is computed on the straight-line method based on estimated useful lives. Leasehold improvements are amortized over the life of the lease.

Deferred income taxes are provided on timing differences arising from computer service revenues. Such revenues are recognized for financial reporting purposes as services are performed and for income tax purposes as billings are rendered. Investment tax credits are reflected as a reduction of federal income taxes in the year realized. Such credits were \$13,500 and \$15,000 for 1977 and 1976, respectively. In addition, the Company, in 1977, availed itself of the maximum credit (\$100,000) available for the hiring of new personnel (Jobs Credit) to reduce its' federal income tax liability by \$52,000.

Inventories are stated at the lower of cost or market, determined on the specific identification method. Used computer equipment held for sale is generally purchased in lots consisting of several models. Cost of the lot is apportioned to the individual components based on the relative fair market value of each component. Costs incurred to refurbish such equipment are added to inventory.

Inventories

Inventories consist of:

	1977	<u>1976</u>
Used computer equipment	\$155,343	\$124,000
Paper and business forms	16,500	83,300
	\$171,843	\$207,300

Profit Sharing

The Company has a profit sharing plan covering all employees with one year of continuous employment. The annual contributions under the plan are determined by the Board of Directors, subject to limitations. Such contributions amounted to \$72,000 and \$60,000 in 1977 and 1976, respectively.

Leases

The Company leases office space under various operating leases that provide for the payment of minimum annual rentals, excluding provisions for escalation based on certain increases in costs incurred by the lessors. Future minimum annual rental payments, by years, required under such leases that have an initial or remaining noncancellable lease term in excess of one year as of December 31, 1977 are: 1978, \$109,000; 1979, \$118,000; 1980, \$115,000; 1981, \$97,000; 1982, \$91,000; 1983 - 1987, \$311,000; 1988, \$10,000. In

addition, the Company leases certain computer equipment under two leases, one of which is a capital lease. The future minimum lease payment under the capital lease, together with the present value of the net minimum lease payments as of December 31, 1977, is as follows:

Minimum annual lease payments of \$29,775	
through August, 1984	\$198,500
Less: Amount representing interest	56,476
Present value of net minimum lease payments	\$142,024

The second computer equipment lease is an operating lease with an affiliated partnership which requires future minimum annual rental payments of \$65,300 through 1981 and \$38,100 in 1982, subject to cancellation provisions.

Total rental expense charged to income in 1977 and 1976 approximated \$69,000 and \$63,000, respectively.

Stock Option Plans

Under the Company's 1974 qualified stock option plan, options may be granted to officers and employees to purchase an aggregate of 30,000 shares of commom stock to March 12, 1984, at prices not lower than the fair market value at dates options are granted. In accordance with terms fixed by the Board of Directors, options become exercisable in three equal annual installments commencing one year from date of grant and in all cases expire five years from date of grant.

The Company had a similar stock option plan which expired in 1973. Options granted under that plan expire no later than 1978.

The Company also has a nonqualified stock option plan, which expires in 1981, under which options to purchase an aggregate of 30,000 shares of common stock may be granted to officers and employees at prices not less than 75% of the fair market value at the date options are granted. In accordance with terms fixed by the Board of Directors, options become exercisable in three equal annual installments commencing one year from date of grant and in all cases expire no later than five years from date of grant.

At December 31, 1977, options for 10,200 and 23,000 shares are available for future grants under the qualified and non-qualified plans, respectively.

Certain information with respect to options granted under all plans is as follows:

	Number of shares	
	1977	1976
Shares under option at January 1 — \$1.00-2.25 a share	29,000	37,700
Granted — \$3.00, 1977; \$1.50, 1976	11,400	1,000
Exercised — \$1.00 a share Cancelled — \$1.00-2.25 a share	(600)	(500)
Shares under option at December 31 — \$1.00-3.00	28,500	29,000

At December 31, 1977, options for 16,000 shares were exercisable.

No charges were made to income in connection with the aforementioned stock option plans since all options granted in 1976 and 1977 were at market.

Computer Equipment

Effective January 1, 1977, the Company contracted to provide computer processing services to a customer for a period of five years (subject to cancellation by either party after December 31, 1978 upon twelve months written notice). The Company purchased computer equipment previously used by the customer to perform these services in the amount of \$100,000 in 1976 and \$303,000 in 1977. During 1977, the Company entered into sale and leaseback transactions for the aforementioned equipment with a bank (\$148,000) and a partnership consisting of four officers/directors of the Company (\$225,000). No gain or loss resulted from the aforementioned sales. The lease with the partnership is cancellable by the Company on the same terms as those between the Company and its customer.

Long Term Sales Contract

In July, 1977, the Company entered into a contract to develop

Company Operations

a computer system for a customer. Under the terms of the contract, the Company is to purchase the computer equipment (for subsequent resale to the customer), and provide the necessary software to make the system operational. The contract provides for completion of the system by January 31, 1979 with a payment schedule by the customer of approximately \$21,000 per month, without interest, from August, 1977 through January, 1983. The Company is recognizing income on this contract under the percentage-of-completion method, based on the estimated man hours to be expended, after discounting the contract amount (\$1,413,000) to the present value of the scheduled payments. The customers recent year end financial statements indicate a net operating loss and a highly leveraged debt to equity ratio. The customer has met all monthly payments to date, and, in the opinion of management, should continue to be able to do so. The Company holds a collateral interest in all equipment furnished to the customer until its full payment under the contract is obtained.

Information about the Company's operations in different industries for the year ended December 31, 1977 is as follows:

	Consulting, Programming & Management Services	Business Forms	Computer Equipment Sales	Consolidated
Sales to unaffiliated customers	\$5,816,219	\$1,752,598	\$ 640,850	\$8,209,667
Operating profit	922,565	30,815	42,485	995,865
General corporate expenses		HE THE WALL		342,328
Income before income taxes				\$ 653,537
dentifiable assets	\$1,906,687	\$ 290,029	\$ 338,870	\$2,535,586
Additions to fixed assets	173,508	\$ —	\$ 18,346	\$ 191,854
Depreciation expense	\$ 44,600	\$ 350	\$ 5,324	\$ 50,274

The Company operates in three industries: consulting, programming and management services; distribution of specialized business forms; purchase and resale of used computers and peripheral equipment.

Identifiable assets by industry are those assets which are used in the Company's operations in each industry.

Revenues arising from numerous contracts with a group of customers under common control account for \$1,341,000 and \$396,000 of the sales of consulting, programming and management services industry and the business forms industry, respectively.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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

We have examined the consolidated balance sheets of AGS Computers, Inc. and subsidiaries as of December 31, 1977 and 1976, and the related statements of income and retained earnings and changes in financial position for the years then ended. Our examinations were 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.

In our opinion, the consolidated financial statements referred to above present fairly the financial position of AGS Computers, Inc. and subsidiaries at December 31, 1977 and 1976, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Newark, New Jersey February 14, 1978

COOPERS & LYBRAND

AGS SERVICES

APPLICATIONS DEVELOPMENT

AGS develops and manages applications projects from conception through implementation. AGS conducts feasibility studies, writes system specifications, formulates project plans, creates programming specifications, codes and tests programs, documents and develops systems and assists in the training and conversion effort.

COMMUNICATIONS AND ENGINEERING

AGS provides design, engineering and implementation services for the development of communication networks, devices and hardware interfaces.

SYSTEMS EDUCATION & TRAINING

AGS Systems Education & Training provides education services for users of large-scale computer systems. The services include surveys of training programs and materials and the conducting of the courses on a lecture, workshop and tutorial basis.

SYSTEM PRODUCTS

AGS designs, programs and integrates computer/sensor bases systems. These products are generally sold on a turn-key basis.

INFORMATION SYSTEMS

AGS utilizes an IBM S/370-135 to provide a facility management service for foundations and various non-profit institutions. The availability of our own facility provides a marketing advantage for our other divisions. AGS can now offer a more complete added-value service in the application development, education and system product areas. This facility will also be used for internal training, development and administrative purposes.

BROKERAGE SERVICES

AGS, through its subsidiaries: AGS System Forms, Inc., and AGS Fundamental Systems, Inc., offers brokerage services. AGS System Forms offers a personalized, professional service for the entire spectrum of tasks required by the design and sale of business forms. AGS Fundamental Systems buys and sells used electronic point-of-sale equipment and the associated computer and communications hardware.

OFFICES

- 1135 Spruce Drive, Mountainside, New Jersey 07092 / (201) 654-4321
 - 111 Broadway, New York, New York 10006 / (212) 732-5700
 - 375 North Broadway, Jericho, New York 11753 / (516) 822-1630
 - 10 Middle Street, Bridgeport, Connecticut 06604 / (203) 366-9341