Fairchild Camera and Instrument Corporation

Annual Report 1976

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On the cover:
Fairchild people at work on varied products...from microprocessors to miniature television cameras.

Annual Meeting of Shareholders
The annual meeting of shareholders of Fairchild Camera and Instrument Corporation will be held at Rickey's Hyatt House, Palo Alto, California, on Friday, May 6, 1977.

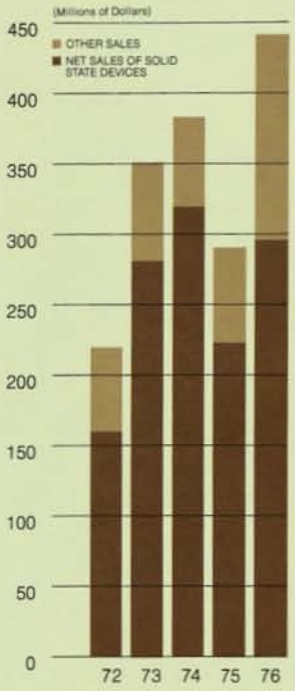
	1976	1975	% Change
For the year:			
Net sales	$443,221,000	$291,542,000	+52.0
Income before cumulative effect of change in accounting method	$ 12,456,000	$ 10,424,000	+19.5
Cumulative effect on prior years (to December 29, 1974) of change in accounting method	–	$ 2,649,000	–
Net income	$ 12,456,000	$ 13,073,000	–4.7
Average number of common and common equivalent shares outstanding	5,476,865	5,372,901	+1.9
End of year:			
Working capital	$113,865,000	$100,506,000*	+13.3
Shareholders' equity	$177,609,000	$166,329,000*	+6.8
Number of employees	21,293	17,405	+22.3
Number of shareholders	10,429	11,179	–6.7
Shares issued	5,359,552	5,278,563	+1.5
Per share statistics:			
Income before cumulative effect of change in accounting method	$ 2.27	$ 1.94	+17.0
Cumulative effect of change in accounting method	–	.51	–
Net income	2.27	2.45	–7.3
Shareholders' equity at year end	33.14	31.51*	+5.2
Cash dividends	.80	.80	–

Restated – see Note 3 of the Notes to Consolidated Financial Statements.

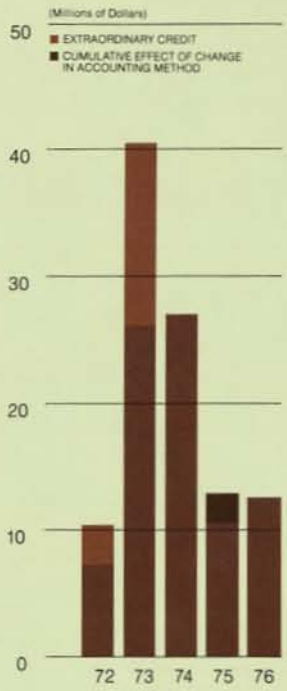
nual Report on Form 10-K

Fairchild's Annual Report on Form 10-K for the year ended January 2, 1977, as filed with the Securities and Exchange Commission, contains additional information about the company and is available to Fairchild shareholders on request, without charge. Please write: Corporate Communications Department, Fairchild Camera and Instrument Corporation, 464 Ellis Street, Mountain View, California 94042.

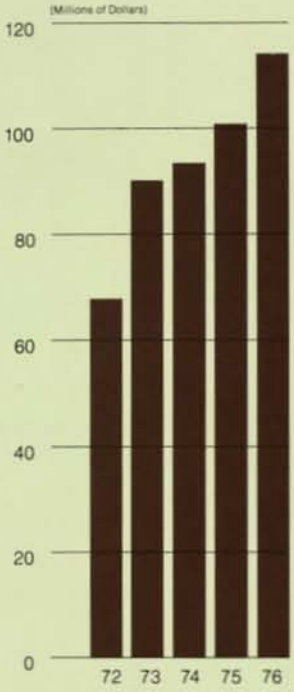
NET SALES



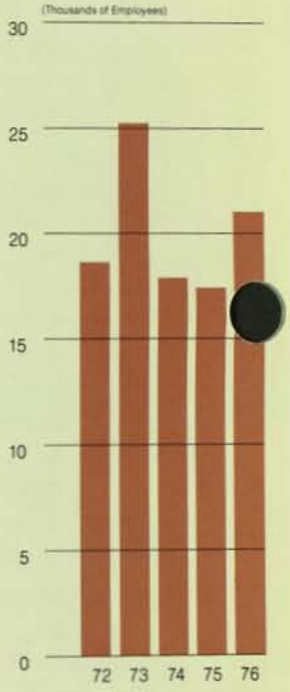
NET INCOME



WORKING CAPITAL



EMPLOYEES AT YEAR END



TO OUR SHAREHOLDERS:

While on many counts 1976 was a difficult business year, it was a milestone for Fairchild Camera, particularly as we begin our eth anniversary as a company.

Worldwide sales grew 52 percent, to the all time high of $443,221,000, from $291,542,000 the year before. All portions of the company contributed to this record, which constitutes an important benchmark in our long-term corporate growth.

Earnings rose 20 percent to $12,456,000, or $2.27 per share. This compares with $10,424,000, or $1.94 per share in 1975. The company reported an additional $2,649,000, or 51 cents per share, in 1975 as the result of an accounting change.

Although sales gained momentum early in the year, profit margins came under pressure from excessively low pricing on commodity components, related to the 1975 recession. Earnings were further depressed by the financial impact of a semiconductor production problem which surfaced in late 1975. Both of these situations improved in subsequent quarters.

The overall business climate changed at mid-year from one of vigorous recovery to a general slackening of demand. Despite this economic pause, our earnings rose in the second half, enabling us to report $2.27 per share for the full year.

are still feeling the effects of the slowdown in components and consumer products. The components market, sensitive to economic trends, has been flat for some months. The consumer products business currently reflects the seasonal, post-holiday lull in buying activity. We expect 1977 as a whole to be a good year, however, as we believe demand will resume its uptrend in the spring.

The company introduced a broad spectrum of advanced, electronic products last year. These included new logic and memory devices, semiconductor test systems, audio/visual equipment and solid-state television cameras. Our position in the LSI (large scale integration) and microprocessor markets continued to grow stronger and represents by far the highest potential portion of our semiconductor business.

Consumer electronics—a field in which the company was not engaged two years ago—has become a new growth area for Fairchild. In addition to digital watches and clocks, we developed and brought to market the Fairchild Video Entertainment System, a programmable home TV game based on our F8™ microcomputer. The system won approval of the Federal ommunications Commission in the fourth quarter and limited pments took place during the holiday season, with excellent customer response.

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The company is in a strong financial position. Working capital at the end of the year was $114 million and shareholders' equity $178 million. Cash and short-term securities approximated $27 million. Inventories during 1976 rose by only 4 percent, despite our 52 percent increase in sales.

Fairchild has moved aggressively to obtain the necessary funds for anticipated future growth. In December, our wholly-owned subsidiary, F.C.I. International Finance N.V., generated additional capital through the sale of $20 million of 5¾ percent convertible subordinated debentures in the Eurobond market. Last month, Fairchild was listed for trading on the London Stock Exchange.

These activities reflect both the strong interest in our company in Europe and the rapid growth of our international business during the past five years. Foreign sales in 1976 exceeded 30 percent of the total.

Despite the lag in the economic growth rate, we have continued to invest significantly in new product development and expanded production facilities around the world. Spending for research, development and engineering in 1976 was approximately $47 million. Capital expenditures amounted to $36 million.

The result of these investments is to give Fairchild a technical and manufacturing capability matching the opportunities we see ahead in our various markets. As a company, our strategic thrust will be in those technologies which have the greatest growth potential. Our target is to penetrate new markets—including those for semiconductor-based end products—and to grow profitably on the frontiers of the LSI revolution.

Since 1927, our people have been designing, building and selling products that have made contributions to progress...from the first aerial camera to the Planar transistor and the modern integrated circuit. The skill and commitment of Fairchild employees have made us a strong, expanding company and an industry leader.

As we move into our second half-century, we will continue to build on that tradition.

Roswell L. Gilpatric
Chairman of the Board

Wilfred J. Corrigan
President and Chief Executive Officer

March 14, 1977

BOARD OF DIRECTORS

Wilfred J. Corrigan,
Louis F. Polk, Jr.,
Directors

William A. Stenson,
Director
Roswell L. Gilpatric,
Chairman

William C. Franklin,
Albert Bowers,
Directors

C. Lester Hogan,
Vice Chairman
James B. Lampert,
Director

Inset:
Roswell L. Gilpatric,
Chairman of the Board;
Wilfred J. Corrigan,
President and
Chief Executive Officer

Not pictured:
J. Bradford Wharton, Jr.,
Director

MANAGEMENT OVERVIEW

Fairchild Camera and Instrument Corporation is organized into six manufacturing/marketing operations in addition to a corporate staff. Collectively the groups produce semiconductor components, systems and end products for the consumer, commercial, industrial and government markets. The company has some 30 manufacturing plants in four states and eight foreign countries.

Semiconductors, a basic product line of the company, are manufactured and marketed by the LSI Group, headed by David J. Marriott, and the Components Group, headed by George D. Wells. Both groups are headquartered in Mountain View, California. John A. Duffy, Jr. is in charge of the International Division, with responsibility for all foreign marketing.

The Instrumentation and Systems Group, based in San Jose, California, manufactures and markets semiconductor test systems, microprocessors and related products, digital panel meters, data acquisition and analysis instruments, and memory systems. James D. Bowen is general manager.

In addition to digital electronic watches, the Consumer Products Group is responsible for digital clocks, video entertainment systems, and a line of optoelectronic products and watch components. Managed by Greg Reyes, this group is presently based in Palo Alto, California, but will be relocating to a new facility in Santa Clara, California, before the end of 1977.

Louis H. Pighi manages the Federal Systems Group based in Syosset, New York. Primary product lines include electronic data systems, radio-frequency monitoring systems, aerial reconnaissance and surveillance systems, and a range of imaging systems based on the CCD (charge-coupled-device) miniature television camera.

The Industrial Products Division is located in Commack, New York, and produces a line of audio-visual equipment for the commercial and industrial markets in addition to a variety of systems and products for aircraft use. Raymond G. Hennessey is division manager.

At corporate level, Warren J. Bowles heads industrial relations, including personnel management and employee training and development programs. Frederick M. Hoar is responsible for internal and external communications, including financial relations, public affairs and advertising.

Fairchild's corporate finance operation is headed by R. Douglas Norby. A. J. Hazle is controller and James A. Unruh is in charge of treasury and corporate planning. Dr. Thomas A. Longo, chief technical officer, has responsibility for overall research and development. Nelson Stone is corporate secretary and general counsel, managing the company's legal and patent affairs.

CORPORATE VICE PRESIDENTS

Left to right, standing: Nelson Stone, General Counsel and Secretary; Frederick M. Hoar, Communications. Seated: Dr. Thomas A. Longo, Chief Technical Officer.

Left to right, standing: George D. Wells, Components Group; John A. Duffy, Jr., International Division; Greg Reyes, Consumer Products Group; David J. Marriott, LSI Group. Seated: James D. Bowen, Instrumentation and Systems Group.

Left to right: Raymond G. Hennessey, Industrial Products Division; Louis H. Pighi, Federal Systems Group.

Left to right: A. J. Hazle, Controller; R. Douglas Norby, Finance; James A. Unruh, Treasury and Corporate Planning.

Not pictured: Warren J. Bowles, Industrial Relations

Inset: Fairchild president and corporate vice presidents hold regular, off-site planning and strategy meeting.

LSI GROUP

Formation of the Large-Scale Integration Group in 1976 spotlights the growing importance of LSI products to our total business. LSI is the term applied to integrated circuits of high complexity and density, frequently in the thousands of components per silicon chip. Our new 265,000-square-foot wafer fabrication plant in San Jose, California, is one of the industry's largest and most modern production facilities dedicated to LSI.

Bipolar Memory and ECL Products This division maintained its dominance of the bipolar memory and high-performance ECL (emitter-coupled logic) markets. New, programmable read-only memories (PROMs) were added to the product line, finding widespread use in microprocessor systems.

The introduction of products combining our proprietary Isoplanar process with injection logic technology (I^3L), made possible the first 4,096-bit bipolar dynamic random access memory (RAM). The 4K dynamic RAM offers the speed of bipolar circuitry at costs comparable with high performance MOS memories, and is the forerunner of a 16,384-bit bipolar memory, scheduled for later this year. A 4K bipolar static RAM utilizing conventional circuit technology also is scheduled for 1977.

Development of a 16-bit bipolar microprocessor, utilizing I^3L technology, was also announced. This product will find many high-end applications during the next five years. Fairchild's sub-nanosecond (trillionths-of-a-second) ECL logic family found significant use in the mainframe computer industry, and total ECL sales quadrupled during the year.

MOS/CCD Products Shipments of components for the Fairchild F8™ microprocessor increased during the year. The F8 is aimed at volume applications in the consumer and industrial areas, including TV tuning, video recorders and games, appliance controllers and "smart" terminals.This division also filled volume orders for MOS (metal-oxide semiconductor) memory devices, including the 4K N-channel RAM produced in our Wappinger Falls, N.Y., plant, and introduced a 16K N-channel RAM in the first quarter of 1977.

In CCD (charge-coupled device) technology, additional imaging arrays were introduced and an improved CCD analog delay line, available in component form or module assembly, designed for European television systems.

Fairchild increased its share of the CCD memory market with its 9,000-element serial memory and its 16,000-bit line-addressable RAM. These products are forerunners to the 65,000-bit CCD memory scheduled for pilot production later this year. Primary applications for the 65K part will be in bulk serial back-up memories for computers.

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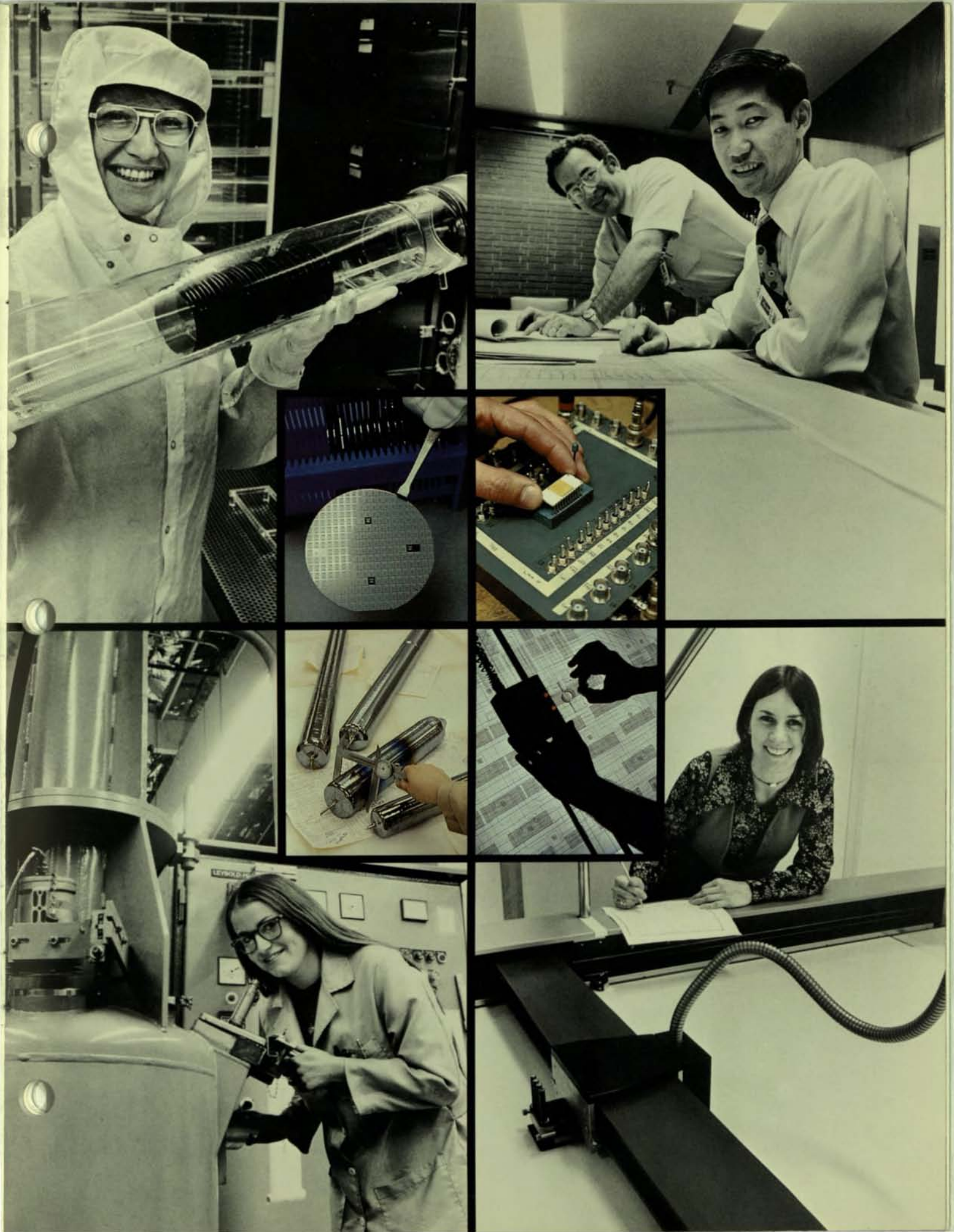
Diffusion operator Ena Aulicino handles MOS circuit wafers at Wappingers Falls plant. Inset: Typical LSI wafer.

Bipolar circuit designers Larry DeClue and Daniel Wang study advanced microprocessor engineering drawing. Inset: Prototype circuit under test.

Operator Dorothy Dudley checks silicon crystal growth in Healdsburg plant. Inset: Completed silicon ingots.

MOS circuit designer Solange Keefe uses computer-driven drawing machine. Inset: Digitizer converts artwork to computer tape information.



COMPONENTS GROUP

New capital investments, coupled with the application of cost reduction measures, helped increase efficiency in our various components divisions. Materials costs, as an example, were reduced through smaller die sizes and new metallization techniques. High-speed, automated handling and test systems were installed in the Far East. The global logistics program, initiated in late 1975, enabled the group to reduce inventories while at the same time improving customer service in the United States, the Far East and Europe.

Digital Products Heavy pricing pressures on commodity-type semiconductors continued to depress the digital products market in 1976. Fairchild expanded its digital product line, including new CMOS (complementary MOS) integrated circuits and low-power Schottky TTL (transistor-transistor logic) devices. Because of their inherent low power drain and high noise rejection characteristics, CMOS circuits are finding widespread use in both consumer and industrial products, particularly in battery-powered instruments. Low-power Schottky is rapidly becoming the standard logic family in most bipolar systems.

Linear Integrated Circuits Fairchild expanded its long-established market position in consumer electronic components with new circuits for television sets and audio equipment. The company saw major growth in Europe where Fairchild is the largest U. S. supplier of PAL (phase-alternating line) TV circuits, the primary broadcast circuits used outside the United States. The division also brought to market a range of new industrial circuits, including high-speed dual operational amplifiers and fixed or adjustable voltage regulators.

The Automotive/Hybrid Unit increased production of solid-state ignition systems for the automotive market, and late in the year introduced a family of high-current regulators that have gained rapid acceptance in power supply design.

Discrete Products The Diode Division's production of silicon diodes, zener diodes and diode arrays increased substantially during 1976. In particular, gains were made in the market for zener diodes, used to provide a stable voltage source in many types of consumer and industrial end products.

The Transistor Division continued to serve the discrete market with a broad line of high-performance transistors, both small-signal and power. More than 50 devices were added to the power transistor line, including a new package type called Dynawatt™ which provides a high degree of power handling capability at very low cost.

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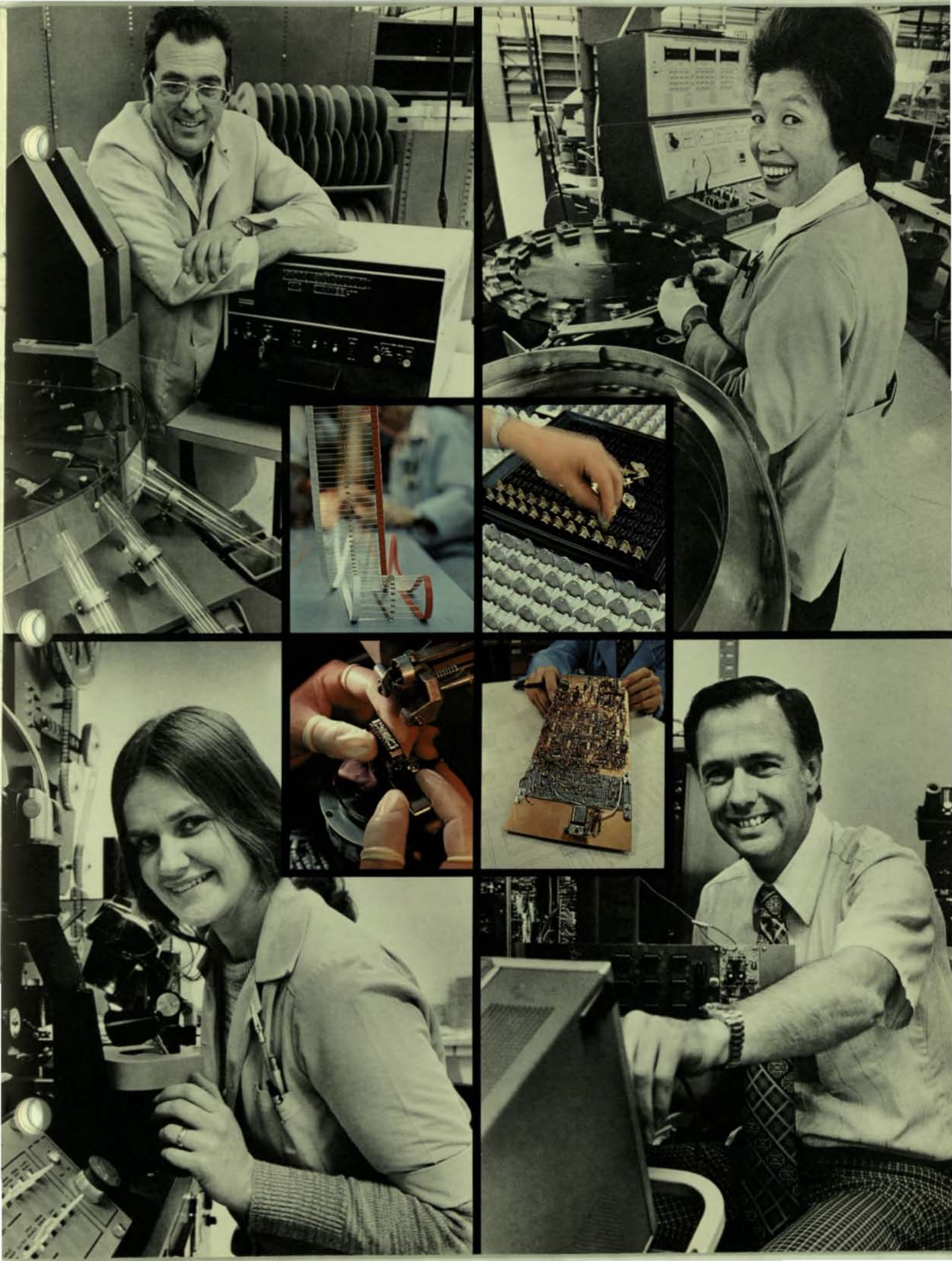
John Reimer helped design machine that doubles diode test rate at San Rafael. Inset: Diodes being packed for shipment.

Test operator Insoon Carman inspects handler during power transistor testing. Inset: Power transistors packed for shipment.

Noella Chadbourne operates automated film-bonding machine that completes integrated circuit connections in one step. Inset: Conventional wire-bonding procedure.

Linear Division engineer Don Smith checks performance of new color tv circuit design. Inset: "Breadboard" of integrated circuit prototype.



INSTRUMENTATION AND SYSTEMS GROUP

The company's position and scope in the instrumentation field gained steadily throughout 1976. The group now encompasses a diversified product line, including distributed test systems, microprocessors, memory systems, digital panel meters and data acquisition systems. This portion of our business will continue to grow in strategic importance to the company.

Systems Technology The Sentry™ IV and Sentry™ VII computer-controlled semiconductor test systems and the Integrator™ data communications systems were the key introductions of the group's largest division. The Sentry systems provide fast, flexible testing capabilities for LSI devices. Sentry VII is designed to interface directly with the Integrator in a test network that integrates raw data from on-line testers to provide status reports at various stages of semiconductor processing.

The Xincom III, introduced in May, is the first commercial tester to make use of distributed system architecture—a concept that permits numerous remote test heads to communicate with a central host computer. The Xincom III is designed primarily for memory testing.

Microsystems This division was formed in 1975 to handle company efforts in the area of microprocessor systems and microcomputers. The two-chip F8™ microprocessor has been the catalyst of this division's growth, gaining a dominant position in the low-cost, high-volume segment of the controller field. Early in 1977 the division announced a one-chip F8 that is expected to further penetrate this market.

During the first quarter of 1977, production began in a 50,000-square-foot addition to the Instrumentation and Systems plant in San Jose, California, housing a fully-automated printed circuit assembly line for microprocessor systems. As part of a technology exchange agreement with Motorola, Inc., Fairchild announced in October that it will also manufacture the Motorola 6800, a leading microprocessor for the data processing industry.

Instruments In December, Fairchild acquired Data Works Instrumentation of Chatsworth, California, a manufacturer of microprocessor-based data acquisition and analysis instruments used primarily in the solar, environmental and process industries. Data Works became part of the Instrumentation Unit, formed in 1975 to produce and sell digital panel meters to electronic instrument manufacturers.

Memory Systems Several large, high-speed bipolar memory systems were shipped during the first quarter of 1977, and design activity is being carried out on other products ranging from complete systems to board-level subsystems. This effort utilizes all of Fairchild's advanced LSI technology, including 4K and 16K MOS and bipolar memories, CCD memories, and Isoplanar integrated injection logic devices.

Emma McConaghy assembles microprocessor components for a microwave oven controller. Inset: Formulator™ microprocessor development system.

Digital panel meter is assembled by Sandra Mendenhall in San Jose plant. Inset: Completed panel meters being tested.

Lydia Coronel assembles printed circuit boards for Sentry test system. Inset: Completed circuit board.

Applications engineer John Hopp checks Sentry VII test system during assembly. Inset: Close-up view of integrated circuit test head.

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CONSUMER PRODUCTS GROUP

Fairchild's successful entry into the digital watch market in 1975 proved to be a base from which the company was able to launch new consumer electronic products last year. In addition to expanding its watch and clock lines the group announced the first computer-based home television game, which drew nationwide attention. Ground was broken late in the year for a new 150,000-square-foot headquarters building.

Time Products During 1976, Fairchild offered the broadest range of digital watches available in the market, both domestic and international. The Timeband™ line of men's and ladies LED (light emitting diode) watches—priced from $19.95 to $54.95—contributed to digital watch demand early in the year, through mass merchandising outlets. The Fairchild™ series, now retailing from $50 to $195, provided the company with additional timepieces in the more expensive jewelry category. Fairchild also marketed a full line of LED solid-state digital clocks, ranging from table models to a clock/high-intensity lamp.

At mid-year, the company introduced a family of LCD (liquid crystal display) watches, with shipments starting in September. By the end of 1977 it is expected that the LCD, or continuous display, technology may account for as much as half of our watch sales. Throughout the year, the Time Products Service Center steadily improved its performance and turnaround time, and the company embarked on a training program to aid dealers in handling simple service requirements.

Exetron This division continued to be a major producer of CMOS circuits and modules for both LED and LCD watches, and started the industry's first four-inch wafer fabrication facility. Exetron also manufactures the Fairchild Video Entertainment System, a programmable TV game with color and sound. The system incorporates Fairchild's F8 microprocessor and MOS RAMs, and can accept an expanding library of unique Videocart™ plug-in memory cartridges. Games ranging from Hockey to Blackjack to Math Quiz are now on the market, and the company will add new program cartridges during the year.

Optoelectronics Demand for optoelectronics products grew in 1976, despite a slowing of orders for watch displays. Applications for light-emitting diodes expanded into such areas as appliances, TV channel indicators, hi-fi equipment and taxi meters. Fairchild was the only supplier of displays to the two major citizens band radio manufacturers, and the company was selected to produce clock/radio frequency displays for Ford's 1978 car models. The division produced 132 new optical coupler products and announced the stackable digit concept—digits mounted on a printed circuit board. The first Fairchild Solid-State Technology Kits™ for educators and hobbyists were marketed toward the end of 1976.

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Angelina Trujillo tests Fairchild Video Entertainment System at Exetron Division. Inset: Blackjack is one of the more popular video games.

Becky Stanton of the Optoelectronics Division prepares machine for packaging of Fairchild Technology Kits. Inset: Various clocks assembled from Technology Kits.

Digital clocks are packaged by Laura Perkinson prior to shipment. Inset: Two new digital clocks announced early in 1977 are the Fairchild Model C-8211 (foreground) and Timeband Model C-6110.

In the watch casing operation in Palo Alto, Linda Carter inspects assembled timepieces. Inset: Model FC 1155 LCD digital watches are new in the Fairchild™ line.


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TECHNOLOGY KIT
FAIRCHILD

FEDERAL SYSTEMS GROUP

During the past year, the Federal Systems Group continued to perform most of its work under government contracts from the military services. A highlight of 1976 was Industrial Research magazine's award for Fairchild's development of the solid-state MV-201 miniature television camera.

Space and Defense Systems In 1976, this division received a sizable contract to continue work on analog/digital converter synchronizer equipment for U.S. Navy electronic countermeasures aircraft. The division also received a major contract to develop self-contained surveillance and tactical communications equipment for the U.S. Army.

Imaging Systems Three new cameras embodying charge-coupled device (CCD) technology were developed in 1976. The first, an electronic gunsight camera, was produced for the Air Force and replaces existing 16 mm film cameras. It will be tested by the Tactical Air Command in 1977. The second, developed for NASA, is compatible with standard 525-line television screen displays and offers the potential for use in commercial broadcasting. A special-purpose TV camera was developed for the U.S. Army to interface with a helicopter-carried tracking sight, permitting an instructor to monitor a gunner's aimpoint during live or simulated missile firings.

A project still in the developmental stage involved mounting a CCD TV camera in an artillery shell which can be fired over a selected area and deployed on a parachute, transmitting terrain and target information to a remote command post.

The KA-99 panoramic aerial camera was developed in 1976 under a U.S. Navy contract. Designed to operate at altitudes ranging from 500 to 12,000 feet, it has been chosen as the prime sensor in a new Navy reconnaissance system. Two contracts for electronic timer systems were received: one, from the U.S. Air Force, for a safety device to be used in a guided weapon program; the second, from the U.S. Army, for an electro-mechanical safety and arming device for the improved Hawk missile.

Art Roberts, a senior staff engineer with the Imaging Systems Division demonstrates the CCD artillery shell television camera. Inset: Soldering operation being performed on the CCD camera.

The Industrial Products Division's Pat Tomasi assembles a Synchromatic 110 filmstrip projector. Inset: Final adjustments on a filmstrip projector are made just prior to shipment.

Leads on a circuit board for an A/D converter are checked by Mavis Catherwood. Inset: A/D converter produced by the Space and Defense Systems Division.

Carl Solomon, optical specialist with the Imaging Systems Division, helps insure that aerial camera lenses meet specifications. Inset: Lens is carefully installed in camera body.

Industrial Products Division

Fairchild audio-visual products introduced in early 1977 include a new generation of Super 8 mm film projection equipment and new 35 mm rear and front screen slide projectors. Sales of the Synchromatic 110 filmstrip projectors advanced during 1976, finding growing customer acceptance both here and abroad. Airline use of our STAN™ integral weight and balance systems increased, particularly in overseas markets. Fairchild voice and flight data recorders maintained their leadership in the field of aircraft recording equipment.

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Fairchild Camera and Instrument Corporation and Subsidiaries

FIVE YEAR SUMMARY OF OPERATIONS AND FINANCIAL REVIEW

	1976	1975	1974	1973*	1972*
Progress in Operations (in thousands, except per share data)					
Net sales	$443,221	$291,542	$384,933	$351,171	$223,896
Royalties and other income	7,157	8,188	10,619	10,397	6,329
	450,378	299,730	395,552	361,568	230,225
Cost of sales	327,381	208,712	264,194	245,450	165,794
Administrative and selling expenses	94,427	69,732	75,882	61,975	47,888
Interest expense	5,504	4,154	3,868	4,176	4,252
	427,312	282,598	343,944	311,601	217,934
Income before income taxes, extraordinary credit and cumulative effect of change in accounting method	23,066	17,132	51,608	49,967	12,291
Provision for income taxes	10,610	6,708	24,576	23,649	4,956
Income before extraordinary credit and cumulative effect of change in accounting method	12,456	10,424	27,032	26,318	7,335
Extraordinary credit (2)	–	–	–	14,506	3,176
Cumulative effect on prior years (to December 29, 1974) of change in accounting method (1)	–	2,649	–	–	–
Net income	$ 12,456	$ 13,073	$ 27,032	$ 40,824	$ 10,511
Per share of common stock:					
Income before extraordinary credit and change in accounting method	$ 2.27	$ 1.94	$ 5.17	$ 5.04	$ 1.51
Extraordinary credit (2)	–	–	–	2.77	.65
Cumulative effect of change in accounting method (1)	–	.51	–	–	–
Net income	$ 2.27	$ 2.45	$ 5.17	$ 7.81	$ 2.16
Per share of common stock assuming full dilution:					
Income before extraordinary credit and change in accounting method	$ 2.27	$ 1.94	$ 5.00	$ 4.86	–
Extraordinary credit (2)	–	–	–	2.59	–
Cumulative effect of change in accounting method (1)	–	.47	–	–	–
Net income	$ 2.27	$ 2.41	$ 5.00	$ 7.45	–
Shares of common stock used to compute primary income per share	5,476,865	5,372,901	5,228,523	5,224,826	4,877,184
Cash dividends per share	$ .80	$ .80	$ .75	$ .30	–

**Restated – see Note 3 of the Notes to Consolidated Financial Statements.*

(1) In 1974 and 1975, the Company adopted improvements in its inventory costing method. The effect of these changes in inventory costing was not material to income before extraordinary credit and cumulative effect of accounting change for any period presented.

(2) Represents income tax reductions resulting from carryforward of prior years' operating losses.

NOTE – See "Management's Discussion and Analysis of the Summary of Operations," on pages 20 to 22.

	1976	1975	1974	1973	1972
Selected Operating Data (in thousands)					
Net sales by line of business:					
Electronic components and systems	$400,765	$256,378	$344,790	$301,091	$178,890
Other products—principally government	42,456	35,164	40,143	50,080	45,006
Income before income taxes, extraordinary credit and change in accounting method by lines of business:					
Electronic components and systems	17,306	13,041	46,909	45,406*	10,738*
Other products—principally government	5,760	4,091	4,699	4,561*	1,553*
Net sales of solid state devices	298,187	226,036	321,548	281,370	161,714
International sales	138,466	82,732	113,574	87,730	42,919
Royalty income	6,373	4,766	7,312	7,467	6,037
Research, development and engineering (1)	46,939	37,550	40,288	38,251	29,287
Depreciation and amortization	16,663	15,890	14,092	12,039	10,368
Capital expenditures	36,076	20,693	41,342	34,558	11,218
Financial Position at Year End (in thousands)					
Cash and temporary cash investments	$ 26,898	$ 25,194	$ 33,392	$ 34,272	$ 25,535
Short-term borrowings	13,618	9,455	6,819	7,265	9,525
Working capital	113,865	100,506*	93,892*	90,809*	68,692*
Property, plant and equipment, net	130,404	112,256	108,847	88,040	66,044
Long-term debt, including current portion	68,088	46,825	49,592	51,674	57,199
Shareholders' equity	177,609	166,329*	153,875*	128,692*	81,511*
Statistics and Key Ratios					
Shares issued at year end	5,359,552	5,278,563	5,161,592	5,106,187	4,979,476
Number of shareholders at year end	10,429	11,179	12,325	10,464	11,836
Shareholders' equity per common share at year end	$ 33.14	$ 31.51*	$ 29.81*	$ 25.20*	$ 16.37*
Employees at year end	21,293	17,405	18,092	25,525	18,866
Net sales per employee (based on average number of employees)	$ 22,100	$ 17,660	$ 17,650	$ 15,800	$ 13,200
Backlog of orders at year end (000's)	$147,000	$128,000	$161,000	$265,000	$129,000
Income before extraordinary credit and change in accounting method as a percent of:					
Net sales	2.8%	3.6%	7.0%	7.5%*	3.3%*
Shareholders' equity at year end	7.0%	6.3%*	17.6%*	20.5%*	9.0%*
Current ratio at year end	2.1	2.2*	2.0*	2.1*	2.2*
Long-term debt to total capitalization at year end (2)	28%	22%*	24%*	29%*	41%*

**Restated—see Note 3 of the Notes to Consolidated Financial Statements.*

(1) Stated in accordance with the definition expressed in Summary of Accounting Policies in the consolidated financial statements. Amounts shown include customer reimbursements.

(2) Total capitalization defined as the sum of long-term debt (including current portion) and shareholders' equity.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

Comparison of 1976 with 1975

Net Sales Net sales increased $151,679,000 (52%) to $443,221,000 as compared to 1975 net sales of $291,542,000. Of this increase, approximately half resulted from continued expansion of the digital watch and watch module product lines which were introduced in 1975. The balance of the increase resulted primarily from increased semiconductor product shipments. Demand for semiconductors increased sharply in the first part of the year, slackened at mid-year and expanded slightly during the last quarter.

Royalties and Other Income Royalties and other income combined decreased $1,031,000 (12.6%) to $7,157,000 as compared to 1975 income of $8,188,000. Royalty income from patents related to the process of manufacturing semiconductor devices generally fluctuates in proportion to semiconductor sales. In 1976, royalty income increased $1,607,000 (34%) to $6,373,000. However, this increase was offset by a $2,638,000 reduction in interest and other income.

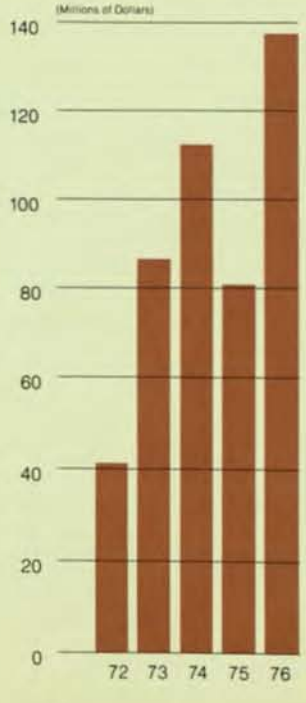
Cost of Sales Cost of sales increased $118,669,000 (56.9%) to $327,381,000 as compared to 1975 cost of sales of $208,712,000. Most of this increase is attributable to the higher sales discussed above. As a percent of net sales, cost of sales increased slightly (2.3%). This slight increase reflects the residual effects of the 1975 recession which continued to depress prices for commodity-type semiconductor components during the first half of 1976.

Administrative and Selling Expenses Administrative and selling expenses increased $24,695,000 (35.4%) to $94,427,000 compared to 1975 expenses of $69,732,000. The increase is primarily attributable to the higher volume of activity in the sale of semiconductor components, digital watches and watch modules. Selling expenses rose in proportion to the increased sales volume, where administrative expenses, as a percent of net sales, declined reflecting the fixed nature of certain of these expenses. Administrative and selling expenses in total, as a percent of net sales, dropped from 23.9% to 21.3% in 1976.

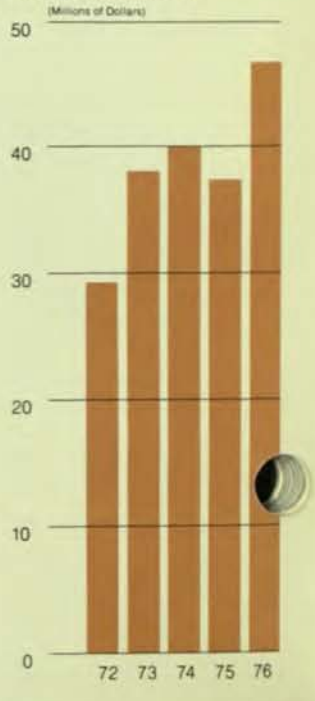
Interest Expense Interest expense increased $1,350,000 (32.5%) to $5,504,000 as compared to 1975 interest expense of $4,154,000, due to a substantial increase in average borrowings partially offset by a reduction in the average interest rate.

Provision for Income Taxes The provision for income taxes increased $3,902,000 (58.2%) to $10,610,000

INTERNATIONAL SALES



RESEARCH, DEVELOPMENT AND ENGINEERING



from the 1975 provision of $6,708,000. This increase is attributable to: (1) the increase in pretax income in 1976; (2) the favorable impact of 1975 net gains of approximately $400,000 from the sale of land and buildings occupied by a foreign subsidiary which were taxed at nominal rates; and (3) the forgiveness in 1975 of taxes of approximately $890,000 on income earned by a foreign subsidiary in a prior year.

Net Income Income before the cumulative effect of a change in accounting increased $2,032,000 ($.33 per share) to $12,456,000 ($2.27 per share) from comparable 1975 income of $10,424,000 ($1.94 per share). Income was depressed during the first half of the year as a result of losses relative to digital medium-scale and small-scale integrated circuits, which came under adverse pricing pressure in mid-1975 and continued into 1976. This unfavorable situation improved during the latter part of the year. Net income for 1975 benefited from the cumulative effect of a change in accounting method amounting to $2,649,000 ($.51 per share).

Comparison of 1975 with 1974

Net sales Net sales declined $93,391,000 (24.3%) to $291,542,000 as compared to 1974 net sales of $384,933,000. This decline in sales reflected a continuation of the worldwide recession in the semiconductor industry which began in the second quarter of 1974 and was aggravated by customer liquidation of inventories. For 1975, the largest sales decline related to digital medium-scale and small-scale integrated circuits, the Company's largest single line of semiconductor devices, for which unit demand fell and prices declined sharply. For 1975, net sales included approximately $12.5 million attributable to digital watches and watch modules, which were first sold in the third quarter of 1975.

Cost of Sales Cost of sales declined $55,482,000 (21.0%) to $208,712,000 as compared to 1974 cost of sales of $264,194,000. During 1975 cost of sales declined along with the sales decline. Even though the Company reacted promptly to the sales decline, production capacity could not be fully utilized, resulting in a smaller percentage decline in cost of sales as compared to sales. Despite the improved sales level in the latter part of 1975, the cost of sales remained proportionately higher because of continued pricing pressure on commodity type components and yield problems in the manufacture of certain semiconductor devices. As a result of the foregoing factors, cost of sales, as a percent of net sales, increased 3.0% in 1975.

Administrative and Selling Expenses
Administrative and selling expenses declined $6,150,000 (8.1%) to $69,732,000 as compared to

1974 expenses of $75,882,000. As a percent of net sales, however, administrative and selling expenses increased from 19.7% to 23.9%. This percentage increase was substantially attributable to the non-variable elements of such expenses. In addition, 1975 marked the Company's entry into the consumer market with the Fairchild line of digital watches, which required introductory promotional expenditures. The Company also temporarily increased marketing costs by adding independent sales representatives to its field organization in an effort to increase market penetration.

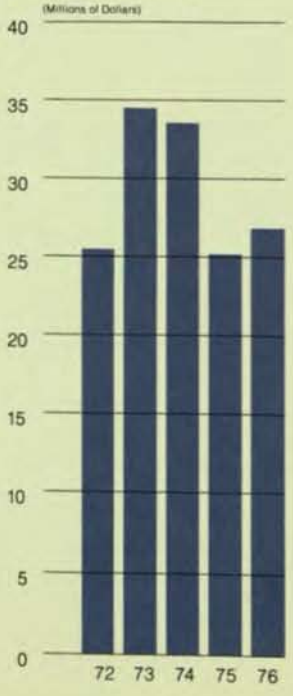
Provision for Income Taxes The provision for income taxes decreased $17,868,000 (72.7%) to $6,708,000 as compared to the 1974 provision for taxes of $24,576,000. This decrease resulted from the decline in sales and net income as well as a reduction in the effective tax rate to 39.2% from the 1974 effective tax rate of 47.6%. The decrease in the effective tax rate reflected the inclusion of credits in the 1975 tax provision related to the tax benefit of a foreign subsidiary's operating loss and forgiveness of taxes on income earned by a foreign subsidiary in a prior year.

Net Income During 1975, the decline in net income was attributable almost entirely to a sharp industry-wide drop in sales, coupled with price reductions, in the Electronic Components and Systems line of business. In particular, sales of digital medium-scale and small-scale integrated circuits (the most profitable products in 1974) resulted in a loss in 1975. In addition, problems encountered in the manufacture of certain memory components in the fourth quarter of 1975 resulted in increased units costs (as a consequence of reduced yields) which almost eliminated any profit contribution for the year for such components. The decline in semiconductor components' profitability did not affect all types of devices and was partially offset by the profitable results of digital watch operations. Income before the cumulative effect of a change in accounting method decreased $16,608,000 ($3.23 per share) to $10,424,000 ($1.94 per share) as compared with comparable income in 1974 of $27,032,000 ($5.17 per share) as a result of factors set forth above. In addition, 1975 net income was increased by the cumulative effect of a change in accounting method amounting to $2,649,000 ($.51 per share).

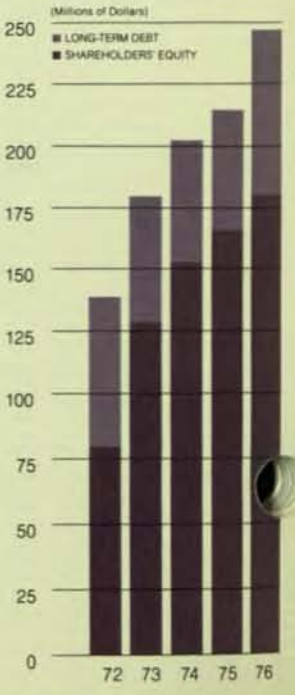
FINANCIAL POSITION

Throughout 1976 and 1975, the Company maintained a strong financial position. Cash and temporary investments at year end 1976 were $26.9 million compared

CASH AND TEMPORARY CASH INVESTMENTS



TOTAL CAPITALIZATION



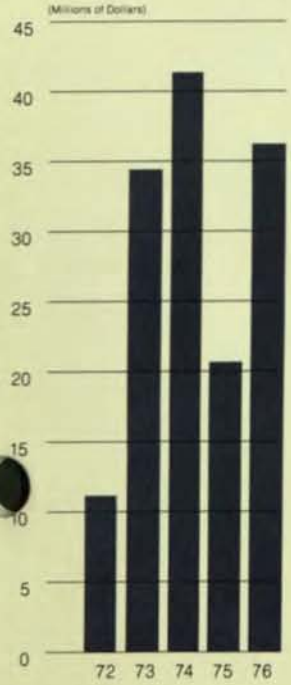
with $25.2 million in 1975. Short-term bank borrowings, the Company's only short-term debt, increased $4.2 million to $13.6 million. At year end 1976, working capital remained strong at $114 million and the current ratio was 2.1:1 compared to $101 million and 2.2:1 in 1975.

Inventories at year end 1976 of $96.5 million increased $3.5 million (4%) over year end 1975, despite a 52 percent increase in sales. Accounts and notes receivable increased $25.6 million at year end 1976 to $82.2 million as a result of the increase in sales.

Net investment in property, plant and equipment increased $18.1 million to $130.4 million in 1976. Capital expenditures were $36.1 million in 1976 as the Company expanded production facilities in anticipation of future sales increases.

Long-term debt increased $21.3 million as a foreign finance subsidiary of the Company issued debentures of $20 million to generate additional capital for future growth. Long-term debt, including the current portion, was 28 percent of total capitalization at year end 1976, an increase of 6 percent over the prior year. Shareholders' equity increased to $178 million, or $33.14 per share, from $166 million, or $31.51 per share, in 1975. Dividends of $.80 per share were paid in both 1976 and 1975.

CAPITAL EXPENDITURES



Despite the lag in the economic recovery, the Company continues to invest significantly in advanced technology and product development programs. Total spending for research, development and engineering was $47 million in 1976 compared to $38 million in 1975. Reimbursements from customers totaled $4.0 million in 1976 compared to $3.3 million in 1975.

COMMON STOCK PRICE AND DIVIDENDS

The Company's common stock is traded on the New York, Pacific and Mid-West Stock Exchanges; Symbol-FCI. The price range of its common stock and dividends per share during 1975 and 1976 were as follows:

	Price Range of Common Stock		Dividends Per Share
	High	Low	
1975			
First quarter	$38¼	$17	$.20
Second quarter	62¼	36	.20
Third quarter	61¾	42¼	.20
Fourth quarter	53¼	31⅛	.20
1976			
First quarter	53¾	36⅝	.20
Second quarter	51⅝	36⅛	.20
Third quarter	55¼	44	.20
Fourth quarter	51¾	36	.20

Fairchild Camera and Instrument Corporation and Subsidiaries

CONSOLIDATED BALANCE SHEET

Assets	January 2, 1977	December 2 1975*
Current assets:		
Cash	$ 14,606,000	$ 12,526,000
Temporary cash investments (interest-bearing) at cost, which approximates market	12,292,000	12,668,000
Accounts and notes receivable, less allowance for doubtful accounts of $2,766,000 and $2,657,000	82,230,000	56,645,000
Inventories (Note 2):		
Raw materials and parts	21,857,000	17,022,000
Work-in-process, less progress payments of $5,130,000 and $3,069,000	46,773,000	45,736,000
Finished goods	27,901,000	30,268,000
Accumulated income tax prepayments (Notes 3 and 4)	6,906,000	10,893,000
Prepaid expenses and other current assets	3,669,000	1,806,000
Total current assets	216,234,000	187,564,000
Investment in joint ventures (Note 9)	2,881,000	2,534,000
Property, plant and equipment, at cost (Note 5):		
Land	4,159,000	4,199,000
Buildings and improvements	78,764,000	66,597,000
Machinery and equipment	104,864,000	94,505,000
	187,787,000	165,301,000
Less accumulated depreciation and amortization	57,383,000	53,045,000
Net property, plant and equipment	130,404,000	112,256,00
Other assets	2,567,000	1,366,00
	$352,086,000	$303,720,000

*Restated—see Note 3.

The accompanying summary of accounting policies and notes to consolidated financial statements are an integral part of these statements.

Liabilities and Shareholders' Equity	January 2, 1977	December 28, 1975*
Current liabilities:		
Notes payable to banks (Note 5)	$ 13,618,000	$ 9,455,000
Current installments of long-term debt (Note 5)	3,030,000	2,318,000
Accounts payable	23,905,000	18,742,000
Accrued compensation and employee benefits (Note 6)	13,559,000	11,017,000
Other accrued liabilities	27,215,000	26,721,000
Estimated income taxes payable (Notes 3 and 4)	21,042,000	18,805,000
Total current liabilities	102,369,000	87,058,000
Long-term employee benefits	2,914,000	2,607,000
Deferred income taxes (Notes 3 and 4)	4,136,000	3,219,000
Long-term debt, less current installments (Note 5):		
Other secured loans	8,233,000	5,932,000
Note payable to insurance company	11,250,000	13,000,000
Convertible subordinated debentures	45,575,000	25,575,000
Total long-term debt	65,058,000	44,507,000
Shareholders' equity (Notes 3, 4, 5, and 7):		
Common stock, $1 par value, authorized 10,000,000 shares; issued 5,359,552 and 5,278,563 shares	5,360,000	5,279,000
Additional paid-in capital	81,316,000	78,308,000
Retained earnings	90,933,000	82,742,000
Total shareholders' equity	177,609,000	166,329,000
Contingencies and commitments (Notes 3, 9, 10, and 11)		
	$352,086,000	$303,720,000

Fairchild Camera and Instrument Corporation and Subsidiaries

CONSOLIDATED STATEMENT OF INCOME

	Year Ended	
	January 2, 1977	December 28, 1975
Revenues:		
Net sales	$443,221,000	$291,542,000
Royalties and other income	7,157,000	8,188,000
	450,378,000	299,730,000
Costs and expenses:		
Cost of sales	327,381,000	208,712,000
Administrative and selling	94,427,000	69,732,000
Interest	5,504,000	4,154,000
	427,312,000	282,598,000
Income before income taxes and cumulative effect of change in accounting method	23,066,000	17,132,000
Provision for income taxes (Note 4)	10,610,000	6,708,000
Income before cumulative effect of change in accounting method	12,456,000	10,424,000
Cumulative effect on prior years (to December 29, 1974) of change in accounting method (Note 2)	–	2,649,000
Net income	$ 12,456,000	$ 13,073,000
Per share of common stock (Notes 2 and 8):		
Income before cumulative effect of change in accounting method	$2.27	$1.94
Cumulative effect of change in accounting method	–	.51
Net income	$2.27	$2.45
Per share of common stock assuming full dilution (Notes 2 and 8):		
Income before cumulative effect of change in accounting method	$2.27	$1.94
Cumulative effect of change in accounting method	–	.47
Net income	$2.27	$2.41

The accompanying summary of accounting policies and notes to consolidated financial statements are an integral part of these statements.

Fairchild Camera and Instrument Corporation and Subsidiaries

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

	Common Stock		Additional Paid-In	Retained
	Shares	Amount	Capital	Earnings
Balance, December 29, 1974 as previously reported	5,161,592	$5,162,000	$74,868,000	$79,360,000
Restatement (Note 3)	–	–	–	(5,515,000)
Balance, December 29, 1974 as restated	5,161,592	5,162,000	74,868,000	73,845,000
Net income – 1975	–	–	–	13,073,000
Sales of common stock under employee stock option plan	110,302	110,000	2,531,000	–
Conversion of convertible subordinated debentures (Note 5)	6,669	7,000	519,000	–
Tax benefit related to employees' premature disposition of option shares and exercise of nonqualified stock options (Note 4)	–	–	390,000	–
Cash dividends – $.80 per share	–	–	–	(4,176,000)
Balance, December 28, 1975	5,278,563	5,279,000	78,308,000	82,742,000
Net income – 1976	–	–	–	12,456,000
Sales of common stock under employee stock option plan	80,989	81,000	2,013,000	–
Tax benefit related to employees' premature disposition of option shares and exercise of nonqualified stock options (Note 4)	–	–	995,000	–
Cash dividends – $.80 per share	–	–	–	(4,265,000)
Balance, January 2, 1977	5,359,552	$5,360,000	$81,316,000	$90,933,000

At January 2, 1977, 1,446,283 shares of unissued common stock are reserved for conversion of convertible subordinated debentures and exercise of employee stock options. See Notes 5 and 7.

The accompanying summary of accounting policies and notes to consolidated financial statements are an integral part of these statements.

Fairchild Camera and Instrument Corporation and Subsidiaries

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	Year Ended	
	January 2, 1977	December 28, 1975
Financial resources were provided by:		
Operations:		
Income before cumulative effect of change in accounting method	$12,456,000	$10,424,000
Charges (credits) to income not affecting working capital:		
Depreciation and amortization	16,663,000	15,890,000
Deferred income taxes	917,000	2,211,000
Provision for employee benefits	307,000	(1,034,000)
Gain on disposition of property, plant and equipment, net of income tax	(134,000)	(441,000)
	30,209,000	27,050,000
Cumulative effect on prior years (to December 29, 1974) of change in accounting method	–	2,649,000
Financial resources provided by operations	30,209,000	29,699,000
Increase in common stock and additional paid-in capital:		
Exercise of stock options	2,094,000	2,641,000
Tax benefits relating to stock options	995,000	390,000
Conversion of subordinated debentures	–	526,000
Proceeds from disposition of property, plant and equipment, net of income tax	1,399,000	1,835,000
Proceeds from long-term borrowings	22,699,000	553,000
Total financial resources provided	57,396,000	35,644,000
Financial resources were applied to:		
Expenditures for property, plant, and equipment	36,076,000	20,693,000
Cash dividends	4,265,000	4,176,000
Reduction of long-term debt, including $526,000 on conversion of subordinated debentures into common stock in 1975	3,193,000	3,106,000
Investment in joint ventures	347,000	641,000
Other	156,000	414,000
Total financial resources applied	44,037,000	29,030,000
Increase in working capital	$13,359,000	$ 6,614,000

The accompanying summary of accounting policies and notes to consolidated financial statements are an integral part of these statements.

Fairchild Camera and Instrument Corporation and Subsidiaries

CHANGES IN ELEMENTS OF WORKING CAPITAL

	Year Ended	
	January 2, 1977	December 28, 1975
Changes in elements of working capital:		
Current assets—increase (decrease):		
Cash and temporary cash investments	$ 1,704,000	$ (8,198,000)
Accounts and notes receivable	25,585,000	(12,312,000)
Inventories	3,505,000	19,642,000
Accumulated income tax prepayments	(3,987,000)	151,000
Prepaid expenses and other current assets	1,863,000	(62,000)
	28,670,000	(779,000)
Current liabilities—(increase) decrease:		
Notes payable to banks	(4,163,000)	(2,636,000)
Current installments of long-term debt	(712,000)	214,000
Accounts payable	(5,163,000)	(2,083,000)
Accruals—compensation, employee benefits and other	(3,036,000)	1,587,000
Estimated income taxes payable	(2,237,000)	10,311,000
	(15,311,000)	7,393,000
Increase in working capital	$13,359,000	$ 6,614,000

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

Fiscal Year The Company's fiscal year ends on the Sunday nearest to December 31. Fiscal year 1976 ended January 2, 1977 and comprised 53 weeks; fiscal year 1975 ended December 28, 1975 and comprised 52 weeks.

Principles of Consolidation The consolidated financial statements include the accounts of the Company and all of its domestic and foreign subsidiaries. The investment in joint ventures is carried in the consolidated financial statements at the Company's equity in the ventures' net assets.

Translation of Foreign Currencies The asset and liability accounts of foreign subsidiaries are translated into United States dollar equivalents at year-end rates of exchange, except for inventories and property, plant and equipment which are translated at historical rates. The income statement accounts of foreign subsidiaries are translated into United States dollar equivalents using average rates of exchange in effect during the year, except that cost of sales and depreciation are translated at historical rates. Exchange adjustments, including those resulting from performed and unperformed forward exchange contracts, are included in the results of operations.

Inventories Inventories are stated at the lower of cost or market. The major portion of the Company's inventories is based on standard costs, adjusted as required to reflect approximate actual costs; other inventories are based on average costs. Quantities in excess of estimated requirements are not valued. Progress payments received on contracts as to which title to the related inventories vests in the United States government are deducted from the applicable inventories. During 1975, the Company changed its method of accumulating manufacturing overhead in inventory. See Note 2.

Property, Plant and Equipment Expenditures for property, plant and equipment and for renewals and betterments which extend the originally estimated economic life of assets or convert the assets to a new use are capitalized. Expenditures for maintenance, repairs and other renewals of assets are charged to operations. When assets become fully depreciated or are disposed of, the cost and accumulated depreciation are removed from the accounts and any gain or loss is included in the results of operations.

Provisions for depreciation and amortization are made using the straight-line method for the major portion of assets acquired after 1968 and for all assets acquired prior to 1954; the sum-of-the-years'-digits method is used for the remaining assets. Depreciation is computed using various estimated economic lives ranging from 20 to 60 years (principally 40 years) for buildings and from 3 to 15 years (principally 6 and 7 years) for machinery and equipment. Leasehold improvements are amortized over the remaining terms of the leases or the estimated economic lives of the improvements, whichever is shorter.

Contracts Revenue on fixed price contracts is recorded at the time deliveries or acceptances are made and the Company has the contractual right to bill. Revenue under cost reimbursement contracts is recorded as cost is incurred in accordance with contractual terms. Provisions are made on a current basis to fully recognize any estimated losses on contracts.

Royalty Income The Company owns certain patents relating to the process of manufacturing semiconductor devices. Licenses to use these patented processes and other technical knowledge of the Company have been granted to a number of companies. Royalty income is based upon either a percentage of sales of licensed products or a fixed schedule of payments. Royalties are included in income in the period that payments are scheduled to be received.

Research and Development 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. In 1976 and 1975, the costs of the research and development programs were approximately $22,000,000 and $21,000,000, respectively. In addition, substantial ongoing support programs relating to existing products and processes are conducted within production engineering departments. The combined costs of research, development and engineering programs were approximately $47,000,000 and $38,000,000 (before re-

imbursements of approximately $4,000,000 and $3,000,000) in 1976 and 1975, respectively. Research, development and engineering expenditures are charged to operations as incurred and are included in cost of sales in the consolidated statement of income.

Pension Plans The Company maintains pension plans for domestic employees. Costs and funding requirements of such plans are determined in accordance with actuarial methods and the costs applicable to past service at the time of adoption or modification of the plans are amortized generally over twenty-five years. The plans are funded and deposits are maintained by trustees.

Income Taxes Investment tax credits are applied to reduce Federal income tax expense by the amount allowable each year.

No provision is made for income taxes relating to potential future distributions of accumulated earnings from foreign subsidiaries, the joint ventures or the Domestic International Sales Corporations, since it is the Company's present intention to utilize substantially all of the undistributed earnings in its foreign operations and qualified export activities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

1. Foreign Operations: The following is a summary of certain combined financial information for the Company's foreign operations:

	January 2, 1977	December 28, 1975
Working capital	$51,495,000	$47,617,000
Net assets	55,700,000	68,816,000
Undistributed earnings	49,790,000	45,118,000

Operations of the foreign joint venture were not material in relation to the consolidated financial statements. Net exchange adjustments, included in the determination of net income for 1976 and 1975, were not material to the consolidated statement of income.

2. Accounting Change: During 1975, the Company made improvements in its method of inventory costing. As a result, the overhead content of inventory was increased to include certain elements of manufacturing overhead (primarily depreciation) which had been excluded from inventory. In the opinion of Management, this accounting change represents adoption of a preferable accounting method and also complies with the Internal Revenue Service inventory costing regulations.

The cumulative effect of the accounting change, as of the beginning of 1975, in the amount of $2,649,000 ($.51 per share) after related income taxes of $2,117,000, is included in income for the year. The effect of the accounting change on 1975 income before cumulative effect of change in accounting method was not material.

3. Federal Income Tax Assessment: In July 1976, the Company reached agreement with an Appellate Conferee of the Internal Revenue Service regarding adjustments which resulted from their examination of the Company's Federal income tax returns for the years 1964 through 1971. Accordingly, retained earnings as of December 29, 1974 have been reduced by $5,515,000. The restatement of retained earnings includes nonrecoverable Federal taxes and interest (net of tax effect) for the years 1964 through 1971, related provisions for additional state taxes (net of Federal tax effect) and additional Federal taxes arising from repatriation of funds from a foreign subsidiary as a result of the agreement. Also, accumulated income tax prepayments, other accrued liabilities, estimated income taxes payable and deferred income taxes have been restated as of December 28, 1975 in the consolidated balance sheet.

The Company's Federal income tax returns for years after 1971 were prepared on bases substantially consistent with those of prior years, and the returns for 1972 and 1973 are currently being examined. In the opinion of Management, any additional provisions that might be required as a result of the examination of tax returns for years subsequent to 1971 will not be material to the Company's consolidated statement of income.

On February 18, 1977, the Company was notified that the agreement with the Appellate Conferee, referred to above, received approval by the Joint Committee on Internal Revenue Taxation. The settlement negotiated with the Conferee has therefore become final.

4. Provision For Income Taxes: The provision for income taxes is comprised of the following:

		1976	1975
Current	– Federal	$ 1,985,000	$ 3,930,000
	– State	1,103,000	472,000
	– Foreign	4,434,000	1,318,000
Deferred	– Federal	2,604,000	2,311,000
	– State	512,000	549,000
	– Foreign	(28,000)	(1,872,000)
		$10,610,000	$ 6,708,000

The 1975 deferred provision for income taxes includes the tax benefit of a foreign subsidiary's operating loss of approximately $2,100,000 which was included in accumulated income tax prepayments in the consolidated balance sheet. In 1976, the foreign subsidiary's operating loss was utilized and the related tax benefit was credited to accumulated income tax prepayments. The 1975 current provision for income taxes includes a credit of approximately $890,000 related to forgiveness of taxes on income earned by a foreign subsidiary in a prior year. In addition, the provision for income taxes for 1976 and 1975 reflects utilization of investment tax credits of approximately $1,300,000 and $950,000, respectively.

Differences between financial and taxable income result primarily from exercise of nonqualified stock options, use of accelerated depreciation and financial statement provisions which are not currently tax deductible. In addition, portions of the taxes related to the inventory accounting change, referred to in Note 2 above, are payable in future periods. The tax effect of deductions applicable to employee exercises of nonqualified stock options and premature dispositions by employees of option shares resulted in tax benefits of approximately $995,000 in 1976 and $390,000 in 1975, which was credited to additional paid-in capital.

5. Long-Term Debt and Notes Payable to Banks: In September 1976, the Company replaced the $50 million international and domestic revolving credit agreement in effect at December 28, 1975 with the following bank credit agreements:

(a) a two-year, $50 million domestic revolving credit agreement which provides for advances at the agent bank's prime rate. The Company is required to pay an annual commitment fee of ½ of 1% of the unused commitment. The Company may, at its option, convert to five-year term debt any advances outstanding at the termination of the revolving credit agreement in September 1978.

(b) Fairchild Consumer Products, Inc., a wholly-owned finance subsidiary of the Company, entered into an agreement with several banks for a one-year credit line in an amount up to the lesser of $20 million or 80% of the accounts receivable generated by the Company's consumer products group and sold to the finance subsidiary. This Agreement provides for short-term advances at the agent bank's prime rate, secured by such accounts receivable.

(c) The Company also has arrangements with several banks under which short-term, multi-currency borrowings may be available to the Company and its foreign subsidiaries. These borrowings are limited to an aggregate of $30 million by the agreement described in (a) above.

At January 2, 1977, no borrowings were outstanding under the agreements described in (a) and (b) abo

At January 2, 1977, notes payable to banks of $13,618,000 were outstanding at a weighted average interest rate of 19.5%, principally related to foreign borrowings. The maximum amount of short-term borrowings outstanding at any month end during 1976 was $27,116,000. The approximate monthly average short-term borrowings during 1976 were $20,469,000 at a weighted average interest rate of 12.1%.

Other secured loans bear interest at a weighted average rate of 7¼% and are repayable in varying installments of principal and interest. These loans are secured by liens and mortgages on property, plant and equipment with an approximate net book value of $8,016,000.

The note payable to an insurance company bears interest at 5½% per annum and requires annual principal payments of $1,750,000 from 1977 to 1979 and a final payment of $7,750,000 in 1980.

The Company's 5¾% convertible subordinated debentures of $25,575,000 are convertible into common stock at the rate of $76.11 per share at any time until their maturity in 1989. No conversions were executed in 1976. During 1975, the Company issued 6,669 shares of previously unissued common stock in connection with conversion of debentures having

$526,000 principal amount. The Company has reserved 336,027 shares for future conversion of these debentures. Commencing in 1979, the Company will be required to redeem 6% of the outstanding principal balance annually. At its option, the Company may redeem all or any part of the debentures at premiums decreasing from 2¾% in 1977 to zero in 1986.

In December 1976, Fairchild Camera and Instrument International Finance N.V. (Fairchild N.V.), a newly formed, wholly-owned foreign finance subsidiary of the Company, sold to foreign investors $20,000,000 of 5¾% convertible subordinated guaranteed debentures due 1991. The debentures are guaranteed by the Company on a subordinated basis and are convertible on or after August 1, 1977 into common stock of the Company at a conversion price of $45.50 per share. The Company has reserved 439,560 shares for future conversion of these debentures. At its option subject to certain conditions, Fairchild N.V. may redeem all or any part of the debentures at premiums decreasing from 4½% in 1978 to zero in 1987.

Under the most restrictive provisions of the loan and bank credit agreements, the Company is required to maintain specified working capital and net worth levels, is restricted as to borrowing under any new debt agreements and purchasing its stock, and is limited as to the maximum amounts of cash dividends which may be paid. At January 2, 1977, the Company was in compliance with all restrictive covenants of the loan and bank credit agreements and approximately $22,500,000 of retained earnings was unrestricted for payment of cash dividends.

Aggregate principal payments on long-term debt in each of the next five years are approximately as follows: 1977—$3,030,000; 1978—$3,017,000; 1979—$4,353,000; 1980—$10,364,000; 1981—$2,511,000.

6. Pension and Profit Sharing Plans: Pension expense charged against operations was $1,768,000 in 1976 and $1,321,000 in 1975. As a result of the Pension Reform Act of 1974, the Company amended the benefit formula, vesting and eligibility provisions of its pension plans as of the beginning of 1976. The effect of these amendments was to increase pension expense by approximately $400,000 in 1976. The pension fund assets and balance sheet accruals exceed the actuarially computed value of vested benefits under the plans.

The Company has a qualified, noncontributory profit sharing plan for eligible employees of the Company and participating subsidiaries. The Company's contribution to the plan, as determined by the Board of Directors, is discretionary but may not exceed 15% of the annual aggregate compensation (as defined) paid to all participating employees. In addition, the maximum contribution may not exceed 15% of the amount by which Income Before Income Taxes for the year (as defined) exceeds 10% of Shareholders' Equity (as defined).

The Company also has an incentive compensation plan for awarding bonuses to certain officers and other key employees. The aggregate awards, which may be in cash or common stock, shall not exceed 6% of the amount by which Income Before Income Taxes for the year (as defined) exceeds 10% of Shareholders' Equity (as defined).

Contributions to these plans during 1976 and 1975 were not material to the consolidated statement of income.

7. Stock Options: At January 2, 1977 and December 28, 1975, there were 670,696 and 776,839 shares, respectively, of common stock reserved for issuance under stock option plans (1965 Plan, which terminated as of March 17, 1975, and 1974 Plan) for officers and key employees. Issuance of the following types of options is permitted:

(a) A "qualified" option (as defined in the Internal Revenue Code) exercisable until the fifth anniversary of the grant date;

(b) A "nonqualified" option exercisable until the tenth anniversary of the grant date.

Options may not be granted at prices lower than the market price at the date of issuance and exercisable options expire 90 days after termination of employment. Under the 1974 Plan, options become exercisable in four annual installments commencing one year after the dates of grant. Under the 1965 Plan, through May 1974, options become exercisable in three annual installments commencing two years after the dates of grant; options granted subsequent to May 1974 become exercisable in four annual installments commencing one year after the dates of grant.

During 1975, the shareholders approved a reduction of the option price for all options outstanding under the 1965 Plan. Such approval covered 448,390 shares of common stock purchasable at an average per share price of $34.09. The new option price was $25.38 per share (equal to 100% of fair market price on February 26, 1975) and each option has a new five or ten year term depending upon the type of new option granted. During 1975, 86,070 options were issued in exchange for 114,836 options previously outstanding.

A summary of transactions relating to outstanding options during 1976 and 1975 is shown below:

	1976	1975
Balance, beginning of year	568,089	559,632
Add (Deduct)—Granted	92,805	296,261
—Exercised ($18.38 to $46.13 per share)	(80,989)	(110,302)
—Cancelled	(56,461)	(177,502)
Balance, end of year	523,444	568,089

At January 2, 1977, options were outstanding at prices of $18.31 to $60.88 (an average of $34.24) per share, of which options as to 164,634 shares were exercisable.

8. Income Per Share of Common Stock: Income per share of common stock for 1976 and 1975 has been calculated using the weighted average number of shares of common stock (5,331,127 and 5,222,255, respectively) and common stock equivalents (stock options—145,738 and 150,646, respectively) outstanding during the year.

Fully diluted income per share of common stock for 1976 and 1975 has been computed based upon the weighted average number of common and common equivalent shares outstanding, and the assumed conversion of the 5¾% convertible subordinated debentures into shares of common stock, after elimination of related interest expense net of taxes.

9. Investment in Joint Ventures: The Company participates with TDK Electronics, Co., Ltd. in a 50-50 corporate joint venture. The venture, TDK-Fairchild Corporation, sells semiconductor products and electronic equipment, parts and components thereof in Japan.

In 1975, the Company invested in a newly-formed corporate joint venture, Great Western Silicon Corporation (Great Western). The venture is 45% owned by the Company and 55% owned by Applied Materials, Inc. (Applied). The venture, whose plant is scheduled for completion in 1978, will manufacture and sell polycrystalline silicon. The Company and Applied have entered into a noncancellable materials purchase agreement with Great Western providing generally that the Company and Applied will purchase 75% and 25%, respectively, of a specified level of production for a period of seven years after production commences. Such purchases are to be at the best price available to such parties from an independent United States source, but in no event at a price less than that which is necessary to provide Great Western with the funds required to pay its manufacturing costs and the cost of debt service and retirement.

In the event Great Western is unable to commence operations or fails to maintain for ninety days delivery of acceptable quantities or quality of silicon, the Company and Applied are obligated to lend to Great Western, in the ratio of their respective equity ownership, amounts sufficient to cover its operating costs and the cost of debt service and retirement. In the event Great Western ceases to deliver specified minimum quantities after commencing operations and maintaining acceptable delivery levels for ninety days, the Company and Applied may be required to provide the funds to cover Great Western's operating costs and the cost of debt service and retirement. Any such payment constitutes an advance payment in the nature of a deposit against future delivery of silicon.

At January 2, 1977, Great Western has a line of credit with a bank for $2,500,000. There are no borrowings outstanding under this line of credit. In addition, arrangements have been made with an insurance company for a long-term construction loan of $7,500,000. Borrowings under this loan agreement amounted to $2,500,000 at January 2, 1977.

10. Customs Matters: As previously reported, the Company is reviewing its practices with respect to compliance with the United States customs laws applicable to products imported into the United States.

The Company has undertaken a review to assure compliance with the highly complex customs laws concerning classification and valuation of imported articles, as well as to determine the propriety and

adequacy of its past practices. Such review includes the classification and valuation, for duty purposes, of a wide variety of items, including semiconductor components partially fabricated in the Company's United States plants and shipped to its Far Eastern plants for labor intensive manufacturing or assembly operations, and then imported into the United States for completion or sale.

In 1973, representatives of the Company initiated contact with the Customs Service and advised it of the Company's voluntary program, and the Company is in the process of submitting to the Service proposals regarding future handling of customs activities and information concerning any past inadequacies discovered in the review. It has also notified the Customs Service that it intends to report to and deposit with the Customs Service amounts found to be owing, if any. In response to requests made, the Company has received several rulings from the Customs Service and is currently engaged in concluding its internal review and preparing the submission of its proposals to the Service.

The Customs Service has statutory authority to collect underpayments of duty and, in some instances, to assess civil penalties based upon the value of the imports involved. Currently, no determination can be made as to whether any penalty assessment will be proposed. Petitions for remission or mitigation are permitted under Customs statutes and regulations, and have been granted to varying degrees in other situations involving electronics companies. After the Company had initiated contact with the Customs Service, in 1974 the Customs Service published its position with respect to voluntary disclosure which provides, in effect, that if the Customs Service determines that a disclosure is made voluntarily any penalty will be mitigated to the amount of any applicable duty underpayment plus a maximum of one times that amount.

It is the Company's position that it voluntarily initiated its pending proceedings with the Customs Service and that, to the extent it may be relevant, it should be considered as having made a voluntary disclosure. There is, however, no assurance that the Company's position will be sustained. The Company intends to pursue this matter diligently so as to minimize the ultimate consequences to the Company. The Company has made provisions in its financial statements for estimated underpayments and penalties, if any, which may result, as well as provisions for other costs being incurred in resolving this matter. In the opinion of Management, any ultimate liability which may result will not have a material effect on the consolidated balance sheet or statement of income of the Company.

11. Contingencies and Commitments: A portion of the Company's sales is subject to renegotiation. Clearances have been received through the year 1974 and no refunds for 1975 and 1976 are anticipated.

The Company leases data processing equipment and various facilities under long-term, noncancellable leases which expire at various dates prior to 1992. Facility leases generally require the Company to maintain the facilities, pay incremental property taxes and provide insurance and utilities. Rent expense under all rental agreements, including the above leases, was $9,520,000 and $7,938,000 in 1976 and 1975, respectively. Minimum annual rentals under long-term, noncancellable leases will be approximately as follows:

Year	Facilities	Equipment
1977	$2,842,000	$1,869,000
1978	2,606,000	1,646,000
1979	2,019,000	1,415,000
1980	1,668,000	1,220,000
1981	1,575,000	905,000
1982-1986	5,759,000	1,297,000
1987-1991	2,805,000	–

Noncapitalized financing leases, as defined by the Securities and Exchange Commission, are not material.

An action against the Company seeking an injunction and damages in an unspecified amount was commenced in December 1975. The plaintiff in its complaint alleges, among other things, that its trade secrets relating to the design of a semiconductor device were improperly obtained and used by the Company. The Company's request for an order dismissing the complaint or alternatively granting summary judgment has been denied. The Company intends to defend this action diligently and, in the opinion of Management, if the Company is ultimately adjudicated to be liable, it will not have a material effect on the consolidated balance sheet of the Company.

12. Selected Quarterly Data (Unaudited): The 1975 interim financial information was not subjected to a

limited review by the Company's independent accountants.

	Net Sales	Gross Profits*	Net Income	Net Income Per Share of Common Stock
1975	(amounts in thousands except per share data)			
First quarter	$ 69,757	$21,070	$3,255**	$.62**
Second quarter	68,964	20,866	3,287	.61
Third quarter	71,453	20,836	2,717	.50
Fourth quarter	81,368	20,058	1,165	.21
1976				
First quarter	94,624	20,762	197	.04
Second quarter	111,753	29,356	2,858	.52
Third quarter	118,157	33,152	4,243	.77
Fourth quarter	118,687	32,570	5,158	.94

**Net sales less cost of sales.*

***Before cumulative effect of change in accounting method of $2,649,000 ($.51 per share)—see Note 2.*

13. General Description of the Impact of Inflation (Unaudited): Although the cumulative impact of inflation over a number of years has resulted in higher costs for replacement of existing plant and equipment, such inflationary increases have partially been offset by technological improvements and design changes which often result in substantial increases in productivity of the newer asset additions. Generally, the Company's rapid rate of technological advance and the resulting production efficiencies have mitigated unfavorable inflationary pressures.

The Company's annual report on Form 10-K contains specific information with respect to year end 1976 replacement cost of inventories and productive capacity, and the approximate effect which replacement cost would have had on the computation of cost of sales and depreciation expense for the year. To obtain a copy of the Company's Form 10-K, please write to the Corporate Communications Department, Fairchild Camera and Instrument Corporation, 464 Ellis Street, Mountain View, California 94042.

REPORT OF INDEPENDENT ACCOUNTANTS

Price Waterhouse & Co.

To the Shareholders and Board of Directors of Fairchild Camera and Instrument Corporation

We have examined the consolidated balance sheets of Fairchild Camera and Instrument Corporation and its subsidiaries as of January 2, 1977 and December 28, 1975, and the related consolidated statements of income, shareholders' equity and of 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.

The method of inventory costing was changed in 1975 as described in Note 2 to the consolidated financial statements.

In our opinion, the consolidated financial statements examined by us present fairly the financial position of Fairchild Camera and Instrument Corporation and its subsidiaries at January 2, 1977 and December 28, 1975, and the results of their operations and the changes in their financial position for the years then ended in conformity with generally accepted accounting principles consistently applied during the period subsequent to the change, with which we concur, made as of December 30, 1974, referred to in the preceding paragaraph.

Price Waterhouse & Co.

121 Park Center Plaza
San Jose, California

January 26, 1977 (except as to the last paragraph of Note 3 which is as of February 18, 1977)

DIRECTORS

Roswell L. Gilpatric	Chairman of the Board of the Corporation; Presiding Partner, law firm of Cravath, Swaine & Moore
C. Lester Hogan	Vice Chairman of the Board of the Corporation
Wilfred J. Corrigan	President and Chief Executive Officer
Albert Bowers	President, Syntex Corporation; Vice Chairman of the Board, Syntex Corporation (pharmaceuticals and chemicals)
William C. Franklin	Consultant
Lt. General James B. Lampert (U.S. Army—Retired)	Vice President, Massachusetts Institute of Technology
Louis F. Polk, Jr.	Chairman, President and Chief Executive Officer, Leisure Dynamics, Inc. (hobby and game products)
William A. Stenson	President, Alliance Capital Management Corporation
J. Bradford Wharton, Jr.	Management Consultant; President of the Wealdon Company (a family corporation—investments and farming)

OFFICERS

Wilfred J. Corrigan	President and Chief Executive Officer
Corporate Staff	
Warren J. Bowles	Vice President—Industrial Relations
A. J. Hazle	Vice President—Controller
Frederick M. Hoar	Vice President—Communications
[illegible]mas A. Longo	Vice President—Chief Technical Officer
[illegible]Douglas Norby	Vice President—Finance
Nelson Stone	Vice President—General Counsel and Secretary
James A. Unruh	Vice President—Treasury and Corporate Planning
Operations	
James D. Bowen	Vice President and General Manager—Instrumentation and Systems Group
John A. Duffy, Jr.	Vice President and General Manager—International Division
Raymond G. Hennessey	Vice President and General Manager—Industrial Products Division
David J. Marriott	Vice President and General Manager—Large-Scale Integration Group
Louis H. Pighi	Vice President and General Manager—Federal Systems Group
Gregorio Reyes	Vice President and General Manager—Consumer Products Group
George D. Wells	Vice President and General Manager—Components Group
Joseph H. Akerman, Jr.	Assistant Treasurer
Richard Franklin	Assistant Secretary
John J. Giblin	Assistant Controller
Philip Haas	Assistant Treasurer
Stanley Winston	Assistant Secretary (Attesting)

Independent Accountants Price Waterhouse & Co.

Transfer Agent The Bank of New York

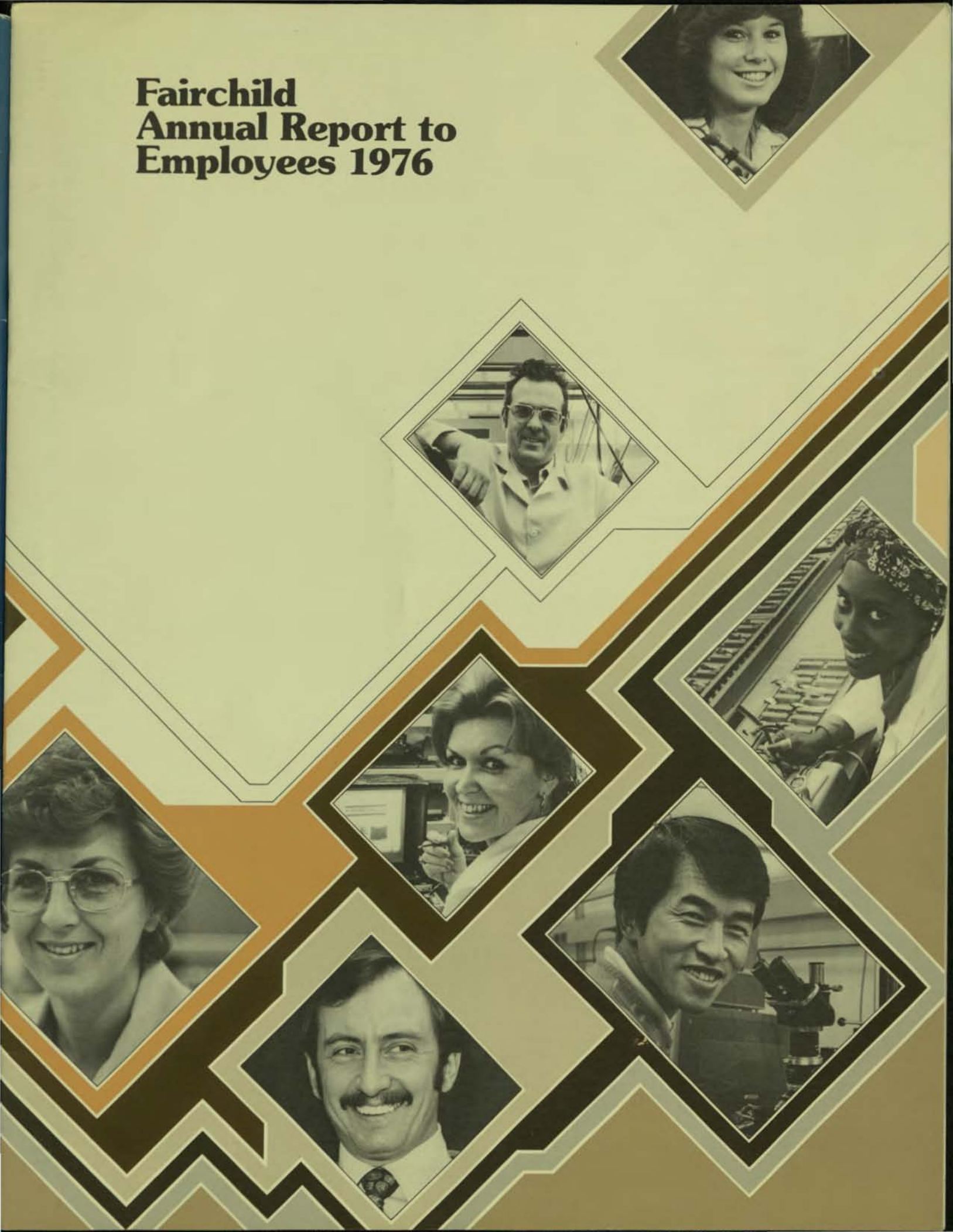
Registrar Citibank, N.A.

[illegible]swell L. Gilpatric has announced that he will retire as Chairman of the Board after the Shareholder's Meeting to be held on May 6, 1977. Mr. Gilpatric is a nominee for re-election as director and will continue as a director of the corporation. The nominees for election to the Board of Directors listed in the Proxy Statement for such Annual Meeting have announced their intention to elect Wilfred J. Corrigan as Chairman of the Board of the Corporation after the meeting.

FAIRCHILD

Fairchild Camera and Instrument Corporation
464 Ellis Street, Mountain View, California 94042
Telephone (415) 962-5011

Fairchild Annual Report to Employees 1976



Wilf Corrigan
President and Chief
Executive Officer

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April, 1977

The Fairchild Annual Report to Employees 1976 is published for employees of Fairchild Camera and Instrument Corporation.

Employees may obtain additional copies of this report and copies of the Annual Report to Shareholders for the year ended Jan. 2, 1977 by writing to the Corporate Communications Department, M.S. 20-2260, Mountain View.

FAIRCHILD
CAMERA AND INSTRUMENT
CORPORATION

An Equal Opportunity Employer

Dear Fellow Employees:

I am pleased to be able to comment to you in this first Annual Report to Employees. This publication, which supplements our Annual Report to Shareholders, recognizes each of us has a special interest in our company—we are concerned with its accomplishments, of which we can be proud, and its problems, on which we need to concentrate our efforts.

At Fairchild, 1976 brought some of both. Your efforts last year produced record sales—an impressive 52 percent gain over fiscal 1975. The company introduced hundreds of advanced new products—many, the result of years of research and development. Our position in our major markets grew stronger, particularly in microprocessors and LSI. This past February, Fairchild listed for trading on the London Stock Exchange, a move which reflects the interest in our company internationally.

Our earnings growth did not match our sales growth, increasing by a modest 20 percent. Our major focus for 1977 will be on increasing margins. I am planning on 1977 being the year where we bring together the right balance of sales growth and earnings.

The LSI (large scale integration) and microprocessor markets offer a particular potential for dramatic future growth. Recognizing this, we formed a separate group last year specifically to address this market. Our Microsystems Division at San Jose recently began operations in a large new addition built to help them better serve a very promising market.

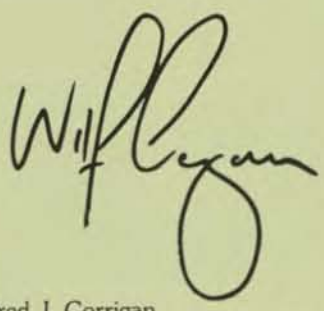
Consumer end products—an area Fairchild was not involved in two years ago—expanded last year, although its growth rate was reduced by the economic slowdown in the second half. The popular liquid crystal display (LCD) timepieces were added to our watch line, and we successfully developed and brought to market the Fairchild Video Entertainment System, a programmable home television game based on our F8™ microprocessor. The game was approved by the FCC in October and limited shipments took place during the holiday season, with excellent customer response.

More than 30 percent of our sales last year came from foreign countries. Our international business has grown rapidly in the last five years, especially in Europe. Last December, our wholly-owned financial subsidiary, F.C.I. International Finance N.V., generated additional capital through the sale of $20 million of 5 & 3/4 percent convertible subordinated debentures in the Eurobond market. This reflects the interest in our company in Europe and the increased emphasis we are putting into market growth in that area.

Internally-developed products are the lifeblood of our company. Despite last year's economic lag, we continued to invest significantly in new product development and expanded production facilities. Spending for research, development and engineering amounted to approximately $48 million, with expenditures for new buildings and equipment at $36 million. These investments will enable Fairchild to take advantage of the market opportunities we see ahead.

Prospects for the coming year—our fiftieth anniversary as a company—are encouraging. Our financial position is strong, and we have an organization of talented people. A corporation is more than good products and new buildings—it is people—men and women who staff our labs, manufacturing areas and offices developing, making and selling our products.

Your contribution to that effort is important. I want to personally thank you for your contribution to last year's record sales level, and I seek your cooperation for an even better 1977.



Wilfred J. Corrigan
President and Chief Executive Officer

Our 1976 Revenue Dollars

In the Annual Report to Shareholders, use of our company's income is shown in a series of financial tables. Here, we've taken the main categories from the Annual Report's Consolidated Statement of Income and expanded them to show their structure.

How We Earned Them:

We received $443,221,000 in sales from our customers + $7,157,000 in royalties and other income = $450,378,000 in total revenue for 1976 (100%).

How We Used Them:

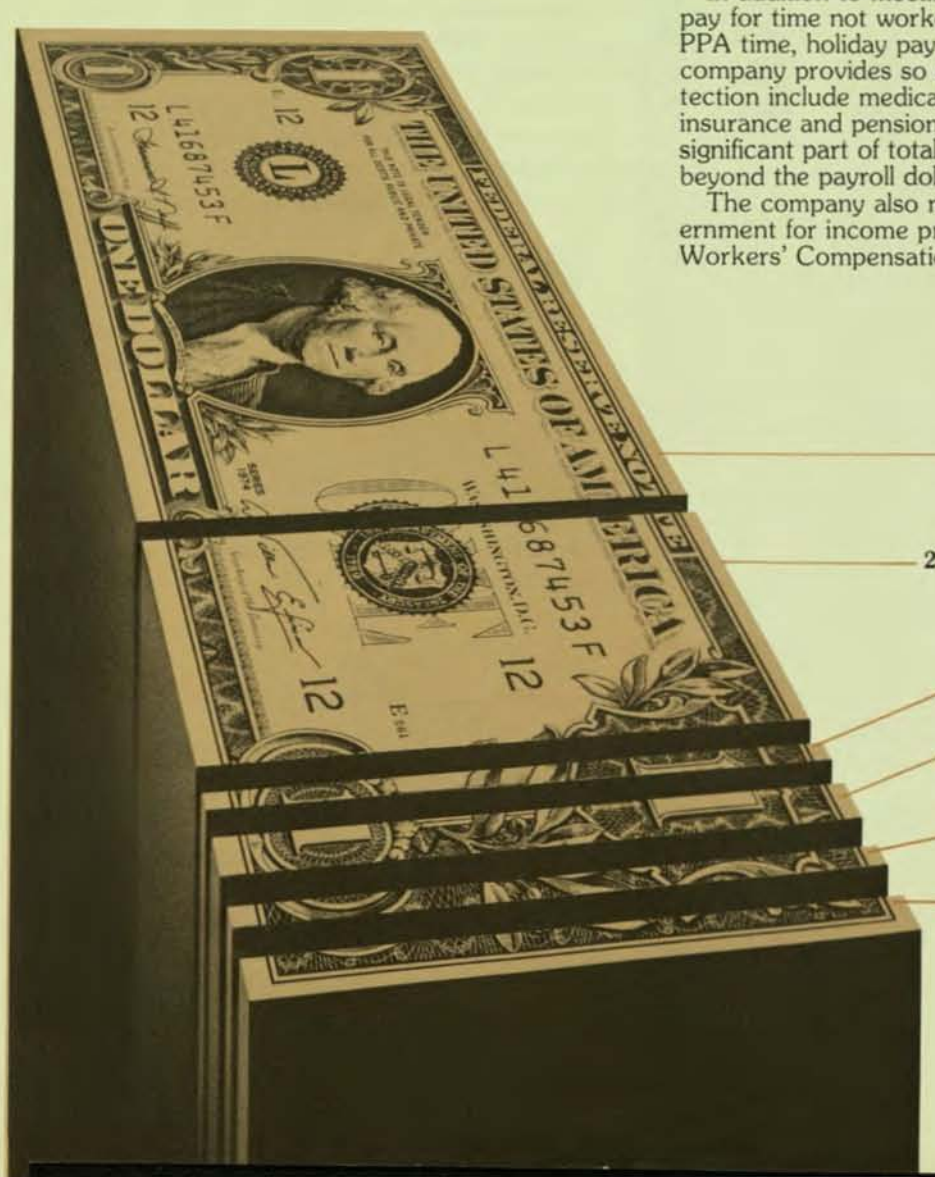
73¢ Cost of Sales ($327,381,000)

To make our products and get them into the hands of our customers requires nearly three-quarters of each revenue dollar. Buying raw materials and supplies, paying utility bills and insurance premiums on our property, packaging our products and delivering them to our customers all cost proportionately more last year than they did before.

Cost of sales also includes compensation and benefits for the majority of our employees - everyone except administrative and sales personnel, whose compensation is included in administrative and selling expenses.

In addition to meeting the payroll, Fairchild must pay for time not worked, in the form of sick leave, PPA time, holiday pay and vacations. Benefits the company provides so employees have income protection include medical and dental insurance, life insurance and pension plan payments. These are a significant part of total employee compensation beyond the payroll dollar.

The company also makes payments to the government for income protection programs including Workers' Compensation, Social Security and



73¢—Cost of Sales ($327,381,000)

21¢—Administrative and Selling Expenses ($94,427,000)

1¢—Interest Expenses ($5,504,000)

2¢—Provision for Income Taxes ($10,610,000)

1¢—Payments to Shareholders ($4,265,000)

2¢—Profit ($8,191,000)

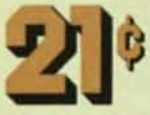
unemployment insurance. Fairchild paid $9,410,000 in payroll taxes for all employees including administrative and sales personnel last year, which included matching each employee's Social Security contribution.

Other forms of tax reported under this heading include those which are part of everyone's cost of living. Property tax on real estate and personal property, for instance, amounted to $4,281,000 last year. Miscellaneous taxes such as license fees and sales tax cost an additional $916,000.

Buildings and equipment we buy eventually become obsolete. In the electronics business, this can happen very quickly as new technology develops. To reflect the limited life of these assets, we make a charge against earnings commonly called depreciation and amortization expense. This figure is computed by determining how long a new asset can be used, then writing off a portion of its cost over each year of its estimated useful life. Fairchild's depreciation expense was $16,663,000.

It is to our advantage, of course, to maintain our present facilities and equipment in the best possible shape for as long as we can. The company paid $10,770,000 for maintenance and repairs during 1976.

To maintain our leadership position in the numerous industries we serve, Fairchild invested $47,000,000 last year in research, development and engineering activities to improve existing products and develop new ones.



Administrative and Selling Expenses ($94,427,000)

Fairchild wouldn't sell many products if our customers didn't know they were available, so the company must invest a substantial amount of money each year to inform people about our products and convince them to buy from us. Advertising Fairchild products through numerous media cost $10,796,000 last year, approximately 2¢ of this 21¢ per revenue dollar.

Also paid from this one-fifth of the revenue dollar was compensation for administrative and sales personnel companywide, and the costs of supporting essential corporate services such as protecting Fairchild patents against unauthorized use, identifying and training promotable employees and providing information to existing and potential investors.

Interest Expense ($5,504,000)

Operating funds for a company come from profits it has left after paying its expenses, plus money invested by shareholders. Most companies find it necessary occasionally to supplement these two sources with money borrowed from banks and other sources. When this happens, it must pay interest, just as you do on your home mortgage or car loan. Last year, Fairchild's interest expense included payments on loans financing plant expansion and interest payments to debenture-holders who invested in our company.

Provision for Income Taxes ($10,610,000)

Taxes are a fact of life for corporations just as they are for individuals. U. S. companies are taxed by our federal government at a stiff 48% of their taxable income. These taxes, of course, pay for schools, roads and many services we have come to expect from government, which few of us would want to be without. Fairchild's federal, foreign and state income tax last year amounted to $10.6 million or $2.49 for every dollar paid in dividends to shareholders. Our total tax expense for 1976, including income, payroll, property and miscellaneous taxes, was slightly more than $25 million.

Payments to Shareholders ($4,265,000)

Just as Fairchild pays interest to banks for borrowing money, it must pay our shareholders dividends in return for their investment in our company. Last year, our net income was $12,456,000. Of this amount, $4,265,000 went to our shareholders. They each received 80¢ for each share of stock they own. These payments are made from funds remaining after the company pays taxes throughout the world.

Profit ($8,191,000)

Without profit, there wouldn't be any jobs. Profit can be thought of as the cost of staying in business—Fairchild must reinvest this money to build and expand plants, develop new products and remain competitive—in short, to grow. This growth provides more jobs as the company expands.

Surveys have shown that many people assume corporate profits run as high as 35 or 40 percent—a figure many times the norm. After all expenses, taxes and shareholder payments were taken out last year, Fairchild had slightly more than $8,000,000 to reinvest in the business—2¢ from every revenue dollar.

1976 Highlights

January 2 Introduction of the Timeband™ low-priced digital watch line

January 7 Construction on a polysilicon plant in Chandler, Arizona begun as a joint venture with Applied Materials, Inc.

January 16 European semiconductor operations decentralized to improve customer service and marketing coverage

March 24 F8 microprocessor kit for design and evaluation announced by Microsystems Division

May 25 Xincom III semiconductor test system unveiled

June 7 I²L™ 4K dynamic RAM brought to market by Bipolar Memory & ECL Products Division

June 11 Semiconductor technology agreement with Hungarian firm announced

June 14 Television game, LCD watches introduced at the Consumer Electronics Show, Chicago

August 6 MOS/CCD Division announced it will be an alternate source for the industry's fastest 4K MOS dynamic memory, the Mostek 4027

September 14 Sentry VII advanced semiconductor test system introduced by Systems Technology Division

September 17 LSI Group formed under Vice President Dave Marriott. International Division to be headed by Vice President John Duffy

September 23 Space and Defense Systems Division CCD camera among IR-100 winners

September 29 $100 million bank credit agreement announced

October 20 Federal Communications Commission approved Video Entertainment Systems for sale

October 28 Fairchild announced technology exchange agreement with Motorola; will produce 6800 microprocessor and 8000-bit EROM

November 8 Construction begun on new Consumer Products headquarters at Santa Clara, Calif.

November 9 European $20 million convertible debenture offering announced

December 13 Initial occupancy of new 265,000 square-foot LSI plant in San Jose, Calif.

December 14 Federal Systems Group received Department of Defense Cogswell Award

The Sentry VII computer-controlled semiconductor test system, introduced in September, provides reliable and efficient testing of microprocessors, high-density memories and other circuits.

The Video Entertainment System, first shown at the June Consumer Electronics Show, uses replaceable cartridges and incorporates Fairchild's F8 microprocessor.

The F8 kit furnishes systems designers with a fully-assembled working microprocessor.

The MV-201 CCD camera received an award from *Industrial Research* magazine as one of the most significant new technical products for 1976.

Components Group

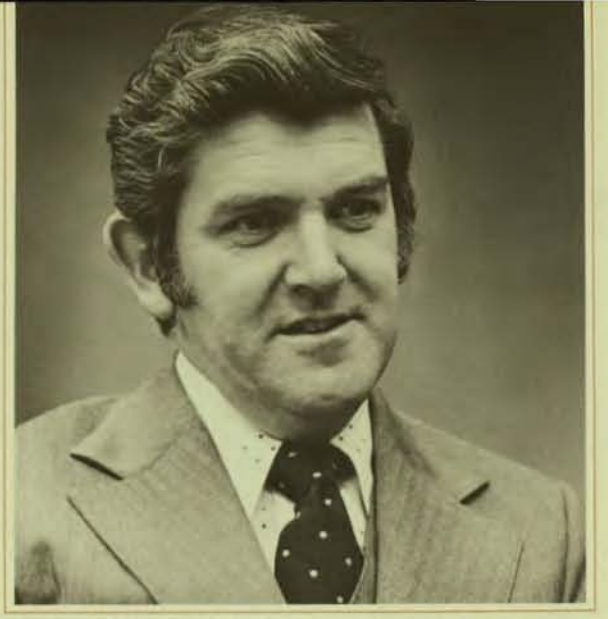
I am pleased to report that Components Group sales growth exceeded that of the industry last year. The four product divisions and Manufacturing Services all cooperated in meeting the Group's goals of sound inventory management and greater cost reductions.

Analog Products Division made great progress in the consumer electronics area during 1976. Linear integrated circuits for the television and audio equipment industries were introduced, and LIC continued to supply components to citizens band radio manufacturers in high volume.

We saw major growth in Europe, where Fairchild is the largest U.S. supplier of PAL (phase-alternating line) television circuits, the primary broadcast circuit used outside the United States. Continuing emphasis in the military area also contributed greatly to Linear's success.

Producing solid-state ignition systems for major car makers continued to be the primary activity of the Automotive/Hybrid Products Division. In 1976, we decided to sell our line of add-on (consumer) ignition systems. That line was purchased by Mallory Electric Co., a division of W. R. Grace, last December. We are now supplying Mallory with components for the add-on system. We will continue to serve as a components supplier to the OEM market.

This move reflects the continuing evaluation we make of our product lines. I believe periodic reviews are necessary to insure all products pull their own weight and do not use resources that could be more effectively applied somewhere else. This action has put the Automotive Division in a much better position to serve their primary market—the major automobile manufacturers.



George Wells–Vice President and General Manager, Components Group

The Digital Products Division experienced lower profits than expected as a result of pricing pressure on the commodity lines. Renewed emphasis in the military market segment, together with many new product introductions in CMOS and low power Schottky TTL, has enabled us to offset the margin squeeze brought on by the general economic lull that occurred in the second half of the year.

While we can do little to control economic conditions, we are concentrating on cost reductions through product redesign and more efficient production methods. The reliability of our CMOS parts and the speed of our low power Schottky circuits are unsurpassed in the industry. Through our cost reduction actions, we plan to be in a better position to take full advantage of our product superiority by mid-year.

Successful cost reduction programs were responsible for significantly improved costs in the Diode Division last year. Even though the industry-wide diode market is maturing, and hence has a slower growth rate, our Diode Division has achieved an impressive annual increase in market share over the past several years.

Above—Sandy Aceto, Digital Products Division, South Portland
Right—John Reimer, Diode Division, San Rafael

Components Group continued

Transistor Division introduced more than 50 new power products during 1976, and the small signal business continued to gain market share. We see major growth opportunities in Transistor during the next decade, and expect this part of our business to increase substantially.

Improved performance last year would not have been possible without implementation of the Global Logistics Program, coordinated by the Manufacturing Services Division. The GLP, launched in late 1975, has consolidated product distribution at three locations—Hong Kong (discrete products), Singapore (integrated circuits) and Mountain View (U.S. distributors). We have been able to respond to customer orders much more quickly, while doubling our inventory turns.

I look forward with anticipation to another good year in which we can plan for further increases in sales and profits.

George.

George D. Wells
Vice President and General Manager
Components Group

Top–Steve Henderson, Manufacturing Services, Healdsburg
Bottom–In Soon Carman, Transistor Division, Mountain View

LSI Group

The LSI Group was formed last September to enable our company to focus resources on a market area that shows perhaps the greatest growth potential in the industry. Our group will be responsible for a full range of state-of-the-art memory and logic devices. Its formation reflects the emerging importance of LSI products in the semiconductor business today.

We have put together a dedicated group of people in marketing, sales, engineering and manufacturing to concentrate on both the current LSI market and Fairchild's forward integration into end products.

LSI products, in which hundreds of circuit functions can be put on one integrated circuit chip, represent the area where future technological breakthroughs will be made. The growth of LSI is primarily due to the continuously decreasing cost per function it can offer to our customers. The average silicon area required to produce a transistor has dropped by a factor of over 100 in the last 10 years, offering greater performance at reduced costs. The worldwide LSI market is expected to expand 17 percent annually over the next decade, becoming a $5.4 billion market by 1985.

Another factor contributing to LSI growth has been the increasing popularity of consumer electronic products incorporating these devices. Items

Left—Solange Keefe, Bipolar Memory & ECL Products Division, Mountain View
Below—Yutaka Watano, MOS/CCD Division, Wappingers Falls

such as digital watches, clocks, calculators and television games accounted for nearly one quarter of the total LSI market last year. Communications products, computers and business equipment accounted for nearly 85 percent of LSI consumption in 1975.

LSI Group's efforts are aimed at three major market segments—electronic data processing, communications and consumer products—and are being carried out through the Bipolar Memory & ECL Products Division, the MOS/CCD Division and the Marketing Unit.

The memories, microprocessors and logic devices produced by Bipolar/ECL offer the high speed and capability made possible through advanced bipolar memory and emitter-coupled logic technology, including the Fairchild-developed Isoplanar integrated injection logic (I^3L™). These products found increasing markets last year in the computer industry and microprocessor systems.

MOS/CCD Division, using metal-oxide-semiconductor and charge-coupled-device technology, produced memories, microprocessors and imaging devices used extensively in computers, consumer products and industrial controls. All these technologies are based on Fairchild's proprietary Isoplanar process.

During 1977, we plan to introduce approximately 35 significant new products. These include static and dynamic memories, microprocessors and high speed logic and communications circuits aimed at the communications and controls markets.

Dave Marriott–Vice President and General Manager, LSI Group

This spring, we began operations in our South San Jose wafer fabrication plant. This brand new, 265,000-square-foot building is one of the world's most modern high volume production facilites dedicated to LSI manufacturing, and will be capable of producing four-inch LSI wafers. One quarter of that building will have more LSI manufacturing capacity than we now have available to the entire group.

Our view of the LSI world has changed over the last several years. Initially, it appeared that a manufacturer could succeed in the LSI business by focusing on one technology and one market segment. It is now clear that long-term success means competing in several markets with a number of LSI technologies. This we intend to do.

The outlook for the LSI Group is very good for 1977. Our organization and start-up phase is now behind us, and we should be able to take full advantage of our technological leadership and new market strategy during our first full year of operation.

Dave Marriott

David J. Marriott
Vice President and General Manager
LSI Group

Top-Lydia Marcado, MOS/CCD Division, Wappingers Falls
Bottom-Larry DeClue, *left* and Daniel Wong, Bipolar Memory & ECL Products Division, Mountain View

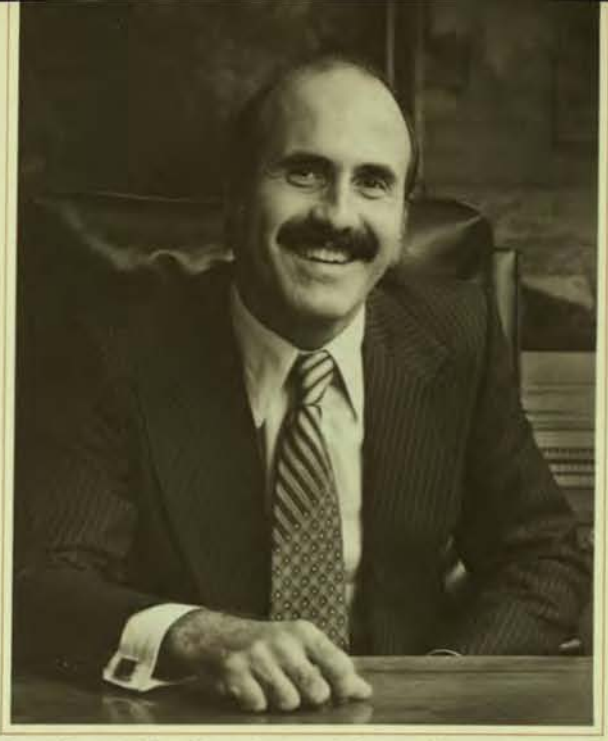
Consumer Products Group

1976 was the year Fairchild established itself as a major factor in the consumer products business. Each of you in the Consumer Products Group can take pride in your contribution to that success.

Introduction of our economy-priced Timeband™ line in January of last year provided Fairchild with the broadest range of electronic timepieces available. Because of increasing demand for liquid crystal watches, CPG introduced five LCD styles in June, with good market acceptance. By the end of the year, we were shipping these models in quantity.

We have also had favorable response to our Timeband and Fairchild lines of LED digital clocks, which are now available in styles ranging from table models to a combination clock and high intensity lamp. In 1977, Time Products will continue to stress a balanced product line, both in price and type of timepieces.

Service improvement was a problem area which Time Products Division addressed last year. Our centralized Service Center in Palo Alto has now reduced turnaround time on watch repairs to one week. We have made changes in our 1977 watch lines to minimize customer problems with battery replacement. Watches are now designed with hatchbacks which permit the customer to change batteries, and we're also including coupon for a free set of batteries with each new watch.



Greg Reyes–Vice President and General Manager, Consumer Products Group

A significant achievement last year was the launching of our Video Entertainment System, the first programmable home television game. The game console and Videocart™ cartridges are based on Fairchild's F8™ microprocessor, supplied by the Microsystems Division.

When we demonstrated a prototype of this unique system at the June Consumer Electronics Show in Chicago, we revolutionized home electronics. Our booth was jammed throughout the entire show. The Video Entertainment System was approved for sale by the Federal Communications Commission in October.

Fairchild is the only company that has a cartridge expandable game. By the end of this year, we expect to have 20 cartridges developed for sale, including high skill games and educational programs. Our company should continue to dominate this market from a technological standpoint.

Exetron Division continued to make important contributions to Consumer Products last year, in-

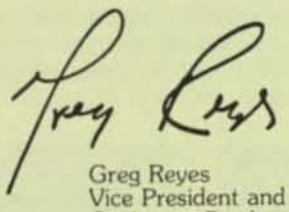
Left, top – Angelina Trujillo, Exetron Division, Santa Clara
Left, bottom – Becky Stanton, Optoelectronics Division, Palo Alto *Above* – Linda Carter, Time Products, Palo Alto

cluding start-up of the first four-inch wafer fabrication facility in the industry. The division supplied CMOS circuits used in watches and maintained excellent performance and control in ramping both LED and LCD watch module production throughout the year to meet watch market demands.

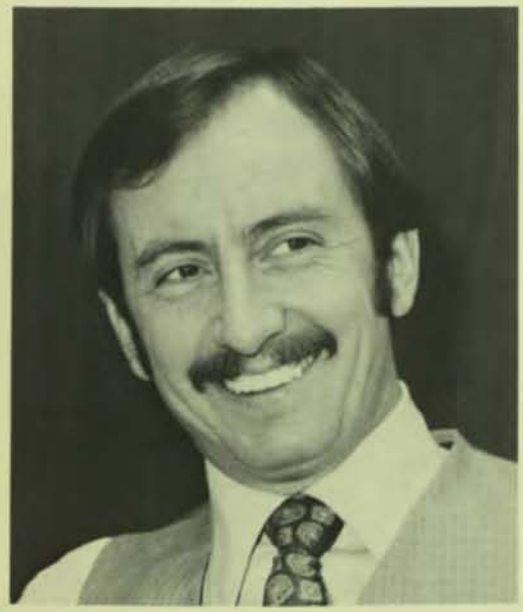
Our Optoelectronics Division experienced steady growth, despite a slowdown in orders for watch displays as many smaller digital watch manufacturers dropped out of the market. Major car and CB radio manufacturers placed large orders for Opto LED displays. At the end of the year, in its first attempt to sell components to the consumer, Opto offered a car clock in its Solid State Technology Kit. This line will be expanded this year to include clock calendars.

Fairchild consumer products were introduced throughout the world last year, and initial market response in areas including Europe and the Far East was gratifying. To accommodate future demand for our products, we broke ground in November for a new 150,000-square-foot CPG headquarters building in Santa Clara, Calif. We expect to move in later this year.

With your help, 1977 should be a good year for our group, both in terms of innovative expansion of our current lines and improved demand for all our products.



Greg Reyes
Vice President and General Manager
Consumer Products Group



Bruce Crockett, Optoelectronics Division, Palo Alto

Instrumentation and Systems Group

I am pleased to report that some of the most dramatic growth within Fairchild last year occurred in the Instrumentation and Systems Group.

Our F8™ microprocessor and Sentry and Xincom testers all produced impressive sales gains. In October, the company announced that Microsystems Division would begin producing the Motorola 6800, a leading microprocessor for the data processing industry, under a second-sourcing agreement with Motorola.

We continued to be the leader in the semiconductor test business last year, with introductions of Sentry VII and Xincom III testers. The Sentry systems test high complexity devices faster than ever before possible. The Sentry VII, introduced at the September Wescon Show in Los Angeles, interfaces directly with our Integrator™ host computer. The Integrator collects data from numerous on-line testers and provides status reports at various stages of semiconductor processing.

Sandy Mendenhall, Instrumentation Unit, San Jose

Instrumentation and Systems Group continued

The Xincom III tester, introduced in May, is the first commercial test system to use distributed system architecture, which permits a number of testers to communicate with a central computer. Systems Technology received more than $900,000 in orders for the Xincom III within the first month of its introduction.

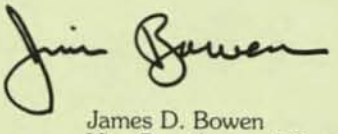
Several major appliance manufacturers have placed high volume orders with the Microsystems Division. Closer to home, the Consumer Products Group has based its programmable home video game system on an F8 controller. We're predicting that, within five years, the majority of American homes will have appliances run by an F8 or similar microprocessor. the majority of American homes will have appliances run by an F8 or similar microprocessor.

In 1976 we introduced our digital panel meter line of products using the Fairchild 0.5 and 0.8-inch LEDs. In our first year in this product area, we captured a significant portion of the available market. Last year we also started the Memory Systems Unit, a supplier of board level memories to the computer OEM market. In December we delivered our first products. Later this year we expect to introduce a line of standard products using our memory systems.

Jim Bowen–Vice President and General Manager, Instrumentation and Systems Group

In December, we acquired another company, Data Works Instrumentation, Chatsworth, Calif. The Data Works products became part of our Instrumentation Unit product line.

I expect 1977 to be another growth year for us in our major markets. I would like to thank you for your help and support during the last active year, and I look forward to working with you during 1977.



James D. Bowen
Vice President and General Manager
Instrumentation and Systems Group

Top–Raj Shankar, Microsystems Division, San Jose
Bottom–George Lew, left and John Hopp, Systems Technology Division, San Jose
Right–Kathy Smallwood, Systems Technology Division, San Jose

Federal Systems Group

Federal Systems Group continued its steady growth last year, with increases in both sales and bookings. These occurred predominantly in electronic countermeasures and electro-optical systems. I want to thank each of you for your contributions to that success.

In addition to being awarded several significant government contracts, we successfully tested product prototypes and launched new product programs in both the Space and Defense Systems and Imaging Systems divisions.

The U.S. government continued to be our major customer—specifically NASA and the military services. Space and Defense Systems led the group in large contracts with an award of $10 million for signal processing equipment for Navy electronic countermeasure and attack aircraft. The division also received a $6.1 million contract from the Army for special purpose electronic warfare systems.

Industrial Research magazine recognized Imaging Systems Division's MV-201 CCD (charge-coupled device) miniature TV camera as one of the "most significant 100 new technical products of 1976." The MV-201 is small, lightweight and adaptable to many uses in industrial security, law enforcement, scientific measurement and industrial control.

Imaging Systems further advanced CCD technology last year with the introduction of three new cameras—an electronic gunsight TV camera, a TOW Missile Sight System and a solid-state television camera for NASA. The NASA project camera is compatible with a standard television screen display. The camera is a forerunner of a family of high resotion solid-state cameras.

Lou Pighi–Vice President and General Manager, Federal Systems Group

We successfully test-fired one of our CCD cameras installed in an artillery shell. Still in development, the shell is fired over a target area, deployed on a parachute and transmits terrain and target information to a remote command post.

Our KA-99 panoramic aerial camera, developed last year, has been selected as the prime photographic sensor for a new Navy reconnaissance system. The camera is designed to operate at medium-to-low altitudes, covering extremely large areas at high speeds. In the aerial camera operation, we are currently emphasizing development of reconnaissance cameras with longer focal lengths.

Through our research, new product development and continuous monitoring of market conditions, Federal Systems Group has maintained leadership in our industry. We are among the leaders in tactical photographic reconnaissance, communications jamming systems and in electro-optical systems using CCD technology. We expect to double our sales within the next two years. With your help, we will continue this excellent growth rate and maintain our position of leadership.

Left, top–Jim Dowling, Space and Defense Systems, Syosset
Right, top–Mavis Catherwood, Space and Defense Systems, Syosset
Left, bottom–Art Roberts, Imaging Systems, Syosset

Louis H. Pighi
Vice President and General Manager
Federal Systems Group

Industrial Products Division

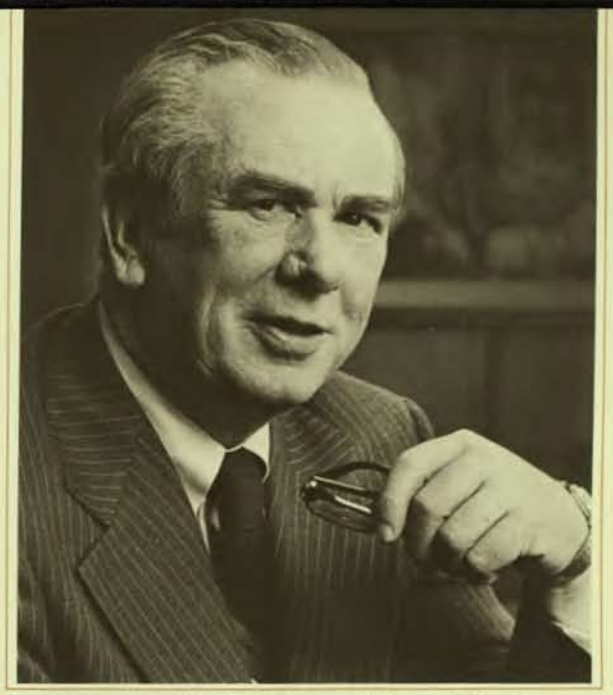
At IPD, 1976 was a year of good fortune resulting from hard work. New product developments and continued aggressive marketing of our established product lines accounted for this growth, and I am grateful to all of you—both long-timers and newcomers—for your help in making it a successful year.

Our audio-visual systems attracted a great deal of customer interest, particularly in industrial sales and training. Fairchild Synchromatic 110 filmstrip projectors are now in use by major U.S. corporations including Ford Motor Company, Exxon and International Harvesters. Formby's Refinishing Products, a Mississippi company, is one of many manufacturers now using IPD's Super 8 projectors in point-of-purchase displays in retail stores.

After many months of field research, the National Retail Hardware Association has selected a customized version of the Fairchild Super 8 as the point-of-purchase display equipment it will recommend for use by its thousands of member retailers.

We introduced the 35mm Synchro-Slide front and rear screen projector early this year to meet demands in the expanding training, education and sales market. To assure our continued leadership in the audio-visual field, new systems development and product improvement continue to play major roles in IPD product planning strategies.

International sales of our aircraft weight and balance systems increased substantially last year, particularly in the Middle East. STAN™ systems were sold to customers including the Royal Saudi Air Force and Iraqi Airways. The personal aircraft of the President of Egypt and the King of Saudi Arabia were also outfitted with STAN systems. Our cockpit voice and flight data recorders continued to contribute to our profitablity.



Ray Hennessey–Vice President and General Manager, Industrial Products Division

Our pressure sensor and magnetic head group continued to gain market share, and contributed to our overall positive performance.

Perhaps the most visible reflection of the growth of our business last year was the addition of a night shift for the first time. This group was added to reduce our delivery time to customers, and it has made substantial progress toward that goal.

As our business continues to expand, we will, undoubtedly, require additional manufacturing space. This is already evident in the obvious stretching of our available space to its maximum capacity. This expansion will, however, be done on a judicious basis with an eye towards maintaining our present profitability. In the final analysis, this provides job security for all of us.

I look to your support in IPD's management efforts to continue the friendly and cooperative climate we all enjoy in this division. There's no question in my mind that it's played a tremendous role in our success.

Top – Steve Blucher, Audio-Visual Products, Commack
Bottom – Pat Tomasi, Audio-Visual Products, Commack

Raymond G. Hennessey
Vice President and General Manager
Industrial Products Division

International Division

John Duffy–Vice President and General Manager, International Division

For the people of the International Division, 1976 was a year of reorganization. I'd like to report to you on the reasons for our restructuring and the improvements resulting from it.

Some significant revamping took place early last year, primarily in Europe. The previously centralized European operation was divided into northern, central and southern areas. Northern headquarters are now in London, Central in Munich, West Germany and Southern in Milan, Italy.

Since making this change, we have appointed nationals of these three countries as general managers of area operations, enabling us to build longevity in these markets by taking advantage of their greater familiarity with the areas. In Latin America, management responsibilities are now being handled by both expatriates and local nationals.

Our business in Latin America and Southeast Asia remained strong, in large part because of the Fairchild manufacturing facilities in Mexico, Brazil and Hong Kong.

European markets continued to strengthen throughout the year. The agreement announced last summer with a Hungarian firm represents a major breakthrough. The firm will assemble packaged circuits from our bipolar semiconductor chips. We will also supply technical expertise. Fairchild is the first American semiconductor company to establish such an agreement with an Eastern European country.

Our major success in Europe continues to be with the television industry, where we are the largest U.S. supplier of PAL television circuits. Europe will continue to be a major market for television games and we have chosen to sell the Fairchild game in conjunction with major European television manufacturers. This strategy was recently implemented, and early 1977 results look very promising.

Sales and profits from TDK-Fairchild, our joint venture in Japan, reached record levels in 1976. Significant trade limitations are imposed on foreign companies operating in Japan, so the joint venture allows us to participate in the Japanese market to a greater degree than would be possible otherwise.

Foreign currency devaluations and changing political situations adversely affected the division's business in some parts of the world last year. In Mexico, for example, the devaluation of the peso weakened customer confidence in the economy as a whole, and forced us to increase prices to maintain profitability.

While 1976 was a year of a lot of change, that is now behind us. This year, we are looking for improved performance in every area—Latin America, Europe and Asia Pacific—and expect excellent growth during the second half of the year.

Right–Bob Blair, Marketing, United Kingdom
Below–Shirley Adamik, International Marketing, Mountain View

John A. Duffy
Vice President and General Manager
International Division

Human Resources

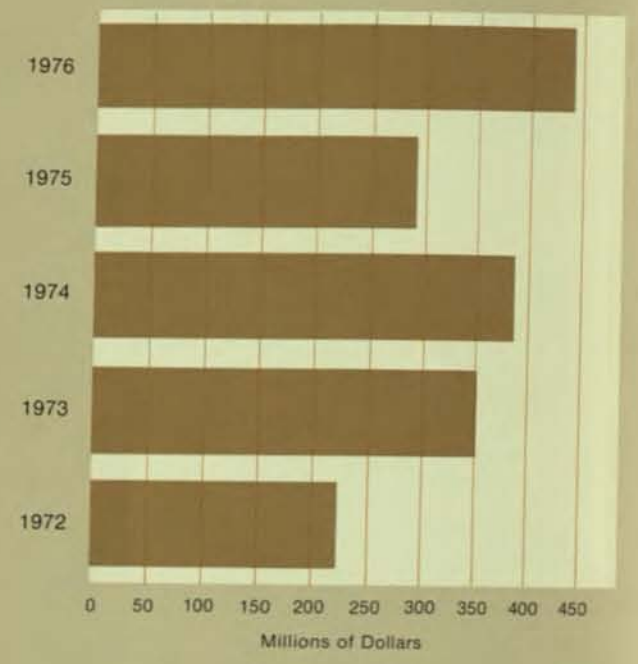
Corporate responsibility is nothing more than a multiple of individual responsibility.

In large companies such as Fairchild, there can be a tendency to think that what we do as individuals doesn't really affect the performance of the company that much. But the fact is that a company can only produce quality goods and services when each individual does the same.

Doing a good job doesn't just show up on your performance review—it shows up on the income statement. More profit means more jobs—more opportunities for promotion, openings for new people and a better chance to implement equal employment opportunity plans. These are all benefits to a company as well as responsibilities.

Whether a handful of people, as we were in 1927, or 21,000, as we are today, Fairchild is a group working together to achieve common objectives—to produce the best products possible and to operate our business so we earn a fair profit for ourselves and our shareholders. The individual commitments of Fairchild people made the performance shown on these charts possible.

NET SALES



Equal Opportunity Report

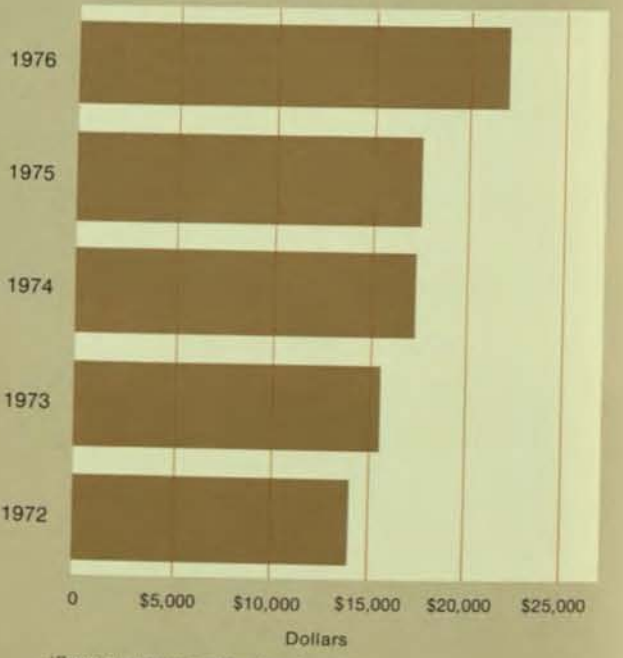
From 1973 to 1976, a statistical analysis of our workforce shows a significant increase in female and minority employment, particularly in the professional, managerial and technical areas.

In January, 1977, Dreyfus Third Century Fund, a New York-based investment firm, rated Fairchild first in equal employment opportunity and second in job safety of 22 instrument and electrical equipment companies evaluated.

Company equal opportunity programs which inform people about new career and training opportunities certainly contribute to this performance, as do the increasing numbers of women and minorities seeking "non-traditional" jobs.

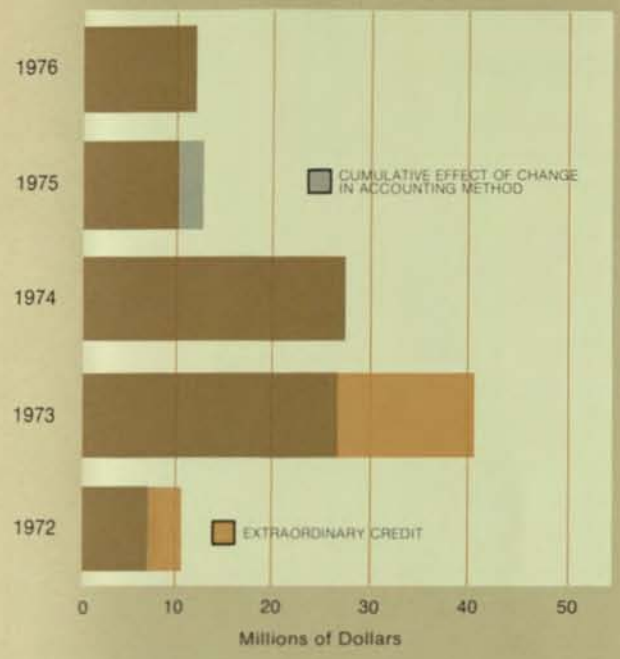
Our Equal Employment Opportunity Department is continuously working to insure equal job access for everyone, and is currently putting special emphasis on a number of job areas, including jobs for veterans and the handicapped.

NET SALES PER EMPLOYEE†



†Based on average number of employees

NET INCOME



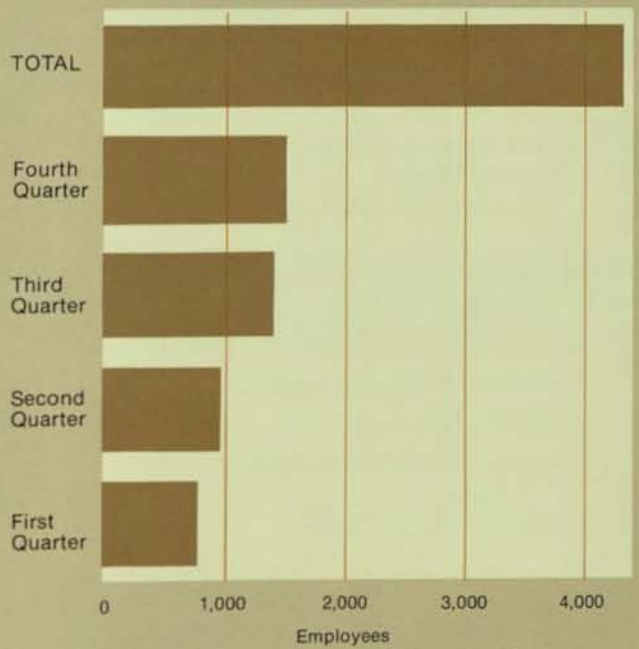
INVESTMENTS PER EMPLOYEE †

Reflects expenditure for property, new equipment, plants and additional property plus research, development and engineering

NET INCOME PER EMPLOYEE†

†Based on average number of employees

CAREER DEVELOPMENT—1976



Fairchild employees who made use of courses through the Management and Career Development Center last year.

Operating Groups and Divisions

Fairchild Camera and Instrument Corporation

Corporate Staff: Corporate Communications, Finance, Industrial Relations, Legal, Technical Administration

Components Group

Mountain View, San Jose, San Rafael and Healdsburg, California; South Portland, Maine; Hong Kong, Seoul, Korea; Jakarta, Indonesia; and Singapore.

Digital Products Division
Analog Products Division
Transistor Division
Diode Division
Automotive/Hybrid Products Division
Manufacturing Services

LSI Group

Mountain View, Palo Alto, California; Wappingers Falls, New York

Bipolar Memory & ECL Products Division

MOS/CCD Products Division

Instrumentation and Systems Group

San Jose, Chatsworth, California

Systems Technology Division
Microsystems Division
Instrumentation Unit

Consumer Products Group

Palo Alto, Santa Clara, California; Sydney, Australia; Frankfurt, West Germany

Time Products Division
Exetron Division
Optoelectronics Division

Industrial Products Division

Commack, New York; Traverse City, Michigan

World Magnetics Inc. (a subsidiary)

Federal Systems Group

Syosset, New York

Space and Defense Systems Division
Imaging Systems Division

International Division

Manufacturing Facilities: Mexico City, Mexico; Campinas, Brazil
Sales Offices Worldwide

Fairchild at Home and Abroad

San Francisco Bay Area

1. Mountain View
2. San Jose
3. Palo Alto
4. Santa Clara
5. San Rafael
6. Healdsburg

The United States

1. California:
   San Francisco Bay Area
   Chatsworth
2. New York:
   Syosset
   Commack
   Wappingers Falls
3. Maine:
   South Portland
4. Michigan:
   Traverse City

The World

1. United States
2. Mexico
3. Brazil
4. West Germany
5. Korea
6. Hong Kong
7. Singapore
8. Indonesia
9. Australia

FAIRCHILD
CAMERA AND INSTRUMENT
CORPORATION

Fairchild Camera and Instrument Corporation
464 Ellis Street, Mountain View, California 94042
(415) 962-5011

FAIRCHILD ANNUAL REPORT TO EMPLOYEES

1978

DEAR FELLOW EMPLOYEE:

Our company's sales passed the half-billion-dollar mark for the first time during 1978. I want to congratulate each of you for your contribution in achieving this company record.

Our earnings rose to $24.8 million, more than double the $11.2 million in 1977. Earnings per share rose to $4.48 from $2.06 last year. Incoming order rates set new highs in both semiconductor components and electronic equipment, and as a result we ended the year with a record backlog of $294 million, up more than 55 percent from 1977.

Strong worldwide demand for semiconductors was reflected in our Semiconductor Products operations, which set sales records in the second, third and fourth quarters of last year. The company expanded employment by some 6000 people and continued its capital expansion programs in both our major product areas. We expect capital expenditures during 1979 to be more than double last year's rate of $32 million.

In January, we announced Fairchild's withdrawal from the digital watch business. The low profit margins and relative instability of the digital watch market, we feel, are not compatible with Fairchild's long-range concentration in the high technology field.

Record growth in Systems and Equipment came from excellent sales in both the Test Systems Group and the Government and Industrial Products Group. In the latter part of the year, the people of Testline in Florida and Faultfinders in New York joined Test Systems. We are pleased to welcome the employees of these two companies to Fairchild.

In the Advanced Technology Group, manufacturing began on Fairchild's 9440 Microflame™ 16-bit microprocessor, and the group centralized in a new Mountain View facility. Further details on accomplishments of our product groups are covered in the individual sections later in this report.

During 1979, we expect the momentum established last year in both semiconductor products and electronic equipment to continue. Everyone at Fairchild can be justifiably proud of our company's achievements last year. Working together, we can continue this record of improvement during 1979.

Wilfred J. Corrigan
Chairman and President

resigned 7 Nov. 1979

Tom Roberts
President & Chief Operating Officer

FAIRCHILD'S 1978 REVENUE DOLLARS

The Annual Report to Shareholders outlines the use of our company's income last year in a series of financial tables. The chart shown on this page is based on the Annual Report's Consolidated Statement of Income. Figures shown are based on percentages of one dollar. Explanations of dollar use should be read from the bottom up, beginning with Cost of Sales.

How The Dollars Were Earned:
We generated $533,832,000 in sales to customers and $16,608,000 in royalties and other income for a total revenue of $550,440,000 in 1978 (100%).

How The Dollars Were Used:

4.5¢ Net Income (Earnings) ($24,764,000)
Last year, Fairchild paid $4,304,000 to our shareholders as dividends in return for their investment in our company. After all expenses and costs, Fairchild retained earnings of $20,460,000 to reinvest in the company to finance expansion and provide new job opportunities.

2.9¢ Provision for Income Taxes ($15,832,000)
U.S. corporations are taxed by the federal government at 48 percent of their taxable income. Other expenses charged to this category include taxes paid to various states and foreign countries.

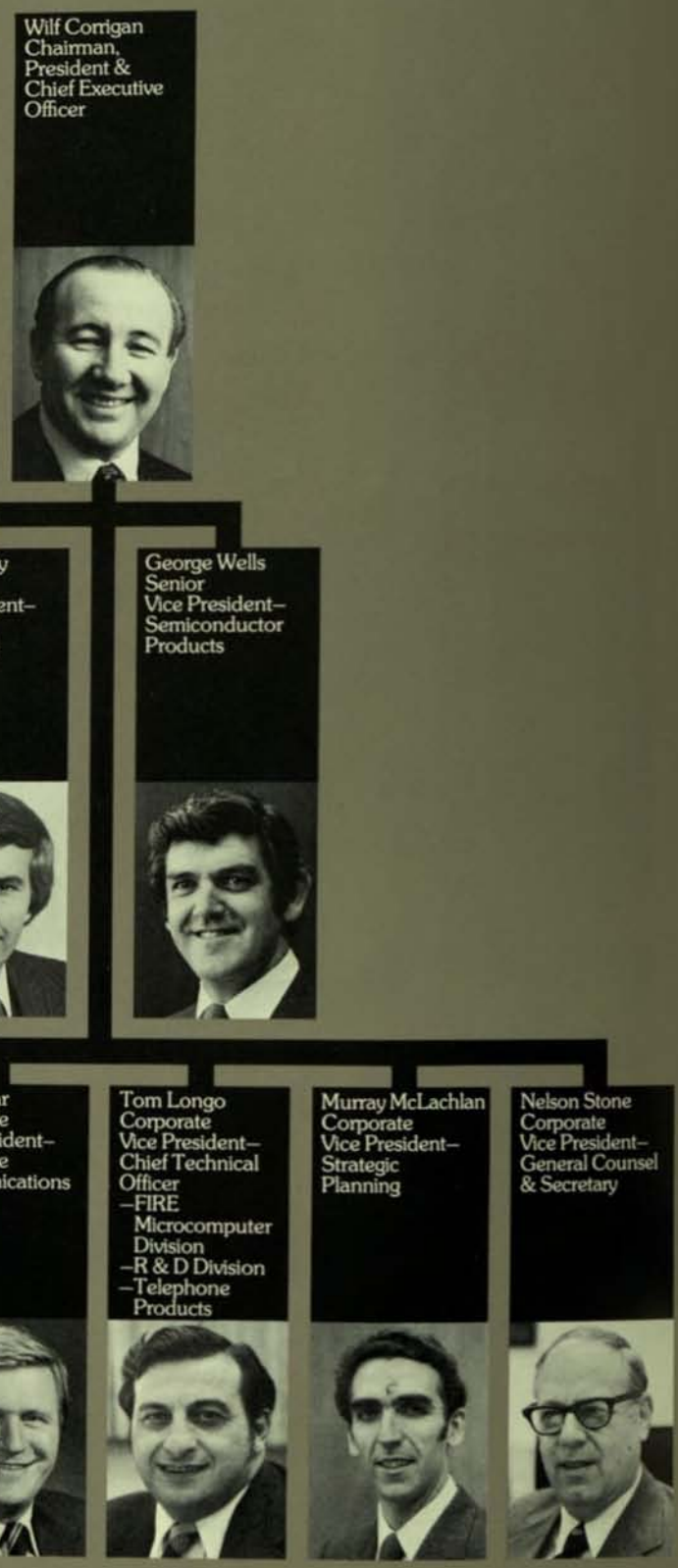
1.3¢ Interest Expense ($7,284,000)
Plant improvements and expansions are frequently financed through bank loans and other sources of external financing. These funds supplement Fairchild's income from earnings and shareholders' investments.

1.1¢ Provision for Discontinued Product Line ($5,932,000)
A one-time pre-tax charge of $5,932,000 was charged to earnings as a result of the company's decision to withdraw from the digital watch business.

22.4¢ Administrative and Selling Expenses ($123,484,000)
Compensation for administrative and sales personnel throughout the company is paid from this portion of the revenue dollar, along with the costs of supporting essential corporate services including employee training and providing information to investors. We also invest a substantial amount informing customers about our thousands of products through advertising.

67.8¢ Cost of Sales ($373,144,000)
Close to 70 percent of every dollar of revenue is used to produce Fairchild products and sell them to our customers. This category includes the cost of raw materials and shipping, as well as compensation and benefits for most of our employees—except administrative and sales personnel. These benefits include income protection programs such as medical, dental and life insurance. Payroll and property taxes, the costs of building maintenance and investments in research, development and engineering also fall into this category.

Corporate Structure



Semiconductor Products

George Wells
Senior
Vice President

Dave Marriott
Corporate
Vice President &
Managing
Director–
GEC-Fairchild
Ltd.

Andy Procassini
Corporate
Vice President–
Worldwide
Semiconductor
Marketing

Chuck Smith
Division
Vice President &
General Manager–
Manufacturing
Services Division

Dick Abraham
Corporate
Vice President &
General Manager–
Bipolar LSI
Group

Gil Amelio
Division
Vice President &
General Manager–
MOS
Products Group

Ed Browder
Corporate
Vice President &
General Manager–
Integrated Circuits
Group
–Automotive
Division
–CMOS Division
–Digital Division
–Linear Division

John Duffy
Corporate
Vice President &
General Manager–
Discrete Products
Group
–Diode Division
–Optoelectronics
Division
–Transisitor
Division

Systems and Equipment

Tom Sherby
Senior
Vice President-

Jim Bowen
Corporate
Vice President &
General Manager–
Test Systems
Group
–Sentry Division
–Subassembly
Test Systems
Division
–Xincom Division

Lou Pighi
Corporate
Vice President &
General Manager–
Government &
Industrial
Products Group
–Imaging Systems
–Space & Defense
–RF Systems Unit
–Industrial Prod.

Tom Sherby
Acting
General Manager
Digital Equipment
Group
MPU-Based
Products

Wappingers Falls

Maria Narciso, Linear Division Hi-Rel, Mountain View

Beta equipment in Singapore

Ron Carlson, Field Sales, Minneapolis, with customers from 3M

Lunchtime outside the Kwun Tong plant, Hong Kong

Jerry Garies, Optoelectronics Division, Mountain View

Teresa Zepeda Cervantes, Mexico City, with a sign proclaiming "At Fairchild, our mandate is to sell quality."

Marc Weiss, Paris sales office, with customers from Francaise des Cables Telegraphiques

George Wells

I am very pleased to report that the people of Semiconductor Products set all-time sales records in the last three quarters of 1978, contributing to Fairchild's overall sales record of $533.8 million last year.

Sales rose to new highs for many product lines in our group, important new products were introduced, and we all did our best to meet industry growth about twice what we expected.

I think everyone in the semiconductor industry was surprised by the strong surge in demand we saw throughout 1978. To take advantage of the opportunities this growth provided meant we first had to deal with two critical shortages—capacity, or enough production space and equipment to manufacture the parts our customers needed, and enough qualified people to do the job. ■

We spent most of 1978 taking steps to deal with these situations. In Integrated Circuits, we are about to complete construction of a four-inch wafer fab in the Digital Division's plant in South Portland, Maine. Work on a four-inch fab to be used by the Linear Division is underway in Mountain View, Calif. These projects will enable these divisions to respond faster to trends in customer demand.

For the MOS Products Division, 1978 was a year of preparation and consolidation. We combined manufacturing operations at several locations into our new MOS facility at South San Jose, Calif. and Wappingers Falls, N.Y. South San Jose now houses our 16K dynamic RAM and 64K CCD memory production, and we have a sizeable backlog of orders for both these products. Wappingers Falls has become Fairchild's microprocessor center with manufacturing operations for the F8™, 3870 and 6800 series microprocessors. ■

These major moves, along with smaller relocations and consolidations in other divisions, will help us reach a major goal for 1979—meeting demand for our products efficiently. One thing that concerned many of us last year was that since much of the growth we experienced wasn't planned, we couldn't efficiently respond to it. We, as well as everyone else in the industry, had to scramble occasionally. This year, we want to make sure we have enough capacity to meet our sales goals in a planned, orderly fashion.

Our continuing need for competent people in all job categories intensified last year, and even attracted attention from national media. The well-publicized shortage of people, particularly in northern California, contributed to the problem we had responding efficiently to high market demand. ■

However, Fairchild developed several programs to address this problem, including the very successful "We Started It All" employee referral program, for which Julia Pitsker from our Transistor Division won the grand prize. More than 800 new hires came to the company as a result of the efforts of many of you, and I think these referrals continue to be an excellent way to recruit good people. Performance records such as we had last year are only possible through the efforts of competent, committed people—they are impossible otherwise.

I'd like to focus briefly on some of the major accomplishments of Semiconductor Products divisions last year—many of our new products again set precedents in speed and capability.

In the Bipolar LSI Division, demand continued to be extremely high. I believe we are recognized as the number one company in bipolar memories. Demand was phenomenal for our 4K static RAMS as well as for the ECL 100K family. In early 1979, Control Data Corporation announced their new Cyber computer, which includes a new high capability ECL F200K gate array that enables this system to lay claim to a prominent position in the new generation of computers in the world today.

■ MOS Products had substantial demand for both its 16K dynamic RAM and 64K CCD memory. This year we will begin shipments of the 3870 and 6800 microprocessors under large contracts with both Chrysler Corporation and the Delco Division of General Motors. These projects, which involve fuel, environmental and entertainment systems control in passenger cars, call for components and circuitry from microprocessors to diodes and transistors. They will mean significant volume to all of Semiconductor Products over the next few years.

In late 1978, the LSI Group was dissolved, making the Bipolar LSI and MOS Divisions separate, reporting directly to me. The rapidly increasing size of both divisions dictated this new arrangement. The move also made it possible for David Marriott, a Vice President and formerly General Manager for the LSI Group, to become General Manager of GEC-Fairchild, our new joint venture with The General Electric Co. of England. It is our intention that GEC-Fairchild will produce MOS memories and microprocessors in a plant currently under construction in Cheshire, in northwest England.

One of our most important new product developments in the Integrated Circuits Group last year was the Digital Division's FAST (Fairchild Advanced Schottky TTL) series. This is an interesting concept, because it combines our Isoplanar™ technology together with low-power Schottky to produce a very small, very fast circuit. Customer response to FAST has been extremely enthusiastic, and we expect to improve our position in the low-power market. ■

Our Linear Division continued to add to its line of op amps, voltage regulators and other components with a variety of products including an eight-bit analog to digital converter, which we think will become an industry standard. Linear's noise-reduction circuits for use in recording equipment also showed excellent growth, as did the division's interface line.

The CMOS Division ended the year with accelerating sales. Due to the Optoelectronics Division's development of LCD (liquid crystal display) modules, we are now packaging LCD's with CMOS chips as a kit, a product that looks very promising.

The Automotive Division began the year with receipt of a large order for hybrid ignition modules from Volkswagen in Germany, marking the first use of hybrid electronic ignition systems in European automobiles. Automotive also will be a major supplier to both Chrysler and Delco for the fuel and environmental control systems I mentioned earlier.

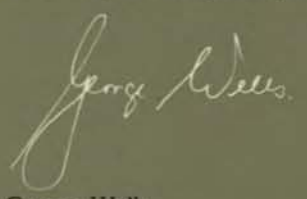
In Discrete Products, Optoelectronics Division had a strong year, with people in the division doing a fine job of identifying new applications for both LEDs and LCDs. In Hong Kong, for example, Fairchild is a major LCD supplier to timepiece and game manufacturers from the Hong Kong plant located in Tuen Mun.

Both the Diode and Transistor Divisions will participate in the large automobile system contracts. Diode, in addition, had good sales results last year from its new line of varactor diodes, and continues to experience strong increases in zener diode sales. Another key area is the diode array, which has excellent potential in the military market. This market, by the way, grew faster than our non-military segments last year. I think this is a good indication of the success of our Semiconductor Products marketing organization, which is now aligned to serve specific market areas also including consumer, automotive and telecommunications.

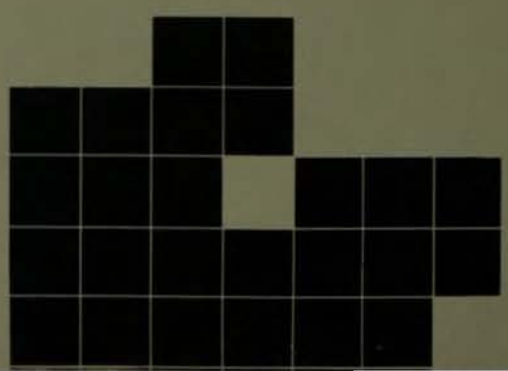
The Transistor Division continued to perform a most important role by producing a very advanced Darlington device which is a key component of the ignition system produced by our Automotive Division.

Our Manufacturing Services Division plants in Hong Kong, Singapore, Korea and Indonesia performed well last year, and contributed a great deal to our sales records. On that division's domestic side, our Healdsburg plant is now, we think, the supplier of the best silicon in the world. We've achieved this goal because we've successfully developed a "super-flat" wafer using projection alignment, which has resulted in major improvements in yield. The people at Healdsburg deserve to be proud of this accomplishment. ■

Each person in Semiconductor Products deserves to be proud of our group's response to the challenges of a very successful, but sometimes frustrating year. The groundwork laid last year should help reduce those frustrations in 1979, and help us achieve another strong sales year. If an economic slowdown occurs, we believe it will be relatively short and that our large current backlog of orders will probably carry us through it with no major problems. Naturally, we will be cautious and will implement contingency plans if a serious downturn threatens. In general, however, we expect continued steady growth to increase profitability and job opportunities in Semiconductor Products this year. ■



George Wells
Senior Vice President
Semiconductor Products



FIRE Microcomputer Division's new facility in Mountain View

John Pierce and May Prine, R&D, Palo Alto

Tom Longo

■ Advanced Technology operations in 1978 expanded to include three main areas. The FIRE Microcomputer Division, and Telephone Products, which researches telecommunications, were added to our Research and Development Division. The focus of these divisions is to work on new ideas and products to maintain Fairchild's leadership in the electronics industry.

The key event of 1978 for Advanced Technology was the formal introduction of the 9440 Microflame™ microprocessor, the first circuit with minicomputer power on a single chip. Late in the year, the FIRE Microcomputer Division was formed to consolidate manufacturing operations and worldwide sales for the 9440 and related products. ■

There has been good worldwide response to the 9440, and the supporting FIRE software system, with Fairchild establishing itself as a potential force in the market for high performance microelectronic systems. 1979 will be a year of substantial growth in both product offerings and revenue, with introductions of several new high-level languages and software packages planned.

Also scheduled for 1979 introduction is the next generation microprocessor, the 9445 Microflame™ II. It will have considerably higher performance capabilities than the 9440.

The FIRE Microcomputer Division also consolidated all its marketing, operations and engineering staff into one new 30,000 square-foot Mountain View facility.

Fairchild entered the telecommunications market with the late-1978 introduction of the Fairdial™ component set and the formation of Telephone Products. The Fairdial kit includes 10 semiconductor components that can be used to construct a telephone repertory dialer with the capability to store up to 44 telephone numbers of 12-digit length. ■

Telephone Products is currently working with companies building telephone equipment, making instruments more capable and more reliable at a marketable cost. We expect the Fairdial to do well in 1979, and our plans call for continued upgrading of our telephone products line.

Several events in our Research and Development Division made 1978 a dynamic year. The device research group has been developing critical process information for new MOS technology, and dynamic memory research has been supplying memories to support the 9440.

The CCD image sensing and signal processing department had a successful pilot production of a new area photosensor close to one-half inch on a side—the largest device Fairchild makes.

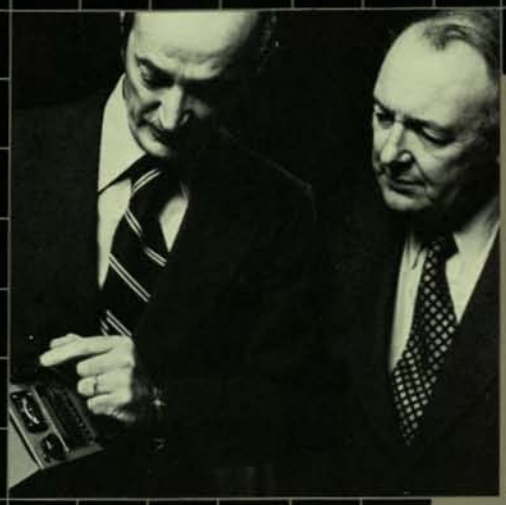
E-beam lithography, which prepares masks for printing on silicon wafers in a fraction of the time necessary with conventional methods, contributed to the success of the FIRE Microcomputer Division and Research and Development. A second E-beam machine will be installed in 1979, which will make Fairchild first in the industry to have a second generation machine of this type. The new machine will produce larger masks at double the operating speed.

1979 will see growth in all our divisions with continued focus on new markets to pursue. ■

Tom Longo

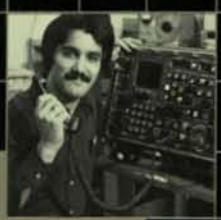
Tom Longo
Vice President and
Chief Technical Officer

Faultfinders headquarters, Latham, N.Y.



Peter Knott, IPD, with Laker Airways President Sir Freddie Laker

Test Systems Training Center in Munich, West Germany



Nick Buonamico, RF Systems, Syosset

Mike Hidalgo, Santa Clara field service office, Test Systems Group

SYSTEMS AND EQUIPMENT

Tom Sherby

During 1978, Systems and Equipment broke records in billings, bookings, sales, profits and number of employees contributing to an excellent overall year. We kept up our momentum in all of our markets, contributed substantially to Fairchild's profits, and worked on development of new areas.

For our Test Systems Group, which includes the Sentry and Xincom Divisions and the recently formed Subassembly Test Division, 1978 was another year of record sales. ■

A major event contributing to Test Systems' success was the excellent market acceptance of Sentry VIII, an advanced efficient general purpose VLSI test system. In early 1979, we introduced Sentinel, a flexible, mid-priced LSI test system designed to cut testing costs for high-volume semiconductor manufacturers and users. Sentinel closes the gap between general purpose testers and dedicated benchtop testers. Xincom had a strong year while readying two major new products for 1979 announcement.

Test Systems Group expanded last year with the acquisition of two companies—Testline Instruments Inc., Titusville, Florida (near Orlando) and Faultfinders, Inc., Latham, N.Y. (a suburb of Albany). Testline employs 100 people and makes in-circuit digital testers that are used primarily for field maintenance. Faultfinders currently has 380 employees and produces analog testers which focus on the production end of the in-circuit test market. This year Faultfinders will construct a 95,000-square-foot additional production facility in Colonie, N.Y., about half a mile from the present headquarters.

These two acquisitions were combined in December to form the new Subassembly Test Systems Division, which will have a joint sales force representing the two product lines. We expect the new division to grow very rapidly in sales and profitability with the strength of Fairchild marketing and service behind them. We will gain broader coverage with our existing customers and will be able to participate in the printed circuit board assembly test business, a fast-growing segment of the test systems market.

In the Government and Industrial Products Group, we capitalized on several market areas—imaging, communications jamming, and commercial airline systems. We developed a significant new product, the TLQ-17A ground-to-ground communications jammer, which is being tested by the Army and may become the NATO standard. We also won significant development contracts with our secure communications and our CCD-based cockpit TV system. ■

The U.S. Air Force awarded a more than $1 million contract to the Imaging Systems Division for prototype production of 25 cockpit CCD-TV camera systems for use in tactical training.

Imaging Systems also developed a CCD scanner system for the U.S. Postal System which will be a part of a proposed nationwide electronic mail transmission system, currently being considered by Congress. Modifications of the system are continuing based on the Postal Service requirements.

The Industrial Products Division had an outstanding year exceeding the sales and profit goals. Market acceptance of our Synchro-Slide™ 35 mm projector has been good and we will be aggressively pursuing the marketplace for this product. We also have been developing an airplane Tire Pressure Monitor System which will improve tire maintenance by providing exact tire pressure readings during flight and while on the ground. Work on this product was started in late 1975 at the request of Boeing Corporation, and we have worked closely with several airlines in developing this product. ■

In early 1979 we will formally annouce the formation of the Digital Equipment Group. This group will handle the design, manufacture and sale of a high-speed, add-on bulk storage system utilizing CCD memory. Digital Equipment will also be responsible for the design, development, sale and manufacture of all processors and microprocessor-based products within the Systems and Equipment operations. We will be using our CCD memory technology to give us a unique edge in the market. We will be able to provide memories at lower cost and higher performance than anyone else currently in the industry.

We look for 1979 to be another successful year for Systems and Equipment, and we expect our group to be somewhat recession-resistant. Test Systems has very good backlogs, which should cushion the group from any slowdown in the economy. The Government and Industrial Products Group should also have a strong business year. ■

In general, we're looking to achieve higher levels of productivity and profitability in 1979, while keeping our business stable. We want to provide security both for employees and the corporation in terms of protection of earnings.

Tom Sherby
Senior Vice President
Systems and Equipment

OFFICERS AND DIRECTORS

DIRECTORS

Wilfred J. Corrigan
Chairman of the Board of the Corporation, President and Chief Executive Officer

C. Lester Hogan,
Vice Chairman of the Board of the Corporation

Albert Bowers
President, Syntex Corporation; Vice Chairman of the Board, Syntex Corporation (pharmaceuticals and agribusiness)

Walter Burke
President, Director and Member of Sherman Fairchild Foundation, Inc.

Walter J. P. Curley
Private Investor and Private Venture Capital Operations

William C. Franklin
Consultant

Roswell L. Gilpatric
Counsel, law firm of Cravath, Swaine & Moore

Louis F. Polk, Jr.
Chairman, President and Chief Executive Officer, Leisure Dynamics, Inc. (hobby and game products)

Alvin Rice
Private Investor
Boards of Tandem Computer Corporation and Memorex Corporation

William A. Stenson
Director, Santa Fe National Bank

OFFICERS

Wilfred J. Corrigan
Chairman of the Board of the Corporation, President and Chief Executive Officer

Corporate Staff

Warren J. Bowles
Vice President—Industrial Relations

A. J. Hazle
Vice President—Finance

Frederick M. Hoar
Vice President—Corporate Communications

Thomas A. Longo
Vice President—Chief Technical Officer

Murray L. McLachlan
Vice President—Strategic Planning

Nelson Stone
Vice President—General Counsel and Secretary

James A. Unruh
Vice President—Treasury and Corporate Development

Ronald J. Alessio
Treasurer

G. F. Taylor
Controller

Richard Franklin
Assistant Secretary

Wallace J. Thomas
Assistant Secretary

Stanley Winston
Assistant Secretary (attesting)

Operations

Thomas A. Sherby
Senior Vice President
Systems and Equipment

George D. Wells
Senior Vice President
Semiconductor Products

Richard P. Abraham
Vice President and General Manager
Bipolar LSI Group

James D. Bowen
Vice President and General Manager
Test Systems Group

Edward H. Browder
Vice President and General Manager
Integrated Circuits Group

John A. Duffy, Jr.
Vice President and General Manager
Discrete Products Group

Raymond G. Hennessey
Vice President—Business Development, Industrial Products Division

David J. Marriott
Vice President
Managing Director, GEC-Fairchild Ltd.

Louis H. Pighi
Vice President and General Manager
Government and Industrial Products Group

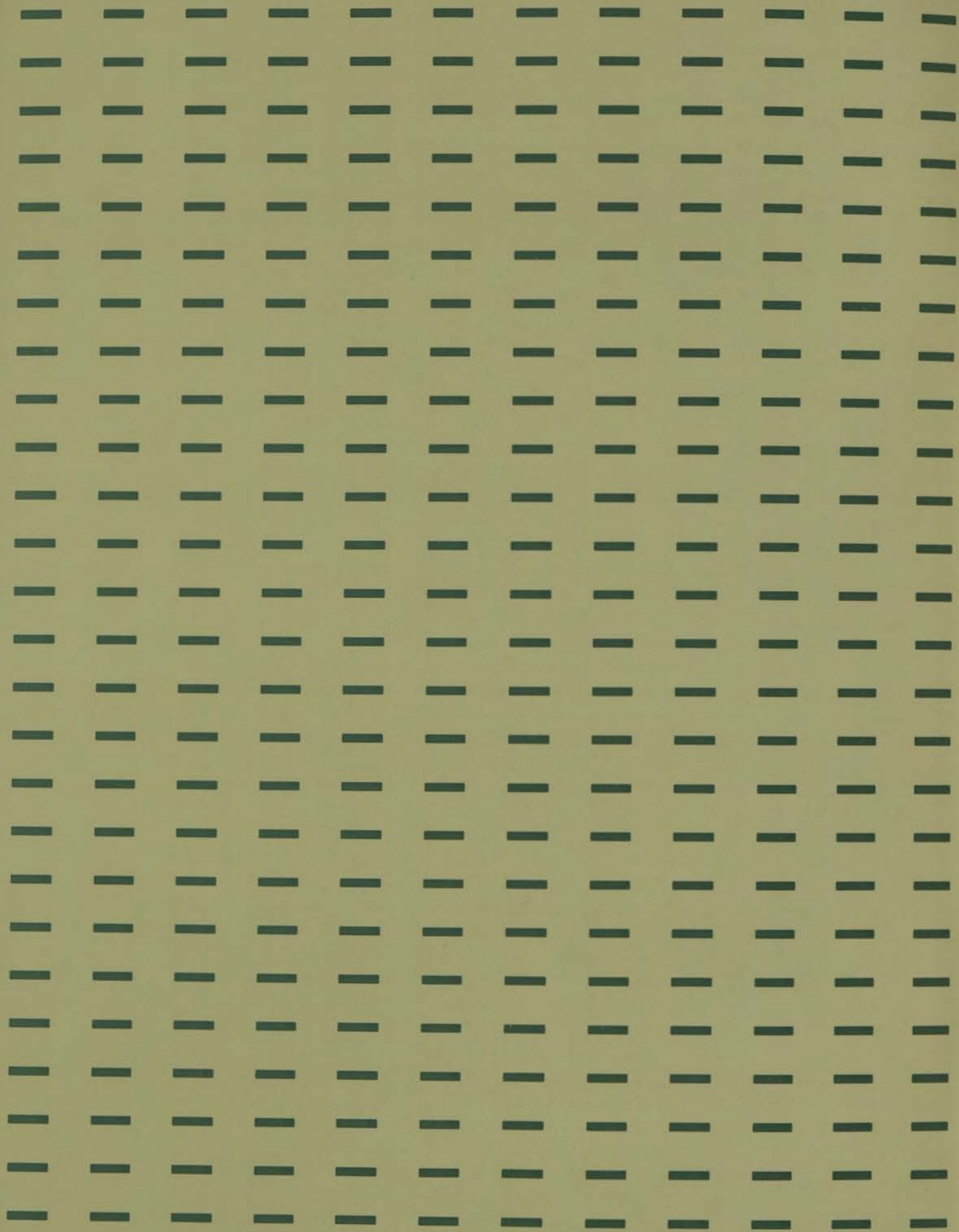
Andrew A. Procassini
Vice President
Worldwide Semiconductor Marketing

March, 1979

The Fairchild Annual Report to Employees 1978 is published for employees of Fairchild Camera and Instrument Corporation.

Employees may obtain additional copies of this report and copies of the Annual Report to Shareholders for the year ended December 31, 1978 by writing to the Corporate Communications Department, M/S 20-2260, Fairchild Camera and Instrument Corporation 464 Ellis Street Mountain View, CA 94042 (415) 962-5011

Schlumberger *1984* *Annual Report*



Schlumberger

IN BRIEF	1984	1983	1982
Revenue	**$6,370,442,000**	$5,797,459,000	$6,283,810,000
Net income	**$1,182,073,000**	$1,084,299,000	$1,348,165,000
Net income per share	**$4.10**	$3.73	$4.60
Dividends declared per share	**$1.12**	$1.00	$0.92

A year ago, I had the difficult task of reporting lower earnings for Schlumberger, the first time in twenty years. Nineteen eighty four was not a year without thorns and problems. I am happy to report that earnings of Schlumberger bounced back. Nothing spectacular, but earnings per share and revenue increased 10%. Yet, in the face of all the pessimism surrounding the oil industry, it is not a bad performance. There is still resilience in the old beast.

The bottom line is the result of many additions and many subtractions. Sorting it out, separating the meaningful from the temporary, is a useful exercise to appraise the major trends of 1984. On the positive side, three factors helped earnings:

□ Growth of the Wireline logging in North America.

□ Return of Fairchild Semiconductor to breakeven.

□ Higher interest income.

On the negative side, three factors had an adverse effect on earnings:

□ Throughout the world, drilling rates remained soft all year. The contagion, due mainly to overcapacity, has extended to other oilfield service activities such as cementing and stimulation.

□ Wireline logging activity outside North America has been basically flat. There were, however, some significant geographical shifts. Activity in the North Sea, China and India grew markedly, offsetting lower activity in the Middle East.

□ The European economy is not coming out of the doldrums. The surge of the dollar against all European currencies compounds the problem when figures are translated into dollars.

Against this background, the main thrusts of our action during this year of recovery were in three directions:

□ Fight back on market share in the United States oilfields. Two years of recessions, of declining drilling activity, have led to an oversupply of equipment, price cutting and stiffer competition. A long experience in the oilfield has taught us that, in the final analysis, quality of service, technology improvements, better answers, are the only way to keep competition at bay and to provide what the customers want. Whether in the reorganized Dowell Schlumberger operations in the U.S. or in Wireline logging in North America, we intend to recapture market share in some areas and maintain our position everywhere else.

□ Complete what was started: the strengthening and reorganization of Fairchild Semiconductor and Computer Aided Systems. There is a widespread belief that Fairchild is still in trouble. Maybe we have been too candid in telling the problems we were facing and the losses we were incurring. Problems there have been, problems there are still. Certainly, we do not want to hide them. But the truth is that the Fairchild we acquired in 1979, including the test equipment and military businesses, was solidly in the black last year. For management purposes we have isolated Fairchild Semiconductor. This division broke even in the last six months of 1984. New products are coming out. They are good and we know how to manufacture them. New plants were built in South Portland, Maine and Puyallup, Washington, and in Germany and Japan, and they are efficient. Everyone knew that it would take time and money. And it did, but it is nice when the bottom line figure shows that you are on the right track. Now it will take perseverance. God knows, we have it.

□ Acquire major units in the oilfield service industry. In April, 1984, the purchase of 50% of Dowell in North America made it possible to create a worldwide cementing and stimulation business, under Schlumberger management. At the end of December, the acquisition of SEDCO changed the magnitude of our presence in the offshore drilling business. SEDCO, the operator of the largest fleet of semisubmersibles in the world, had revenue of $597 million and net income of $102 million in 1984. Both figures will be significantly lower in 1985 as a number of long-term drilling contracts at favorable daily rates expire. Also, additional

expenses — amortization of goodwill, interest expenses related to the acquisition — will be incurred.

Both acquisitions will entail some dilution in earnings. In 1984, our share (50%) of Dowell Schlumberger in North America reduced earnings $30 million (10 cents per share). The situation will improve this year as this unit will regain market share, set more units offshore in the Gulf of Mexico, control field cost and reduce dramatically headquarters expenses.

For the last two decades, the strategy of Schlumberger for growth has been to progress along two avenues: to be the best oilfield service enterprise in the world and to be a significant factor in the high technology of measurement and components. The change of cycle in the oil industry, the temporary recession in the search for hydrocarbons was a unique opportunity to seize. We have the cash and we love working in the oil fields, helping our customers to find and produce oil. It does not mean for one minute that we abandon or curtail our endeavor in the second undertaking. Each cycle has its opportunities and its risks. If and when opportunities arise in America, in Japan, in Europe, in the fields of semiconductors, of computer aided systems (automatic tests, CAD-CAM), of measurement and control, we will move in as we did in the oilfield services.

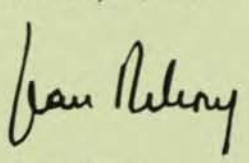
■ There is a lot of pessimism in the oil business these days. Yet the oil industry is not in a state of disarray. Search for new reserves continues in all parts of the world. Oil is produced, transported, delivered at the doorstep of the customer. But everybody at each link of this long chain is concerned with the price of crude oil. Will OPEC collapse, will Norway or Nigeria take the lead in lowering the price, will the oil glut last forever, is oil getting to be a commodity, fluctuating like copper or coffee beans? A real question and a real concern. Meanwhile, every producer, every refiner, every transporter, every customer expecting lower prices, reduces inventories to the bone, restricting demand.

Historically, ever since oil became a major source of energy some eighty years ago, its price level has never been entirely determined by market conditions, by the strict law of supply and demand. For decades, the Standard Oil Company in the old days, the Texas Railroad Commission, the international oil companies in the Middle East, lately the OPEC, have more or less controlled the price of crude oil. Probably history will tell that OPEC, taking advantage of its temporary dominating position, raised the price of crude oil too fast and too much. But as Henry Kissinger wrote recently, "revenge even when sweet, is not foreign policy." Today the governments of Saudi Arabia, Great Britain and Mexico have in fact the grave responsibility to bring some order and some long-term stability. Hectic movements of the pendulum, either up or down, amplified tremendously by the swing in inventories and in the futures market are detrimental to the economies of all nations. Personally, I believe that reason and common sense will prevail. The first signs of wisdom are in sight.

Looking further in the future, I remember all the pundits and the experts who predicted that the world would run out of oil before the year 2,000. It did not take two years for the same people to announce that the glut of oil will last a hundred years. If one thinks only of the demand side, Asia alone has close to two billion human beings in China and in India who are still at the age of the bicycle and of the steam engine.

■ This is the world we live in. The problems, the concerns have been with us for the last two years. We have survived the change of cycle in the oil industry reasonably well. Stubbornly, we move forward with the same basic convictions: advanced technology and new products, better service and more answers to the customers, more laboratories and more R&D, better trained, better motivated and more determined people at all levels, in all countries.

February 19, 1985



Jean Riboud
Chairman & Chief Executive Officer

Wireline Services

Wireline Services principal activities are: Measurements of the physical properties of underground rock formations which provide the petroleum industry with information necessary to discover and produce oil and gas efficiently. Instruments are lowered into a well on an armored electrical cable called a "wireline"; measurements are transmitted to the surface where they are recorded on magnetic tape and also plotted on a graph called a "log". Computer-processed interpretation of several different measurements can produce Answer Products specially tailored to the specific needs of geophysicists, geologists and petroleum engineers. Operations were conducted in 98 countries during the year.

□ *SCHLUMBERGER DOLL RESEARCH located in Ridgefield, Connecticut.*

Business Review

Wireline revenue in 1984 was 6% above 1983 as some stability returned to the petroleum industry after the sharp declines of drilling in 1982 and 1983. If the upturn in demand for petroleum products persists, continuation of this gradual improvement is expected.

North America

Revenue was 16% above the prior year, while the rig count increased by 11%. Improvements were particularly notable in offshore Gulf Coast exploration as a result of the recent lease sales. Drilling for gas in the U.S. remained at a very low level as the industry felt that gas imports from Canada would prolong the gas bubble.

Overcapacity continued to make all branches of the oilfield service industry very competitive.

Atlantic *(Europe, Africa, Latin America)*

Revenue was flat with the prior year as the drop in revenue experienced in 1983 bottomed in the second quarter of 1984. The recovery in the second half was led by the North Sea, where the incentive to explore in the U.K. continues to be attractive, and by Latin America.

Asia *(Middle East, Far East, Australasia)*

Revenue was down 1% from the previous year but, here again, the second half showed some improvement and the fourth quarter was above the same quarter of 1983. Areas which experienced declines like Abu Dhabi, Saudi Arabia and Indonesia were compensated by increased revenues in Australia, China and Oman.

Revenue in China, in particular, was higher as activity increased both offshore and on land. At year end, the first phase of a long-term contract was signed with the Chinese National Oil Company which will ensure continued growth in coming years. As a result of its growing importance, a separate China business unit was created within Wireline Asia.

Early in 1984, construction began on a $32 million Wireline engineering and manufacturing facility in Fuchinobe, near Tokyo. This facility will provide the necessary technical support for Wireline Asia operations; completion is expected in March 1985.

Services for the Petroleum Geologist

Two separate technological developments in Wireline are converging to give petroleum geologists additional analysis tools in their search for oil and gas.

First, several new logging devices — the High-Resolution Dual-Dipmeter Tool (SHDT), the Micro-Electrical Scanning Tool (MST), and the Enhanced Resolution Spectrometry Tool (ERT) — are being field tested. Measurements made by these tools inside a borehole provide geologists with the same information that, up to now, was available only by analyzing core samples in the laboratory.

Second, significant advances in log interpretation are providing new geological perspectives. Dipmeter Advisor, a dipmeter interpretation based on artificial intelligence, is now being offered at six different field sites; furthermore, two geological interpretation techniques, Litho and Syndip, were introduced commercially in 1984.

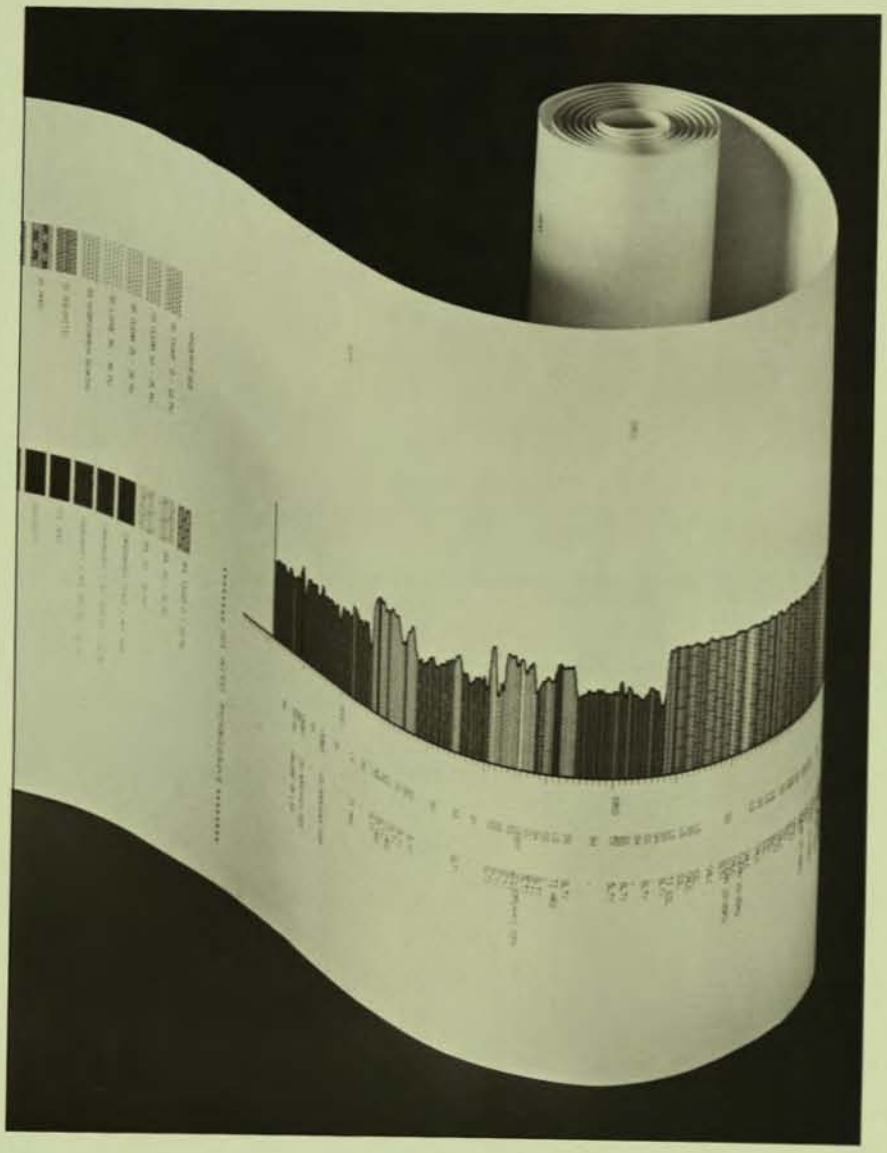
The new logging tools with geological applications are based on nuclear and micro-electrical techniques.

□ The Dual-Dipmeter Tool (SHDT) provides information on how sediments were deposited and on the geological environment at the time of deposition. This second generation high-resolution dipmeter tool records eight micro-conductivity curves — from two electrodes located on each of four pads.

Besides structural information, the electrode configuration of the SHDT provides information about detailed sedimentary features, including shale laminations, cross beddings and small discontinuities which do not even extend across the borehole.

□ The Micro-Electrical Scanning Tool (MST) records an image of the borehole wall using an array of tiny electrical buttons mounted on a pad. By applying sophisticated signal processing to the recorded data, the MST resolves sedimentary details at least 100 times better than was possible before.

Four-armed stratigraphic high-resolution dipmeter measures the dip of formations penetrated by the well bore.



The improved definition of rock structure provided by these new measurements is one of the essential elements in understanding rock productivity.

□ The Enhanced Resolution Spectrometry Tool (ERT) identifies individual chemical elements in downhole rock formations. High-energy neutrons are emitted by an electronic neutron generator, and the effects of the nuclear reactions are detected by a high-purity germanium crystal. Data from the ERT reveal details on the mineralogy and rock types. In addition, it can detect, in the rock fluids, trace elements such as vanadium which is related to the API gravity of the oil.

New interpretation methods have been developed in the language of the oil company geologists. This approach is fundamental because interpretation from single wells is later merged into a geological analysis of the entire reservoir.

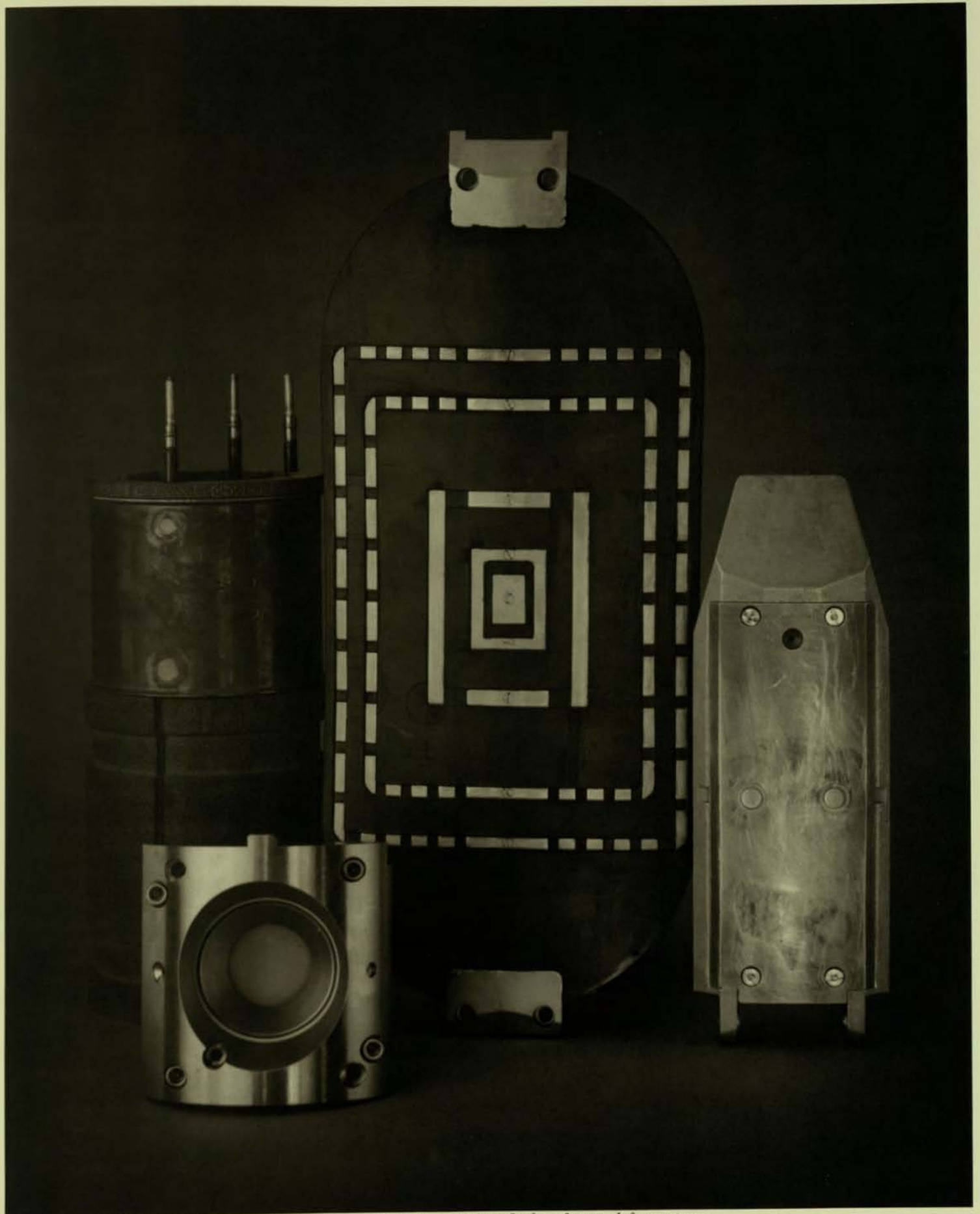
□ The *Dipmeter Advisor* is an interpretation product, based on artificial intelligence techniques, which was introduced in the field during 1984. The *Dipmeter Advisor* is a knowledge-based computer program that codifies an expert's views of interpreting dipmeter data in a variety of depositional environments. This service has the potential of disseminating the expertise in the geological interpretation of dipmeter data, throughout the Wireline field organization.

□ *Litho* is an interpretation technique which provides a detailed description of the rock types along the entire length of the well. This description is obtained by combining data from all standard logs; over 50 rock types are uniquely defined from combinations of logging measurements and the list may be optimized for local conditions.

Litho interpretations represent the geological knowledge needed to connect a well with its surrounding subsurface environment, including neighboring wells.

□ *Syndip* creates from dipmeter logging data a series of synthetic curves that can be related to the texture of the rock and the structure of the formation. This information helps the geologist predict the producibility of the reservoir in the vicinity of the wellbore.

A section of a typical Litho log which gives petroleum geologists a description of the rock types over the entire length of a borehole.



Various types of logging tool sensors which measure the characteristics of subsurface rock formations.

Drilling & Production Services

Drilling & Production Services has three operating units: ☐ *DRILLING SERVICES: Forex Neptune – contract drilling on land and offshore; Anadrill – well-site computer analysis of surface and downhole drilling data acquired while drilling, directional drilling services.* ☐ *TESTING AND COMPLETION SERVICES: Flopetrol Johnston – well testing, pressure measurements, completion and workover services, production services, drilling tool rentals.* ☐ *PUMPING SERVICES: Dowell Schlumberger (50% owned) – cementing and well stimulation.*

☐ *SCHLUMBERGER CAMBRIDGE RESEARCH located in Cambridge, England.*

Business Review

Revenue of Drilling & Production Services was 7% higher than in 1983. Excluding the Schlumberger share of the revenue of Dowell Schlumberger-North America acquired in 1984, revenue was 13% lower.

Oilfield activities were at low levels in most areas, except in the North Sea where exploration and development drilling continues to show strength and in North America which is recovering from a two-year recession. Prices remained soft, especially for drilling and pumping services.

Schlumberger Cambridge Research continued to expand and, early in 1985, occupied new facilities which include a unique experimental drilling test station.

Research & engineering expenditures amounted to $37 million, up 8%, excluding Dowell Schlumberger-North America. Capital expenditures, excluding the SEDCO and Dowell acquisitions, increased $111 million to $164 million.

Drilling Services

Forex Neptune revenue was 17% below the preceding year. Despite some improvement in drilling activity, daily rates, on average, were lower than a year ago. Toward the end of the year, increasing activity in the Gulf of Mexico and in the North Sea caused a slight recovery in daily rates for offshore rigs, particularly semisubmersibles.

Offshore rig utilization averaged 75% compared to 78% in 1983; land rig utilization improved to 61% compared to 51% in 1983.

At the end of 1984, Forex Neptune owned 17 offshore rigs and 51 land rigs and also operated 13 drilling rigs owned by others.

Two harsh environment jack up rigs, capable of drilling in 300 feet of water were acquired in 1984. Both units, Trident X and Trident XI, are drilling in the North Sea.

By year end, computers were installed on nearly all Forex Neptune rigs to acquire and present data such as time analysis, bit and mud parameters, casings used and hole deviation.

At midyear, the Drilling Services division of Dowell Schlumberger was combined with The Analysts in a new unit, called Anadrill. Anadrill provides real-time monitoring of geological and drilling parameters and directional drilling services. Revenue of the traditional surface monitoring services was flat but downhole Measurements While Drilling services grew 36%. Overall, directional drilling services revenue was lower but increased in the second half of the year.

The Advisor™, a new surface logging computer system, was introduced during the year and had excellent customer acceptance.

Testing and Completion Services

Flopetrol Johnston revenue was 12% lower than last year. A modest increase in activity was more than offset by strong price competition for testing services, especially in North America, the Far East and the Middle East.

The drill stem testing (DST) activity of Dowell Schlumberger was transferred to Flopetrol Johnston during the year. Flopetrol Johnston now offers a complete line of testing services worldwide, including downhole DST tools, surface well testing equipment and downhole pressure measurements. These services, with high-accuracy pressure gauges and wellsite computer interpretation, have presented many more opportunities for Flopetrol Johnston to handle entire testing programs: well test design, data acquisition and interpretation, and recommendations on well completion and stimulation.

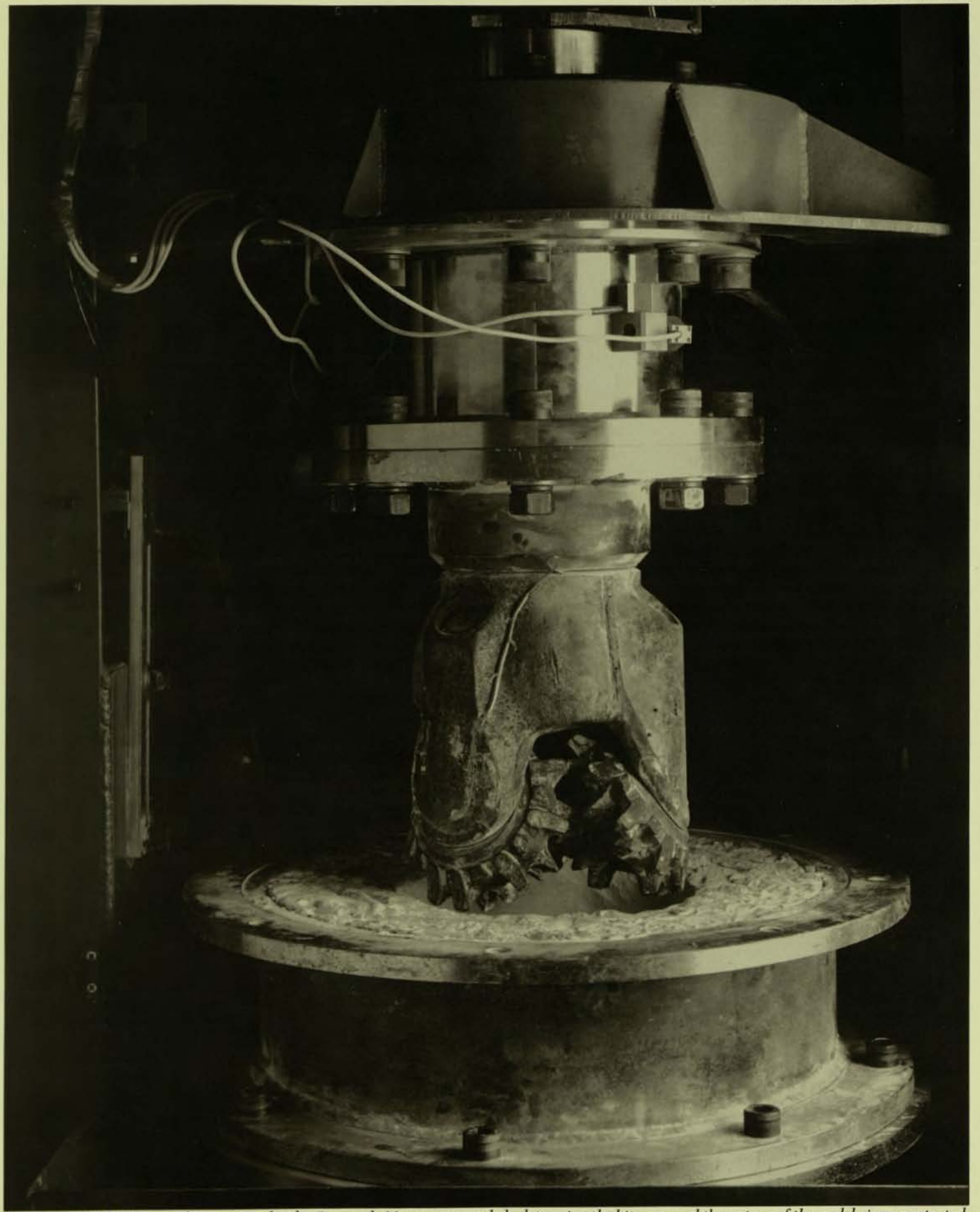
A significant contract for well testing services was signed in November with the Chinese National Oil Company.

Workover services revenue declined further in 1984 as activity remained depressed and price competition intensified.

Pumping Services

During 1984, Schlumberger purchased 50% of Dowell operations in North America from The Dow Chemical Company. Following this transaction, Dowell Schlumberger now operates worldwide.

In North America, Dowell Schlumberger pumping services revenue improved 9%. Prices stayed soft, particularly in stimulation, due to overcapacity in the pumping industry. Activity was stronger in all regions of the U.S., notably fracturing services in the central and southern states and Alaska, and cementing in the Gulf of Mexico and in California. Canadian revenue improved significantly, particularly in the second half of the year.



Experimental drilling machine at Cambridge Research. Measurements help determine the bit wear and the nature of the rock being penetrated.

Several new cementing additives were introduced to the North American market, especially Gasblok™ which prevents gas channeling. A new blender for fracturing operations was field tested successfully.

Outside North America, pumping services revenue decreased 13% due to soft prices and reduced drilling activity.

Cementing and stimulation revenues declined 9% and 14% respectively, while pipeline cleaning revenue was strong, due to the large Statpipe project in Norway which was completed during the year.

Europe was up strongly while Africa continued to decline. The Far East and Middle East were behind last year, and Latin America was adversely affected by the continuing currency devaluations.

A new offshore stimulation vessel, *Big-Orange 18*, designed by the Dowell Schlumberger engineering center in Saint-Etienne, France, began to operate in the North Sea. This dynamically positioned boat can execute, in automatic mode, the largest stimulation operations required in the North Sea.

Schlumberger Cambridge Research

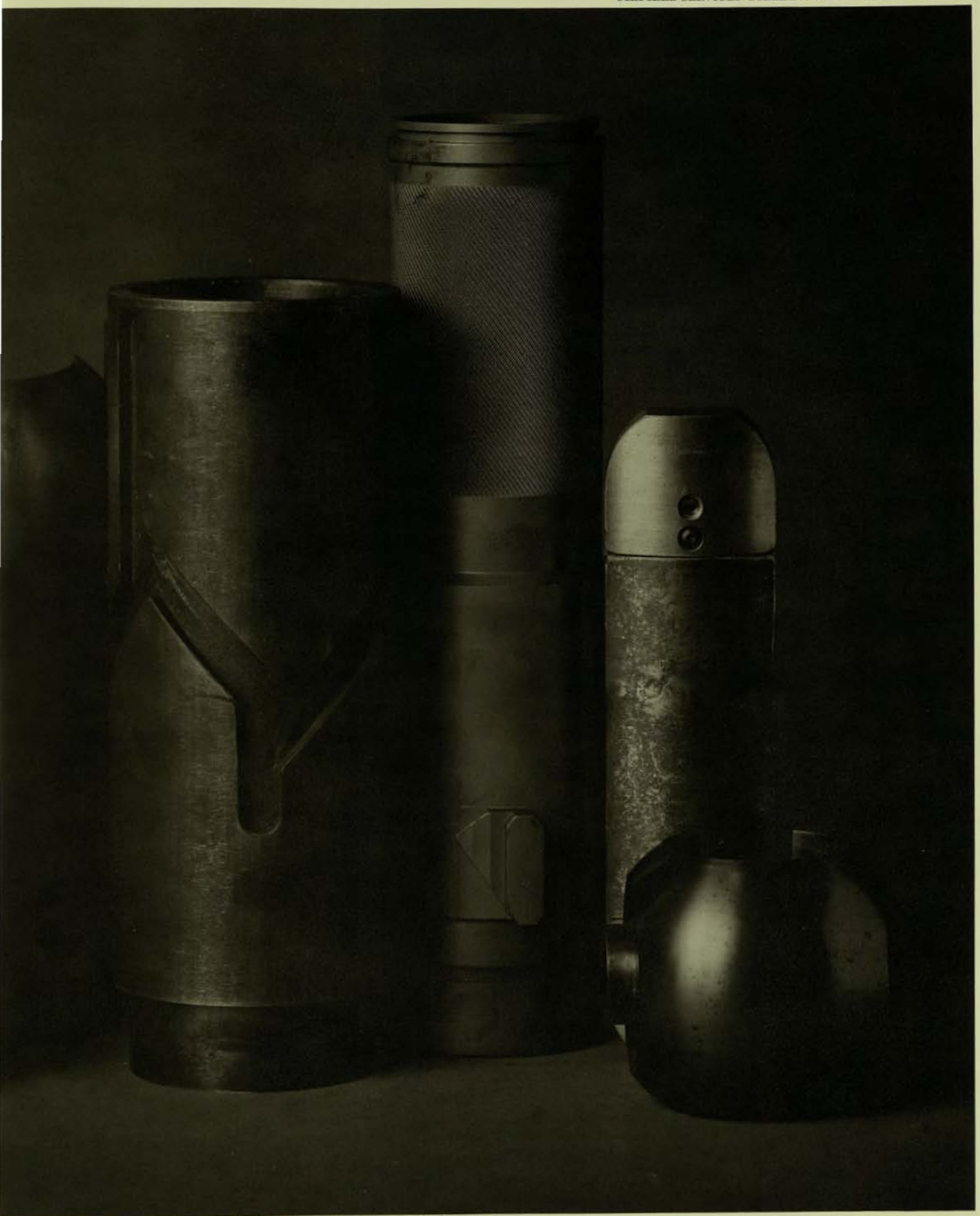
In 1984, Schlumberger Cambridge Research continued to expand. The total number of scientists and oilfield specialists is 55.

The new research center, completed early in 1985, includes offices and laboratories (50,000 square feet) and a test station (10,000 square feet) that will house a drilling simulator and a flow loop.

The new drilling simulator should be assembled and commissioned by June. The machine can simulate full-scale drilling operations for detailed studies of the drilling process under typical downhole pressure and temperature conditions.

During 1984, progress was made in several areas such as the measurement of drill bit wear and the detection of bit bearing failures. Such techniques could help decisions on when a drill bit should be replaced. Also, multiphase flow research may help develop novel testing techniques.

Disassembled parts of Flopetrol Johnston drill stem test too



ls used to determine the types of fluids and production rate of oil wells.

Measurement & Control

Measurement & Control consists of six operating units: ☐ *ELECTRICITY MANAGEMENT: Electricity meters and equipment for electric power distribution; load and rate management systems; network protection systems and measuring transformers for electric power transmission.* ☐ *WATER AND GAS METERING: Water meters and distribution systems; gas meters and distribution systems.* ☐ *INSTRUMENTS: Magnetic tape recorders, data acquisition systems; electronic instruments for industrial, laboratory and aerospace applications; radar simulation, training systems; industrial data logging and telemetry systems; transducers.* ☐ *PAYMATEC: Electronic payment systems, smart cards with an imbedded semiconductor logic and memory chip; gasoline pumps; time control devices.* ☐ *FAIRCHILD WESTON SYSTEMS: Data acquisition, signal processing and electronic countermeasures systems for aerospace and defense applications; controls for nuclear power systems.* ☐ *CONTROL, VALVES AND TECHNOLOGY: Process control equipment; petroleum, nuclear and industrial valves.*

☐ *SCHLUMBERGER MONTROUGE RESEARCH located in Montrouge, near Paris.*

Business Review

Revenue of Measurement & Control was level with 1983. In Europe, revenue increased 9%, expressed in national currencies.

Unless otherwise specified, comparisons given in this presentation refer to U.S. dollars.

Incoming orders for the year were up 2%; in Europe, they increased 17% when expressed in national currencies.

Measurement & Control has been organized worldwide along product lines, mainly electricity management, water and gas, instruments and electronic payment systems. Research & engineering expenditures amounted to $59 million, up 6%; capital investment was $64 million, up 12%.

Electricity Management

Overall revenue was flat.

Revenue of Sangamo in North America was 10% higher than the prior year as sales of residential meters in the U.S. and Canada grew 17%. Also, shipments of industrial meters were up 16%. Data Star™, a new remotely readable industrial billing recorder, was introduced in the fourth quarter to electrical utilities.

In Europe, revenue increased 2% expressed in national currencies. A new plant in Felixstowe, England will be operational early in 1985. This facility will manufacture a new generation of solid state residential electricity meters and other products such as radio teleswitches, and magnetic and smart card-operated prepayment electricity meters to replace coin-operated meters.

Production of residential meters in Jakarta for the Indonesian market began.

Orders for Balteau instrument transformers used in network protection systems increased 30%. Two new plants were built to replace older facilities: the Itajuba, Brazil plant will produce transformers for service up to 245kv and the Montrouge, France plant will produce transformers for up to 500kv.

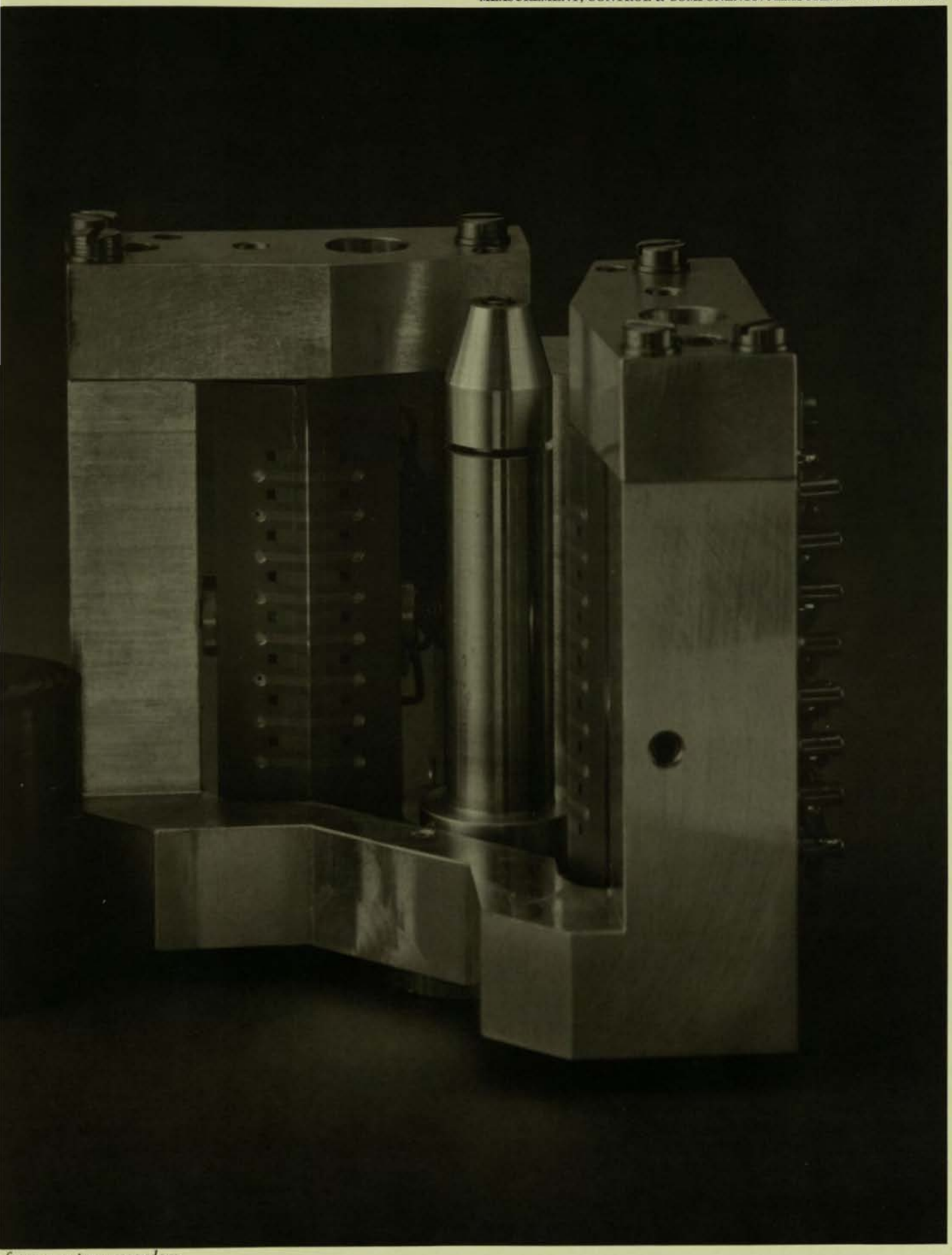
Water and Gas Metering

Overall revenue was up 4%.

Revenue for gas meters and gas distribution equipment worldwide was up 11%. This was due mostly to a significant increase of orders in southern Italy where the gas distribution system is being expanded.

A new plant is under construction by Flonic

Multiple track magnetic read-out head used in a variety of high-pe



rformance tape recorders.

in Reims, France for the production of the new Gallus™ 2000 gas meter.

Revenue of water meters and water distribution equipment in Europe and in Latin America declined 4%. A new residential mono-jet water meter, Flostar™, which meets the standards of the European Economic Commission, was introduced during the year.

Instruments

Instruments revenue was flat.

Data recorder revenue increased 16% with all product lines contributing. A new airborne high density recorder, ME 4115, used mainly for aircraft and missile test flights, had good customer acceptance in both Europe and the United States.

A prototype of a new rotary head digital tape recorder which increases tape data storage capacity by a factor of 20 was recently introduced. The primary applications are in telemetry and data systems for image processing and storage. Recorders have been installed in locations such as the Canary Islands and the Arctic to collect data from the earth observation satellites Landsat and Spot.

Solartron and Enertec general instruments revenue increased 12% in local currencies. Major product lines, such as dynamic analysis instruments, digital voltmeters and radio test equipment, were strong.

In telecommunications, a new instrument was introduced that can make comprehensive tests on the growing number of telephone networks which are being converted to digital transmission. This equipment, designed by Enertec in Saint-Etienne, can be used worldwide by both telecommunications equipment manufacturers and operators.

At Solartron in the U.K., a line of rugged measurement modules was introduced that allow data loggers to acquire data in hostile environments remote from the central logger. These modules also can be used directly with most personal computers.

Transducer revenue grew over 18% worldwide. Solartron recorded substantial sales in high accuracy density transducers to the U.S. oil and gas industry.

Paymatec

Paymatec revenue increased 28%. However, excluding the revenue of Koppens which was acquired in July, revenue remained flat.

Koppens is a Dutch manufacturer of automated fuel dispensing systems for gas stations. In the U.S., Koppens introduced Micromax for self-service gas stations. This unit combines gasoline dispensing and electronic payment systems in one unit. Sizable orders were received from two major oil companies.

In 1984, Paymatec became the first company to manufacture "smart cards" on a full industrial scale. This plastic credit card, which incorporates an integrated circuit chip, has many future applications such as public telephones, parking meters and point-of-sale payments.

Fairchild Weston Systems

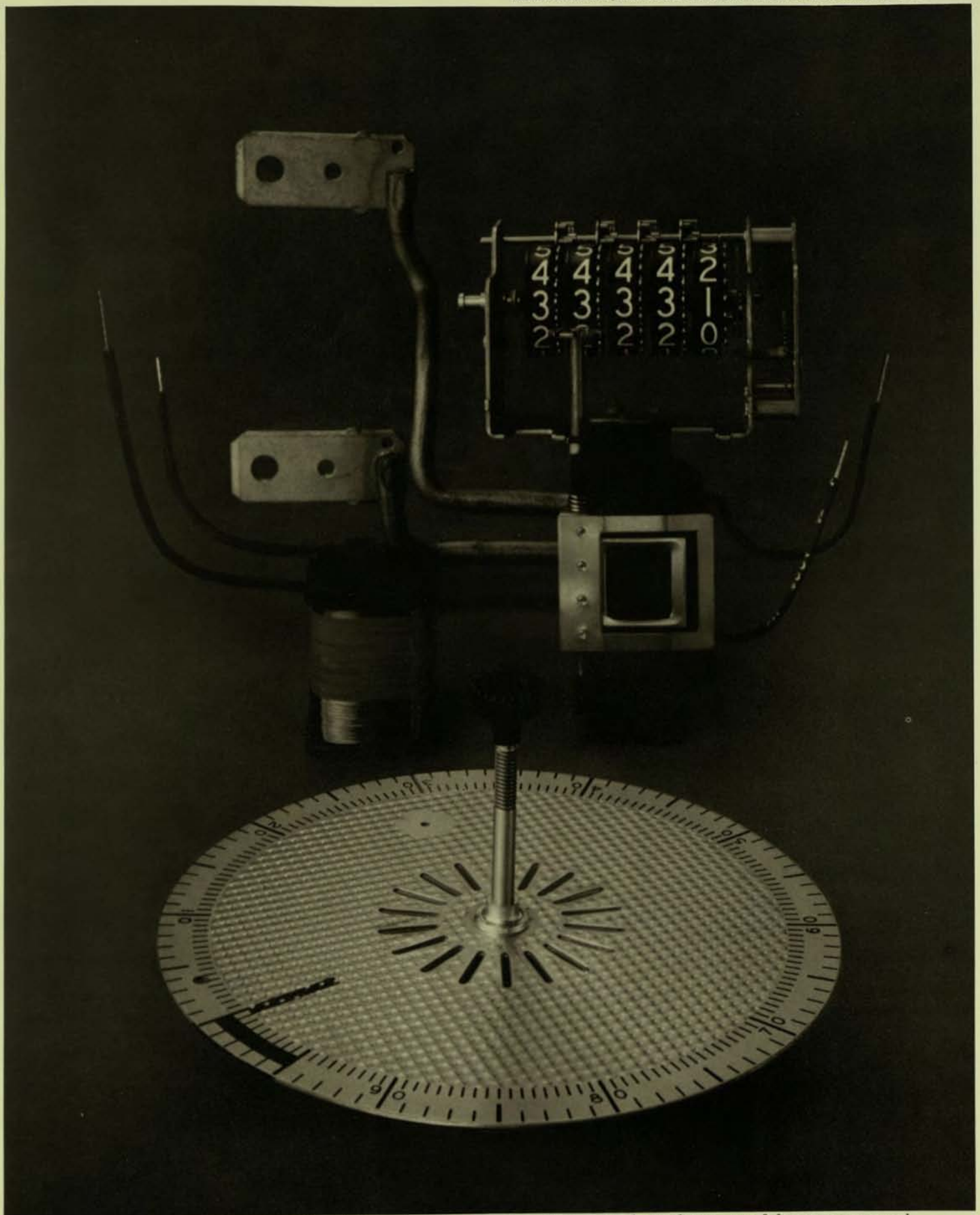
Revenue increased 6% due to improved sales of telemetry, electronic countermeasures equipment and instrumentation for nuclear powered vessels. Orders were strong for telemetry and imaging device systems.

Control, Valves and Technology

Expressed in national currencies, revenue declined 2% in 1984. Sales of valves dropped 12% due to a sharp decrease in capital investments by the petroleum, nuclear and other industries. However, revenue from process control activities increased 12% in national currencies as sales of the digital control system Modumat 800 multiplied threefold.

Research

At Schlumberger Montrouge Research, the first prototypes of the optical current transformer were successfully tested, and a program was initiated to develop an optical voltage sensor. These sensors, based on fiber-optic technology, would replace the traditional measurement transformers used for protecting electrical power networks. Several development programs are underway on sensors for pressure and flow measurements in fluid systems, on semiconductors which include a sensor as an integral part of the chip and on nondestructive testing techniques using nuclear radiation.



Parts of a Sangamo electromechanical residential electricity meter. Rotations of the disk indicate the amount of electricity consumed.

Fairchild Semiconductor

Fairchild Semiconductor includes four main operating units: ☐ *DIGITAL: Digital logic including FAST and low-power Schottky products.* ☐ *MEMORY & HIGH SPEED LOGIC: Computer memory products including PROMS and static RAMS and high-speed 100K ECL logic products.* ☐ *ANALOG: Linear, small signal, hybrids, telecommunications and computer interface products.* ☐ *MICROLOGIC: Microprocessors, gate arrays and CCD imaging products.*

☐ *SCHLUMBERGER PALO ALTO RESEARCH-FAIRCHILD located in Palo Alto, California.*

Business Review

Fairchild revenue rose 42% but orders were up only 8% over 1983. The semiconductor business started the year with strong sales and bookings, but ended 1984 in a much weaker position: first quarter orders were 71% higher but the fourth quarter was 52% lower than the corresponding quarters of 1983. For the full year, orders were slightly lower in the United States but grew significantly in Europe and Asia despite the effects of the strong dollar.

Research & engineering expenses were $84 million, up 20%. Capital expenditure increased $43 million to $168 million for new facilities and improvements to existing plants.

Digital

Revenue at Digital was 66% ahead with FAST and low-power Schottky Logic products showing the largest gains. Orders fell somewhat from the prior year, although demand for FAST logic products remained strong.

The FAST family surpassed 100 part types in production by year end. During 1985, new FAST types will include LSI products which are high density, high-value products implementing complex system-level functions.

Demand for FAST products stretched existing production capacity to the limit. As a result, the Wappingers Falls, New York plant is being converted to produce FAST products. This, and planned expansion in South Portland, Maine, will create in 1985 a 30% capacity increase in digital and 100% in FAST.

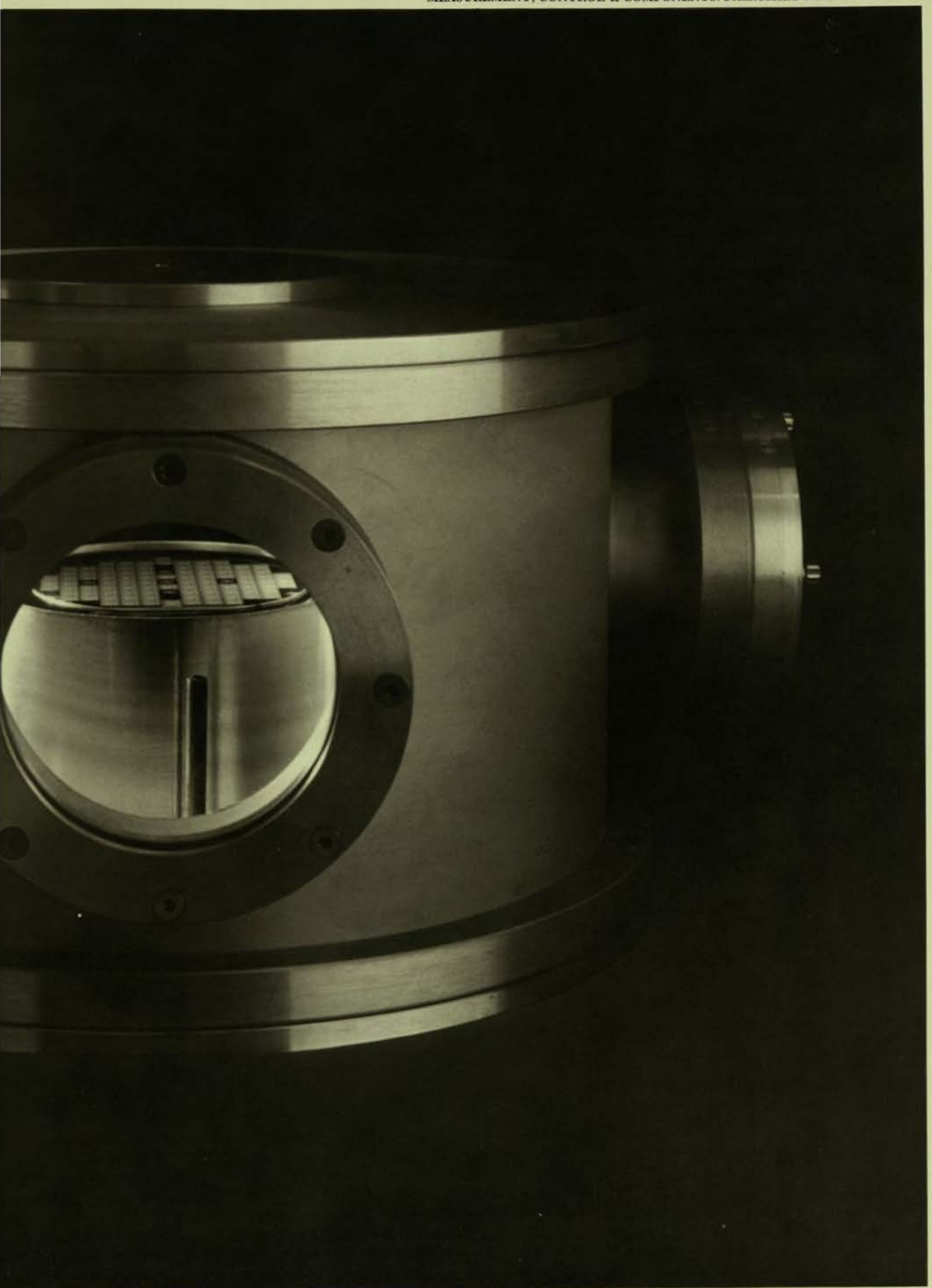
First wafers were processed on the new two micron CMOS fabrication line in South Portland, Maine. This line will also support the advanced CMOS logic family which will be introduced in 1985.

Memory & High Speed Logic

Revenue grew 54% and orders 32% over 1983. Business was strong for logic products. However, orders were erratic, double the 1983 rate in the first quarter but only 66% of the prior year in the fourth quarter.

The Memory & High Speed Logic unit completed the consolidation of Bipolar products in Puyallup, Washington and brought additional manufacturing capacity on line to help meet demand. Record productivity and output were reached during the year on both the 100K ECL logic and high-density 64K PROM

This reactor, at Fairchild Research, is used for plasma deposition of thin



dielectric films which will be used in future generations of high-performance integrated circuit memories.

product lines. A 175,000 square foot expansion of the Puyallup plant was started.

Two micron, 64K CMOS Static RAMs were brought into preproduction by the end of 1984. This product has the highest speed (45 nanoseconds) and the lowest power consumption of any product available on the market.

Analog

The Analog unit includes linear, small signal, hybrids, telecommunications and computer interface products. Revenue was 19% ahead of 1983 but orders were flat. Linear products for telecommunications and computer peripherals had the strongest growth.

The Power System division and General Motors have reached an agreement that calls for the delivery of new electronic ignition modules in the next few years. In addition, a new microprocessor-based electronic ignition system will be developed for the 1988-1989 car model year.

First units of a major new CMOS product, the Bell 212A compatible single-chip modem, were produced and samples were delivered to key customers. Another telecommunications product, the μA5800 SLIC (subscriber line interface circuit), entered production.

Micrologic

Revenue and orders were both up about 14% over 1983 on the strength of the growing gate array business.

The Micrologic unit in Mountain View consolidates operations of Microcontrollers, Gate Arrays and CCD Imaging products. Shipments of the high-speed 9450 microprocessor began during the year.

Following startup of a new two micron CMOS facility in Milpitas, California, the first products of the CMOS Gate Array family were shipped during the year. The CMOS Gate Array family now includes 500-, 2400- and 6000-gate products. A major second-sourcing agreement covering the new family was signed with VLSI Technology of San Jose, California and includes five additional products scheduled for release in 1985.

Major customer contracts were signed for both the ECL gate array family and CCD imaging products. The ECL family of gate array products was completed during 1984.

Europe

Revenue in Europe rose 29% and orders grew 21% over the prior year. Expressed in national currencies, revenue was up 47% and orders 41%. Fourth quarter orders fell 50% from the same quarter of 1983 as the slowdown which started in the U.S. at midyear began to affect Europe.

At Wasserburg, Germany, construction of a two micron bipolar and CMOS wafer fabrication facility is in progress.

Asia

Revenue in Asia was up 62% and orders were 24% greater than 1983 with higher sales in all product lines, especially digital logic. Orders in the fourth quarter fell 28% compared to the same period of 1983.

The Nagasaki plant, completed in Japan in August, assembles FAST products for Asian markets. Plans to add a new two micron CMOS wafer fabrication facility in Nagasaki were approved.

Research

Schlumberger Palo Alto Research-Fairchild concentrates on bipolar and CMOS processes and high-speed logic design. The research in artificial intelligence and automatic test equipment was combined into a new laboratory within the Computer Aided Systems group.

In 1984, the two micron CMOS process was transferred from the laboratory to all the operating units. Now, research is focused on a one micron CMOS process for next generation products.

In bipolar research, polysilicon technology was developed for high-speed VLSI circuits such as the 64K Bipolar Static RAM that can operate faster than 15 nanoseconds.

High performance CMOS microprocessor technology was transferred during the year to the Micrologic unit.

A processed silicon wafer (center) before it is cut into individual chips, surrounded by typical semiconductor integrated circuit chips.

Computer Aided Systems

Computer Aided Systems consists of five operating units:
☐ *SENTRY: Computer controlled systems for testing semiconductors.*
☐ *FACTRON: Computer controlled systems for testing printed-circuit board subassemblies.*
☐ *APPLICON: Computer aided design and manufacturing (CAD/CAM) systems.* ☐ *MDSI: Computer aided manufacturing (CAM), computer based systems to translate parts descriptions into instructions for numerically controlled machine tools.*
☐ *BENSON: Computer aided drafting products including pen and electrostatic plotters.*

☐ *SCHLUMBERGER PALO ALTO RESEARCH-CAS located in Palo Alto, California.*

Business Review

Computer Aided Systems (CAS) completed its first full year as a separate business entity.

The primary customers of CAS are manufacturers of semiconductors, mechanical, electromechanical and electronic products and systems. CAS provides these manufacturers a variety of computer aids which are interposed in the engineering, design, manufacturing and testing stages.

Revenue of Computer Aided Systems was up 18% and orders were 13% ahead of 1983. However, orders slackened in the fourth quarter due to a significant slowdown in three key markets: semiconductors, computers and telecommunications. Backlog was still 6% higher than the backlog at the end of 1983.

Research & engineering expenses were $74 million, up 11%, and capital expenditures were $42 million, down 7%.

Sentry

Revenue of Sentry, previously the Component Test Systems division, was 38% higher and orders were up 13% for the year. The year-end semiconductor industry slowdown was reflected in reduced demand for integrated circuit production testers. Orders for memory testers continued strong through the fourth quarter, due to heavy demand from Southeast Asian semiconductor manufacturers. A new engineering and manufacturing plant was opened in Saint-Etienne, France to provide Sentry testers for European markets.

Late in the year, the first Sentry-50 VLSI tester was delivered to a U.S. customer. This is the first commercial tester capable of 50 MHz operation. The Sentry-50 is able to test the latest generation of high-speed very-large-scale integrated circuits with up to 256 pins.

The 5588Q Memory Tester, introduced in 1984, is the only U.S.-made machine capable of conducting final tests on eight 256K memories in parallel.

Factron

Revenue of Factron, previously the Subassembly Test Systems division, was up 17% and orders were 20% higher in 1984. Orders for electronic subassembly testers fell in the second half, as personal computer and telecommunications manufacturers scaled back their programs. However, orders in Europe were up 37%, or 53% expressed in national currencies, as a result of the strong acceptance of the 700 Series printed-circuit board testers.

The Models 750 and 780 in the 700 Series are high-speed automatic test systems that combine both in-circuit and functional test capabilities. The in-circuit test verifies that a printed-circuit board has been manufactured correctly while the functional test establishes that the printed-circuit board operates within its design specifications.

A new Integrated Circuit Verifier tests components when they are automatically inserted in a printed-circuit board, detecting those that are faulty, misplaced or oriented the wrong way. The first units were shipped in the second quarter. A new plant was opened in Ferndown, England for the design and manufacture of printed-circuit board subassembly testers for European markets.

Applicon

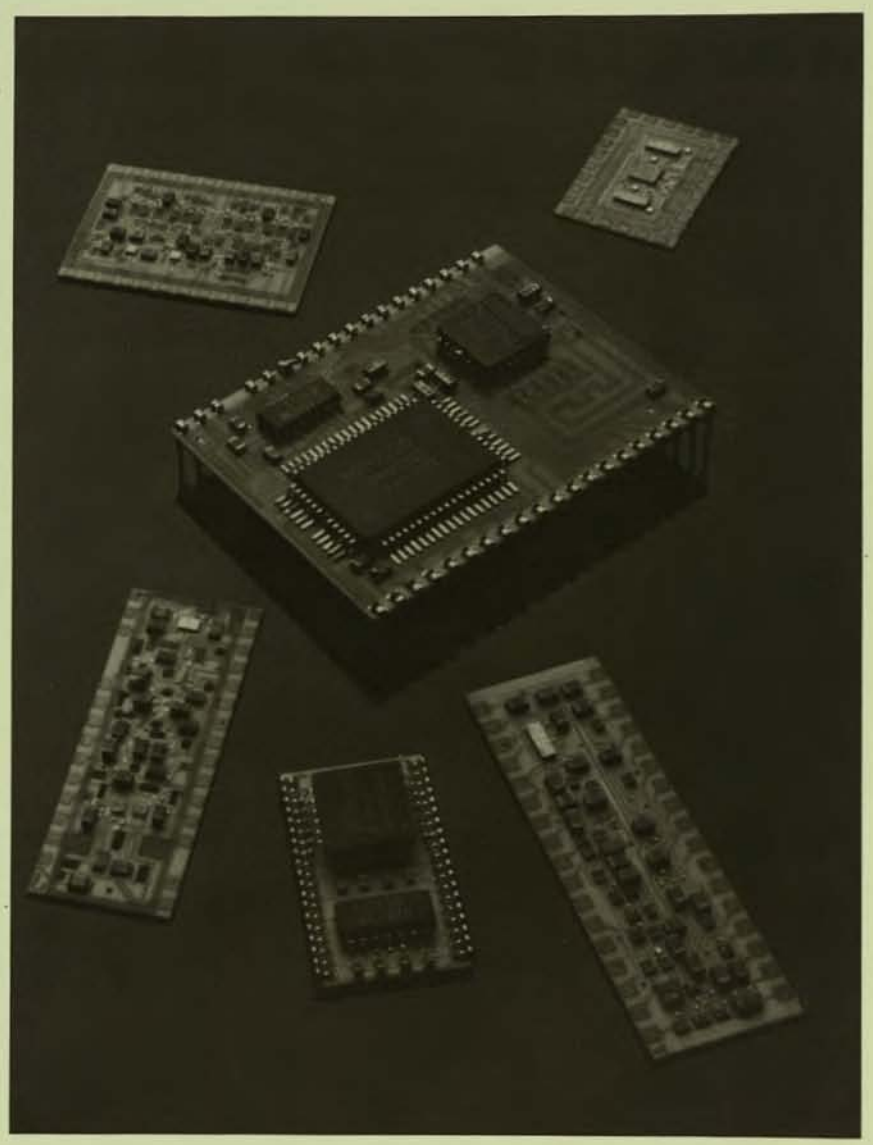
Revenue was 2% higher and orders increased 4% after a very slow first three quarters while substantial product improvement and reorganization were in progress. Orders were up 18% in the fourth quarter due to the release of a new version of the BRAVO! computer aided engineering, design and manufacturing system. The new BRAVO! has a greatly increased speed of response, additional user features and improved reliability.

Also introduced was ARIA™, an engineering workstation which provides a low-cost entry to computer aided design.

MDSI

Revenue of MDSI gained 4% and orders were 21% ahead as MDSI's major market, machine-tool users, continued to recover from a severe recession. Orders strengthened throughout the year, with the fourth quarter showing 41% growth over the same quarter a year ago. A new computer integrated manufacturing system called EQINOX™ contributed significantly to growth, accounting for 75% of orders received in the fourth quarter. EQINOX consists of a series of graphics workstations and communications that can be used for creating programs for numerically controlled machine tools and for design/drafting tasks as well.

An important use of Applicon Computer Aided Design is laying out printed-circuit boards.



EQINOX workstations can be integrated with existing CAD/CAM systems and can be networked with each other and with machine tools on the factory floor.

Benson

Revenue of Benson increased 10% and orders were ahead 7%. Four new products were introduced: two models of high-speed pen plotters, one accepting sheets of paper and the other rolls; Colorscan, a four-color ink jet plotter that plots points instead of lines; and a low-price thermal transfer plotter.

Research

Schlumberger Palo Alto Research-CAS was organized in 1984, combining the artificial intelligence and automatic test equipment activities, formerly of Fairchild research. The laboratory conducts basic and applied research in computer aided engineering, computer integrated manufacturing and automatic test and repair.

In 1984, the results of several research programs were transferred to operating units for further development. The *Electric* software system for computer aided engineering of integrated circuits and printed-circuit boards was transferred to Applicon which will introduce a commercial product based on it in 1985. Also, new approaches to visual signal processing were developed that may lead to a new Benson product that can capture color images from video data streams and process them so they can be printed in color, inexpensively, on a Benson plotter. Other ongoing work has led to improved computer tools to assist in testing printed-circuit boards on Factron testers.

For the future, artificial intelligence techniques are being focused on engineering, manufacturing, test generation and trouble shooting processes. To aid this effort, new computer architectures are under development to accelerate signal processing and symbolic reasoning by orders of magnitude.

Hybrid circuit modules are some of the elements making up a Sentry-50 VLSI tester.

SEDCO

On December 24, 1984 SEDCO became part of Schlumberger. The next few pages describe SEDCO, its people and its business.

The SEDCO 703 drilling for AMOCO in the British sector of the North Sea, 115 miles northeast of Aberdeen, near the Piper field.

SEDCO

History

SEDCO, located in Dallas, Texas, was formed 38 years ago by William P. Clements, Jr. and two partners. The company had two used diesel powered land rigs and drilled its first well near Brookhaven, Mississippi. Two of the men who drilled that 10,000-foot well with Rig No. 1 are still with SEDCO, Bill Clements and Bobby Lynch.

From its start in Mississippi, SEDCO expanded into Texas, New Mexico and Oklahoma and also began offshore drilling in the shallow bay areas of the Gulf Coast. By 1955, the company had 16 land rigs, eight inland barges, three offshore fixed platform rigs, one offshore tender with an associated platform rig and one small offshore submersible barge.

In that year, SEDCO began a planned expansion outside the United States with drilling contracts in India and Pakistan. Activity in Iran began in 1958 with two land rigs. By 1959, international operations were solidly established and the company drilled 1,039 wells in Argentina in the next three years — the largest land drilling contract ever awarded. Over time, operations outside the United States accounted for the bulk of SEDCO's business.

In the early 1960s, SEDCO set in motion long-range plans to drill in the deep oceans of the world. For deep, rough water environments, they designed the SEDCO 135 series of semisubmersible drilling units. A few years later, aided by this experience, design work was initiated on a new generation semisubmersible for work in even more severe conditions. The SEDCO 700 series was the result. Over the next decade, 13 of these 700 series units were constructed for use in the northern part of the North Sea and similar areas.

The Equipment

SEDCO offshore drilling and support equipment includes 41 mobile units: 28 semisubmersible vessels, ten jack up units and three deep water drill ships. Some of these units are jointly owned. In addition to drilling offshore wells, this equipment has been utilized for offshore support services such as production platforms, pipeline covering activities and ocean mining research. Onshore operations include four land drilling rigs.

☐ *Semisubmersible Vessels.* Semisubmersible vessels are designed for offshore drilling and support activities under difficult weather and ocean conditions. A semisubmersible vessel is lowered to its operating mode by taking on ballast water in the footings and caissons. When ballasted to its operating draft, it is a stable platform with motion characteristics suitable for sustained drilling operations in waves of up to 40 feet. The water depth in which a semisubmersible may operate is determined primarily by its anchoring and riser systems.

Two of the semisubmersible units, the SEDCO 709 and the SEDCO 710, have dynamic stationing systems consisting of eight computer controlled thrusters which, instead of anchors, position and maintain the vessel on location during operations. The dynamic stationing equipment gives these units the capability to work in water depths up to 6,000 feet, or in oceans where icebergs are common, because of the instant mobility of this semisubmersible. The SEDCO 709 and 710 are the world's only dynamically stationed semisubmersible drilling units.

☐ *Drill Ships.* The three SEDCO drill ships are dynamically stationed and have been engaged for up to 14 years in worldwide exploration drilling in water depths up to 5,000 feet. One of the drill ships, the SEDCO/BP 471, has been modified to conduct a long term contract working for Texas A&M University on a National Science Foundation research project to study how the earth was formed and developed. The vessel will be working worldwide, drilling in water depths up to 27,000 feet and retrieving core samples for scientific analysis.

Rig superintendent Al Ruel (left) and rig manager Bob Olsen examine the drill bit pulled from the well bore.

From the left: roughnecks Dave Robertson, John Hunter and Cliff Taylor in action on the drill floor.

George Darby, assistant driller, unlatches drill pipe elevators to allow removal of a riser joint from the drill floor to a storage area.

☐ *Jack Ups.* SEDCO operates ten jack up units. These units have maximum water depth capabilities ranging from 100 to 250 feet. Each is designed to be towed to a drilling location and then raised above the water to a desired height by means of lowering self-contained legs.

SEDCO Today

SEDCO customers include most of the international and national oil companies around the world. The major operating locations today are the North Sea, the Gulf of Alaska, the Gulf of Mexico, the Indian Ocean, the Arabian Gulf, the Mediterranean, offshore Brazil, offshore Africa, offshore China and offshore eastern Canada.

☐ *The People.* SEDCO has approximately 4,300 employees of 30 different nationalities.

Almost 15% of all SEDCO people are college graduates, and two-thirds of those are engineers. Engineers and other graduates share one thing in SEDCO — they start as trainees on drilling rigs and spend years building a solid foundation in the drilling business. However, much of SEDCO's basic strength comes from the large number of experienced rig personnel who have learned on the job. With this in mind, high priority is given to the hiring, development and promotion of nationals in every country where SEDCO has operations.

☐ *Training.* Personnel training has been a long-standing commitment in SEDCO. The centerpiece of the training program is the Modular Training System, a demanding, self-paced course of study consisting of modules for each position on a drilling rig. The modular training material includes manuals, workbooks, videotapes and examinations which must be completed. On-the-job training is the rule. In support of the on-board training program, each rig carries a library of about 250 videotapes most of which were produced internally. This library is growing at the rate of about 20-30 new productions per year.

SEDCO maintains training centers in Aberdeen, Scotland and Dallas, with

Captain Mack Dixon conducts training in marine stability and trim using a realistic simulator at the Dallas Training Center.

Tommy Bicknell at the Dallas Training Center instructs a group on a drilling simulator.

At Earl and Wright, engineers John Pavey and Michael Roche discuss finite element analysis of a large tubular connection, part of a proposed deep water fixed structure development.

major training efforts being devoted to Well Control Schools and Marine Stability and Trim Seminars. SEDCO has been a pioneer in well control training, opening the first schools 12 years ago. Upon completion of Well Control Schools, employees can be certified to work in high risk areas for well control problems.

☐ *Engineering.* SEDCO engineers, with technical assistance from Earl and Wright, a wholly owned consulting engineering subsidiary, have designed and supervised the building of most of SEDCO's offshore drilling and support equipment.

SEDCO pioneered the development of dynamic stationing for full scale deepwater exploration with both semisubmersibles and drill ships.

Earl and Wright

Earl and Wright is a consulting group of experts that specializes primarily in the design of deep water development platforms, floating production facilities, onshore petroleum handling facilities, drilling vessels and marine terminals. Earl and Wright designed much of the SEDCO offshore drilling and support equipment; they also perform consulting work for oil companies and drilling contractors in the areas of computer stress analyses, dynamic model tests, strength and stability calculations, mooring systems and joint analyses. Other services, provided to both governmental and private groups, include design and project management of harbors, bridges and other civil engineering works.

FINANCIAL REVIEW

Financial Review

Results of Operations

Net income for 1984 was $1.18 billion as compared to $1.08 billion in 1983 and $1.35 billion in 1982. Net income increased 9% in 1984 following a 20% decline in 1983 and a growth of 6% in 1982. Net income per share was $4.10, $3.73 and $4.60 in 1984, 1983 and 1982, respectively. The acquisition of 50% of the Dowell operations in North America during 1984 had the effect of reducing earnings by $30 million or 10 cents per share.

Oilfield Services

Oilfield Services operating revenue increased 6% in 1984 as compared to a decrease of 16% in 1983 and a 7% increase in 1982. The 6% growth in operating revenue includes the acquisition, earlier this year, of 50% of the Dowell operations in North America. Excluding this acquisition, Oilfield Services revenue was about the same as last year.

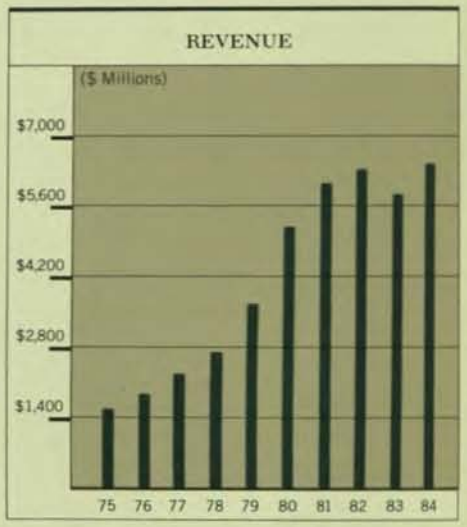
Wireline revenue worldwide was up 6%. In North America, revenue increased 16% as the average number of active rigs increased to 2,697 rigs (11%) from the 2,430 rigs last year. Outside of North America, Wireline revenue was flat when compared to 1983. In 1983, revenue outside of North America declined 5% following a 21% increase in 1982. Compared to 1983, revenue in Europe increased 12% as offshore activity increased and jobs per rig were higher, while Africa/Mediterranean and Latin America were below last year by 1% and 10%, respectively. Revenue in Central East Asia increased 14% above 1983 as average active rigs increased 18% to 167 while the Middle East and Indonesia/Australasia declined from last year by 8% and 2%, respectively.

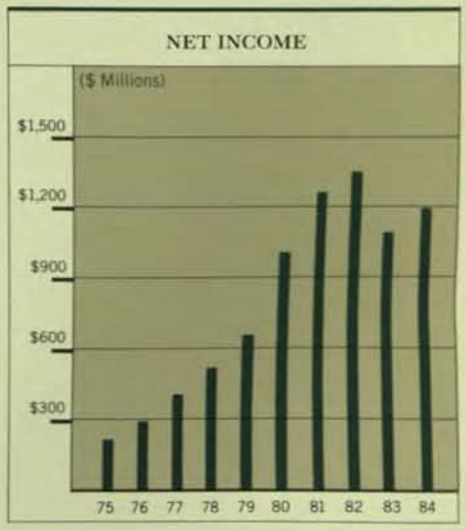
Drilling & Production Services revenue (including the Company's share of Dowell Schlumberger in North America) was 7% above 1983 following a decline of 19% in 1983 and an increase of 12% in 1982. Excluding the results of Dowell Schlumberger in North America, 1984 revenue declined 13%. Forex Neptune revenue was 17% below last year due primarily to lower day rates as overall rig utilization during 1984 was 64% compared to 58% in 1983. Outside of North America, Dowell Schlumberger revenue was 13% below 1983 and the revenue of Flopetrol Johnston was 12% below last year; both declines are attributable to lower activity and pricing pressures. On a comparable basis, including Drilling Services, revenue of Anadrill was even with 1983.

Measurement, Control & Components

Measurement, Control & Components operating revenue increased 11% in 1984 following an increase of 2% in 1983 and a decline of 1% in 1982. The high revenue growth at Fairchild and Computer Aided Systems was partially offset by flat revenue at Measurement & Control.

Measurement & Control revenue was even with 1983 after declining 6% in both 1983 and 1982. In North America, revenue increased 7% over 1983 (pri-





marily due to increased sales of defense systems, meters and telemetry systems) after declining 5% in 1983 and 6% in 1982. In Europe, when expressed in national currencies, revenue improved 9% in 1984 following an 8% increase in 1983 and 13% in 1982.

Fairchild revenue increased 42% in 1984 after increasing 15% in 1983 and declining 10% in 1982. Demand improved for commercial logic, mostly FAST, and aerospace & defense products at Digital and F100K logic and custom gate array products at Memory & High Speed Logic. Worldwide orders were 8% ahead of last year, however, a significant decline occurred during the second half of 1984.

Revenue at Computer Aided Systems increased 18% in 1984 and 4% in 1983. At Sentry and Factron (formerly Component Test Systems and Subassembly Test Systems, respectively) revenue increased 38% and 17%, reflecting continued strong demand for digital and in-circuit test systems. At Applicon and MDSI, revenue was up 2% and 4%, respectively; Benson revenue increased 10% from 1983.

Interest Income

Interest income was $390 million in 1984 as compared to $298 million and $254 million in 1983 and 1982, respectively. The 31% increase in 1984 compared to 1983 was due to increased funds available for investment.

Research & Engineering

Research & engineering expenditures were $393 million, $44 million above 1983 and $67 million higher than 1982. Oilfield Services expenditures for research & engineering totaled $176 million, $157 million and $138 million in 1984, 1983 and 1982, respectively. Measurement, Control & Components spent $217 million, $192 million and $188 million for the same years.

Taxes

On a worldwide basis the effective income tax rate was 25%, 22% and 25% for the years 1984, 1983 and 1982, respectively. The increase in the effective tax rate resulted primarily from a higher proportion of income earned in high tax countries.

The estimated liability for taxes on income provides for taxes on current earnings as well as provisions for income taxes which may be payable in future years depending upon interpretation of tax laws and regulations of taxing authorities in various countries.

Acquisitions

In April 1984, a subsidiary of the Company acquired 50% of the Dowell business in the United States from The Dow Chemical Company and in July 1984 a subsidiary of the Company acquired 50% of Dowell in Canada at a combined cost of $439 million. The acquisitions have been accounted for as purchases and are carried in investments in affiliated companies.

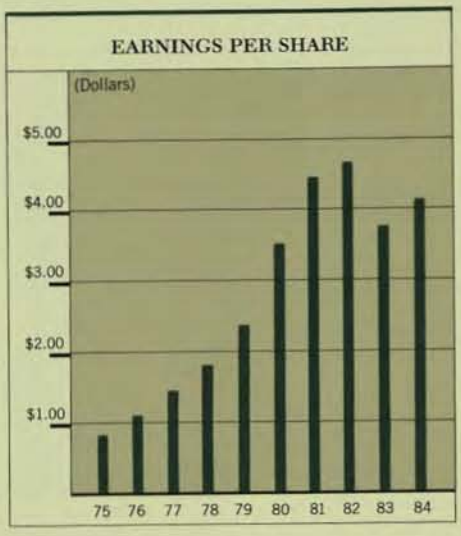
On December 24, 1984, the Company completed the merger of SEDCO, Inc. into a subsidiary of the Company. The cost of the acquisition was $968 million ($482 million in cash and approximately 13 million shares of Schlumberger Common Stock valued at $486 million).

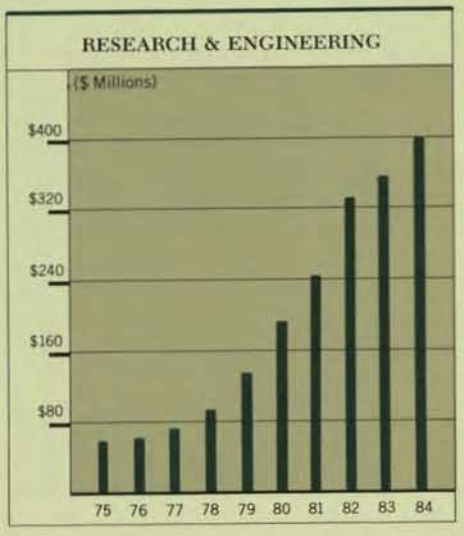
Fixed Assets

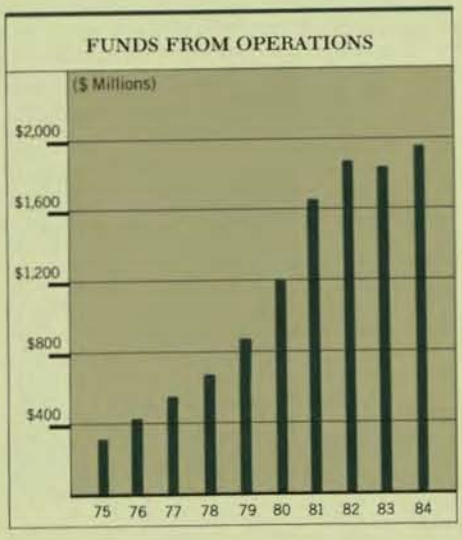
Expenditures for fixed assets in 1984 were $727 million compared to $517 million in 1983.

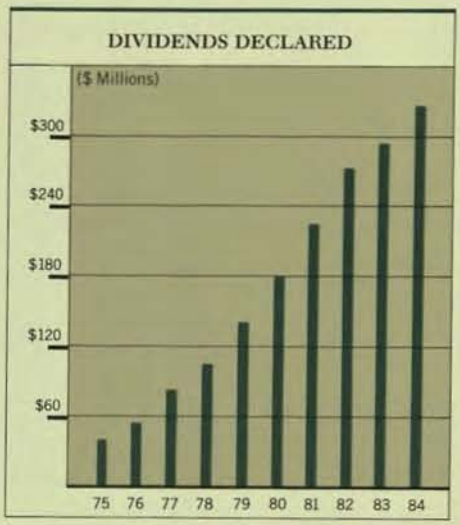
Additions by business sector were as follows:

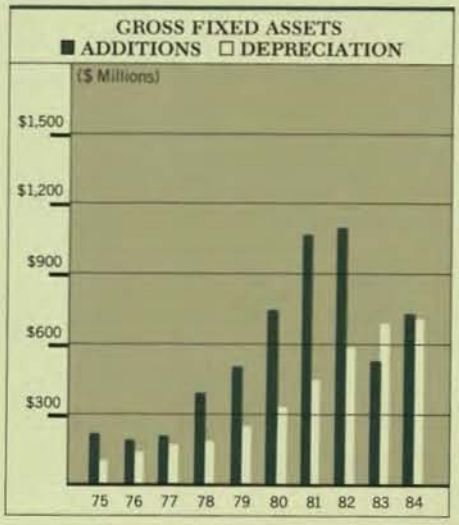
	1984	1983
	(Stated in millions)	
Oilfield Services		
Wireline	**$277**	$234
Drilling & Production Services	**164**	53
	441	287
Measurement, Control & Components		
Measurement & Control	**64**	57
Fairchild	**168**	123
Computer Aided Systems	**42**	44
	274	224
Other	**12**	6
	$727	$517

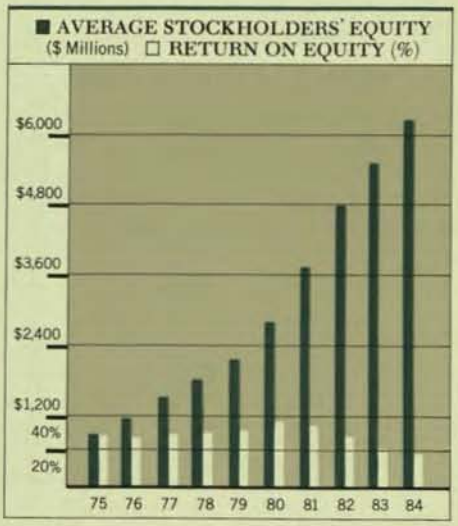












Common Stock, Market Prices and Dividends Declared Per Share

Quarterly high and low prices for the Company's Common Stock as reported by the New York Stock Exchange (composite transactions), together with dividends declared per share in each quarter of 1984 and 1983 were:

	PRICE RANGE HIGH	PRICE RANGE LOW	DIVIDENDS DECLARED
1984			
Quarters			
First	$54⅜	$43⅝	$0.260
Second	55	44	0.260
Third	49¼	37¼	0.300
Fourth	45⅞	35⅞	0.300
1983			
Quarters			
First	$52	$38¼	$0.240
Second	57⅜	40⅜	0.240
Third	62⅝	53¼	0.260
Fourth	56½	44⅝	0.260

The number of holders of record of the Common Stock of the Company at January 4, 1985 was approximately 39,000. There are no legal restrictions on the payment of dividends or ownership or voting of such shares. United States stockholders are not subject to any Netherlands Antilles withholding or other Netherlands Antilles taxes attributable to ownership of such shares.

Financial Position

At year end, working capital was $3.2 billion, $191 million over the prior year; the current ratio was 2.16 to 1.

Liquidity, which represents cash and short-term investments less debt was $2.18 billion and $2.28 billion at December 31, 1984 and 1983, respectively. The decrease of $97 million in liquidity is a result of $970 million of debt issued or assumed with the purchase of 50% of the Dowell business and assets in North America and SEDCO, Inc. compared to $873 million of liquidity generated from operations.

Information on Effects of Changing Prices

The following selected supplementary financial data adjusted for effects of changing prices are presented in compliance with current disclosure requirements. Under these requirements, which are experimental in nature, the information presented represents only a partial restatement of financial statements and the specified inflation index may not necessarily represent the true impact of inflation on the Company. Therefore, this information should not be viewed as a precise measurement of the effects of inflation on the Company and caution should be exercised in using this information to assess the effects of inflation or for comparative evaluations.

The current cost method used below shows the impact on net income that would have occurred if all products sold by the Company were purchased in the current year, and additionally if all fixed assets were completely replaced and depreciated at year-end values. The current cost of fixed assets was calculated using various internally and externally generated price indexes. The current cost amounts of inventory and fixed assets were measured in the functional currency and then translated into U.S. dollars. The effect of general inflation on this information was calculated using indexes which approximate the U.S. CPI(U).

Consolidated Statement of Income Adjusted for Effects of Changing Prices

FOR THE YEAR ENDED	DECEMBER 31, 1984 AS REPORTED	DECEMBER 31, 1984 IN CURRENT COSTS
	(Stated in millions) (In average 1984 dollars, except "As reported" amounts)	
Revenue	$6,370	$6,370
Expenses		
Cost of goods sold and services	3,653	3,837
Interest	153	153
Other	992	995
Taxes on income	390	390
Net income	$1,182	$ 995

Note: At December 31, 1984, the current cost of inventories was $693 million and the current cost of fixed assets net of accumulated depreciation was $3.4 billion. Depreciation expense as reported was $712 million; adjusted for current cost, it amounted to $878 million.

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

YEAR ENDED DECEMBER 31,	1984	1983	1982	1981	1980
	(In average 1984 dollars, except "As reported" amounts; dollar amounts in millions except per share)				
Revenue					
As reported	**$ 6,370**	$ 5,797	$ 6,284	$ 5,978	$ 5,137
Net income					
As reported	**1,182**	1,084	1,348	1,266	994
In current costs	**995**	946	1,307	1,232	1,070
Net income per share					
As reported	**4.10**	3.73	4.60	4.37	3.47
In current costs	**3.45**	3.25	4.46	4.26	3.74
Excess of inflation over current costs	**6**	5	(9)	(5)	101
Net assets at year end*					
As reported	**6,992**	5,819	5,226	4,235	3,218
In current costs	**7,178**	6,294	5,950	5,182	4,450
Average consumer price index	**311.1**	298.4	289.2	272.3	246.8

*Translation adjustment as reported: 1984 — $210 million, 1983 — $140 million, 1982 — $82 million; adjusted for current cost: 1984 — $250 million, 1983 — $185 million, 1982 — $117 million.

Consolidated Balance Sheet
Assets

DECEMBER 31,	1984	1983
		(Stated in thousands)
CURRENT ASSETS		
Cash	**$ 41,349**	$ 21,564
Short-term investments	**3,964,119**	3,167,077
Receivables less allowance for doubtful accounts (1984 — $25,526; 1983 — $27,083)	**1,215,143**	1,089,599
Inventories	**689,748**	602,330
Other current assets	**87,802**	73,181
	5,998,161	4,953,751
INVESTMENTS IN AFFILIATED COMPANIES	**731,964**	267,693
LONG-TERM INVESTMENTS AND RECEIVABLES	**219,982**	111,859
FIXED ASSETS less accumulated depreciation	**3,145,158**	2,621,027
EXCESS OF INVESTMENT OVER NET ASSETS OF COMPANIES PURCHASED less amortization	**760,756**	366,676
OTHER ASSETS	**57,173**	32,233
	$ 10,913,194	$ 8,353,239

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Balance Sheet
Liabilities and Stockholders' Equity

DECEMBER 31,	1984	1983
		(Stated in thousands)
CURRENT LIABILITIES		
Accounts payable and accrued liabilities	$ 942,196	$ 796,320
Estimated liability for taxes on income	890,894	597,584
Bank loans	829,555	441,272
Dividend payable	86,597	75,432
Long-term debt due within one year	27,884	12,955
	2,777,126	1,923,563
LONG-TERM DEBT	965,580	455,259
OTHER LIABILITIES	159,806	140,915
MINORITY INTEREST IN SUBSIDIARIES	18,480	14,652
	3,920,992	2,534,389
STOCKHOLDERS' EQUITY		
Common stock	421,583	359,537
Income retained for use in the business	6,908,246	6,049,223
Treasury stock at cost	(127,472)	(449,967)
Translation adjustment	(210,155)	(139,943)
	6,992,202	5,818,850
	$ 10,913,194	$ 8,353,239

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Statement of Income

YEAR ENDED DECEMBER 31,	1984	1983	1982
			(Stated in thousands)
REVENUE			
Operating	**$ 5,978,552**	$ 5,513,246	$ 6,025,380
Interest and other income	**391,890**	284,213	258,430
	6,370,442	5,797,459	6,283,810
EXPENSES			
Cost of goods sold and services	**3,652,790**	3,388,364	3,478,525
Research & engineering	**393,441**	349,377	326,458
Marketing	**287,480**	270,756	258,875
General	**311,402**	284,347	303,965
Interest	**153,436**	115,578	116,634
Taxes on income	**389,820**	304,738	451,188
	5,188,369	4,713,160	4,935,645
NET INCOME	**$ 1,182,073**	$ 1,084,299	$ 1,348,165
Net income per share	**$ 4.10**	$ 3.73	$ 4.60
Average shares outstanding (thousands)	**288,580**	290,933	293,119

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Statement of Changes in Financial Position

YEAR ENDED DECEMBER 31,	1984	1983	1982
			(Stated in thousands)
SOURCE OF WORKING CAPITAL			
Net income	**$1,182,073**	$1,084,299	$1,348,165
Add (deduct) amounts not affecting working capital			
Depreciation and amortization	**735,276**	692,194	596,044
Earnings of companies carried at equity less dividends received (1984 — $99,000; 1983 — $61,164; 1982 — $15,272)	**77,764**	12,328	(62,390)
Other — net	**(51,460)**	30,910	(20,894)
Working capital provided from operations	**1,943,653**	1,819,731	1,860,925
Value of shares exchanged for SEDCO	**485,745**	—	—
Net worth of Applicon acquired for shares	**—**	—	49,312
Increase in long-term debt	**620,572**	121,380	192,047
Retirement and sale of fixed assets	**59,337**	84,179	51,510
Proceeds from sale of shares to optionees	**9,663**	7,302	9,239
Total working capital provided	**3,118,970**	2,032,592	2,163,033
APPLICATION OF WORKING CAPITAL			
Net noncurrent assets of SEDCO acquired	**1,129,459**	—	—
Purchase of Dowell business and assets in North America	**438,661**	—	—
Increase in excess of investment over net assets of companies purchased	**35,417**	—	104,029
Increase in other long-term investments and receivables	**14,029**	57,233	40,971
Additions to fixed assets	**726,578**	517,030	1,094,334
Dividends declared	**323,050**	290,769	269,626
Reduction of long-term debt	**120,509**	126,033	13,336
Effect of exchange rate changes on working capital	**24,758**	28,114	31,306
Purchases of shares for Treasury	**110,867**	150,483	63,279
Other — net	**4,795**	4,084	12,202
Total working capital applied	**2,928,123**	1,173,746	1,629,083
NET INCREASE IN WORKING CAPITAL	**$ 190,847**	$ 858,846	$ 533,950
INCREASE IN WORKING CAPITAL CONSISTS OF			
Increase (decrease) in current assets			
Cash and short-term investments	**$ 816,827**	$ 866,058	$ 640,395
Receivables	**125,544**	(36,382)	(56,795)
Inventories	**87,418**	(73,765)	63,711
Other current assets	**14,621**	(16,368)	26,532
(Increase) decrease in current liabilities			
Accounts and dividend payable	**(157,041)**	42,611	(76,397)
Estimated liability for taxes on income	**(293,310)**	20,919	4,545
Bank loans and debt due within one year	**(403,212)**	55,773	(68,041)
NET INCREASE IN WORKING CAPITAL	**$ 190,847**	$ 858,846	$ 533,950

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Consolidated Statement of Stockholders' Equity

	COMMON STOCK				TRANSLATION ADJUSTMENT	INCOME RETAINED FOR USE IN THE BUSINESS
	ISSUED		IN TREASURY			
	SHARES	AMOUNT	SHARES	AMOUNT		
						(Dollar amounts in thousands)
Balance, January 1, 1982	302,247,565	$ 307,210	12,978,316	$ 239,889		$ 4,167,312
Translation adjustment, opening					$ (25,561)	
Translation adjustment, 1982					(56,439)	
Purchases for Treasury			1,569,500	63,279		
Issued for Applicon		37,867	(4,005,634)	(1,603)		9,842
Sales to optionees	337,046	7,804	(137,766)	(1,435)		
Net income						1,348,165
Dividends declared ($0.92 per share)						(269,626)
Balance, December 31, 1982	302,584,611	352,881	10,404,416	300,130	(82,000)	5,255,693
Translation adjustment, 1983					(57,943)	
Purchases for Treasury			3,011,000	150,483		
Sales to optionees less shares exchanged	395,170	6,656	(60,425)	(646)		
Net income						1,084,299
Dividends declared ($1.00 per share)						(290,769)
Balance, December 31, 1983	302,979,781	359,537	13,354,991	449,967	(139,943)	6,049,223
Translation adjustment, 1984					(70,212)	
Purchases for Treasury			2,328,000	110,867		
Issued for SEDCO		52,564	(12,996,526)	(433,181)		
Sales to optionees less shares exchanged	391,000	9,482	(17,449)	(181)		
Net income						1,182,073
Dividends declared ($1.12 per share)						(323,050)
Balance, December 31, 1984	303,370,781	$ 421,583	2,669,016	$ 127,472	$ (210,155)	$ 6,908,246

SEE NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Notes to Consolidated Financial Statements

Summary of Accounting Policies

The Consolidated Financial Statements of Schlumberger Limited have been prepared in accordance with accounting principles generally accepted in the United States. Within those principles, the Company's more important accounting policies are set forth below.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of majority-owned subsidiaries. Significant 20%–50% owned companies are carried in investments in affiliated companies on the equity method. The pro rata share of revenue and expenses of 50% owned companies is included in the individual captions in the Consolidated Statement of Income. Schlumberger's pro rata share of after tax earnings of other equity companies is included in interest and other income.

Translation of Non-U.S. Currencies

Effective January 1, 1982, the Company adopted Financial Accounting Standard No. 52–Foreign Currency Translation. Under this method, all assets and liabilities recorded in functional currencies other than U.S. dollars are translated at current exchange rates. The resulting adjustments are charged or credited directly to the Stockholders' Equity section of the balance sheet. Stockholders' Equity has been reduced by $70.2 million, $57.9 million and $56.4 million in 1984, 1983 and 1982, respectively. Revenue and expenses are translated at the weighted average exchange rates for the period.

All transaction gains and losses are included in income in the period in which they occur. Transaction gains included in 1984 net income amounted to $9 million compared to $14 million in 1983 and $11 million in 1982.

Short-Term Investments

Short-term investments are stated at cost plus accrued interest, which approximates market, and comprised mainly U.S. dollar time deposits and U.S. Government obligations.

Inventories

Inventories are stated principally at average or standard cost, which approximates average cost, or at market, if lower.

Fixed Assets and Depreciation

Fixed assets are stated at cost less accumulated depreciation, which is provided for by charges to income over the estimated useful lives of the assets by the straight-line method. Fixed assets include the cost of Company manufactured oilfield technical equipment. Expenditures for renewals, replacements and betterments are capitalized. Maintenance and repairs are charged to operating expenses as incurred. Upon sale or other disposition, the applicable amounts of asset cost and accumulated depreciation are removed from the accounts and the net amount, less proceeds from disposal, is charged or credited to income.

Excess of Investment Over Net Assets of Companies Purchased

Costs in excess of net assets of purchased companies having an indeterminate life are amortized on a straight-line basis over 40 years. Accumulated amortization was $59 million and $48 million at December 31, 1984 and 1983, respectively.

Deferred Benefit Plans

The Company and its subsidiaries have several voluntary pension and other deferred benefit plans covering substantially all officers and employees, including those in countries other than the United States. These plans are substantially fully funded with trustees in respect to past and current services. Charges to expense are based upon costs computed by independent actuaries.

In France, the principal pensions are provided for by union agreements negotiated by all employers within an industry on a nationwide basis. Benefits when paid are not identified with particular employers, but are made from funds obtained through concurrent compulsory contributions from all employers within each industry based on employee salaries. These plans are accounted for on the defined contribution basis and each year's contributions are charged currently to expense.

Taxes on Income

Schlumberger and its subsidiaries compute taxes on income in accordance with the tax rules and regulations of the many taxing authorities where the in-

come is earned. The income tax rates imposed by these taxing authorities vary substantially. Taxable income may differ from pretax income for financial accounting purposes. To the extent that differences are due to revenue or expense items reported in one period for tax purposes and in another period for financial accounting purposes, an appropriate provision for deferred income taxes is made. The provisions were not significant in 1984, 1983 or 1982.

Approximately $6.5 billion of consolidated income retained for use in the business at December 31, 1984 represented undistributed earnings of consolidated subsidiaries and Schlumberger's pro rata share of 20%–50% owned companies. It is the policy of the Company to reinvest substantially all such undistributed earnings and, accordingly, no provision is made for deferred income taxes on those earnings considered to be indefinitely reinvested.

Investment credits and other allowances provided by income tax laws of the United States and other countries are credited to current income tax expense on the flow-through method of accounting.

Net Income Per Share

Net income per share is computed by dividing net income by the average number of common shares outstanding during the year.

Research & Engineering

All research & engineering expenditures are expensed as incurred, including costs relating to patents or rights which may result from such expenditures.

Acquisitions

In April 1984, a subsidiary of the Company acquired 50% of the Dowell business and assets in the United States from The Dow Chemical Company and in July 1984, a subsidiary of the Company acquired 50% of the Canadian operation of Dowell at a combined cost of $439 million. Dowell Schlumberger provides cementing, stimulation and other oilfield services. The acquisitions have been accounted for as purchases and are carried in investments in affiliated companies, including cost in excess of the fair values of the net assets acquired amounting to $196 million which is being amortized on a straight-line basis over 40 years. The pro rata share of revenue and expenses, from the dates of acquisition, is included in the individual captions in the Consolidated Statement of Income.

On December 24, 1984, a subsidiary of the Company acquired SEDCO, Inc., an offshore drilling contractor operating mainly outside the United States, at a total cost of $968 million ($482 million in cash and approximately 13 million shares of Schlumberger Common Stock valued at $486 million). The acquisition has been accounted for as a purchase and the accounts of SEDCO have been consolidated with those of Schlumberger effective December 31, 1984 after assigning estimated fair values to the individual assets acquired and liabilities assumed. Cost in excess of net assets acquired is currently estimated at $372 million which will be amortized on a straight-line basis over 40 years.

If these acquisitions had taken place on January 1, 1983, the consolidated pro forma unaudited results of Schlumberger would have been:

YEAR ENDED DECEMBER 31,	1984	1983
	(Stated in millions)	
Revenue	$7,035	$6,727
Net income	$1,236	$1,117
Net income per share (dollars)	$ 4.10	$ 3.68
Average shares outstanding (thousands)	301,577	303,930

Fixed Assets

A summary of fixed assets follows:

DECEMBER 31,	1984	1983
	(Stated in millions)	
Land	$ 81	$ 66
Buildings & improvements	722	644
Machinery and equipment	4,990	4,068
Total cost	5,793	4,778
Less accumulated depreciation	2,648	2,157
	$3,145	$2,621

Estimated useful lives of buildings & improvements range from 8 to 50 years and of machinery and equipment from 2 to 15 years.

Investments in Affiliated Companies

Investments in affiliated companies at December 31, 1984 comprised mainly the Company's 50% investment in the worldwide Dowell Schlumberger business which aggregated $610 million and investments in 50% owned companies acquired through the acquisition of SEDCO. The excess of the Company's investment in all 50% owned affiliated companies over its underlying equity is $261 million, representing primarily the goodwill arising from the acquisition of 50% of the Dowell business and assets in North America.

Combined financial data for all 50% owned affiliated companies are as follows:

DECEMBER 31,	1984
	(Stated in millions)
Current assets	$ 683
Fixed assets	1,039
Other assets	29
	$1,751
Liabilities	$ 857
Equity	894
	$1,751

Equity in undistributed earnings of all 50% owned companies, since acquisition, at December 31, 1984 and 1983, amounted to $172 million and $238 million, respectively.

Long-Term Debt

Long-term debt consisted of the following:

DECEMBER 31,	1984	1983
	(Stated in millions)	
Bank loan due 1990, interest at money market based rates	$800	$350
Other bank loans	166	105
	$966	$455

Long-term debt at December 31, 1984 is payable principally in U.S. dollars and is due $46 million in 1986, $26 million in 1987, $35 million in 1988, $16 million in 1989 and $843 million thereafter.

Lines of Credit

The Company's principal U.S. subsidiary has a Revolving Credit Agreement with a group of banks. The

agreement provides that the subsidiary may borrow up to $1.2 billion until December 31, 1990 at money market based rates, of which $800 million was outstanding as of December 31, 1984. In addition, at December 31, 1984, the Company had available unused short-term lines of credit of $258 million.

Capital Stock

The Company is authorized to issue 500,000,000 shares of Common Stock, par value $.01 per share, of which 300,701,765 and 289,624,790 shares were outstanding on December 31, 1984 and 1983, respectively. The Company is also authorized to issue 200,000,000 shares of cumulative Preferred Stock, par value $.01 per share, which may be issued in series with terms and conditions determined by the Board of Directors. No shares of Preferred Stock have been issued. Holders of Common Stock and Preferred Stock are entitled to one vote for each share of stock held.

Options to officers and key employees to purchase shares of the Company's Common Stock were granted at prices equal to 100% of fair market value at date of grant.

Transactions under stock option plans were as follows:

	NUMBER OF SHARES	OPTION PRICE PER SHARE
Outstanding Jan. 1, 1983	3,060,635	$ 1.57–74.82
Granted	1,023,550	$43.75–56.88
Exercised	(631,044)	$ 1.57–54.67
Lapsed or terminated	(226,038)	$ 1.57–74.64
Outstanding Dec. 31, 1983	3,227,103	$ 1.57–74.82
Granted	1,744,800	$37.38–51.38
Exercised	(555,005)	$ 1.57–43.75
Lapsed or terminated	(400,304)	$ 2.09–74.82
Outstanding Dec. 31, 1984	4,016,594	$ 2.09–74.72
Exercisable at Dec. 31, 1984	1,120,165	$ 2.09–74.72
Available for grant Dec. 31, 1983	10,913,635	
Dec. 31, 1984	9,509,329	

Income Tax Expense

The Company is incorporated in the Netherlands Antilles where it is subject to an income tax rate of 3%. The Company and its subsidiaries operate in over 100 taxing jurisdictions with statutory rates ranging up to about 50%. Consolidated operating revenue of $6.0 billion in 1984 shown elsewhere in this report includes $2.5 billion derived from operations within the United States. On a worldwide basis, the Company's effective income tax rate was 25% in 1984, 22% in 1983 and 25% in 1982.

Leases and Lease Commitments

Total rental expense was $159 million in 1984, $144 million in 1983 and $149 million in 1982. Future minimum rental commitments under noncancelable leases for years ending December 31 are: 1985 – $74 million; 1986 – $63 million; 1987 – $50 million; 1988 – $40 million; and 1989 – $29 million. For the ensuing three five-year periods, these commitments decrease from $60 million to $13 million. The minimum rentals over the remaining terms of the leases aggregate $11 million.

Tax Assessments

The U.S. Internal Revenue Service has completed its examinations for the years 1970 through 1978 and, as previously reported, has proposed assessments based upon income from continuing Wireline operations on the outer continental shelf. Similar assessments are expected for years subsequent to 1978. The Company is contesting these assessments. A trial has been scheduled in the U.S. District Court in Houston for the years 1970 through 1975.

Management is of the opinion that the reserve for estimated liability for taxes on income is adequate and that any adjustments which may ultimately be determined will not materially affect the financial position or results of operations.

Contingencies

During 1980, a floating hotel, the Alexander Kielland, functioning as a dormitory for offshore work crews in the North Sea, capsized in a storm. The substructure of the floating hotel had been originally built as a drilling rig by an independent shipyard from a design licensed by a subsidiary of the Company. The Company's subsidiary was not involved in the ownership or operation of the drilling rig or in its conversion or use as a floating hotel. The accident has been investigated by a Commission appointed by the Norwegian Government, which has published its report. In October of 1981 and in February of 1982, the Company's subsidiary, the independent shipyard and one of its subcontractors were sued in France by Phillips Petroleum Company Norway and eight others operating as a group in the Ekofisk Field in the North Sea and by the Norwegian insurers of the Alexander Kielland seeking recovery for losses resulting from the accident of approximately $75 million (at December 31, 1984 currency exchange rates).

While the Company does not believe it has liability in this matter, the litigation will involve complex international issues which could take several years to resolve and involve substantial legal and other costs. In the opinion of the Company, any liability that might ensue would not be material in relation to its financial position or results of operations.

In 1981, a solvent tank failure was discovered at a Fairchild Semiconductor manufacturing plant in South San Jose, California. The failure allegedly contaminated soil and ground water. Legal actions claiming actual and punitive damages in an unspecified amount resulting from the failure are pending. The Company does not believe it has any material liability in this matter.

Pension and Deferred Benefit Plans

Expense for pension and deferred benefit plans was $104 million, $90 million and $90 million, and for compulsory contributions for French retirement benefits was $17 million, $20 million and $24 million in 1984, 1983 and 1982, respectively.

Actuarial present value of accumulated benefits at January 1, 1984 and 1983 for U.S. and Canadian defined benefit plans was $235 million and $201 million, respectively, substantially all of which were vested. Net assets available for benefits at January 1, 1984 and 1983 for such plans were $326 million and $276 million, respectively. The assumed rate of return used in determining the actuarial present value of accumulated plan benefits for 1984 and 1983 was 7%.

The Company's business comprises two segments: (1) Oilfield Services and (2) Measurement, Control & Components. The Oilfield Services segment offers wellsite services to the petroleum industry throughout the world. The Measurement, Control & Components segment provides computer-aided design, manufacturing and testing services, and manufactures measurement and control products and electronic components, which are sold to public utilities, governments, laboratories and industrial plants primarily in the U.S. and Europe. Services and products are described in more detail earlier in this report.

Financial information for the years ended December 31, 1984, 1983 and 1982 by industry segment and by geographic area is as follows:

Segment Information

	OILFIELD SERVICES	MEASUREMENT, CONTROL & COMPONENTS	ADJUST. AND ELIM.	CONSOLIDATED
				(Stated in millions)
INDUSTRY SEGMENT 1984				
Operating revenue				
Customers	$ 3,617	$ 2,362	$ —	$ 5,979
Intersegment transfers	—	30	(30)	—
	$ 3,617	$ 2,392	$ (30)	$ 5,979
Operating income	$ 1,170	$ 161	$ 10	$ 1,341
Interest expense				(153)
Interest and other income less other charges — $7				384
Income before taxes				$ 1,572
Depreciation expense	$ 554	$ 155	$ 3	$ 712
Fixed asset additions	$ 441	$ 274	$ 12	$ 727
At December 31				
Identifiable assets	$ 4,473	$ 2,338	$ (91)	$ 6,720
Corporate assets				4,193
Total assets				$ 10,913
INDUSTRY SEGMENT 1983				
Operating revenue				
Customers	$ 3,414	$ 2,099	$ —	$ 5,513
Intersegment transfers	—	55	(55)	—
	$ 3,414	$ 2,154	$ (55)	$ 5,513
Operating income	$ 1,187	$ 61	$ (23)	$ 1,225
Interest expense				(116)
Interest and other income less other charges — $4				280
Income before taxes				$ 1,389
Depreciation expense	$ 540	$ 136	$ 2	$ 678
Fixed asset additions	$ 287	$ 224	$ 6	$ 517
At December 31				
Identifiable assets	$ 2,900	$ 2,239	$ (95)	$ 5,044
Corporate assets				3,309
Total assets				$ 8,353
INDUSTRY SEGMENT 1982				
Operating revenue				
Customers	$ 4,054	$ 1,971	$ —	$ 6,025
Intersegment transfers	—	131	(131)	—
	$ 4,054	$ 2,102	$ (131)	$ 6,025
Operating income	$ 1,656	$ 34	$ (18)	$ 1,672
Interest expense				(117)
Interest and other income less other charges — $14				244
Income before taxes				$ 1,799
Depreciation expense	$ 483	$ 99	$ 2	$ 584
Fixed asset additions	$ 802	$ 289	$ 3	$ 1,094
At December 31				
Identifiable assets	$ 3,242	$ 2,325	$ (95)	$ 5,472
Corporate assets				2,374
Total assets				$ 7,846

Transfers between segments and geographic areas are for the most part made at regular prices available to unaffiliated customers. Certain Oilfield Services segment fixed assets are manufactured within that segment and some are supplied by Measurement, Control & Components.

Corporate assets largely comprise short-term investments.

During the years ended December 31, 1984, 1983 and 1982 neither sales to any government nor sales to any single customer exceeded 10% of consolidated operating revenue.

	WESTERN HEMISPHERE		EASTERN HEMISPHERE			ADJUST. AND ELIM.	CONSOL-IDATED
	U.S.	OTHER	FRANCE	OTHER EUROPEAN	OTHER		
GEOGRAPHIC AREA 1984							(Stated in millions)
Operating revenue							
Customers	$ 2,113	$ 750	$ 573	$ 981	$ 1,562	$ —	$ 5,979
Interarea transfers	361	7	161	61	471	(1,061)	—
	$ 2,474	$ 757	$ 734	$ 1,042	$ 2,033	$(1,061)	$ 5,979
Operating income	$ 210	$ 231	$ 45	$ 296	$ 581	$ (22)	$ 1,341
Interest expense							(153)
Interest and other income less other charges — $7							384
Income before taxes							$ 1,572
At December 31							
Identifiable assets	$ 2,979	$ 843	$ 625	$ 985	$ 1,527	$ (239)	$ 6,720
Corporate assets							4,193
Total assets							$10,913
GEOGRAPHIC AREA 1983							
Operating revenue							
Customers	$ 1,652	$ 712	$ 619	$ 867	$ 1,663	$ —	$ 5,513
Interarea transfers	300	9	147	22	389	(867)	—
	$ 1,952	$ 721	$ 766	$ 889	$ 2,052	$ (867)	$ 5,513
Operating income	$ 81	$ 191	$ 35	$ 255	$ 681	$ (18)	$ 1,225
Interest expense							(116)
Interest and other income less other charges — $4							280
Income before taxes							$ 1,389
At December 31							
Identifiable assets	$ 1,957	$ 585	$ 650	$ 677	$ 1,354	$ (179)	$ 5,044
Corporate assets							3,309
Total assets							$ 8,353
GEOGRAPHIC AREA 1982							
Operating revenue							
Customers	$ 1,796	$ 884	$ 632	$ 824	$ 1,889	$ —	$ 6,025
Interarea transfers	421	10	231	11	358	(1,031)	—
	$ 2,217	$ 894	$ 863	$ 835	$ 2,247	$(1,031)	$ 6,025
Operating income	$ 255	$ 320	$ 63	$ 229	$ 799	$ 6	$ 1,672
Interest expense							(117)
Interest and other income less other charges — $14							244
Income before taxes							$ 1,799
At December 31							
Identifiable assets	$ 2,135	$ 648	$ 724	$ 651	$ 1,504	$ (190)	$ 5,472
Corporate assets							2,374
Total assets							$ 7,846

Supplementary Information

Operating revenue and related cost of goods sold and services comprised the following:

YEAR ENDED DECEMBER 31,	1984	1983	1982
		(Stated in millions)	
Operating revenue			
Sales	**$2,499**	$2,140	$2,045
Services	**3,480**	3,373	3,980
	$5,979	$5,513	$6,025
Direct operating costs			
Goods sold	**$1,561**	$1,443	$1,383
Services	**2,092**	1,945	2,096
	$3,653	$3,388	$3,479

The caption "Interest and other income" includes interest income, principally from short-term investments, of $390 million, $298 million and $254 million for 1984, 1983 and 1982, respectively.

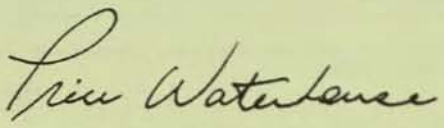
Accounts payable and accrued liabilities are summarized as follows:

DECEMBER 31,	1984	1983
	(Stated in millions)	
Payroll, vacation and employee benefits	**$268**	$237
Trade	**320**	251
Other	**354**	308
	$942	$796

Report of Independent Accountants

To the Board of Directors and Stockholders
of Schlumberger Limited:

In our opinion, the accompanying consolidated balance sheet and the related consolidated statements of income, stockholders' equity and of changes in financial position present fairly the financial position of Schlumberger Limited and its subsidiaries at December 31, 1984 and 1983, and the results of their operations and the changes in their financial position for each of the three years in the period ended December 31, 1984, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements 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.



New York, New York
February 6, 1985

Quarterly Results (Unaudited)

The following table summarizes results for each of the four quarters for the years ended December 31, 1984 and 1983:

	OPERATING REVENUE	OPERATING GROSS PROFIT*	NET INCOME AMOUNT	NET INCOME PER SHARE
			(Stated in millions)	(Dollars)
Quarters — 1984				
First	$ 1,404	$ 566	$ 274	$ 0.95
Second	1,466	568	292	1.01
Third	1,516	587	305	1.06
Fourth	1,593	605	311	1.08
	$ 5,979	$ 2,326	$ 1,182	$ 4.10
Quarters — 1983				
First	$ 1,417	$ 545	$ 259**	$ 0.89**
Second	1,355	549	286	0.98
Third	1,337	530	279	0.96
Fourth	1,404	501	260	0.90
	$ 5,513	$ 2,125	$ 1,084	$ 3.73

*Operating revenue less cost of goods sold and services.

**Includes unusual items with a net after-tax effect of $28 million, 10 cents per share; they include the anticipated cost of closing the South San Jose manufacturing facility at Fairchild, the provision for a loss on the disposal of Accutest, only partially offset by foreign exchange gains.

Five Year Summary

YEAR ENDED DECEMBER 31,	1984	1983	1982	1981	1980*
					(Amounts in millions except per share amounts)
SUMMARY OF OPERATIONS					
Revenue:					
Oilfield Services	**$ 3,617**	$ 3,414	$ 4,054	$ 3,788	$ 2,814
Measurement, Control & Components	**2,362**	2,099	1,971	1,995	2,070
Interest and other income	**391**	284	259	195	153
Gain on sale of Rowan shares	**—**	—	—	—	100
	$ 6,370	$ 5,797	$ 6,284	$ 5,978	$ 5,137
% Increase (decrease) over prior year	**10%**	(8%)	5%	16%	41%
Cost of goods sold and services	**$ 3,653**	$ 3,388	$ 3,479	$ 3,244	$ 2,813
Operating income:					
Oilfield Services	**$ 1,170**	$ 1,187	$ 1,656	$ 1,702	$ 1,184
Measurement, Control & Components	**161**	61	34	131	230
Eliminations	**10**	(23)	(18)	(25)	(14)
	$ 1,341	$ 1,225	$ 1,672	$ 1,808	$ 1,400
% Increase (decrease) over prior year	**9%**	(27%)	(8%)	29%	42%
Interest expense	**$ 153**	$ 116	$ 117	$ 108	$ 102
Taxes on income	**$ 390**	$ 305	$ 451	$ 580	$ 522
Net income	**$ 1,182**	$ 1,084	$ 1,348	$ 1,266	$ 994
% Increase (decrease) over prior year	**9%**	(20%)	6%	27%	51%
Per common share:					
Net income	**$ 4.10**	$ 3.73	$ 4.60	$ 4.37	$ 3.47
Cash dividends declared	**$ 1.12**	$ 1.00	$ 0.92	$ 0.77	$ 0.63
SUMMARY OF FINANCIAL DATA					
Net income as % of revenue	**19%**	19%	21%	21%	19%
Return on average stockholders' equity	**19%**	20%	28%	34%	36%
Fixed asset additions	**$ 727**	$ 517	$ 1,094	$ 1,063	$ 748
Depreciation expense	**$ 712**	$ 678	$ 584	$ 433	$ 323
Average number of shares outstanding	**289**	291	293	289	286
AT DECEMBER 31,**					
Working capital	**$ 3,221**	$ 3,030	$ 2,171	$ 1,637	$ 1,249
Total assets	**$ 10,913**	$ 8,353	$ 7,846	$ 6,525	$ 5,242
Long-term debt	**$ 966**	$ 455	$ 462	$ 278	$ 238
Stockholders' equity	**$ 6,992**	$ 5,819	$ 5,226	$ 4,235	$ 3,218

*Net income includes $70 million after-tax gain ($0.24 per share) on sale of Rowan shares.
**The December 31, 1984 balance sheet includes SEDCO which was acquired in December 1984.

DIRECTORS

DON E. ACKERMAN°
Partner, J.H. Whitney & Co.
New York City

ROBERT A. CHARPIE*
President, Cabot Corporation
Boston, Massachusetts

ROLAND GENIN*
Chairman of the Executive Committee
Schlumberger

BERNARD HANON
Former Chief Executive Officer
Régie Renault, Paris

GEORGE H. JEWELL°
Partner, Baker & Botts, attorneys
Houston, Texas

PAUL LEPERCQ*□
Managing Director
Lepercq International N.V.
London

GEORGES DE MENIL
Economist, Professor
Ecole des Hautes Etudes
en Sciences Sociales, Paris

JEAN RIBOUD*□
Chairman and Chief Executive Officer
Schlumberger

FELIX G. ROHATYN*□
General Partner, Lazard Frères & Co.
New York City

PIERRE MARCEL SCHLUMBERGER°
Attorney, Houston, Texas

NICOLAS SEYDOUX
Chairman and Chief Executive Officer
Gaumont, Paris

RICHARD R. SHINN°□
Former Chairman and Chief Executive
Officer, Metropolitan Life Insurance
Company, New York City

MICHEL VAILLAUD*
President and Chief Operating Officer
Schlumberger

JEROME B. WIESNER*
Institute Professor, President Emeritus
Massachusetts Institute of Technology
Cambridge, Massachusetts

OFFICERS

JEAN RIBOUD
Chairman and Chief Executive Officer

MICHEL VAILLAUD
President and Chief Operating Officer

ROLAND GENIN
Chairman of the Executive Committee

ARTHUR LINDENAUER
Executive Vice President and
Chief Financial Officer

D. EUAN BAIRD
Executive Vice President

DONALD W. BROOKS
Executive Vice President

B. GILL CLEMENTS
Executive Vice President

MICHEL GOUILLOUD
Executive Vice President

JIMMY G. LEE
Executive Vice President

RENE MITIEUS
Executive Vice President

ROY R. SHOURD
Executive Vice President

DAVID S. BROWNING
Secretary and General Counsel

JEAN BABAUD
Vice President

VICTOR E. GRIJALVA
Vice President

ALLEN D. KLEIN
Vice President

ANDRE MISK
Vice President

PATRICK J.B. CORSER
Treasurer

WILLIAM W. DUNN
Controller

ANDRE LALOUX
Assistant Secretary

JAMES A. MACKENZIE
Assistant Secretary

THOMAS O. ROSE
Assistant Secretary

In 1984, the following officers were elected:

Donald W. Brooks, Executive Vice President, responsible for Fairchild Semiconductor operations worldwide.

B. Gill Clements, Executive Vice President.

Patrick J.B. Corser, Treasurer.

At its February 14, 1985 meeting, the Board of Directors nominated William Clements, Jr. and Yoshihiko Morozumi for election as Directors at the shareholders' meeting to be held May 7, 1985.

Bill Clements is the founder and former Chairman of SEDCO. He was governor of Texas for four years.

Yoshihiko Morozumi is Chairman of the Schlumberger companies in Japan. He was Vice Minister of the Ministry of International Trade and Industry (MITI) and more recently, Chairman of Japan Electric Power Development Company.

Viscount Trenchard of Wolfeton was elected Chairman of Schlumberger Measurement & Control (U.K.) Ltd. Lord Trenchard spent thirty years with Unilever, where he was Executive Director, and more recently was Minister of State at the Department of Industry and later at the Ministry of Defence, in the British Government.

° Member Audit Committee
* Member Executive Committee
□ Member Finance Committee

Schlumberger

OILFIELD SERVICES

WIRELINE SERVICES

Measurements of physical properties of underground formations to help locate and define oil and gas reservoirs and assist in the completion, development and production phases of oil wells. Measurements are made by lowering electronic instruments in the wells at the end of an electric cable called the "wireline".

DRILLING & PRODUCTION SERVICES

Drilling Services
Forex Neptune: drilling on land and offshore.
Anadrill: well-site computer analysis of surface and downhole drilling data; directional drilling services.

Testing and Completion Services
Flopetrol Johnston: well testing; pressure measurements; completion and workover services; production services; drilling tool rentals.

Pumping Services
Dowell Schlumberger (50% owned): cementing and well stimulation.

MEASUREMENT, CONTROL & COMPONENTS

MEASUREMENT & CONTROL

Electricity Management: electricity meters and equipment for electric power distribution; network protection systems, measuring transformers.

Water and Gas Metering: water meters and distribution systems; gas meters and distribution systems.

Instruments: magnetic tape data recorders; data acquisition systems; electronic instruments; radar simulators; training systems; industrial data logging and telemetry systems; transducers.

Paymatec: electronic payment systems, smart cards; gasoline pumps; time control devices.

Fairchild Weston Systems: data acquisition; signal processing and electronic countermeasures systems; controls for nuclear power systems.

Control, Valves and Technology: process control equipment; petroleum, nuclear and industrial valves.

FAIRCHILD SEMICONDUCTOR

Digital: digital logic including FAST and low-power Schottky products.

Memory & High Speed Logic: computer memory products including PROMS and static RAMS and high-speed 100K ECL Logic products.

Analog: linear, small signal, hybrids, telecommunications and computer interface products.

Micrologic: microprocessors, gate arrays and CCD imaging products.

COMPUTER AIDED SYSTEMS

Sentry: computer controlled systems for testing semiconductors.

Factron: computer controlled systems for testing printed-circuit board subassemblies.

Applicon: computer aided design and manufacturing (CAD/CAM) systems.

MDSI: computer aided manufacturing (CAM), computer based systems to translate parts descriptions into instructions for numerically controlled machine tools.

Benson: computer aided drafting products including pen and electrostatic plotters.

STOCK TRANSFER AGENTS
Morgan Guaranty Trust Co.
New York, New York

MBank Houston, N.A.
Houston, Texas

REGISTRARS
Morgan Guaranty Trust Co.
New York, New York

MBank Houston, N.A.
Houston, Texas

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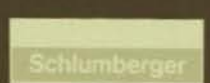

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