FORM 10-K

Annual report pursuant to section 13 and 15(d)

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ADVANCED LOGIC RESEARCH INC

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SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

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

For the Fiscal Year Ended September 30, 1996

Commission File Number 0-18753

ADVANCED LOGIC RESEARCH, INC.

A Delaware Corporation IRS Employer ID No. 33-0084573

9401 Jeronimo Road
Irvine, California 92618
(714) 581-6770

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act:

Common Stock, Par Value $.01

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, and (2) has been subject to such filing requirements for the past 90 days. YES X NO ___

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. [X]

The aggregate market value of the voting stock held by non-affiliates of the Registrant was $98,098,052 on December 13, 1996, based on the closing sale price of such stock on The Nasdaq Stock Market.

The number of shares outstanding of Registrant's Common Stock, $.01 par value, was 12,452,536 at December 13, 1996.

DOCUMENTS INCORPORATED BY REFERENCE

Part III of this Report incorporates information by reference from the definitive Proxy Statement for the Annual Meeting of Stockholders, to be held February 18, 1997.

ADVANCED LOGIC RESEARCH, INC.

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For the Fiscal Year Ended September 30, 1996

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PART I

This report contains the following trademarks of the Company, many of which are registered: Advanced Logic Research, Inc., ALR, Evolution, etc. The following trademarks of other companies also appear in this report: Compaq, Data General, IBM, Intel, Pentium, Pentium Pro, Unisys. Any other products or brand names are trademarks or registered trademarks of their respective companies.

PART I

Item 1. Business.

General

Advanced Logic Research, Inc. ("ALR" or the "Company"), founded in 1984, designs, manufactures, markets and supports a broad line of computer systems ("PCs") that offer leading-edge performance and value. The Company's comprehensive portfolio of environmentally friendly, upgradeable products includes sophisticated network servers, high-performance workstations and entry-level PCs. All ALR systems feature advanced designs to enhance performance while supporting the major industry standards. ALR markets its products through a worldwide network of resellers, system integrators, dealers and distributors. It also sells to selected Original Equipment Manufacturer ("OEM") customers and direct to end-users through its PrimeLine Direct program.

Products

The Company's product strategy is focused on becoming a leading provider of computers targeted at the client/server and high-end/mid-range desk-top markets. The Company currently offers a number of high-performance server, workstation and personal computer product families based on Intel's Pentium Pro and Pentium microprocessors ("CPUs"). To achieve broad market acceptance for its products, the Company's PCs incorporate either Industry Standard Architecture ("ISA") or Extended Industry Standard Architecture ("EISA") bus architecture and either Video Electronics Standard Association ("VESA") or Peripheral Component Interconnect ("PCI") local bus architecture.

For compatibility with a broad range of application software, ALR supports the major industry single user and multi-user/network operating systems: MS DOS, MS Windows, MS Windows 95, MS Windows NT, SCO UNIX, OS/2, Novell NetWare, Banyan VINES, as well as Intel's MP Spec v1.1 and v1.4 multiprocessing specifications.

ALR's SERVER SYSTEMS. The Company's server systems are designed in-house and feature enhanced performance and expandability. This family of computers is based on Intel's Pentium Pro and Pentium CPUs. The ALR Revolution Quad6, Dual6 and MP Pro feature Intel's Pentium Pro CPUs whereas the ALR Revolution Q-SMP and MP II feature Intel's Pentium CPUs. ALR also offers rack-mount version of its ALR Revolution Quad6, Dual6 and Q-SMP servers.

ALR REVOLUTION QUAD6. The innovative award-winning ALR Revolution Quad6 is a fully symmetrical multiprocessing server featuring up to four Intel 166-, or 200-megahertz ("MHz") Pentium Pro CPUs. The unique ALR system board design utilizes an advanced 64-bit multiprocessor bus and a symmetrical design to distribute the workload evenly between the different processors. The system comes standard with 64- megabytes ("MB") of random access memory ("RAM") which is expandable to two gigabytes ("GB") and features Error Checking and Correction ("ECC") technology to secure data integrity within the system.

All ALR Revolution Quad6 servers come standard with ALR's InforManager, a server management package designed to monitor system information and minimize downtime. The ALR Revolution Quad6 features 13 drive bays and 15 expansion slots (seven 32-bit PCI local bus, seven 32-bit EISA and one shared PCI/EISA slot). The easily accessible chassis makes the drive bays ideal for hot swappable drives, tape backups, multiple CD-ROMs and other removable storage devices. The ALR Revolution Quad6 was the recipient of UNIX Review magazine's Outstanding Product Award in the hardware category in the December 1996 issue and was selected as a finalist by PC/Computing Magazine for its `Most Valuable Product' award at COMDEX '96 in Las Vegas.

ALR REVOLUTION DUAL6. The ALR Revolution Dual6 is a fully symmetrical multiprocessing server featuring up to two Intel 200-MHz Pentium Pro CPUs. The system is designed for customers with large data storage requirements and features 14 drive bays and eight expansion slots (four 32-bit PCI local bus, one 32-bit EISA and three shared PCI/EISA slots). The system comes standard with 64-MB of ECC RAM which is expandable to 1-GB. The ALR Revolution Dual6 features ALR's InforManager server management system.

ALR REVOLUTION MP PRO. The ALR Revolution MP Pro is designed for use as a departmental server and features up to two Intel 200-MHz Pentium Pro CPUs. The system has 11 drive bays and 8 expansion slots (four 32-bit PCI local bus, one 32-bit EISA and three shared PCI/EISA slots). The system comes standard with 32-MB of ECC RAM which is expandable to 1-GB. The ALR Revolution MP Pro features ALR's InforManager server management system.

ALR REVOLUTION Q-SMP. The award-winning ALR Revolution Q-SMP is a fully symmetrical multiprocessing server featuring up to four Intel 100-, 133- or 166-MHz Pentium CPUs. System performance is enhanced by ALR's proprietary memory architecture supporting 256 kilobytes ("KB") (optional 1- or 2-MB) of two-way associative high-speed "write-back" memory cache per processor module. The system comes standard with 16-MB of RAM which is expandable to 1-GB with built-in Error Detection and Correction technology to secure data integrity within the system. The ALR Revolution Q-SMP features ALR's NetTune server management system. The ALR Revolution Q-SMP has 13 drive bays and 10 expansion slots (six EISA bus slots and four PCI local bus extensions). The ALR Revolution Q-SMP has received numerous awards including PC/Computing Magazine's `Most Valuable Product' award at COMDEX '94 in Las Vegas and the `Overall Best Hardware Product for 1995' by UNIX Review in its December 1995 issue.

ALR REVOLUTION MP II. The ALR Revolution MP II offers affordable Pentium processing while providing an upgrade path from 100-MHz Pentium processing to dual 100-, 133-, 166- or 200-MHz Pentium multiprocessing. To enhance performance the system features 512-KB pipeline burst level 2 cache and its memory can be expanded to 512-MB of ECC RAM. Complementing the scaleable processing power of the ALR Revolution MP II is its tower chassis which features nine drive bays and 10 expansion slots (three PCI slots, six EISA slots, and one shared PCI/EISA slot). Designed for mission critical network applications the ALR REVOLUTION MP II features ALR's InforManager server management system and is fully compatible with multiprocessing versions of popular multi-user/network operating systems.

RACK-MOUNTABLE SERVERS. The ALR Revolution Quad6, Dual6 and Q-SMP technology has also been incorporated in a rack-mount chassis designed to provide maximum availability, flexibility and performance while economizing on space. ALR offers two rack-mount options designed to accommodate either two or four server units in a single, organized location. The system is designed to offer safeguards against downtime and lost data. An optional DAT drawer provides up to 32-GB of back-up data storage with a redundant hot-swappable power supply for mission critical environments. Additionally, the racks can be configured to house disk array subsystems or uninterruptible power supplies depending on the needs of the user.

ALR's MINI-TOWER/HIGH-END DESK-TOP SYSTEMS. The Company's mini-tower/high-end desk-top systems feature 32-bit local bus technology and superior memory cache/local bus combinations to optimize CPU performance. This family of computers consists of the ALR EVOLUTION DUAL6 and the ALR EVOLUTION 5 Series.

ALR EVOLUTION DUAL6. The ALR EVOLUTION DUAL6 is designed to use up to two 200-MHz Pentium Pro CPUs and is targeted at high-end workstation applications including CAD, graphics design and animation. To enhance overall system performance the ALR EVOLUTION DUAL6 incorporates 32-bit PCI local bus technology. This bus provides compatibility with the latest video cards and access to other 32-bit enhancement products. The systems come standard with 16-MB of ECC RAM expandable to 1-GB.

ALR EVOLUTION 5 SERIES. The ALR Evolution 5DT and 5ST are engineered to take advantage of the latest advances in Pentium technology and offer a selection of processor options including Intel's 100-, 133-, 150- or 166-MHz Pentium CPUs. To enhance overall performance, the systems incorporate 32-bit PCI local bus technology and an advanced memory cache architecture. The systems utilize the same motherboard and are packaged in either a sport-tower or desk-top chassis. The systems come standard with 8-MB of RAM which is expandable to 128-MB on the system board.

ALR's MID-RANGE AND ENTRY-LEVEL DESK-TOP SYSTEMS. The Company's mid-range desk-top PCs optimize performance through advanced technology. The systems incorporate PCI local bus technology and consist of the ALR OPTIMA SL, OPTIMA DT and Optima MT.

ALR OPTIMA SL, DT & MT. The ALR Optima series combines performance with ease of use by featuring "Plug `n' Play" technology. The system offers a selection of processor options including Intel's 100-, 133-, 166- or 200-MHz Pentium CPUs. For enhanced video performance a 64-bit video subsystem has been integrated onto the PCI local bus. The systems utilize the same motherboard and are packaged in either a slimline (SL), desktop (DT) or mini-tower (MT) chassis. The system comes standard with 8-MB of RAM expandable to 128-MB on the system board.

Other Hardware Options. ALR offers a number of hardware options, including the ALR DataStation for data storage in networking and multi-user environments, VESA and PCI local bus video adapters and hard drive controllers. For certain systems, ALR offers a Multimedia Upgrade kit which includes an IDE CD-ROM drive and various titles, a 16-bit sound card, external speakers and a microphone. The Company also offers systems and memory boards, hard disk drives, CD-ROM drives, tape backup systems, fax modems, keyboards, monitors and other related peripherals.

Research and Product Development

The Company believes that being early-to-market with high-performance systems is critical to its success. To achieve this goal, the Company uses technology modules which can be transported effectively and used in its other computer systems with minimal modification, as "building blocks" for concurrent and future product development efforts. Examples of these building blocks include the Company's memory management technology and custom chip sets. The Company believes this approach better enables it to control its engineering, research and development expenditures while increasing the speed with which it can bring new products to market.

The Company's research and product development staff consists of 39 hardware and systems engineers located in the U.S. The Company's engineers are divided into two groups involved in the design of new products as well as the continued development and support of existing products. The Company's hardware engineers focus on the design of the Company's CPU platforms, while its systems engineers are responsible for enclosure design, software/system compatibility and integration of input/output peripherals to the system.

During the fiscal years ended September 30, 1996, 1995 and 1994, the Company's engineering, research and development expenses were $5.4 million, $4.8 million and $4.4 million, respectively.

Sales, Marketing and Support

ALR and its subsidiaries sell the Company's products worldwide through an extensive network of value added resellers ("VARs"), system integrators, dealers, distributors, and selected OEM customers. In the U.S., the Company also sells directly to end-users through its PrimeLine Direct program.

Since 1992, the PC industry has experienced a significant increase in price competition. See "Competition". The Company has responded to this new environment by focusing its product strategy towards providing computers aimed at the high-performance, multi-processing server and desk-top markets. The Company has also attempted to optimize the pricing structure offered to its different distribution channels and the marketing programs provided to its reseller channels.

The Company has focused on providing its reseller channel (VARs, system integrators and dealers) with some of the most competitive programs in the PC industry. The Company's reseller programs include free shipping, cooperative advertising, lead referral, toll-free technical support, warranty reimbursement and the facilitation of product purchases through flooring companies offering up to 60 days free financing. The Company has implemented a "Channel Build" strategy for its resellers and distributors allowing them to purchase base models and determine their own margins by customizing these products for resale. Additionally, the Company has adopted a "Cost Plus" pricing strategy for its reseller channel where the "Cost" is the price paid by its distributors. Sales to the Company's reseller channel accounted for 61%, 68% and 69% of net sales for fiscal 1996, 1995 and 1994, respectively.

The Company currently markets its products through two major distributors, Gates/Arrow and Tech Data and one regional distributor, Jones Business Systems. This channel provides broad market penetration for the Company's products. Distributors represented approximately 7%, 5% and 8% of the Company's net sales in fiscal 1996, 1995 and 1994, respectively. Since fiscal 1993, ALR has experienced significant changes in its distributor and national retail organization ("NRO") channel due to a reorientation of its sales channel focus in North America. As a result, product purchase agreements with certain distributors (GBC/Vitek, Ingram Micro, and Merisel) and NROs (ComputerLand and Intelligent Electronics) have been terminated. However, ALR continues to sell its products directly to the franchisees of Intelligent Electronics and ComputerLand through its reseller program.

The Company's PrimeLine Direct channel, established in fiscal 1993, serves the requirements of customers who choose to purchase directly from the Company. Since 1993, ALR's PrimeLine Direct sales force has evolved into three groups focused on serving the disparate needs of the small business customer and the large corporate and government end-users. The government sales group negotiated a contract with the federal government (GSA contract) in fiscal 1994 allowing federal agencies to procure product directly from ALR at pre-negotiated prices. Additionally, qualified resellers can sell products to government end-users based on the pre-negotiated prices in ALR's GSA contract and receive a pass-through commission from ALR. PrimeLine Direct sales represented 21%, 17% and 16% of the Company's net sales for fiscal 1996, 1995 and 1994, respectively.

In September 1996, ALR expanded its OEM relationships by entering into an agreement with Data General Corporation for ALR's high-end servers. This agreement added to the Company's existing OEM relationship with Unisys. However, an OEM relationship with Siemens Nixdorf, Germany, for certain Pentium-based systems terminated in fiscal 1996. OEM sales represented 10%, 9% and 4% of the Company's net sales for fiscal 1996, 1995 and 1994, respectively.

The Company's resellers, distributors and OEM customers are not contractually committed to future purchases of the Company's products and, therefore, could discontinue carrying the Company's products at any time. Additionally, consistent with industry practice, the Company provides its distributors with stock balancing and price protection rights, which permit these customers to return products to the Company for credit and to receive price adjustments for inventories of the Company's products if ALR lowers the prices of these products.

ALR serves its markets worldwide through export sales from the U.S. and a network of subsidiaries and branches. ALR's sales subsidiaries include ALR International (Pte) Ltd. ("ALR International"), Advanced Logic Research Inc. (U.K.) Limited and Advanced Logic Research (Deutschland) GmbH which are located in Singapore, London and Frankfurt, respectively. ALR International maintains branch sales and support offices in Hong Kong and Malaysia. International sales represented 36%, 43% and 46% of the Company's net sales for fiscal years 1996, 1995 and 1994, respectively. For further geographic information, see Note 12 of Notes to Consolidated Financial Statements.

A portion of the sales made by the Company in international markets are priced in local currency and are subject to currency exchange fluctuations. At September 30, 1996, the Company had no forward contracts outstanding. International sales are subject to the risk of compliance with laws of various countries and the risk of import/export restrictions and tariff regulations. ALR has not experienced any difficulty in obtaining export licenses from the United States Department of Commerce for international sales.

ALR maintains a sales and service staff at each of its locations worldwide to support the Company's end-users, authorized resellers and distributors. Reseller and distributor sales and service training classes are conducted at most of the Company's major worldwide locations. See "Customer Service and Product Warranty."

The Company's corporate marketing communications group has primary responsibility for launching and maintaining product exposure including advertising, promotion and public relations. This group also develops sales materials such as brochures, merchandising kits and point-of-purchase displays.

Backlog

The Company's customers generally order products on an as-needed basis. Therefore, a significant portion of product shipments in a given fiscal quarter result from orders received in that quarter. Consequently, order backlog represents a small percentage of the product sales anticipated by the Company in a given fiscal quarter and is not indicative of the Company's actual sales for any future fiscal period. Manufacturing plans and expenditure levels are based primarily on sales forecasts. The absence of scheduled backlog could lead to unanticipated fluctuations in operating results in any quarter in which anticipated sales and shipments do not occur as expected.

Manufacturing and Quality Control

The Company's manufacturing operations are located at its Irvine facilities in the United States. They include procurement and testing of parts, components and subassemblies and final assembly of its systems. In order to reduce capital investment requirements, the Company subcontracts a substantial portion of its printed circuit board assembly to several vendors in the United States and Taiwan, including affiliates of Wearnes Technology (Private) Limited ("Wearnes", Wearnes holds approximately 39% of the outstanding common stock of ALR). All subcontracted components are tested either by the Company or the subcontractor before undergoing final assembly. Once assembled, all systems undergo a fully operational test cycle including stress testing. Quality control also includes ongoing production reliability audits for early identification of production problems.

The Company has focused on improving its inventory controls and enhancing its management information systems. The inability of the Company to continue to improve its inventory controls and other management information systems, or to successfully produce, test and deliver sufficient products in time to meet demand, would adversely affect the Company's operating results.

The Company generally utilizes industry standard parts and components available from multiple vendors. However, the Company and the microcomputer industry, from time to time, have experienced shortages of key components including memory chips and standard integrated circuits. Prices for these and other key components have periodically increased and the Company could be put on allocation by its suppliers. On occasion, this has resulted in production delays for some of the Company's products.

Certain parts and components used in the Company's systems are available only from a single source. Components for which the Company does not have multiple manufacturers include Intel's Pentium and Pentium Pro CPUs as well as certain chip sets used on ALR motherboards. The CPUs and chip sets are either generally available through distribution or available from Intel in quantities that are usually adequate to meet the Company requirements. If, contrary to its expectations, the Company is unable to obtain sufficient quantities of any of these parts and components, the Company will experience delays in product shipments. As is generally known, the industry is currently facing a shortage of Pentium Pro 200-MHz CPU and the Company is experiencing some delays in product shipments.

The Company is currently sourcing motherboards for its Optima SL, DT and MT systems from Acer and is considering sourcing certain Pentium Pro-based systems from Intel on an OEM basis. In the future, the Company may choose to source additional products from these and other vendors. If, contrary to its expectations, the Company is unable to obtain sufficient quantities of these motherboards or systems, the Company could experience delays in product shipments.

Certain proprietary chip sets based on ALR designs are currently supplied by single sources including Matra Semiconductor. A disruption in the manufacture of these chip sets could result in additional expense, as well as delays in product shipment.

Supply shortages of any of the foregoing or other components may cause an increase in material cost that could result in a decline in the Company's operating results. In certain circumstances, supply shortages could result in production delays that could also adversely affect the Company's operating results.

Customer Service and Product Warranty

ALR maintains a customer support hotline at its Irvine headquarters to answer questions from its customers relating to ALR systems and other products. The Company also offers a variety of customer support and repair services which are made available on a fixed-fee or time and materials basis after the product warranty period has expired. Internationally, the Company provides service to end-users through selected resellers trained by ALR, as well as through the Company's own technical support personnel.

The Company has strengthened its service and technical support to end-users through a relationship with Unisys Corporation and DecisionOne to provide on-site field service and warranty support in the U.S. The Company's in-house technical support department in the U.S. has benefited from advanced telephone tracking technology that streamlines the routing, processing and tracking of calls. The Company also offers on-line support service 24 hours a day through its facsimile question and response system. This service supplements the Company's 24-hour bulletin board service which allows customers to confer with ALR technicians, download software and receive support updates and technical bulletins. These services are now also available through the ALR CompuServe forum.

In November 1994, ALR enhanced its product warranty policy to offer a 5-year/36-month warranty (five years system warranty and 36 months warranty on factory installed peripherals) and a one year warranty on monitors. For fiscal 1996, technical support expenses, which include warranty and non-warranty repairs, were approximately $4.4 million. Except for stock-balancing agreements with its distributors, the Company does not customarily allow returns of its products for reasons other than malfunction or failure.

FCC Approvals

The Federal Communications Commission (the "FCC") has adopted regulations setting radio frequency emission standards for computing equipment. All of the Company's current products meet the FCC's Class A requirements and certain of the Company's products qualify for the more stringent Class B approval. From time to time, however, the Company has experienced delays in securing FCC Class B approvals. To the extent the Company's present and future products may be required to meet the more stringent Class B requirements, there can be no assurance that similar delays will not occur in the future.

Competition

The principal elements of competition among PC manufacturers are pricing, performance, product quality and reliability, compatibility, marketing and distribution capability, service and support, reputation and the capability to deliver products in large volumes. ALR competes with a large number of manufacturers, including Apple Computer, AST Research, Compaq Computer, Dell Computer, Digital Equipment Corporation, Gateway 2000, Hewlett Packard, IBM Corporation ("IBM"), NCR and NEC Information Systems, as well as private label products manufactured by companies such as Intel. Most of these companies have significantly greater financial, marketing and technological resources than ALR and may be able to command better terms with their suppliers due to higher purchasing volumes.

The Company has entered into OEM agreements with certain large computer manufacturers who are competitors of ALR. While selecting its OEM customers, the Company tries to ensure that there is a minimum amount of overlap between the markets and end-users targeted by ALR and its OEM customers. However, changes in the marketing strategy of its OEM customers may adversely affect ALR's future revenue mix and gross margin rate.
See "Sales, Marketing and Support."

Since 1992, the PC industry has experienced a significant increase in price competition from the top tier PC manufacturers like Compaq and IBM. This has resulted in a rapid decline in PC prices and an increase in marketshare for the top tier manufacturers. ALR has responded to this new environment by focusing its product strategy towards providing computers aimed at the high-performance multi-processing server and desk-top markets. ALR's long-term success will depend primarily on the continued market acceptance of its existing products, its ability to develop and introduce similarly acceptable new products, its ability to continue to reduce costs through product design and operating efficiencies and its ability to expand its channels of distribution and the number of customers within these channels.

Patents, Trademarks and Licenses

The Company believes that its continued success will depend primarily upon the technical expertise, creative skills and management abilities of its directors, officers and key employees rather than on patent ownership. The Company has been issued patents covering certain aspects of its upgrade technology in the United States and Taiwan, which expire in 2111 and 2005, respectively. The Company has also applied for patents covering its upgrade module technology in Europe, Canada and Australia, although there can be no assurance that these patents will be granted or that these patents will provide adequate protection, if granted. The Company currently relies on trade secrets and confidentiality agreements to protect its proprietary information, although there can be no assurance that the confidentiality agreements on which ALR relies to protect its trade secrets will be adequate or that the Company's competitors will not independently develop or patent substantially equivalent or superior technologies.

The Company has obtained federal trademark registration on the following trademarks: Advanced Logic Research, Inc., ALR, the ALR logo, PowerFlex, Business Veisa, PowerVeisa, BusinessServer, PowerFlex Flyer, Business Station, Evolution and Express and has applied for federal trademark registration on certain other product names and logos. The Company has also trademarked the ALR logo in various countries including Singapore, Mexico, Canada, Brazil and throughout the European Union and has applied for registration of its logo in certain other foreign countries in which it anticipates expanding its international business.

ALR currently licenses from IBM, through a nonexclusive fixed fee agreement, the right to use certain technology covered under patents issued to IBM. The licensing agreement permits the Company to develop, manufacture and sell personal computers without liability for infringement on IBM's existing patents. The Company pays, and expects to pay in the future, royalties to IBM on sales of the Company's existing and future personal computer products. See Note 10 of Notes to Consolidated Financial Statements. IBM's policy is to offer lower royalty rates to licensees that possess patent rights of interest to IBM if these licensees provide IBM with a cross-license. To the extent that ALR's competitors avoid the payment of royalties or obtain more favorable royalty payment terms from IBM, ALR could be at a disadvantage.

In the past, the Company has licensed certain of its designs to a large computer manufacturer. In the future, the Company may choose to license its designs to other computer manufacturers which may permit these manufacturers to compete directly with the Company. See "Sales, Marketing and Support."

From time to time, companies have asserted exclusive patent, copyright and other intellectual property rights to technologies that are important to the microcomputer industry. The Company evaluates each claim and, if appropriate, seeks a license to use the protected technology. There can be no assurance that the Company would be able to obtain licenses to use such technology or obtain such licenses on terms that would not have a material adverse effect on the Company. If the Company or its suppliers are unable to license protected technology used in ALR's products, ALR could be prohibited from marketing such products. The Company could also incur substantial costs to redesign its products or to defend any legal action taken against it. If the Company's products should be found to infringe protected technology, ALR could be required to pay damages to the infringed party and to stop using such protected technology.

Environmental Laws and Regulations

The Company recognizes that operating in a manner compatible with the environment is good for its community, employees, customers, and business. The Company's products are designed and manufactured to meet a variety of the world's environmental standards and expectations. Compliance with laws enacted for protection of the environment to date has not had a material effect upon the Company's financial or competitive position. Although the Company does not anticipate any material adverse effects in the future based on the nature of its operations and the purpose of environmental laws and regulations, there can be no assurance that such laws or future laws will not have a material adverse effect on the Company.

Employees

As of September 30, 1996, ALR had 512 full-time employees worldwide, of whom 42 were engaged in engineering, research and development, 98 in sales and marketing, 57 in customer support and service, 267 in manufacturing and 48 in administrative activities. No employee of the Company is represented by a labor union or is subject to a collective bargaining agreement.

The Company believes its ability to attract and retain skilled technical and management personnel has been and will continue to be critical to its success. Accordingly, the Company has adopted stock option plans and other benefit plans to assist in attracting and retaining qualified employees at all levels. Foreign and Domestic Operations

A substantial portion of the Company's sales are made outside the United States. See Note 12 of Notes to Consolidated Financial Statements.

Item 2. Properties.

The Company leases approximately 75,000 square feet of space for its corporate headquarters in Irvine under a lease which expires in June 1999. The Company leases an additional 40,000 square feet of space at a nearby facility for manufacturing and warehousing operations under a lease which also expires in June 1999. ALR International leases approximately 22,000 square feet of space in Singapore for sales, support and warehousing needs under a lease that expires in 1997. In addition, the Company leases space for sales and support offices in London, Frankfurt, Hong Kong and Malaysia. See Note 13 of Notes to Consolidated Financial Statements.

ALR is currently considering expanding its warehousing operations. The Company believes that space will be available at commercially reasonable rates to accommodate either a move or an expansion of the Company's operations.

Item 3. Legal Proceedings.

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

Item 4. Submission of Matters to a Vote of Security Holders.

None.

PART II

Item 5. Market for Registrant's Common Stock and Related Stockholder Matters.

Market Information (Unaudited)

Advanced Logic Research, Inc.'s common stock is traded on The Nasdaq Stock Market under the symbol AALR. The following table sets forth the range of high and low closing sale prices for the Company's common stock for the fiscal quarters indicated.

Year ended September 30,	High	Low
1996:		
First fiscal quarter	$ 8.50	$ 6.00
Second fiscal quarter	7.75	6.13
Third fiscal quarter	9.88	6.69
Fourth fiscal quarter	$ 8.63	$ 6.50
1995:		
First fiscal quarter	$ 4.88	$ 3.75
Second fiscal quarter	5.38	4.00
Third fiscal quarter	6.75	4.50
Fourth fiscal quarter	$ 9.38	$ 5.75

At December 13, 1996, the closing sale price of the Company's common stock as reported on The Nasdaq Stock Market was $13.625.

Holders of Record

At September 30, 1996, ALR had approximately 256 stockholders of record of the Company's common stock.

Dividends

The Company has never paid dividends on its capital stock. The Company presently intends to retain earnings for use in its business and, therefore, does not anticipate paying any cash dividends in the foreseeable future. In addition, the terms of the Company's current loan agreement restrict the ability of the Company to pay cash dividends.

<TABLE>

Item 6. Selected Consolidated Financial Data.

<CAPTION>

Fiscal year ended September 30, (In thousands, except per share data)	1996	1995	1994	1993	1992
CONSOLIDATED STATEMENTS OF OPERATIONS:					
<S>	<C>	<C>	<C>	<C>	<C>
Net sales	$ 217,855	$ 192,425	$ 183,387	$ 169,254	$ 206,817
Cost of sales	170,035	156,465	155,652	149,974	165,483
Gross profit	47,820	35,960	27,735	19,280	41,334
Selling, general & administrative	25,701	21,915	19,308	22,898	30,797
Engineering, research & development	5,447	4,762	4,409	3,935	5,121
Royalty expense, net	5,125	5,289	5,867	5,183	4,704
Total operating expenses	36,273	31,966	29,584	32,016	40,622
Operating income (loss)	11,547	3,994	(1,849)	(12,736)	712
Net interest income	2,590	2,502	1,355	388	488
Income (loss) before taxes and cumulative effect of change in accounting principle	14,137	6,496	(494)	(12,348)	1,200
Income tax expense (benefit)	3,534	1,624	(148)	(2,640)	651
Income (loss) before cumulative effect of change in accounting principle	10,603	4,872	(346)	(9,708)	549
Cumulative effect of change in accounting for income taxes	---	---	---	(919)	---
Net income (loss)	$ 10,603	$ 4,872	$ (346)	$ (10,627)	$ 549
Income (loss) before cumulative effect of change in accounting principle per common & common equivalent share	$ 0.87	$ 0.41	$ (0.03)	$ (0.86)	$ 0.05
Net income (loss) per common & common equivalent share	$ 0.87	$ 0.41	$ (0.03)	$ (0.94)	$ 0.05
Common and common equivalent shares used in per share calculation	12,249	11,750	11,434	11,336	11,414

As of September 30, (In thousands)	1996	1995	1994	1993	1992
CONSOLIDATED BALANCE SHEET DATA:					
Cash & cash equivalents	$ 60,272	$ 46,580	$ 40,836	$ 34,447	$ 29,638
Accounts receivable, net	25,849	26,524	24,507	21,947	35,189
Inventories	23,437	27,088	22,555	36,525	44,264
Total assets	118,640	107,220	97,929	108,095	125,846
Long-term debt	---	---	---	---	6,000
Stockholders' equity	$ 96,778	$ 83,249	$ 76,861	$ 75,917	$ 87,425

</TABLE>

Item 7. Management's Discussion and Analysis of Results of Operations and Financial Condition.

This report contains forward-looking statements which involve risks and uncertainties. The Company's actual results may differ significantly from the results in the forward-looking statements. Factors that might cause such differences include, but are not limited to, those discussed under "Factors That

May Affect Future Results".

NET SALES In thousands)	FY96	Change From FY95	FY95	Change From FY94	FY94
Net Sales by Distribution Channel					
VARs and Dealers	$132,937	2%	$130,033	3%	$126,210
Direct	45,401	36%	33,365	17%	28,523
OEM	22,869	30%	17,544	169%	6,524
Distributors and Other	16,648	45%	11,483	(48%)	22,130
Total	$217,855	13%	$192,425	5%	183,387
Net Sales by Geographic Location					
U.S.	$139,101	28%	$108,870	11%	$ 98,331
International	78,754	(6%)	83,555	(2%)	85,056
Total	$217,855	13%	$192,425	5%	$183,387

Net sales increased to $217.9 million for fiscal 1996 from $192.4 million and $183.4 million for fiscal 1995 and 1994, respectively. The consecutive years of sales growth was principally due to the reorientation of the Company's product and marketing focus to network servers and high-end desk-top systems. As a result of the shift in product mix to servers and high-end desk-top systems, and a general demand for system configurations which include more memory, larger disk drives and additional peripherals, the average system selling price for fiscal 1996 increased to $2,199 from $1,963 and $1,673 for fiscal 1995 and 1994, respectively.

In fiscal 1996, the Company's principal channel of distribution continued to be value added resellers ("VARs") and dealers. However, due to the growth in sales made directly to small businesses, government entities, corporate and individual end-users and to OEM customers, sales to resellers as a percentage of total sales declined to 61% of net sales in fiscal 1996 from 68% and 69% of net sales for fiscal 1995 and 1994, respectively. The 2% growth in sales through the reseller channel in fiscal 1996 compared to fiscal 1995 breaks down into a 13% growth in sales to U.S. resellers and a 6% decline in sales to foreign resellers. The 3% growth in sales through the reseller channel in fiscal 1995 compared to fiscal 1994 breaks down into a 16% increase in sales to U.S. resellers and a 4% decline in sales to foreign resellers.

From fiscal 1994 through fiscal 1996, direct sales to small businesses, government entities, corporate and individual end-users grew to become the Company's second major channel of distribution. Direct sales increased from $28.5 million for fiscal 1994 to $33.4 million and $45.4 million for fiscal 1995 and 1996, respectively. The growth in sales through this channel during the three year period was predominately due to the negotiation of a GSA contract in fiscal 1994 with the federal government allowing federal agencies to procure product directly from ALR. Sales to federal, state and local government entities for fiscal 1996 more than doubled from fiscal 1995.

For fiscal 1994 through fiscal 1996, sales to OEM customers grew from $6.5 million for fiscal 1994 to $22.9 million for fiscal 1996. This growth stemmed from the signing of OEM agreements with Unisys Corporation in October 1994 and Data General Corporation in September 1996. Both agreements are for certain of the Company's high-end products. Partially mitigating the growth in sales to these customers was the termination of the Company's OEM relationship with Siemens Nixdorf, Germany, for certain Pentium-based systems during the first half of fiscal 1996.

Sales to distributors and other customers in fiscal 1996 rebounded to $16.6 million after a 48% decline in sales for fiscal 1995 from fiscal 1994. Increased sales to the Company's principal distributors, Gates/Arrow and Tech Data, and the addition of a regional distributor, Jones Business Systems, in fiscal 1996 principally accounted for the 45% growth in sales from fiscal 1995. However, another factor contributing to the growth in sales to distributors and other customers was a $1.1 million reduction in the Company's estimated allowance for sales returns. (See Financial Statement Schedule - Schedule II Valuation and Qualifying Accounts.) Lower returns experience led to the reduction in the Company's estimated allowance for sales returns.

For fiscal 1996, international sales declined to $78.8 million from $83.6 million and $85.1 million for fiscal 1995 and 1994, respectively. The decline in international sales for fiscal 1996 reflected a softness in European sales which decreased by 25% from fiscal 1995. Partially offsetting this decline was a 19% increase in sales to Asia-Pacific region customers. In fiscal 1995 the decline in international sales was principally due to lower sales to Asia-Pacific region and Canadian customers. Partially offsetting this decline was an 18% increase in sales to customers in Europe and Latin America during fiscal 1995.

GROSS PROFIT

(In thousands)	FY96	Change From FY95	FY95	Change From FY94	FY94
Gross Profit	$47,820	33%	$35,960	30%	$27,735
Percentage of Net Sales	22.0%		18.7%		15.1%

Gross profit margins for fiscal 1996 increased to 22.0% from 18.7% for fiscal 1995 and 15.1% for fiscal 1994. The shift in sales to servers and high-end desk-top systems favorably impacted gross profit margins since these systems typically generate greater gross profit margins than the Company's entry-level and mid-range systems. Design changes, chiefly to product chassis and motherboards, coupled with lower vendor component costs, particularly on memory, CPUs and disk drives, lowered material costs and contributed to improving gross profit margins. Also contributing was the growth in sales volume which allowed manufacturing and technical support costs to be absorbed over a greater revenue base.

The Company anticipates that competitive pricing pressures will continue throughout the personal computer industry. Although vendor component costs generally decreased during the three year period, a change in market conditions brought about by increased demand for these components could result in price increases which would adversely affect the Company's gross profit margins and profitability.

OPERATING EXPENSES

SELLING, GENERAL AND ADMINISTRATIVE

(In thousands)	FY96	Change From FY95	FY95	Change From FY94	FY94
Selling, General and Administrative Expenses	$25,701	17%	$21,915	14%	$19,308
Percentage of Net Sales	11.8%		11.4%		10.5%

Selling, general and administrative expenses increased by 17% to $25.7 million or 11.8% of net sales for fiscal 1996 compared to $21.9 million or 11.4% of net sales for fiscal 1995. The growth in selling, general and administrative expenses as a percentage of sales was principally due to expanded product advertising related to new product introductions and specific channels of distribution, and special product promotional incentives. As a percentage of net sales, advertising and promotional expenses increased to 4.8% compared to 4.3% for fiscal 1995. The growth in advertising and promotional expenditures accounted for $2.1 million of the increase between fiscal 1996 and fiscal 1995 while an increase in payroll and personnel-related expenses driven principally by an increase in sales personnel accounted for $1.4 million of the increase. The remaining growth in selling, general and administrative expenses was principally related to an increase in pass-through commissions paid to qualified resellers.

Selling, general and administrative expenses increased by 14% to $21.9 million for fiscal 1995 compared to $19.3 million for fiscal 1994. Expanded product advertising and increased dealer cooperative promotional activities principally accounted for the increase in expenses during fiscal 1995. As a percentage of net sales, advertising and promotional expenses increased to 4.3% for fiscal 1995 compared to 3.5% for fiscal 1994. Also contributing to the increase was a reduction in bad debt reserves during fiscal 1994. In fiscal 1994, $0.8 million in bad debt expense was reversed against the allowance for doubtful accounts.

ENGINEERING, RESEARCH AND DEVELOPMENT

(In thousands)	FY96	Change From FY95	FY95	Change From FY94	FY94
Engineering, Research and Development Expenses	$5,447	14%	$4,762	8%	$4,409
Percentage of Net Sales	2.5%		2.5%		2.4%

Engineering, research and development expenses increased during the three year period to $5.4 million for fiscal 1996 compared to $4.8 million and $4.4 million for fiscal 1995 and 1994, respectively. Increases in payroll and payroll-related costs associated with increased employee headcount and higher engineering material expense from ongoing and expanded product development principally accounted for the increase for each fiscal year.

ROYALTY EXPENSE, NET

	FY96	Change From FY95	FY95	Change From FY94	FY94
(In thousands)					
Royalty Expense, Net	$5,125	(3%)	$5,289	(10%)	$5,867
Percentage of Net Sales	2.4%		2.7%		3.2%

The reduction in royalty expense for fiscal 1996 compared to fiscal 1995 despite a 13% increase in sales was primarily the result of a modified three year agreement with IBM Corporation completed in the fourth quarter of fiscal 1996. This agreement impacted the royalty expense accrual amount for calendar 1996 and resulted in a $1.2 million pretax reduction in royalty expense in the fourth quarter of fiscal 1996.

The decline in net royalty expense for fiscal 1995 to 2.7% of net sales from 3.2% for fiscal 1994 resulted because certain of the Company's products were exempt from royalties.

INTEREST INCOME, NET

	FY96	Change From FY95	FY95	Change From FY94	FY94
(In thousands)					
Interest Income, Net	$2,590	4%	$2,502	85%	$1,355

Despite an increase in fiscal 1996 average cash and cash equivalents balance compared to fiscal 1995, net interest income only increased by 4% because of lower rates of return on short-term investments compared to fiscal 1995. The 85% increase in net interest income from fiscal 1994 to fiscal 1995 was due to an increase in cash and cash equivalents balances, increased rates of return on short-term investments and the repayment of outstanding bank debt in January 1994.

INCOME TAXES

	FY96	FY95	FY94
(In thousands)			
Income Tax Expense (Benefit)	$3,534	$1,624	$(148)
Effective Tax Rate	25.0%	25.0%	30.0%

For fiscal 1996, 1995 and 1994, the Company recorded effective income tax rates of 25.0%, 25.0% and 30.0%, respectively. The effective tax rate of 25% for fiscal 1996 remained unchanged from fiscal 1995 principally due to a $1.7 million reduction in the deferred tax asset valuation allowance during fiscal 1996. The changes in the effective tax rates between fiscal 1995 and 1994 were principally attributable to changes in the earnings mix among the Company's subsidiaries located in various taxing jurisdictions and utilization of certain net operating loss carryforwards.

LIQUIDITY AND CAPITAL RESOURCES

	Sept. 30, 1996	Sept. 30, 1995
(In thousands)		
Cash and cash equivalents	$60,272	$46,580
Working capital	$93,553	$79,771
Current ratio	5.3	4.3
Stockholders' equity	$96,778	$83,249

The Company's cash and cash equivalents increased to $60.3 million at September 30, 1996 compared to $46.6 million at September 30, 1995. The $13.7 million increase in cash and cash equivalents during the fiscal year was due to positive cash flow from operating activities and proceeds of $3.3 million from the issuance of stock under the Company's stock option plans partially offset by the purchase of property, plant and equipment.

The significant sources of cash provided by operations during fiscal 1996 included $10.6 million from net income and $3.5 million from a decrease in inventories which were partially offset by a $4.4 million decline in accounts payable.

As a consequence of the 13% increase in sales and a decline in inventories, inventory turns improved to 7.3 for fiscal 1996 compared to 5.8 turns for fiscal 1995. The improvement in inventory turns stemmed from the Company's ability to reduce inventories despite the increase in sales. In fiscal 1997, the Company expects to increase its safety stock of key parts, components and certain finished systems to improve product availability.

Operating cash flows were also enhanced through an improvement in accounts receivable turns. In fiscal 1996, average days outstanding improved to 43 from 50 days for fiscal 1995. This improvement reduced accounts receivable by $0.7 million at September 30, 1996 compared to September 30, 1995, despite the 13% growth in sales during the year.

The $4.4 million decline in accounts payable between September 30, 1996 and September 30, 1995, arose from the timing of inventory purchases in August and September 1996 compared to the previous year and the timing of the resulting payments.

ALR International continues to have available uncommitted revolving credit lines with a combined availability of approximately $4.3 million which are used to supplement its working capital requirements. At September 30, 1996, the Company had not borrowed against these lines of credit.

The Company's primary credit facility continues to be a $15.0 million revolving line with Heller Financial, Inc. The line is secured by the Company's assets and availability is subject to a borrowing base requirement. In October 1995, the Company signed an amendment to this existing credit agreement extending the expiration to August 1998 and reducing the borrowing rate to Prime, based on the Prime rate charged by Bank of America, from Prime plus 1%. A commitment fee of 0.50% per annum is paid on the unused portion of the revolving line of credit. The facility contains certain net worth, profitability, financial ratio and other covenants with which the Company was in compliance at September 30, 1996 and 1995. During fiscal 1996 and 1995, the Company had no outstanding borrowings against this line of credit.

The Company believes that its existing cash resources, combined with anticipated cash flows from future operating activities, supplemented as necessary with funds expected to be available under the Company's various credit agreements, will provide it with sufficient resources to meet present and reasonably foreseeable working capital requirements and other cash needs.

FACTORS THAT MAY AFFECT FUTURE RESULTS

The personal computer industry is intensely competitive. The principal elements of competition among personal computer manufacturers are pricing, product quality and reliability, compatibility, price/performance characteristics, marketing and distribution capability, service and support, reputation and the capability to deliver products in large volumes. ALR competes with a large number of manufacturers, most of which have significantly greater financial, marketing and technological resources than ALR. There can be no assurance that ALR will be able to continue to compete effectively.

The Company does business worldwide. Global and/or regional economic factors and potential changes in laws and regulations affecting the Company's business, including without limitation, currency fluctuations, changes in monetary policy and tariffs, and federal, state and international laws regulating the environment, could impact the Company's future results of operations.

The microcomputer market is characterized by rapid technological change and product obsolescence, often resulting in short product life cycles and rapid price declines. The Company's success will continue to depend primarily on its ability to continue to reduce costs through manufacturing efficiencies, the continued market acceptance of its existing products and its ability to develop and introduce similarly acceptable new products. There can be no assurance that ALR will successfully develop new products or that the new products it develops will be introduced in a timely manner and receive substantial market acceptance. There can also be no assurance that product transitions will be managed in such a way to minimize inventory levels and product obsolescence of discontinued products. The Company's operating results could be adversely affected if ALR is unable to manage all aspects of product transitions successfully.

The Company generally utilizes standard parts and components available from multiple vendors. However, certain parts and components used in the Company's systems are available from a single source. If, contrary to its expectations, the Company is unable to obtain sufficient quantities of any single-sourced components, the Company will experience delays in product shipments.

The Company offers its products directly and through indirect channels of distribution. Changes in the financial condition of, or in the Company's relationship with, OEM customers, distributors and other indirect channel partners could cause actual operating results to vary from those expected. Also, the Company's customers generally order products on an as-needed basis. Therefore, virtually all product shipments in a given fiscal quarter result from orders received in that quarter. The Company anticipates that the rate of new orders will vary significantly from month to month. Because ALR operates with a limited backlog, the Company's manufacturing plans and expenditure levels are based primarily on sales forecasts. Consequently, if anticipated sales and shipments in any quarter do not occur when expected, expenditure and inventory levels could be disproportionately high and the Company's operating results for that quarter, and potentially future quarters, would be adversely affected.

From time to time, certain companies have asserted exclusive patent, copyright and other intellectual property rights to technologies that are important to the microcomputer industry. ALR evaluates each claim relating to its products and, if appropriate, seeks a license to use the protected technology. There can be no assurance that the Company would be able to obtain licenses to use such technology or that such licenses could be obtained on terms that would not have a material adverse effect on the Company. If the Company or its suppliers are unable to license protected technology used in ALR's products, ALR could be prohibited from marketing such products. The Company could also incur substantial costs to redesign its products or to defend any legal action taken against it. If the Company's products should be found to infringe protected technology, ALR could be required to pay damages to the infringed party.

The market price of the Company's common stock could be subject to fluctuations in response to quarter to quarter variations in operating results, changes in analysts' earnings estimates, market conditions in the information technology industry, as well as general economic conditions and other factors external to the Company.

NEW ACCOUNTING STANDARDS Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (Statement No. 123), which is effective for the Company's fiscal 1997, encourages, but does not require, a fair-value based method of accounting for employee stock options or similar equity instruments. Statement No. 123 allows an entity to elect to continue to measure compensation cost under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APBO No. 25), but requires pro forma disclosures to net income and income per share as if the fair-value based method of accounting had been applied. While the Company is still evaluating Statement No. 123, the Company currently expects to elect to continue to measure compensation cost under APBO No. 25 and comply with the pro forma disclosure requirements. If the Company makes this election, Statement No. 123 will have no impact on the Company's financial position or results of operations.

Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", (Statement No. 121), which is effective for the Company's fiscal 1997, establishes accounting standards for the recognition and measurement of impairment of long-lived assets, certain identifiable intangibles and goodwill either to be held or disposed of. Management believes that adoption of Statement No. 121 will not have a material impact on the Company's financial position or results of operations.

SUBSEQUENT EVENT
On November 26, 1996, the Company consummated an agreement to acquire a 20% interest (on a fully-diluted basis) in RouterWare, Inc. ("RouterWare"), a Newport Beach, California-based data communications products company, for $2.25 million in cash. RouterWare develops and markets software technologies for use in data communications products such as bridges, routers, gateways and remote access devices. The agreement also calls for the Company to fund agreed-upon joint development projects with RouterWare over the next three years with an aggregated spending limit of $1.0 million.

Item 8. Financial Statements, Financial Statement Schedule and Supplementary Data.

Index to Financial Statements and Financial Statement Schedule

Consolidated Financial Statements:

Financial Statement Schedule:
(For the three years ended September 30, 1996)

All other schedules and financial statements are omitted because they are not applicable or the required information is shown in the consolidated financial statements or notes thereto.

Item 9. Changes In and Disagreements with Accountants on Accounting and Financial Disclosure.

None.

REPORT OF INDEPENDENT AUDITORS

To the Board of Directors
Advanced Logic Research, Inc.:

We have audited the accompanying consolidated financial statements of Advanced Logic Research, Inc. and subsidiaries as listed in the accompanying index. In connection with our audits of the consolidated financial statements, we also have audited the financial statement schedule as listed in the accompanying index. These consolidated financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and financial statement schedule based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Advanced Logic Research, Inc. and subsidiaries at September 30, 1996 and 1995, and the results of their operations and their cash flows for each of the years in the three-year period ended September 30, 1996 in conformity with generally accepted accounting principles. Also in our opinion, the related financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

KPMG Peat Marwick LLP

Orange County, California
October 24, 1996 except
as to note 14 which is as of
November 26, 1996

<TABLE>

Consolidated Balance Sheets
(In thousands, except share data)

<CAPTION>

	September 30, 1996	September 30, 1995
Assets (note 8)		
<S> <C> <C> <C> <C> <C> <C>		
Current assets:		
Cash and cash equivalents	$ 60,272	$ 46,580
Trade accounts receivable, less allowance of $2,027 and $1,999 at September 30, 1996 and 1995, respectively	25,849	26,524
Inventories (note 2)	23,437	27,088
Prepaid expenses and other assets	1,868	1,692
Deferred income taxes (note 9)	3,989	1,858
Total current assets	115,415	103,742
Equipment, furniture and fixtures, net (note 3)	2,760	2,764
Other assets	465	714
	$ 118,640	$ 107,220
Liabilities and Stockholders' Equity (notes 7 and 8)		
Current liabilities:		
Accounts payable	$ 7,198	$ 11,607
Payable to affiliates (note 4)	237	330
Accrued expenses (note 5)	11,558	10,528
Income taxes (note 9)	2,869	1,506
Total current liabilities	21,862	23,971
Commitments and contingencies (notes 10 and 13)		
Stockholders' Equity (note 6)		
Preferred stock, $.01 par value; 2,500,000 shares authorized; none issued	---	---
Common stock, $.01 par value; 25,000,000 shares authorized; 12,250,480 and 11,668,871 shares issued and outstanding at September 30, 1996 and 1995, respectively	123	117
Additional paid-in capital	57,924	54,675
Retained earnings	37,406	26,803
Adjustments for foreign currency translation	1,325	1,654
Total stockholders' equity	96,778	83,249
Subsequent event (note 14)		
	$ 118,640	$ 107,220

<FN>

See accompanying notes to consolidated financial statements

</FN>
</TABLE>

<TABLE>

Consolidated Statements of Operations
(In thousands, except per share data)
<CAPTION>

	Year ended September 30, 1996	1995	1994
<S>	<C>	<C>	<C>
Net sales (note 12)	$ 217,855	$ 192,425	$ 183,387
Cost of sales (notes 4 and 10)	170,035	156,465	155,652
Gross profit	47,820	35,960	27,735
Operating expenses:			
Selling, general and administrative	25,701	21,915	19,308
Engineering, research and development	5,447	4,762	4,409
Royalty expense, net (note 10)	5,125	5,289	5,867
Total operating expenses	36,273	31,966	29,584
Operating income (loss)	11,547	3,994	(1,849)
Interest income	2,662	2,513	1,435
Interest expense	(72)	(11)	(80)
Income (loss) before income taxes	14,137	6,496	(494)
Income tax expense (benefit) (note 9)	3,534	1,624	(148)
Net income (loss)	$ 10,603	$ 4,872	$ (346)
Net income (loss) per common and common equivalent share	$ 0.87	$ 0.41	$ (0.03)
Common and common equivalent shares used in per share calculation	12,249	11,750	11,434

<FN>

See accompanying notes to consolidated financial statements

</FN>
</TABLE>

<TABLE>

Consolidated Statements of Stockholders' Equity
(In thousands, except share data)

<CAPTION>

	Common Stock Shares	Amount	Additional Paid-in Capital	Retained Earnings	Adjustment for Foreign Currency Translation	Total Stockholders' Equity
<S>	<C>	<C>	<C>	<C>	<C>	<C>
Balance, September 30, 1993	11,380,643	$ 114	$53,483	$22,277	$ 43	$75,917

Exercise of stock options	97,704	1	359	---	---	360
Foreign currency translation	---	---	---	---	930	930
Net loss	---	---	---	(346)	---	(346)
Balance, September 30, 1994	11,478,347	115	53,842	21,931	973	76,861
Exercise of stock options	190,524	2	833	---	---	835
Foreign currency translation	---	---	---	---	681	681
Net income	---	---	---	4,872	---	4,872
Balance, September 30, 1995	11,668,871	117	54,675	26,803	1,654	83,249
Exercise of stock options	581,609	6	3,249	---	---	3,255
Foreign currency translation	---	---	---	---	(329)	(329)
Net income	---	---	---	10,603	---	10,603
Balance, September 30, 1996	12,250,480	$ 123	$57,924	$37,406	$1,325	$96,778

<FN>

See accompanying notes to consolidated financial statements

</FN>
</TABLE>

<TABLE>

Consolidated Statements of Cash Flows
(In thousands)
<CAPTION>

<S> <C> <C> <C> <C> <C> <C>

	Year ended September 30, 1996	1995	1994
Cash flows from operating activities:			
Net income (loss)	$ 10,603	$ 4,872	$ (346)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:			
Depreciation and amortization	1,369	1,840	2,358
(Gain) loss on disposal of equipment	61	(79)	203
Provisions for losses on accounts receivable	223	310	(752)
Deferred income tax provision (benefit)	(2,131)	(261)	4,208
Changes in assets and liabilities:			

Trade accounts receivable	310	(1,761)	(1,215)
Inventories	3,467	(4,135)	14,554
Prepaid expenses and other assets	42	2,615	(889)
Accounts payable	(4,410)	2,389	(5,878)
Payable to affiliates	(93)	(2,289)	891
Accrued expenses	1,027	991	278
Income taxes	1,363	1,506	(735)
Net cash provided by operating activities	11,831	5,998	12,677
Cash flows from investing activities -			
Purchase of equipment, furniture and fixtures	(1,433)	(1,164)	(967)
Cash flows from financing activities:			
Net repayments to banks	---	---	(316)
Repayments under notes payable	---	---	(6,000)
Issuance of stock under stock option plans	3,255	835	360
Net cash provided by (used in) financing activities	3,255	835	(5,956)
Effect of exchange rate changes on cash	39	75	635
Net increase in cash and cash equivalents	13,692	5,744	6,389
Cash and cash equivalents at beginning of year	46,580	40,836	34,447
Cash and cash equivalents at end of year	$ 60,272	$ 46,580	$ 40,836
Supplemental disclosure of cash flow information:			
Cash paid (refunded) during the year for:			
Interest	$ 16	$ 2	$ 119
Income taxes	$ 3,343	$ (2,070)	$ (4,294)

<FN>

See accompanying notes to consolidated financial statements

</FN>
</TABLE>

Notes to Consolidated Financial Statements

Years ended September 30, 1996, 1995, 1994

(1) Summary of Significant Accounting Policies

ORGANIZATION
Advanced Logic Research, Inc., together with its wholly-owned subsidiaries, Advanced Logic Research International, Inc., ALR International (Pte) Ltd. ("ALR International"), Advanced Logic Research Inc. (U.K.) Limited and Advanced Logic Research (Deutschland) GmbH, herein referred to collectively as the "Company", designs, manufactures, markets and supports a broad line of microcomputer systems based on Intel's Pentium and Pentium Pro microprocessors. These operations comprise the Company's only business segment.

Wearnes Technology (Private) Limited ("Wearnes") holds approximately 39% of the Company's outstanding common stock.

PRINCIPLES OF CONSOLIDATION
The accompanying consolidated financial statements include the accounts of Advanced Logic Research, Inc. and its subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

USE OF ESTIMATES
The financial statements have been prepared in conformity with generally accepted accounting principles. In preparing the financial statements, management is required to make estimates and assumptions that affect the reported amounts of assets and liabilities as of the dates of the balance sheets and revenues and expenses for the periods. Actual results could differ from those estimates.

INVENTORIES
Inventories are valued at the lower of cost (first-in, first-out) or market (net realizable value).

DEPRECIATION
Depreciation of equipment, furniture and fixtures and the amortization of leasehold improvements is provided over the estimated useful lives of the assets using the straight-line method. The useful lives range from three to five years for equipment, furniture and fixtures, and the shorter of the useful lives or the terms of the leases for leasehold improvements.

FAIR VALUE OF FINANCIAL INSTRUMENTS
During 1996, the Company adopted Statement of Financial Accounting Standards No. 107, "Disclosure about Fair Value of Financial Instruments," (SFAS 107). SFAS 107 requires all entities to disclose the fair value of financial instruments, both assets and liabilities recognized and not recognized on the balance sheet, for which it is practicable to estimate fair value. SFAS 107 defines fair value of a financial instrument as the amount at which the instrument could be exchanged in a current transaction between willing parties. As of September 30, 1996, the carrying value of all financial instruments approximates fair value.

REVENUE RECOGNITION AND WARRANTY POLICY
Revenue is recognized upon product shipment, except for sales to the U.S. government, which are recognized when product is delivered. The Company grants certain distributors limited rights to exchange product and price protection on unsold merchandise. The Company also has financing agreements with credit corporations that provide alternative financing to pre-approved dealers. These financing agreements generally require the Company to repurchase inventory that has been repossessed by the credit corporations from these dealers. The Company establishes estimated allowances based on experience for future product returns and price adjustments by charges to current operations. The Company provides, by a current charge to income, an amount it estimates will be needed to cover future warranty obligations for products sold during the year.

FOREIGN CURRENCY TRANSLATION
The Company uses the local currency as the functional currency for its international operations. Accordingly, assets and liabilities outside the United States are translated into U.S. dollars at the rate of exchange in effect at the balance sheet date. Income and expense items are translated at the weighted average exchange rates prevailing during the year. The cumulative translation gain or loss is shown as an adjustment to stockholders' equity. During fiscal 1996, 1995 and 1994, the Company recorded foreign currency transaction gains (losses) of ($57,000), $30,000 and ($154,000), respectively.

Forward contracts are used by the Company to hedge certain portions of its foreign currency exposure resulting from exchange rate fluctuations and are not used to engage in speculation. At September 30, 1996, the Company had no forward contracts outstanding.

INCOME TAXES
The Company accounts for income taxes using the asset and liability method. This method requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the consolidated financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax bases of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

NET INCOME (LOSS) PER SHARE
Net income (loss) per share is computed using the weighted average number of common shares and dilutive common stock options outstanding, at the average market price for the period, which are considered common stock equivalents. Fully diluted net income (loss) per share amounts are not presented because they approximate primary net income (loss) per share or are anti-dilutive.

CASH EQUIVALENTS
Cash equivalents are highly liquid investments with an original maturity of three months or less, consisting primarily of commercial paper, variable-rate demand notes, short-term government obligations and other money market instruments.

NEW ACCOUNTING STANDARDS Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" (Statement No. 123), which is effective for the Company's fiscal 1997, encourages, but does not require, a fair-value based method of accounting for employee stock options or similar equity instruments. Statement No. 123 allows an entity to elect to continue to measure compensation cost under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" (APBO No. 25), but requires pro forma disclosures to net income and income per share as if the fair-value based method of accounting had been applied. While the Company is still evaluating Statement No. 123, the Company currently expects to elect to continue to measure compensation cost under APBO No. 25 and comply with the pro forma disclosure requirements. If the Company makes this election, Statement No. 123 will have no impact on the Company's financial position or results of operations.

Statement of Financial Accounting Standards No. 121, "Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of", (Statement No. 121), which is effective for the Company's fiscal 1997, establishes accounting standards for the recognition and measurement of impairment of long-lived assets, certain identifiable intangibles and goodwill either to be held or disposed of. Management believes that adoption of Statement No. 121 will not have a material impact on the Company's financial position or results of operations.

RECLASSIFICATIONS

Certain reclassifications have been made to the fiscal 1995 and 1994 consolidated financial statements to conform to the fiscal 1996 presentation.

(2) Inventories

A summary of the components of inventories follows (in thousands):

	September 30, 1996	1995
Raw materials and component parts	$ 6,281	$10,944
Work in process	5,745	3,647
Finished goods	11,411	12,497
	$23,437	$27,088

(3) Equipment, Furniture and Fixtures

Equipment, furniture and fixtures, at cost, consist of the following (in thousands):

	September 30, 1996	1995
Machinery and equipment	$ 8,432	$ 8,211
Vehicles	252	248
Furniture and fixtures	997	958
Leasehold improvements	1,257	1,101
	10,938	10,518
Less accumulated depreciation and amortization	(8,178)	(7,754)
	$ 2,760	$ 2,764

(4) Transactions with Related Parties

A summary of the payable to Wearnes' subsidiaries follows (in thousands):

	September 30, 1996	1995
Wearnes Automation	$ 205	$ ---
Other Wearnes' subsidiaries	32	330
	$ 237	$ 330

The balance payable to Wearnes' subsidiaries is due and payable 30 days from the shipment date. Total inventory purchases from Wearnes' subsidiaries during fiscal 1996, 1995 and 1994 were $3,000, $7,426,000 and $14,350,000, respectively.

(5) Accrued Expenses

A summary of accrued expenses follows (in thousands):

	September 30, 1996	1995
Accrued royalty	$ 3,332	$ 2,903
Accrued warranty	2,592	2,148
Accrued payroll	2,098	1,755
Accrued co-operative advertising	1,693	700
Other	1,843	3,022

$ 11,558	$ 10,528

(6) Stockholders' Equity
During 1986, the Board of Directors authorized the granting of up to 714,000 shares of common stock for issuance to key individuals or the directors under an informal stock option program ("1986 Plan"). The options became exercisable at varying periods relative to the date of employment or the grant of the option. The options expired at the earlier of termination of employment or January 31, 1996.

The following is a summary of transactions under the 1986 Plan:

	Number of shares	Price per share
Options outstanding at September 30, 1993	108,735	$ .07 - 1.68
Exercised	(60,053)	.07 - 1.68
Options outstanding at September 30, 1994	48,682	.10 - .42
Exercised	(45,542)	.10 - .42
Options outstanding at September 30, 1995	3,140	.42
Exercised	(3,140)	.42
Options outstanding at September 30, 1996	---	$ ---

During 1990, the Board of Directors of the Company adopted the Flexible Stock Incentive Plan (the "Plan") authorizing the granting of common stock to key individuals of which 2,500,000 shares have been registered with the Securities and Exchange Commission. The Plan contains three components: a stock option component, a stock bonus/stock purchase component and a stock appreciation rights component. The purpose of the plan is to provide incentives to selected individuals whose services contribute to the financial success and growth of the Company and its affiliates.

The Plan provides for the granting of stock options, stock bonuses, stock appreciation rights or rights to purchase stock for up to an aggregate of not more than the greater of (i) 10% of the authorized shares of the Company's common stock or (ii) 15% of the shares of common stock outstanding as of the close of business on the last day of the Company's prior fiscal year. Awards under the Plan can be granted to officers, employees and other individuals as determined by the committee of the Board of Directors which administers the Plan (the "Committee").

Options granted under the Plan may be either "incentive" stock options or options that do not qualify as Incentive Options ("Nonqualified Options"). The exercise price of shares of common stock covered by each Incentive Option cannot be less than the per share fair market value of the Company's common stock on the date the option is granted. The exercise price in the case of Nonqualified Options granted under the Plan is set by the Committee with a minimum exercise price of at least 85% of the fair market value of the Company's common stock on the date the option is granted.

The following is a summary of transactions under the Plan:

	Number of shares	Price per share
Options outstanding at September 30, 1993	807,053	$ 4.25 - 12.50
Granted	351,000	3.38 - 3.625
Exercised	(37,651)	4.25 - 6.25
Canceled	(57,598)	3.38 - 12.50
Options outstanding at September 30, 1994	1,062,804	3.38 - 11.00
Granted	600,000	4.50
Exercised	(137,482)	3.38 - 6.25
Canceled	(34,483)	3.38 - 6.25
Options outstanding at September 30, 1995	1,490,839	3.38 - 11.00
Granted	600,000	7.00
Exercised	(578,469)	3.38 - 6.25
Canceled	(19,459)	3.38 - 4.50
Options outstanding at September 30, 1996	1,492,911	$ 3.38 - 11.00

All options granted under the Plan are Nonqualified Options which were granted at an exercise price that approximated fair market value. As of September 30, 1996, 645,736 of the outstanding options are exercisable.

On August 13, 1990, the Board of Directors of the Company adopted the Director's Nonqualified Stock Option Plan ("Director's Plan") authorizing the registration of 60,000 shares of common stock for issuance to directors at an exercise price equal to the fair market value on the date the option is granted. In February 1996, the Director's Plan was amended to increase the number of shares of common stock for issuance to 120,000. The purpose of the Director's Plan is to provide incentives to participants for increased efforts and successful achievements on behalf of or in the interest of the Company while serving on the Company's Board of Directors. In each of fiscal 1996, 1995 and 1994, 10,000 shares were granted to the non-employee directors of ALR under the Director's Plan. During fiscal 1996 and 1994 no options were exercised. During fiscal 1995, 7,500 options were exercised. As of September 30, 1996, the number of options outstanding and exercisable under the Director's Plan was 62,500 at a price per share of $3.44 to $8.75. During fiscal 1996, 1995 or 1994 no options were canceled.

(7) Notes Payable to Banks

ALR International currently has lines of credit totaling approximately $4,300,000. The lines of credit bear interest at the lending bank's prime rate. At September 30, 1996 and 1995, ALR International had no outstanding borrowings against these lines of credit. The maximum and average amounts outstanding during fiscal 1996 were $1,416,000 and $413,000, respectively, with a weighted average interest rate of 4.34%. The maximum and average amounts outstanding during fiscal 1995 were $718,900 and $59,900, respectively, with a weighted average interest rate of 6.13%.

(8) Long-Term Debt

During June 1993, the Company entered into a three-year agreement with Heller Financial, Inc. providing the Company with a $15,000,000 revolving line of credit. The line is secured by the Company's assets and availability is subject to a borrowing base requirement. In October 1995, the Company signed an amendment to this existing credit agreement extending the expiration to August 1998 and reducing the borrowing rate to Prime, based on the Prime rate charged by Bank of America, from Prime plus 1%. A commitment fee of 0.50% per annum is paid on the unused portion of the revolving line of credit. The facility contains certain net worth, profitability, financial ratio and other covenants with which the Company was in compliance at September 30, 1996 and 1995. During fiscal 1996 and 1995, the Company had no outstanding borrowings against this line of credit.

(9) Income Taxes

The components of income (loss) before income taxes are as follows (in thousands):

Year ended September 30,	1996	1995	1994
U.S.	$14,608	$ 4,005	$ (1,908)
Foreign	(471)	2,491	1,414
	$14,137	$ 6,496	$ (494)

Income tax expense (benefit) consists of the following (in thousands):

Year ended September 30,		1996	1995	1994
Current:				
	Federal	$ 4,373	$ 1,603	$ (4,501)
	State	463	29	1
		$ 4,836	$ 1,632	$ (4,500)
Deferred:				
	Federal	$(1,413)	$ (261)	$ 4,208
	State	(718)	---	---
		(2,131)	(261)	4,208
Additional paid-in capital from the benefit of stock options exercised		829	253	144
		$ 3,534	$ 1,624	$ (148)

Total income tax expense (benefit) differs from the amount computed by applying the federal corporate income tax rate of 34% (35% for income greater than $10 million) to income (loss) before income taxes as follows (in thousands):

Year ended September 30,	1996	1995	1994
Computed expected income taxes (benefit)	$4,807	$2,209	$ (168)

Changes in valuation allowance	(1,675)	102	469
State income taxes, net of federal income tax benefit	412	27	1
Effect of foreign operations	150	(486)	(278)
Tax exempt foreign sales corporation income	(138)	(132)	(99)
Tax exempt interest income	(23)	(91)	(64)
Other	1	(5)	(9)
	$3,534	$1,624	$ (148)

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax assets as of September 30, 1996 and September 30, 1995 are as follows (in thousands):

Year ended September 30,	1996	1995
Deferred tax liabilities:		
Prepaid expenses	$ 317	$ 333
Deferred tax assets:		
Net operating loss carryforwards	1,813	1,703
Inventories	1,695	1,379
Warranty provisions	773	773
Allowance for doubtful accounts	583	601
Promotional and sales allowances	500	510
Other	755	633
	6,119	5,599
Valuation allowance	(1,813)	(3,408)
Deferred tax assets	4,306	2,191
Net deferred tax assets	$3,989	$1,858

The Company has recorded a valuation allowance in the amount set forth in the above table for certain deductible temporary differences for which it is not certain whether the Company will receive future tax benefit. The net decrease in the total valuation allowance for the year ended September 30, 1996 was $1,595,000. The change in the valuation allowance for the year ended September 30, 1996, was primarily due to the recognition of federal and state deferred tax assets based on taxable income generated in the current year and other potential sources of taxable income of an appropriate character. The Company believes that the remaining net deferred tax assets will more likely than not be realizable due to availability of the net operating loss carryback.

The Company has approximately $6,042,000 of net operating loss carryforwards in various foreign tax jurisdictions which can be utilized to offset the Company's future taxable earnings. These net operating loss carryforwards have no expiration dates.

(10) Operating Expenses

In 1988, the Company entered into a nonexclusive licensing agreement with IBM Corporation ("IBM") which enables the Company to make, use, lease, sell, manufacture or have manufactured certain products under patent with IBM. In 1996 the Company consummated a new nonexclusive fixed fee agreement with IBM which expires in December 1998. The new agreement still allows the Company to utilize certain patents. Under this agreement, the Company will pay a fixed fee royalty to IBM (see note 14). Royalty expense under this agreement for fiscal 1996, 1995 and 1994 was $5,125,000, $5,289,000 and $5,867,000, respectively.

In April 1991, the Company entered into a non-exclusive distribution agreement with Microsoft Corporation ("Microsoft") whereby the Company was granted the right to distribute specific Microsoft products. Royalty expense under this agreement for fiscal 1996, 1995 and 1994 was $2,802,000, $2,174,000 and $1,971,000, respectively, which is included in cost of sales in the accompanying Consolidated Statements of Operations.

(11) Profit Sharing Plan

In September 1988, the Company established a pretax savings and profit sharing plan under Section 401(k) of the Internal Revenue Code. Under the plan, eligible employees are able to contribute from 3% to 15% of their compensation. The Company makes a matching contribution of 50% of the first 5% contributed by the employee and may, at its discretion, make additional contributions to the plan, up to a maximum of 15% of the employee's compensation. The Company's contribution to the Plan was approximately $264,000, $234,000 and $195,000 for fiscal 1996, 1995 and 1994, respectively.

The Financial Accounting Standards Board has issued Statement of Financial Accounting Standards No. 112 ("SFAS No. 112"), "Employers Accounting for Postemployment Benefits" requiring accrual basis accounting for post employment benefits. The Company does not offer post employment benefits subject to guidelines established by SFAS No. 112. Accordingly, no provisions have been reflected in the Company's consolidated financial statements at September 30, 1996.

<TABLE>

(12) International Operations
The following table reflects information with respect to the Company's domestic and foreign operations (in thousands):

<CAPTION>

<S>	North America <C>	Asia	Europe	Elimination	Total
Year ended September 30, 1996					
Sales to unaffiliated customers	$ 155,736	$ 39,212	$ 22,907	$ ---	$ 217,855
Intercompany sales	20,856	---	---	(20,856)	---
Net sales	$ 176,592	$ 39,212	$ 22,907	$ (20,856)	$ 217,855
Net income (loss)	$ 11,038	$ (38)	$ (432)	$ 35	$ 10,603
Identifiable assets	$ 102,892	$ 15,941	$ 11,460	$ (11,653)	$ 118,640
Year ended September 30, 1995					
Sales to unaffiliated customers	$ 128,858	$ 32,945	$ 30,576	$ ---	$ 192,379
Intercompany sales	22,408	---	---	(22,408)	---
Sales to affiliated customers	28	18	---	---	46
Net sales	$ 151,294	$ 32,963	$ 30,576	$ (22,408)	$ 192,425
Net income (loss)	$ 2,781	$ 1,041	$ 1,450	$ (400)	$ 4,872
Identifiable assets	$ 90,022	$ 14,569	$ 14,317	$ (11,688)	$ 107,220
Year ended September 30, 1994					
Sales to unaffiliated customers	$ 116,403	$ 40,348	$ 25,997	$ ---	$ 182,748
Intercompany sales	21,244	---	---	(21,244)	---
Sales to affiliated customers	163	476	---	---	639
Net sales	$ 137,810	$ 40,824	$ 25,997	$ (21,244)	$ 183,387
Net income (loss)	$ (1,840)	$ (79)	$ 1,493	$ 80	$ (346)
Identifiable assets	$ 83,701	$ 14,087	$ 11,430	$ (11,289)	$ 97,929

</TABLE>

The U.S. Company had export sales to unaffiliated customers of $15,266,000, $20,002,000 and $18,075,000 for fiscal 1996, 1995 and 1994, respectively.

During fiscal 1996, 1995 and 1994, no customer accounted for more than 10% of net sales.

(13) Commitments and Contingencies
The Company leases its U.S. manufacturing and office facilities under noncancelable operating leases which expire in 1999. Additionally, office facility leases for the U.K. subsidiary expire in 2010, for the German subsidiary in 2002 and for the Singapore subsidiary in 1997. Rental expense for fiscal 1996, 1995 and 1994 amounted to $1,507,000, $1,685,000 and $1,931,000, respectively.

At September 30, 1996, future minimum rental payments under all noncancelable operating leases with terms in excess of one year are as follows (in thousands):

Year ending September 30,	
1997	$ 1,606
1998	945
1999	735
2000	250
2001	250
Thereafter	436
	$ 4,222

The Company has been notified that certain of its products may require licenses under patents held by others. The Company evaluates these licensing proposals on a case-by-case basis to determine whether licenses are necessary. In the opinion of Company management, the liability, if any, resulting from such claims would not have a material adverse affect on the Company's consolidated financial statements.

The Company is involved with certain legal proceedings and other claims arising in the normal course of business. In the opinion of Company management, the liability, if any, resulting from such litigation would not have a material adverse affect on the Company's consolidated financial position or results of operations.

(14) Subsequent Event
On November 26, 1996, the Company consummated an agreement to acquire a 20% interest (on a fully-diluted basis) in RouterWare, Inc. ("RouterWare"), a Newport Beach, California-based data communications products company, for $2.25 million cash. The agreement also calls for the Company to fund agreed-upon development projects with RouterWare over the next three years with a combined spending limit of $1.0 million.

(15) Selected Quarterly Financial Data (unaudited)
The tables below set forth selected quarterly financial information for the years ended September 30, 1996 and 1995 (in thousands, except per share data):
<TABLE>
<CAPTION>

<S>	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1996					
Net sales	$ 57,139	$ 55,047	$ 50,230	$ 55,439	$ 217,855
Gross profit	11,921	11,558	11,362	12,979	47,820
Net income (1)	2,360	2,014	2,196	4,033	10,603
Net income per share	$ 0.20	$ 0.17	$ 0.18	$ 0.32	$ 0.87
1995					
Net sales	$ 45,718	$ 47,359	$ 45,951	$ 53,397	$ 192,425
Gross profit	8,053	8,429	9,159	10,319	35,960
Net income	649	1,058	1,177	1,988	4,872
Net income per share	$ 0.06	$ 0.09	$ 0.10	$ 0.17	$ 0.41

</TABLE>

The sum of quarterly net income per share will not necessarily equal the annual amount since the calculations are based on the weighted average number of shares outstanding during each period.

(1) During the fourth quarter of fiscal 1996, the Company consummated a three year agreement with IBM Corporation. This agreement impacted the royalty expense accrual amount for calendar 1996 and resulted in a $1.2 million pretax reduction in royalty expense in the fourth quarter of fiscal 1996.

SCHEDULE II

ADVANCED LOGIC RESEARCH, INC. AND SUBSIDIARIES
VALUATION AND QUALIFYING ACCOUNTS
(Amounts in thousands)

	Year ended September 30, 1996	1995	1994
Allowance for doubtful accounts			
Balance, beginning of year	$1,999	$1,870	$3,158
Additions (reductions) charged (credited) to expense	223	310	(752)
Reductions	(195)	(181)	(536)
Balance, end of year	$2,027	$1,999	$1,870

Allowance for sales returns			
Balance, beginning of year	$2,800	$2,050	$2,150
Net additions (reductions) charged (credited) to sales	(1,100)	750	(100)
Balance, end of year	$ 1,700	$2,800	$2,050

Allowance for price protection			
Balance, beginning of year	$ 324	$ 225	$ ---
Net additions charged to sales	123	99	225
Balance, end of year	$ 447	$ 324	$ 225

PART III

Certain information required by Part III is omitted from this report in that the Registrant will file a definitive proxy statement within 120 days after the end of its fiscal year pursuant to Regulation 14A (the "Proxy Statement") for its Annual Meeting of Stockholders to be held February 18, 1997 and the information included therein is incorporated herein by reference.

Item 10. Directors and Executive Officers of the Registrant.

Information with respect to directors of ALR is incorporated by reference from the information under the caption "Election of Directors--Nominees" in the Company's Proxy Statement. Information with respect to executive officers of ALR is incorporated by reference from the information under the caption "Executive Officers" in the Company's Proxy Statement.

Item 11. Executive Compensation.

The information under the caption "Executive Compensation and Other Information" in the Company's Proxy Statement is incorporated by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management.

The information under the caption "Stock Ownership of Management and Principal Stockholder" in the Company's Proxy Statement is incorporated by reference.

Item 13. Certain Relationships and Related Transactions.

The information under the caption "Certain Transactions" in the Company's Proxy Statement is incorporated by reference.

PART IV

Item 14. Exhibits, Financial Statement Schedule and Reports on Form 8-K.

(a) The following documents are filed as a part of this report:

Financial Statements and Financial Statement Schedule -- See Index to

Consolidated Financial Statements on page 20.

(3) Exhibits included herein (numbered in accordance with Item 601 of the Regulation S-K):

Exhibit
Number Description of Exhibits

3.1 Articles of Incorporation (California) (1)

3.2 Restated Certificate of Incorporation (following the reincorporation of registrant in Delaware) (1)

3.3 Bylaws of Registrant (California) (1)

3.4 Bylaws of Registrant (following the reincorporation of Registrant in Delaware) (1)

3.5 Amended and Restated Bylaws of Registrant (2)

10.1 Agreement (relating to term loan facility of U.S. $15,000,000 dated January 26, 1989) among Registrant, The Mitsui Trust & Banking Co., Ltd., The Tokai Bank, Limited and Singapore International Merchant Bankers Limited and Amendments (1)

10.4 Right of Participation Agreement dated March 1, 1990 between Registrant and Wearnes Technology (Private) Limited (1)

10.7 Stock Option Letter dated January 5, 1987 between Registrant and David Kirkey and Amendments (1)

10.9 Stock Option Letter dated November 28, 1989 between Registrant and Vic Sangveraphunsiri (1)

10.11 Registrant's Flexible Stock Incentive Plan and related forms of Agreement (1)

10.12 Form of Indemnification Agreement (1)

10.13 Manufacturing Agreement dated as of October 22, 1985 between Registrant and Wearnes Technology (Private) Limited (1)

10.14 Agreement dated September 14, 1989 between Registrant and Wearnes Technology (Private) Limited (1)

10.16 Brand Name Distributor Reseller Purchase Agreement dated April 24, 1989 between Registrant and Gates/FA Distributing (1) (3)

10.17 Agreement dated October 1, 1988 between Registrant and International Business Machines Corporation (1) (3)

10.18 Computer Technology License Agreement dated December 12, 1988 between Registrant and Phoenix Technologies Ltd. (1) (3)

10.19 Amendment to Computer License Agreement dated as of May 5, 1989 between Registrant and Phoenix Technologies Ltd. (1) (3)

10.20 Amendment to Computer Technology License Agreement dated as of November 9, 1989 between Registrant and Phoenix Technologies Ltd. (1) (3)

10.21 OEM Distribution Agreement dated October 27, 1987 between Registrant and The Santa Cruz Operation, Inc. (1)

10.22 Amendment to OEM Distribution Agreement dated October 27, 1987 between Registrant and The Santa Cruz Operation, Inc. (1)

10.23 Amendment to OEM Distribution Agreement dated October 27, 1987 between Registrant and The Santa Cruz Operation, Inc. (1)

10.24 Standard Form Lease dated April 27, 1988 between Registrant and Alton Technical Center, Ltd. (1)

10.25 First Amendment to Standard Form Lease dated August 15, 1988 between Registrant and Alton Technical Center, Ltd. (1)

10.26 Second Amendment to Standard Form Lease dated June 23, 1989 between Registrant and Alton Technical Center Holding Company, Ltd. (1)

10.27 Standard Form Lease (Single Tenant) dated August 21, 1989 between Registrant and The Irvine Company (1)

10.28 Registrant's Directors' Non-Qualified Stock Option Plan (2)

10.33 ALR Reseller Terms and Agreement dated February 4, 1991 between Registrant and JWP Information Systems and Addendum thereto (4) (5)

10.35 Loan and Security Agreement dated June 16, 1993, between Registrant and Heller Financial, Inc. (6)

10.36 Third Amendment to Standard Form Lease dated March 31, 1994 between Registrant and Alton Technical Center Holding Company, Ltd. (8)

10.37 First and Second Amendments to Standard Form Lease (Single Tenant) dated August 17, 1993 and April 15, 1994, respectively, between Registrant and The Irvine Company (8)

10.38 First Amendment to Loan and Security Agreement dated August 7, 1995, between Registrant and Heller Financial, Inc. (9)

10.39 Third Amendment to Standard Form Lease (Single Tenant) dated November 14, 1996 between Registrant and The Irvine Company (10).

11. Statement Regarding the Computation of Per Share Earnings (Included on page 42.)

21. Subsidiaries of Registrant (7)

23.1 Consent of KPMG Peat Marwick LLP

24.1 Power of Attorney (Included on page 41.)

(b) Reports on Form 8-K: None

(1) Incorporated by reference to identically numbered exhibits filed in response to Item-16(a), "Exhibits", of Registrant's Registration Statement on Form S-1 (file No. 33-33907), which became effective on April 11, 1990.

(2) Incorporated by reference to identically numbered exhibits filed in response to Item 14 of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1990 filed with the Securities and Exchange Commission on December 31, 1990.

(3) Confidential treatment of certain portions of this agreement granted August 9, 1990.

(4) Incorporated by reference to identically numbered exhibits filed in response to Item 14 of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1991 filed with the Securities and Exchange Commission on December 27, 1991.

(5) Confidential treatment of certain portions of this agreement granted April 22, 1992.

(6) Incorporated by reference to identically numbered exhibit filed in response to Item 6 of the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 1993 filed with the Securities and Exchange Commission on August 13, 1993.

(7) Incorporated by reference to identically numbered exhibit filed in response to Item 14 of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1993 filed with the Securities and Exchange Commission on December 29, 1993.

(8) Incorporated by reference to identically numbered exhibits filed in response to Item 14 of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1994 filed with the Securities and Exchange Commission on December 22, 1994.

(9) Filed herewith in response to Item 14 of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1995.

(10) Filed herewith in response to Item 14 of the Company's Annual Report on Form 10-K for the fiscal year ended September 30, 1996.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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, in the City of Irvine, State of California, on the 26th day of December, 1996.

ADVANCED LOGIC RESEARCH, INC.

By: /s/ Eugene Lu
Eugene Lu,
Chairman of the Board of Directors,
President, and Chief Executive Officer

POWER OF ATTORNEY

KNOW ALL PERSONS BY THESE PRESENTS, that each person whose signature appears below constitutes and appoints Eugene Lu and Ronald J. Sipkovich, jointly and severally, his or her attorneys-in-fact, each with the power of substitution, for him or her in any and all capacities, to sign any amendments to this Report on Form 10-K, and to file the same, with exhibits thereto and other documents in connection therewith, with the Securities and Exchange Commission, hereby ratifying and confirming all that each of said attorneys-in-fact, or his substitute or substitutes, may do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this Report has been signed below by the following persons on behalf of the Registrant and in the capacities indicated on December 26, 1996.

Signature	Title
/s/ Eugene Lu Eugene Lu	Chairman of the Board of Directors, President, and Chief Executive Officer (Principal Executive Officer)
/s/ Ronald J. Sipkovich Ronald J. Sipkovich	Vice President, Finance and Administration, Chief Financial Officer and Secretary (Principal Accounting Officer)
/s/ Chun Win Wong Chun Win Wong	Director
/s/ Philip A. Harding Philip A. Harding	Director
/s/ Therese E. Myers Therese E. Myers	Director
/s/ Kenneth W. Simonds Kenneth W. Simonds	Director

<TABLE>

EXHIBIT 11

ADVANCED LOGIC RESEARCH, INC. AND SUBSIDIARIES
STATEMENT RE COMPUTATION OF PER SHARE EARNINGS
(Amounts in thousands, except per share amounts)

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	Year ended September 30,		
	1996	1995	1994
Primary earnings per share:-			
Shares used in computing earnings per share:			
Weighted average number of shares outstanding	11,969	11,512	11,434
Incremental shares attributed to outstanding options	280	238	-
	12,249	11,750	11,434
Earnings:			
Net income	$ 10,603	$ 4,872	$ (346)
Net income per common and common equivalent share	$ 0.87	$ 0.41	$ (0.03)
Earnings per share - assuming full dilution:-			
Shares used in computing earnings per share:			
Weighted average number of shares outstanding	11,969	11,512	11,434
Incremental shares attributed to outstanding options	320	419	-
	12,289	11,931	11,434
Earnings:			
Net income	$10,603	$ 4,872	$ (346)
Net income per common and common equivalent share	$ 0.86	$ 0.41	$ (0.03)

</TABLE>

Exhibit 10.39

THIRD AMENDMENT TO LEASE

I. PARTIES AND DATE.

This Third Amendment to Lease (the "Third Amendment") dated November 14, 1996, is by and between THE IRVINE COMPANY, a Michigan corporation ("Landlord"), and ADVANCED LOGIC RESEARCH, INC., a Delaware corporation ("Tenant").

II. RECITALS.

On August 21, 1989, Landlord and Tenant entered into a lease, as amended by a First Amendment to Lease dated August 17, 1993, and by a Second Amendment to Lease dated April 15, 1994 (as amended, the "Lease") for space in a building located at 9700 Jeronimo Road, Irvine, California ("Premises").

Landlord and Tenant each desire to modify the Lease to extend the Lease Term, adjust the Monthly Rent, and make such other modifications as are set forth in "III. MODIFICATIONS" next below.

III. MODIFICATIONS.

A. Basic Lease Provisions. The Basic Lease Provisions are hereby amended as follows:

1. thereof: Item I is hereby deleted in its entirety and the following shall be substituted in lieu

"1. Address of Landlord:

With a copy of notices to:
Insignia Commercial Group, Inc.
One Technology Drive, Suite F-207
Irvine, CA 92618
Irvine Industrial Company
P.O. Box 6370
Newport Beach, CA 92658-6370
Attn: Vice President, Industrial Operations

2. Item 4 is hereby deleted in its entirety and the following shall be substituted in lieu thereof

"4. Tenant's Contact: Vic Sial Telephone (714) 581-6770

3. thereof: Item 8 is hereby deleted in its entirety and the following shall be substituted in lieu

"8. Term: the Term of this Lease shall expire at midnight on June 30, 1999."

4. Effective as of July 17, 1996, Item 9 shall be deleted in its entirety and the following shall be substituted in lieu thereof:

"9. Monthly Rent: $20,802.00 per month, based on $.52 per rentable square foot.

Monthly Rent is subject to adjustment as follows: The Monthly Rent shall be increased, as of July 1, 1998 (the "Rental Adjustment Date"), by the percentage increase, if any, in the United States Department of Labor, Bureau of Labor Statistics, Consumer Price Index for all Urban Consumers, Los Angeles-Anaheim Riverside Area Average, all items (1982-84=100) (the "Index"). The adjustment shall be calculated by comparing the Index published for the third month preceding the Rental Adjustment Date with the Index published for April, 1997, and the Monthly Rent then in effect shall be increased by the amount of the percentage increase, if any, between those published Index amounts. In no event shall the Monthly Rent be reduced by reason of such computation. If at the Rental Adjustment Date the Index shall not exist, Landlord may substitute another reasonable index published by any governmental agency. Landlord shall use diligent efforts to calculate and give Tenant notice of any such increase in the Monthly Rent on or near the Rental Adjustment Date, and Tenant shall commence to pay the increased Monthly Rent effective on the Rental Adjustment Date. In the event Landlord is unable to deliver to Tenant the notice of the increased Monthly Rent at least five (5) days prior to the Rental Adjustment Date, Tenant shall commence to pay the increased Monthly Rent on the first day of the month following the delivery of such notice (the "Payment Date"), provided Landlord1s notice has been given at least five (5) days in advance. Tenant shall also pay, together with the first payment of the increased Monthly Rent, an amount determined by multiplying the amount of the increase in Monthly Rent times the number of months that have elapsed between the Rental Adjustment Date and the Payment Date."

IV. GENERAL.

A. Effect of Amendments. The Lease shall remain in full force and effect except to the extent that it is modified by this Amendment.

B. Entire Agreement. This Amendment embodies the entire understanding between Landlord and Tenant with respect to the modifications set forth in "III. MODIFICATIONS" above and can be changed only by a writing signed by Landlord and Tenant.

C. Counterparts. If this Amendment is executed in counterparts, each is hereby declared to be an original; all, however, shall constitute but one and the same amendment. In any action or proceeding, any photographic, photostatic, or other copy of this Amendment may be introduced into evidence without foundation.

D. Defined Terms. All words commencing with initial capital letters in this Amendment and defined in the Lease shall have the same meaning in this Amendment as in the Lease, unless they are otherwise defined in this amendment

E. Corporate and partnership Authority. If Tenant is a corporation or partnership, or is comprised of either or both of them, each individual executing this Amendment for the corporation or partnership represents that he or she is duly authorized to execute and deliver this Amendment on behalf of the corporation or partnership and that this Amendment is binding upon the corporation or partnership in accordance with its terms.

F. Attorneys' Fees. The provisions of the Lease respecting payment of attorneys' fees shall also apply to this Amendment.

V. EXECUTION.

Landlord and Tenant executed this Amendment on the date as set forth in "I. PARTIES AND DATE." above.

LANDLORD:

THE IRVINE COMPANY,
a Michigan corporation

Clarence W. Baker, President
Irvine Industrial Company, a
division of The Irvine Company

TENANT:

ADVANCED LOGIC RESEARCH, INC.
a Delaware corporation

Ron Sipkovich
VP Finance, CFO

Exhibit 23.1

CONSENT OF INDEPENDENT AUDITORS

To Board of Directors
Advanced Logic Research, Inc.

We consent to the incorporation by reference in the Registration Statements (No. 333-10865 and 33-59763) on Form S-8 of Advanced Logic Research, Inc. of our report dated October 24, 1996, except as to note 14 which is as of November 26, 1996, related to the consolidated balance sheets of Advanced Logic Research, Inc. as of September 30, 1996 and 1995, and the related consolidated statements of operations, shareholders' equity and cash flows and related schedule for each of the years in the three-year period ended September 30, 1996, which report appears in the September 30, 1996 Annual Report on Form 10-K of Advanced Logic Research, Inc.

KPMG Peat Marwick LLP
Orange County, California
December 26, 1996

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