Measurex Corporation Annual Report 1972

Cover graph depicts Measurex operating revenues 1968-1972.

Highlights

For the Current Year	1972	Percent Increase from 1971
Operating revenues	$16,336,000	90%
Income before extraordinary credit:		
Amount	1,727,000	67%
Per share	.71	37%
Average number of common shares	2,429,000	22%

(Dollar amounts in thousands except per-share income)	1972	1971	1970	1969	1968[1]
Operating Summary for all Years					
Operating revenues	$16,336	$ 8,613	$3,527	$ 302	
Income (loss) before taxes and extraordinary credit[2]	2,887	1,974	(25)	(781)	$ (334)
Income (loss) before extraordinary credit[2]	1,727	1,034	(25)	(781)	(334)
Extraordinary credit[2]		545			
Net income (loss)	$ 1,727	$ 1,579	$ (25)	$ (781)	$ (334)
Net income (loss) per common and common equivalent share:					
Income before extraordinary credit[2]	$ .71	$ .52	$ (.02)	$ (.72)	$ (1.16)
Extraordinary credit[2]		.27			
Net income (loss)	$ .71	$ .79	$ (.02)	$ (.72)	$ (1.16)
Financial Position at Year-End (November 30)					
Working capital	$ 8,021	$ 5,219	$ 764	$ 665	$ 362
Total assets	34,657	18,296	8,222	2,765	750
Capitalization:					
Long-term debt	10,386	9,033	1,649	835	62
Shareholders' equity	20,099	7,155	5,464	1,496	530

[1] From inception on January 18, 1968, to November 30, 1968.

[2] Extraordinary credit arises from reduction of provision for federal income taxes through utilization of net operating loss carry-forward.

To Our Shareholders:

We would like to begin this first annual report as a public company by welcoming our new shareholders to the Measurex family. We appreciate the confidence you have expressed in Measurex and shall make every effort to warrant that confidence.

Highlights of the financial results for our fifth year, ended November 30, 1972, and for all previous years are presented on the previous page. 1972 was a very good year for Measurex. A more complete report on 1972 operations is included later in this letter. Before that discussion, however, it is appropriate to describe the business in which Measurex is engaged.

Measurex's Business

Our business is materials control, throughput control, and quality control for the sheet process industries. We accomplish these controls through the use of dedicated digital computers linked to proprietary sensors that measure the product variables "on line" in the customer's process. The data obtained from the sensors, after processing by the computer, are displayed for use by the machine operators, are used to effect automatic control of the process, and are summarized in a management information report.

Measurex pioneered the application of computer integrated control systems in the paper industry. We now have the leadership position in this industry, having delivered more dedicated digital computer-based systems than all of our competitors combined. Currently we are well along in the application of this technology to other sheet process industries.

We have selected this business focus for a number of reasons. First, the latent potential market is very large—approximating $3 billion. Sheet products are numerous—from the broad range of paper grades to coated tapes, laminates, plastic sheeting, floor and ceiling tile, metal foil, and aluminum and steel sheet and strip. To date the paper market, representing approximately $1 billion of the $3 billion potential, is only 5-6% penetrated with digital computer-based systems. Penetration of the other markets is only beginning.

Secondly, the economics of the processes indicate substantial opportunity for cost reduction. In the case of each product the cost of raw materials is high—typically over 50% of the sales value of the end product. The raw material is purchased by the manufacturer in bulk, and the finished product is used by the sheet. As a result, tangible economic savings are achieved by the manufacturer through the application of a Measurex system to produce:
more sheets per ton of raw material,
more usable product per hour,
more uniform product.

For most Measurex systems in operation today, our customers are achieving profit improvement of two to ten times the amount paid to Measurex each month for rent and services.

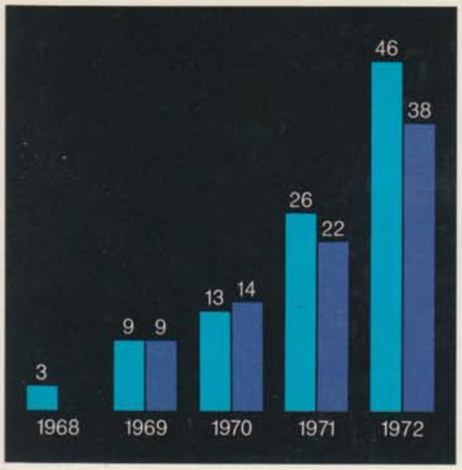
Customers usually achieve reductions in raw material usage of at least 2% and increases in productivity of 3% to 10%. Applying a 2% materials savings and a 3% throughput increase to a medium-sized machine producing 300 tons per day of newsprint results in annual savings of about $150,000 in raw material and $225,000 in increased throughput for a total savings of $375,000 per year. In addition, improved product quality and thus improved acceptance and fewer claims from the paper mills' customers are also realized. The annual charge for rent and service on a typical Measurex system is less than $100,000—or less than one-third of these savings.

To achieve these results requires that a number of technologies be brought to bear on an industry's particular process—the technologies of sensors, digital logic, informational displays, software and, of critical importance, control and process engineering. We are proud of the success we have had in melding these multiple technologies into the development of computer control systems that have a commanding lead over competitive systems.

Our primary corporate objective is best stated in terms of results for our customers. We intend to provide such outstanding economic benefits to these customers that Measurex can continue to offer above-average rewards for its investors and employees. Only by so doing will we achieve our second objective: to become the leading supplier of systems for the control of materials and throughput within the continuous process industries—worldwide. Our ambitions extend beyond the sheet process indutries to the continuous process industries, and our systems installed and under development for the control of pulping processes and cigarette making are the initial entries into these broader markets.

Report for 1972

We are happy to report that fiscal year 1972 brought steady progress toward these corporate objectives.



Shipments and New Orders

During the year we received orders for a total of 46 systems and shipped 38 systems. Shipments included our first systems to control paper machines making tissue paper, sheet formers making ceiling tile, and processes for bleaching pulp. Remaining in the backlog at year-end were orders for systems to control alumnium foil rolling mills and a rubber tire fabric calender. Our first shipments to each of the aluminum and rubber industries were made in early 1973.

Our growth in orders and shipments, expressed in number of systems rather than dollar value, from the inception of the company in 1968, is depicted in the bar chart above, with the orders shown in light blue and the shipments in dark blue. Of the 38 systems shipped in 1972, 36 were for the control of paper making machines. The other two were for the control of a pulp bleaching operation and a ceiling tile line.

Our backlog for shipment or performance within the following 12 months stood at $5,782,000 at the end of fiscal 1972, compared with $3,914,000 at the end of fiscal 1971.

We are proud of our record of acceptance by the paper industry. We believe that we have been able to achieve these results only because we have been successful in producing tangible economic results for our customers.

Marketing

We continue to place much emphasis on deepening and strengthening our marketing and field organization. On a worldwide basis our growth by field function is shown in the table below:

	Nov. 30, 1971	Nov. 30, 1972
Area and Regional Managers	16	29
Application Engineers	18	28
Field Engineers	54	94
	88	151

In January 1973 we realigned our marketing organization in order to give greater concentration to our activities in new industries and to enhance our effectiveness in our current primary market, the paper industry. Marketing and field sales activities were separated along industry lines, and industry division managers were appointed with responsibility for directing the overall marketing, selling, application engineering and field service within each of the industries — paper, metal, tobacco, and rubber and plastics.

Dean A. Forseth, a Vice President of the Company, assumed the position of Manager of our Paper Division. Robert L. Yeager, who joined Measurex in February 1972 from his former position as Marketing Manager at Hewlett-Packard Company's computer division, assumed the position of Vice President and Manager of our Metals Division.

Early in 1972 we formed a Tobacco Division. S. Keith Swanson was appointed Manager of this Division and later in the year was elected a Vice President.

To do an effective marketing job in the area of sophisticated process control requires thorough knowledge of the customer's process. Formation of these industry divisions will allow our field and marketing staff personnel to concentrate their attention and thereby do a better job of serving our present and future customers within the paper industry while accelerating our penetration of the newer industries — metals, tobacco, and rubber and plastics.

Internationally, our business has expanded rapidly, and our international organization has been strengthened to manage this expansion. Our international activities are managed by Charles M. Worthley, Managing Director, Measurex International, and are based outside of London. We now have systems in eight countries outside of North America—Australia, Austria, Denmark, Finland, France, Republic of South Africa, Sweden and the United Kingdom. In each of these countries we have a staff of Measurex personnel—predominantly local nationals. A growing portion of our business came from the international market in 1972, and we anticipate that those markets will continue to play a large role in 1973 and future years.

Organization

In addition to the management appointments mentioned, several other key appointments were made during the year by the Measurex Board of Directors. Robert N. Johnsen was appointed Vice President-Manufacturing, coming to Measurex from the Colorado Springs Division of Hewlett-Packard Company, where he served as Manufacturing Manager and more recently as Engineering Manager. Dr. Doris S. Bossen, for several years Personnel Director at Measurex, was elected a Vice President.

These various appointments, together with many other additions and promotions within our staff, resulted in a rounding-out of our management group with experienced and hard-working professionals. Total employment grew from 227 at the beginning of the year to 360 at November 30, 1972. We are extremely proud of the Measurex staff throughout the world.

New Industries and Products

During 1972, increased emphasis was directed to Measurex's expansion within new industries. Early in the year we received orders for systems to contol the manufacture of ceiling tile. The first of these systems was delivered midyear and is operating well. During the second quarter we received an order for a system to control a single-stand rolling mill producing aluminum foil. This order was supplemented late in the year by an additional order from the same customer for two similar systems for installation on other rolling mills at the same site. The first of these systems was shipped in early 1973.

During the third quarter, a major tire manufacturer in the United States placed an order for a Measurex system to control the calendering operation by which rubber is applied to tire fabric. This system was installed early in 1973.

New developments for the paper industry illustrate our continued technical leadership. Many "firsts" were recorded within the paper industry in 1972: the successful installation of our first system to control the pulp bleaching process; the first successful installation of a digital computer process control system on a machine producing tissue paper; the development of an opacity sensor; and the development of many software packages for advanced control strategies.

As we mentioned earlier in this report, the integration of a number of technologies is necessary to develop sophisticated computer-based control systems. Our development activities for each of the industries we serve include the design and development of sensors to measure precisely nuclear, infrared and microwave radiation and their interaction with matter; digital integrated circuit logic for data communications among elements of our systems; precision mechanical devices for use in difficult industrial environments; graphic and digital terminals; and real time process computer programs (software) to support all elements of our systems.

The extension of this engineering effort into other industries has of course necessitated further expansion of our engineering department. Our total engineering expenditures in 1972 were \$1,868,000 versus \$1,265,000 in 1971.

New Facilities

Our continuing growth made it necessary early in the year to relocate our manufacturing, development and headquarters' administration activities. This move to new facilities located in Cupertino, California, permitted us to consolidate at one site our California operations that had previously been located in several buildings in Santa Clara. Cupertino is located on the San Francisco peninsula, where the growing electronics industry has attracted an impressive pool of scientific and engineering talent.

The new company-owned facility consists of a two-story office and laboratory building and an adjoining one-story manufacturing building, totaling about 52,000 square feet. The 18-acre site, also owned by Measurex provides considerable room for expansion. Plans are now underway to add to the present one-story building approximately 40,000 square feet, providing additional manufacturing space and engineering laboratory and office accommodations.

Finance

The initial public offering of Measurex common stock was successfully completed on March 28, 1972, by an underwriting group led by Blyth Eastman Dillon & Co. Incorporated. Measurex common stock is quoted over the NASDAQ system under the symbol "MSRX," and the daily trading results are carried in most National Over-the-Counter listings.

The proceeds from this offering were supplemented by credit arrangements completed during the year that permit us to continue our rapid expansion and to finance long-term full-payout leases with Measurex customers. The company now has a domestic credit agreement with the Bank of America and Manufacturers Hanover Trust Company. This revolving credit agreement converts to a term loan at the end of the revolving period and permits Measurex to borrow up to $20 million through November 1973, with repayment over the following 5½ years.

In February 1973, a similar credit arrangement was concluded to permit up to $7 million of Eurocurrency borrowing to finance the company's international leasing program.
Finally, the lease financing line with Manufacturers Hanover Trust Company, originally established in 1971, was renewed for fiscal year 1973 at an additional $4 million.

Summary

We are pleased to present this report of the significant advances that Measurex has made in 1972. Our growth in sales and earnings evidences the increasing acceptance of modern computer integrated control systems by the paper and other sheet producing industries throughout the world. We believe that the ability of our customers to achieve significant profit improvement through use of our systems, coupled with improved economic outlook for the industries we serve, should result in a continuation of our profitable growth.

All of us at Measurex want to welcome again those of you who became shareholders of Measurex in 1972 and to thank all of our shareholders for their continuing support.

Sincerely,

David A. Bossen

David A. Bossen
President

Measurex System Orders

Shown in bar chart format are the orders received by Measurex in each fiscal year since the founding of the company in early 1968. Each company name represents an order for one Measurex system.

These orders are for systems to control machines making a wide variety of papers and to control certain other processes as well. The small numbers to the right of the customer names indicate the following applications:

1 Fine paper
2 Coated magazine
3 Newsprint
4 Tissue
5 Coated bleached board
6 Linerboard
7 Corrugating medium
8 Cylinder board
9 Miscellaneous kraft
10 Pulp bleaching
11 Ceiling tile (sheet former)
12 Tire fabric (calender)
13 Aluminum foil (rolling mill)

A name shown in blue indicates a repeat order from a customer after the customer (or one of its affiliates) has had operating experience with its first Measurex system.

1968	1969
	Boise Southern 6
	Boise Southern 3
	Continental Can Co., Inc. 5
	Newton Falls Paper Mill, Inc. 1
	Interstate Paper Corp. 6
	International Paper Co. 2
Garden State Paper Co., Inc. 3	Mosinee Paper Corp. 9
Fibreboard Corp. 6	Plainwell Paper Co. 1
Simpson Lee Paper Co. 1	Boise Cascade Corp. 1

Chesapeake Corp. of Virginia 6
Fundy Forest Industries, Ltd. 7
Mondi Paper Co., Ltd. 3
Mondi Paper Co., Ltd. 1
FSC Paper Corp. 3
Weyerhaeuser Co. 7
Weyerhaeuser Co. 6
Bowaters U.K. Paper Co., Ltd. 3
Garden State Paper Co., Inc. 3
Garden State Paper Co., Inc. 3
Hoerner Waldorf Corp. 7
Bowaters U.K. Paper Co., Ltd. 7
A. Ahlstrom Osakeyhtio 3

1970

Bowaters U.K. Paper Co., Ltd. 9
Georgia-Pacific Corp. 1
Canadian International Paper Co. 6
International Paper Co. 6
Canadian International Paper Co. 5
Bowaters Mersey Paper Co., Ltd. 3
Michigan Carton Co. 8
Alton Box Board Co. 7
Stora Kopparbergs Bergslags AB 3
Weyerhaeuser Co. 7
Wisconsin Tissue Mills 4
Plainwell Paper Co. 2
Georgia-Pacific Corp. 1
Crown Zellerbach Corp. 2
Crown Zellerbach Corp. 2
International Paper Co. 7
Veitsiluoto Osakeyhtio 3
Oxford Paper Co. 2
Fibreboard Corp. 7
Olinkraft, Inc. 7
Weyerhaeuser Co. 1
Pineville Kraft Corp. 6
Fibreboard Corp. 5
Olinkraft, Inc. 5
Southwest Forest Industries, Inc. 6
Westvaco Corp. 9

1971

Chesapeake Corp. of Virginia 9
Consolidated Aluminum Corp. 13
Consolidated Aluminum Corp. 13
De Forenede Papirfabrikker 4
Canadian International Paper Co. 3
Eddy Forest Products Ltd. 9
Kennebec River Pulp & Paper Co. 1
Plainwell Paper Co. 1
Westvaco Corp. 5
Nettingsdorfer Papier 6
Georgia-Pacific Corp. 1
Nova Scotia Forest Industries Ltd. 3
Brown Co. 1
Kajaani Oy 2
Kajaani Oy 3
Papeteries de la Chapelle 3
Kemi Oy 6
Stora Kopparbergs Bergslags AB 1
Sterling Stubbins, Ltd. 4
S. African Pulp & Paper Industries 9
Wisconsin Tissue Mills 4
Consolidated Aluminum Corp. 13
Oxford Paper Co. 2
American Can Co. 5
Australian Newsprint Mills Ltd. 3
Stora Kopparbergs Bergslags AB 3
Stora Kopparbergs Bergslags AB 3
Westvaco Corp. 9
The Firestone Tire & Rubber Co. 12
Brown Co. 7
Yhtyneet Paperitehtaat 1
Kimberly-Clark Corp. 2
United States Gypsum Co. 8
La Rochette — Cenpa 7
Bowaters U.K. Paper Co., Ltd. 2
Bowaters U.K. Paper Co., Ltd. 1
Veitsiluoto Osakeyhtio 1
Veitsiluoto Osakeyhtio 3
Westvaco Corp. 5
Conwed Corp. 11
Conwed Corp. 11
Anglo-Canadian Pulp and Paper Mills 3
Eddy Forest Products Ltd. 10
S. African Pulp & Paper Industries 6
De Forenede Papirfabrikker 1
Veitsiluoto Osakeyhtio 3

1972

Measurex Corporation and Subsidiary Companies

Consolidated Statements of Income
for the years ended November 30, 1972 and 1971

Operating Revenues	**1972**	**1971**
Sales	**$15,201,000**	$8,041,000
Rental and service income	**1,135,000**	572,000
	16,336,000	8,613,000
Cost of sales, rentals and services	**7,058,000**	3,073,000
Gross profit	**9,278,000**	5,540,000
Selling, general and administrative expenses	**6,414,000**	3,458,000
	2,864,000	2,082,000
Interest income	**607,000**	275,000
Interest expense	**(584,000)**	(383,000)
	23,000	(108,000)
Income before taxes on income and extraordinary credit	**2,887,000**	1,974,000
Taxes on income	**1,160,000**	940,000
Income before extraordinary credit	**1,727,000**	1,034,000
Extraordinary credit—reduction of provision for federal income taxes through utilization of net operating loss carry-forward	**—**	545,000
Net income	**$ 1,727,000**	$1,579,000
Net income per common and common equivalent share:		
Income before extraordinary credit	**$ .71**	$ .52
Extraordinary credit	**—**	.27
Net income	**$ .71**	$ .79

See accompanying notes.

Measurex Corporation and Subsidiary Companies

Consolidated Statements of Changes in Financial Position

for the years ended November 30, 1972 and 1971

Resources Provided	**1972**	**1971**
Issuances of common stock for cash	**$11,210,000**	$ 42,000
Issuance (cancellation) of warrants	**(42,000)**	70,000
Additions to long-term debt	**13,160,000**	10,329,000
Reduction in non-current portion of lease contracts receivable	**2,417,000**	4,178,000
	$26,745,000	$14,619,000
Resources Applied		
To operations:		
Net income	**$(1,727,000)**	$(1,579,000)
Non-working capital items entering into the determination of net income:		
Depreciation and amortization	**(707,000)**	(524,000)
Non-current portion of deferred taxes on income	**(874,000)**	(355,000)
Net book amount of systems (including installation costs) on leases converted from short-term to long-term	**(741,000)**	(573,000)
Additions to non-current portion of lease contracts receivable related to sales which did not create working capital	**13,649,000**	7,109,000
Working capital applied to operations	**9,600,000**	4,078,000
Payments and current portion of long-term debt	**11,807,000**	2,944,000
Additions to systems leased to others under short-term leases (including installation costs)	**317,000**	845,000
Additions to fixed assets	**1,373,000**	651,000
Additions to investment in new product development	**915,000**	631,000
Additions to residual value of systems leased to others	**—**	551,000
Other	**(69,000)**	464,000
Increase in working capital	**2,802,000**	4,455,000
	$26,745,000	$14,619,000
Changes in Components of Working Capital:		
Current assets—increase (decrease) in:		
Cash	**$ 721,000**	$ 843,000
Current portion of lease contracts receivable	**1,726,000**	683,000
Accounts receivable	**(606,000)**	1,959,000
Inventories	**2,256,000**	1,537,000
Prepaid expenses	**(105,000)**	77,000
Increase in current assets	**3,992,000**	5,099,000
Current liabilities—increase (decrease) in:		
Long-term debt due within one year	**63,000**	(66,000)
Trade accounts payable	**262,000**	243,000
Accrued expenses	**755,000**	427,000
Deferred taxes on income	**110,000**	40,000
Increase in current liabilities	**1,190,000**	644,000
Increase in working capital	**$ 2,802,000**	$ 4,455,000

See accompanying notes.

Measurex Corporation and Subsidiary Companies

Consolidated Balance Sheet
November 30, 1972 and 1971

Assets	**1972**	**1971**
Current assets:		
Cash	**$ 1,871,000**	$ 1,150,000
Current portion of lease contracts receivable	**2,619.000**	893,000
Accounts receivable	**1,457,000**	2,063,000
Inventories	**4,991,000**	2,735,000
Prepaid expenses	**26,000**	131,000
Total current assets	**10,964,000**	6,972,000
Lease contracts receivable less current portion and valuation provision	**17,222,000**	5,989,000
Systems leased to others under short-term leases (including installation costs), at cost less accumulated depreciation and amortization of $261,000 (1972) and $174,000 (1971)	**1,066,000**	1,691,000
Residual value of systems leased to others under long-term leases	**691,000**	691,000
Fixed assets, at cost less allowance for depreciation	**2,631,000**	1,466,000
Investment in new product development less accumulated amortization of $814,000 (1972) and $451,000 (1971)	**1,491,000**	962,000
Other	**592,000**	525,000
	$34,657,000	$18,296,000

See accompanying notes.

Liabilities	1972	1971
Current liabilities:		
Long-term debt due within one year	**$ 210,000**	$ 147,000
Trade accounts payable	**955,000**	693,000
Accrued expenses:		
Payroll and payroll related items	**989,000**	466,000
Initial and continuing services	**421,000**	212,000
Other	**218,000**	195,000
Deferred taxes on income	**150,000**	40,000
Total current liabilities	**2,943,000**	1,753,000
Long-term debt less amount due within one year	**10,386,000**	9,033,000
Deferred taxes on income	**1,229,000**	355,000
	14,558,000	11,141,000
Contingent liabilities		
Shareholders' Equity		
Preferred stock, $1 par value: Authorized: 1,000,000 shares; issued and outstanding: none		
Common stock, without par value: Authorized: 5,000,000 shares; issued and outstanding: 2,597,284 shares (1972) and 1,927,406 (1971)	**68,000**	34,000
Additional paid-in capital	**17,865,000**	6,682,000
Retained earnings	**2,166,000**	439,000
	20,099,000	7,155,000
	$34,657,000	$18,296,000

Measurex Corporation and Subsidiary Companies

Consolidated Statements of Shareholders' Equity
for the years ended November 30, 1972 and 1971

	Common Stock		Additional Paid-In	Retained	
	Shares	Amount	Capital	Earnings	Total
Balance, December 1, 1970	1,901,011	$33,000	$ 6,571,000	$ (1,140,000)	$ 5,464,000
Issuance of warrants to purchase 72,000 shares of common stock			70,000		70,000
Other issuances (including 24,245 shares upon exercise of employee stock options)	26,395	1,000	41,000		42,000
Net income for the year ended November 30, 1971				1,579,000	1,579,000
Balance, November 30, 1971	1,927,406	34,000	6,682,000	439,000	7,155,000
Public offering of common stock less related expenses of $1,114,000	600,000	30,000	10,829,000		10,859,000
Cancellation of warrant to purchase 42,000 shares of common stock			(42,000)		(42,000)
Other issuances (including 65,878 shares upon exercise of employee stock options)	69,878	4,000	396,000		400,000
Net income for the year ended November 30, 1972				1,727,000	1,727,000
Balance, November 30, 1972	2,597,284	$68,000	$17,865,000	$ 2,166,000	$20,099,000

See accompanying notes.

Measurex Corporation and Subsidiary Companies
Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

Basis of Consolidation:

The accompanying consolidated financial statements include the accounts of the Company and its subsidiaries all of which are wholly owned excepting directors' qualifying shares. All significant intercompany items have been eliminated.

Lease Accounting:

Measurex offers its customers both short-term and long-term leases. Generally, short-term leases have terms from 12 to 42 months and long-term leases have terms from 66 to 102 months.

Substantially all the amounts shown as "Sales" are represented by long-term leases accounted for on the financing method. Such method recognizes as revenue at the time of shipment of a system an amount equal to the lesser of (a) the discounted amount of future committed lease payments discounted at a rate which the Company believes approximates the customer's borrowing rate or (b) the cash purchase price of the system. The excess of the aggregate committed lease payments over the discounted amount of such payments is recognized as interest income on the sum-of-the-digits method over the term of the lease.

In years prior to 1972 it was the Company's practice to record residual value on financing leases; had this practice been continued in 1972 net income would have been increased by approximately $336,000, or $.15 per share. (In fiscal year 1972 the American Institute of Certified Public Accountants published an Accounting Interpretation recommending that in accounting for financing leases residual value not be recorded; the Company has conformed to this recommendation.)

Short-term leases are accounted for on the operating method whereby the aggregate rentals are reported as revenue on a straight-line basis over the term of the leases. Under the operating method the statement of income reflects, as expenses, depreciation of the leased property and amortization of the installation costs.

Since its inception it has been the Company's practice to grant its customers an initial period, generally six months following installation, in which to evaluate the system. During the initial period the customer may return the system and require the refund of all rentals theretofore paid. Although no systems have been returned through November 30, 1972, provisions have been made which management believes to be sufficient to provide for losses which may result from returns.

See Note 2.

Inventory Valuation:

Purchased parts and components are stated at the lower of average cost or market. Finished sub-assemblies and systems and work in process are stated at the lower of standard cost (which approximates actual cost) or market.

See Note 3.

Properties:

The Company provides for depreciation and amortization by charges to expense which are sufficient to write off the costs of the assets over their estimated useful lives, on a straight-line basis.

The basis for computing depreciation and amortization is as follows:

Class of Property	Estimated Useful Lives
Systems leased to others under short-term leases	9 Years
Installation costs on systems leased to others under short-term leases	4 Years
Buildings	25-40 Years
Machinery and equipment	2-10 Years

Investment in New Product Development:

The Company is capitalizing new product development costs which are identifiable to significant new systems or products having a potential commercial value; those costs not meeting these criteria are charged to selling, general and administrative expense currently. The capitalized costs are being amortized to expense over the anticipated useful life of the system or product, or three years from the beginning of routine production, whichever is shorter. Costs applicable to projects abandoned are written off in the year of abandonment.

See Note 5.

Taxes on Income:

Deferred taxes are provided on all significant differences between taxable income and pre-tax income as shown in the accompanying consolidated statements of income except taxes are not provided on the income of the Company's Domestic International Sales Corporation subsidiary inasmuch as management believes that the payment of taxes on such income can be deferred indefinitely by investing and distributing such income as the DISC regulations allow.

Investment tax credit on fixed assets is recognized on the flow-through method. Generally, it is the Company's policy to allow the end-user of the leased Measurex system to claim the related investment tax credit; unclaimed investment tax credit is recognized by the Company either as additional sales or as financing income over the term of the lease.

Deferred taxes arise principally as a result of the following differences between taxable income and pre-tax income as shown in the accompanying consolidated statements of income:

(a) new product development costs which have been deferred in the accompanying financial statements are expensed for tax purposes,

(b) long-term leases, which are reported under the financing method for financial statement purposes, are reported under either the installment method or the operating method for tax purposes, and

(c) losses upon non-collection and system return are deducted for tax purposes as the losses are incurred.

See Note 8.

Net Income per Common and Common Equivalent Share: Net income per common and common equivalent share has been computed based upon the average number of common shares outstanding during the year assuming the exercise of employee stock options and stock warrants to the extent that such options and warrants were dilutive. In this computation, the proceeds from the assumed exercise of the options and warrants are assumed to have been used to purchase shares of common stock at the average market price for the period such options and warrants were outstanding. The number of shares used in the computation was 2,429,000 in 1972 and 1,994,000 in 1971.

2. Lease Contracts Receivable

Lease contracts receivable are summarized below:

	1972	1971
Aggregate lease payments to be received under long-term leases accounted for under the financing method	$25,939,000	$9,079,000
Less unearned financing income	4,449,000	1,774,000
	21,490,000	7,305,000
Less amount due within one year	2,619,000	893,000
	18,871,000	6,412,000
Less reserve for non-collection and system returns	1,649,000	423,000
	$17,222,000	$5,989,000

For a more complete description of lease transactions, see Note 1—"Lease Accounting."

The aggregate amount of principal payments due in years subsequent to 1972 are set forth below:

1973	$ 2,619,000
1974	3,048,000
1975	3,201,000
1976	3,343,000
1977	3,277,000
Thereafter	6,002,000
	$21,490,000

With respect to certain leases which have been or will be accounted for under the financing method, the Company has arranged financing with Manufacturers Hanover Trust Company ("Manufacturers") in amounts not to exceed $7,456,000 through November 30, 1973. Pursuant to such arrangement, the Company sells to Manufacturers such lease contracts receivable and related equipment on a full recourse basis and participates with Manufacturers in revenues received from the customers pursuant to purchase or lease renewal options. The effective interst rate of this arrangement varies between 8¾% and 10%. As of November 30, 1972 the Company had received $3,456,000 from Manufacturers pursuant to this agreement and was contingently liable to Manufacturers for approximately $2,990,000 of such amount.

3. Inventories

Inventories are as follows:

	1972	1971
Purchased parts and components	$3,077,000	$1,232,000
Finished sub-assemblies and systems	1,064,000	1,085,000
Work in process	850,000	418,000
	$4,991,000	$2,735,000

See Note 1—"Inventory Valuation."

4. Fixed Assets

Details of fixed assets less allowance for depreciation are set forth below:

	1972	1971
Buildings (under construction in 1971)	$1,127,000	$ 350,000
Machinery and equipment	1,025,000	537,000
Leasehold improvements	—	9,000
	2,152,000	896,000
Less allowance for depreciation (see Note 1—"Properties")	293,000	164,000
	1,859,000	732,000
Land	772,000	734,000
	$2,631,000	$1,466,000

5. New Product Development

Total new product development expenditures:

	1972	1971
Capitalized (before amortization)	$ 915,000	$ 631,000
Charged to operating expenses currently	953,000	634,000
	$1,868,000	$1,265,000
Amortization of capitalized costs	$ 363,000	$ 273,000

See Note 1—"Investment in New Product Development."

6. Long-Term Debt

Details of long-term debt are presented below:

	1972	1971
Credit agreement with banks	$ 8,935,000	$7,110,000
4% mortgage payable in annual installments of $83,000	249,000	332,000
8¾% mortgage payable in monthly installments from 1973 to 1998	1,050,000	380,000
Capitalized lease obligations on equipment used by Measurex (8¾% interest rate)	362,000	158,000
2% above prime subordinated note	—	1,200,000
	10,596,000	9,180,000
Less amount due within one year	210,000	147,000
	$10,386,000	$9,033,000

The credit agreement with Bank of America and Manufacturers Hanover Trust Company allows the Company to borrow up to $20,000,000 through November 30, 1973. The funds borrowed as of November 30, 1973 are repayable in 66 monthly installments beginning in December 1973. The monthly installments are determined by a formula related to the Company's rental receipts, but in no case will the installments be less than 1/66th of the November 30, 1973 borrowed funds.

Borrowings under the credit agreement bear interest at ½% above the prime interest rate to November 30, 1973 and thereafter at 1% above prime. In addition, the Company is required to maintain compensating balances with the bank equal to the greater of 20% of the borrowed funds or $1,000,000; such compensating balance requirements at November 30, 1972 raise the Company's cost of borrowed funds under this agreement to approximately 7½% per annum.

The credit agreement prohibits payment of cash dividends and requires the Company to keep working capital and indebtedness within specified levels. As collateral for the credit agreement, the banks may require the Company to assign its rights to future rentals on certain systems leased to end users. As of January 23, 1973, the banks had not requested any collateral.

As of January 23, 1973, borrowings under the credit agreement have increased to $11,565,000.

The aggregate amount of principal payments of long-term debt required to be paid for each of the five years following fiscal year 1972 is set forth below:

1973	$ 210,000
1974	1,817,000
1975	1,802,000
1976	1,693,000
1977	1,661,000
Thereafter	3,413,000
	$10,596,000

Subsequent to November 30, 1972, the Company arranged for a $7 million Eurocurrency borrowing.

7. Profit-Sharing Plans

The Company presently has an employee cash profit-sharing plan whereby up to 10% of the consolidated pre-tax income may be contributed to the plan. The plan is subject to annual renewal and has been renewed for 1973. The Company's contributions under the plan are set forth below:

	Percent of Pre-Tax Income	Amount
Year ended November 30, 1972	7.9%	$248,000
Year ended November 30, 1971	8.2%	178,000

The Company also has an annually renewable bonus plan whereby the Company's president is paid 1% of pre-tax (and pre-profit-sharing) income.

8. Taxes on Income

The components of taxes on income are as follows:

	1972	1971
Provision for federal income taxes which would be required in the absence of the availability of the net operating loss carry-forward		$545,000
Deferred taxes	$1,283,000	475,000
Investment tax credit (recognized under the flow-through method)	(123,000)	(80,000)
	$1,160,000	$940,000

As of November 30, 1972 the Company had a net operating loss carry-forward for federal income tax purposes of approximately $9,000,000 of which amount approximately $500,000 will expire in 1973, $700,000 in 1974, $1,500,000 in 1975, $400,000 in 1976 and $5,900,000 in 1977, if not theretofore used to reduce taxable income. If the net operating loss carry-forward is utilized, it will not affect financial statement income in the year of utilization but will reduce federal income taxes otherwise payable.

In 1972 the Company formed a Domestic International Sales Corporation ("DISC"). Through the proper utilization of a DISC, federal income taxes on transactions with foreign customers may be indefinitely deferred. The 1972 statement of income includes $430,000 of DISC-related income for which no federal income tax provision has been made inasmuch as management believes they will be able to defer the payment of such tax indefinitely.

See Note 1—"Taxes on Income."

9. Qualified Stock Option Plans

Under the Company's qualified stock option plans, 405,000 shares of common stock have been reserved for granting of options to officers and key employees of which 150,000 shares are subject to shareholder approval. Options may be granted at prices not less than 100% of the fair market value of the stock at the date of grant and become exercisable either ⅓ each year commencing two years from the date of grant or ¼ each year commencing one year from the date of grant. Options expire if not exercised within five years from the date of grant. Information concerning options granted under the plans is set forth below:

	Shares Available for Grant	Options Outstanding Shares	Price per Share	Total
Balance, December 1, 1971	30,802	179,124	$.33-$15	$1,670,000
Additional shares reserved for grant	150,000			
Options granted	(58,750)	58,750	$17-$32	1,424,000
Options terminated	9,852	(9,852)	$10-$32	(147,000)
Options exercised		(65,878)	$.33-$15	(331,000)
Balance, November 30, 1972	131,904	162,144	$.33-$32	$2,616,000
Options exercisable at November 30, 1972		30,286	$.33-$15	$ 280,000

10. Warrants

At November 30, 1972, the Company has the following warrants to purchase common stock outstanding:

Shares	Price per Share	Expiration Date
12,000	$15.00	December 29, 1975
18,000	$13.33	May 30, 1977

Auditors' Report

To the Board of Directors
Measurex Corporation

We have examined the consolidated balance sheet of Measurex Corporation and Subsidiary Companies as of November 30, 1972, and the related consolidated statements of income, shareholders' equity and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We previously examined and reported upon the consolidated financial statements of Measurex Corporation and Subsidiary Companies for the year ended November 30, 1971.

In our opinion, the above-mentioned financial statements present fairly the consolidated financial position of Measurex Corporation and Subsidiary Companies at November 30, 1972 and 1971, and the consolidated results of their operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis, except for the change, with which we concur, in accounting for residual value on finance leases as described in Note 1 of Notes to Consolidated Financial Statements.

Lybrand, Ross Bros. + Montgomery

Lybrand, Ross Bros. & Montgomery
Palo Alto, California

January 23, 1973

Directors of Measurex Corporation

Paul Bancroft III
Vice President
Bessemer Securities Corporation

Dwight C. Baum
Senior Vice President
Blyth Eastman Dillon & Co. Incorporated

David A. Bossen
President
Measurex Corporation

William H. Draper III
President
Sutter Hill Capital Corporation

John W. McKittrick
President
Plantronics, Inc.

Principal Officers of Measurex Corporation and Subsidiaries

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President

Doris S. Bossen
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Vice President

Dean A. Forseth
Vice President
Measurex Leasing Corporation

Fernand Ostiguy
Vice President
Measurex (Canada) Ltd.

Charles M. Worthley
Managing Director
Measurex International Corporation

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San Francisco, California

Manufacturers Hanover Trust Company
New York, New York

Registrars

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Bankers Trust Company
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Auditors

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