

PANACOLOR

INC.

1961 Annual Report

This is PANACOLOR

The Panacolor Process is a film printing method, exclusive with your Company,* which, in a fully-automatic and continuous 3-stage printing and chemical process, produces color movie release prints ready for exhibition.

This Process is a photographic printing system producing color film of the highest quality. It is the only process which reproduces color images on black and white positive film stock, which materially reduces production costs.

Color fidelity is maintained at the same time film is being printed since our process has the unique feature of permitting easy and rapid adjustments of color values and scene-to-scene light densities.

* U. S. Patent #2,886,435 granted May 12, 1959; other Patent Applications pending.



PANACOLOR, INC.

6660 Santa Monica Blvd.
Hollywood 38, Calif.

100 E. 42nd St.
New York 17, N. Y.

DIRECTORS

HARRY HARRIS
HARRY E. ELLER
MORTIMOR S. GORDON

HERMAN KELLER
A. JACK AVERICK
HYMAN L. FEDERMAN

OFFICERS

HARRY HARRIS *Chairman of the Board and Treasurer*
HARRY E. ELLER *President*
MORTIMOR S. GORDON *Chairman of the Finance Committee*
LEO J. NICASTRO *Vice President in Charge of Production*
H. L. BAUMBACH *Vice President in Charge of Research and Engineering*
HERMAN KELLER *Secretary*
ADOLPH H. GRAETZ *Assistant Treasurer*
JAMES V. JOY, JR. *Assistant Secretary*

Counsel

GORDON, BRADY, CAFFREY & KELLER
New York, N. Y.

Certified Public Accountants

ALFRED R. BACHRACH & Co.
New York, N. Y.

Transfer Agent

THE MARINE MIDLAND TRUST COMPANY OF NEW YORK
New York, N. Y.

To the Shareholders:

On February 1, 1961 following completion of preliminary engineering and development work, the Company began construction of its first commercial production unit which embodied an entirely new concept of producing color film, and the installation of additional facilities and auxiliary equipment at its building located at 6660 Santa Monica Boulevard, Hollywood, California.

We are proud to announce that on March 1, 1962 only 13 months later, the installation was completed and our first color film processing unit, which was specially designed, engineered and constructed, was ready for commercial production of 35-millimeter film by the Panacolor process. Our plant is equipped not only for the original unit but for three additional units which are planned for this plant. Construction of a second unit is already well under way and it is expected that it will be completed by mid-1962. The unit now being constructed and each subsequent unit will be capable of producing either 35-millimeter film or 16-millimeter film interchangeably. The first unit has passed various tests to determine its capacity to run continuously for a minimum of 16 hours per day, 5 days per week and we are satisfied that we can produce, on a continuous basis, film of the highest quality at the original estimate of 200 feet per minute for 35-millimeter film, and 400 feet per minute for 16-millimeter film when additional units are put into service.

The Company's immediate objective is to complete four processing units which will have an aggregate capacity of approximately 160 million feet of film per annum, and all engineering, planning and installation of equipment has been done on this basis.

An integral part of the Panacolor process is the temperature and humidity control system which was specially designed and constructed for the Company's operations. Originally it was planned to install equipment which initially would service only the first processing unit, and then as other units were constructed and put into operation, would be expanded to control each particular unit. As construction of the first unit began, it became evident that it would be more advantageous to install a system in the first instance which would be capable of

controlling all processing units. Although the installation of the over-all system increased the Company's budget for current capital expenditures, it was judged that a complete installation at one time would be, in the long run, less costly and less disruptive of future production. Accordingly, installation of the entire system was undertaken and was completed at approximately the same time as the production unit. As a result of this step further processing units can be installed and integrated into the system economically and, more importantly, without interruption of production. This system, by means of electronic controls, maintains temperature (plus or minus $\frac{1}{2}$ degree) and humidity (plus or minus 2 $\frac{1}{2}$ %) at the close tolerances which are vital in maintaining constant film size for registration printing; for supplying washed and filtered air and for removing dirt particles as small as micron in size.

Other facilities installed were a chemical mix room, testing laboratory and machine shop, which ultimately will be used as a maintenance and development shop; existing electrical, water and gas facilities were modified and expanded to fit the Company's requirements. Specialized equipment to produce working negatives, mats, timing and color balancing and projection as well as other ancillary equipment were also installed and tested. Modern electronic controls and devices were incorporated to insure maximum quality with minimum waste. Many of the departments referred to are shown in this report.

The Panacolor process uses thick solutions which are continuously coated on the surface of the film instead of immersing the film in tanks of solutions as used by other systems. This results in a more consistent product. The thickened chemical solutions are mixed in specially designed stainless steel and polyethylene mixing vats with counter rotating agitators. Once prepared, the solutions are pumped to the various coating stations of the processing unit where the correct amount of material is metered to an applicator of special design (patents pending). Each dye has its own separate mixing vat to eliminate the possibility of color contamination. The chemical mix room is shown on page 6.

The Company's testing laboratory contains re-

ording spectrophotometer for analysis of dyes, recording voltmeters for printing voltage control, color densitometers for product density and contrast analysis and control, electronic brightness meters for printer control, toolmakers microscope for registration checks, viscosimeters for chemical control, pH meters and other chemical analytical equipment. The testing laboratory is shown on page 6.

The Company has been successful in attracting top level engineers and technicians and a loyal and dedicated organization has been assembled whose background, training and experience in the color film industry aided the Company in its achievements and should enable it to exploit its full potential. A separate section of this report is devoted to pictures and biographies of these men whose dedication to the Company and its affairs has been unusual and noteworthy.

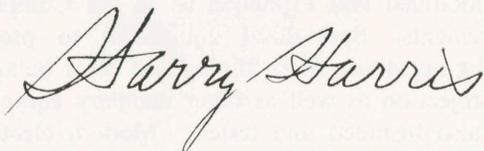
The Company is building up a sales organization to develop the potential market for the Company's services and products in the motion picture and T.V.

industry and in governmental, military, commercial, educational and religious fields.

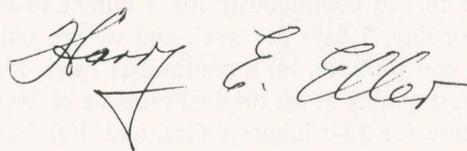
In June, 1961 the Company's public offering of Common Stock was made and the Company received net proceeds of approximately \$652,000. On July 11, 1961 the Company, pursuant to an agreement entered into on May 8, 1961, sold to Metro-Goldwyn-Mayer Inc. 50,000 shares of Common Stock for \$200,000 and also granted options, ranging from two to three years, to purchase 50,000 shares of Common Stock at \$7.50 per share and 50,000 shares of Common Stock at \$10.00 per share.

The past fiscal year has been a most significant one in the Company's history. We are justly proud of the progress the Company has made and we are looking toward the future and to the fulfillment of the great promise which the Panacolor process holds out.

We wish to express our thanks to the officers and directors of the Company and to our employees and our shareholders for their contribution to the great strides the Company made during 1961.

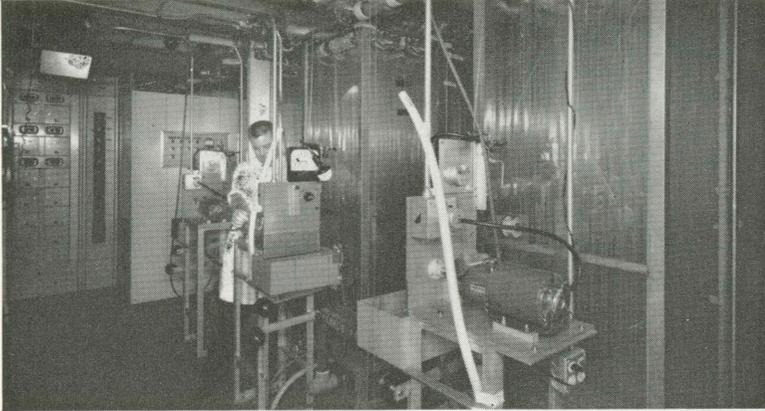


Chairman of the Board

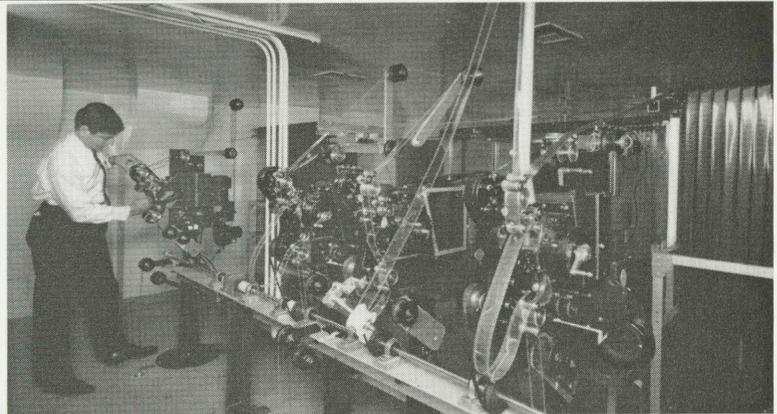


President

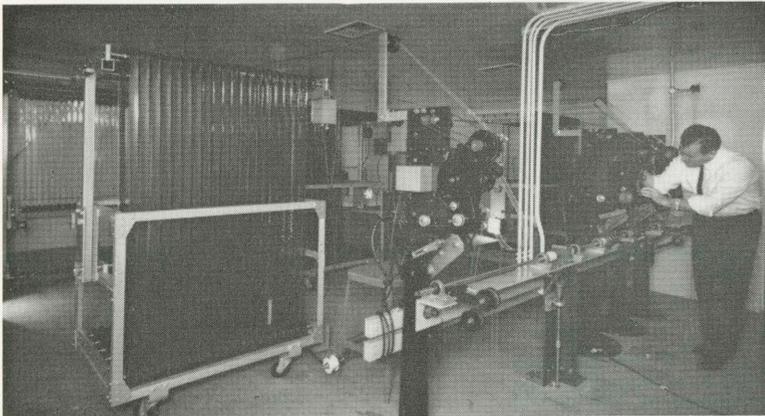
May 4, 1962



CONTINUOUS PROCESSOR



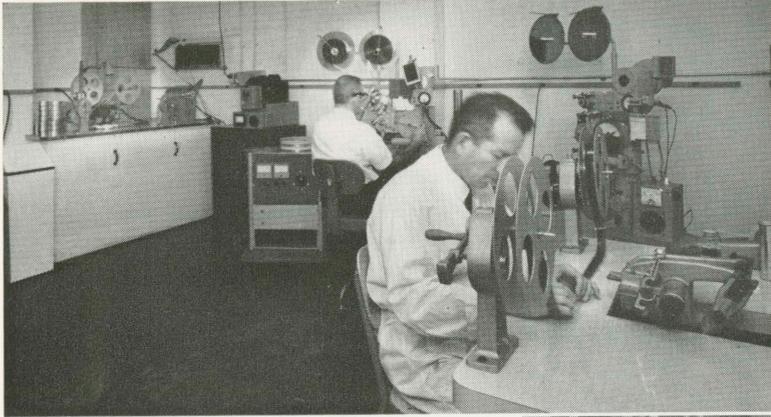
CONTINUOUS PROCESSOR



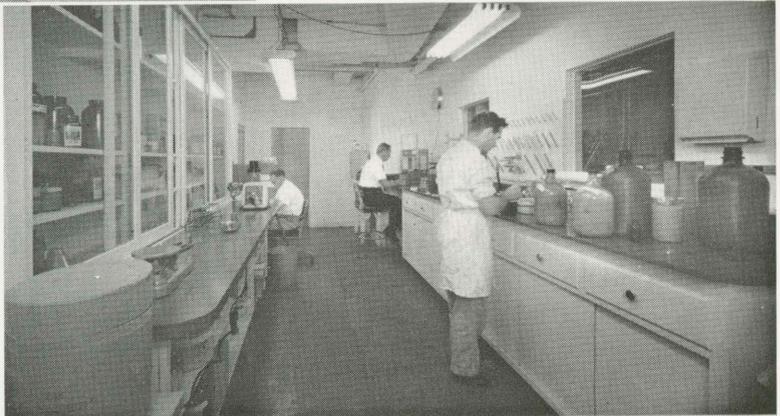
CONTINUOUS PROCESSOR



NEGATIVE PRINTING



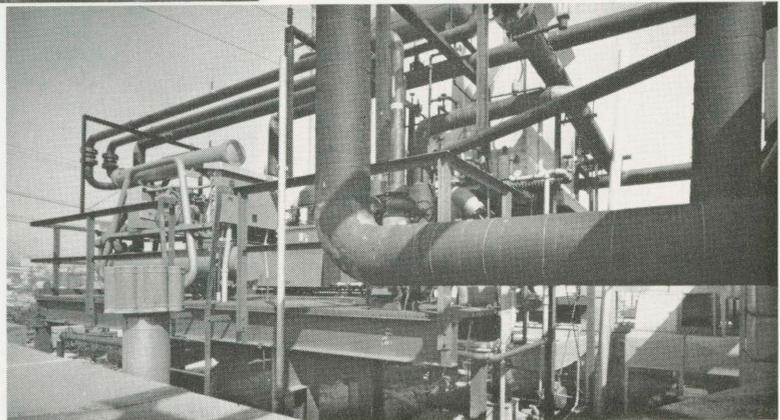
COLOR BALANCING



CHEMICAL TESTING LABORATORY



CHEMICAL MIX DEPARTMENT



**HUMIDITY AND TEMPERATURE
CONTROL SYSTEM**



HARLAN L. BAUMBACH

Vice President—Research & Engineering

Joined the Company in September, 1960 as chief engineer; formerly Head—Chemical Department, Paramount Pictures Corporation, October, 1943 to March, 1952; Chemical Control Supervisor for Technicolor Corporation, March, 1952 to March, 1953; Technical Director, General Film Laboratories Corporation, March, 1953 to August, 1955, when he joined the engineering research organization, Unicorn Engineering Corporation, Hollywood, California; author numerous technical papers and holds number of patents in his own name.

LEO J. NICASTRO

Vice President in Charge of Production

Joined the Company in 1957 to direct research and development; with the assistance of Mr. Baumbach he directed the building and testing of the Panacolor Process pilot unit; thoroughly experienced in all phases of color and black-and-white sensitometry printing; from 1953 to 1957 employed by Metro-Goldwyn-Mayer Studios as research assistant to Dr. Michele Martinez in developing the Martinez process, the exclusive license for which is held by the Company.



DONN LADUE

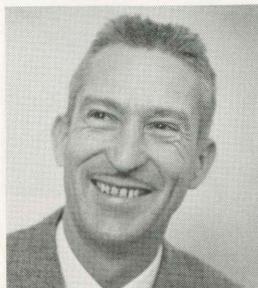
Technical Director

Joined the Company in 1961 where as Technical Director designed the Cinex machine, production contact printers and associated optics, spectrograph and electrical automated and electrical regulating devices for in-line and out-of-line printers and developing machines; formerly associated with Computer Measurements Co., Unicorn Engineering Corporation, Paramount Pictures Corporation and Lookout Mountain Laboratory (Chemical Control) of the U. S. Air Force where he assisted in perfecting the re-alignization process for color negative which enabled the Atomic Energy Commission to reduce by 100 the number of cameras needed for instrumentation photography at each atomic blast.

ALFONSO BLANCO

Timer—Color Consultant

Joined the Company in January, 1962 and was put in charge of all color timing balancing; formerly employed for thirty-two years by Technicolor Corporation where he worked in all phases of motion picture laboratory work and in 1959 in the Italian and London Plants; in the Hollywood Plant of Technicolor Corporation assisted in setting up the black-and-white TV program and in timing many of the feature pictures from major studios, including Metro-Goldwyn-Mayer, Disney, Universal and Paramount.



THOMAS J. LOWE

Processing Supervisor

Joined the Company in 1961 as Assistant Senior Engineer in design, installation and maintenance of pilot and production machines and established maintenance procedures and practices for this specialized equipment; formerly U. S. Air Force Developing Foreman at Lookout Mountain Photography Laboratory from 1952 to 1961 where he supervised film processing section and installation of developing machines and chemical system and redesigned processing equipment to meet special Air Force requirements; coordinated several phases of film processing laboratory for the Vandenberg Air Force Base photography section; established and supervised a training program for personnel assigned to Air Force photography laboratories.

MELVIN W. JONES

Production Control Supervisor

Joined the Company in 1961; assisted in the design and development of the Panacolor Processing System; co-inventor of the Loop Rack Drive System; formerly employed by Computer Measurements Co., Arpee Products, and Fonda Corporation, where he acted as field engineering supervisor and worked on solution system engineering, continuous motion picture film processing, and the supervision of installing system components.



RICHARD M. HAFF

Chief Chemist

An expert in negative-positive materials and methods, he joined the Company in 1961 to perform services in connection with chemical supervision, control and formula improvement under the direction of Messrs. Baumbach and Nicastro; formerly associated with Ansco for many years and most recently was Technical Supervisor on motion picture products for this firm on the West Coast.

DONALD J. SHEAF

Production Superintendent

Joined the Company in 1961 as Production Superintendent which includes production, printing, sensitometry, optical printing and the training of personnel in these areas; formerly Supervisor of Lookout Mountain Air Force Laboratory in charge of laboratory production for Pacific missile range launches at Vandenberg Air Force Base, 1957 to 1961; supervised production of all Air Force training and educational films on the West Coast; other activities included classified work for the Atomic Energy Commission, Ballistic Missile Division, Aerospace and laboratory liaison for Air Force contractors in motion picture production; employed by Technicolor Corporation from 1946 to 1957.



ARTHUR L. FORD, JR.

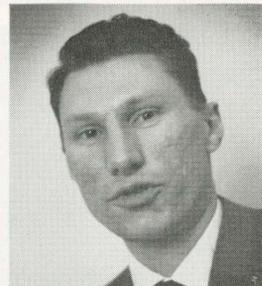
Senior Engineer

Joined the Company in 1961 as project engineer in charge of design and fabrication of the Panacolor Processing System; co-inventor of the Loop Rack Drive System; formerly associated with Computer Measurements Co., Unicorn Engineering Corporation and General Film Laboratories Corporation, where he worked on film handling equipment, development of printing machine design, magnetic coating machine design, film slitting, printing specifications and projection screen framing.

RAYMOND V. POWER

Senior Engineer

Joined the Company in 1961 as project engineer in charge of the automatic chemical mixing and supply system for the Panacolor Processing System; formerly associated with Computer Measurements Co., Unicorn Engineering Corporation and Lockheed Aircraft Corporation; his experience includes work with high-speed film handling equipment, solutions systems layout, installation of color film processors, inspection gages and testing instruments for digital printers and automatic light control modification for DePue reduction printers.



CHARLES J. WILLIAMS

Machine Shop Foreman

Joined the Company in 1961 where he directed machine shop personnel in the fabrication of components used in the Panacolor Processing System; in recent years associated with General Film Laboratories Corporation, Computer Measurements Co., Unicorn Engineering Corporation and Technicolor Corporation.

PANACOLOR, INC.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

To the Board of Directors
PANACOLOR, INC.
New York, N. Y.

We have examined the Balance Sheet of PANACOLOR, INC., a Delaware corporation, at December 31, 1961 and the Statement of Cash Receipts and Disbursements for the year then ended.

Our examination was made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the statements mentioned above, with the notes thereto, present fairly the financial position of PANACOLOR, INC. at December 31, 1961 and the cash receipts and disbursements for the year then ended in conformity with generally accepted accounting principles consistently applied.

ALFRED R. BACHRACH & Co.
Certified Public Accountants

New York, N. Y.
April 16, 1962

P A N A C O

BALANCE SHEET

ASSETS

CURRENT ASSETS:

Cash on hand and in banks.....	\$ 317,788.98
Time certificates of deposit, including accrued interest.....	302,092.99
Prepayments	11,886.14
TOTAL CURRENT ASSETS.....	<u>\$ 631,768.11</u>

PROPERTY, PLANT AND EQUIPMENT—at Cost:

Land	\$ 60,243.71	
Building including parking lot.....	126,532.50	
	<u>\$ 186,776.21</u>	
Office equipment	9,178.26	
Plant installation and equipment—completed or in course of construction:		
Production units and production control.....	380,153.41	
Plant improvements (mainly temperature and humidity control system).....	220,008.84	
Chemical mix room.....	38,659.01	
Testing and research laboratory.....	19,875.18	
Machine shop.....	31,078.86	
	<u>\$ 885,729.77</u>	
Less: depreciation of building, parking lot and office equipment	6,123.83	
TOTAL PROPERTY, PLANT AND EQUIPMENT.....		879,605.94

OTHER ASSETS AND DEFERRED CHARGES:

Patent applications.....	\$ 12,562.00	
Organization expense.....	2,227.08	
Insurance and other deposits.....	970.09	
TOTAL OTHER ASSETS AND DEFERRED CHARGES.....		15,759.17

TOTAL		<u><u>\$1,527,133.22</u></u>
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See accompanying notes.

L O R, I N C.

DECEMBER 31, 1961

LIABILITIES

CURRENT LIABILITIES:

Current portion of note payable—6% secured by Deed of Trust.....	\$	4,686.27
Accounts payable—trade		12,397.42
—others (construction, equipment, etc.).....		107,526.94
Accrued liabilities:		
Salaries		12,764.31
Payroll and franchise taxes.....		8,004.26
Interest and other accruals.....		5,403.07
TOTAL CURRENT LIABILITIES.....	\$	<u>150,782.27</u>

LONG-TERM DEBT:

Note payable—6%, secured by Deed of Trust:		
Original amount.....	\$	123,400.00
Less repayments.....		6,496.25
	\$	<u>116,903.75</u>
Less: principal due within one year included in current liabilities		4,686.27
Balance, due in 1963.....	\$	<u>112,217.48</u>
6% convertible note, dated January 31, 1961—due February 1, 1971		500,000.00
TOTAL LONG TERM DEBT.....		<u>612,217.48</u>

CONTINGENT LIABILITIES AND COMMITMENTS.....

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TOTAL LIABILITIES..... \$ 762,999.75

STOCKHOLDERS' EQUITY

6% CUMULATIVE PREFERRED STOCK, par value \$2.00 per share—convertible into common stock at the rate of two preferred shares for one common share of \$.20 par value:		
Authorized		—57,000 shares
Issued and outstanding— 3,750 shares.....	\$	7,500.00
COMMON STOCK—par value \$.20 per share		
Authorized		—2,000,000 shares
Issued and outstanding— 748,125 shares.....		149,625.00
COMMON STOCK PURCHASE WARRANTS—30,000 warrants outstanding		300.00
PAID-IN SURPLUS.....		<u>1,107,900.29</u>
		<u>\$1,265,325.29</u>
DEDUCT DEFICIT.....		501,191.82
TOTAL		<u><u>764,133.47</u></u>
		<u><u>\$1,527,133.22</u></u>

See accompanying notes.

PANACOLOR, INC.

Statement of Cash Receipts and Disbursements For the Year Ended December 31, 1961

RECEIPTS:

Sale of \$500,000.00 6% Convertible Note to National Outlook Corporation.....	\$ 500,000.00
Sale of Common Stock, par value \$.20 per share, and of Common Stock Purchase Warrants:	
200,000 shares sold to underwriters at \$3.50 per share less \$15,000.00 underwriters' expense of \$15,000.00 and 30,000 warrants sold to underwriters for \$300.00.....	685,300.00
50,000 shares sold to Metro-Goldwyn-Mayer Inc. at \$4.00 per share.....	200,000.00
Redemption of temporary investments in U. S. Treasury bills and time certificates of deposit (total includes \$4,106.76 interest income)—contra.....	803,253.43
Total receipts	\$2,188,553.43

DISBURSEMENTS:

U. S. Treasury bills and time certificates of deposit (comprising \$799,146.67 subsequently redeemed and \$300,000.00 time certificates on hand)—contra.....	\$1,099,146.67
Prepayments and deposits.....	10,371.67
Capital expenditures (contractors, supplies, salaries, wages and allocated plant overhead expense) (a):	
Parking lot	1,021.00
Office equipment	5,655.81
Production units and production control.....	316,685.85
Plant improvements (mainly temperature and humidity control system).....	136,252.51
Chemical mix room.....	35,889.76
Testing and research laboratory	13,874.93
Machine shop	30,879.82
Patent applications	10,024.00
Accounts payable—trade	7,861.65
—others	3,223.46
Accrued liabilities—payroll, property and franchise taxes.....	3,695.85
—interest	825.10
Note payable—6% secured by Deed of Trust—monthly amortization of principal.....	5,216.86
Printing, legal, accounting and other costs of sale of Common Stock.....	32,974.71
Expenses:	
Salaries and wages other than administrative.....	54,087.10
Administrative salaries—officer (b)	33,000.00
—other	22,732.87
Payroll and other taxes.....	3,961.10
Employees' welfare fund, etc.....	2,520.58
Purchase—filmstock and chemicals.....	13,775.95
Miscellaneous factory supplies.....	3,308.19
Rental of leased equipment.....	4,152.90
Laboratory services	4,298.29
Insurance and allocated expense.....	3,939.59
Maintenance	446.85
Office expense	8,531.18
Legal and accounting.....	5,768.53
Transfer agent and other corporate expense.....	5,427.35
Travel and entertainment.....	16,855.59
Advance royalty payments—Estate of Michele P. L. Martinez	3,900.00
Miscellaneous administrative expense.....	2,176.83
Interest—on Note secured by Deed of Trust.....	7,172.54
—on 6% Convertible Note.....	22,500.00
Total disbursements	\$1,932,155.09

NET INCREASE IN CASH DURING YEAR ENDED DECEMBER 31, 1961.....	\$ 256,398.34
CASH ON HAND AND IN BANKS—January 1, 1961.....	61,390.64
CASH ON HAND AND IN BANKS—December 31, 1961.....	\$ 317,788.98

(a) Cash disbursements for capital expenditures include \$134,904.48 for contract work (mainly plant improvements).

(b) Salaries amounting to \$33,988.00 paid to two officers are included under the captions "capital expenditures", "salaries and wages other than administrative" and "administrative salaries—other".

See accompanying notes.

PANACOLOR, INC.

NOTES TO FINANCIAL STATEMENTS

1. ACCOUNTING PRINCIPLES

In 1960 the Company developed the Panacolor process which is a photographic film printing system for producing color movie prints ready for exhibition; patents are pending. On December 31, 1961 construction of the first production unit in addition to the pre-production processor was substantially completed; the Company expects commercial production to commence during 1962.

All expenditures incurred since the Company's incorporation on June 10, 1957 in research and development of the "Martinez process"—which preceded the development of the Panacolor Process—were written off and charged to deficit on December 31, 1960. During the calendar year 1961, the Company wrote off and charged to deficit all expenditure other than that incurred in the construction of production units and other equipment—see Note 8. The Company has obtained the consent of the Internal Revenue Service to write off currently all research and experimental expenditures paid or incurred in the calendar year 1961 and subsequent years.

The Company maintains its books on the accrual method of accounting; accordingly, all known liabilities are recorded on the books and reflected on the Balance Sheet. The books do not, however, reflect the Company's obligation to future advance royalty payments under its agreement dated September 15, 1957 with the executrix of the Estate of Michele P. L. Martinez. Under this agreement the Company is liable to pay to the Estate advance royalties in the amount of \$75.00 per week and, upon starting commercial production of film, is obligated to pay to the estate one-half mil (\$.0005) per foot royalty on film commercially produced up to a total amount of \$52,000.00 per year with advance royalty payments of \$75.00 per week (which commenced on September 22, 1957 and have been paid up to and including December 31, 1961) being deductible therefrom. This agreement is effective for a period of twenty years from its date, with a renewal option in favor of the Company for a term of another twenty years. However, the Company has the sole right to cancel the agreement at any time by giving sixty days' notice in writing to the executrix and shall thereafter be relieved of any and all obligations. Any cancellation or termination is subject to the rights and interests of the inventor and of Metro-Goldwyn-Mayer Inc. (from whom the Company had acquired its rights in and to the Martinez invention by assignment) under their original agreement. Because of the aforementioned cancellation clause, the books do not reflect any future advance royalty obligation to the Estate of Michele P. L. Martinez nor any related asset value of the Company's right in and to the Martinez invention. The past advance royalty payments have been written off and charged to deficit and the Company intends to charge off all future payments if and as incurred.

Reference is also made to Note 4 regarding royalty payment obligations, based on commercially produced film.

2. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment are valued at cost. The apportionment of the cost of the real property as between land and building is in accordance with an appraisal report submitted in March, 1960 by Union Appraisal Company, Los Angeles, California. Cost of machinery constructed by the Company, comprises payments made to contractors and outside suppliers, as well as the Company's own direct engineering and fabricating salaries and wages incurred in construction and an appropriate allocation of plant overhead expense—see also Note 4.

Depreciation on the building, parking lot and office equipment has been computed on the "straight-line" method at the following annual rates:

Building	4%
Parking lot	6 $\frac{2}{3}$ %
Office equipment	10%

The Company intends to depreciate plant installation and equipment over a seven to ten year period to begin upon commencement of commercial operations.

The expense of patent applications comprising patent attorneys' fees in preparing United States patent applications, Government filing fees and incidentals in respect of inventions covering and relating to the Panacolor process are carried at cost. Organization expense is carried at cost.

3. LIABILITIES

Accounts payable—others include \$54,154.00 balance owing to a contractor for the installation of a temperature and humidity control system of which \$25,000.00 is due on commencement of operations of the plant and \$29,154.00 thirty-five days after final acceptance by the Company—see also Note 4.

The 6% note payable to the seller of the real property is secured by Deed of Trust. Principal and interest are payable in installments of \$1,000.00 or more on the first day of each month beginning October 1, 1960 and continuing until September 1, 1963 at which time the unpaid principal (\$108,644.12) and interest are due and payable.

The \$500,000.00 6% convertible note, dated January 31, 1961 is convertible in whole or in part before February 1, 1971, its due date, into common stock of the Company at

PANACOLOR, INC.

NOTES TO FINANCIAL STATEMENTS—Continued

the conversion price of \$4.50 per share and the Company has reserved an aggregate of 111,111 shares of its authorized but unissued common stock to provide for such conversion. The note requires the Company to maintain at all times after two years from January 31, 1961 a net working capital of at least \$250,000.00 and the Company may not apply any sum to the redemption, retirement or purchase of any shares of any class of its capital stock.

For advance royalty payments to the Estate of Michele P. L. Martinez see Note 1.

4. CONTINGENT LIABILITIES AND COMMITMENTS

(A) *Agreement with Metro-Goldwyn-Mayer Inc. and Estate of Michele P. L. Martinez.*

On May 27, 1957 (re-affirmed on February 5, 1958), the Company entered into an agreement with Loew's Incorporated, now Metro-Goldwyn-Mayer Inc. ("MGM") wherein the latter assigned and transferred to the Company Loew's right, title and interest in and to the agreement, dated March 1, 1954 between it and Michele P. L. Martinez. In consideration of the execution of the agreement of May 27, 1957, the Company agreed that it would pay to Loew's the sum of \$100,000.00 in royalties by making payments to Loew's of the sum of one-half mil (\$.0005) per lineal foot of commercial film produced by the Company or any licensee upon the terms and conditions described in such agreement. The agreement also retained for the benefit of MGM various rights including a non-exclusive right to use the Martinez Process and any and all improvements thereon commercially, for its own use.

On May 8, 1961, the Company and MGM entered into an agreement under which the Company agreed among other things to pay MGM \$200,000.00 in royalties on commercial film produced, printed, processed or developed under any process, in lieu of \$100,000.00 as agreed upon on May 27, 1957 and MGM agreed not to exercise for a period of ten years its aforementioned non-exclusive right to use the Martinez Process; and if at the end of such ten-year period \$200,000.00 in total royalties have been paid to MGM, it will then permanently surrender such non-exclusive right; if, however, at the end of such ten-year period the Company has not paid to MGM total royalties of \$200,000.00, MGM's agreement not to exercise such non-exclusive rights shall terminate.

Under the agreement dated September 15, 1957 between the Company and the Executrix of the Estate of Michele P. L. Martinez, the Company is obligated to pay to the estate one-half mil (\$.0005) per foot royalty on film commercially produced up to a total amount of \$52,000.00 per year—see Note 1 above.

(B) *Contracts and Leases.*

In addition to the amounts included in "Accounts Payable—Others" (see Note 3), the Company is committed under contracts to payments of approximately \$37,000.00 for additional temperature and humidity control work to be done. Completion cost of the first color film processing unit (completed in March, 1962) and of the second processing unit now in course of construction is estimated at \$170,000.00. On December 31, 1961, the Company was obligated under 7-year equipment lease contracts aggregating \$55,928.45 payable in annual amounts as follows: 1962 through 1967—\$8,337.16 each year; 1968—\$5,905.49. These lease payment figures do not include a contract cancelled in February, 1962 and superseded by another 7-year equipment lease; such lease together with other contracts entered into by the Company in February and March, 1962 obligate the Company to make payments of \$67,886.00 over a period of seven years.

The leases provide for termination at the request of the Company prior to the end of the terms set forth in the contracts; in such event the Company shall pay termination fees ranging from 15% to 50% of the rentals earned.

5. CAPITAL STOCK

In January and February 1962, the 3,750 shares of Preferred Stock were converted into 1,875 shares of Common Stock. Under the terms of the Certificate of Incorporation dividend arrears on December 31, 1961 of \$.45 per share of Preferred Stock were not payable upon such conversion. The Company may not re-issue any Preferred Stock.

All shares of Preferred and Common Stock have been issued for cash.

In June, 1961 the Company sold to underwriters 30,000 Common Stock Purchase Warrants for a total cash consideration of \$300.00. The warrants entitle the holders to purchase until June 6, 1966 30,000 shares of Common Stock at \$4.00 per share.

Pursuant to the agreement of May 8, 1961—see Note 4—the Company on July 11, 1961 sold to MGM 50,000 shares of Common Stock for \$200,000.00 and also granted options to MGM to purchase 100,000 shares of Common Stock expiring July 11, 1964 as follows:

(a) 50,000 shares, or any part thereof, at \$7.50 per share at any time within two years from July 11, 1961, and

(b) 50,000 shares, or any part thereof, at \$10.00 per share at any time within three years from July 11, 1961, with the right on the part of MGM, prior to July 11, 1964, to exercise at \$10.00 per share any part of the option under "(a)" with respect to which it has not exercised its right at \$7.50 per share.

PANACOLOR, INC.

NOTES TO FINANCIAL STATEMENTS—Concluded

6. STOCK OPTION PLAN

Under a Restricted Stock Option Plan adopted by the Board of Directors on January 31, 1961, 100,000 shares of authorized, but unissued shares of \$.20 par value Common Stock have been reserved for issuance to officers and key employees. Options covering 86,750 shares of Common Stock were granted on January 31, 1961 at \$3.50 per share, this option price being considered by the Board of Directors to be at least 110% of the then fair market value of \$1.00 per share; total option price on such date being \$306,775.00, total market price on such date being \$87,650.00. Options covering 3,000 shares of Common Stock were granted on December 18, 1961 at \$7.50 per share, this option price being considered by the Board of Directors to be at least 95% of the then fair market value of \$7.875 per share; total option price on such date being \$22,500.00, total market price on such date being \$23,625.00. Under the plan the holder of an option may not exercise any part thereof for the first two years; thereafter he may exercise 25% during the third year; 25% during the fourth year; 25% during the fifth year; and the balance during sixty (60) days after the end of the fifth year, all on a cumulative basis. None of the aforementioned options have been exercised.

7. PAID-IN SURPLUS

Balance—January 1, 1961.....	\$ 278,325.00
Add:	
\$3.30 per share on 200,000 shares of \$.20 par value Common Stock sold on June 6, 1961 to underwriters for cash at \$3.50 per share less \$47,599.71 expense	612,400.29
\$3.80 per share on 50,000 shares of \$.20 par value Common Stock sold on July 11, 1961 to Metro-Goldwyn- Mayer Inc. for cash at \$4.00 per share less \$375.00 expense.....	189,625.00
Conversion during the calendar year 1961 of 14,500 shares of \$2.00 par value Preferred Stock into 7,250 shares of \$.20 par value Common Stock.....	27,550.00
Balance—December 31, 1961.....	<u>\$1,107,900.29</u>

8. DEFICIT:

Balance—January 1, 1961.....	\$259,517.58
Add:	
Charges during the year ended December 31, 1961:	
Salaries and wages other than administrative	\$ 56,026.97
Administrative salaries— officers	39,875.00
Administrative salaries— other	23,113.05
Payroll and other taxes.....	4,184.08
Employees' welfare fund, etc.	2,679.34
Purchases—filmstock and chemicals	14,738.44
Miscellaneous factory supplies	3,732.56
Rental of leased equipment....	4,152.90
Laboratory services	5,409.70
Insurance and allocated ex- pense	6,511.45
Maintenance	375.16
Office expense	8,948.59
Legal and accounting.....	12,820.72
Transfer agent and other cor- porate expense	5,966.49
Travel and entertainment.....	17,966.48
Advance royalty payments— Estate of Michele P. L. Martinez.....	3,900.00
Miscellaneous administrative expense	2,176.83
Interest—on Note secured by Deed of Trust.....	7,172.54
Interest—on 6% Convertible Note	27,500.00
Depreciation—office equip- ment	623.69
	<u>\$247,873.99</u>
Deduct:	
Interest income on U. S. Treas- ury bills and time certificates of deposit	6,199.75
Net charges for year ended Decem- ber 31, 1961.....	241,674.24
Balance—December 31, 1961.....	<u>\$501,191.82</u>

