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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

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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 March 31, 1998

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 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 shares	As of March 31, 1998, 4,454,411 outstanding

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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)

December 31,	March 31,	1998 (Unaudited)	1997
ASSETS			
Current assets:			
Cash and cash equivalents			
Restricted cash	\$	-	
\$ 280			
Cash		3,508	
1,301			
-----		-----	
Total cash and cash equivalents		3,508	
1,581			
Accounts receivable - trade, net		20,701	
23,759			
Accounts receivable - affiliates			
527	434		
Inventory		6,042	
4,700			
Deferred taxes			
212	212		
Other current asset			
428	404		
-----		-----	
Total current assets		31,418	
31,090			
Property and equipment		2,004	
2,013			
Other assets			
253	81		

Total 33,184 \$ 33,675 \$
=====

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities

Notes payable		\$ 4,821	\$
1,572			
Accounts payable		10,290	
12,805			
Accrued expenses		3,528	
3,565			
Income taxes payable			
(194)	82		
Deferred service revenue			
188	242		

	Total current liabilities	18,633	
18,266			
Deferred Credit - Stock warrants			
195	195		

Total liabilities		\$ 18,828	\$
18,461			
		=====	

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,
4,454,411 and 4,454,411 shares
issued and outstanding on December
31, 1997 and March 31, 1998, respectively

45 45

Additional paid in capital	10,013
10,013	
Retained earnings	4,789
4,665	

Total stockholders' equity	14,847
14,723	

Total	\$33,675
\$33,184	
	=====
=====	

See notes to consolidated financial statements

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

	Three Months Ended	
March 31,	1998	
	1997	

Total Revenue	\$ 32,542	\$
26,593		
Cost of sales and services	27,732	
22,762		
Gross Profit	4,810	
3,831		
Selling, general and administrative expenses	4,576	
3,135		

Operating income

234 696

Interest expense and other income (net)

28 289

Income before provision for income taxes

206 407

Provision for income taxes

82 154

Net income

\$ 124

\$ 253

=====

=====

Net income per share:

Basic

\$0.03

\$0.09

=====

=====

Diluted

\$0.03

\$0.09

=====

=====

Weighted average shares outstanding:

Basic

4,454,411

2,675,000

=====

=====

Diluted

4,457,106

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)
 (Unaudited)

Months ended March 31, 1997	Three Months ended March 31, 1998	Three
Net income 253	\$ 124	\$
Adjustments to reconcile net income to net cash provided by (used in) operating activities		
Gain of disposal of assets ---	---	
Depreciation and amortization 125	167	
Deferred taxes ---	---	
Changes in assets and liabilities that provided (used) cash:		
Accounts receivable - trade, net (676)	3,058	
Accounts receivable - affiliates (119)	(93)	
Inventory (272)	(1,342)	
Other current assets ---	(24)	
Other assets (40)	(177)	
Accounts payable 1,896	(2,515)	
Accrued expenses	(37)	

(71)		
	Income taxes payable	(276)
136		
	Deferred service revenue	(54)
(69)		
-----		-----
	Net cash provided by (used in) operating activities	(1,169)
(1,163)		
	Cash flows from investing activities:	
	Capital Expenditures	(153)
(109)		
	Proceeds from sale of fixed assets	---
---		-----

	Net cash used in investing activities:	(153)
(109)		
	Cash flows from financing activities:	
	Net increase (decrease) in notes payable	3,249
436		-----

	Net cash provided by (used in) financing activities:	3,249
436		
	Net increase (decrease) in cash and cash equivalents	1,927
1,490		
	Cash and cash equivalents at beginning of period	1,581
229		-----

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 March 31, 1998 and for the three-month period ended March 31, 1997 and 1998 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, 1997 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.

New Accounting Pronouncements. On January 1, 1998, the Company adopted Statement of Financial Accounting Standards ("SFAS") No. 130, Reporting Comprehensive Income. Comprehensive income is a more inclusive financial reporting methodology that includes disclosure of certain financial information that historically has not been recognized in the presentation of net income. SFAS No. 130 requires the, reporting of comprehensive income in addition to net income from operations. For the three months ended March 31, 1998 and 1997, the Company had no items of comprehensive income, and as a result the Company's reported net income was the same as comprehensive income.

In March 1998, the Accounting Standards Executive Committee ("AcSEC") of the American Institute of Certified Public Accountants ('AICPA') reached a consensus on Statement of position ("SOP") No. 98-1, Accounting for the Cost of Computer Software Developed or Obtained for Internal Use, which provides guidance on accounting for the costs of computer software. SOP No. 98-1 is effective for fiscal years beginning after December 15, 1998. Management is evaluating what, if any, impact this SOP will have on the Company upon implementation.

In April 1998, the ACSEC of the AICPA reached a consensus on SOP No. 98-5, Reporting on the Costs of Start-up Activities, which provides that the costs of such activities be expensed as incurred. SOP No. 98-5 is effective for fiscal years beginning after December 15, 1998. Management is evaluating what, if any, impact this SOP will have on the Company upon implementation.

In March 1998, the Emerging Issues task Force ("EITF") of the FASB

reached

a consensus on Issue No. 97-11, Accounting for the Internal Costs Relating to Real Estate Property Acquisitions, which requires that internal costs of identifying and acquiring operating properties be expensed as incurred.

Management is currently evaluating the impact this EITF, which was effective for transactions on or after March 20, 1998, will have on the Company.

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2. 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

March 31, 1998, 20,000 stock option grants have been issued to directors under the Director Plan. The exercise price of the directors' options is \$4.625 per share. As of March 31, 1998 incentive stock options totaling 180,300 shares have been issued to employees. The exercise price of 80,000 of the stock option grants is \$6.00 per share and 100,300 of the stock option grants have an exercise price of \$4.625 per share. The stock option grants will vest ratably over the five year period from the date of issuance. 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.

3. 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.

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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, business telephone systems 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 from offices in Houston, Austin, El Paso, Mcallen and Dallas, Texas and in Albuquerque, New Mexico. While all offices offer computer related products and services, certain offices do not offer telecommunications products and services. The Company develops and markets CTI Software through its wholly-owned subsidiary Stratasoft, Inc. To date, most of the Company's revenue has been derived from Computer Products sales. During the quarter ended March 31, 1998, Computer Products totaled 85.3% of revenues while IT Services, Telecom Systems

and CTI Software totaled 8.9%, 3.3% and 2.5% 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.

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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.

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 1997, 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.

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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.

		Three months ended March 31, 1998	
1997		Amount	%
Amount	%		
Revenue(1)			
Computer Products.....		\$27,752	85.3
87.3			
IT Services.....		2,892	8.9
1,991	7.5		
Telecom systems.....		1,072	3.3
953	3.6		
CTI Software.....		826	2.5
427	1.6		

-----	-----	-----	-----

Total revenue.....	32,542	100.0	26,593
100.0			
Gross Profit			
Computer Products.....	3,352	12.8	2,555
11.0			
IT Services.....	975	33.7	782
39.3			
Telecom Systems.....	172	16.0	303
31.9			
CTI Software.....	311	37.7	191
44.8			
-----	-----	-----	-----

Total Gross Profit.....	4,810	14.8	3,831
14.4			
Selling, general and administrative expense.....	4,576	14.1	3,135
11.8			
-----	-----	-----	-----

Operating income.....	234	0.7	
696 2.6			
Interest expense (net of other income..	28	0.1	
289 1.1			
-----	-----	-----	-----

Income before provision for income taxes	206	0.6	
407 1.5			
Provision (benefit) for income taxes.....	82	0.3	
154 0.6			
-----	-----	-----	-----

Net Income.....	\$ 124	0.4	\$
253 1.0			
=====	=====	===	
=====			
Earnings per share.....	\$0.03		\$0.09
	=====		=====

Weighted average shares outstanding.	4,457,107	2,675,000
	=====	=====

(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 March 31, 1998 Compared To Three Months Ended March 31, 1997

TOTAL REVENUE. All of the Company's business units increased revenues over the prior year's comparable period. Total revenue increased by \$5.9 million (22.4%) from \$26.6 million in 1997 compared to \$32.5 million in 1998. Revenue from Computer Products increased by \$4.5 million (19.5%) from \$23.2 million in 1997 to \$27.8 million in 1998. Revenue from Computer Products as a percentage of total revenue decreased 2.0% from 87.3% in 1997 to 85.3% in 1998. Approximately \$1.6 million of the increase in Computer Products from the prior period was realized in new offices while \$2.9 million was realized in offices existing in 1997. Revenue from IT Services increased \$901,000 (45.3%) from \$2.0 million in 1997 to \$2.9 million in 1998 because of the continued expansion of its billable technical staff, together with an emphasis on higher level services to the Company's existing customers and the addition of new customers. Revenue from IT Services as a percentage of total revenue increased from 7.5% in 1997 to 8.9% of total revenues in 1998. Revenue from Telecom Systems increased by \$119,000 (12.5%) from \$953,000 million in 1997 to \$1.1 million in 1998. The increase in Telecom Systems revenue was primarily the result of the Company's ability to obtain new orders for system installations from new customers. Revenue from

Telecom Systems as a percentage of total revenue decreased from 3.6% in 1997 to 3.3% in 1998 because other business units grew revenues at a greater rate than Telecom Systems.. CTI Software revenue increased by \$399,000 (93.5%) from \$427,000 in 1997 to \$826,000 in 1998. The growth in CTI Software revenues was primarily due to increased marketing efforts which resulted in the addition of new customers and increased acceptance of the Company's software products in the marketplace. Revenue from CTI Software, as a percentage of total revenue, increased from 1.6% in 1997 to 2.5% in 1998.

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GROSS PROFIT. Gross profit increased by \$979,000 (25.5%) from \$3.8 million in 1997 to \$4.8 million in 1998 and gross margin increased from 14.4% in 1997 to 14.8% in 1998. The gross margin for Computer Products increased from 11.0% in 1997 to 12.8% in 1998, which was primarily the result of lower unit costs on the products purchased relative to their selling prices which reflects intensified competition among the Company's suppliers. The gross profit from IT Services increased 24.7% from \$782,000 in 1997 to \$975,000 in 1998. Gross margin decreased from 39.3% in 1997 to 33.7% in 1998. This decrease in gross margin was primarily attributable to a lower utilization rate of the Company's billable technical staff leading to higher labor costs as a percent of revenue. Additionally, the wage costs of the Company's billable staff are generally higher in the 1998 period compared to the 1997 period, due to the relative scarcity of qualified technical staff in the computing services industry. The gross margin for Telecom Systems sales decreased from 31.9% in 1997 to 16.0% in

1998, reflecting higher installation costs than are normally incurred. The Company treats its costs associated with its technical staff as part of the cost of sales. Due to the relatively fixed nature of technical staff costs, when lower than expected revenues are realized, cost of sales, expressed as a percentage of revenues, increases proportionately. During the 1998 period the Company was unable to complete the installation of several of its projects resulting in the recognition of lower revenues and gross profits than were expected. The gross margin for CTI Software decreased from 44.8% in 1997 to 37.7% in the 1998 due to higher installation costs on its products.

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES . Selling, general and administrative expenses increased by \$1.4 million (45.9%) from \$3.1 million in 1997 to \$4.6 million in 1998. As a percentage of total revenue, selling, general and administrative expenses increased from 11.8% in 1997 to 14.1% in 1998. Those components of selling, general and administrative expenses which increased significantly, as a percentage of revenues, were commission expense, personnel related costs and general expenses related to opening new offices. Commission expense increased, as a percent of revenues, because gross margin, upon which the Company bases its commission rates, increased in the 1998 period versus 1997. During the 1998 quarter, the Company employed a significant number of new employees in its El Paso and New Mexico offices. Since these employees received compensation prior to the realization of significant revenues the amount of selling, general and administrative expenses increased both as to amount and as expressed as a percent of revenues. The Company also increased the number of

administrative employees relative to the increases in revenues in order to enhance its ability to meet the requirements of revenue growth and increases in the number of offices operated by the Company. Most notably, the Company commenced the upgrading of its computing systems to enhance the speed and capacity of its systems. In addition, during the 1998 period the Company incurred costs related to the opening of offices in McAllen and El Paso, Texas and Albuquerque and Las Cruces, New Mexico without realizing revenues commensurate with those expenses.

OPERATING INCOME. Operating income decreased by \$462,000 (66.3%) from \$696,000 in 1997 to \$234,000 in 1998 due to higher selling, general and administrative expenses. Operating income decreased as a percentage of total revenue from 2.6% in 1997 to 0.7% in 1998. Contributing to the decrease in operating income were operating losses incurred in newly opened offices. The combined operating losses incurred in the operation of newly opened offices was approximately \$109,000.

INTEREST EXPENSE (NET OF OTHER INCOME). Interest expense (net of other income) decreased \$261,000 from \$289,000 during 1997 period compared to \$28,000 in the 1998 period. This reflects the reduced level of the Company's short-term debt during the 1998 period when compared to 1997. The reduction 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 \$82,000 (reflecting an effective tax rate of 39.8% in 1998 compared to 37.8% in 1997),

decreased by \$129,000 from \$253,000 in 1997 to \$124,000 in 1998.

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Liquidity And Capital Resources

The Company's working capital was \$12.8 million and \$12.8 million at December 31, 1997 and March 31, 1998, respectively. As of March 31, 1998, the Company had borrowing capacity under the Company's credit facility of \$12.6 million.

Cash Flow

Operating activities used net cash totaling \$1.2 million during the three months ended March 31, 1998. Operating activities used net cash during the three months ended March 31, 1998 because of decreases in accounts payable and increases in inventories. While trade accounts receivable decreased by \$3.1 million this decrease was offset by increases in accounts payable and inventories. Net income and depreciation provided cash of \$291,000.

Investing activities used cash totaling \$153,000 during the three months ended March 31, 1998. 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 refurbishment of its Dallas branch office and the opening of branch offices in El Paso and 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 \$3.2 million during the three
months ended March 31, 1998.

Asset Management

The Company had trade accounts receivable, net of allowance for doubtful
accounts, of \$20.7 million at March 31, 1998. The number of days' sales
outstanding in trade accounts receivable was 53 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 March 31, 1998.
Bad debt
expense as a percentage of total revenue for the three months ended
March 31,
1998 was 0.3%, which was higher than bad debt expense for the three months
ended
March 31, 1997 because during the 1997 period the Company realized a
recovery of
a previously charged off account. The Company's allowance for doubtful
accounts,
as a percentage of trade accounts receivable, was 1.0% at December 31,
1997, and
1.5% at March 31, 1998. Inventory turnover for the three months ended
March 31,
1998 and 1997 was 18.7 times, and 16.9 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 Deutsche Financial Services ("DFS Facility")

The total credit available under the DFS Facility is \$30.0 million, subject to borrowing base limitations which are generally computed as a percentage of various classes of eligible accounts receivable and qualifying inventory. Credit available under the DFS Facility for floor plan financing of inventory from approved manufacturers (the "Inventory Line") is \$20.0 million. Available credit under the DFS Facility, net of Inventory Line advances, is \$10.0 million, which 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 minus 1.0% per annum. Under the Inventory Line, DFS pays the Company's inventory vendors directly, generally in exchange for negotiated financial incentives. Typically, the financial incentives received are such that DFS does not charge interest to the Company until 40 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 DFS. Inventory Line advances not paid within 40 days after the financing date bear interest at the fluctuating prime rate plus 5.0%. For purposes of calculating interest charges the minimum prime rate under the New DFS Facility is 7.00%. DFS may change 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 DFS Facility is collateralized by a security interest in
substantially
all of the Company's assets, including its accounts receivable,
inventory,
equipment and bank accounts. Collections of the Company's accounts
receivable
are required to be applied through a lockbox arrangement to repay
indebtedness
to DFS; however, DFS has amended the lockbox agreement to make such
arrangements
contingent upon certain financial ratios. Provided the Company is in
compliance
with its debt to tangible net worth covenant, the Company has
discretion over
the use and application of the funds collected in the lockbox. If the
Company
exceeds that financial ratio, DFS may require that lockbox payments be
applied
to reduce the Company's indebtedness to DFS. If in the future DFS
requires that
all lockbox payments be applied to reduce the Company's
indebtedness, the
Company would be required to seek funding from DFS or other sources
to meet
substantially all of its cash needs.

The Company has a \$2.0 million credit facility with IBM Credit
Corporation
(the "IBMCC Facility") for the purchase of IBM branded inventory from
certain
suppliers. Advances under the IBMCC Facility are typically interest free
for 30
days after the financing date for transactions in which adequate
financial
incentives are received by IBMCC from the vendor. Within 30 days
after the
financing date, the full invoice amount for inventory financed through
IBMCC 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%.

IBMCC retains a security interest in the inventory financed. The IBMCC Facility is immediately terminable by either party by written notice to the other.

Under the DFS Facility the Company is required to maintain (i) a tangible net worth of \$10.0 million, (ii) a ratio of debt minus subordinated debt to tangible net worth of 4 to 1 and (iii) a ratio of current tangible assets to current liabilities of not less than 1.4 to 1.

Both the IBMCC Facility and the DFS Facility prohibit the payment of dividends unless consented to by the lender.

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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.

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.

Allstar Systems, Inc.

MAY 15, 1997
Date

By: /s/ JAMES H. LONG
James H. Long, Chief Executive Officer

MAY 15, 1997
Date
Officer
<PAGE>

By: /s/ DONALD R. CHADWICK
Donald R. Chadwick, Chief Financial

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-----END PRIVACY-ENHANCED MESSAGE-----