
TWENTY
YEARS OF
ACHIEVEMENT...

AGS

1986 ANNUAL REPORT

Corporate Profile

At ABC, we provide...
...to ensure...
...the right...
...an...
...and...
...and...
...and...

- 1. System Development and Consulting
- 2. Software Development
- 3. Database and Information Systems

And in...
...the...
...and...
...and...
...and...

Revenue



Employees



Profit



...JUST THE BEGINNING

Corporate Profile

AGS' 3,000 people provide automation solutions to finance, telecommunications, computer and government organizations.

To develop the right solutions for our clients, we provide an extensive portfolio of:

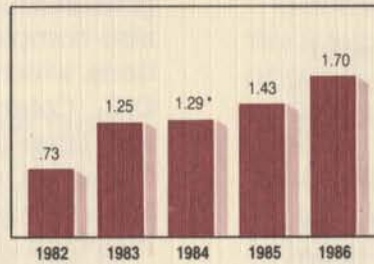
- A. Systems Development and Consulting Services
- B. Software Products and
- C. Microcomputer Distribution Services

AGS is pleased to be recognized as a leader in each of its market niches. For AGS, being a leader means always striving to be the best at what we do, and this continues to be our goal.

Revenues
(\$ in 000's)



Earnings Per Share



*Continuing Operations

Total Assets
(\$ in 000's)



Our People

Our greatest strength for the future is of course our "AGS People". At AGS, we believe the difference is people – our management talent, our dedicated staff and our organization philosophy.

We believe we have a management structure that is well prepared to lead AGS into the 1990's. Executive management has been with the Company since its founding; senior management averages 15 years of experience in the computer services industry; more than 90% of the executives who have joined AGS as a result of acquisitions are still with us. Our operating units are entrepreneurial and profit oriented.

Today AGS people own 40% of the outstanding shares of AGS and are committed to increasing the value of the Company by serving our clients to the best of our ability.



Left to Right:
Joseph Abrams, Lawrence J. Schoenberg

We offer special thanks to our "AGS people", our clients and our shareholders for their contribution to AGS' first twenty years. In the text of this annual report, we describe the strategies that shaped our success in the past and the actions that were responsible for our record performance. It's these strategies that will provide our continuing growth in the years ahead.

Yours sincerely,

LAWRENCE J. SCHOENBERG
*Chairman,
Chief Executive Officer*

JOSEPH ABRAMS
*President,
Chief Operating Officer*

February, 1987

WHO WE ARE

Our Philosophy

The people of AGS have a very straightforward philosophy of doing business.

- **Provide the 'Right' Services!**

For AGS this means

- solving important problems for major clients in growing markets.

- providing cost effective and truly value-added solutions.

- recognizing that its clients have a complex variety of problems which can best be solved with an extensive variety of custom and package solutions.

- **Provide Services 'Right'!**

For AGS this means

- having the right resources...
(people and capital)

- bringing innovative technologies and concepts to the markets it serves, and

- deploying an effective operating style (entrepreneurial, hands-on, close to the client).

- **Strive to be the Best!**

For AGS this means understanding what our clients want, thereby doing our best on their behalf.

Our History

Thanks to our clients, staff and investors, AGS has achieved notable success in its first twenty years.

- In 1967, AGS started with one employee and generated \$51,000 in revenues.
- In 1980, 300 employees generated \$17,000,000.
- In 1986, 3000 people in sixty offices generated \$382,000,000 in revenues.
- Operating profits grew to over \$25,000,000 during this period.

Throughout our first twenty years, we established and followed business princi-

ples that were important and fundamental to achieving our success. These are:

Provide Quality Service

- Solve important problems for clients – 'those that are money-makers'. (This often means building strategic or 'mission-critical' systems for our clients.)
- Build on proven success, i.e., leverage successful markets, clients, services, products and technology.
- Attract and retain superior professional staff.

Maintain Financial Stability and Consistency

- Develop significant business from current clients.
- Focus on clients in growth markets.
- Set realistic plans – short and long range.
- Strive to achieve controlled growth, above the average rate for the total computer services industry.

Make Appropriate Acquisitions

- Strive to achieve proper balance of growth – between internal operations and acquisitions.
- Acquire firms which:
 - meet investment criteria
 - provide complementary products and services
 - Increase AGS' market share
- Work to make acquisitions successful – don't just assume they will be.

How Well Has AGS Stuck To Its Principles?

The record speaks for itself –

Quality Service

- Advanced communication networks, integrated manufacturing systems, cash management systems and unique stock bond trading systems are but a few examples of 'money-making' solutions AGS has recently provided clients.

- At AGS we believe in innovation. We also believe in building on proven success. For example, our successful consulting work at AT&T led us to acquiring Systems Strategies, a communications software firm who subsequently built sophisticated networking software for AT&T. Our successful consulting work with banks and brokerage firms led to the acquisitions of DISC and Vista Concepts, unique specialists in these markets.
- The cover of our first brochure in 1967 defined AGS' people orientation with the following quote: "At AGS, the difference is people." Today that quote is even more applicable. That is why the Company has dedicated significant resources and programs to locating and retaining quality people.

Financial Stability and Consistency

- Current clients provide more than 90 percent of our software business. Our largest have been clients for over ten years.
- Our primary markets – telecommunications, computers, financial (banking, brokerage, insurance), and government are all significant growth markets. Our typical clients – e.g., AT&T, ITT, IBM, DEC, Citicorp, Chase-Manhattan, Merrill-Lynch, Morgan Guaranty, Prudential, Guardian Life, etc. are the leaders in their fields.
- Our revenue growth has been steady at an average compound rate of 58 percent for the last five years; our profits grew at a 37 percent rate for the same period. AGS' average pretax return on investment during this period has been 40 percent. All of these well exceed industry norms. Existing operations have been the foundation for our growth. Carefully selected acquisitions which complement these operations have contributed consistent incremental growth in both

revenues and profits to that foundation.

- Realistic plans are vital to the success of any organization. To AGS, this means setting annual and long range goals which are "a bit of a stretch" but are achievable. It also means not overextending your organization. For example, in 1980 when AGS was a \$17,000,000 company, executive management believed the computer services market offered a significant growth opportunity without taking on undue risk. They assessed the situation and believed AGS could become a \$200,000,000+ company by 1985. In fact AGS achieved more than \$275,000,000 in revenues that year.

Make Appropriate Acquisitions

- To help our acquisitions succeed, AGS relies on three principles:
 1. Give the entrepreneurs running the acquisitions as much freedom and flexibility as possible to build on the success which attracted AGS to them initially.
 2. Provide corporate financial and marketing support whenever appropriate.
 3. Work to leverage the capabilities between the acquisitions and current AGS units to capitalize on solid market opportunities.
- AGS' acquisition program began in 1978 and since that time, we have acquired 15 companies. All of the acquisitions involved privately owned companies and all except one were cash transactions. The results of this approach have been impressive. Every significant acquisition has grown since joining AGS. Our two largest acquisitions have together increased revenues and profits by 2 1/2 times in the past three years and have had a very positive effect on earnings per share.

PROSPECTUS

AGS Computers, Inc.

100,000 Shares Common Stock

The Date of this Prospectus is May 21, 1969.



Street Talk:

New Respect For AGS

The stock of AGS Computers, Inc. in Wall Street has been the subject of a "Street Talk" column in the financial press. The column, which appeared in the Wall Street Journal on May 19, 1969, discussed the company's performance and its potential for growth. The article noted that AGS had a strong track record and was well-positioned to capitalize on the growing market for computer services.



AT AGS THE DIFFERENCE IS PEOPLE



MICROAMERICA: GOOD GUYS DO FINISH FIRST

It's Time...

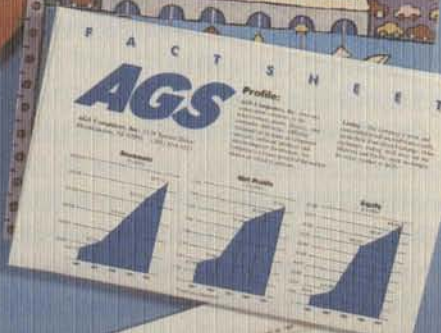
Our growth has been carried out in a careful and understandable manner. We've set meaningful goals, and have consistently met or exceeded them. Simply put, we've done what we've said we would do."

The New York Times

Programmer: An Assault on Bugs

AGS HELPS YOU FINISH FIRST

AGS



The Daily Journal

Computer service firm 'shooting for the moon'

A Report From **DATAMATION**

THE APPLICATIONS SOFTWARE SURVEY

by Data Resources

COMPUTER Retail News

100 OPPORTUNITIES

HARDWARE DISTRIBUTORS

Microamerica

\$150 M

AGS Computers achieves sales growth in competitive market

VISTA CONCEPTS, INC.

WE'RE #1

The following is a special feature from Software '69. The Software User Survey '69. Management. It shows how the software market is growing and how it is being used. It also shows how software is being used in various industries and how it is being used in the home.

In our first twenty years, AGS people have relied on some basic principles which have worked. They worked in the past and in 1986, and we expect they also will work in the future.

AGS Today

AGS was founded in 1967 as a professional services company specializing in the design and implementation of automated systems, i.e., helping clients solve problems.

Today AGS is still helping clients solve important problems, but it is now composed of three major units capable of providing an extensive portfolio of automation solutions for its clients.

The three units are:

1. Systems Development and Consulting Services
2. Software Products
3. Microcomputer Distribution Services

Each unit has established leading positions in its respective markets. Equally important, each unit provides opportunities to leverage the other.

Systems Development

Our systems development unit, AGS Information Services, is one of the largest professional services companies in the industry. It is comprised of more than 2000 people with significant expertise in designing, building and maintaining information systems. Clients are served from offices throughout the United States and Europe.

Business and government want better systems to sharpen decision making, improve operating efficiency, strengthen their competitive advantage and increase profits. Creating such systems is often a complex task, requiring significant investment in people and equipment. The rewards for better systems can be great but so can the risk in creating them.

Clients turn to AGS professionals to help minimize that risk, plus ensure the appli-

cation of innovative technology and thus help them achieve their systems objectives as soon as possible.

AGS Information Services continually seeks opportunities to expand its portfolio of services and its geographic scope to serve our clients better. Thus in 1986 we completed these key acquisitions:

- Genasys – Washington, DC – Federal
- APR – Columbus, Ohio – Mid-West and State Government
- Systemtech – Dallas, Texas – Southwest
- Select Western branches of another firm

Systems Development and Software Products

The Interplay

AGS continues to develop opportunities to penetrate our primary markets further by leveraging our technology expertise and extensive applications capabilities. This is evident in the interplay between our systems development work and our software products.

For example, AGS Information Services has built many major systems for leading banks and brokerage firms. Our DISC subsidiary develops and markets a wide range of specialized cash and account management software products for banks. These products are used by more than 300 major banks in the U.S. and Canada including 70 of the top 100. Our Vista Concepts subsidiary provides software products and consulting to fulfill the total securities processing and personal trust functions within banks.

As another example, we provide an extensive portfolio of development capabilities to the telecommunications and computer industries. AGS is well regarded for its long-standing relationship with the AT&T companies and our expertise in UNIX. We are also frequently asked to provide UNIX based systems expertise to firms using computers from AT&T and other manufacturers. Evolving from these

activities have been significant opportunities for our Systems Strategies subsidiary (SSI). SSI is a leading supplier of communications software designed to allow mini and microcomputer systems of many different manufacturers to communicate effectively with IBM mainframes.

To build information systems successfully requires the effective use of three critical resources:

- Qualified People
- Proven Tools (hardware and software)
- Proven Management and Development Methodologies

From its broad experience, AGS Information Services can select from a wide variety of tools and methodologies those appropriate for a given client. Some of the most successful ones come from our own subsidiary, AGS Management Systems, a leading developer and marketer of state-of-the-art project management systems and development methodologies. Its products and consulting services are used throughout the world.

In summary, this unique blend of software capabilities, custom systems development services and state-of-the-art software products – distinguishes AGS from its competition in the computer services industry and allows us to serve the diverse needs of our clients most effectively.

Microcomputer Distribution Services

Our Microamerica subsidiary is the largest distributor of microcomputer related products in the United States, serving systems integrators, value-added resellers, computer retailers and consultants throughout the country. In 1986, Microamerica completed the acquisition of Compuserve, Canada's largest distributor, thus extending its leadership position throughout North America.

In just seven years, the company has grown to be the preeminent firm in its field, recognized as such by leading publications and even its competition.

By providing a unique and innovative program of training, support and service to its customers, Microamerica has become a full-service resource, and not just another intermediary in the distribution business. In a period when microcomputer distributors have seen competition severely erode profit margins, Microamerica continues to set new sales and profit records year after year. This is substantially due to a superb management team that is unmatched in its marketing skills and organizational ability.

“Microamerica: The IBM of microcomputer distribution.”

COMPUTER RESELLER - Nov. 1986

What Makes Microamerica Special?

Microamerica has set itself apart in a number of ways. First is its creation of a series of innovative services that were industry firsts. They include:

- MicroCharge, the industry's first comprehensive inventory financing program for dealers.
- TIPS, a unique Technical Information and Product Support service to answer dealers technical questions.
- MicroSchool, an extensive curriculum of sales and product-related training courses for dealers.
- MicroPromotions, an innovative series of promotional and advertising programs designed to stimulate dealer sales.
- Microamerica has recently extended its value added services by packaging a complete desktop publishing system and offering a variety of functional solutions which combine products from several vendors.

In addition to these programs, Microamerica offers incentive plans, co-op advertising, lead referrals and a broad range

of other support services designed to ensure dealer success and maintain dealer loyalty.

The company sells only to resellers, and never to end-users. This prevents the appearance of competition and is designed to show dealers that they have a distributor who has THEIR long-term success in mind. Gordon Hoffstein, Microamerica's President says:

"We've always tried to put ourselves in our dealers' shoes. More than any other factor, this seems to explain our record of unparalleled dealer support, and our resulting success in the marketplace."

Relationships With Suppliers: A Strategic Approach

There's another side to Microamerica's success—its formation of important continuing relationships with its suppliers. Microamerica calls the relationships "strategic alliances". These relationships extend far beyond simply being an approved distributor of a given product line.

Microamerica becomes, in effect, an extension of the manufacturers' sales and marketing organizations – a resource in bringing products to market. Supplying promotion, technical support, product information and publications, Microamerica provides a means of accomplishing certain functions that manufacturers might otherwise have to provide themselves.

In fulfilling its broad-based role, Microamerica works with its key suppliers on

their marketing plans, product positioning, support and training. This gives the manufacturers marketing leverage that is not otherwise available. These close working relationships have led Microamerica to focus itself on a limited number of key suppliers. This is in sharp contrast to the hundreds that more typical distributors might represent, and emphasizes the special qualities of the Microamerica approach.

A Special Sense of the Market

Microamerica couldn't have grown so large so quickly without being extremely sensitive to developments in the markets for microcomputers and related equipment.

The company's nationally recognized expertise in product evaluation and selection has helped in selecting the key manufacturers with whom Microamerica has formed its "strategic alliances". From the outset, it has helped to avoid costly inventory problems by leading the company away from potential problem products.

It is this blending of strengths and integrating of services to BOTH dealers and manufacturers that explains Microamerica's success. It remains a continuing source of promise for the future, reflecting most directly on the company's management team, and the unique abilities they bring to the development of a truly outstanding company within the AGS family of companies.

AGS – "Twenty Years of Achievement...Just the Beginning!"

Strategy for Growth

AGS' strategy for growth is predicated upon our ability to successfully deliver value-added solutions to our customers. Toward this goal, we shall continue to have a management style that is entrepreneurial and profit oriented. We shall balance internal growth and acquisitions – acquisitions that will improve our market share – and be cost effective. We shall enhance the value of our company to shareholders, employees and customers by achieving a financial performance that exceeds industry norms.

To meet the growth objectives:

Systems Development will

- Enhance our leadership position in existing markets
- Expand our base of government business and geographic markets through acquisitions
- Provide total systems integration for 'mission critical' applications
- Leverage our existing client base and technical and application skills

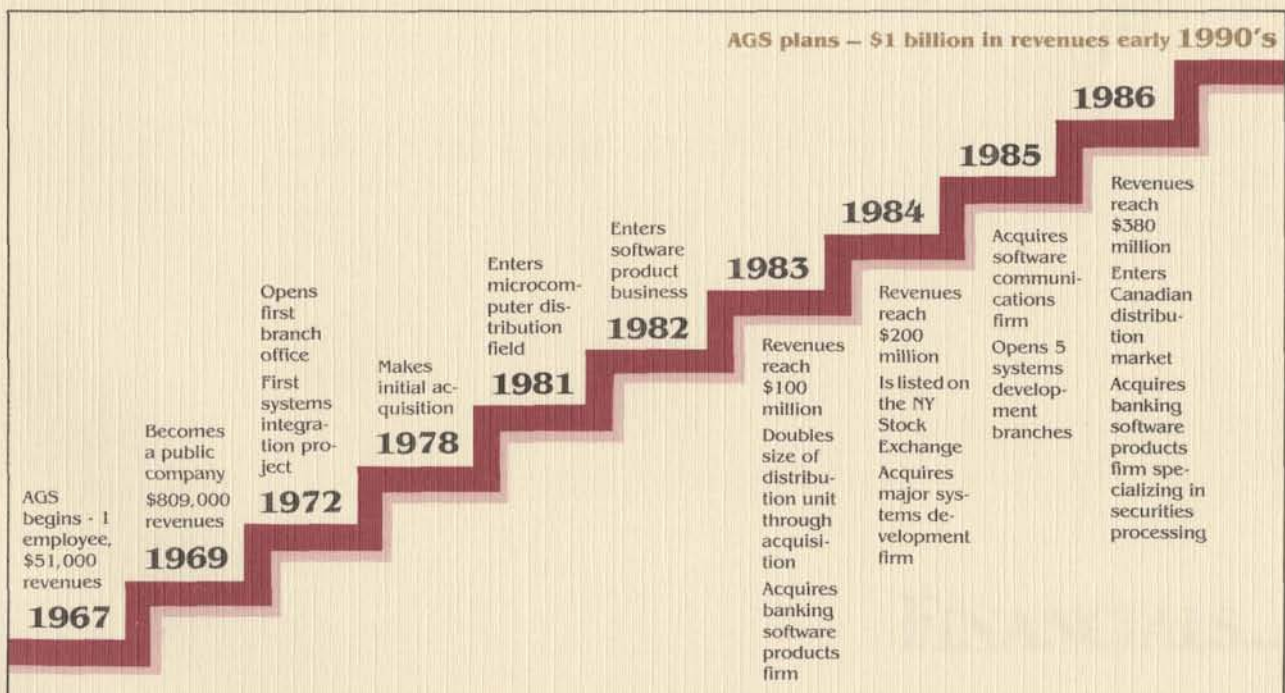
Software Products will

- Stress IBM and DEC connectivity
- Continue to penetrate financial markets with new product offerings
- Leverage our technology – UNIX and communications
- Provide consulting services related to the products to provide an ongoing revenue stream

Microcomputer Distribution will

- Stress market share leadership by providing value-added services
- Continue our program of strategic alliances so that we are positioned to distribute the best products by the best manufacturers
- Have the most cost effective operations for delivering products

AGS is committed to being a leading company in the computer services industry. We have the technical skill, market position, management depth and financial resources to achieve our goals.



The first part of the report discusses the current state of the world economy and the challenges it faces. It highlights the impact of the global financial crisis and the need for coordinated international action to address the economic downturn. The report also examines the role of the International Monetary Fund (IMF) in providing financial assistance and technical support to member countries.

The second part of the report focuses on the impact of the crisis on developing countries. It discusses the challenges these countries face in maintaining growth and employment, and the need for targeted support from the international community. The report also examines the role of the World Bank in providing financial assistance and technical support to developing countries.

The third part of the report discusses the impact of the crisis on the environment. It highlights the need for sustainable development and the role of the international community in addressing environmental challenges. The report also examines the role of the United Nations in promoting sustainable development and the need for coordinated international action to address environmental challenges.

The fourth part of the report discusses the impact of the crisis on the social sector. It highlights the need for social protection and the role of the international community in addressing social challenges. The report also examines the role of the United Nations in promoting social development and the need for coordinated international action to address social challenges.

The fifth part of the report discusses the impact of the crisis on the labor market. It highlights the need for labor market reforms and the role of the international community in addressing labor market challenges. The report also examines the role of the International Labour Organization (ILO) in promoting labor market reforms and the need for coordinated international action to address labor market challenges.



The sixth part of the report discusses the impact of the crisis on the financial system. It highlights the need for financial reforms and the role of the international community in addressing financial challenges. The report also examines the role of the Financial Stability Board (FSB) in promoting financial reforms and the need for coordinated international action to address financial challenges.

The seventh part of the report discusses the impact of the crisis on the trade system. It highlights the need for trade reforms and the role of the international community in addressing trade challenges. The report also examines the role of the World Trade Organization (WTO) in promoting trade reforms and the need for coordinated international action to address trade challenges.

The eighth part of the report discusses the impact of the crisis on the energy sector. It highlights the need for energy reforms and the role of the international community in addressing energy challenges. The report also examines the role of the International Energy Agency (IEA) in promoting energy reforms and the need for coordinated international action to address energy challenges.

The ninth part of the report discusses the impact of the crisis on the health sector. It highlights the need for health reforms and the role of the international community in addressing health challenges. The report also examines the role of the World Health Organization (WHO) in promoting health reforms and the need for coordinated international action to address health challenges.



SELECTED FINANCIAL INFORMATION
 In thousands, unless otherwise noted

	1992	1993	1994	1995	1996
Revenue	\$24,100	\$24,370	\$23,732	\$27,071	\$28,497
Operating income	2,400	2,700	2,701	7,400	8,700
Income tax expense	1,200	1,350	1,350	7,400	8,700
Net income	1,200	1,350	1,351	0	0
Other income	0	0	0	0	0
Income before taxes	1,200	1,350	1,351	0	0
Income tax expense	0	0	0	0	0
Net income	1,200	1,350	1,351	0	0
Operating income	2,400	2,700	2,701	7,400	8,700
Income tax expense	1,200	1,350	1,350	7,400	8,700
Net income	1,200	1,350	1,351	0	0

FINANCIALS...

SELECTED FINANCIAL INFORMATION
(In Thousands, except per share data)

	1982	1983	1984	1985	1986
Income Statement Data:					
Total revenues	\$64,696	\$145,288	\$221,232	\$278,871	\$381,497
Income from continuing operations	2,484	5,785	6,781	7,493	8,752
Net income	2,484	5,785	5,839	7,493	8,752
Income per share continuing operations	.73	1.25	1.29	1.43	1.70
Net income per share	.73	1.25	1.11	1.43	1.70
Total assets	33,800	68,853	93,259	111,101	182,718
Long-term obligations	9,866	221	14,822	15,283	64,906
Shareholders' Equity	10,059	35,222	42,017	49,002	52,975

Also see Note K (Acquisitions).

AGS Computers, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF INCOME

For the years ended December 31,	1986	1985*	1984*
Sales:			
Software	\$140,605,000	\$117,375,000	\$ 97,177,000
Microcomputer distribution	240,892,000	161,496,000	124,055,000
	<u>381,497,000</u>	<u>278,871,000</u>	<u>221,232,000</u>
Cost of sales:			
Software	93,827,000	78,879,000	65,154,000
Microcomputer distribution	205,854,000	138,941,000	106,429,000
	<u>299,681,000</u>	<u>217,820,000</u>	<u>171,583,000</u>
Selling, general and administrative expenses	60,131,000	43,934,000	33,821,000
Interest expense-net	3,276,000	1,989,000	2,433,000
	<u>363,088,000</u>	<u>263,743,000</u>	<u>207,837,000</u>
Income from continuing operations before income taxes	18,409,000	15,128,000	13,395,000
Income taxes	9,657,000	7,635,000	6,614,000
Income from continuing operations	<u>8,752,000</u>	<u>7,493,000</u>	<u>6,781,000</u>
Loss from discontinued operations (Less applicable income taxes of \$808,000)			<u>(942,000)</u>
Net income	<u>\$ 8,752,000</u>	<u>\$ 7,493,000</u>	<u>\$ 5,839,000</u>
Income per share from continuing operations:			
Primary	\$1.70	\$1.43	\$1.29
Fully diluted	\$1.56	\$1.43	\$1.29
(Loss) per share from discontinued operations:			
Primary			\$ (.18)
Net income per share:			
Primary	\$1.70	\$1.43	\$1.11
Fully diluted	<u>\$1.56</u>	<u>\$1.43</u>	<u>\$1.11</u>
Weighted average shares outstanding:			
Primary	5,160,000	5,253,000	5,270,000
Fully diluted	6,258,000	5,253,000	5,270,000

* Reclassified for comparative purposes.

See accompanying notes to consolidated financial statements.

AGS Computers, Inc. and Subsidiaries
CONSOLIDATED BALANCE SHEETS

December 31,	1986	1985*
Assets		
Current assets:		
Cash and temporary investments	\$ 3,343,000	\$ 2,969,000
Accounts receivable-trade, less allowances of \$1,678,000 and \$1,010,000	62,208,000	37,150,000
Inventories	35,539,000	20,060,000
Prepaid expenses and other assets	5,340,000	5,254,000
Total current assets	<u>106,430,000</u>	<u>65,433,000</u>
Fixed assets	8,081,000	6,417,000
Software products	10,996,000	7,239,000
Costs in excess of net assets of subsidiaries acquired	54,430,000	30,971,000
Other assets	2,781,000	1,041,000
	<u>\$182,718,000</u>	<u>\$111,101,000</u>
Liabilities and Stockholders' Equity		
Current liabilities:		
Current maturities of long-term debt	\$ 2,620,000	\$ 4,139,000
Accounts payable and accrued liabilities	35,992,000	25,359,000
Deferred income	4,217,000	3,431,000
Income taxes payable	2,784,000	302,000
Deferred income taxes payable	15,985,000	10,949,000
Total current liabilities	<u>61,598,000</u>	<u>44,180,000</u>
Deferred income taxes	3,239,000	2,636,000
Long-term debt, less current maturities	64,906,000	15,283,000
Total liabilities	<u>129,743,000</u>	<u>62,099,000</u>
Stockholders' equity:		
Common stock, par value \$. 10 per share: authorized 25,000,000 shares in 1986 and 1985; issued 5,349,000 and 5,311,000	535,000	531,000
Paid-in capital	23,938,000	23,347,000
Retained earnings	34,716,000	25,964,000
	<u>59,189,000</u>	<u>49,842,000</u>
Less 351,000 and 54,000 shares of treasury stock, at cost	6,214,000	840,000
Total stockholders' equity	<u>52,975,000</u>	<u>49,002,000</u>
	<u>\$182,718,000</u>	<u>\$111,101,000</u>

*Reclassified for comparative purposes.

See accompanying notes to consolidated financial statements.

AGS Computers, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF CHANGES IN CASH POSITION

For the years ended December 31,	1986	1985*	1984*
Sources of cash:			
From continuing operations:			
Income	\$ 8,752,000	\$ 7,493,000	\$ 6,781,000
Equity in losses of affiliated companies		338,000	365,000
Depreciation and amortization of fixed assets and costs in excess of net assets acquired	3,248,000	2,420,000	1,912,000
Amortization of software products	2,492,000	2,291,000	1,418,000
Increase in deferred income taxes	5,639,000	4,059,000	5,538,000
Increase in deferred income	102,000	637,000	720,000
	<u>20,233,000</u>	<u>17,238,000</u>	<u>16,734,000</u>
From discontinued operations			(2,024,000)
Total from operations	<u>20,233,000</u>	<u>17,238,000</u>	<u>14,710,000</u>
Increase in accounts payable and accrued expenses	938,000	5,875,000	3,201,000
Common stock issued upon acquisition of subsidiaries and equity interests			584,000
Common stock issued under employee stock ownership and stock purchase plans	288,000	327,000	152,000
Stock options exercised	307,000	135,000	92,000
Tax benefit from the issuance of stock options			128,000
Issuance of convertible debentures	40,000,000		
Increase in long-term debt	40,500,000	4,500,000	20,000,000
Total sources of cash	<u>102,266,000</u>	<u>28,075,000</u>	<u>38,867,000</u>
Uses of cash:			
Acquisitions of subsidiaries and equity interests	31,200,000	349,000	18,362,000
Decrease in notes payable		1,932,000	10,621,000
Payment of long-term debt	32,396,000	3,173,000	2,527,000
Additions to fixed assets, net	3,065,000	3,607,000	1,615,000
Decrease in income taxes payable	224,000	1,739,000	807,000
Increase in accounts receivable	13,456,000	9,004,000	1,509,000
Increase in inventories	10,410,000	5,301,000	1,111,000
Increase in prepaid expenses	10,000	765,000	167,000
Additions to software products	2,660,000	2,580,000	2,056,000
Increase (decrease) in other assets	3,097,000	(1,175,000)	1,248,000
Decrease in other liabilities		100,000	360,000
Purchase of treasury stock	5,374,000	528,000	
Total uses of cash	<u>101,892,000</u>	<u>27,903,000</u>	<u>40,383,000</u>
Increase (decrease) in cash and temporary investments	<u>\$ 374,000</u>	<u>\$ 172,000</u>	<u>\$ (1,516,000)</u>

*Reclassified for comparative purposes.

See accompanying notes to consolidated financial statements.

AGS Computers, Inc. and Subsidiaries
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

For the years ended December 31, 1984, 1985 and 1986

	Common Stock		Paid-in Capital	Retained Earnings	Treasury Stock	
	Shares	Amount			Shares	Cost
Balance, December 31, 1983	5,222,000	\$522,000	\$22,068,000	\$12,632,000		
Net income				5,839,000		
Common stock issued	39,000	4,000	580,000			
Stock options exercised	13,000	1,000	91,000			
Common stock issued under employee ownership plan	6,000	1,000	123,000			
Common stock issued under employee stock purchase plan	3,000		28,000			
Tax benefit from the issuance of stock options			128,000			
Balance, December 31, 1984	5,283,000	528,000	23,018,000	18,471,000		
Net income				7,493,000		
Treasury stock acquired					62,000	\$ 970,000
Stock options exercised	15,000	2,000	133,000			
Common stock issued under employee ownership plan	13,000	1,000	198,000			
Common stock issued under employee stock purchase plan			(2,000)		(8,000)	(130,000)
Balance, December 31, 1985	5,311,000	531,000	23,347,000	25,964,000	54,000	840,000
Net income				8,752,000		
Treasury stock acquired					297,000	5,374,000
Stock options exercised	26,000	3,000	304,000			
Common stock issued under employee ownership plan	12,000	1,000	287,000			
Balance, December 31, 1986	5,349,000	\$535,000	\$23,938,000	\$34,716,000	351,000	\$6,214,000

See accompanying notes to consolidated financial statements.

AGS Computers, Inc. and Subsidiaries
NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS

Note A - Significant Accounting Policies:

The financial statements include the accounts of the Company and its wholly-owned subsidiaries, after elimination of all significant intercompany accounts and transactions.

Service revenues arising from time and material contracts are recognized as services are rendered. Revenues from sales of software packages are recognized as follows: (a) on sales made on standard terms, 90% of the sale amount is recognized when the package is in deliverable form with the balance recognized upon completion of training and support; (b) on sales made subject to client acceptance of the package, revenues are recognized after acceptance is received for the package and the collateral training and support. Revenues from maintenance contracts are recognized ratably over the term of each contract. Microcomputer sales, costs of microcomputer sales and related selling expenses are recorded when delivery is made to the customer.

Fixed assets are recorded at cost. Depreciation is computed principally on the straight line method based on estimated useful lives. Leasehold improvements are amortized over the life of the lease, or their estimated useful lives, whichever is shorter.

Costs in excess of net assets acquired are being amortized over thirty to forty-year periods. Accumulated amortization aggregated \$3,087,000 and \$2,058,000 at December 31, 1986 and 1985, respectively.

Inventories, consisting of microcomputer systems, peripherals and computer accessories, are stated at the lower of cost or market; cost is determined by the first-in first-out (FIFO) method.

Deferred income taxes result from reporting certain revenue and expense items differently for financial and tax reporting. Investment and research and development tax credits are reflected as a reduction of federal income taxes in the year realized.

Research and development costs which are charged to operations, amounted to \$3,570,000 (1986), \$5,174,000 (1985) and \$4,413,000 (1984).

In December 1985, the Company adopted as of January 1, 1985 the capitalization and amortization of software cost provisions of FASB 86. Costs of new products and enhancements to existing products are capitalized when technological feasibility exists and are amortized over the greater of the ratio of the product's current-to-future revenue stream or the straight line method over its estimated useful life which generally approximates five to seven years. Costs deferred net of amortization of \$2,492,000, \$2,291,000 and \$1,418,000 were \$168,000, \$289,000 and \$638,000 for 1986, 1985 and 1984, respectively. The change had an immaterial effect on the results of operations.

Software products at December 31, 1986 and 1985 include \$5,067,000 and \$4,608,000 arising from the purchase of subsidiaries and are stated net of accumulated amortization of \$3,095,000 and \$2,191,000, respectively.

The assets and liabilities of the Company's foreign subsidiaries are translated into U.S. dollars using current exchange rates; the income and expense accounts are translated at average rates prevailing during the year. Foreign currency translation adjustments and exchange gains and losses are not material.

Primary net income per share is based on the weighted average number of shares of common stock outstanding. Dilution resulting from stock options on primary net income per share is not significant. Fully diluted net income per share assumed conversion of all convertible debentures into common stock and that outstanding stock options were exercised and the proceeds used to purchase common shares.

Note B-Fixed Assets:

December 31,	1986	1985
Fixed assets consist of:		
Furniture and equipment	\$ 6,952,000	\$ 5,252,000
Computer equipment	5,464,000	3,847,000
Leasehold improvements	1,720,000	1,357,000
	<u>14,136,000</u>	<u>10,456,000</u>
Less - accumulated depreciation and amortization	6,055,000	4,039,000
	<u>\$ 8,081,000</u>	<u>\$ 6,417,000</u>

Note C-Notes Payable:

There were no short-term borrowings outstanding in 1986 and 1985. Short-term borrowings averaged (on a month-end basis) \$1,033,000 in 1984 at a monthly weighted average interest rate of 11.0%. The maximum amount of short-term borrowings at any month-end was \$12,400,000 in 1984.

Note D-Long Term Debt:

December 31,	1986	1985
Long-term debt consists of the following:		
Bank revolving credit note	\$14,500,000	\$ 8,500,000
Bank term note	13,000,000	9,750,000
7-1/2% convertible subordinated debentures	40,000,000	
Other	26,000	1,172,000
	<u>67,526,000</u>	<u>19,422,000</u>
Less-current maturities	<u>2,620,000</u>	<u>4,139,000</u>
	<u>\$64,906,000</u>	<u>\$15,283,000</u>

The Company's bank credit facility, as amended during 1986, aggregated \$40,000,000 at December 31, 1986 of which \$20,000,000 was available under the revolving credit note and \$20,000,000 under the term note. The revolving credit note terminates on December 31, 1988, at which date all amounts then outstanding are converted to a Funded Term Loan payable in quarterly installments commencing on March 31, 1989 with a final maturity date of December 31, 1991; interest, at the Company's choosing, is either at prime or LIBOR (plus 1-1/4% and other adjustments) to December 31, 1988 and 1/4% over prime or 1-1/2% over LIBOR thereafter. The bank is not obligated to advance additional funds under the term note. The term note requires quarterly installments of principal of \$650,000 to maturity at December 31, 1991 plus interest at prime plus 1/4% or LIBOR (plus 1-1/2% and other adjustments). Under this credit facility the payment of cash dividends is prohibited and the Company is required to maintain minimum tangible capital (as defined) and several financial ratios. The agreement also requires the Company to maintain a compensating cash balance of \$600,000. The Company has a \$3,000,000 standby letter of credit available under this facility through December 31, 1987. At December 31, 1986 commitments under standby letters of credit amounted to \$1,000,000.

The 7-1/2% convertible subordinated debentures, due 2011, are convertible into common stock of the Company at anytime prior to maturity, unless previously redeemed, at \$27.30 per share, subject to adjustment in certain events. The debentures are not redeemable prior to April 15, 1988, unless certain common stock trading prices are maintained and require annual sinking fund payments commencing in 1997 equal to 5% of the aggregate principal amount.

Maturities of the non-current portion of long-term debt at December 31, 1986 are as follows:

1988	\$ 2,606,000
1989	7,433,000
1990	7,433,000
1991	7,434,000
1992 and thereafter	40,000,000
	<u>\$64,906,000</u>

Note E-Income Taxes:

The provisions for income taxes on continuing operations consist of the following:

Years ended December 31,	1986	1985	1984
Currently payable:			
Federal	\$2,792,000	\$2,461,000	\$ 493,000
State and local	<u>1,226,000</u>	<u>1,115,000</u>	<u>583,000</u>
	<u>4,018,000</u>	<u>3,576,000</u>	<u>1,076,000</u>
Deferred:			
Federal	4,586,000	3,571,000	4,742,000
State and local	<u>1,053,000</u>	<u>488,000</u>	<u>796,000</u>
	<u>5,639,000</u>	<u>4,059,000</u>	<u>5,538,000</u>
	<u>\$9,657,000</u>	<u>\$7,635,000</u>	<u>\$6,614,000</u>

The effect on deferred taxes from (i) reporting of income on the cash basis for income tax purposes was \$3,582,000, \$1,731,000 and \$1,196,000 for 1986, 1985 and 1984, respectively, (ii) the expensing of software product enhancements for income tax purposes was \$513,000, \$501,000 and \$659,000 in 1986, 1985 and 1984, respectively and (iii) differences in the valuation and amortization of acquired subsidiary assets was \$721,000, \$1,001,000 and \$802,000 in 1986, 1985 and 1984, respectively.

A reconciliation of the provisions for taxes on income from continuing operations at the applicable Federal statutory income tax rate to the tax provisions as reported is as follows:

Years ended December 31,	1986	1985	1984
Provision computed at the Federal statutory income tax rate	\$8,468,000	\$6,959,000	\$6,162,000
State and local income taxes, net of federal tax benefit	1,008,000	829,000	732,000
Amortization of costs in excess of net assets acquired	427,000	376,000	326,000
Research and development credit		(155,000)	(510,000)
Investment tax credit		(246,000)	(136,000)
Other	(246,000)	(128,000)	40,000
As reported	<u>\$9,657,000</u>	<u>\$7,635,000</u>	<u>\$6,614,000</u>

Note F-Accounts Payable and Accrued Liabilities:

December 31,	1986	1985
Accounts payable and accrued liabilities consist of:		
Accounts payable to vendors	\$26,837,000	\$20,220,000
Accrued payroll, vacation and bonus expenses	5,679,000	3,010,000
Other	3,476,000	2,129,000
	<u>\$35,992,000</u>	<u>\$25,359,000</u>

Note G-Stock Plans:

During 1984, the Company increased the maximum number of options under its incentive stock option plan ("ISOP") from 250,000 shares to 500,000 shares. The options may be granted at not less than the market price of the shares at date of grant and are generally exercisable over a 5 year period. At December 31, 1986 options for 309,476 shares were outstanding under the ISOP. The Company intends to use its treasury stock to fulfill obligations under its ISOP.

Certain information with respect to options granted under the above noted plan is as follows:

Years ended December 31,	Number of Shares		
	1986	1985	1984
Shares under option at beginning of year (\$.53-\$28.75 a share)	284,365	235,615	184,265
Granted (\$11.50-\$27.88)	112,238	129,634	81,450
Exercised (\$.53-\$26.50)	(26,683)	(14,567)	(13,047)
Cancelled (\$9.75-\$28.75)	(60,444)	(66,317)	(17,053)
Shares under option at end of year (\$.53-\$28.75 a share)	<u>309,476</u>	<u>284,365</u>	<u>235,615</u>

At December 31, 1986 and 1985 options for 106,393 and 99,312 shares, respectively, were exercisable. No charges were made to income in connection with the aforementioned stock option plans since all options granted were at market.

The Company's employee stock purchase plan (ESPP) authorizes the sale of 250,000 shares of stock to all full-time employees of the Company and its subsidiaries at a price not less than 85% of the market value of the stock at the date the right to purchase is granted. Through December 31, 1986, 11,343 shares were issued under the plan. There are no shares currently issuable.

Under the Company's employee stock ownership purchase plan all qualified employees of the Company and its subsidiaries are granted shares of stock equal in value to .5% of their annual compensation. In connection with this plan, expenses of \$334,000, \$291,000 and \$223,000 were reflected in the statements of income for the years ended December 31, 1986, 1985 and 1984, respectively.

Note H-Commitments:

The Company is obligated under operating lease agreements for its offices, warehouse facilities and equipment. The minimum aggregate rentals payable under all operating leases at December 31, 1986 are as follows:

1987	\$ 5,063,000
1988	4,359,000
1989	3,025,000
1990	2,002,000
1991	1,473,000
1992 and beyond	<u>3,829,000</u>
	<u>\$19,751,000</u>

Total rental expense charged to income was \$5,135,000 (1986), \$4,244,000 (1985) and \$2,961,000 (1984).

Note I-Profit Sharing and 401K Investment Plan:

The Company has profit sharing plans covering substantially all employees of the parent and certain of its subsidiaries. Profit sharing contributions are funded as accrued. In 1985, the Company and some subsidiaries amended their profit sharing plans to become a 401K employee investment plan. The Company and subsidiaries match employee contributions in varying amounts. The contributions under all plans amounted to \$451,000 (1986), \$327,000 (1985) and \$218,000 (1984).

Note J-Litigation:

Management and legal counsel are of the opinion that pending litigation is not material.

Note K-Businesses Acquired:

In January 1984 the Company acquired Software Design Associates, Inc. (SDA), a software services company, for approximately \$12,900,000.

In December 1984 the Company acquired for \$3,450,000 Systems Strategies Inc. which develops and markets telecommunications computer software. The acquisition was effective January 1, 1985 and accordingly their results of operations (not material) were not reflected in the Statement of Income for 1984.

In January 1986, the Company acquired Compuserve, a Canadian distributor of microcomputer hardware and software for approximately \$5,000,000.

In December 1986, the Company acquired for approximately \$19,500,000 Vista Concepts, Inc. which develops and markets computer software for the financial services industry.

These acquisitions have been accounted for as purchases; accordingly, results of operations of the acquired companies are included in the accompanying financial statements since their respective dates of acquisition.

The purchase agreements for certain of these acquisitions call for additional payments, if future pre-tax income exceeds certain standards.

During 1986, the Company also acquired three software systems development companies for an aggregate purchase price of approximately \$6,700,000. The results of operations for 1985 and 1986 would not have been materially affected if these companies had been acquired on January 1, 1985.

The unaudited pro forma consolidated results of operations of the Company as if Compuserve and Vista Concepts, Inc. had been acquired on January 1, 1985 are as follows:

Years ended December 31,	1986	1985
Sales	\$395,857,000	\$321,300,000
Cost of sales	307,835,000	249,203,000
Selling, general and administrative expenses	68,081,000	56,508,000
Income taxes	10,697,000	8,061,000
Net income	9,244,000	7,528,000
Net income per share:		
Primary	\$ 1.79	\$ 1.43
Fully diluted	\$ 1.64	\$ 1.43

Note L-Discontinued Operations:

Effective December 31, 1984, the Company adopted a plan to discontinue its subsidiary which wholesaled microcomputer software manufactured and packaged by outside vendors. Discontinued operations for the year ended December 31, 1984 included a loss on disposal of \$459,000 (net of applicable income taxes of \$391,000) and a loss from operations of \$483,000 (net of applicable income taxes of \$417,000).

Note M-Quarterly Financial Information:

Unaudited quarterly financial data for the years 1986 and 1985 is as follows:

1986	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Sales	\$82,537,000	\$89,166,000	\$95,349,000	\$114,445,000
Gross profit	17,172,000	19,625,000	20,936,000	24,083,000
Net income	1,580,000	2,133,000	2,310,000	2,729,000
Net income per share:				
Primary	\$.30	\$.40	\$.45	\$.55
Fully diluted	\$.30	\$.38	\$.41	\$.47
1985				
Sales	\$65,659,000	\$70,251,000	\$67,519,000	\$ 75,442,000
Gross profit	14,363,000	15,642,000	14,999,000	16,047,000
Net income	1,925,000	1,734,000	1,854,000	1,980,000
Net income per share	\$.37	\$.33	\$.35	\$.38

Note N-Company Operations:

Information about the Company's operations is as follows:

	Software	Microcomputer Distribution	Consolidated
Year Ended December 31, 1986:			
Sales	\$140,605,000	\$240,892,000	\$381,497,000
Operating profit	\$ 14,485,000	\$ 11,036,000	\$ 25,521,000
General and corporate expense			(3,567,000)
Interest expense			(3,545,000)
Income before income taxes			\$ 18,409,000
Identifiable assets:			
Operations	\$ 94,304,000	\$ 84,120,000	\$178,424,000
Corporate (principally temporary investments)			4,294,000
Total			\$182,718,000
Additions to fixed assets	\$ 1,606,000	\$ 1,459,000	\$ 3,065,000
Depreciation and amortization of fixed assets	\$ 1,408,000	\$ 780,000	\$ 2,188,000

	Software	Microcomputer Distribution	Consolidated
Year Ended December 31, 1985:			
Sales	<u>\$117,375,000</u>	<u>\$161,496,000</u>	<u>\$278,871,000</u>
Operating profit	<u>\$ 13,192,000</u>	<u>\$ 7,679,000</u>	<u>\$ 20,871,000</u>
General and corporate expenses			(3,443,000)
Interest expense			(2,300,000)
Income before income taxes			<u>\$ 15,128,000</u>
Identifiable assets:			
Operations	<u>\$ 62,542,000</u>	<u>\$ 45,087,000</u>	<u>\$107,629,000</u>
Corporate (principally temporary investments)			<u>3,472,000</u>
Total			<u>\$111,101,000</u>
Additions to fixed assets	<u>\$ 1,105,000</u>	<u>\$ 2,502,000</u>	<u>\$ 3,607,000</u>
Depreciation and amortization of fixed assets	<u>\$ 1,120,000</u>	<u>\$ 482,000</u>	<u>\$ 1,602,000</u>
Year Ended December 31, 1984:			
Sales	<u>\$ 97,177,000</u>	<u>\$124,055,000</u>	<u>\$221,232,000</u>
Operating profit	<u>\$ 13,078,000</u>	<u>\$ 5,411,000</u>	<u>\$ 18,489,000</u>
General and corporate expenses			(2,262,000)
Interest expense			(2,832,000)
Income before income taxes			<u>\$ 13,395,000</u>
Identifiable assets:			
Operations	<u>\$ 57,172,000</u>	<u>\$ 33,265,000</u>	<u>\$ 90,437,000</u>
Corporate (principally temporary investments)			<u>2,822,000</u>
Total			<u>\$ 93,259,000</u>
Additions to fixed assets	<u>\$ 1,362,000</u>	<u>\$ 253,000</u>	<u>\$ 1,615,000</u>
Depreciation and amortization of fixed assets	<u>\$ 924,000</u>	<u>\$ 275,000</u>	<u>\$ 1,199,000</u>

The Company operates in two industries: Software and the distribution of microcomputer hardware and software.

In 1986 microcomputer distribution includes sales, operating profits and identifiable assets from Canadian operations of \$42,923,000, \$1,613,000 and \$22,184,000, respectively. In 1985 and 1984 foreign operations were insignificant.

Sales to a group of customers under common control were \$24,790,000 and \$286,000 (1986), \$29,194,000 and \$188,000 (1985) and \$27,087,000 and \$504,000 (1984) of the sales of the software and microcomputer distribution segments, respectively.

REPORT OF MANAGEMENT

To the Stockholders of AGS Computers, Inc.:

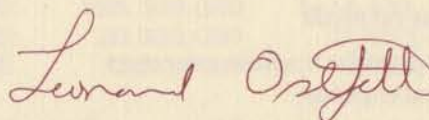
The management of AGS Computers, Inc. is responsible for the integrity and objectivity of its consolidated financial statements and related financial information in this Annual Report. These statements were prepared in conformity with generally accepted accounting principles appropriate in the circumstances and consistently applied. The consolidated financial statements include management's informed judgment and estimation as to the effect of events and transactions that are accounted for or disclosed.

The Company maintains an internal auditing function which evaluates and formally reports on the adequacy and effectiveness of internal accounting controls, policies and procedures. The Audit Committee of the Board of Directors, chaired and controlled by non-employee directors, meets with the external and internal auditors and management to satisfy itself that they are properly discharging their responsibilities. The external and internal auditors have direct access to the Audit Committee.

Coopers & Lybrand is engaged to render an opinion as to whether management's financial statements present fairly the financial condition and operating results of AGS Computers, Inc. The scope of their engagement included a review of the internal control system to the extent deemed necessary to render an opinion.



Lawrence J. Schoenberg
Chairman, Chief Executive
Officer and Treasurer



Leonard Ostfeld
Chief Financial
Officer

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

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

We have examined the consolidated balance sheets of AGS Computers, Inc. and Subsidiaries as of December 31, 1986 and 1985 and the related consolidated statements of income, stockholders' equity and changes in cash position for the years ended December 31, 1986, 1985 and 1984. 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 consolidated financial position of AGS Computers, Inc. and Subsidiaries at December 31, 1986 and 1985 and the consolidated results of their operations and changes in their cash position for the years ended December 31, 1986, 1985 and 1984 in conformity with generally accepted accounting principles applied on a consistent basis.

Newark, New Jersey
February 20, 1987

Coopers & Lybrand

**MANAGEMENT'S DISCUSSION AND ANALYSIS
OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION**

The following table sets forth for the periods indicated the percentages which certain income and expense items bear to sales and the percentage increase of such items as compared to the prior year:

	Percentage of Sales			Period to Period Increase	
	1986	1985	1984	1986 compared to 1985	1985 compared to 1984
Sales:					
Software	36.9%	42.1%	43.9%	19.8%	20.8%
Microcomputer distribution	<u>63.1</u>	<u>57.9</u>	<u>56.1</u>	<u>49.2</u>	<u>30.2</u>
Total sales	100.0	100.0	100.0	36.8	26.1
Cost of software	24.6	28.3	29.5	19.0	21.1
Cost of microcomputer distribution	<u>54.0</u>	<u>49.8</u>	<u>48.1</u>	<u>48.2</u>	<u>30.5</u>
Total costs	78.6	78.1	77.6	37.6	26.9
Selling, general and administrative expenses	15.8	15.8	15.3	36.9	29.9
Interest expense-net	<u>.8</u>	<u>.7</u>	<u>1.1</u>	<u>64.7</u>	<u>(18.2)</u>
Total costs and expenses	95.2	94.6	94.0	37.7	26.9
Income before income taxes	4.8	5.4	6.0	21.7	12.9
Income taxes	<u>2.5</u>	<u>2.7</u>	<u>3.0</u>	<u>26.5</u>	<u>15.4</u>
Net income from continuing operations	<u>2.3</u>	<u>2.7</u>	<u>3.0</u>	<u>16.8</u>	<u>10.5</u>
Net loss from discontinued operation	<u>-</u>	<u>-</u>	<u>.4</u>	<u>-</u>	<u>-</u>
Net income	<u>2.3%</u>	<u>2.7%</u>	<u>2.6%</u>	<u>16.8%</u>	<u>28.3%</u>

SALES

The Company's Software sales increased 19.8% in 1986 and 20.8% in 1985 from prior periods. Acquisitions accounted for approximately 6% and 4% of the sales growth in those periods, respectively. The balance of the increase was mainly attributable to growth in System Development Services through the placement of additional billable staff, and to a lesser extent, to price increases. In 1986 higher sales from our banking software products were offset by lower sales from project management products.

Microcomputer Distribution sales increased 49.2% in 1986 and 30.2% in 1985 from prior periods. The acquisition of Compuserve accounted for approximately 27% of the sales growth in 1986. The balance of the percentage increase in sales was due to a broad-based, industry wide increase in the demand for microcomputer products, the opening of a new distribution center and having the benefit of a full year of operations at distribution centers opened in 1985. Furthermore in 1986, as compared to 1985, the unit volume of sales increased at a greater rate than the sales dollars.

COST OF SALES AND GROSS PROFIT MARGINS

Cost of Software sales were 66.7%, 67.2% and 67.0% of Software sales in 1986, 1985 and 1984, respectively. In 1986 the increase in software products gross profit margin from banking software products was offset by lower margins from project management products. The 1985 increase in the sales of Software Products that have higher margins than System Development Services was offset by higher salary costs in System Development Services which were not matched by increased customer charges. Cost of Software sales were affected by start-up costs of \$911,000 in 1985 and \$408,000 in 1984 relating to a product that was discontinued.

Microcomputer Distribution's cost of sales as a percentage of Microcomputer Distribution sales were 85.5%, 86.0% and 85.8% in 1986, 1985 and 1984, respectively. The reduction in cost of sales in 1986 as compared to prior years is primarily attributable to a slightly higher gross profit margin in the Canadian market place.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses were 15.8%, 15.8% and 15.3% as a percentage of sales in 1986, 1985 and 1984, respectively.

The increase in selling, general and administrative expenses for 1986 and 1985 over 1984 as a percentage of sales results from costs of approximately \$400,000 incurred in 1986 in connection with the merger of our major software systems development companies, writedown in 1985 of the Company's equity investments in micro software publishing and costs incurred in opening new branch offices without achieving normal sales levels. Selling, general and administrative expenses include the amortization of acquisition-related "goodwill". Management believes that the amortization of goodwill without recognition of replacement assets understates the Company's assets.

PRETAX OPERATING PROFIT

Operating margins for Software were 10.3%, 11.2% and 13.5% as a percentage of sales in 1986, 1985 and 1984, respectively. The margin reductions were primarily caused by the factors noted in Selling, General and Administrative Expenses.

The Distribution operating margins were 4.6% (1986), 4.8% (1985) and 4.4% (1984). The 1986 reduction as compared to 1985 results from the additional costs of integrating the Canadian Microcomputer acquisition into our operating mode.

INCOME TAXES

The income tax rate as a percentage of income from continuing operations has varied from 52.5% (1986), 50.5% (1985) to 49.4% (1984). The higher tax rate in 1986 results from the elimination of the investment tax credit and no research and development credit. The Company's effective income tax rate is adversely affected by the amortization of goodwill which is not deductible for income tax purposes.

During 1984 through 1986, amounts accrued for income taxes have exceeded actual tax payments. The difference between tax accruals and payments is primarily due to the Company's use of the cash basis to report its Software segment for tax purposes while using the accrual method for financial reporting purposes.

The new tax law will reduce the Company's effective federal income tax rate for financial reporting purposes and eliminate the cash basis method. The Company expects the greater part of the rate reduction to occur in 1988. From the balance of \$9,300,000 of deferred income taxes resulting from the utilization of the cash basis method, \$7,200,000 will be paid over the next four years and \$2,100,000 will be taken into income. Future tax payments will approximate tax accruals.

NET INCOME

The lower net income as a percentage of sales in 1986 as compared to 1985 was caused by an increased tax rate, a lower operating margin and a higher percentage of revenues from the low margined distribution business.

LIQUIDITY AND CAPITAL RESOURCES

Working capital requirements for the Company's internal growth and operations have been satisfied principally from funds generated from operations. The Company's seasonal needs and funds for acquisitions have been obtained from bank borrowings and part of the \$40,000,000 7-1/2% convertible subordinated debenture offering completed April 28, 1986. In December, the Company paid \$19,500,000 as part of the cost of acquiring Vista Concepts, Inc. The Company's credit facility provides for potentially \$12,500,000 of additional borrowings. See Note D to the Consolidated Financial Statements. The Company's business has not been materially affected by inflation.

PRICE RANGE OF COMMON STOCK

The following table sets forth the quarterly high and low prices for the Common Stock:

	1984		1985		1986	
	High	Low	High	Low	High	Low
First Quarter	30-1/2	19-3/4	17-3/8	12-1/8	25	20-1/4
Second Quarter	20-1/4	15	15-1/4	10-1/4	23-3/8	18-5/8
Third Quarter	16-3/4	9-3/8	17	14-7/8	21-1/8	16-7/8
Fourth Quarter	13-1/2	9-3/4*	23-1/2	13-3/4	28-1/2	18-1/8
Fourth Quarter	13-1/4	10-1/2**				

*All prices through October 17, 1984 are high and low bid in the Over-the-Counter market.

**AGS shares were listed on the New York Stock Exchange on October 18, 1984 and these are the high and low closing prices from that date through December 31, 1986.

Form 10-K

The Company's Form 10-K Annual Report is filed with the Securities and Exchange Commission and contains certain additional information. A copy of Form 10-K is available without charge to any shareholder by writing to:
Shareholder Relations, AGS Computers, Inc.,
1139 Spruce Drive, Mountainside, NJ 07092.

Listing

AGS is listed on the New York Stock Exchange, Mid-West Stock Exchange and Pacific Stock Exchange under the New York Stock Exchange Symbol, AGS.

Shareholder Relations

Pearl Turtleaub (201) 654-4321
Manager-Shareholder Relations

Registrar and Transfer Agent

Registrar & Transfer Company
10 Commerce Drive, Cranford, New Jersey 07016

Annual Meeting

May 6, 1987
Vista International Hotel
3 World Trade Center, New York, NY 10048

AGS Computers, Inc. & Subsidiaries

Systems Development

AGS Information Services Inc.
Mountainside, NJ
Anthony F. Stepanski

AGS Genasys Corporation
Rockville, MD
John Puhala

APR, Inc.
Dublin, OH
Kenneth Sherman
Barry C. Heagren

Eastern Design Co., Inc.
White Plains, NY
Kurt Hurst
David Levine

Erdman, Anthony and
Associates, Inc.
Rochester, NY
Paul Erdman

Software Products

AGS Management
Systems, Inc.
King of Prussia, PA
Joseph S. Herbets

DISC, Inc.
Baltimore, MD
Albert M. Harris

Systems Strategies Inc.
New York, NY
Stanley Adelman

Vista Concepts, Inc.
New York, NY
Ellis Denmark

Distribution

AGS System Forms, Inc.
Mountainside, NJ
Michael Kolba

Microamerica, Inc.
Marlborough,
Gordon B. Hoffstein

Compuserve
Markham, Ontario
Gordon B. Hoffstein

AGS Computers, Inc.

Corporate Officers

Lawrence J. Schoenberg
Chairman, Chief Executive
Officer and Treasurer

Joseph Abrams
President, Chief Operating
Officer and Secretary

Anthony F. Stepanski
Executive Vice President

Leonard Ostfeld
Chief Financial Officer

Allen Pearl
General Counsel

Richard W. Thatcher, Jr.
Vice President
Corporate Planning

Mario Incalichio
Controller

Corporate Directors

Lawrence J. Schoenberg
Chairman, Chief Executive
Officer and Treasurer

Joseph Abrams
President, Chief Operating
Officer and Secretary

Arthur M. Goldberg*
President
International Controls
Corporation

Peter Graf*
Managing Partner,
Joseph Graf & Company
Certified Public Accountants

Gordon B. Hoffstein⁽¹⁾
President, Chief Executive
Officer
Microamerica

William A. Marquard⁽¹⁾
Chairman of
Executive Committee
American Standard, Inc.

Kenneth Peskin*
President, Chief Executive
Officer Of The Pathmark
Division Of Supermarkets
General Corporation

Anthony F. Stepanski
Executive Vice President;
President, Chief Executive
Officer
AGS Information Services, Inc.

⁽¹⁾Effective February 24, 1987

*Audit Committee



*Board of Directors, Left to Right:
Standing – Kenneth Peskin, Arthur M. Goldberg, William A. Marquard, Anthony
F. Stepanski. Seated - Lawrence J. Schoenberg, Joseph Abrams, Peter Graf.
(Not pictured - Gordon B. Hoffstein).*



AGS Computers, Inc.
1139 Spruce Drive
Mountainside, New Jersey 07092
(201) 654-4321