

Taglich Brothers, Inc.

The Standard of Excellence in the Microcap Market

Member: NASD, SIPC

Research Report-Update

I-Sector Corp

Rating: Hold

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ISEC \$0.88 (NASDAQ)

	<u>FY1999A</u>	<u>FY2000A</u>	<u>FY2001A</u>	<u>FY2002E</u>	<u>FY2003E</u>
Revenues(Thousands)	\$17,798	\$17,087	\$23,620	\$38,040	\$47,698
Earnings per share	\$(0.20)	\$(0.01)	\$(0.95)	\$(0.19)	\$0.14
52-Week Range	\$1.25 -\$0.45		Fiscal Year Ends	December	
Shares Out-fully dil (thousands)	3,855		Revenues/Share (TTM)	\$6.04	
Approximate Float (thousands)	1,118		Price/Sales(TTM)	0.15X	
Insider Holdings	71%		Price/Sales(2003E)	0.08X	
Tangible Book value/Share	\$1.73		Price/Earnings(TTM)	NM	
Price/ Tangible Book	0.51X		Price/Earnings(2003E)	6.8X	

The Company owns and operates wholly owned subsidiary companies that are engaged in various aspects of the information and communications technology industries.

Key Investment Considerations:

- *We are maintaining our Hold rating on I-Sector Corp (ISEC) and establishing a 24-month price target of \$2.80 per share based on our P/S and discounted cash flow analysis.*
- *ISEC reported a 4Q01 net loss from continuing operations of \$0.451 million or \$(0.12) per share, on revenues of \$7.4 million.*
- *We are fine tuning our estimates for fiscal 2002 and are now estimating revenues of \$38.0 million and a net loss from continuing operations of \$0.736 million or \$(0.19) per share. We had previously forecasted revenues of \$39.6 million and a net loss from continuing operations of \$0.210 million or \$(0.05) per share.*
- *We are introducing fiscal 2003 estimates. We are forecasting revenues of \$47.7 million, EBITDA of \$1.1 million, and net income from continuing operations of \$0.579 million or \$0.14 per share.*
- *We believe that the Company will become EBITDA positive in the third quarter and reach profitability in the fourth quarter of fiscal 2002.*
- *The Company continues to have a healthy balance sheet with a tangible book value of \$6.7 million or \$1.73 per share with minimal long-term debt of \$0.4 million. As of December 31, 2001, cash and cash equivalents stood at \$3.4 million or \$0.89 per share, while working capital stood at approximately \$2.2 million. We estimate that ISEC's current cash burn rate is approximately \$250 thousand per quarter and project the Company to be cash flow positive by late 2002.*

** Please view our disclaimer located at the end of the text portion of this report.*

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Company Overview

I-Sector (ISEC), formerly known as Allstar Systems, operates or invests in companies that are primarily engaged in information and communications technologies. The Company operates through three distinct wholly owned subsidiaries:

- **Stratasoft, Inc.** - Develops and markets proprietary software that integrates business telephone systems and networked computer systems including software for call center management, and interactive voice response software. Its proprietary software integrates business telephone systems and networked computer systems.
- **Allstar Solutions, Inc.** - Formed through the recent merger of the Company's wholly owned subsidiaries, Synergy Helpdesk Solutions and Allstar Computer Products, it provides a comprehensive set of information technology solutions.
- **Internetwork Experts, Inc. (INX)** - A network infrastructure professional services firm providing network design and implementation, voice/data convergence, network management and security.

Recent Results- 4th Quarter 2001

ISEC reported 4Q01 net loss from continuing operations of \$0.451 million or \$(0.12) per share, on revenues of \$7.4 million. Net loss from continuing operations for 4Q00 was \$1.4 million, or \$(0.34) per share, on revenues of \$3.9 million. The increase in revenues and decrease in losses resulted from additional sales and marketing efforts and operational improvements. The following tables illustrate these improvements at the subsidiary level.

Subsidiary	Sales Growth(%)	Revenue Mix(%)	Revenue Mix(\$ 000's)
Stratasoft, Inc.	85.9	31.1	2,298
Allstar Solutions, Inc	25.8	21.6	1,592
Internetwork Experts, Inc.	200.9	47.9	3,535

Subsidiary	Gross Margins %	Operating Margins %
Stratasoft, Inc.	59.0	19.6
Allstar Solutions, Inc	27.1	-12.1
Internetwork Experts, Inc.	12.1	-15.7

4Q01 revenues and net loss were slightly better than Taglich Brothers' estimates of \$7.3 million and \$0.6 million or \$(0.16) per share, respectively. Margins for the most part were slightly better than expectations.

	Reported	Estimated
Gross Margins	30.0%	28.5%
SG&A Expenses	36.5%	37.2%
Operating Margin	-6.5%	-8.7%
Net margin	-6.1%	-8.3%

ISEC continues to have a healthy balance sheet with a tangible book value of \$6.7 million or \$1.73 per share with minimal long term debt of \$0.4 million. At the end of the fiscal year, cash and cash equivalents stood at \$3.4 million or \$0.89 per share, while working capital stood at approximately \$2.2 million. We believe that the Company will be able to satisfy its capital requirements for the foreseeable future from existing cash balances, working capital, and credit facility. Also, the Company has improved its credit terms with suppliers, which will allow ISEC to better manage cash outflows and inflows.

We estimate that ISEC's current cash burn rate is approximately \$250 thousand per quarter and project the Company to be cash flow positive by late 2002.

Recent Developments

During the fourth quarter, ISEC sold its I.T. Staffing, Inc. subsidiary to the subsidiary's management for a minimal dollar amount. I.T. Staffing is a professional staffing firm specializing in the placement of experienced Information Technology professionals with clients throughout Texas. Management of ISEC believed that this subsidiary no longer functioned as part of the core business.

During fiscal 2001, ISEC recognized an after-tax loss from this discontinued subsidiary of \$85 thousand and an after-tax loss on the disposal of assets of \$4 thousand.

Outlook & Projections

We are fine tuning our estimates for fiscal 2002 and introducing fiscal 2003 estimates.

For fiscal 2002, we are estimating revenues of \$38.0 million and a net loss from continuing operations of \$0.736 million or \$(0.19) per share. We had previously forecasted revenues of \$39.6 million and a net loss from continuing operations of \$0.210 million or \$(0.05) per share. **We believe that the Company will become EBITDA positive in the third quarter and reach profitability in the fourth quarter of fiscal 2002.**

For fiscal 2003, we are forecasting revenues of \$47.7 million, EBITDA of \$1.1 million, and net income from continuing operations of \$0.579 million or \$0.14 per share.

Estimated Revenue Mix (\$ thousands)

Segment	FY2000A	FY2001A	FY2002E	FY2003E
Allstar	6,946	5,668	5,895	6,201
INX	1,874	10,775	24,525	33,532
Stratasoft	6,660	7,257	7,620	7,966
Overall	17,087	23,620	38,040	47,698

We believe past investments in sales and marketing should drive increases in revenues and operating margins during 2002 and 2003. The Company has been aggressive in hiring talented sales people with proven track records and solid books of business. In this way, ISEC has positioned itself to increase its financial results in adverse economic and industry environments. We believe ISEC's existing customer base has not yet increased spending substantially and future spending will be limited by economic concerns and industry factors. On the horizon, we believe that there may be more favorable business conditions given several industry trends, including the recent release of Windows XP, faster CPU's, increasingly complex systems, and upgrading of computer equipment that was purchased prior to Y2K. Our belief is supported by Goldman Sachs and Gartner Group.

- An up tick in 2003 IT spending is forecasted by Goldman Sachs, which released the results of a survey on March 13 indicating that normalized spending may return in 2003; and
- Gartner Group believes that IT budgets are starting to loosen up.

We believe that during fiscal 2003 unprofitable subsidiaries should become profitable. Operating and net margins at the subsidiary and corporate level are expected to increase, as there is improved staff utilization, inventory management, collections, compensation management, and overall cost controls. Gross margins are

expected to decline as segments with lower margins become an increasing larger component of overall revenues.

Risks

Competitive

The Company's prospects are tied to the future prospects of the IT and Communications Industries. These industries are characterized by intense competition, short product cycles, and rapid technological developments.

In the past several quarters there has been significant turmoil in companies with exposure to these industries. Many competitors' stock prices have suffered as a result of this turmoil and many companies have posted lower earnings and have warned about future expectations. Wachovia Securities believes that there is significant near term risk for technology vendors given current economic environment. Nevertheless, we believe that the long-term prospects are positive for companies such as I-Sector involved in the IT and Communications Industries. Our belief is supported by Kaufman Brothers, which believes expenditures by firms in these Industries are more than a line item expenses. Expenditures for products and services in these industries are critical, as companies seek to run their businesses in an efficient and productive manner. Small and microcap peers include:

eGain Communication (NASDAQ: EGAN), a CRM software vendor focusing on customer service interactions;

eOn Communications (NASDAQ: EONC), a provider of integrated communications systems for call centers;

GTSI Corp (NASDAQ: GTSI), a provider of networking products and IT solutions;

Interactive Intelligence (NASDAQ: ININ), a provider of software solutions for call centers and enterprises; and

Nuance Communications (NASDAQ: NUAN), a provider of software solutions for customer relationship management.

Liquidity

Shares of ISEC have risks common to those of the microcap segment of the market. Often these risks cause microcap stocks to trade at discounts to their peers. The most common of these risks is liquidity risk, which is typically caused by small trading floats and very low trading volume and can lead to large spreads and high volatility in the stock price. Therefore, risk averse investors should be cautious with shares of ISEC. The Company has approximately 1 million shares in the float. On average, approximately 863 shares are traded daily.

Valuation & Conclusion

We are maintaining our Hold rating on the shares of I-Sector (ISEC) and establishing a 24-month price target of \$2.80 per share. Our price target is based on averaging the following valuations and discounting the two values by 30% to give consideration to concerns associated with the Company's micro-capitalization and other risks:

- Applying a richer, yet conservative price-to-sales (P/S) multiple of 0.5X our 2003 revenue estimate of \$11.36 per share. Shares are currently trading at 0.1X fiscal 2003;
- Our discounted cash flow analysis using EBITDA as a proxy for cash flows. Our assumptions include a discount rate of 12.35% and a terminal value multiple of 10.0X.



Public Companies mentioned in this report:

- eGain Communication (NASDAQ: EGAN)
- eOn Communications (NASDAQ: EONC)
- Interactive Intelligence (NASDAQ: ININ)
- Nuance Communications (NASDAQ: NUAN)

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I-Sector Corp.
Annual Income Statement Model
For Years Ended December 31
(in thousands)

	FY1999A	FY2000A	FY2001A	FY2002E	FY2003E
Total Revenues	\$ 17,984	\$ 17,087	\$ 23,620	\$ 38,040	\$ 47,698
Costs of Goods Sold	<u>11,806</u>	<u>12,968</u>	<u>17,325</u>	<u>28,115</u>	<u>36,129</u>
Gross Profit	6,178	4,119	6,295	9,924	11,569
<i>Gross Margins</i>	34.35%	24.11%	26.65%	26.09%	24.25%
S,G&A	<u>6,207</u>	<u>9,479</u>	<u>10,573</u>	<u>10,700</u>	<u>11,000</u>
Operating Income	(29)	(5,360)	(4,278)	(776)	569
<i>Operating Margin</i>	-0.16%	-31.37%	-18.11%	-2.04%	1.19%
Interest Expense(Income)-net	<u>(23)</u>	<u>(239)</u>	<u>(316)</u>	<u>(40)</u>	<u>(10)</u>
Pre-Tax Income	(6)	(5,121)	(3,962)	(736)	579
<i>Pre-Tax Margins</i>	-0.03%	-29.97%	-16.77%	-1.93%	1.21%
Taxes (Benefit)	<u>20</u>	<u>(1,493)</u>	<u>(87)</u>	<u>-</u>	<u>-</u>
<i>Tax Rate</i>	-333%	29.15%	2.20%	0.00%	0.00%
Net Income-continuing ops	<u>\$ (26)</u>	<u>\$ (3,628)</u>	<u>\$ (3,875)</u>	<u>\$ (736)</u>	<u>\$ 579</u>
EPS-fully diluted- cont ops	<u>\$ (0.01)</u>	<u>\$ (0.89)</u>	<u>\$ (0.99)</u>	<u>\$ (0.19)</u>	<u>\$ 0.14</u>
Avg Shares Out-fully diluted	<u>4,168</u>	<u>4,060</u>	<u>3,911</u>	<u>3,900</u>	<u>4,200</u>
Income (loss) from discontinued	319	195	(167)	-	-
Gain (loss) on Disposal	(1,138)	3,390	337	-	-
Net Income	<u>\$ (845)</u>	<u>\$ (43)</u>	<u>\$ (3,705)</u>	<u>\$ (736)</u>	<u>\$ 579</u>
EPS-fully diluted	<u>\$ (0.20)</u>	<u>\$ (0.01)</u>	<u>\$ (0.95)</u>	<u>\$ (0.19)</u>	<u>\$ 0.14</u>
Avg Shares Out-fully diluted	<u>4,168</u>	<u>4,060</u>	<u>3,911</u>	<u>3,900</u>	<u>4,200</u>
Percent of Revenue					
Costs of Goods Sold	65.65%	75.89%	73.35%	73.91%	75.75%
SG&A	34.51%	55.47%	44.76%	28.13%	23.06%
Net Margin	-4.70%	-0.25%	-15.69%	-1.93%	1.21%
YEAR / YEAR GROWTH					
Total Revenues	16.72%	-4.99%	38.23%	61.05%	25.39%
Operating Income	NM	NM	NM	NM	NM
Pre-Tax Income	NM	NM	NM	NM	NM
Net Income	NM	NM	NM	NM	NM

I-Sector Corp.
Quarterly Income Statement Model
For Year Ended December 31, 2000
(in thousands)

	Q1(3/00)A	Q2(6/00)A	Q3(9/00)A	Q4(12/00)A	FY2000A
Total Revenues	\$ 5,663	\$ 3,913	\$ 3,839	\$ 3,672	\$ 17,087
Costs of Goods Sold	<u>3,358</u>	<u>3,263</u>	<u>3,064</u>	<u>3,283</u>	<u>12,968</u>
Gross Profit	2,305	650	775	389	4,119
<i>Gross Margins</i>	40.70%	16.61%	20.19%	10.59%	24.11%
S,G&A	<u>2,205</u>	<u>1,881</u>	<u>3,144</u>	<u>2,249</u>	<u>9,479</u>
Operating Income	100	(1,231)	(2,369)	(1,860)	(5,360)
<i>Operating Margin</i>	1.77%	-31.46%	-61.71%	-50.65%	-31.37%
Interest Expense(Income)-net	<u>15</u>	<u>(50)</u>	<u>(100)</u>	<u>(104)</u>	<u>(239)</u>
Pre-Tax Income	85	(1,181)	(2,269)	(1,756)	(5,121)
<i>Pre-Tax Margins</i>	1.50%	-30.18%	-59.10%	-47.82%	-29.97%
Taxes (Benefit)	<u>27</u>	<u>(391)</u>	<u>(690)</u>	<u>(439)</u>	<u>(1,493)</u>
<i>Tax Rate</i>	31.76%	33.11%	30.41%	25.00%	29.15%
Net Income-continuing ops	<u>\$ 58</u>	<u>\$ (790)</u>	<u>\$ (1,579)</u>	<u>\$ (1,317)</u>	<u>\$ (3,628)</u>
EPS-fully diluted- cont ops	<u>\$ 0.01</u>	<u>\$ (0.20)</u>	<u>\$ (0.39)</u>	<u>\$ (0.33)</u>	<u>\$ (0.89)</u>
Avg Shares Out-fully diluted	<u>4,287</u>	<u>4,049</u>	<u>4,049</u>	<u>4,048</u>	<u>4,060</u>
Income (loss) from discontinued	286	9	(36)	(64)	195
Gain (loss) on Disposal	4,872	(387)	(1,095)	-	3,390
Net Income	<u>\$ 5,216</u>	<u>\$ (1,168)</u>	<u>\$ (2,710)</u>	<u>\$ (1,381)</u>	<u>\$ (43)</u>
EPS-fully diluted	<u>\$ 1.22</u>	<u>\$ (0.29)</u>	<u>\$ (0.67)</u>	<u>\$ (0.34)</u>	<u>\$ (0.01)</u>
Avg Shares Out-fully diluted	<u>4,287</u>	<u>4,049</u>	<u>4,049</u>	<u>4,048</u>	<u>4,060</u>
Percent of Revenue					
Costs of Goods Sold	59.30%	83.39%	79.81%	89.41%	75.89%
SG&A	38.94%	48.07%	81.90%	61.25%	55.47%
Net Margin	92.11%	-29.85%	-70.59%	-37.61%	-0.25%
YEAR / YEAR GROWTH					
Total Revenues	31.15%	-13.35%	-21.97%	-32.26%	-4.99%

I-Sector Corp.
Quarterly Income Statement Model
For Year Ended December 31, 2001
(in thousands)

	Q1(3/01)A	Q2(6/01)A	Q3(9/01)A	Q4(12/01)A	FY2001A
Total Revenues	\$ 4,601	\$ 5,399	\$ 6,241	\$ 7,379	\$ 23,620
Costs of Goods Sold	<u>3,507</u>	<u>4,119</u>	<u>4,533</u>	<u>5,166</u>	<u>17,325</u>
Gross Profit	1,094	1,280	1,708	2,213	6,295
<i>Gross Margins</i>	23.78%	23.71%	27.37%	29.99%	26.65%
S,G&A	<u>2,819</u>	<u>2,544</u>	<u>2,517</u>	<u>2,693</u>	<u>10,573</u>
Operating Income	(1,725)	(1,264)	(809)	(480)	(4,278)
<i>Operating Margin</i>	-37.49%	-23.41%	-12.96%	-6.50%	-18.11%
Interest Expense(Income)-net	<u>(96)</u>	<u>(61)</u>	<u>(116)</u>	<u>(43)</u>	<u>(316)</u>
Pre-Tax Income	(1,629)	(1,203)	(693)	(437)	(3,962)
<i>Pre-Tax Margins</i>	-35.41%	-22.28%	-11.10%	-5.92%	-16.77%
Taxes (Benefit)	<u>37</u>	<u>(159)</u>	<u>21</u>	<u>14</u>	<u>(87)</u>
<i>Tax Rate</i>	-2.27%	13.22%	-3.03%	-3.20%	2.20%
Net Income-continuing ops	<u>\$ (1,666)</u>	<u>\$ (1,044)</u>	<u>\$ (714)</u>	<u>\$ (451)</u>	<u>\$ (3,875)</u>
EPS-fully diluted- cont ops	<u>\$ (0.42)</u>	<u>\$ (0.27)</u>	<u>\$ (0.19)</u>	<u>\$ (0.12)</u>	<u>\$ (0.99)</u>
Avg Shares Out-fully diluted	<u>3,945</u>	<u>3,905</u>	<u>3,855</u>	<u>3,855</u>	<u>3,911</u>
Income (loss) from discontinued	(71)	(41)	(41)	(14)	(167)
Gain (loss) on Disposal	-	348	-	(11)	337
Net Income	<u>\$ (1,737)</u>	<u>\$ (737)</u>	<u>\$ (755)</u>	<u>\$ (476)</u>	<u>\$ (3,705)</u>
EPS-fully diluted	<u>\$ (0.44)</u>	<u>\$ (0.19)</u>	<u>\$ (0.20)</u>	<u>\$ (0.12)</u>	<u>\$ (0.95)</u>
Avg Shares Out-fully diluted	<u>3,945</u>	<u>3,906</u>	<u>3,854</u>	<u>3,855</u>	<u>3,911</u>
Percent of Revenue					
Costs of Goods Sold	76.22%	76.29%	72.63%	70.01%	73.35%
SG&A	61.27%	47.12%	40.33%	36.50%	44.76%
Net Margin	-37.75%	-13.65%	-12.10%	-6.45%	-15.69%
YEAR / YEAR GROWTH					
Total Revenues	-18.75%	37.98%	62.57%	100.95%	38.23%

I-Sector Corp.
Quarterly Income Statement Model
For Year Ended December 31, 2002
(in thousands)

	Q1(3/02)E	Q2(6/02)E	Q3(9/02)E	Q4(12/02)E	FY2002E	FY2003E
Total Revenues	\$ 8,450	\$ 9,200	\$ 9,850	\$ 10,540	\$ 38,040	\$ 47,698
Costs of Goods Sold	<u>6,169</u>	<u>6,817</u>	<u>7,299</u>	<u>7,831</u>	<u>28,115</u>	<u>36,129</u>
Gross Profit	2,282	2,383	2,551	2,709	9,924	11,569
<i>Gross Margins</i>	27.00%	25.90%	25.90%	25.70%	26.09%	24.25%
S,G&A	<u>2,675</u>	<u>2,675</u>	<u>2,675</u>	<u>2,675</u>	<u>10,700</u>	<u>11,000</u>
Operating Income	(394)	(292)	(124)	34	(776)	569
<i>Operating Margin</i>	-4.66%	-3.18%	-1.26%	0.32%	-2.04%	1.19%
<i>EBITDA</i>	(244)	(142)	26	184	(176)	1,144
Interest Expense(Income)-net	<u>(10)</u>	<u>(10)</u>	<u>(10)</u>	<u>(10)</u>	<u>(40)</u>	<u>(10)</u>
Pre-Tax Income	(384)	(282)	(114)	44	(736)	579
<i>Pre-Tax Margins</i>	-4.54%	-3.07%	-1.16%	0.41%	-1.93%	1.21%
Taxes (Benefit)	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>	<u>-</u>
<i>Tax Rate</i>	0.00%	0.00%	0.00%	0.00%	0.00%	0.00%
Net Income-continuing ops	<u>\$ (384)</u>	<u>\$ (282)</u>	<u>\$ (114)</u>	<u>\$ 44</u>	<u>\$ (736)</u>	<u>\$ 579</u>
EPS-fully diluted- cont ops	<u>\$ (0.10)</u>	<u>\$ (0.07)</u>	<u>\$ (0.03)</u>	<u>\$ 0.01</u>	<u>\$ (0.19)</u>	<u>\$ 0.14</u>
Avg Shares Out-fully diluted	<u>3,900</u>	<u>3,900</u>	<u>3,900</u>	<u>4,200</u>	<u>3,900</u>	<u>4,200</u>
Percent of Revenue						
Costs of Goods Sold	73.00%	74.10%	74.10%	74.30%	73.91%	75.75%
SG&A	31.66%	29.08%	27.16%	25.38%	28.13%	23.06%
Net Margin	-4.54%	-3.07%	-1.16%	0.41%	-1.93%	1.21%
YEAR / YEAR GROWTH						
Total Revenues	83.66%	70.40%	57.83%	42.83%	61.05%	25.39%

I-Sector Corp.
Consolidated Balance Sheet
For Periods Ended December 31
(in thousands)

	F1999A	F2000A	F2001A
Assets			
Current Assets			
Cash & Equivalents	\$ 4,647	\$ 8,346	\$ 3,434
Net Receivables	38,764	4,917	4,742
Inventory	7,442	774	587
Prepaid Expense & Other	<u>1,220</u>	<u>1,096</u>	<u>2,148</u>
Total Current Assets	52,073	15,133	10,911
Plant, Property, & Equipment-net	2,280	1,579	1,226
Intangibles	-	326	1,356
Other	<u>178</u>	<u>104</u>	<u>55</u>
Total Assets	<u>\$ 54,531</u>	<u>\$ 17,142</u>	<u>\$ 13,548</u>
Liabilities & Shareholders' Equity			
Current Liabilities			
Current portion of LTD	\$ -	\$ -	\$ 213
Notes Payable	15,869	-	-
Accounts Payable	21,687	1,892	1,772
Accrued Expenses & Other	4,511	2,138	2,163
Discontinued ops liabilities	199	869	654
Deferred revenue	<u>240</u>	<u>136</u>	<u>126</u>
Total Current Liabilities	42,506	5,035	4,928
LTD	-	-	410
Deferred Liabilities	195	195	195
Total Shareholders' Equity	<u>11,830</u>	<u>11,912</u>	<u>8,015</u>
Total Liabilities & Equity	<u>\$ 54,531</u>	<u>\$ 17,142</u>	<u>\$ 13,548</u>
SHARES OUT	4,061	4,042	3,850