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MEMOREX 1980 Annual Report

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1961~1981

MEMOREX

For 20 Years the Expression of Excellence.

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For 20 Years the Expression of Excellence.

Memorex...
The First 20 Years

This annual report covers the 20th year of Memorex Corporation, which was founded on February 9, 1961.

Since then Memorex has become a significant force in the information storage and communications industries. Its annual revenues have reached more than three quarters of a billion dollars, and its skilled and dedicated employees number more than 11,000 around the world. With its innovative technology and its response to customer needs, it has helped to shape the industries in which it competes. Starting with computer tape in 1961, Memorex moved into video recording tape in 1963, recording discs and storage equipment in 1967, and consumer audio recording and communications equipment in 1970.

Memorex is an integrated company with broad strengths in engineering, manufacturing, and marketing. It designs and produces most of its own products, including their major components, thus optimizing performance and quality. It has manufacturing plants in four countries, 130 sales and service offices in 22 countries, and distributors or agents in 60 additional countries.

In Memorex's young and dynamic industries, 20 years of business represent a huge reservoir of experience and expertise. In its second 20 years, Memorex will play a still larger role in applying technology to the world's information storage and communications needs.

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Letter to Shareholders

C.W. Spangle, Chairman and Chief Executive Officer (left), and Charles S. Strauch, President and Chief Operating Officer

Memorex has just completed its first 20 years, and its progress in those years has been remarkable.

It has one of the largest and most effective worldwide marketing organizations in the industry.

Its research and development capability keeps it in the forefront of key disciplines needed to meet changing customer needs with new products.

Its annual revenues are more than three-quarters of a billion dollars.

Memorex has accomplished these things in an industry of high technology, and hence of high risk. While revenues have developed steadily over the past 20 years, profits have not shown steady progress.

In 1980 a number of difficulties converged to bring disappointing results for Memorex. Although revenue increased by 4 percent to a record level of $769 million, Memorex lost $29 million, or $4.42 per share. This compares with net income of $31.5 million or $3.91 per share in 1979. A substantial portion of the loss for 1980 was attributable to write downs and other charges, most of which were taken during the second quarter.

The 1980 results were due in part to economic conditions—inflation, high interest rates and recession. They were also due in part to Memorex's own operations—high manufacturing costs and inventory charges, and startup costs on a number of new products. Also contributing to the results were reduced equipment sales to third party financing institutions. This was due in part to our emphasis on reducing third party financing of operating leases because of the shortage of these funds on acceptable terms.

Throughout the year your management addressed these issues aggressively to restore Memorex's profitability and set it on a proper course for the 1980s. As a result, operating performance did improve in the last two quarters of 1980. However, given the array of problems and opportunities with which the Company is currently dealing, a steady quarter-by-quarter improvement is not expected, and a return to consistent profitability can be foreseen only over a longer term.

Early in 1980 your management began a series of reorganizations throughout the Company to effect economies of scale and to establish a proper business focus, relative to our competition, in the changing marketplace.

We recognized customer engineering as a business of its own, put the U.S. customer engineering force into a single organization under its own vice president and improved its performance.

International activities account for nearly one-half of our revenues. We increased the effectiveness of our international business by consolidating all non-U.S. sales and service into a single group, Memorex International, headquartered in London.

Several corporate operating committee positions were consolidated or eliminated. We combined all storage equipment manufacturing, whether for the end-user or original equipment manufacturer (OEM) markets, into a single organization. At the same time we combined large storage equipment development engineering, marketing, and U.S. sales and service into one group.

We also recently combined the Computer Media and the Consumer Products groups into a single Media Products Group.

Management of assets was improved. Inventories were sharply reduced—by $20 million in the last quarter of 1980. By year's end, days sales in receivables were the lowest in recent years. In addition, operating cash flow (increase in cash net of new borrowings) in the fourth quarter was positive for the first time since the third quarter of 1977.

Just after the year's end we entered into two real estate transactions which, together, give Memorex added future flexibility. We repurchased our headquarters buildings that we had been leasing since 1972, thus gaining full control of this asset. We contracted for the sale of 24 acres of vacant land next to our Santa Clara headquarters, in keeping with Memorex's policy of converting under-utilized assets into investment funds for the future.

Manufacturing costs continue at a high level, but action is being taken to reduce them. We are improving manufacturing procedures where necessary and investing in production processes that should both reduce cost and further enhance quality. We are also adding new production to our lower cost operations in Ireland and Mexico.

Besides these financial and operating improvements in the last half of 1980, other steps were taken during the year to strengthen the company's future.

We introduced or brought to volume production a number of new products to bring improved performance to our customers.

In computer media, Memorex introduced a new coating process for rigid discs, the M Formula, which improves recording characteristics and significantly advances the state-of-the-art. This is another step in increasing the density of recording surfaces for the next generation of disc drives.

Initial shipments were made on the 101 8-inch mini disc drive for the small system OEM market and production was increased on the 3652 disc subsystem for the large end-user market.

The Intelligent Dual Interface (IDI) feature, which increases the throughput for computer systems using the 3650 and 3652 disc drives, was widely installed and won excellent customer acceptance around the world.

In communications products, the 2078 display station was introduced early in the year; production and shipments increased sharply and customer satisfaction has been excellent.

Just after the end of the year our consumer audio tape operations introduced a new metal particle formulation, Metal IV, which gives Memorex a new high-performance, high-quality coating to serve the top of the audio market.

To assure that Memorex continues to assert competitive leadership through future products, our commitment to research and development continued to grow. R&D expenditures reached $34.6 million, a 22 percent increase over those in 1979.

The Recording Technology Center brought its intensive, four-year program for thin-film-head technology to the product engineering stage, and Memorex announced that it is developing a thin-film technology disc storage subsystem of 1.26 billion bytes per spindle. To speed the use of thin-film technology in their future products, Memorex and Control Data Corporation signed a technical information exchange agreement covering work on thin-film heads and head-arm assemblies.

Memorex has also joined with Dainippon Ink and Chemicals, Inc. in a company that will carry on Memorex's word processing supplies business.

Important management changes were made during the year.

In February, Robert C. Wilson retired as chief executive officer. He provided challenging and effective leadership for the Company during some of its most difficult years. C.W. Spangle became chief executive officer on March 1.

Charles S. Strauch, who had been executive vice president since January 1979, became president and chief operating officer in May.

In April, James A. Unruh joined Memorex as vice president, Finance. He had held a similar position with Fairchild Camera and Instrument Company.

After the year's end Richard W. Martin, previously president of the Communications Group, was appointed president of the combined Media Products Group.

Paul L. Klein, formerly marketing vice president of the Communications Group, was made its president.

In the period ahead, the data processing market will continue to grow. In the next 20 years our industry will become the second largest—after energy. Memorex can and will continue to offer high-quality, cost effective products—and thus will continue to grow with the industry.

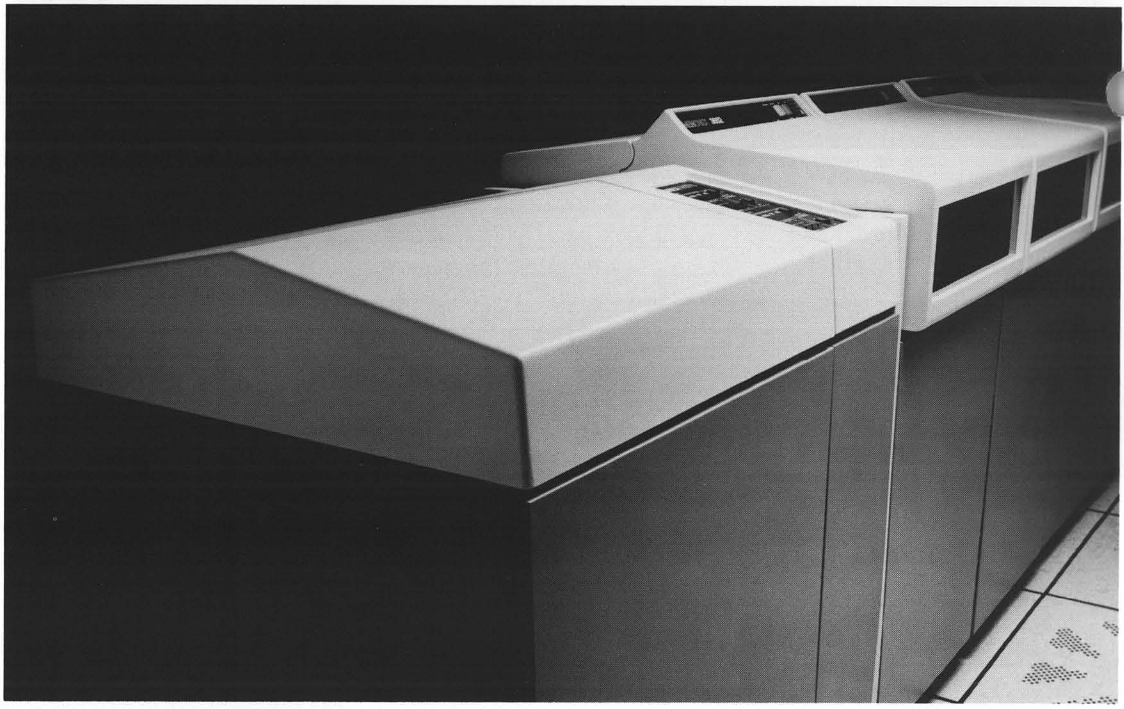
For our 20th anniversary year of 1981, your management's priority objective is to improve profitability. The environment for this goal in 1981 presents a mixed picture. On the one hand, the recession of 1980 is fading, and there is a prospect for some U.S. tax relief. On the other hand, inflation continues at a double-digit level, interest rates remain high, and the strengthening dollar is putting pressure on the profitability of our international operations.

Memorex faces a challenge in 1981 and in the years beyond. However, the more than 11,000 Memorex employees have demonstrated their ability to meet challenges in the past, including the challenge of 1980, and their continuing dedication constitutes our most important strength in the future. Among Memorex's many other lasting assets is its large base of loyal customers around the world. With these and other vital resources, we are confident that Memorex will continue to develop and improve its operations in the years of opportunity ahead.

CW Spangle

C.W. Spangle
Chairman and Chief Executive Officer

Storage Systems



The new 3676 controller (foreground) serves twice as many disc drives as its predecessor, with higher reliability and lower power and space requirements. Shown with it is the 3652 disc storage subsystem, which provides a capacity of 635 million bytes of on-line data per spindle.

Worldwide usage of Memorex data storage products continued to expand in 1980 as new data processing systems were installed, and as existing ones were upgraded. Memorex serves the data processing market with advanced hardware, software and technical services. During the past year, sizable investments were made in technology, engineering, manufacturing and marketing to further enhance the company's ability to serve its end-user and OEM customers.

Added Focus on New Product Development

Product innovation has been a hallmark of Memorex's growth since its formation 20 years ago. To help secure the company's future product leadership in data storage equipment, added focus was placed on advanced technology, product development and product planning functions throughout 1980. This is enabling Memorex to offer higher customer value in established product lines, and to bring new products to market at a more rapid pace.

In research and development, spending in key technologies reached record levels as Memorex scientists continued to extend the previous technical limits of materials and components used in computer data storage and retrieval. These important investments have placed the company in the forefront of digital recording technology.

Through ongoing R&D programs in Memorex's Recording Technology Center (RTC) in Santa Clara, California, major progress was made in the application of thin-film technology to the company's next-generation disc storage subsystem. Disc drive engineering prototypes using thin-film read/write heads were built and are being tested. Concurrently, a thin-film head manufacturing pilot line is being established in the RTC to aid Memorex in evaluating and refining head design before qualification for volume production.

In addition to these programs, Memorex entered into a thin-film technology exchange agreement with Control Data Corporation. This strategic action by management is expected to accelerate the availability of Memorex's planned thin-film technology product line.

To extend product leadership in the rapidly growing OEM disc drive business, the company again increased R&D and engineering investments in its 8-inch and 14-inch rigid disc drive lines during 1980.

New Investments in Plant and Equipment

To maintain a balance between rising demand for its products and product availability, Memorex continued on a program to expand manufacturing capacity and more fully automate critical production and test processes for both end-user and OEM disc storage equipment.

A major phase of the program included construction of added capacity for production of Head-Disc Assemblies (HDAs) used primarily in the company's 3650 and 3652 end-user disc drives. This addition has enabled the company to increase manufacturing volume of HDAs while achieving improved quality in the finished product. Because of the extremely precise tolerances engineered into Memorex HDAs, all component assembly work is performed in air-filtered clean room areas to assure a contamination-free environment.

With its continuing emphasis on product quality and reliability, Memorex also invested in new test equipment and processes for disc drive components and subassemblies during the year. In many cases it has been desirable for the company to

Production units of the 101 8-inch mini disc drive are undergoing final test in the Company's 100,000 square-foot plant in San Jose, California.

design and build its own test systems. One of these is a highly sophisticated, proprietary HDA servo-writer.

In OEM equipment products, a 100,000 square-foot plant in San Jose, California, was acquired for production of 8-inch rigid disc drives. This new plant is highly automated and designed for high-volume manufacturing.

Protecting User Investments in Data Processing

The company's marketing strategy has been to protect its customers' investments in data processing by offering ongoing enhancements to improve computer system performance and extend product life. This strategy was further emphasized in 1980 with the increased availability of the Intelligent Dual Interface (IDI).

Memorex's exclusive IDI feature enhances system throughput by providing two simultaneous data transfers per string of disc drives, and narrowing resource contention down to the individual disc drive spindle. This reduces processor load, permitting programs to be run up to 30 percent faster in certain applications. IDI is now available with Memorex's 100-, 200-, 317.5- and 635-megabyte disc subsystems.

The 3773 disc cache incorporates a microprocessor and high-speed semiconductors. In combination with the company's disc drives, the 3773 provides a data management system capable of significantly improving data input/output efficiency in certain applications.

The company plans to broaden further the disc drive line with a thin-film technology subsystem offering 1.26 billion bytes of storage capacity per spindle. This product, utilizing Memorex-designed thin-film read/write heads, will provide added value to customers requiring high-performance, cost effective on-line data storage.

The company also offers a high-performance tape subsystem for a wide range of applications. The 3220 tape storage subsystem continues to be the performance and quality leader in large system tape storage, with models available for 800-, 1600- and 6250-bpi (bits-per-inch) usage in either 125- or 200-ips (inches-per-second) tape speeds.

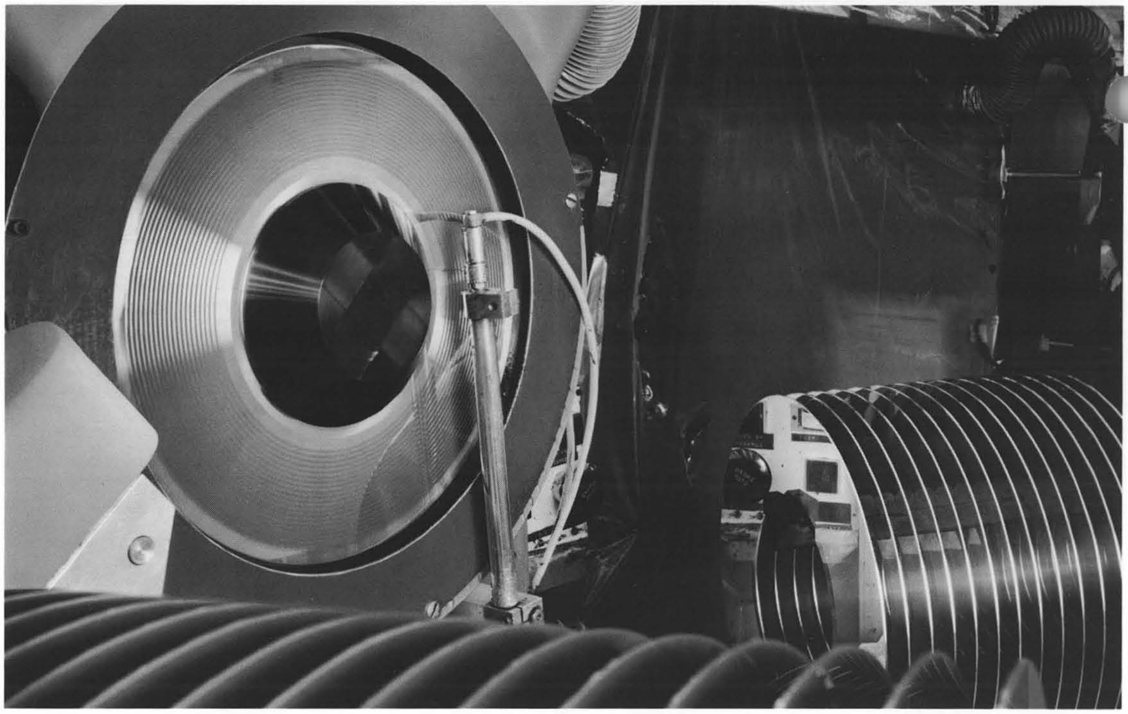
Added responsiveness to customer needs was also achieved during 1980 as sales and service regions in the United States were consolidated into four areas. At the same time, field sales and service functions, which had been part of a single operation, were split into two separate organizations, each under the direction of a vice president. All of these actions enabled Memorex to shorten lines of communications between field and headquarters personnel, and provide greater focus on the customer needs served by each organization. Memorex operates 70 sales and service offices, with 700 customer engineers, in the United States.

OEM Equipment Product Lines Strengthened

Memorex continued to broaden its OEM equipment offerings in 1980 with the introduction of new 8-inch and 14-inch rigid disc drives. In the 8-inch product area, Memorex announced the 23.4-mebabyte model 102 and the 25-megabyte model 201. The 201 features a fixed disc/removable cartridge design.

The 14-inch product line includes both disc pack and HDA-type storage devices ranging in capacities from 25 to 688 megabytes. During the year, new 14-inch drives were added to the line. These included the 25/50/84 megabyte model 612 and the 688-megabyte model 659.

Media Products



M Formula, a revolutionary rigid disc coating developed by Memorex, is applied to both sides of the disc as it spins rapidly to distribute the coating to a specified thickness.

Computer Media

Memorex is one of the world's leading suppliers of computer media products, including a full line of computer tape, rigid disc products, flexible discs, plastic components, and word processing supplies.

M Formula Redefines State-of-the-Art

In 1980, Memorex enhanced its reputation as a technology leader when it introduced the rigid disc products featuring the M Formula coating mixture, which advanced the magnetic coating state-of-the-art.

The smoother surface achieved by M Formula reduces noise, provides the highest signal-to-noise ratio in the industry, and improves head-flying uniformity. Combined with their durability, M Formula discs provide greater data integrity.

Memorex introduced two rigid disc products in 1980—the Guardian line of disc cartridges and the CMD-16 cartridge module, a 16-megabyte cartridge.

Flexible Disc Expands Products

Memorex introduced two new flexible disc products in 1980—a double-density, 5¼-inch mini flexible disc and a single-density, 5¼-inch mini flexible disc.

Flexible disc operations are being expanded with the addition of a converting and packaging line in the Memorex plant in Clondalkin, Ireland.

Teijin Memorex Corporation—a company owned jointly by Memorex Corporation, Memorex Japan, Limited and Teijin Limited—is a full-scale converting and finishing operation in Mihara, Japan. During 1981 this plant will also incorporate a coating line for flexible media.

Continuing Leadership in Computer Tape

During 1981 Memorex plans to invest substantially in upgrading the manufacturing processes for finishing, testing and packaging computer tape.

For two decades, Memorex has provided product, market and technology leadership. It has a full line of computer tape products. Cubic HD, with a new proprietary oxide coating and improved process control, offers better signal recovery on today's high density, 6250-bpi, computer tape drives. Geo-XL computer tape is used in the growing geoseismic market. Quantum computer tape is particularly suited for critical data storage. Memorex IV is a premium quality work tape for universal applications.

All computer tape products are offered on Memorex's advanced SuperReel tape reel, designed to meet the demands of today's high-performance tape drives.

New Developments in Word Processing Supplies

In 1980 the Company opened a manufacturing and distributing facility in Summerville, South Carolina. Memorex also participates with Kores Nordic Ltd. of the United Kingdom in a joint venture which coats correctable film.

In February, 1981, Memorex and Dainippon Ink and Chemicals, Inc., of Tokyo, Japan, entered into an agreement that established a new joint company. Memorex transferred its Word Processing Supplies Division to the new company and Dainippon purchased a 43 percent interest in the new venture called Memorex DIC Corporation, which will be headquartered in Santa Clara.

Growth in Precision Plastics

Located in Irvine, California, Memorex's precision plastics operation is a leading manufacturer of plastic components for computer media.

Precision Plastics provides products for Memorex media and equipment and sells products to a growing outside customer market.

Among the new products introduced in 1980 was the 5440 topload cartridge for rigid discs, which offers ease of assembly for OEM customers.

New packaging for the worldwide Memorex audio and video cassette product lines was developed to reflect their high quality.

Consumer Products

Memorex provides a growing line of high-quality audio and video tape products and accessories for the consumer market.

Enhanced Research and Development Focus

Consumer products development has been augmented with a research team drawn from the former Magnetic and Chemical Technology Center to create an R&D function dedicated to accelerating Memorex's leadership position in the consumer products industry.

Among the current areas of research are an electron-beam cure process in making video tape, and water-based formulations and high-quality oxides for audio tape.

Landmark Year in Consumer Product Development

In 1980, Memorex observed the tenth anniversary of the company's entry into the consumer products field. During the year, Memorex introduced more new consumer products than in any previous five-year period. New products will replace the entire audio and video product lines by early 1981. Each of the new products has a new oxide formulation and improved mechanics, and each sets a new standard of performance. These products will be packaged in a new award-winning, patented audio cassette album.

MRX I, a completely new and improved normal-bias tape, replaces America's best-selling single brand, the MRX_3 cassette. MRX I has a better signal-to-noise ratio than any other tape in the normal-bias class, and even outperforms some competitive tape in the high-bias class.

The new High Bias II audio tape has a frequency response rivaling those of most metal tapes.

Memorex Metal IV, the new metal particle tape, represents the state-of-the-art in audio tapes. It provides the ultimate in accurate cassette sound reproduction.

Further new product developments included a newly formulated and repackaged VHS video cassette and the introduction of the Beta cassette to give Memorex a full line of home video products. The new VHS formulation offers higher output, increased durability, longer head life and greater reliability.

Memorex's distribution of home video products continues to expand rapidly, aided by the company's well-established distribution base system for audio products.

Advances in Manufacturing, Quality Assurance

All video tape manufacturing has been relocated to a new clean-air facility. Significant investments have been made in refurbishing existing coating equipment, creating a state-of-the-art solvent recovery system, and automating equipment for assembly and quality control.

Tape finishing capacities were increased at the Memorex media plant at Clondalkin, Ireland, which now supports most of the audio marketing in Europe.

Memorex has continued its joint venture with Bell & Howell and expanded the capacity for assembly and packaging of home video cassettes.

Consumer Products Get a New Look

As the result of extensive market research and testing, new packaging was developed for the worldwide audio and video cassette product lines. The new packaging is designed to better reflect the high quality of Memorex products.

The new product and packaging changes will receive continued support from Memorex's national advertising program featuring the shattering glass demonstration and "Is it live or is it Memorex?" slogan.

Communications Products

Following completion of final quality test, these Memorex 2078 Display Stations are lined up awaiting packaging for shipment to customers around the world.

Memorex entered the fast-growing data communications business as early as 1970 with its 1270 Terminal Controller, which still continues as a popular product through added features and enhancements. New products such as a programmable communications controller, remote cluster controller, display stations and printers have been added.

Two Thrusts for Communications Technology

Today the data communications industry is being shaped by the customer's need to communicate between remotely located computers and terminals, especially between dissimilar terminals and computer equipment. This worldwide network requirement is being addressed by two industry approaches known as the Systems Network Architecture and the X.25, which is used by public networks. Memorex is developing products to participate in both.

Further Improvements in Manufacturing

Along with the development of new technology, manufacturing and quality assurance received management priority in 1980.

In communications product manufacturing, Memorex installed a new transporter system to boost production and quality control of its 2078 Display Station. The system is also adaptable to products similar to the 2078.

As part of its commitment to quality, Memorex continues to add superior test equipment. New equipment, programs and processes have been added to improve the ability to analyze defects and determine the causes, so these can be promptly corrected.

Communications Product Line is Expanded

The most important communications product introduced by Memorex in 1980 was the popular 2078 Display Station, which was engineered to make the operator's job faster, easier and less fatiguing.

Other new communications products for 1980 include the 2076 Remote Cluster Controller, the Model 1300/1373 Screen Printer, the 2087 Matrix Printer, the 1270 Model 8 Terminal Control Unit, and the 2056 Matrix Printer for systems 34 and 35.

In addition, Memorex extended its present product line with new additions to software programs for the 1380 Communications Controller and a high-speed asynchronous line adapter for the 1270 Terminal Control Unit.

All of these additions reflect Memorex's commitment to maximize customer value in installed Memorex communications equipment through a continuing series of hardware/software enhancements.

New Strengths in Marketing

The marketing and sales organizations for Memorex communications products in the United States were significantly improved during 1980.

A sales force dedicated to selling Memorex communications products was formed, headed by five regional communications sales managers. Complementing this team is an even larger number of dual-purpose sales representatives.

By creating this sales organization dedicated to communications products, Memorex has completed its objective of establishing data communications as a comprehensive, fully integrated business. This business should continue to grow rapidly with the development of large-scale networks to handle data communications on a global basis.

Worldwide Operations

During 1980, production of the 1377 Display Station was centered in the Memorex plant in Liege, Belgium. Computer media products are also manufactured at Liege for the European market.

Memorex operates a total of 130 company sales and service offices in 22 countries, and uses over 50 distributors and agents in 60 more countries.

Plants Operated in Four Countries

Memorex also operates manufacturing plants in four countries. These include eight equipment and media plants in California; a printed circuit board facility in Eau Claire, Wisconsin; a word processing supplies plant in Summerville, South Carolina; an assembly plant in Nogales, Mexico, with a support facility in Tucson, Arizona; a computer media and communications product plant in Liege, Belgium; and an audio cassette and flexible disc plant in Clondalkin, Ireland.

During 1980, production of the 1377 display station was centered in the Liege plant.

The company is also engaged in joint ventures with other companies for manufacturing Memorex products. With Bell and Howell, a factory for home video tape cassettes is located in Lombard, near Chicago. A word processing supplies plant is operated with a British firm, Kores Nordic, Ltd., at Summerville, South Carolina, near Memorex's own plant there.

The Memorex word processing supplies business is now conducted through an affiliation with Dainippon Ink & Chemicals, Inc. With Teijin Limited, Memorex operates a flexible disc plant in Mihara, Japan.

Improvements Made in Marketing

During 1980, steps were taken to streamline the sales and service organizations to reduce overhead, shorten lines of communications, and give still faster response to customer needs.

In the United States, nine regions were consolidated into four areas, plus a Federal region in the District of Columbia. Customer engineering functions were placed in a single organization with its own vice president.

International operations, previously carried out by two groups headquartered in California and the United Kingdom, were combined into a single worldwide organization.

International Marketing Through Four Regions

Headquartered in London, the Memorex International Group is divided into four regions. One region covers Southern Europe and Latin America, including Italy, France, Spain, Mexico, Venezuela, Brazil and Puerto Rico. Another includes Scandinavia, the United Kingdom, Ireland, Canada, and Australia. The third covers a Central European area—the low countries, West Germany, Switzerland and Austria. Due to its unique importance, Japan is a fourth region.

From the beginning of its international activity in 1964, Memorex's policy has been to rely on nationals to manage operations in each country. Every international subsidiary is staffed and managed by nationals of that country.

During 1980 a sales and service office was opened in Scotland, based in Livingston, West Lothian. Paris headquarters for the subsidiary in France were moved to a new and expanded location. The Netherlands headquarters were reestablished in larger offices in Marssenbrock. The Canadian headquarters in Toronto were also expanded.

International operations added software packages to its line in 1980, and established a separate sales force for OEM products.

Financial information on business segments and foreign operations is presented on pages 23 and 24.

MEMOREX CORPORATION

Consolidated Statements of Operations

For the Years Ended December 26, 1980, December 28, 1979 and December 29, 1978

	1980	1979	1978
		Thousands	
Revenues			
Sales	$564,642	$563,404	$483,370
Rental and Service	204,019	174,357	149,896
Total Revenues	768,661	737,761	633,266
Costs and Expenses			
Cost of Sales	408,092	352,282	287,420
Cost of Rental and Service	142,855	122,713	96,769
Selling, General and Administrative	187,467	175,908	146,280
Research and Development	34,573	28,345	23,619
Interest Expense	24,932	16,176	13,640
Other Income and Expense, Net	(3,104)	(6,951)	(6,787)
Provisions for Product Phaseouts	6,000		
Total Costs and Expenses	800,815	688,473	560,941
Income (Loss) Before Income Taxes and Extraordinary Credit	(32,154)	49,288	72,325
Provision (Credit) for Income Taxes	(3,176)	17,744	30,377
Income (Loss) Before Extraordinary Credit	(28,978)	31,544	41,948
Extraordinary Credit—			
Income Tax Benefit from Utilizing Loss Carryforwards			8,249
Net Income (Loss)	$ (28,978)	$ 31,544	$ 50,197

	Primary	Primary	Primary	Fully Diluted
Income (Loss) Per Common Share				
Before Extraordinary Credit	$(4.42)	$3.91	$5.65	$5.64
Net Income (Loss)	$(4.42)	$3.91	$6.90	$6.88
Proforma Income (Loss) Per Common Share—Assuming preferred dividends had been payable at the maximum rate scheduled to be paid after 1980:				
Before Extraordinary Credit	$(4.60)	$3.73	$5.45	$5.44
Net Income (Loss)	$(4.60)	$3.73	$6.70	$6.68
Common Shares and Equivalents (Thousands)	7,232	7,578	7,198	7,220

See accompanying notes to consolidated financial statements.

MEMOREX CORPORATION

Consolidated Balance Sheets

December 26, 1980 and December 28, 1979

	1980	1979
	Thousands	
Assets		
Current Assets:		
Cash and Temporary Investments, at cost of $2,751 and $2,322 which approximates market	$ 15,135	$ 14,940
Accounts Receivable, less allowances of $6,439 and $4,205	135,747	145,076
Inventories	163,920	184,130
Prepaids and Other	6,035	6,146
Total Current Assets	320,837	350,292
Rental Equipment and Spare Parts, at cost less accumulated depreciation	115,170	110,172
Property, Plant and Equipment, at cost less accumulated depreciation and amortization	125,817	114,478
Other Assets	26,856	23,377
Total Assets	$588,680	$598,319
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current Debt	$ 54,001	$ 17,352
Accounts Payable	54,260	66,419
Accrued Income Taxes	11,496	22,669
Accrued Liabilities	68,505	64,160
Total Current Liabilities	188,262	170,600
Long-Term Debt	182,898	172,160
Deferred Income Taxes	7,680	14,260
Redeemable Preferred Stock—1,000,000 Shares Authorized:		
Series A—159,639 Shares Outstanding	15,964	15,964
Series B—499,490 Shares Outstanding	49,949	49,949
Total Redeemable Preferred Stock	65,913	65,913
Common Shareholders' Equity:		
Common Stock—Shares Authorized 30,000,000; 7,255,499 and 7,211,346 Outstanding (net of 78,804 Treasury Shares)	7,255	7,211
Additional Capital	96,806	96,375
Retained Earnings	39,866	71,800
Total Common Shareholders' Equity	143,927	175,386
Total Liabilities and Shareholders' Equity	$588,680	$598,319

See accompanying notes to consolidated financial statements.

MEMOREX CORPORATION

Consolidated Statements of Changes in Financial Position

For the Years Ended December 26, 1980, December 28, 1979 and December 29, 1978

	1980	1979	1978
		Thousands	
Funds were provided by:			
Operations—			
Income (loss) before extraordinary credit	$ (28,978)	$ 31,544	$ 41,948
Items included in determining income (loss) but not requiring (providing) funds—			
Depreciation and amortization—			
Rental equipment and spare parts	37,488	32,017	27,813
Property, plant and equipment	17,648	14,155	11,982
Intangibles	404	635	392
Provisions for product phaseouts	1,918		
Stock bonus plan		2,495	2,030
Deferred income taxes	(6,580)	8,852	10,290
Gain on purchase of subordinated debentures		(1,179)	(3,377)
Funds provided by operations before extraordinary credit	21,900	88,519	91,078
Extraordinary credit—Income tax benefit from utilizing loss carryforwards			8,249
Funds provided by operations after extraordinary credit	21,900	88,519	99,327
Long-term borrowings	18,640	52,557	50,000
Debt related to acquisition			12,115
Dispositions of property, plant and equipment	1,521	648	710
Common stock:			
Public offering			36,444
Exercise of warrants			5,114
Employee benefit plans	475	3,039	4,120
Total Funds Provided	42,536	144,763	207,830
Funds were used for:			
Net additions to rental equipment and spare parts (includes $10,670 in 1978 related to acquisition)	43,961	50,210	55,348
Additions to property, plant and equipment	30,951	37,749	31,181
Long-term debt becoming current	7,902	17,193	31,329
Purchase of convertible subordinated debentures, net		2,997	7,558
Additions of other assets (includes $5,177 in 1978 related to acquisition)	3,883	8,147	7,516
Dividends on preferred stock	2,956	2,956	2,798
Total Funds Used	89,653	119,252	135,730
Increase (Decrease) in Working Capital	$ (47,117)	$ 25,511	$ 72,100

	1980	1979	1978
Increase (decrease) in working capital by component:			
Cash and temporary investments	$ 195	$ (13,432)	$ 16,351
Accounts receivable	(9,329)	33,067	35,920
Inventories	(20,210)	40,251	58,564
Prepaids and other	(111)	2,133	(1,709)
Current debt	(36,649)	(5,809)	(4,793)
Accounts payable	12,159	(21,034)	(15,290)
Accrued income taxes	11,173	186	6,304
Accrued liabilities	(4,345)	(9,851)	(23,247)
Increase (Decrease) in Working Capital	$ (47,117)	$ 25,511	$ 72,100

See accompanying notes to consolidated financial statements.

MEMOREX CORPORATION

Consolidated Statements of Common Shareholders' Equity

For the Years Ended December 26, 1980, December 28, 1979 and December 29, 1978

	Common Stock Shares	Common Stock Amount	Additional Capital	Retained Earnings (Deficit)	Total
			Thousands		
Balance, January 1, 1978	5,513	$ 5,513	$ 44,831	$ (4,187)	$ 46,157
Net Income for 1978				50,197	50,197
Issuance of stock:					
Public offering	750	750	35,694		36,444
Warrant exercise	520	520	4,594		5,114
For employee benefit plans	248	248	5,902		6,150
Dividends on preferred stock				(2,798)	(2,798)
Balance, December 29, 1978	7,031	7,031	91,021	43,212	141,264
Net Income for 1979				31,544	31,544
Issuance of stock for employee benefit plans	180	180	5,354		5,534
Dividends on preferred stock				(2,956)	(2,956)
Balance, December 28, 1979	7,211	7,211	96,375	71,800	175,386
Net Loss for 1980				(28,978)	(28,978)
Issuance of stock for employee benefit plans	44	44	431		475
Dividends on preferred stock				(2,956)	(2,956)
Balance, December 26, 1980	7,255	$ 7,255	$ 96,806	$ 39,866	$143,927

See accompanying notes to consolidated financial statements.

Summary of Significant Accounting Policies

Consolidated Financial Statements

The consolidated financial statements include Memorex Corporation and its subsidiaries. Significant intercompany transactions have been eliminated. Investments in Memorex Finance Company and in various joint ventures generally operating as suppliers to the Company and others are accounted for using the equity method. The aggregate of such investments and the Company's equity in the investees' earnings for 1978, 1979 and 1980 are not material in relation to the consolidated financial statements.

Revenue Recognition

Revenue is recognized in accordance with the following methods:

- At the time of delivery or installation if products are sold to customers or third-party financing institutions;
- At the time of delivery or installation if under a lease transaction which qualifies as a sales-type lease; and,
- Ratably over the term of the contract for maintenance services and operating leases.

Inventories, Rental Equipment and Spare Parts

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

Depreciation and Amortization

Depreciation and amortization 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; capital lease—30 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.

Income Taxes

U.S. income taxes are not provided on the undistributed earnings of foreign subsidiaries or the Company's DISC subsidiaries since it is the Company's intention to indefinitely reinvest these earnings in foreign operations or qualified export assets. 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 30 years. Pension costs are funded as accrued.

Income (Loss) Per Common Share

Income per share amounts are computed by dividing income, adjusted to eliminate preferred stock dividends and interest on convertible subordinated debentures (net of income taxes), by the weighted average number of common shares outstanding plus common stock equivalents resulting from stock options, warrants and convertible subordinated debentures. Loss per share amounts exclude the effects of common stock equivalents since their inclusion would be anti-dilutive. When primary and fully diluted income (loss) per share are the same, only primary information is presented on the statement of operations.

Leasing Activities

The Company earns a significant portion of its revenues through leasing activities. Most leases with end users are either fixed-term leases (some of which are sales-type leases), under which the lessee is obligated to make payments over a term of generally 36 months or more, or cancellable leases, under which the lessee may terminate the lease upon relatively short notice. In mid-1980, the Company began using shorter fixed-term leases (typically 12 to 24 months) in preference to cancellable leases, neither of which are sales-type leases.

Third Party Transactions

The Company sells or assigns a significant portion of its rental equipment and related lease agreements to unrelated third-party financing institutions (Third-Parties). Such transactions qualify as sales for accounting purposes and aggregated $109,000,000, $134,000,000 and $130,000,000 in 1980, 1979 and 1978, respectively.

Transactions with one of these Third-Parties, Lease Financing Corporation, accounted for approximately $20,000,000, $52,000,000 and $74,000,000 of 1980, 1979 and 1978 sales, respectively. The arrangements between the Company and these Third-Parties vary due to lease terms, availability of funds, and other factors. Under longer fixed-term leases the Company generally receives an amount equal to the present value of the aggregate future rentals, agrees to perform maintenance for which it receives its normal charges and, in some cases, performs certain lease administration services. There is usually no remarketing obligation and, when there is, the Company is entitled to recover its costs. Under shorter fixed-term leases and cancellable leases, the Company typically receives an amount equal to a multiple of the monthly rentals and agrees to perform certain services and obligations with respect to the equipment and related leases, such as general lease administration, invoicing and collection of rentals, maintenance of the equipment, payment of insurance and personal property taxes, and remarketing of equipment which comes off lease. For these services and obligations, the Company generally receives its normal maintenance charges and a remarketing and administration fee. In some cases during 1980, a portion of the Company's proceeds from one Third Party included notes receivable.

Virtually all of the agreements with Third-Parties provide the Company with residual rights in revenues derived from the equipment after the Third-Parties have received a designated return. In most transactions the Company receives a percentage of residual revenues ranging from 50% to 100%. The Company began to receive residual revenues from some of the earlier Third-Party transactions in 1978. These revenues are reflected in results of operations as they are realized.

Inventories

Inventories, net of allowances for obsolescence and excess stock of approximately $21,268,000 and $6,900,000 as of December 26, 1980 and December 28, 1979, respectively, are as follows:

	1980	1979
	Thousands	
Raw materials	$ 48,040	$ 60,079
Work in progress	52,611	53,155
Finished goods	63,269	70,896
Total	$163,920	$184,130

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

Rental Equipment and Spare Parts

Rental equipment and spare parts (sometimes referred to as lease base) as of December 26, 1980 and December 28, 1979 are as follows:

	1980	1979
	Thousands	
Cost:		
Rental equipment:		
Computer peripheral equipment	$157,655	$148,865
Disc packs	13,360	14,150
Spare parts	52,395	47,649
Total	223,410	210,664
Accumulated depreciation:		
Rental equipment:		
Computer peripheral equipment	76,059	73,567
Disc packs	10,494	9,917
Spare parts	21,687	17,008
Total	108,240	100,492
Net	$115,170	$110,172

Rental equipment includes equipment installed in and used by various Memorex facilities in the amount of $10,100,000 and $9,200,000 as of December 26, 1980 and December 28, 1979, respectively; accumulated depreciation for this equipment was $4,905,000 and $4,475,000, respectively.

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 $18,000,000 and $22,300,000 as of December 26, 1980 and December 28, 1979, respectively. During 1980 and 1979, respectively, $11,300,000 and $10,800,000 of fully depreciated products which no longer had economic value were removed from the accounts.

Net additions to rental equipment and spare parts presented in the Consolidated Statements of Changes in Financial Position represent the excess of additions at cost over the net book value of equipment sold and other dispositions. Other dispositions include retirement of fully depreciated products which no longer have economic value.

Property, Plant and Equipment

Property, plant and equipment as of December 26, 1980 and December 28, 1979 are as follows:

	1980	1979
	Thousands	
Land	$ 9,291	$ 8,928
Buildings and improvements	40,491	37,518
Capital lease	15,205	15,205
Equipment, furniture and fixtures	132,747	107,373
Construction in progress	13,276	15,740
Total	211,010	184,764
Less accumulated depreciation and amortization	85,193	70,286
Net	$125,817	$114,478

The net book value of assets under the capital lease (primarily manufacturing facilities) was $10,981,000 and $11,488,000 at December 26, 1980 and December 28, 1979, respectively. On January 9, 1981, the Company acquired assets under the capital lease in exchange for approximately $17,300,000 of cash, notes and assumption of indebtedness. See Current and Long-Term Debt footnote.

The Company occupies certain 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 $18,300,000 in 1980, $14,100,000 in 1979, and $9,800,000 in 1978.

Minimum rental commitments under non-capitalized leases as of December 26, 1980 are as follows:

	Thousands
Year Ending December:	
1981	$10,461
1982	6,709
1983	4,702
1984	3,506
1985	2,402
Thereafter	21,421
Total	$49,201

Business Acquisition

In January 1978, the European marketing and service operations of Telex Computer Products, Inc. were acquired and its operations have been consolidated with the results of the Company since January 1, 1978.

Other Assets

Other assets as of December 26, 1980 and December 28, 1979 are as follows:

	1980	1979
	Thousands	
Intangibles arising from business acquisitions, net	$ 4,225	$ 4,629
Investment in sales-type leases, non-current	4,937	6,609
Trade receivables due after one year	4,712	2,700
Investments in affiliates	5,426	4,103
Other	7,556	5,336
Total	$26,856	$23,377

Accrued Liabilities

Accrued liabilities as of December 26, 1980 and December 28, 1979 are as follows:

	1980	1979
	Thousands	
Payroll	$24,195	$24,346
Taxes, other than income taxes	8,513	6,443
Interest	2,738	3,7[illegible]
Warranty reserves	2,565	2,0[illegible]
Minority interest in consolidated subsidiaries	5,113	4,328
Other	25,381	23,253
Total	$68,505	$64,160

Current and Long-Term Debt

Debt as of December 26, 1980 and December 28, 1979 is as follows:

	1980		1979	
	Current	Long-Term	Current	Long-Term
	Thousands			
Long-Term:				
Notes Payable, Banks	$ 25,587	$ 63,556	$ 13,122	$ 46,557
Notes Payable, Others	3,566	2,531	4,039	5,102
9¾% Notes, Due 1990	4,500	45,500	—	50,000
5¼% Convertible Subordinated Debentures Due 1990	—	50,576	—	50,576
7⅝% Industrial Development Revenue Bonds	—	6,000	—	6,000
Capital Lease Obligations	440	14,735	191	13,925
Total	34,093	182,898	17,352	172,160
Current Loans Payable to Banks	19,908	—	—	—
Total Debt	$ 54,001	$182,898	$ 17,352	$172,160

Current Loans Payable to Banks represent borrowings outstanding under two $10,000,000 one-year unsecured line of credit agreements with two domestic banks. These credit lines expire in March and May 1981, unless renewed. The types of borrowings available, interest rates and commitment fee arrangements are similar to those provided for in the revolving credit/term loan agreement described below.

Notes Payable, Banks comprises: $63,526,000 under the Company's revolving credit/term loan agreement described below; $4,667,000 (interest rates range from 11.5% to 19.3%) under a $20,000,000 credit agreement with Bank of America which expires on January 4, 1982 unless renewed by the bank; and $20,950,000 (interest rates range from 5.8% to 19.3%) payable to various foreign banks under agreements which are subject to renewal on an annual basis.

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 the form of domestic dollar advances, Eurodollar loans, Eurocurrency loans and bankers' acceptances; up to $40,000,000 of the $80,000,000 is available for domestic dollar borrowings.

The revolving period expires on January 4, 1982 with an option to convert all or part of the facilities into a term loan repayable in eight equal semi-annual installments. Outstanding borrowings (interest rates range from 10.6% to 23.1%) of $63,526,000 in the form of bankers' acceptances ($26,526,000), Eurodollar loans ($13,000,000) and domestic dollar advances ($24,000,000) under this agreement have been classified as long-term as it is management's intention to convert such borrowings to term loans.

The revolving credit/term loan borrowing arrangements provide for: interest rates ranging from below the participating banks' prime rates to 110% of such rates depending on the type of borrowing; the Company maintaining average non-interest bearing demand deposits (not legally restricted) with participating banks in amounts equal to 10% of average domestic dollar advances; a commitment fee equal to ½% per annum of the average unused portion of the credit line; and, a facility fee equal to 7½% of the bank's prime rate times the domestic portion of the credit line ($40,000,000). Commitment and facility fees aggregated approximately $600,000 in both 1980 and 1979. There were no such fees in 1978. At December 26, 1980 and during the year then ended, essentially no non-interest bearing bank deposits were required to support borrowings under this agreement.

Notes Payable, Others includes $3,816,000 in 6% notes payable in quarterly installments to Telex Computer Products, Inc. in connection with the Company's acquisition of certain of Telex's European operations in 1978 and $2,281,000 payable in varying installments to several domestic and foreign non-bank creditors.

The 9¾% 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 5¼% 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 $18,424,000 through December 26, 1980, net of $6,000,000 used to satisfy the 1980 sinking fund requirement.

On June 29, 1979, the Company entered into a 7⅝% $6,000,000 secured loan agreement (industrial development revenue bonds) with the City of Eau Claire, Wisconsin to cover costs associated with constructing and equipping its plant in Eau Claire. The principal is repayable at the rate of $600,000 per annum commencing in 1985.

Capital lease obligations include $210,000 current portion and $13,716,000 long-term portion relating to a lease of buildings used primarily as manufacturing facilities. On January 9, 1981 the Company purchased all of the assets subject to the above lease in exchange for $2,970,000 cash which had been deposited in escrow in December 1980 and which is included in other assets in the balance sheet, two notes aggregating $1,000,000 which bear interest at 12% and which are payable in 60 equal monthly installments, and the Company's assumption of the existing 8½% mortgage on the property in the amount of $13,314,000 which is payable at the rate of $112,000 (including interest) per month until September 2002.

Annual maturities of debt are: 1981—$54,001,000, 1982—$22,312,000, 1983—$21,145,000, 1984—$26,756,000, 1985—$27,324,000, and thereafter—$85,361,000. Approximately $27,575,000 of the Notes Payable, Banks and Others are payable in currencies other than the U.S. dollar.

Certain of the above agreements contain financial and other covenants relating to the maintenance of specified working capital and net worth levels, the incurrence of additional debt and payment of cash dividends on common stock. Effective in June 1980, the Company obtained one-year modifications of certain provisions in its agreements with lenders to provide for up to a $35,000,000 increase in its then existing borrowing capacity.

Redeemable Preferred Stock

As of December 26, 1980 and December 28, 1979, 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. Shares of Series A and B preferred stock were issued to senior lenders, principally Bank of America, under terms of loan agreements. 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.

The Series A has terms which provide for: cumulative annual dividends at $5 per share in 1978, $6 per share in 1979 and 1980 and $8 per share thereafter; sinking fund payments during 1983-1987 in equal annual amounts; and a liquidation preference over any other issue of stock.

The Series B has terms which provide for: cumulative annual dividends at $4 per share beginning in 1978 and increasing to $6 per share in 1981; sinking fund payments during 1983-1992 in equal annual amounts; and a 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 Shareholders' Equity

Common Stock

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 are 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	813,373
Common stock bonus plan	189,590
Total shares reserved	1,828,395

Retained Earnings

Under the most restrictive provisions of the Company's loan agreements, approximately $15,000,000 of retained earnings was available for the payment of dividends on common stock at December 26, 1980.

Other Income and Expense, Net

Components of other income and expense (net) are as follows:

	1980	1979	1978
		Thousands	
Interest income	$ 4,002	$ 2,588	$ 1,580
Gain on repurchase of debentures	—	1,179	3,377
Sale of non-exclusive license	—	1,125	—
Gain on sale of stock investment	—	—	1,400
Foreign exchange adjustments, net	(2,398)	2,059	430
Other	1,500	—	—
Total	$ 3,104	$ 6,951	$ 6,787

Product Phaseouts

In connection with actions taken to alleviate cash and profit pressures, management concluded to phase out certain older products. As a result, reserves in the aggregate amount of $6,000,000 were established in the second quarter of 1980 for anticipated inventory, lease base and property, plant and equipment losses as well as for estimated liabilities and operating losses during the phaseout periods.

Income Taxes

The provisions (credit) for income taxes are as follows:

	U.S.	Foreign	Total
		Thousands	
1980			
Pretax income (loss)	$ (37,671)	$ 5,517	$ (32,154)
State income taxes	$ 200	$ —	$ 200
U.S. Federal income taxes	(11,490)	—	(11,490)
Foreign income taxes	—	8,114	8,114
Provision (credit) for income taxes	$ (11,290)	$ 8,114	$ (3,176)
Current	$ (2,700)	$ 6,228	$ 3,528
Deferred	(8,590)	1,886	(6,704)
Provision (credit) for income taxes	$ (11,290)	$ 8,114	$ (3,176)
1979			
Pretax income	$ 23,242	$ 26,046	$ 49,288
State income taxes	$ 2,000	$ —	$ 2,000
U.S. Federal income taxes	2,790	—	2,790
Foreign income taxes	—	12,954	12,954
Provision for income taxes	$ 4,790	$ 12,954	$ 17,744
Current	$ 1,666	$ 10,685	$12,351
Deferred	3,124	2,269	5,393
Provision for income taxes	$ 4,790	$ 12,954	$ 17,744
1978			
Pretax income	$ 44,278	$ 28,047	$ 72,325
State income taxes	$ 3,208	$ —	$ 3,208
U.S. Federal income taxes	12,524	—	12,524
Foreign income taxes	—	14,645	14,645
Provision for income taxes	$ 15,732	$ 14,645	$ 30,377
Charge in lieu	$ 5,943	$ 2,306	$ 8,249
Current	3,208	11,345	14,553
Deferred	6,581	994	7,575
Provision for income taxes	15,732	14,645	30,377
Extraordinary credit—Loss carryforward benefits	5,943	2,306	8,249
Net provision for income taxes	$ 9,789	$ 12,339	$ 22,128

For financial reporting purposes, the Company provides deferred income taxes for timing differences between financial accounting and income tax accounting. Principal timing differences have related to U.S. income taxes and arose from: 1) the use of an installment method of revenue recognition for income tax purposes, 2) the use of accelerated depreciation methods for income tax purposes, 3) intercompany profits which are taxed but have been eliminated in the consolidated statement of operations, and 4) inventory valuation allowances which are not yet deductible in tax returns. As of December 26, 1980, cumulative timing differences for U.S. income tax purposes were insignificant and U.S. deferred income taxes at the beginning of the year were reversed.

Investment tax credits in the amount of $3,800,000 relating to 1979 acquisitions of qualifying property and equipment were recognized in 1979 for financial reporting purposes and the deferred tax liability was correspondingly reduced. Such tax benefit was reversed in 1980 as a result of the above-mentioned reversal of U.S. deferred income taxes. As of December 26, 1980, the 1979 investment tax credits, together with approximately $3,500,000 arising in 1980, are available for both financial and income tax reporting purposes to offset up to approximately $7,300,000 of future income taxes through 1987. For income tax purposes there is a Federal net operating loss carryforward of approximately $5,000,000 which expires in 1987 and certain foreign subsidiaries have net operating loss carryforwards aggregating approximately $11,000,000 as of December 26, 1980.

Undistributed earnings of foreign subsidiaries and the Company's DISC subsidiaries for which no U.S. income taxes have been provided aggregate approximately $50,000,000 as of December 26, 1980.

Income taxes for 1980, 1979 and 1978 at the Federal statutory rate are reconciled to the provision (credit) for income taxes for financial reporting purposes as follows:

	1980	1979	1978
		Thousands	
Computed tax expense (benefit) at Federal statutory rate	$ (14,791)	$ 22,672	$ 34,716
Increase (reduction) in taxes resulting from:			
Foreign subsidiaries—rate differences and losses with no current tax benefit	5,576	973	1,930
Undistributed earnings of DISC subsidiaries	—	(2,914)	(2,880)
Domestic loss carryforward with no current tax benefit	2,250	—	—
Investment tax credits	3,800	(3,800)	(6,000)
State taxes, net of Federal tax benefit	200	1,080	1,668
Other—net	(211)	(267)	943
Provision (credit) for income taxes	$ (3,176)	$ 17,744	$ 30,377
Federal statutory rate	46.0%	46.0%	48.0%
Effective rate	9.9%	36.0%	42.0%

The Internal Revenue Service has completed examinations of the Company's Federal income tax returns for the years 1975 through 1977. The Revenue Agents Report contains proposed adjustments for which additional income taxes would aggregate approximately $3,800,000 if the Service prevailed on all issues. The Company intends to defend vigorously against certain of the issues including, if necessary, recourse to the courts. In management's opinion, the ultimate settlement of this matter will not have a material adverse impact on the consolidated financial position or results of operations.

Employee Benefit Plans

Stock Option Plans

The Company has four stock option plans: the 1973 Stock Option Plan, for "non-qualified" options; the 1974 Stock Option Plan, for "qualified" options; the 1976 Stock Option Plan, for either "qualified" or "non-qualified" options; and the 1979 Stock Option Plan, for "non-qualified" options. Under these plans, options may be granted to key employees to purchase up to 1,735,000 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 Committee of the Board of Directors which administers the plans and all options granted through December 26, 1980 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:

	Options Available for Grant	Options Outstanding Number	Options Outstanding Price per Share
December 31, 1977	205,096	424,995	$1.45-31.06
Options granted	(143,000)	143,000	27.00-56.63
Options exercised	—	(173,454)	2.06-31.06
Options terminated	48,571	(50,527)	1.45-56.63
December 29, 1978	110,667	344,014	2.06-56.63
Options granted	(197,700)	197,700	20.25-38.13
Options exercised	—	(30,192)	2.75-31.06
Options terminated	46,054	(49,048)	2.06-56.63
Additional shares reserved	400,000	—	—
December 28, 1979	359,021	462,474	3.25-56.63
Options granted	(283,150)	283,150	12.06-18.25
Options exercised	—	(8,122)	3.25- 8.94
Options terminated	150,992	(150,992)	6.81-56.63
December 26, 1980	226,863	586,510	$8.70-56.63

In December 1979, certain employees were granted the right to exchange certain outstanding options for new options to purchase an aggregate of 144,200 shares at a per share price of $19.875.

At December 26, 1980, 118,712 options were exercisable at prices ranging from $8.70 to $56.63.

Information as to options which became exercisable and as to options which were exercised is as follows:

	1980	1979	1978
Became exercisable:			
Number of shares covered	85,099	57,822	74,226
Option price per share	$15.88-56.63	$7.25-56.63	$2.06-31.06
Aggregate option price	$2,122,338	$1,774,469	$1,374,342
Aggregate fair market value at date becoming exercisable	$1,261,957	$1,691,452	$2,584,417
Exercised:			
Number of shares covered	8,122	30,192	173,454
Option price per share	$3.25-8.94	$2.75-31.06	$2.06-31.06
Aggregate option price	$ 45,672	$ 266,920	$1,140,787
Aggregate fair market value at date exercised	$ 120,230	$ 948,063	$5,832,349

The net proceeds from sale of common stock upon exercise of stock options are added to the common stock and additional capital accounts. No amounts are charged or credited to operations.

Incentive Compensation Plans

There are incentive compensation and bonus plans for key management employees and, in 1980, for an increased number of key technical employees engaged in research and development projects. Incentive awards, which are charged to operations in the year earned, were approximately $1,700,000 in 1980, $2,600,000 in 1979 and $2,300,000 in 1978.

Pension Plan

The Company has a pension plan for the benefit of all eligible U.S. employees. Pension costs charged to 1980, 1979 and 1978 operations were approximately $3,100,000, $3,300,000 and $2,500,000, respectively. In December 1980, the Company modified certain actuarial assumptions (principally future salary increase rates) used in determining pension expense and funding requirements. This modification had the effect of reducing pension expense by approximately $1,200,000 from what it would have otherwise been in 1980.

The table below sets forth accumulated plan benefits and plan net assets (using an 8% assumed rate of return) for the 1980 and 1979 fiscal year ends based on actuarial valuations as of January 1 of each year.

	1980	1979
	Thousands	
Actuarial present value of accumulated benefits:		
Vested	$ 2,573	$ 1,170
Nonvested	3,502	3,266
Total	$ 6,075	$ 4,436
Net assets available for benefits	$11,199	$ 8,297

Common Stock Bonus Plan

Effective January 1, 1978, the Company adopted a common stock bonus plan (Employee Share 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. Nothing was payable under this plan for 1980 due to the loss for the year; amounts charged against operations for 1979 and 1978 aggregated $2,495,000 and $2,030,000. These amounts were payable after year-end by the issuance to a trustee of common stock. In this connection, 139,000 shares relating to 1979 are reported in the consolidated balance sheet as though they were outstanding at December 28, 1979.

Financing Subsidiary

In December 1978 the Company formed a subsidiary, Memorex Finance Company (MFC), which commenced active operations in 1979. The Company owns all of MFC's authorized and outstanding preferred stock ($2,700,000) and owns 80,000 shares of MFC's common stock which it purchased for $300,000. MFC employees owned the remaining 13,000 and 15,000 shares of outstanding common stock at the 1980 and 1979 respective year-ends and the Company has options to acquire shares owned by employees through 1985. An additional 7,000 shares are reserved for sale by MFC to key employees. The Company accounts for its investment in MFC under the equity method.

MFC was formed for the purpose of financing end-user equipment leases. These leases are either operating or finance type leases as defined by Financial Accounting Standard No. 13 and cover both Memorex and other equipment manufacturers' products which are packaged under a common lease. For domestic income tax purposes, the subsidiary is included in the Company's income tax returns; accordingly, the Company's income tax provision includes the tax effect relating to the subsidiary's pretax results of operations. Summarized financial information of the subsidiary as of and for the years ended December 26, 1980 and December 28, 1979 is as follows:

	1980	**1979**
	Thousands	
Assets		
Cash and Receivables	$ 3,346	$ 2,162
Investment in Sales-Type Leases	2,571	874
Rental Equipment, Net	3,443	1,576
Other	1,934	936
Total Assets	$11,294	$ 5,548
Liabilities		
Due to Memorex Corporation	$ 2,187	$ 264
Due to Financial Institutions ($661,000 due in 1981)	1,503	842
Other Liabilities	3,665	1,163
Total Liabilities	$ 7,355	$ 2,269
Shareholders' Equity	$ 3,939	$ 3,279
Operations		
Sales Revenue	$15,271	$13,242
Rental Revenue	2,021	1,132
Other	1,094	445
Total Revenue	18,386	14,819
Less Costs and Expenses	17,480	14,535
Income Before Income Taxes	$ 906	$ 284

Litigation

In 1973 the Company filed an action against IBM in the United States District Court for the Northern District of California alleging violation of the federal antitrust laws. At the trial the Company presented evidence of actual damages totaling $333 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. 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 appealed the trial court's rulings to the United States Court of Appeals for the Ninth Circuit. That court has denied the appeal. The Company intends to request that the United States Supreme Court review the case and rule upon the validity of the other courts' decisions. The Company is unable to predict whether or not the Supreme Court will hear the case or, if it should, what its decision might be.

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. IBM would also be entitled to recover certain costs of the appeal and interest. These amounts would approximate $500,000 should final judgment be entered against the Company. Both the Company and IBM have agreed not to contest this amount.

In 1979 the Company and various other parties including its independent accountants were named as defendants in two purported class actions. The complaints allege violations of the federal securities laws and state securities and common laws in connection with a public offering of the Company's common stock in August 1978. The plaintiffs seek damages, including punitive damages in an unspecified amount or, in the alternative, rescission of the stock purchased in the offering. The Company believes both lawsuits are without merit and intends to defend them vigorously. The cases are now in the discovery phase. Management is of the opinion that neither action will have a material adverse impact on operations or on the financial position of the Company.

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

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, home audio equipment users and users of electronic word processing and video equipment. The Company's products are principally distributed by its own sales force and, to a lesser extent, through independent distributors. Operations are conducted worldwide and are grouped into three geographic areas: United States; Europe, Middle East and Africa; and Americas and Asia.

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 Third-Party Transactions for sales to a customer (Lease Financing Corporation) exceeding 10% of total revenues in 1978. No single customer accounted for 10% or more of the Company's total revenues in 1980 or 1979.

The following tables summarize the operations of the Company on a geographic and on a product line basis as of December 26, 1980, December 28, 1979 and December 29, 1978 and for the years then ended.

Geographic Basis *(Thousands)*	REVENUES			OPERATING INCOME (Loss)			Identifiable Assets
	External	Internal	Total	External	Internal	Total	
1980							
United States	$414,564	$127,156	$541,720	$ (16,959)	$ 27,530	$ 10,571	$340,936
Europe, Middle East & Africa	268,416	—	268,416	3,757	—	3,757	174,000
Americas & Asia	85,681	—	85,681	12,532	—	12,532	73,548
General Corporate	—	—	—	(9,656)	—	(9,656)	25,252
	768,661	127,156	895,817	$ (10,326)	27,530	17,204	613,736
Elimination	—	(127,156)	(127,156)	—	(27,530)	(27,530)	(25,056)
	$768,661	$ —	$768,661	$ (10,326)	$ —	$ (10,326)	$588,680
1979							
United States	$379,260	$172,923	$552,183	$ 41,602	$ 40,173	$81,775	$333,271
Europe, Middle East & Africa	279,150	—	279,150	21,882	—	21,882	203,610
Americas & Asia	79,351	—	79,351	9,137	—	9,137	66,746
General Corporate	—	—	—	(14,108)	—	(14,108)	26,688
	737,761	172,923	910,684	58,513	40,173	98,686	630,315
Elimination	—	(172,923)	(172,923)	—	(40,173)	(40,173)	(31,996)
	$737,761	$ —	$737,761	$ 58,513	$ —	$ 58,513	$598,319
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

Product Line Basis *(Thousands)*	Revenue	Operating Income (Loss)	Identifiable Assets	Depreciation		Capital Expenditures	
				Prop. Plant & Equip.	Rental Equip. & Spare Parts	Prop. Plant & Equip.	Rental Equip. & Spare Parts
1980							
Equipment Products	$501,343	$ (14,629)	$410,077	$ 9,069	$ 34,954	$ 15,634	$ 42,794
Media Products	267,318	13,959	153,351	7,566	2,534	15,220	1,167
General Corporate	—	(9,656)	25,252	1,013	—	97	—
	$768,661	$ (10,326)	$588,680	$ 17,648	$ 37,488	$ 30,951	$ 43,961
1979							
Equipment Products	$490,899	$ 45,710	$407,515	$ 6,277	$ 28,569	$ 23,325	$ 48,228
Media Products	246,862	26,911	164,116	6,777	3,448	13,485	1,982
General Corporate	—	(14,108)	26,688	1,101	—	939	—
	$737,761	$ 58,513	$598,319	$ 14,155	$ 32,017	$ 37,749	$ 50,210
1978							
Equipment Products	$424,726	$ 77,775	$311,360	$ 4,645	$ 23,877	$ 17,562	$ 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	$ 31,181	$ 55,348

- Operating income (loss) is derived by adding interest expense and other income and expense (net) to income (loss) before income taxes and extraordinary credit.
- Internal revenues of United States operations arise 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.

Subsequent Event

Modification to Credit Agreement

On March 13, 1981, the Company obtained a modification, effective January 30, 1981, to its revolving credit/term loan agreement. This modification, which now requires the Company to maintain at least $180 million of tangible net worth (as defined), expires on May 30, 1981. Although no assurances can be given, management believes that it will be able to obtain changes to this and its other credit agreements so that the Company will not be in violation of any covenants when the January 30, 1981 and June 1980 modifications expire.

Report of Independent 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 26, 1980 and December 28, 1979 and the related consolidated statements of operations, common shareholders' equity, and changes in financial position for each of the three years in the period ended December 26, 1980. 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 26, 1980 and December 28, 1979 and the results of their operations and the changes in their financial position for each of the three years in the period ended December 26, 1980, in conformity with generally accepted accounting principles consistently applied.

Deloitte Haskins & Sells

San Jose, California
January 27, 1981
(March 13, 1981 as to note on subsequent event).

Quarterly Summary (Unaudited)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
		Thousands		
1980				
Sales revenues	$136,660	$135,452	$138,078	$154,452
Rental and service revenues	48,229	50,287	51,776	53,727
Total Revenues	184,889	185,739	189,854	208,179
Cost of sales, rental and service	126,381	136,728	138,092	149,746
Selling, administrative and development	52,637	61,514	52,740	55,149
Interest expense	5,923	6,381	5,959	6,669
Other income and expense, net	(1,780)	(358)	(731)	(235)
Provisions for product phaseouts	—	6,000	—	—
Total Costs and Expenses	183,161	210,265	196,060	211,329
Income (loss) before income taxes	1,728	(24,526)	(6,206)	(3,150)
Provision (credit) for income taxes	622	(2,822)	(600)	(376)
Net Income (loss)	$ 1,106	$ (21,704)	$ (5,606)	$ (2,774)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
		Thousands		
1979				
Sales revenues	$136,124	$138,991	$140,664	$147,625
Rental and service revenues	41,824	42,307	44,328	45,898
Total Revenues	177,948	181,298	184,992	193,523
Cost of sales, rental and service	109,363	113,560	119,407	132,665
Selling, administrative and development	47,767	48,883	52,558	55,045
Interest expense	3,530	3,476	4,335	4,835
Other income and expense, net	(2,307)	(991)	(1,236)	(2,417)
Total Costs and Expenses	158,353	164,928	175,064	190,128
Income before income taxes	19,595	16,370	9,928	3,395
Provision for income taxes	7,838	5,819	2,854	1,233
Net Income	$ 11,757	$ 10,551	$ 7,074	$ 2,162

Per Common Share	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Primary net income (loss):				
1980	$ .05	$ (3.11)	$ (.88)	$ (.48)
1979	$ 1.47	$ 1.32	$ .87	$ .20
Fully diluted net income (loss)				
1980	$ .05	$ (3.11)	$ (.88)	$ (.48)
1979	$ 1.47	$ 1.32	$ .87	$ .20
Fully diluted proforma net income (loss), assuming preferred dividends had been payable at maximum scheduled rate after 1980—				
1980	$ .01	$ (3.15)	$ (.92)	$ (.53)
1979	$ 1.43	$ 1.27	$ .83	$ .15

Notes to Quarterly Summary

The annual effective tax rates for 1980 and 1979 were 9.9% and 36%, 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. The interim rates are as follows.

	1980	1979
First Quarter	36.0%	40%
Second Quarter	11.5%	36%
Third Quarter	9.7%	29%
Fourth Quarter	11.9%	36%

Fourth quarter 1980 results were unfavorably impacted by provisions of approximately $2.5 million for certain parts inventory which did not meet the Company's specifications and by a loss of $.7 million on the agreed sale of the Company's domestic add-on memory business. Results for the quarter included a favorable impact of approximately $1.2 million representing the cumulative 1980 effect of a modification to an actuarial assumption used in calculating pension plan costs.

Third quarter 1980 results were unfavorably impacted by inventory charges of approximately $2 million resulting from a reduction in scheduled production of the Company's disc cache product.

Second quarter 1980 results included charges totaling $15.5 million which were not principally attributable to normal operations. These charges included: 1) reserves aggregating approximately $6 million for anticipated write-downs of potentially excess inventories and other assets, as well as for expected operating losses, as a result of decisions made to phase out certain older products; 2) inventory adjustments in the net amount of approximately $3.5 million for certain other products where quantities were in excess of estimated requirements, offset partially by the favorable results of a physical inventory; and, 3) charges and reserves aggregating approximately $6 million relating to estimated costs in connection with reduced staffing requirements, potential liabilities arising from the preliminary results of a sales and use tax audit, and a number of miscellaneous items.

First quarter 1980 results included an approximate $2.7 million gain from the sale of substantially depreciated equipment which had been in the Company's lease base and a $1.5 million credit to operations due to amending an agreement with a third party financing institution thereby rendering unnecessary provisions for an estimated obligation to that institution.

Fourth quarter 1979 results were favorably affected by the sale of a non-exclusive license for the manufacture of flexible disc media in Japan. The related $1.1 million income is reported as a component of Other Income and Expense, Net.

MEMOREX CORPORATION

Five-Year Summary of Selected Financial Data

Years Ended December

	1980	1979	1978	1977	1976
		(Thousands except per share amounts)			
For the Year:					
Sales Revenue	$564,642	$563,404	$483,370	$330,019	$237,811
Rental and Service Revenue	204,019	174,357	149,896	120,093	106,822
Total Revenue	768,661	737,761	633,266	450,112	344,633
Less—Cost of Sales	408,092	352,282	287,420	196,166	141,858
Cost of Rental and Service	142,855	122,713	96,769	62,094	55,414
Gross Profit	$217,714	$262,766	$249,077	$191,852	$147,361
Income (Loss) Before Extraordinary Credit	$ (28,978)	$ 31,544	$ 41,948	$ 33,869	$ 24,682
Net Income (Loss)	$ (28,978)	$ 31,544	$ 50,197	$ 55,963	$ 39,755
Income (Loss) Per Common Share:					
Before Extraordinary Credit	$(4.42)	$3.91	$5.65	$5.25	$4.31
Net	$(4.42)	$3.91	$6.90	$8.81	$7.03
Proforma Income (Loss) Per Common Share:					
Before Extraordinary Credit	$(4.60)	$3.73	$5.45	$4.75	$3.74
Net	$(4.60)	$3.73	$6.70	$8.32	$6.46
Total Domestic Revenue	$414,564	$379,260	$347,991	$281,922	$208,633
Total International Revenue	$354,097	$358,501	$285,275	$168,190	$136,000
Total Equipment Revenue	$501,343	$490,899	$424,726	$273,351	$210,370
Total Media Revenue	$267,318	$246,862	$208,540	$176,761	$134,263
Interest Expense	$ 24,932	$ 16,176	$ 13,640	$ 12,138	$ 13,191
Research & Development Expense	$ 34,573	$ 28,345	$ 23,619	$ 19,216	$ 13,943
Net Additions to Gross Lease Base	$ 12,746	$ 17,729	$ 29,708	$ (8,956)	$ (10,028)
Additions to Property, Plant and Equipment	$ 30,951	$ 37,749	$ 31,181	$ 25,307	$ 13,239
At Year End:					
Cash & Temporary Investments	$ 15,135	$ 14,940	$ 28,372	$ 12,021	$ 43,803
Inventories	$163,920	$184,130	$143,879	$ 85,315	$ 55,603
Gross Lease Base	$223,410	$210,664	$192,935	$163,227	$172,183
Total Assets	$588,680	$598,319	$487,649	$330,256	$262,596
Total Debt	$236,899	$189,512	$152,515	$127,871	$172,771
Less—Current Debt	54,001	17,352	11,543	6,750	22,710
Long-term Debt	$182,898	$172,160	$140,972	$121,121	$150,061
Redeemable Preferred Stock	$ 65,913	$ 65,913	$ 65,913	$ 65,913	$ 62,815
Common Shareholders' Equity (Deficit)	$143,927	$175,386	$141,264	$ 46,157	$ (16,865)
Dividends on Preferred Stock (None on Common)	$ 2,956	$ 2,956	$ 2,798	$ 798	$ 634

Management's Discussion and Analysis of Financial Condition and Results of Operations

Overview

Memorex markets its products and services throughout the free world. Domestic operations include development, manufacturing, marketing and service. Foreign operations consist principally of marketing and service. Effective January 1, 1978, Memorex acquired the Telex Computer Products, Inc. European marketing and service operations (Telex Europe). The annual percentage of international revenues to total revenues since the acquisition has ranged between 45% and 49% compared with 37% and 39% in the two preceding years.

Products in the equipment segment (principally computer peripheral equipment) are marketed to either users of large IBM computers (end-users) or to original equipment manufacturers (OEMs) who market stand-alone computer systems which include the Company's products. Products marketed to OEMs are generally sold outright and profit and cash are realized on a current basis. Products marketed to end-users are sold or leased. Leasing generally results in deferring profit and cash realization over the terms of the individual leases but does provide a steady stream of rental revenues as long as the equipment remains on lease. Whether a customer elects to lease rather than purchase depends on the relationship between lease rates and purchase prices, prevailing interest rates, the customer's financing policies, the imminence of potentially improved computer and related peripheral equipment products and other factors beyond the control of Memorex. Memorex has to varying extents sold equipment under lease and assigned the leases to unrelated third party financing institutions. The desirability, and sometimes the ability, to finance leasing transactions in this manner is dependent on the availability of funds to third party financing institutions, prevailing interest rates, lease terms, and other factors.

In 1980 the Company experienced losses of $32.2 million before taxes. During the second quarter, the Company identified areas where it believed resources could be utilized more effectively and where certain costs could be reduced or eliminated. In this connection, decisions were made to phase out certain older products. This required establishing reserves of approximately $6 million for anticipated write-downs of potentially excess inventories and related assets and for expected losses as such products are phased out. At the same time, inventory adjustments were also made in the net amount of approximately $3.5 million consisting primarily of adjustments for inventories in excess of estimated requirements. These adjustments were partially offset by the favorable results of a physical inventory. Additionally, reserves and charges aggregating approximately $6 million were recorded for estimated costs in connection with reduced staffing requirements, potential liabilities related to preliminary results of a sales and use tax audit and a number of miscellaneous items. Charges not principally attributable to normal operations were thus recorded in the second quarter in the approximate aggregate amount of $15.5 million. As described in Notes to Quarterly Summary on page 26, additional charges and credits of a similar nature but lesser magnitude were included in the other three quarters of 1980.

Supplementary financial data adjusted for the effects of inflation, together with management's discussion and analysis thereof, are presented on pages 30 and 31.

Results of Operations

For each of the last several years Memorex has shown year-to-year revenue growth, reaching total annual revenues of $768.7 million in 1980. Revenues for 1978 through 1980 include amounts attributable to Telex Europe operations which were acquired and integrated with the Company's beginning in 1978 (Telex Europe's unaudited revenues for the year prior to the acquisition were approximately $39 million). International revenues increased 26% in 1979, primarily as a result of increased product shipments, and decreased 1% in 1980 due to European customers' reluctance to purchase or enter into long-term leases early in the year and to a shortage of certain Memorex end-user equipment late in the year. United States revenues increased 9% in both 1979 and 1980.

Rental and Service Revenue—Total rental and service revenues have grown at a rate of 16% to 25% each year since 1977 due primarily to increases in the lease base, to an expanding base of leased and sold equipment under service contracts and, to a lesser extent, to selected maintenance price increases in 1980.

Sales Revenue—Sales revenue did not increase measurably in 1980 over 1979 as compared to increases of 17% and 46% in 1979 and 1978, respectively. The lower growth rates were due primarily to factors referred to in the following two paragraphs.

In 1980, OEM and communications equipment sales revenue increases, resulting primarily from increased product shipments, were offset to some extent by a decline in end-user equipment sales revenue. Reduced demand for end-user equipment during a portion of the year and manufacturing problems with certain end-user equipment resulted in lower than planned product shipments. In addition, revenues and costs were affected by slower than expected development of the market for 8-inch rigid disc drives. Sales to third party financing institutions were approximately 20% lower in 1980 than in 1979 due to higher interest rates, reduced availability of funds to and from such institutions on acceptable terms, and other factors. The equipment revenue growth rate declined in 1979 primarily as a result of lower sales and rental prices on certain products and a series of IBM actions during 1979, including product announcements and marketing tactics. Revenue growth in the immediately preceding two years was primarily attributable to the increased volume of product shipments.

Revenues from Media products have increased during the last three years due primarily to increased shipments and prices of computer, audio and home video tapes. The rate of media products revenue growth declined in 1980, however, due primarily to the recession, which affected consumer purchases of audio tapes, and to reduced shipments of certain rigid disc products.

Increasing revenues notwithstanding, pretax operating results have declined since 1978. The gross profit margin on sales revenues declined to 28% in 1980 compared with 37% in 1979 and 41% in each of the three prior years. Margins on rental and service revenues declined to 30% in 1980 and 1979 compared with 35% in 1978 and 48% in both 1977 and 1976.

Costs and Expenses—Continuing high manufacturing costs and inventory charges, as well as start-up costs on new products, have unfavorably impacted sales margins, particularly for equipment products. High manufacturing costs resulted from production problems beginning late in 1979 and from reduced production schedules for certain equipment products during mid-1980. Overall sales margins were also unfavorably impacted in 1980 by reduced margins on sales to third party financing institutions, caused in part by high interest rates which have the effect of reducing the effective sales prices. Corrective actions are underway, but it is expected that margins will continue to be adversely affected by high manufacturing and start-up costs with respect to certain equipment products.

Rental and service margins have declined to 30% in 1980 and 1979 compared with 35% in 1978. The effect of selected rental price increases in 1979 and maintenance price increases in 1980 has been offset by higher service costs associated with additional assets and personnel required to service an expanding base of sold and leased equipment under maintenance contracts and by higher depreciation charges as newer equipment replaces older equipment in the lease base. The significant reduction in margins in 1978 (35% compared with 48% in both 1977 and 1976) was primarily the result of higher costs attributable to the Telex Europe operations which were acquired in 1978.

Selling, general and administrative expenses increased steadily from 1976 through 1979 primarily as a result of increased levels of employment to support expanding sales and marketing activities. Expenses of Telex Europe are included beginning in 1978. The rate of increase in 1980 was reduced compared with the prior years, primarily as a result of expense and staffing reduction programs effected during 1980.

Research and development expenditures aggregated $34.6 million in 1980, a 22% increase over 1979 and a 46% increase over 1978.

Interest expense increased to $24.9 million in 1980 from $16.2 million and $13.6 million in 1979 and 1978, respectively. The 1980 increase was attributable to increased interest rates and higher average outstanding borrowings.

Other income and expense, net was approximately $3 million in 1980 compared with approximately $7 million in each of 1979 and 1978. The decrease is attributable primarily to foreign exchange losses and the lack of debenture repurchases in 1980 as shown in the note on page 19 captioned Other Income and Expense, Net.

Financial Condition

At December 26, 1980, the Company had working captial of $132.6 million compared with $82.1 million at the 1977 year-end. However, as a result of the loss incurred in 1980 and increased borrowings to fund operations, working capital at the end of 1980 was $47.1 million lower than working capital at the end of 1979. Various programs were pursued in 1980 which were intended to improve liquidity. These included programs to reduce inventory levels, to improve the aging of trade accounts receivable, and to identify areas where assets could be disposed of or redeployed to increase return and where costs and expenses could be reduced or eliminated. Inventory growth, which had been escalating for the past several years, was curtailed and inventories at December 26, 1980 were $37 million lower than the peak level of $201 million in May 1980. Current and long-term debt aggregated $237 million at year-end 1980 compared with $190 million at year-end 1979.

The Company's growth of the past several years has been funded by profits, new debt and $41 million received from a public offering of common stock and the exercise of stock purchase warrants in 1978. Operating cash flow (change in cash net of change in debt) has been negative for each year since 1977, although the fourth quarter of 1980 showed positive operating cash flow for the first time since 1977. Funds normally have been available through conventional loan arrangements and through third party lease financing transactions.

Credit arrangements with banks at December 26, 1980 (including an $80 million revolving credit/term loan agreement with a group of nine banks) aggregated approximately $160 million, of which approximately $110 million was outstanding in the form of short and long-term borrowings. Certain of these and other credit agreements contain covenants under which the Company has agreed to maintain minimum working capital and net worth levels as well as certain minimum financial ratios. The agreements also limit the amount of cash dividends which may be paid on common stock, the incurrence of new debt and lease obligations and acquisitions of the Company's stock. As of June 27, 1980, the Company obtained one-year modifications to certain of these credit agreements in order to increase its then borrowing capacity by approximately $35 million. Effective January 30, 1981, the Company obtained a further modification until May 30, 1981, which requires that the Company maintain consolidated tangible net worth (as defined) of at least $180 million. Relief provided by all of the foregoing modifications will terminate at the end of the modification periods unless extended by the lenders or unless the related credit agreements are otherwise modified.

If such modifications expire and the existing credit agreements are not changed, the Company might then be in violation of certain of the financial covenants in such agreements. In order to avoid a default, failure to comply with any of the Company's long-term debt covenants must be cured within the time permitted in the agreement in which the respective covenant is contained. A default under any of the Company's principal credit agreements constitutes a default under all such agreements and would entitle the lenders to declare all amounts immediately due and payable. Although no assurances can be given, management believes that the Company will be able to obtain changes to its credit agreements so that the Company will not be in violation of any covenants when the above-referenced modifications expire. In January 1982, borrowings under the revolving credit/term loan agreement may be converted to term loans at the Company's option, assuming that the Company is in compliance with the terms of the agreement in effect at that time.

Investments in research and development, capital equipment, and lease base additions (net of sales and retirements) have aggregated between $78 million and $84 million for each of the last three years, a spending level that is likely to continue into 1981. In addition, principal non-operating cash requirements for 1981 include installments on long-term debt obligations (approximately $8 million), repayments of current debt (approximately $46 million) unless related agreements are renewed and payment of dividends on preferred stock ($4.2 million). Annual requirements to redeem $6 million principal amount of outstanding convertible debentures may be satisfied during 1981 through 1983 by the use of debentures previously repurchased by the Company. Beginning in 1983, the Company will be required to make annual sinking fund payments on preferred stock in the amount of $8.2 million. Principal sources of cash are expected to include banks and other financing institutions as well as conversions of certain assets to cash.

MEMOREX CORPORATION

Five-Year Comparison of Selected Supplementary Financial Data Adjusted for Effects of Changing Prices

For the Years Ended December

	1980	1979	1978	1977	1976
		Adjusted to Average 1980 Dollars			
		Dollars in Thousands except per share amounts			
Total Revenues	$768,661	$837,532	$799,847	$612,053	$498,858
Historical Cost Information Adjusted for General Inflation					
Net Income (Loss)	$ (66,528)	$ 1,776	*	*	*
Net Loss Per Common Share**	$ (9.61)	$ (.23)	*	*	*
Net Assets at Year-End	$275,982	$359,105	*	*	*
Current Cost Information					
Net Income (Loss)	$ (59,177)	$ 29,400	*	*	*
Net Income (Loss) Per Common Share**	$ (8.18)	$ 3.88	*	*	*
Increase in Specific Prices Under Increase in General Price Level	$ 18,507	$ 6,920	*	*	*
Net Assets at Year-End	$289,343	$363,474	*	*	*
Other Information					
Gain from Decline in Purchasing Power of Net Monetary Liabilities	$ 21,691	$ 20,821	*	*	*
Market Price Per Common Share at Year-End	$ 12.66	$ 20.15	$ 37.11	$ 43.17	$ 35.10
Average Consumer Price Index	246.8	217.4	195.4	181.5	170.5

*Information not required for years prior to 1979.

**Loss per common share amounts are computed by dividing net income/loss, adjusted for preferred stock dividends, by the weighted average number of common shares outstanding; common stock equivalents are excluded since their inclusion would be anti-dilutive.

Statement of Operations Adjusted for Changing Prices

For the Year Ended December 26, 1980

	As Reported In the Primary Statements	Adjusted For General Inflation (Constant Dollar)	Adjusted For Changes In Specific Prices (Current Costs)
		Thousands	
Total Revenues	$768,661	$768,661	$768,661
Cost of Revenues*	550,947	586,086	580,533
Selling, Administrative and Development*	222,040	224,451	222,653
Other Costs and Expenses	27,828	27,828	27,828
Credit for Income Taxes	(3,176)	(3,176)	(3,176)
Net Loss	$ (28,978)	$ (66,528)	$ (59,177)
Gain from Decline in Purchasing Power of Net Monetary Liabilities		$ 21,691	$ 21,691
Increase in Specific Prices of Inventories, Rental Equipment, Spare Parts and Property, Plant and Equipment held during the year**			$ 59,903
Effect of Increase in General Price Level			$ 78,410
Increase in Specific Prices Under Increase in the General Price Level			$ 18,507

*The aggregate total of depreciation and amortization expense that has been allocated to the various expense categories totaled $55,540,000 on a historical cost basis, $71,150,000 adjusted for general inflation and $61,425,000 adjusted for changes in specific prices.

**At December 26, 1980 the current costs of inventory, rental equipment, spare parts and property, plant and equipment, net of accumulated depreciation, were $176,378,000, $91,557,000, $31,629,000 and $176,550,000, respectively.

Management's Discussion and Analysis of Financial Data Adjusted for the Effects of Changing Prices

Inflation has had a pervasive impact on the economy of the United States and other countries where Memorex conducts business. In the United States, the value of a 1967 dollar, as determined by the Consumer Price Index for all Urban Consumers (CPI-U), deteriorated to less than $.40 as of the end of 1980. In accordance with generally accepted accounting principles, financial statements have traditionally reported amounts based on actual (historical) dollars without adjustment for the ever changing purchasing power of currency. In recognition of the increasing significance of inflation, the Financial Accounting Standards Board issued Statement No. 33 (FAS 33), Financial Reporting and Changing Prices, requiring certain public enterprises to present supplementary financial information in their annual reports, depicting the effects of general inflation (constant dollar) and specific price changes (current costs). Because the methods used to calculate the effect of changing prices involve numerous assumptions, approximations and estimates it is recommended that such supplementary information be viewed as a subjective estimate of the approximate effect of inflation, rather than as a precise measurement.

Two different methods are prescribed by FAS 33 for calculating the supplemental information. The first method, constant dollar accounting, adjusts the historical cost financial statement dollars to dollars of the same general purchasing power. Historical costs of rental equipment, spare parts, property, plant, equipment and capital leases and related depreciation and amortization expense are adjusted by using the CPI-U. Inventories and the related effect of inventories on cost of revenues are similarly adjusted. The constant dollar data is expressed in average 1980 dollars and reflects changes that have occurred in the purchasing power of the dollar as measured by the CPI-U.

The second method, current cost accounting, measures and reports the number of dollars currently required to purchase or manufacture assets having the same service potential as specific assets owned by the Company. The current costs of inventories, rental equipment, spare parts and related cost of revenues and depreciation were based on recent manufacturing costs. Adjustments for changes in specific prices of property, plant, equipment and capital leases and related depreciation and amortization expense were based on external indexes closely related to the assets being measured. These indexes do not reflect technological changes or improved production methods associated with the normal replacement of productive capacity.

In calculating constant dollar and current cost net income (loss), total revenues and other costs and expenses were considered to reflect the average price levels for the year and accordingly have not been adjusted. In addition, as required by FAS 33, adjusted net income (loss) amounts are exclusive of any income tax effect for constant dollar or current cost adjustments.

Under both the constant dollar and the current cost methods, the Company's after tax operating results are lower than as determined under the historical cost method. Under each method, however, the indicated decline in net income (increase in net loss) is partially offset by the gain from decline in purchasing power of net monetary liabilities. This theoretical gain results from an excess of monetary liabilities (obligations to pay a fixed sum of money) over monetary assets (money or claims to an amount of money which is fixed). That is, historical dollar liabilities are assumed to be repayable or have been repaid using inflated dollars. In the Company's consolidated balance sheets, a significant portion of assets is represented by assets classified as nonmonetary while substantially all liabilities are classified as monetary.

The five-year comparison shows the additional effect of adjusting historical revenues and market price per common share to amounts expressed in terms of average 1980 dollars, as measured by the CPI-U. Revenues for 1976 through 1979 are higher than reported in the primary financial statements. Moreover, 1980 revenues show a decline compared with 1979 and 1978 whereas an increase is shown in the primary financial statements. The decline in revenues expressed in terms of average 1980 dollars results from the Company's sales, rental and service prices not keeping pace with general inflation.

Shareholder Information

Annual Meeting of Shareholders

You are cordially invited to attend Memorex's Annual Meeting of Shareholders, which will take place on Monday, May 11, at 1:30 p.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 5¼% 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
Mail Stop 12-39
San Tomas at Central Expwy.
Santa Clara, CA 95052

Common Stock and Convertible Debentures

Memorex common stock and 5¼% Convertible Subordinated Debentures are traded on the New York Stock Exchange, and the common stock is also traded on the Pacific Stock Exchange. Memorex has approximately 29,000 shareholders. 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
1980	High	19⅝	16¾	18⅜	16⅜
	Low	10	11	12¾	12
1979	High	37½	39	34	23¾
	Low	28¾	26½	19¼	16⅝

Convertible Debentures

		1st Quarter	2nd Quarter	3rd Quarter	4th Quarter
1980	High	53	54¼	54¼	52½
	Low	40	42	51½	44
1979	High	66½	71	66	58½
	Low	60¼	65	57	49

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

Officers and Directors

Board of Directors

C.W. Spangle
Memorex Chairman of the Board and Chief Executive Officer

Robert L. Chambers
Chairman of the Board, Envirotech Corporation, Menlo Park, California, manufacturer of waste control and process 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
Chairman of the Board and President, HLX Data Systems Corporation, a point-of-sale computer systems manufacturer.

Vester T. Hughes, Jr.
Partner, Hughes & Hill, Dallas, Texas, a law firm.

[illegible]in C. Rice
Chairman of the Board and President, Imperial Bank, San Francisco, California, a bank.

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

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

Charles S. Strauch
Memorex President and Chief Operating Officer.

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

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

Board Committees

Executive Committee
Mr. Spangle, Chairman; Members: Messrs. Chambers, Chaney, Rice, Sandberg, Strauch, Vermeulen and Wilson.

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

Stock Option and Purchase Plan and Compensation Committees
Mr. Schmidt, Chairman; Members: Messrs. Gomez and Rice.

Nominating Committee
Mr. Schmidt, Chairman; Members: Messrs. Chambers and Rice.

Memorex Fellows

Eric D. Daniel
Manager, Consumer Products Research and Development

Frank J. Sordello
Vice President, Recording Technology

Corporate Officers

C.W. Spangle
Chairman and Chief Executive Officer

Charles S. Strauch
President and Chief Operating Officer

George L. Bragg
Vice President, Corporate Development

Reto Braun
Vice President and President, Memorex International Group

Robert L. Erickson
Vice President, Legal and Secretary

Paul L. Klein
Vice President and President, Communications Group

Robert L. Malcolm
Vice President, Industrial Relations

Richard W. Martin
Vice President and President, Media Products Group

James Simpson
Vice President and President, Storage Systems Group

F. Gordon Smith
Vice President, Communications

James A. Unruh
Vice President, Finance and Chief Financial Officer

Staff Officer

Thomas S. Stevens
Vice President and Treasurer

Memorex Corporation

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

Sales and Service Locations

United States

Alabama
Birmingham
Arizona
Phoenix
Arkansas
Little Rock
California
Glendale
Garden Grove
Los Angeles
Riverside
San Diego
San Francisco
Santa Clara
Colorado
Denver
Connecticut
Old Greenwich
East Hartford
District of Columbia
Washington
Florida
Jacksonville
Miami
Orlando
Tampa
Georgia
Atlanta
Illinois
Chicago
Peoria
Indiana
Fort Wayne
Indianapolis
South Bend
Kansas
Kansas City
Kentucky
Louisville
Lexington
Louisiana
New Orleans
Maryland
Baltimore
Maine
Portland
Massachusetts
Waltham
Michigan
Detroit
Minnesota
Minneapolis
Missouri
St. Louis
Nebraska
Lincoln
Omaha
New Jersey
West Orange
New York
Albany
Buffalo
Long Island
New York City
Rochester
Syracuse
North Carolina
Charlotte
Greensboro
Raleigh
Ohio
Cincinnati
Cleveland
Columbus
Dayton
Oklahoma
Oklahoma City
Tulsa
Oregon
Portland
Pennsylvania
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Harrisburg
Philadelphia
Pittsburgh
Rhode Island
Providence
South Carolina
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Chattanooga
Texas
Austin
Dallas
Houston
Virginia
Richmond
West Virginia
Dunbar
Washington
Seattle
Wisconsin
Madison
Milwaukee

International Headquarters:
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Australia
Melbourne
Perth
Sydney
Austria
Vienna
Belgium
Brussels
Brazil
Rio de Janiero
Sao Paulo
Canada
Calgary
Dorval
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Ottawa
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Winnipeg
Denmark
Copenhagen
Finland
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Lille
Lyon
Nantes
Paris
Strasbourg
Germany
Cologne
Dortmund
Dusseldorf
Frankfurt/Main
Hamburg
Munich
Nuernberg
Stuttgart
Ireland
Cork
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Manufacturing Plants

Belgium
Liege
Ireland
Clondalkin
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