

MEMOREX

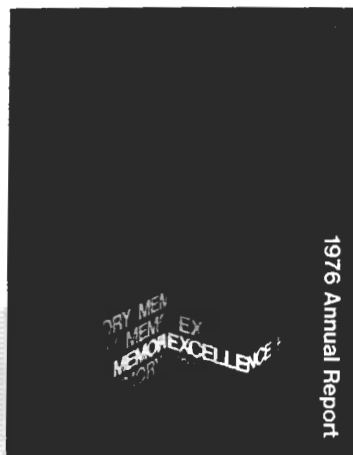
1976 Annual Report

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Memorex Corporation 1976 Annual Report

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On the cover, "Memorex-excellence" signifies the company's dedication to excellence in information storage and communication products. The building blocks symbolize the basis for continuing profitable growth that has been established. As a Memorex symbol, the building block is featured at entrances to company plants.



The Memorex Corporate Headquarters building at Santa Clara, California, has been reoccupied by the corporate staff as other space at the main plant was needed for expanded manufacturing in anticipation of 1977 customer needs.

Financial Highlights*

	1976	1975	Difference
<i>(For the year ended December 31)</i>			
Revenues	\$344,633,000	\$263,994,000	\$ 80,639,000
Depreciation and amortization charged to operations	30,138,000	40,532,000	(10,394,000)
Income before extraordinary credits	24,876,000	8,245,000	16,631,000
Extraordinary credits	15,254,000	9,777,000	5,477,000
Net income	40,130,000	18,022,000	22,108,000
Average number of common shares and equivalents	5,674,000	4,740,000	934,000
<i>(End of year)</i>			
Cash and temporary investments	43,803,000	40,182,000	3,621,000
Total assets	262,596,000	228,137,000	34,459,000
Notes payable	90,958,000	117,562,000	(26,604,000)
Convertible subordinated debentures	67,218,000	68,045,000	(827,000)
Shareholders' equity (deficiency):			
Preferred shareholders' equity	62,815,000	59,057,000	3,758,000
Common shareholders' (deficiency)	(15,279,000)	(55,966,000)	40,687,000
Total shareholders' equity	47,536,000	3,091,000	44,445,000
Number of employees	6,840	5,364	1,476

*Please refer to the financial statements included in the 1976 Financial Report which is an integral part of this 1976 Annual Report.

Report to Shareholders

1976 was a great year for Memorex with operating results well above previous record levels. These results were achieved despite the fact that worldwide economic conditions were fair to poor. Inflation, political unrest, and unstable currencies were the order of the year. The good things that took place at Memorex were made to happen by the people of Memorex.

In addition to the excellent current performance, your company made major investments in the future. Impressive current operating results were matched by equally impressive, if less visible, progress in building the Memorex of the future.

Revenue growth has been one of your company's distinguishing characteristics. In 1976, revenues broke through the third of a billion mark to \$345 million. This is an increase of 31 percent or \$81 million over the prior year. This increase is larger than the total company revenue in 1970. Fourth quarter revenues were \$100 million, an annualized rate of \$400 million.

Thus Memorex has become a large company. It will be our continuing objective to retain the warmth, flexibility, and decisiveness that has made this growth possible.

Profit before taxes was \$51 million, which was more than two and a half times the \$18 million recorded on an equivalent basis in 1975. Net income for 1976 was \$40 million or \$7.10 per share. Thus net income is 12 percent of revenue. This performance was achieved despite the rapid acceleration of expenditures for the future and conservative accounting practices. Thus, they are truly quality earnings.

Cash requirements were high throughout 1976. Substantial amounts were used to finance the \$81 million dollars of revenue growth and to make the investments required to assure future growth. In addition, debt service required \$39 million — including a cash debt repayment of \$30 million. The cash and short-term investments at year end were \$44 million. This is 10 percent higher than at year-end 1975. Thus, your company has been able to generate internally the very substantial amounts of cash utilized in 1976. This enabled Memorex to enter the new year with ample cash to provide freedom of action.

Debt at year end was \$158 million. With debt coming down and revenue growing, the impact of debt service on operations has declined rapidly. Thus, debt service was 24 percent of revenue in 1975 and fell to 11 percent in 1976. It should continue to decline as revenues grow and debt is repaid.

Total shareholders' equity increased from \$3 million to \$48 million during the year. Common shareholders' equity improved from a negative \$56 million to a negative \$15 million. It should become solidly positive in 1977.

Futures investments were made in a number of different areas. All of them will enable Memorex to better serve its customers in the future.

The most important investment was in organization structuring, staffing, and personnel development. During the year responsibilities were delegated and decentralized. New profit centers were added and professional skills strengthened throughout the company. Thus, at year end, Memorex was professionally structured and staffed for continuity of growth.

Our continuing objective is to earn from our customers the reputation as their "standard of value." During the year, investments were made in quality assurance systems, field engineering, plant capacity, and regional distribution centers. Customer service was emphasized throughout the company and new sales and distribution coverage was added.

Product lines were substantially strengthened with the improvement of existing products and the addition of new ones. Major product developments were pursued for products to be introduced during 1977. The most significant of these is our new 317.5-megabyte disc drive, the 3650, but other programs of significance were established throughout the company.

The improved price of Memorex stock and our growing reputation as a quality company have made it possible to consider a number of acquisitions. During 1976 Memorex agreed to acquire Lencor International, which is the sole owner of CFI Memories, Inc., a manufacturer of computer media. Early in 1977 a letter of intent was signed to acquire Business Systems Technology, Inc. (BST), a supplier of computer peripheral products for small computer systems. Their combined revenues for the most recently

reported fiscal year are \$21 million and their combined net incomes are two million dollars. Both proposed acquisitions are consistent with our basic strategic plans.

Our investment in litigation against IBM increased during the year. It is our estimate that the trial will start in the summer or fall of 1977. Memorex has an excellent case and it will be vigorously pursued. The level of expenditures for this litigation peaked in 1976 and will decline rapidly once the initial trial phase of litigation is concluded.

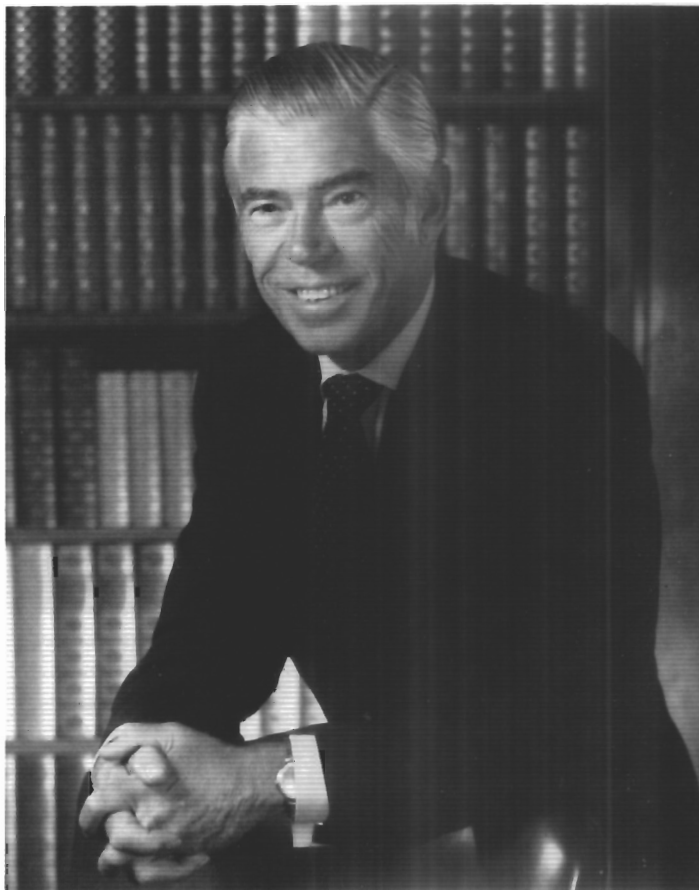
All of us can take pride in the contributions that were made in the area of public responsibility. Two of the most important problems faced by our society were unemployment and inflation. Over 1,000 new jobs were added and price increases were held below the rate of inflation. Growth was accompanied by more than 500 internal promotions during the year. Recognition of contributions to balance

of payments came in the form of an "E" pennant from the U.S. Department of Commerce. The company also received an award of excellence from the Federal Energy Commission for its energy conservation program. Equal opportunity was emphasized with an affirmative action program at all locations. At the community level the company significantly increased its participation in and support for a wide range of activities.

As we look forward to 1977, we anticipate a relatively flat worldwide economic picture. The principal continuing concern is governmental actions—particularly the actions of regulatory agencies. However, Memorex enters the new year as a much stronger company than the one that entered 1976. The major futures investments made during the year will improve our ability to provide substantial customer values to the growth markets we serve. With the continuing support of customers, suppliers, lenders, and shareholders, the talented people of Memorex will make 1977 another great year.



**Robert C. Wilson, President, Chairman
and Chief Executive Officer**



Equipment Products



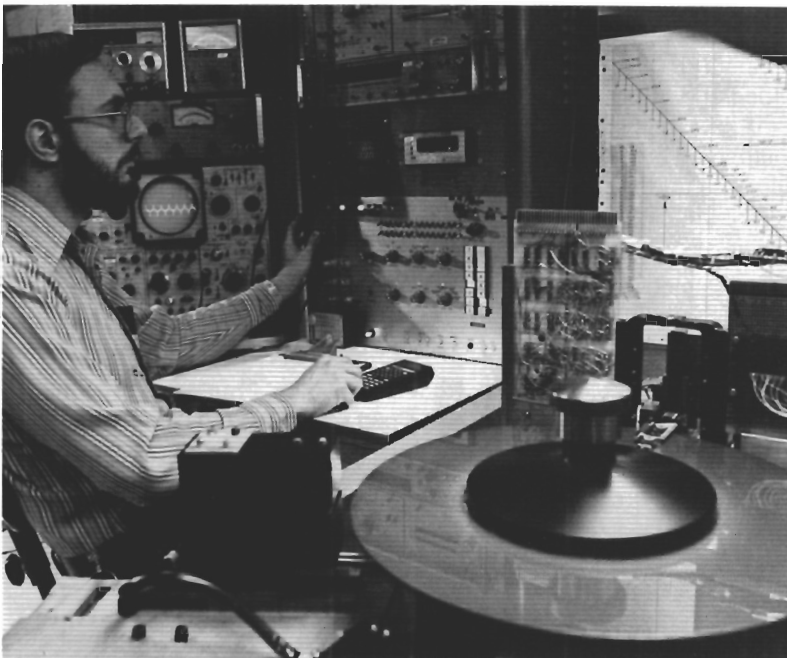
Entrance to Equipment Products complex, Santa Clara, California

*James Dobbie
Executive Vice President, Equipment*

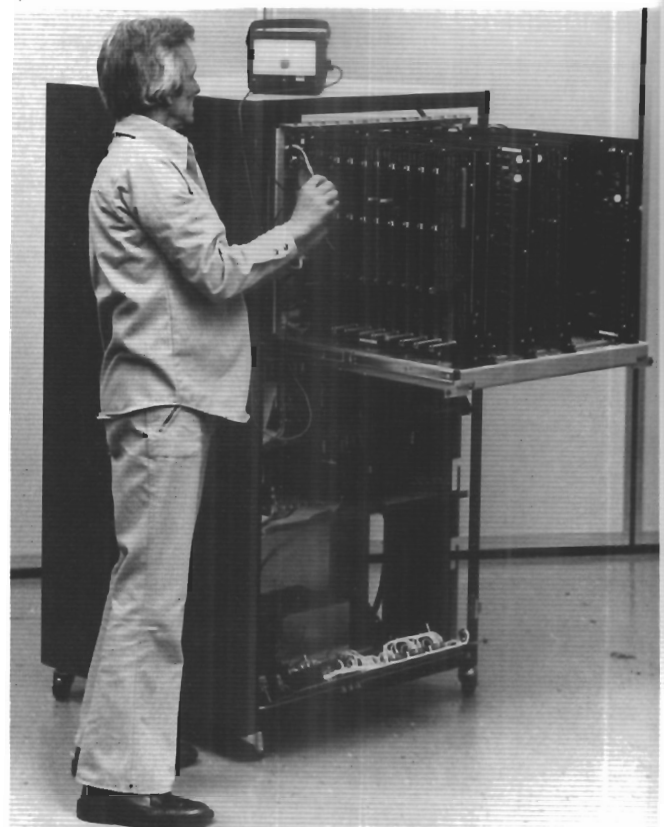
Overview

During 1976 Memorex made substantial investments to provide improved customer values in equipment for information storage and communication.

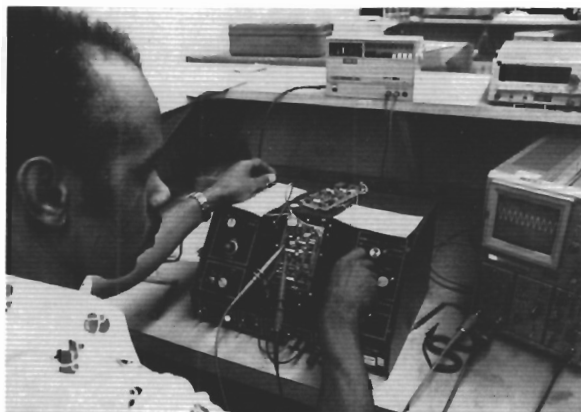
Engineering personnel were increased by more than 40 percent. Investments were made in a wide range of technol-



As part of the quality assurance procedure, the heads performing the read/write function in disc drives are tested to assure proper electrical performance through this automated machine, which is controlled by a microprocessor and displays the test data visually through an oscilloscope.



The new programmable 1380 Communications Controller, shown undergoing final quality assurance tests, was installed for numerous customers during 1976.



Printed circuit boards, vital elements in many Memorex equipment products, are rigidly tested for specified performance.

ogies and engineering disciplines. Those included large scale integrated circuits, the application of advanced semiconductors, magnetic heads, magnetic disc surfaces, computer design capability, and software. In-house investments were supplemented through vendor support and technology obtained from other companies.

Product quality and reliability were emphasized throughout the year. A Total Quality System was installed which provides for complete control and measurement, throughout the total planning, design, and manufacturing cycle.

Field engineering was expanded and improved. Distribution centers estab-

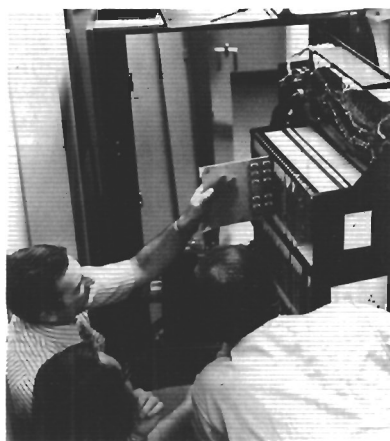
lished in Philadelphia and Chicago included training facilities, diagnostics, refurbishing capabilities, and spare parts warehouses. Additional portable diagnostic tools enable Memorex field engineers to minimize the time required to serve customers.



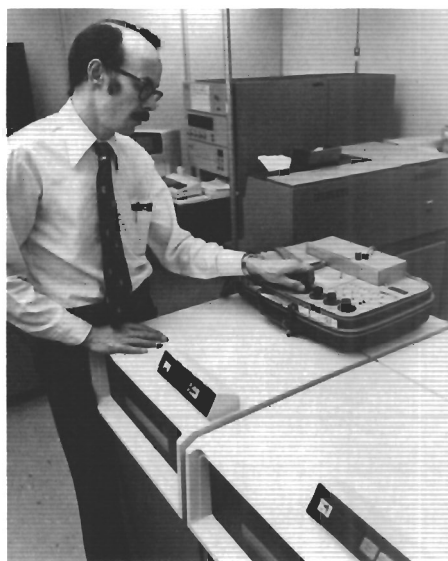
Memorex service personnel respond quickly to calls anywhere in market areas to assure maximum operational time for customer equipment.



New Distribution Center in Chicago is one of four established or planned in the United States to speed delivery, service and parts distribution for Memory customers.



Field engineers are being trained for installation and maintenance of the 1270 Terminal Control Unit.



Portable diagnostic kit, providing complete testing of disc file equipment, is used by field engineer on a 3640 Disc Storage Subsystem.

In the disc drive field, the 367X family of equipment continues to maintain a leadership position by providing outstanding customer value. Available in both 100 and 200 megabyte ratings, it has a wide range of customer applica-

During 1976 Memorex made initial shipments of the Model 3640, the first in a new line of advanced disc files. It is designed for use with small system computers. The magnetic heads for these drives are included in the data module along with the recording discs.



3670 disc files at Cal Tech's Jet Propulsion Laboratory were used to improve the accuracy of the remarkable photos of the Mars landscape (example below) received from Viking Lander 2.

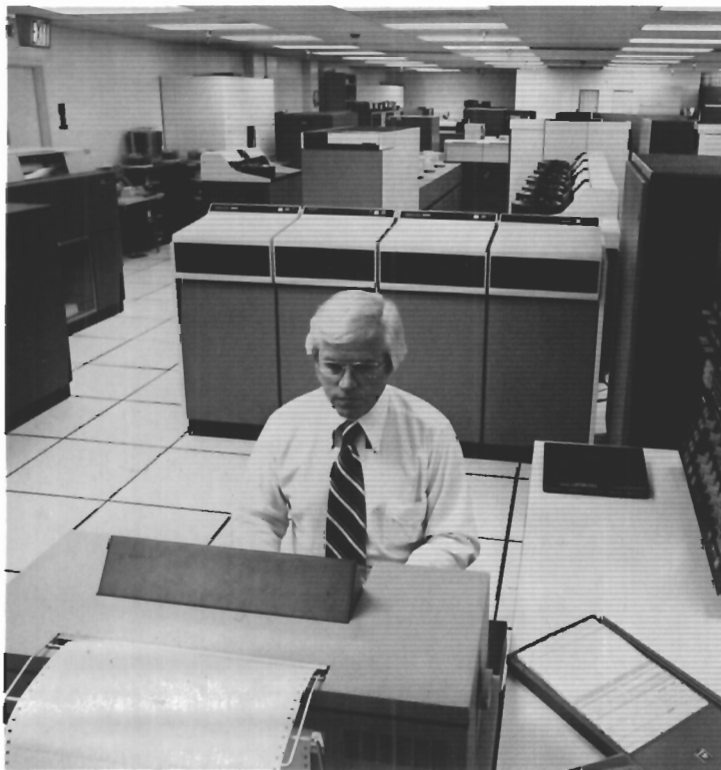


One of the 367X series of proven, highly reliable Memorex disc files, the 200-megabyte 3675 model is in operation at Bendix Corporation, among the many customers for this storage subsystem.

This arrangement facilitates higher recording density and improved data integrity. The 70-megabyte data modules are available with either fixed or moving heads. The performance of both the disc file and Data Mark modules has been excellent.

The top of this line of advanced disc files, with a capacity of 317.5 megabytes, has been designated the 3650. Designed for large on-line storage applications, the 3650 utilizes an advanced read/write storage module which employs large scale integrated circuitry. A team of top

technical, manufacturing and field engineering people has been developing this program. Every step is being taken to assure reliability and maintainability in handling the large amount of data involved. First customer shipments will be made during the third quarter of 1977.



Major new product introduction is the 3650 Disc Storage Subsystem, providing the most advanced performance in Winchester technology for large storage capacity.



3650 Disc Storage Subsystems are being assembled at the Equipment Products Complex in Santa Clara, California.



The new 3640 Disc Storage Subsystem, providing Winchester technology for use with small system computers, is installed at the Advertising Checking Bureau, New York.

Semiconductor Memories

Disc files provide the major part of information storage that is available for on-line access. However, significant amounts of storage are provided by semiconductor devices known as RAMs (Random Access Memories). Memorex offers a full line of semiconductor memories which utilize the latest advances in semiconductor technology.

During the year major improvements were announced in the product line. These included increased maintain-

ability and more memory capacity for some computers. In addition a new memory system, the 6268, was introduced.

Major new customers for add-on memories included Burlington Industries, Planning Resource Corporation, Southwestern Bell, Deering-Milliken, Beckwith Machine Company, Omnis Corporation, and First National Bank of Birmingham.

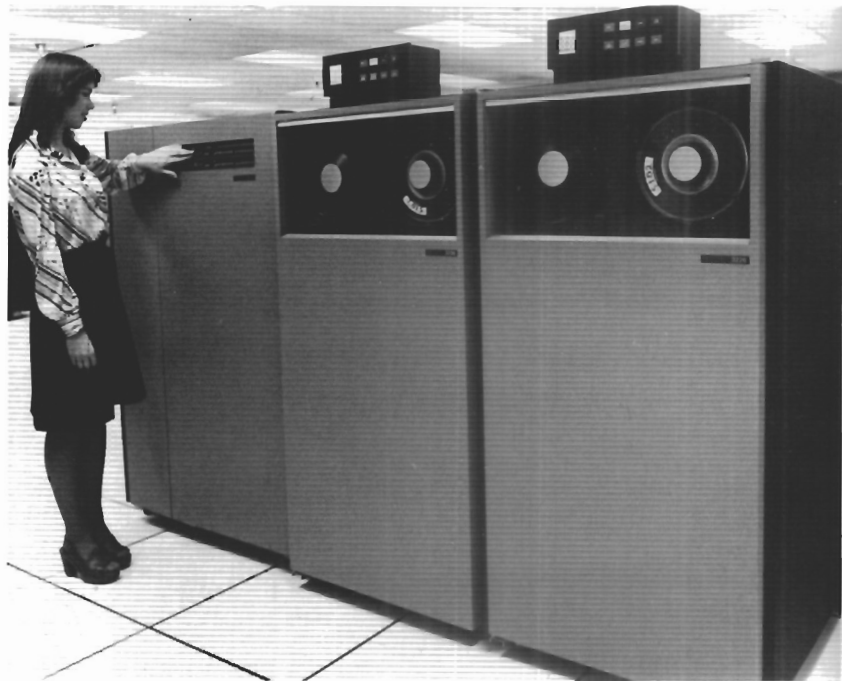
Tape Drives

Tape drives and media provide the basis for the majority of off-line information storage operations. Memorex has long been a leader in computer tape. During 1977 high-speed tape systems will be added to the product line. Utilizing the latest 6250 BPI technology, they will be available in 125 and 200 inches per second ranges.

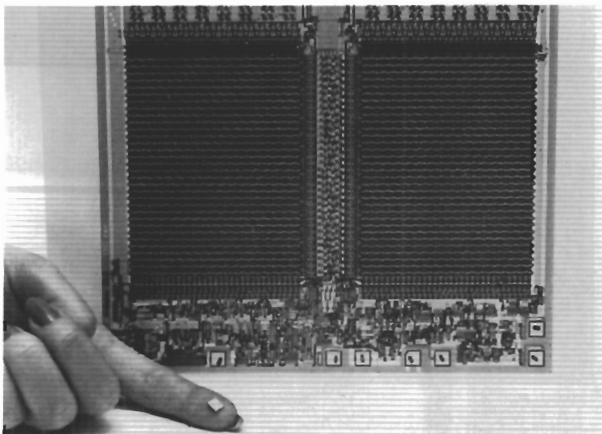
The combination of disc files, semiconductor memories, and tape systems enables Memorex to serve a wide range of customer information storage needs.



The new 6268 Memory System is thoroughly tested as part of the Company's total Quality System.



Advanced 6250-bpi tape drive, providing superior performance and cost-effectiveness, is a major addition to the Memorex line of storage products.



The four-thousand-bit MOS device is a four-fold capacity increase over those in previous solid state memories. It is magnified 2000 times in photo behind hand.

Data Communications

With the current trend toward decentralization of data processing, the market for related communications equipment is growing rapidly. Moving into this marketplace at an early date, Memorex introduced additional products in 1976 and continued to expand its capabilities and product offerings.

The 1270 Terminal Control Unit continues to demonstrate its superior, trouble-free performance for a widening range of customers. Among its customer uses are the fast processing of applications by

an insurance company, the management of manufacturing by an aerospace company, and the ordering of parts for customers by an air transport company. The new dual-port 1270, for use with two computers simultaneously, was introduced in 1976.

The first units of the new 1380 family of programmable communications controllers were installed during the year. The 1380 is distinguished by current and planned software packages covering a broad range of customer requirements. The market for this type of controller is

expanding rapidly.

The company's first entry in the video display terminal market is the 1377 Display Station, which was introduced to customers at the Datacomm '76 Conference in New Orleans. The 1377-4 model is the latest in this family of display terminals to provide customers with a widening range of performance and capabilities at low operating cost.



The 1270 Terminal Control Unit, being tested for specified performance levels, is among the proven, highly reliable Memorex communications products.



The new 1377 Display Station offers exclusive features including a tiltable screen for operator convenience.



New programmable 1380 Communications Controllers were installed around the world.

Original Equipment Manufacturers (OEM) Products

The principal equipment products supplied by Memorex to original equipment manufacturers are disc files. The 30-megabyte disc file, Model 660, gave excellent performance. It will continue to be a significant part of the product line.

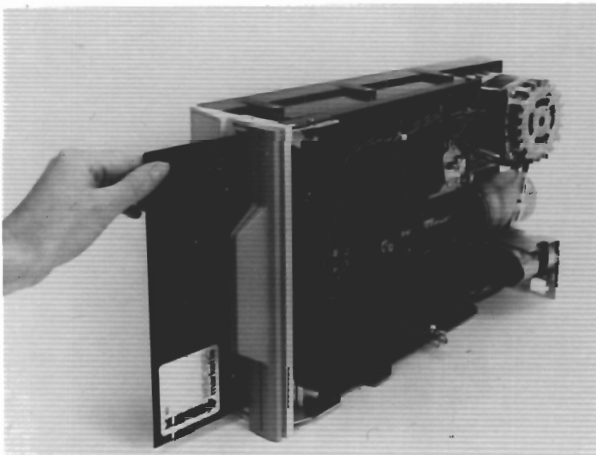
During 1976 the company introduced the Model 677, a high-performance disc storage drive for large-capacity OEM

needs. The 677 is a single-spindle OEM version of the dual-spindle rotating storage products for end users. With a capacity of either 100 or 200 megabytes, the 677 represents the fourth generation of this disc drive. A Winchester-technology extension of the 677 will be available for future large-capacity needs. Memorex maintained superior values in the 670 series by cost improvements throughout the year.

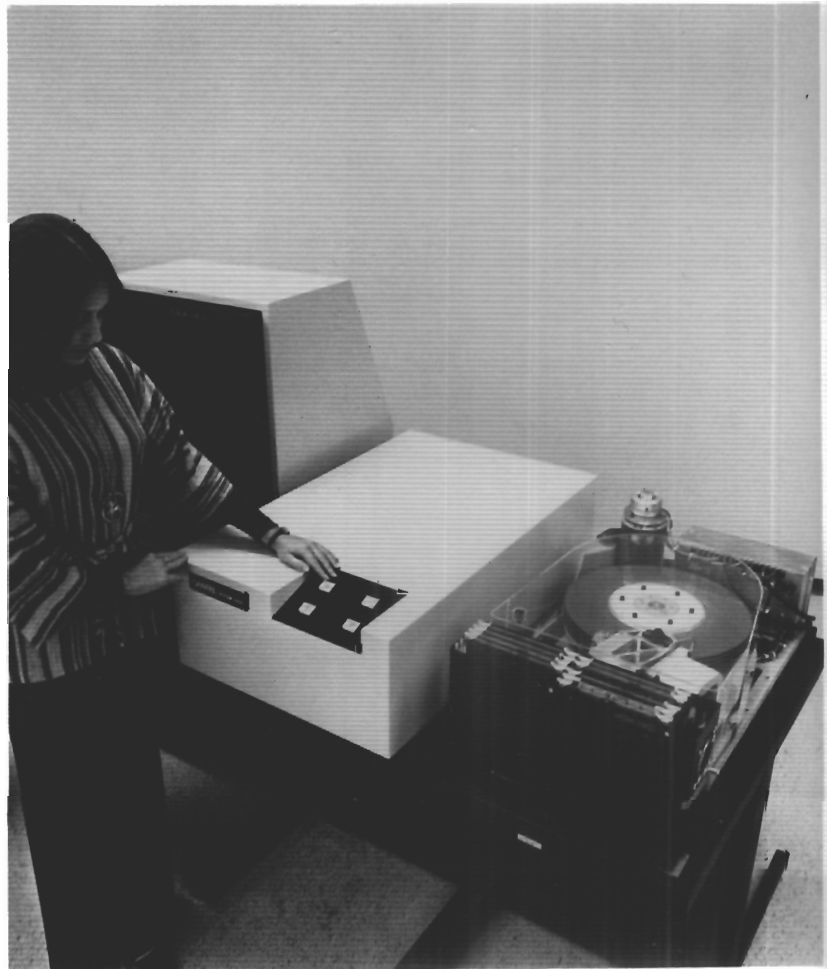
The company announced the 601 family of non-removable disc files, which brings Winchester technology to the medium computer market. Combining fixed and moving heads into one unit, it optimizes performance for the smaller disc drive. Capacities are offered in 25, 50 and 75 megabytes. With much improved cost effectiveness and reliability, it has a modular design for capacity growth.



The 677 Disc Storage Drive has unique advantages that provide added reliability and maintainability.



The 550 Flexible Disc File, for a variety of small system needs, features a housing material that reduces weight and increases strength.



Using low mass head technology, the new 601 family of fixed disc files offers a major improvement in total system performance.

The 550 Flexible Disc File was also introduced into manufacturing during 1976. This is a direct-access file for a wide range of low-cost, low-capacity data storage and retrieval applications. The 550 is the next-generation follow-on to the 651 Flexible Disc File, of which 20,000 have been shipped. The 550 offers improved performance in reliability, operating cost, and capacities, which range from 243 to 802 kilobytes.

Computer-Output-Microfilm

An effective means of storing and retrieving large volumes of data is to print the output of computers on microfilm. Memorex provides the complete 1600 System for printing, storing, retrieving, distributing and displaying computer readouts on microfilm. It includes a full line of micrographic supplies.

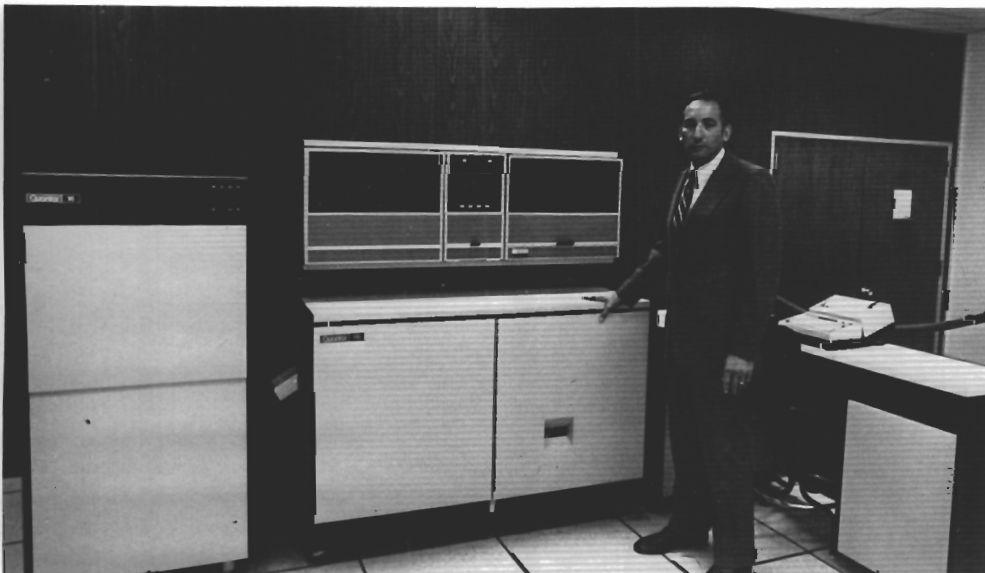
Printing the computer data is accomplished by the 1603 COM Printer. The film is developed by a self-contained unit

and is stored and distributed in a small cassette. Information is retrieved at various locations by manual and automatic viewers and viewer/printers.

Besides being a major saver of space, the system greatly speeds the time needed to retrieve information. Since the cassettes can be sent to outlying locations by mail, the system provides a low-cost, high-volume means of data communication and distribution.

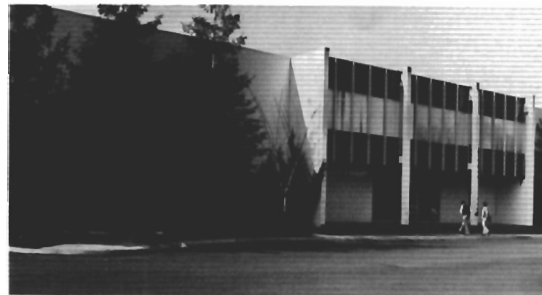


A feature of the Memorex Computer-Output-Microfilm system is the 1644 viewer, shown here at data center of the city of Richmond, Virginia. It offers rapid and easy retrieval through use of cassettes that do not require rethreading or rewinding.



Memorex is supplying Computer-Output-Microfilm printers and duplicators to Quantor Corporation, which adds them to its line of COM equipment.

Media Products

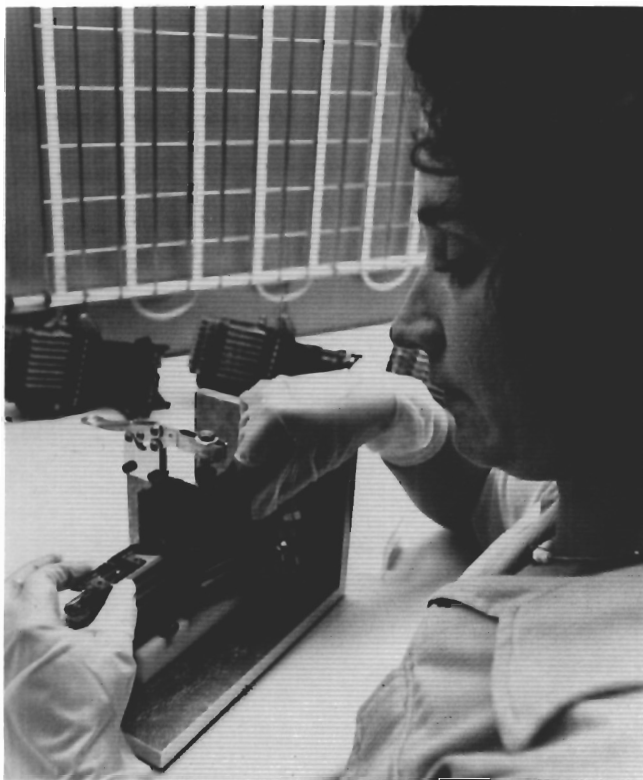


Audio Tape Plant, Santa Clara, California, showing new addition.

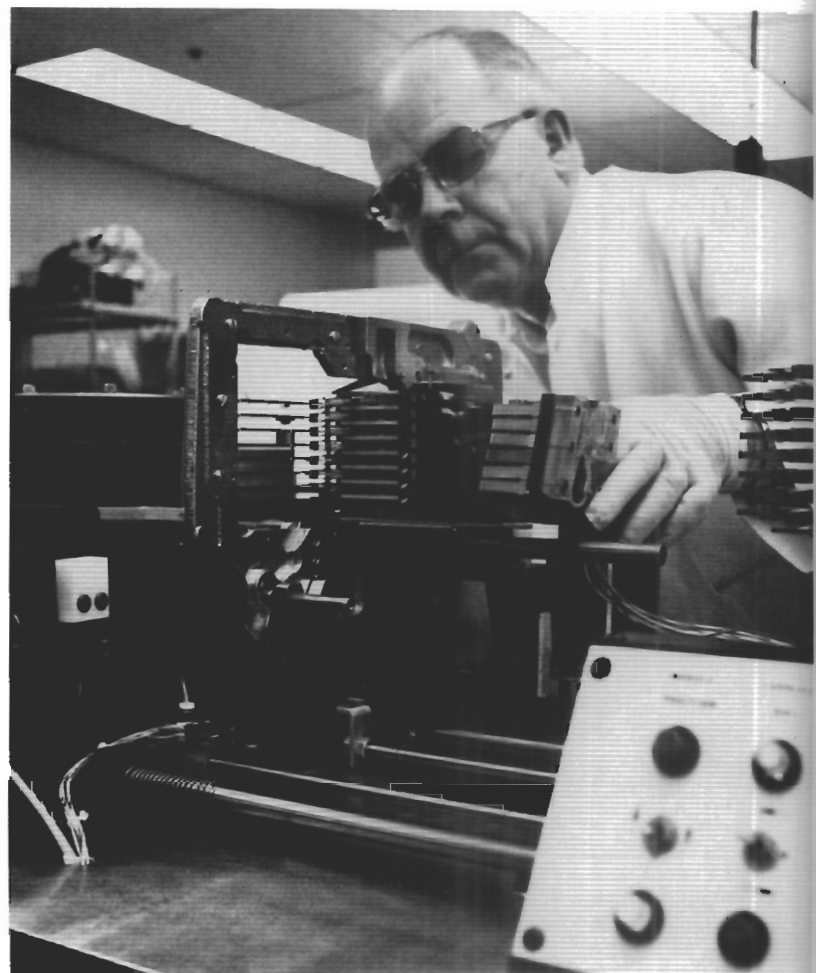
*Robert Jaunich II
Executive Vice President, Media*

Overview

Media products are consumable supplies used in conjunction with equipment that stores, processes, or duplicates information. These products are used in a wide variety of markets including data processing, word processing, education, and entertainment. Products include disc packs, computer tape, flexible discs, precision plastics, audio tape, video tape, toners, developers, magnetic



Carefully inserted in the head subassembly during the manufacturing process, the heads will record and play back information on the discs in the Head Disc Assembly of the 3650 Disc Storage Subsystem.



In the manufacturing process for the 3650 Disc Storage Subsystem, the head subassembly is placed in a machine which then automatically inserts it into the Head Disc Assembly. The heads perform the read/write functions in rotating disc-type data storage and retrieval equipment.

cards, and typewriter ribbons. Substantial investments were made during the year to assure superior customer values in these product lines.

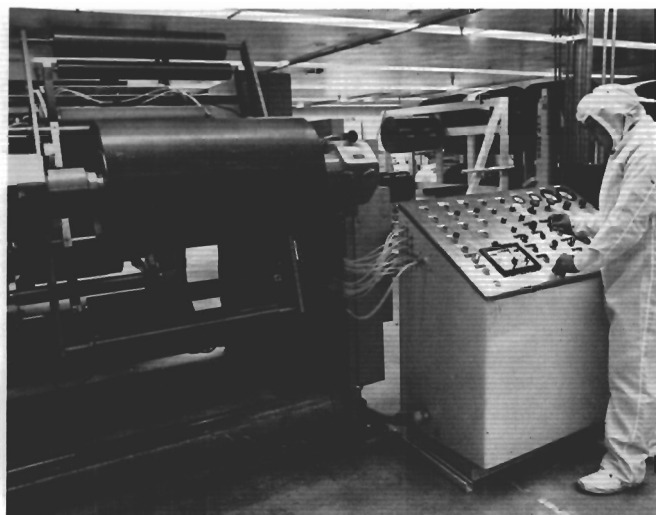
Technologies include chemical formulations, magnetic particles, magnetic heads, thin films, metal finishing, electronics and precision plastics processes. During 1976, investments in technical capability included additional professional staff and a new development

laboratory for advanced disc-head assemblies.

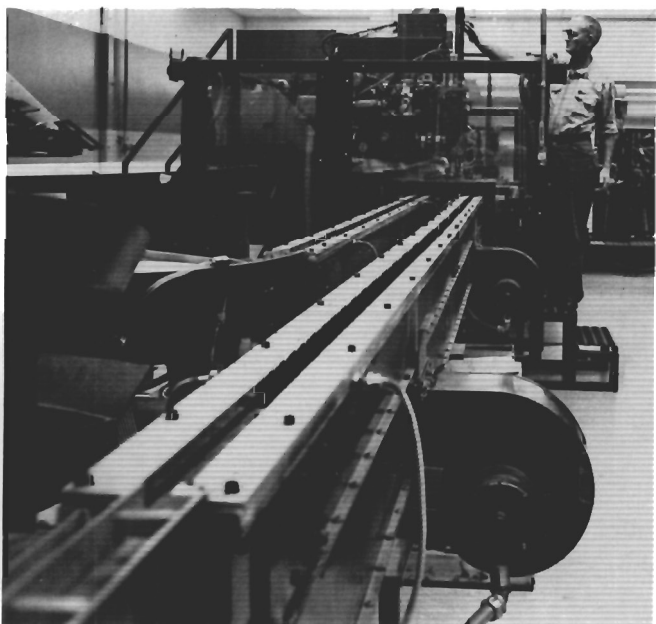
Quality assurance investments were made throughout the year. These included process control equipment with advanced instrumentation, and automatic assembly equipment embodying advanced quality control techniques.

Customer service was improved through

a wide range of investments. These included increased professional staff, regional inventories in distribution centers, plant and equipment additions, and improved systems and procedures. Organization was structured to establish a complete business team dedicated to providing superior service and value to each major market segment.



Memorex installed new surface treater, an improved means of enhancing the magnetic qualities of computer tape.



Audio tape cassettes are assembled automatically by this new Rockford machine.



Special Stanford University classes are telecast to off-campus business students and are recorded on Memorex video tape for later viewing by subscribers around the country. Technical advances have made such remote education possible and opened a new market for video tape.

Disc Packs

The Memorex versions of industry standard disc packs—the Memorex Mark VI, Mark X and Mark XI—provide up to 29, 100 and 200 megabytes of data storage, respectively. The market for these disc packs exceeded expectations throughout 1976. To provide additional market coverage a series of special disc packs, the Mark V, Mark VIII, Mark XII, Mark XIV and Mark XVIII, with capacities of 10 to 200 megabytes, will be introduced in 1977. These special disc packs are offered on both an OEM basis and

directly to end users of disc drives not compatible with the standard disc packs.

The new 70-megabyte Data Mark module was produced in quantity with leadership quality. It embodies the advanced low mass head technology, with both the magnetic recording heads and the discs within the module. It is used in conjunction with Winchester-type disc files such as the Memorex 3640.

A major advance in large-capacity disc storage was made with the design of a 317.5-megabyte Head Disc Assembly or

HDA for use in the new Memorex 3650 disc drive. Within the HDA is a very sophisticated LSI chip which represents the next evolutionary step in Memorex disc module technology. Its position close to the magnetic head permits much higher density, capacity per disc, and reliability of data transfer.

The small disc file market is served with the 3-megabyte Mark III. In the new Mark III F for front loading disc drives, the patented latch design is a major improvement over traditional cartridges.



The 200-megabyte Mark XI is the latest in the proven, reliable family of disc packs for the 367X series disc drives.



Key element in the new Memorex 3650 Disc Storage Subsystem technology is the Head Disc Assembly. It incorporates the discs (on which the information is stored) in the same unit with the read/write heads.



The Data Mark data module, for use with the Memorex 3640 and comparable disc drives, is assembled and sealed in clean rooms of the most rigid standards.



To assure that the new Mark III-F Disc Cartridge meets precise dimension standards in the manufacturing process, it is cooled after forming in this special rotating fixture.

Computer Tape

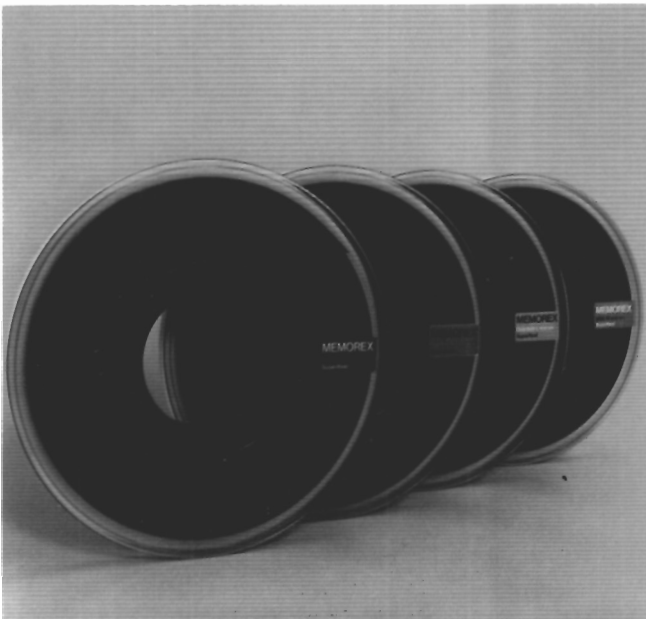
The company's superior capabilities throughout the information storage and communications area have stemmed from its magnetic-technology skills in the computer tape field, where it has been a leading supplier of quality products for 15 years. Memorex continues to invest in techniques for quality and process control, product testing, and instrumentation for materials analysis. The result is a complete range of computer tapes that are the standard of value for every customer need.

The Memorex IV ultra-durable tape provides the best price/performance ratio in the industry. Its unique smoothness and tough oxide coating insure peak performance on today's high-speed, high-density tape drives.

The high-quality, high-test Quantum/L has a stress resistant oxide coating especially formulated for maximum data integrity. It is the best choice for archival storage of important records. Quantum/L CX tape is designed to maintain clean surfaces despite frequent use for retrieval of critical data.

A further dimension of performance is provided by Cubic^{T.M.} tape, designed to minimize edge damage due to possible drive malfunction or mishandling.

One of the company's most important product introductions is the new Super Reel^{T.M.} a significant improvement in reliability and performance to meet the requirements of the high-speed tape drives. After its introduction in 1977, Memorex computer tape for this market will be wound on the new SuperReel, which will be a major factor in strengthening Memorex leadership in this area.



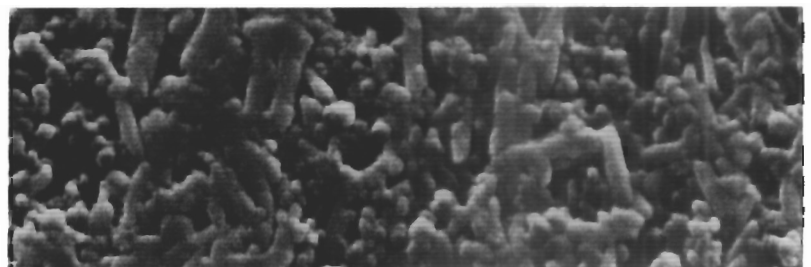
All Memorex computer tape will be offered with the new SuperReel, designed to meet the requirements of high-speed drives.



To insure long-lasting computer tapes and trouble-free reels, critical components are inspected with an optical comparator.



Essential tool in quality analysis for computer tape is the new scanning electron microscope.



Tape showing magnetic particles seen through electron microscope is magnified 20,000 times.

Flexible Discs

The company's experience in manufacturing both disc drives and media enables it to optimize the performance of its flexible disc products.

The advantage of instant access to data at low cost has created a rapidly growing market for flexible discs.

During 1976, Memorex met specific customer needs by introducing various products with added characteristics—dual-sided, high-density, variable format

and new-diameter—as part of the Markette family of flexible discs.

The company also developed advanced high-density coatings for media, and brought additional manufacturing and test equipment into operation, in anticipation of continued growth in this market.

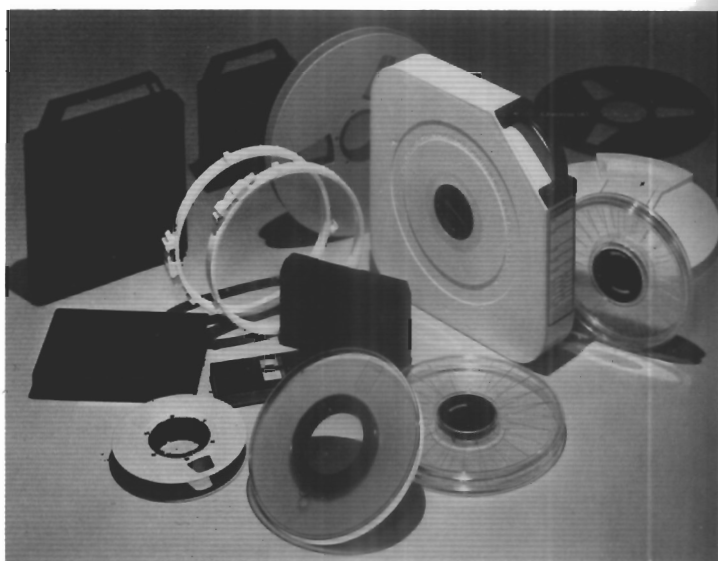
Precision Plastics

As part of its broad capability in information processing, Memorex provides high-quality reels, cassettes and cartridges to house video and computer tape products. These are sold to original equipment manufacturers.

In 1976, Memorex made further manufacturing improvements to meet the demanding needs of the industry. Automated assembly and molding equipment was installed to provide more cost-effective production for the benefit of customers.



Family of Markette flexible discs, used in the 550 OEM drive and other small capacity systems, offers variety of characteristics for different customer needs.



Memorex manufactures the quality precision plastics for housing its computer and video tapes as well as certain disc media.



For superior operation, the dimensions of the new Super Reel are inspected by special electronic gauges. The diameter of the reel hub is checked to an accuracy of .00015 of an inch.

Word Processing Products

Technical changes are extending information processing from the computer room to the office, opening a growing market for a wide range of products for duplicating, printing, editing, and storing information. The extensive experience of Memorex in recording tapes and accessories has positioned it to participate strongly in this market. Memorex high-quality word processing products are sold to business customers worldwide. In 1976 Memorex successfully introduced new products

in almost all of its lines:

- A toner for use in the new 9200 Xerox Duplication System.
- A double-sided magnetic card which reduces cost and storage requirements.
- Word processing cassettes for use with text editing typewriters.
- A family of flexible discs used for text editing in word processing systems as well as new data processing systems.

The market for cartridge typewriter ribbons for use with electric typewriters and text editing machines continues to expand, and the high quality of Memorex ribbons has placed them in the forefront of this growth.

The line of word processing products will be expanded later in 1977 through the addition of thermal transparencies for overhead projectors. These Memorex viewgraph foils will provide superior quality through the use of a special formulation.



During 1976 Memorex introduced a word processing cassette for use with text editing typewriters.



A new toner designed for the Xerox 9200 Duplicator System was offered during the year in the fast-growing duplicator products market.



Memorex offers a family of top quality cartridge ribbons for electric typewriters and text editing machines.



New double-sided magnetic card for electric typing systems adds to convenience and reduces cost.



Superior quality transparencies for overhead projectors will be added to the Memorex line in 1977.

Audio Tapes

Memorex audio tape of superior quality is sold to the consumer market in all three recording formats—cassettes, eight-track, and reel-to-reel. The MRX 2 audio tape is formulated with a pure ferric oxide magnetic powder with a perfected crystalline shape. This results in a tape with exceptionally high sensitivity and maximum usable output over the whole audible frequency band. A chromium dioxide cassette tape, an advanced product for specially designed equipment, offers a superior frequency

response and other exceptional qualities.

High-quality audio duplicator tape and training cassettes are also made for the fast-growing professional market.

During 1976 Memorex introduced the high-quality Quantum Open Reel Tape. This ferric oxide product, the finest in Memorex's consumer line, is carefully manufactured by a sophisticated process to surpass all other ferric open reel tapes in overall recording performance. Quantum is expected to make a major contribution to the audio business in the years to come.

Effective consumer advertising throughout the year has featured Ella Fitzgerald, the "First Lady of Song," who often refers to herself as "the Memorex Lady." At year-end a new campaign was launched with both Ella and Melissa Manchester, the dynamic young singer, songwriter and musician. Sales promotion and merchandising efforts were stepped up during the year to achieve increased consumer trial of Memorex products and more effective in-store displays. Important domestic and international retail accounts were added.



Memorex high-quality audio recording tapes are offered to consumers in retail outlets throughout the United States and in expanding market areas around the world.



During 1976 Memorex added a record cleaning fluid to its extensive line of quality audio recording accessory products.



Memorex Quantum audio tape has been tested against other leading premium open reel tapes and has outperformed them all.



Ella Fitzgerald joins Melissa Manchester at the piano during production of new TV commercials, in which Melissa tries to distinguish between Ella's live voice and the Memorex recording.

Video Products

Superior quality video tape for the professional entertainment, news gathering, and consumer markets is manufactured by Memorex under the most stringent quality control standards. Operating in cleanroom conditions, Memorex technicians carefully monitor each production step to insure that every tape shipped meets exacting standards.

The Chroma 90 line continued to enjoy high customer acceptance for professional taping of television shows and found increasing use in new applica-

tions. Two feature motion pictures have been shot with Memorex Chroma 90 and others are in the planning stage.

In conjunction with the new one-inch helical scan video tape recorders offered to broadcasters in 1976, Memorex introduced its MRX-716 tape. Color performance is better than competing tapes, and customer response has been excellent.

Home video recorders have been brought within reach of a wide range of customers. The ability to displace time and record a TV program for later viewing has promised a fast-growing

market and Memorex is well postured to participate in it. The company has worked with Sony and expects to produce Betamax cassettes with Memorex tape for use with the Sony home video recorder.

Portable video cassette recorders, used in taping news events and "on location" TV shows, have greatly reduced the cost and time required from shooting to broadcast. In 1976 Memorex introduced a new 20-minute UCS mini-U-matic cassette for this fast-growing market.



Memorex manufactures a full line of high-quality video tape for TV studios and other professional customers.



Improved performance at lower cost is provided by the new Memorex two-inch helical scan video tape, shown here in use with the IVC 9000 machine for making master recordings of studio programs.



Memorex Chroma 90 video tape is used by Compact Video Systems in producing a commercial under outside "on-location" conditions where quality and reliability are critical.

International

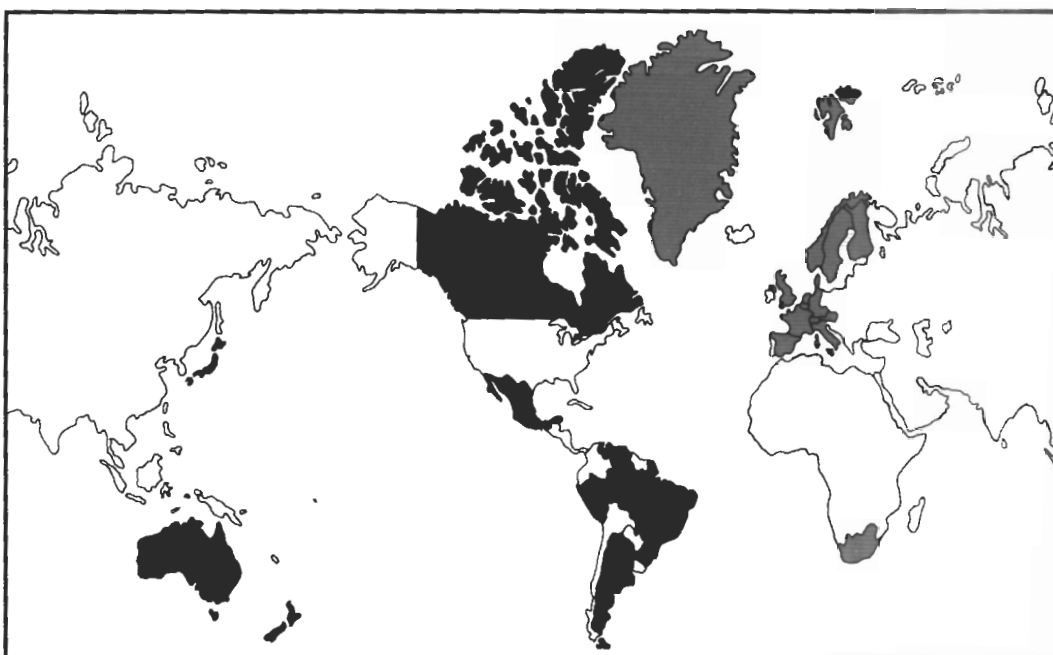
Memorex products and services are marketed throughout the world. Subsidiaries in 23 countries serve over 80 percent of the free world markets. The EUMEA Group, headquartered in Liege, Belgium, is responsible for Europe, the Middle East, and Africa. The Americas and Asia Group, headquartered in Santa Clara, Calif., is responsible for the Americas and Australasia. Both groups

serve customers for all Memorex products and are responsible for the integrity and quality of customer service throughout these areas.

During 1976 international sales and service capabilities were further expanded around the world, and a number of representatives were established in additional countries that extended the Memorex market area. Customer inter-

est was promoted with exhibits in trade shows and exhibitions in Europe and the Far East.

Increased emphasis has been placed on word processing and consumer products. During 1976 a merchandising program for audio tape featuring Ella Fitzgerald was launched in the United Kingdom. A similar program is being undertaken in other countries.



Countries served by subsidiaries in EUMEA area are shown in gray; those in Americas and Asia area are in black.



All ticketing on the British Airways supersonic Concorde airliner is booked through Memorex information storage and communications equipment.



During the year the U.S. Department of Commerce awarded Memorex the E Pennant for its significant growth pattern in exports.



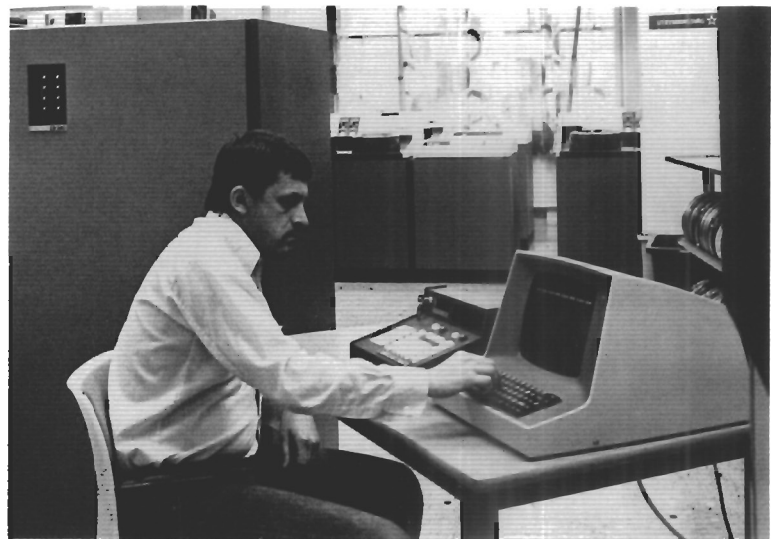
*EUMEA Headquarters, Liege, Belgium
William S. McCalmont, Vice President and
General Manager, Europe-Middle East-
Africa Group*

Europe, Middle East, and Africa (EUMEA)

In addition to the basic Memorex product line, EUMEA offers products for users of small systems. They include disc files, controllers, add-on memories, printers, terminals, and flexible disc reader/writers. These high-quality products, coupled with Memorex media products and field engineering services, provide excellent values to small system users.



Memorex van in Paris provides fast delivery and service to customers in this important market.



New programmable 1380 Communications Controller was added to other Memorex equipment at the data center of Postgirot, the national postal bank system, in Stockholm, Sweden, as part of its communication system with 1200 post offices.



The Olivetti data center in Ivrea, near Turin, Italy, utilizes extensive Memorex equipment including 3675 disc drives and controllers, three 1270 Terminal Control Units, and a Computer-Output-Microfilm System 1600.

During 1976 Memorex made a number of installations in Europe for a wide range of equipment customers.

British Airways installed 6168 add-on memories and a communications control unit, while Shell UK Ltd. installed Memorex disc drives in three computer sites.

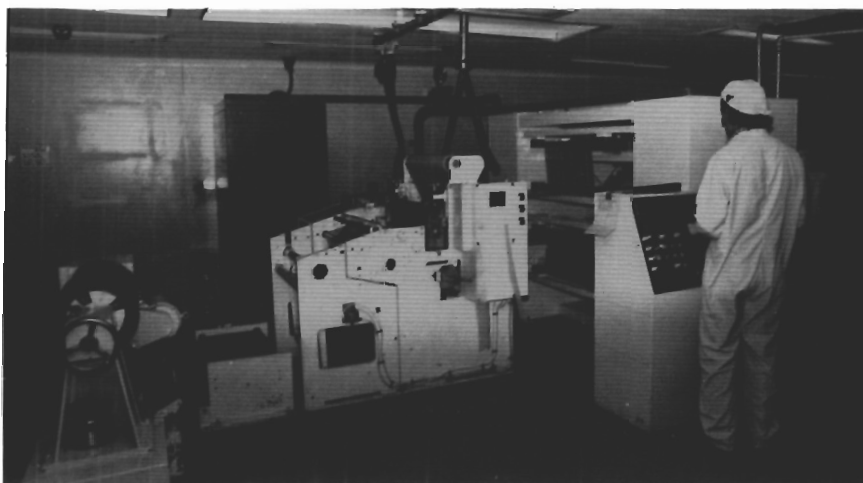
In France, Saint Gobain acquired a 1380 controller. Saint Gobain is a large diversified industrial company.

The Max Planck Institute in Germany installed Memorex disc drives.

In Belgium, Memorex delivered a 1380 controller to Catholic University of Louvain la Neuve. In the Netherlands, disc drives and add-on memories were installed at a savings bank, Gemeente Giro, for use with its credit card system.

Memorex continued to supply the disc

storage and communications needs for most of Sweden's banking community. In Denmark, new add-on memory equipment was sold to the Scandinavian Airlines System. Memorex was awarded the contract for the largest disc storage system in Norway by IDA, a service organization for commercial banks. A large contract was obtained to deliver computer tape to ships operated at sea by Geco A/S, a Norwegian-based



During 1976 the Liege plant installed a new computer tape slitting machine, the most modern of its type in the world, to provide a substantial increase in production.



M. Schoolaert, Chef du Cabinet for the Belgian Ministry of Foreign Trade (left), presents gold medal to Memorex President and Chairman, Robert C. Wilson, for the company's contribution to Belgian business.



During 1976 the Executive Committee of the Board of Directors held a meeting at Liege and toured the plant. Left to right, T. Robert Sandberg, Member of Board of Directors; James Simpson, Vice President, Operations Support, EUMEA; William S. McCalmont, Vice President and General Manager, EUMEA Group; Alvin C. Rice, Member of Board of Directors; and Jo Renard, General Manager, Liege Division.

geophysical survey company.

In Italy, a number of disc drives, add-on memories, and 1380 Communications Controllers were installed for such customers as Banca d'America e d'Italia, Italsiel, Datamont, Euratom, Banca d'Italia, and the Italian Government Social Security System.

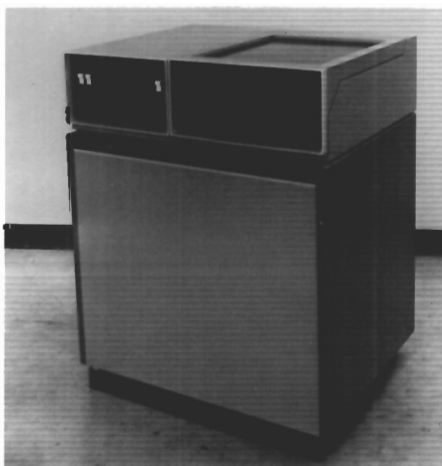
In order to provide improved service to EUMEA customers, Memorex maintains

a manufacturing facility at Liege, Belgium. Operations include finishing of computer and video tapes, disc pack assembly, disc pack and equipment refurbishing, printed circuit board repairs, and spare parts and finished goods inventories.

During the year substantial investments were made to provide improved products and customer service. An expanded

quality assurance system was installed and new equipment added. A major installation was an advanced magnetic tape slitter which improves quality, increases capacity, and reduces cost.

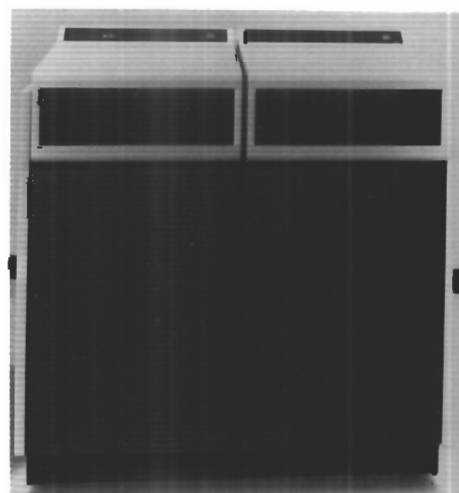
For small systems users, Memorex offers international customers a complete line of information storage and communications products and media supplies, as shown below:



660 Disc File, with 30-megabyte capacity, is a low cost, high speed information storage system.



1377 Display Station enters (and displays) data to small computers and communications systems.



The 3640 Disc Storage Subsystem provides higher recording density and improved data integrity.



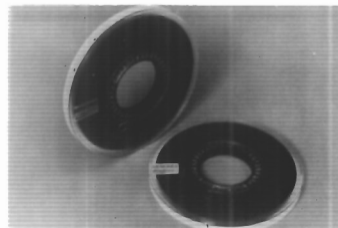
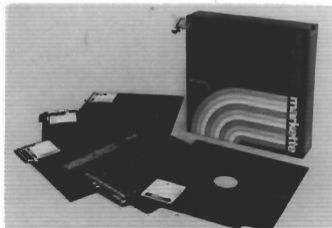
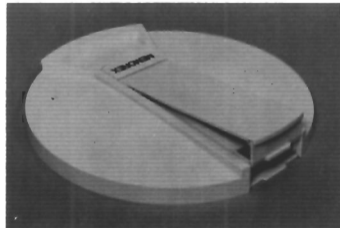
Flexible Disc Reader/Writer provides system entry to small computers. A later model will feature a keyboard and CRT.



Add-on Core Memory is available in capacities from 8 up to 56 kilobytes.



The MRX 550 and 750 Printers, using the superior chain/train technology, type 550 and 750 lines per minute.



Memorex media supplies for small information storage systems range in capacity from the 70-megabyte Data Mark module to 800-bpi computer tape.



*Americas and Asia Group Headquarters,
Santa Clara, California
Marcelo Gumucio, Vice President and
General Manager, Americas and Asia Group*

Americas and Asia

During 1976 Memorex further increased its activity in its biggest Asian market, Japan. Major customers served during the year include Bank of Tokyo Ltd., Teijin Limited, Bridgestone Liquified Gas Company Ltd., Japan Travel Bureau, Nissan Motors Ltd. (Datsun), and Nippon Oil Seal Industry Ltd.

Memorex further developed its association with Fujitsu, one of the leading computer companies in Japan.



In 1976 new Memorex equipment was installed with the 3675 disc drives in the data center of the Ministry of Government Services, Province of Ontario, Canada.



Memorex 1270 Terminal Control Unit is part of data communications equipment operated by Philippine Airlines, Manila.



Memorex 3670 disc drives are in operation at the data processing room of Japan Travel Bureau Ltd., Tokyo.



Among the first 3640 disc drives installed were these units at Bridgestone Liquified Gas Company Ltd., Japan.

New representatives were added in Korea, the Philippines, Singapore and Thailand. Product offerings were expanded from computer media to include video tape and, in certain markets, equipment and word processing products.

In Australia new disc drives, communications controllers and terminals were installed for major customers including Computer Sciences, Qantas Airlines and Philips International of Australia.

In Canada, Memorex extended its activity to Winnipeg and Calgary. Disc drives,

add-on memories and communications equipment were installed for such major accounts as Bell Northern Research, Bell Canada, Insurance Corporation of British Columbia, Ontario Provincial Ministry of Government Services, Royal Bank, Systems Dimensions, Ltd., Industrielle Service Technique, British Columbia Telephone, and Data Crown, a service bureau.

Data storage and communications equipment is provided to major customers in

Venezuela such as Maraven, S.A., a large oil company; C.A.N.T.V., the nation's telephone company; and Electricidad de Caracas, a major power company.

In Brazil, Memorex won important new orders from TV Cultura, a government-owned station in Sao Paulo, and TV Globo Network, Brazil's largest television network, headquartered in Rio de Janeiro.

Distributors were established in Chile, Colombia, Bolivia and Trinidad.



In 1976 the Australian headquarters of Memorex in Sydney were moved to larger quarters to provide better service to customers.



Memorex headquarters for New Zealand were established in the Bank of New South Wales building in Wellington during 1976.



Television series, "Dona Barbara," is videotaped with Memorex Chroma 90 tape by Videomovil Studios for broadcast on Radio Caracas TV, Venezuela.

Corporate Capabilities



*Henry C. Montgomery
Vice President, Finance*

Financial

In 1976, the Finance Organization supported the company's operations while concurrently investing in preparations for growth. Significant productivity gains in data processing and transactional activities were achieved. Investments were made in data processing operations and systems, while budgeting, measurement, and control systems were expanded and improved.

During the year much of the financial function was decentralized throughout the world to provide management with close visibility and control at division and regional levels. Budgeting and management control systems were key factors in the successful decentralization.

Auditing activities were expanded in 1976. Internal audit capability, including a Europe-based internal audit team, was more than doubled. A strong and active audit function is an integral and important supporting element of management and control for a decentralized, worldwide company.

During 1976 the financial strategy for the company was further developed. This roadmap for the future provides structure and direction for managing the finance function, assuring adequate financing and determining resource allocations.

Asset management continued to receive high priority throughout Memorex. The successful management of foreign currencies in a year of unusual and dramatic changes to many major currencies was a notable accomplishment.

Future plans include significant investments in systems development and decentralized data processing capabilities, personnel development, refinements to control and measurement systems, improvements in asset management, and support and direction to resource allocation decisions.

Complete integrity in financial reporting, utilizing highest professional standards and conservative accounting practices, continues to guide Memorex financial operations.



The Memorex Data Center is the focal point for the company's financial reporting and control system. New processing equipment was added in 1976.



*Richard C. Allen
Vice President, Engineering*

Engineering

In 1976, Memorex greatly expanded its already substantial investments in high technology products, to provide future increases in value to customers.

The new 3650 disc storage product embodies Memorex advancement across the whole spectrum of magnetic recording technology. Use of custom-designed Large-

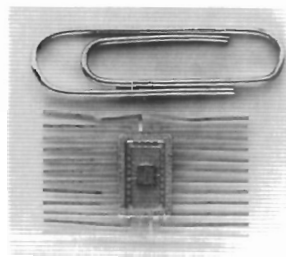
Scale Integrated circuits, improved magnetic disc surfaces, error-prevention coding and high-efficiency power technology—all contributed to a superior product offering reliable availability of customer data. As an integrated supplier of both equipment and media, Memorex is particularly well positioned to optimize design of dependable storage products.

The uses of data communications are expanding rapidly. In 1976 Memorex expanded the capabilities of its 1380 Communications Controller. This product, involving hardware, software and system technologies, represents a significant extension of Memorex's ability to serve its customers' data communications needs.

Memorex media products incorporate a broad technology spectrum. In 1976 Memorex invested in new personnel, equipment, and facilities that increased its ability to develop and produce high quality products for increasingly demanding market needs.



Precise alignment of heads in the 3650 Head Disc Assembly is accomplished by this servo-writer which uses a laser beam positioning device.



Critical element in the Head Disc Assembly is an LSI chip shown in actual size at center of electronic device at left.



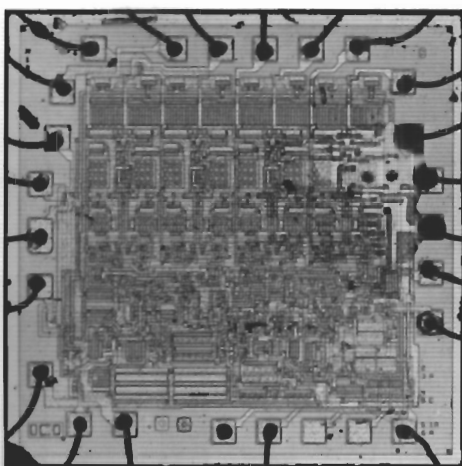
*George L. Bragg
Vice President,
Corporate Development*

Corporate Development

The Corporate Development function is responsible for business strategy, acquisitions and affiliations, and resource allocations among alternative investment opportunities.

Memorex agreed to acquire Lencor International, the sole owner of CFI Memories, Inc., a manufacturer of disc cartridges, flexible discs, computer tape, and add-on memories. Early in 1977 Memorex agreed in principle to acquire Business Systems Technology, Inc. (BST), a supplier of disc drives, memories, and printers to users of small computer systems (see note 14, page 44).

A substantial increase was made during the year in resources allocated for future benefits, including quality assurance, field engineering, product availability, new product programs, personnel development, and lease base additions.



The LSI chip above is magnified 1300 times, showing hundreds of individual devices.



*Robert L. Malcolm
Vice President,
Industrial Relations*

Industrial Relations

In 1976 the number of employees grew by more than 1,000 to a total of 6,840 to support current and future growth.

Despite this rapid growth, the people of Memorex improved the quality of the products they manufactured. Growth was also accompanied by the promotion of more than 500 Memorex people.

Memorex continues to build on its reputation as a good place to work. Memorex employees have confidence in the future of the company and in the career opportunities that it offers, and they recognize the attractive compensation and benefits. In 1976 the company included a dental benefit in its benefit program, and extended a hospital/medical and life insurance plan to provide for employees who retire under the pension plan.

Affirmative action to promote equal employment opportunity is vigorously pursued at Memorex. Training for supervisors and for employees developing their skills also expanded, as did the program to compensate employees for outside education.



An equal opportunity employer with an effective Affirmative Action Program, Memorex hires and promotes employees on the basis of merit.



*Robert L. Erickson
Vice President,
Legal, and Secretary*

Legal

The most demanding activity of the Legal Department during 1976 was preparation for the anti-trust suit against IBM, scheduled for trial this summer or fall. The litigation support group working on the case grew to approximately 100 people by the end of the year. The group is organized to assist counsel in preparation of the case. It has developed a computerized document index system for rapid retrieval of documents totalling 2 million pages by the end of the year. Three law firms are retained in the case. The damages sought, when trebled as provided by law, approximate \$3 billion.

Also in 1976, a large amount of litigation was resolved. In line with the company's strong technology commitment, patent activity increased substantially in 1976, and a patent attorney will be added to the staff.



Computerized document index system is used for rapid retrieval of documents in IBM suit

Financial Review

Overview

Record results in revenue and income, together with decisive balance sheet improvements, made 1976 an excellent year for Memorex. The company continued to increase its investments in future opportunities, financing them with cash flow from current operations. Altogether, 1976 has been the year of establishing a firm foundation for long-term profitable growth.

Revenue

Total revenue reached \$344.6 million, a 31 percent increase over 1975. Although Memorex has shown consistently strong revenue growth throughout its 15-year history, the revenue increase of 1976, both in dollars and percent, represents an unusual achievement. Revenues from sales, and from rental and service, both increased, with sales providing the larger proportional increase. While all geographic areas shared in the growth, domestic revenues recorded the largest percent of increase. All product types showed revenue improvement.

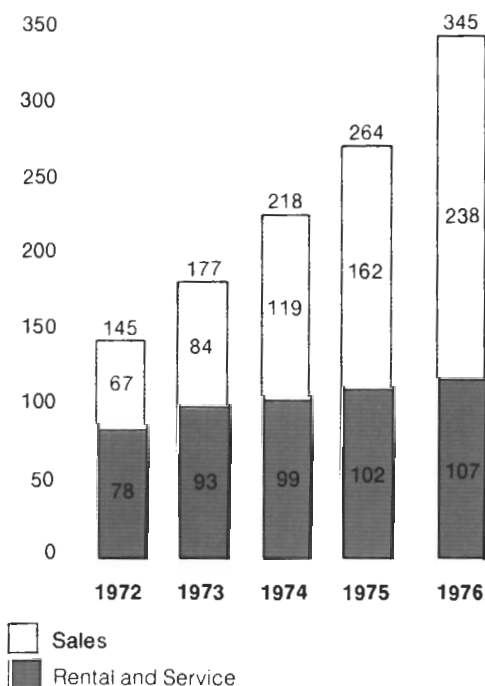
Results of Operations

Income before extraordinary credits was \$24.9 million, representing more than three times the comparable 1975 results of \$8.2 million. Income per common share before extraordinary credits was \$4.35 compared to \$1.74 in 1975.

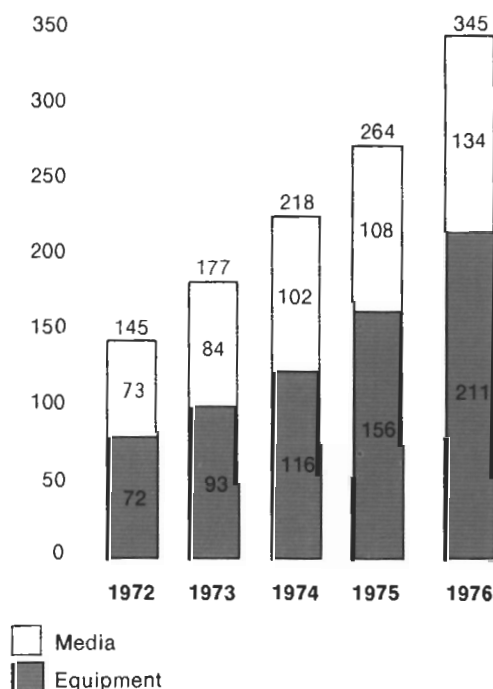
Net income for 1976 was a record \$40.1 million or \$7.10 per share, including an extraordinary credit of \$15.2 million or \$2.75 per share from utilizing tax loss carryforwards.

In 1975, the company purchased a significant number of Memorex debentures.

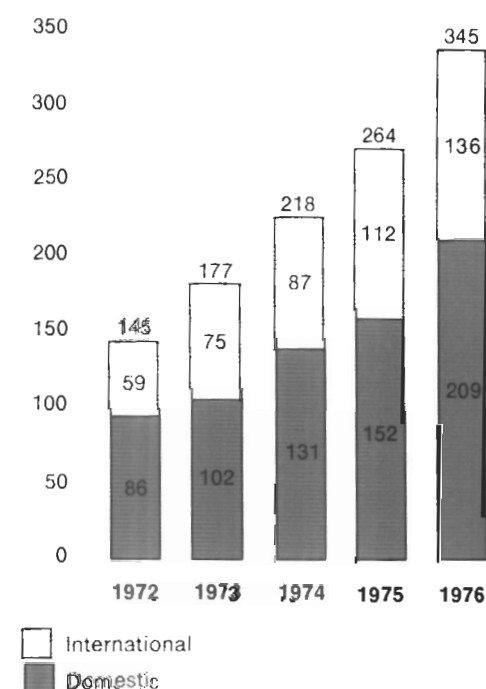
Revenues: Sales, and Rental and Service
Millions of Dollars



Revenues: Major Product Groups
Millions of Dollars



Revenues: Domestic and International
Millions of Dollars



tures. This purchase and the related tax loss carryforwards resulted in an extraordinary credit of \$3.9 million or 83 cents per share. The other extraordinary credit from tax loss carryforwards of \$5.9 million, or \$1.23 per share, brought the net income to \$18.0 million or \$3.80 per share in 1975.

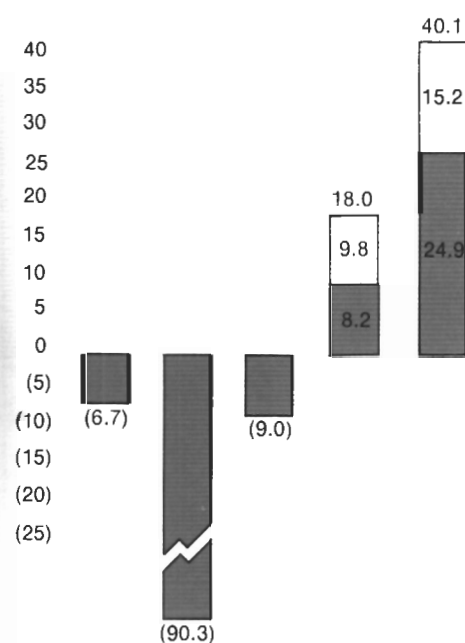
The excellent 1976 results are attributable to increased revenue, improved productivity, professional management of costs and foreign currencies, reduced interest expense, and continued demand for certain lease products that have

been fully depreciated. In every quarter the profit represented not only a significant increase over the comparable quarter of 1975, but also an increase over the previous quarter.

Asset Management

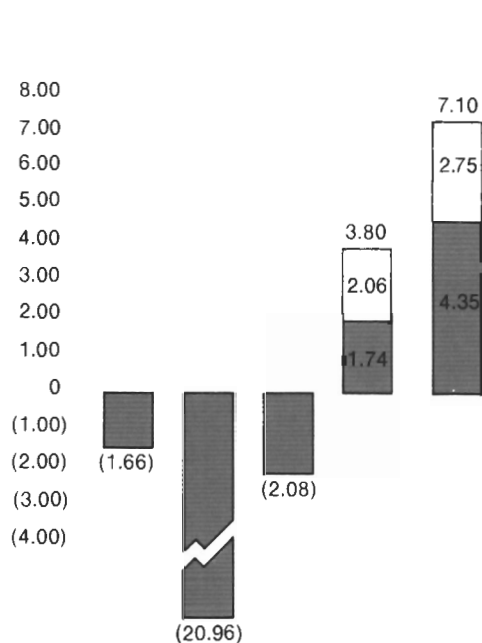
Cash and temporary investments increased despite the cash requirements which accompanied the substantial increase in revenues, significant investments in futures opportunities, and scheduled debt repayments. Cash and temporary investments were \$43.8 million at year-end, compared to \$40.2 million at the end of 1975.

Net Income (Loss)
Millions of Dollars



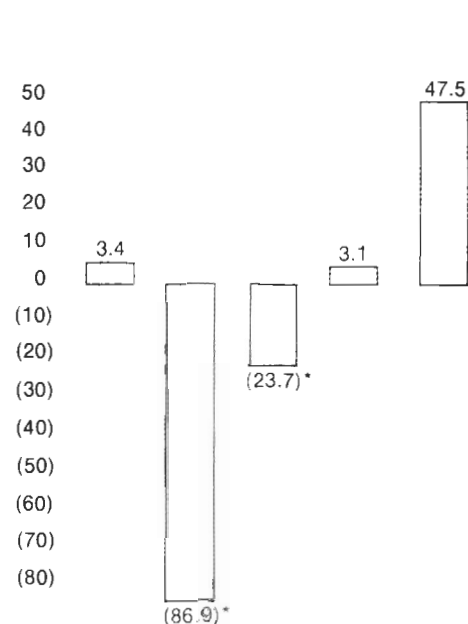
□ Extraordinary Items
■ Before Extraordinary Items

Net Income (Loss) Per Share
In Dollars



□ Extraordinary Items
■ Before Extraordinary Items

Shareholders' Equity
Millions of Dollars



*Deficiency

Debt reduction alone totaled \$27.4 million in 1976, while futures investments were substantially higher than in 1975. Inventory turns and days sales in receivables again improved in 1976; asset management continues to be a high priority throughout Memorex. While the lease base net book value decreased by 14 percent during 1976, the gross value was reduced by only 6 percent. Assets in the lease base are increasingly the newer products of the company. Management is continually weighing the issue of allocating resources to the lease base or to other opportunities, and decisions are made on the basis of maximum overall return and asset liquidity for management flexibility.

Financial Position

The \$3.1 million total shareholders' equity achieved by the end of 1975 had been a major achievement for that year. Equally significant is the dramatic increase recorded in 1976 as total shareholders' equity reached a positive \$47.5 million and common shareholders' deficiency was brought to within \$15.3 million of a positive position. During 1976 common shareholders' deficiency was reduced by \$40.7 million.

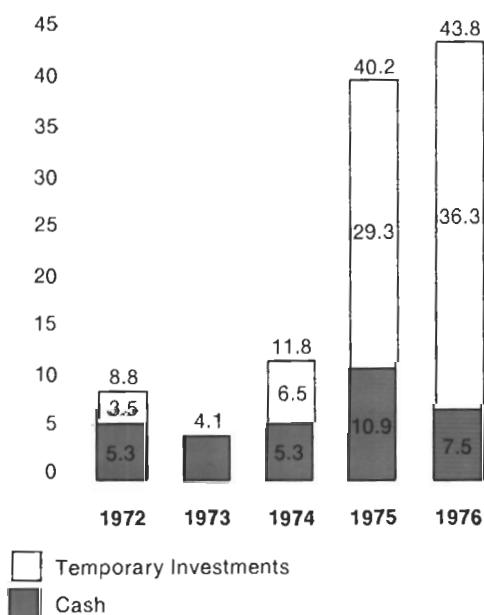
At the same time, total debt was reduced by \$27.4 million, from \$185.6 million at the end of 1975 to \$158.2 million at year end 1976. In April the company prepaid the ILC lenders. During the fourth quarter, minor amounts of the company's convertible subordinated debentures were purchased on the open market.

Summary

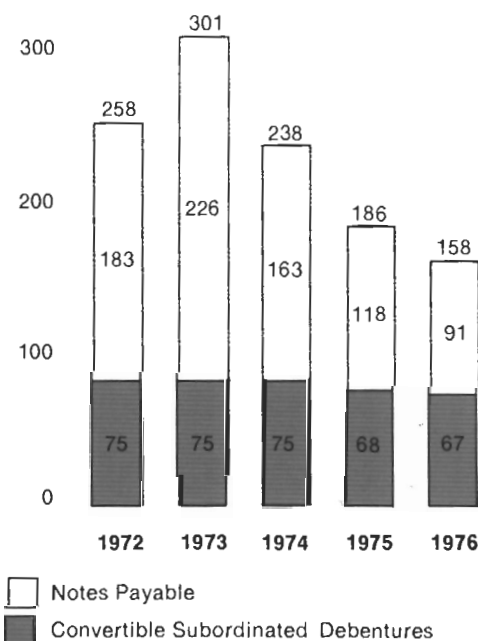
Your company's performance in 1976 greatly improved upon the results of 1975. Including extraordinary credits, income more than doubled the comparable results of 1975, and before extraordinary credits, income more than tripled.

Cash was generated in amounts sufficient to reduce debt significantly and concurrently fund the revenue growth. Equally important, investments were continued in operating improvements and new activities that laid the basis for continued long-term profitable growth. The company's cash resources provide the flexibility for management to capitalize on acquisitions and similar attractive growth opportunities.

Cash and Temporary Investments
Millions of Dollars



Total Debt
Millions of Dollars



Shareholder Information

Annual Meeting of Shareholders

You are cordially invited to attend Memorex's Annual Meeting of Shareholders which will take place on Thursday, April 28, 1977, at 10 a.m. at the Hyatt House, 1740 North First Street, San Jose, California. Resolutions to be voted by shareholders are described in the proxy material which accompanies this report.

Transfer Agent and Registrar

The Transfer Agent and Registrar for both the common stock and 5¼ % Convertible Subordinated Debentures is:

Bank of America-NT&SA
San Francisco, California

10K Report

Memorex Corporation will furnish its 10K Report, as filed with the Securities and Exchange Commission, to shareholders without charge. Written requests should be sent to:

Corporate Public Relations
Memorex Corporation
San Tomas at Central Expy.
Santa Clara, CA 95052

Memorex Common Stock is traded on the Pacific Stock Exchange. The 5¼ % Convertible Subordinated Debentures are traded over-the-counter. The following tables show high and low sales prices per quarter for the Common Stock on the Pacific Stock Exchange, as reported by the *Wall Street Journal*, and high and low bid and asked prices for the Convertible Debentures, as reported by the National Quotation Bureau, Inc.

YEAR	COMMON STOCK*		CONVERTIBLE DEBENTURES			
	High	Low	Bid Prices		Asked Prices	
1976			High	Low	High	Low
1st Quarter	26 ⁷ / ₈	7 ⁵ / ₈	48 ¹ / ₂	37	52	39
2nd Quarter	33 ³ / ₄	22	50 ¹ / ₂	46	53	47 ¹ / ₂
3rd Quarter	32	19	50 ¹ / ₂	47	52	48 ¹ / ₂
4th Quarter	24 ⁷ / ₈	16 ¹ / ₂	59	48 ¹ / ₂	60 ¹ / ₂	51

*No dividend has been paid. Trading symbol is MRX.

Officers & Directors

Board of Directors

Robert C. Wilson
Memorex Chairman of the Board,
President and Chief Executive Officer

Robert L. Chambers
Chairman of the Board and Chief
Executive Officer, Envirotech
Corporation, Menlo Park, California.

Alger Chaney
Chairman of the Board, Medford
Corporation, Medford, Oregon,
Senior Vice President and Director,
Baker, Fentress & Company, Chicago.

Philip J. Gomez
President and Director, Western
Gear Corporation, Los Angeles.

Vester T. Hughes, Jr.
Partner, Hughes, Luce, Hennessy,
Smith & Castle, Dallas, Texas.

Alvin C. Rice
Executive Vice President, Bank of
America National Trust and Savings
Association, San Francisco.

T. Robert Sandberg
Vice President (Ret.), Cutter Labora-
tories, Inc., Berkeley, California.

Benno C. Schmidt
Managing Partner, J. H. Whitney
& Company, New York City.

Theodore Vermeulen
Chemical Engineer; Professor,
University of California, Berkeley.

Board Committees

Executive Committee
Mr. Wilson, Chairman; Members,
Messrs. Schmidt, Rice, Sandberg
and Vermeulen.

Audit Committee
Mr. Hughes, Chairman; Members,
Messrs. Rice, Chambers and Chaney.

Stock Options and
Compensation Committee
Mr. Schmidt, Chairman; Members,
Messrs. Rice and Gomez.

Corporate Operating Committee

Robert C. Wilson*
President, Chief Executive Officer,
Chairman

James Dobbie*
Executive Vice President, Equipment

Robert Jaunich II*
Executive Vice President, Media

Richard C. Allen
Vice President, Engineering

George L. Bragg
Vice President, Corporate Development

Robert L. Erickson
Vice President, Legal, and Secretary

Marcelo A. Gumucio
Vice President and General Manager,
Americas and Asia Group

Robert L. Malcolm
Vice President, Industrial Relations

William S. McCalmont
Vice President and General Manager,
Europe—Middle East—Africa Group

Henry C. Montgomery
Vice President, Finance

Staff

Robert G. Coe
Treasurer

John R. Eastling
Vice President,
Litigation Support Activity

James Simpson
Vice President,
Operations Support—EUMEA

Charles E. Spaine
Vice President, Sales—Equipment

*Member, Office of the President

MEMOREX


1976 Financial Report

Report of Independent Public Accountants

To the Shareholders and Board of Directors of
Memorex Corporation:

We have examined the consolidated balance sheets of Memorex Corporation and subsidiaries as of December 31, 1976 and 1975, and the related consolidated statements of income, shareholders' equity (deficiency), and changes in financial position for the years then ended. Our examination was 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 opinion, the above mentioned financial statements present fairly the financial position of Memorex Corporation and subsidiaries at December 31, 1976 and 1975, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied.

A handwritten signature in cursive script that reads "Haskin & Sells".

San Francisco, California
January 19, 1977

Consolidated Statements Of Income
For the Years Ended December 31, 1976 and 1975

	1976	1975		
	Thousands			
Revenues:				
Sales	\$237,811	\$162,139		
Rental and Service	106,822	101,855		
Total Revenues	344,633	263,994		
Operating Costs and Expenses (Notes 1 and 4):				
Cost of Sales	142,454	100,521		
Cost of Rental and Service	55,647	63,130		
Selling, General and Administrative	70,118	57,354		
Research and Development	13,943	9,282		
(Gain) Loss from Foreign Exchange Adjustments	(205)	609		
Total Operating Costs and Expenses	281,957	230,896		
Operating Income	62,676	33,098		
Interest Expense (Notes 6 and 7)	11,827	15,268		
Income Before Taxes and Extraordinary Credits	50,849	17,830		
Provision For Income Taxes (Notes 1 and 10)	25,973	9,585		
Income Before Extraordinary Credits	24,876	8,245		
Extraordinary Credits (Notes 7 and 10):				
Gain on Purchase of Debentures, net of tax of \$2,214	—	2,031		
Income Tax Benefit from Utilizing Loss Carryforwards—				
On Income before Taxes and Extraordinary Credits	15,254	5,871		
On Gain on Purchase of Debentures	—	1,875		
Net Income	\$ 40,130	\$ 18,022		
	Primary	Fully Diluted	Primary	Fully Diluted
Income Per Common Share (Note 1):				
Before Extraordinary Credits	\$4.35	\$4.29	\$1.74	\$1.72
Net Income	\$7.10	\$7.01	\$3.80	\$3.77
Proforma Income Per Common Share—Assuming preferred dividends had been payable at the maximum rate scheduled to be paid after 1980 (Notes 1 and 11):				
Before Extraordinary Credits	\$3.78	\$3.73	\$1.03	\$1.01
Net Income	\$6.53	\$6.45	\$3.09	\$3.06

The accompanying notes are an integral part of these statements.

Consolidated Balance Sheets
December 31, 1976 and 1975

	1976	1975
	Thousands	
Assets (Note 6)		
Cash and Temporary Investments, at cost of \$36,263 and \$29,262 which approximates market	\$ 43,803	\$ 40,182
Accounts Receivable, less allowance for doubtful accounts of \$1,937 and \$2,968...	56,118	40,413
Inventories, at lower of cost (first-in, first-out) or market (Note 3)	61,228	44,797
Equipment for Lease, at cost less accumulated depreciation (Notes 1 and 4)	52,414	61,067
Property, Plant and Equipment, at cost less accumulated depreciation (Note 5)	43,637	37,185
Other Assets	5,396	4,493
Total	\$262,596	\$228,137
Liabilities and Shareholders' Equity		
Accounts Payable	\$ 18,849	\$ 16,470
Accrued Liabilities	25,061	20,239
Income Taxes Accrued (Notes 1 and 10)	15,930	9,393
Notes Payable, less unamortized imputed discount of \$2,956 and \$6,663 (Note 6)	88,002	110,899
Convertible Subordinated Debentures, 5¼ %, due 1990 (Note 7)	67,218	68,045
Total Liabilities	215,060	225,046
Commitments and Litigation (Notes 8 and 9)		
Shareholders' Equity (Notes 11, 12, and 13):		
Preferred Shareholders' Equity, Preferred Stock	62,815	59,057
Common Shareholders' (Deficiency)—		
Common Stock	4,875	4,484
Additional Capital	39,205	38,405
Deficit	(59,359)	(98,855)
Total Common Shareholders' (Deficiency)	(15,279)	(55,966)
Total Shareholders' Equity	47,536	3,091
Total	\$262,596	\$228,137

The accompanying notes are an integral part of these statements.

Consolidated Statements Of Changes In Financial Position
For the Years Ended December 31, 1976 and 1975

	1976	1975
	Thousands	
Funds were Provided by (Used for):		
Operations—		
Income before extraordinary credits	\$24,876	\$ 8,245
Items not requiring cash outlay—		
Depreciation and amortization	30,138	40,532
Amortization of imputed discount	3,513	4,853
Interest paid with preferred stock	3,758	5,294
Other	(399)	—
Funds provided from operations excluding extraordinary credits	61,886	58,924
Extraordinary credits—		
Income tax benefit from utilizing loss carryforwards	15,254	5,871
Taxes and expenses related to purchase of debentures	—	(615)
	77,140	64,180
Assets—		
Accounts receivable	(15,705)	1,872
Inventories	(16,431)	5,950
Equipment for lease:		
Additions	(33,630)	(38,289)
Dispositions	18,823	28,667
Property, plant and equipment:		
Additions	(13,239)	(5,415)
Dispositions	234	1,259
Other assets	(1,028)	2,081
	(60,976)	(3,875)
Liabilities—		
Accounts payable and accrued liabilities	7,201	\$,684
Income taxes	6,537	3,634
Increase (reductions) of notes payable:		
Proceeds from borrowings	4,868	483
In exchange for preferred stock	—	(3,373)
Cash payments	(27,602)	(35,013)
Cash payments by sale of products	(1,812)	(7,341)
Foreign exchange adjustments	(2,058)	(311)
Convertible subordinated debentures:		
Amounts purchased, at face value	(827)	(6,955)
Excess of face value over purchase price	399	4,521
	(13,294)	(35,671)
Shareholders' Equity—		
Preferred stock issued in exchange for debt	—	3,373
Dividends on preferred stock	(634)	—
Exercise of common stock options and purchase of minority interest of subsidiaries	1,385	392
	751	3,765
Increase in Cash and Temporary Investments	3,621	28,399
Cash and Temporary Investments, Beginning of Year	40,182	11,783
Cash and Temporary Investments, End of Year	\$43,803	\$40,182

The accompanying notes are an integral part of these statements.

Consolidated Statements Of Shareholders' Equity (Deficiency)
For the Years Ended December 31, 1976 and 1975

	Preferred Shareholders' Equity	Common Shareholders' (Deficiency)				Total Shareholders' Equity (Deficiency)
	Preferred Stock	Common Stock	Additional Capital	(Deficit)	Total	
	Thousands					
Balance, January 1, 1975	\$50,390	\$ 4,340	\$38,470	\$(116,877)	\$(74,067)	\$(23,677)
Net income for 1975	—	—	—	18,022	18,022	18,022
Issuance of stock:						
In exchange for notes payable (Notes 6 and 11)	3,373	—	—	—	—	3,373
In payment of interest accrued through December 31, 1975; issued in 1976 (Note 11)	5,294	—	—	—	—	5,294
For purchase of minority interest of subsidiaries and stock options exercised (Note 13)	—	144	248	—	392	392
Imputed discount adjustments (Note 6)	—	—	(313)	—	(313)	(313)
Balance, December 31, 1975	59,057	4,484	38,405	(98,855)	(55,966)	3,091
Net income for 1976	—	—	—	40,130	40,130	40,130
Issuance of stock:						
In payment of interest accrued through December 31, 1976; to be issued in 1977 (Note 11)	3,758	—	—	—	—	3,758
For stock options exercised (Note 13)	—	391	994	—	1,385	1,385
Imputed discount adjustments (Note 6)	—	—	(194)	—	(194)	(194)
Dividends on preferred stock (Note 11)	—	—	—	(634)	(634)	(634)
Balance, December 31, 1976	\$62,815	\$ 4,875	\$39,205	\$(59,359)	\$(15,279)	\$ 47,536

The accompanying notes are an integral part of these statements.

Notes To Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include Memorex Corporation and its subsidiaries, including ILC Peripherals Leasing Corporation (ILC), after elimination of the intercompany accounts and transactions.

Translation of Foreign Currencies

Financial statements of foreign operations are translated into United States dollars in accordance with the requirements of the Statement of Financial Accounting Standards No. 8 — Accounting for the Translation of Foreign Currency Transactions and Foreign Currency Financial Statements issued by the Financial Accounting Standards Board.

Equipment for Lease

Lease agreements are for initial periods of up to five years and usually contain purchase options whereby a portion of the rental payments may be applied to purchase the equipment. Such agreements are accounted for on the "operating method" and lease revenue is recognized only as earned.

Equipment is stated at cost and depreciation is computed using principally accelerated methods at rates based upon principally 7 year estimated economic lives of the equipment. Depreciation policies are reviewed not less than annually for reasonableness and, if required, depreciation rates are changed (see Note 4).

Income Taxes

Deferred taxes are provided for timing differences between financial and tax reporting in the recognition of certain costs and expenses. The Company's intention is to reinvest earnings of its foreign subsidiaries and accordingly no domestic income taxes have been provided on these amounts. The Company does not provide taxes on the undistributed earnings of its Domestic International Sales Corporation (D.I.S.C.) since the Company does not presently intend to distribute these earnings or perform any other act which would cause these taxes to become due and payable. As of December 31, 1976 and 1975, undistributed earnings of foreign subsidiaries aggregated \$9,736,000 and \$6,622,000, respectively.

Investment tax credits are accounted for as reductions of the provision for income taxes on the "flow-through" method.

Pension Plan

The voluntary contribution pension plan covers all eligible U.S. employees who elect to participate. Amounts charged to operations under the plan include normal cost and amortization of past service costs over thirty years. Pension costs accrued have been fully funded at December 31, 1976 in accordance with the Company's policy. Pension expense charged to operations was \$1,199,000 in 1976 and \$1,328,000 in 1975.

Income Per Common Share

Income per share amounts are computed by dividing income, after deducting dividend requirements on preferred stock (which commenced in 1976), by the weighted average number of common shares outstanding plus common stock equivalents resulting from stock options, and, for 1976, warrants and convertible subordinated debentures. Fully diluted income per share amounts are computed using the treasury stock method assuming the common share market price is the higher of market price at the end of the period or average market price during such period. The average market price is used to compute primary income per share.

Proforma per share amounts reflect what the effect on income per common share would have been had dividends on the preferred stock been payable at the maximum rates payable after 1980. See Note 11 for additional preferred stock information.

2. Foreign Operations

The financial data of foreign subsidiaries as reflected in their accounts are as follows:

	1976	1975
	Thousands	
Total assets	\$121,000	\$103,000
Revenues	\$136,000	\$112,000
Operating income	\$ 12,000	\$ 8,000

3. Inventories

Inventories, net of allowances for obsolescence and excess stock of \$13,179,000 for 1976 and \$9,591,000 for 1975, are classified as follows:

	1976	1975
	Thousands	
Raw materials	\$ 16,144	\$ 8,319
Work in process	13,455	12,252
Finished goods	26,004	16,524
Spares	5,625	7,702
Total	\$ 61,228	\$ 44,797

4. Equipment for Lease

	1976	1975
	Thousands	
Computer peripheral equipment, net of accumulated depreciation of \$99,371 and \$101,184	\$45,855	\$55,121
Disc packs, net of accumulated depreciation of \$8,503 and \$9,053	6,559	5,946
Total	\$52,414	\$61,067

Depreciation charges to operations include \$2,100,000 in 1975 resulting from revisions of estimated economic lives. Depreciation charges ended during 1976 for certain classes of products in the lease base which became fully depreciated. Depreciation charges relating to those products aggregated approximately \$3,400,000 and \$12,900,000 for 1976 and 1975, and cost approximated \$49,700,000 and \$57,220,000 as of December 31, 1976 and 1975, respectively.

5. Property, Plant and Equipment

	1976	1975
	Thousands	
Land	\$ 5,849	\$ 3,316
Buildings and improvements	20,211	19,350
Equipment, furniture and fixtures	52,696	51,307
Construction in progress	7,171	3,703
Total	85,927	77,676
Less accumulated depreciation (straight-line method)	(42,290)	(40,491)
Net	\$43,637	\$37,185

6. Notes Payable

Bank of America (the Bank) is the remaining lender under the agreement with senior lenders which was revised in 1974. In 1976, the Company prepaid all notes payable due to the ILC lenders, and accordingly eliminated the terms and provisions of the ILC loan agreement.

The Company's agreement with its senior lenders provides for a reduction in the interest rate from 7¾ % to 4% during the period April 1, 1974 through December 31, 1977. Accordingly, the Company recorded an unamortized imputed discount representing the 3¾ % difference which is being amortized over the reduced interest rate period. Amortization of imputed discount charged to interest expense was \$3,513,000 for 1976 and \$4,853,000 for 1975. Minor amounts of imputed discount have been charged to additional capital as a result of debt prepayments.

The following describes the significant terms and provisions of the revised Bank loan agreement and certain related transactions:

- (1) Bank loan principal payments of \$750,000 are due monthly to April 1, 1977 and \$2,250,000 monthly commencing May 1, 1977 until the debt is paid.
- (2) Mandatory prepayments are required if:
Net cash proceeds in excess of \$10 million are derived from sale of assets other than in the ordinary course of business.

Net proceeds are received in excess of \$1 million from litigation with International Business Machines Corporation (IBM), after amounts therefrom are applied toward repurchase of Series A and Series B Preferred Stock to the extent legally permissible (see Notes 9 and 11).
- (3) Interest is at the rate of 4% per annum through 1977 payable in cash or in preferred stock, at the option of the Company. On January 1, 1978, interest becomes payable in cash at the prime rate for domestic loans and 1% over the Bank's cost of funds for overseas loans. Interest for 1975 and 1976 was or will be paid in preferred stock.
- (4) The Bank has a security interest in all assets. Cash dividends cannot be paid without Bank approval except on the Series A and Series B Preferred Stock.
- (5) At the Company's option, the Bank will exchange up to \$20 million of debt for shares of Series B Preferred Stock (up to 200,000 shares) at the rate of 50% of any equity created by the conversion prior to December 31, 1977 of the Company's 5¼ % Convertible Subordinated Debentures into equity securities junior to the Company's Series A and Series B Preferred Stock, or by purchase of such debentures by the Company for cash at less than face value. Warrants to purchase two shares of common stock at \$10 per share would be issued for each share of preferred stock so issued. In 1975, senior lenders exchanged \$3,373,000 of debt for 33,730 shares of preferred stock and warrants to purchase 67,460 shares of common stock at \$10 per share as a result of the 1975 debenture purchases. In 1976, the Company elected not to exchange Bank debt pursuant to the insignificant debenture purchases made in 1976.
- (6) An additional line of credit up to \$32 million is available under certain conditions through 1978. There were no loans outstanding under this line of credit during the two years ended December 31, 1976.

Notes payable transactions for 1976 and 1975 are summarized as follows:

	ILC Loan	Bank Loan	Other	Total
Thousands				
Balance of indebtedness, January 1, 1975	\$43,211	\$115,142	\$ 4,764	\$163,117
Additions	—	—	483	483
Repayments	(25,960)	(13,723)	(2,671)	(42,354)
Foreign exchange adjustments	—	(311)	—	(311)
Exchanged for preferred stock	(1,113)	(2,260)	—	(3,373)
Balance of indebtedness, December 31, 1975 ..	16,138	98,848	2,576	117,562
Additions	—	3,860	1,008	4,868
Repayments	(16,138)	(11,782)	(1,494)	(29,414)
Foreign exchange adjustments	—	(2,010)	(48)	(2,058)
Balance of indebtedness, December 31, 1976 ..	—	88,916	2,042	90,958
Less unamortized imputed discount	—	(2,956)	—	(2,956)
Balance, December 31, 1976—Net	\$ —	\$85,960	\$ 2,042	\$88,002

Notes include \$22,126,000 and \$26,046,000 payable in currencies other than the U.S. dollar as of December 31, 1976 and 1975, respectively.

The annual maturities of notes payable as of December 31, 1976 are: 1977, \$22,565,000; 1978, \$27,091,000; 1979, \$27,084,000; 1980, \$13,985,000; 1981, \$67,000; 1982 and thereafter, \$166,000.

7. Convertible Subordinated Debentures, 5¼ %, Due 1990

Interest is payable semiannually. Outstanding debentures are convertible into shares of common stock, at \$142.50 per share. The debentures are redeemable at a premium and are subordinated to senior indebtedness.

For ten years, beginning in 1980, annual sinking fund payments of \$6,000,000 are required. Debenture purchases can be used to satisfy sinking fund requirements.

In 1975, the Company purchased \$6,955,000 of the debentures, resulting in an extraordinary credit of \$2,031,000 (net of income tax effect) or 43 cents per common share. In 1976, \$827,000 of the debentures were purchased. The gain on the 1976 purchases was not material.

8. Commitments

Lease Commitments

Total lease rentals were as follows:

	1976	1975
Thousands		
Noncapitalized financing lease (buildings)	\$ 1,779	\$ 1,804
Other leases (principally sales offices and distribution centers)	5,308	4,365
Total	\$ 7,087	\$ 6,169

The discounted present value of the noncapitalized financing lease payments at 9.3% was approximately \$14,607,000 and \$17,823,000 as of December 31, 1976 and 1975, respectively. There would not have been a significant effect on operations if this lease had been capitalized.

Minimum rental commitments remaining under non-cancellable leases as of December 31, 1976 are as follows:

	Non- capitalized Financing Lease	Total Commit- ments
Thousands		
Five Years Ending December 31,		
1981	\$ 7,480	\$18,207
1986	7,480	9,636
1991	7,480	9,196
1996	7,480	9,296
Subsequent to December 31, 1996	8,230	8,665
Total	\$38,150	\$55,000

The rental commitments for each of the five years ending December 31, 1981 (including \$1,496,000 per annum relating to the noncapitalized financing lease) are \$5,148,000 in 1977; \$4,237,000 in 1978; \$3,384,000 in 1979; \$2,914,000 in 1980; and \$2,524,000 in 1981.

Incentive Compensation Plans

The Company has an employment agreement with its President and Chief Executive Officer and incentive compensation and bonus plans for certain other employees. Incentive awards depend on earnings and are charged to operations in the year earned (1976, \$1,965,000; 1975, \$1,665,000).

9. Litigation

In December 1973, Memorex and certain of its subsidiaries (the Company) 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 Company further alleges that in violation of the federal antitrust laws, IBM has monopolized and attempted to monopolize the development, production, distribution, sale, leasing and servicing of certain markets for computers and computer equipment, including, but not limited to, computer peripheral products for use with IBM central processing units. The Company estimates that its actual damages as a result of IBM's actions approximate \$1 billion, and seeks to recover treble damages. The Company also seeks such injunctive relief, including divestiture, as is reasonably necessary to restore effective competition in the electronic data processing industry. IBM has denied liability, raised affirmative defenses and asserted that it is entitled to offset for unjust enrichment. Extensive pretrial discovery efforts continue and trial is expected to start in the summer or fall of 1977.

During 1975, class action, derivative and certain individual suits alleging violations of federal securities laws by Memorex and other defendants were settled pursuant to an agreed upon final judgment. The Company's portion was provided for in years prior to 1975. The plaintiffs received \$4 million under the settlement. One million dollars of this amount was contributed by Memorex. Neither Memorex nor the other defendants admitted any liability in connection with the suits or their settlement.

The Company has been sued by two female former employees, who have alleged that Memorex has discriminated in employment against women, against racial minorities, and against individuals of Cuban national origin. Each plaintiff has sued in her own right and on behalf of a class. In November 1975 the two suits were consolidated. Relief sought is for an injunction requiring that Memorex (1) cease alleged discrimination against minority and female applicants and employees and (2) appoint an ombudsman to review all actions taken by Memorex which might have an adverse effect on minorities and females. The suits

also seek attorneys' fees, punitive damages and back pay. Pretrial discovery efforts are in progress. The Company contends that it has a superior record in the employment of minorities and females and that it has a highly effective affirmative action program. In the opinion of management, relief granted in the suits, if any, will not have a material adverse impact on operations or on the financial position of the Company.

Although there are other actions pending to which the Company is a party, management is of the opinion that such actions will not have a material adverse impact on operations or on the financial position of the Company.

10. Income Taxes

The provision for income taxes for 1976 and 1975 consists of the following:

	Taxes on Income Before Extraor- dinary Credits	Taxes on Gain on Purchase of Debentures	Total
Thousands			
1976			
Charge in lieu of Federal taxes	\$14,031	—	\$14,031
State	4,889	—	4,889
Foreign, including deferred taxes of \$233	7,053	—	7,053
Income taxes before utilization of net operating loss carry- forwards	25,973	—	25,973
Utilization of net operating loss carryforwards, reported as an extraordinary credit:			
Federal	14,031	—	14,031
Foreign	1,223	—	1,223
Total	15,254	—	15,254
Net Provision	\$10,719	—	\$10,719
1975			
Charge in lieu of Federal taxes	\$5,090	\$1,875	\$ 6,965
State	1,200	339	1,539
Foreign, including deferred taxes of \$647	3,295	—	3,295
Income taxes before utilization of net operating loss carry- forwards	9,585	2,214	11,799
Utilization of net operating loss carryforwards, reported as an extraordinary credit:			
Federal	5,090	1,875	6,965
Foreign	781	—	781
Total	5,871	1,875	7,746
Net Provision	\$3,714	\$ 339	\$ 4,053

The effective tax rates of 51% in 1976 and 54% in 1975 are in excess of the Federal statutory rate due principally to the effect of state taxes, certain foreign losses for which tax benefits are not currently available and foreign taxes in excess of Federal rates, offset partially by investment tax credits and Domestic International Sales Corporation income not taxable. Income taxes due within one year as of December 31, 1976 and 1975 were \$9,300,000 and \$6,472,000, respectively.

Estimated net operating loss carryforwards of \$20,100,000, which are available to offset future U.S. and foreign taxable income, expire at various dates. The Company has additional estimated deductions to be claimed in future Federal and foreign income tax returns of \$46,200,000 from deductions recorded in previous years for financial reporting purposes.

Unused investment tax credits of \$6,200,000 and foreign tax credits of \$1,400,000 as of December 31, 1976 may be offset against future Federal income tax liabilities and expire at various dates through 1983.

11. Preferred Stock

As of December 31, 1976 and 1975, 1,000,000 shares of Series A and B \$100 par value preferred stock (\$100 liquidation and redemption value) were authorized.

A summary of shares included in the accompanying balance sheet is as follows:

	Series A	Series B
December 31, 1976:		
Outstanding	158,381	432,189
To be issued in 1977 for payment of 1976 interest (Note 6)	1,263	36,317
Total	159,644	468,506
December 31, 1975:		
Outstanding	146,143	391,482
Issued in 1976 for payment of 1975 interest (Note 6)	12,238	40,707
Total	158,381	432,189

The Series A has terms which provide for:

- (1) Cumulative annual dividends which commenced in 1976 at \$4 per share, increasing to \$5 per share in 1977 and 1978, \$6 per share in 1979 and 1980 and \$8 per share thereafter.
- (2) Sinking fund payments during 1983-1987 in equal annual amounts.
- (3) Liquidation preference over any other issue of stock.

The Series B has terms which provide for:

- (1) Cumulative annual dividends at \$4 per share beginning in 1978 through 1980 increasing to \$6 per share thereafter.
- (2) Sinking fund payments during 1983-1992 in equal annual amounts.
- (3) Liquidation preference over any other issue of stock except Series A Preferred Stock.

Early redemption of a portion of the preferred stock may be required if Memorex receives net proceeds in excess of \$1 million from the litigation against IBM.

During 1975, 33,730 shares of preferred stock were issued in exchange for \$3,373,000 of notes payable in conjunction with the 1975 purchase of 5 1/4 % Convertible Subordinated Debentures (see Note 7). Additional preferred stock, up to a maximum of 177,396 shares, is reserved for potential exchange of notes payable and an additional 86,042 shares are reserved for potential payment of interest subsequent to December 31, 1976 (see Note 6).

During 1975, 1,500,000 shares of no par preferred stock with such rights, preferences and terms as may be determined by the Board of Directors were authorized. As of December 31, 1976, no shares were issued or outstanding.

12. Common Stock

Ten million shares of \$1 par value common stock were authorized as of December 31, 1976 and 1975. Shares outstanding (net of treasury shares of 48,804) totaled 4,875,027 and 4,484,213 as of December 31, 1976 and 1975, respectively.

Shares reserved for possible future issuance as of December 31, 1976 were as follows:

	Number of Shares
Warrants at \$10 per share:	
Issued in 1974 and 1975 to senior lenders	867,460
Potentially issuable (Note 6)	354,792
Conversion of subordinated debentures (Note 7)	471,705
To employees under stock option plans (Note 13) ...	699,342
Total shares reserved	2,393,299

The warrants expire in 1989.

13. Stock Option Plans

Under the 1973 Stock Option Plan, "non-qualified" options may be issued to key employees to purchase up to 635,000 shares of common stock at 100% of market value on the dates the options are granted. The term of each option is determined by the Board of Directors but options are exercisable not more than ten years from the date of grant. All options granted as of December 31, 1976 expire five years from date of grant.

Under the 1974 Stock Option Plan, "qualified" options may be issued to key employees to purchase up to 400,000 shares of common stock (including the options granted in 1974 to the President and Chief Executive Officer to purchase 250,000 shares) at 100% of market value on the dates the options are granted. Additional options for 5,500 and 46,000 shares were granted in 1976 and 1975, respectively. The term of each option is determined by the Board of Directors. All options granted as of December 31, 1976 expire five years from date of grant.

Under the 1976 Stock Option Plan, "qualified" or "non-qualified" options may be issued to key employees to purchase up to 300,000 shares of common stock at 100% of market value on the dates the options are granted. The term of each option is determined by the Board of Directors but options are exercisable not more than ten years from the date of grant. As of December 31, 1976, no options were granted under the 1976 plan.

Stock option transactions under these plans are summarized as follows:

	1976		1975	
	Price per Share	Number of Shares	Price per Share	Number of Shares
Outstanding, Beginning of Year	\$1.00- 9.06	696,744	\$1.00- 5.06	726,718
Exercised	1.00- 9.06	(390,814)	1.00- 6.81	(108,690)
Terminated	1.00- 9.06	(26,762)	1.00- 4.50	(90,609)
Qualified Options Granted	27.31-31.06	5,500	2.06- 8.81	46,000
Non-Qualified Options Granted	15.06-31.06	55,000	1.00- 9.06	123,325
End of Year:				
Outstanding	\$1.75-31.06	339,668	\$1.00- 9.06	696,744
Exercisable . .		<u>202,757</u>		<u>450,641</u>
Available for Grant		<u>359,674</u>		<u>93,412</u>

14. Pending Acquisitions

In December 1976, the Company entered into an agreement to acquire Lencor International, a computer media manufacturer, and in January 1977, signed a letter of intent to acquire Business Systems Technology, Inc., a supplier of computer peripheral products for small computer systems. These pending acquisitions have not been finalized as they are subject to various matters including approval of the shareholders of the companies to be acquired.

The pending acquisition of Lencor International, which is to be accounted for as a purchase, involves payment to Lencor International shareholders of \$2.4 million in cash and 200,000 shares of Memorex common stock. The pending acquisition of Business Systems Technology, Inc., which is to be accounted for as a pooling of interests, involves the exchange of approximately 346,000 shares of Memorex common stock for all the outstanding shares of common stock of Business Systems Technology, Inc.

15. Replacement-Costs (Unaudited)

In 1976, the Securities and Exchange Commission (SEC) adopted a requirement that certain companies disclose the impact which current estimated replacement-costs would have on their operations, and on the economic investment which would be required for inventories, equipment for lease, and productive capacity if such assets were valued on a replacement-cost basis.

The replacement of the Company's inventories and equipment for lease would generally entail lower estimated replacement-costs primarily due to improved technology in semiconductor components and increased capacity utilization. The replacement of the Company's plant and equipment would generally entail higher estimated replacement-costs which reflect the cumulative impact of inflation on the long-lived nature of these assets. The net impact of the estimated replacement-costs would be to decrease the Company's operating costs.

The Company's annual report to the SEC on Form 10-K includes specific information relating to the estimated replacement-costs of inventories, equipment for lease, and productive capacity (plant and equipment and leased facilities) as of December 31, 1976 and the related cost of sales and depreciation expense for 1976 based on estimated replacement-costs.

16. Quarterly Summary (Unaudited)

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	1976	1975	1976	1975	1976	1975	1976	1975
Revenues:	(Thousands except per share amounts)							
Sales	\$53,785	\$35,914	\$54,661	\$39,818	\$57,181	\$41,770	\$72,184	\$44,637
Rental and Service	25,634	25,711	26,178	25,802	27,139	25,221	27,871	25,121
Total Revenues	79,419	61,625	80,839	65,620	84,320	66,991	100,055	69,758
Costs and Expenses:								
Cost of Sales, Rental and Service	47,156	39,628	46,253	41,756	46,989	41,299	57,703	40,968
Other Costs and Expenses	17,605	15,874	20,006	17,232	21,379	16,265	24,866	17,874
Operating Costs and Expenses	64,761	55,502	66,259	58,988	68,368	57,564	82,569	58,842
Operating Income	14,658	6,123	14,580	6,632	15,952	9,427	17,486	10,916
Interest Expense	3,160	4,080	2,991	3,932	2,923	3,813	2,753	3,443
Income before Taxes and Extraordinary Credits	11,498	2,043	11,589	2,700	13,029	5,614	14,733	7,473
Provision for Income Taxes	6,209	1,035	5,565	1,365	6,645	2,940	7,554	4,245
Income before Extraordinary Credits	5,289	1,008	6,024	1,335	6,384	2,674	7,179	3,228
Extraordinary Credits	3,794	575	3,132	4,881	3,909	1,690	4,419	2,631
Net Income	\$ 9,083	\$ 1,583	\$ 9,156	\$ 6,216	\$10,293	\$ 4,364	\$11,598	\$ 5,859
Primary Income per Common Share:								
Before Extraordinary Credits ...	\$.95	\$.23	\$ 1.04	\$.28	\$ 1.11	\$.56	\$ 1.23	\$.67
Net Income	\$ 1.66	\$.36	\$ 1.59	\$ 1.32	\$ 1.80	\$.91	\$ 2.03	\$ 1.21
Fully Diluted Income per Common Share:								
Before Extraordinary Credits ...	\$.91	\$.22	\$ 1.03	\$.28	\$ 1.11	\$.56	\$ 1.22	\$.67
Net Income	\$ 1.59	\$.35	\$ 1.58	\$ 1.29	\$ 1.80	\$.91	\$ 2.01	\$ 1.21
Proforma Income per Common Share—Assuming preferred dividends had been payable at the maximum rate scheduled to be paid after 1980:								
Primary:								
Before Extraordinary Credits	\$.80	\$.04	\$.90	\$.10	\$.96	\$.40	\$ 1.10	\$.49
Net Income	\$ 1.51	\$.17	\$ 1.45	\$ 1.14	\$ 1.66	\$.75	\$ 1.90	\$ 1.03
Fully Diluted:								
Before Extraordinary Credits	\$.77	\$.03	\$.89	\$.10	\$.96	\$.40	\$ 1.09	\$.49
Net Income	\$ 1.45	\$.16	\$ 1.44	\$ 1.11	\$ 1.66	\$.75	\$ 1.88	\$ 1.03

Five-Year Summary

(Thousands except per share amounts)

	Year Ended December 31				
	1976	1975	1974	1973	1972
Summary of Operations					
Revenues:					
Sales	\$237,811	\$162,139	\$118,297	\$ 83,991	\$ 67,100
Rental and Service	106,822	101,855	99,330	92,932	78,322
Total Revenues	344,633	263,994	217,627	176,923	145,422
Costs and Expenses:					
Cost of Sales, Rental and Service	198,101	163,651	147,743	138,392	86,146
Other Costs and Expenses	83,856	67,245	60,181	103,427	45,247
Operating Costs and Expenses	281,957	230,896	207,924	241,819	131,393
Operating Income (Loss)	62,676	33,098	9,703	(64,896)	14,029
Interest Expense	11,827	15,268	18,675	20,487	19,951
Income (Loss) before Taxes and Extraordinary Credits	50,849	17,830	(8,972)	(85,383)	(5,922)
Provision for Income Taxes	25,973	9,585	—	4,925	752
Income (Loss) before Extraordinary Credits	24,876	8,245	(8,972)	(90,308)	(6,674)
Extraordinary Credits	15,254	9,777	—	—	—
Net Income (Loss)	\$ 40,130	\$ 18,022	\$ (8,972)	\$ (90,308)	\$ (6,674)
Per Share Data					
	Primary	Fully Diluted	Primary	Fully Diluted	Primary
Income (Loss) per Common Share:					
Before Extraordinary Credits	\$4.35	\$4.29	\$1.74	\$1.72	\$ (2.08)
Net Income (Loss)	7.10	7.01	3.80	3.77	(2.08)
Proforma Income (Loss) per Common Share:					
Before Extraordinary Credits	\$3.78	\$3.73	\$1.03	\$1.01	\$ (2.60)
Net Income (Loss)	6.53	6.45	3.09	3.06	(2.60)
Common Shares and Equivalents	5,674	5,747	4,740	4,781	4,314
Operating Data					
Total Revenue:					
Equipment	\$210,370	\$156,307	\$116,043	\$ 92,678	\$ 71,993
Media	134,263	107,687	101,584	84,245	73,429
Operating Income (Loss):					
Equipment	45,478	27,942	(1,267)	(71,380)	—
Media	17,198	5,156	10,970	6,484	—
International Revenue	136,000	112,000	87,000	75,000	59,000
Research and Development Expenses	13,943	9,282	7,462	3,658	11,159
Depreciation and Amortization	30,138	40,532	46,323	59,162	33,560
Financial Position at Year End					
Cash and Temporary Investments	\$ 43,803	\$ 40,182	\$ 11,783	\$ 4,099	\$ 8,828
Inventories	61,228	44,797	50,747	58,779	44,710
Equipment for Lease:					
At Cost	160,288	171,304	192,433	170,608	162,579
Net of Accumulated Depreciation	52,414	61,067	84,878	92,654	111,293
Notes Payable	90,958	117,562	163,117	226,022	182,626
Convertible Subordinated Debentures	67,218	68,045	75,000	75,000	75,000
Shareholders' Equity (Deficiency)	47,536	3,091	(23,677)	(86,857)	3,437

Management's Discussion and Analysis of the Summary of Operations

The following discussion contains general comments on the results of Memorex's operations during 1976 and 1975 as compared to the previous years (1975 and 1974).

Revenues

Total revenues increased 31 percent in 1976 and 21 percent in 1975, with no significant price increases. Sales revenue increased 47 percent in 1976 and 37 percent in 1975. Equipment products revenue increased 35 percent in both 1976 and 1975, and media products revenue increased 25 percent in 1976 and 6 percent in 1975.

Cost of Sales

Cost of sales increased 42 percent in 1976 and 36 percent in 1975. The increases were primarily due to increased sales volume. The percentage increases in costs were not as large as the related percentage increases in sales revenue, primarily due to cost benefits from increased capacity utilization of manufacturing facilities, continued productivity improvements and other cost reductions.

Cost of Rental and Service

Cost of rental and service decreased 12 percent in 1976 and 14 percent in 1975 primarily due to reductions in depreciation as certain classes of products in the lease base became fully depreciated and as products were sold from the lease base. These decreases were partially offset by increased costs of service which were primarily due to providing contract maintenance services to an expanding base of sold equipment.

Selling, General and Administrative

Selling, general and administrative expenses increased 22 percent in 1976 and 12 percent in 1975. Increases were primarily due to employees added to support the Company's higher level of operations, especially sales and marketing activities, partially offset by continued improvements in productivity. Additionally, higher expenses were incurred in preparation for the IBM trial.

Research and Development

Research and development increased 50 percent in 1976 and 24 percent in 1975 primarily due to increased research and development activity relating to equipment products.

Foreign Exchange Adjustments

Operating results improved in 1976 and 1975 over each of the previous years due to the favorable effect of foreign currency fluctuations in relation to the Company's net assets denominated in foreign currencies.

Interest Expense

Interest expense declined 23 percent in 1976 and 18 percent in 1975 as a result of reductions in notes payable and the purchase, principally in 1975, of a portion of the Company's convertible subordinated debentures.

Provision for Income Taxes

The effective tax rates of 51 percent in 1976 and 54 percent in 1975 represent taxes on Federal, State, and foreign income. The effective tax rates are in excess of the Federal statutory rate due principally to the effect of state taxes, certain foreign losses for which tax benefits are not currently available and foreign taxes in excess of Federal rates, offset partially by investment tax credits and Domestic International Sales Corporation income not taxable. The reduction in the effective tax rate from 1975 to 1976 was principally due to increased utilization of investment tax credits. 1974 resulted in a net loss, and accordingly, no taxes were provided.

Extraordinary Credits

Extraordinary credits in 1976 and 1975 consisted of the estimated tax benefit from utilizing tax loss carryforwards available from years prior to 1975, and in 1975, the gain on the purchase of a portion of the Company's convertible subordinated debentures.

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Robert L. Chambers
Chairman of the Board and Chief
Executive Officer, Envirotech
Corporation, Menlo Park, California,
manufacturer of engineering equipment.

Alger Chaney
Chairman of the Board, Medford
Corporation, Medford, Oregon, forest
products manufacturer; Senior Vice
President and Director, Baker, Fentress
& Company, Chicago, a non-diversified,
closed-end registered investment
company.

Philip J. Gomez
President and Director, Western Gear
Corporation, Los Angeles, manufacturers
of mechanical systems, specialized
machines and power transmission
equipment.

Vester T. Hughes, Jr.
Partner, Hughes, Luce, Hennessy, Smith
& Castle, Dallas, Texas, a law firm.

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