

The Company warrants certain equipment against defects in design, materials and workmanship, generally for one year. Upon shipment of equipment sold at a price which includes a warranty, the Company establishes, as part of cost of goods sold, a provision for the expected costs of such warranty.

**Foreign Currency Translation**

Balance sheet accounts of international subsidiaries are translated at the current exchange rate as of the end of the accounting period. Income statement items are translated at average exchange rates. The resulting translation adjustment is recorded as a separate component of stockholders' equity.

**Forward Exchange Contracts**

The Company does not use derivative financial instruments for speculative or trading purposes. As part of distributing its products, the Company regularly enters into intercompany transactions. The Company enters into forward foreign exchange contracts to hedge against future movements in foreign exchange rates that affect foreign currency denominated intercompany receivables and payables. These contracts generally have maturity dates of 60 days or less, relate primarily to currencies of industrial countries and are marked to market at each balance sheet date. The resulting gains or losses are included in other income and expense offsetting exchange losses or gains on the related receivables and payables. Unrealized gains and losses are not deferred. Exchange gains and losses on these contracts are net of premiums and discounts resulting from interest rate differentials between the U.S. and the countries of the currencies being traded. The cash flows related to these contracts are classified as cash flows from investing activities in the statement of cash flows.

**Stock Compensation Plans**

Stock-based compensation is recognized using the intrinsic value method. For disclosure purposes, pro forma net income and earnings per share are provided as if the fair value method had been applied.

**Earnings Per Share**

Basic earnings per share are calculated on the basis of the weighted average number of common shares outstanding for each period. Diluted earnings per share are calculated assuming the exercise of certain stock options. Treasury stock is not considered outstanding for purposes of calculating weighted average shares.

**Fair Value of Financial Instruments**

For certain of the Company's financial instruments, including cash and cash equivalents, accounts receivable, notes payable, accounts payable, long-term debt and forward exchange contracts, the carrying amounts approximate fair value. The fair values of other instruments are disclosed in relevant notes to the financial statements.

**2. ACQUISITIONS**

In December 1997, the Company acquired, for cash, the assets used by Chiron Diagnostics Corporation in the business of manufacturing, marketing and selling diagnostic controls (exclusive of blood gas controls). The business has been combined with the Clinical Diagnostics controls business based in southern California.

In October 1997, the Company acquired, for cash, substantially all of the assets of Protein Databases, Inc. The assets purchased have been utilized by the Life Science segment in its imaging products.

In September 1997, the Company acquired, for cash, certain assets related to the design and manufacture of the optical production profiler from Pacific Scientific Company. This expanded the semiconductor products offered by the Analytical Instruments segment.

In conjunction with these acquisitions, liabilities were assumed and incurred as follows (in thousands):

Assigned value of assets acquired	\$ 12,173
Goodwill	20,959
Cash paid	<u>(31,238)</u>
Liabilities assumed and incurred	<u>\$ 1,894</u>

**3. MARKETABLE SECURITIES**

The Company's portfolio is comprised principally of equity securities with an aggregate market value of \$6,174,000 and \$18,092,000 and cost of \$5,469,000 and \$12,289,000 at December 31, 1998 and 1997, respectively. At December 31, 1998, gross unrealized holding gains and losses were \$1,044,000 and \$339,000, respectively. At December 31, 1997, gross unrealized holding gains and losses were \$6,039,000 and \$236,000, respectively.

Information regarding the proceeds and gross realized gains and losses from sales of securities is as follows (in thousands):

	Year Ended December 31,		
	1998	1997	1996
Proceeds	<u>\$ 16,367</u>	<u>\$ 3,419</u>	<u>\$ 2,968</u>
Gross realized gains	<u>\$ 9,168</u>	<u>\$ 1,211</u>	<u>\$ 1,130</u>
Gross realized losses	<u>(548)</u>	<u>(82)</u>	<u>—</u>
Net realized gain	<u>\$ 8,620</u>	<u>\$ 1,129</u>	<u>\$ 1,130</u>

**4. INVESTMENT IN AFFILIATES**

Beginning in December 1997, Bio-Rad began investing in Instrumentation Laboratory, S.p.A. (IL), an Italian based clinical diagnostics company with fiscal 1997 revenues in excess of \$200 million. At December 31, 1998, Bio-Rad held approximately 26% of the outstanding stock of IL. Grupo CH-Werfen, S.A., a privately held company based in Spain, controls over 50% of the outstanding stock of IL. Approximately 29% of the outstanding stock of IL is available in the U.S. evidenced by American Depositary Shares (Nasdaq:ILABY). The most recently published financial statements for IL are as of February 28, 1998.

Prior to September 1998, Bio-Rad classified the investment as Marketable Securities. Given the limited availability of financial information and the low volume of shares traded in recent months, Bio-Rad management does not believe there is a sufficient liquid market for IL stock. Accordingly, the investment was reclassified to Other Assets. Additionally, since Bio-Rad does not have the ability to significantly influence the operating and financial policies of IL, the investment has been recorded at its cost of \$18,159,000.

An unrealized holding gain of \$652,000 was included in comprehensive income in 1997. This amount was reversed in 1998 when the investment in IL was reclassified to Other Assets.

5. NOTES PAYABLE AND LONG-TERM DEBT

Notes payable include local credit lines maintained by the Company's subsidiaries aggregating approximately \$33,311,000, of which \$24,592,000 was unused at December 31, 1998. The weighted average interest rate on these lines was 5.14% and 5.78% at December 31, 1998 and 1997, respectively. The parent company guarantees most of these credit lines.

The principal components of long-term debt are as follows (in thousands):

	December 31,	
	1998	1997
Revolving credit agreement	\$ 42,000	\$ 38,000
Capitalized leases	606	1,046
Other	405	836
	<u>43,011</u>	<u>39,882</u>
Less current maturities	672	930
Long-Term Debt	<u>\$ 42,339</u>	<u>\$ 38,952</u>

The Company entered into a \$100 million revolving credit agreement on May 15, 1998, replacing the \$60 million credit agreement previously in place. The new agreement provides for borrowings on an unsecured basis through May 2003. Interest is based upon Eurodollar or corporate base (prime) rates. The applicable interest rates at December 31, 1998 and 1997 were 5.96% and 6.49%, respectively. A fee ranging from 0.15% to 0.30% annually is charged on the daily unborrowed portion of the commitment.

The Company entered into interest rate swap agreements to reduce the impact of changing interest rates on its revolving credit agreement. At December 31, 1998, the Company had two interest rate swap agreements with commercial banks, having an aggregate notional amount of \$25 million. The agreements essentially fix the Company's interest rate exposure on \$25 million worth of floating rate loans under its revolving credit agreement at 6.30%. The agreements mature in December 2000, and June 2002. The resulting applicable interest rate was 6.23% on the revolving credit agreement. In terms of the interest rate swap, the Company is exposed to credit loss in the event of nonperformance by a counterparty, however the Company has not experienced such nonperformance to date and considers such a possibility remote.

The Company redeemed all of its 10.9% Subordinated Notes in December 1996. This redemption resulted in an extraordinary charge of \$1,176,000, net of income tax benefits of \$817,000. The debt was extinguished with current operating funds and \$5,000,000 borrowed from the Company's revolving credit agreement.

The revolving credit agreement (including amendments) requires the Company, among other things, to comply with certain financial ratio covenants. The Company was in compliance with all financial ratio covenants as of December 31, 1998. This agreement also contains certain other restrictions, including the limitation of cash dividends. Approximately \$11,486,000 of retained earnings were available for payment of cash dividends at December 31, 1998.

Maturities of long-term debt at December 31, 1998, are as follows: 1999 - \$672,000; 2000 - \$213,000; 2001 - \$116,000; 2002 - \$10,000; 2003 - \$42,000,000.

6. INCOME TAXES

The U.S. and international components of income before taxes and extraordinary charge are as follows (in thousands):

	Year Ended December 31,		
	1998	1997	1996
U.S.	\$ 24,173	\$ 11,343	\$ 23,766
International	10,055	11,385	12,707
Income before taxes and extraordinary charge	<u>\$ 34,228</u>	<u>\$ 22,728</u>	<u>\$ 36,473</u>

The provision for income taxes consists of (in thousands):

	Year Ended December 31,		
	1998	1997	1996
Current:			
U.S. Federal	\$ 8,564	\$ 3,277	\$ 7,613
International	4,974	3,226	6,070
U.S. State	374	552	1,122
	<u>13,912</u>	<u>7,055</u>	<u>14,805</u>
Deferred	(3,986)	(691)	(5,687)
Provision for income taxes	<u>\$ 9,926</u>	<u>\$ 6,364</u>	<u>\$ 9,118</u>

The Company's income tax provision differs from the amount computed by applying the U.S. federal statutory rate to income before taxes as follows:

	Year Ended December 31,		
	1998	1997	1996
U.S. statutory tax rate	35%	35%	35%
State taxes, net of federal income tax benefit	(1)	1	1
Foreign Sales Corporation tax benefit	(5)	(6)	(4)
Research and development tax credit	(1)	(2)	(1)
International taxes in excess of			
U.S. Foreign Tax Credit	—	1	4
Loss carryforwards utilized	(1)	(6)	(4)
Amortization of goodwill	—	2	—
Other	2	3	(6)
Provision for income taxes	<u>29%</u>	<u>28%</u>	<u>25%</u>

Deferred income taxes reflect the net tax effect of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of deferred tax assets and liabilities are as follows (in thousands):

	December 31,	
	1998	1997
Deferred Tax Assets:		
Reserves for obsolete inventory, warranty and bad debts	\$ 12,102	\$ 10,418
Eliminated intercompany profit	3,265	3,483
Tax benefit of foreign loss carryforwards	4,732	1,822
Other	3,583	3,086
	<u>23,682</u>	<u>18,809</u>
Valuation allowance	(5,342)	(3,285)
Deferred Tax Assets	<u>\$ 18,340</u>	<u>\$ 15,524</u>
Deferred Tax Liabilities:		
Deferred gain on condemnation	\$ 4,473	\$ 4,426
Depreciation	1,174	1,921
Development cost of Hercules facility	1,413	1,438
Other	6,322	7,680
	<u>13,382</u>	<u>15,465</u>
Deferred Tax Liabilities	<u>\$ 13,382</u>	<u>\$ 15,465</u>

The valuation allowance is needed to reduce the deferred tax assets to an amount that is more likely than not to be realized. The net change in the valuation allowance in 1998 was an increase of \$2,057,000, primarily resulting from an increase in tax loss carryforwards. The net change in 1997 was a decrease of \$2,287,000, primarily resulting from unanticipated utilization of foreign loss carryforwards.

At December 31, 1998, Bio-Rad's international subsidiaries had combined net operating loss carryforwards of \$11,600,000. A portion of these loss carryforwards will expire in the following years: 1999 - \$1,440,000; 2000 - \$762,000; 2001 - \$371,000; 2002 - \$1,148,000; 2003 - \$422,000; 2004 - \$260,000; 2005 - \$1,543,000 and 2008 - \$243,000. The remainder of these loss carryforwards have no expiration date. The utilization of these carryforwards is limited to the separate taxable income of each individual subsidiary.

Bio-Rad does not provide for taxes which would be payable if the cumulative undistributed earnings of its international subsidiaries, approximately \$24,923,000 at December 31, 1998, were remitted to the U.S. parent company. Unless it becomes advantageous for tax or foreign exchange reasons to remit a subsidiary's earnings, such earnings are indefinitely reinvested in subsidiary operations. The withholding tax and U.S. federal income taxes on these earnings, if remitted, would in large part be offset by tax credits.

## 7. STOCKHOLDERS' EQUITY

### Stock Classification

The Company's outstanding stock consists of Class A Common Stock (Class A) and Class B Common Stock (Class B). Each share of Class A and Class B participates equally in the earnings of Bio-Rad, and is identical in most respects except that (i) Class A has limited voting rights, each share of Class A being entitled to one-tenth of a vote on most matters and each share of Class B being entitled to one vote; (ii) Class A stockholders are entitled to elect 25% of the Board of Directors (rounded up to the nearest whole number) and Class B stockholders are entitled to elect the balance of the directors; (iii) cash dividends may be paid on Class A shares without paying a cash dividend on Class B shares, but no cash dividend may be paid on Class B shares unless at least an equal cash dividend is paid on Class A shares; and (iv) Class B shares are convertible at any time into Class A shares on a one-for-one basis at the option of the stockholder.

### Stock Option Plans

Bio-Rad maintains incentive and non-qualified fixed stock option plans for officers and certain other key employees. Under the Amended 1994 Stock Option Plan, the Company may grant options to its employees for up to 1,175,000 shares of common stock provided that no option shall be granted after March 1, 2004. Under the plans, Class A and Class B options are granted at prices not less than fair market value on the date of grant, are exercisable on a cumulative basis at a rate not greater than 25% per annum commencing one year after the date of grant and expire five years after the date of grant.

The Company has made no charge to income with respect to any stock options. At the time options are exercised, the par value of the shares is credited to common stock and the excess is credited to additional paid-in capital. The Company may receive income tax benefits from the exercise of non-qualified stock options and from certain dispositions of stock received by employees under qualified or incentive stock options. The fair value of each option granted since January 1, 1995, was estimated on the date of the grant using the Black-Scholes option-pricing model with the following assumptions for grants in 1998, 1997 and 1996, respectively: no dividend yield for all periods; expected lives of 2.0 and 2.9 years in 1998 and 1.8 and 2.8 years in 1997 and 1996; expected volatility of 35%, 33% and 33%; and risk-free interest rates ranging from 5.39% to 5.48%, 5.63% to 6.15% and 4.85% to 5.27%.

Activity under the plans is summarized below (amounts reported in the Price columns represent the weighted average exercise price):

	Year Ended December 31,					
	1998		1997		1996	
	Shares	Price	Shares	Price	Shares	Price
Outstanding at beginning of year	517,018	\$21.40	482,900	\$16.34	427,457	\$12.39
Granted	150,653	23.54	147,050	32.54	147,000	26.55
Exercised	(89,625)	10.09	(90,445)	11.88	(59,576)	11.12
Forfeited	(14,677)	25.07	(19,909)	25.38	(31,981)	20.21
Expired	(2,322)	9.46	(2,578)	12.04	—	—
Outstanding at end of year	<u>561,047</u>	23.73	<u>517,018</u>	21.40	<u>482,900</u>	16.34
Options exercisable at year-end	<u>222,539</u>		<u>172,689</u>		<u>149,605</u>	
Weighted average fair value of options granted during the year	\$7.62		\$10.76		\$8.57	

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

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number Outstanding at 12/31/98	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable at 12/31/98	Weighted Average Exercise Price
\$7.37 - \$18.21	150,276	0.7 years	\$ 14.11	123,223	\$ 13.23
\$19.80 - \$23.94	147,106	3.9	23.10	6,976	19.89
\$25.92 - \$31.63	161,971	2.4	27.53	66,952	27.14
\$32.63 - \$35.89	<u>101,694</u>	3.1	32.82	<u>25,388</u>	32.82
\$7.37 - \$35.89	<u>561,047</u>	2.5	23.73	<u>222,539</u>	19.86

**Employee Stock Purchase Plan**

Under the Amended and Restated 1988 Employee Stock Purchase Plan (the Plan), the Company has authorized the sale of 645,000 shares of Class A to eligible employees. The purchase price of the shares under the Plan is the lesser of 85% of the fair market value on the first day of each calendar quarter, or 85% of the fair market value on the last day of each calendar quarter. Employees may designate up to 10% of their compensation for the purchase of stock. Under the Plan, the Company sold 51,446 shares for \$1,129,000; 43,785 shares for \$982,000 and 30,888 shares for \$742,000 to employees in 1998, 1997 and 1996, respectively. At December 31, 1998, 64,126 shares remained authorized under the Plan. Management anticipates a stockholder resolution to extend the Plan.

The fair value of the employees' purchase rights since January 1, 1995, was estimated using the Black-Scholes model with the following assumptions for 1998, 1997 and 1996, respectively: no dividend yield for all periods; an expected life of three months for all periods; expected volatility ranging from 28% to 38%, 19% to 30% and from 26% to 38%; and risk-free interest rates ranging from 4.27% to 5.23%, 5.02% to 5.41% and from 4.90% to 4.99%. The weighted average fair value of those purchase rights granted in 1998, 1997 and 1996 was \$5.55, \$5.50 and \$6.81, respectively.

**Pro Forma Disclosures**

Had compensation cost for the Company's stock-based compensation plans been determined based upon the fair value at grant dates for awards under those plans consistent with the method of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation", the Company's net income and earnings per share would have been reduced to the pro forma amounts indicated below (in thousands, except per share):

		Year Ended December 31,		
		1998	1997	1996
Net income	As reported	\$ 24,302	\$ 16,364	\$ 26,179
	Pro forma	\$ 23,026	\$ 15,173	\$ 25,348
Diluted earnings per share	As reported	\$1.97	\$1.32	\$2.10
	Pro forma	\$1.86	\$1.22	\$2.03

Under the requirements of SFAS No. 123, the above disclosures relate only to options granted after December 15, 1994, and do not include the impact of outstanding options that were made prior to the period for which SFAS No. 123 is effective. Since employee stock options vest over several years, and additional grants are likely to be made in the future, during the phase-in period of SFAS No. 123 the disclosures are not likely to be representative of the effects on reported pro forma net income or earnings per share in future years.

**8. EARNINGS PER SHARE**

In the fourth quarter of 1997, Bio-Rad adopted SFAS No. 128, "Earnings per Share". Basic earnings per share as required by SFAS No. 128 are equal to earnings per share as historically reported by Bio-Rad. No historical restatement was necessary.

Weighted average shares used for diluted earnings per share include the dilutive effect of outstanding stock options of 94,000, 134,000 and 199,000 shares, for the years ended December 31, 1998, 1997 and 1996, respectively.

Options to purchase 229,000 and 133,000 shares of common stock were outstanding during 1998 and 1997, respectively, but were excluded from the computation of diluted earnings per share because the exercise price of the options was greater than the average market price of the common shares. The options were still outstanding at the end of 1998. No options were excluded in 1996.