



March 11, 1986

Dear Shareholder:

I am pleased to invite you to attend a Special Meeting of Shareholders of Mohawk Data Sciences Corp. to be held at the Parsippany Hilton Hotel, Ballroom Room 8, Route 10, Parsippany, New Jersey on Tuesday, April 15, 1986 at 10:00 A.M. local time, to consider and vote on the sale of five divisions of MDS.

As you are aware, your Company has for the past two years been operating in a loss position. Last spring a new management team was put in place with the mission of preserving as many of the corporate assets as possible for the benefit of Shareholders. At that time, the Company's senior bank loans were in default, which placed the Banks in a position to exercise their foreclosure rights, thereby possibly forcing MDS into a bankruptcy proceeding. In an attempt to avoid this alternative, an effort was put forth to sell some of the Company's subsidiaries and divisions, with the proceeds of the sales going mainly to pay down bank debt, with the intention of preserving and rebuilding the remaining assets.

The Company has successfully sold off its European subsidiary network, and is now in the process of finalizing the sale of five domestic divisions, as described in the attached Proxy Statement. Your management and Board of Directors feel that the proposed sale is the best arrangement that could be obtained under the circumstances, for the benefit of all Shareholders. In the event the sale is not finalized, there can be no assurance that the Banks will continue to refrain from demanding payment on their bank loans, or that management would be able to negotiate as favorable a transaction with any third party or parties, and the alternative of a bankruptcy filing might become necessary. In such a case, the prospects for Shareholders would be dismal, since a sale of our assets in such a proceeding might not be sufficient to cover the indebtedness of the Banks, which are the only secured lenders.

Your management and Board of Directors feel that the proposal contained in the Proxy Statement is fair and realistic to all parties involved and that the proposed Sale and related financial arrangements will give us time to implement a turnaround in the remaining MDS Qantel operations, although there can be no assurances that this will be the case. This is an important move for the Company and we want each Shareholder to be a part of it. **We hope you will take a few moments to read the enclosed material, complete the proxy card and return it in the envelope provided.**

Thank you for your support. We will continue on everyone's behalf to rebuild the Company with the hopes of returning it to a solid, profitable business enterprise that will be beneficial to all involved. We hope that you will have the opportunity to join us at our Special Meeting so that we may meet more of you personally.

Sincerely,

Matthew E. Tutino
Chairman of the Board and
Chief Executive Officer

MOHAWK DATA SCIENCES CORP.
Seven Century Drive
Parsippany, New Jersey 07054

NOTICE OF SPECIAL MEETING OF SHAREHOLDERS

To be held April 15, 1986

To the Shareholders of
MOHAWK DATA SCIENCES CORP.:

NOTICE IS HEREBY GIVEN that a special meeting of shareholders (the "Special Meeting") of Mohawk Data Sciences Corp. (the "Company") will be held at the Parsippany Hilton Hotel, Algonquin Room 8, Route 10, Parsippany, New Jersey, on Tuesday, April 15, 1986 at 10:00 A.M., Eastern Standard Time, for the following purposes:

1. To consider and vote upon a proposal to approve the sale pursuant to the Purchase Agreement, set forth in Exhibit 1 to the accompanying Proxy Statement, by the Company to Mohawk Acquisition Corporation (and/or to certain of its wholly-owned subsidiaries) of all of the capital stock of MDS Credit Corp. and substantially all the assets, properties and business, subject to certain liabilities, of the Company's MDS Service, MDS Systems, MDS Storms and MDS Herkimer Divisions, and the Company's "G&A" operation located in Herkimer, New York, as well as certain other financial assets of the Company.

2. To transact such other business as may properly come before the Special Meeting and any adjournments thereof.

Only holders of record of the Company's Common Stock at the close of business on February 24, 1986 will be entitled to vote at the Special Meeting and at any and all adjournments or postponements thereof.

By Order of the Board of Directors

JOHN C. WALTERS
Secretary

Dated: March 11, 1986

IT IS IMPORTANT THAT YOUR SHARES BE REPRESENTED AT THE SPECIAL MEETING. YOU ARE CORDIALLY INVITED TO ATTEND THE MEETING. WHETHER OR NOT YOU PLAN TO ATTEND THE SPECIAL MEETING, PLEASE COMPLETE, SIGN AND RETURN THE PROXY CARD IN THE ENCLOSED ENVELOPE AS SOON AS POSSIBLE.

MOHAWK DATA SCIENCES CORP.
PROXY STATEMENT
FOR SPECIAL MEETING OF SHAREHOLDERS
TO BE HELD APRIL 15, 1986

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MOHAWK DATA SCIENCES CORP.

Seven Century Drive
Parsippany, New Jersey 07054

PROXY STATEMENT

For

SPECIAL MEETING OF SHAREHOLDERS

To Be Held April 15, 1986

INTRODUCTION

This Proxy Statement is being furnished to holders of common stock, par value \$.10 per share (the "Common Stock"), of Mohawk Data Sciences Corp., a New York corporation (the "Company"), in connection with the solicitation of proxies by the Board of Directors of the Company for use at a special meeting of shareholders (the "Special Meeting") to be held on Tuesday, April 15, 1986 at the Parsippany Hilton Hotel, Parsippany, New Jersey, at 10:00 A.M., Eastern Standard Time, and at any and all adjournments or postponements thereof.

This Proxy Statement, related Notice of Special Meeting and the enclosed form of proxy are first being mailed to shareholders of the Company (the "Shareholders") on or about March 11, 1986.

Matters to be Considered at the Special Meeting

At the Special Meeting, the Shareholders will consider and vote upon the approval of the sale (the "Sale") by the Company to Mohawk Acquisition Corporation, a Delaware corporation ("MAC"), and/or its wholly-owned Delaware subsidiaries, Mohawk Systems Corporation ("MoSys"), Mohawk Manufacturing Corporation ("MMC"), and Mohawk Computer Service Corporation ("MoServ") (such subsidiaries are collectively referred to as the "Subsidiaries"), of all of the issued and outstanding capital stock of MDS Credit Corp., a wholly-owned Delaware subsidiary of the Company ("MDS Credit"), and substantially all the assets, properties and business (the "Assets"), subject to certain liabilities, of the Company's (i) MDS Service Division ("MDS Service"), (ii) MDS Systems Division ("MDS Systems"), (iii) MDS Storms Division ("MDS Storms"), (iv) MDS Herkimer Division and certain unimproved real property located in Hayward, California ("MDS Herkimer"), (v) "G&A" operation located in Herkimer, New York ("G&A"), and (vi) certain financial assets related to MDS Credit and the operations referred to in (i) through (v) above (the "Other Accounts"). MDS Credit, MDS Service, MDS Systems, MDS Storms, MDS Herkimer, G&A and the Other Accounts are collectively called the "Units", and the respective businesses and/or activities of the Units are collectively called the "Businesses."

The Sale is pursuant to the Purchase Agreement, dated as of December 13, 1985 (the "Purchase Agreement"), between MAC and the Company, a copy of which is attached as Exhibit 1 hereto. The Purchase Agreement provides that the Assets of the respective Units other than MDS Credit will be purchased, and certain of the liabilities of the respective Units will be assumed, by (i) MoSys in the case of MDS Systems and MDS Storms, (ii) MoServ in the case of MDS Service, (iii) MMC in the case of MDS Herkimer, and (iv) MAC in the case of G&A and the Other Accounts. The issued and outstanding shares of capital stock of MDS Credit will be purchased by MAC.

Pursuant to the Purchase Agreement the purchase price for the Units will be equal to the net book value of the Units, subject to certain adjustments as defined in the Purchase Agreement (the "Book Value"), on the closing date (the "Closing Date"), plus \$218,000, plus the assumption of certain contingent liabilities of the Units, plus 1,250,000 shares of common stock of MAC (the "MAC Shares") which will represent ten percent (10%) of the outstanding common stock of MAC, after giving effect to common stock that MAC intends to reserve in connection with employee stock plans. On October 31, 1985 the Book Value equaled \$79,572,000. Such amount was determined by netting, as of such date, the adjusted consolidated book value of the Assets in the amount of \$104,015,000 with the book value

of liabilities of the Units being assumed of \$24,443,000. In addition, unconsolidated liabilities of MDS Credit will also be assumed in connection with the Sale, which amounted to \$14,623,000 at October 31, 1985. See Note (A) of Notes to Pro Forma Balance Sheet on page 19.

In addition, MAC and MoServ will enter into a ten-year Marketing and Technical Support Agreement (the "Support Agreement") with the Company and MDS-Qantel, Inc., a wholly-owned subsidiary of the Company ("MDS Qantel" or "Qantel"). A copy of the form of the Support Agreement is attached hereto as Exhibit 2. Pursuant to the Support Agreement, the Company and MDS Qantel will provide technical support and spare parts to MAC and MoServ with respect to the computer maintenance service customers of MDS Qantel and MDS Systems, and MAC and MoServ will provide maintenance services for the end-user customers of MDS Qantel and MDS Service. For technical support with respect to the MDS Systems customer base, MAC and MoServ have agreed to pay the Company a commission of \$417,000 per month for 24 months for a total of \$10,008,000. In consideration for providing marketing, maintenance and support services to the customers of MDS Qantel, MAC and MoServ have agreed to pay the Company and MDS Qantel a monthly service revenue fee based on a sliding scale from 8% to 18% of the average monthly maintenance payments by Qantel end-user customers. In addition, MDS Qantel will receive a commission equal to one month's maintenance charge for each new Qantel end-user customer who enters into a service agreement with MoServ after the Closing Date. Such commission and fee payments will be used to finance the ongoing operations of Qantel. Had the Support Agreement been in effect on May 1, 1984, the additional revenues derived by the Company and MDS Qantel thereunder for the six months ended October 31, 1985 and the twelve months ended April 30, 1985 would have been \$4,841,000 and \$9,550,000, respectively.

Based on the Company's projections of the MDS Qantel end-user maintenance base, the revenues expected to be derived during the ten-year term of the Support Agreement are estimated to be approximately \$90,000,000. There can be no assurance that the MDS Qantel customer base will meet the projections and that the Company and MDS Qantel will receive such estimated amount. In addition, under certain circumstances, the Company may lose its right to receive such revenues under the Support Agreement. See "The Proposed Sale—The Support Agreement."

Financing of the Sale

The Sale is to be financed through credit agreements, one of which will be entered into by MAC, MoServ and MoSys with a syndicate of ten banks, who are also the same banks that are members of the Company's Senior Bank Syndicate (the "Banks"). MMC will enter into a separate credit agreement with the Banks. In addition, MDS Credit will enter into a seven-year credit agreement with three of the Banks who currently provide financing for its portfolio of long-term lease agreements. These three credit agreements are referred to hereinafter as the "MAC Financing Arrangements." Furthermore, the Company, MDS Qantel and certain other subsidiaries of the Company will enter into a new eight-year credit agreement with the Banks to restructure the Company's remaining bank debt on a long-term basis (the "MDS Debt Arrangements"). All of the credit agreements referred to in this paragraph, which are expected to be executed by the parties thereto shortly, are collectively referred to hereinafter as the "Financial Arrangements."

In addition to the bank financing, the principals of MAC have agreed to provide \$10 million in equity funding in the form of common and preferred stock. Providing such equity funding is a condition to the consummation of the Sale. Furthermore, the principals of MAC will enter into a contingency agreement with the Banks pursuant to which they will agree to provide up to an additional \$10 million in financing to MAC under certain circumstances. See "The Proposed Sale—Financing of the Sale."

Use of Proceeds; Repayment of Bank Debt

All of the cash proceeds from the Sale will be used to pay down bank debt. The Financial Arrangements require that a minimum of \$81,000,000 of bank debt (the "Minimum Bank Debt Reduction") be repaid pursuant to the Sale. In the event the Cash Purchase Price (as defined in the Purchase Agreement) is less than \$81,000,000, the Banks will require MoServ to participate indirectly in their loans to the Company in an amount equal to the amount by which the Cash Purchase Price is less than \$81,000,000 up to a maximum participation of \$4,000,000. If the Cash Purchase Price is less than the Preliminary Cash Purchase Price, as defined below, of \$77,398,000 (subject to certain adjustments), MAC and MoServ will deduct such deficiency from the monthly revenues due to MDS Qantel under the Support Agreement commencing in the fourth year thereof in an amount not to exceed 25% of such monthly revenues without making any provision for interest on such deficiency.

It is expected that the Company's bank debt after the Closing Date will be approximately \$42,600,000, subject to adjustment after final determination of the Cash Purchase Price. Such amount includes accrued interest from October 1, 1985 to the Closing Date of approximately \$6,000,000, but excludes the contingent liability relating to the guarantee of a bank loan to the Company's Mexican affiliate of \$3,410,000. See "The Proposed Sale—Purchase Price."

Reasons for the Sale

The Company has experienced significant operating and cash flow problems during the past two years. As a result, and after a thorough analysis of all of its operations in November 1984, the Company decided to enter into a restructuring process, the objective of which was to reduce cash outflow by eliminating excess overhead, to sell various operating divisions and subsidiaries in order to reduce bank debt to more acceptable levels and to strengthen the remaining business so that it could return to profitability.

During 1985 the Company sold its MDS DEK Identification Systems Division ("MDS DEK") and its international MDS Systems subsidiary network in Europe, South Africa and Canada. These operations, in the aggregate, were profitable and had a positive cash flow for the six months ended October 31, 1985. In addition, the operations of the Units to be transferred in the Sale were profitable in the aggregate and had a positive cash flow during the six months ended October 31, 1985 taking into consideration the non-cash depreciation charge of \$7,719,000 associated with these operations. See Pro Forma Statements on pages 20 and 28. At the same time, MDS Qantel has experienced negative cash flow during the past two years and has shown operating losses during such periods, and is expected to continue to generate losses and negative cash flow through the remainder of the calendar year.

The Company is currently in default under its credit agreement with the Banks which have the right to demand payment of such loans. The obligation of the Banks to provide the necessary financing for the Sale will be subject to certain conditions which are customary in credit agreements of this type. **There can be no assurance that the MDS Debt Arrangements will be finalized, that the financing necessary for the Sale will be available at the closing of the Sale or that the Banks will continue to forbear from demanding payment on the loans.**

Management of the Company believes that the Company's best prospects revolve around restructuring its bank debt to permit it to pursue the marketing potential of the MDS Qantel products and that the Proposed Sale and the Financial Arrangements will give the Company the opportunity to do so. Despite the losses and negative cash flow at MDS Qantel, Management also believes that the three-year deferral of principal and interest on the reduced amount of bank debt remaining after the proposed Sale will give it time to implement a turnaround in the MDS Qantel business computer operations. However, there can be no assurance that the Company will be able to do so.

In the event that the Sale is not approved by the Shareholders, or the other conditions to the consummation of the Sale are not satisfied or waived, the Company's management will continue to operate the Company as an ongoing business while seeking other purchasers for the Units. **No assurances can be given that some other offer for the Units might be made or, if made, whether the consideration will be more or less than that offered by MAC. In addition, in the event that the Banks do not continue to refrain from demanding payment on their loans, the Company may be forced into a bankruptcy or reorganization proceeding.**

Parties to the Purchase Agreement

The Company is a New York corporation and has its principal executive offices at Seven Century Drive, Parsippany, New Jersey 07054. Its telephone number is (201) 540-9080. See "Business and Property of the Company and MDS Qantel." The issued and outstanding shares of MAC are owned 45% by J.H. Whitney & Co. ("JHW"), 45% by Welsh, Carson, Anderson & Stowe IV ("WCAS IV"), and 10% by the Company. JHW and WCAS IV are venture capital firms. MAC and the Subsidiaries are recently-formed corporations organized by JHW and WCAS IV under the laws of the State of Delaware in preparation for the transactions contemplated by the Sale and have not engaged in any trade or business other than the execution of the Purchase Agreement, the Support Agreement, and the agreements relating to the equity funding to be provided to MAC and the MAC Financing Arrangements. MAC's address is c/o J.H. Whitney & Co., 630 Fifth Avenue, New York, New York 10111 and its telephone number is (212) 757-0500. See "Information Concerning MAC and the Subsidiaries."

Mr. Don E. Ackerman, a general partner of JHW, is Chairman of MAC and Mr. Bruce K. Anderson, a general partner of the sole general partner of WCAS IV, is President of MAC. There is no

relationship among the Company, its officers or directors or, to the Company's knowledge, any Shareholders and such venture capital firms, other than the equity interest of the Company in MAC.

Proxies

All shares of Common Stock represented at the Special Meeting by properly executed proxies received prior to or at the Special Meeting, and not revoked, will be voted at the Special Meeting in accordance with the instructions specified in the proxies. **If no specification is made, the proxies will be voted FOR approval of the Sale.** Proxies will also be valid for any adjournments of the Special Meeting. A person giving a proxy has the power to revoke the same at any time prior to the exercise thereof by written notice to the Company bearing a later date than the proxy, provided the notice is received by the Company prior to the start of the Special Meeting, or by appearance at the Special Meeting to vote in person. No such revocation shall affect any vote previously taken.

The Board of Directors is not aware of any matters which will come before the Special Meeting other than those described in this Proxy Statement. However, if any other matters are properly presented at the Special Meeting for action, the persons named in the enclosed form of proxy and acting thereunder will have discretion to vote on such matters in accordance with their best judgment.

Costs of Proxy Solicitation

The costs of soliciting proxies will be borne by the Company. Proxies will be solicited through the mails and personal calls or telephone or telegraphic communications to Shareholders or their representatives by directors, officers and other employees of the Company who will receive no additional compensation therefor. The Company has retained Hill and Knowlton, Inc. to solicit proxies for the Special Meeting for a fee estimated at \$11,000 plus out-of-pocket expenses. In addition, the Company will request banks, brokers and other custodians, nominees and fiduciaries to send proxy materials to the beneficial owners and to secure their voting instructions.

Record Date; Vote Required

The Board of Directors has fixed the close of business on February 24, 1986 as the record date (the "Record Date") for determination of Shareholders who are entitled to vote at the Special Meeting and any and all adjournments or postponements thereof. As of the Record Date, 15,028,096 shares of Common Stock were outstanding and entitled to vote on the Sale. Holders of record of Common Stock on the Record Date are entitled to one vote per share, exercisable in person or by proxy, on each matter presented at the Special Meeting.

The presence, in person or by proxy, of the holders of a majority of the outstanding shares of Common Stock entitled to vote at the Special Meeting is necessary to constitute a quorum at such meeting. Approval of the Sale will require the affirmative vote of the holders of at least a majority of the outstanding shares of Common Stock. In the event such vote is not received, the Sale will not be consummated. See "The Proposed Sale—Shareholder and Debentureholder Approval."

The Board of Directors of the Company unanimously recommends that Shareholders vote FOR approval of the Sale. See "The Proposed Sale—Recommendation of the Board of Directors; Reasons for and Purpose of the Sale" and "The Proposed Sale—Interests of Certain Persons in the Sale."

Material Contingencies

The closing of the Sale is contingent upon a number of conditions, including approval of the Sale by the holders of at least a majority of the outstanding Common Stock, the completion of the Financial Arrangements and the receipt by MAC of the equity and debt funding to finance the transactions contemplated by the Purchase Agreement. **There can be no assurance that the conditions to the consummation of the Sale will be satisfied and that the Sale will take place.** Furthermore, the Sale may be abandoned, and the Purchase Agreement may be terminated, on the terms and conditions set forth in the Purchase Agreement. See "The Proposed Sale—Representations and Warranties; Conditions to Closing; Amendments; Termination." **In view of such terms and conditions of the Purchase Agreement, the Company and MAC might not be obligated to consummate the Sale even if the Sale is approved by the Shareholders.**

Information Concerning Ownership of the Company's Voting Securities

As of the Record Date, directors and officers of the Company beneficially owned an aggregate of 1,879,575 shares of Common Stock of which only 200 shares were outstanding voting shares. See "Management of the Company—Common Stock Ownership of Management." The Company knows of no person who beneficially owned more than 5% of its outstanding Common Stock on the Record Date other than a group of persons represented by Mr. Asher B. Edelman, who held an aggregate of

1,206,200 shares, or approximately 8.0% of such outstanding shares, as of October 1984. See "Management of the Company—Voting Rights and Principal Shareholders."

Other

All information in this Proxy Statement concerning MAC and the Subsidiaries contained under the headings (i) "Introduction—Parties to the Purchase Agreement," (ii) "The Proposed Sale—Financing of the Sale", (iii) "Information Concerning MAC and the Subsidiaries", and (iv) "Conduct of the Business After the Sale—Other Post-Sale Matters" has been supplied by the officers of MAC. All other information contained in this Proxy Statement has been supplied by the Company.

Summary Selected Financial Data

The following table summarizes certain historical financial information relating to the Company and should be read in conjunction with "Selected Financial Data," the Company's unaudited interim Condensed Consolidated Financial Statements and the Notes thereto, its Consolidated Financial Statements and the Notes thereto, and "Management's Discussion and Analysis of Financial Condition and Results of Operations" included elsewhere in this Proxy Statement.

Historical

	Six Months Ended October 31		Year Ended April 30				
	1985	1984	1985	1984	1983	1982	1981
	(In millions except per share amounts)						
Total revenues	\$136.7	\$199.0	\$ 362.9	\$402.5	\$363.6	\$333.9	\$320.9
Income (loss) before income taxes and extraordinary items	\$(13.0)	\$(43.1)	\$(176.7)	\$(43.7)	\$ 18.1	\$ 18.4	\$ 26.1
Net income (loss)	(14.5)	(45.8)	(181.2)	(53.0)	12.0	15.6	18.1
Net income (loss) per share	\$ (.97)	\$(3.13)	\$(12.37)	\$(3.65)	\$.83	\$ 1.16	\$ 1.51
Financial position							
Total assets	\$167.7	\$329.1	\$ 255.0	\$334.0	\$342.8	\$299.3	\$268.2
Borrowings	133.4	157.0	162.9	138.3	109.5	85.6	52.2
Shareholders' equity (deficit)	(64.7)	56.5	(49.9)	107.7	165.5	156.9	146.4

The following table summarizes certain pro forma financial information relating to the remaining operations of the Company (primarily MDS Qantel), giving effect to the proposed Sale for the periods indicated. The calculation of pro forma total revenues does not include an estimate of the revenue that would have been derived from the Support Agreement. In addition, the calculation of pro forma income (loss) before income taxes and extraordinary items also excludes a provision for interest expense on bank debt.

Pro Forma

	Six Months Ended October 31		Year Ended April 30				
	1985	1984	1985	1984	1983	1982	1981
	(In millions)						
Total revenues	\$ 37.3	\$ 43.9	\$ 106.2	\$119.7	\$ 88.3	\$104.6	\$ 81.9
Income (loss) before income taxes and extraordinary items	\$(14.9)	\$(13.3)	\$(76.6)	\$(24.4)	\$ (3.8)	\$ 7.6	\$ 2.7

The Company has for many years centrally managed its debt structure and did not allocate borrowings to each of its operations. Accordingly, information concerning financial position is not available on a pro forma basis.

THE TRANSACTION TO BE CONSIDERED AT THE SPECIAL MEETING IS OF GREAT IMPORTANCE TO THE SHAREHOLDERS WHO ARE URGED TO READ AND CAREFULLY CONSIDER THE INFORMATION PRESENTED IN THIS PROXY STATEMENT.

THE PROPOSED SALE

This section of the Proxy Statement describes certain of the more important aspects of the proposed Sale. This is not a complete explanation or description of the Sale and is qualified in its entirety by reference to the Purchase Agreement, which is attached hereto as Exhibit 1. The term "Company" or "MDS" as used in this Proxy Statement means and includes Mohawk Data Sciences Corp. and all of its divisions and subsidiaries except as indicated or unless the context otherwise requires.

General

The Sale will result in the sale on the Closing Date by the Company to MAC of all of the outstanding stock of MDS Credit, and the Assets of the respective Units will be purchased and the liabilities of the respective Units will be assumed, by (i) MoSys in the case of MDS Systems and MDS Storms, (ii) MoServ in the case of MDS Service, (iii) MMC in the case of MDS Herkimer, and (iv) MAC in the case of G&A and the Other Accounts. If the Sale is approved by the Shareholders and if each of the other conditions to the Sale set forth in the Purchase Agreement is satisfied or waived, it is anticipated that the Sale will become effective as soon as practicable after the Special Meeting.

Purchase Price

Pursuant to the Purchase Agreement the purchase price (the "Purchase Price") for the Units will be equal to the Book Value on the Closing Date subject to the adjustment described below, plus \$218,000, the assumption of certain contingent liabilities of the Units, and the MAC Shares. At April 30 and October 31, 1985, the Book Value equaled \$82,180,000 and \$79,572,000, and the consolidated liabilities to be assumed equaled \$19,656,000 and \$24,443,000, respectively. In addition, the unconsolidated liabilities of MDS Credit of \$14,546,000 and \$14,623,000, at such dates, will also be assumed in connection with the Sale. In the event the Book Value on the Closing Date is less than \$79,180,000 the Cash Purchase Price will be adjusted to equal \$79,398,000 minus 80% of the difference between the Book Value on the Closing Date and \$79,180,000. The MAC Shares will represent ten percent (10%) of the sum of the outstanding common stock of MAC and the shares MAC proposes to make available to employees under stock option and stock purchase programs.

In addition, MAC and MoServ will enter into a ten-year Support Agreement with the Company and MDS Qantel. Pursuant to the Support Agreement, the Company and MDS Qantel will provide technical support and spare parts to MAC and MoServ with respect to the computer maintenance service customers of MDS Qantel and MDS Systems, and MAC and MoServ will provide maintenance services for the end-user customers of MDS Qantel and MDS Systems. For technical support with respect to the MDS Systems customer base, MAC and MoServ have agreed to pay the Company a commission of \$417,000 per month for 24 months for a total of \$10,008,000. In consideration for providing marketing and maintenance support services for the customers of MDS Qantel, MAC and MoServ have agreed to pay the Company and Qantel a monthly service revenue fee based on a sliding scale from 8% to 18% of the average monthly maintenance payments by Qantel end-user customers. In addition, Qantel will receive a commission equal to one month's maintenance charge for each new Qantel end-user customer who enters into a service agreement with MoServ after the Closing Date. Had the Support Agreement been in effect on May 1, 1984, the revenues derived by the Company and MDS Qantel for the six months ended October 31, 1985 and the twelve months ended April 30, 1985 would have been \$4,841,000 and \$9,550,000, respectively.

Based on the Company's projections of the MDS Qantel end-user maintenance base, which assumes a growth rate of 10% per year, the anticipated revenues to be derived during the ten year term of the Support Agreement are estimated to be approximately \$90,000,000. Such projected revenue stream would have a present value of approximately \$55,000,000, utilizing a discount rate of 10%. There can be no assurance that the MDS Qantel customer base will meet the projections and that the Company and MDS Qantel will receive such estimated amount. In addition, under certain circumstances, the Company may lose its right to receive such revenues under the Support Agreement. The Company made these projections solely for the purpose of evaluating the Sale and does not intend to update them after the Closing Date. See "The Proposed Sale—The Support Agreement."

On the Closing Date, MAC will pay to the Company an amount (the "Preliminary Cash Purchase Price") equal to (i) \$82,398,000, minus (ii) the aggregate amount transferred by any Unit to any other

component of the Company (except for any Unit) subsequent to April 30, 1985, in excess of unaudited profits distributed in the ordinary course of business and consistent with past practice, minus (iii) a \$5,000,000 holdback, and will also deliver to the Company the MAC Shares. On the Closing Date, the Company will turn in its current shares of common stock of MAC in exchange for the MAC Shares. JHW and WCAS IV will each pay \$500,000 to MAC and exchange their current common stock ownership of MAC for 5,000,000 post-split shares of common stock of MAC and they will each also pay \$4,500,000 for 45,000 shares of preferred stock of MAC. The net effect of these exchanges will be that the Company will own 10% of the common stock of MAC, after giving effect to proposed employee stock options and stock purchase programs in the amount of 1,250,000 shares, as if the shares to be reserved under such proposed plans were outstanding.

The final settlement and payment of the Cash Purchase Price will be made thirty days after the determination of the Final Consolidated Closing Net Book Value (as such term is defined in the Purchase Agreement) and the Cash Purchase Price. If the Cash Purchase Price so determined is more than the Preliminary Cash Purchase Price paid on the Closing Date, MAC will pay to the Company the amount of such excess. If the Cash Purchase Price, as so determined, is less than the Preliminary Cash Purchase Price, MAC and MoServ will deduct such deficiency from the monthly revenues due to MDS Qantel under the Support Agreement commencing in the fourth year thereof in an amount not to exceed 25% of such monthly revenues without making any provision for interest on such deficiency. In the event that upon termination or expiration of the Support Agreement such amounts were insufficient to repay such deficiency, MAC will have a claim against MDS for any remaining deficiency.

Use of Proceeds; Repayment of Bank Debt

All of the cash proceeds from the Sale will be used by the Company to pay down bank debt. A requirement of the Financial Arrangements is that the \$81,000,000 Minimum Bank Debt Reduction be repaid by the Company or refinanced through MoServ pursuant to the Participation Agreement (as hereinafter defined). In the event the Cash Purchase Price is less than \$81,000,000, the Banks and MoServ will agree that the Banks will refinance the difference between \$81,000,000 and the Cash Purchase Price up to a total of \$4,000,000 through MoServ. In the event the Cash Purchase Price is less than the Preliminary Cash Purchase Price, MAC and MoServ will deduct such deficiency from the monthly revenues due to MDS Qantel under the Support Agreement as described above. If, due to the adjustments described above, the Preliminary Cash Purchase Price is less than \$77,000,000, the Banks will not be obligated to consummate the Financial Arrangements, and, unless the Minimum Bank Debt Reduction is waived by the Banks, the Sale may not be consummated. The Company anticipates that the Preliminary Cash Purchase Price will exceed \$77,000,000. The Company expects to use the revenue payments under the Support Agreement for working capital to finance the ongoing operations of Qantel.

Assumption of Liabilities

On the Closing Date, as part of the consideration for the purchase of the Assets, MAC and the Subsidiaries will execute and deliver to the Company an assumption agreement pursuant to which, subject to the non-assumption of certain liabilities, MAC or a Subsidiary, as the case may be, will assume and agree to pay, perform and discharge when due all liabilities and obligations of the Company with respect to the Businesses of the respective Units on the Closing Date, including liabilities which are current liabilities incurred in the ordinary course of business and which, together with the liabilities of MDS Credit, are reflected on the Final Consolidated Closing Balance Sheet (as such term is defined in the Purchase Agreement) or arise under the terms of a contract assigned to MAC or a Subsidiary pursuant to the Purchase Agreement. On October 31, 1985 the book value of the liabilities of the Units other than MDS Credit was \$24,443,000 and the liabilities of MDS Credit were \$14,623,000.

The Support Agreement

Pursuant to the terms of the Purchase Agreement, the Company, MDS Qantel, MAC and MoServ will enter into the Support Agreement on the Closing Date. The following summary is qualified in its entirety by reference to the Support Agreement, a copy of which is annexed hereto as Exhibit 2.

During the ten-year term of the Support Agreement, the Company has agreed to use its best efforts to cause the distributors of its Qantel equipment (and any equipment which may be manufactured and/or marketed by the Company or any of its subsidiaries or affiliates as a substitute for or successor to such equipment) (collectively the "Qantel Equipment") to recommend MAC (acting directly or through a subsidiary) to their end-user customers as the sole Qantel-supported provider of maintenance services for Qantel Equipment. During the term of the Support Agreement (and thereafter to the extent provided below), the Company will not, with certain exceptions, provide parts, documentation, test programs or fixtures or any other assistance to anyone servicing Qantel Equipment in the United States other than MAC and MoServ.

In consideration of the marketing and maintenance support to be provided by the Company and Qantel, MAC has agreed to pay to the Company a monthly fee during the term of the Support Agreement equal to a percentage of the "Qantel Service Revenues" (as defined in the Support Agreement) during such month, determined as follows: (i) if the arithmetic average of Qantel Service Revenues for such month and (except in the case of the first two months of the term of the Support Agreement) the preceding two months is less than \$2,500,000, the percentage shall be 8%; or (ii) in all other cases, the percentage shall be 12%, plus an additional percentage (up to 6%) of the portion of Qantel Service Revenues for such month in excess of \$2,500,000, determined in accordance with the sliding scale set forth in the Support Agreement. In addition, MAC will pay to the Company a commission equal to the first month's maintenance billing on all new maintenance service agreements executed by end-user purchasers of Qantel Equipment who were not already users of Qantel Equipment, such commission to be payable when such billing is paid by the customer. The MDS Qantel maintenance base currently provides a major portion of the revenues and earnings of MDS Service, and the operations of MDS Qantel and MoServ after the Closing Date will be highly interdependent.

In addition, during the first two years of the Support Agreement, in consideration for marketing efforts and consultation services provided by the Company and Qantel with respect to maintenance of the equipment marketed by MDS Systems, MAC will pay the Company a commission of \$417,000 per month for 24 consecutive months for a total of \$10,008,000.

During the term of the Support Agreement, MAC and MoServ will have, subject to certain exceptions, the exclusive right to purchase spare parts for Qantel Equipment. The Company will sell spare parts for Qantel Equipment to MAC and MoServ at a price equal to 115% of the Company's own direct costs for material, labor and factory overhead. The Company will also provide to MAC and MoServ and keep current all engineering documentation, including engineering changes and test programs, relating to Qantel Equipment, and MAC and MoServ will have the exclusive right to utilize all documentation associated with the repair and maintenance of Qantel Equipment.

MAC and MoServ have agreed to continue to provide substantially the same level of service to the Company and end-user customers of Qantel Equipment as that currently provided by MDS Service, including without limitation responsibility for the installation of engineering changes, reports on products and preventive maintenance.

The above-stated marketing and support fee for Qantel Equipment presumes that Qantel will continue to provide marketing services to maintain and enhance the existing Qantel maintenance customer base and add new customers to that base. Thus, if Qantel ceases to function as an ongoing business then the above-stated marketing and support fees will be terminated and pursuant to the Support Agreement MAC will have a royalty-free, non-exclusive, non-assignable right to manufacture, have manufactured, use and sell Qantel Equipment and parts. The filing of a bankruptcy petition or any other proceeding designed to restructure the Company's debt will not impair or otherwise affect the payment of the above-stated marketing and support fees, nor will such action confer upon MAC the right to produce Qantel Equipment and parts, so long as the Company continues to remain in business and to offer computer products and services for sale to its existing and prospective customers within the United States. However, such fees will be terminated, and MAC will have such right to manufacture, have manufactured, use and sell Qantel Equipment and parts, if sales within the United States by Qantel (net of distributor discounts) for any consecutive six-month period are less than \$7,500,000. Such sales aggregated \$29,165,000, \$17,480,000 and \$15,897,000 for the six-month periods ended October 31, 1984, April 30, 1985 and October 31, 1985, respectively.

Prior to the end of the term of the Support Agreement, the parties thereto will negotiate in good faith with respect to a new arrangement between them covering the subject matter of the Support Agreement. In the event such an arrangement cannot be agreed upon, the Support Agreement will terminate at the end of its term, and for a period of five years thereafter, neither the Company nor Qantel will provide maintenance services on Qantel Equipment for which MoServ shall have provided maintenance services under the Support Agreement or disclose the identity of the customers owning or using any such Qantel Equipment, or any information with respect to the service arrangements of any such customer to any third party. Subject to the above and during such five-year period, the Company will be free to enter into marketing and technical support agreements with other parties, provided that the Company and MAC will negotiate in good faith with respect to a pricing structure for parts for Qantel Equipment, and that if they shall not be able to agree on such a structure, then MoServ will be entitled to purchase parts at prices not in excess of the lowest prices charged to any third party or end-user customer for similar quantities and subject to similar conditions.

The Support Agreement also contains remedies for certain types of nonperformance by MoServ with respect to the terms thereof. Such nonperformance includes the failure by MoServ (i) to achieve certain response times with respect to services provided under standard maintenance contracts; (ii) to have the proper parts in its possession to remedy end-user customer problems in more than 22% of all remedial maintenance calls measured over a 90-day period; and (iii) to achieve an average rating of less than "70" in the most recent quarterly customer survey conducted by MoServ of the end-user customers for whom MoServ is providing services under standard maintenance contracts (a "Level I Failure"). If MoServ fails to remedy a Level I Failure within 90 days after being requested to do so, MDS Qantel has the right to receive, subject to certain limitations, the payment by MoServ of an additional royalty equal to 1% of Qantel Service Revenues with respect to the most recent three-month period and such obligation of MoServ will continue from such three-month period until such failure is remedied.

In the event MoServ receives an average rating of "50" or less in the two most recent quarterly customer surveys conducted by MoServ and if either of the events described in clauses (i) or (ii) above are present, Qantel may seek, if MoServ does not remedy such failure within 90 days after being requested to do so, alternative sources of maintenance services for Qantel Equipment and the termination of the above-discussed exclusivity provisions in favor of MoServ with respect to the providing of maintenance services and spare parts for Qantel Equipment. In the event Qantel chooses to take such action, MoServ will be required to pay during the remainder of the term of the Support Agreement a monthly revised service fee with respect to Qantel Service Revenues as calculated in accordance with the terms of the Support Agreement.

Background of the Sale

The Company has experienced significant operating and cash flow problems during the past two years. As a result of these problems, the Company commenced a thorough analysis of all of its operations, both in the United States and abroad, in November 1984. Based on this analysis the Company decided to enter into a restructuring process, the objective of which was to reduce cash outflow by eliminating excess overhead, to sell various operating divisions and subsidiaries in order to reduce bank debt, which in early 1985 had reached approximately \$175,000,000 (including the bank debt of the Company's finance subsidiaries and borrowings of the Company and certain of its subsidiaries from sources other than the Banks), to more acceptable levels and to strengthen the remaining core business so that it could return to profitability. Initially management explored the possibility of selling or merging the Company as a whole, but after preliminary efforts to market the Company as a single entity, management concluded it was not feasible to do so under the circumstances surrounding the Company at such time.

As of June 1, 1984 the Company entered into an Amended and Restated 1981 Credit Agreement with the Banks, providing for a commitment of \$118,500,000 through October 31, 1984, and declining on a quarterly basis thereafter until maturity on May 1, 1988. The Credit Agreement requires the Company to meet certain financial covenants. The Company has not complied with these covenants for more than a year. In addition, quarterly principal reductions which had been due commencing November 1, 1984 were deferred by the Banks. In the second and third quarters of fiscal 1985, the Company entered into agreements with the Banks pursuant to which they loaned the Company an

additional \$23,000,000. As part of this additional financing and in exchange for further financial facilities in connection with the settlement of legal matters, the Company granted the Banks a security interest in all of its assets and issued warrants to the Banks to purchase 1,825,000 shares of Common Stock (the "1984 Warrants") originally exercisable at \$10.125 and \$11.25 per share through November 1991. The 1984 Warrants contain a provision whereby the Banks can put them back to the Company at their expiration date at prices ranging from \$1.50 to \$6.00 per warrant or in the aggregate \$4,425,000.

More specifically, with respect to the restructuring, the sales of the Company's divisions and subsidiaries were negotiated at arms-length and included the sale of MDS DEK for \$13 million as of January 31, 1985. Such amount was based on a multiple of the MDS DEK book value.

In February 1985 the Company and Continental Telecom Inc. ("CTI") signed a letter of intent for CTI's purchase of MDS Service, MDS Credit and the Company's Canadian finance subsidiary for \$152,500,000. The original purchase price reflected the purchase of MDS Service for approximately \$118,000,000, representing a multiple of 1.6 times revenues and \$34,000,000 for the assets of the finance subsidiaries. The letter of intent did not provide for assuming the bank debt relating to the finance subsidiaries of approximately \$22,500,000. The negotiations between CTI and the Company were terminated when CTI requested a substantial reduction in the purchase price.

In April 1985 the Company entered into a letter of intent with Datapoint Corporation ("Datapoint") whereby Datapoint would spin off its Service Division which in turn would acquire MDS Service. The new entity, Intelogic Trace, Inc. ("Intelogic"), would provide service for all of the Company's products on a third-party contract basis. The proposed purchase price of \$85,000,000 was based on a multiple of the book value of MDS Service. In addition, the proposal provided for a \$25,000,000 long-term loan to the Company. The transaction also provided for commissions on the MDS Qantel maintenance base, but did not include any substantial royalty payments. The negotiations between the Company and Intelogic were discontinued when the two companies could not agree on material conditions with respect to various aspects of the acquisition agreement, additional financing by Intelogic to the Company, and the terms for the provision of service to the Company's customers by Intelogic. The Company conducted discussions with other third parties regarding the purchase of MDS Service, none of which resulted in an executed letter of intent.

In June and July 1985, the Company consummated the sales of its South African, Canadian and Swiss subsidiaries. In October 1985, the Company sold five additional European subsidiaries to Recognition Equipment Incorporated and sold its remaining European subsidiaries. The aggregate sale price of the Company's international subsidiary network including the assumption of local bank debt by the purchasers was approximately \$43,000,000, and in each case was based primarily on the book value of the subsidiaries involved. Of such proceeds approximately \$37,000,000 was used to reduce principal and pay interest on the Company's overall bank debt. All of these former subsidiaries continue to distribute MDS Systems products as independent distributors.

As of April 30, 1985, the Company entered into an agreement to sell MDS Herkimer, which manufactures products for MDS Systems and others, to Mohawk Valley Industries, Inc. ("MVI"), a corporation controlled by the MDS Herkimer management group, for approximately \$10 million in cash and \$4 million in preferred stock, which represented a discount from book value. Such agreement contemplated that MVI would continue to manufacture certain products of the Company, as well as those of other companies, as a third-party contractor. After various delays in negotiating the transactions with MVI, the Company's management determined that it was in the best interests of the Shareholders to include MDS Herkimer in the proposed Sale.

In addition, the Company entered into various letters of intent with respect to the sale of MDS Storms, including a proposed management buyout. However, the purchasers in each of these proposed transactions experienced difficulty in raising the necessary financing.

Finally, on October 4, 1985, the Company and MAC entered into a letter of intent with respect to the Sale. At meetings held on December 3 and 10, 1985, the Company's Board of Directors unanimously approved, and on December 13, 1985, the Company and MAC entered into, the Purchase Agreement. The Cash Purchase Price was based on the book value of each of the Units, less a general corporate reserve of \$15,000,000. This method provided the Company and MAC with an appropriate

basis for supporting the underlying bank debt to be assumed by MAC. In addition a royalty stream was established to ensure working capital to the Company without incurring additional debt.

Although the Company continues to experience negative cash flow at MDS Qantel, it has been able to continue to finance its operations through cash flow generated by the Units and benefits derived in connection with the sale of various divisions and subsidiaries. There can be no assurance that the Company can continue to finance its operations in this manner with or without the proceeds from the proposed Sale. In addition, the Company has used the proceeds from the sale of various subsidiaries and divisions and will use all of the Cash Purchase Price from the proposed Sale to pay down bank debt to more acceptable levels. It is anticipated that the proposed Sale will reduce such bank debt to approximately \$42,600,000 as of the Closing Date. Such amount includes accrued interest from October 1, 1985 to the Closing Date of approximately \$6,000,000, but excludes the contingent liability relating to the guarantee of a bank loan to the Company's Mexican affiliate of \$3,410,000. The Company anticipates using the revenue payments under the Support Agreement for working capital to finance the ongoing operations of Qantel.

Financing of the Sale

The Sale will be financed by MAC through the MAC Financing Arrangements. More specifically, MAC, MoSys and MoServ will enter into a credit agreement with the Banks which provides an eight-year term/revolver loan, subject to certain covenants, in the amounts of up to \$3 million and \$65 million to MoSys and MoServ, respectively, collateralized by a first security interest in all the assets of MAC, MoSys and MoServ. Such loan will be subject to a standby equity commitment with the Banks, callable in the event of an acceleration of the loans by the Banks, pursuant to which JHW and WCAS IV will agree to provide up to \$10 million in financing to MAC beyond the initial \$10 million of equity financing such firms have agreed to provide.

MMC will enter into a separate credit agreement with the Banks providing for an eight-year, \$18 million term loan, subject to certain covenants, collateralized by a first security interest in all the assets of MMC. In addition, MDS Credit will enter into a seven-year credit agreement, subject to certain covenants, with three of the Banks to finance its portfolio of long-term lease arrangements in the amount of \$14,500,000. Such loan, which will be collateralized by a first security interest in all the assets of MDS Credit, is structured as a three-year revolver with a four-year term option.

The Company is currently in default under its Credit Agreement with the Banks which have the right to demand payment of such loans. However, the Company will enter into the MDS Debt Arrangements with the Banks to restructure the Company's remaining bank debt on a long-term basis if the Sale is consummated. The MDS Debt Arrangements provide that MDS Qantel will be primarily responsible to repay up to \$37,600,000 of existing debt, that MDS Qantel Canada Inc. ("Qantel Canada") will be primarily responsible for a refinancing loan of up to \$5,000,000 and that the Company will be primarily responsible for contingent indebtedness of \$3,410,000 in respect of an outstanding letter of credit, in each case collateralized by a first security interest in all of each company's respective assets. These banking facilities will be cross-guaranteed, on a secured basis, by the Company, MDS Qantel, Qantel Canada and MDS Capital Corporation, a subsidiary of the Company ("MDS Capital"). The MDS Debt Arrangements will be subject to certain covenants, have an eight-year term, require no principal amortization during the first three years, except certain mandatory prepayments, and quarterly repayments thereafter and (except as to the loan to Qantel Canada) provide for interest payment deferral during the first three years. Pursuant to such interest payment deferral the amounts that would otherwise be payable as interest will be added to the principal on a quarterly basis during the first three years. Included in the MDS Qantel portion of such debt is approximately \$3,000,000 representing two years of capitalized interest concessions on the MMC debt arrangement which MDS Qantel has agreed to assume as an inducement for MAC to acquire MDS Herkimer.

In consideration for the Banks entering into the MAC Financing Arrangements and the MDS Debt Arrangements necessary to consummate the Sale, the Company has agreed to issue the Banks warrants to purchase 500,000 shares of Common Stock at \$5.00 per share expiring ten years from the Closing Date. In addition, the Company has agreed to amend the 1984 Warrants to reduce their exercise price to \$3.50, extend their term to ten years from the Closing Date, and eliminate the provision whereby the

Banks can put the 1984 Warrants back to the Company on their expiration date at prices ranging from \$1.50 to \$6.00 per warrant or an aggregate amount of \$4,425,000.

The obligation of the Banks to provide the necessary financing for the Sale will be subject to certain conditions which are customary in credit agreements of the type described above. **There can be no assurance that the MDS Debt Arrangements will be finalized or that financing necessary for the Sale will be available on the Closing Date.**

All of the cash proceeds from the Sale will be used by the Company to pay down its existing bank debt. The Preliminary Cash Purchase Price of \$77,398,000 (subject to certain adjustments for amounts transferred from the Units to other components of the Company in excess of the earnings of the Units) to be paid by MAC and the Subsidiaries to the Company on the Closing Date will be used by the Company in such manner. The Financial Agreements require that the \$81,000,000 Minimum Bank Debt Reduction be repaid by the Company pursuant to the Sale or acquired from the Banks by MoServ. Pursuant to a Participation Agreement (the "Participation Agreement") between MoServ and the Banks, MoServ, as principal obligor, will agree to borrow up to \$4 million from the Banks to be used in connection with the Minimum Bank Debt Reduction. Under the terms of such agreement, the Banks will refinance the difference between the Minimum Bank Debt Reduction and the Book Value of the Units up to a total of \$4 million through MoServ. To such extent MoServ would participate indirectly in the MDS Debt Arrangements as a non-voting, second-tier member of the MDS Debt Arrangements. If the Book Value equals or exceeds the Minimum Bank Debt Reduction, there will be no refinancing through MoServ by the Banks pursuant to the Participation Agreement, and, in any event, the entire Cash Purchase Price would be used by the Company to pay down its existing bank debt. If the Cash Purchase Price is less than the Preliminary Cash Purchase Price of \$77,398,000 (subject to such adjustments), MAC and MoServ will deduct such deficiency from the monthly revenues due to Qantel under the Support Agreement commencing in the fourth year thereof in an amount not to exceed 25% of such monthly revenues without making any provision for interest on such deficiency. If, due to such adjustments, the Preliminary Cash Purchase Price is less than \$77,000,000, the Banks will not be obligated to consummate the Financial Arrangements, and unless the Minimum Bank Debt Reduction is waived by the Banks, the Sale may not be consummated.

Shareholder and Debentureholder Approval

Section 909(a) of the New York Business Corporation Law (the "BCL") requires that a "sale of all or substantially all the assets" of a corporation, if not made in the usual or regular course of business, be approved by the holders of two-thirds of all outstanding shares entitled to vote thereon. Furthermore, Sections 910 and 623 of the BCL provide shareholders in the event of such a sale with a procedure to exercise dissenters' rights. However, the Company has been advised by counsel that the proposed Sale does not constitute a "sale of all or substantially all the assets" of the Company within the meaning of Section 909(a) of the BCL. In view of such advice, the Company is not seeking the approval of the Sale by the vote of the holders of at least two-thirds of the Common Stock nor will dissenters' rights under Sections 910 and 623 of the BCL be made available to the Shareholders.

The Indenture, dated December 15, 1969, between the Company and Chemical Bank, as trustee, under which the 5-1/2% Convertible Subordinated Debentures due December 15, 1994 in the principal amount of \$6,205,000 (the "1994 Debentures") of the Company were issued prohibits the Company from making a "sale of all or substantially all" of its assets without obtaining an undertaking by the transferee of such assets to assume the obligation to pay the 1994 Debentures. Furthermore, the Indenture, dated May 1, 1969, among MDS Capital and the Company, as guarantor, and Chemical Bank, as trustee, under which the 5-1/2% Subordinated Guaranteed Debentures due 1989 in the principal amount of \$12,587,000 (the "1989 Debentures") of MDS Capital were issued contains a similar prohibition. However, the Company has been advised by counsel that the proposed Sale does not constitute a "sale of all or substantially all of its assets" within the meaning of the respective indentures. In view of such advice, the Company has not obtained an undertaking by MAC to assume the obligations to pay the 1994 Debentures or the 1989 Debentures nor has the Company obtained the consent of the holders of such Debentures for the consummation of the proposed Sale.

However, in view of the significance and material nature of the proposed Sale, the Company has decided to seek its approval by the holders of at least a majority of the outstanding shares of Common

Stock. In the event such approval is not received, the Sale will not be consummated. See "Introduction—Record Date: Vote Required."

Right to Use Name

In connection with the Sale, MAC will acquire the right to use certain trademarks and trade names of the Company including "Mohawk". In addition, in connection with the provision of maintenance services for Qantel Equipment under the Support Agreement, MAC has the right to identify itself by the name "Qantel" during the term of such agreement. The use by MAC of "Mohawk" will, however, be limited to areas not in competition with the then use thereof by the Company and will be without prejudice to the continued such use thereof by the Company in its ongoing business.

Participation in Future Offerings

The Purchase Agreement provides that in the event the Banks require JHW and WCAS IV to purchase additional securities of MAC up to an aggregate of an additional \$10 million, to the extent such securities include common stock, MAC will issue the Company sufficient additional shares of common stock at no additional cost to the Company so that the Company's percentage of common stock of MAC will not be reduced. The Purchase Agreement also provides that in the event that at any time prior to (i) the effective date of a public offering registered under the Securities Act of 1933 covering equity securities of MAC or (ii) the date on which any class of equity securities of MAC shall first be registered under the Securities Exchange Act of 1934, whichever shall first occur, MAC proposes to sell for cash to an investor or investors (other than employees of MAC or any of the Subsidiaries) any shares of common stock of MAC, MAC will offer to the Company the right to purchase, on the same terms as such investor or investors, a number of shares of common stock of MAC which will maintain the percentage of MAC owned by the Company after such sale as it owned before such sale.

Sale to Third Party

As an inducement to JHW and WCAS IV to provide equity funding to MAC, the Company has agreed, subject to certain exceptions set forth in the Purchase Agreement, including, among other things, the failure of the Shareholders to approve the proposed Sale, that in the event a third party shall purchase or otherwise acquire the Assets and Businesses from the Company, to pay each of JHW and WCAS IV an amount equal to the greater of \$500,000 or 5% of the amount by which (A) the purchase price paid for the Assets and Businesses, plus the present value of any estimated future revenues from arrangements entered into in connection with such transaction, exceeds the sum of (B) the purchase price for the Assets and Businesses under the Purchase Agreement, plus the present value of the anticipated future revenues to be realized by the Company pursuant to the Support Agreement.

Indemnification

Subject to certain terms and conditions of the Purchase Agreement, the Company has agreed to indemnify MAC, each Subsidiary and MDS Credit from and against all claims (including certain claims for taxes for periods prior to the Closing Date), actions, assessments, losses, damages, liabilities, costs and expenses (collectively "Damages") asserted against or incurred by MAC, any Subsidiary or MDS Credit resulting from a breach of any representation, warranty or covenant of the Company contained in the Purchase Agreement, or any liabilities or obligations of, or claims against or imposed on, MAC, the Subsidiaries or MDS Credit not assumed by MAC or a Subsidiary pursuant to the Purchase Agreement. Notwithstanding the foregoing, the Company will be obligated to indemnify MAC only for Damages in respect of breaches, liabilities, obligations, or certain other claims as to which MAC has provided the Company with written notice within 18 months after the Closing Date, and only to the extent that the aggregate amount of Damages exceeds \$400,000.

Subject to the terms of the Purchase Agreement, MAC has agreed to indemnify, defend and hold the Company harmless from and against all Damages asserted against or incurred by the Company resulting from a breach of any representation, warranty or covenant of MAC contained in or made pursuant to the Purchase Agreement, or any facts or circumstances constituting such a breach, or the failure of MAC to pay, perform and discharge when due the liabilities and obligations assumed by MAC pursuant to the Purchase Agreement.

Federal Income Tax Consequences

The Company's tax counsel believes that the Sale will qualify as a transaction described in section 351 of the Internal Revenue Code of 1954, as amended (the "Code"). In such event, the Company would recognize no gain or loss with respect to its receipt of the MAC Shares except to the extent, if any, that certain liabilities which will be assumed in the Sale exceed the Company's basis in the Assets to be transferred to MAC. Any gain recognized on the Cash Purchase Price will constitute taxable income in the year of the Sale. To the extent the cash is attributable to assets that are capital assets in the hands of the Company, the cash will, except for any recapture income, be taxable as a capital gain.

The Company's tax basis in the MAC Shares will equal its aggregate tax basis in the Assets which will be transferred in the Sale, reduced by the amount of cash the Company will receive and increased by the amount of gain the Company recognizes in the Sale.

As noted above, to the extent the Company receives cash in the Sale, it may be liable for recapture of certain depreciation and investment tax credit benefits. Such recaptured amounts, if any, will be taxable to the Company as ordinary income.

The Company plans on utilizing net loss carryforwards, to the extent available, to satisfy any tax obligations it may incur due to the transactions contemplated by the Purchase Agreement.

Expenses of the Sale

Pursuant to the terms of the Purchase Agreement, the Company and MAC will each pay its own expenses in connection with the transactions contemplated thereby. In addition, the Company estimates that fees to be paid to its counsel, investment bankers, proxy solicitors and accountants and the costs of printing and mailing this Proxy Statement will aggregate approximately \$600,000.

Representations and Warranties; Conditions to Closing; Amendments; Termination

The Purchase Agreement contains representations and warranties by the Company and MAC, which will survive for 18 months following the Closing Date. Each party's obligation to consummate the Sale is subject to a number of conditions including, among others, approval of the Sale by the Shareholders, the receipt of satisfactory legal and investment banker opinions, the accuracy of representations and warranties (financial or other), and the consummation of the MAC Financing Arrangements and the MDS Debt Arrangements.

The Purchase Agreement provides that it may, at any time, be amended or supplemented as may be determined by the Company and MAC to be necessary or desirable. The Purchase Agreement may be terminated and the Sale abandoned prior to the Closing Date, whether before or after the approval of the Sale by the Shareholders, by mutual consent of the Company and MAC, or by either the Company or MAC if certain conditions to its obligations to consummate the Sale have not been satisfied. **In view of such terms and conditions of the Purchase Agreement, the Company and MAC might not be obligated to consummate the Sale even if the Sale is approved by the Shareholders. There can be no assurance that the conditions to the consummation of the Sale will be satisfied and that the Sale will take place.** In addition, if the Sale has not been consummated by May 15, 1986, the Purchase Agreement may be terminated by the Company without penalty provided that it had complied with all of its obligations in all material respects, used its best efforts to cause the conditions to MAC's obligations which are under its control to be satisfied and was prepared to consummate the Sale.

Interests of Certain Persons in the Sale

As of the Record Date, the directors and officers of the Company together beneficially owned 1,879,575 shares of Common Stock (including 1,009,375 shares of Common Stock assuming the exercise of options granted under various stock option plans of the Company and the Company's Special Incentive Compensation Program; 370,000 shares of Common Stock assuming the exercise of certain warrants issued by the Company; and 500,000 non-voting, restricted shares of Common Stock issued to Mr. Tutino pursuant to the Company's Special Incentive Compensation Program, which may be deemed to be beneficially owned by him upon the lapsing of certain restrictions) of which only 200 shares were outstanding voting shares.

During the three-year period commencing on the Closing Date, at the request of the Company, MAC has agreed to use its best efforts to cause an individual designated by the Company to be elected

as a member of the Board of Directors of MAC. Initially, it is expected that such person will be Matthew E. Tutino, Chairman and President of the Company.

As provided in the Purchase Agreement, the Company's officers and directors will be indemnified by MAC against certain liabilities, including liabilities, if any, which arise out of or relate to the transactions contemplated by the Purchase Agreement.

With respect to severance arrangements, the Purchase Agreement provides that MAC will be responsible for "salary continuation" benefits which had been previously provided by the Company to the Transferred Employees (as such term is defined herein). Any "salary continuation" benefits previously awarded by the Company to employees who are not Transferred Employees will remain as obligations of the Company. Consummation of the proposed Sale will not result in or "trigger" any severance or other payments to any present or former officer, director or employee of the Company.

No present officer or director of the Company, other than Franklin C. Baylis, the Company's Treasurer, is expected to become employed by MAC or the Subsidiaries. In addition, Robert J. Hingre, President of MDS Herkimer and a former Senior Vice President of the Company, and Michael V. Bergamo, President of MDS Service and a former Vice President of the Company, are expected to continue with MAC and/or the Subsidiaries after the Sale.

Recommendation of the Board of Directors; Reasons for and Purpose of the Sale

The Board of Directors of the Company has unanimously authorized and approved the Purchase Agreement and the transactions contemplated thereby, believes that the proposed Sale is in the best interests of and is fair to all Shareholders and **unanimously recommends that Shareholders vote FOR approval of the Sale.** The Board of Directors reached this belief as to the fairness of the Sale because the terms of the Sale and the basis for determining the consideration offered in the Sale were the result of arm's length negotiations between representatives of the Company and representatives of MAC and its affiliates. After more than one year of negotiating, selling and attempting to sell various divisions and subsidiaries, the proposed Sale appears to be the most advantageous to the Company and the Shareholders in light of the Company's current financial situation. See "The Proposed Sale—Background of the Sale."

The proposed Sale results from the Company's consideration of a number of factors: the consideration to be paid to the Company; conditions and availability of financing, timing, and certainty of consummation of the proposed Sale; the Company's results of operations, cash flow and financial condition; current projections of future sales, cash flow and earnings; the Company's ability to survive without the transaction; the alternative of continuing to seek other offers for the Units; the fairness of the proposed Sale to the Shareholders from a financial point of view; and the opportunity for the Company to participate in MAC. The management of the Company believes that the Company's best prospects revolve around restructuring the bank debt to permit the Company to pursue the marketing potential of the MDS Qantel products for its future growth and believes that the proposed Sale and Financial Arrangements will give it the opportunity to do so. Although basing its conclusion upon the different considerations discussed above, the Board of Directors did not assign any relative weight to the various factors it considered in reaching its decision.

It is expected that if the Sale is not approved by the Shareholders, or the other conditions to the consummation of the Sale are not satisfied or waived, the Company's management, under the general direction of the Board of Directors, will continue to manage the Company as an ongoing business and seek other purchasers for the Units. **No assurance can be given that some other offer for the Units might be made or, if made, whether the consideration will be more or less than that offered by MAC or whether the Banks will continue to forbear from demanding payment on the loans. In the event that the Banks demand payment on their loans, the Company may be forced into a bankruptcy or reorganization proceeding.**

Opinion of Investment Bankers

The Board of Directors engaged Salomon Brothers Inc ("Salomon Brothers") as its financial advisor in connection with the Sale, although Salomon Brothers did not participate in the negotiations leading to the execution of the Purchase Agreement. Salomon Brothers has delivered a written opinion, dated the date of this Proxy Statement, to the Board of Directors of the Company that the

consideration to be received in the Sale is fair, from a financial point of view, to the Company. In rendering its opinion, Salomon Brothers has relied upon, among other things, the accuracy and completeness of the financial and other information furnished to it or publicly available. The full text of such opinion, which sets forth a description of the assumptions and qualifications made, procedures followed, matters considered and limitations on the review undertaken by Salomon Brothers in rendering its opinion, is attached hereto as Exhibit 3, and should be read in its entirety.

The Company has agreed to pay Salomon Brothers an aggregate of \$250,000, plus any additional amounts which may be mutually agreed to in the future, for its services in connection with the Company's restructuring process, including the proposed Sale. Such firm has previously rendered other investment banking and financial advisory services to the Company in connection with its restructuring process, for which it has received fees aggregating \$97,500, which fees shall be credited against the foregoing amounts. In addition, the Company has agreed to indemnify Salomon Brothers against certain potential liabilities, including liabilities that arise under the federal securities laws, and to reimburse Salomon Brothers for its expenses incurred in connection with its engagement.

INFORMATION CONCERNING MAC AND THE SUBSIDIARIES

MAC and the Subsidiaries are recently formed corporations organized by JHW and WCAS IV under the laws of the State of Delaware solely to facilitate the consummation of the transactions contemplated by and relating to the Purchase Agreement, the Support Agreement, the Equity Agreements (as such term is defined in the Purchase Agreement), and the agreements relating to the MAC Financing Arrangements. MAC has not engaged in any trade or business other than the execution of such agreements and the issuance of its initial capital stock. The authorized capitalization of MAC consists of 1,000 shares of common stock, par value \$1 per share. Prior to the Closing Date, the authorized capital stock of MAC will be increased to consist of 20,000,000 shares of common stock, par value \$.01 per share, and 190,000 shares of Nonconvertible Preferred Stock, par value \$1 per share, in order to accommodate the issuance of the MAC Shares and the common and preferred shares of MAC to JHW and WCAS IV.

CONDUCT OF BUSINESS AFTER THE SALE; OTHER POST-SALE MATTERS

It is the intention of MAC to continue the Businesses after the Closing Date so that the Company's customers will continue to be supplied with the Company's products and services without interruption and with the same high standards that the Company has provided such products and services in the past. Moreover, MAC has agreed to offer each employee of the Company employed at any of the Units on the Closing Date and certain members of the Company's corporate staff mutually agreed upon by the Company and MAC, the opportunity for continued employment as an employee of MAC or a Subsidiary, as the case may be. Such employment will be employment at will, subject to MAC's being responsible for certain salary continuation rights previously granted by the Company to such transferred employees, which MAC has agreed to assume under the Purchase Agreement. All such persons who may accept such employment are hereinafter referred to as "Transferred Employees."

MAC has also agreed to provide for the Transferred Employees medical, hospitalization and similar employee welfare plan coverages substantially similar to those currently available to such employees. MAC has further agreed to establish a pension plan (and/or, at its option, a 401(k) plan) for the Transferred Employees, and the Purchase Agreement provides that a certain portion of the assets of the pension plan of the Company currently in effect will be transferred to such new plan or plans so established. The Purchase Agreement does not limit or restrict in any way the right of the Company or MAC to terminate, modify or amend any pension plan or other employee benefit plan in any way at any time after the Closing Date, so long as such action does not result in any liability to the other or to any corporation affiliated with the other. The Purchase Agreement further provides that neither MAC nor the Company, nor their respective such plans, will have any liability to any Transferred Employee in respect of any rights of such employee against such plan or plans of the other. MAC currently proposes to make available 1,250,000 shares of its common stock to key employees under stock option and/or stock purchase programs.

After the consummation of the proposed Sale, the principal assets of the Company will be MDS Qantel and its subsidiaries, the MAC Shares, the right to receive certain support revenues and commissions under the Support Agreement and its net operating tax loss carryforwards. The MDS Qantel maintenance base currently provides a major portion of the revenues and earnings of MDS Service, and the operations of MDS Qantel and MoServ after the Closing Date will be highly interdependent.

Initially, the Company plans on operating MDS Qantel as a subsidiary, but may, at some point in the future, merge it into the Company, if it appears to be in the best interests of the Company and the Shareholders to do so.

MARKET PRICES AND DIVIDENDS

The Common Stock is listed on the New York Stock Exchange ("NYSE") and is also traded on the Pacific Stock Exchange. The following table sets forth, for the fiscal quarters indicated, the high and low sales prices per share of the Common Stock as reported in the NYSE Composite Transactions.

	<u>High</u>	<u>Low</u>
Year Ended April 30, 1984		
Third Quarter	16¾	12½
Fourth Quarter	15¼	9½
Year Ended April 30, 1985		
First Quarter	13¾	8½
Second Quarter	15	9½
Third Quarter	12½	8¾
Fourth Quarter	12	3
Year Ended April 30, 1986		
First Quarter	3½	2
Second Quarter	2½	1¼
Third Quarter and through March 6, 1986	2¾	1½

MOHAWK DATA SCIENCES CORP. AND SUBSIDIARIES

SELECTED FINANCIAL DATA

Set forth below are selected financial data of the Company and its subsidiaries. This information should be read in conjunction with the Company's unaudited interim Condensed Consolidated Financial Statements and its Consolidated Financial Statements and Notes thereto included elsewhere herein. The results of operations for the six months ended October 31, 1985 are not necessarily indicative of the results that may be expected for the full year.

	Six Months Ended October 31		Year Ended April 30				
	<u>1985</u>	<u>1984</u>	<u>1985</u>	<u>1984</u>	<u>1983</u>	<u>1982</u>	<u>1981</u>
	(In millions except per share amounts)						
Revenues							
Net sales	\$ 80.7	\$125.3	\$ 221.7	\$253.0	\$217.0	\$206.6	\$186.4
Rentals and service	56.0	73.7	141.2	149.5	146.6	127.3	134.5
Total revenues	<u>\$136.7</u>	<u>\$199.0</u>	<u>\$ 362.9</u>	<u>\$402.5</u>	<u>\$363.6</u>	<u>\$333.9</u>	<u>\$320.9</u>
Income (loss) before income taxes and extraordinary items	\$(13.0)	\$(43.1)	\$(176.7)	\$(43.7)	\$ 18.1	\$ 18.4	\$ 26.1
Net income (loss)	<u>(14.5)</u>	<u>(45.8)</u>	<u>(181.2)</u>	<u>(53.0)</u>	<u>12.0</u>	<u>15.6</u>	<u>18.1</u>
Net income (loss) per share							
Income (loss) before extraordinary items	\$ (.97)	\$(3.13)	\$(12.37)	\$(3.65)	\$.79	\$ 1.16	\$ 1.44
Net income (loss)	<u>(.97)</u>	<u>(3.13)</u>	<u>(12.37)</u>	<u>(3.65)</u>	<u>.83</u>	<u>1.16</u>	<u>1.51</u>
Financial Position							
Total assets	\$167.7	\$329.1	\$ 255.0	\$334.0	\$342.8	\$299.3	\$268.2
Borrowings	133.4	157.0	162.9	138.3	109.5	85.6	52.2
Shareholders' equity (deficit)	<u>(64.7)</u>	<u>56.5</u>	<u>(49.9)</u>	<u>107.7</u>	<u>165.5</u>	<u>156.9</u>	<u>146.4</u>
Shareholders' equity (deficit) per share	<u>\$(4.32)</u>	<u>\$ 3.85</u>	<u>\$(3.40)</u>	<u>\$ 7.39</u>	<u>\$11.42</u>	<u>\$11.71</u>	<u>\$10.99</u>

MOHAWK DATA SCIENCES CORP. AND SUBSIDIARIES
PRO FORMA FINANCIAL STATEMENTS

The following unaudited pro forma condensed consolidated financial statements illustrate certain pro forma effects of the proposed Sale at October 31, 1985 and for the year ended April 30, 1985 and the six months ended October 31, 1985, giving effect to the adjustments described in the accompanying notes. The pro forma condensed consolidated financial statements should be read in conjunction with the historical Consolidated Financial Statements and Notes thereto of the Company and its subsidiaries and "Management's Discussion and Analysis of Financial Condition and Results of Operations," each appearing elsewhere herein. The pro forma data are provided for informational purposes only and should not be construed to be indicative of what the financial condition and results of operations would have been if the Sale had been consummated at the balance sheet date or at the beginning of the periods for which the pro forma consolidated statements of earnings are presented, nor indicative of future financial condition or future results of operations.

PRO FORMA BALANCE SHEET

October 31, 1985
(Unaudited)

	<u>Consolidated Company</u>	<u>Eliminate Proposed Sale to MAC</u>	<u>Pro Forma Adjustments</u>	<u>Pro Forma Balance Sheet</u>
	(In Thousands)			
ASSETS				
Cash	\$ 2,659	\$	\$	\$ 2,659
Accounts receivable—net	45,824	24,330		21,494
Net investment in sales-type leases	596	596		
Inventories	36,552	28,039		8,513
Rental equipment—net	40,120	39,286		834
Property, plant and equipment—net	19,486	10,951		8,535
Cost in excess of net assets of acquired companies	1,717	949		768
Investments in and receivable from affiliates	11,780	9,599(G)	125 (B)	2,306
Other assets	12,822	2,564	(3,800)(C)	6,458
Total assets	<u>\$171,556</u>	<u>\$116,314</u>	<u>\$ (3,675)</u>	<u>\$51,567</u>
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT)				
Bank debt	\$107,943	\$	{ \$(79,790)(A) 3,000 (B) 1,382 (D) 5,498 (E)	\$38,033
Accounts payable	16,031	11,006		5,025
United States and foreign income taxes	5,950			5,950
Salaries, wages and commissions accrued	5,860	2,109		3,751
Taxes other than income taxes	2,441	1,160		1,281
Other accrued expenses	30,193	7,984	{ (1,382)(D) (4,425)(C)	16,402
Accrual for estimated loss on disposition	36,156		{ (16,075)(F) (14,956)(B)	5,125
Subordinated debentures	18,792			18,792
Mortgages and other debt	6,685	46	(5,498)(E)	1,141
Deferred income taxes	1,670			1,670
Deferred credits	4,550	2,138		2,412
Total liabilities	<u>236,271</u>	<u>24,443</u>	<u>(112,246)</u>	<u>99,582</u>
Shareholders' equity (deficit)	<u>(64,715)</u>	<u>91,871</u>	<u>108,571</u>	<u>(48,015)</u>
Total liabilities and shareholders' equity (deficit)	<u>\$171,556</u>	<u>\$116,314</u>	<u>\$ (3,675)</u>	<u>\$51,567</u>
Shareholders' (deficit) per share	<u>\$ (4.32)</u>			<u>\$ (3.21)</u>

See accompanying notes.

MOHAWK DATA SCIENCES CORP. AND SUBSIDIARIES
NOTES TO PRO FORMA BALANCE SHEET

- (A) Estimated cash proceeds from the Sale of the Units to MAC, computed in accordance with the Purchase Agreement as follows:

	(In Thousands)
Historical net book value of Units	\$91,871
Increase in book value of unimproved real property to be sold to MAC ...	<u>2,701</u>
Adjusted historical net book value	\$94,572
Portion of accrual for estimated loss on disposition to be transferred to MAC	<u>(15,000)</u>
Book Value	79,572
Premium on Book Value	<u>218</u>
Estimated cash proceeds	<u>\$79,790</u>

The payments by MAC and MoServ under the Support Agreement will be recorded as received.

- (B) Estimated loss on proposed Sale of Units to MAC, computed as follows:

	(In Thousands)
Historical net book value of Units	\$91,871
Deduct—Estimated cash proceeds	(79,790)
—Value assigned to MAC Shares to be received, per preliminary estimate from investment banker	(125)
Add—Interest concession to MMC as an inducement to acquire MDS Herkimer	<u>3,000</u>
Estimated loss on proposed Sale	<u>\$14,956</u>

This loss was recorded as of April 30, 1985, as part of the estimated loss on disposition.

- (C) To eliminate unamortized portion of value assigned to warrants issued to the Banks in fiscal 1985 (\$3,800,000) and liability for the put provision associated with such warrants (\$4,425,000). For purposes of preparing the accompanying Pro Forma Balance Sheet, no value has been assigned to the new warrants to be issued to the Banks nor to the previously issued warrants based on their new terms, since such values would not be material to the pro forma financial condition of the Company.
- (D) To reclassify accrued interest and Bank fees which will become part of Bank debt. The MDS Debt Arrangements require all unpaid interest and fees to be added to the Bank debt. Assuming no interest is paid to the Banks from November 1 until the Closing Date, the Bank debt would be increased by approximately \$4,600,000.
- (E) MDS Qantel issued a note to National Surety Corporation in connection with a settlement of litigation against it. Such note is supported by an irrevocable letter of credit issued by the Banks on behalf of the Company. The amount has been reclassified as Bank debt as the Company intends to utilize this letter of credit.
- (F) To reverse the portion of accrual for estimated loss on disposition no longer required after the proposed Sale.
- (G) Represents the Company's investment in its unconsolidated finance subsidiary net of liabilities of \$14,623,000 of which \$14,500,000 represents bank debt. See Note 6 of Notes to Condensed Consolidated Financial Statements on page F-27.
- (H) The Company has consistently issued unclassified balance sheets due to its substantial leasing operations. After the completion of the Sale, the Company intends to issue classified balance sheets since Qantel (the principal remaining operation) primarily markets its products through sales rather than leases.

MOHAWK DATA SCIENCES CORP. AND SUBSIDIARIES

PRO FORMA STATEMENT OF OPERATIONS

Six Months Ended October 31, 1985

(Unaudited)

	Consolidated Company	Eliminate Subsidiaries Sold(A)	Pro Forma Adjustments	Pro Forma Before Proposed Sale	Eliminate Proposed Sale to MAC	Pro Forma Adjustments	Pro Forma Statement of Operations
(In thousands except per share amounts)							
Revenue							
Net sales	\$ 80,668	\$ 11,404	\$	\$ 69,264	\$ 34,222	\$	\$ 35,042
Rentals and service	55,986	16,690		39,296	37,037		2,259
Service royalties and commissions						4,841 (C)	4,841
Total revenue	<u>136,654</u>	<u>28,094</u>		<u>108,560</u>	<u>71,259</u>	<u>4,841</u>	<u>42,142</u>
Costs and expenses							
Cost of sales	42,904	6,709		36,195	23,812		12,383
Cost of rentals and service	39,226	11,588		27,638	26,211		1,427
Development, software and engineering expenses	10,395	(161)		10,556	2,325		8,231
Marketing, general and administrative expenses	49,064	8,934		40,130	11,985		28,145
Other expenses—net	524	(1,395)		1,919	368		1,551
Total costs and expenses	<u>142,113</u>	<u>25,675</u>		<u>116,438</u>	<u>64,701</u>		<u>51,737</u>
Operating income (loss)	(5,459)	2,419		(7,878)	6,558	4,841	(9,595)
Interest expense	9,081	210	(1,060)(B)	7,811		(3,989)(D)	3,822
Interest income	776	597		179	155		24
Equity in net income of finance subsidiary	809			809	809		
Income (loss) before income taxes	(12,955)	2,806	1,060	(14,701)	7,522	8,830	(13,393)
Provision for income taxes	1,555	923		632	267		365
Net income (loss)	<u>\$ (14,510)</u>	<u>\$ 1,883</u>	<u>\$ 1,060</u>	<u>\$ (15,333)</u>	<u>\$ 7,255</u>	<u>\$ 8,830</u>	<u>\$ (13,758)</u>
Net loss per common and common equivalent share	<u>\$ (.97)</u>						<u>\$ (.92)</u>
Average outstanding shares	14,902						14,902

See accompanying notes.

MOHAWK DATA SCIENCES CORP. AND SUBSIDIARIES

PRO FORMA STATEMENT OF OPERATIONS

Year Ended April 30, 1985

(Unaudited)

	Consolidated Company	Eliminate Subsidiaries Sold(A)	Pro Forma Adjustments	Pro Forma Before Proposed Sale	Eliminate Proposed Sale to MAC	Pro Forma Adjustments	Pro Forma Statement of Operations
(In thousands except per share amounts)							
Revenue							
Net sales	\$ 221,685	\$ 42,742	\$	\$ 178,943	\$ 77,012	\$	\$101,931
Rentals and service	141,222	66,101		75,121	70,859		4,262
Service royalties and commissions						9,550 (C)	9,550
Total revenue	<u>362,907</u>	<u>108,843</u>		<u>254,064</u>	<u>147,871</u>	<u>9,550</u>	<u>115,743</u>
Costs and Expenses							
Cost of sales	124,205	26,586		97,619	60,607		37,012
Cost of rentals and service	104,363	45,300		59,063	55,352		3,711
Development, software and engineering expenses	28,369	3,993		24,376	5,549		18,827
Marketing, general and administrative expenses	183,379	30,468		152,911	53,186		99,725
Other expenses-net	7,525	2,504		5,021	3,648		1,373
Total costs and expenses	<u>447,841</u>	<u>108,851</u>		<u>338,990</u>	<u>178,342</u>		<u>160,648</u>
Operating income (loss)	(84,934)	(8)		(84,926)	(30,471)	9,550	(44,905)
Interest expense	19,678	1,199	(3,618)(B)	14,861	369	(8,537)(D)	5,955
Interest income	2,203	1,589		614	566		48
Equity in net income of finance subsidiaries	1,793	83		1,710	1,710		
Provision for estimated loss on disposition	76,094	39,938		36,156	14,956	(16,075)(E)	5,125
Income (loss) before income taxes	(176,710)	(39,473)	3,618	(133,619)	(43,520)	34,162	(55,937)
Provision for income taxes	4,461	1,870		2,591	314		2,277
Net income (loss)	<u>\$(181,171)</u>	<u>\$(41,343)</u>	<u>\$3,618</u>	<u>\$(136,210)</u>	<u>\$(43,834)</u>	<u>\$ 34,162</u>	<u>\$(58,214)</u>
Net loss per common and common equivalent share	<u>\$(12.37)</u>						<u>\$(3.97)</u>
Average outstanding shares	14,648						14,648

(A) Represents the results of the Company's international subsidiaries that distributed MDS Systems products for the six months ended October 31, 1985. For the year ended April 30, 1985 represents the results of such subsidiaries as well as MDS DEK sold effective January 31, 1985.

(B) To record estimated reduction of interest expense resulting from the repayment of Bank debt with the proceeds from the sales of certain of the Company's divisions and subsidiaries. The calculations assume interest rates of 10.7% and 10% for the year ended April 30, 1985 and the six months ended October 31, 1985, respectively.

(C) To record estimated income which would have been derived from the Support Agreement.

(D) To record estimated reduction of interest expense resulting from the repayment of Bank debt with the proceeds from the proposed Sale. The calculations assume interest rates of 10.7% and 10% for the year ended April 30, 1985 and the six months ended October 31, 1985, respectively.

(E) To reverse the portion of accrual for estimated loss on disposition no longer required after the proposed Sale.

MOHAWK DATA SCIENCES CORP. AND SUBSIDIARIES

CAPITALIZATION

The following table sets forth the unaudited capitalization of the Company as of October 31, 1985, and the pro forma capitalization of the Company after giving effect to the Sale. See "The Proposed Sale—Financing of the Sale" and "Conduct of Business after the Sale; Other Post-Sale Matters." This table should be read in conjunction with the pro forma condensed consolidated financial statements and notes thereto and the historical Consolidated Financial Statements and Notes thereto of the Company and its subsidiaries each appearing elsewhere herein.

	<u>Actual</u>	<u>As Adjusted</u>
	(Unaudited)	
	(In Thousands)	
Bank debt	\$107,943	\$38,033
Subordinated debentures	18,792	18,792
Mortgages and other debt	6,685	1,141
Total debt	133,420	57,966
Shareholders' deficit	(64,715)	(48,015)
Total capitalization	<u>\$ 68,705</u>	<u>\$ 9,951</u>

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Interim Results of the Company

For the six months ended October 31, 1985 total revenues decreased by 31% over the prior year. Net equipment sales decreased by 36%. Rentals and service revenues decreased by 24%. The primary reason for the decrease in revenues was \$30,000,000 of decreased revenue from the subsidiaries and divisions sold in 1985. The remaining revenue drop was experienced within the domestic operation due to the uncertainty surrounding the Company which adversely affected business particularly at MDS Qantel where revenues fell by 45%. MDS Service revenue increased by a modest 4% reflecting lower hardware placements compared to prior years.

Gross margins on equipment sales decreased to 47% from 51% for the six months ended October 31, 1985, as a result of product mix and type of sale. Rentals and service margins decreased from 34% to 30% resulting from reduced rental revenue due to subsidiaries being sold.

Development, software and engineering expenses decreased by 25% for the six months ended October 31, 1985 as compared to the same period a year ago, as a result of heavy staff reductions within MDS Systems where development expenditures fell \$1,625,000 and savings realized at MDS Qantel from a reduced number of projects.

Marketing, general and administrative expenses included provisions for severance costs in connection with staff and office reductions, legal judgments and related legal fee accruals in 1984. After deleting the effect of these provisions, expenses still fell in the six month period ended October 31, 1985, resulting from staff reductions, lower discounts and commissions to dealers and salesmen due to lower revenue and the sale of subsidiaries.

Other expenses decreased for the six months ended October 31, 1985 as a result of smaller transaction losses with the Company's international operations. Bank debt decreased \$25,561,000 from April 30, 1985 reflecting repayments as a result of the sale of certain of the Company's subsidiaries. Despite such payments of bank debt, interest expense increased 3% for the six months ended October 31, 1985 due to higher average levels of outstanding borrowings during such period and the effect of the Company's interest rate exchange agreements. The Company has paid interest on its bank debt through September 30, 1985.

The Company expects its losses to continue for the balance of the fiscal year.

Liquidity and Capital Resources

The Company has been experiencing operating losses and cash flow difficulties but has been able to finance its operations through internally generated cash flow and the benefits derived from the sale of various divisions and subsidiaries and from continued cost cutting measures. The proceeds from the previous sales of various divisions and subsidiaries have been used to pay down bank debt and to finance the Company's operations. The Company expects to finance future operations through internally generated cash flow and the benefits derived from the proposed Sale, including the revenues to be derived under the Support Agreement, but there can be no assurance that it will be able to do so.

The Sale will reduce the Company's bank debt from \$107,943,000 on October 31, 1985 to approximately \$42,600,000 on the Closing Date. The MDS Debt Arrangements will have an eight-year term, require no principal amortization during the first three years, except for certain mandatory prepayments, with quarterly repayments thereafter, and (except as to the loan to Qantel Canada) provide for interest payment deferral during the first three years. Such interest deferrals will be added to the principal amount of the bank debt on a quarterly basis during the first three years. Under the MDS Debt Arrangements the Banks will continue to have a security interest in all of the Company's assets. The three year deferral of principal and interest payments will permit the Company to concentrate its internally generated cash flow on pursuing the marketing potential of the Qantel products for its future growth.

1985 Compared with 1984

Total revenues decreased 10%. Sales decreased 12%. MDS Systems' sales were off by 15% with the European marketing group showing the largest decline. Sales within MDS Qantel were off by 16% with the U.S. market showing the largest drop. Both MDS Systems and MDS Qantel were unfavorably affected by the publicity surrounding the Company's adverse financial condition and the uncertainties in the marketplace with respect to the Company's future due to proposed plans of restructuring through the sale of various business operations or possible liquidation. Rentals and service revenue decreased by 6%. The decrease is primarily composed of reduced rentals resulting from the sale of the Trivex lease portfolio which had generated approximately \$4,970,000 of revenue in fiscal 1984; and continued decline of rental revenue in MDS Systems which has generated new business through sales rather than rentals. MDS DEK's revenue also declined reflecting the sale of that division as of January 31, 1985. Maintenance revenue showed a 7% increase reflecting a combination of both new placements and price increases.

Cost of sales increased from 43% to 56% of revenue. This increase consists principally of increased provisions for inventory obsolescence and overstocking resulting from lower demand for the Company's products, unfavorable volume variances at all manufacturing locations, and year-end write-down of inventory as a result of decreases in the cost of certain inventory items.

Cost of rentals and service increased to 74% from 65% of rental and service revenue. This increase reflects decreasing rental revenue with a relatively fixed cost base, and write-downs of rental equipment due to lower demand for the Company's products.

Development, software and engineering expenses decreased by \$6,739,000 to \$28,369,000. The decrease primarily reflects the savings realized in the closing of the Los Gatos Laboratory. This category also includes the write-off of capitalized software associated with the discontinuation of certain Qantel product lines in fiscal 1985.

Marketing, general and administrative expenses increased by 8% over fiscal 1984. Marketing expense which includes distributor discounts, commissions and related expenses decreased 6% to \$124,341,000 which reflects both cost cutting and lower discounts and commissions due to reduced sales volume.

The general and administrative category includes the \$25,000,000 provision for restructuring discussed more fully in Note B of Notes to Consolidated Financial Statements; legal provisions primarily associated with settlement of a distributor suit against MDS Qantel and increased provisions for doubtful accounts. Excluding the effect of these items general and administrative expenses decreased over the prior year reflecting the effect of cost cutting in fiscal 1985.

Other expenses (net) represents increased transaction losses experienced from international subsidiaries particularly in South Africa and Australia.

Interest expense increased 57% reflecting increased levels of borrowing and increased interest rates being charged the Company by the Banks. Interest income decreased reflecting a reduced volume of long-term leases qualifying as sales type leases.

Estimated loss on disposition represents a provision for losses to be incurred or expected to be incurred upon the sale of certain operating units. The largest single component of this provision represents the realization of accumulated translation adjustments (applicable to international operating units expected to be sold) previously shown as a reduction of shareholders' equity on the consolidated balance sheet. For further discussion see Note B of Notes to Consolidated Financial Statements.

The provision for income taxes decreased 52%. The significant reduction reflects reduced profitability in international subsidiaries where the Company has in the past experienced high effective tax rates.

Funds used in operations were \$30,190,000 in 1985 compared to funds provided of \$17,917,000 in 1984. The decrease was primarily attributable to reduced profitability and was financed through increased bank borrowings.

Reference is made to Note M of Notes to Consolidated Financial Statements for information concerning the impact of inflation and changing prices on net sales and revenues.

1984 Compared with 1983

Total revenues increased by 11%. Sales increased by 17% primarily due to improved business computer sales by MDS Qantel, particularly in its various vertical markets. Sales of Series 21 and plug-compatible terminals were relatively flat. Rentals and service revenues increased by 2%. A strong gain in maintenance revenues of 10% was offset by declining rental revenue as a result of both continued sales of leases to independent financial institutions and the Company's marketing objective to generate a higher percentage of sales versus rentals. Identification product revenues declined by 4% due to the loss of a support contract and normal yearly renewal cycles.

Cost of sales increased from 40% to 43% of revenue primarily due to discounts granted to large volume customers and the adverse effect of the stronger U.S. dollar on international sales.

Cost of rentals and service increased to 65% of rentals and service revenue from 62% due to a reduced rental revenue base with a relatively fixed rental depreciation base, and a reduced volume within the identification product business.

Development, software and engineering expenses increased 23% as a result of increased software expenditures to develop the MDS Qantel vertical markets.

Marketing, general and administrative expenses increased to 42% of revenues from 36%. The increase within marketing is the result of larger sales volume through distributor and agency channels which receive higher commissions, the continued establishment of an in-house sales force at MDS Qantel, record advertising outlays for new product introductions and the establishment of a marketing group in Australia. General and administrative expenses increased 57% as a result of increased legal fees and settlement costs, particularly within MDS Qantel, increased provisions for uncollectible accounts, corporate advertising expenditures and start-up costs within MDS Australia.

Other expenses (net) increased as a result of foreign exchange losses relating to transactions with the international subsidiaries and lower earnings of the Company's Mexican affiliate.

Interest expense increased 8% as a result of an increased level of borrowing. Interest income decreased reflecting purchases of long-term receivables by the Company's finance subsidiaries. This reduction in interest income is offset by the equity in the net income of the finance subsidiaries.

Estimated loss on disposition primarily consists of provisions for the closing of MDS Trivex Division, the consolidation of advanced development activities and other matters. For further discussion see Note B of Notes to Consolidated Financial Statements.

The provision for income taxes increased 38%. The significant increases occurred in international subsidiaries where high effective tax rates prevail without benefit of offsetting tax credits, and in addition, provisions were made for potential tax audit adjustments and distribution of earnings previously intended to be permanently reinvested.

Funds provided from operations were \$17,917,000 in 1984 compared with \$72,412,000 in 1983. The decrease was primarily attributable to reduced profitability.

MOHAWK ACQUISITION CORPORATION AND SUBSIDIARIES
PRO FORMA CONDENSED CONSOLIDATED BALANCE SHEET

October 31, 1985
(Unaudited)

The following pro forma condensed consolidated balance sheet of MAC has been derived from the unaudited historical balance sheet of the Units, included elsewhere herein, as of October 31, 1985. The pro forma condensed consolidated balance sheet gives effect to the acquisition by MAC of the Units under the terms of the Purchase Agreement and the MAC Financing Arrangements, all of which are described elsewhere herein, as if the Sale had been consummated on October 31, 1985. The acquisition has been accounted for as a purchase. For purposes of the pro forma condensed consolidated balance sheet, the assumed difference between the Purchase Price and the Book Value of the Assets acquired and the liabilities assumed has been deducted principally from other long-term assets. The values assigned to the Assets acquired and the liabilities assumed and the related recorded amount of consideration given are subject to adjustment based principally upon an audit of the Assets and completion of a third-party appraisal of the Assets.

	<u>Units Historical</u>	<u>Pro Forma Adjustments</u> (In Thousands)	<u>Pro Forma Amounts</u>
ASSETS			
Cash	\$	\$ 10,000 (A)	\$ 10,000
Accounts receivable—net	24,330		24,330
Net investment in sales-type leases	596		596
Inventories	28,039		28,039
Rental equipment—net	39,286		
Property, plant and equipment—net	10,951	(14,956)(B)	38,794
Costs in excess of net assets of acquired companies	949		
Other assets	2,564		
Investments in and receivable from affiliates	9,599	(3,735)(C)	5,864(E)
Total assets	<u>\$116,314</u>	<u>\$ (8,691)</u>	<u>\$107,623</u>
LIABILITIES AND SHAREHOLDERS' EQUITY			
Bank debt	\$	\$ 76,790 (D)	\$ 76,790
Accounts payable	11,006		11,006
Salaries, wages and commissions accrued	2,109		2,109
Taxes other than income taxes	1,160		1,160
Other accrued expenses	7,984	(3,735)(C)	4,249
Mortgages and other debt	46		46
Deferred credits	2,138		2,138
Total liabilities	<u>24,443</u>	<u>73,055</u>	<u>97,498</u>
Redeemable preferred stock		9,000 (A)	9,000
Common stock		1,000 (A) }	1,125
Equity in the Units	91,871	125 (B) }	
Total shareholders' equity	<u>91,871</u>	<u>(91,871)(B)</u>	<u>10,125</u>
Total liabilities and shareholders' equity	<u>\$116,314</u>	<u>\$ (8,691)</u>	<u>\$107,623</u>

See accompanying notes.

- (A) To record equity contribution by MAC shareholders.
- (B) To report the preliminary allocation of the Purchase Price for the Assets and the liabilities assumed by MAC and the Subsidiaries and to record the issuance of the MAC Shares to the Company (\$125,000) and elimination of historical shareholders' equity of the Units.
- (C) To reclassify the Company's liabilities due MDS Credit against the related investment.
- (D) To record the MAC and Subsidiaries Bank debt (\$79,790,000 less \$3,000,000 of unamortized discount) for the Cash Purchase Price.
- (E) The investment in MDS Credit as of October 31, 1985 is summarized as follows:

	<u>(In Thousands)</u>
Assets	
Cash	\$ 33
Receivables, net	9,699
Investment in sales-type leases	<u>10,755</u>
Total	<u>20,487</u>
Liabilities	
Bank debt	14,500
Accrued expenses	<u>123</u>
Total	<u>14,623</u>
Net investment	<u>\$ 5,864</u>

MDS Credit has entered into a credit agreement subject to certain covenants with three of the Banks to finance its portfolio of long-term lease arrangements in the amount of \$14,500,000. Such loan is collateralized by a first security interest in all of the assets of MDS Credit, and is structured as a three-year revolver with a four year term option.

MOHAWK ACQUISITION CORPORATION AND SUBSIDIARIES

PRO FORMA CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

The following pro forma consolidated statements of operations of MAC have been derived from the unaudited historical statements of operations of the Units for the indicated periods. The pro forma consolidated statements of operations give effect to the acquisition by MAC of the Units under the terms of the Purchase Agreement and the MAC Financing Arrangements, all of which are described elsewhere herein, as if the Sale had been consummated on May 1, 1985 and May 1, 1984. The pro forma statements of operations are not necessarily indicative of the results that would actually have resulted if the Sale had been in effect for the periods indicated or that may result in the future.

<u>Six Months Ended October 31, 1985</u>	<u>Historical Results</u>	<u>Pro Forma Adjustments</u> (In Thousands)	<u>Pro Forma Amounts</u>
Revenues			
Net sales	\$34,222	\$	\$34,222
Rentals and service	37,037	_____	37,037
Total revenues	<u>71,259</u>	_____	<u>71,259</u>
Costs and expenses(A)			
Cost of sales	23,812		23,812
Cost of rentals and service	26,211	4,841 (B)	31,052
Development, software and engineering expenses	2,325		2,325
Marketing, general and administrative expenses	11,985		11,985
Other expenses, net	368		368
Total costs and expenses	<u>64,701</u>	<u>4,841</u>	<u>69,542</u>
Operating income (loss)	6,558	(4,841)	1,717
Interest income (expense)—net	155	(3,840)(C)	(3,685)
Equity in net income of finance subsidiary	809		809
Income (loss) before income taxes	7,522	(8,681)	(1,159)
Provision for income taxes	267		267
Net income (loss)	<u>\$ 7,255</u>	<u>\$(8,681)</u>	<u>\$(1,426)</u>

See accompanying notes.

MOHAWK ACQUISITION CORPORATION AND SUBSIDIARIES
PRO FORMA CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

<u>Year Ended April 30, 1985</u>	<u>Historical Results</u>	<u>Pro Forma Adjustments (In Thousands)</u>	<u>Pro Forma Amounts</u>
Revenues			
Net sales	\$ 77,012	\$	\$ 77,012
Rentals and service	70,859	_____	70,859
Total revenues	<u>147,871</u>	_____	<u>147,871</u>
Costs and expenses(A)			
Cost of sales	60,607	_____	60,607
Cost of rentals and service	55,352	9,550 (B)	64,902
Development, software and engineering expenses	5,549	_____	5,549
Marketing, general and administrative expenses	53,186	(7,752)(D)	45,434
Other expenses, net	3,648	_____	3,648
Total costs and expenses	<u>178,342</u>	<u>1,798</u>	<u>180,140</u>
Operating loss	(30,471)	(1,798)	(32,269)
Interest income (expense)	197	(7,679)(C)	(7,482)
Equity in net income of finance subsidiary	1,710	_____	1,710
Provision for estimated loss on disposition	14,956	_____	14,956
Loss before income taxes	(43,520)	(9,477)	(52,997)
Provision for income taxes	314	_____	314
Net loss	<u>\$ (43,834)</u>	<u>\$ (9,477)</u>	<u>\$ (53,311)</u>

- (A) Included in costs and expenses is approximately \$7,719,000 and \$17,098,000 of depreciation expense for the six months ended October 31, 1985 and the twelve months ended April 30, 1985.
- (B) To reflect service revenue fees and commissions payable to the Company and MDS Qantel for the year ended April 30, 1985 (\$9,550,000) and the six months ended October 31, 1985 (\$4,841,000) pursuant to the Support Agreement.
- (C) Adjustment for additional interest expense for the year ended April 30, 1985 (\$7,679,000) and six months ended October 31, 1985 (\$3,840,000) resulting from the borrowings by MAC of \$76,790,000 under the MAC Financing Arrangements, including amortization of discount, at an assumed interest rate of 9½%.
- (D) To eliminate cost and expenses provided in connection with the Company's closing of sales, administrative and other facilities, severance of terminated employees and sundry matters.
- (E) Net income per common share is not presented since MAC is not a public company.

MOHAWK ACQUISITION CORPORATION AND SUBSIDIARIES

PRO FORMA CAPITALIZATION

The following table and the related notes set forth the pro forma capitalization of MAC after giving effect to the financing of the proposed Sale, as if the Sale had been consummated on October 31, 1985.

	<u>(In Thousands)</u>
Long-term debt:	
MMC secured term loan(a)	\$15,000
MAC secured term loan(b)	<u>61,790</u>
Total long-term debt	76,790
Redeemable preferred stock(c)	9,000
Common stock(c)	125
Capital in excess of par value(c)	<u>1,000</u>
Total long-term debt and capital	<u>\$86,915</u>

- (a) MMC has obtained a \$18 million, eight-year, term loan commitment from the Banks. Borrowings would bear no interest for the first two years (capitalized interest aggregating approximately \$3,000,000 for such period will be included in the MDS Debt Arrangements), interest at 10% in the third year, and interest at the prime rate in the fourth through eighth years. No principal payments would be required in the first three years, with quarterly payments of \$250,000 beginning in the fourth year, monthly payments of \$166,667 in the fifth through eighth years, and a final payment due at the end of the term. The loan would be collateralized by certain receivables, inventory and property, plant and equipment having a pro forma carrying value of approximately \$15,000,000. In addition, the agreement provides for possible principal prepayment based upon the achievement of certain operating results, starting in the first year of the agreement. The amount shown above is stated net of \$3,000,000 of unamortized discount computed at an annual rate of 9½%.
- (b) MAC has arranged to borrow up to \$68 million under a term loan agreement with the Banks. Such loans would have aggregated \$61,790,000 on a pro forma basis. Borrowings under the agreement would bear interest at 10% for the first three years, at the prime rate plus ½% for the next two years, and at prime plus 1% for the next three years. No principal payments would be required in the first three years. Beginning in the fourth year, an amount equal to qualifying domestic receivables and inventory would convert to a revolving credit, with the remainder to be paid in 32 equal quarterly instalments, subject to possible principal prepayments based upon the achievement of certain operating results. Borrowings would be collateralized by assets having a pro forma carrying value of approximately \$93,000,000. In addition, MAC has made arrangements to refinance the bank debt of MDS Credit Corp. under a three-year revolving credit agreement which provides for interest at the prime rate. The revolving credit would convert to a four-year term loan at the end of the third year. Borrowings would be collateralized by the MDS Credit receivables and leases on equipment.
- (c) The authorized stock of MAC consists of 190,000 shares of redeemable nonconvertible preferred stock, par value \$1 per share, and 20,000,000 shares of common stock, par value \$.01 per share. The preferred stock would receive dividends at an annual rate of \$10 per share, as declared, on a cumulative basis. The preferred stock may be redeemed by MAC at any time at a redemption price of \$100 per share plus accrued and unpaid dividends. Unless sooner redeemed, the preferred stock is subject to mandatory redemption at a rate of \$750,000 quarterly, plus accrued and unpaid dividends, beginning on April 1, 1992. Upon any liquidation or dissolution of MAC, the holders of preferred stock are entitled to a liquidation distribution of \$100 per share, plus any accrued and unpaid dividends. JHW and WCAS IV have agreed to invest an additional \$10 million of capital in the event the Banks accelerate the loan.

BUSINESS AND PROPERTY OF THE COMPANY AND MDS QANTEL

General

The Company, a New York corporation organized in 1964, is engaged in the design, development, manufacture, marketing and maintenance of computer and communications systems and services. The Company's corporate headquarters are located at Seven Century Drive, Parsippany, New Jersey 07054, and its telephone number at such address is (201) 540-9080. MDS Qantel has its corporate headquarters in Hayward, California. All of the properties and product lines of MDS Qantel will be retained by the Company after the Sale, except one undeveloped parcel of real estate in Hayward. All of the other product lines and properties described below are being sold to MAC and the Subsidiaries as part of the Sale.

Hardware Products

The principal products of the Company are the MDS Systems Series 21[®] and Super 21[™] distributed data processing systems and MDS Hero[™] networked personal computer systems and the MDS Qantel[™] Systems 10, 20, 40 and 64 business computer systems.

MDS Systems Hardware Products

The Series 21 family of intelligent distributed processing systems serves as a multi-functional, multi-station processing system performing a wide variety of commercial office roles. The major components of Series 21 Systems include one to 16 operator stations, each with its own keyboard and video display screen, one to four diskette drives, memory capacity up to a half-million characters, and fixed or fixed-removable disk drives and other peripherals. In addition to the general purpose processor, the Series 21 architecture utilizes specialized parallel processors for execution of concurrent communications, input-output functions, display subsystem control, and index sequential file access.

In 1984 the Company introduced the MDS Hero networked personal computers and the Super 21 communications processors. The MDS Hero workstations provide individualized personal computing and permit the creation of intelligent workstation clusters in local area networks for office automation, while simultaneously providing access to mainframe computer programs and corporate and public data bases. The controller for a cluster of MDS Hero workstations can be either a specially configured MDS Hero or a Super 21 which can also support nonintelligent workstations. The Super 21 incorporates a wide variety of networking software which permits smooth integration of MDS Hero clusters into IBM 3270 networks. The MDS Hero can execute ten programs concurrently and can quickly switch between applications, as well as support multiple windowing within certain applications.

The compact MDS Hero workstations can be expanded in functionality and power through user installable memory cartridges and by snapping book size disk storage modules in place. The processor utilizes a 16-bit microprocessor with random access memory up to 1,024,000 bytes. Dual floppy disk drives and up to four hard disk drives can be added allowing a maximum hard disk storage capacity of 8 megabytes for a single MDS Hero workstation. The Super 21 permits shared resources for the MDS Hero workstations, permitting access to common disk files, printers and communications with mainframe computers and other terminal stations in the network. Most existing MDS Series 21's can be field upgraded to include MDS Hero networked personal computers.

The MDS distributed processing systems extend the benefits of computer automation beyond the mainframe environment by relocating specific processing functions to the source of data or point of use, avoiding the delay, error and expense associated with the centralization of data entry and data processing functions. Series 21, Super 21 and MDS Hero systems offer a simple way to connect dispersed business activities into a corporate information network, and function either independently or in conjunction with a central computer. The user of an MDS Systems product may perform data entry, data processing, batch and interactive communications, electronic mail and word processing on the same system.

In July 1984 the Company introduced the MDS 9000 Series clustered computer terminal systems, which are plug-to-plug compatible replacements for certain IBM terminal systems utilized for both data entry and as interactive terminals. The MDS 9000 Series offers both local and remote controllers which

support up to 32 devices. The customer may configure both controllers by means of customization software, permitting the units to be field changed from Bisynchronous to Systems Network Architecture ("SNA"). In addition, the controllers have Local Control Point software, a unique feature that permits access to, and monitoring of, the system from any display station. The MDS 9000 Series terminals offer high quality clarity and self-contained terminal power and logic boards.

A number of mature products in data entry and batch communications are still marketed and supported by MDS Systems. The System 2400 is a programmable system configured in a variety of specialized data processing applications including data entry, data communications and peripheral processing. A related product is the System 1200, a high-performance key-to-disk system allowing decentralized data entry for smaller operations.

MDS Qantel Hardware Products

The principal products of MDS Qantel are currently its Systems 10, 20, 40 and 64. The basic components of each of these systems typically consist of a central processor, internal memory, a data storage disk system, cathode ray tube ("CRT") video terminals and printers. These systems are multi-user, multi-terminal, interactive, disc-based, minicomputer systems which vary in processor architecture and speed, and which support various numbers of users and disc capacities. The System 10, designed to meet the needs of the first-time user, supports up to eight CRT terminals and four printers while the System 20, currently offered only in international markets, supports up to 16 CRT terminals. The System 40 is similar to the System 20, but includes a faster processor with up to one megabyte of main memory, 40 CRT terminals and six disk drives. The System 64 has up to four megabytes of main memory, 75 intelligent workstations and six disk drives. The System 264, the most powerful member of the Qantel family, is designed for high volume, fast access, on-line data processing requirements, supports up to 150 CRT terminals, and utilizes bipolar technology, bit-slice architecture and simultaneous fetch and compute operations. Each of the systems provides up to eight communications ports supporting most standard communications protocols.

Beginning in February 1986, MDS Qantel plans on introducing a new line of four computer systems, based on three different processors, one of which will be a new internally developed mid-range processor. These new systems will be re-packaged into smaller, more architecturally pleasing cabinetry, typical of today's competitive mini- and micro-computer systems. System 45, the smallest of the new systems, will be based on the processor currently used in today's middle-of-the-line System 40, thus substantially improving performance in the very competitive area of entry level systems. System 45 will support eight to ten active users, and disk capacities of over 400 million bytes. Systems 55 and 58 are designed around a new processor and are intended to fill the new mid-range product line position. Although Systems 55 and 58 both use the same processor, they support different peripheral capacities. Both systems will support over 20 active users, but System 58 is designed to support up to 16 million bytes of main system memory, and over two billion bytes of disk storage. As currently designed, System 55 will be limited to four million bytes of main system memory and about 400 million bytes of disk storage. System 78, which will be the high-end system in this new family, will use the same processor as the current System 264. System 78 is designed to support 40 to 50 active users, up to 16 million bytes of main system memory, and disk capacities exceeding two billion bytes.

All of these new systems can physically connect three or four times the number of users identified above, as well as up to 100 printers with speeds from 35 characters per second to 1,000 lines per minute. Each of the systems supports a choice of magnetic tape devices for disc back-up and has multiple communications channels supporting numerous standard communications devices and protocols. All of the systems described above, including the new systems, can be configured with BEST/NET™, a proprietary local area network which connects up to 16 Qantel computer systems, allowing the users on each system to share the data and certain peripheral devices of all of the other systems. In general, this new range of systems will cover the same performance and capacity ranges as the currently marketed systems, but will offer a substantially better price-performance ratio to the customer.

After the consummation of the Sale, the Company will retain its MDS Qantel engineering and manufacturing facilities in Hayward, California and Juncos, Puerto Rico. See "Description of Properties" on page 37. The principal manufacturing facilities in Hayward are currently producing at

approximately 30% of their total effective capacity. Qantel has relied solely on the Hayward and Juncos facilities for its manufacturing requirements, and the sale of the MDS Herkimer facilities will have no impact on its capabilities. The Company believes that it will have sufficient productive capacity and development facilities to meet the continuing expected demand for the MDS Qantel products.

Software Products

The Company develops and maintains several families of software products which allow the use of MDS Systems and MDS Qantel systems for a wide variety of tasks. Significant software enhancements are provided to customers on a periodic basis.

MDS Systems Software Products

General purpose software is provided on Series 21 and Super 21 systems to enable sophisticated customers who write their own application programs to tailor or customize their Company systems. Mohawk Business Oriented Language ("MOBOL"), Common Business Oriented Language ("COBOL") and BASIC are provided as general purpose software for Series 21 and Super 21. MOBOL is a high-level programming language which provides remote processing and user customization for specialized data entry and transaction processing. MDS COBOL complements MOBOL and facilitates batch processing, report editing and general data manipulation. BASIC 21™ is a Dartmouth BASIC high-level English programming language with data file storage and retrieval enhancements.

The MDS Hero processor employs the H/OS operating system which provides multi-partition, multi-tasking capabilities and allows a number of system activities to take place concurrently. In addition, the MDS Hero supports the popular MS-DOS Version 2 operating system which was designed by Microsoft Corporation for personal computers and permits the users to select from hundreds of application programs written for such computers. MDS Hero workstations also allow the users to execute application programs written in COBOL, BASIC, Pascal and Fortran. MDS Hero workstations attached to Super 21 processors have access to Super 21 applications through emulation of non-intelligent workstations.

The MDS Hero offers a comprehensive set of data management facilities that may be incorporated directly into the application system, including Index Sequential Access Method ("ISAM"), which permits efficient flexible random access to data identified by multiple keys. The MDS Hero also provides various sort/merge facilities. MDS Hero can operate Multiplan, a popular electronic spreadsheet developed by Microsoft Corporation, and business graphics which can be integrated with Multiplan to allow the user to put illustrations in financial reports.

MDS Systems products support communications protocols compatible with virtually every mainframe computer in common use worldwide. These protocol emulators include IBM SNA and the vendor-specific protocols of other major United States and European vendors. IBM 3270 protocol, whether in Bisynchronous, Synchronous Data Link Control, or SNA versions, is offered in an Intelligent 3270 mode that puts a user-written program in control of the communications line. This provides local processing in the remote location with on-line access to the mainframe as required.

MDS Systems software offerings have focused on automated solutions to office requirements including electronic spreadsheet, indexed filing and retrieval, report writer and source program generator, access to public data bases, enhanced word processing software and personal computing.

In 1983 the Company became the first supplier of multi-station systems to make a personal computing operating system available on a fully-integrated basis. The product, called Personal Computing 21™, provides the CP/M based operating system on Series 21 and Super 21. CP/M is a general-purpose control program designed for microcomputers by Digital Research, Inc. More than 3,000 pre-written software applications are available from various software vendors under this operating system. Personal Computing 21 gives Series 21 and Super 21 users the advantage of a personal computer without sacrificing the superior networking or shared resource processing, storage and printing capabilities of a full-function distributed processing system. Up to five different CP/M programs

on five operator stations may be executed concurrently. In addition to sharing disk files, a file transfer utility enables the transfer of information between CPM format and the Series 21 format.

In 1980 MDS Systems introduced an electronic mail service, called WINC® (for Worldwide Integrated Communications). WINC ties Company terminals and distributed processing equipment to message switching and network management facilities. The WINC service routes intra-company word processing and data processing as well as inter-company TWX and telex messages to locations in the United States and overseas. Users may prepare messages with the Series 21 word processing package, or appropriately configured non-Company systems, and deliver them automatically via the appropriate communications network to the receiving terminal. In 1983 a network communications center was opened in London, which reduces costs on international electronic mail and telex services. In the fourth quarter of fiscal 1985, the Company introduced the WINC Service on the MDS Hero.

MDS Qantel Software Products

All MDS Qantel systems utilize BEST/AOS™, a multi-user, interactive operating system which provides a user-friendly conversational interface to the system through interactive video workstations. Additionally, all MDS Qantel systems utilize QICBASIC®, which was developed specifically to provide maximum support for the programming of interactive, business-oriented applications. QICBASIC is similar in concept and command structure to Dartmouth BASIC, but has more sophisticated file handling and input/output capabilities. MDS Qantel also offers a low-intermediate level of COBOL.

MDS Qantel provides a variety of widely applicable support software products for its systems including QICLOOK™, a report generator which produces reports from any number of data files, and Automatic Program Generator which permits the automatic generation of customized programs. MDS Qantel also offers StarCalc Plus™ which was designed by Dynamic Data Systems, Inc. as a business planning and analytical tool for the merging of business data with planning and forecast data to enable the user to monitor business performance and objectives. MDS Qantel offers QIC-PC™ to interface IBM Personal Computers to MDS Qantel systems.

Since most businesses have similar general accounting requirements, MDS Qantel provides SOLUTIONS™, a comprehensive library of general applications software modules, including order processing, inventory analysis, sales analysis, accounts payable, purchase orders, general ledger and payroll.

MDS Qantel has developed a vertical marketing program by offering software packages that can handle the unique problems of specific industries. As an example, QMRP Plus™, Qantel's Manufacturing Resource Planning system, has received broad acceptance in its marketplace, providing both financial and manufacturing applications software for made-to-order or made-to-forecast manufacturers. QMRP Plus has become a leading, fully integrated management system for the entire company that includes modules for inventory control, bill of materials processing, manufacturing order processing, labor distribution and full financials. MDS Qantel also offers SPORTS-PAC™ for sports organizations, which is used by professional football, baseball, basketball and soccer teams, as well as for college athletic programs. Hospitality and Leisure System ("HAL™") delivers the essential software modules necessary to operate a hotel, including reservations, inventory, point-of-sales information, accounting, administration and marketing. TRANS-PAC® provides management information for transit authority systems.

In addition to vertical markets in which MDS Qantel participates directly with its own proprietary software packages, several other vertical markets are being addressed by Value Added Dealers ("VADs") who add their own proprietary software packages to MDS Qantel hardware systems. Currently the products offered by VADs address self-insurance risk management, retailers and food brokers. Moreover, MDS Qantel's dealers add applications software to the MDS Qantel equipment they sell in order to provide a complete computer system for their end users. Thus, the applications software offered by the dealers may be supplied by MDS Qantel or may be delivered by the dealer as its own proprietary software.

MDS Service

In 1981 the Company established MDS Service, which brings together the combined resources of the customer service organizations of the entire Company. MDS Service provides maintenance for all lines of equipment in the United States and coordinates service provided by the Company's foreign distributors.

MDS Service has implemented a number of programs to provide better customer service and improve profitability. The Service Call Management System ("SCMS") uses Series 21 systems to link service offices throughout the United States, collecting data on service response time, spare parts inventories, type of service calls and mean time to repair. This data permits a thorough analysis of the service business, reducing costs and improving efficiency. A National Dispatch System, staffed by MDS Service personnel, initiates responses to customer service requests on a 24 hour per day basis. Centrally located distribution centers in the United States maintain inventories of more than a million items for delivery within 24 hours to locations throughout the world. MDS Service meets specific customer requirements such as stationing customer engineers on-site and establishing a Service Support Center which utilizes remote diagnostics to speed repairs. To meet economic considerations of its customers, MDS Service has introduced new service plans including depot, deferred, flexible, and networked service. The offering of various plans permits the customers to choose the degree of service and response time best suited for them on a cost-performance basis.

In 1984 MDS Service entered the third-party maintenance business and is now the exclusive maintenance representative for several equipment manufacturers.

MDS Herkimer

In addition to manufacturing certain Series 21 and terminals products for MDS Systems, MDS Herkimer has also been engaged in subcontract manufacturing for other companies since 1980. Thus, the Company is able to use its extensive manufacturing facilities in Herkimer to offer engineering, assembly and manufacturing services and products on an OEM basis to non-affiliated companies.

Marketing

MDS Systems Marketing

MDS Systems products are marketed through offices located in the United States and Mexico and by independent distributors in many countries throughout the world. As part of the restructuring process commenced in November 1984, the Company has reduced the number of marketing offices in the United States in order to lower marketing expenses. In addition, in June 1985 the Company consummated the sale of its subsidiaries that marketed MDS Systems products in Canada, Switzerland and South Africa, and in October 1985 it sold its nine remaining subsidiaries in Western Europe. These former subsidiaries have continued to market MDS Systems products as distributors.

MDS Systems customers include large industrial corporations, banks and insurance companies, government subdivisions and agencies, and other sophisticated computer users. MDS Systems either sells its equipment or leases it for periods ranging up to five years under leases which provide for discounts varying with the type of equipment and the length of the lease term.

MDS Qantel Marketing

MDS Qantel's marketing efforts are primarily aimed toward the first-time user market, consisting of wholesale distributors, manufacturers, and certain other small businesses as well as divisions of large multinational corporations, although more recently MDS Qantel has increased its marketing efforts toward larger, more sophisticated users, particularly with respect to its larger systems. MDS Qantel markets its products domestically almost entirely through independent VADs and to a much lesser extent through its own sales force. Dealers purchase equipment from MDS Qantel for resale to end users, normally adding applications software either supplied by Qantel or proprietary to the dealer. During fiscal 1984 and the first half of fiscal 1985, MDS Qantel purchased the assets and customer bases of several of its distributors and integrated their operations with its own direct sales force. Qantel has recently decided to deemphasize its direct sales force and is in the process of selling its branch offices to

qualified buyers. MDS Qantel also markets its products through subsidiaries in Canada and Australia and to independent foreign distributors for resale in approximately 25 countries.

In July 1985 MDS Qantel entered into agreements with most of its distributors and sales agents pursuant to which the previously exclusive marketing rights of such persons have been converted to nonexclusive dealerships. As VADs the former distributors are now permitted to market non-Qantel products.

Backlog

Backlog as of October 31, 1985 and 1984 was approximately \$59,600,000 and \$111,000,000, respectively. Of such amounts, \$9,200,000 and \$12,000,000 represented backlog of MDS Qantel. Such figures represent the minimum aggregate future revenues to be realized from equipment installed under unexpired fixed-term lease and maintenance contracts and unshipped equipment on order for sale or lease. The decrease in backlog primarily reflects the elimination of backlog associated with the sale of certain subsidiaries and one division, as well as lower backlog for the remaining subsidiaries and divisions of the Company resulting from the unfavorable effect of the publicity surrounding the Company's adverse financial condition and the uncertainties in the marketplace with respect to the Company's future due to various proposed plans of restructuring. The Company cannot predict the actual time such equipment will remain on rent or the eventual profits therefrom, and due to the varying market arrangements with respect to such equipment, the above figures cannot be converted into annual revenues or net income. It is expected that substantially all unshipped equipment included in the October 31, 1985 backlog will be delivered during the next 12 months.

Competition

In the electronic data processing industry, competition is intense, technological advances are rapid and new hardware and software products are continually being introduced. Among the principal methods of competition, product performance and function are generally most significant; however, factors such as price, equipment service and the ability to offer the customer a wide variety and choice of hardware and software products also determine competitive position. The Company encounters active competition with respect to its entire line of equipment from several manufacturers of computers and communication systems, some of which are larger and have far greater resources than the Company.

In particular, MDS Systems competes with Wang Laboratories, Inc., Datapoint Corporation, NCR Corporation and Burroughs Corporation in the distributed processing field and with Telex Corp. and Memorex Corp., a subsidiary of Burroughs Corporation, in its Terminals Product Line. MDS Qantel competes primarily with Digital Equipment Corp., Wang Laboratories, Inc. and Hewlett-Packard Co. in the business systems marketplace. International Business Machines Corporation competes in all segments of the data processing market including all of those in which MDS Systems and MDS Qantel compete. In addition, now that Qantel's VADs are no longer exclusive dealers, Qantel is experiencing competition from other products being carried by its VADs, particularly from Wang Laboratories, Inc.

Historically MDS Service has had substantially no competition in its business of supplying maintenance services with respect to the Company's equipment; however, its pricing and quality of service must be competitive since the Company's customers consider such factors in determining which hardware products they will acquire. As MDS Service expands its third-party service business, it will encounter increased competition from other third party service suppliers. MDS Storms has been experiencing increased competition from other ribbon suppliers, particularly with respect to price. MDS Herkimer's third-party manufacturing business competes primarily by offering custom engineering and manufacturing services, but also competes with respect to price.

International Operations

Revenues from international operations amounted to \$115,072,000, \$134,691,000 and \$127,482,000 or 32%, 33% and 35% of total revenues during fiscal 1985, 1984 and 1983, respectively. Of such amounts, \$20,646,000, \$19,417,000 and \$14,031,000 or 18%, 14% and 11% of total revenues represented revenues from international operations of Qantel during such periods. Operating profit

(loss) from international operations, before general corporate expenses, interest and provision for taxes amounted to \$(4,374,000), \$3,475,000 and \$9,492,000, respectively, during such years. The translation of the various European currencies into a much stronger U.S. dollar adversely affected such revenues and profits. The Company attributed identifiable assets to its international operations of \$94,219,000, \$115,607,000 and \$116,821,000, respectively, during such years. The majority of such revenues, operating profits and assets were connected with operations in Western Europe and Canada which have since been sold. Between June and October 1985 the Company sold its marketing subsidiaries in Canada, South Africa and Western Europe which represented approximately 82% of the total revenues from international operations in fiscal 1985, 6% of the losses from such operations in such year, and 87% of the identifiable assets from such operations in such year. See Note B of Notes to Consolidated Financial Statements. The Company's international operations have been subject to the usual international business risks, including unsettled political conditions, currency fluctuations, exchange controls and import and export restrictions. Some of these risks will still be applicable as the former subsidiaries of the Company operate as independent distributors of the Company's products. Future international operations will consist of Qantel Canada, Qantel Australia and the Company's Mexican affiliate.

Capital Requirements

The Company requires substantial capital to finance its lease base, accounts receivable and investment in sales-type leases, as do other companies in the industry, since the costs of production and marketing are recovered over an extended period rather than immediately as in the case of outright sales. Development costs associated with new products also require additional capital. In 1982 the Company established MDS Credit, a United States finance subsidiary, to finance certain sales-type lease receivables. The substantial capital requirements have often resulted in the Company's experiencing negative cash flow which it has usually financed through bank borrowings and sales of lease receivables to MDS Credit. During the last year the Company has financed its negative cash flow through the sale of assets, subsidiaries and a division.

Research and Development

The Company's research efforts are directed primarily toward the design and development of new software programs and hardware products for the communications, distributed data processing and business computer markets and the enhancement of existing products. The Company expended \$28,369,000, \$35,108,000 and \$28,555,000 on research and development activities during fiscal 1985, 1984 and 1983, respectively, and \$10,395,000 and \$13,842,000 during the six months ended October 31, 1985 and 1984, respectively. Of such amounts, \$18,827,000, \$18,577,000 and \$11,012,000 represented research and development of MDS Qantel during fiscal 1985, 1984, and 1983, respectively, and \$8,231,000 and \$8,805,800 represented research and development of MDS Qantel during the six months ended October 31, 1985 and 1984, respectively. Substantially all of such activities were Company-sponsored and were expensed as incurred.

Environmental Matters

Compliance with Federal, state and local environmental regulations has not had and is not expected to have a material effect on the capital expenditures, earnings or competitive position of the Company or MDS Qantel.

Employees

At December 31, 1985, the Company employed approximately 2,300 persons, of whom 600 were employed by MDS Qantel and its subsidiaries.

Intellectual Property Rights

The Company holds numerous rights in intellectual property including copyrights, patents, trademarks and trade secrets. The Company believes that although its intellectual property rights are and will be of value, they will not be solely determinative of the Company's success, which depends

principally upon its manufacturing, engineering, marketing and service skills and the quality and economic value of its products. The Company also holds various licenses and has entered into licensing agreements with others covering certain products. In the event that products offered by the Company may be covered by intellectual property rights of others, the Company may consider it advisable to obtain additional licenses.

The Company considers its trademarks "MDS", "QANTEL" and several other trademarks that apply to its products and services to be of material importance.

Description of Properties

The Company has its corporate headquarters in Parsippany, New Jersey. MDS Qantel has its corporate headquarters and its principal manufacturing facilities in Hayward, California and additional manufacturing facilities in Juncos, Puerto Rico. In addition, the Company conducts administrative activities, manufacturing operations and applications and product engineering functions in two modern buildings owned by the Company, aggregating 315,000 square feet, located on 38 acres of land in Herkimer, New York which are part of the Assets being sold. Additional administrative and manufacturing facilities in the Herkimer area aggregating 260,000 square feet are also owned by the Company. All of the Herkimer facilities will be transferred to MMC as part of the proposed Sale.

MDS Qantel conducts its administrative, engineering and manufacturing activities in two modern leased buildings in Hayward, aggregating 156,000 square feet, and in a 46,000 square foot leased building in Juncos. MDS Service maintains spare parts and repair facilities in Hayward and Herkimer aggregating 138,000 square feet. The Company leases sales and service offices throughout the United States, each of which maintains a supply of spare parts and devices used by Company-trained field service engineers to install and maintain Company systems and equipment.

The Company has closed several facilities during the past two years, including certain manufacturing, product development and marketing facilities. The Company believes that its remaining facilities for Qantel and the Units, respectively, are well-suited for their intended purposes and that its continuing productive capacity and development facilities will be adequate to meet expected demand for their products and product development requirements.

Certain Litigation Concerning the Company

The Company and a former officer and director are defendants in a lawsuit commenced in May 1985 in the United States District Court for the District of New Jersey under the Securities Exchange Act of 1934. The suit, which claims to be brought on behalf of all persons who purchased shares of Common Stock in the period between June 21 and October 29, 1984, alleges that there were false or misleading statements in, or material omissions from, reports disseminated by the Company to its shareholders and the financial community during and prior to the above-mentioned period. The suit demands damages in an unspecified amount. Management of the Company believes that its financial statements and periodic reports disseminated to its shareholders and the financial community were properly prepared in accordance with existing law and that the Company has meritorious defenses available to it.

The Company is a party to a shareholder derivative action commenced against certain persons who were directors of the Company during the period covered by the complaint, including directors who were former officers of the Company, and against the Company's independent auditors. The suit was commenced in September 1985 in the New York State courts and alleges breach of fiduciary duty, mismanagement and waste of assets. The complaint requests the awarding of damages in favor of the Company in an unspecified amount with respect to the alleged actions. The complaint also requests the recovery on behalf of the Company with respect to any profits a former officer of the Company may have received upon the sale of Common Stock of the Company and the recovery of fees paid to the Company's independent auditors. Management is currently evaluating its position regarding this litigation.

In November 1985 an action was commenced in U.S. District Court for the Eastern District of California against the Company and one of its officers alleging, among other things, breach of contract.

fraud and negligent representation in connection with the sale by the Company of MDS DEK. The plaintiff seeks an unstated amount of actual damages and claims punitive damages in the amount of \$50 million against the Company and \$5 million against the officer. Management believes that the claims are totally without merit.

In January 1986 the former Chairman and President of the Company commenced an action in Massachusetts State Court against the Company seeking payment of benefits under an insurance agreement between the Company and said individual. The suit alleges that the Company terminated payment of severance arrangements to said person which action entitled him to certain rights under said agreement. The Company has moved to dismiss the action and, in the alternative, to stay the proceedings pending the outcome of the derivative action referred to above.

The United States income tax returns of the Company for the period 1969 through 1981 are presently under examination by the Internal Revenue Service. A number of issues have been raised by the Internal Revenue Service, the most significant of which are international in nature. At the request of the Company, the international issues are being dealt with under U.S. income tax treaties in a Competent Authority proceeding which involves both a review of the adjustments in question and negotiations with foreign Competent Authorities, several of which have been successfully negotiated. In addition, the Company's former international subsidiaries have various periods that are subject to review by the local taxing authorities. Although the ultimate outcome of these matters is presently indeterminable, management believes that such outcome, individually or in the aggregate, will not have a material adverse effect on the financial position of the Company.

The Company is a party to various other legal proceedings which arose in the ordinary conduct of its business. While some of them allege substantial claims against MDS Qantel and their eventual outcome cannot be predicted with certainty, in the opinion of management they will not have a material adverse effect on the business or financial position of the Company.

MANAGEMENT OF THE COMPANY

Common Stock Ownership of Management

The following sets forth the number of shares of the Common Stock beneficially owned by all directors of the Company and by directors and officers of the Company as a group.

Name of Beneficial Owner	Number of Shares of Common Stock Owned Beneficially as of December 31, 1985	Percent of Class
Thomas K. Christo	220,000(1)	1.4
Francis P. Lucier	150,200(2)	1.0
Matthew E. Tutino	1,500,000(3)	9.1
All Directors and Officers as a Group (7 Persons) ..	1,879,575(4)	11.1

- (1) Represents warrants to purchase 200,000 and 20,000 shares of Common Stock at prices of \$1.50 and \$10.375 per share, respectively, held by Mr. Christo.
- (2) Represents warrants to purchase 150,000 shares at \$1.50 per share and 200 shares for which Mr. Lucier has sole voting and investment power.
- (3) Such amount includes 1,000,000 shares of Common Stock issuable upon the exercise of stock options granted to Mr. Tutino, pursuant to a Special Incentive Compensation Program previously approved by shareholders at the 1985 Annual Meeting of Shareholders. Such amount also includes 500,000 restricted shares of Common Stock issued to Mr. Tutino pursuant to such Program, which are non-voting during the period of the restriction and which may be deemed to be beneficially owned by him upon lapsing of certain restrictions.
- (4) Represents, in addition to the shares referred to in notes 1, 2 and 3 above, 9,375 shares of Common Stock which may be acquired by all directors and officers as a group upon the exercise of currently exercisable stock options.

Compensation of Directors

During the past fiscal year, each non-employee director received \$14,000 per year for serving on the Company's Board of Directors and \$1,500 for serving on any Committee of the Board. Committee Chairmen received an additional \$3,000 for serving in such capacity. Each non-employee director currently receives \$1,000 per year for serving on the Board.

During the period from April 30, 1985 through January 31, 1986, the Company paid \$226,357 to Mr. Christo for legal and consulting services rendered to the Company and its subsidiaries.

Voting Rights and Principal Shareholders

As of the Record Date, the Company had outstanding 15,028,096 shares of Common Stock. No other class of capital stock is outstanding or authorized. The holders of Common Stock are entitled to one vote per share exercisable in person or by proxy at all meetings of shareholders. Unless otherwise indicated, all persons described in this Proxy Statement as owning shares of the Company are beneficial owners having sole voting and investment power.

As of the Record Date, the Company knows of no person who beneficially owned more than 5% of the Company's outstanding Common Stock other than a group of persons represented by Mr. Asher B. Edelman (the "Edelman Group"), who reported in a Form 3 Initial Statement filed by them with the Securities and Exchange Commission (the "Commission") that they beneficially owned as of October 1984 an aggregate of 1,206,200 shares, or approximately 8.0% of the currently outstanding shares. The following table sets forth certain information concerning the Edelman Group, all of which is based on the Form 3 filed by them.

<u>Name and Address of Beneficial Owner</u>	<u>Sole Voting Power</u>	<u>Shared Voting Power</u>	<u>Sole Dispositive Power</u>	<u>Shared Dispositive Power</u>	<u>Percent of Class</u>
Plaza Securities Company 717 Fifth Avenue New York, NY 10022	-0-	502,600	-0-	502,600	3.3
Arbitrage Securities Company 717 Fifth Avenue New York, NY 10022	-0-	158,400	-0-	158,400	1.1
Arrow Associates, L.P. 717 Fifth Avenue New York, NY 10022	-0-	517,600	-0-	517,600	3.4
Asher B. Edelman(1)(2) 717 Fifth Avenue New York, NY 10022	1,178,600	-0-	1,178,600	-0-	7.8
United Stockyards Corporation(3) 277 Park Avenue New York, NY 10017	27,600	-0-	27,600	-0-	0.2

- (1) The Edelman Group has reported that since Mr. Edelman is the controlling general partner of Plaza Securities Company ("Plaza"), the controlling general partner of the sole general partner of Arbitrage Securities Company ("Arbitrage"), and the sole general partner of Arrow Associates, L.P., he may be deemed to be the beneficial owner of the shares of Common Stock owned by those partnerships.
- (2) Mr. Edelman was elected as a Director and as Vice Chairman of the Company in October 1984. In March 1985, Mr. Edelman resigned from the Board of Directors of the Company. In April 1985, he also resigned as Vice Chairman of the Company.
- (3) A group of shareholders consisting of Mr. Edelman, Plaza, Arbitrage and a limited partnership of which Mr. Edelman is the sole general partner controls approximately 28.7% of the outstanding shares of United Stockyards Corporation ("United"), and Mr. Edelman is a member of the Board of Directors of United.

INDEPENDENT PUBLIC ACCOUNTANTS

The Consolidated Financial Statements as of April 30, 1985 and 1984 and for each of the three years in the period ended April 30, 1985 included in this Proxy Statement have been examined by Arthur Andersen & Co., independent public accountants, as indicated in their report dated July 18, 1985 and appearing on page F-2 with respect thereto, and are included herein in reliance upon the authority of such firm as experts in accounting and auditing. Reference is made to said report which is qualified with respect to uncertainties relating to the Company's ability to continue in existence and to uncertainties relating to the outcome of various legal actions, tax proceedings and other matters.

Arthur Andersen & Co. has served as the Company's auditors since 1972 and had previously audited its European operations since 1968. Representatives of Arthur Andersen & Co. are expected to attend the Special Meeting, will be given the opportunity to make a statement if they so desire and will be available to answer questions of the Shareholders.

ADDITIONAL INFORMATION

The Company is currently subject to the informational requirements of the Securities Exchange Act of 1934, and in accordance therewith files reports, proxy statements and other information with the Commission. Such reports, proxy statements and other information may be inspected at the public reference facilities maintained by the Commission at Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549 and should also be available for inspection and copying at the regional offices of the Commission located in Room 1102, Jacob K. Javits Federal Building, 26 Federal Plaza, New York, New York 10278; Room 1204, Everett McKinley Dirksen Building, 219 South Dearborn Street, Chicago, Illinois 60604; and Suite 500 East, 5757 Wilshire Boulevard, Los Angeles, California 90036. Copies of such material may also be obtained at prescribed rates by mail addressed to the Commission's Public Reference Section, Room 1024, Judiciary Plaza, 450 Fifth Street, N.W., Washington, D.C. 20549. Such material should also be available for inspection at the offices of the NYSE, 20 Broad Street, New York, New York 10005.

PROPOSALS OF SHAREHOLDERS

Proposals of Shareholders intended to be presented at the 1986 Annual Meeting of Shareholders of the Company must be received by the Company no later than May 27, 1986 for inclusion in the 1986 annual proxy statement and form of proxy.

OTHER MATTERS

The Board of Directors of the Company knows of no other matter to be presented which is a proper subject for action by the Shareholders at the Special Meeting. However, if any other matters should properly come before the Special Meeting, it is intended that proxies solicited hereby will be voted thereon and the person or persons holding such proxies will vote them in their discretion.

By the Order of the Board of Directors,

JOHN C. WALTERS
Secretary

March 11, 1986