

MEMOREX

1978
Annual Report



Table of Contents

Page 1	Financial Highlights
2	Letter to Shareholders
4	Memorex Technology
6	Large Storage Systems
10	Communications Products
12	General Systems
14	Computer Media
18	Consumer and Business Media
20	Field Operations Worldwide
28	Memorex People
30	Financial Review
33	Financial Report

On the cover:

The view of the earth signifies the company's growing strength in providing customers with quality information storage and communications products around the world. In 1978, international revenues were nearly half of total revenues.

Financial Highlights*

For the year ended December	1978	1977	Difference
Revenues	\$633,266,000	\$450,112,000	\$183,154,000
Depreciation and amortization charged to operations	40,187,000	27,629,000	12,558,000
Income before extraordinary credit	41,948,000	33,869,000	8,079,000
Extraordinary credit	8,249,000	22,094,000	(13,845,000)
Net income	50,197,000	55,963,000	(5,766,000)
Average number of common shares and equivalents	7,198,000	6,613,000	585,000

End of year

Cash and temporary investments	28,372,000	12,021,000	16,351,000
Total assets	487,649,000	330,256,000	157,393,000
Notes payable	83,472,000	47,734,000	35,738,000
Convertible subordinated debentures	54,752,000	65,687,000	(10,935,000)
Shareholders' equity:			
Preferred stock	65,912,000	65,912,000	—
Common shareholders' equity	141,264,000	46,157,000	95,107,000
Total shareholders' equity	207,176,000	112,069,000	95,107,000
Number of employees	11,085	8,823	2,262

*Please refer to the financial statements included in the 1978 Financial Report which is an integral part of the 1978 Annual Report. Additional financial highlights are on the last page of the Annual Report.

Letter to Shareholders

1978 was another good year for Memorex. It was a year of strong market growth. It was a year of shortages of skilled personnel, material, and facilities. It was also a competitive year—old competitors became more aggressive and new competitors entered or announced plans to enter the markets we serve. Revenues of your Company grew by \$183 million. This means that the increase in revenue in 1978 was greater than the Company's total revenue in 1973.

In addition to rapid growth, the year featured our trial with IBM, the acquisition of Telex Europe, increased emphasis on technology, facilities expansion, decentralization of operating responsibilities, marketing of new products, and a major financing program.

Managing the growth while concurrently posturing the Company for the future has made this a strenuous year. The strains imposed on the business were intensified when the IBM litigation and the Telex Europe acquisition were added to demanding operational objectives. It is a tribute to the dedication of Memorex people that they delivered a 41 percent revenue increase and a 24 percent profit increase despite the magnitude of the challenge.

Revenue was \$633 million—an increase of 41 percent. Some of this growth is the result of the acquisition of the Telex operations in Europe. Their 1977 revenue was approximately \$39 million.

Income before extraordinary credit was \$41.9 million, an increase of \$8 million or 24 percent. Net income after extraordinary items was \$50.2 million, a decrease of \$5.8 million from the prior year. The extraordinary credit in 1977 was \$22.1 million, due to tax loss carry-forward benefits. The extraordinary credit in 1978 was reduced to \$8.2 million because Federal tax loss carryforwards had been utilized by mid-year.

Earnings per common share before extraordinary credit on a fully diluted basis were \$5.64, an increase of 8 percent over the \$5.22 figure for 1977. The number of shares and equivalents increased from 6.6 million in 1977 to 7.2 million in 1978, a gain of 9 percent, due principally to the public offering of common shares during the year.

Cash requirements continued at high levels. In order to provide adequate long-term financing for future growth, three major actions were taken:

- \$50 million was borrowed from two leading insurance companies and the Bank of America credit agreement was restructured.
- \$42 million in cash was obtained through a new common stock offering and the exercise of the majority of outstanding warrants.
- An \$80 million revolving line of credit with nine major international and domestic banks was established in January 1979. \$49 million was made available for borrowing at the time of the agreement and the remainder will be available as the Company generates additional earnings.

Debt at the end of the year was \$153 million, compared with \$128 million at the end of 1977. Virtually all of this debt is long term.

Especially gratifying was the increase in shareholders' equity to \$207.2 million from \$112.1 million. The debt to equity ratio improved to 0.7 at year end from 1.1 at year-end 1977. Retained earnings became positive for the first year since 1970, and at year end were \$43.2 million compared with a deficit of \$4.2 million at the end of 1977. Your Company's financial position is excellent.

Although operating performance was good, with substantial gains in most areas, the real story of 1978 was that of the investments made to build the future.

- Perhaps the most significant single area of investment was in people and in organization. A basic decentralized organization structure was put in place late in 1977. During 1978 it was strengthened and modified. The communications business was elevated to Group status in recognition of its importance to our future. New divisions were established in the General Systems Group to serve customers for rigid and flexible disc drives.
- The decentralized organization has provided opportunity for personal growth. During the past year there were over 860 internal promotions. The "business team" approach enables Memorex to retain its warm, friendly, and personal environment as it grows. This is important in ensuring the career dedication of all employees.
- During 1978 Memorex made substantial progress in technology. Centers of Excellence for Recording Technology and for Magnetic and Chemical Technology were expanded. Their primary mission is to establish the technical feasibility of innovative approaches that will enable future products to maintain leadership in customer value.
- The Company announced many new products. Our 3770 Disc Cache is particularly significant since it represents an industry first, which can mean substantially enhanced values for our customers. It consists of a microprocessor and advanced semiconductor memory devices. When placed in front of our 367X disc drives, it has the potential of providing faster access time and more efficient use of the main computer. Another innovation which can provide substantial customer benefit is our new operating software package for IBM System/3 users. It permits on-line operation for some computers that were previously limited to batch processing.

- The acquisition of Telex Europe has increased our customer base and our ability to serve customers effectively in most major European countries. Capabilities to maintain, repair, refurbish and train were strengthened. This process will continue through 1979. The end result is a Memorex presence in Europe which has much greater capability to serve our growing customer base.
- Facilities expansion occurred at a number of locations. Our Communications Group moved into a leased facility. A new and efficient printed circuit board facility was dedicated in Eau Claire, Wisconsin. Warehousing, refurbishing, and training facilities were expanded in the United States and Europe. Further expansion of manufacturing facilities outside California is planned for 1979.
- Two significant affiliations occurred during the year. A joint venture was established with Bell and Howell Company for effective production of home video cassettes. In Japan, a joint venture with Teijin Limited, a major manufacturer, will produce flexible discs for the growing Japanese market.
- The jury trial in our litigation against IBM was completed in early July when the judge declared a mistrial after the jury deadlocked 9 to 2 in favor of Memorex. He subsequently directed a verdict in favor of IBM. Despite the judge's decision, we came close to winning a substantial award. We are confident that we will ultimately prevail and are vigorously pursuing a new trial. We believe it is important that our customers be assured of freedom of choice in their information systems.

Throughout 1978 your Company contributed significantly to our society. It contributed to employment by adding 1,900 jobs. Affirmative action plans for equal employment opportunity were carried out. Export sales were strong, with benefits both to jobs and our balance of payments. Participation in community activities increased and contributions to worthy causes were substantially above those in 1977.

The outlook for 1979 is generally favorable. Just how favorable will depend largely upon international events, the effectiveness of our government, and the actions of IBM. Recent developments appear to have increased the probability of energy shortages, higher inflation rates, and an economic slowdown. During the fourth quarter of 1978 and continuing into 1979, IBM has sharply reduced prices and introduced a number of new products, technologies and services.

Assuming energy availability, the markets for Memorex products should be strong. Our products generally contribute to productivity and efficiency—thus they tend to be recession-resistant. IBM's recent aggressive actions have caused a slowdown in order placements. However, there is a strong underlying market for our products and order placement is expected to improve. 1979 should be a good revenue year for Memorex.

Our anticipation of competitive disc drive technology has been generally sound. Our efforts in 1979 will be directed to product leadership, consolidation, and margin improvement. We look forward to delivering good results while strengthening the base for continued growth in the '80s.

Robert C. Wilson

ROBERT C. WILSON
President, Chairman, and
Chief Executive Officer



Members of the Office of the President: Robert C. Wilson, Chairman, President, and Chief Executive Officer (right); Charles S. Strauch, Executive Vice President (center); and James Dobbie, Executive Vice President.

Memorex Technology

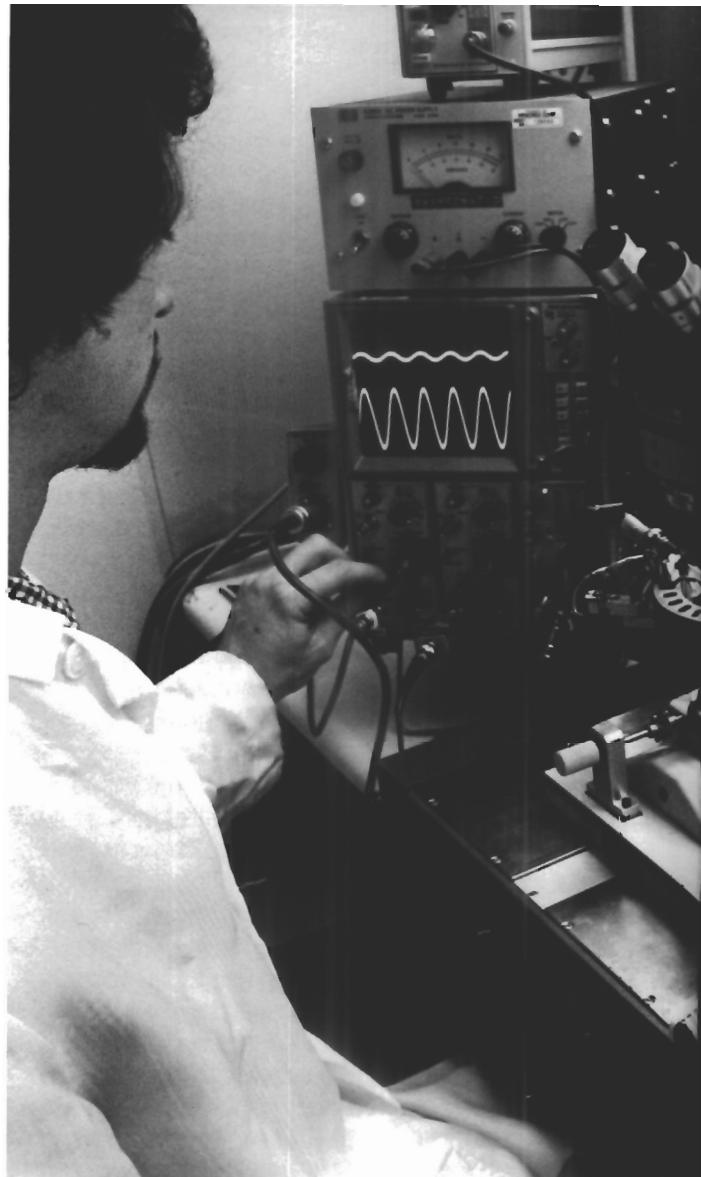
Memorex made substantial investments in advanced technology during 1978. Expenditures for in-house research and development grew 23 percent over the previous year to a record \$23.6 million. At the same time, cost improvement and quality enhancement programs were expanded worldwide. These investments contributed to increased customer values in the Company's products and technical services.

In R&D, technical staffs were strengthened in the scientific and engineering disciplines critical to product leadership in data storage and communications. These covered all technology levels, from raw materials through systems and communications software. R&D capabilities were further enhanced with the expansion of the two corporate centers in Santa Clara for research and application of emerging digital recording and magnetic coating technologies.

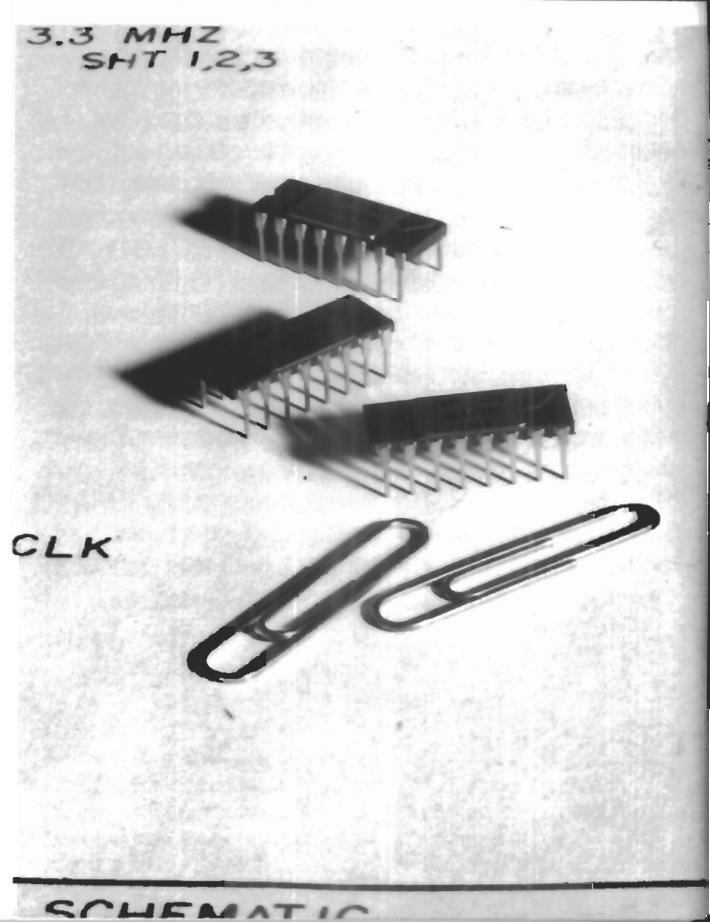
These centers greatly extend the company's skills in advanced product development. The Recording Technology Center focuses on digital recording concepts such as thin films, bubble memories, charge-coupled devices, and advanced microelectronics.



► Steven H. Puthuff, Vice President, Engineering, discusses new test procedures in Memorex's Engineering Computer Laboratory. Here, engineering models must pass rigid performance and quality tests before being certified for manufacture.



3.3 MHZ
SHT 1,2,3

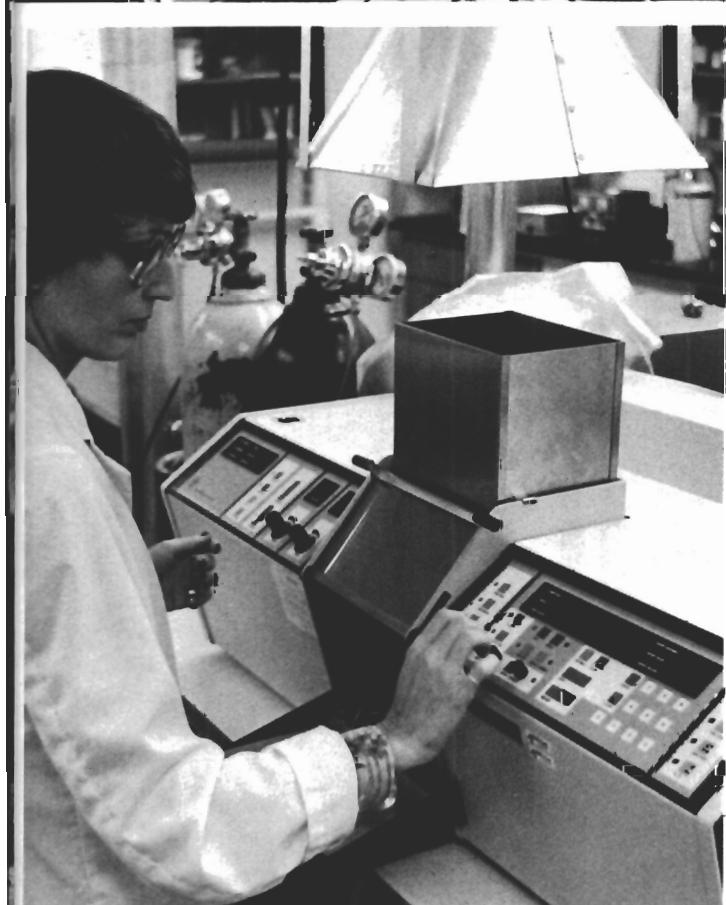




Memorex scientists in the new Recording Technology Center are developing advanced digital recording methods, such as thin film heads and recording surfaces for the next generation of data storage equipment.



In the Magnetic and Chemical Technology Center, this liquid chromatograph analyzes the chemical content of experimental coating formulations for use in Memorex computer, audio, and video tape products.



The Magnetic and Chemical Technology Center is advancing Memorex's media technologies in such areas as formulations, chemistry, physics, and new media concepts for future data storage applications.

Memorex's internal R&D programs were supplemented during the year through selective affiliations with other domestic and international high-technology companies. These affiliations provided important technology gains in advanced materials, components, and finished products.

Advanced technology was also extensively applied in manufacturing to increase throughput capacity, reduce costs, and enhance quality. Worldwide manufacturing capacity increased more than 200,000 square feet in 1978. This included a new, modern plant in Eau Claire, Wisconsin, for printed circuit board fabrication, and a new facility in Mountain View, California, for production of flexible disc drives. In existing facilities, processes were improved with the installation of new manufacturing and test equipment.

These investments in technology during 1978 more firmly positioned Memorex as a major, independent, full-line supplier of data storage and communications products and services, and further postured the Company as a product leader offering top value to customers throughout the world.

To assure superior quality, the fabrication of high-density printed circuit boards requires continuous process control, such as this on-line chemical analyzer in the company's Eau Claire, Wis., plant.

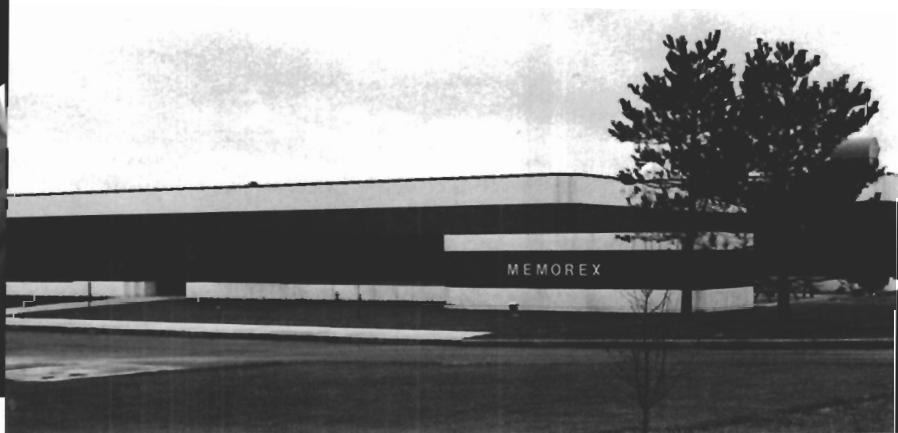
Large Storage Systems

Memorex is a leading supplier of data storage and retrieval equipment for large processing systems. Since the introduction of the Company's first disc drive in 1967, the line has grown to include a complete range of advanced disc and tape subsystems and semiconductor memories. During 1978, values in these products increased as new models and enhancements improved the cost-effectiveness of customer processing systems.

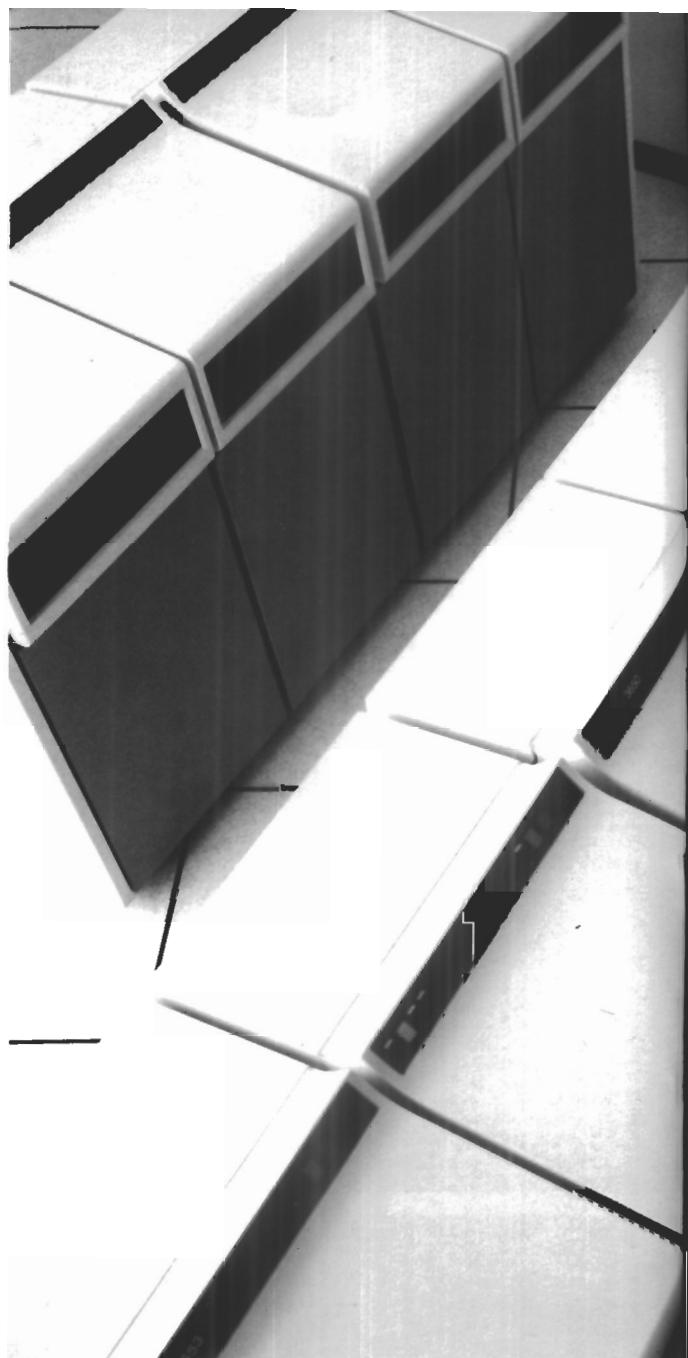
Greater Data Availability Offered with New Disc Storage Products

Memorex's experience in disc drive development spans four generations of products, encompassing more than 35,000 spindles and well over 500 million operating hours in large systems environments. This experience assures customers superior quality and value in on-line data storage.

Orders for the Company's most advanced and largest-capacity disc storage subsystem, the Memorex 3650, reached record levels in 1978. Exceptional performance and reliability is provided through the 3650 Head-Disc Assembly (HDA). Modular packaging of 3650 disc drive components improves operating reliability and maintainability. This modular concept also requires less floor space for on-site maintenance than equivalent-capacity devices. Extensive on-line and off-line diagnostics further improve maintainability.

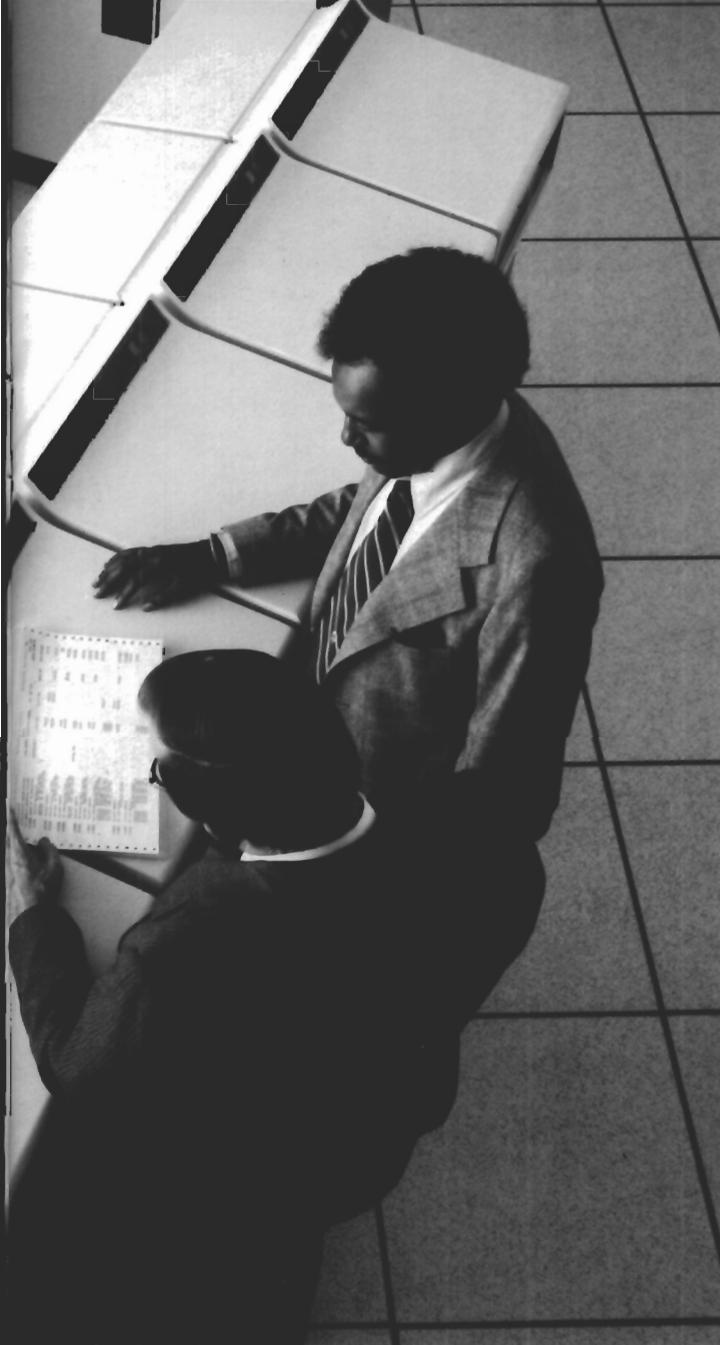


Memorex's new printed circuit board facility in Eau Claire is among the most sophisticated in the industry. Dedicated in September 1978, this plant doubles production capacity.



These Head-Disc Assemblies (HDAs) are used in the company's 3644 and 3650 disc drives.

By in-house manufacture of many critical HDA components, such as read/write heads, recording discs, and printed circuit boards, Memorex is able to maintain consistently high quality standards.



► The high-capacity 3650 subsystem stores 317.5 million characters of data per spindle. Improved data availability is offered through built-in error detection and correction logic.

Memorex's 3640 Disc Storage Subsystem, which utilizes 35- or 70-megabyte data modules, provides up to 20 percent faster data access than other medium-capacity storage devices. A low-profile cabinet design adds to the operator's convenience in loading and unloading the data module. The new 3644 Disc Storage Subsystem offers increased on-line capacity through the use of an HDA that stores up to 280 megabytes per spindle.



► Marcelo A. Gumiucio, Vice President and General Manager, Large Storage Systems Group, reviews final test results on 3650 disc drives in Santa Clara



► Memorex's new 3644 disc drives, introduced in 1978, store up to 280 million characters of data through the use of an advanced HDA. These 3644's can be used with System/370 and System 3 computers.

Customer acceptance of the 3670 Disc Storage Subsystem was strong again in 1978, reflecting the engineering advantages of this line of disc drives. A unique read/write head design on the 3675 disc drive improves data integrity by its ability to "fly" 50 percent higher above the disc surface than similar-capacity drives. This reduces the risk of head-to-disc interference. Both the 100-megabyte (million characters of data) 3670 and 200-megabyte 3675 disc drives feature an average data seek time up to 10 percent faster than competitive offerings.

A major enhancement to the 3670 subsystem in 1978 was the 3770 Disc Cache. This product, which incorporates a microprocessor and advanced semiconductor memory devices, provides an ingenious means of improving system throughput by placing a portion of the most recently used data in a disc cache. In numerous applications, the 3770 can significantly reduce data access times. Thus it can extend the value and life of Memorex 3670/3675 products.

Also announced during the year was the Intelligent Dual Interface (IDI) for 3650 and 3670 subsystems. This exclusive feature enhances data availability by providing redundant data paths from the central processing unit's (CPU's) main memory to the disc spindle. Unlike conventional dual path configurations, IDI can reduce costly CPU overhead by resolving data path contention at the head of a string rather than in the CPU.



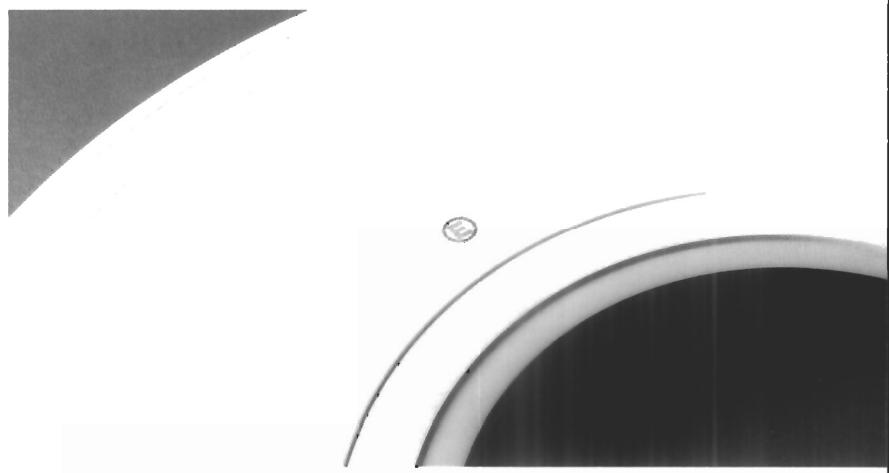
▲ The 3670 Disc Storage Subsystem provides over 6.4 billion characters of on-line storage capacity for medium to large computer systems. These high-performance disc drives offer improved data access time over competitive storage devices.



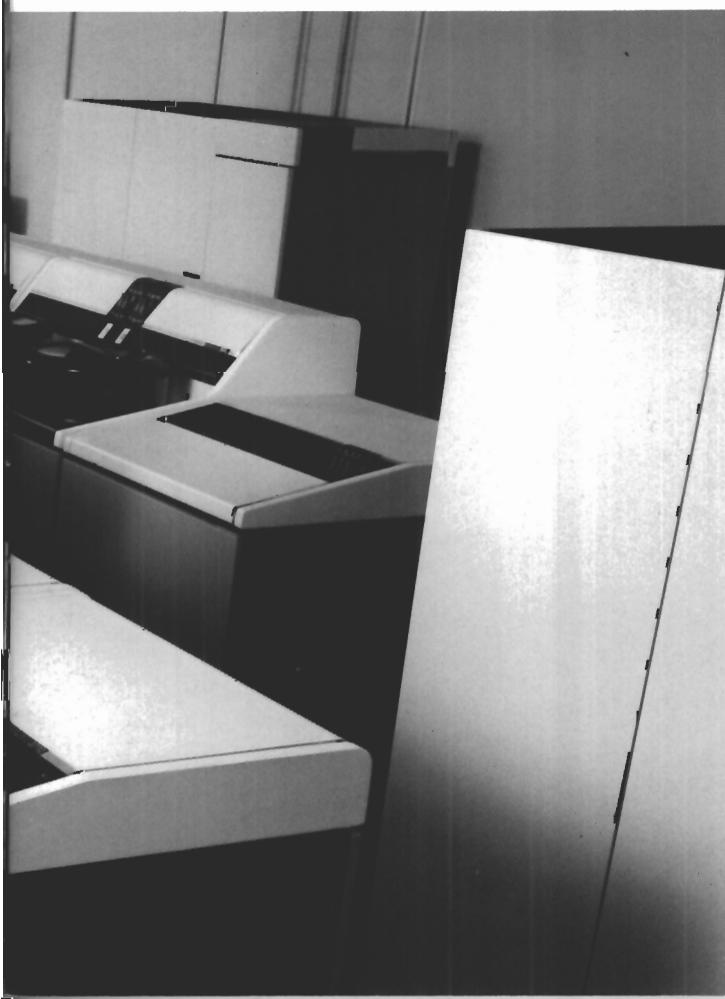
The new 3770 Disc Cache extends the value of Memorex's 3670 subsystem by providing the potential for greatly improved computer system throughput.



◀ Memorex's 3220 Magnetic Tape Subsystem offers customers significant performance and reliability features not available with competitive offerings. A microprocessor reduces the number of electronic components normally required. This further enhances data availability.



◀ An exclusive feature on the 3220 Tape Subsystem is a Tape Maintenance Monitor. This feature automatically stamps an "E" on the back of a tape reel whenever a predetermined data error level is exceeded. This provides added data integrity.



Advanced Tape Subsystem Provides Improved Performance and Reliability

Memorex is rapidly building product leadership in large systems tape storage applications through its 3220 Magnetic Tape Subsystem. Outstanding customer values are provided by this line of tape drives and controllers, which offer densities of 1600 and 6250 bits of information per inch. Tape speeds of 125 or 200 inches per second are available, with data transfer rates of 200 to 1,250 kilobytes per second. Optional dual controllers, packaged within a single cabinet, offer a 35 percent reduction in floor space requirements for large tape subsystem applications.

Semiconductor Memory Products Enhance Performance of Large CPUs

Memorex's semiconductor memories are used to upgrade the internal main memory of System/370 and 303X central processing units. In many cases, the Memorex products provide upgrades beyond that offered by the CPU manufacturer, thus offering added customer values.

Communications Products

In recent years Memorex has placed increasing emphasis on data communications as a second major thrust of the business. This product area has been given Group status, and a separate facility has been established in Cupertino, California, for expanded communications operations. Memorex is one of the few data communications companies offering products for both ends of the transmission line.

Performance Enhancements Increase Capabilities of Front-End Controllers

Memorex's 1270 Terminal Control Unit continued to set the quality standards in hard-wired controllers. A series of enhancements further improved performance capabilities in 1978. An Intelligent Line Adapter feature was introduced to support a greater variety of computer terminals and communications networks. SWIFT (Society for Worldwide Interbank Financial Telecommunications) protocol was also added to enable the 1270 to interface with the expanding international bank network.

Memorex continued to broaden its terminal products line in 1978 with the introduction of terminal controllers and impact line printers.



Volume production of the new 2089 Line Printers began in 1978 at the company's recently acquired communications plant in Cupertino, California.



Superior network management and control is offered through the 1380 Communications Controller's video display console. New flexible disc-stored software was added during the year to further extend 1380 performance capabilities.



For customers requiring the network management and control of a programmable communications controller, Memorex offers the high-performance 1380. This controller incorporates flexible disc-stored software, in combination with video display consoles, to reduce expensive CPU overhead for such features as code conversion and control of communications lines and terminals.

New Terminal Products Improve Information System Flexibility

Memorex's new 1371/1372 Terminal Controllers join the company's 1377 Video Display Stations and 2089 Line Printers to form a cost-effective information system. Superior configuration flexibility is achieved through the ability to attach up to 32 display stations to the Memorex controller, or to the CPU manufacturer's controller.

The 1377 Display Station provides high-speed data entry/data retrieval from a movable keyboard and CRT display that offer a wide range of human-engineered features. The 2089 is a 410 line-per-minute impact printer that produces data on continuous fan-fold paper. Self-diagnostics add to improved data availability.



► Richard C. Allen, Vice President and General Manager, Communications Group, shows customers through the expanded 1377 Display Station manufacturing facilities in Cupertino, California.

► Memorex's 1270 Terminal Control Unit is one of the most popular hardwired communications controllers in the industry because of its exceptional reliability. Continued enhancements added to its value during 1978.

General Systems

Memorex offers a growing line of data storage and communications equipment, plus applications software, for markets served by the general systems organization. Customers include end users and original equipment manufacturers (OEMs) of business computers, minicomputers, word processing systems, and related equipment. During 1978, the Company enhanced its ability to serve these customers by strengthening product lines and enlarging manufacturing capacity.

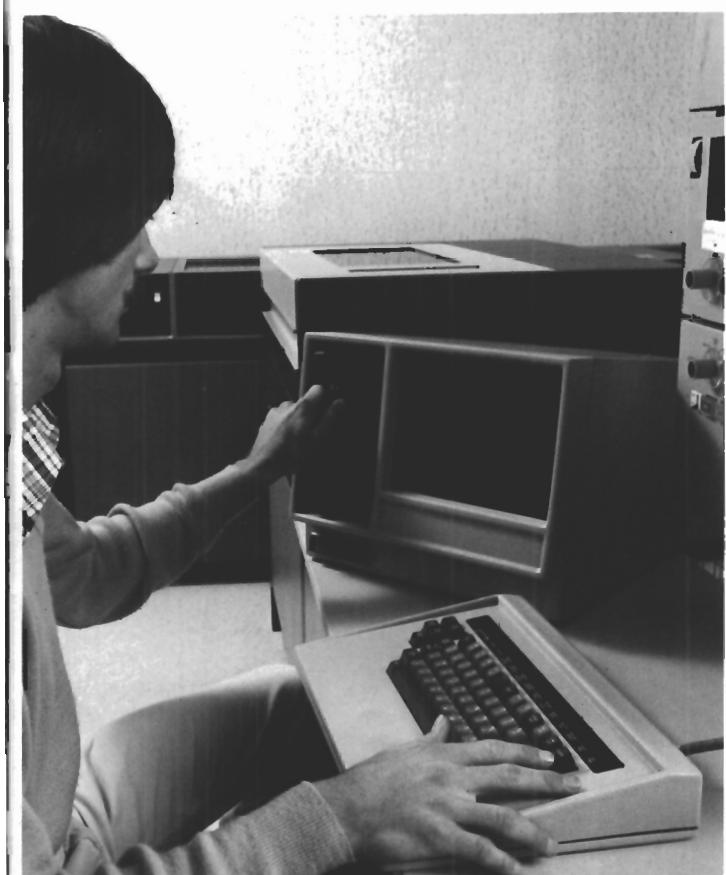
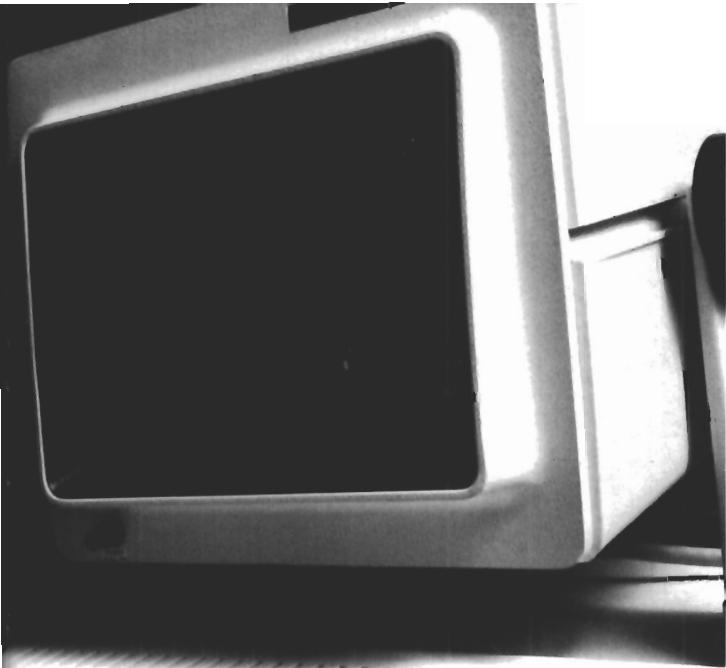
Added Customer Values in Small Business Computing

Memorex manufactures and markets a broad line of equipment for use with small computers such as the System/3. These include disc and tape subsystems, add-on memories, line printers, data entry devices, and software. In addition, the Company now offers a leasing arrangement which encompasses both the peripherals and the CPU. This can enable Memorex customers to obtain maximum value in the total systems investment.



▲ A. Keith Plant, Vice President and General Manager, General Systems Group, holds one of the company's high-density printed circuit boards used in Memorex's 601 HDA. In the background is the 601 disc drive assembly area.





◆ To enhance the throughput of System/3 computers Memorex introduced Super 3, a unique software package that allows the attachment of up to 32 on-line display stations for such applications as file enquiry, file update, and data entry.

For on-line data storage, Memorex provides three disc subsystems with disc drives ranging in capacities from 29 to 203 megabytes per spindle. Higher access speeds and faster data transfer rates contribute to improved throughput of the host CPU. Storage backup is available with the new 3213/3214 Magnetic Tape Subsystem. Offered in one- or two-drive configurations, this 1600-bits-per-inch line of tape drives and controllers offers exceptional versatility and performance.

Accelerated throughput can also be achieved by adding Memorex high-speed line printers, SPOOL/10 software, and add-on memory to boost CPU performance even further. For on-line processing, Super 3 software allows cost-effective conversion with minimal interruption of operations. For data entry, Memorex offers the 41-2 Data Entry Device to read and write flexible discs into the CPU on-line, or to program discs off-line through a keyboard-CRT unit.

Rigid and Flexible Disc Drives For OEM Application

During 1978, Memorex continued to invest in its OEM equipment with a new flexible disc drive manufacturing plant in Mountain View, California, together with expanded production capacity in Santa Clara, California, and Nogales, Mexico, for both rigid and flexible disc drives. Memorex is in full production on all of its OEM equipment products.

The rigid disc drive line consists of three models. The 29-megabyte model 660 and the 100/200-megabyte model 677 are disc drives offering exceptional performance and field-proven reliability. Many users consider the 677 to be the quality standard of its type. The 25- to 75-megabyte model 601 employs Memorex's Head-Disc Assembly. This HDA has proven so reliable that routine maintenance has been virtually eliminated.

Memorex's line of flexible disc drives includes the single-sided model 651, offering a storage capacity of 250 kilobytes, and the model 550 single-sided and model 552 dual-sided. Both the 550 and 552 feature double-density recording, permitting up to 1.6 megabytes of data to be stored per side. The 552 also features two recording heads for dual-sided read/write capabilities.

◆ Memorex offers a growing line of data entry, storage, and communications equipment for the business computing market.

Computer Media

Memorex is one of the world's leading suppliers of computer media, and one of the few companies manufacturing both data storage equipment and the magnetic recording media used on that equipment. The computer media line includes premium quality computer tape, rigid discs and assemblies, flexible discs, and a growing line of precision plastics for media storage and handling.

New Rigid Discs Offer Higher Densities and Broader Compatibility

The Company's disc pack line was broadened during the year to provide models ranging in storage capacities from three to 300 megabytes. These quality packs feature outstanding recording characteristics and durability resulting from proprietary formulations and special disc coating techniques.

The Data Mark line of 70-megabyte data modules is available in moving- or fixed-head configuration. These modules, utilizing Winchester technology, incorporate read/write heads, discs, and associated circuitry into an environmentally sealed cartridge. Memorex's advanced spin-coating process greatly extends disc surface durability to withstand recording head-loading stress, thus offering improved data integrity.

Production of Memorex's Head-Disc Assembly, used in the company's 3650 and 3644 disc drives, reached record levels in 1978. All manufacturing, assembly and testing of the HDA is done in special cleanrooms which continually filter the air to remove particles as small as 0.5 microns: This assures maximum reliability.



► James Simpson, Vice President and General Manager, Computer Media Group, reviews manufacturing operations in the company's flexible disc formatting area.





Memorex manufactures one of the most complete lines of disc packs in the industry, with storage capacities ranging up to 300 million characters of data per pack.

Memorex manufactures both top- and front-loading disc cartridges for small system disc drives. The Mark III-T and Mark III-F provide up to 5 megabytes of data storage capacity. Two new models were introduced in 1978 featuring capacities to 10 megabytes. The new Mark V-F is used with the Hewlett-Packard 7905 and equivalent disc drives, while the Mark V-T is compatible with Datapoint, Wangco, Pertec and similar storage devices.



Memorex manufactures the entire disc pack to ensure consistently superior quality. Here, disc substrates must pass nine separate tests prior to assembly.



More than 100 separate tests are conducted each Memorex disc pack during the critical assembly process. In the driving test shown here, skilled technicians subject the assembled and balanced pack to actual computer room conditions.

New 6250-BPI Computer Tape Enhances Data Integrity

The Company's technical leadership in flexible media was further strengthened with the introduction in 1978 of an advanced line called Cubic HD computer tape. This new line, designed specifically to perform on 6250 bits-per-inch tape drives, features a proprietary oxide and binder system formulation that improves signal recovery and extends head life. A 25-percent-thicker base film increases side-load strength and reduces the risk of tape edge damage. 100 percent testing at both 1600 and 6250 bits-per-inch is conducted for added data integrity.

In addition, Memorex offers two other specialized tape lines. Quantum tape is formulated specifically for applications requiring extended periods of storage. MRX IV is the company's premium, all-purpose tape, providing exceptional value and reliable performance on today's high-speed, high-density equipment.

Cubic HD, introduced by Memorex in 1978, is an advanced computer tape tested specifically to perform at 6250 bits per inch.



► Disc cartridges, manufactured by Memorex in Anaheim, Calif., and Liege, Belgium, are designed for use in a broad range of small system disc drives.





Data integrity is greatly enhanced through a uniquely constructed SuperReel tape reel. This reel incorporates an exclusive I-Beam hub design, which makes it up to 90 percent stronger than conventional reels.

Continued Investments in Markette Flexible Discs

Customer values in Markette flexible discs improved significantly with the introduction of 14 new products during 1978. The line includes single-sided, single-density; single-sided, double-density; and double-sided, double-density flexible discs, as well as new 5 1/4-inch mini-Markette flexible discs. Investments were also made to enlarge manufacturing capacity. A new computer-controlled test system was installed to allow more extensive product testing.

Precision Plastics Improve Value of Magnetic Media Products

Memorex designs and manufactures most of the plastic parts used in shipping, operating, and packaging the Company's media products. These range from SuperReel tape reels to audio and video tape housings. During 1978 Memorex added to its production capabilities with the installation of advanced equipment to increase the quality of finished media products.



► Memorex offers a full line of flexible disc media for data processing, word processing, and personal computer applications.

► A fully automatic, self-contained, mini-pilot line is used to duplicate computer tape manufacturing processes. This permits continuous evaluation of media coating and slitting techniques to assure maximum product quality.

Consumer and Business Media

Memorex serves the business and consumer markets with a premium line of audio recording tape and accessories, video tape, and word processing supplies. These products are sold to end users through direct sales, distributors, and retail outlets worldwide. During 1978, the company made sizable investments in new products, advanced manufacturing and testing equipment, and advertising to strengthen its position in these growth markets.

New MRX₃ Oxide Formulation Enhances Customer Values in Audio Tape

The Memorex brand of blank audio tape for in-home recording has become synonymous with quality sound reproduction. The line consists of audio cassettes, 8-track cartridges, and reel-to-reel formats. In 1978, Memorex replaced its highly successful MRX₂ audio cassette with an improved ferric formulation—MRX₃ Oxide. This new line utilizes a proprietary oxide formulation that offers exceptional recording characteristics on all types of tape recorders. With the introduction of the improved MRX₃ product, Memorex strengthened its position as the leader in the audio cassette market. Memorex also markets an expanding line of audio accessories such as record care and tape care products for home use. These quality accessories complement the company's audio tape line.

"Is it live, or is it Memorex?" The company strengthened its image as the quality leader in consumer audio tape during the year. Joining Ella Fitzgerald in Memorex's advertising campaign was noted jazz musician Chuck Mangione, shown here in a recording session.



◆ Theodore J. Cutler, Vice President and General Manager, Consumer and Business Media Group (right), views the company's recently installed tape slitter in the word processing manufacturing plant in Santa Clara, California.



Memorex's 3/4-inch video cassettes are extensively tested to assure superior recording characteristics on all 3/4-inch video recorders and duplicators.



Cassettes for Home Video Market Expand Consumer Products Line

In 1978, Memorex announced its entry into the growing home video market. Major investments were made in video engineering and manufacturing, and a joint venture was established with Bell & Howell to assemble and package Memorex video tape in the cassette format. The outstanding consumer brand recognition achieved through Memorex audio tape advertising, coupled with its demonstrated expertise in advanced magnetic coating technology, have positioned the company to serve this marketplace effectively.

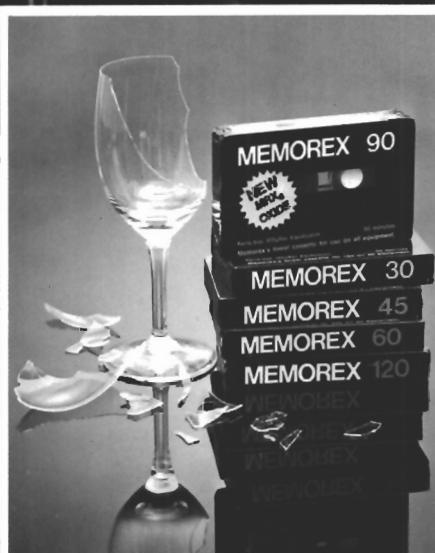
MRX-716 Tape Sets New Standards for Professional Video Products

Memorex offers a broad line of video tape for broadcast, educational, and industrial markets. The company is a technical leader in one-inch professional video tape. Its MRX-716 line, for use with helical scan recorders, provides exceptional durability to withstand the demands of still framing and editing. Orders from major networks continued at a strong pace, and many VTR manufacturers are now shipping their equipment with MRX-716 tape. Memorex Q₂HD 3/4-inch video cassettes feature a proprietary oxide formulation and binder system that provides improved magnetic properties for superior picture clarity and brilliant color reproduction. Optimum performance is also achieved over temperature variations, making Q₂HD tape ideal for location recording and Electronic News Gathering applications.

Added Products Broaden Line of Word Processing Supplies

Memorex markets a quality line of word processing supplies such as magnetic cards, digital cassettes, and flexible discs for text-editing equipment; ribbons and correcting tapes for typewriters; and toners and developers for copier machines. A new line of ribbons was introduced in 1978 for the IBM 6240 and Qume printers. Correctable ribbons for non-correcting typewriters and correcting fluids in various colors were also added during the year.

◀ The MRX-716 line of one-inch video tape has become the standard of quality in professional broadcast applications.



Cassettes for Home Video Market Expand Consumer Products Line

In 1978, Memorex announced its entry into the growing home video market. Major investments were made in video engineering and manufacturing, and a joint venture was established with Bell & Howell to assemble and package Memorex video tape in the cassette format. The outstanding consumer brand recognition achieved through Memorex audio tape advertising, coupled with its demonstrated expertise in advanced magnetic coating technology, have positioned the company to serve this marketplace effectively.

MRX-716 Tape Sets New Standards for Professional Video Products

Memorex offers a broad line of video tape for broadcast, educational, and industrial markets. The company is a technical leader in one-inch professional video tape. Its MRX-716 line, for use with helical scan recorders, provides exceptional durability to withstand the demands of still framing and editing. Orders from major networks continued at a strong pace, and many VTR manufacturers are now shipping their equipment with MRX-716 tape. Memorex Q₂HD 3/4-inch video cassettes feature a proprietary oxide formulation and binder system that provides improved magnetic properties for superior picture clarity and brilliant color reproduction. Optimum performance is also achieved over temperature variations, making Q₂HD tape ideal for location recording and Electronic News Gathering applications.

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The MRX-716 line of one-inch video tape has become the standard of quality in professional broadcast applications.

Field Operations Worldwide

Memorex serves its customers through direct sales and service offices in the United States and in 21 other countries. In addition, the Company maintains a growing network of independent dealers, distributors, and agents worldwide. During 1978, Memorex made sizable investments in domestic and international marketing to further enhance the value to customers of the Company's products and technical services.

Quality in U.S. Sales and Service Assures Fast Response to Customer Needs

In the United States, Memorex extended the range and quality of its sales, field engineering, systems engineering, and customer service activities.

Continued decentralization of responsibilities to the regional and branch office levels enabled the Company to improve responsiveness to customer needs, and to emphasize personalized service. This was accomplished despite an increase of nearly 25 percent in the number of field personnel to serve an expanded customer base in virtually all product and geographic areas during 1978.

Memorex field engineers install and maintain Memorex data storage and communications equipment throughout the world.



F. Gordon Smith, Vice President, Marketing, reviews the company's worldwide activities with the Corporate Marketing Council.



Memorex sales representatives assist customers in evaluating their data processing requirements.



Memorex's field facilities were also expanded throughout the year, and several existing offices were enlarged to more effectively support market growth. At the same time, the Company's regional distribution centers in Philadelphia, Chicago, and Dallas were supplemented with the completion of an 86,000-square-foot warehouse in Santa Clara to better serve customers in the western states.

Memorex has traditionally offered its customers a very broad range of purchase and lease plans. During the year, a new marketing service was provided with formation of Memorex Finance Company for lease financing of Memorex's data storage and communications equipment and the mainframe computer in one package. This allows even greater financial flexibility for the customer.



Charles E. Spaine, Vice President, Field Operations Group (right), maintains close contact with field engineering personnel to continually analyze customer service needs in the United States.

Technical support is provided through Memorex's network of distribution centers. Here, a technician tests a disc drive in the Company's Dallas, Texas, center.

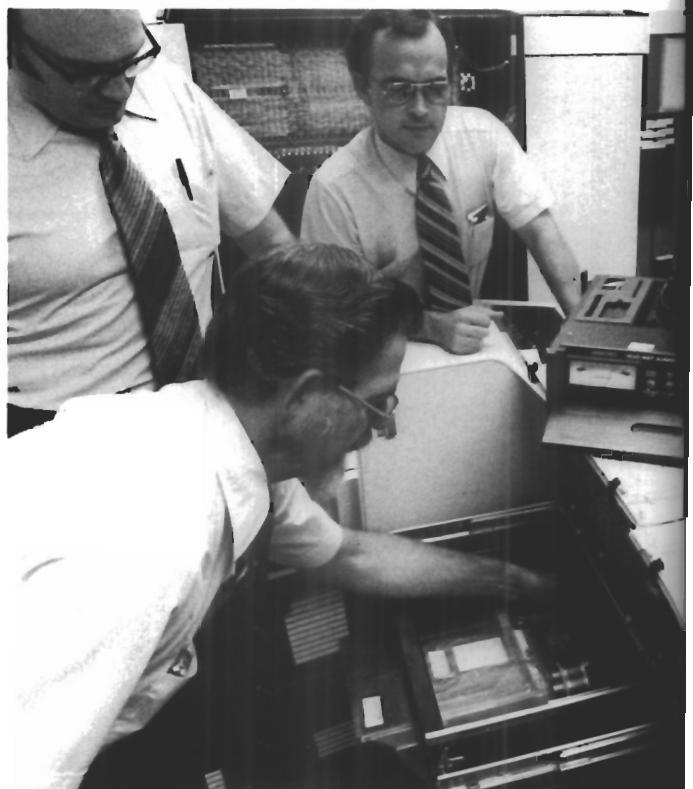
The Company's technical services were strengthened substantially in 1978. A new system for field engineer dispatching further improves the Company's response to customer equipment service or related product support needs.

The systems engineering organization was again expanded to provide higher levels of product and systems hardware/software support. This organization also expanded and improved the specialized technical education programs available to customers. These programs are conducted at customer facilities, or in specially equipped classrooms in each of Memorex's regional distribution centers.

Memorex sales representatives are effectively supported by the company's systems engineering organization, which can assist customers in the planning or expansion of data storage and communications systems.



► The Company maintains modern classroom facilities in each of its regional distribution centers for both internal and customer training.





Added Marketing Strength in Europe, Middle East, and Africa

With the completed acquisition of Telex Europe, Memorex's ability to serve customers throughout Europe, the Middle East, and Africa was significantly enhanced. Besides adding quality products and a large customer base, this acquisition provided new sales, distribution, and field engineering capabilities in key geographic areas. Memorex now offers European customers the most complete lines of data storage and communications products, and the most extensive marketing and support organizations, of any independent peripheral or media manufacturer.



► *Memorex sales representative discusses software with customers at major new installation of 3650 Disc Storage Subsystems at Sweden's Handelshaken, one of the largest banks in Scandinavia.*



► *Discussing products with field engineer is Reto Braun, Vice President and General Manager of the Europe, Middle East and Africa Group*

► *Permanent U.S. Department of Commerce exhibit in Milan, Italy, was utilized by Memorex in April to display its products to potential Italian customers — first time the exhibit had been devoted to a single company*

During the year, headquarters for Europe, the Middle East and Africa were moved from Liege, Belgium, to London, England, to provide a more cost-effective base of operations for administrative, engineering, manufacturing, marketing, and technical support activities. Country headquarter facilities in Milan, Italy, were also enlarged. Employment rose more than 40 percent by year-end.

Enhanced customer service is provided through the company's expanded network of distribution centers. In London, Memorex has a facility for field engineering training, product refurbishing, and warehousing for spare parts and finished products. In Liege, a distribution and refurbishing center serves customers in the surrounding area. Liege also has a manufacturing facility for computer media products marketed throughout Europe. Other distribution and service centers are maintained by Memorex in Germany, Italy, and France.

Instruction of field engineers for European locations takes place at Engineering Center near London.



Memorex field engineers install the company's 367X disc storage drives at a customer site in Norway.



Data Center at Frankfurt is focal point for financial controls of Memorex operations in Germany.



In 1978, Memorex extended its market coverage to include India, Scotland, and, through the Telex Europe acquisition, the Republic of Ireland. The company strongly improved its market position in such key areas as the United Kingdom, France, Germany, Italy, and Sweden. Led by new installations of 3650 Disc Storage Subsystems, Memorex equipment products made strong advances in these and other countries. Memorex is now the largest supplier of computer media in Europe. With audio tape sales growing over 400 percent in two years' time, Memorex has become a European leader in this market area.



► Tape drives for the European market are refurbished at the Memorex center near London.

► Large installation of 3650 Disc Storage Subsystems was made during 1978 at the Willis Faber Dumas company in Ipswich, the United Kingdom.

Expanded Marketing Operations in the Americas and Asia

Memorex made investments during the year to enhance its marketing operations throughout the Americas and Asia. Direct sales and service capabilities were strengthened with establishment of a marketing subsidiary in Puerto Rico. The Company's distributor network was broadened with addition of a distributor in Seoul, Korea. Product and technical skills of existing distributors were enhanced through expanded training in such growth markets as the Philippines, Hong Kong, Singapore, Thailand, Trinidad, Costa Rica, and Nicaragua, among others.

In Mexico, Memorex celebrated its tenth anniversary with the introduction of equipment products into the country, highlighted by the installation of 3650 disc drives at Banco de Comercio, a leading commercial bank. A new and well-established distributor now sells and services Memorex media products in Colombia.

A large installation of Memorex 3675 Disc Storage Subsystems was made at Maraven, a leading petroleum company in Venezuela.



► Memorex operations in Canada, Australia, Latin America, and the Far East are headed by Richard W. Martin, Vice President and General Manager, Americas and Asia Group.



Memorex 3650 disc drives were installed at Data Crown, a large data processing service in Canada.



Memorex also celebrated its tenth anniversary in Canada with expanded office and warehouse facilities in Toronto, and new sales and service offices in Calgary and Edmonton.

In Australia, continued growth in sales and service operations brought further expansion of facilities. The headquarters office in Sydney was enlarged, the Melbourne sales and service office moved to bigger quarters and a new sales office was opened in Perth.

In Japan, Memorex continued to expand sales and service for equipment and media customers, led by large new installations of 3650, 3670, 3640/3644, and 3220 storage products. Flexible disc media sales increased sharply and won an important part of that market in Japan. To meet current growth, a third sales and service office was opened in Tokyo.

Installation of 3650 and 3670 disc drives and various communications equipment also highlighted the year in the Philippines, Singapore, and Hong Kong.

► Memorex high-speed 3220 Tape Drives are installed at Nippon Hodo Company Limited in Japan



► Present during signing of joint venture agreement to form Teijin Memorex, Ltd., were Tetsushi Yamada, Executive Director, Memorex Japan, Ltd. (left); Kanji Takahashi, Director of Teijin, Ltd., and General Manager, Chemical and Plastics Sales Division (center); and George L. Bragg, Memorex Vice President, Corporate Development

► At the Philips data processing center in Sydney, Australia Memorex installed several strings of 3675 disc drives

Memorex People

At Memorex people are the most important and valued asset. The company's commitment to its employees during 1978 was demonstrated in a number of ways.

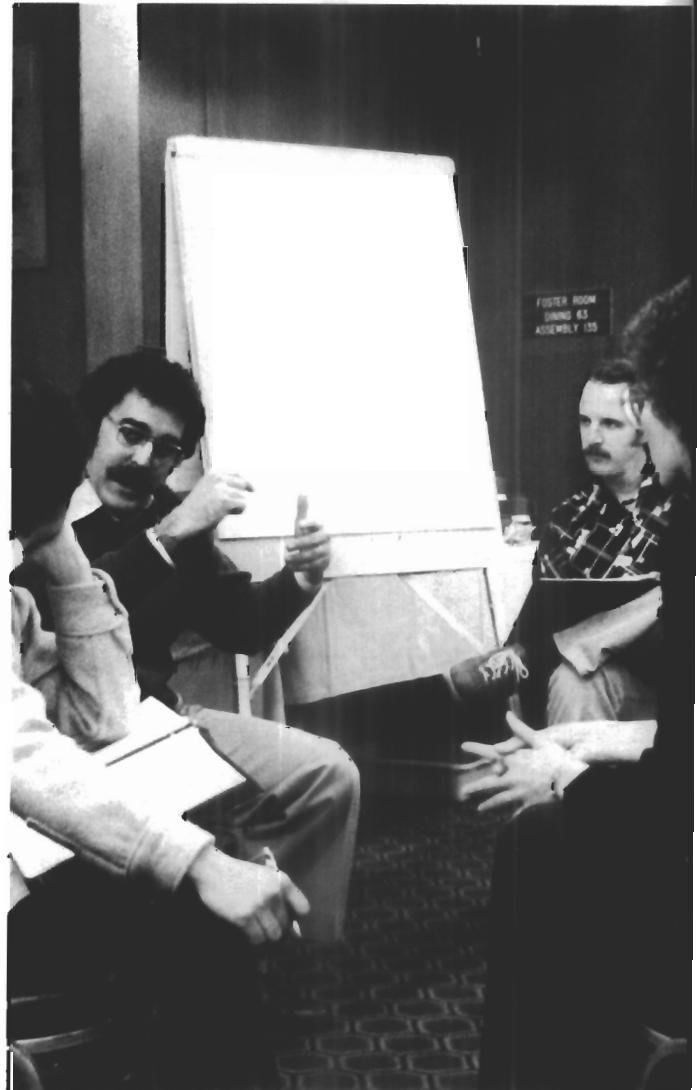
Memorex provides extensive training programs for occupational, professional and managerial skills. Approximately 4700 Memorex employees participated in training courses during 1978, and more than 860 Memorex employees were promoted to higher positions and responsibilities.

Memorex provides a full range of benefits that add substantial value and security to employees' total compensation. Improvements made in 1978 include the Share Plan, a stock bonus plan which enables employees to acquire a proprietary interest in Memorex through stock ownership at no cost to them. The existing U.S. pension plan was converted to a non-contributory plan, and all past employee contributions were refunded. Additionally, a Health Maintenance Organization alternative health care program was offered to Santa Clara employees. Educational reimbursement was doubled in 1978.

President and Chairman Robert C. Wilson gives yearly report to employees in several addresses to all shifts at all Memorex locations in manufacturing complex in Santa Clara, California.



◆ Awards for excellence in key result areas are presented at annual Memorex Management Conference by Robert L. Malcolm, Vice President, Industrial Relations.





◆ Memorex Activities Group, operated by employees, sponsors special travel and entertainment packages and events such as annual picnic, held in 1978 at Santa Cruz, California.

The Memorex Spirit

Memorex people take special pride in living up to their company's quality reputation. In 1978 there were many examples of Memorex people making extra commitments of energy, time and talent to meet customer needs.

- In the move from the old to the company's new printed circuit board plant in Eau Claire, Wisconsin, product delivery commitments were maintained by employees despite the interruption to normal business operations during relocation.
- When Japanese railroads went on strike, Memorex people in the Tokyo office walked or bicycled to work, and some even slept on office floors, to make certain they would be available to attend to customer needs.
- In Europe establishment of new headquarters in London required multiple moves from various localities, which were accomplished while maintaining a high level of customer service during a year of record performance.



◆ Robert L. Erickson, Vice President, Legal, and Secretary (right), consults with members of his staff

◆ At meeting of Memorex employees, officers and committee members were elected for a Federally chartered Credit Union, which provides savings plans, loans and other financial services.

Financial Review

Overview

For the fourth straight year, Memorex posted record revenue and income before extraordinary credit. Net income was lower than 1977, due to a lower extraordinary credit as the remaining Federal tax loss carryforwards were used in 1978.

Revenues

Revenues from sales, rental and service reached \$633 million, an increase of 41 percent over 1977. This was the largest increase on the largest base in the last five years. The increase of \$183 million was equivalent to the combined increases of the two previous years and was more than the total revenue of Memorex in 1973.

While growth was broadly based in virtually all product and geographic areas, the strongest revenue performance was an increase of \$117 million or 70 percent in international markets. International revenue was aided by the acquisition of Telex Europe and the improved competitive position of U.S. manufactured products due to the devaluation of the dollar. International revenue was 45 percent of total revenue.

Results of Operations

Income before extraordinary credit was \$41.9 million, a 24 percent increase over 1977. Fully diluted income per common share before extraordinary credit was \$5.64, an increase of 8 percent over 1977. Earnings per common share grew at a slower rate than total earnings because of a larger number of outstanding common shares and equivalents and higher dividends on preferred stock.

Net income for 1978 was \$50.2 million, or \$6.88 per share, including an extraordinary credit (from tax loss carryforwards) of \$8.2 million, or \$1.24 per share.

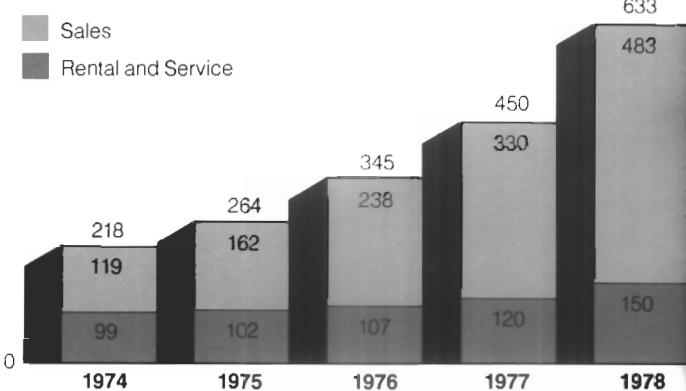
While revenue increased dramatically, gross margins were lower than in 1977 primarily because of increased costs of service associated with an expanding base of installed equipment. Selling, general and administrative costs included two major non-recurring expenditures—the assimilation of Telex Europe and the trial of the Company's antitrust suit against IBM. Gains from foreign exchange were insignificant.

Asset Management

During the year, inventories increased by \$59 million to support increased revenues, lease base additions, and substantial new product activity. Receivables management was excellent in 1978. Accounts receivable increased by \$35 million, but at an average rate which was much slower than the rate of revenue growth. In addition to the inventory build, major futures investments were represented by an increase in lease base and additions to productive capacity. In 1978, additions to lease base and spare parts (net of

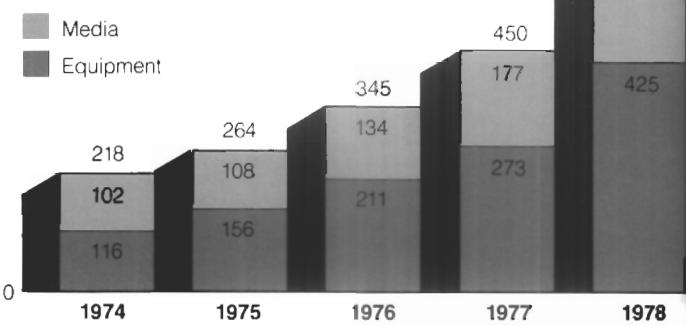
Revenues: Sales and Rental and Service

Millions of Dollars



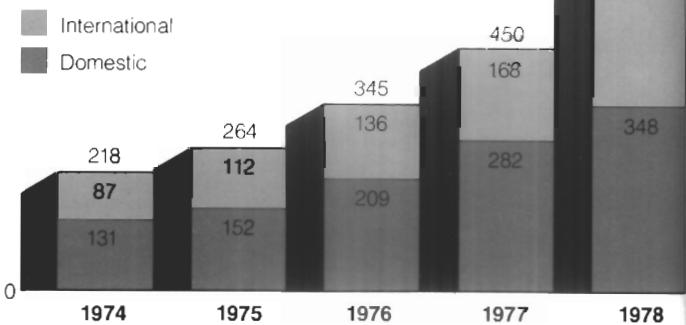
Revenues: Major Products Group

Millions of Dollars



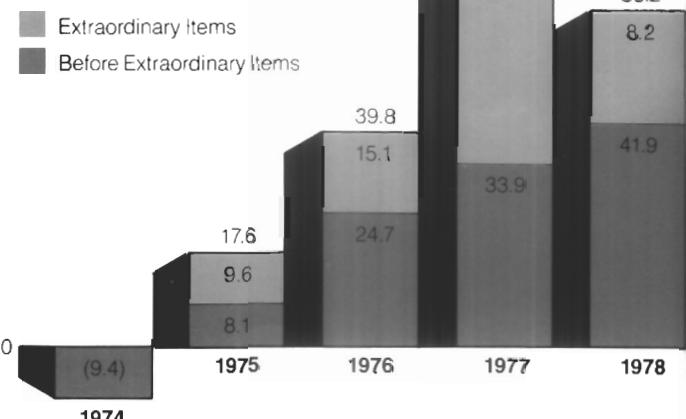
Revenues: Domestic and International

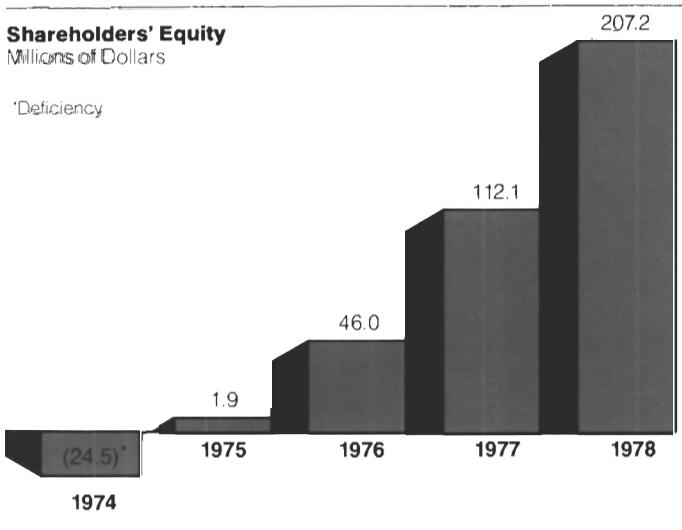
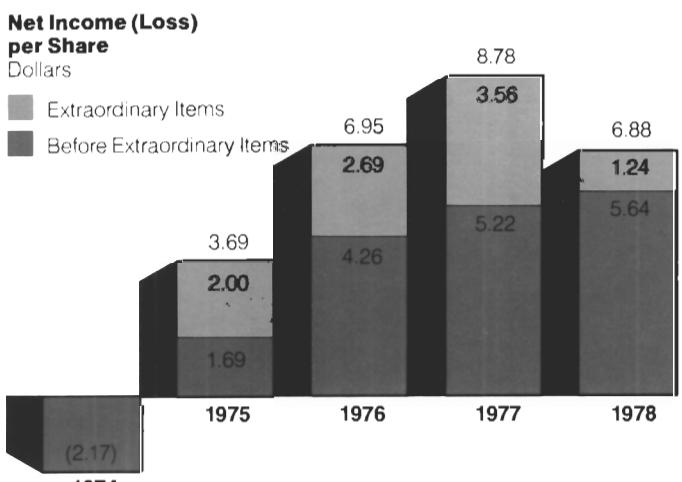
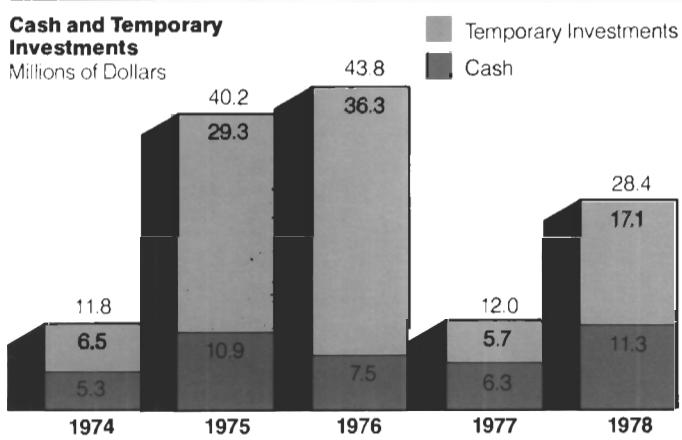
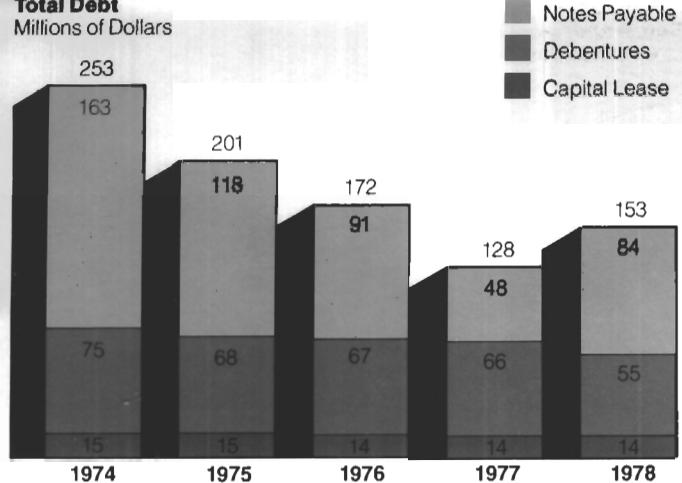
Millions of Dollars



Net Income (Loss)

Millions of Dollars





deletions but including the lease base acquired with Telex) totaled \$55 million. This is more than double the 1977 amount. Additions to property, plant and equipment totaled \$32 million, an increase of 26 percent over the 1977 level. Cash and temporary investments were \$28.4 million at year-end. Overall, 1978 was marked by the substantial improvements in our asset base necessary to support future progress.

Financial Position

In 1978, total shareholders' equity increased by 85 percent from \$112 million to \$207 million. Common shareholders' equity increased from \$46 million to \$141 million.

A successful common stock issue of 750,000 shares and the associated exercise of warrants to purchase an additional 520,000 shares added approximately \$42 million to our equity base.

Total debt, including notes payable, convertible subordinated debentures, and capital lease obligations, was \$153 million at the end of 1978, compared to \$128 million at year-end 1977. Of special note was a private placement of \$50 million of debt with two major insurance companies; concurrently, our credit agreement with the Bank of America was restructured. One beneficial effect of the private placement was to extend significantly the maturation dates of our debt.

Early in 1979, Memorex entered into an \$80 million revolving credit/term loan agreement with a group of nine banks, with Bank of America as agent (\$49 million was made available at the time of the agreement and the remainder will become available as the Company generates additional earnings). This additional financing, in combination with the common stock issue and private placement, enhances our operational flexibility.

The ratio of debt to equity improved from 1.1 at the end of 1977 to 0.7 at year-end 1978.

Other financial measurements were strengthened. Retained earnings improved from a negative \$4 million at the end of 1977 to a positive \$43 million at year-end 1978. Required debt service as a percent of revenue decreased from 7.2 to 6.5 percent. Long-term debt as a percent of total capitalization improved from 48 percent at the end of 1977 to 40 percent at year-end 1978.

Summary

The year 1978 was one of rapid expansion to meet the growth in demand for Memorex products and services. Substantial improvements in financial position were achieved. While the financial benefits of extraordinary credits are no longer available and the future promises new challenges to manage and fund profitable growth, Memorex enters 1979 with the strongest financial capability of any time in its recent history.

Financial Highlights

(Millions except per share amounts and statistics and ratios)

	AMOUNT		CHANGE	
	1978	1977	Amount	Percent
Operating Data				
Revenues by product line:				
Equipment products	\$ 424.7	\$ 273.4	\$ 151.3	55.3%
Media products	208.5	176.7	31.8	18.0
Operating income by product line:				
Equipment products	77.8	74.9	2.9	3.9
Media products	17.0	15.6	1.4	9.0
Depreciation:				
Rental equipment and spare parts	27.8	19.3	8.5	44.0
Property, plant and equipment	12.0	8.0	4.0	50.0
Research and development	23.6	19.2	4.4	22.9
Interest	13.6	12.1	1.5	12.4
Income before extraordinary credit	41.9	33.9	8.0	23.6
Net income	50.2	56.0	(5.8)	(10.4)
Fully diluted income per common share:				
Before extraordinary credit	\$ 5.64	\$ 5.22	\$.42	8.0
Net income	6.88	8.78	(1.90)	(21.6)

Financial Position at Year End

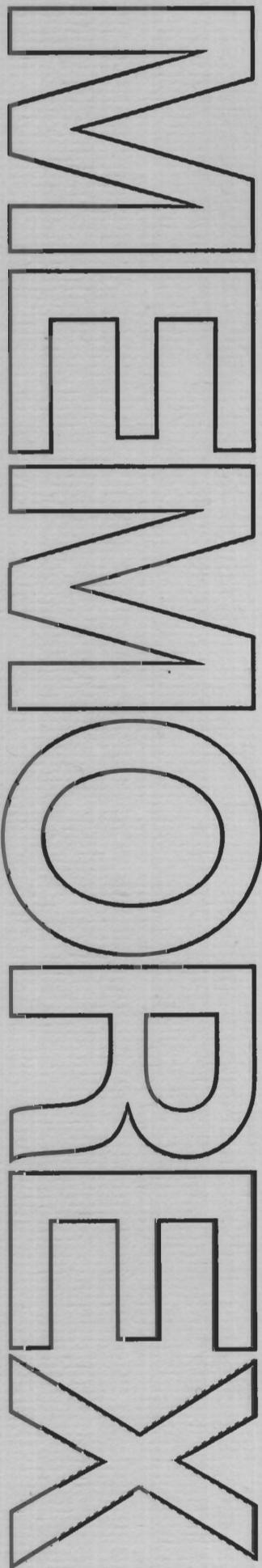
Working capital	\$ 153.6	\$ 82.1	\$ 71.5	87.1%
Rental equipment and spare parts—cost	192.9	163.2	29.7	18.2
Rental equipment and spare parts—net	92.0	64.4	27.6	42.9
Property, plant and equipment—cost	150.0	122.7	27.3	22.2
Property, plant and equipment—net	91.5	73.0	18.5	25.3
Total debt	152.5	127.9	24.6	19.2
Common shareholders' equity	141.3	46.2	95.1	205.8
Total shareholders' equity	207.2	112.1	95.1	84.8

Statistics and Ratios

As a percent of revenues:

Gross margin	39.3%	42.6%		
Research and development	3.7	4.3		
Interest	2.2	2.7		
Income before extraordinary credit	6.6	7.5		
Net income	7.9	12.4		
Current ratio at year end	2.15 to 1	1.85 to 1		
Total debt as a percent of total capitalization	41.4%	53.0%		
Common shares outstanding at year end (thousands)	7,031	5,513	1,518	27.5%
Common shareholders' equity per common share at year end	\$ 20.09	\$ 8.38	\$ 11.71	140.0
Employees at year end	11,085	8,823	2,262	25.6
Revenues per employee (based on average number of employees)	\$63,619	\$57,475	\$ 6,144	10.7
Market price of common stock, December 31 ending	\$ 29.38	\$ 31.75	\$ (2.37)	(7.5)
Price/earnings ratio (based on December 31 market price and fully diluted income per common share)	5.2 to 1	6.0 to 1		

1978 Financial Report



Report of Independent Certified 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 29, 1978 and December 31, 1977 and the
related consolidated statements of income,
shareholders' equity, and changes in financial position
for the years then ended. Our examinations were made
in accordance with generally accepted auditing
standards and, accordingly, included such tests of the
accounting records and such other auditing procedures
as we considered necessary in the circumstances.

In our opinion, the consolidated financial statements
referred to in the preceding paragraph present fairly the
financial position of Memorex Corporation and
subsidiaries at December 29, 1978 and December 31,
1977 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 after restatement for the
change, with which we concur, in the method of
accounting for leases as described in Notes to
Consolidated Financial Statements (Summary of
Significant Accounting Policies—Consolidated Financial
Statements).

Deloitte Haskins & Sells

San Francisco, California
January 19, 1979

MEMOREX CORPORATION

Consolidated Statements of Income

For the Years Ended December 29, 1978 and December, 31 1977

	1978	1977
	<i>Thousands</i>	
Revenues		
Sales	\$483,370	\$330,019
Rental and Service	149,896	120,093
Total Revenues	633,266	450,112
Costs and Expenses		
Cost of Sales	287,420	196,166
Cost of Rental and Service	96,769	62,094
Selling, General and Administrative	146,280	97,922
Research and Development	23,619	19,216
Interest and Other, Net	6,853	9,581
Total Costs and Expenses	560,941	384,979
Income Before Income Taxes and Extraordinary Credit	72,325	65,133
Provision for Income Taxes	30,377	31,264
Income Before Extraordinary Credit	41,948	33,869
Extraordinary Credit—		
Income Tax Benefit from Utilizing Loss Carryforwards	8,249	22,094
Net Income	\$ 50,197	\$ 55,963

	Primary	Fully Diluted	Primary	Fully Diluted
Income Per Common Share				
Before Extraordinary Credit	\$5.65	\$5.64	\$5.25	\$5.22
Net Income	\$6.90	\$6.88	\$8.81	\$8.78
Proforma Income Per Common Share —Assuming preferred dividends had been payable at the maximum rate scheduled to be paid after 1980:				
Before Extraordinary Credit	\$5.45	\$5.44	\$4.75	\$4.73
Net Income	\$6.70	\$6.68	\$8.32	\$8.28
Common Shares and Equivalents (Thousands)	7,198	7,220	6,613	6,642

See accompanying notes to consolidated financial statements.

MEMOREX CORPORATION

Consolidated Balance Sheets

December 29, 1978 and December 31, 1977

	1978	1977
	<i>Thousands</i>	
Assets		
Current Assets:		
Cash and Temporary Investments, at cost of \$17,082 and \$5,699 which approximates market	\$ 28,372	\$ 12,021
Accounts Receivable, less allowance for doubtful accounts of \$3,619 and \$2,605	111,454	76,089
Inventories	143,879	85,315
Prepaid Income Taxes and Other	4,013	5,722
Total Current Assets	287,718	179,147
Rental Equipment and Spare Parts, at cost less accumulated depreciation	91,979	64,444
Property, Plant and Equipment, at cost less accumulated depreciation	79,537	60,541
Capital Lease, at cost less accumulated depreciation	11,995	12,502
Intangibles Arising from Business Acquisitions	4,977	4,119
Prepaid Income Taxes and Other	11,443	9,503
Total Assets	\$487,649	\$330,256
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current Portion of Long-Term Debt	\$ 11,543	\$ 6,750
Accounts Payable	45,385	30,095
Accrued Income Taxes	22,855	29,159
Accrued Liabilities	54,310	31,062
Total Current Liabilities	134,093	97,066
Long-Term Debt	140,972	121,121
Deferred Income Taxes	5,408	—
Shareholders' Equity:		
Preferred Stock	65,912	65,912
Common Shareholders' Equity—		
Common Stock	7,031	5,513
Additional Capital	91,021	44,831
Retained Earnings (Deficit)	43,212	(4,187)
Total Common Shareholders' Equity	141,264	46,157
Total Shareholders' Equity	207,176	112,069
Total Liabilities and Shareholders' Equity	\$487,649	\$330,256

See accompanying notes to consolidated financial statements.

MEMOREX CORPORATION

Consolidated Statements of Changes in Financial Position

For the Years Ended December 29, 1978 and December 31, 1977

	1978	1977
	<i>Thousands</i>	
Funds were provided by:		
Operations—		
Income before extraordinary credit	\$ 41,948	\$ 33,869
Items included in determining income but not requiring (providing) funds—		
Depreciation and amortization—		
Rental equipment and spare parts	27,813	19,340
Property, plant and equipment	11,982	8,048
Intangibles	392	241
Interest paid with preferred stock	—	3,097
Stock bonus plan	2,030	—
Deferred (prepaid) income taxes	10,290	(7,700)
Gain on purchase of subordinated debentures	(3,377)	(576)
Funds provided by operations before extraordinary credit	91,078	56,319
Extraordinary credit—Income tax benefit from utilizing loss carryforwards	8,249	22,094
Funds provided by operations after extraordinary credit	99,327	78,413
Borrowings —9 3/4% Notes	50,000	—
Debt related to acquisition	12,115	—
Dispositions of property, plant and equipment	1,522	862
Common stock issued:		
Public offering	36,444	—
Exercise of warrants	5,114	—
Employee benefit plans	4,120	524
Acquisitions	—	7,462
Total Funds Provided	208,642	87,261
Funds were used for:		
Additions to rental equipment and spare parts, net (includes		
\$10,670 in 1978 related to acquisition)	55,348	25,745
Additions to property, plant and equipment	31,993	25,307
Reduction of long-term notes payable—Bank	25,757	27,250
Purchase of convertible subordinated debentures, net	7,558	955
Reduction of other long-term debt, net	5,572	158
Additions (reductions) of other assets (includes		
\$3,927 in 1978 related to acquisition)	6,822	(1,449)
Dividends on preferred stock	2,798	798
Intangibles arising from business acquisitions	1,250	4,212
Total Funds Used	137,098	82,976
Increase in Working Capital	\$ 71,544	\$ 4,285
Increase (decrease) in working capital by component:		
Cash and temporary investments	\$ 16,351	\$(31,782)
Accounts receivable	35,365	19,971
Inventories	58,564	29,712
Prepaid income taxes and other	(1,709)	3,855
Current portion of long-term debt	(4,793)	13,005
Accounts payable	(15,290)	(11,246)
Accrued income taxes	6,304	(13,229)
Accrued liabilities	(23,248)	(6,001)
Increase in Working Capital	\$ 71,544	\$ 4,285

MOREX CORPORATION

Consolidated Statements of Shareholders' Equity

For the Years Ended December 29, 1978 and December 31, 1977

	Common Shareholders' Equity					Total Shareholders' Equity
	Preferred Stock	Common Stock	Additional Capital	Retained Earnings (Deficit)	Total	
<i>Thousands</i>						
Balance, January 1, 1977	\$ 62,815	\$ 4,875	\$ 39,205	\$ (59,359)	\$ (15,279)	\$ 47,536
Cumulative effect to January 1, 1977 of lease capitalization	—	—	—	(1,586)	(1,586)	(1,586)
Net Income for 1977	—	—	—	55,963	55,963	55,963
Issuance of stock:						
Acquisitions	—	540	5,329	1,593	7,462	7,462
In payment of interest	3,097	—	—	—	—	3,097
For employee benefit plans	—	98	426	—	524	524
Imputed discount adjustments	—	—	(129)	—	(129)	(129)
Dividends on preferred stock	—	—	—	(798)	(798)	(798)
Balance, December 31, 1977	65,912	5,513	44,831	(4,187)	46,157	112,069
Net Income for 1978	—	—	—	50,197	50,197	50,197
Issuance of stock:						
Public offering	—	750	35,694	—	36,444	36,444
Warrant exercise	—	520	4,594	—	5,114	5,114
For employee benefit plans	—	248	5,902	—	6,150	6,150
Dividends on preferred stock	—	—	—	(2,798)	(2,798)	(2,798)
Balance, December 29, 1978	\$ 65,912	\$ 7,031	\$ 91,021	\$ 43,212	\$ 141,264	\$ 207,176

See accompanying notes to consolidated financial statements.

Summary of Significant Accounting Policies**Consolidated Financial Statements**

The consolidated financial statements include Memorex Corporation and all of its subsidiaries. The 1977 statements have been restated to retroactively reflect a capital lease entered into in 1972 and capitalized in January 1978 under provisions of Financial Accounting Standard (FAS) No. 13. This capitalization does not have a material effect on previously reported net income. Commencing in 1978, the Company adopted a 52/53 week fiscal calendar.

The 1977 consolidated statements of income and changes in financial position have been reclassified to conform to the classifications adopted in 1978.

Inventories, Rental Equipment and Spare Parts

Inventories, rental equipment and spare parts are valued at the lower of standard cost (which approximates actual cost on a first-in, first-out basis) or market.

Depreciation and Amortization

Depreciation of property, plant and equipment and amortization of intangibles are computed using the straight-line method. Rental equipment and spare parts are depreciated using accelerated methods. Estimated economic lives and amortization periods are as follows: buildings and improvements—15 to 33 years; manufacturing equipment, furniture and fixtures—3 to 10 years; rental equipment and spare parts—4 to 7 years; and intangibles arising from business acquisitions—5 to 30 years. Different depreciation methods and estimated economic lives are used in some instances for income tax purposes.

Income Taxes

U.S. income taxes are not provided on the earnings of foreign subsidiaries or on the undistributed earnings of the Company's DISC subsidiaries since it is the Company's intention to indefinitely reinvest these earnings in foreign operations or qualified export assets. Undistributed earnings of these subsidiaries for which no U.S. income taxes have been provided approximate \$22,000,000 as of December 29, 1978. Investment tax credits are accounted for as reductions of the provision for income taxes on the "flow-through" method.

Pension Costs

Pension costs charged against operations include normal costs and amortization of prior service costs over thirty years. Pension costs are funded as accrued.

Income Per Common Share

Income per share amounts are computed by dividing adjusted income by the weighted average number of common shares outstanding plus common stock equivalents resulting from stock options, warrants and convertible subordinated debentures. Income is adjusted for dividends on preferred stock and interest on convertible subordinated debentures.

Acquisitions**Year ended December 31, 1977**

During 1977, the Company acquired Business Systems Technology, Inc. (BST), a manufacturer of computer peripheral equipment for small business computers, and Lencor International (CFI), a computer media manufacturer. The BST acquisition was consummated in July 1977, involved the issuance of approximately 340,000 shares of common stock, and was accounted for as a pooling of interests. BST's results of operations from January 1, 1977 have been consolidated. The CFI acquisition was consummated in April 1977 and was accounted for as a purchase. CFI shareholders received approximately 200,000 shares of common stock with a market value of approximately \$5,200,000 plus \$2,440,000 in cash. The excess of purchase price over net assets acquired is reported with intangibles arising from business acquisitions. CFI's results of operations since acquisition have been consolidated. BST and CFI are not material to the consolidated financial statements.

Year Ended December 29, 1978

In January 1978, the Company acquired the European marketing and service operations (Telex Europe) of Telex Computer Products, Inc. The Company assumed management control of Telex Europe as of January 1, 1978, the effective date of the acquisition, and the results of Telex Europe's operations have been consolidated with the results of the Company since that date.

The purchase price of Telex Europe was approximately \$14,000,000 based upon its net book value as of January 1, 1978. Notes payable of approximately \$7,000,000 are to be used as payment of a portion of the purchase price and the balance was paid in cash. The notes, which bear interest at an average rate of 8 1/2%, are payable in quarterly installments over a four-year period which commenced in February 1978.

Based upon information provided by Telex Computer Products, Inc., the unaudited revenues of Telex Europe for the year ended December 31, 1977 were approximately \$39,000,000. For the three months ended March 31, 1978, unaudited revenues of Telex Europe were approximately \$12,000,000. Since April 1, 1978, the Telex Europe operations have been integrated with those of the Company's existing subsidiaries in Europe. Consequently, operating results attributable to Telex Europe subsequent to that date cannot be determined.

Proforma information for 1977, as though the Telex Europe acquisition had been effective as of January 1, 1977, is not presented because the proforma effect of this acquisition is not material to the 1977 consolidated financial statements.

Financing Subsidiary

In December 1978, the Company formed a subsidiary, Memorex Finance Company, for the purpose of financing end user equipment leases. These leases will be finance type leases as defined by FAS No. 13 and will cover both Memorex and other equipment manufacturers' products which are packaged under a common lease. Memorex Finance Company is expected to commence active operations in 1979.

Inventories

Inventories, net of allowances for obsolescence and excess stock of approximately \$7,700,000 and \$5,700,000, as of December 29, 1978 and December 31, 1977, respectively, are as follows:

	1978	1977
	Thousands	
Raw materials	\$ 41,728	\$ 23,920
Work in progress	43,440	26,159
Finished goods	58,711	35,236
Total	\$143,879	\$ 85,315

Inventories include amounts which ultimately may be capitalized as rental equipment and spare parts.

Rental Equipment and Spare Parts

Rental equipment and spare parts as of December 29, 1978 and December 31, 1977 are as follows:

	1978	1977
	Thousands	
Rental equipment:		
Computer peripheral equipment	\$144,243	\$131,062
Disc packs	15,742	15,809
Spare parts	32,950	16,356
Total	192,935	163,227
Less accumulated depreciation:		
Rental equipment:		
Computer peripheral equipment	80,001	83,336
Disc packs	10,043	9,159
Spare parts	10,912	6,288
Total	100,956	98,783
Net	\$ 91,979	\$ 64,444

Certain classes of rental products are fully depreciated but generally continue to produce revenues. The original cost of these classes of products included above was approximately \$36,600,000 and \$33,100,000 as of December 29, 1978 and December 31, 1977, respectively. During 1978 and 1977, respectively, \$3,100,000 and \$8,200,000 of fully depreciated products which no longer have economic value were removed from the accounts.

Property, Plant and Equipment

	1978	1977
	Thousands	
Land	\$ 6,446	\$ 6,721
Buildings and improvements	33,917	22,305
Equipment, furniture and fixtures	87,868	66,678
Construction in progress	6,539	11,765
Total	134,770	107,469
Less accumulated depreciation	55,233	46,928
Net	\$ 79,537	\$ 60,541
Capital lease	\$ 15,205	\$ 15,205
Less accumulated depreciation	3,210	2,703
Net	\$ 11,995	\$ 12,502

In addition to property owned or occupied under a capital lease (primarily manufacturing facilities), the Company occupies certain other administrative, manufacturing and marketing facilities under non-capitalized lease agreements. Most of these non-capitalized leases contain renewal options and management expects that in the normal course of business the leases will either be renewed or replaced by other leases. Rental expense was approximately \$9,800,000 in 1978 and \$7,500,000 in 1977. Amortization of the capital lease is included in depreciation expense.

Minimum rental commitments, excluding amounts relating to the capital lease, as of December 29, 1978 are as follows:

	Thousands
Year Ending December:	
1979	\$ 4,761
1980	3,603
1981	2,095
1982	1,223
1983	1,037
Thereafter	8,971
Total	\$21,690

Estimated Replacement Cost Information (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, rental equipment, and productive capacity if such assets were valued on a replacement cost basis.

The replacement of the Company's inventories and rental equipment 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. It is believed that the net impact of the estimated replacement costs would not be material to the Company's consolidated results of operations.

The Company's annual report to the SEC on Form 10-K includes specific information relating to the estimated replacement costs of inventories, rental equipment and productive capacity (plant and equipment and leased facilities) as of December 29, 1978 and December 31, 1977 and the related cost of sales and depreciation expense for the years then ended based on estimated replacement costs.

Long-Term Debt

Long-term debt consists of the following:

	December 29, 1978		December 31, 1977	
	Current Portion	Non-Current Portion	Current Portion	Non-Current Portion
Thousands				
Notes Payable—Bank	\$ 4,341	\$ 15,000	\$ 1,741	\$ 40,757
Notes Payable—Others	7,028	7,103	4,850	386
9 3/4% Notes, Due 1990	—	50,000	—	—
Capital Lease Obligation	174	14,117	159	14,291
5 1/4% Convertible Subordinated Debentures Due 1990	—	54,752	—	65,687
Total:	\$ 11,543	\$ 140,972	\$ 6,750	\$ 121,121

Annual maturities of long-term debt as of December 29, 1978 are: 1979—\$11,543,000, 1980—\$20,579,000, 1981—\$5,363,000, 1982—\$4,789,000, 1983—\$8,565,000, thereafter—\$101,676,000. Approximately \$27,108,000 of the Notes Payable—Bank and Others was payable in currencies other than U.S. dollars.

At December 29, 1978, the Company and its subsidiaries had \$42,000,000 of credit availability remaining under its revolving, reducing, multicurrency line of credit with the Bank of America (the Bank), of which \$19,341,000 was outstanding at that date. Domestic borrowings under the

line of credit bear interest at the prime rate, eurocurrency borrowings at the London interbank offered rate plus 1% and other foreign borrowings at the Bank's best prevailing rate for similar advances. The Company pays a 1/2% commitment fee for the unused portion of the line. The amount of borrowings available under the line declines at the rate of \$2,250,000 per month. This agreement also contains certain financial and other covenants and restrictions.

On January 11, 1979, the Company entered into an \$80,000,000 revolving credit/term loan agreement with a group of nine banks with Bank of America as agent. The agreement provides for borrowings in eurodollars, eurocurrencies and bankers' acceptances; up to \$40,000,000 of the \$80,000,000 is available for domestic dollar borrowings. The revolving period expires on December 31, 1981 with an option to convert all or part of the facility into a term loan repayable in eight equal semi-annual installments. Approximately \$48,790,000 of this credit could have been utilized at December 29, 1978 within the covenants and restrictions of other debt of the Company had this agreement been in effect at that date. This agreement also contains certain financial and other covenants and restrictions.

The 9 3/4% Notes, due 1990, were issued during 1978 to The Prudential Insurance Company of America and The Equitable Life Assurance Society of the United States. The principal amount of the notes is repayable in annual installments of \$4,500,000 commencing in 1981 with the balance of \$9,500,000 due in 1990. The agreement pursuant to which the Notes were issued contains certain financial and other covenants including covenants relating to the maintenance of working capital, the incurrence of additional debt and the payment of cash dividends on common stock.

The capital lease obligation extends through the year 2002. The obligation requires monthly rentals of approximately \$125,000 and, discounted at 9.3%, had a present value of \$14,291,000 at December 29, 1978.

The 5 1/4% Convertible Subordinated Debentures are convertible into shares of common stock at \$142.50 per share. The debentures were issued for an original principal amount of \$75,000,000 repayable in annual sinking fund payments of \$6,000,000 commencing in 1980 with the balance of \$15,000,000 payable in 1990.

Debenture purchases can be used to satisfy sinking fund requirements and aggregated \$20,248,000 through December 29, 1978.

Shareholders' Equity

Preferred Stock

As of December 29, 1978 and December 31, 1977, 1,000,000 shares of Series A and B \$100 par value (\$100 liquidation and redemption value) and 1,500,000 shares of no par preferred stock were authorized. The Board of Directors is authorized to determine rights, preferences and terms of the no par preferred stock. No shares of the no par preferred stock have been issued.

Shares of Series A and B preferred stock were issued to senior lenders, principally Bank of America, under terms of loan agreements. Shares included in the balance sheet as of December 29, 1978 and December 31, 1977 were: Series A—159,639 and Series B—499,490.

The Series A has terms which provide for:

- (1) Cumulative annual dividends at \$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 and increasing to \$6 per share in 1981.
- (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.

Common Stock

Ten million shares of \$1 par value common stock were authorized as of December 29, 1978 and December 31, 1977. Shares outstanding, net of treasury shares, were 7,030,969 and 5,513,230 as of December 29, 1978 and December 31, 1977, respectively. Treasury shares were 78,804 as of December 29, 1978 and December 31, 1977.

In August 1978, the Company issued 750,000 shares of its common stock through a public offering. Concurrently, 519,536 shares of common stock were issued upon exercise of warrants to purchase common stock at \$10 per share. Net proceeds from the public offering and exercise of warrants aggregated \$41,558,000.

Shares reserved for possible future issuance as of December 29, 1978 were as follows:

	Number of Shares
Warrants issued at \$10 per share to senior lenders, expiring in 1989	347,924
Conversion of subordinated debentures	477,508
To employees under:	
Stock option plans	454,681
Common stock bonus plan (net of 69,000 shares accrued as if outstanding at December 29, 1978)	81,000
Total shares reserved	1,361,113

Retained Earnings

Under the most restrictive provisions of the Company's loan agreements, approximately \$12,500,000 of retained earnings was available for the payment of dividends on common stock at December 29, 1978.

Leasing Activities

The Company earns a significant portion of its revenues through leasing activities. As a lessor, the Company markets its products under variable term lease agreements which usually provide the customer with the opportunity to apply a portion of previously paid rentals toward the purchase of the equipment. Most of these leases are cancellable and are for periods of three years or less. The lease agreements between the Company and its customers are generally operating leases under which rental revenues are recorded as earned.

The Company also sells or assigns a significant portion of its rental equipment and related lease agreements to unrelated third-party financing institutions. Such transactions qualify as sales for accounting purposes and aggregated \$130,000,000 and \$54,000,000 in 1978 and 1977, respectively. Transactions with one of these institutions, Lease Financing Corporation, accounted for \$74,000,000 and \$27,000,000 of 1978 and 1977 sales. The arrangements between the Company and these third-party financial institutions vary; however, the Company usually administers and is reimbursed for the rental billing and collection process. Most of the agreements provide the Company with residual rights in the sold equipment after the institutions have achieved measured returns on their investments. Certain of these agreements provide the Company with the option to reacquire the sold equipment at nominal cost; other agreements provide for sharing on a percentage basis in any future rental revenues. Residual benefits began to accrue in 1978 and were reflected in income as realized.

Employee Benefit Plans

Stock Option Plans

The Company has three stock option plans: the 1973 Stock Option Plan, for "non-qualified" options; the 1974 Stock Option Plan, for "qualified" options; and the 1976 Stock Option Plan, for either "qualified" or "non-qualified" options. Under these plans, options may be granted to key employees to purchase up to 1,335,000 shares of common stock at 100% of market value on the date options are granted. The term of each option granted is determined by the Board of Directors and all options granted through December 29, 1978 expire either five or ten years from date of grant.

Stock option transactions under these plans and options assumed in an acquisition are summarized as follows:

	1978		1977	
	Price per Share	Number of Shares	Price per Share	Number of Shares
Outstanding, beginning of year	\$1.45-31.06	424,995	\$1.75-31.06	339,668
Exercised	2.06-31.06	(173,454)	1.45-27.31	(95,241)
Terminated	1.45-56.63	(50,527)	2.06-27.31	(26,172)
Qualified options				
Granted	—	—	24.75	40,000
Assumed	—	—	1.45- 8.69	25,990
Non-qualified options				
Granted	27.00-56.63	143,000	24.75-27.81	140,750
Outstanding, end of year	\$2.06-56.63	344,014	\$1.45-31.06	424,995
Exercisable		76,497		180,263
Available for grant		110,667		205,096

Additionally, in October 1978, the Board of Directors approved, for future ratification by shareholders, a 1979 Stock Option Plan for "non-qualified" options. This plan provides for the issuance of options to purchase up to 400,000 shares of common stock under terms similar to existing plans.

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, which depend on earnings and are charged to operations in the year earned, were approximately \$2,300,000 in 1978 and \$2,100,000 in 1977.

Pension Plan

The Company has a pension plan for the benefit of all eligible U.S. employees. Effective January 1, 1978, the plan was changed from a contributory to a non-contributory plan. Participation in the non-contributory plan is automatic. Pension costs charged to 1978 and 1977 operations were approximately \$2,500,000 and \$1,500,000, respectively.

Common Stock Bonus Plan

Effective January 1, 1978, the Company adopted a common stock bonus plan for the benefit of all qualified U.S. employees. Amounts payable under the plan are based upon participating employees' earnings and depend upon consolidated income. Amounts charged against operations for 1978 aggregate \$2,030,000 and will be paid in 1979 by the issuance to a trustee of approximately 69,000 shares of common stock. These shares are reported in the consolidated balance sheet as though they were outstanding at December 29, 1978.

Income Taxes

The provisions for income taxes are as follows:

	Federal	Foreign	State	Total
1978				
Charge in lieu	\$ 5,943	\$ 2,306	\$ —	\$ 8,249
Currently payable	—	11,345	3,208	14,553
Deferred	6,581	994	—	7,575
Provision for income taxes	12,524	14,645	3,208	30,377
Loss carryforward benefits	5,943	2,306	—	8,249
Net provision for income taxes	\$ 6,581	\$ 12,339	\$ 3,208	\$ 22,128
1977				
Charge in lieu	\$21,226	\$ 868	\$ —	\$22,094
Currently payable	10,000	3,000	5,800	18,800
Deferred (prepaid)	(10,000)	370	—	(9,630)
Provision for income taxes	21,226	4,238	5,800	31,264
Loss carryforward benefits	(21,226)	(868)	—	(22,094)
Net provision for income taxes	\$ —	\$ 3,370	\$ 5,800	\$ 9,170

For financial reporting purposes, the Company provides deferred (prepaid) income taxes for timing differences between financial accounting and income tax accounting. Principal timing differences at December 29, 1978 relate to U.S. income taxes and arise from 1) the use of an installment method of revenue recognition for income tax purposes, 2) intercompany profits which are taxed but have been eliminated in the consolidated income statement and 3) inventory valuation allowances which are not yet deductible in tax returns.

For purposes of filing U.S. Federal income tax returns, the Company had approximately \$12,000,000 of investment tax credit carryforwards at December 29, 1978. The Company has utilized its Federal net operating loss carryforwards. For purposes of filing foreign income tax returns, certain subsidiaries of the Company have net operating loss carryforwards aggregating approximately \$3,000,000 as of December 29, 1978.

Income tax expense for 1978 and 1977 at the Federal statutory rate is reconciled to the provision for income taxes for financial reporting purposes as follows:

	1978		1977	
	Amount	%	Amount	%
<i>Thousands</i>				
Computed tax on income before taxes and extraordinary credit at Federal statutory rate	\$34,716	48.0	\$31,264	48.0
Increase (reduction) in taxes resulting from:				
State taxes, net of Federal tax benefit	1,668	2.3	3,016	4.6
Foreign subsidiaries—rate differences and losses of subsidiaries	1,930	2.7	2,384	3.6
Undistributed earnings of Domestic International Sales Corporation	(2,880)	(4.0)	(1,920)	(2.9)
Investment tax credits	(6,000)	(8.3)	(3,297)	(5.0)
Other—net	943	1.3	(183)	(0.3)
Provision for Income Taxes	\$30,377	42.0	\$31,264	48.0

Litigation

In 1973 Memorex and certain of its subsidiaries (the Company) filed an action against IBM in the United States District Court for the Northern District of California alleging that IBM has used its monopoly power to control prices and eliminate competition. The Company also alleged that IBM has monopolized and attempted to monopolize development, production distribution, sale, leasing and servicing in certain markets for computers and computer equipment in violation of the federal antitrust laws. At the trial the Company presented evidence of actual damages totaling \$333 million (of which the jury was instructed by the trial court to disregard \$27 million) and sought to recover treble damages, its costs and attorneys' fees.

On July 5, 1978 the court declared a mistrial because the jury was unable to reach a verdict after twenty days of deliberation. On August 11, 1978 the court granted IBM's motion for a directed verdict, i.e., the court ruled that no reasonable jury could find in favor of Memorex on any of the substantive issues. The court also ruled that if its directed verdict in favor of IBM is overturned on appeal, Memorex will not be entitled upon retrial to a jury trial because of the complexity of the case. The Company has appealed the trial court's rulings to the United States Court of Appeals for the Ninth Circuit. The Company is unable to predict either when the appeal will be decided or, in the event of a reversal, when a new trial would begin.

The Company's costs incurred in the litigation have been expensed as incurred, and a final judgment adverse to the Company will not result in any writeoff of assets. The trial court judgment entitles IBM to recover its own court costs (not including attorneys' fees). IBM has submitted to the court a statement of expenses totaling approximately \$700,000, of which the Company contests approximately \$500,000. If a final judgment is entered against the Company, the amount of such costs ultimately determined to be proper will be payable.

In 1978, actions were commenced by certain stockholders seeking recovery on behalf of the Company of approximately \$15,000,000 representing profit allegedly realized in violation of certain applicable provisions of law by certain sellers of warrants and common stock. Management presently believes that recovery by Memorex on the actions is remote.

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.

Interest and Other

Components of interest and other are as follows:

	1978	1977
<i>Thousands</i>		
Interest expense	\$13,640	\$12,138
Interest income	(1,580)	(2,283)
Gain on repurchase of debentures	(3,377)	(576)
Gain on sale of stock investment	(1,400)	—
Foreign currency (gains) losses	(430)	302
Total	\$ 6,853	\$ 9,581

Business Segments

The Company manufactures and markets computer peripheral equipment and media products which utilize magnetic coating technology for information storage. The principal markets for its products include users of data processing installations, manufacturers of data processing systems, broadcasters and educational users of videotape, home audio equipment users, and users of electronic word processing equipment. The Company's products are principally distributed by its own sales force and, to a lesser extent, through independent distributors. Operations are conducted in three geographic areas: United States; Europe, Middle East and Africa (EUMEA); and Americas and Asia (A&A).

Operations are grouped into two product lines. Equipment Products and Media Products. The Equipment Products

line consists of computer peripheral equipment based on electromechanical and electronic technology, such as disc storage systems, semiconductor memory units, communications controllers and terminals, tape storage systems and printers. The Media Products line consists of products such as computer tape, disc packs, audio tape and video tape, based on magnetic coating technology which are used in computer information storage systems, recording equipment and word processing equipment.

See Leasing Activities for sales to a customer (Lease Financing Corporation) exceeding 10% of total revenues.

The following tables summarize the operations of the Company on a geographic and on a product line basis as of December 29, 1978 and December 31, 1977 and for the years then ended.

Geographic Basis (Thousands)	REVENUES			OPERATING INCOME			Identifiable Assets
	External	Internal	Total	External	Internal	Total	
1978							
United States	\$347,991	\$161,863	\$509,854	\$ 66,751	\$ 40,907	\$107,658	\$256,967
Europe, Middle East & Africa	217,049	—	217,049	16,050	—	16,050	169,203
Americas & Asia	68,226	—	68,226	11,977	—	11,977	59,492
General Corporate	—	—	—	(15,600)	—	(15,600)	37,668
	633,266	161,863	795,129	79,178	40,907	120,085	523,330
Elimination	—	(161,863)	(161,863)	—	(40,907)	(40,907)	(35,681)
	\$633,266	\$ —	\$633,266	\$ 79,178	\$ —	\$ 79,178	\$487,649
1977							
United States	\$281,922	\$ 88,288	\$370,210	\$ 81,811	\$ 31,688	\$113,499	\$188,277
Europe, Middle East & Africa	126,102	—	126,102	4,000	—	4,000	102,197
Americas & Asia	42,088	—	42,088	4,700	—	4,700	37,386
General Corporate	—	—	—	(15,797)	—	(15,797)	31,470
	450,112	88,288	538,400	74,714	31,688	106,402	359,330
Elimination	—	(88,288)	(88,288)	—	(31,688)	(31,688)	(29,074)
	\$450,112	\$ —	\$450,112	\$ 74,714	\$ —	\$ 74,714	\$330,256
Product Line Basis (Thousands)							
	Revenue	Operating Income	Identifiable Assets	Prop. Plant & Equip.	Rental Equip. & Spare Parts	Depreciation	Capital Expenditures
1978							
Equipment Products	\$424,726	\$ 77,775	\$311,360	\$ 4,645	\$ 23,877	\$ 18,374	\$ 52,364
Media Products	208,540	17,003	138,621	6,776	3,936	11,732	2,984
General Corporate	—	(15,600)	37,668	561	—	1,887	—
	\$633,266	\$ 79,178	\$487,649	\$ 11,982	\$ 27,813	\$ 31,993	\$ 55,348
1977							
Equipment Products	\$273,351	\$ 74,870	\$184,479	\$ 2,677	\$ 16,002	\$ 7,431	\$ 22,316
Media Products	176,761	15,641	114,307	4,416	3,338	12,902	3,429
General Corporate	—	(15,797)	31,470	955	—	4,974	—
	\$450,112	\$ 74,714	\$330,256	\$ 8,048	\$ 19,340	\$ 25,307	\$ 25,745

- Operating income is derived by adding interest and other, net to income before income taxes and extraordinary credit.
- Internal revenues accrue to United States operations from product sales to foreign subsidiaries which are principally sales and service operations. Internal selling prices are designed to allocate manufacturing profits to manufacturing entities and sales and service profits to those entities.
- The nature of the international operations requires allocations to develop product line information. During 1978 the Company refined cost allocation procedures relating to international operations. Accordingly, to conform to the 1978 method of allocation, 1977 product line operating income has been restated (increase equipment product operating income by \$11,000,000 and decrease media product operating income by the same amount).

Quarterly Summary (Unaudited)

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	1978	1977	1978	1977	1978	1977	1978	1977
Revenues:								
Sales	\$103,212	\$ 74,466	\$121,491	\$ 78,641	\$114,215	\$ 84,432	\$144,452	\$ 92,480
Rental and Service	35,652	29,290	37,015	29,541	38,370	29,699	38,859	31,563
Total Revenues	138,864	103,756	158,506	108,182	152,585	114,131	183,311	124,043
Costs and Expenses:								
Cost of Sales, Rental and Service	83,745	58,857	95,960	63,559	92,578	65,010	111,906	70,834
Selling, Administrative and Development	35,824	26,385	41,318	27,163	42,243	30,484	50,514	33,106
Interest and Other, Net	2,236	2,397	3,240	2,443	1,884	2,804	(507)	1,937
Total Costs and Expenses	121,805	87,639	140,518	93,165	136,705	98,298	161,913	105,877
Income before Income Taxes and Extraordinary Credit	17,059	16,117	17,988	15,017	15,880	15,833	21,398	18,166
Provision for Income Taxes	7,677	7,886	7,744	7,156	5,970	7,500	8,986	8,718
Income before Extraordinary Credit	9,382	8,231	10,244	7,861	9,910	8,333	12,412	9,448
Extraordinary Credit	4,979	5,421	3,270	5,105	—	5,679	—	5,885
Net Income	\$ 14,361	\$ 13,652	\$ 13,514	\$ 12,966	\$ 9,910	\$ 14,012	\$ 12,412	\$ 15,333
Primary Income per Common Share:								
Before Extraordinary Credit	\$1.35	\$1.31	\$1.45	\$1.23	\$1.30	\$1.27	\$1.56	\$1.43
Net Income	\$2.15	\$2.21	\$1.98	\$2.06	\$1.30	\$2.18	\$1.56	\$2.36
Fully Diluted Income per Common Share:								
Before Extraordinary Credit	\$1.34	\$1.31	\$1.43	\$1.23	\$1.30	\$1.26	\$1.56	\$1.42
Net Income	\$2.14	\$2.21	\$1.96	\$2.06	\$1.30	\$2.16	\$1.56	\$2.35
Proforma Income per Common Share—								
Assuming preferred dividends had been payable at the maximum rate scheduled to be paid after 1980;								
Primary:								
Before Extraordinary Credit	\$1.29	\$1.18	\$1.39	\$1.10	\$1.25	\$1.15	\$1.51	\$1.31
Net Income	\$2.09	\$2.08	\$1.92	\$1.93	\$1.25	\$2.05	\$1.51	\$2.24
Fully Diluted:								
Before Extraordinary Credit	\$1.28	\$1.18	\$1.38	\$1.10	\$1.25	\$1.14	\$1.51	\$1.30
Net Income	\$2.08	\$2.08	\$1.90	\$1.93	\$1.25	\$2.04	\$1.51	\$2.23

Notes to Quarterly Summary

The Company purchases its outstanding 5 1/4% Convertible Subordinated Debentures to satisfy future sinking fund requirements. Gains from such purchases are included in Interest and Other and increased pre-tax earnings as follows:

	1978	1977
First Quarter	\$ 497	\$ 349
Second Quarter	45	227
Third Quarter	465	—
Fourth Quarter	2,370	—
Total	\$3,377	\$ 576

The annual effective tax rates for 1978 and 1977 were 42% and 48%, respectively. Quarterly effective tax rates were based upon interim estimates of the annual rate. As changes in the estimated annual rate were made, the cumulative effect was recorded in the quarter of change. Following are the interim rates:

	1978	1977
First Quarter	45%	49%
Second Quarter	43%	48%
Third Quarter	38%	47%
Fourth Quarter	42%	48%

Third quarter 1978 results were favorably affected by the sale of common stock holdings in Computer Communications, Inc. The common stock was purchased in 1975 in connection with a cross-manufacturing agreement and its sale resulted in a pre-tax gain of approximately \$1.4 million. This gain is reported as a component of Interest and Other.

Fourth quarter results were affected by unusual items, the net effect of which decreased net income by approximately \$1.5 million. These items consisted of net year-end adjustments which decreased income by approximately \$2.9 million after tax and were offset by a gain of \$1.4 million after tax from purchase of the Company's 5 1/4% Convertible Subordinated Debentures. The year-end adjustments related to changes in accounting estimates, corrections of accounting errors and inventory valuations. Such adjustments also resulted in decreasing Rental and Service Revenues by \$2.6 million and increasing Cost of Sales by \$2.4 million. These adjustments did not have a material effect on previously reported quarterly results. The annual physical inventory was completed during the fourth quarter and resulted in a decrease of inventory valuation of approximately \$8.4 million. The related study of the Company's inventory standard cost procedures resulted in increasing inventories by approximately \$7.8 million to adjust standard cost to approximate actual cost. The net effect of these inventory valuation adjustments was not significant.

MEMOREX CORPORATION
Five-Year Summary

Years Ended December

	1978	1977	1976	1975	1974	
Summary of Operations		<i>(Thousands except per share amounts)</i>				
Revenues:						
Sales	\$483,370	\$330,019	\$237,811	\$162,139	\$118,297	
Rental and Service	149,896	120,093	106,822	101,855	99,330	
Total Revenues	633,266	450,112	344,633	263,994	217,627	
Costs and Expenses:						
Cost of Sales, Rental and Service	384,189	258,260	197,272	162,821	146,914	
Selling, Administrative and Development	169,899	117,138	86,727	67,941	56,756	
Interest and Other, Net	6,853	9,581	10,160	15,788	23,326	
Total Costs and Expenses	560,941	384,979	294,159	246,550	226,996	
Income (Loss) before Taxes and Extraordinary Credits	72,325	65,133	50,474	17,444	(9,369)	
Provision for Income Taxes	30,377	31,264	25,792	9,385	—	
Income (Loss) before Extraordinary Credits	41,948	33,869	24,682	8,059	(9,369)	
Extraordinary Credits	8,249	22,094	15,073	9,577	—	
Net Income (Loss)	\$ 50,197	\$ 55,963	\$ 39,755	\$ 17,636	\$ (9,369)	
	Primary	Fully Diluted	Primary	Fully Diluted	Primary	
Per Share Data						
Income (Loss) per Common Share:						
Before Extraordinary Credits	\$5.65	\$5.64	\$5.25	\$5.22	\$4.31	
Net Income (Loss)	\$6.90	\$6.88	\$8.81	\$8.78	\$7.03	
Proforma Income (Loss) per Common Share:						
Before Extraordinary Credits	\$5.45	\$5.44	\$4.75	\$4.73	\$3.74	
Net Income (Loss)	\$6.70	\$6.68	\$8.32	\$8.28	\$6.46	
Common Shares and Equivalents	7,198	7,220	6,613	6,642	5,674	
	7,198	7,220	6,613	6,642	5,747	
	7,198	7,220	6,613	6,642	4,740	
	7,198	7,220	6,613	6,642	4,781	
	7,198	7,220	6,613	6,642	4,314	
Operating Data		1978	1977	1976	1975	1974
Total Revenues:						
Equipment	\$424,726	\$273,351	\$210,370	\$156,307	\$116,043	
Media	208,540	176,761	134,263	107,687	101,584	
Operating Income (Loss):						
Equipment	77,775	74,870	60,930	28,425	1,462	
Media	17,003	15,641	11,624	4,807	12,495	
General Corporate	(15,600)	(15,797)	(11,920)	*	*	
International Revenue	285,275	168,190	136,000	112,000	87,000	
Research and Development Expenses	23,619	19,216	13,943	9,282	7,462	
Depreciation and Amortization	40,187	27,629	33,710	39,281	47,393	
Financial Position at Year End						
Cash and Temporary Investments	\$ 28,372	\$ 12,021	\$ 43,803	\$ 40,182	\$ 11,783	
Inventories	143,879	85,315	55,603	37,095	43,394	
Rental Equipment and Spare Parts:						
At Cost	192,935	163,227	172,183	182,211	204,749	
Net of Accumulated Depreciation	91,979	64,444	58,039	68,769	92,231	
Notes Payable	83,472	47,734	90,958	117,562	163,117	
Convertible Subordinated Debentures	54,752	65,687	67,218	68,045	75,000	
Total Shareholders' Equity (Deficiency)	207,176	112,069	45,950	1,880	(24,502)	

*General Corporate expenses were allocated to product lines in these years.

Management's Discussion and Analysis of the Summary of Operations

The following discussion contains general comments on the results of Memorex's operations during 1978 and 1977 as compared to the previous years (1977 and 1976).

Revenues

Total revenues increased 41% in 1978 and 31% in 1977. Sales revenue increased 46% in 1978 and 39% in 1977 while rental and service revenues increased 25% in 1978 and 12% in 1977. These increases were primarily due to increased volumes of product shipments and included revenues attributable to acquisitions. In January 1978, the Company acquired the European marketing and service operations (Telex Europe) of Telex Computer Products, Inc. Since April 1978, the Telex Europe operations have been integrated with those of the Company's existing subsidiaries in Europe. Consequently, operating results attributable to Telex Europe for 1978 cannot be determined; however, unaudited revenues of Telex Europe for 1977 were approximately \$39,000,000. Acquisitions during 1977 accounted for 7% of the 1977 revenue increase. Unit selling price changes were not significant between the periods.

Equipment and media product revenues increased 55% and 18%, respectively, over 1977 and 30% and 32%, respectively, over 1976. The increase in equipment revenues in 1978 is due in part to the acquisition of Telex Europe.

Cost of Sales, Rental and Service

Cost of sales increased 47% in 1978 and 38% in 1977. These increases were principally due to increased sales volumes. Cost of rental and service increased 56% in 1978 and 12% in 1977. These increases are primarily the result of the increased costs of service associated with an expanding base of installed equipment. Additionally, in 1978 the integration of the Telex Europe operations significantly increased service costs. The 1977 cost increase parallels the increase in rental and service revenues.

Selling, Administrative and Development

Selling, administrative and development costs increased 45% in 1978 and 35% in 1977. These increases were due to continued expansion in the volume of the Company's business and are comprised of increased selling, general and administrative expenses of 49% in 1978 and 35%

in 1977 and increased research and development expenditures of 23% and 38% in 1978 and 1977, respectively. The annual increases in selling, general and administrative expenses are primarily due to increased levels of employment which are necessary to support expanding sales and marketing activities. Also included in the 1978 increase are the expenses of Telex Europe. The increases in research and development expenditures are primarily due to the Company's expanded product development efforts.

Interest and Other, Net

Interest expense net of other income, decreased 28% in 1978 and 6% in 1977. In 1978 a 12% increase in interest costs was more than offset by gains on repurchased debentures and the sale of a stock investment, both of which were not significant in 1977 and 1976. The increase in 1978 interest expense was principally caused by an increase in average outstanding borrowings, whereas an 8% decrease in 1977 interest expense was caused by a decrease in average outstanding borrowings.

Provision for Income Taxes

The effective tax rates of 42% in 1978 and 48% in 1977 represent the combined effect of taxes on Federal, state and foreign income. The effective rates are governed by the origin of the various components of consolidated financial income and the tax rates applicable to those components. Factors which tended to raise the effective rates above the Federal statutory rate included losses of foreign subsidiaries for which tax benefits were not currently available, state income taxes and foreign income taxes at rates in excess of the Federal rate. Factors which tended to lower the effective rates were investment tax credits, Domestic International Sales Corporation income not currently taxable and foreign taxes which were lower than the Federal rate. The 1977 effective tax rate was higher than the 1978 rate principally because of the effect of investment tax credits. The 1977 rate was lower than the 1976 rate principally because of the effect of certain foreign losses.

Extraordinary Credit

The extraordinary credit in 1978 and 1977 consisted of the estimated tax benefits from utilizing operating loss carryforwards.

Directors

Robert C. Wilson

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

Robert L. Chambers

Chairman of the Board, 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

Business Consultant

Vester T. Hughes, Jr.

Partner, Hughes & Hill, Dallas, Texas,
a law firm.

Alvin C. Rice

Consultant, private investments.

T. Robert Sandberg

Vice President (Ret.), Cutter Laboratories,
Inc., Berkeley, California, pharmaceutical
manufacturer and distributor.

Benno C. Schmidt

Managing Partner, J. H. Whitney &
Company, New York City, a private
investment firm.

Theodore Vermeulen

Chemical Engineer; Professor,
University of California, Berkeley

Memorex Corporation

San Tomas at Central Expressway
Santa Clara, California 95052
(408) 987-1000
Telex 346 442

Officers and Directors

Board of Directors

Robert C. Wilson

Memorex Chairman of the Board, President and Chief Executive Officer

Robert L. Chambers

Chairman of the Board, 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

Business Consultant

Vester T. Hughes, Jr.

Partner, Hughes & Hill, Dallas, Texas.

Alvin C. Rice

Consultant, private investments.

T. Robert Sandberg

Vice President (Ret.), Cutter Laboratories, 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, Chambers 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, Chairman, and Chief Executive Officer

James Dobbie*

Executive Vice President

Charles S. Strauch*

Executive Vice President

Richard C. Allen

Vice President and General Manager, Communications Group

George L. Bragg

Vice President, Corporate Development

Reto Braun

Vice President and General Manager, Europe-Middle East-Africa Group

Theodore J. Cutler

Vice President and General Manager, Consumer and Business Media Group

Robert L. Erickson

Vice President, Legal, and Secretary

Marcelo A. Gurmucio

Vice President and General Manager, Large Storage Systems Group

Robert L. Malcolm

Vice President, Industrial Relations

Richard W. Martin

Vice President and General Manager, Americas and Asia Group

Henry C. Montgomery**

Vice President, Finance

A. Keith Plant

Vice President and General Manager, General Systems Group

Steven H. Puthuff

Vice President, Engineering

James Simpson

Vice President and General Manager, Computer Media Group

F. Gordon Smith

Vice President, Marketing

Charles E. Splaine

Vice President, Field Operations Group

Staff

Robert G. Coo

Treasurer

William M. George

Controller

*Member, Office of the President

**Resigned position in February 1979

Shareholder Information

Annual Meeting of Shareholders

You are cordially invited to attend Memorex's Annual Meeting of Shareholders, which will take place on Wednesday, April 25, 1979, at 10 a.m. at the Le Baron Hotel, 1350 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 5 1/4% Convertible Subordinated Debentures is:

Bank of America-NT&SA
San Francisco, CA 94104

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 Expwy.
Santa Clara, CA 95052

Common Stock and Convertible Debentures

Memorex common stock and 5 1/4% Convertible Subordinated Debentures are traded on the New York Stock Exchange, and the common stock is also traded on the Pacific Stock Exchange. The following tables represent the high and low sales range, as reported in the Wall Street Journal.

Common Stock*		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
1978					
High	32 1/8	49 1/8	60 3/4	52 3/4	52 3/4
Low	26 1/4	30	37 1/2	25 1/2	25 1/2

Convertible Debentures		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
1978					
High	70	71	73	72 1/4	72 1/4
Low	63	67	66 3/4	60	60

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

Corporate Facilities

Sales and Service Locations

UNITED STATES

ALABAMA
Birmingham (205) 870-4240

ARIZONA
Phoenix (602) 254-5466

ARKANSAS
Little Rock (501) 374-0279

CALIFORNIA
Anaheim (714) 776-8571
Glendale (213) 240-4732
Long Beach (213) 891-2541
Los Angeles (213) 473-0811
Riverside (714) 784-3836
San Diego (714) 571-1133
San Francisco (415) 397-9496
Santa Clara (408) 987-1450

COLORADO
Denver (303) 837-0205

CONNECTICUT
Greenwich (203) 637-5421
Hartford (203) 568-1370

DISTRICT OF COLUMBIA
Washington D.C. (703) 821-3300

FLORIDA
Jacksonville (904) 398-4440
Miami (305) 558-9320
Tampa (813) 879-4680

GEORGIA
Atlanta (404) 321-0200

ILLINOIS
Chicago (312) 620-3200

INDIANA
Indianapolis (317) 293-8055

KANSAS
Kansas City (913) 362-1650

KENTUCKY
Louisville (502) 425-8395

LOUISIANA
New Orleans (504) 522-4401

MARYLAND
Baltimore (301) 666-8800

MASSACHUSETTS
Boston (617) 890-0700

MICHIGAN
Detroit (313) 354-4511

MINNESOTA
Minneapolis (612) 835-6635

MISSOURI
St. Louis (314) 576-4570

NEBRASKA
Omaha (402) 391-0486

NEW JERSEY
Newark (201) 325-0164

NEW YORK
Albany (518) 458-7099
Buffalo (716) 631-5410
New York City (212) 541-7780
Syracuse (315) 451-4330

NORTH CAROLINA
Charlotte (704) 527-4923
Greensboro (919) 294-4374
Raleigh (919) 787-7660

OHIO
Cincinnati (513) 621-7120
Cleveland (216) 447-0780
Columbus (614) 885-0415

OKLAHOMA
Oklahoma City (405) 235-1245
Tulsa (918) 622-6743

OREGON
Portland (503) 620-4800

PENNSYLVANIA
Philadelphia (215) 337-1050
Pittsburgh (412) 531-8711

SOUTH CAROLINA
Greenville (803) 235-9637

TENNESSEE
Chattanooga (615) 756-3760

TEXAS
Dallas (214) 258-3510
Houston (713) 688-1451

VIRGINIA
Richmond (804) 288-3116

WASHINGTON
Seattle (206) 575-3823

WISCONSIN
Milwaukee (414) 327-4040

MANUFACTURING PLANTS

BELGIUM

Liege

CALIFORNIA

Anaheim
Cupertino
Irvine
Mountain View
Santa Ana
Santa Clara

MEXICO

Nogales

WISCONSIN

Eau Claire

EUROPE, MIDDLE EAST AND AFRICA

HEADQUARTERS:
London, United Kingdom
Tel: 01-570-7716
Telex: 851-938795

AUSTRIA
Vienna
Tel: 0222-73.24.17
Telex: 847-12734

BELGIUM
Brussels
Tel: 02-673.80.80
Telex: 846-23438

DENMARK
Copenhagen
Tel: 02-45.83.11
Telex: 855-33215

FINLAND
Helsinki
Tel: 90-585544
Telex: 857-121654

FRANCE
Lille
Tel: 20-57.34.34
Telex: 842-120278

LYON
Tel: 78-90.82.12
Telex: 842-380418

NANTES
Tel: (40) 471063
Telex: 700261

PARIS
Tel: 1-655.66.55
Telex: 842-270232

STRASBOURG
Tel: (88) 32.10.20

GERMANY
Bremen
Tel: 9421-48480
Telex: 841-25486

COLOGNE
Tel: 0221-88.10.31/35
Telex: 841-8873704

DORTMUND
Tel: 0231-65465
Telex: 841-822382

DUSSELDORF
Tel: 0211-68.44.38
Telex: 8588355

FRANKFURT/MAIN
Tel: 611-66051
Telex: 841-0411240

HAMBURG
Tel: (040) 6/30.10.31/35
Telex: 841-215019

MUNICH
Tel: 089-19.40.71
Telex: 841-5215500

NUREMBERG
Tel: 0911-80.30.51
Telex: 841-623601

STUTTGART
Tel: 0711-76.60.03
Telex: 841-7255415

IRELAND
Dublin
Tel: (01) 680 145

CORK
Tel: 306022

TELEGRAMS
Tel: (0001) 57057

ITALY
Bologna
Tel: 051-58.05.55/6
Telex: 843-52174

MILAN
Tel: 02-71.85.51
Telex: 843-33108

PADUA
Tel: 49-55.20.30
Telex: 843-43120

ROME
Tel: 06-542.17.41
Telex: 843-63013

TURIN
Tel: 011-54.74.13
Telex: 843-22127

NETHERLANDS
Amsterdam
Tel: 020-45.98.72
Telex: 844-13634

NORWAY
Oslo
Tel: 02-21.91.60
Telex: 856-16753

SPAIN
Barcelona
Tel: 3-227.70.02
Madrid
Tel: 01-207.83.45

NANTES
Tel: 831-43018
Telex: 700261

SWEDEN
Goteborg
Tel: (031) 122700, 127022

MALMO
Tel: (040) 18.30.08
Stockholm
Tel: (08) 98.09.80

GERMANY
Bremen
Tel: 9421-48480
Telex: 841-25486

SWITZERLAND
Bern
Tel: (031) 22.70.32

GENEVA
Tel: 022-36.03.85
Telex: 845-28752

MUTTENZ
Tel: 061-41.96.68
Zurich
Tel: 01-60.46.46

DORTMUND
Tel: 0211-68.44.38
Telex: 8588355

FRANKFURT/MAIN
Tel: 611-66051
Telex: 841-0411240

HAMBURG
Tel: (040) 6/30.10.31/35
Telex: 841-215019

MUNICH
Tel: 089-19.40.71
Telex: 841-5215500

NUREMBERG
Tel: 0911-80.30.51
Telex: 841-623601

STUTTGART
Tel: 0711-76.60.03
Telex: 841-7255415

IRELAND
Dublin
Tel: (01) 680 145

CORK
Tel: 306022

TELEGRAMS
Tel: (0001) 57057

AMERICAS AND ASIA

HEADQUARTERS:
Santa Clara, California
Tel: (408) 987-1000

AUSTRALIA
Melbourne
Tel: 267-2955
Perth
Tel: (09) 381-7535
Telex: 93370
Sydney
Tel: 908-2211
Telex: 790-23005

BRAZIL
Rio de Janeiro
Tel: 264-3483
Sao Paulo
Tel: 287-6988, 2262
288-7503, 289-7522
Telex: 391-1122368

CANADA
Calgary
Tel: (403) 243-1710
Telex: 038-22544

DORVAL
Tel: (514) 636-9912
Telex: 05-821654

EDMONTON
Tel: (403) 454-8671
Telex: 037-3712

HALIFAX
Tel: (902) 435-1813
Telex: 019-23533

OTTAWA
Tel: (613) 737-3411
Telex: 053-3670

TORONTO
Tel: (416) 449-9940
Telex: 06-966851

VANCOUVER
Tel: (604) 873-3322
Telex: 04-508656

WINNIPEG
Tel: (204) 477-1855
Telex: 07-55578

JAPAN
Tokyo
Tel: (03) 273-8901/7
Telex: 02224709 MRX JPN

OSAKA
Tel: (06) 203-6601/4
Telex: 5228622 MRX OSK

NAGOYA
Tel: (052) 231-5005, 5008
Telex: 4424750 MRX NGY

HIROSHIMA
Tel: (0822) 28-1780, 1742
Telex: 653377 MRX HRM

FUKUOKA
Tel: FUKUOKA (092)
471-3205, 3290
Telex: 722939 KANEMATSU FUK

MEXICO
Mexico City
Tel: (905) 553-5302-1244
Telex: 001773086
Via TRT: 3831773086

PUERTO RICO
San Juan
Tel: (809) 754-7936
Telex: 3450470

VENEZUELA
Caracas
Tel: 929198
Telex: 395-24164

Memorex Corporation

San Tomas at Central Expressway
Santa Clara, California 95052
(408) 987-1000
Telex 346 442