

Taglich Brothers, Inc.

The Standard of Excellence in the Microcap Market

Member: NASD, SIPC

Research Report-Update

I-Sector Corp

Rating: Hold

Luis Martins

ISEC \$1.00 (NASDAQ)

September 6, 2001

	<u>FY1998A</u>	<u>FY1999A</u>	<u>FY2000A</u>	<u>FY2001E</u>	<u>FY2002E</u>
Revenues(Thousands)*	\$16,278	\$19,175	\$18,329	\$23,878	\$38,300
Earnings per share *	\$(0.21)	\$(0.02)	\$(0.92)	\$(1.13)	\$0.05
52-Week Range	\$2.00 -\$0.625		Fiscal Year Ends	December	
Shares Out-fully dil (thousands)	3,906		Revenues/Share (TTM)	\$4.69	
Approximate Float (thousands)	1,133		Price/Sales(TTM)	0.21X	
Insider Holdings	71%		Price/Sales(2002)	0.10X	
Book value/Share	\$2.38		Price/Earnings(TTM)	NM	
Price/Book	0.42X		Price/Earnings(2002)	20.0X	

*Continuing operations

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

Key Investment Considerations:

- *We are maintaining coverage of I-Sector (ISEC) with a Hold rating and establishing a 12-month price target of \$1.44 per share. We believe that ISEC represents an increasingly compelling investment opportunity for risk tolerant investors seeking exposure to the technology sector.*
- *We believe that the Company should continue to grow revenues and reach profitability in fiscal 2002 despite a severe downturn in the IT and communications industries.*
- *For fiscal 2002, we project that the Company will achieve revenues of \$38.3 million and EPS of \$0.05 per share.*
- *As of June 30 2001, the Company's book value was \$2.38 per share. ISEC had cash of \$1.39 per share with no debt.*
- *ISEC reported 2Q01 net loss from continuing operations of \$1.08 million, or \$(0.27) per share, on revenues of \$5.7 million.*

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

1370 Avenue of the Americas, 31st Floor, New York, N.Y. 10019

(800) 456-1220 ● Fax (212) 265-4744

www.taglichbrothers.com

Company Overview

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

- Stratasoft, Inc.
- I.T. Staffing, Inc.
- Allstar Solutions, Inc.
- Internetwork Experts, Inc. (INX)

During the six months ended June 30, 2001, Stratasoft, Allstar, INX, and IT Staffing produced 30.9%, 22.6%, 41.2%, and 5.5% of total revenues, respectively. This compares to 35.7%, 41.8%, 0%, and 6.2%, respectively, during the six months ended June 30, 2000. During the two periods, all segments, except for Stratasoft, operated at a loss.

Management has employed the following strategies to pursue rapid growth of its currently existing subsidiary companies:

- 1) Increased hiring of sales and marketing staff;
- 2) Increased marketing and promotional activities;
- 3) Performed selective acquisitions to supplement current businesses.

Management believes that these activities are essential to enhance the long-term value of the Company.

Recent Results- 2nd Quarter 2001

ISEC reported 2Q01 net loss from continuing operations of \$1.08 million, or \$(0.27) per share, on revenues of \$5.7 million. Net loss from continuing operations for 2Q00 was \$0.8 million, or \$(0.20) per share, on revenues of \$4.2 million. Revenues and EPS were slightly above Taglich Brothers' estimates of \$5.7 million and \$(0.31) per share, respectively. Margins from continuing operations for the most part were slightly above expectations.

	Reported	Estimated
Gross Margins	24.6%	26.0%
SG&A Expenses	47.7%	49.1%
Operating Margin	-23.1%	-23.1%
Net margin	-18.9%	-21.8%

The Company had income from discontinued operations of \$346 thousand or \$0.08 per share for the quarter. This was related primarily to the receipt of funds that had been held in escrow related to the sale of its Computer Products business in a previous period. In the year ago quarter, ISEC had a loss from discontinued operations of \$387 thousand or (\$0.09) per share.

The Company continues to have no debt and adequate liquidity. At the end of the second quarter, cash and cash equivalents stood at \$5.4 million, while working capital stood at approximately \$7.7 million. Furthermore, ISEC has \$1.7 million available under a credit facility with Deutsche Financial Services. The Company believes that it will be able to satisfy its capital requirements from existing cash balances and collection of accounts receivable.

Outlook & Projections

Based on recent trends we believe that the Company will continue to grow revenues, decrease losses, and reach profitability in the third quarter of fiscal 2002.

We are increasing our revenue estimates for fiscal 2001. We now believe that revenues will be \$23.9 million and the net loss for the year will be \$4.4 million or \$(1.13) per share. We had previously projected revenues of \$22.8 million. We believe past increases in expenditures and sales efforts should drive increases in revenues in the second half of 2001 and fiscal year 2002.

For fiscal 2002 we believe that the Company will achieve revenues of \$38.3 million and EPS of \$0.05 per share. We are projecting a marginal profit in the third quarter. Our conservative estimates for 2002 are based on a combination of operating trends, management's public guidance, and the lackluster outlook for the IT and communications industries. We are only slightly increasing our margin assumptions for the remainder of fiscal year 2001 and 2002. However, we suspect that as conditions do improve, margins will also improve, perhaps above what we have projected. We believe these industries will start to rebound in the near future driven by economic growth and industry events such as the industry's software upgrade cycle. Additionally, we believe that there could be acquisitions in the Company's future and/or management may start new businesses. These acquisitions and/or startups may operate as separate wholly owned subsidiary companies.

Other Considerations

The Company's prospects are tied to the future prospects of the IT and communications industries. It should be noted that in the past several months there has been significant turmoil in companies with exposure to these industries. Although, we are of the view that companies with sound business models will prosper in the long-run, the short-term impact is uncertain. Many competitors' stock prices have suffered as a result of this turmoil. Additionally, many companies have warned of lower earnings and have reduced future expectations. Struggling firms have been hurt by a decrease in spending by clients concerned about the slowing economy and the dot-com collapse.

The shares of ISEC have risks common to those of the Micro-cap segment of the market. Often these risks cause Micro-cap 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 1,954 shares are traded daily.

Valuation & Conclusion

We are maintaining our Hold rating on the shares of I-Sector and establishing a 12-month target of \$1.44 per share. The Company has grown revenues and decreased losses despite a general severe downturn in the IT and communications industries. We believe that profitability is in sight, and we believe that will focus attention on this currently under-followed equity.

Our price target is based the technology sector's trailing twelve month P/E multiple of 36X applied to our 2002 EPS estimates of \$0.05 per share. We have further discounted this figure by 20% to give consideration to concerns associated with the Company's micro-capitalization and other risks. We believe that there could be significantly more upside should there be improvement in the technology sector coupled with a sustained improvement in the Company's quarterly results.



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

	FY1999A	FY2000A	FY2001E	FY2002E
Total Revenues	\$ 19,175	\$ 18,329	\$ 23,878	\$ 38,300
Costs of Goods Sold	<u>12,598</u>	<u>13,881</u>	<u>17,528</u>	<u>27,131</u>
Gross Profit	6,577	4,448	6,350	11,169
<i>Gross Margins</i>	<i>34.30%</i>	<i>24.27%</i>	<i>26.60%</i>	<i>29.16%</i>
S,G&A	<u>6,671</u>	<u>9,970</u>	<u>11,202</u>	<u>11,046</u>
Operating Income	(94)	(5,522)	4,851	123
<i>Operating Margin</i>	<i>-0.49%</i>	<i>-30.13%</i>	<i>20.32%</i>	<i>0.32%</i>
Interest Expense(Income)-net	<u>(23)</u>	<u>(239)</u>	<u>262</u>	<u>(70)</u>
Pre-Tax Income	(71)	(5,283)	4,589	193
<i>Pre-Tax Margins</i>	<i>-0.37%</i>	<i>-28.82%</i>	<i>19.22%</i>	<i>0.50%</i>
Taxes (Benefit)	<u>(2)</u>	<u>(1,548)</u>	<u>(179)</u>	<u>-</u>
<i>Tax Rate</i>	<i>2.82%</i>	<i>29.30%</i>	<i>-3.90%</i>	<i>0.00%</i>
Net Income-continuing ops	<u>\$ (69)</u>	<u>\$ (3,735)</u>	<u>\$ (4,410)</u>	<u>\$ 193</u>
EPS-fully diluted- cont ops	<u>\$ (0.02)</u>	<u>\$ (0.92)</u>	<u>\$ (1.13)</u>	<u>\$ 0.05</u>
Avg Shares Out-fully diluted	<u>4,168</u>	<u>4,060</u>	<u>3,915</u>	<u>4,000</u>
Income (loss) from discontinued	362	302	-	-
Gain (loss) on Disposal	(1,138)	3,390	346	-
Net Income	<u>\$ (845)</u>	<u>\$ (43)</u>	<u>\$ (4,064)</u>	<u>\$ 193</u>
EPS-fully diluted	<u>\$ (0.20)</u>	<u>\$ (0.01)</u>	<u>\$ (1.04)</u>	<u>\$ 0.05</u>
Avg Shares Out-fully diluted	<u>4,168</u>	<u>4,060</u>	<u>3,915</u>	<u>4,000</u>
Percent of Revenue				
Costs of Goods Sold	65.70%	75.73%	73.41%	70.84%
SG&A	34.79%	54.39%	46.91%	28.84%
Net Margin	-4.41%	-0.23%	-17.02%	0.50%
YEAR / YEAR GROWTH				
Total Revenues	17.80%	-4.41%	30.27%	60.40%

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

	<u>Q1(3/00)A</u>	<u>Q2(6/00)A</u>	<u>Q3(9/00)A</u>	<u>Q4(12/00)A</u>	F2000A
Total Revenues	\$ 5,984	\$ 4,228	\$ 4,173	\$ 3,944	\$ 18,329
Costs of Goods Sold	<u>3,599</u>	<u>3,494</u>	<u>3,314</u>	<u>3,474</u>	<u>13,881</u>
Gross Profit	2,385	734	859	470	4,448
<i>Gross Margins</i>	39.86%	17.36%	20.58%	11.92%	24.27%
S,G&A	<u>2,309</u>	<u>1,951</u>	<u>3,282</u>	<u>2,428</u>	<u>9,970</u>
Operating Income	76	(1,217)	(2,423)	(1,958)	(5,522)
<i>Operating Margin</i>	1.27%	-28.78%	-58.06%	-49.65%	-30.13%
Interest Expense(Income)-net	<u>15</u>	<u>(50)</u>	<u>(100)</u>	<u>(104)</u>	<u>(239)</u>
Pre-Tax Income	61	(1,167)	(2,323)	(1,854)	(5,283)
<i>Pre-Tax Margins</i>	1.02%	-27.60%	-55.67%	-47.01%	-28.82%
Taxes (Benefit)	<u>19</u>	<u>(386)</u>	<u>(708)</u>	<u>(473)</u>	<u>(1,548)</u>
<i>Tax Rate</i>	31.15%	33.08%	30.48%	25.51%	29.30%
Net Income-continuing ops	<u>\$ 42</u>	<u>\$ (781)</u>	<u>\$ (1,615)</u>	<u>\$ (1,381)</u>	<u>\$ (3,735)</u>
EPS-fully diluted- cont ops	<u>\$ 0.01</u>	<u>\$ (0.19)</u>	<u>\$ (0.40)</u>	<u>\$ (0.34)</u>	<u>\$ (0.92)</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	302			-	302
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	60.14%	82.64%	79.42%	88.08%	75.73%
SG&A	38.59%	46.14%	78.65%	61.56%	54.39%
Net Margin	87.17%	-27.63%	-64.94%	-35.02%	-0.23%
YEAR / YEAR GROWTH					
Total Revenues	38.58%	-6.38%	-15.18%	-27.25%	-4.41%

I-Sector Corp.
Quarterly Income Statement Model
For Year Ended December 31, 2001 & 2002
(in thousands)

	Q1(3/01)A	Q2(6/01)A	Q3(9/01)E	Q4(12/01)E	FY2001E	FY2002E
Total Revenues	\$ 4,840	\$ 5,738	\$ 6,200	\$ 7,100	\$ 23,878	\$ 38,300
Costs of Goods Sold	<u>3,661</u>	<u>4,326</u>	<u>4,464</u>	<u>5,077</u>	<u>17,528</u>	<u>27,131</u>
Gross Profit	1,179	1,412	1,736	2,023	6,350	11,169
<i>Gross Margins</i>	24.36%	24.61%	28.00%	28.49%	26.59%	29.16%
S,G&A	<u>3,012</u>	<u>2,735</u>	<u>2,700</u>	<u>2,755</u>	11,202	11,046
Operating Income	(1,833)	(1,323)	(964)	(732)	(4,852)	123
<i>Operating Margin</i>	-37.87%	-23.06%	-15.55%	-10.31%	-20.32%	0.32%
Interest Expense(Income)-net	<u>(96)</u>	<u>(61)</u>	<u>(60)</u>	<u>(45)</u>	(262)	(70)
Pre-Tax Income	(1,737)	(1,262)	(904)	(687)	(4,590)	193
<i>Pre-Tax Margins</i>	-35.89%	-21.99%	-14.58%	-9.67%	-19.22%	0.50%
Taxes (Benefit)	<u>-</u>	<u>(179)</u>	<u>-</u>	<u>-</u>	(179)	-
<i>Tax Rate</i>	0.00%	14.18%	0.00%	0.00%	3.90%	0.00%
Net Income-continuing ops	<u>\$ (1,737)</u>	<u>\$ (1,083)</u>	<u>\$ (904)</u>	<u>\$ (687)</u>	\$ (4,411)	\$ 193
EPS-fully diluted- cont ops	<u>\$ (0.44)</u>	<u>\$ (0.28)</u>	<u>\$ (0.23)</u>	<u>\$ (0.18)</u>	\$ (1.13)	\$ 0.05
Avg Shares Out-fully diluted	<u>3,946</u>	<u>3,906</u>	<u>3,905</u>	<u>3,905</u>	3,915	4,000
Gain (loss) on Disposal	-	346	-	-	346	-
Net Income	<u>\$ (1,737)</u>	<u>\$ (737)</u>	<u>\$ (904)</u>	<u>\$ (687)</u>	\$ (4,065)	\$ 193
EPS-fully diluted	<u>\$ (0.44)</u>	<u>\$ (0.19)</u>	<u>\$ (0.23)</u>	<u>\$ (0.18)</u>	\$ (1.04)	\$ 0.05
Avg Shares Out-fully diluted	<u>3,946</u>	<u>3,906</u>	<u>3,905</u>	<u>3,905</u>	3,915	4,000
Percent of Revenue						
Costs of Goods Sold	75.64%	75.39%	72.00%	71.51%	73.41%	70.84%
SG&A	62.23%	47.66%	43.55%	38.80%	46.91%	28.84%
Net Margin	-35.89%	-12.84%	-14.58%	-9.67%	-17.02%	0.50%
YEAR / YEAR GROWTH						
Total Revenues	-19.12%	35.71%	48.57%	80.02%	30.27%	60.40%

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

	F1999A	F2000A	1Q01	2Q01
Assets				
Current Assets				
Cash & Equivalents	\$ 4,647	\$ 8,346	\$ 6,871	\$ 5,440
Net Receivables	38,764	4,917	4,127	5,252
Inventory	7,442	774	831	692
Prepaid Expense & Other	<u>1,220</u>	<u>1,096</u>	<u>1,104</u>	<u>1,024</u>
Total Current Assets	52,073	15,133	12,933	12,408
Plant, Property, & Equipment-net	2,280	1,579	1,341	1,289
Other	<u>178</u>	<u>430</u>	<u>426</u>	<u>420</u>
Total Assets	<u>\$ 54,531</u>	<u>\$ 17,142</u>	<u>\$ 14,700</u>	<u>\$ 14,117</u>
Liabilities & Shareholders' Equity				
Current Liabilities				
Notes Payable	\$ 15,869	\$ -	\$ -	\$ -
Accounts Payable	21,687	1,892	1,640	1,086
Accrued Expenses & Other	4,511	2,138	2,150	2,781
Discontinued ops liabilities	199	869	441	660
Deferred revenue	<u>240</u>	<u>136</u>	<u>149</u>	<u>115</u>
Total Current Liabilities	42,506	5,035	4,380	4,642
Deferred Liabilities	195	195	195	195
Total Shareholders' Equity	<u>11,830</u>	<u>11,912</u>	<u>10,125</u>	<u>9,280</u>
Total Liabilities & Equity	<u>\$ 54,531</u>	<u>\$ 17,142</u>	<u>\$ 14,700</u>	<u>\$ 14,117</u>
SHARES OUT	4,061	4,043	3,985	3,882