

***Semco***

***INSTRUMENTS, INC.***

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*ANNUAL  
REPORT  
1998*

*SEMCO INSTRUMENTS, INC. was founded in December 1965 as an engineering based aerospace manufacturer of precision sensors and electronic controls. Our primary market has been the gas turbine engine manufacturers and the related commercial aircraft industry. Company efforts continue to be directed toward the expansion of our market share of temperature sensors and speed sensors in the commercial and military markets.*

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## To Our Shareholders:

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Sales achieved by your Company in 1998 were \$6,791,165 as compared to 1997 sales of \$6,374,961. In 1998, net income was \$285,262 or \$0.06 per share as compared to a 1997 net income of \$214,812 or \$0.05 per share before the effect of change in accounting principle. The 1997 net income after the change in accounting principle was \$90,861 or \$0.02 per share.

In 1998 the Company achieved a 6.5% growth in sales in a very tight market wherein supplier-customer partnerships and long-term agreements have some limiting effect upon new business opportunities. Still, the Company was able to participate in several new gas turbine engine programs that will benefit the Company in future years. In addition, the continuing consolidation in the aerospace market had an effect upon several of the Company's competitors and we have found that this has created additional opportunities for our Company. Our experience has indicated that the larger companies in our niche market tend to be less responsive to customer needs as well as burdened by higher overhead rates, manifesting itself in less competitive pricing. In this environment, our Company has the opportunity to be very successful.

The Company initiated multiple process improvement efforts in 1998 and the Company benefited with an increase in the return on sales. Significant among these process improvement efforts was the use of Kaizen events in order to streamline the flow of processes, to eliminate non-value-added operations, and to reduce the level of work-in-process. The Company also completed implementation of a new business information system in 1998. This new information system is a fully integrated manufacturing and accounting system that will allow the Company to reduce the cycle time of product planning and manufacturing resulting in more responsive deliveries to our customers' just-in-time needs. The system also facilitates electronic communication, transactions with customers, suppliers, and financial institutions, and readiness for Year 2000 compliance.

We remain optimistic about the future of the Company. The Company continues to gain market share while distinguishing itself in the areas of technical expertise, quality, delivery, and customer support in a competitive market.

I am thankful for your continued interest and support.

Sincerely,



Michael G. Moore  
President



# Balance Sheets

## ASSETS

	December 31	
	1998	1997
Current assets		
Cash	\$ 381,824	\$ 35,315
Trade receivables	945,934	1,075,846
Inventories	2,271,658	2,280,583
Prepaid expenses and other current assets	66,831	76,205
Deferred taxes	116,000	70,100
<b>Total current assets</b>	<b>3,782,247</b>	<b>3,538,049</b>
Property, Plant and Equipment		
Land	898,993	898,993
Building and improvements	2,022,397	2,012,601
Machinery and equipment	1,530,022	1,486,757
Automotive equipment	67,376	64,524
Furniture, fixtures and computers	656,067	638,915
	<b>5,174,855</b>	<b>5,101,790</b>
Less accumulated depreciation	<b>2,588,691</b>	<b>2,384,010</b>
	<b>2,586,164</b>	<b>2,717,780</b>
	<b>\$ 6,368,411</b>	<b>\$ 6,255,829</b>

## LIABILITIES AND STOCKHOLDERS' EQUITY

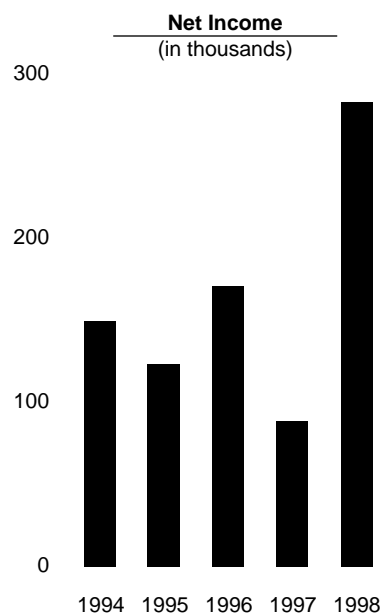
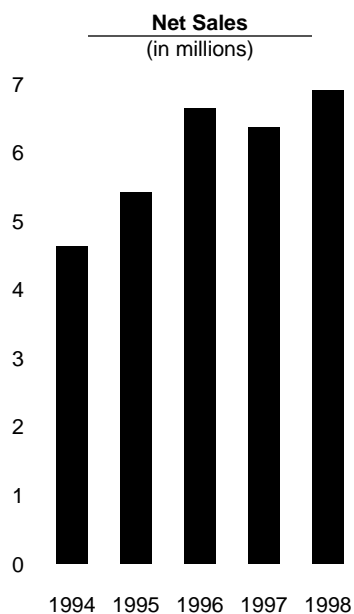
Current Liabilities		
Notes payable, revolving lines of credit	\$ —	\$ 420,000
Current maturities of long-term debt	48,303	97,535
Accounts payable and accrued expense	664,489	633,264
<b>Total current liabilities</b>	<b>712,792</b>	<b>1,150,799</b>
Long-term Debt, less current maturities	<b>1,865,534</b>	<b>1,624,615</b>
Deferred Taxes	<b>253,000</b>	<b>208,600</b>
Stockholders' Equity		
Common stock, \$0.01 par value; 6,000,000 shares authorized	43,945	44,890
Additional paid-in capital	869,065	890,018
Treasury stock	(17,054)	(18,960)
Retained earnings	2,641,129	2,355,867
<b>Total stockholders' equity</b>	<b>3,537,085</b>	<b>3,271,815</b>
	<b>\$ 6,368,411</b>	<b>\$ 6,255,829</b>

See Notes to Financial Statements.

# Statements of Income

	Years Ended December 31		
	1998	1997	1996
Net sales	\$ 6,791,165	\$ 6,374,961	\$ 6,634,551
Cost of sales	5,107,063	4,909,688	5,188,712
<b>Gross profit</b>	<b>1,684,102</b>	<b>1,465,273</b>	<b>1,445,839</b>
Selling, general and administrative expenses	1,021,394	914,927	941,936
<b>Operating income</b>	<b>662,708</b>	<b>550,346</b>	<b>503,903</b>
Interest expense, net	232,446	219,534	261,880
Income before income taxes	430,262	330,812	242,023
Federal and state income taxes	145,000	116,000	80,000
<b>Net income before cumulative effect of change in accounting principle</b>	<b>285,262</b>	<b>214,812</b>	<b>162,023</b>
Cumulative effect on prior years of changing to a different method of accounting for precontract costs, net of related tax effect	—	(123,951)	—
<b>Net income</b>	<b>\$ 285,262</b>	<b>\$ 90,861</b>	<b>\$ 162,023</b>
Earnings per common share:			
Net income before cumulative effect of change in accounting principle	\$ 0.06	\$ 0.05	\$ 0.04
Cumulative effect on prior years of change in accounting principle	—	(0.03)	—
	<b>\$ 0.06</b>	<b>\$ 0.02</b>	<b>\$ 0.04</b>
Weighted average number of common shares outstanding	<b>4,406,549</b>	<b>4,431,643</b>	<b>4,488,999</b>

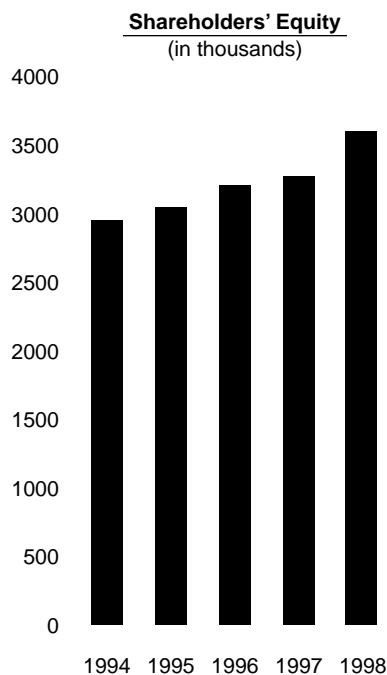
See Notes to Financial Statements.



# Statements of Shareholders' Equity

	Common Stock		Additional Paid-in Capital	Retained Earnings	Treasury Stock, at Cost		Total
	Shares Outstanding	Amount			Shares Purchased (Retired)	Amount	
Balance, December 31, 1995	4,488,999	\$ 44,890	\$ 890,018	\$ 2,102,983	–	\$ –	\$ 3,037,891
Net income	–	–	–	162,023	–	–	162,023
Balance, December 31, 1996	4,488,999	44,890	890,018	2,265,006	–	–	3,199,914
Net income	–	–	–	90,861	–	–	90,861
Repurchase of common stock	–	–	–	–	(79,000)	(18,960)	(18,960)
Balance, December 31, 1997	4,488,999	44,890	890,018	2,355,867	(79,000)	(18,960)	3,271,815
Net income	–	–	–	285,262	–	–	285,262
Retirement of previously repurchased treasury stock	(94,463)	(945)	(20,953)	–	94,463	21,898	–
Repurchase of common stock	–	–	–	–	(102,088)	(19,992)	(19,992)
Balance, December 31, 1998	<b>4,394,536</b>	<b>\$ 43,945</b>	<b>\$ 869,065</b>	<b>\$ 2,641,129</b>	<b>(86,625)</b>	<b>\$ (17,054)</b>	<b>\$ 3,537,085</b>

See Notes to Financial Statements.



# Statements of Cash Flows

	Years Ended December 31		
	1998	1997	1996
Cash Flows from Operating Activities			
Net income	\$ 285,262	\$ 90,861	\$ 162,023
Adjustments to reconcile net income to net cash provided by operating activities:			
Cumulative effect on prior years of changing to a different method of accounting for pre-contract costs	–	181,476	–
Depreciation and amortization	229,968	170,702	179,948
Deferred taxes	(1,500)	7,500	27,086
Changes in working capital components:			
(Increase) decrease in trade receivables	129,912	(183,340)	(99,540)
(Increase) decrease in inventories	8,925	(1,276)	538,826
(Increase) decrease in prepaid expenses and other current assets	9,374	(24,492)	(81,999)
Increase (decrease) accounts payable and accrued expenses	31,225	19,146	(52,792)
<b>Net cash provided by operating activities</b>	<b>693,166</b>	<b>260,577</b>	<b>673,552</b>
Cash Flows from Investing Activities			
Purchase of equipment	(72,213)	(283,424)	(119,848)
<b>Net cash (used in) investing activities</b>	<b>(72,213)</b>	<b>(283,424)</b>	<b>(119,848)</b>
Cash Flows from Financing Activities			
Borrowings under lines of credit	380,000	1,540,000	1,867,000
Repayments on lines of credit	(800,000)	(1,410,000)	(2,332,000)
Borrowings on long-term debt	1,874,998	–	–
Principal repayments of long-term debt	(1,709,450)	(88,770)	(76,607)
Repurchase of common stock	(19,992)	(18,960)	–
<b>Net cash provided by (used in) financing activities</b>	<b>(274,444)</b>	<b>22,270</b>	<b>(541,607)</b>
<b>Net increase (decrease) in cash</b>	<b>346,509</b>	<b>(577)</b>	<b>12,097</b>
Cash			
Beginning	35,315	35,892	23,795
Ending	\$ 381,824	\$ 35,315	\$ 35,892
Supplemental Disclosures of Cash Flow Information			
Cash payments for:			
Interest expense	\$ 240,255	\$ 219,866	\$ 265,590
Income taxes	\$ 5,696	\$ 100,966	\$ 13,600
Supplemental Schedule of Noncash Investing and Financing Activities			
Issuance of notes payable for vehicle	\$ 26,139	\$ –	\$ –

See Notes to Financial Statements.

# Notes to Financial Statements

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## 1 NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

### **Nature of Business**

Semco Instruments, Inc. (the Company) manufactures and sells precision sensors and systems for measurement and control, principally to original equipment manufacturers in aerospace and commercial industries primarily located in North America.

***A summary of the Company's significant accounting policies follows:***

### **Use of estimates in preparation of financial statements**

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities and the reported amounts of revenue and expenses. Actual results could differ from those estimates and could materially affect the reported amount of assets, liabilities and future operating results.

### **Cash**

The Company maintains its cash in bank deposit accounts which, at times, may exceed federally insured limits. The Company has not experienced any losses in such accounts. The Company believes it is not exposed to any significant risk relative to its cash accounts.

### **Concentrations**

The Company's customers are concentrated in the commercial aviation industry. The Company performs periodic credit evaluations of its customers' financial condition and does not require collateral. Receivables are generally due within 30 days. Credit losses have historically been within management's expectations.

### **Fair value of financial instruments**

The Company's financial instruments consist of cash, accounts receivable, accounts payable and debt. The value reported in the financial statements approximates fair value due to their short-term nature and/or market rates of interest.

### **Accounting for Stock-based Compensation**

The Company follows Accounting Principles Board Opinion No. 25, *Accounting for Stock Issued to Employees*, to measure stock-based employee compensation. Accordingly, stock compensation expense is measured as the excess, if any, of the quoted market price of the Company's stock at the date of grant over the exercise price. The Company also discloses the pro forma effects on net income and earnings per share as if compensation was measured in accordance with the requirements of Statement of Financial Accounting Standards (SFAS) No. 123, *Accounting for Stock-based Compensation*.

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## NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### **Inventories**

Inventories are stated at the lower of weighted average cost or market. The Company periodically reviews the age and turnover of its inventory to determine whether any inventory has become obsolete or has declined in value and incurs a charge to operations for known and anticipated inventory obsolescence.

### **Property, plant and equipment**

Property, plant and equipment is recorded at cost. The Company uses the straight-line depreciation method for financial reporting purposes. The estimated useful lives by classes of assets used in computing depreciation are as follows:

	<u>Years</u>
Building and improvements	30
Machinery and equipment	5–10
Furniture and fixtures	7–8
Automotive equipment	5
Molds and tooling	5

### **Revenue and cost recognition**

Revenue is primarily recognized as units are shipped under the units-of-delivery method of accounting for contracts. Revenue applicable to a certain cost plus fixed fee contracts was \$0, \$0 and \$380,000 for the years ended December 31, 1998, 1997 and 1996, respectively. Any anticipated losses on contracts (estimated final contract costs in excess of estimated final contract revenue) are charged to current operations as soon as they are determined.

### **Income taxes**

Deferred taxes are provided on a liability method whereby deferred tax liabilities are recognized for taxable temporary differences and deferred tax assets are recognized for deductible temporary differences and operating loss and tax credit carryforwards. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred tax assets are reduced by a valuation allowance when it cannot be demonstrated that the deferred tax assets are more likely than not to be realized. Deferred tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

### ***Segment information***

The Company operates as one segment, manufacturing and selling precision sensors and systems for measurement and control. For purposes of reporting and aggregating revenue to foreign countries, sales are attributed to the country of the headquarters of the customer.

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## NATURE OF BUSINESS AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (continued)

### Basic and fully diluted net loss per common share

Basic earnings (loss) per share (EPS) excludes dilution and is computed by dividing income available to common stockholders by the weighted average number of common shares outstanding for the period. Diluted EPS is based upon the weighted average number of common shares outstanding during the period plus the additional weighted average common equivalent shares during the period. Common equivalent shares are not included in the per-share calculations where the effect of their inclusion would be antidilutive. Common equivalent shares result from the assumed exercise of outstanding stock options, the proceeds of which are then assumed to have been used to repurchase outstanding stock options using the treasury-stock method. For the years ended December 31, 1998, 1997 and 1996, basic and diluted earnings per common share were computed based on the weighted average number of common shares outstanding during the period, because the effect of common stock equivalents would be antidilutive. Common stock options were not included in the computation of diluted earnings per share for the years ended December 31, 1998, 1997 and 1996, because they would have an antidilutive effect. Options to purchase 900,000, 450,000 and 450,000 shares of common stock for the years ended December 31, 1998, 1997 and 1996, respectively, have been excluded.

## 2 INVENTORIES

Inventories consist of the following at December 31:

	<u>1998</u>	<u>1997</u>
Raw materials and fabricated parts	<b>\$ 1,373,693</b>	\$ 1,116,566
Work in process	<b>650,511</b>	957,311
Finished goods	<b>247,454</b>	206,706
	<u><b>\$ 2,271,658</b></u>	<u>\$ 2,280,583</u>

## 3 REVOLVING LINES OF CREDIT

The Company has a revolving line-of-credit agreement with a bank for borrowings up to a maximum of \$1,000,000, of which \$0 and \$420,000 were outstanding at December 31, 1998 and 1997, respectively. At December 31, 1998, \$1,000,000 was available for borrowing under the line of credit. The agreement provides for interest, payable monthly, at the bank's prime rate (7.75% at December 31, 1998), plus 0.25%. The line of credit is collateralized by trade receivables, inventories, equipment and fixtures, and is personally guaranteed by the chairman of the Company's Board of Directors. The line of credit expires June 1, 1999.

Under the line-of-credit agreement, the Company agrees to maintain minimum amounts of working capital, limit capital expenditures and lease commitments, and maintain certain financial ratios related to working capital, stockholders' equity, debt and cash flow. In addition, the Company is prohibited from paying dividends and is limited in its ability to purchase additional capital stock without the consent of the bank.

## REVOLVING LINES OF CREDIT (continued)

The Company also has a \$100,000 term loan facility available for equipment purchases with terms similar to the revolving line of credit. Outstanding balances accrue interest at the bank's prime rate plus 1% per annum, which interest is payable monthly. The line of credit expires June 1, 1999. There was no balance outstanding under the equipment line of credit at December 31, 1998 and 1997.

## 4 ACCOUNTS PAYABLE AND ACCRUED EXPENSES

Accounts payable and accrued expenses at December 31 consist of:

	1998	1997
Accounts payable	\$ 294,848	\$ 425,085
Compensation and related payroll taxes	220,446	176,247
Federal and state income taxes	113,717	-
Interest	27,178	25,982
Other	8,300	5,950
	<u>\$ 664,489</u>	<u>\$ 633,264</u>

## 5 LONG-TERM DEBT

Long-term debt at December 31 is as follows:

	1998	1997
Note payable, bank, refinanced during September 1998	\$ -	\$ 1,155,662
Note payable, bank, secured by vehicle, payable in monthly installments of \$522 including interest at 8.5%, maturing September 1999	4,045	9,693
Note payable, bank, secured by equipment, payable in monthly installments of \$824 plus interest at the bank's prime rate (7.75% at December 31, 1998) plus 1%, maturing in June 2000	14,840	24,735
Note payable, bank, refinanced during September 1998	-	532,060
Note payable, bank, secured by first deed of trust on real estate, payable in monthly installments of \$14,045 including interest at 7.545%, maturing in September 2,005	1,872,744	-
Note payable, bank, secured by a vehicle, payable in monthly installments of \$614 including interest at 5.9%, maturing in May 2002	22,208	-
	<u>1,913,837</u>	<u>1,722,150</u>
Less current portion	48,303	97,535
	<u>\$ 1,865,534</u>	<u>\$ 1,624,615</u>

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## LONG-TERM DEBT (continued)

Aggregate maturities of long-term debt as of December 31, 1998 are as follows:

Year	Amount
1999	\$ 48,303
2000	41,907
2001	42,262
2002	35,338
2003	38,098
Thereafter	1,707,929
	<u>\$ 1,913,837</u>

## 6 INCOME TAXES

Components of income tax expense for the years ended December 31 are as follows:

	1998	1997	1996
Currently paid or payable:			
Federal	\$ 119,000	\$ 33,500	\$ 52,514
State	27,500	17,475	400
	<u>146,500</u>	<u>50,975</u>	<u>52,914</u>
Deferred	(1,500)	65,025	27,086
	<u>\$ 145,000</u>	<u>\$ 116,000</u>	<u>\$ 80,000</u>

The following table presents a reconciliation of income tax determined by applying the U.S. federal income tax rate to pretax income.

	1998	1997	1996
Computed expected statutory rate	35 %	35 %	35 %
Increase (decrease) in rate resulting from:			
State taxes, net of federal benefit	5	4	5
Nondeductible expenses	—	—	2
Benefit of income taxed at lower rates	(1)	(2)	(6)
Other	(5)	(2)	(3)
	<u>34 %</u>	<u>35 %</u>	<u>33 %</u>

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## Income Taxes (continued)

Net deferred tax assets (liabilities) as of December 31 consist of the following components:

	<u>1998</u>	<u>1997</u>
Deferred tax liabilities:		
Depreciation	\$ (93,000)	\$ (78,400)
Undistributed DISC income	(158,600)	(124,400)
Other	(1,400)	(7,380)
	<u>(253,000)</u>	<u>(210,180)</u>
Deferred tax assets:		
Inventory	28,900	23,600
Other	87,100	48,080
	<u>116,000</u>	<u>71,680</u>
	<u>\$ (137,000)</u>	<u>\$ (138,500)</u>

Net deferred tax assets (liabilities) described above have been included in the accompanying balance sheets as follows:

	<u>1998</u>	<u>1997</u>
Current assets	\$ 116,000	\$ 70,100
Long-term liabilities	(253,000)	(208,600)
	<u>\$ (137,000)</u>	<u>\$ (138,500)</u>

## 7 Stock Option Plan

The Company has adopted qualified and nonqualified stock option plans covering the Company's common shares. A revised plan was adopted in 1996. Nonqualified stock options may be issued to officers, directors or key employees of the Company. Qualified stock options may be issued to employees of the Company. Qualified and nonqualified stock options are exercisable at prices not less than the fair market value on the date of grant (not less than 110% of the fair market value for participating individuals who own more than 10% of the outstanding voting stock of the Company).

Options granted under all of the above plans and actions are exercisable beginning one year from the date of grant at the rate of 25% per year on a cumulative basis. The options expire at the earlier of five years from the date of grant or three months from the stock option holder's termination of employment.

## STOCK OPTION PLAN (continued)

A summary of stock option activity is as follows:

	1998		1997		1996	
	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price	Shares	Weighted Average Exercise Price
Outstanding at beginning of year:	450,000	\$0.27	450,000	\$ 0.27	450,000	\$ 0.27
Granted	450,000	0.18	—	—	—	—
Canceled	—	—	—	—	—	—
Outstanding at end of year	<u>900,000</u>	0.23	<u>450,000</u>	0.27	<u>450,000</u>	0.27
Options exercisable, end of year	<u>337,500</u>	0.27	<u>112,500</u>	0.27	<u>112,500</u>	0.27
Options available for grant, end of year	<u>150,000</u>		<u>600,000</u>		<u>600,000</u>	
Weighted average fair value of options granted during the year	<u>\$ 0.04</u>		<u>—</u>		<u>—</u>	

The following table summarizes information about stock options outstanding at December 31, 1998:

Exercise Price	Options Outstanding			Options Exercisable	
	Number Outstanding	Remaining Contractual Life (in Years)		Number Exercisable	Exercise Price
\$ 0.19	350,000	5		—	\$ 0.19
0.20	100,000	5		—	0.20
0.24	150,000	2		112,500	0.24
0.28	200,000	2		150,000	0.28
0.31	100,000	2		75,000	0.31
	<u>900,000</u>			<u>337,500</u>	

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### Stock Option Plan (continued)

The Company applies APB Opinion 25 and related Interpretations in accounting for its grants to employees. Accordingly, no compensation cost has been recognized in the financial statements. Had compensation cost for the Company's stock option plans been determined based on the fair value at the grant dates for awards under this plan consistent with the method of FASB Statement No. 123, the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below:

	1998	1997	1996
Net income			
As reported	\$ 285,262	\$ 90,861	\$ 162,023
Pro forma	281,252	87,111	158,273
Earnings per common share:			
As reported	0.06	0.03	0.04
Pro forma	0.06	0.02	0.04

The pro forma compensation cost was recognized for the fair value of the stock options granted, which was estimated using the Black-Scholes model with the following assumptions for 1998 and 1995, respectively: expected volatility of 21% and 27%, risk-free interest rate of 4.75% and 6.75%, the options would be exercised at the end of the exercise period and the Company would declare and pay no dividends. There were no stock options granted during 1997 and 1996.

## 8 CONCENTRATIONS

The Company derived 65% of its sales from three unrelated customers during 1998 (67% in 1997 and 74% in 1996). Individually, the three customers accounted for 36%, 16% and 13% of 1998 sales (43%, 15% and 9% in 1997 and 43%, 22% and 9% in 1996).

## 9 RELATED PARTY TRANSACTIONS

The Company rents aircraft from its chairman on a month-to-month basis for development and certification of Company products. Such expenses were approximately \$19,500, \$18,000 and \$23,000 in 1998, 1997 and 1996, respectively.

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## **10 ACCOUNTING CHANGE**

In 1998 the Accounting Standards Executive Committee issued Statement of Position (SOP) 98-5, *Reporting on Costs of Start-up Activities*, which provides guidance on accounting for start-up costs. The Company adopted this SOP for its year ended December 31, 1997. This SOP amends SOP 81-1 under which the Company previously deferred certain precontract costs. The unamortized portion of the costs at December 31, 1996 of \$123,951, net of tax of \$57,525, was recorded as cumulative effect of change in accounting principle.

Net income in 1997, before cumulative effect on prior years of accounting change, would have been lower by approximately \$25,000 or \$0.01 per share if the Company had used its previous method of accounting for precontract costs.

## **11 PROFIT SHARING PLANS**

In 1998 the Company started a 401(k) profit sharing plan for full-time employees who have completed 12 months of service and reached age 21. Eligible employees may contribute from 2% to 20% of their wages up to the allowable Internal Revenue Service limit. The plan allows for a discretionary matching contribution up to 5% of each employee's contributed salary deferral. The Company's matching contributions to the 401(k) plan were \$0 for the year ended December 31, 1998.



**Independent Auditor's Report**

To the Board of Directors and Stockholders  
Semco Instruments, Inc.  
Valencia, California

We have audited the accompanying balance sheets of Semco Instruments, Inc. as of December 31, 1998 and 1997, and the related statements of income, stockholders' equity and cash flows for each of the three years in the period ended December 31, 1998. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall balance sheet presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of Semco Instruments, Inc. as of December 31, 1998 and 1997 and the results of its operations and its cash flows for each of the three years in the period ended December 31, 1998 in conformity with generally accepted accounting principles.

As discussed in Note 10 to the financial statements, the Company changed its method of accounting for precontract costs during 1997.

Pasadena, California  
April 14, 1999

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# Financial Highlights

## FIVE YEAR SUMMARY

	1998	1997	1996	1995	1994
<b>Income Statement Data</b>					
Net income before cumulative effect of change in accounting principle	285,262	214,812	162,023	120,574	140,739
Cumulative effect on prior years of changing to a different method of accounting for pre-contract costs, net of related tax effect	—	(123,951)	—	—	—
Net income	285,262	90,861	162,023	120,574	140,739
Return on sales before cumulative effect of change in accounting principle	4.2%	3.4%	2.4%	2.2%	3.0%
Earnings per share before cumulative effect of change in accounting principle	0.06	0.05	0.04	0.03	0.03
Cumulative effect on prior years of change in accounting principle	—	(0.03)	—	—	—
Earnings per share	0.06	0.02	0.04	0.03	0.03
Weighted average # of shares outstanding	4,406,549	4,431,643	4,488,999	4,522,169	4,576,050
Net sales	6,791,165	6,374,961	6,634,551	5,423,648	4,634,653
Cost of sales	5,107,063	4,909,688	5,188,712	4,151,824	3,282,585
Gross profit margin	24.8%	23.0%	21.8%	23.4%	29.2%
Selling & administrative expense	1,021,394	914,927	941,936	865,383	916,580
Selling & administrative % of sales	15.0%	14.3%	14.2%	16.0%	19.8%
Interest expense	232,446	219,534	261,880	243,814	220,725
EBITDA*	892,676	721,048	686,561	584,291	578,917
EBITDA margin*	13.1%	11.3%	10.3%	10.8%	12.5%
<b>Working Capital</b>					
Quick ratio	1.9	1.1	0.9	0.5	1.5
Current ratio	5.3	3.1	3.4	2.5	4.9
Debt/Equity	0.8	0.9	0.9	1.1	0.9
Liabilities/Assets	0.4	0.5	0.5	0.5	0.5
Days sales in receivables	51	62	49	53	62
Working capital as % of sales	45.2%	37.4%	33.3%	41.4%	48.4%
Inventory turnover	2.24	2.15	2.04	1.78	1.92
<b>Leverage and Other</b>					
Asset turnover	1.09	0.98	1.02	0.98	0.85
Shareholder's equity	3,537,085	3,271,815	3,199,914	3,037,891	2,945,427
Return on shareholders' equity*	8.1%	6.6%	5.1%	4.0%	4.8%
Debt/Equity	0.8	0.9	0.9	1.1	0.9
Liabilities/Assets	0.4	0.5	0.5	0.5	0.5

\*The Company adopted SOP 98-5 for the year ended December 31, 1997. The unamortized portion of pre-contract costs at December 31, 1996, net of tax, was recorded as cumulative effect of change in accounting principle.

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## DIRECTORS

M. S. Moore  
Chairman/CEO  
Semco Instruments, Inc.

Arnold Twersky  
Certified Public Accountant  
Northridge, California

Edwin H. Boyer  
Principal – Ed Boyer Insurance Agency  
Hollywood, California

Daniel C. de Brauwere  
Senior Vice President  
BankAmerica Business Credit, Inc.  
Pasadena, California

Michael G. Moore  
President  
Semco Instruments, Inc.

## OFFICERS

M.S. Moore – CEO  
Michael G. Moore – President  
Edwin H. Boyer – Secretary/Treasurer

## COUNSEL

Whitman Breed Abbott & Morgan  
Los Angeles, California

## AUDITORS

McGladrey & Pullen, LLP  
Pasadena, California

## TRANSFER AGENT AND REGISTRAR

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10 Commerce Drive  
Cranford, New Jersey 07016

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