Measurex Corporation
Annual Report 1977

The First Decade

Financial Highlights

(Dollar amounts in thousands except per share data)

	1977	1976	Percent Change
For the Year:			
Operating revenues	**$ 64,123**	$ 52,243	23%
Net income:			
Amount	**$ 5,357**	$ 2,985	79%
Per share	**$ 1.65**	$ .93	77%
Average number of common and common equivalent shares	**3,241,000**	3,222,000	1%
End of Year:			
Working capital	**$ 35,366**	$ 34,702	2%
Total assets	**$ 113,639**	$ 115,876	−2%
Shareholders' equity:			
Amount	**$ 48,984**	$ 43,851	12%
Per share	**$ 15.27**	$ 13.68	12%
Number of employees	**1,463**	1,253	17%
Systems backlog	**$ 26,000**	$ 12,600	106%
Shares issued and outstanding	**3,208,000**	3,205,000	—

To our Shareholders:

Measurex celebrated its tenth anniversary on January 18, 1978. I am pleased to announce that during 1977, our tenth fiscal year, new records in orders, backlog, revenues and profits were recorded by our Company. Our successes during the year could not have been attained without the concerted effort of Measurex employees, worldwide.

Market Penetration

Backlog at the end of 1977 reached $26 million. This is the highest backlog level in the Company's ten year history. Order levels during the fourth quarter exceeded the Company's previous quarterly record by $9 million (or 53%). All geographic areas of our business contributed to this strong order performance.

Since the introduction in 1976 of our 2000/25 System which was originally designed for use in the manufacture and control of extruded plastic sheet and film, we have attempted to emphasize key account penetration. We have met the goals that we set for ourselves, having booked orders for thirty 2000/2001/25 Systems from 16 customers. We look forward to continuing market penetration in this industry.

In 1977, we introduced what we believe is the first computer based Tire Tread Extrusion Control System. The system was delivered to Firestone Tire and Rubber Company. We view the introduction of this System as an important step in broadening our market potential in the rubber industry. The market for tread systems is approximately three times that for calender control systems, and to date the Company has received 42 orders for calender control systems.

New Measurex 2001 Family

In September, 1977, the first process control family of elements with fully distributed intelligence, the Measurex 2001, was introduced to the industry. This product line allows the user to configure his own system from the smallest to the largest requirement, with added reliability, maintainability, and diagnostics. A few of the key technical characteristics of the 2001 family of elements are:

☐ In each major system element microcomputers provide the advantage of distributed processing. This reduces the demands on the central processing unit, increasing the system's total capability and providing for separate independent diagnostics for each system element.

☐ Several important new control capabilities expand the use of the computer systems in such key areas as control of cross-machine caliper and moisture variations, advanced stock blending and refiner control.

☐ Redesigned sensors with new features provide greater accuracy, reliability, and maintainability.

☐ New hierarchical computer communication packages provide new capabilities for data processing and management reporting.

Since its introduction, we have received orders for over 80 Measurex 2001 Systems, demonstrating the market acceptance of this new product. Systems configured from the new family of elements were shipped during the fourth quarter of 1977.

Energy Control

In the energy management field, during 1977 we purchased certain rights to designs, technology, and patents for sensors for the measurement of combustion products and effluents. The integration of these sensors with Measurex digital electronics will provide the most advanced system available to industrial power producers. The Measurex Energy Control Systems will minimize fuel usage in boilers and assist in controlling emissions within EPA regulations. Measurex has installed or has on order energy systems for customers in the United States, Finland, and the Soviet Union.

Financial Results

In 1977, Measurex was listed on the New York and Pacific Stock Exchanges and now trades under the symbol MX. The Company's stock was previously traded in the over-the-counter market. Also, your Board of Directors declared the initial dividend of 8 cents per share. The Board has announced its intention to continue to declare dividends on a quarterly basis, assuming that future economic and business conditions so warrant.

During 1977 the Company refinanced its bank debt with new loan agreements providing for a $25 million domestic term loan, at a fixed interest rate of 8.5% per annum and a $20 million multicurrency term loan at variable interest rates. Short-term working capital lines in various currencies totaling $20 million are also available to the Company. These facilities give the Company the flexibility required to support our growing domestic and international operations.

A review of the Company's financial performance indicates we have progressed in the following areas:

☐ Gross margins on sales and installation revenues improved 3% over 1976. The improved profit margins, which occurred principally as a result of cost reduction programs combined with the higher factory throughput and higher absorption of our fixed overhead costs, resulted in a $4.9 million (22%) improvement in margins with only a $6.6 million (16%) increase in sales and installation revenues.

☐ For the first time in the Company's history, service and rental operations have contributed to profits. Profit margins from this segment of our business were $478,000 in 1977 compared to a loss of $1,041,000 in 1976.

☐ We embarked on major construction projects to expand our headquarters and manufacturing facility in Cupertino, California, and our manufacturing facilities in Waterford, Ireland. These expanded facilities will enable us to meet the growing demand for Measurex's process control systems.

☐ Return on average stockholders' equity increased to 11.5% compared to 7.1% in 1976, with continued improvement anticipated in 1978.

☐ Inventories decreased by $549,000 from 1976 levels even though operating revenues increased by 23%.

☐ The debt to equity ratio improved to 1.0 in 1977 from 1.2 in 1976.

☐ Net interest expense declined to $550,000 in 1977 from $1,504,000 in 1976.

Management

The Company has made the following key management changes during 1977:

☐ Doctor William I. Robinson was promoted to the newly created position of Vice President-Operations. Dr. Robinson, previously Vice President-Engineering, will be responsible for the Company's worldwide engineering, manufacturing, material control, and product planning activities.

☐ Mr. Fernand Ostiguy was appointed Managing Director—Europe. Mr. Ostiguy continues as President of Measurex (Canada) Ltd.

☐ Mr. Richard C. Bentley joined the Company as Corporate Controller. Mr. Bentley was previously a Marketing Controller for Xerox Corporation.

Summary

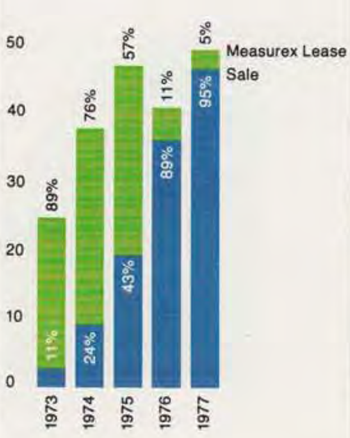
In summary, 1977 was a good year for Measurex. With our year end record backlog as a starting point, we are looking forward to a successful year in 1978. Once again, I would like to thank our stockholders and all of our employees for their effort in making this first decade a success for Measurex.

Sincerely,

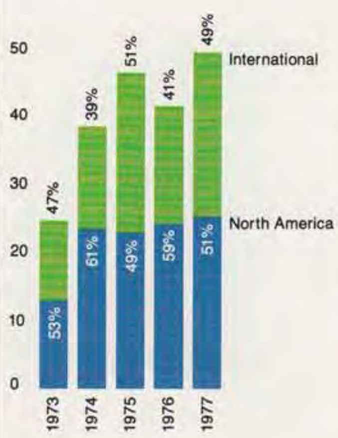
David A. Bossen

David A. Bossen
President
February 6, 1978

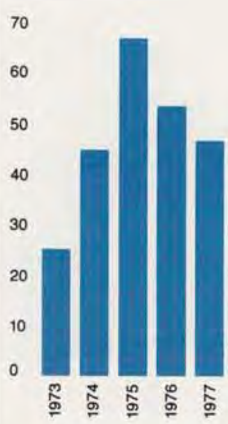
System Revenue Sales vs. Lease
Millions of Dollars



System Revenue Geographic Distribution
Millions of Dollars

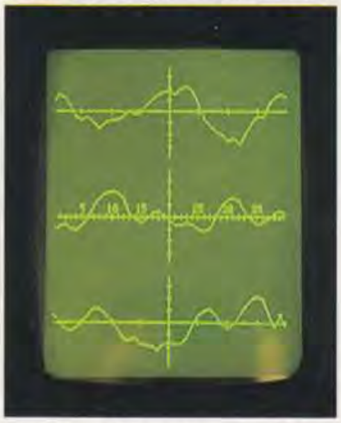


External Borrowing
Millions of Dollars



1968

The concept of Measurex evolved with the realization that the advent of the minicomputer permitted the design of very sophisticated turn-key control systems for the continuous process industries. The system, with the computer at its heart, would support on-line sensors measuring the characteristics of the finished product; would display and print out information for the use of the process operators and plant management; and would provide sophisticated digital control of the



process. The system would be unique (at the time) and would supercede "do it yourself" computer-based systems assembled by users from analog sensors, recorders and controllers acquired from various suppliers and interfaced and programmed at great expense. The result of, and motivation for, use of the Measurex system by our customer: reduced material costs, more throughput and higher quality product.

In 1968 Measurex pioneered the development of digital computer integrated control systems for the paper industry. The paper industry was the first of the process industries to be served; once developed, the technology and application expertise would be taken to other continuous process industries, including metal, rubber and plastics.

Measurex's business was defined in 1968 as providing materials control, throughput control and quality control systems for the continuous process industries. Measurex selected this business focus for a number of reasons. First, the latent potential market was and is very large. Sheet products are numerous—from the broad range of paper grades to coated tapes, laminates, plastic sheeting, floor and ceiling tile, metal foil, rubber calendered tire fabric, and aluminum and steel sheet and strip.

Secondly, the economics of the processes indicate substantial opportunity for cost reduction. In the case of most sheet products made by continuous processes the cost of raw material is high—typically over 50 percent 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. The efficiency of this conversion from a bulk commodity to a sheet product determines to a major degree the manufacturer's profitability. Tangible and significant 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.

In the paper industry, customers achieve reductions in raw material usage of 2 to 5 percent and increases in productivity of 3 percent to 15 percent. In addition, improved product quality and thus improved acceptance and fewer complaints from the paper mills' customers are also realized.

The year 1968 was devoted to attracting a top-flight technical, marketing and management team and performing the initial development and marketing of the Measurex system.

1969

In the first half of 1969 the first three Measurex systems were installed, all in the paper industry: one on a fine paper machine, one on a newsprint machine, and one on a linerboard machine. These three installations on paper machines of quite different capacities producing very different end products, allowed Measurex to test and prove the economics of the systems. The systems contained the first sensors designed specifically for integration with a digital computer—nuclear radiation sensors to assess the basis weight of the paper and infrared sensors to determine the moisture content of the paper.

The systems proved their economic viability and in the course of the year nine additional orders were received from seven different companies within the paper industry.

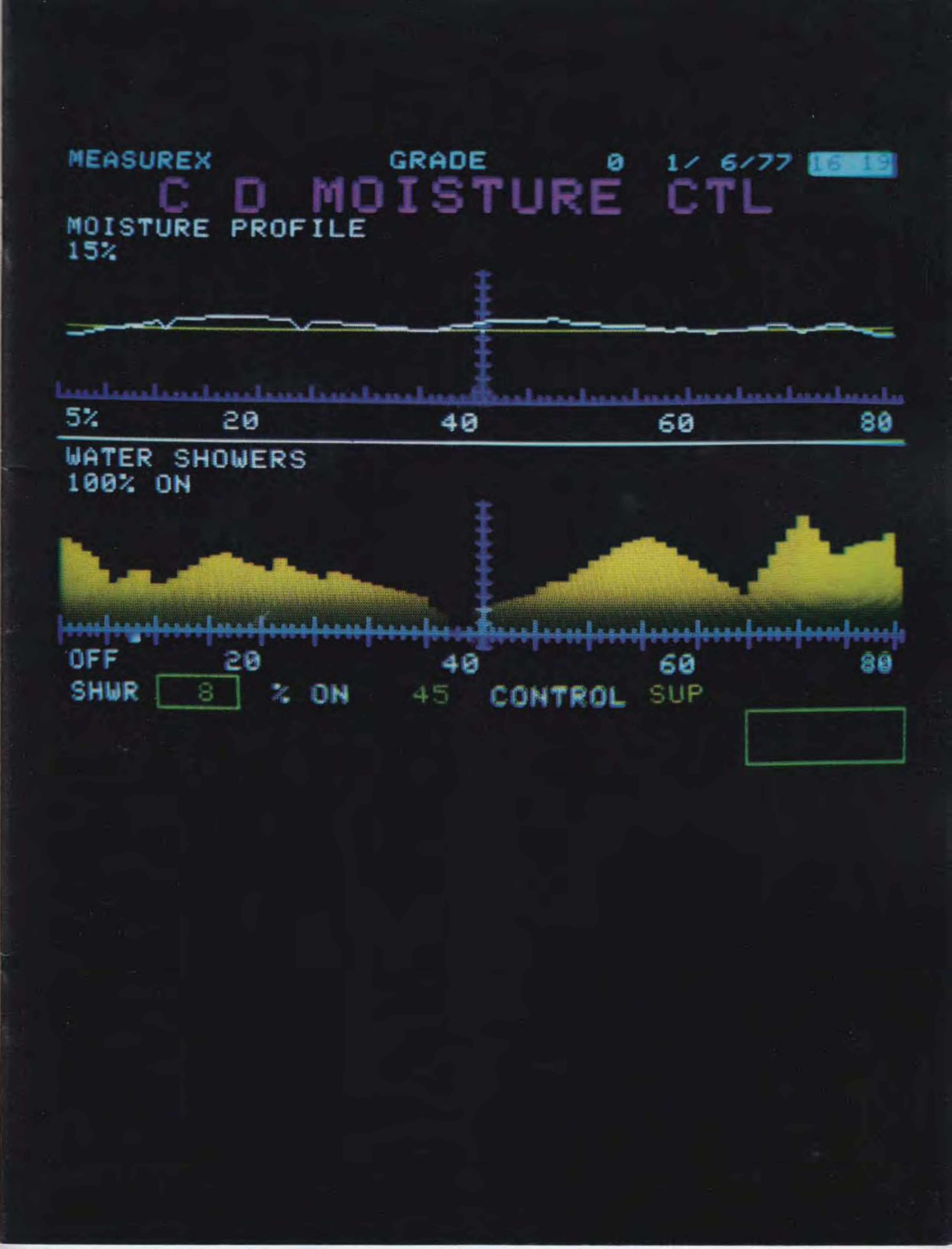
1970

In 1970, just two years after the founding of Measurex, our first systems were delivered to international customers. International marketing had commenced in late 1969 and the first two orders received in 1970 were from international customers, one from Finland and one from the United Kingdom. Since 1970, customers in Finland have ordered 48 Measurex systems, and our United Kingdom customers have ordered 29 systems.

The international market has continued to be important to Measurex. The Company has received a total of 744 system orders from its inception through 1977, 52% of which have been from customers outside the United States.

The first three years at Measurex—1968 through 1970—were devoted to proving the company's initial strategy: provide computer-integrated control systems to improve material control, throughput control and quality control in the sheet process industries, and accomplish this control through the use of dedicated digital computers linked to proprietary sensors that measure the product variables "on line", display the data for use by the machine operators, effect automatic control, and summarize production information in management reports. By the end of 1970 Measurex had proven that its strategy was sound, both in the United States and in the international marketplace.

Auto control of cross-direction moisture content on paper machines is a microprocessor driven option of the 2001 family.


MEASUREX
GRADE
0
1/ 6/77
16 19
C D MOISTURE CTL
MOISTURE PROFILE
15%
5%
20
40
60
80
WATER SHOWERS
100% ON
OFF
20
40
60
80
SHWR
8
% ON
45
CONTROL
SUP

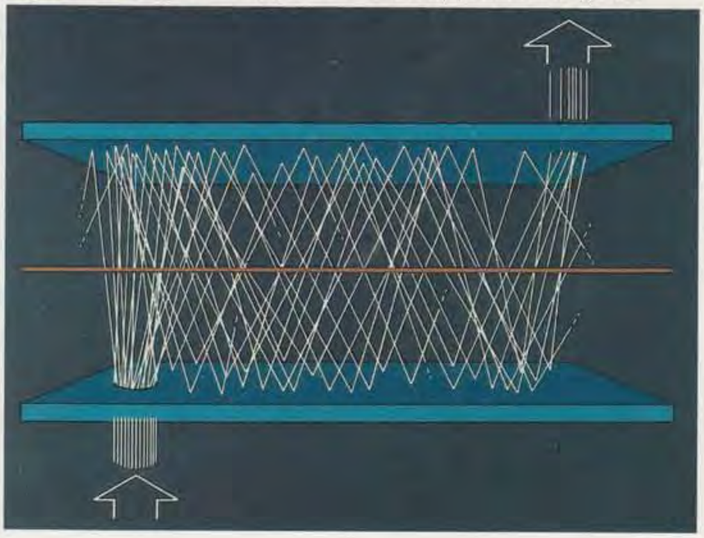
1971

Successful application of a Measurex system to the control of a continuous process requires detailed knowledge of the Measurex system itself, including the capabilities and characteristics of the digital sensors, control algorithms, displays and management information systems, as well as thorough understanding of the customers' processes.

Measurex has placed and will continue to place strong emphasis on the development of an extensive and well-trained field sales and service organization. By the end of 1971, when a total of 45 systems had been shipped, the field force was comprised of 16 area and regional managers, 18 application engineers, and 54 field engineers. Today the field force numbers 69 area and regional managers, 58 application engineers, and 464 service specialists. Building this team of professionals has been one of the most significant challenges of the decade. The existence of this worldwide distribution network is a strength of the Company and is important for future profitable growth.

Area managers carry the primary responsibility for selling Measurex systems and, equally important, assuring that after installation, the customer is achieving the projected economic results. Assisting the area manager in these efforts is the application engineer who is available to assist the customer in achieving improved process economics and quality output. In addition, virtually all customers contract with Measurex for continuing service. These service contracts provide for both routine preventative service and quick response emergency service by a field service engineer resident at or near the customer's plant.

Measurex has devoted, and will continue to devote, substantial resources to the training of its field personnel. By the end of 1977, the Company had established training centers in Cupertino, California, Waterford, Ireland, and Tokyo, Japan, where a mix of sophisticated educational techniques, including self-pacing instruction, color video tapes and on-site apprenticeships, is used to train personnel.



Proprietary digital caliper sensor accurately measures plastic sheet thickness.

1972

The year 1972 was a year of major expansion for Measurex in terms of physical facilities and financial resources. Measurex had acquired in 1970 an 18-acre site in Cupertino, California, and in early 1972 occupied the first building at this site—a 52,000 square-foot administration, engineering and manufacturing building.

The move allowed the Company to consolidate its operations from four scattered locations in Santa Clara, California, and to plan for the efficient expansion of facilities as growth continued in future years. When the Company first occupied this Cupertino site, the 52,000 square-foot facility housed 221 employees; today there are 563 employees in Cupertino (37 percent of total company employment) and 102,000 square feet of office, laboratory and manufacturing space.

Also in 1972 Measurex became a publicly-owned company: an offering of 600,000 shares of the Company's common stock, managed by Blyth, Eastman Dillon and Co., Inc., realized about $11,000,000 for the Company. Since its initial stock offering the Company has received broad support from investors, both individuals and institutions.

1973

Initial major efforts to penetrate markets outside of the paper industry commenced in 1973. During the year we installed two systems to control single-stand rolling mills producing aluminum foil and one system to control the calendering operation by which rubber is applied to tire fabric for use in passenger car and truck tires. During 1973 four additional orders were received from the rubber and plastics industry, including a repeat order from our first customer; four additional orders were received from the metals industry for the control of foil rolling mills, including a repeat order from our first customer; and two orders were received from the textile industry for control of the finishing of knit goods.

Within the paper industry our capabilities were expanded to include the control of pulp processes. Following the successful operation of our first bleach plant control system, we received, in 1973, orders for the control of both batch and continuous pulp digesters.

The rapid expansion in 1973 and subsequent years in the number of different processes controlled by Measurex computer-based systems has been facilitated by our development and use of standard proprietary hardware and software modules. The largest portion of our engineering budget has been devoted to multi-industry developments—developments that find application across two or more industry segments.

In 1973 the Company's manufacturing facility in Waterford, Ireland was opened. The expansion of our international business necessitated the development of manufacturing capabilities at an overseas location that was closer to what was then becoming a major geographical market for the Company. In 1973 about 47% of revenues were derived from outside of North America. After considering a number of potential sites, the Republic of Ireland was chosen because it is in the Common Market and because its government is supportive of overseas companies commencing manufacturing within the country.

1974

In January, 1974, six years after the Company's formation, Measurex introduced a major new system to the paper industry—the Measurex 2000. This new system had been in development for about three years and, when introduced, incorporated the latest proven developments in process computer hardware and software technologies. This product introduction demonstrated Measurex's technical leadership in the industry in 1974. Subsequent product introductions have enabled the Company to maintain this leadership position over the years.

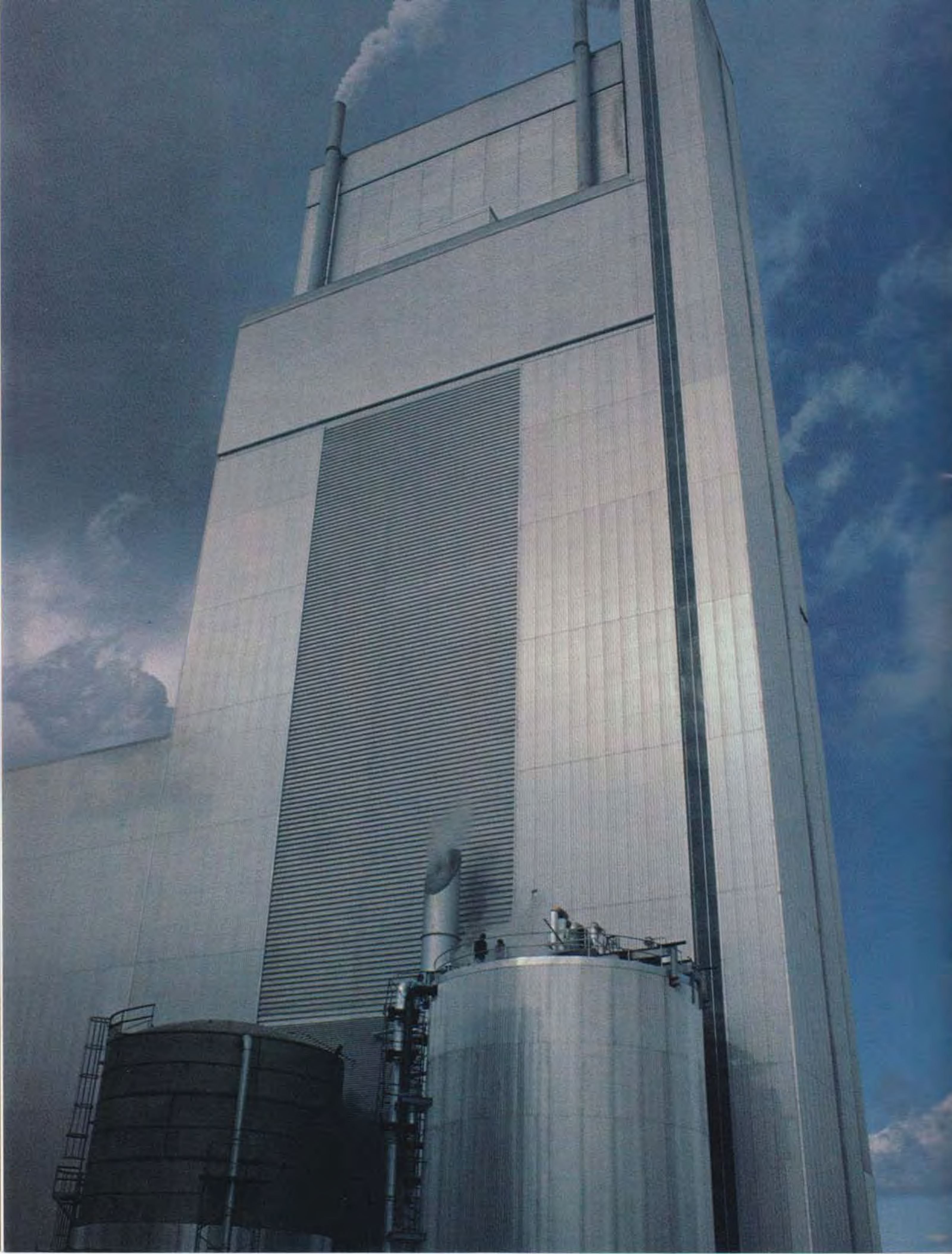
The Measurex 2000 represented a significant step forward from Measurex's original 1000 System. The System took advantage of revolutionary developments within the electronics industry at that time—particularly the development of microprocessors and semiconductor memory.

The Measurex 2000 System increases the quantity and quality of useful information for operators and mill management. The System includes an interactive graphic color video unit, utilizing a proprietary semiconductor memory system in conjunction with a proprietary microprocessor controller. This unit, together with Measurex sensors, a computer with a proprietary extended memory and an advanced software system, provides flexibility for a very broad range of displays, operator interface functions and automatic controls. Serial data transmission greatly simplifies installation and improves reliability. The original decision to avoid the use of rotating memory in favor of core or semiconductor memory has proven to be most fortunate as the decline in price of semiconductor and core memory generated substantial savings for Measurex combined with superior reliability for our customers.

Measurex continues to monitor trends in technology with a view toward incorporating in process control the latest developments in sensor, computer, communication and related sciences. The Company's policy however is to introduce these new developments only at test sites until they have been thoroughly proven and debugged.

In 1974 the Company also entered into the market for power plant energy management systems. During the year the Company received orders for systems to control the operation of two black liquor recovery boilers in Georgia and California.

Fast, highly reliable scanner guarantees accurate scan average and cross-directional profile measurements.



1975

The first three years at Measurex—1968 through 1970—were devoted to proving our basic business concept. The next five years—1971 through 1975—were devoted to growing rapidly and increasing market share. By 1975 the Company had achieved significant market share positions in most of the markets served. During 1975 attention was turned to improved management techniques and internal controls. Specifically, cash management, service operations and quality improvements were the areas of concentration.

In 1975 the scope of our commitment to energy management was also broadened by entering into a joint development agreement with Union Camp Corporation for the supply of systems for the control of Power Boilers and Turbine Generator Cogeneration units.

The mandate of this program was to create systems which would be applicable to steam generating units and which would minimize fossil fuel costs at industrial power generation sites.

One of three Recovery Boilers at Union Camp Corporation under Measurex control.

1976

Clearly, 1976 was the most difficult year of the decade; a year that tested the Company's management skills. The downturn of the world economy resulted in a modest decline in revenues in 1976 from 1975 as well as a decline in profitability.

Throughout Measurex's history an objective has been to manage growth in such a way that would ensure employees a stable work environment. There

was no layoff in 1976. Indeed, our field force was augmented in order to meet commitments to customers.

In July of 1976 a major new low-cost system was introduced, the Measurex 2000/25 for the control of plastic film and sheet extrusion and other processes with relatively low throughput. Also in 1976 our initial systems for the control of large industrial energy power plants were delivered to Union Camp Corporation.

Efforts in cash and asset management, which commenced in 1975, yielded substantial results in 1976. The large majority of the Company's system revenues had, in previous years, been realized from long-term finance leases. In 1976 this condition was reversed, as 89 percent of system revenue was generated from outright sales. The Company's portfolio of lease contracts was reduced by 28 percent, from about $64 million to $46 million. Long-term debt was also reduced by about $7 million. Through careful management of foreign currency exchange exposure, the Company's losses from exchange adjustments were reduced from $1.2 million in 1975 to $0.2 million in 1976. Losses from service operations were reduced from $2.5 million to $1.0 million.

With a broad customer base—in terms of both geography and industry—and with a strong base of shareholders' equity, Measurex weathered the test of 1976.

1977

As 1977 ends, Measurex looks back with pride on its first decade and forward with optimism to the coming decade. A fundamental strength of Measurex is the original business definition, a definition that prevails today: providing computer-based process control systems, encompassing proprietary sensors, software, computer processing, operator displays, management information and continuing services, for the purpose of increasing throughput, decreasing materials costs, and improving quality. While the original focus was solely on the sheet process industries, the Company's business definition now includes the control of other continuous processes and of industrial energy systems. Our objective has always been to establish Measurex as the leading supplier of such systems worldwide.

State-of-the-art technology will continue to be stressed in our systems. Broad capabilities in our development and engineering team—capability in sensors, control theory, computer software, digital logic, electronic communication and mechanical hardware are required. The 2001 System, introduced in 1977, is typical of the type of new system to which Measurex is dedicated. The 2001 System is evolutionary, providing full compatibility with the Measurex 2000. It incorporates the expanded use of microprocessors with distributed intelligence for sensor support, the video, printer/plotter and operator stations. The System incorporates in "firm ware" diagnostic routines to further improve overall system serviceability.

During 1977, sensor technology for the measurement of combustion products in boiler fuel gasses was acquired. This technology which is being combined with Measurex digital technology provides unique new sensors for control of power plants to minimize fossil fuel costs while maintaining stack gas effluents within EPA regulations. To date, 14 Energy Management Systems have been ordered.

Measurex continues to stress excellence in and continuity of staff. The Company's original Board of Directors continues to serve the Company today. Practically all senior managers have been promoted from within. Our staff will continue to grow but without compromise in quality.

The opportunities for profitable growth have never been greater. The majority of process machines in the paper, rubber, plastics and other industries served by Measurex are not yet equipped with digital, computer-based systems. Moreover, opportunities exist to extend penetration of these industries by adapting systems to the control of processes with lower total throughput; by offering additional features for present and future customers, such as cross-direction caliper and moisture control and extended stock blending, introduced to the paper industry in 1977. Further opportunities also exist for undertaking the control of additional processes within the current industries served, as well as other continuous process industries.

New 2001 Operation Center links operator to the process closer than ever before.


SPEED HDBX CONTROL
TARGET VALUE STATUS
JET WIRE
TOTAL HEAD
BYPASS VALVE
STREAM FLOW
SLICE
WIRE SPEED
MACHINE SPEED
SPEED CHANGE
CD MOISTURE CNTL
MOISTURE BY WATER JET
WET
DRY
WATER JETS
100% ON
OFF
JET
CONTROL
measurex
2001

Management Discussion and Analysis of the Summary of Operations

Net Income

Net income for 1977 was $5,357,000 ($1.65 per share). This represented a 77% increase in net income per share over the prior year. For 1976, net income was $2,985,000 ($.93 per share) which was a 23% decrease in net income per share compared to 1975. The factors contributing to these changes are discussed below.

Operating Revenues

Sales and installation revenues increased $6,663,000 (16%) in 1977, primarily due to an increase in the number of unit shipments to geographic areas outside North America. In 1976, sales and installation revenues decreased $5,925,000 (12%) compared to 1975, primarily due to a decrease in system shipments to customers in Western Europe.

Service revenues and rentals on short-term leases increased by $5,217,000 (51%) in 1977 and $4,383,000 (74%) in 1976. These increases were due to the greater volume of systems sold and then serviced by the Company and increases in service rates charged to customers.

Costs Related to Operating Revenues

Cost of sales and installations increased $1,812,000 (9%) during 1977. The cost as a percentage of sales and installation revenues decreased from 46.8% in 1976 to 44.1% in 1977. This decrease resulted primarily from a number of cost reduction programs implemented early in 1977, improvements in the absorption of fixed overhead costs resulting from increases in the number of units manufactured during the year, and a decrease in the average length of time required to install new systems. In 1976 the decline in cost of sales and installations of $2,132,000 (10%) was consistent with the decrease in sales and installation revenues.

Service and rental costs increased by $3,698,000 (33%) in 1977 and by $2,930,000 (35%) in 1976. These increases were due to the increased number of systems serviced by the Company and the effect of inflation on service costs.

Operating Expenses

In 1977 selling, general and administrative expenses increased by $3,566,000 (31%) over the previous year. The 1977 increase was primarily due to an increase in the number of sales and marketing personnel and increased activity levels in the Company's sales, marketing, and finance organizations.

In 1976 selling, general and administrative expenses decreased by $241,000 (2%) compared to 1975. The decrease in 1976 was consistent with the decrease in operating revenues during that year.

Product development expenses increased $147,000 (4%) and $317,000 (8%) during 1977 and 1976 respectively. These increases reflect the continuing high level of development effort required to maintain the technical excellence of the Company's product.

Foreign Currency Exchange Adjustments

In 1977, foreign currency exchange adjustments were $422,000, an increase of $193,000 (84%) compared to 1976. In 1976, foreign currency exchange adjustments were $229,000, a decrease of $1,020,000 (82%) compared to 1975. Since 1975, it has been the Company's policy to offset its foreign currency asset positions where practical with foreign currency borrowings and other hedging activities.

Interest

Interest income decreased by $119,000 (2%) during 1977, primarily as a result of selling a portion of lease contracts receivable to financial institutions during the year. The 1976 increase in interest income of $923,000 (23%) was due to an increase in interest rates charged to customers and an acceleration of payment terms which enabled the Company to bill customers for principal and interest at an earlier date subsequent to the shipment of systems compared to prior years.

Interest expense decreased $1,073,000 (17%) in 1977 and resulted from lower interest rates and lower average outstanding debt. The $70,000 (1%) increase in interest expense during 1976 was attributable to higher average borrowings which was largely offset by a decrease in long-term interest rates.

Provision for Income Taxes

The provision for income taxes increased by $1,046,000 and $371,000 in 1977 and 1976 respectively. The effective tax rate during 1977 was 27.6% compared to a rate of 25.0% in 1976. This increase reflects a reduction in tax benefits from the Company's Domestic International Sales Corporation due to changes made by the Tax Reform Act of 1976 and the increased earnings of foreign subsidiaries which were subject to a higher tax rate.

Measurex Corporation and Subsidiary Companies
Five Year Financial Review
(Dollar amounts in thousands except per share data)
Fiscal years ended November 30

	1977	1976	1975	1974	1973
Summary of Operations					
Operating revenues	**$ 64,123**	$ 52,243	$ 53,785	$42,086	$27,123
Costs related to operating revenues	**36,464**	30,954	30,156	23,137	14,409
Operating expenses	**19,288**	15,575	15,499	11,938	8,488
Foreign currency exchange adjustments	**422**	229	1,249	132	(619)
Interest income	**4,796**	4,915	3,992	2,222	1,331
Interest expense	**5,346**	6,419	6,349	4,186	2,108
Income before income taxes	**7,399**	3,981	4,524	4,915	4,068
Provision for income taxes	**2,042**	996	625	950	1,590
Net Income	**$ 5,357**	$ 2,985	$ 3,899	$ 3,965	$ 2,478
Net income per common and common equivalent share	**$ 1.65**	$ .93	$ 1.20	$ 1.31	$ .92
Average number of common and common equivalent shares (in thousands)	**3,241**	3,222	3,248	3,031	2,685
Financial Position at Year-end					
Working capital	**$ 35,366**	$ 34,702	$ 25,430	$25,882	$14,528
Total assets	**113,639**	115,876	122,813	92,157	56,034
Capitalization:					
Long-term debt—senior	**26,544**	33,454	45,062	32,572	20,919
Long-term debt—subordinated	**6,000**	9,000	10,000	10,000	5,000
Shareholders' equity	**48,984**	43,851	40,657	36,304	22,110
Statistics and Key Ratios					
Employees at year-end	**1,463**	1,253	1,077	947	667
Systems backlog at year-end	**$ 26,000**	$ 12,600	$ 12,500	$17,043	$ 8,058
Net income as a percentage of:					
Operating revenues	**8%**	6%	7%	9%	9%
Shareholders' equity at beginning of year	**12%**	7%	11%	18%	13%
Current ratio at year-end	**2.3**	2.3	2.1	3.4	3.3
Ratio of external debt to shareholders' equity at year-end	**1.0**	1.2	1.7	1.3	1.2
System revenue:					
Percentage sold	**95%**	89%	43%	24%	11%
Percentage under long-term Measurex lease	**5%**	11%	57%	76%	89%

Measurex Corporation and Subsidiary Companies

Consolidated Statement of Income—1977 and 1976 by Quarter (Unaudited)
(Dollar amounts in thousands except per share data)

	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	1977	1976	**1977**	1976	**1977**	1976	**1977**	1976
Operating revenues:								
Sales and installation revenues	**$10,930**	$ 9,065	**$11,837**	$10,127	**$11,829**	$11,130	**$14,041**	$11,652
Service revenues and rentals on short-term leases	**3,264**	1,939	**3,613**	2,411	**4,151**	2,753	**4,458**	3,166
Total operating revenues	**14,194**	11,004	**15,450**	12,538	**15,980**	13,883	**18,499**	14,818
Costs related to operating revenues:								
Cost of sales and installation	**4,857**	4,321	**5,233**	4,609	**5,179**	5,469	**6,187**	5,245
Cost of service and rentals	**3,260**	2,293	**3,597**	2,691	**3,857**	3,037	**4,294**	3,289
Total costs related to operating revenues	**8,117**	6,614	**8,830**	7,300	**9,036**	8,506	**10,481**	8,534
Gross profit	**6,077**	4,390	**6,620**	5,238	**6,944**	5,377	**8,018**	6,284
Selling, general and administrative expenses	**3,229**	2,592	**3,478**	2,777	**3,824**	2,643	**4,536**	3,489
Product development expenses	**855**	975	**1,124**	1,065	**1,070**	1,001	**1,172**	1,033
Operating income	**1,993**	823	**2,018**	1,396	**2,050**	1,733	**2,310**	1,762
Foreign currency exchange adjustments	**114**	(31)	**67**	103	**116**	161	**125**	(4)
Interest income	**(1,259)**	(1,130)	**(1,189)**	(1,132)	**(1,113)**	(1,346)	**(1,235)**	(1,307)
Interest expense	**1,471**	1,564	**1,386**	1,656	**1,264**	1,611	**1,225**	1,588
	326	403	**264**	627	**267**	426	**115**	277
Income before income taxes	**1,667**	420	**1,754**	769	**1,783**	1,307	**2,195**	1,485
Provision for income taxes	**462**	105	**480**	192	**490**	327	**610**	372
Net income	**$ 1,205**	$ 315	**$ 1,274**	$ 577	**$ 1,293**	$ 980	**$ 1,585**	$ 1,113
Net income per common and common equivalent share	**$ .37**	$ .10	**$ .40**	$ .18	**$ .40**	$ .30	**$ .48**	$ .35
Dividends per share	**—**	—	**—**	—	**—**	—	**$ .08**	—
Price Range of Common Stock								
High	**$ 13⅞**	$ 17¼	**$ 14⅜**	$ 15⅞	**$ 19**	$ 14⅞	**$ 19⅜**	$ 14¼
Low	**10⅞**	11⅜	**10½**	12⅝	**13½**	11½	**16¼**	8⅜

The Company's common stock was listed on the New York Stock Exchange and the Pacific Stock Exchange in July, 1977, and the table above reflects closing prices quoted on the New York Stock Exchange since listing. Prior to listing on the Exchanges, the table reflects the range of daily bid prices on the over-the-counter market as reported by the National Association of Securities Dealers.

On September 29, 1977, the Board of Directors declared the Company's initial cash dividend on common stock.

Measurex Corporation and Subsidiary Companies
Consolidated Statements of Income
For the years ended November 30, 1977 and 1976

	1977	1976
Operating revenues:		
Sales and installation revenues	**$48,637,000**	$41,974,000
Service revenues and rentals on short-term leases	**15,486,000**	10,269,000
Total operating revenues	**64,123,000**	52,243,000
Costs related to operating revenues:		
Cost of sales and installation	**21,456,000**	19,644,000
Costs of service and rentals	**15,008,000**	11,310,000
Total costs related to operating revenues	**36,464,000**	30,954,000
Gross profit	**27,659,000**	21,289,000
Selling, general and administrative expenses	**15,067,000**	11,501,000
Product development expenses	**4,221,000**	4,074,000
Operating income	**8,371,000**	5,714,000
Foreign currency exchange adjustments	**422,000**	229,000
Interest income	**(4,796,000)**	(4,915,000)
Interest expense	**5,346,000**	6,419,000
	972,000	1,733,000
Income before income taxes	**7,399,000**	3,981,000
Provision for income taxes	**2,042,000**	996,000
Net income	**$ 5,357,000**	$ 2,985,000
Net income per common and common equivalent share	**$ 1.65**	$ .93

The accompanying notes are an integral part of the financial statements.

Measurex Corporation and Subsidiary Companies

Consolidated Balance Sheets

November 30, 1977 and 1976

Assets	**1977**	1976
Current assets:		
Cash	**$ 2,692,000**	$ 1,733,000
Lease contracts receivable due within one year	**8,023,000**	8,424,000
Accounts receivable, less allowance for non-collection of $800,000 in 1977 (1976: $1,100,000)	**26,843,000**	24,429,000
Inventories:		
Purchased parts and components	**13,601,000**	14,773,000
Work in process	**4,899,000**	5,065,000
Subassemblies and finished systems	**6,587,000**	5,798,000
	25,087,000	25,636,000
Prepaid expenses	**444,000**	670,000
Total current assets	**63,089,000**	60,892,000
Lease contracts receivable, less allowance for non-collection and system returns of $1,090,000 in 1977 (1976: $1,497,000) and amounts due within one year	**36,978,000**	45,678,000
Property, plant and equipment, at cost less accumulated depreciation	**9,413,000**	7,465,000
Long-term cash deposits	**1,650,000**	—
Other assets	**2,509,000**	1,841,000
	$113,639,000	$115,876,000

The accompanying notes are an integral part of the financial statements.

Liabilities	1977	1976
Current liabilities:		
Short-term bank debt	**$ 3,187,000**	$ 5,750,000
Long-term debt due within one year	**11,188,000**	6,390,000
Trade accounts payable	**2,720,000**	3,226,000
Accrued liabilities:		
Payroll and payroll related items	**3,706,000**	3,196,000
Initial services	**1,291,000**	1,539,000
Other	**4,182,000**	4,820,000
Income taxes payable	**674,000**	625,000
Deferred income taxes	**775,000**	644,000
Total current liabilities	**27,723,000**	26,190,000
Long-term debt less amount due within one year	**32,544,000**	42,454,000
Deferred income taxes	**4,388,000**	3,381,000
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: 3,207,704 shares in 1977 (1976: 3,205,154)	**98,000**	98,000
Additional paid-in capital	**29,035,000**	29,002,000
Retained earnings	**19,851,000**	14,751,000
Total shareholders' equity	**48,984,000**	43,851,000
	$113,639,000	$115,876,000

Measurex Corporation and Subsidiary Companies

Consolidated Statements of Changes in Financial Position

For the years ended November 30, 1977 and 1976

	1977	1976
Financial Resources Provided		
Operations:		
Net Income	**$ 5,357,000**	$ 2,985,000
Items included in net income not affecting working capital:		
Depreciation and amortization	**1,533,000**	1,077,000
Deferred income taxes	**1,007,000**	154,000
Net book value of systems converted from short-term to long-term leases	**—**	164,000
Operating revenues financed under long-term lease contracts receivable from customers	**(2,429,000)**	(4,588,000)
Provision for non-collection and system returns related to lease contracts receivable	**1,648,000**	1,287,000
Financial resources provided by operations	**7,116,000**	1,079,000
Carrying value of lease contracts sold	**3,867,000**	11,348,000
Reduction in long-term lease contracts receivable	**7,228,000**	10,559,000
Additions to long-term debt	**32,966,000**	10,830,000
Other, net	**(450,000)**	449,000
Total financial resources provided	**50,727,000**	34,265,000
Financial Resources Applied		
Conversion of accounts receivable to long-term lease contracts receivable	**1,614,000**	—
Payment of cash dividends	**257,000**	—
Expenditures for property, plant and equipment	**3,666,000**	1,555,000
Reductions of long-term debt	**42,876,000**	23,438,000
Long-term cash deposits	**1,650,000**	—
Total financial resources applied	**50,063,000**	24,993,000
Increase in working capital	**$ 664,000**	$ 9,272,000
Changes in Elements of Working Capital		
Current assets-increase (decrease):		
Cash	**$ 959,000**	$ 629,000
Lease contracts receivable due within one year	**(401,000)**	819,000
Accounts receivable	**2,414,000**	4,259,000
Inventories	**(549,000)**	5,371,000
Prepaid expenses	**(226,000)**	517,000
	2,197,000	11,595,000
Current liabilities-increase (decrease):		
Short-term bank debt	**(2,563,000)**	(7,293,000)
Long-term debt due within one year	**4,799,000**	6,227,000
Trade accounts payable	**(506,000)**	114,000
Accrued liabilities	**(377,000)**	2,446,000
Income taxes payable	**49,000**	515,000
Deferred income taxes	**131,000**	314,000
	1,533,000	2,323,000
Increase in working capital	**$ 664,000**	$ 9,272,000

The accompanying notes are an integral part of the financial statements.

Measurex Corporation and Subsidiary Companies

Consolidated Statements of Shareholders' Equity

For the years ended November 30, 1977 and 1976

	Common Stock		Additional Paid-In	Retained	
	Shares	Amount	Capital	Earnings	Total
Balance December 1, 1975	3,200,241	$98,000	$28,793,000	$11,766,000	$40,657,000
Issuance of warrants to purchase 155,000 shares of common stock	—	—	155,000	—	155,000
Stock issued under employee stock option plans	4,913	—	54,000	—	54,000
Net income—1976	—	—	—	2,985,000	2,985,000
Balance November 30, 1976	3,205,154	$98,000	$29,002,000	$14,751,000	$43,851,000
Stock issued under employee stock option plans	2,550	—	33,000	—	33,000
Cash dividends at $ .08 per share	—	—	—	(257,000)	(257,000)
Net income—1977	—	—	—	5,357,000	5,357,000
Balance November 30, 1977	3,207,704	$98,000	$29,035,000	$19,851,000	$48,984,000

The accompanying notes are an integral part of the financial statements.

Report of Independent Certified Public Accountants

To the Shareholders
Measurex Corporation

We have examined the consolidated balance sheets of Measurex Corporation and Subsidiary Companies as of November 30, 1977 and 1976, and the related consolidated statements of income, shareholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the abovementioned financial statements present fairly the consolidated financial position of Measurex Corporation and Subsidiary Companies at November 30, 1977 and 1976 and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

Palo Alto, California
December 31, 1977

1. Summary of Accounting Policies

Accounting policies of the Company and its subsidiaries conform with generally accepted accounting principles and reflect practices appropriate to the industry in which they operate. The significant policies are summarized below.

Consolidation

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

Foreign Currency Translation

Foreign currency balance sheet accounts are translated into United States dollar equivalents at year-end rates of exchange, except for property, plant and equipment, inventories, and certain other assets which are translated at historical rates. Income statement accounts are translated into United States dollar equivalents using rates of exchange which approximate the average rates in effect during the year, except that depreciation of plant and equipment, costs of inventory used, and amortization of certain other assets are translated at historical rates.

Net foreign currency exchange adjustments, including those resulting from forward exchange contracts, are included in net income except for gains and losses resulting from forward exchange contracts which are intended to be a hedge of an identifiable foreign currency commitment. Such forward exchange contract gains or losses are deferred and included in the dollar basis of the related foreign currency transaction.

Sales and Lease Accounting

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 systems. During the initial period, customers may return systems and require the refund of all rentals, service fees or the purchase price paid for the systems. The Company has provided amounts which, in the opinion of management, are sufficient to absorb losses which may be incurred in the event systems are returned.

Long-term leases with non-cancellable terms ranging from 60 to 102 months entered into prior to December 31, 1976 have been accounted for using the finance method. Such method recognizes as revenue at the time of shipment of a system an amount equal to the present value of future committed lease payments discounted using a rate which approximates the customers' borrowing rate. The discount rate used to calculate the present value of future committed lease payments ranged from 9¾% to 10½% in 1976. The excess of the aggregate committed lease payments over the present value of such payments is recognized as interest income on the sum-of-the-digits method over the term of the lease.

In November, 1976, the Financial Accounting Standards Board issued "Statement on Financial Accounting Standards No. 13" which establishes standards of financial accounting and reporting for leases entered into subsequent to December 31, 1976; the Company's adoption of these new standards has not materially impacted the 1977 financial statements. Prior to November 30, 1979 the Company will be required to restate previously issued financial statements to conform its accounting for pre-1977 leases to the new standards. Management does not believe this restatement will materially impact shareholders' equity.

The amounts shown as "sales and installation revenues" in the Company's consolidated statements of income include the following:

	1977	1976
Systems sold	$47,250,000	$38,570,000
Systems under long-term finance leases	2,429,000	4,578,000
Other	723,000	762,000
	50,402,000	43,910,000
Less provision for non-collection and system returns	1,765,000	1,936,000
	$48,637,000	$41,974,000

Product Development Expenses

The company is actively engaged in basic technology and applied research and development programs which are designed to develop new or improved products, processes and applications. The costs of these programs are charged to net income as incurred.

Income Taxes

The provision for income taxes includes provision for timing differences between financial and taxable income. The most significant timing differences relate to:

a) Long-term leases, which are reported using the finance method of accounting for financial reporting purposes and the operating method for tax purposes.
b) Provisions for non-collection of accounts receivable and system returns.
c) Provisions for unrealized foreign currency exchange adjustments.
d) Provisions for obsolete inventory.

Investment tax credits relating to the acquisition of eligible fixed assets are accounted for using the flow-through method, which reduces the provision for federal income taxes during the year in which the related assets are acquired. Investment tax credits retained by the Company relating to the cost of systems leased to customers are accounted for when they are utilized to reduce taxes currently payable for any given year.

Provision has not been made for income taxes relating to potential future distributions of accumulated earnings from the Irish subsidiary or the Company's Domestic International Sales Corporation, since it is the Company's present intention to utilize substantially all of the undistributed earnings of these companies in its foreign operations and qualified export activities.

Inventory Valuation

Inventories are stated at the lower of standard cost (which approximates actual cost determined on a first-in first-out basis) or market. Included in inventories is approximately $13,116,000 (1976: $11,156,000) representing inventories held for the purpose of servicing systems covered by service contracts.

Property, Plant and Equipment

Property, plant and equipment, other than land, are depreciated or amortized on a straight-line basis over various estimated useful lives ranging from 3 to 40 years. Expenditures for property, plant and equipment and for renewals are capitalized. Expenditures for maintenance and repairs are charged to expense. When items are sold or disposed of, the cost and accumulated depreciation are removed from the accounts, and any gain or loss is included in net income.

Net Income per Common and Common Equivalent Share

Net income per common and common equivalent share is computed using the average number of common shares outstanding during the year, adjusted to reflect the assumed exercise of outstanding employee stock options and warrants to the extent these items had a dilutive effect on the computation.

The number of shares used in the computation of net income per share was 3,241,000 in 1977 (1976: 3,222,000 shares).

Audit Committee of the Board of Directors

The Company has an Audit Committee of the Board of Directors. This Committee meets with the Company's financial management and its independent accountants at various times during each year and reviews internal control conditions, audit plans and results, and financial reporting procedures.

2. International Operations

At November 30, 1977 and 1976, the consolidated financial statements include the following which are attributable to the Company's international operations:

	1977	1976
Net current assets	$22,098,000	$15,488,000
Total assets	$65,395,000	$66,179,000
Operating revenues	$35,174,000	$30,986,000

The company has installed systems in the United States, Canada and 20 other countries. The geographic distribution of revenues from sales and long-term leases of systems for the years ended November 30, 1977 and 1976 are as follows:

	1977	1976
United States and Canada	51%	59%
Other countries	49%	41%

3. Lease Contracts Receivable

Lease contracts receivable are summarized as follows:

	1977	1976
Aggregate lease payments to be received under long-term leases accounted for using the finance method	$61,034,000	$74,398,000
Less unearned financing income	14,943,000	18,799,000
	46,091,000	55,599,000
Less amount due within one year	8,023,000	8,424,000
	38,068,000	47,175,000
Less allowance for non-collection and system returns	1,090,000	1,497,000
	$36,978,000	$45,678,000

The aggregate amount of payments receivable by the Company in years subsequent to 1977 is set forth below:

Year Ending November 30	Principal	Interest	Total
1978	$ 8,023,000	$ 4,118,000	$12,141,000
1979	7,715,000	3,537,000	11,252,000
1980	7,482,000	2,689,000	10,171,000
1981	6,758,000	1,921,000	8,679,000
1982	6,004,000	1,269,000	7,273,000
Thereafter	10,109,000	1,409,000	11,518,000
	$46,091,000	$14,943,000	$61,034,000

4. Property, Plant and Equipment

Property, plant and equipment comprise the following:

	Estimated Useful Life	1977	1976
Buildings and improvements	4-40 years	$3,163,000	$2,947,000
Machinery and equipment	3-10 years	8,542,000	5,803,000
Systems leased to others under short-term lease	9 years	955,000	740,000
		12,660,000	9,490,000
Less: accumulated depreciation and amortization		4,485,000	3,240,000
		8,175,000	6,250,000
Land		1,238,000	1,215,000
		$9,413,000	$7,465,000

5. Short-Term Debt

Details of short-term debt, which is payable to banks, are presented below:

	November 30, 1977	
	Maximum Commitment	Borrowings
Multi-currency Working Capital Agreement:		
Domestic	$10,500,000	$ 700,000
International	6,500,000	2,379,000
Canadian Currency Working Capital Agreement	3,000,000	108,000
	$20,000,000	$ 3,187,000

The Multi-currency Working Capital Agreement expires on April 30, 1978; however, it is the intention of management to renegotiate the Agreement prior to April 30, 1978. Borrowings under the Canadian Currency Working Capital Agreement are payable on demand. The Agreements provide that interest is payable by the Company as follows:

Multi-currency Working Capital—various rates, ranging from 7⅛% to 12½%, plus average compensating balances equal to approximately 10% of the total domestic commitment under the Agreement.

Canadian Currency Working Capital—¾% above the Canadian prime rate.

Average aggregate borrowings under the Multi-currency and Canadian Currency Working Capital Agreements during 1977 and 1976 were approximately $6,573,000 and $13,272,000, respectively. The maximum amount outstanding at the end of any month was $13,834,000 in 1977 (1976: $17,978,000). The weighted average interest rate for the borrowings was 8.8% in 1977 (1976: 9.4%).

The provisions of the Multi-currency Working Capital Agreement allow the banks to obtain a security interest in the Company's accounts receivable. As of November 30, 1977, the banks had not requested any security interest in the Company's accounts receivable. Amounts borrowed under the Canadian Currency Working Capital Agreement are collateralized by accounts receivable of the Company's Canadian subsidiary.

In accordance with provisions of the Multi-currency and Canadian Currency Working Capital Agreements, the Company may borrow varying amounts based on a formula applied to accounts receivable which satisfy certain criteria regarding customer payment status and system installation status. At November 30, 1977, the maximum borrowings available to the Company under provisions of the Working Capital Agreements were $20,000,000.

The Multi-currency Working Capital Agreement contains certain restrictive provisions regarding working capital, indebtedness and shareholders' equity. In the event of default by the Company, the banks are entitled to accelerate the maturity of all amounts owing under the Agreement. At November 30, 1977, the Company was in compliance with all restrictive covenants of the Agreement.

6. Long-Term Debt

Details of long-term debt as of November 30, 1977 and 1976 are presented below:

	1977	1976
Bank borrowings	$30,228,000	$36,513,000
9% subordinated notes with warrants	10,000,000	10,000,000
8¼% and 8¾% mortgages payable in monthly installments through 1999	1,787,000	1,819,000
Other borrowings	1,717,000	512,000
	43,732,000	48,844,000
Less amount due within one year	11,188,000	6,390,000
	$32,544,000	$42,454,000

A summary of the bank borrowings follows:

	November 30, 1977	
	Maximum Commitment	Borrowings
U.S. Currency Term Loan Agreement	$25,000,000	$22,500,000
Multi-currency Term Loan Agreement	20,000,000	7,728,000
	$45,000,000	$30,228,000

In May, 1977, the Company replaced its existing bank borrowings with U.S. Currency and Multi-currency Term Loan Agreements.

On May 20, 1977, $25,000,000 was borrowed under the U.S. Currency Term Loan Agreement and is payable in 20 equal quarterly installments commencing August 20, 1977.

The Multi-currency Term Loan Agreement provides that funds may be borrowed by the Company through April 30, 1978 and are repayable in 24 equal quarterly installments commencing July, 1978.

The Agreements also provide that interest is payable by the Company as follows:

U.S. Currency Term Loan—8½%

Multi-currency Term Loan—1% (1¼% after April 30, 1978 and 1½% after April 30, 1979) above the London Interbank Offered Rate, except for the Canadian Currency portion (Canadian $5,000,000) which bears interest at 1% above the Canadian prime rate.

The Multi-currency Term Loan Agreement requires the Company to pay a commitment fee of ½% per annum on the total unused commitment.

In accordance with provisions of the Term Loan Agreements, the Company may borrow varying amounts based on a formula applied to lease payments owing to the Company under long-term lease contracts which satisfy certain criteria regarding collectibility, customer payment status, and leased system installation status. At November 30, 1977, the maximum borrowings available to the Company under such provisions were $37,407,000.

The provisions of the Agreements allow the banks to obtain a security interest in certain leased systems owned by the Company. As of November 30, 1977, the banks had not requested any security interests in the Company's assets.

The Term Loan Agreements contain certain restrictive provisions regarding working capital, indebtedness and shareholders' equity. In the event of default by the Company, the lenders are entitled to accelerate the maturity of all amounts owing under the agreements. At November 30, 1977, the Company was in compliance with all restrictive covenants of the Agreements.

The subordinated notes were issued in 1973 ($5,000,000) and 1974 ($5,000,000) and bear interest at 9% per annum. The 1973 notes are payable in five equal semi-annual installments commencing November 30, 1977. In conjunction with the 1973 notes, six-year warrants (expiring on November 30, 1979) were issued for the purchase of a total of 160,000 shares of the company's common stock at $28 per share. The 1974 notes are payable in three annual installments of $1,000,000 commencing October 1, 1978, with the remaining amount payable on October 1, 1981. In conjunction with the 1974 notes, six-year warrants (expiring on October 1, 1981) were issued for the purchase of a total of 200,000 shares of the company's common stock at $25 per share.

Aggregate principal payments on long-term debt in each of the next five years and thereafter are approximately as follows:

1978—$11,188,000, 1979—$12,258,000,
1980—$8,655,000, 1981—$6,326,000,
1982—$3,718,000, thereafter—$1,587,000

7. Income Taxes

The provision for income taxes consists of the following:

	1977	1976
Deferred income taxes:		
United States	$ 583,000	$ (796,000)
Foreign	472,000	1,245,000
State	84,000	19,000
	1,139,000	468,000
Current income taxes:		
Foreign	320,000	187,000
State	583,000	341,000
	903,000	528,000
Total	$2,042,000	$ 996,000

The principal items accounting for the difference between income taxes computed at the U.S. Statutory rate and the provision for income taxes are as follows:

	1977	1976
Computed tax at 48% of income before income taxes	$3,552,000	$1,911,000
Effect of:		
Income of Irish subsidiary not subject to tax	(1,963,000)	(990,000)
Income of Domestic International Sales Corporation not subject to tax	(136,000)	(191,000)
Losses of foreign subsidiaries not providing tax benefit	219,000	120,000
Investment tax credit	(127,000)	(81,000)
State income taxes	347,000	187,000
Other items, principally foreign income subject to tax rates in excess of 48%	150,000	40,000
Provision for income taxes	$2,042,000	$ 996,000
Effective tax rate	27.6%	25.0%

A description of the Company's significant accounting policies regarding income taxes is included in Note1—"Income Taxes."

It is not practical to allocate deferred taxes to the various timing differences, due to the Company's net operating losses for Federal income tax purposes.

The accumulated net income of the Company's Domestic International Sales Corporation for which no provision for income taxes has been made is $2,271,000 at November 30, 1977.

The Company's wholly-owned subsidiary in Ireland operates under a tax holiday granted by the Government of the Republic of Ireland which extends for a minimum of fifteen years from the date the subsidiary was formed in 1973. The accumulated undistributed net income of the Irish subsidiary for which no provision for taxes has been made is $13,676,000 at November 30, 1977.

At November 30, 1977 the Company has cumulative net operating loss carryforwards for U.S. income tax purposes of approximately $2,556,000 expiring in 1979. These net operating loss carryforwards, which result from timing differences between income for financial reporting and tax purposes, may be utilized to reduce future income for tax purposes. Utilization of these net operating loss carryforwards will not affect net income for financial reporting purposes.

In addition, at November 30, 1977, the Company has investment tax credit carryforwards of approximately $1,050,000 which may be utilized to reduce U.S. income taxes payable. Of the carryforward amount, $570,000 has been utilized to reduce the provision for income taxes for financial reporting purposes. The benefit for the remainder has not been so utilized and, if realized, will reduce the provision for income taxes in future years. The investment tax credit carryforwards expire in varying amounts during the years 1978 through 1984.

Federal income tax returns for all years from the Company's inception in 1968 through November 30, 1975, are presently under examination by the Internal Revenue Service and a revenue agent's report is expected to be issued in the near future. Although the proposed deficiencies are expected to be material in amount, the Company believes that the majority of such deficiencies will relate to timing differences and that adequate provision has been made on the consolidated balance sheet at November 30, 1977, for any additional taxes which may ultimately result with respect to the years under examination.

8. Employee Benefit Plans

The Company has an employee cash profit-sharing plan for eligible employees, which provides for distributions of up to 10 percent of consolidated income before provisions for income taxes and amounts payable under the plan. The plan is subject to annual renewal and has been renewed for 1978. Distributions to eligible employees under the plan for 1977 was $624,000 (1976: $314,000).

In 1976, the Company established an incentive award plan which provides for incentive awards to officers and senior management employees from an annual incentive fund determined by several factors relating to the financial performance of the Company. The provision charged against operations for the incentive award plan was $296,000 in 1977 (1976: None). The participants in the incentive award plan are not eligible for the profit-sharing plan.

The Company has a retirement plan which provides for partial matching of eligible employee contributions to Individual Retirement Accounts. Company contributions are based on the years of service and profit-sharing participation of individual employees, with a maximum annual contribution after five years of service of $750 per employee. The provision charged against operations for contributions to employees was $122,000 in 1977 (1976: $121,000).

9. Stock Option Plans

Under the Company's stock option plans 820,000 shares of common stock have been reserved for issuance to officers and key employees. Options cannot be granted under the Company's most recent plans if the aggregate number of outstanding options at any time exceeds 10% of the common stock outstanding.

Options may be granted at prices not lower than the fair market value of the Company's common stock at the date of grant. Options generally become exercisable in four equal annual installments commencing one year from the date of grant. Options expire if not exercised within five years from the date of grant.

In August 1974, the Company issued qualified stock options (new options) to certain of its employees to purchase 161,800 shares at $12.25 per share and 10,000 shares at $11.50 per share. In February 1975, additional new options were issued to purchase 1,550 shares at a price of $16.25 per share. The number of new options issued was equal to the number of unexercised options (old options) held by each respective employee at the date of grant. The old options had been issued to the employees at various dates from February 1972 to August 1974 and were issued for prices higher than the prices for the new options. The new options expire in August 1979 (except for 1,550 which expire in February 1980) and may be exercised only if old options have expired. The exercise of an old option will reduce the number of shares available to each respective employee under the new options. At November 30, 1977, 99,162 new options were outstanding.

A summary of transactions relating to options during 1977 is set forth below (the information regarding outstanding options assumes the optionees will exercise the new options described in the preceding paragraph):

	Shares Available For Grant	Options Outstanding Shares	Price Per Share	Amount
Balance December 1, 1976	308,490	213,188	$9.75-$35.13	$2,635,000
Options granted	(63,200)	63,200	12.00- 18.50	934,000
Options terminated	62,825	(29,025)	9.75- 33.50	(424,000)
Options exercised	—	(2,550)	11.50- 13.50	(33,000)
Increase for termination of new options	7,988	—	—	—
Balance November 30, 1977	316,103	244,813	$9.75-$35.13	$3,112,000
Options exercisable at November 30, 1977 (140,753 shares if old options are exercised)		78,344	$9.75-$35.13	$1,045,000

The Company makes no charges to income in connection with its stock option plans.

10. Sale of Contracts Receivable

The Company has, at various times, sold portions of its domestic and foreign lease contracts receivable and the related equipment to certain financial institutions. These sales have been made on both a non-recourse and full-recourse basis. The Company generally is entitled to participate with the financial institutions in revenues received pursuant to purchase or lease renewal options included in the lease contracts.

At November 30, 1977, the Company was contingently liable to financial institutions for approximately $14,500,000 relating to those sales made on a full recourse basis.

In addition, at November 30, 1977, the Company was contingently liable for obligations (approximately $2,600,000) of others to third parties, which arose from sales of systems to third party lessors, financial institutions and customers.

11. Interim Financial Information (Unaudited)

The Company's independent public accountants have made a limited review of the 1977 interim financial information in accordance with standards for such reviews established by the American Institute of Certified Public Accountants. Their limited review did not constitute an audit and, accordingly, they do not express an opinion on the 1977 interim financial information presented on page 16.

Directors of Measurex Corporation

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(Investment company)

*Dwight C. Baum
Senior Vice President
Blyth Eastman Dillon & Co. Incorporated
(Investment banking firm)

David A. Bossen
President and Chief Executive Officer
Measurex Corporation

*William H. Draper III
General Partner
Sutter Hill Ventures
(Investment company)

John W. Larson
Partner
Brobeck, Phleger and Harrison
(Law firm)

*John W. McKittrick
President and Chief Executive Officer
Plantronics, Inc.
(Telecommunications equipment manufacturer)

*Member of Audit Committee

Principal Officers of Measurex Corporation and Subsidiaries

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President and Chief Executive Officer

Richard C. Bentley
Corporate Controller

Doris S. Bossen
Vice President-Personnel

Robert K. Dahl
Vice President-Finance

Donald V. Fluken
Treasurer

John W. Larson
Secretary

William I. Robinson
Vice President-Operations

Fernand Ostiguy
President-
Measurex (Canada) Ltd.
and Managing Director-
Europe

Kenneth P. Ostrow
Vice President
Measurex Systems Inc.

Charles M. Worthley
President-
Measurex International Corp.

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San Francisco, California

Manufacturers Hanover Trust Company
New York, New York

Registrars

Wells Fargo Bank
San Francisco, California

Bradford Trust Company
New York, New York

Auditors

Coopers & Lybrand
Palo Alto, California

General Counsel

Brobeck, Phleger and Harrison
San Francisco, California

Measurex's common stock is listed on the New York and Pacific Stock Exchanges and trades under the symbol MX.

Copies of Measurex's Form 10-K, the Company's annual report filed with the Securities and Exchange Commission, are available on request. Please write the Assistant Secretary, Measurex Corporation, One Results Way, Cupertino, California 95014.

measurex
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