MEMOREX

1973 Annual Report

April 25, 1974

To Memorex Shareholders:

In 1973 Memorex and consolidated subsidiaries (including ILC Peripherals Leasing Corporation, a wholly-owned subsidiary) had total revenues of $176,923,000. The loss for the year was $119,090,000 or $27.63 per share based on 4,309,395 shares outstanding.

Included in the 1973 loss were charges against income totalling $99,808,000: $38,716,000 in net writeoff of the Memorex computer system program; $37,373,000 relating to changes in accounting policy for research and development expenses and lease acquisition costs; $20,858,000 in asset revaluation and accelerated depreciation charges; and $2,861,000 in other charges. Notes 2, 3 and 4 to the enclosed financial statements describe these charges. Also included in the 1973 loss is an operating loss of $19,282,000, which loss includes a provision for income taxes of $4,925,000, primarily on the income of foreign subsidiaries which could not be set off against domestic business losses. This operating loss resulted primarily from a lower than expected gross margin contribution from equipment for lease operations in 1973, arising principally from a higher than anticipated percentage of equipment off rent, which, in addition to reducing revenues, resulted in an acceleration of planned depreciation charges against such equipment and charges to the profit and loss statement resulting from excess manufacturing costs in equipment products during the latter part of 1973.

In 1972 total revenues were $145,422,000 and net income was $1,193,000, or $.30 per share on 4,028,953 shares outstanding. Comparison of the revenues for the two years indicates a growth of 22%.

Agreements were consummated in December with the Bank of America and with creditors of ILC Peripherals Leasing Corporation for restructuring Memorex and ILC senior debt obligations (see notes 7 and 8 of the financial statements). These restructured agreements are to be substantially modified as a result of the negotiations during March of this year of an agreement in principle which provides for the conversion of $40 million of debt to Memorex preferred stock, the reduction of interest on the remaining loans from 7¾% to 4%, the payment of this interest in Memorex preferred stock, and extension of the maturity of the loans. (See the text of this Report and footnotes 7, 8 and 17 to financial statements for further discussion.)

The acquisition of ILC Peripherals Leasing Corporation in 1972, and its consolidation into Memorex, had previously permitted a considerable simplification in our financial reporting. Similarly, the accounting policy changes in 1973 have further reduced the complexity of presentation. Memorex now expenses on a current basis all new product development and marketing spending. Revenue from leased equipment is, of course, accounted for only as currently billed, consistent with prior years. Memorex's accounting policies are summarized in Note 1.

I believe that Memorex's present position is much improved from the conditions prevailing during the summer of 1973. Our problems last year resulted largely from the difficulties experienced since 1970 in competing in the information processing equipment business. The capital requirements of significant penetration in this leasing-oriented business are large, as we have emphasized in previous reports to shareholders.

Despite our best efforts, we were unable to raise the needed additional equity capital in 1972 or in the first half of 1973. We had, therefore, no choice but to scale back operations. Our ability to raise new equity capital was greatly impaired by IBM's actions in the peripheral equipment market. In December 1973, Memorex filed suit in Federal District Court in San Francisco on antitrust grounds against IBM. We seek damages as well as injunctive relief to restore a fair basis for on-going competition in our industry.

During 1973 the senior management of the Company was augmented by the addition of Mr. George E. Dashiell, a man with 25 years experience in the industry; the promotion of Mr. Robert Stender to the position of Vice President of Development and Planning; and the promotion of Mr. Philippe Yaconelli to Vice President of Marketing for Computer Media Products. As in the past, the performance of Memorex's employees during the difficult year of 1973 was exemplary. While employment during 1973's fourth quarter averaged 5,100, record quarterly revenues of $48,439,000 were achieved. Revenue per employee thus reached an annualized rate just under $40,000, which is more than double the rate of three years ago and which compares very well with other firms in our industry.

Mr. Robert C. Wilson has been elected to succeed me as President and Chairman of the Board of Directors of Memorex effective May 15, 1974. Mr. Wilson comes to Memorex from Collins Radio Company, where he served as President and Chief Executive Officer, and his earlier experience was in executive positions with Rockwell International Corporation and General Electric Corporation. Memorex is indeed fortunate to employ an executive of Mr. Wilson's stature and talents to assume the leadership of our Company.

After 13 years as Chief Executive Officer, a period which spans Memorex's corporate history from its founding, I have resigned to pursue a career apart from industry. I leave Memorex with profound gratitude for the opportunity given to me to participate in the ground-up building of an important entity in the magnetic media and computer equipment industries, and, above all, for the immeasurable rewards of my association with co-workers of incomparable capabilities, endurance and accomplishments.

Sincerely,

Laurence L. Spitters

Laurence L. Spitters,
President

Business Overview

The primary objective of Memorex management is a return to profitability and, in concert with that, the assurance of a positive cash flow from operations. The major source of our current cash flow in 1974 is our substantial and growing lease base currently yielding revenues at a rate exceeding $8 million per month. A shift to greater outright sales revenue for equipment products is currently being pursued to provide a more significant contribution to total cash flow in 1974. Total sales revenues increased 25% in 1973 over the prior year, the first such growth in sales revenue since 1969.

To help meet our objectives, we have adopted major programs within the new operating plan to control total expenditures at their now reduced levels from 1973 and to increase revenues. Longer term programs include improved utilization of our plant, increased sales and service productivity, and application of advanced technology. These programs also place increased operational emphasis on outright sales products and markets, rather than depending mainly upon growth in leasing revenue.

The rapid growth of the information processing equipment and media supplies business continues to offer large opportunities, particularly since the technological trends of the industry foretell an increasing emphasis upon new on-line, data base applications. These data networks multiply the usefulness of computer equipment to users. The concomitance of this trend is increasing importance of storage and communication devices within the typical user peripheral configuration. Peripherals total 50% to 75% of the system cost at present. We anticipate, therefore, expansion of our product entry around the focal points of disc storage and communications controller products in which our experience and reputation are well established.

The business elements which constituted Memorex's program in this market-place are largely still in place. These include: the largest independent sales and service capability active within the IBM customer base; the proven Memorex reliability and service capability recognized by over 2,000 end-users; product development capability and an established product line in the storage and communications sectors of the business; a large-scale manufacturing facility with a demonstrated capability for low-cost manufacturing; and a large capital base of past investment in revenue-producing leased equipment.

Memorex's strategy for peripheral equipment products is based upon our ability to leverage these business elements within our established market areas. In an industry in which technology abounds, an element of great scarcity is a sales and service capability, and in this area—despite reductions in scale—Memorex has a leading position among independent suppliers.

Clearly, the dominant competitor in the computer equipment business is IBM. Selective pricing and other anti-competitive practices pursued by IBM have had a significant adverse effect on the Company's business. Memorex, ILC and certain foreign subsidiaries of Memorex recently filed suit against IBM, alleging violations by IBM of the antitrust laws in its competitive practices and claiming damages of approximately $1,050,000,000. Numerous other litigants have alleged similar violations by IBM.

In our media business, 1973 was a year of restoration, stabilization and re-investment toward a goal of renewed leadership. In computer media, each succeeding quarter of 1973 saw increased revenue and regaining of market share. Our consumer media program, particularly the audio tape cassette, demonstrated its established brand franchise through reliable revenue generation. The video tape business also made progress during 1973; regaining a position of technical superiority for this most exacting product. Thus, in all three aspects of our magnetic media operations, Memorex is well positioned to leverage our technology, marketing capability, and manufacturing expertise in growing markets.

Memorex is a world-wide enterprise. Again in 1973, our international operations offered an important contribution to our business. With the exception of Belgium, where Memorex finishes media products and assembles and refurbishes data processing equipment for European markets, business is carried on through marketing and service subsidiaries. Competition varies widely among the various countries in which Memorex operates, but in general the Company must contend with the aforementioned pricing and other practices of IBM in foreign markets. Currency fluctuations and uncertain balance of payments outlook for most industrial countries due to rapid increases in commodity prices including petroleum, may adversely affect international performance and create an exposure for our 1974 plan.

Financial Agreements

In December of 1973, agreements with the Bank of America and with the creditors of ILC Peripherals Leasing Corporation restructuring Memorex and ILC senior debt obligations (see Notes 7 and 8 of the financial statements) were executed. These agreements provided a debt service moratorium during the fourth quarter of 1973 and the months of January and February of 1974.

In connection with the employment of Mr. Robert C. Wilson as President and Chief Executive Officer of Memorex, in March of 1974 an agreement in principle was reached with these lenders for conversion of $40 million of debt to Memorex preferred stock, other beneficial adjustments in the terms of the remaining senior debt, and provision of credit for equipment financing. The execution by the lenders of definitive agreements implementing this agreement in principle is subject to Mr. Wilson's being the President and Chief Executive Officer of Memorex at the time such agreements are to be executed.

The accounting treatment of this agreement to reflect the timing and form of the transaction, including the amounts of interest and dividends to be charged against earnings, has not yet been determined. The commitments under the agreement in principle with senior lenders of Memorex and ILC are summarized below.

(1) The principal Memorex creditor, Bank of America, will convert $30 million of principal obligation into a new series of Memorex preferred stock, and the ILC Lenders will convert $10 million of their indebtedness into a second series of Memorex preferred stock. Conversion will be made at the par value of such preferred stock.

(2) The interest rate on all remaining senior obligations to Bank of America and the ILC Lenders (approximately $169 million) will be reduced from 7¾% to 4% retroactive to August 1, 1973. The 4% rate will continue in effect through December 31, 1977, and the prime rate will apply thereafter. All presently accrued and future interest payments required through December 31, 1977, may be satisfied through issuance to the Lenders of additional Memorex preferred stock. Any issuance of preferred stock for this purpose will satisfy the Memorex obligation on a dollar-for-dollar basis at par value.

(3) Principal payments for all senior obligations will be reduced from the current rate of $3 million per month to $1 million per month in April, May and June of 1974, and will average $2.25 million per month thereafter until the obligations are paid in full.

(4) All presently outstanding conversion features and options for Memorex Common Stock held by the senior lenders, which aggregate up to 1,286,950 shares at acquisition prices ranging from $15.90 to $23.85 per share, will be cancelled.

(5) Bank of America will provide a $35 million line of credit through 1978 for new equipment placed on lease by Memorex. This line of credit can be drawn against to the extent that present obligations to the Bank are repaid (which repayments are scheduled initially at $750,000 per month starting in July 1974). Interest on these loans shall be at the prime rate through December 31, 1977, and two points over the prime rate thereafter. The Bank also will provide, if requested through September 1974, up to $3 million in advance payments for Memorex equipment to be sold to the Bank.

(6) In exchange for the cancellation of conversion features and options noted above, the senior lenders will receive 15-year warrants to purchase 800,000 shares of Memorex Common Stock at $10 per share (such exercise price to be reduced to the price of any new shares or rights should Memorex issue additional Common Stock, warrants or conversion rights within 12 months at a price less than $10 per Common share, other than shares issued pursuant to an employee benefit plan).

(7) Bank of America and the ILC Lenders have agreed to convert, if requested by Memorex, up to an additional $25 million of senior debt to preferred stock prior to December 31, 1977. Such additional conversion would be in the amount of 75% of any equity which might be created by conversion of Memorex's 5¼% convertible subordinated debentures into equity securities junior to those of the Bank and the ILC Lenders, or by purchase of the debentures by Memorex for cash at less than face value. If such conversion occurs, the converting senior

debt holders would receive up to 500,000 additional 15-year warrants exercisable at $10.

Memorex preferred stock to be issued to senior lenders of ILC will have the following characteristics:

1. Par Value, Liquidating and Redemption Value—$100 per share.
2. Dividend Rate—$4 per share starting in 1976, $5 in 1977-1978, $6 in 1979-1980, and $8 thereafter. No dividends are to accrue until January 1, 1976.
3. A program for complete retirement of the preferred stock during 1983-1987.
4. Liquidation preference over any other issue of preferred stock.

Memorex preferred stock to be issued to Bank of America will have the same $100 par value, dividends of $4 per share starting in 1978 through 1980 and $6 thereafter, a retirement program beginning 1983 through 1992, and a liquidation preference junior to the ILC Lenders preferred stock, but senior to any other Memorex preferred stock.

Any proceeds received from the litigation recently instituted against IBM are to be used to retire shares of both series of preferred stock ratably, with any excess to be used to repay Memorex and ILC senior debt ratably. Memorex currently has no outstanding preferred stock.

Product Programs

A) **Storage Products**

1973 was Memorex's second highest year for the installation of new disc file subsystems and a record year for lease revenue derived from disc file products. During the year we noted the installation of our 1000th model 3670 Disc Storage Module, the leading alternative to the IBM 3330 or 3340 disc files. Memorex shipped in 1973 3670's for lease whose aggregate rental exceeds one million dollars per month.

The 3670 product line was enhanced in 1973 by the announcement of several products and features, including a double-density version (the 200 million byte capacity model 3675) which will compete with IBM's recently announced double-density 3330. Also, Memorex announced entry of its 3670 product line into the IBM 370/125-135 marketplace, by virtue of the new model 3673 file controller. Memorex is the only supplier which offers an alternative new product to IBM's 3340 disc file for these computers. As 370/125-135 users follow larger members of the 370 computer line into data-base applications, Memorex anticipates obtaining a reasonable share of market.

We were especially pleased in 1973 at the acceptance and outright preference earned for the Memorex 3670 from a number of IBM large computer users. These users employ constant heavy access to on-line data (for reservation systems, timesharing, credit files, parts inventories, or order backlogs) making them the most demanding of disc file performance. Reliability and service in such accounts distinguish Memorex's 3670 product superiority, and substantiate our claim that the 3670 is the most reliable disc file available to the industry. In early 1974, several further additions to the 3670 product line were announced which extend its competitive range and attractiveness to large-scale end-users, as well as to the large number of smaller computer users whose disc file usage is rapidly increasing.

Production of new 3660's ceased in 1972, over 18 months ago, yet at the end of 1973 Memorex maintained 82% of its units on rent. Discontinuances of 3660 systems increased during the year as larger numbers of 370 systems replaced their 360 predecessors. By year-end lease revenues from 3660's constituted less than half of total leasing revenue, compared to a peak of two-thirds of the base.

In 1974 and 1975 we expect continued erosion in our 3660 lease base but also continued substantial revenue. The remaining pool of placement opportunities for this 360 generation of product is still large and populated increasingly by disc files of independent peripheral manufacturers. By the end of 1975, Memorex's investment in the 3660 will have been almost totally depreciated. We are examining other market areas in which to place off-rent 3660's.

Our plan for 1974 in storage products calls for continued deliveries of 3670's at approximately the rate of 1973, comprising nearly three-quarters of our discretionary investment in equipment-for-lease.

B) **Communication Products**

The communications marketplace is fast changing as new transmission networks emerge. Over the past four years Memorex has invested considerable money, time, and effort to learn customer requirements for this market area.

In 1973, the lease revenue of our communications products surpassed that of disc packs to become the second most important segment of our lease base. This market holds a large potential for future growth, as computer users increasingly implement communication networks to link geographically distributed operations together. A combination of IBM software product slippages in the communications control area, plus the solid performance of Memorex's 1270, yielded for Memorex a strong market position in communications controllers. We expect the population of on-rent 1270's to peak in 1974. Marketing of the Memorex printing terminal product line has been focused on the 1242 buffered terminal and the 1280 cassette terminal. These products are increasingly widely used in data communications networks and are companion products to the 1270.

C) **Computer Media**

1973 was an active year for new product and service introductions by our Media Group. During the year Memorex announced and delivered the new Mark III disc cartridge for IBM System 3 users, Markette I flexible disc media for terminal and data entry users, Memorex IV computer tape which replaced the industry-standard MRX III tape, life-time warranties for its premium tapes, and tape library software services for Memorex customers.

In addition, 1973 saw large shipments of the Mark X disc packs for use on Memorex 3670 or IBM 3330 disc files plus announcement of the Mark XI double-density pack which will be available late in 1974. We experienced record levels of disc pack lease revenue as derived from the thousands of Mark I (1316) and Mark VI (2316) disc packs remaining on rent. For the Mark I, 1973 was the beginning of residual revenue as many of these packs remaining on lease had been fully depreciated.

Renewed leadership and investment placed into computer media operations arrested the distressing trend of business in domestic markets over the past several years. New process equipment and technology has led to cost improvements as well as the new products cited above. A dedicated marketing force was re-established and enlarged. Promotional spending was increased in support of innovative product marketing. As a result revenue increased in each succeeding quarter through the year.

A new premium computer tape was announced early in 1974. Named Cubic, the new tape is the strongest in the industry, particularly resistant to edge damage. Cubic is a new generation of tape appropriate for the newly available self-loading 6250 byte-per-inch tape drive equipment.

Many of the materials used by Memorex to manufacture tape products are petroleum based, and in some cases costs have gone up several times over early 1973 levels. The Company has generally been successful in acquiring adequate amounts of raw materials. Although some raw materials are now being allocated by their manufacturers, the Company believes it can maintain production at or above 1973 levels under present supplier arrangements. The Company is endeavoring to institute price increases to recover increased costs and must obtain such increases to achieve acceptable gross margins.

D) **Audio-Video**

Memorex became in 1973 one of the two leading brand suppliers of blank audio cassettes purchased by consumers. This achievement was anticipated in the 1972 report where we noted having obtained the second broadest base of distribution among all brand name competitors. By the end of 1973, we were satisfied that our diversification into the consumer marketplace had been successfully launched. Our new tape cassette MRX 2 improved our technical leadership in the quality-conscious audio market.

Memorex introduced in 1973 a video cassette for the Sony ¾-inch recorder, popular in the industrial and educational markets and forerunner of a potential consumer video industry. Our video technology is again well established on the basis of our broadcast video tape which throughout 1973 evidenced superior quality in customer use.

E) Office Products

In 1973 we continued modest investment in a number of small operations which are prospective in the longer run. These products include toner for Xerox and IBM copiers, magnetic card and tape supplies for the power typewriting industry, and computer-output-microfilm equipment and supplies which offer an economic alternative to the shortages and cost increases of paper. Together these products accounted for less than $10 million of corporate revenue.

F) Components and Services

In 1973, Memorex increased its emphasis upon supply of components and services to other manufacturers. In the late 1960's Memorex had enjoyed considerable business with Original Equipment Manufacturers (OEM) in tape, disc packs, and disc files. We have devoted additional attention to this market area and will attempt to expand our OEM volume and customer relationships in 1974 and beyond. During 1973 we provided plastic reels and cases to other tape manufacturers and we received OEM contracts for disc packs and computer tape.

We have launched a major new OEM equipment program in the supply of disc drives using flexible discs to communication terminal manufacturers, mini-computer manufacturers and other customers requiring a low-cost random-access storage. The flexible disc offers removable, mailable storage of up to a quarter million bytes of information, with access time counted in milli-seconds. The unit sells for a small fraction of the cost of previous random access devices, and is competitive with slower, less reliable, serial-access tape cassette storage devices. Memorex enjoys the leading position in both flexible disc media and equipment. Either IBM-compatible or enhanced versions are available. The flexible disc program reflects Memorex's commitment adopted in 1973 to offer a wide range of components and services based upon unique Memorex capabilities, for inclusion in the product lines of other manufacturers.

Memorex Corporation

Consolidated and Combined Statements of Income (Loss) for the Years Ended December 31, 1973 and 1972

(Dollars in Thousands, Except Per Common Share Amounts)

	1973 (Note 1)	1972 (Note 1)
Net Sales and Revenues:		
Rental and Service Revenues	$ 92,932	$ 78,322
Net Sales	83,991	67,100
Total Revenues (including $245 of computer systems revenues in 1973)	176,923	145,422
Operating Costs and Expenses (including charges in 1973 of $20,858 as described in Note 4):		
Cost of Rental and Service Revenues	82,574	47,758
Cost of Sales	56,877	39,674
Selling, General and Administrative Expenses	48,596	34,724
Research and Development Expenses (Note 2)	3,604	2,006
Foreign Exchange and Translation (Gain) or Loss (Note 1)	2,861	(182)
Charges for Termination of Deferral Accounting Policy (Note 2)	37,373	—
Charges for Termination of Computer Systems Program (Note 3)	38,716	—
	270,601	123,980
Income (Loss) From Operations	(93,678)	21,442
Interest Expense (Notes 7 and 8)	(20,487)	(19,951)
Other Shareholders' Equity in Net Loss of ILC (Note 1)	—	454
Income (Loss) Before Income Taxes	(114,165)	1,945
Credit (Provision) for Income Taxes (Notes 1 and 12):		
Taxes Currently Payable	(801)	(1,548)
Deferred Taxes	(4,124)	796
	(4,925)	(752)
Net Income (Loss)	$(119,090)	$ 1,193
Earnings (Loss) Per Common Share (Note 15)	$ (27.63)	$ .30

The accompanying notes are an integral part of these statements.

Memorex Corporation

Consolidated and Combined Statements of Changes In Financial Position for the Years Ended December 31, 1973 and 1972

(Dollars in Thousands)

	1973 (Note 1)	1972 (Note 1)
Cash Was Provided By (Used For):		
Operations—		
Net income (loss)	$(119,090)	$ 1,193
Add items not requiring cash outlay—		
Depreciation and amortization charged to income, including accelerated depreciation (Note 4)	60,221	34,846
Charges to income resulting from—		
Termination of deferral accounting policy (Note 2)	37,373	—
Asset write-offs from termination of computer systems program—net of recoveries (Note 3)	32,170	—
Revaluation of assets relating to certain product lines (Note 4)	5,158	—
Cash Obtained From Operations (restricted to reduce notes payable to the extent required under loan agreements—see Notes 7 and 8)	15,832	36,039
Increase (decrease) in liabilities—		
Proceeds from issuance of notes payable (excluding reborrowing of $10,800 of ILC payments in 1973)	66,021	66,014
Payments of notes payable (excluding $10,800 in 1973 under ILC loan agreements—see Note 8)	(29,702)	(66,586)
Deferred interest on notes payable	6,970	—
Increase in income taxes	2,849	395
Accounts payable and accrued liabilities	3,509	(2,790)
Decrease in other shareholders' equity in ILC	—	(454)
	49,647	(3,421)

(Continued on following page)

	1973 (Note 1)	1972 (Note 1)
Increase (decrease) in shareholders' equity—		
Valuation of shares issued to acquire other shareholders' equity in ILC (Note 1)	—	4,800
Other ILC shareholders' equity acquired	—	(4,492)
Proceeds from issuance of common stock	14	83
Valuation of conditional warrants issued upon restructuring of ILC debt in 1972	—	187
	14	578
Decrease (increase) in assets—		
Temporary investments	3,488	(3,488)
Accounts receivable	(10,937)	(5,580)
Inventories (net increase in 1973 before writeoffs and adjustments described in Notes 3 and 4)	(26,624)	2,044
Equipment-for-lease to others (net of capitalized depreciation and amortization of $6,291 and $6,774)	(29,975)	(35,877)
Investment in computer systems program (Note 3)	—	(14,565)
Deferred lease acquisition and marketing costs through June 30, 1973 (Note 2)	(2,674)	(5,745)
Deferred research and development costs through June 30, 1973 (Note 2)	(749)	(5,214)
Cash of ILC deposited as required by long-term loan agreement	—	13,590
Claims for refund of income taxes	—	5,573
Prepayments and other assets	555	(685)
Property, plant and equipment		
Additions	(3,500)	(6,309)
Net book value of dispositions	3,682	19,751
	(66,734)	(36,505)
Decrease in Cash	$ (1,241)	$ (3,309)

The accompanying notes are an integral part of these statements.

Memorex Corporation

Consolidated Balance Sheets
December 31, 1973 and 1972
(Dollars in Thousands)

	1973 (Note 1)	1972 (Note 1)
ASSETS (Notes 7 and 8)		
Cash	$ 4,099	$ 5,340
U.S. Treasury Bills, at cost plus accrued interest	—	3,488
Accounts Receivable, less allowance for doubtful accounts of $2,412 and $1,804 respectively	41,365	30,428
Inventories, at the lower of cost (first-in, first-out) or market (Note 5)*	58,779	44,710
Equipment-for-Lease to Others, at cost (Notes 1 and 4):*		
Disc pack equipment	26,820	28,668
Computer peripheral equipment	143,788	133,911
Less accumulated depreciation	(77,954)	(45,650)
	92,654	116,929
Property, Plant and Equipment, at cost (Note 6):*	71,940	74,056
Less accumulated depreciation	(28,828)	(22,094)
	43,112	51,962
Investment in Computer Systems Program (Note 3)	—	22,604
Deferred Lease Acquisition and Marketing Costs (Note 2)*	—	19,787
Deferred Research and Development Costs (Note 2)*	—	12,623
Other Assets:		
Prepayments	2,975	3,702
Other assets and deferred charges	3,220	4,906
	6,195	8,608
	$246,204	$316,479

*Excludes amounts classified as Investment in Computer Systems Program as of December 31, 1972 (See Note 3).

	1973 (Note 1)	1972 (Note 1)
LIABILITIES AND SHAREHOLDERS' EQUITY		
Accounts Payable	$ 9,319	$ 14,967
Accrued Liabilities (Note 3)	16,028	7,824
Unsubordinated Notes Payable:		
Memorex Corporation and Subsidiaries, excluding ILC (including $11,549 and $26,437 payable within one year, respectively) (Notes 7 and 17)	154,068	97,186
ILC Peripherals Leasing Corporation (including $36,000 repayable in 1974, of which amount $14,000 may be readvanced under certain conditions, and $24,750 payable in 1973, respectively) (Notes 8 and 17)	71,954	85,440
Federal, State and Foreign Income Taxes (including $1,094 and $1,872 payable within one year, respectively) (Note 12)	6,692	3,843
Lease Commitments and Litigation (Notes 10 and 11)		
Subordinated Debentures,		
Memorex Corporation—5¼% convertible, due 1990 (Note 9)	75,000	75,000
Shareholders' Equity (Notes 7, 8, 9, 13, 14 and 17):		
Common Stock	4,322	4,305
Paid-in Surplus	16,726	16,729
Retained Earnings (Deficit)	(107,905)	11,185
	(86,857)	32,219
	$246,204	$316,479

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

Memorex Corporation

Consolidated and Combined Statements of Shareholders' Equity for the Years Ended December 31, 1973 and 1972
(Dollars in Thousands)

	Total Shareholders' Equity	Common Stock	Paid-In Surplus	Retained Earnings (Deficit)
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 resulting from restructuring of ILC debt (Note 8)	187	—	187	—
Balance December 31, 1972	32,219	4,305	16,729	11,185
Net loss	(119,090)	—	—	(119,090)
Sale of common stock to employees under stock option plan of 1965	14	17	(3)	—
Balance December 31, 1973	$(86,857)	$4,322	$16,726	$(107,905)

The accompanying notes are an integral part of these statements.

Memorex Corporation

Notes to Consolidated and Combined Financial Statements
December 31, 1973

(Notes 7, 8, 13, and 14 are affected by subsequent events described in Note 17)

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 shareholders' equity in subsidiaries is not material and is included in accrued 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, 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 to others and is being depreciated over four years.

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 pro forma effect were given to this purchase as of December 31, 1971, the results of operations for 1972 would be affected by the elimination of other shareholders' equity in ILC loss of $454,000 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 pro forma basis.

International Operations

The financial statements of foreign operations are translated into U.S. dollars using the monetary-nonmonetary method of translation. Cash, temporary investments, accounts receivable and all liabilities are translated at the rates of exchange in effect as of year-end; all other assets are translated at the rates of exchange when acquired (historical rates). Income accounts, except depreciation and amortization which are translated at the rates used for the related asset, are translated at average exchange rates during the year. Exchange adjustments are deferred to the extent they are attributable to long-term notes payable and are amortized over the remaining

Notes (Continued)

term of the debt. As of December 31, 1973 and 1972, there were no deferred exchange adjustments related to long-term notes payable.

Total revenues from International Operations included in the Consolidated and Combined Statements of Income (Loss) were approximately $75,000,000 for the year 1973, as compared to approximately $59,000,000 for the year 1972.

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 peripheral 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 peripheral equipment (subsequent costs of reinstalling equipment are expensed as incurred). Such costs are depreciated on a straight-line basis for certain products and on an accelerated basis for other products over the estimated economic lives of the equipments, which vary between 4 and 7 years. The Company establishes depreciation policies relative to economic lives and depreciation methods 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 economic lives and depreciation methods continue to be reasonable. If the future economic life is estimated to be shorter than previously estimated, additional depreciation charges are provided at the time of such review. During 1973, such reviews resulted in providing additional depreciation of $10,500,000 on certain products as of June 30, 1973 (see Note 4) and additional depreciation provisions of $5,200,000 for the six months ended December 31, 1973. Under currently established depreciation policies, the Company's investment in 3660 Disc File subsystems will be substantially depreciated by December 31, 1975.

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.

Initial Lease Acquisition Costs
Initial lease acquisition costs have previously been deferred and amortized on a straight-line basis over 4 years; however, effective June 30, 1973, the Company changed its policy from one of deferring initial lease acquisition costs to an alternative method of charging such costs against income as incurred (see Note 2 for additional information relating to the change in accounting policy).

Research and Development
Until June 30, 1973, research and development costs related to new product developments were deferred. Effective June 30, 1973, the Company changed its accounting policy from one of deferring new product development costs to an alternative method of charging such costs against income as incurred (see Note 2 for additional information relating to the change in accounting policy).

Income Taxes
Current and deferred income taxes are provided for federal, state and foreign income taxes of the Company and its subsidiaries based upon the operating results in specific countries and the related income taxes thereon. Losses in one country are not applied against profits in another country nor is any effect given to potential income tax benefits which might be realized from net operating loss carryforwards in future periods (see Note 12).

2. Change in Accounting Policy
Effective June 30, 1973, the Company changed its accounting policy from one of deferring research and development costs of new products and initial lease acquisition costs to an alternative method of charging such costs against income as incurred.

The primary reason for the charge against income of $37,373,000 and the decision to change accounting policy was due to recent events, both internal and external. These events are summarized below:

1. Reduced scale of the Company's computer peripheral equipment operations (to match the Company's reduced capacity to obtain capital), resulting in less future revenue than planned, and
2. The cumulative effect upon the Company resulting from the changed method of competition by the Company's predominant competitor (IBM) including, among other things, price cuts, product lock-outs, premature obsolescence and other anti-competitive acts. These acts have resulted and are expected to continue to result in a reduction of the Company's competitive opportunities, a shortening of product revenue producing lives and an adverse effect on the Company's capacity to obtain capital.

The new accounting policy was adopted in partial recognition of the change in estimated future benefits of the costs previously deferred; therefore, the change in policy is being accounted for as a change in estimate. It is not practicable to determine the allocation of the adjustment to all products; however, the Company estimates that approximately $14,000,000 of such charge related to the products revalued as discussed in Note 4. A summary of the components of the total charge is as follows:

Research and Development Costs (including $6,175,000 which had been included in manufacturing costs of equipment-for-lease)	$17,481,000
Lease Acquisition Costs	19,892,000
Total Charge in 1973	$37,373,000

The Company's projected operating plan calls for continued new product developments and for continued leasing operations. However, because of the events described above, it is deemed preferable that no cost deferrals be made in the future for research and development on new products or for acquisition of new leases and that such costs be charged against income as incurred.

The total amount expended for research and development costs related to new product development in 1973 was $3,955,000 of which $749,000 was deferred up to June 30, 1973. Similar amounts for the year 1972 were $11,577,000 incurred, of which $10,077,000 was deferred. The total amount expended for initial lease acquisition costs up to June 30, 1973 was $3,349,000, which was deferred. Subsequent to June 30, 1973 these costs have not been separately identified. The total amount expended for the year 1972 was $8,102,000, which was deferred.

3. Termination of Computer Systems Program

On July 6, 1973, the Company announced the termination of its computer systems program. Accordingly, a charge against income of $40,000,000 was made as of June 30, 1973, such charge resulting from write-offs of Systems related assets and accruals for estimated Systems termination costs. A summary of the components of the net charge for 1973 is as follows:

Asset Write-Offs	
Inventories	$12,405,000
Fixed Assets and Manufacturing Line Design and Start-Up Costs	2,639,000
Equipment-for-Lease to Others	5,984,000
Deferred Research and Development Costs	10,296,000
Deferred Lease Acquisition Costs	2,130,000
	33,454,000
Estimated Termination Costs	6,546,000
Total Charge as of June 30, 1973	40,000,000
Less—Net Recoveries through December 31, 1973....	(1,284,000)
Net Charge in 1973	$38,716,000

At mid-year 1973, recoveries were expected to be minimal and, accordingly, no allowance was made for recoveries. However, the total charge in 1973 reflects net recoveries, predominantly from sales of systems during the last half of 1973. Remaining estimated termination costs of $3,200,000 as of December 31, 1973 are included in accrued liabilities.

4. Revaluation of Certain Assets

In the accompanying Statements of Income (Loss), operating costs and expenses for 1973 include charges aggregating $15,658,000 resulting from revaluation of assets and accelerated depreciation relating to certain products as of June 30, 1973, and $5,200,000 of accelerated depreciation provided during the six months ended December 31, 1973 (see Note 1 for depreciation policies). The charges, necessitated (after adjustments set forth in Note 2) primarily for the reasons set forth in Note 2 above, were as follows:

Asset Revaluation	
Inventories	$ 3,478,000
Machinery and Equipment	634,000
Other Assets	1,046,000
	5,158,000
Accelerated depreciation applicable to Equipment-for-Lease to Others (see Note 1)	10,500,000
Total Charge as of June 30, 1973	15,658,000
Accelerated depreciation provided during six months ended December 31, 1973 (see Note 1)	5,200,000
Total Charge in 1973	$20,858,000

5. 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	
	1973	1972
Raw Materials	$17,340,000	$ 9,029,000
Work in Process	17,686,000	21,294,000
Finished Goods	23,753,000	14,387,000
	$58,779,000	$44,710,000

Of the December 31, 1973 inventories, $38,641,000 are for computer peripheral equipment, a significant portion of which will be subsequently capitalized as equipment-for-lease to others. The comparable amount of inventories at December 31, 1972 was $27,196,000.

Notes (Continued)

6. Property, Plant and Equipment

As of December 31, 1973 and 1972, property, plant and equipment consisted of the following:

	1973	1972
Land	$ 3,871,000	$ 5,420,000
Buildings and improvements	18,988,000	19,544,000
Equipment, furniture and fixtures	46,880,000	48,218,000
Construction in progress	2,201,000	874,000
	71,940,000	74,056,000
Less accumulated depreciation	(28,828,000)	(22,094,000)
	$43,112,000	$51,962,000

7. Unsubordinated Notes Payable—Memorex Corporation and Subsidiaries, Excluding ILC

(See Note 17 for effect of subsequent events.)

On December 28, 1973, Memorex and the Bank of America National Trust and Savings Association, entered into a revised loan agreement (the "Credit Agreement") and a First Amendment to Convertible Note Agreement (the "First Amendment to Convertible Note Agreement") which superseded agreements signed on September 28, 1973 (simultaneous revisions were made in the ILC Loan Agreement, see Note 8). The revised agreements, which are effective as of July 31, 1973, extend certain additional credit facilities, substantially revise principal repayment terms, revise certain financial convenants, defer payment of interest until 1977 and reduce interest rates as of July 31, 1973 by establishing a maximum rate of 7¾%, up to March 31, 1977, in substitution for floating rates based upon prime plus ¾% to 1½%. In addition, the creditors waived any defaults and events of default which existed up to December 28, 1973, under the previous agreements with the Bank.

The revised agreements are designed to allow Memorex to meet its estimated financing requirements through 1976, assuming the Company is able to meet the projected operating and financing plans incorporated in the Credit Agreement. Assuming that Memorex meets its projected operating and financing plans through 1976, the scheduled maturities due after that date will require financing from other sources or a further extension of debt maturities (see Item 1 under revised Credit Agreement provisions set forth below). The following table sets forth the estimated fixed cash payment requirements (excluding those applicable to lease commitments and 5¼% convertible subordinated debentures, see Notes 9 and 10) as of December 31, 1973, of the Company and its subsidiaries, including ILC, based on current agreements and, accordingly, does not give effect to changes that could affect those fixed requirements, including changes in interest rates, conversions of long-term indebtedness into equity and changes in foreign currency exchange rates.

	Year Ending December 31,				
	1974	1975	1976	1977 & Beyond	Total
Bank of America Principal	$ 9,000,000	$12,000,000	$12,000,000	$110,620,000	$143,620,000
ILC Lenders Principal (see Note 8)	22,000,000	24,000,000	23,690,000	—	69,690,000
Other unsubordinated notes payable	2,549,000	2,349,000	217,000	627,000	5,742,000
Total	33,549,000	38,349,000	35,907,000	111,247,000	219,052,000
Deferred interest on above indebtedness as of December 31, 1973.	—	—	—	6,970,000	6,970,000
Total	$33,549,000	$38,349,000	$35,907,000	$118,217,000	$226,022,000

Unsubordinated notes payable, excluding ILC which is described in Note 8, consist of the following:

	December 31,	
	1973	1972
Bank of America loans, secured* (including interest deferral notes of $4,706,000 as of December 31, 1973)	$148,326,000	$92,599,000
First National City Bank (International-San Francisco) non U.S. lease financing secured*	2,735,000	723,000
Other liabilities, mostly secured	3,007,000	3,864,000
	$154,068,000	$97,186,000

*Of these amounts, $41,832,000 and $33,054,000 in 1973 and 1972 respectively, were payable in currencies other than the U.S. dollar.

Under the Credit Agreement, the previously existing short-term bank advances and the term Loans as of July 31, 1973, are combined into new loans designated as Overseas Facilities, Eximbank Line, Term Loan, and New Revolving Line of Credit. Under the First Amendment to Convertible Note Agreement, Memorex exchanged a $14,500,000 convertible note of Memorex due July 3, 1977 for a convertible note of Memorex due in 1978 and 1979 (the "New Convertible Note"). The Bank may convert the New Convertible Note into the Company's common stock based upon a conversion price of $23.85 per share as of December, 1973, which decreases in increments of 10% annually to $15.90 by July 1, 1976, representing a minimum of 607,966 shares and up to a maximum of 911,950 shares (subject to adjustment under anti-dilution provisions). The loans under the Credit Agreement and the New Convertible Note are hereafter collectively referred to as the "Bank Loan".

Notes (Continued)

The Credit Agreement provides, among other things, for the following:

1. Monthly payments of $1,000,000 per month between April 1, 1974 and December 31, 1974, totalling $9,000,000 in 1974, $12,000,000 during each of the years 1975 and 1976 and $3,000,000 in 1977. The balance of the Bank Loan matures on March 31, 1977, except the Term Loan and the New Convertible Note (totalling $33,050,000), which are repayable at the rate of $1,000,000 per month between April 1, 1977 and July 1, 1978, and thereafter at the rate of $2,000,000 per month until paid in full. In the event that on December 31, 1976, the Company has achieved a consolidated positive net worth of not less than $20,000,000 and has a ratio of debt (excluding subordinated debt) to net worth plus subordinated debt of not greater than 2 to 1, the outstanding Bank Loan except the New Convertible Note may, at the Company's election, be converted into a New Term Loan payable in 24 equal monthly installments commencing April 1, 1977.
2. Mandatory prepayments, subject to retention by the Company of adequate cash reserves, as defined in the Credit Agreement, in the event that (1) the Company and its subsidiaries, excluding ILC, at the end of any fiscal year have excess cash flow from operations, as defined in the Credit Agreement (prepayment not to exceed 50% of such excess), or (2) the Overseas Facilities or the New Revolving Line of Credit exceeds a borrowing base which consists of the sum of cash, plus a defined percentage of accounts receivable (excluding inter-company), inventories and equipment-for-lease to others (prepayments not to exceed an aggregate cumulative maximum of $3,000,000). In addition, prepayments are required, subject to certain restrictions and conditions, in the event the Company derives net proceeds from the sale of assets other than in the ordinary course of business; from the sale of securities (other than net proceeds from employee stock purchase or stock option plans) if unanimously required by the Bank and all ILC Lenders; or from settlement of any litigation or judgment in excess of $1,000,000. Under certain conditions, prepayments are to be applied ratably to reduction of the outstanding Bank Loan and ILC's loans.
3. Interest on the New Convertible Note, the Term Loan and the New Revolving Line of Credit will be accrued by the Company at the same rate as the ILC Loans and Advances (described in Note 8) until March 31, 1975 with a minimum of 6%, and thereafter at 7¾% per annum; however, payment of such interest is to be deferred by the Bank during the term of the Credit Agreement in consideration of the Company's issuing interest deferral notes to the Bank for the amount of interest accrued at the end of each calendar year. Such interest deferral notes will be payable 4 years from date of issuance and will bear interest at 6% per annum from date of issuance. Commencing April 1, 1977, the Term Loan and the New Convertible Note will bear interest without deferral at 1% in excess of the Bank's prime rate and is payable monthly. Payment of interest on the Eximbank Line (the principal balance totalling $5,582,000 at December 31, 1973)

shall continue to be made according to the terms of the promissory notes issued thereunder; however, such interest payments may be reborrowed by Memorex, to be evidenced by interest deferral notes in the manner set forth above. Interest on the Overseas Facilities is payable at the earlier of maturity of the advance or annually commencing with the year 1974, or, at the option of the Bank, payment may be deferred, evidenced by interest deferral notes, in the manner set forth above. All interest payments made in cash may be reborrowed by Memorex, evidenced by interest deferral notes payable in the manner set forth above, except that the interest payments in excess of 7¾% per annum made by Memorex to third party Lenders may not be reborrowed. The Overseas Facilities bear interest at variable rates as set forth in the Credit Agreement. The amount of interest accrued on the New Revolving Line of Credit will be reduced by an amount equal to the amount by which the interest paid on the Overseas Facilities and the Eximbank Line exceeds the amount that would have been paid at the rate set forth above for the New Revolving Line of Credit.

4. The Company to reach and maintain certain levels of income from operations in the future, to meet certain net worth requirements which are related to the projected operating and financing plans incorporated in the Credit Agreement and maintain certain monthly rental revenues, rental revenue ratios and cumulative gross investments in equipment-for-lease as defined in the Credit Agreement.

The Bank also has exercised its right to take security interests in all of Memorex's real and personal property and is in process of perfecting those security interests. Under the Credit Agreement, Memorex may not pay cash dividends.

On December 21, 1973, Memorex and First National City Bank (International-San Francisco) ("FNCB") entered into an agreement dated as of October 1, 1973 (the "FNCB Credit Agreement") amending a prior agreement providing for non-U.S. lease financing. The FNCB Credit Agreement provides, among other things, for the following:

1. The continued extension of credit to Memorex in the aggregate amount of $2,735,547.
2. Monthly repayments of $125,000 between April 1, 1974 and December 1, 1975, with a final payment of $110,547 on January 1, 1976.
3. Interest at the rate of 7¾% per annum, payment to be deferred as follows: Interest accrued during each month is computed at the end of that month and from that day bears interest at the rate of 6% per annum. All such interest is payable in the amount of $14,453 on January 1, 1976; $125,000 on February 1, 1976 and March 1, 1976; and the balance on April 1, 1976.
4. Generally the same financial covenants as the Credit Agreement.
5. Waiver by FNCB of any events of default which existed under its previous agreement with Memorex.

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.

Notes (Continued)

8. Unsubordinated Notes Payable—ILC Peripherals Leasing Corporation (ILC)

(See Note 17 for effect of subsequent events.)

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.

On December 28, 1973, at the same time the Bank of America agreements were revised (see Note 7), ILC, Memorex, the ILC Lenders (the Lenders), the Bank of America, as creditor of Memorex, and The Chase Manhattan Bank (National Association) as Security Agent, entered into a Loan Agreement dated as of July 31, 1973 (the "Loan Agreement") whereby the Lenders to ILC agreed to revisions of certain terms of the previous loan agreement and also waived defaults and events of default up to December 28, 1973, under the previous loan agreement. The following paragraphs describe the significant terms and provisions of the Loan Agreement.

Line of Credit

The Lenders agreed to continue their extension of credit to ILC in the aggregate amount of $69,690,000 (the "Existing Loan") and to readvance under certain conditions out of ILC's cash flow a portion of the repayments of existing credit to ILC up to a maximum of $30,500,000 (the "Advances") (the Existing Loan and the Advances are hereinafter referred to collectively as the "Loan") for the purpose of equipment purchases from Memorex during the period from August 1, 1973 through March 31, 1975, as follows:

1. During the period ending January 15, 1974, up to an aggregate amount of $13,500,000.
2. During the period from January 1, 1974 through March 31, 1975 up to $1,000,000 per month, aggregating up to $15,000,000.
3. During the month of March, 1974, an additional amount contingent on Memorex's cash needs and certain other conditions, not to exceed $2,000,000.
4. The aggregate outstanding principal amount of the Existing Loan and the Advances may not exceed $69,690,000 (excluding Interest Notes).

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 through March 31, 1975, and thereafter at rates to be determined by unanimous agreement of the ILC Lenders in light of conditions prevailing at that time. As of December 31, 1973, the cumulative maximum interest rate permitted under the Loan Agreement had been reached; therefore, the present interest rate is 7¾%.

Repayments are to be applied entirely to principal, with payment of interest deferred (evidenced by interest deferral notes—"Interest Notes") until all principal is repaid in full. ILC Interest Notes at December 31, 1973 totalled $2,264,000. The Interest Notes are to bear interest not to exceed 6% per annum with a maximum rate which will result in a cumulative interest rate on all ILC loans from December 29, 1970 to maturity not exceeding 10% per annum. The Loan and the Interest Notes mature on March 31, 1977, subject to mandatory prepayment as follows: (1) in monthly installments of $2,700,000 during the period of September 1, 1973 through January 1, 1974 (totalling $13,500,000), (2) in monthly installments of $3,000,000 subject to re-advance of $1,000,000 from February 1, 1974 until the Loans and the Interest Notes are paid in full, except that $7,500,000 of principal may be converted into Memorex common stock, and is referred to below as "Convertible Installments".

Prepayments may be required, subject to retention by Memorex of adequate cash reserves as defined in the Loan Agreement, in the event that Memorex and its subsidiaries, excluding ILC, derive net proceeds from (1) the sale of assets other than in ordinary course of business, or (2) the sale of securities (other than net proceeds from employee stock purchase or stock option plans) if unanimously required by the Bank and by all ILC Lenders. Prepayment is also required in the event that Memorex receives net proceeds from the settlement of any litigation or judgment in excess of $1,000,000 and under certain conditions, in the event that Memorex has excess cash flow, as defined in the Credit Agreement or in the event that ILC has excess cash flow, as defined in the Loan Agreement. Under certain conditions, prepayments are to be applied ratably to reduction of the outstanding loan with the ILC Lenders and Memorex's outstanding Bank Loan with the Bank.

Covenants

ILC has agreed, among other things, to maintain a borrowing base, consisting of a multiple of lease revenues recorded for the month then ended at least equal to the Loan and the Interest Notes, and to maintain consolidated tangible net worth as defined in the Loan Agreement equal to at least $25,000,000. In the event that ILC does not meet these financial tests, Memorex is obligated to purchase from ILC, upon call by ILC, the number of shares of common stock determined by ILC to be the minimum necessary to cure all existing defaults under such financial covenants. As of December 31, 1973, ILC's tangible net worth was $28,833,000. The Loan Agreement also contains the same financial covenants as the Credit Agreement (see Note 7).

Convertible Installments

A part of the Loan (the "Convertible Installments") in the principal amount of $7,500,000 may be converted into an aggregate of 375,000 shares of Memorex common stock at $20 per share subject to adjustment by reason of anti-dilution provisions. The Convertible Installments may be converted in whole or in part, as to each Convertible Installment until the day before such Convertible Installment matures (until August 31, 1976 as to all such Installments, and until November 30,

Notes (Continued)

1976 as to the final Convertible Installment). The Convertible Installments are not prepayable, except that if the market value of Memorex common stock is equal to or greater than $40 per share, ILC may elect to prepay the Convertible Installments, or any portion thereof, called for prepayment prior to the date of prepayment. From September 1, 1976 to June 30, 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's common stock for each $20 of such Lender's percentage interest in the Convertible Installments which has not been prepaid by ILC nor converted as set forth above.

Security

ILC has continued the previous grant to the Lenders of a security interest in all of its assets (Cash, Accounts Receivable, Equipment-for-Lease at Memorex cost, less accumulated depreciation, and Other Assets totalling $50,380,000 at December 31, 1973). Memorex has continued its grant to the Lenders of a security interest in that portion of its raw materials, work in process and inventory held for sale to ILC. Memorex has also agreed to grant a security interest to the Bank and the Lenders in the non-cash portion of proceeds from the settlement of litigation or judgment in excess of $1 million; has guaranteed the obligations of ILC under the Loan Agreement, for the ratable benefit of the Bank and the ILC Lenders; and has agreed to grant to the Lenders a security interest, subordinated to that of the Bank, in all of its causes of action. Also, Memorex has pledged the securities of ILC owned by Memorex as security for ILC's and Memorex's obligations under the Loan Agreement.

Security Agent and Collateral Account

All of ILC's cash receipts must be deposited in a collateral account under the control of a Security Agent. The Loan Agreement instructs the Security Agent to make direct payments of ILC's obligations, including monthly payments to Memorex for services and maintenance. ILC must prepay portions of the Loan, subject to a $3 million cash reserve, 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 purchases by ILC) and upon the occurrence of certain other events.

9. Memorex Corporation—5¼% Convertible Subordinated Debentures, Due 1990

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.

10. Lease Commitments

During 1972, Memorex consummated the sale and leaseback (30-year lease) of a portion of its administration and equipment manufacturing facilities 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.

The discounted present value of the above-mentioned lease payments at 9.8% (contract rate) was $18,250,000 as of December 31, 1973 and 1972. Had this lease (a financing lease) been capitalized and the related assets been amortized on a straight-line basis and had interest cost been accrued on the basis of the outstanding lease liability, the net income for 1972 would have been decreased by $332,000 and the net loss for 1973 would have been increased by $673,000.

Total lease rentals were as follows:

	1973	1972
Financing lease	$1,804,000	$ 752,000
Other leases	4,471,000	2,354,000
Total	$6,275,000	$3,106,000

Minimum rental commitments remaining under noncancellable leases as of December 31, 1973, were as follows:

Five Years Ending December 31,	
1978	$13,470,000
1983	9,673,000
1988	9,251,000
1993	9,023,000
Subsequent to December 31, 1993	15,486,000
Total	$56,903,000

The rental commitments for each of the five years ending December 31, 1978 are $3,473,000 in 1974; $3,040,000 in 1975; $2,496,000 in 1976; $2,319,000 in 1977; and $2,142,000 in 1978.

Notes (Continued)

11. Litigation

On December 14, 1973, Memorex and its subsidiaries (the plaintiffs) filed complaints against International Business Machines Corporation (IBM) alleging that IBM is using and has used its monopoly power to control prices and eliminate competition. The plaintiffs further allege that IBM has monopolized and attempted to monopolize the development, production, distribution, sale, leasing and servicing of electronic data processing equipment as a whole, including but not limited to computer peripheral products for use with IBM central processing units, to the direct detriment of plaintiffs, in violation of the federal antitrust laws. The plaintiffs estimate actual damages to be in excess of $1 billion, and seek to recover treble damages ($3.1 billion) under the Clayton Act, as well as costs and attorneys' fees. Plaintiffs also seek such preliminary and permanent injunctive relief, including divestiture, as is reasonably necessary to restore effective competition in the electronic data processing industry. The defendant has filed an answer denying liability, raising affirmative defenses and asserting that it is entitled to offset for unjust enrichment.

On June 24, 1971, the Securities and Exhange 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 for any purpose . . .".

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 or punitive damages sought for the entire class sought to be represented.

Plaintiffs in eight of the class action suits filed a motion requesting the Court to certify a class action. On June 14, 1973, the Court consolidated these eight cases for all purposes and certified a class consisting of all persons who purchased Memorex securities on the open market between July 31, 1970 and April 14, 1971 and who suffered a loss as a result of the defendants' alleged misstatements and omissions. The class determination is limited to plaintiffs' federal law claims. In the opinion of Counsel, the Company has meritorious defenses to all of these currently pending actions.

On May 10, 1973, a complaint against the Company was filed by three former Memorex employees alleging breach of incentive compensation contracts and fraud and seeking injunctive relief, $1,855,000 damages and $3,000,000 punitive damages. In the opinion of Counsel, the Company has meritorious defenses to this action.

On or about January 2, 1974, the Company was served with a complaint by Quadra-Data, Inc. The complaint alleges that Memorex breached a four-year contract for the lease of a computer and computer services and seeks general damages of $1 million and an additional $1 million in punitive damages. On March 1, 1974 Memorex filed an answer denying liability. Since discovery in this case has not yet been completed, counsel has not yet conducted a sufficient investigation to venture an opinion as to the Company's possible ultimate liability.

Although there are other actions pending to which the Company is a party, the Company is of the opinion, based upon the advice of Counsel as to the current status of such litigation, and based upon information known by the Company to date, that such actions will not have a material adverse impact on the business of the Company.

12. Income Taxes

The Company's federal income tax returns through 1969 have been examined by the Internal Revenue Service without material adjustments. 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 accruals have been provided for any potential tax assessments.

The consolidated and combined (credit) provision for income taxes for 1973 and 1972 consists of the following:

	December 31, 1973	December 31, 1972
Federal	$ 110,000	$(1,127,000)
State	—	80,000
Foreign	4,815,000	1,799,000
	$4,925,000	$ 752,000

The provision for income taxes of $4,925,000 and $752,000 for 1973 and 1972, respectively, includes current and deferred taxes of the Company and its subsidiaries based upon the operating results in specific countries and the related income taxes thereon. It does not include the application of losses in one country against profits in another country, nor does it include the effect of potential income tax benefits which might be realized from net operating loss carryforwards in future periods. No accrual has been made for withholding taxes that might be payable upon distribution of dividends from foreign subsidiaries inasmuch as the Company has no present intention to remit dividends. Undistributed retained earnings in foreign subsidiaries at December 31, 1973 totalled $3,573,000.

As of December 31, 1973, the Company had consolidated net operating loss carryforwards available per U.S. income tax returns filed through December 31, 1972, of $28,007,000 to offset against future U.S. taxable income expiring as follows:

December 31,	
1976	$14,749,000
1977	13,258,000
	$28,007,000

The Company will have net additional estimated income tax deductions to be claimed in the 1973 and subsequent years' U.S. income tax returns of approximately $48,900,000 from losses recorded for financial reporting purposes during the year 1973, which may be offset against future U.S. taxable income for a period of five years. The Company does not expect that the cash outlay for income taxes with respect to any of the succeeding three years will substantially exceed income tax expense for those years.

In addition, the Company has available unused investment tax credits as of December 31, 1973, of approximately $5,748,000 which may be offset against future U.S. income tax liabilities. Expiration of the investment tax credits will be $25,000 in 1974; $106,000 in 1975; $69,000 in 1976; $1,238,000 in 1977; $2,077,000 in 1978; $824,000 in 1979; and $1,409,000 in 1980.

13. Preferred and Common Stock

(See Note 17 for Effect of Subsequent Events.)

Authorized and outstanding shares of $100 par value preferred stock and $1 par value common stock of Memorex Corporation were as follows:

	December 31, 1973	December 31, 1972
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)	4,312,133	4,295,268

Memorex has entered into agreements with key employees of certain of its subsidiaries which call for the potential issuance of up to 66,874 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 conversion rights contained in the Credit Agreement (see Note 7).

Shareholders approved in May, 1973, a new employee Savings and Investment Plan which may purchase the Company's common stock, either in the open market or from the Company (at the Company's discretion). Memorex has reserved 250,000 shares for potential issuance at market price under the Plan.

Memorex has reserved 375,000 shares of its common stock for potential issuance to Lenders to ILC under convertible note agreements (see Note 8).

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 9).

Memorex has reserved 516,237 shares of its common stock for issuance under the Company's 1965 and 1973 Stock Option Plans.

14. Stock Options (Memorex Corporation)

(See Note 17 for effect of subsequent events.)

On May 17, 1973, Memorex shareholders approved the adoption of the Company's 1973 Stock Option Plan ("nonqualified") as an alternative to the 1965 Plan ("qualified"). Options for 174,800 shares were granted under the 1973 Plan to certain optionees in substitution on a share-for-share basis for options held under the 1965 Plan; however, certain optionees having options outstanding under the 1965 Plan did not receive 1973 Plan option grants and such options continue to be exercisable under the 1965 Plan. Also, options under the 1973 Plan were not granted in substitution of options exercisable at $1.00 and $1.50 per share, which were assumed upon acquisition of minority interests in subsidiaries, such options continuing to be exercisable under the 1965 Plan at one-fourth the total shares each year on a cumulative basis, beginning one year from date of grant, and expiring five years after date of grant.

Under the 1973 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. This 1973 Plan provides that options are exercisable at the rate of 33⅓% after six months from the date of grant, and 33⅓% after each of the following two years. The term of the options may be up to ten years. The 1973 Plan options are "nonqualified" options which will be exercisable notwithstanding the existence of an earlier option.

Additional options for 152,600 shares granted under the 1973 Plan were outstanding at December 31, 1973.

Notes (Continued)

The net proceeds from sale of stock at the time the options are exercised are credited to the common stock and paid-in surplus accounts. No entries are made to income accounts with respect to recording the exercise of such options.

Changes during 1973 in the status of options granted under the 1965 and 1973 Stock Option Plans:

Year Granted	Option Price	Jan. 1, 1973	Granted	Exchanged for Non-qualified	Exercised	Terminated	Dec. 31, 1973
		Shares Under Option—Changes During Year					
Qualified							
1967	$34.79 to $ 63.92	33,857				(33,857)	—
1968	65.81 to 66.63	675		(675)			—
1968	1.00	125					125
1969	71.25 to 163.50	44,250		(33,575)		(10,325)	350
1969	1.00 to 1.50	15,690			(4,200)	(3,713)	7,777
1970	45.44 to 116.25	24,400		(17,700)		(6,700)	—
1970	1.00 to 1.50	9,900			(3,037)	(3,500)	3,363
1971	20.00 to 35.38	92,600		(84,200)		(7,800)	600
1971	1.00	30,270			(8,191)	(8,711)	13,368
1972	29.06 to 36.81	63,200		(38,650)		(24,550)	—
1972	1.00	11,550			(562)	(1,750)	9,238
		326,517	—	(174,800)	(15,990)	(100,906)	34,821
Non-qualified							
1973	1.75 to 5.06¼	—	169,300	174,800	—	(16,700)	327,400

The Company has adopted special incentive compensation programs for key employees of certain divisions of the Company. All incentive programs are designed to assure a profit contribution from the new product business developed by the applicable division before any incentive payment will be made to the participants and are also designed to help the Company obtain and retain key employees.

The incentive compensation program for key employees of the Consumer Products Division provides for incentive awards payable, at the Company's option, in cash or Common Stock of the Company, upon the attainment of specified performance goals in the period 1970 to 1976 inclusive. The maximum total of incentive awards provided for by the program if all specified goals are met, is $2,000,000 (increased to $3,000,000 if the total of all goals is exceeded by 25%). As of February 27, 1974, $1,433,000 of the aggregate incentive participation had been allocated under this program, of which $350,000 had been allocated to officers of the Company. During 1973 and 1972, $573,000 and $230,000, respectively, has been charged to expense for the Consumer Products Division Plan. The Company has also approved a similar incentive program for key employees in its Business Products Division which authorizes incentive awards of up to $4,000,000, payable, at the Company's option, in cash or Common Stock of the Company, upon attainment of specified sales goals of toner products and a determination of reasonable operating profits by the Board of Directors. As of February 27, 1974, $763,000 of the aggregate incentive participation had been allocated under this program, none of which has been allocated to officers of the Company.

15. 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 years (4,309,395 in 1973 and 4,028,953 in 1972) 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 nor do other common stock equivalents (stock options) result in dilution.

Memorex has entered into convertible debt agreements with Bank of America and with ILC Lenders (see Notes 7 and 8) 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.

16. Income (Loss)—(Unaudited) Summary for Three Months Ended December 31, 1973 and 1972

Unaudited income (loss) for the three months ended December 31, 1973 and 1972 is summarized below as additional information:

	Three Months Ended December 31 (Unaudited) 1973	1972
Revenue:		
Rental and Service	$ 24,376,000	$20,948,000
Sales	24,063,000	18,495,000
	48,439,000	39,443,000
Operating Costs and Expenses	56,504,000	33,885,000
Income (Loss) from Operations	(8,065,000)	5,558,000
Interest Expense	(5,748,000)	(4,220,000)
Other Shareholders' Equity—ILC	—	(81,000)
Income (Loss) before Taxes	(13,813,000)	1,257,000
Credit (Provision) for Income Taxes	—	646,000
Net Income (Loss)	$(13,813,000)	$ 611,000
Net Income (Loss) Per Share	$(3.20)	$.14

Included in the 1973 loss were charges against income totalling $4,465,000: $3,600,000 in asset revaluation and accelerated depreciation charges; and $865,000 in foreign exchange and translation loss. The remaining 1973 loss of $9,348,000 occurred principally in worldwide equipment operations. The gross margin contribution from equipment operations for the period in 1973 was lower than expected due primarily to a higher percentage of equipment off-rent, and adjustments to the cost of equipment for lease that would more properly align the costs associated with equipment leasing with anticipated future revenues.

Notes (continued)

17. Event Subsequent to December 31, 1973

On March 29, 1974, Memorex obtained agreement in principle for modifications of its Loan Agreement dated December 28, 1973 with Bank of America, National Trust and Savings Association ("Bank of America"). Simultaneously, Lenders to ILC agreed in principle to modifications of the ILC Loan Agreement dated December 28, 1973. The accounting treatment of these agreements to reflect the timing and form of the transaction, including the amounts of interest and dividends to be charged against earnings, has not yet been determined. The execution by the Lenders of definitive agreements, representing the agreement in principle, is subject to Mr. Robert C. Wilson's being the Chairman of the Board, President and Chief Executive Officer of Memorex at the time such agreements are to be executed. Mr. Wilson has agreed to serve as President and Chief Executive officer pursuant to an employment contract, certain of the compensation provisions of which are guaranteed by the Bank of America.

The significant modifications are set forth below:

1. Conversion of Debt to New Senior Preferred Stock
   A total of $30 million of Memorex's outstanding senior debt due to Bank of America and $10 million of ILC's senior debt will be converted to new senior preferred stock of equal par value. The preferred stock to be issued to Bank of America will bear no dividend until 1978, and then bear cumulative annual dividends of 4% in 1978, increasing to 6% on January 1, 1981 until redemption. The redemptions are to be made at 1/10 per year from 1983 through 1992. The preferred stock to be issued to Lenders to ILC will bear no dividend until 1976 and then bear cumulative annual dividends of 4% in 1976, increasing in varying amounts to 8% in 1981 and thereafter and will be redeemable in equal annual installments from 1983 through 1987.

2. Interest Rate Reductions
   The rate of interest on the remaining Bank of America and ILC loans of $173,310,000 outstanding as of December 31, 1973 will be reduced from 7¾% to 4%, retroactive to August 1, 1973, and extending through December 31, 1977 at which time the prime rate will apply. All presently accrued and future interest payments (at 4%) required through December 31, 1977, may be paid with preferred stock of equal par value.

3. Warrants and Conversion Rights
   Bank of America and ILC will cancel warrant and conversion rights aggregating potential maximum issuance of 1,286,950 shares at acquisition prices ranging from $15.90 to $23.85 per share. In exchange for cancellation of conversion features and rights noted above, the senior creditors will receive 15-year warrants to purchase 800,000 shares at $10 per common share (exercise price to be reduced

to the price of any new shares or rights should Memorex issue additional common stock, warrants or conversion rights within 12 months at a price of less than $10 per common share, other than shares issued pursuant to any employee benefit plan). The Bank of America and ILC's Lenders have agreed to convert, if requested by Memorex, up to an additional $25 million of senior debt to preferred stock prior to December 31, 1977. Such additional conversion would be in the amount of 75 percent of any equity which might be created by conversion of Memorex's 5¼% convertible subordinated debentures into equity securities junior to those of the Lenders, or by purchase of the debentures by the Company for cash at less than face value. If such conversion occurs, the converting Senior Debt holders would receive up to 500,000 additional 15-year warrants exercisable at $10.

4. Revisions in Principal Repayments

In addition to the above mentioned conversion of debt to preferred stock, maturities of debt not converted falling due in 1974 and subsequent years have been modified to the following—

a. Bank of America principal repayments, excluding future lease equipment line of credit discussed below, shall be $750,000 per month commencing July 1, 1974 until May 1, 1977 ($26,250,000) at which time principal repayments shall increase to $2,250,000 per month ($91,370,000) until fully repaid.

b. ILC principal repayments shall be $1 million per month from April 1, 1974 through June 1, 1974 ($3 million), increasing to $1½ million per month from July 1, 1974 through January 1, 1976 ($28½ million) then increasing to $2 million per month until fully repaid ($28 million).

The effect of these changes on cash repayments of debt for the year 1974 and beyond are as set forth below:

Year	Under Agreements in Principle	Under December 28, 1973 Agreements(1)
1974	$ 20,500,000(2)	$ 31,000,000(2)
1975	27,000,000	36,000,000
1976	33,000,000	35,690,000
1977 and beyond	92,810,000	117,590,000
Total	$173,310,000	$220,280,000

(1) Includes $6,970,000 of Interest Deferral Notes as of December 31, 1973.

(2) Of these amounts $4 million of debt repayments had been made in 1974 by the date of reaching the Agreement in Principle.

Notes (continued)

5. New Line of Credit—Lease Financing

   Bank of America will make available a line of credit of $35,000,000 through 1978. This new credit will be available to finance new equipment for lease during the period 1974 through 1978, to the extent that present obligations to Bank of America are repaid (which payments are indicated in paragraph 4 above).

   Interest on these loans shall be at the prime rate through December 31, 1977 and two points over the prime rate thereafter. Monthly principal and interest repayments shall be 75% of monthly lease payments and 100% of receipts from sales, if applicable, of leased equipment financed under this line of credit.

6. Security Agent and Collateral Account

   The Security Agent and collateral account will continue to function as in the past. However, there will be no mandatory prepayment of excess cash flow and all cash in excess of principal payments defined above and payments to Memorex for services and maintenance will be available to purchase new equipment until March 31, 1975. Beginning April 1, 1975, ILC must prepay portions of the Loan, subject to a $3 million cash reserve, to the extent it has excess cash flow.

7. The Accounting Treatment

   The accounting treatment of this agreement to reflect the timing and form of the transaction, including the amounts of interest and dividends to be charged against earnings, has not yet been determined.

To the Shareholders and Board of Directors of Memorex Corporation:

We have examined the consolidated balance sheets of Memorex Corporation (a California corporation) and subsidiaries as of December 31, 1973 and 1972, and the related consolidated and 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.

In our auditors' report, dated March 5, 1973, our opinion on the Company's consolidated and combined financial statements as of December 31, 1972, was qualified as being subject to the realization of sufficient future revenues to recover the Company's investment in the MRX/Computer Systems Program. As explained in Note 3 to the accompanying financial statements, the MRX/Computer Systems Program has been terminated, and related deferred and accrued costs, net of recoveries, in the amount of $38,716,000 have been charged against operations during the year ended December 31, 1973.

In our opinion, subject to the effect on the financial statements for the year ended December 31, 1972, of the matter discussed in the preceding paragraph, and subject to the effect on the financial statements of any adjustments that may result from litigation mentioned in Note 11 to the accompanying financial statements, the financial statements referred to above present fairly the consolidated financial position of Memorex Corporation and subsidiaries as of December 31, 1973 and 1972, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles which, other than for the change, with which we concur, to an alternative method of accounting for research and development costs of new products and initial lease acquisition costs, as indicated in Note 2 to the accompanying financial statements, were consistently applied during the periods.

ARTHUR ANDERSEN & CO.

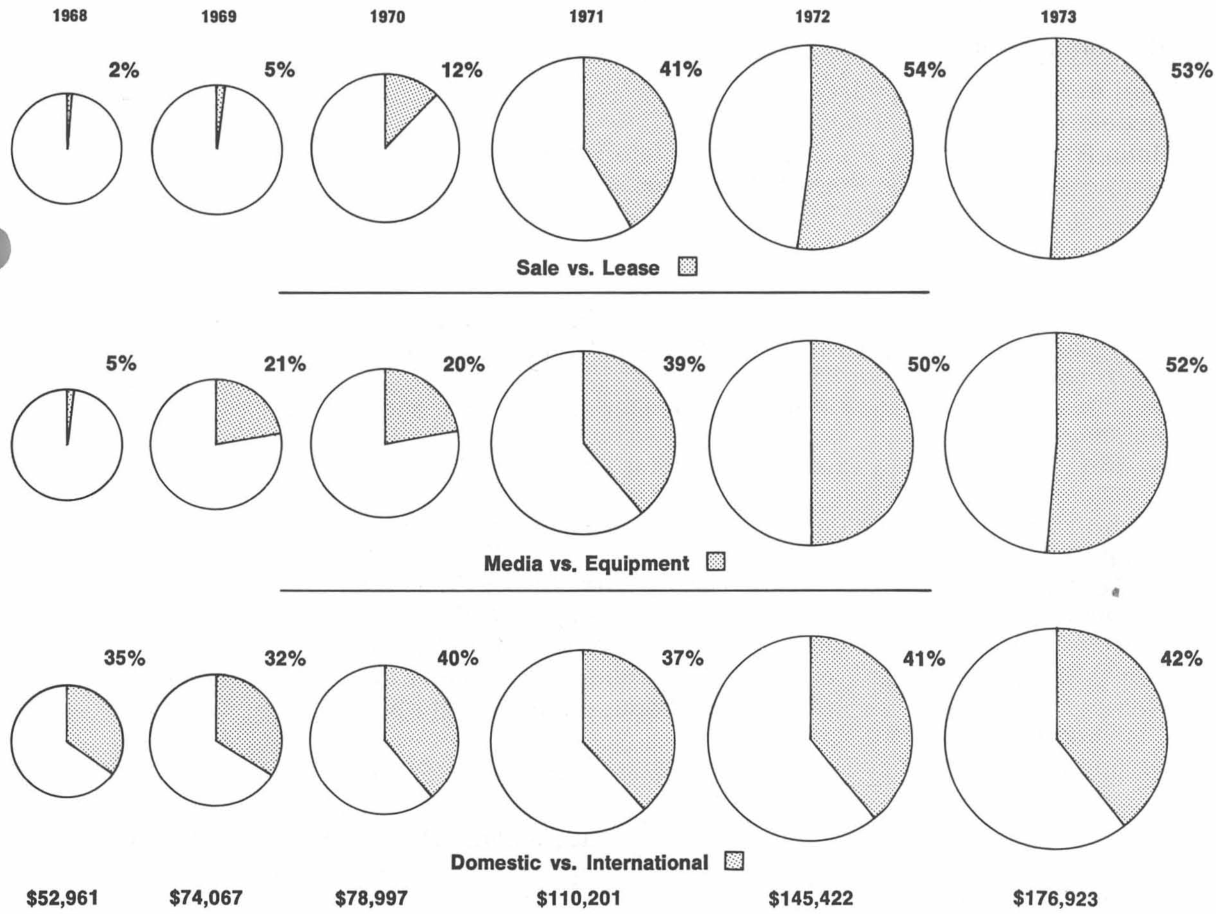
San Jose, California,
February 28, 1974 (except with respect to the matters discussed in Note 17, as to which the date is March 29, 1974).

Business Balance of Revenue

The chart on the next page illustrates the evolution of Memorex's revenue sources. Until 1968, the Company was engaged in the sale of media products, mainly in the U.S. The equipment-for-lease business was started that year and has grown so that, in 1973, Memorex derived approximately half its revenues from the diversification. The increase of lease revenues relates to equipment products which are primarily attached to leased computers. Both media and equipment are worldwide markets, reflecting the common application of information processing technology in all major industrial nations.

Memorex Revenue History 1968-1973

(Dollars in Thousands)



Officers

Executive Staff

Laurence L. Spitters*, President and Chairman of the Board

J. Garrett Fitzgibbons, Vice President, General Manager of Media Operations

John J. Kramer, Vice President, General Manager of Equipment Products and International Operations

Corporate Staff

Carl A. Anderson, Secretary

Donald M. Campbell, Treasurer

John R. Eastling, Vice President, Corporate Planning

Harold J. Krauter, Vice President, Finance

Edward J. Phillippe, Vice President and Controller

George L. Bragg**

Operations Staff

George E. Dashiell, Vice President, General Manager of Marketing for Equipment Products

William F. Emmons, Vice President for Market Development, Equipment Products

Robert Jaunich II, Vice President, General Manager of Consumer Products

John P. Kelly, Vice President of Product and Marketing Support, Equipment Products

E. Douglas Larson, Vice President of Manufacturing, Equipment Products

William S. McCalmont, Vice President of European Operations

Hiroshi Nagakura, Vice President of Materials Operations, Equipment Products

Robert C. Stender, Vice President of Product Development and Planning for Equipment Products

Philippe Yaconelli, Vice President of Marketing, Media Products

*Laurence L. Spitters resigned as President and Chairman of the Board as of April 26, 1974. Robert C. Wilson assumes office on May 15, 1974, as President, Chief Executive Officer and Chairman of the Board.

**George L. Bragg elected Vice President, Administration, April 22, 1974.

Board of Directors

Laurence L. Spitters,*
Chairman of the Board

Alger Chaney, Chairman of the Board,
Medford Corporation

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

*Laurence L. Spitters resigned as President and
Chairman of the Board as of April 26, 1974. Robert C.
Wilson assumes office on May 15, 1974, as President, Chief Executive Officer
and Chairman of the Board.

Memorex Executive Offices

San Tomas at Central Expressway
Santa Clara, Calif. 95052
(408) 987-1000

Sales and Service Offices

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Memorex Common Stock and 5¼% Convertible Subordinated Debentures Are Traded Over-the-Counter.

Common Stock

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Corporate Trust Department
111 Wall Street
New York, New York 10015

Bank of America-NT&SA
Corporate Agency-Service Center
P. O. Box 37002
San Francisco, California 94137

Registrars:

Morgan Guaranty Trust Company of New York
30 West Broadway
New York, New York 10015

Wells Fargo Bank
464 California Street
San Francisco, California 94120

5¼% Convertible Subordinated Debentures

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Corporate Agency-Service Center
P. O. Box 37002
San Francisco, California 94137

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