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ACCESSION NUMBER: 0001020017-97-000017

CONFORMED SUBMISSION TYPE: 10-Q

PUBLIC DOCUMENT COUNT: 2

CONFORMED PERIOD OF REPORT: 19970930

FILED AS OF DATE: 19971105

SROS: NASD

FILER:

## COMPANY DATA:

COMPANY CONFORMED NAME:	ALLSTAR SYSTEMS INC
CENTRAL INDEX KEY:	0001020017
STANDARD INDUSTRIAL CLASSIFICATION:	WHOLESALE-COMPUTER &
PERIPHERAL EQUIPMENT & SOFTWARE [5045]	
IRS NUMBER:	760515249
STATE OF INCORPORATION:	DE
FISCAL YEAR END:	1231

## FILING VALUES:

FORM TYPE:	10-Q
SEC ACT:	
SEC FILE NUMBER:	000-21479
FILM NUMBER:	97707795

## BUSINESS ADDRESS:

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CITY:	HOUSTON
STATE:	TX
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STATE: TX  
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</SEC-HEADER>  
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<TYPE>10-Q  
<SEQUENCE>1  
<DESCRIPTION>QUARTERLY REPORT  
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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

(Mark One)

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

For the quarterly period ended September 30, 1997

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number: 333-09789

Allstar Systems, Inc.  
(Exact name of Registrant as specified in its charter)

Delaware  
(State or other jurisdiction of  
incorporation or organization)

76-0062751  
(I.R.S. Employer  
Identification No.)

6401 Southwest Freeway  
Houston, Texas 77074  
(Address of principal executive offices) (Zip code)

(713) 795-2000

(Registrant's telephone number including area code)

Not applicable (Former name, former address, and former fiscal year, if changed since last report)

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

APPLICABLE ONLY TO REGISTRANTS INVOLVED IN BANKRUPTCY PROCEEDINGS DURING THE PRECEDING FIVE YEARS:

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Section 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes \_\_\_\_ No \_\_\_\_

(APPLICABLE ONLY TO CORPORATE REGISTRANTS)

Indicate the number of shares outstanding of each of the registrant's classes of common stock, as of the latest practicable date.

Title	Outstanding
Common Stock \$.01 par value per share outstanding	As of September 30, 1997 4,440,125 shares

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Part I. Financial Information

Item 1. Financial Statements

ALLSTAR SYSTEMS, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS

(In thousands, except share and par value amounts)  
(Unaudited)

	September 30, 1997	December 31, 1996
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents		
Restricted cash	\$407	\$94
Cash	709	135
Total cash and cash equivalents	1,117	229
Accounts receivable - trade, net	18,999	16,517
Accounts receivable - affiliates	664	140
Inventory	5,005	4,862
Deferred taxes	160	350
Deferred offering costs	-	412
Other current asset	253	174
Total current assets	26,198	22,684
Property and equipment	1,727	1,644
Other assets	52	392
<b>Total</b>	<b>\$27,977</b>	<b>\$24,720</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities		
Notes payable	\$2,954	\$9,975
Accounts payable	7,966	7,157
Accrued expenses	3,084	2,759
Income taxes payable	(346)	206
Deferred service revenue	184	296

Total current liabilities	13,842	20,393
Deferred Credit - Stock warrants	195	-
Total liabilities	14,037	20,393
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$.01 par value, 5,000,000 shares authorized, no shares issued		
Common stock:		
\$.01 par value, 50,000,000 shares authorized, 2,675,000 and 4,440,125 shares issued and outstanding on December 31, 1996 and September 30, 1997, respectively		44 27
Additional paid in capital	9,973	1,479
Retained earnings	3,923	2,821
Total stockholders' equity	13,940	4,327
Total	\$27,977	\$24,720

See notes to consolidated financial statements

<PAGE>

ALLSTAR SYSTEMS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF INCOME  
(In thousands, except share and per share amounts)  
(Unaudited)

Three Months Ended September.

30,.

	1997	1996
	----	----
Total Revenue	\$31,914	
\$29,187		
Cost of sales and services	27,777	
24,669		

-----	-----		
Gross Profit		4,137	
4,518			
-----	-----		
Selling, general and administrative expenses		3,439	
3,319			
-----	-----		
Operating income		698	
1,199			
-----	-----		
Interest expense and other income (net)		82	
338			
-----	-----		
Income before provision for income taxes		616	
861			
-----	-----		
Provision for income taxes		236	
362			
-----	-----		
Net income		\$ 380	\$
499			
-----	=====		
=====			
Net income per share:			
Primary		\$0.09	
\$0.19			
-----	=====		
=====			
Fully diluted		\$0.09	
\$0.19			
-----	=====		
=====			
Weighted average shares outstanding:			
Primary		4,268,664	
2,675,000			
-----	=====		
=====			
Fully diluted		4,195,991	
2,675,000			
-----	=====		
=====			

## Nine Months Ended September.

	1997	1996
30,		
Total Revenue	\$90,745	
\$87,337		
Cost of sales and services	77,850	
75,630		
-----	-----	
Gross Profit	12,895	
11,707		
-----	-----	
Selling, general and administrative expenses	10,412	
8,985		
-----	-----	
Operating income	2,483	
2,722		
-----	-----	
Interest expense and other	680	
922		
-----	-----	
Income before provision for income taxes	1,803	
1,802		
-----	-----	
Provision for income taxes	701	
696		
-----	-----	
Net income	\$ 1,102	\$
1,106		
-----	=====	
=====		
Net income per share:		
Primary	\$0.34	
\$0.41		
-----	=====	
=====		
Fully diluted	\$0.34	
\$0.41		

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-----
=====
=====
Weighted average shares outstanding:
    Primary                                3,212,059
2,675,000
-----
=====
    Fully diluted                          3,187,569
2,675,000
-----
=====

```

See notes to consolidated financial statements

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ALLSTAR SYSTEMS, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands, except share and per share amounts)  
(Unaudited)

	Nine months ended September 30,	Nine Months ended September
	1997	1996
30,		
Net income .....	\$ 1,102	\$ 1,106
Adjustments to reconcile net income to net cash provided by (used in) operating activities		-----
Gain of disposal of assets .....	--	
(11)		-----
Depreciation and amortization .....	384	264
Deferred taxes .....	190	
(12)		-----
Deferred offering costs .....	412	--
		-----
Changes in assets and liabilities that provided (used) cash:		

Accounts receivable - trade, net .....	(2,482)	
(1,329)		-----
Accounts receivable - affiliates .....	87	77
		-----
Inventory .....	(143)	
(1,580)		-----
Other current assets .....	(176)	
(41)		-----
Accounts payable .....	809	
(986)		-----
Accrued expenses .....	325	
(901)		-----
Income taxes payable .....	(552)	404
		-----
Deferred service revenue .....	(112)	
(15)		-----
-----		
Net cash provided by (used in) operating activities .....	(330)	
(3,024)		-----
Cash flows from investing activities:		
Capital Expenditures .....	(467)	
(448)		-----
Proceeds from sale of fixed assets .....	--	13
		-----
Net cash used in investing activities: .....	(467)	
(435)		-----
Cash flows from financing activities:		
Net proceeds from sale of common stock .....	8,706	--
		-----
Net increase (decrease) in notes payable .....	(7,021)	3,956
-----	-----	-----
-----		

Net cash provided by (used in) financing  
activities: .....

1,685            3,956  
-----

Net increase (decrease) in cash and cash  
equivalents .....

888            497  
-----

Cash and cash equivalents at beginning of period .....

229            1,029  
-----

Cash and cash equivalents at end of period .....

\$ 1,117        \$ 1,526  
-----

=====

=====

Supplemental disclosures of cash flow information:

Cash paid for interest .....

\$ 794            \$ 560  
=====

Cash paid for taxes .....

\$ 976            \$ 318  
=====

See notes to consolidated financial statements

<PAGE>

ALLSTAR SYSTEMS, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(In thousands, except share and per share amounts)

1. BASIS OF PRESENTATION

Allstar Systems, Inc. and subsidiaries ("Allstar") is engaged in the sale and service of computer and telecommunications hardware and software products. Allstar's wholly owned subsidiary, Stratasoft, Inc. creates and markets software related to the integration of computer and telephone technologies. In January, 1997 Allstar formed IT Staffing Inc. to provide temporary and permanent placement services of technical personnel. All operations of the business are primarily conducted from offices located in Houston, Dallas and Austin, Texas.

A substantial portion of Allstar's sales and services are authorized

under  
arrangements with product manufacturers and Allstar's operations are  
dependent  
upon maintaining its approved status with such manufacturers. As a  
result of  
these arrangements and arrangements with its customers, gross profit  
could be  
limited by the availability of products or allowance for volume  
discounts.  
Furthermore, net income before income taxes could be affected by  
changes in  
interest rates which underlie the credit arrangements which are used for  
working  
capital.

The condensed consolidated financial statements presented  
herein at  
September 30, 1997 and for the three-month and nine-month periods  
ended  
September 30, 1996 and 1997 are unaudited; however, all adjustments which  
are,  
in the opinion of management, necessary for a fair presentation of the  
financial  
position, results of operations and cash flows for the periods covered have  
been  
made and are of a normal, recurring nature. Accounting measurements at  
interim  
dates inherently involve greater reliance on estimates than at year end.  
The  
results of the interim periods are not necessarily indicative of results for  
the  
full year. The consolidated balance sheet at December 31, 1996 is derived  
from  
audited consolidated financial statements but does not include all  
disclosures  
required by generally accepted accounting principles. Although  
management  
believes the disclosures are adequate, certain information and  
disclosures  
normally included in the notes to the financial statements has been  
condensed or  
omitted as permitted by the rules and regulations of the Securities and  
Exchange  
Commission.

Accounting Pronouncements - In October 1995, the Financial  
Accounting

Standards Board ("FASB") issued Statement of Financial Accounting Standards No.

123, "Accounting for Stock-Based Compensation" ("SFAS No. 123") which determines compensation cost using the fair value method of accounting. Allstar has elected to continue to follow Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," which determines compensation cost using the intrinsic value based method of accounting. At December 31, 1996 Allstar had no stock options or similar equity instruments outstanding. During the quarter ended September 30, 1997, Allstar issued stock options and restricted stock under certain incentive stock plans (see Note 3). The impact of SFAS No. 123 on proforma earnings per share was not significant.

In February 1997, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards No. 128, Earnings Per Share ("SFAS 128"), which is effective for periods ending after December 15, 1997, specifies the computation, presentation and disclosure requirements of earnings per share ("EPS") and supersedes Accounting Principles Board Opinion No. 15 ("APB No. 15"). SFAS 128 requires a dual presentation of basic and diluted EPS. Basic EPS, which excludes the impact of common stock equivalents, replaces primary EPS. Diluted EPS, which utilizes the average market price per share as opposed to the greater of the average market price per share or ending market price per share when applying the treasury stock method in determining common stock equivalents, replaces fully diluted EPS. Pro forma basic and diluted EPS for all historical periods presented, assuming SFAS No. 128 was effective at the beginning of each such historical period, would not be materially different than the presentations using APB No. 15.

In September 1997, the FASB issued SFAS No. 130, Reporting Comprehensive Income, and SFAS No. 131, Disclosures About Segments of an Enterprise and Related Information. SFAS No. 130 establishes standards for reporting and displaying of comprehensive income and its components. SFAS No. 131 establishes standards for the way that public business enterprises report information about operating segments and related information in interim and annual financial statements. SFAS No. 130 and 131 are effective for periods beginning after December 15, 1997. These three statements will not have any effect on the Company's 1997 financial statements, however, management is evaluating what, if any additional disclosures may be required when these three statements are implemented.

## 2. OPERATING LEASES

Operating Leases - Allstar subleases office space from Allstar Equities, Inc. ("Equities"), a company wholly owned by the principal stockholder of Allstar. In 1996, Allstar renewed its office sublease with monthly rental payments of \$31.5 in 1997 and \$32 in 1998, plus certain operating expenses through December 1998. Rental expense under this agreement amounted to approximately \$93 and \$95 during the three months ended September 30, 1996 and 1997, respectively.

In August, 1997 Allstar leased certain facilities in Austin, Texas and extended its lease in Dallas, Texas for monthly rental payments of \$2 and \$10, respectively. Under these and other operating leases, minimum annual rentals at September 30, 1997 on other operating leases amount to approximately \$144 for 1997, \$114 in 1998, \$32 in 1999 and \$8 in 2000.

### 3. INCENTIVE STOCK PLANS

In September 1996 Allstar adopted the 1996 Incentive Stock Plan (the "Incentive Plan") and the 1996 Non-Employee Director Stock Option Plan (the "Director Plan"). Under the Incentive Plan, Allstar's Compensation Committee may grant up to 417,500 shares of common stock, which have been reserved for issuance, to certain key employees of Allstar. The Incentive Plan provides for the granting of incentive awards in the form of stock options, restricted stock, phantom stock, stock bonuses and cash bonuses in accordance with the provisions of the plan. Additionally, no shares may be granted after the tenth anniversary of the Incentive Plan's adoption. Allstar has reserved for issuance, under the Director Plan, 100,000 shares of common stock, subject to certain antidilution adjustments. The Director Plan provides for a one-time option by newly elected directors to purchase up to 5,000 common shares, after which each director is entitled to receive an option to purchase up to 2,000 common shares upon each date of re-election to Allstar's Board of Directors. Options granted under the Director Plan have an exercise price equal to the fair market value on the date of grant and generally expire ten years after the grant date. As of September 30, 1997 incentive stock options totaling 80,000 shares have been issued to key employees. The exercise price of all of the stock option grants is \$6.00 per share and the stock option grants will vest ratably over the five year period ending July 7, 2002. In addition, an incentive award in the form of restricted stock was granted for 14,286 shares which will vest ratably over the two year period ending July 7, 1999.

### 4. INITIAL PUBLIC OFFERING

On July 7, 1997 Allstar completed an initial public offering of 1,765,125 shares of Allstar's common stock and received proceeds of \$8,706, net of expenses.

In connection with a public offering of the Company's common stock, the Company has sold to the Representatives of the underwriters warrants to purchase 176,750 shares of the Company's common stock at an exercise price of \$9.60 per share. The warrants will be exercisable for the period beginning July 7, 1998 until July 7, 2002. The warrants were issued as additional compensation for their services in connection with the sale of the company's common stock. Using the Black-Scholes pricing model, the Company has valued the warrants at \$195. The value of the warrants has been treated as underwriting costs in connection with the offering and charged against paid in capital.. A deferred credit has been established to offset the charge to paid in capital. Upon the exercise or expiration of the warrants the deferred credit will be added to paid in capital.

## 5. LITIGATION

On July 13, 1996, a former customer brought suit against the Company in the 152nd Judicial District Court of Harris County, Texas. The plaintiff alleges that the Company failed to provide and complete promised installation and configuration of certain computer equipment within the time promised by the Company. Based on these allegations, the plaintiff is suing for breach of contract and other statutory violations and is seeking actual monetary damages of approximately \$3 million and treble damages under the Texas Deceptive Trade Practices Act. The Company is unable to estimate the range of possible

recovery  
by the plaintiff because the suit is still in the early stages of  
discovery.  
However, the Company is vigorously defending the action.

Allstar is party to other litigation and claims which management  
believes  
are normal in the course of its operations; while the results of such  
litigation  
and claims cannot be predicted with certainty, Allstar believes the  
final  
outcome of such matters will not have a materially adverse effect on its  
results  
of operations or financial position.

## 6. RELATED-PARTY TRANSACTIONS

Allstar has from time to time made payments on behalf of Equities and  
the  
Company's principal stockholders for taxes, property and equipment.  
Effective  
July 1, 1996, Allstar and its principal stockholder entered into a  
promissory  
note to repay certain advances, which were approximately \$173 at July 1,  
1996,  
in equal annual installments of principal and interest, from August 1997  
through  
2001. This note bears interest at 9% per year. Also effective July 1,  
1996,  
Allstar and Equities entered into a promissory note whereby Equities would  
repay  
the balance of amounts advanced, which were approximately \$387 at July 1,  
1996,  
in monthly installments of \$6.5, including interest, from July 1996  
through  
November 1998 with a final payment of \$275 due on December 1, 1998. This  
note  
bears interest at 9% per year. The principal amounts as of December 31, 1996  
are  
classified as Accounts receivable - affiliates and Other assets based on  
the  
repayment terms of the promissory notes. The principal amounts as of  
September  
30, 1997 are classified as Accounts receivable - affiliates based on  
the  
expectation of repayment within one year. At December 31, 1996 and September  
30,

1997, Allstar receivables from these affiliates amounted to approximately \$501 and \$535, respectively.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operation

ALLSTAR SYSTEMS. INC.  
MANAGEMENT'S DISCUSSION AND ANALYSIS  
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is qualified in its entirety by, and should be read in conjunction with, the Company's Consolidated Financial Statements, including the Notes thereto.

OVERVIEW

The Company is engaged in the business of reselling computer hardware and software products and providing related services. In addition, the Company derives revenue from providing IT Services to purchasers of Computer Products and other customers. The Company operates Computer Products and IT Services from offices in Houston, Austin and Dallas, Texas. In 1994, the Company began offering Telecom Systems in its Houston office and during the quarter ended June 30, 1997 commenced offering Telecom Systems in its Dallas office. In the fourth quarter of 1995, the Company acquired and began marketing CTI Software. To date, most of its revenue has been derived from Computer Products sales. During the quarter ended September 30, 1997, Computer Products totaled 87.0% of revenues while IT Services, Telecom Systems and CTI Software totaled 8.5%, 2.5% and 2.0% of revenues, respectively.

The Company's Computer Products division sells a wide variety of computer hardware and software products available from over 600

manufacturers and suppliers. The Company's products include desktop and laptop computers, monitors, printers and other peripheral devices, operating system and application software, network products and mid-range host and server systems. The Company is an authorized reseller of products from a number of leading manufacturers of computer hardware, software and networking equipment.

Generally, Computer Products sales are made on a purchase order basis, with few on-going commitments to purchase from its customers. On certain occasions, large "roll-out" orders are received with delivery scheduled over a longer term, such as six to nine months, while normal orders are received and delivered to the customers usually within approximately thirty days of the receipt of the order. Because of this pattern of sales and delivery, the Company normally does not have a significant backlog of computer product sales.

IT Services are provided by the Company both in conjunction with and separately from its Computer Products sales. The Company typically prices its IT Services on a time and materials basis or under fixed fee service contracts, depending on customer preference and the level of service commitment required. In markets where the Company does not maintain branch offices, it often subcontracts for necessary technical personnel, particularly where required for larger scope or prolonged duration contracts. The Company's IT Services include information systems support, authorized warranty service, hardware repair and maintenance services, complex network diagnostic services, end user support services and software diagnostic services. The Company also offers complete outsourcing of a customer's computer and network management and technical

support needs on a contract basis. In addition, the Company provides temporary and permanent staffing services.

To support and maintain the quality of these services and to maintain vendor accreditation necessary to resell and service its significant product lines, the Company's technical staff participate in various certification and authorization programs sponsored by hardware manufacturers and software suppliers. The Company's ability to attract and retain qualified professional and technical personnel is critical to the success of its IT Services business. The most significant portion of the costs associated with the delivery of IT Services are of personnel costs. Therefore, in order to be successful, the Company's billable rates must be in excess of the personnel costs and its margin is dependent upon maintaining high utilization of its service personnel. In addition, the competition for high quality personnel has generally intensified causing the Company's, along with other IT Service providers, personnel costs to increase. The Company's costs of goods and services includes the personnel costs of its billable technical staff.

While the Company has service contracts with its larger customers, many of these contracts are project based or are terminable on relatively short notice.

Through the Telecom Systems division, the Company markets, installs and services business telephone systems, including large PBX systems and smaller "key systems", along with a variety of related products including hardware and software products for data and voice integration, wide area connectivity and telephone system networking, wireless communications and video conferencing.

The Company develops and markets proprietary CTI Software, which integrates business telephone systems and networked computer systems, under the trade name "Stratasoft." Basic products offered by the Company are typically customized to suit a customer's particular needs and are often bundled with computer hardware supplied by the Company at the customer's request. Stratasoft products include software for call center management, both in-bound and out-bound, as well as interactive voice response software.

The Company believes that each of its four separate businesses are complementary to each other and allow the Company to offer a broader range of integrated products and services in order to satisfy its customers' information and communication technology requirements than many of its competitors. The Company's strategy is to maintain and expand its relationships with its customers by satisfying a greater portion of these requirements.

The Company's gross margin varies substantially between each of its businesses. The Company's Computer Products sales produced a gross margin ranging from 10.3% to 10.4% over the three year period ended December 31, 1996, due to the commodity nature of Computer Products market. The gross margin for IT Services, which reflects direct labor costs, has ranged from 30.4% to 40.9% over the same period. This variation is primarily attributable to the pricing and the mix of services provided, and to the level of direct labor as a component of cost during any given period. The gross margin for Telecom Systems, which includes both product sales and services, has varied between 23.0% and 42.7% since the Company entered the Telecom Systems market in 1994. The gross margin

for CTI Software was 40.2% in 1996.

The Company's overall gross margin has ranged between 12.3% and 13.3% for the three year period ended December 31, 1996. During any period, overall gross margin may vary significantly because of the mix of the various products and services revenues realized by the Company during any such period. While the Company endeavors to strengthen its computer products sales on a continuing basis, the Company is endeavoring to grow its higher margin products and services at a higher rate than Computer Products thereby increasing its overall gross margins.

Manufacturers of many of the computer products resold by the Company have consistently reduced unit prices near the end of a product's life cycle, most frequently following the introduction of newer, more advanced models. While the major manufacturers of computer products have a policy of providing price protection to resellers when prices are reduced, on occasion, and particularly during 1994, manufacturers introduced new models of their products and then reduced the price of, or discontinued, the older models without price protection. In these instances, the Company often sells the older models at reduced prices, which adversely affects gross margin.

A significant portion of Company's selling, general and administrative expenses relate to personnel costs, some of which are variable and others of which are relatively fixed. The Company's variable personnel costs are substantially comprised of sales commissions, which are typically calculated based upon the Company's gross profit on a particular sales transaction and thus generally fluctuate with the Company's overall gross profit. The

remainder of  
the Company's selling, general and administrative expenses are relatively  
more  
fixed and, while still somewhat variable, do not vary with increases in  
revenue  
as directly as do sales commissions.

Inacom Corp. ("Inacom") is the largest supplier of products sold by  
the  
Company. In August 1996, the Company renewed its long-term supply  
arrangement  
with Inacom and agreed to purchase at least 80% of its Computer Products  
from  
Inacom, but only to the extent that such products are made available  
within a  
reasonable period of time at reasonably competitive pricing. Inacom does  
not  
carry certain product lines sold by the Company and Inacom may be  
unable to  
offer reasonable product availability and reasonably competitive pricing  
from  
time to time on those product lines that it carries. The Company thus  
expects  
that less than 80% of its total purchases will be made from Inacom, and that  
any  
increase or decrease over historical levels in the percentage of  
products it  
purchases from Inacom under the new Inacom agreement will not have any  
material  
impact on the Company's results of operations.

The Company manages its inventory in order to minimize the  
amount of  
inventory held for resale and the risk of inventory obsolescence and  
decreases  
in market value. The Company attempts to maintain a level of inventory  
required  
to reach only its near term delivery requirements by relying on the  
ready  
availability of products from its principal suppliers. Manufacturers of  
the  
Company's major products generally provide price protection, which reduces  
the  
Company's exposure to decreases in prices. In addition, its suppliers  
generally  
allow for returns of excess inventory, which, on a limited basis, are  
made

without material restocking fees.

This Form 10-Q contains forward looking statements that involve risks and uncertainties. The Company's actual results may differ significantly from the results discussed in the forward looking statements. Such forward looking statements include risks and uncertainties. Such risks and uncertainties, many of which are not within the control of the Company, may cause the actual results to differ materially from the results discussed in the forward looking statements, including, but not limited to, the Company's ability to execute and implement its plans and strategies and /or control the economic environment in which the Company it operates.

The following table sets forth, for the periods indicated, certain financial data derived from the Company's consolidated statements of operations and indicates the percentage of total revenue for each item.

<TABLE>

<CAPTION>

				Three months ended September			
		Nine months ended September		30,			
		1997		1997			
				1996			
				Amount	%	Amount	%
Amount	%	Amount	%				
-----	---	-----	---	-----	---	-----	---
<S>	<C>	<C>	<C>	<C>	<C>	<C>	<C>
Revenue(1)							
Computer Products.....				\$27,767		\$25,589	87.7
\$78,620	86.6	\$78,115	889.4				
IT Services.....				2,696	8.5	2,022	6.9
7,413	8.2	5,740	6.6				
Telecom systems.....				801	2.5	1,113	3.8
3,038	3.4	2,511	2.9				

CTI Software.....	650	2.0	463	1.6
1,674 1.8 971 1.1				
Total revenue.....	31,914	100.0	29,187	100.0
90,745 100.0 87,337 100.0				
Gross Profit				
Computer Products.....	2,879	10.4	3,447	13.5
8,602 10.9 8,674 11.1				
IT Services.....	843	31.3	450	22.3
2,725 36.8 1,592 27.7				
Telecom Systems.....	183	22.8	416	37.3
820 27.0 969 38.6				
CTI Software.....	232	35.7	205	44.3
748 44.7 472 48.6				
Total Gross Profit....	4,137	13.0	4,518	15.5
12,895 14.2 11,707 13.4				
Selling, general and administrative expense..				
3,439 10.8 3,319 11.4				
10,412 11.5 8,985 10.3				
Operating income.....	698	2.2	1,199	4.1
2,483 2.7 2,722 3.1				
Interest expense (net of other income).....	82	0.3	338	1.2
680 0.7 920 1.1				
Income before provision for income taxes.....	616	1.9	861	2.9
1,803 2.0 1,802 2.1				
Provision (benefit) for income taxes.....	237	0.7	362	1.2
701 0.8 696 0.8				
Net Income.....	\$ 380	1.2	\$ 499	1.7
1,102 1.2 \$ 1,106 1.3				
Earnings per share.....				
\$0.34 \$0.41	\$0.09		\$0.19	
====	====		====	
====	====			
Weighted average shares outstanding.....				
4,268,664 2,675,000				
3,212,059 2,675,000				
=====	=====		=====	
=====	=====			

&lt;/TABLE&gt;

(1) Percentages shown are percentages of total revenue, except gross

profit

percentages which represent gross profit by each business unit as a percentage for each such unit.

Three Months Ended September 30, 1997 Compared To Three Months Ended September 30, 1996

TOTAL REVENUE. All of the Company's business units, except Telecom Systems, increased revenues over the prior year's comparable period. Total revenue increased by \$2.7 million (9.3%) from \$29.2 million in 1996 compared to \$31.9 million in 1997. Revenue from Computer Products increased by \$2.2 million (8.5%) from \$25.6 million in 1996 to \$27.8 million in 1997. Revenue from Computer Products as a percentage of total revenue decreased 0.7% from 87.7% in 1996 to 87.0% in 1997. Revenue from IT Services increased \$674,000 (33.3%) from \$2.0 million in 1996 to \$2.7 million in 1997 because of the continued expansion of its billable technical staff, together with an emphasis on higher level service offerings to the Company's customers. Revenue from IT Services as a percentage of total revenue increased from 6.9% in 1996 to 8.5% of total revenues in 1997. Revenue from Telecom Systems decreased by \$312,000 (28.0%) from \$1.1 million in 1996 to \$801,000 in 1997. The decrease in Telecom Systems revenue was primarily the result of the Company's inability to obtain orders for system installations from new customers together with construction delays associated with the installation of two systems. These systems are expected to be installed in the succeeding quarter. Revenue from Telecom Systems as a percentage of total revenue decreased from 3.8% in 1996 to 2.5% in 1997. CTI Software revenue increased by \$187,000 (40.4%) from \$463,000 in 1996 to \$650,000 in 1997. The growth in CTI Software revenues was primarily due to

increased marketing efforts which resulted in the addition of new customers. Revenue from CTI Software, as a percentage of total revenue, increased from 1.6% in 1996 to 2.0% in 1997.

GROSS PROFIT. Gross profit decreased by \$381,000 (8.4%) from \$4.5 million in 1996 to \$4.1 million in 1997 and gross margin decreased from 15.5% in 1996 to 13.0% in 1997. The gross margin for Computer Products decreased from 13.5% in 1996 to 10.4% in 1997, which was primarily the result of lower unit prices on the products sold, intensified competition and higher freight costs due to a work stoppage affecting one of the Company's freight carriers. The gross profit from IT Services increased 87.3% from \$450,000 in 1996 to \$842,000 in 1997. Gross margin increased from 22.3% in 1996 to 31.3% in 1997. This increase in gross margin was primarily attributable to the replacement of less profitable IT Services business with more profitable business from new and existing IT Services customers. Additionally, the prices being charged for services are generally higher in the 1997 period compared to the 1996 period, due to the relative scarcity of qualified technical staff in the computing services industry. In 1996 the Company commenced the implementation of a program to replace less profitable hardware maintenance and repair services with a variety of services that were expected to generate higher gross margins. This program resulted in the elimination of certain IT Services customer relationships which had been producing lower than average gross margin. The loss of this lower margin revenue was offset by revenues from new IT Services customers and from existing customers at higher gross margins. The gross margin for Telecom Systems

sales decreased from 37.3% in 1996 to 22.8% in 1997, reflecting the commencement of Telecom Systems operations in the Company's Dallas office, lower product margins and higher installation costs than are normally incurred. The Company treats its costs associated with its technical staff as parts of the cost of sales. Due to the relatively fixed nature of technical staff costs, when lower revenues are realized, cost of sales, expressed as a percentage of revenues, increases proportionately. The gross margin for CTI Software decreased from 44.3% in 1996 to 35.7% in the 1997 due to higher installation costs on its products.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES . Selling, general and administrative expenses increased by \$120,000 (3.6%) from \$3.3 million in 1996 to \$3.4 million in 1997. As a percentage of total revenue, selling, general and administrative expenses decreased from 11.4% in 1996 to 10.8% in 1997. While no single component of selling, general and administrative expenses increased significantly, as a percentage of revenues, commission expense decreased from 3.0% of revenues in the 1996 period to 2.7% of revenues in the 1997 period. This decrease was the result of the lower gross profits and gross margins realized by the Company in the 1997 period..

OPERATING INCOME. Operating income decreased by \$501,000 (41.8%) from \$1.2 million in 1996 to \$698,000 in 1997 due to lower gross profits and slightly higher selling, general and administrative expenses. Operating income decreased as a percentage of total revenue from 4.1% in 1996 to 2.2% in 1997.

INTEREST EXPENSE (NET OF OTHER INCOME). Interest expense (net of other income) decreased \$256,000 from \$338,000 during 1996 period compared to

\$82,000

in the 1997 period. This reflects the repayment of a substantial portion of the Company's short-term debt during the 1997 period. The repayment was accomplished by applying all of the net proceeds from the sale of common stock to the repayment of the Company's debt.

NET INCOME. Net income, after a provision for income taxes totaling \$236,000 (reflecting an effective tax rate of 38.3% in 1997 compared to 42.0% in 1996), decreased by \$119,000 from \$499,000 in 1996 to \$380,000 in 1997.

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Nine Months Ended September 30, 1997 Compared To The Nine Months Ended September 30, 1996

TOTAL REVENUE. Total revenue increased by \$3.4 million (3.9%) from \$87.3 million in the nine months ended September 30, 1996 to \$90.7 million in the 1997 period. Revenue from Computer Products, which comprised 86.6% of total revenue, increased by \$505,000 (0.6%). Revenue from Computer Products as a percentage of total revenue decreased 2.8% from 89.4% in 1996 to 86.6% in 1997. Revenue from IT Services increased by \$1.7 million (29.1%) from \$5.7 million in 1996 to \$7.4 million in 1997 because of the Company's implementation of a program at the beginning of 1996 to replace less profitable hardware maintenance and repair services with a variety of services that were expected to generate higher revenues. This program resulted in the elimination of certain IT Services customer relationships which had been producing lower than average gross margin. The loss of this lower margin revenue has been offset, however, by sales to new

IT Services customers and to existing customers in the 1997 period, generally at higher gross margins than those earned on sales to the former customers. IT Services revenues also increased because of the expansion of its sale force and billable technical staff, together with an emphasis on higher level service offerings to the Company's customers. Revenue from IT Services as a percentage of total revenue increased from 6.6% in 1996 to 8.2% in 1997. Revenue from Telecom Systems increased by \$527,000 (21.0%) from \$2.5 million in the nine months ended September 30, 1996 to \$3.0 million in the 1997 period. The increase in Telecom Systems revenue was primarily the result of hiring additional sales personnel and expanding marketing efforts, which resulted in the addition of new customers. Revenue from Telecom Systems as a percentage of total revenue increased from 2.9% in the 1996 period to 3.4% in the 1997 period. CTI Software revenue increased by \$703,000 (72.4%) from \$971,000 in the nine months ended September 30, 1996 to \$1.7 million in the 1997 period. The growth in CTI Software revenues was primarily due to increased marketing efforts which resulted in the addition of new customers. Revenue from CTI Software, as a percentage of total revenue, increased from 1.1% in the 1996 period to 1.8% in the 1997 period.

GROSS PROFIT. Gross profit increased by \$1.2 million (10.1%) from \$11.7 million in the nine months ended September 30, 1996 to \$12.9 million in the nine months ended September 30, 1997, while gross margin increased from 13.4% in the 1996 period to 14.2% in the 1997 period. The gross margin for Computer Products decreased from 11.1% in the nine months ended September 30, 1996 to 10.9% in the 1997 period, which was primarily a result of lower prices and profit margins

due to competitive factors and higher freight costs. Gross profit from IT Services increased \$1.1 million (71.2%) from \$1.6 million in the 1996 period to \$2.7 million in the 1997 period. The gross margin from IT Services increased from 27.7% in the nine months ended September 30, 1996 to 36.8% during the 1997 period. As noted above, this increase was primarily attributable to the replacement of less profitable IT Services business with more profitable business from new and existing IT Services customers. Gross profit from Telecom Systems decreased by \$149,000 (15.4%) from \$969,000 in 1996 to \$820,000 in 1997. The gross margin for Telecom Systems sales decreased from 38.6% in the 1996 period to 27.0% in the 1997 period, reflecting the commencement of Telecom Systems operations in the Company's Dallas office, lower product margins and higher installation costs than are normally incurred. Gross profit from CTI Software increased \$276,000 (58.5%) from \$472,000 in 1996 to \$748,000 in 1997. The gross margin for CTI Software decreased from 48.6% in the nine months ended September 30, 1996 to 44.7% in the 1997 period, which was primarily a result of increased spending on technical staff related to new product installation and development.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES. Selling, general and administrative expenses increased by \$1.4 million (15.9%) from \$9.0 million in the nine months ended September 30, 1996 to \$10.4 million in the 1997 period. As a percentage of total revenue, selling, general and administrative expenses increased from 10.3% in the 1996 period to 11.5% in the 1997 period. The increase as a percentage of total revenue resulted primarily from the hiring of

new employees in sales support functions, as well as additional personnel hired

for IT Services administration and other general administration functions.

OPERATING INCOME. Operating income decreased by \$239,000 ( 8.8%) from \$2.7 million in the nine months ended September 30, 1996 to \$2.5 million in the 1997 period. Operating income decreased as a percentage of total revenue from 3.1% in the 1996 period to 2.7% in the 1997 period.

INTEREST EXPENSE (NET OF OTHER INCOME). Interest expense (net of other income) decreased from \$920,000 during the nine months ended September 30, 1996 to \$680,000 during the 1997 period.. This reflects the repayment of a substantial portion of the Company's short-term debt during the 1997 period. The repayment was accomplished by applying all of the net proceeds from the sale of common stock to the repayment of the Company's debt.

NET INCOME. Net income, after a provision for income taxes totaling \$701,000 (reflecting an effective tax rate of 38.9% compared to 38.6% in the 1996 period), decreased by \$4,000 (0.4%) from \$1,106,000 in the nine months ended September 30, 1996 to \$1,102,000 in the 1997 period. Net income decreased as a percentage of revenues from 1.3% in the 1996 period to 1.2% in the 1997 period.

#### Liquidity And Capital Resources

The Company's working capital was \$2.3 million and \$12.4 million at December 31, 1996 and September 30, 1997, respectively. As of September 30, 1997, the Company had borrowing capacity under the Company's credit facility of \$7.4 million.

#### Cash Flow

Operating activities used net cash totaling \$331,000 during the nine months ended September 30, 1997. Operating activities used net cash during the nine months ended September 30, 1997 because the increase in trade accounts receivable was not offset by net income and depreciation, increases in accounts payables.

Investing activities used cash totaling \$468,000 during the nine months ended September 30, 1997. The Company's investing activities that used cash during this period was primarily related to capital expenditures. During the next twelve months, the Company expects to incur an estimated \$700,000 million for capital expenditures, a majority of which is expected to be incurred for leasehold improvements and other capital expenditures in connection with the planned consolidation of its warehouse facilities into a single facility in the Dallas-Fort Worth area, the relocation of its Dallas branch office and the opening of a branch office in San Antonio, Texas. The actual amount and timing of such capital expenditures may vary substantially depending upon, among other things, the actual facilities selected, the level of expenditures required to render the facilities suitable for the Company's purposes and the terms of lease arrangements pertaining to the facilities.

Financing activities provided cash totaling \$1.7 million during the nine months ended September 30, 1997. During the quarter ended September 30, 1997 the Company completed the sale of 1,765,125 common shares which resulted in the receipt of net proceeds of \$8.7 million, all of which was used to repay short-term debt.

## Asset Management

The Company had trade accounts receivable, net of allowance for doubtful accounts, of \$19.0 million at September 30, 1997. The number of days' sales outstanding in trade accounts receivable was 52 days, which is equal to the days outstanding of the prior quarter but reflecting slower than normal payment by the Company's customers during the three months ended September 30, 1997. Bad debt expense as a percentage of total revenue for the three months ended September 30, 1997 was 0.3%, which was slightly less than bad debt expense for the three months ended September 30, 1996. The Company's allowance for doubtful accounts, as a percentage of trade accounts receivable, was 1.3% at December 31, 1996, and 1.1% at September 30, 1997. Inventory turnover for the three months and nine months ended September 30, 1997 was 19.7 times, and 19.4 times, respectively.

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## Current Debt Obligations

Historically, the Company has satisfied its cash requirements principally through borrowings under its lines of credit and through operations. The Company maintains a cash position sufficient to pay only its immediately due obligations and expenses. When the amount of cash available falls below its immediate needs, the Company requests advances under a credit facility provided by IBM Credit Corporation ("IBMCC Facility")

The total credit available under the IBMCC Facility is currently \$20.0 million, subject to borrowing base limitations which are generally computed as a percentage of various classes of eligible accounts receivable and qualifying inventory. Borrowings are available under the IBMCC Facility for floor plan financing of inventory from approved manufacturers (the "Inventory Line"). Available credit under the IBMCC Facility, net of Inventory Line advances, is used by the Company primarily to carry accounts receivable and for other working capital and general corporate purposes (the "Accounts Line"). Borrowings under the Accounts Line bear interest at the fluctuating prime rate plus 2.0% per annum (10.5% at September 30, 1997). Under the Inventory Line, IBMCC pays the Company's inventory vendors directly, generally in exchange for negotiated financial incentives. Typically, the financial incentives received are such that IBMCC does not charge interest to the Company until approximately 30 days after the transaction is financed, at which time the Company is required to either pay the full invoice amount of the inventory purchased from corporate funds or to borrow under the Accounts Line for the amount due to IBMCC. Inventory Line advances not paid within 30 days after the financing date bear interest at the fluctuating prime rate plus 6.0%. IBMCC is permitted to fix a minimum prime rate for the IBMCC Facility of not less than the average prime rate in effect at the time the minimum prime rate is set but has not done so. IBMCC is authorized to change, on 30 days notice, the computation of the borrowing base and to disqualify accounts receivable upon which advances have been made and require repayment of such advances to the extent such disqualifications cause the Company's borrowings to exceed the reduced borrowing base. The IBMCC

## Facility

renews for successive periods of 13 months unless either party chooses to terminate the arrangement on 60 days notice.

The IBMCC Facility is collateralized by a security interest in substantially all of the Company's assets, including its accounts receivable, inventory, equipment and bank accounts. The Company's Chief Executive Officer and principal stockholder has personally guaranteed the Company's indebtedness to IBMCC. Collections of the Company's accounts receivable are required to be applied through a lockbox arrangement to repay indebtedness to IBMCC; however, IBMCC customarily releases a portion of the Company's daily collections to the extent that they exceed the daily estimated borrowing base. IBMCC is not obligated to continue this accommodation. If in the future IBMCC insists that all lockbox payments be applied to reduce the Company's indebtedness, the Company would be required to seek funding from IBMCC or other sources to meet substantially all of its cash needs.

At September 30, 1997, the total indebtedness of the Company under the IBMCC Facility was \$7.7 million of which \$3.0 million was outstanding under the Accounts Line and \$4.7 million was outstanding under the Inventory Line. The Company's remaining available credit at September 30, 1997, based on its borrowing base was approximately \$7.4 million.

The Company has a \$3.0 million credit facility with Deutsche Financial Services (the "DFS Facility") for the purchase of inventory from certain suppliers. As in the case of the IBMCC Inventory Line, advances under the DFS Facility are typically interest free for 30 days after the financing date for

transactions in which adequate financial incentives are received by DFS from the vendor. Within 30 days after the financing date, the full invoice amount for inventory financed through DFS is required to be paid by the Company. Amounts remaining outstanding thereafter bear interest at the fluctuating prime rate (but not less than 6.5%) plus 6.0%. DFS retains a security interest in the inventory financed. The DFS Facility is immediately terminable by either party by written notice to the other. At September 30, 1997, the amount outstanding under the DFS Facility was \$1.7 million.

Both the IBMCC Facility and the DFS Facility prohibit the payment of dividends, repurchase of the Company's shares and advances to affiliates unless consented to by the lender.

#### Subsequent Events

In October, 1997 the Company commenced the renegotiation of the Company's credit facilities with its existing lenders and sought financing proposals from other financing sources. Based upon the proposals the Company has received it is likely that the Company will restructure its existing credit facilities on terms more favorable to the Company than its currently existing credit facilities.

In October, 1997 the Company's Board of Directors authorized the establishment of the 1997 Employee Stock Purchase Plan whereby the Company's employees may voluntarily purchase shares of the Company's stock. Under the Plan the Company may issue newly issued shares or purchase shares in the open market. The Company expects to purchase such shares as may be required for the plan in the open market. The Board of Directors has, however, authorized the issuance of up to 100,000 shares for such purpose.

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EXHIBIT

11

ALLSTAR SYSTEMS, INC.  
 COMPUTATION OF EARNINGS PER COMMON SHARE AND COMMON SHARE EQUIVALENTS  
 (In thousands of dollars, except per share amounts)

	For the Three Months September 30, 1997	
ended		
1996		
PRIMARY EARNINGS PER SHARE:		
Weighted average shares of common stock outstanding 2,675,000	4,261,609	
Effect of issuance of shares from exercise of stock options or warrants (treasury stock method)	7,055	
-	-----	
-----		
Weighted average shares 2,675,000	4,268,664	
-----	=====	
=====		
Net Income 499	\$ 380	\$
-----	=====	
=====		
Primary earnings per share 0.19	\$ 0.09	\$
-----	=====	
=====		
FULLY DILUTED EARNINGS PER SHARE: (a)		
Weighted average shares of common stock outstanding 2,675,000	4,261,609	
-		
Effect of issuance of shares from exercise of stock		

options or warrants (treasury stock method)	(65,618)
---	----------

-	-
-----	-----
Weighted average shares	4,195,991
2,675,000	

-----	=====
Net Income	\$ 380 \$
499	

-----	=====
Fully diluted earnings per share	\$ 0.09 \$
0.19	
-----	=====
-----	=====

For the Nine Months

ended	September 30,
	1997

1996

## PRIMARY EARNINGS PER SHARE:

Weighted average shares of common stock outstanding	3,209,681
2,675,000	

Effect of issuance of shares from exercise of stock options or warrants (treasury stock method)	3,278
-	

-----	-----
Weighted average shares	3,212,059
2,675,000	

-----	=====
Net Income	\$ 1,102 \$
1,106	

-----	=====
Primary earnings per share	\$ 0.34 \$
0.41	
-----	=====
-----	=====

FULLY DILUTED EARNINGS PER SHARE: (a)

Weighted average shares of common stock outstanding	3,209,681
2,675,000	

Effect of issuance of shares from exercise of stock options or warrants (treasury stock method)	
(22,112)	-

Weighted average shares	3,187,569
2,675,000	

-----  
=====

Net Income	\$	1,102	\$
1,106			

-----  
=====

Fully diluted earnings per share	\$	0.35	\$
0.41			

-----  
=====

(a) This calculation is submitted in accordance with Regulation S-K item 601(b)(11) although it is contrary to paragraphs 14, 30 and 40 of APB Opinion No. 15 because it produces an antidilutive result for period set forth above.

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## Part II. Other Information

### Item 1. Legal Proceedings

On July 13, 1996, a former customer brought suit against the Company in the 152nd Judicial District Court of Harris County, Texas. The plaintiff alleges that the Company failed to provide and complete promised installation and configuration of certain computer equipment within the time promised by the Company. Based on these allegations, the plaintiff is suing for breach of contract and other statutory violations and is seeking actual monetary damages

of approximately \$3 million and treble damages under the Texas Deceptive Trade Practices Act. The Company is unable to estimate the range of possible recovery by the plaintiff because the suit is still in the early stages of discovery. However, the Company is vigorously defending the action.

Allstar is party to other litigation and claims which management believes are normal in the course of its operations; while the results of such litigation and claims cannot be predicted with certainty, Allstar believes the final outcome of such matters will not have a materially adverse effect on its results of operations or financial position.

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#### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

October 4, 1997  
Date

BY: /s/ James H. Long  
James H. Long, Chief Executive Officer

October 4, 1997  
Date

BY: /s/ Donald R. Chadwick  
Donald R. Chadwick, Chief Financial Officer

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