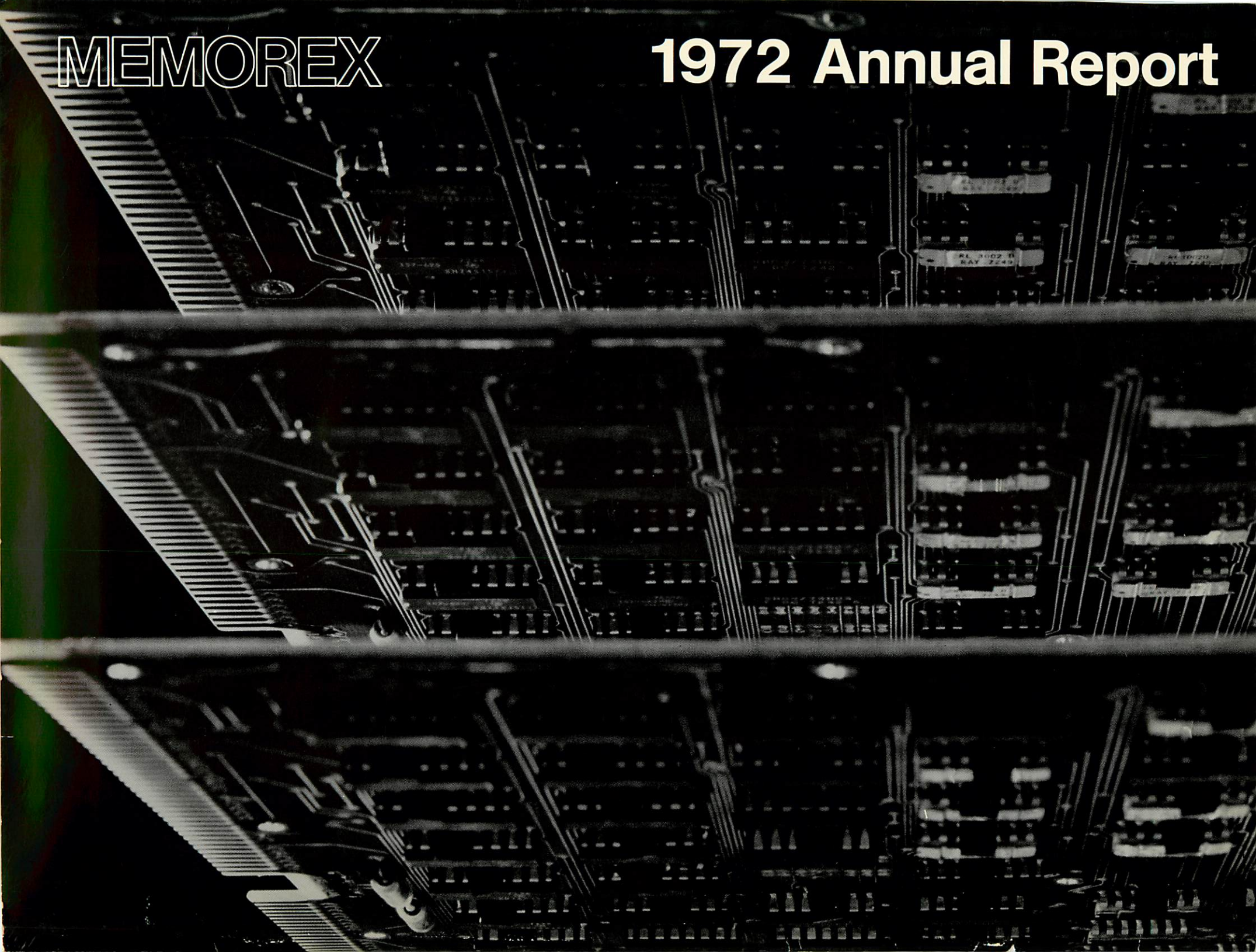
MEMOREX

1972 Annual Report



Memorex Corporation
1972 Annual Report

Contents

Shown on the cover are flexible disc interface printed circuit boards for the 3671 Controller of the Memorex 3670 Disc Storage System. Use of printed circuit boards, which eliminate manual wiring, and integrated circuits for logic and memory functions illustrates the "state of the art" technology incorporated into Memorex products. The benefits to Memorex customers are increased reliability, easier servicing, and lower cost.

Management

Laurence L. Spitters, *President*
J. Garrett Fitzgibbons, *Vice President, General Manager of Media Products*
John J. Kramer, *Vice President, General Manager of Equipment Marketing and International Operations*
E. Douglas Larson, *Vice President, General Manager of Equipment Operations*
John R. Eastling, *Vice President, Corporate Planning*
Harold J. Krauter, *Vice President, Finance*
Edward J. Phillippe, *Vice President, Controller*
Donald M. Campbell, *Treasurer*
Carl A. Anderson, *Secretary*

Vice Presidents:
Richard M. Bourgerie
William F. Emmons
Robert Jaunich II
John P. Kelly
William S. McCalmont
Hiroshi Nagakura
John A. Perri
Robert H. Smith
N. David Wheeler, *Vice President, MRX Engineering and Development Corporation*

Board of Directors

Laurence L. Spitters, *Chairman of the Board*
Alger Chaney, *Chairman of the Board, Medford Corporation*
Prentis C. Hale, *Chairman of the Executive Committee, Broadway-Hale Stores, Inc.*
T. Robert Sandberg, *Vice President (Retired), Cutter Laboratories, Inc.*
Benno C. Schmidt, *Managing Partner, J. H. Whitney & Co.*
Fred M. van Eck, *Partner, J. H. Whitney & Co.*
Dr. Theodore Vermeulen, *Chemical Engineer; Professor, University of California, Berkeley*
Dr. Alejandro Zaffaroni, *President, ALZA Corporation*

Memorex Corporation

Financial Highlights
for the years ended December 31, 1972 and 1971

	1972	1971
Net sales and revenues	$ 145,422,000	$ 110,201,000
Net income (loss)	1,193,000	(13,390,000)
Earnings (loss) per common share	.30	(3.43)
Depreciation and amortization charged to income	34,846,000	26,984,000
Net additions to property, plant and equipment	*†(10,599,000)	*20,885,000
Additions to equipment-for-lease to others	*46,247,000	72,460,000
Net increase in total capitalization employed	32,035,000	85,192,000
Total assets	316,479,000	318,129,000
Capitalization		
Unsubordinated notes payable		
Memorex Corporation and Subsidiaries	97,186,000	93,480,000
ILC Peripherals Leasing Corporation, after deducting compensating balances for 1971	85,440,000	76,128,000
Other shareholders' equity in ILC	—	4,946,000
	182,626,000	174,554,000
Subordinated capitalization		
Memorex Corporation 5¼% debentures	75,000,000	75,000,000
Shareholders' equity	32,219,000	25,956,000
	$ 107,219,000	$ 100,956,000
Number of employees at end of year	5,353	5,729

*Includes amounts classified as investment in Computer Systems Program.

†During 1972, Memorex consummated the sale and leaseback of its Santa Clara administration and equipment manufacturing facilities. Proceeds from this transaction approximated Memorex's net investment of $17,700,000 in these facilities, which proceeds represent a net increase in capitalization employed (see Note 5 of Notes to Financial Statements).

To Shareholders:

1972 was a year of major achievements in Memorex's corporate development. In growth of business, turnaround of financial results from loss to profit, and evolution of new product lines, the past year marked the turning point in our strategy to establish a significant position for Memorex in the data processing industry.

Total revenues in 1972 increased 32% to $145,422,000 from $110,201,000 in 1971. For the first year in corporate history, revenues from our leasing of computer equipment related products exceeded the volume of outright sales. Growth of rental and service revenues by over 71%, to $78,322,000 from $45,647,000 in 1971, reflects Memorex's increasing investment in computer equipment-for-lease. Net sales were slightly higher in 1972 than in 1971, $67,100,000 and $64,554,000, respectively.

Operating income during the year was $21,442,000, 15% of total revenues, compared to an operating loss in 1971 of $7,881,000. Interest expense of Memorex's large capitalization remained high, however, so that this turnaround in operating profitability resulted in net income of $1,193,000, or $0.30 per share. Of this amount, earnings per share in the fourth quarter of 1972 were $0.15. For the year 1971, the net loss was $13,390,000, or $3.43 per share.

Memorex retains its deferral accounting policy and, as a result of the 1972 year-end audit, there was no material write-off of amounts deferred ("intangibles"). The Company had a year-end investment in the Systems program aggregating $22,604,000 in deferred research and development, facilities, inventories, lease acquisition costs, and computer systems for lease. The opinion of the auditors relating to 1972's financial statements is subject to the realization of sufficient future revenues to recover this investment in the MRX/Computer Systems program.

The restoration of profit was Memorex's foremost objective in 1972, as noted in last year's annual report, yet other important objectives were also accomplished. They included the substantial growth of our equipment-for-lease business in the United States and in international markets (more than one-third of our equipment is leased overseas); the transition to new generation equipment products in Santa Clara manufacturing operations and in worldwide marketing; and the redirection of our magnetic media business to more profitable and growing market opportunities centered upon audio cassette and video tape products.

Expanded leasing activity in each quarter of 1972, while operating spending was under tight control, was the principal factor in the operating profit turnaround. Leasing revenues constituted over 92% of our $35 million revenue increase during the year. While revenues grew in 1972, gross operating expenses declined by $10 million. The amount of deferred operating spending was also reduced, as anticipated in last year's annual report and, significantly, the net deferred balance declined in the fourth quarter of 1972.

The rate of 1972 additions to the base of equipment-for-lease was lower than anticipated, in part because of slower-than-planned build-up in the manufacture of new products, and in part due to the curtailment of 3660 Disc File production. The decision to end 3660 production by mid-year 1972, plus excellent remarketing, resulted in the off-rent portion of the lease base being reduced to its practical minimum during the second half of the year. By ending 3660 production while demand for the product remains strong among both domestic and international customers, we have increased the expected revenue life of the substantial portion of our lease base represented by 3660's. Overall, the recovery of our sizeable investment in our equipment leasing business, including intangible assets, is dependent primarily upon the flow of lease revenues. In 1972, lease revenues increased over 71%, as noted above, an increase substantially greater than the increase in size of our leasing investment.

Revenue increases among media products were achieved by consumer audio cassette and video tape products; both are higher than average margin products whose market positions improved strongly during the year. Gains in audio and video revenues served to diversify the media business, and to offset a reduced level of domestic computer tape sales which continued unsatisfactory. International media products business in 1972 was a strong contributor to the improved corporate results, reflecting relatively better prices and margins, and Memorex's higher share of international media markets than those in the domestic market.

Two major product introductions in 1972 culminated several years of planning and development efforts. The first customer installations of both the advanced 3670 Disc Storage System and MRX/40 and 50 Computer Systems were accomplished on schedule in the fourth quarter. The MRX 3670 Disc Storage System is a superior performance alternative to the IBM 3330; the MRX/40 and 50 computers are superior performance alternatives to the IBM Model 360/20. Together, these excellent equipment products, which are compatible to the IBM equipment they are designed to replace, are the backbone of Memorex's strategy to build a major new corporate entry in the data processing industry.

Both products have received positive customers' response to their performance in initial installations. Their commercialization ends the deferral of research and development spending for these products, and, as a result, the total amount of intangible deferred expenses carried on our balance sheet was reduced in the fourth quarter of 1972, the first such reduction since inauguration of Memorex's equipment business in 1967.

The deferred research and development expenditures relating to the new equipment products commercialized in late 1972 amounted to approximately 55% of the total gross amount of R&D expenditures deferred in the period 1967 through

1972, and over 85% of the $23.1 million of intangible R&D assets not yet amortized as of December 31, 1972. The deferred R&D expenditures relating to products commercialized prior to 1972 were almost entirely amortized (approximately 90%) as of December 31, 1972.

Another milestone reached in 1972 was the acquisition of 100% voting control of ILC Peripherals Leasing Corporation and concurrent modification of ILC's $85 million loans. Benefits to Memorex include simplification of our financial reporting (consolidation of ILC with Memorex) and a considerable reduction in interest rates. (Details of the transaction are set forth in Footnotes 1 and 7 to the financial statements.) The result is a subsidiary with excellent financing and a very large lease base, comprised of most of our domestic equipment-for-lease, which is expected to be a major source of future cash flow. Its consolidation with Memorex places our Company among the 300 largest industrial companies in the United States measured by the amount of total assets.

In 1972, external financing programs (net loan take-downs by ILC, sale-and-leaseback of Santa Clara administration and equipment manufacturing facilities, and additions to senior credit) produced a net increase of about $30 million or 10% of our total capitalization. Similarly, in 1973 we expect a net increase of about $30 million from external financing. (Memorex's year-to-year net increases of external additions to total capitalization decreased substantially from 1970-71, due in part to the increase of cash flow from the enlarged base of equipment-for-lease.) Specific programs for 1973 external financing, including refinancing of existing senior credits, are not yet finalized. Such programs are expected to include approximately $15 million of additions to subordinated capital during the year and approximately $65 million of additions to, and rollovers of, existing senior debt.

In summary, 1972's principal operating objectives have been met: Memorex is again profitable; the 3670 Disc Storage System and MRX Computer System are in commercial production; a worldwide sales and service organization is operating efficiently; a large base of equipment-for-lease is generating rental revenues at a high level of on-rent status; and our media business has improved, especially in audio cassette and video tape products and in the new Mark X Disc Pack product.

In 1973, we enter the phase of our corporate development in which we anticipate substantial return on our prior investments. Our emphasis will be upon revenue growth to leverage Memorex's large scale investments in entrepreneurial and start-up operations of prior years. Our expectation is to achieve growth of earnings by reducing the ratio of fixed operating costs and interest expenses to revenues. External factors conducive to this growth, which were emergent in 1972, are a stronger domestic economy and a more stable environment in the computer industry.

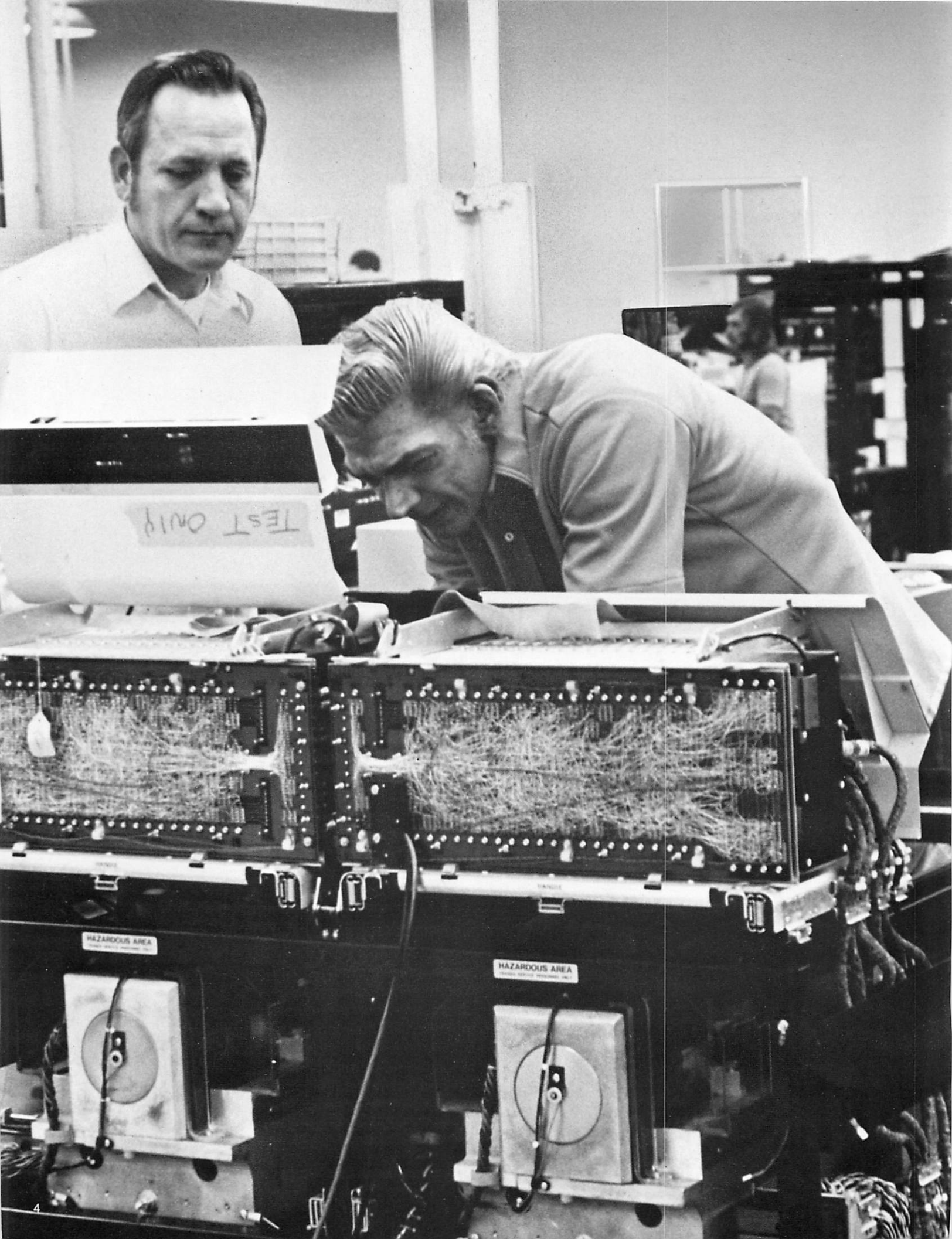
This phase of our corporate development is being pursued in a decentralized business organization adopted in early 1973. We have restructured our operations under three general managers: John J. Kramer, J. Garrett Fitzgibbons, and E. Douglas Larson, who have been principal operating executives at Memorex and who have strong backgrounds in the computer industry. This operating management team provides effective leadership to more than 5,300 worldwide Memorex employees, whose dedication and competency are responsible for the bright outlook of the Company's programs.

Sincerely,

Laurence L. Spitters

Laurence L. Spitters
President

March 5, 1973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Memorex Strategy and Corporate Development

Memorex's principal business is the manufacture of computer equipment-for-lease. This business encompasses about two-thirds of our capitalization, revenues, and employment. Our principal corporate opportunity lies in the exploitation of this investment. The economic characteristics of our leasing business are capital intensiveness, investment/disinvestment product cycles extending for periods of up to 10 years, and a premium upon skillful management of computer equipments through a series of non-payout lease contracts in a marketplace which experiences continual technological advance.

Memorex also has outright sales business of substantial size which involves predominantly magnetic media products. Changes in our volume of sales business are immediately reflected in current revenue and profit, in contrast to the leasing business' long-term profit effect. Thus, management of our sales business bears importantly on near term results. Our strategy in the media sales business has involved shifts from the domestic/industrial/computer tape market sectors (which have been impacted by severe price competition) to international/consumer/video markets which have strong growth character and afford relatively better profit margins.

In combination, Memorex's leasing business and outright sales business are mutually supporting. Our manufacture of equipment-for-lease, under "operating lease accounting", provides minimal impact on revenues and earnings during the year in which equipments are initially

Together with the MRX/40 and 50 computers, the Memorex 3670 Disc Storage System forms the backbone of Memorex's strategy to build a major new corporate entry into the data processing industry. In the photo at left, a 3670 Disc Drive undergoes final testing in the Santa Clara manufacturing facility. Note that the 3670 is directly attached for these tests to the MRX/50 in the background. This marks the first time a Memorex computer has been used to test Memorex peripheral equipment.

placed. However, future years' revenues and profits are benefited from these investments. Our outright sales business, on the other hand, impacts current revenue and profit. In combination, the two businesses provide the potential for satisfactory short-term results and the potential for steady, long-term growth. Moreover, outright sales during periods of strong selling absorb a greater proportion of current operating spending, which relieves the investment cost of equipment-for-lease in such periods. Conversely, the cumulative flow of rental revenues and expected profits from the lease base, which derive from previous investments, tends to be stable even in periods of diminished selling.

Strategic Criteria

Since our entry into the data processing equipment business, Memorex has followed a consistent strategy to establish itself as a major, permanent and profitable member of the industry.

Our attraction to this goal reflects the immense opportunity in the data processing market, which is perhaps the fastest-growing sector of the world's business, and the demonstrated profitability of manufacturing equipment-for-lease as exhibited by the computer industry's leading competitor.

The competitive difficulties of attaining a significant niche in the data processing market have eliminated all but a few extraordinary competitors. Our industry has been characterized as much by the

Memorex's reputation for product excellence stems in large part from the skill and dedication of the Company's employees. In the photo at left, a technician works on a 3670 Disc Drive in the final assembly stage at the Santa Clara manufacturing facility. Positive response to initial customer installations of the 3670 Disc Storage System in 1972 indicates that the system is meeting all specifications, providing improved systems performance resulting from increased reliability, availability and serviceability.

failures of large corporate entries as it has been by the success of a few dedicated firms. The strategic criteria which has differentiated the few successes, and which Memorex has used to shape its corporate developments, are as follows:

- provision of a large capitalization for investments in the development, manufacture, and marketing of equipment-for-lease on short-term (non-payout) leases.
- technical leadership in product development, which, when reflected in long-term rental revenues and low maintenance service costs of leases, is a primary determinant of long-term return on capital investment.
- large scale manufacturing, multiple product lines, and deployment of a worldwide sales and service organization, which provide economy of scale for cost efficiency and which have advantages of offsetting economic or product cycles.
- management's understanding of the market, products, and financial dynamics of the computer industry, and management's insights and commitment to the long-term results of a leasing business.

These factors relate directly to the computer customer's satisfaction, since the customer is rightfully concerned about his supplier's technical competence, service capability, and long-term responsiveness to the customer's needs. Perhaps in no other capital equipment industry is the supplier-customer relationship so cautiously developed or, once established, so valued, as is the case for computer mainframe, software and data communications products. Memorex has, in the past five years, made an auspicious start in satisfying the strategic criteria outlined above.

Equipment Business Evolution

The corporate development of Memorex's equipment business, as described at some length in prior annual reports (see especially the 1971 report), has been pursued in three phases. In brief, Phase I occurred in 1968-70, during which Memorex demonstrated its technical capability to produce high quality computer equipment in volume and at low cost. The primary products were disc storage drives, sold to other equipment suppliers for marketing within their product lines.

Phase II, 1970-72, saw Memorex establish itself as a supplier to end-users of plug-compatible equipment. Then the key effort was building a sales and service organization capable of effecting a fundamental change in the historical single vendor-customer relationship. The change occurred with the routine acceptance by customers of multiple suppliers for data processing equipment comprising an integral computer system. The MRX 3660 Disc Storage System and the MRX 1270 Transmission Control Unit are two very successful plug-compatible products, widely accepted by IBM 360 customers. Accomplishment of this objective in domestic and international markets has reduced Memorex's vulnerability to the risks of an OEM supplier, and considerably expanded the potential market for our products.

In Phase III, 1973 and beyond, Memorex is in the process of establishing a systems supplier relationship with end-users. Our objective is an involvement with our customers solving problems in computer applications, a natural extension of our plug-compatible supplier relationship. Success in Phase III will result in greater differentiation between Memorex's products and competitors', which should tend to offset the price competition in the plug-compatible peripherals marketplace. The introduction of the MRX/40 and 50 Computer Systems in 1972 is the initial thrust of this third phase.

The further implementation of Phase III corporate development centers around the major programs described below: lease base management, forward investment program, worldwide operations, new opportunities, research and development, and media products.

Lease Base Management

Memorex's gross investment in the leasing business over the past three years has exceeded $250 million. It has provided Memorex with a solid foundation for continued forward investment: 5 computer equipment product lines; 2 million square feet of plant, laboratory, and offices; more than 2,000 equipment leasing customers; and over 1,000 sales and service personnel devoted to equipment operations.

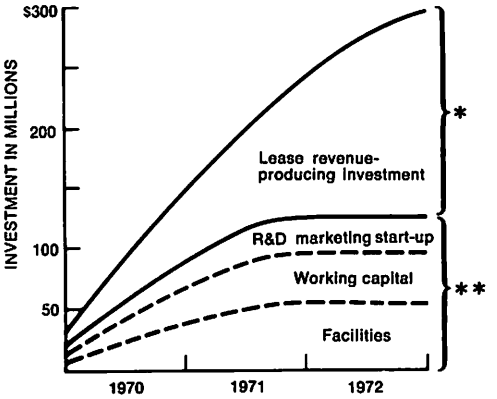
Over $100 million of Memorex's gross investment has been in one-time, long-term "enabling" assets, including $35 million in facilities devoted to development and production of equipment-for-lease, $20 million in working capital, $35 million in development of computer products, and $10 million in recruiting and training an international sales and service capability. This enabling but non-revenue producing investment has been a prerequisite to the manufacture and leasing of computer equipment—our going business operations which involve an even more substantial investment in the building of a rental revenue-producing and self-liquidating lease base. The large scale of Memorex's enabling investment will inevitably determine the Company's market share and the economics of its investment in the lease base.

Memorex essentially completed the enabling investment in 1971, thereby acquiring manufacturing and marketing capacity to sustain a program for additional annual capital investment up to $100 million (approximately 5% of industry's annual shipments) in new leased assets with excellent economic value. In consequence, in 1972 Memorex's investment was concentrated chiefly in additions to equipment-for-lease and, to a lesser extent, in development of next-generation products. At year-end 1972 over half of our cumulative

investment was in revenue-producing assets. This investment in equipment-for-lease is, of course, the investment of a manufacturer, not a third-party lessor. Memorex's economics reflect its own costs of product development, manufacture, lease acquisition, and installation; these costs are substantially less than costs incurred by third-party equipment lessors who purchase other manufacturers' products at full retail price.

The following chart is illustrative of the present situation: a relatively level amount of long-term enabling investment, and an increasing amount of investment in the revenue-producing and cash flow generating equipment-for-lease assets. Note that in 1970-71, the bulk of investment was for the start-up of the equipment business, such that in those years, lease revenue and total revenue were not indicative of the longer term financial result of our total leasing investment.

GROSS INVESTMENT IN MEMOREX'S LEASING BUSINESS, 1970-1972



* Investment includes costs of assets-for-lease and deferred costs related to commercialized products.

** Long-term enabling investment

Approximately four-fifths of our expected lease revenue in 1973 will come from managing Memorex's past investments in equipment-for-lease. To support this future revenue flow from the established lease base, Memorex will incur the costs of service, remarketing, and refurbishment. Together these costs amount to somewhat over one-third of the lease revenue received, the remainder being net cash flow available for investment in new additions to the lease base, for operations and for debt service. Our cumulative receipts to date of lease revenue exceed $140 million and represent less than one-fourth of the projected revenues from our existing investments in equipment-for-lease (evidenced by our depreciation reserves of about 25% of gross equipment-for-lease). We believe that, in light of this experience, the profitable recovery of our leasing investment is a reasonable expectation.

A leasing milestone will be reached in 1973 as Memorex experiences residual values for the first time. (Residuals are derived from lease revenue which continues beyond the depreciable life of an asset without the usual burden of depreciation expense.) 1973 residual revenue comes from disc packs placed in 1968-69 and fully depreciated in four years. Although the amount of residuals will not become material until 1975 and beyond, our disc pack experience is indicative of Memorex's conservative estimates of asset life.

In 1972, Memorex coped successfully with discontinuances of equipment on lease. It was the first significant year of equipment changeovers in the medium and large scale computer market segments from IBM 360 computer models to the recently introduced 370 models. The predominant equipment in our lease base is the 3660 Disc File System, and it is leased primarily into these computer market segments. With growing experience in lease base management as the year progressed, we were able to remarket discontinued units with a minor portion of our total marketing effort. Indeed, so successful was our remarketing activity that in the latter part of the year, an excellent on-rent status approached the practical maximum (approximately 95%) after allowing time for rehabilitation and relocation of re-leased units. In both domestic and international markets, several months backlog for the 3660 existed at year-end 1972 to utilize units as they are discontinued. No new 3660's are now being manufactured.

The key indices which were displayed in each of the 1972 quarterly reports and on Page 18 in this report show the results of Memorex's management of its leasing business. Lease revenue has increased at a faster rate than additions to the lease base. Cash flow has increased in proportion to lease revenue. The turn-over ratio of lease revenue to net assets has held steady above the 0.50 level which we identified as a satisfactory ratio in last year's report and which is indicative of prudent investment and prudent depreciation of equipment-for-lease. In the fourth quarter of 1972, tangible net worth increased, net equipment-for-lease increased and, for the first time since 1967, intangible assets did not increase.

In sum, 1972 was the proving year for Memorex's management of its leasing business. The results, we believe, were excellent, lending credence to the estimated revenue lives of the equipment, and reflecting the establishment of a sound control system for these assets.

Forward Investment Program

Memorex's capital investment in 1973-74 is projected to be at a level comparable to that of recent years, i.e., $75-$100 million per year. Unlike the earlier investment, about four-fifths of the 1973-74 investment will be used for new additions to equipment-for-lease. Forward capital resourcing will also change: in 1973-74 the majority of Memorex's capital requirements will, for the first time since the Company entered the computer equipment business, be provided by internal cash flow.

Reinvestment of Memorex's large cash flow in additions to equipment-for-lease is a cornerstone of our corporate strategy. In 1973, Memorex finds itself in an expanding economy and both of Memorex's major development programs (the

3670 and MRX Systems) are in manufacture and have been proved in initial customer installations. Expected revenue producing lives of the 3670 and MRX/40 and 50 are excellent because their introduction lies early in the life cycle of comparable IBM 370 products. Our reinvestment, therefore, is attracted by the projected rate of return, which is discussed at Page 11.

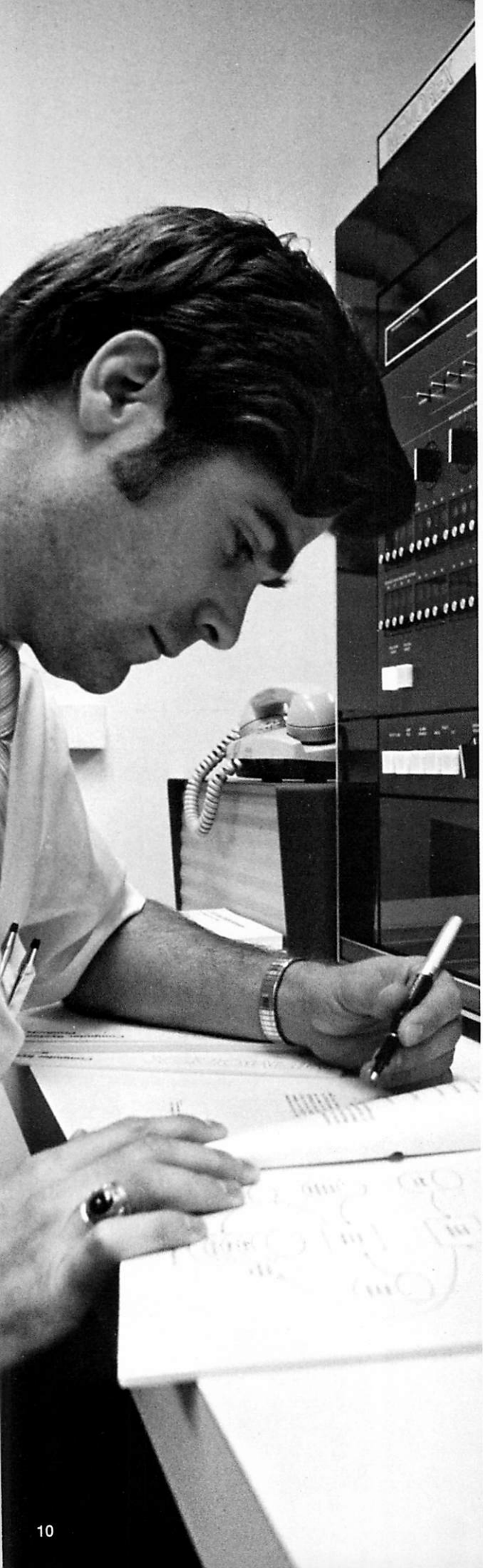
The projected 1973-74 investment in new equipment-for-lease will shift the predominance of our cumulative investments in Memorex's equipment business significantly towards *rental revenue-producing* assets. In this period, as in 1972, additions to plant and fixed assets and to working capital will be minor compared to prior years. (As discussed above, in 1969-71, more than $100 million was spent for enabling but non-revenue producing assets of our equipment business; this capital was provided principally by our 1970 issue of $75 million subordinated debentures.)

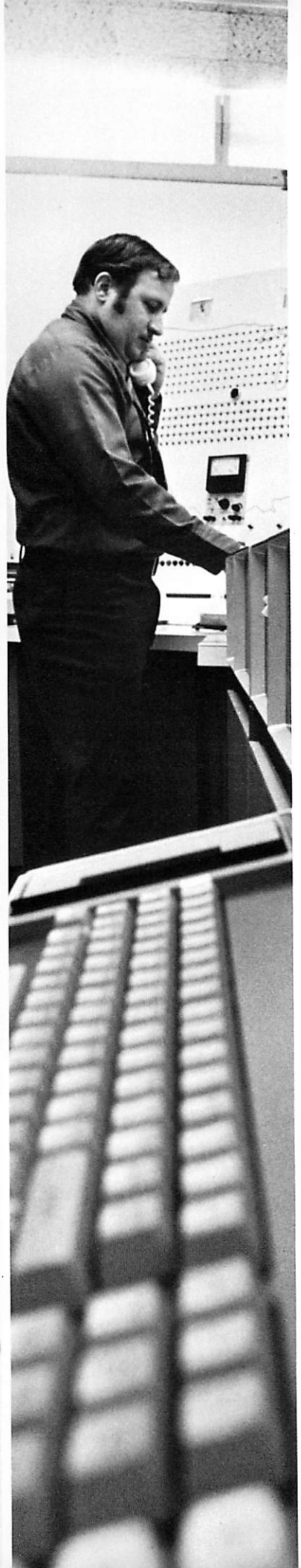
No net additional investment in deferred expenses is projected in 1973, and the $45 million balance of these "intangibles" at year-end 1972 is expected to be significantly reduced by year-end 1973.

No net additional investment in, and a reduction of, deferred expenses is projected because of the off-setting changes in the balances of the Deferred R&D and Deferred Lease Acquisition Cost accounts as determined by the additions of the deferred period costs less the greater amortization of the prior period deferred costs.

The advanced technology utilized in all Memorex products requires the most precise manufacturing techniques. In the photograph at left, griplets are installed in a printed circuit board for the 3671 Controller for the 3670 Disc Storage System.

Read/Write heads for the 3670 Disc Drive (right) are assembled at the Santa Clara manufacturing facility. The magnetic heads of the 3670 "fly" about 90 millionths of a inch above the disc surfaces to record and locate information stored magnetically on Mark X Disc Packs. A 10X microscope is used to allow the technician to assemble the tiny components of the head.





Financing Programs

The net increase in intangible assets in 1972 was approximately one-half the amount that intangibles increased in 1971, as anticipated in last year's annual report.

No increase in "intangibles" will occur, and their amortization will proceed in 1974 because Memorex has now completed most of the business diversification programs envisioned in our original equipment business strategy. As a result of the shift of investment in our equipment business to predominantly equipment-for-lease assets, at year-end 1973 we project that fully two-thirds of our cumulative investment will be revenue-producing, compared to less than one-half as recently as year-end 1971.

As stated above, the shift of investment has been paralleled by a changed pattern of capital resourcing. In 1970-71, almost all investment in the equipment business was provided by external capital sources. In 1972, about $0.49 of each $1.00 of capital investment in operations was provided by internal operating cash flow. (Internal cash flow amounted to $36.4 million, external and other sources

In the photograph at far left, a member of Memorex's software development staff checks the performance of programs on an MRX/50 computer. The initial shipments of Memorex computers in 1972 featured complete software support packages, including MRX/OS operating system, compilers for Cobol, Fortran and RPG II, assemblers, telecommunications support and diagnostic programs. All of these software packages at initial customer installations are performing well with few of the problems typical of advanced software systems.

Support for Memorex products once installed is a key factor in Memorex's reputation for excellence. The Memorex Remote Analysis Center (adjacent photograph) is a remote, computer-based diagnostic center available directly to Memorex customers. The RAC permits on-line analysis of terminal problems. A customer can telephone the center at any time and receive an automatic series of diagnostics.

including sale-and-30-year-leaseback of Santa Clara administration and equipment manufacturing facilities were $38.1 million.) In 1973, we expect that approximately two-thirds of our investment will be provided by internal cash flow. Our objective is to reach a fully self-financing equipment business in 1975.

Relative to the amounts of capital acquired in recent years from external sources, the amounts required in 1973-74 for additions to equipment-for-lease are expected to be small. Satisfying the required external financing should also be eased by the significantly improved bases for financing. In contrast to 1970-72, when their required external financing was equal to 24-36 times the monthly rentals of additions to equipment-for-lease, the projected 1973-74 financing should be equal to only 12-18 times the projected monthly rentals of equipment additions.

The 1973-74 external financing should be strengthened by the advanced technology of our products, their projected long revenue-producing lives, and the lower relative costs of maintaining the lease base as our population density of equipment increases. A shift in industry practice has caused a greater likelihood of securing two-year fixed term leases for the new products, such that the lease contract term (24 months) in many cases will exceed the required term of lease financing (12-18 months). Finally, the forward investment program and its financing requirements are grounded upon projected shipments from a large backlog for our new products.

Although Memorex's specific programs for securing external capital for 1973-74 are not yet finalized, pending this publication of audited 1972 results, our intention is to employ equity financing as well as lease financing and commercial bank credits. Lease financing and bank credits will undoubtedly be used to refund existing short term debt maturities, but we expect to limit the 1973 net increase of total debt to less than 10%. Memorex's objective will be to employ equity financing to improve its capitalization's ratio of equity-to-debt and to improve the ratio of equipment-for-lease rentals-to-debt.

Return on Investment Factors

Our leasing investment program is based upon the assumptions that: (a) Memorex is able to install computer equipment-for-lease whose gross cost of development, manufacture, lease acquisition, and installation approximates 20 times its initial monthly rental; (b) Memorex's marketing operations are predicated upon support expenses for computer equipment, including maintenance, continuation engineering, and remarketing, at approximately 35% of aggregate revenue generated by the equipment over an average revenue producing life of six years; and (c) Memorex's expectation regarding effects of competition and technological advance are that revenue erosion due to off-rent and price changes of the equipment over its life will approximate a rate not greater than 10% per year. The achievement of these investment objectives and assumptions will produce a return upon investment in equipment-for-lease of approximately 25% on a discounted cash flow basis. Thus, these factors are the specific criteria for Memorex's management of its equipment-for-lease business.

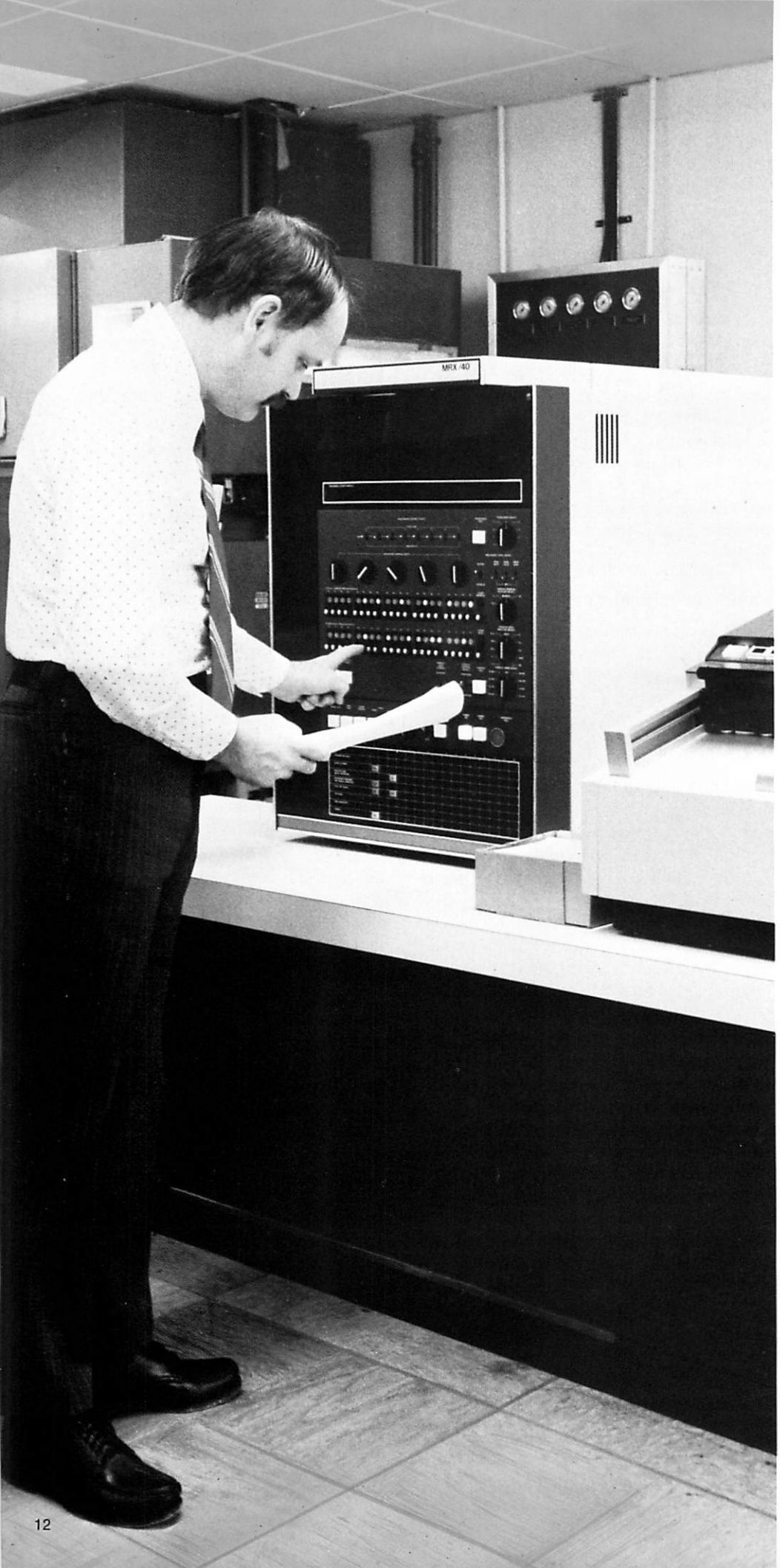
Our experience with the MRX 3660, currently representing 60% of Memorex's investment in equipment-for-lease, has met these criteria to date. Viewing the 3660 program in isolation from other leasing assets, Memorex's total 3660 investment is less than 20 times its monthly rental, support expenses are less than 35%, and revenue erosion has approximated 10% per year, all after adjustment for rental price changes in recent years experienced in this segment of the computer market.

These criteria are important to investment analysts and shareholders, as well as to Memorex management, because they provide a consistent and straightforward return-on-investment measurement for our leasing business, despite its complex mix of products, diverse geographical areas, and unfamiliar operating expense classifications. Indeed, without this measurement technique, the economic results of Memorex (or any other manufacturer of equipment-for-lease) could not be ascertained until the final phase of a 10-year investment/disinvestment period.

Worldwide Operations

Memorex obtained slightly over 40% of its 1972 total revenues and more than one-half of its total operating profits, from international markets. In common with successful firms in the computer industry, Memorex's international business dimension is vital to the economics of the Company's current and future operations.

In addition to the expansion of opportunity, which relates to worldwide marketing, other advantages derive from our strong position in Europe, Canada, Australia, Japan and Latin America. Lease base management benefits from the less established competition, longer product lives, and the potential for redeployment of assets from the United States. New investment in additions to equipment-for-lease is more economic because lower cost of investment is effected by larger production volumes resulting from a worldwide demand for Memorex equipment. Support expenses to leasing in Europe also benefit from greater concentration in a smaller geographic area. As they have to date, Memorex's future economics should continue to be advantaged by our strong international position.



New Opportunities

As a result of Memorex's long-term corporate policy of large investment in technology, our products have always enjoyed an excellent reputation for quality. Never before, however, have the Company's products been so well positioned in the technical forefront of their markets.

In the equipment business, Memorex's new products are available with advanced technology characterizing the next generation of data processing equipment. For example, in all of our equipment products, there is extensive use of low-cost, high-speed semiconductor memories, and no employment of technologically outdated magnetic core memory elements.

Illustrated in this report are 3670's attached to IBM 370 computers in the United States and Canada. Their performance in initial installations has met or exceeded all of the exacting specifications announced for this product. The 3670 Disc File, together with its competitors, is expected to constitute the basic data storage unit in computer systems for years to come. Recently, the evolution towards virtual storage in the computer industry places even more emphasis on this class of device, and expands the market potential for disc files considerably. Additional product enhancements and derivatives should flow from the basic technology embodied in the 3670 as broadened market demand and competitive developments warrant.

First customer installations of both the advanced 3670 Disc Storage System and MRX/40 and 50 computer systems were accomplished on schedule in the fourth quarter of 1972. The MRX 3670 Disc Storage System is a compatible and superior performance alternative to the IBM 3330; the MRX/40 and 50 computers are compatible and superior performance alternatives to IBM's System/360 Model 20. Both products have received positive customer response to their performance in initial installations. The photograph at left shows an MRX/50 at work in its first domestic customer installation, the Kroger Co., Cincinnati, Ohio.

Memorex's backlog for 3670's remains large; at year-end 1972, 3670 lease orders on hand called for deliveries of equipment-for-lease representing aggregate monthly rentals exceeding one million dollars. This high level of customer demand is a strong indication of the 3670's competitive standing as well as our customers' confidence in the outstanding reliability, availability and serviceability of its predecessor, the 3660.

The magnitude of market demand in the next five years for the 3670 product class is generally estimated at several billions of dollars. Given more orderly competition and a more stable industry environment apparent in 1973, our market penetration is expected to be limited only by our manufacturing capacity and our decisions to optimize the return on investment of both the 3670 and 3660. Thus, we will endeavor to execute the 3670 investment program at a rate designed to obtain the economies of full scale production, without either an overextension in market penetration or an adverse impact upon the 3660 lease base.

MRX computer systems operating in customer environments here and abroad are pictured in this report. Both hardware and software have performed exceptionally well in early installations. Conversion of IBM System/360 Model 20 programs in several locations has proceeded smoothly and economically. As the only computer systems manufacturer to offer 360/20 users a practical alternative in the under $10,000/month price class, Memorex has an excellent market position. This segment of computer market opportunity is large because 360/20's alone represent over $2 billion of aging installed equipment.

In the photo at right is the first domestic customer installation of a 3670 Disc Storage System at Reserve Life Insurance Co. of Dallas, Texas. All initial shipments of the 3670 and Memorex computers were to customers who already had significant installations of Memorex equipment.

We anticipate additional competition from other computer systems in this price class. Yet, the comparative evaluations of MRX/Computers which additional competitive announcements should invite among 360/20 users can also work to Memorex's advantage. Our initial market goals in 1973 are to demonstrate the ease of conversion to the MRX/Computers, and to demonstrate the increased performance available in the wide range of Memorex's operating software which is now being delivered to users. To this end, Memorex data centers have been established across the United States and in Europe. We are confident that comparative analysis of the capabilities of the MRX/ System with those of any other system in its class, will be most favorable to the MRX/40 and 50 equipment.

Research and Development Expenditures

Sizeable expenditures for research and development have characterized Memorex's business throughout its corporate history. Corporate policy for R&D spending is subsumed in our program of corporate diversification. The specific annual budgets for R&D reflect Memorex's commitment to satisfy our strategic criteria: multiple product lines in the computer equipment market and selected magnetic media markets; and concentration of R&D spending in advanced technology to obtain technical

The opportunity for marketing MRX/40 and 50 Computer Systems and the 3670 Disc Storage Systems is worldwide. Approximately 40% of the Company's revenues are currently derived from international markets, indicating a large base of satisfied equipment and media customers. As in the domestic marketplace, the first international installations of the MRX/Systems and 3670 were at customers who were already users of Memorex equipment. At left is the first international installation of a Memorex computer at Tecalemit in Paris. Tecalemit is a large French industrial company specializing in manufacturing for the aeronautical and automotive industries.

leadership in these products. The result of our R&D policy has been the parallel development of several product lines incorporating equipment, programming system, and media technologies, and which in 1972 yielded the 3670 Disc Storage System, MRX/40 and 50 Computer Systems, and Mark X Disc Packs. In 1972, R&D spending for all programs aggregated $17.5 million, a reduction of 15% from the peak level of spending for the several programs in 1971.

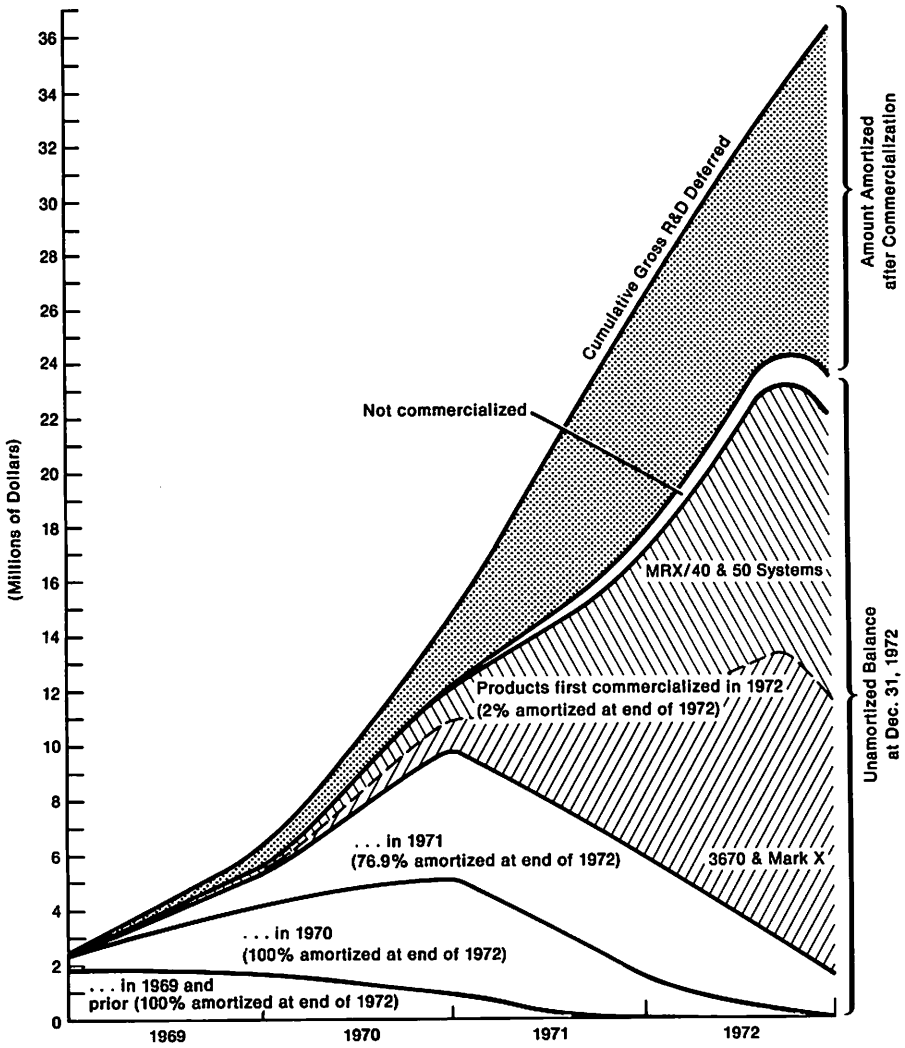
In 1972, and in prior years, R&D spending more closely related to the building of our future business than to current revenues. We have now reached the culmination of Memorex's principal diversification programs, and of the deferral phase of R&D spending. Beginning in 1973, the level of spending will correlate to the projected total revenues of the Company. Memorex's operating plan for 1973 has budgeted more than $12 million for continued development to exploit the many product enhancement opportunities and the revenue potential inherent in our commercialized product lines.

The advanced technology of Memorex products is the basis for the predicted long revenue life and recovery of the deferred development expenditures. The chart on Page 16 illustrates that new equipment products, introduced in late 1972, represent about 55% of the gross amount of R&D expenditures originally deferred, and over 85% of the intangible R&D assets not yet amortized on December 31, 1972. It is also evident that commercialization of those products

In the photo at right is the first installation of a 3670 in the international marketplace at Manufacturers Life Insurance Company in Toronto, Ontario, Canada.

Magnetic media products continue to play an important role in Memorex's corporate strategy. In the left photo, Memorex "Master Grade" video tape is previewed before shipment to a customer. Each reel of the new, premium quality video tape is 100% previewed before shipment, eliminating the need for preliminary viewing or testing by users with critical applications. In the photo at far right, Mark X Disc Packs are at the completion of the manufacturing process at the disc pack manufacturing facility in Santa Clara. The Mark X is Memorex's third generation disc pack with over one hundred million bytes capacity, providing high speed, interchangeable storage for the Memorex 3670 and IBM 3330 Disc Drives.

Record of gross deferred research and development expenditures (cumulative to year-end 1972) and unamortized balance including the MRX/40 and 50 systems.



The breakdown of the Unamortized Balance of Deferred R&D costs shown above divides the cumulative expenditures for R&D into amounts which are determined by the year of commercialization. In each of the four years 1969-1972 Memorex has commercialized significant additions to its product line, culminating in the MRX/40 and 50 and 3670 products first shipped in 1972. The successful commercialization of new products is denoted by the subsequent amortization of their related R&D deferred cost. Note that the amounts deferred for products first commercialized in 1969 and 1970 have been fully amortized by year-end 1972. The unamortized amount which relates to products first commercialized in 1971 is reduced to approximately $1.6 million; the amount which relates to products first commercialized in 1972 is approximately $20 million; and the amount for products yet to be commercialized is approximately $1.5 million. (First commercialization of products is deemed to occur when regular production units are first shipped to customers. The date of first commercializations marks the end of deferral of related research and development expenditures and the start of amortization of the amount previously deferred.)

introduced prior to 1972 has resulted in amortization of nearly all of their related R&D deferrals. The net deferred amount should decrease significantly in 1973 as amortizations of prior period costs exceed additional 1973 deferrals.

Media Products Business

Improving trends were experienced in Memorex's media products business in 1972, and excellent prospects were identified for the Company's consumer audio and video products and the new Mark X Disc Pack.

The single exception to the media business's general improvement was sales of computer tape in the domestic market which again was subject to intensive price competition. Fortunately, we were able to shift the media business increasingly to other markets and to other products. Currently the majority of computer tape revenue is obtained outside the domestic market at favorable prices. Disc pack sales and leasing continued satisfactorily in both domestic and international markets. Disc pack volume should materially benefit in 1973 from the first full year's shipments of the Mark X pack, designed for the MRX 3670 and IBM 3330 Disc Storage System. Progressive improvement in the media business should be facilitated by the realignment and reorganization of operations relating to all media products, which were accomplished in early 1973.

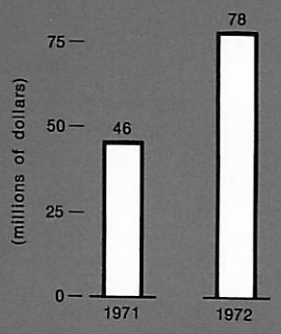
Consumer awareness and purchase levels for Memorex audio tape products burgeoned in 1972, as the Consumer Products line (pictured herein) obtained the second broadest base of distribution among all brand name competitors. Planned introduction in early 1973 of an improved MRX_2 audio cassette product should enhance our technical leadership and provide for further business gains in this fast growing consumer market.

Audio and video products both achieved planned objectives in 1972 and today

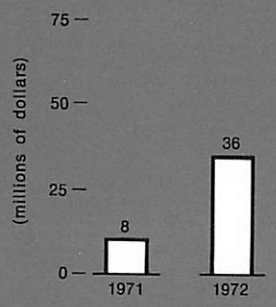

TR-722
CHROMA 90-MG

Memorex Corporation
Key Indices for Measurement of Performance

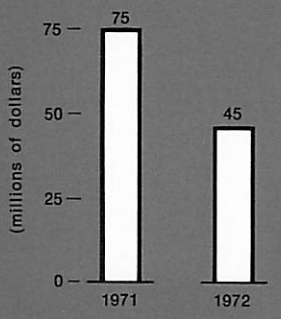
Consolidated and Combined Accounting Basis (Millions)



Lease Revenue

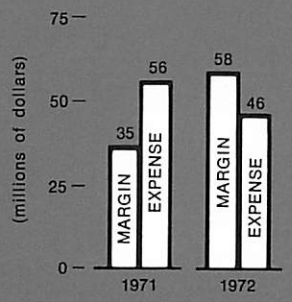


Cash Flow from Operations
(Net income plus non-cash charges to income)



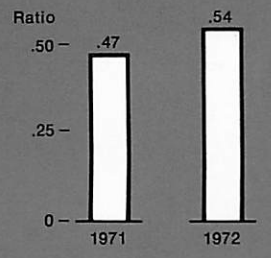
Additions to Investment in Equipment-for-Lease

("Investment" includes only manufacturing costs and does not include related deferred lease acquisition costs and deferred research and development costs.)



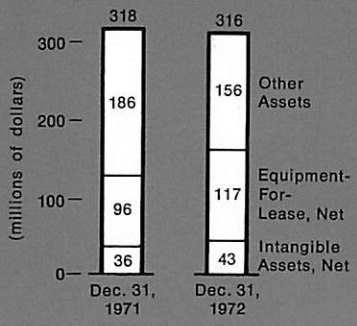
Gross Margin versus Gross Operating Expense

(Gross Operating Expense includes current marketing, development, and general/administrative expense before any amounts are deferred or amortized.)



Turnover Ratio: Annual Rentals to Net Investment in Assets-for-Lease

(Annual lease revenues, divided by average net assets-for-lease. Net assets-for-lease include equipment and disc packs for lease, and related deferred lease acquisition costs and deferred research and development costs.)



Intangible Assets as Related to Equipment-for-Lease and Total Assets

("Intangible Assets" includes only those pertaining to deferred spending of the Company's equipment business. "Other Assets" includes other intangibles which were $5 million at December 31, 1971 and at December 31, 1972.)

enjoy favorable product and market positions. The combined volume of these products in domestic markets during 1972 exceeded domestic computer tape volume. Our consumer cassette business is now well established, and profitable. Our broadcast and industrial video tape line has regained technical leadership in an exacting market.

Together, the audio/video tape operations have an outstanding future. Large scale commercialization of yet another mass market consumer product, video tape cassettes, is widely anticipated by consumer electronic manufacturers. Memorex, with its established brand name in the consumer marketplace and its video tape technology, has laid the groundwork for participation in this potentially very large market.

We believe that Memorex's business outlook in 1973 exceeds that of any recent year, reflecting the turning point we believe we have achieved in corporate development. Markets show a strong demand for our products. Operations are lean. Our organization is experienced and structured to pursue Memorex's diversified, multi-product business. We are confident that 1973 results will evidence the soundness of our long-term strategy and the wisdom of our investments in facilities, product development, equipment-for-lease base, and worldwide marketing and service capability.

The Consumer Products Division has established Memorex as the second leading brand of blank consumer audio tape by aggressive and forward-looking merchandising and advertising. Building upon the basic "Reproduction So True It Can Shatter Glass" theme by having jazz vocalist Ella Fitzgerald demonstrate Memorex tape's superior fidelity, Memorex carries the "Is It Ella or Is It Memorex?" selling story directly to consumers through extensive use of television commercials, consumer magazines and point-of-purchase advertising. The consumer audio tape is a higher margin product whose revenue gains have served to diversify the Company's media business.


MEMOREX
Price
Shattering
Sale
PLAYBOY
Is it Ella or
is it Memorex?

Memorex Corporation

Five Year Summary of Financial Highlights
for the years ended December 31
(Dollar amounts in thousands, except per common share amounts)

	1972	1971	1970	1969	1968
Rental and service revenues	$ 78,322	$ 45,647	$ 9,124	$ 3,953	$ 1,101
Net sales	67,100	64,554	69,873	70,114	51,860
	145,422	110,201	78,997	74,067	52,961
Net income (loss)	1,193	(13,390)	3,183	6,902	4,939
Earnings (loss) per common share	.30	(3.43)	.83	1.85	1.34
Depreciation and amortization charged to income	34,846	26,984	9,391	5,860	3,476
Net additions to property, plant and equipment	*†(10,599)	*20,885	37,201	11,901	8,363
Additions to equipment-for-lease to others	*46,247	72,460	37,901	7,441	4,236
Total assets	316,479	318,129	225,807	88,197	52,988
Capitalization					
Unsubordinated notes payable					
Memorex Corporation and Subsidiaries	97,186	93,480	41,958	32,684	15,139
ILC Peripherals Leasing Corporation, after deducting compensating balances for 1971 and 1970	85,440	76,128	17,288	—	—
	182,626	169,608	59,246	32,694	15,139
Subordinated capitalization					
Memorex Corporation 5¼% debentures	75,000	75,000	75,000	—	—
Shareholders' equity	32,219	25,956	39,117	35,074	27,295
	$107,219	$100,956	$114,117	$ 35,074	$ 27,295
Number of employees at end of year	5,353	5,729	6,191	3,409	1,916

*Includes amounts classified as investment in Computer Systems Program.

†During 1972, Memorex consummated the sale and leaseback of its Santa Clara administration and equipment manufacturing facilities. Proceeds from this transaction approximated Memorex's net investment of $17,700,000 in these facilities (see Note 5 of Notes to Financial Statements).

Memorex Corporation

Consolidated and Combined Statements of Income (Loss)
for the years ended December 31, 1972 and 1971
(Dollars in Thousands, Except Per Common Share Amounts)

	1972 (Note 1)	1971 (Note 1)
Net Sales and Revenues:		
Rental and service revenues	$ 78,322	$ 45,647
Net sales	67,100	64,554
	145,422	110,201
Operating Costs and Expenses:		
Cost of sales	39,674	45,675
Cost of rental and service revenues	47,758	29,244
Research and development expenses (Note 1)	2,006	5,096
Selling, general and administrative expenses	34,542	38,067
	123,980	118,082
Operating Income (Loss)	21,442	(7,881)
Interest expense	(19,951)	(16,271)
Other shareholders' equity in net (income) loss of ILC (Note 1)	454	(730)
Income (Loss) Before Income Taxes	1,945	(24,882)
Provision (Credit) for Income Taxes:		
Taxes payable (refundable) for the period	1,548	(3,964)
Deferred taxes	(796)	(7,528)
	752	(11,492)
Net Income (Loss)	$ 1,193	$ (13,390)
Earnings (Loss) Per Common Share (Note 12)	$ .30	$ (3.43)

The accompanying notes are an integral part of these statements.

Memorex Corporation

Consolidated and Combined Balance Sheets
December 31, 1972 and 1971
(Dollars in Thousands)

ASSETS (Notes 6 and 7)	1972 (Note 1)	1971 (Note 1)
Cash	$ 5,340	$ 8,649
U.S. Treasury Bills, at cost plus accrued interest	3,488	—
Accounts Receivable (less allowance for doubtful accounts of $1,804 and $1,393 respectively)	30,428	24,848
Inventories, at the lower of cost (first-in, first-out) or market (Note 3)*	44,710	46,754
Equipment-for-Lease to Others, at cost (Note 1):*		
Disc pack equipment	28,668	30,211
Computer peripheral equipment	133,911	89,717
Less accumulated depreciation	(45,650)	(23,519)
	116,929	96,409
Property, Plant and Equipment, at cost (Note 5)*	74,056	91,246
Less accumulated depreciation	(22,094)	(17,565)
	51,962	73,681
Investment in Computer Systems Program (Notes 1 and 2)	22,604	8,039
Deferred Lease Acquisition and Marketing Costs, including sales and service organization start-up expenses incurred prior to 1972, less amortization of $9,482 and $3,425 respectively (Note 1)*	19,787	20,099
Deferred Research and Development Costs (Note 4)*	12,623	11,809
Other Assets:		
Cash of subsidiary deposited as required by long-term loan agreement	—	13,590
Claims for refund of income taxes	—	5,573
Prepayments	3,702	3,582
Other assets and deferred charges	4,906	5,096
	8,608	27,841
	$ 316,479	$ 318,129

*Excludes amounts classified as Investment in Computer Systems Program (See Note 2).

The accompanying notes are an integral part of these balance sheets.

LIABILITIES AND SHAREHOLDERS' EQUITY	1972 (Note 1)	1971 (Note 1)
Accounts Payable and Accrued Liabilities	$ 22,791	$ 25,581
Unsubordinated Notes Payable:		
Memorex Corporation and Subsidiaries, excluding ILC (including $26,437 and $28,334 payable within one year, respectively) (Note 6)	97,186	93,480
ILC Peripherals Leasing Corporation (including $24,750 for 1972 payable within one year) (Note 7)	85,440	89,718
Federal, State and Foreign Income Taxes (including $1,872 and $578 payable within one year respectively) (Note 9)	3,843	3,448

Commitments and Contingent Liabilities (Note 8)

Subordinated Debentures, Memorex Corporation — 5¼% convertible due 1990 (Note 6)	75,000	75,000
Other Shareholders' Equity in ILC (Note 1)	—	4,946
Shareholders' Equity (Notes 6, 7, 10 & 11):		
Common stock	4,305	3,922
Paid-in surplus	16,729	12,042
Retained earnings	11,185	9,992
	32,219	25,956
	$ 316,479	$ 318,129

Memorex Corporation

Consolidated and Combined Statements of Changes in Financial Position
for the years ended December 31, 1972 and 1971
(Dollars in Thousands)

	1972 (Note 1)	1971 (Note 1)
Source of Cash		
Net income (loss)	$ 1,193	$ (13,390)
Depreciation and amortization charged to income	34,846	26,984
Increase (decrease) in Federal, state and foreign income taxes	395	(5,311)
Cash Obtained from Operations	36,434	8,283
Decrease in inventories	2,044	991
Depreciation and amortization capitalized	6,774	6,924
Disposition of land and buildings — net book value	19,751	—
Decrease in cash of ILC deposited as required by long-term loan agreement	13,590	750
(Increase) decrease in claims for refund of income taxes	5,573	(3,421)
Proceeds from issuance of notes payable	66,014	121,669
Proceeds from issuance of common stock	83	229
Valuation of conditional warrants resulting from restructuring of ILC debt	187	—
Issuance of common stock to acquire other shareholders' equity in ILC (Note 1)		
Valuation of shares issued	4,800	—
Other shareholders' equity acquired	(4,492)	—
	150,758	135,425
Use of Cash		
Increase in U.S. Treasury Bills	3,488	—
Increase in accounts receivable	5,580	2,905
Increase in equipment-for-lease to others	42,651	72,460
Increase in investment in computer systems program	14,565	6,781
Deferred lease acquisition and marketing costs	5,745	12,916
Additions to property, plant and equipment	6,309	18,895
Deferred research and development costs	5,214	5,893
Increase in prepayments and other assets	685	1,569
(Increase) decrease in accounts payable and accrued liabilities	2,790	(30)
Payments of notes payable	66,586	12,057
(Increase) decrease in other shareholders' equity in ILC	454	(1,152)
	154,067	132,294
Increase (Decrease) in Cash	$ (3,309)	$ 3,131

The accompanying notes are an integral part of these statements.

Memorex Corporation

Consolidated and Combined Statements of Shareholders' Equity
for the years ended December 31, 1972 and 1971
(Dollars in Thousands)

	Total Shareholders' Equity	Common Stock	Paid-in Surplus	Retained Earnings
Balance December 31, 1970	$ 39,117	$ 3,870	$ 11,865	$ 23,382
Net (loss)	(13,390)	—	—	(13,390)
Sale of common stock to employees under stock option plan of 1965	224	19	205	—
Shares issued under various agreements with subsidiaries	5	33	(28)	—
Balance December 31, 1971	25,956	3,922	12,042	9,992
Net income	1,193	—	—	1,193
Sale of common stock to employees under stock option plan of 1965	11	11	—	—
Acquisition of minority interests in subsidiary companies	72	72	—	—
Acquisition of other shareholders' equity in ILC (Note 1)	4,800	300	4,500	—
Valuation of conditional warrants issued upon restructuring of ILC debt (Note 7)	187	—	187	—
Balance December 31, 1972	$ 32,219	$ 4,305	$ 16,729	$ 11,185

The accompanying notes are an integral part of these statements.

1. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the financial statements of Memorex Corporation and its majority-owned subsidiaries after elimination of intercompany accounts and transactions. The minority stockholders' equity in subsidiaries is not material and is included in other liabilities.

On November 9, 1972, Memorex acquired all of the outstanding voting stock of ILC Peripherals Leasing Corporation (ILC), a leasing company incorporated on June 29, 1970 in which Memorex held a 10% voting interest, in exchange for 300,000 shares of Memorex common stock (as part of the simultaneous restructuring of ILC's debt (see Note 7) additional Memorex shares are potentially issuable). This acquisition has been accounted for as a purchase and therefore the accounts of ILC have been included in the consolidated financial statements since the date of acquisition. The purchase price ($4,800,000) exceeded the net assets acquired by $308,000. This amount has been allocated to equipment-for-lease and is being depreciated over four years.

All statements of operations prior to the acquisition date continue to be reported on a combined basis after elimination of intercorporate accounts in accordance with usual principles of consolidation. This combined financial statement presentation of Memorex and ILC was used to reflect the interrelationship between the operations of Memorex and ILC.

If proforma effect were given to this purchase as of December 31, 1970, the results of operations for 1971 and 1972 would be affected by the elimination of other shareholders' equity in ILC income (loss) of $730,000 in 1971 and ($454,000) in 1972 and by reduced interest expense as a result of the debt refinancing related to this acquisition. The net effect would be to increase earnings on a proforma basis.

Statement Presentation

Leasing activities have now become the majority of the Company's operations. Under the operating method, lease receivables are not recorded until earned and no recognition is given to the ensuing months under contract. However, related financing obligations are recorded in full. Therefore, the Company believes that it is no longer of significance to segregate its assets and liabilities into current and non-current classifications. Accordingly, the financial statements are presented in a format used by companies whose activities are predominantly leasing equipment to others and the previously reported 1971 financial statements have been reclassified to conform with the 1972 presentation.

International Operations

The financial statements of foreign operations have been translated into U.S. dollars at exchange rates in effect as of year-end for monetary assets and liabilities; historical exchange rates for non-monetary assets and liabilities; and average exchange rates during the year for income accounts, except depreciation and amortization which have been translated at appropriate historical rates. The resultant translation credit is not material and is included in net income for the year.

In February 1973, when the U.S. dollar was devalued, Memorex had significant long-term borrowings payable in non-U.S. dollar currencies. The resultant increase (approximately $2,700,000) in long-term borrowings expressed in U.S. dollars will be allocated in 1973 to inventories, equipment-for-lease, and fixed assets.

Net sales and revenues from International Operations included in the Consolidated and Combined Statements of Income (Loss) were approximately $59 million for 1972 and $41 million in 1971.

Property, Plant and Equipment

Capital additions, improvements and major renewals or

betterments are classified as property, plant and equipment. Maintenance, repairs and minor renewals are charged to expense as incurred. The net gain or loss on disposition of property is credited or charged to income and the asset cost and accumulated depreciation are removed from the accounts. Depreciation, for financial reporting purposes, is computed using the straight-line method based upon the following estimated useful lives:

Buildings and improvements	15-33 years
Equipment, furniture and fixtures	3-10 years

Equipment-for-Lease to Others

Memorex and subsidiaries, including ILC, sell or lease computer equipment and disc pack equipment to customers. Lease agreements are for periods of up to five years and a portion of the rentals earned may be applied (under purchase options) by customers for purchase of the equipment.

Equipment leased to customers is accounted for on the operating method with lease revenue recorded as earned. Equipment leased is capitalized at cost, including initial installation costs of computer equipment. Such costs are depreciated on a straight-line basis for certain products (including 3660 disc file subsystems on a 4-year estimated life, after allowing for an estimated residual value of 20% of original cost) and on an accelerated basis for other products over the estimated useful lives of the equipments, which varies between 4 and 7 years. The Company establishes depreciation policies relative to useful lives for each product based upon its best estimates. These policies are reviewed periodically (not less than annually) to determine that, in management's opinion, the established estimated useful lives continue to be reasonable.

Initial lease acquisition costs are deferred and amortized on a straight-line basis over 4 years. Subsequent costs of re-leasing and of reinstalling equipment are expensed as incurred.

Should a customer exercise his option to purchase the equipment, the equipment cost and accumulated depreciation are removed from the accounts. The proceeds received are recorded as sales, and the net book value (cost less accumulated depreciation) of the equipment is charged to cost of sales.

Research and Development

Research and development costs related to major new product developments are deferred. When commercial production commences, costs are no longer deferred and amortization begins.

It is Memorex's policy to amortize these costs over a period which does not exceed the expected production life of the products. Memorex presently amortizes such costs based upon expected product shipments over approximately three years from the time commercial production begins. Costs amortized are: (1) charged to expense if the product shipped is sold, or, (2) capitalized as equipment-for-lease to others if the product shipped is leased to customers.

Should it be determined in any period that any deferred costs cannot be recovered from future revenues, they will be written off against operations for that period. Costs amortized in 1971 include $2,370,000 of such write-offs.

Income Taxes

Deferred income taxes are provided to recognize timing differences in reporting certain income and expenses in tax returns from those reported for financial purposes. The significant net timing differences result from (1) depreciating on the accelerated method for tax purposes and the straight-line method for financial purposes, (2) expensing research and development costs and certain deferred lease acquisition costs for tax purposes and deferring the costs for financial purposes and (3) using a different method for tax purposes of reporting profits on billings to ILC.

2. Investment in Computer Systems Program

In October 1970, the Company commenced research and development of computer systems hardware and software products. Initial products were publicly announced as MRX/40 and 50 Computer Systems in March 1972. First customer shipment of an MRX/Computer System with related software products occurred in September of 1972 as planned.

The Company's diversification in MRX/Computer Systems products is still in its start-up phase of manufacturing and marketing. Initial systems products have been installed and are operating in customer locations. The number of installations to date and rental revenues from installed systems are not yet significant. The number of orders received to date is not yet significant relative to the total quantity of shipments anticipated over the life of the program and reflects the present start-up phase of manufacturing and marketing. All production of MRX/Computer Systems products scheduled for shipment through June 1973 is covered by orders in the backlog as of March 1, 1973. During 1973, the Company's systems program will require continuing development efforts at an annual rate consistent with 1972, and a substantial number of systems must be maintained on lease or sold for the Company to recover the cost of its investment in this program.

The Company's investment in all assets related to the MRX/Computer Systems program, as of December 31, 1972, and December 31, 1971, was as follows:

	December 31	
	1972	1971
	(Dollars in Thousands)	
Inventories and Equipment-for-Lease to Others	$ 7,562	$ 210
Fixed Assets and Manufacturing Line Design and Start-up Costs	2,843	1,990
Deferred Research and Development Costs	10,523	5,839
Deferred Lease Acquisition Costs	1,676	—
Total Investment	$ 22,604	$ 8,039

The Company believes that initial installations of the MRX/Computer Systems products have demonstrated the competitive quality of both hardware and software products, and that ease and economy of converting customers from competitive computer systems to MRX/Computer Systems products have been demonstrated. Continuing development of hardware and software products, a number of which are planned for delivery to customers in 1973, are expected to enhance the operating and price/performance characteristics of MRX/Computer Systems products.

On the basis of results of the start-up phase of manufacturing and marketing, continuing development program, and planned marketing of MRX/Computer Systems products, the Company believes that its investment in the program will be recovered through future sales and rental revenues of its existing and future products.

The Company leases a substantial portion of its equipment products; therefore, the Computer Systems program as well as other additions to the equipment-for-lease account will require substantial additional financing. The Company's program for financing the development, manufacture and marketing of its lease base in 1973 is set forth in Note 6 to the consolidated and combined financial statements.

3. Inventories

Inventories used in determining amounts to be charged to cost of sales or capitalized as equipment-for-lease to others were as follows:

	December 31	
	1972	1971
	(Dollars in Thousands)	
Raw materials	$ 9,029	$ 13,492
Work in process	21,294	16,470
Finished goods	14,387	16,792
	$ 44,710	$ 46,754

Of the December 31, 1972 inventories, $27,196,000 are for computer peripheral equipment, a significant portion of which will be capitalized as equipment-for-lease to others during 1973. The comparable amount of inventories at December 31, 1971 was $30,540,000.

4. Deferred Research and Development Costs

Changes in deferred research and development costs relating to products other than the MRX Computer System were as follows:

	1972	1971
	(Dollars in Thousands)	
Balance, beginning of year	$ 11,809	$ 10,891
Costs deferred	5,214	7,259
Costs amortized —		
Charged to income	(956)	(2,804)
Capitalized to equipment-for-lease	(3,444)	(3,537)
Balance, end of year	$ 12,623	$ 11,809

The deferred research and development costs were related to the following:

	December 31	
	1972	1971
	(Dollars in Thousands)	
Equipment products	$ 10,675	$ 9,291
Media products	1,948	2,518
Total balance	$ 12,623	$ 11,809

Deferred costs relative to development of the 3670 advanced disc file subsystems represent the significant portion of the above equipment-related deferred costs as of December 31, 1972.

5. Property, Plant and Equipment

Property, plant and equipment consist of the following:

	December 31	
	1972	1971
	(Dollars in Thousands)	
Land	$ 5,420	$ 7,413
Buildings and improvements	19,544	35,438
Equipment, furniture and fixtures	48,218	43,532
Construction in progress	874	4,863
	74,056	91,246
Less accumulated depreciation	(22,094)	(17,565)
	$ 51,962	$ 73,681

During 1972, Memorex consummated the sale and leaseback of its Santa Clara administration and equipment manufacturing facilities constructed in early 1971 (see Note 8). Proceeds from this transaction approximated Memorex's net investment of $17,700,000 in these facilities. This transaction accounted for substantially all of the 1972 decrease in land and buildings and improvements.

6. Notes Payable (excluding ILC)

Notes payable, excluding ILC, consisted of the following:

	December 31	
	1972	1971
	(Dollars in Thousands)	
Unsubordinated —		
Term loans, secured	$ 78,099	$ 87,861
Non-U.S. lease financing, secured	723	—
Other liabilities, mostly secured	3,864	5,619
Convertible note, due July 3, 1977, secured	14,500	—
Total unsubordinated	$ 97,186	$ 93,480
5¼% convertible subordinated debentures due April 1, 1990	$ 75,000	$ 75,000

Term loans at December 31, 1972, are with domestic, Canadian, Japanese and European banks with interest rates ranging from 5⅞% to 8⅞%. The loan agreement with Bank of America, as amended November 9, 1972, requires among other things that: (1) the ratio of consolidated current assets to consolidated current liabilities must be at least 1.2 to 1 through December 31, 1972 and 1.0 to 1 thereafter, (2) the ratio of consolidated unsubordinated debt to tangible net worth (as defined in the agreement) plus subordinated debt must not exceed 3.5 to 1 through June 29, 1973, decreasing in varying amounts

to 1.8 to 1 on December 31, 1973 and thereafter, and (3) the consolidated tangible net worth plus subordinated debt must be at least $57.5 million through March 30, 1973, $60.0 million through June 29, 1973, increasing in varying amounts to $125.0 million on December 31, 1974 and thereafter. Memorex meets all the above requirements, as of December 31, 1972. Bank of America also has exercised its right to take security interests in all of Memorex's personal property and is in process of perfecting that security interest. Under the loan agreement, Memorex may not pay cash dividends.

Non-U.S. lease financing is under a $5 million revolving line of credit with First National City Bank (International-San Francisco), new advances under which cease after 1973. Under this revolving credit line, the bank will make advances to Memorex in the U.S. for a period of up to 180 days for financing the inventory build-up of equipment to be shipped and leased abroad and the receivables resulting from these shipments (subject to 20% compensating balances). Interest on domestic advances is at ¾% above the bank's base rate for loans to prime commercial customers. As the equipment goes on-rent abroad under a firm non-cancellable lease, advances may be converted to financing of 75% of the future payments due under the lease. Interest on loans against firm rentals will be at the best available commercial overdraft rate for borrowings in foreign currencies, and 1% over base for U.S. borrowings (the latter subject to 15% compensating balances). The loan agreement contains generally the same covenants with respect to certain financial ratios as the Bank of America credit agreement.

Other liabilities are primarily for the purchase of real property with interest rates ranging from 6% to 8%, with a portion thereof secured by deeds of trust.

The convertible note due July 3, 1977, was sold by Memorex to Bank of America. This note is secured along with the Bank of America term loans by all of Memorex's personal property (see above description of term loans). This note is convertible into shares of Memorex's common stock at $26.50 per share from January 1, 1973, to June 30, 1973, and thereafter the conversion price decreases in increments of 10% annually until June 30, 1977, to a conversion price of $15.90, representing a minimum of 547,170 shares and up to a maximum of 911,950 shares (subject to adjustment under anti-dilution provisions) potentially issuable upon conversion. Memorex may prepay the $14.5 million of the note in whole or in part (not less than $5 million) plus a fee of up to $500,000 (prorata fee if a portion of the note is prepaid), in which case the portion of the prepaid note is not convertible. Memorex's right to prepay any of the note is subject to the condition that Memorex repay to the Bank $40 million of its term loan indebtedness outstanding on July 3, 1972, and that Memorex has obtained $40 million from the sale of its subordinated securities and/or from sale and leaseback of its real property. As of December 31, 1972, Memorex had reduced the aforementioned indebtedness by $17,750,000. The note bears interest at a varying rate 1½% in excess of Bank of America's prime rate subject to a 6¾% minimum. However, after January 1, 1973, the interest rate will be equal to the Bank's prime rate for each month in which the average market price of Memorex's common stock equals or exceeds the conversion price then in effect.

Interest on the 5¼% convertible subordinated debentures is payable April 1 and October 1. The debentures are convertible into 526,315 shares of common stock, unless previously redeemed, at a conversion price of $142.50 per share, subject to adjustment under certain conditions. The debentures are redeemable at the Company's option at prices set forth in the Indenture. The Company will pay into a sinking fund, beginning in 1980, an amount sufficient to redeem $6,000,000 of debenture principal annually on April 1 from 1980 through 1989. The debentures are subordinated to all senior indebtedness as defined in the Indenture.

Financing Program for 1973

In 1972, the Company's investment in new additions to its base of equipment-for-lease, including development, manufacturing and lease acquisition costs, represented a major application of cash. In 1973, with plans for increasing production of recently introduced disc storage systems, computer systems, and disc pack products, the Company's continuing investment in equipment-for-lease is expected to exceed the 1972 investment.

The Company's present operating plans indicate cash requirements in 1973 of approximately $10 million for additions to property, plant and equipment and to working capital, approximately $85 million for the development and manufacturing of new equipment-for-lease, and $70 million for external debt service (including estimated interest) on existing credit agreements. It is estimated that cash generated by operations will be $85 million, primarily from lease revenues. This amount will not be sufficient to provide for the above cash expenditures, and external capital of approximately $80 million will be sought in 1973.

The Company has established a program for securing or refinancing $80 million of external capital in 1973, which program includes subordinated capital and senior debt. The Company is currently negotiating to obtain a significant portion of its expected 1973 external capital needs, as well as negotiating with certain of its creditors to reduce the principal payments due in 1973 under existing credit agreements. There, of course, can be no assurance that the present negotiations will be satisfactorily concluded.

Annual maturities of notes payable including loans to ILC

(see Note 7), over the next five years are:

$51,187,000 in 1973, $72,888,000 in 1974, $43,258,000 in 1975, $123,000 in 1976, and $14,604,000 in 1977.

7. Unsubordinated Notes Payable - ILC Peripherals Leasing Corporation (ILC)

On November 9, 1972, Memorex acquired all of the outstanding voting stock of ILC (see Note 1), and Lenders to ILC agreed to significant modifications of the terms and provisions of loan agreements with ILC. Coincident with this acquisition, Memorex contributed its subordinated notes due from ILC of $17,450,000 to paid-in capital of ILC.

Line of Credit

Under a New Loan Agreement (effective September 30, 1972), the Lenders have agreed to continue their extension of credit to ILC in the aggregate amount of $85,439,665. The Lenders have also agreed, subject to the condition that Memorex increase its subordinated capital by $10,000,000, to extend additional credit to ILC based on firm rental obligations on equipment sold by Memorex to ILC during the period January 1, 1973 to June 30, 1973 pursuant to a revised Master Sales and Maintenance Agreement between ILC and Memorex. The "firm rental obligation" on a particular item of leased equipment means the current monthly rental for that item times the number of months of the lease not yet elapsed (not to exceed 20 months). If obtained, the additional loan may not exceed $12,205,668 and would be repaid in 20 monthly installments commencing August 1, 1973, and continuing through March 1, 1975. Loans outstanding under the credit arrangement with the Lenders, including the additional loan, if made, may not exceed $85,439,665 at any time.

Interest and Payment Terms

The interest rate on the Loan is equal to 1½% above the prime rate charged by The Chase Manhattan Bank (National Association), with a minimum of 6¾% per annum and a cumulative maximum of 7¾% per annum. The outstanding debt at December 31, 1972 is due in: (1) 27 equal monthly installments of $2,250,000 commencing February 1, 1973, and continuing through April 1, 1975; (2) one installment of $17,189,665 on May 1, 1975; and (3) one installment of $7,500,000 on July 1, 1975, which installment is convertible under certain conditions into Memorex common stock, and is referred to below as the "Convertible Notes."

Covenants

The new Loan Agreement requires, among other things, that: (1) the ratio of consolidated current assets to consolidated current liabilities must be at least 1.2 to 1 through December 31, 1972, and at least 1.0 to 1 thereafter, (2) the consolidated tangible net worth (as defined in the agreement) plus subordinated debt must be at least $56.0 million to December 30, 1973, increasing in varying amounts to $75,000,000 after December 30, 1974, ($85,000,000 after December 30, 1974, in the event Memorex increases its subordinated capital by $10,000,000 in the first six months of 1973), and (3) the ratio of consolidated senior liabilities to consolidated tangible net worth plus subordinated debt not exceed 3.8 to 1; in the event Memorex's subordinated capital is so increased the ratio would be 3.0 to 1. Memorex meets all the above requirements, as of December 31, 1972.

If ILC fails to meet certain financial tests, including maintenance of a minimum tangible net worth of $30,000,000, Memorex is required under an amended Subscription Agreement with ILC to purchase additional shares of common stock of ILC to enable ILC to meet such tests. As of December 31, 1972, ILC's tangible net worth was $42,810,000.

Convertible Notes

The Convertible Notes are not prepayable, except that if the average market value over 20 consecutive trading days of Memorex common stock is equal to or greater than $40 per share, ILC may elect to prepay the Convertible Notes, or any portion thereof (subject to the right of the Lenders to convert their interest in the Convertible Notes, or portion thereof) called for prepayment prior to actual payment at the rate of $20 per share of Memorex common stock. To the extent that the Convertible Notes are not so prepaid, the Lenders may convert their percentage interests of the Convertible Notes into Memorex common stock at such rate at any time until June 30, 1975. After such date and prior to July 1, 1985, each Lender may purchase at $20 per share, by exercising stock subscription warrants, one share (subject to adjustment by reason of anti-dilution provisions) of Memorex common stock for each $20 of such Lender's percentage interest in the Convertible Notes which has not been prepaid by ILC nor converted as set forth above.

Security

Simultaneously with the execution of the New Loan Agreement, ILC entered into a Company Security Agreement (Equipment) with the Security Agent named therein, pursuant to which it granted to the Security Agent, for the benefit of the Lenders, a security interest in all of its assets (Cash, U.S. Treasury Bills, Accounts Receivable, Equipment-for-Lease at Memorex cost, less accumulated depreciation, and Other Assets) totalling $98,783,000 at December 31, 1972. Memorex entered into a Memorex Security Agreement (Equipment) with the Security Agent pursuant to which it granted a security interest in that portion of its raw materials, work in progress and inventory held for sale to ILC. In addition, Memorex has guaranteed the obligations of ILC under the New Loan Agreement. Simultaneously with the acquisition of 100% voting control of ILC as described in Note 1, ILC, Memorex and the Security Agent entered into a Security Agreement (Pledge), pursuant to which Memorex pledged the securities of ILC owned by Memorex as security for ILC's and Memorex's obligations under the New Loan Agreement.

Security Agent and Collateral Account
All of ILC's cash receipts must be deposited in a collateral account under the control of the Security Agent. ILC must prepay portions of the Loan to the extent that it has excess cash flow (defined as the excess of ILC's receipts over its required payments for loan principal, interest, taxes, operating expenses, Memorex's fee, security agent's fee, and amounts due to Memorex for equipment purchased by ILC) and upon the occurrence of certain other events.

8. Commitments and Contingent Liabilities
During 1972, Memorex consummated the sale and leaseback (30-year lease) of a portion of its real estate (administration and equipment manufacturing facilities constructed in early 1971), located in Santa Clara, California. Memorex has the option to repurchase the facilities at various times beginning with the 12th lease year at a price of fair market value or $18,250,000 whichever is greater. As part of the sale-leaseback transaction, Memorex agreed to guarantee the performance of the lessor under a ground lease between the lessor and the holder of title to the property. This guarantee, as well as Memorex's performance of its own obligations as lessee, are secured by encumbrances of certain real property of Memorex situated in California and Minnesota. In addition, Memorex and subsidiaries lease certain buildings, including district sales offices, under long-term lease contracts which expire at various dates through 1993.

Aggregate rentals remaining under these contracts and amounts due within one year are:

	Aggregate Remaining Rentals	Due Within One Year
Administration and equipment facilities	$53,374,000	$ 1,804,000
All other lease contracts	8,211,000	1,851,000
Total	$61,585,000	$ 3,655,000

On June 24, 1971, the Securities and Exchange Commission filed a complaint against the Company and certain of its officers alleging that the Company violated certain sections of the Securities Exchange Act and rules thereunder by making false and misleading statements in interim financial statements, press releases, reports to shareholders and a Form 9-K filing with the Commission in 1970, and by making false and misleading statements in connection with a revision of a previous interim earnings report. The suit was settled without trial or admission of any liability with the filing of a consent decree on July 21, 1971. The consent decree makes clear the consent "does not constitute an admission by or presumption against the [defendants] of any wrongdoing, misconduct or liability . . ."

Since the consent decree, a number of private class actions and two derivative actions, based substantially on the allegations of the Commission's complaint, have been filed against the Company, certain officers, directors and non-Memorex defendants. All allege violations of the federal securities laws or common law fraud. The defendants are alleged to have violated the federal securities laws by employing accounting methods to reflect Memorex's transactions with ILC during part of 1970, which methods are alleged to have materially overstated Memorex's sales and income for the second and third quarters of 1970, as reflected in the interim reports issued by Memorex for those two periods. In addition, the defendants are alleged to have issued public statements and press releases which were, in the same respect, assertedly false and misleading. None of the various complaints names a precise amount of compensatory damages sought for the entire class sought to be represented. One complaint seeks rescission of purchases of the Company's securities in the alternative to compensatory damages of $1,300,000, and another seeks punitive damages of $1,500,000. Certain of the complaints also seek punitive damages against Memorex in unstated amounts. In the opinion of counsel, the Company has meritorious defenses to all of these currently pending actions.

9. Income Taxes
The Company's Federal income tax returns through 1969 have been examined by the Internal Revenue Service without material adjustments to taxable income. The income tax returns of certain foreign subsidiaries have also been examined while others are still to be examined. In some instances, it is not possible to determine the ultimate liability until such examination has been completed. However, management is of the opinion that adequate reserves have been provided for any potential tax assessments.

Income taxes in the amount of $1,971,000 remain deferred at December 31, 1972, to reflect timing differences in reporting certain income and expenses in the tax returns from those reported for financial purposes (see Note 1).

10. Preferred and Common Stock
Authorized and outstanding shares of $100 par value preferred stock and $1 par value common stock of Memorex Corporation were as follows:

	December 31	
	1972	1971
Authorized preferred stock	1,000,000	1,000,000
Outstanding preferred stock	—	—
Authorized common stock	10,000,000	10,000,000
Outstanding common stock (excluding 10,000 shares held in treasury)	4,295,268	3,912,155

Memorex has entered into agreements with key employees of several of its subsidiaries which call for the potential issuance of up to 130,000 shares of Memorex common stock upon the occurrence of certain events.

Memorex has reserved a maximum of 911,950 shares of its common stock for potential issuance to Bank of America under convertible note agreement (see Note 6).

Memorex has reserved 375,000 shares of its common stock for potential issuance to Lenders to ILC under convertible note agreements (see Note 7).

Memorex has reserved 526,315 shares of its common stock for potential issuance upon conversion by holders of the 5¼% convertible subordinated debentures, due 1990 (see Note 6).

11. Stock Options (Memorex Corporation)

Changes during 1972 in the status of options granted under the Stock Option Plan were:

		Shares Under Option — Changes During Year				
Year Granted	Option Price	Jan. 1, 1972	Granted	Exercised	Terminated	Dec. 31, 1972
1967	$34.79 to $63.92	44,082	—	—	10,225	33,857
1968	65.81 to 66.63	2,750	—	—	2,075	675
1968	1.00	989	—	864	—	125
1969	71.25 to 163.50	63,113	—	—	18,863	44,250
1969	1.00 to 1.50	26,902	—	9,124	2,088	15,690
1970	45.44 to 116.25	31,200	—	—	6,800	24,400
1970	1.00 to 1.50	15,212	—	2,387	2,925	9,900
1971	20.00 to 35.38	118,687	—	—	26,087	92,600
1971	1.00	48,685	—	11,577	6,838	30,270
1972	29.06 to 36.81	—	65,200	—	2,000	63,200
1972	1.00	—	13,250	—	1,700	11,550
		351,620	78,450	23,952	79,601	326,517

Stock options outstanding at option prices of $1.00 and $1.50 were assumed by Memorex during the period 1970-1972 upon acquisition of the minority interests of certain subsidiaries. Terms for exercise of the assumed options are the same as under the Company plan. Options were granted under a Qualified Stock Option Plan adopted in 1965. Under this plan, options may be issued to key employees to purchase common stock at 100% of market value of the shares at the dates the options are granted. The plan provides that options may be exercised at one-fourth the total shares each year on a cumulative basis, beginning one year after date of grant, with options to expire five years after date of grant. Of the 326,517 shares under option as of December 31, 1972, wrap-around options for 103,182 shares have been granted at a price of $35.38 per share. The wrap-around options do not increase the number of options outstanding, and can be exercised only to the extent the earlier options have expired and have not been exercised. As of December 31, 1972, the Company has reserved 532,227 shares of its common stock for issuance under this plan.

A substantial portion of the stock options held by optionees under the Company's Qualified Stock Option Plan of 1965 referred to above are exercisable at prices substantially in excess of the present fair market value of the Company's common stock. For those optionees, the Executive Committee of the Board of Directors believes that the 1965 Plan has lost much of its value as an aid to motivating high performance and retaining key employees, as it was originally intended to do. Accordingly, in February, 1973, the Executive Committee adopted the Company's 1973 Stock Option Plan, subject to shareholder approval, as an alternative to the 1965 Plan. The affirmative vote of the holders of a majority of the Company's Common Stock is required to approve the 1973 Plan.

The 1973 Plan is essentially the same as the 1965 Plan described above except that: (1) the options are exercisable under the 1973 Plan at the rate of 33⅓% after six months from the date of grant, and 33⅓% after each of the following two years, rather than at the rate of 25% per year beginning one year after the date of grant under the 1965 Plan; (2) the 1973 Plan terminates on February 1, 1983, whereas the 1965 Plan terminates in December, 1975; (3) under the 1973 Plan the term of the options may be up to ten years rather than five years under the 1965 Plan; and (4) under the 1973 Plan the options will be "nonqualified" options which are exercisable notwithstanding the existence of an earlier option granted at a higher price.

In February, 1973, the Executive Committee granted options for 199,582 shares under the 1973 Plan at an exercise price of $13.125 per share (the fair market value of the Common Stock on the date granted) to certain optionees under the 1965 Plan in substitution on a share-for-share basis for options held under the 1965 Plan which were exercisable at a price higher than $13.125 per share. This grant is subject to shareholder approval of the 1973 Plan. Options under this Plan were not granted to replace options exercisable at $1.00 and $1.50 per share, which were assumed upon acquisition of minority interests in subsidiaries. These options will continue to be exercisable under the 1965 Plan.

Additional options were granted under the 1973 Plan in February, 1973, for an aggregate of 81,000 shares at option prices of $13.125 and $11.063 per share. All options granted to date are for a term of five years and are subject to shareholder approval of the 1973 Plan.

12. Earnings (Loss) Per Common Share

Earnings (loss) per common share have been computed on the basis of the weighted average number of common shares outstanding during the year (4,028,953 in 1972 and 3,900,899 in 1971), excluding 10,000 shares held in Treasury. Shares potentially issuable in exchange for the 5¼% Convertible Subordinated Debentures do not result in dilution of earnings per common share. Other common stock equivalents (stock options) do not result in a material dilution of earnings per common share.

Memorex has entered into agreements to exchange shares of the Company's common stock for minority interests in subsidiaries upon occurrence of specific profit performance of the subsidiaries. The Company does not expect that issuance of shares under these agreements would result in material dilution of earnings per common share.

Memorex has entered into various convertible debt agreements with Bank of America and ILC lenders (see Notes 6 and 7) which call for issuance of Memorex common stock upon conversion of the notes. These securities (not common stock equivalents) do not result in dilution (fully diluted) of earnings per common share.

Auditors' Report

To the Shareholders and Board of Directors of Memorex Corporation

We have examined the balance sheets of Memorex Corporation (a California corporation) and subsidiaries as of December 31, 1972 (consolidated) and 1971 (combined) and the related consolidated or combined statements of income (loss), shareholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As set forth in Note 2 to the accompanying financial statements, the Company has a substantial investment in inventories, equipment-for-lease and other deferred costs incurred in the development of commercial production of MRX/Computer Systems products. Recovery of this investment is dependent upon the Company obtaining and maintaining sufficient future revenues from these computer systems. Because this program is in the initial manufacturing and marketing phase, we have been unable to determine whether sufficient future revenues will be realized from this program.

In our opinion, subject to the realization of sufficient future revenues to recover the Company's investment in the MRX/Computer Systems program, the financial statements referred to above present fairly the consolidated or combined financial position of Memorex Corporation and subsidiaries as of December 31, 1972 and 1971, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

Arthur Andersen & Co.

San Jose, California
March 5, 1973.

For additional information relating to the products or business of Memorex Corporation, write to:

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Santa Clara, California 95052

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Memorex Corporation has its headquarters and major manufacturing facilities in Santa Clara, California.

Printed in U.S.A.

MEMOREX

1972 Annual Report