

← MAXIMUM POSSIBLE IF ALL  
MILESTONES ARE MET

THE \$12,000,000.00 MEGADIAMOND TECHNOLOGY SALE (MERGER)  
TO SMITH INTERNATIONAL  
February 12, 1985

← COGEMA CONTRACT  
DID NOT

This contract does provide for the 2% royalty  
to be paid to Hall on polycrystalline diamond  
sales.

Pages copied from the contract showing this follow.

*Items pertinent to:*

SMITH-MEGA MERGER §

COGEMA TECHNOLOGY SALE

*in light of so called "PATENT SALES AGREEMENT"*

Megadiamond, which are to be performed and paid by April 1, 1985 in accordance with the terms of the settlement agreement with Bill Pope and U.S. Synthetic.

Megadiamond has purchased certain technology and inventions from H. Tracy Hall, Sr., pursuant to a patent sales agreement dated December 2, 1970. The patent sales agreement provides that Megadiamond is obligated to pay Mr. Hall a royalty of two percent of the net sales of all products sold by Megadiamond relating to the patents and technology that it purchased from Mr. Hall.

During the year ended April 30, 1984, Megadiamond purchased land and a building for \$338,000 from a partnership, which included as partners M. Duane Horton and Vera C. Stratford, wife of Richard C. Stratford, Chairman of the Board of Directors of Megadiamond. Prior to this purchase, Megadiamond leased the land and building under an operating lease from the partnership. Lease payments of \$6,750 and \$27,000 were made to the partnership during the years ended April 30, 1984 and 1983, respectively.

During the year ended April 30, 1984, David R. Hall, exercised an option to purchase 1,000 shares of treasury stock for \$5,000. During the month of October, 1984, David R. Hall exercised an option to purchase 3,000 shares of treasury stock for \$15,000.

During June, 1981, litigation was settled which involved Megadiamond, M. Duane Horton, H. Tracy Hall, Sr. and David R. Hall. Megadiamond agreed to pay these individuals who were named in the lawsuit the costs incurred by them in defending the suit. These costs plus accrued interest totalled approximately \$90,000 and were paid in the year ended April 30, 1983.

It is contemplated that prior to the merger that Megadiamond will acquire all of the assets of DHD, Incorporated, a Utah corporation, which is owned by David R. Hall. Mr. Hall would receive 16,282 shares of Megadiamond stock if the transaction is completed. All of the per share prices and stock ownership calculations are based upon the assumption that the 16,282 shares of stock have been issued to David R. Hall in exchange for the assets of DHD, Incorporated. If the transaction is not completed there would be an appropriate change in these calculations.

#### AUDITORS OF MEGADIAMOND

The firm of Touche Ross & Company was selected by the Megadiamond Board of Directors as the auditors for the current fiscal year. Representatives of Touche Ross & Company are expected to be present at the special meeting of stockholders to make a statement if they desire to do so and to respond to appropriate questions.

SMITH/MEGA Sale Agreement



H. INCOME TAXES

The income tax benefit consists of the following:

	Year ended April 30,	
	1984	1983
Currently payable	\$ (9,000)	\$ -
Deferred	318,000	423,000
	<u>\$309,000</u>	<u>\$423,000</u>

Deferred income taxes arise primarily from reporting income on the sale of technology for book purposes currently as opposed to using the installment method for tax purposes.

Income taxes (benefit) vary from the federal statutory income tax rate for the following reasons:

	Year ended April 30,	
	1984	1983
Estimated federal income tax benefit at 46%	\$168,000	\$272,000
State income (taxes) benefit, net of federal benefit	(4,000)	12,000
Investment tax, research, and targeted jobs credits	145,000	139,000
	<u>\$309,000</u>	<u>\$423,000</u>

For income tax purposes, at April 30, 1984, the Company has targeted jobs and research credit carryovers of approximately \$14,000 and \$132,000, respectively, expiring in 1997 through 1998. The targeted jobs and research credits have been used as an offset against deferred income taxes for financial statement purposes. The deferred income taxes will be reinstated in the year the credits are claimed for income tax purposes.

I. COMMITMENTS

The Company has an agreement with one of its stockholders which requires a royalty payment of \$1,500 per month through December 1986. The Company has also agreed to pay this stockholder 2% on sales of certain types of products in exchange for the use of patent applications and rights. This agreement expires December 2, 1990. The Company paid royalties to this stockholder of approximately \$35,000 and \$26,000 during the years ended April 30, 1984 and 1983, respectively.

HALL, Sr.

Income taxes (benefit) vary from the federal statutory income tax rate for the following reasons:

	Year ended April 30,	
	1983	1982
Estimated federal income tax (benefit) at 46%	\$ (272,000)	\$1,470,000
State income taxes (benefit), net of federal benefit	(12,000)	78,000
Surtax exemption	-	(19,000)
Investment tax and research credits	(139,000)	(83,000)
Benefit resulting from use of alternative tax rate	-	(316,000)
	<u>\$ (423,000)</u>	<u>\$1,130,000</u>

For income tax purposes, at April 30, 1983, the Company has investment tax and research credit carryovers of approximately \$64,000 and \$83,000, respectively, expiring in 1997 through 1998. The investment tax and research credits have been used as an offset against deferred income taxes for financial statement purposes. The deferred income taxes will be reinstated when the credits are claimed for income tax purposes.

The Company utilized a net operating loss carryforward of \$1,095,949 in the year ended April 30, 1982. The benefit reflected in the financial statements is not proportionary due to the use of the alternative tax method in computing income taxes.

I. COMMITMENTS

The Company has an ongoing agreement with one of its stockholders which requires a royalty payment of 2% on sales of certain types of products in exchange for the use of patent applications and rights. The term of the agreement is 20 years, expiring December 2, 1990. The Company paid royalties to this stockholder of approximately \$26,000 in each of the years ended April 30, 1983 and 1982.

The Company has an agreement with a Swedish corporation for the right to use certain patents in the manufacture of coated diamonds. In return for the use of these patents, the Company pays a royalty of 4 1/2% of the net sales value of all coated diamonds manufactured and/or sold in the United States. The agreement expires as of the last expiration date of the related patents. Royalties earned during the years ended April 30, 1983 and 1982, amounted to approximately \$13,500 and \$6,000, respectively.

HALL, Sr.

2%

4 1/2%