OPTEL

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Annual Report

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Dear Shareholder:

Our efforts during 1973 were concentrated in three main areas: the manufacture and sale of liquid crystal *displays* as components; the development and manufacture of liquid crystal *watches*; and the continued research and development of advanced display technologies. Further, Optel Corporation moved into mass production during the year, increasing its revenues to $2,565,704 from $170,205 in 1972. While we did report a modest profit for the third quarter, the fourth quarter sustained a loss of $800,812, as explained below. We operated at an overall loss of $1,696,292 for the year compared to a loss of $1,783,909 in 1972.

Despite our inability to maintain profitability for the balance of 1973, we believe that the development and successful application of a truly new technology to the marketplace was in itself no minor accomplishment. Mass producing such a product in an environment of production start-up difficulties and component shortages was a demanding experience. For example, delays in receiving watch cases and other components contributed to a substantial curtailment of deliveries to our customers, resulting in the fourth quarter's loss.

While (at this writing) the final results for the first quarter of the current year are not yet available, present indications are that the Company has operated during this first quarter at breakeven or better. During this period, moreover, the Company strengthened its financial position by securing a $1 million, two-year revolving credit guaranteed by a Swiss bank affiliated with one of its Swiss investors.

In mid-1973, the Company entered into a previously announced agreement with Essex International Inc., now a subsidiary of United Aircraft Company, to develop electrochromic displays for the automobile and related markets. We are hopeful that, sometime in 1974, this development project will lead to a joint venture to be financed by Essex for the manufacture of products employing electrochromic displays.

We are currently in volume production of digital watches and watch displays employing both the dynamic scattering and field effect technologies. The manufacturing experience gained last year has led to significant improvements in productive capacity. Our efforts during 1973 also resulted in important advances in product quality and, since returns from watch company customers have not yet met our goals, we intend to continue our emphasis in this area. The availability of integrated circuit chips, while still erratic, has improved as new suppliers enter the field. The shortage of watch cases is still a problem although this should not be a persistent one.

While Optel was experiencing delivery delays last year, a number of companies announced their entry into the digital watch market. Such competition may well present new challenges both in marketing and in the availability of component supplies, challenges which we are confident we will be able to meet. To do so both in liquid crystals and electrochromic materials, Optel continues to maintain an R & D effort unusually strong for a company of its size. In 1973, the Company charged to operations $982,621 of research and development expenses compared with $740,031 in 1972. These expenditures should prove to be justified in the Company's eventual impact in the market.

We remain convinced that the market for electronic time-pieces has only been scratched. In our opinion, we should see a significant penetration into this market during the current year.

Zoltan J. Kiss

Zoltan J. Kiss
President and Chairman of the Board

OPTEL CORPORATION
CONSOLIDATED BALANCE SHEETS
December 31, 1973 and 1972

ASSETS	1973	1972
CURRENT ASSETS:		
Cash	$ 330,189	$ 183,589
Commercial paper and certificates of deposit, at cost which approximates market	–	2,500,000
Accounts receivable, less allowance for doubtful accounts of $40,000 and $3,500, respectively	854,055	84,450
Inventories (Note 1)		
Finished goods	386,060	11,827
Work in process	748,445	33,146
Raw materials	688,669	133,862
Prepaid expenses (Note 2)	62,384	57,656
Total current assets	$3,069,802	$3,004,530
PROPERTY, PLANT AND EQUIPMENT (Notes 1, 2 and 4):		
Land	$ 95,607	$ 95,607
Building	480,779	464,893
Building improvements	71,025	29,282
Machinery and equipment	918,606	585,680
Office furniture and fixtures	49,357	31,403
	$1,615,374	$1,206,865
Less – Accumulated depreciation	196,380	75,980
	$1,418,994	$1,130,885
RIGHTS TO USE LEASED EQUIPMENT, less accumulated amortization of $7,900 (Notes 1, 2 and 4)	$ 118,410	$ –
DEFERRED CHARGES AND DEPOSITS (Note 2)	$ 4,926	$ 26,190
	$4,612,132	$4,161,605

The accompanying notes to consolidated financial statements are an integral part of these balance sheets.

LIABILITIES AND STOCKHOLDERS' INVESTMENT	1973	1972
CURRENT LIABILITIES:		
Accounts payable	$ 935,629	$ 318,273
Accrued liabilities	171,274	38,509
Current portion of long-term debt (Note 4)	20,500	8,000
Equipment financing obligation	–	1,338
Total current liabilities	$1,127,403	$ 366,120
LONG–TERM DEBT (Note 4):		
Notes payable under revolving credit agreement	$1,250,000	$ –
8½% mortgage note payable, less current portion	383,030	392,000
Capitalized lease obligations, less current portion	109,626	–
	$1,742,656	$ 392,000
COMMITMENTS (Note 7)		
STOCKHOLDERS' INVESTMENT (Notes 3, 4 and 5):		
Class A cumulative convertible preferred stock, $5 par value; authorized 200,000 shares; outstanding 88,100 shares in 1973 and 194,000 shares in 1972 (redemption and liquidation value–$547,400 in 1973)	$ 440,500	$ 970,000
Class B cumulative convertible preferred stock, $10 par value; authorized and outstanding 70,002 shares (redemption and liquidation value–$756,900 in 1973)	700,020	700,020
Common stock, $.01 par value; authorized 5,000,000 shares; issued 1,312,982 shares in 1973 and 1,195,297 shares in 1972	13,130	11,953
Capital in excess of par value	5,468,160	4,904,957
Accumulated deficit	(4,878,887)	(3,182,595)
	$1,742,923	$3,404,335
Less–Cost of 85,000 shares of common stock held in treasury	850	850
	$1,742,073	$3,403,485
	$4,612,132	$4,161,605

OPTEL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

For the years ended December 31, 1973 and 1972

	1973	1972
REVENUES (Note 2)	$2,565,704	$ 170,205
COSTS AND EXPENSES (Note 1):		
Manufacturing (preproduction in 1972)	$2,471,062	$ 647,899
Research and product development	982,621	740,031
General, administrative and marketing	769,050	550,330
	$4,222,733	$1,938,260
Loss from operations	($1,657,029)	($1,768,055)
OTHER INCOME (EXPENSE):		
Interest income	$ 56,543	$ 78,623
Financing costs	–	(76,892)
Interest expense	(95,806)	(17,585)
	($ 39,263)	($ 15,854)
Net loss (Note 6)	($1,696,292)	($1,783,909)
NET LOSS PER COMMON SHARE (Note 8)	($1.49)	($2.07)

The accompanying notes to consolidated financial statements are an integral part of these statements.

OPTEL CORPORATION

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

For the years ended December 31, 1973 and 1972

	1973	1972
WORKING CAPITAL WAS PROVIDED (USED) AS FOLLOWS:		
Net loss	($1,696,292)	($1,783,909)
Deduct–Expenses not requiring outlay of working capital in current period–depreciation and amortization	167,413	59,302
Working capital used in operations	($1,528,879)	($1,724,607)
Proceeds from the sale of 5,785 shares of common stock in 1973 and 440,705 shares in 1972, net of related expenses of $558,044 incurred in 1972	29,780	4,725,481
Proceeds from the issuance of long-term debt	1,250,000	400,000
Capitalized lease obligations	126,310	–
Conversion of note payable and related accrued interest into 22,592 shares of common stock	–	203,333
Value assigned to 10,000 warrants issued in 1973 and 70,000 warrants issued in 1972	5,000	3,500
Additions to property, plant and equipment	(408,509)	(1,008,164)
Capitalization of rights to use leased equipment	(126,310)	–
Repayments and current portion of long-term debt	(25,654)	(8,000)
Other, net	(17,749)	(2,747)
Increase (decrease) in working capital	($ 696,011)	$2,588,796
INCREASE (DECREASE) IN WORKING CAPITAL REPRESENTED BY:		
Increase (decrease) in current assets–		
Cash	$ 146,600	$ 112,978
Commercial paper and certificates of deposit	(2,500,000)	2,400,385
Accounts receivable	769,605	54,114
Inventories	1,644,339	178,835
Prepaid expenses	4,728	56,514
	$ 65,272	$2,802,826
Decrease (increase) in current liabilities–		
Accounts payable and accrued liabilities	($ 750,121)	($ 220,755)
Current portion of long-term debt	(12,500)	(8,000)
Equipment financing obligation	1,338	14,725
	($ 761,283)	($ 214,030)
Increase (decrease) in working capital	($ 696,011)	$2,588,796

The accompanying notes to consolidated financial statements are an integral part of these statements.

OPTEL CORPORATION

CONSOLIDATED STATEMENTS OF STOCKHOLDERS' INVESTMENT

For the years ended December 31, 1973 and 1972

	Class A Cumulative Convertible Preferred Stock $5 Par Value
Balance, January 1, 1972	$1,000,000
Proceeds from sale of 705 shares of common stock	–
Conversion of $200,000 note payable and related accrued interest into 22,592 shares of common stock	–
Value assigned to 70,000 warrants issued in connection with $70,000 short-term borrowings	–
Proceeds from sale of 440,000 shares of common stock through public offering net of related expenses of $610,708	–
Conversion of 6,000 shares of Class A preferred stock into 6,000 shares of common stock	(30,000)
Purchase of 6,000 shares of common stock	–
Net loss for the year ended December 31, 1972	–
Balance, December 31, 1972	$ 970,000
Conversion of 105,900 shares of Class A preferred stock into 105,900 shares of common stock	(529,500)
Issuance of 6,000 shares of common stock in connection with the acquisition of MKS Systems, Inc. (Note 3)	–
Value assigned to 10,000 warrants issued for consulting services	–
Proceeds from the sale of 5,785 shares of common stock (Note 5)	–
Net loss for the year ended December 31, 1973	–
Balance, December 31, 1973	$ 440,500

The accompanying notes to consolidated financial statements are an integral part of these statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(1) **Significant accounting policies:**
The consolidated financial statements for the year ended December 31, 1973, include the accounts of the Company and its wholly-owned subsidiary, MKS Systems, Inc., which was acquired in July, 1973 (see Note 3). All intercompany balances and transactions have been eliminated.

Inventories are stated at the lower of cost (first-in, first-out) or market.

Property, plant and equipment is stated at cost. Provision for depreciation is made using the straight-line method over the estimated useful lives of the respective assets.

Rights to use leased equipment is stated at the discounted value of future lease payments (see Note 4) and is being amortized using the straight-line method over the estimated useful life of the related equipment.

Research and development and pre-production costs are charged to expense as incurred.

(2) **Operations of the Company:**
The Company's activities prior to 1973 were directed primarily toward research and development of products and markets, and the implementation of manufacturing processes. During this period the Company incurred losses of $3,165,095. In 1973, the Company started production of its liquid crystal displays and watches, however, difficulties were encountered in obtaining key components supplied by others and in attaining satisfactory quality standards. As a result, the Company had certain problems with respect to meeting delivery dates and it experienced a significant quantity of product returns (approximately $900,000). The Company incurred a loss for the year of $1,696,292 and experienced a decrease in working capital of $696,011. As a result, the Company was in default under certain provisions of its revolving credit agreement with respect to the maintenance of minimum working capital, tangible net worth and ratio of total liabilities to tangible net worth. An amendment was obtained to reduce these requirements until May 31, 1974 (see Note 4). The ultimate realization of the Company's investment in prepaid expenses, property, plant, equipment, rights to use leased equipment and deferred charges (aggregating $1,604,714 at December 31, 1973) is dependent upon the success of its future operations.

(3) **Acquisition:**
In July 1973, the Company acquired MKS Systems, Inc. (MKS) for 6,000 shares of common stock in a transaction accounted for as a pooling of interests.

Class B Cumulative Convertible Preferred Stock $10 Par Value	Common Stock $.01 Par Value	Capital in Excess of Par Value	Accumulated Deficit	Cost of Common Stock Held in Treasury
$ 700,020	$ 7,260	$ –	($1,398,686)	$ 790
–	7	3,518	–	–
–	226	203,107	–	–
–	–	3,500	–	–
–	4,400	4,664,892	–	–
–	60	29,940	–	–
–	–	–	–	60
–	–	–	(1,783,909)	–
$ 700,020	$ 11,953	$4,904,957	($3,182,595)	$ 850
–	1,059	528,441	–	–
–	60	40	–	–
–	–	5,000	–	–
–	58	29,722	–	–
–	–	–	(1,696,292)	–
$ 700,020	$ 13,130	$5,468,160	($4,878,887)	$ 850

MKS was incorporated in December 1972; however, it did not issue its capital stock and did not commence operations until January 1973. MKS is engaged in the design and development of integrated circuits for use in the Company's liquid crystal watches. Prior to the date of the merger MKS had revenues of $46,719 and expenses of $46,723, which are included in the accompanying consolidated statement of operations for the year ended December 31, 1973.

(4) **Long-term debt:**

In April 1973, the Company entered into a revolving credit agreement with a bank, which agreement expires in February 1976. Under the terms of the agreement, the Company may borrow an amount equal to the sum of 80% of accounts receivable and 50% of inventory, up to a maximum amount of $2,000,000. The interest rate on the borrowed portion of the commitment is 2% per annum above the bank's prime rate. In addition, the Company has agreed to pay the bank a commitment fee of ½ of 1% per annum on the unused portion of the bank's commitment. During the year ended December 31, 1973, the average balance outstanding under this agreement was $882,000 with a weighted average effective interest rate of 12½%.

Under the terms of the agreement the Company cannot, among other things, declare or pay any dividends, acquire any treasury stock or make any investments. In addition, the terms of the agreement require the Company to maintain working capital, as defined, and tangible net worth of not less than $1,000,000 and $2,000,000, respectively; and the ratio of total liabilities to tangible net worth cannot be more than 1 to 1. As of December 31, 1973, the Company did not meet these requirements, however, this was remedied by a subsequent amendment whereby the requirements were reduced until May 31, 1974. After May 31, 1974, the Company must comply with the various provisions of the original revolving credit agreement as described above. As of December 31, 1973, working capital, as defined, and tangible net worth were $692,399 and $1,742,073, respectively; and the ratio of total liabilities to tangible net worth was 1.65 to 1.

In March 1974, the Company entered into an additional revolving credit agreement, with the same bank, which expires in February 1976. Under the terms of this agreement, the Company may borrow an additional $970,000. The interest rate on the borrowed portion is 1% per annum above the bank's prime rate. In addition, the Company has agreed to pay the bank a commitment fee of ½ of 1% per annum on the unused portion of the bank's commitment. The borrowings under this agreement are subordinated to the amounts outstanding under the April 1973 revolving credit agreement and are guaranteed by a Swiss financial institution. Under the terms of the guarantee, the Company is required to pay a guarantee fee of 2% per annum on the $970,000 and has agreed to sell, to the guarantor, 50,000 shares of common stock at par value.

The 8½% mortgage note payable is due in monthly installments, including interest, of $3,472 through December 1992. The note is secured by a first mortgage on the Company's land and building.

The capitalized lease obligations relate to equipment leased under long-term noncancelable leases and bear interest at approximately 11% per annum. The obligations are due in monthly payments, including interest, of $1,847 through November 1981.

(5) **Stockholders' investment:**
The cumulative convertible preferred stock is entitled to a $.30 per share annual dividend but only if declared by the Board of Directors, or upon redemption of the stock by the Company or upon liquidation; is convertible share for share into common stock (subject to antidilution adjustment); and is redeemable at par value plus accumulated unpaid dividends. No preferred stock dividends have been declared by the Board. Dividends payable upon redemption or upon liquidation would amount to $163,780 as of December 31, 1973.

Under the Company's Qualified Stock Option Plan, options may be granted to officers and key employees at a price which is not less than the fair market value of the Company's common stock at the date of grant. Options are exercisable over a period not to exceed five years and in accordance with the terms established in each case by the Stock Option Committee of the Board of Directors. During 1972, options for 27,600 shares at prices ranging from $6.50 to $8.00 per share were granted and options for 5,000 shares were canceled. During 1973, options for 34,100 shares at prices ranging from $8.00 to $10.00 per share were granted, options for 5,785 shares were exercised, and options for 10,100 shares were canceled. At December 31, 1973, options were outstanding for 67,815 shares at prices ranging from $5.00 to $10.00 per share, of which options for 14,349 were exercisable and the balance become exercisable in 1974 (23,133 shares), in 1975 (21,333 shares) and in 1976 (9,000 shares).

At December 31, 1973, the Company had warrants outstanding for the purchase of 103,250 shares of its common stock at prices ranging from $5.00 to $12.00 per share, subject to antidilution adjustments, which expire at various dates through September 1978.

In summary, as of December 31, 1973, 355,567 shares of common stock were reserved for (1) conversion of convertible preferred stock (158,102), (2) stock option plan (94,215) and (3) exercise of warrants (103,250).

In February 1974, the Board of Directors amended the stock option plan, subject to stockholders' approval, to increase the number of shares available for future grant by 42,100 shares.

(6) **Federal income taxes:**
As of December 31, 1973, the Company had operating loss carry-forwards aggregating approximately $4,800,000, which can be used to reduce the amount of future earnings which would otherwise be subject to Federal income taxes through 1975 ($4,800,000), 1976 ($4,700,000), 1977 ($4,000,000), 1978 ($2,100,000) and then in decreasing amounts through 1981.

In addition, the Company has available investment tax credit carry-forwards which can be used to offset Federal income taxes payable through 1978 ($60,000), 1979 ($55,000) and 1980 ($35,000).

(7) **Commitments:**
The Company has entered into employment agreements with certain officers and key employees. The agreements, which expire at various dates through 1976, provide for aggregate annual current salaries of approximately $425,000 and contain, among other things, noncompetition provisions.

(8) **Net loss per common share:**
The computations of net loss per common share have been based on the weighted average number of common shares outstanding during each period, after giving effect to dividend requirements on cumulative preferred stock (see Note 5). Such dividend requirements increased net loss per common share by $.04 in 1973 and by $.09 in 1972. Shares of common stock issuable upon conversion of the preferred stock and upon exercise of stock options and warrants have been excluded from the computations because they would reduce the loss per share.

To the Stockholders and Board of Directors of Optel Corporation:

AUDITORS' REPORT

We have examined the consolidated balance sheets of Optel Corporation (a Delaware corporation) and subsidiary as of December 31, 1973 and 1972, and the related statements of operations, stockholders' investment and changes in financial position for the years 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.

As discussed in Note 2, realization of the Company's investment in prepaid expenses, property, plant and equipment, rights to use leased equipment and deferred charges (aggregating $1,604,714 at December 31, 1973) is dependent upon the success of its future operations.

In our opinion, subject to the realization of the investment in the assets described in the preceding paragraph, the consolidated financial statements described above present fairly the financial position of Optel Corporation and subsidiary as of December 31, 1973 and 1972, 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 periods.

Newark, New Jersey
March 22, 1974

ARTHUR ANDERSEN & CO.

OFFICERS AND DIRECTORS

Zoltan J. Kiss,
President and Chairman of the Board, Optel Corporation

David J. Barnett,
Executive Vice President, Optel Corporation

M. Douglas Beals,
Manager, Development Engineering, Director, Optel Corporation

Adolf Brandle,
Director. Vice President, Union Bank of Switzerland

Richard M. Corbin,
Vice President, Secretary and Treasurer, Director, Optel Corporation

Lawrence Goldmuntz,
Director. Chairman of the Board, Economics and Science Planning Inc. Independent Management Consultant

Jack Kotik,
Director. Independent Management Consultant

Nunzio A. Luce,
Vice President, Director, Optel Corporation

Joel F. Spivak,
Vice President and General Counsel, Optel Corporation

E. E. Strickland,
Director. Vice President, Senior Staff Officer, Control Data Corporation

Hans Widmer,
Director. Vice President, Societe Suisse pour l' Industrie Horlogere Management Services S. A.

AUDITORS

Arthur Andersen & Co., Newark, N.J.

COUNSEL

Blum, Haimoff, Gersen Lipson & Szabad, New York, N.Y.

STOCK TRANSFER AGENT

The First National Bank of Princeton, Princeton, N.J.

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