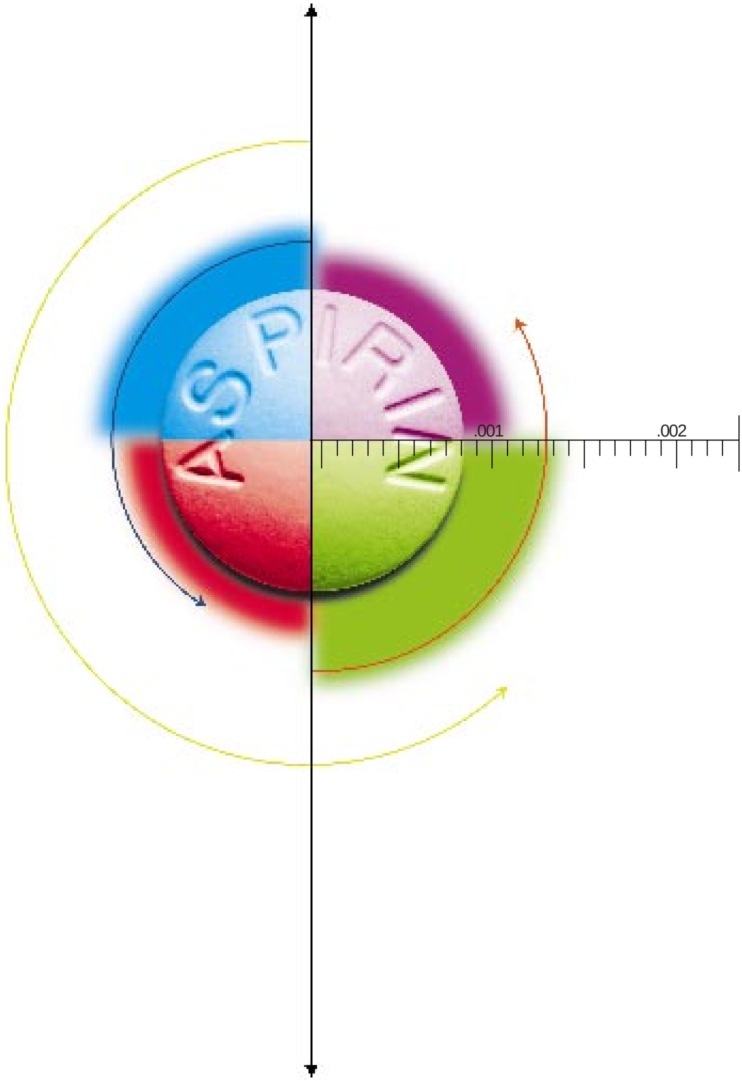
1996

The year in measurement



Waters

ANNUAL REPORT

Waters™ Corporation (NYSE: WAT) is the world's leading supplier of high performance liquid chromatography instrumentation and consumables, as well as thermal analysis products. Around the world, Waters products are used by pharmaceutical, industrial and university research and development laboratories. For these markets, we provide technology that helps break matter down to its molecular level. By turning analytical data into useful information, Waters helps its clients understand the complexities of chemistry and life itself.

FINANCIAL HIGHLIGHTS

Adjusted Financial Results (A):

($ in thousands, except per share data)	1996	1995	Percentage Change
For the year:			
Net sales	$391,113	$332,972	17%
Operating income	71,229	56,267	26%
Income from continuing operations before income taxes	56,489	38,621	46%
Net income available to common stockholders	44,338	30,700	44%
Income per common share from continuing operations	$1.40	$1.02	37%
At year end:			
Total assets	$365,502	$299,816	
Stockholders' equity	57,780	58,118	
Return on assets	12.1%	10.2%	
Return on equity	76.7%	52.8%	

(A) Adjusted financial results for 1996 reflect adjustments to reported results of operations necessary to eliminate nonrecurring charges related to the May 1996 acquisition of TA Instruments, Inc. and the Company's April 1996 tender for its then remaining subordinated debt. These amounts had no related tax effects. Adjusted financial results for 1995 reflect adjustments to reported results primarily necessary to eliminate nonrecurring charges related to the Company's November 1995 initial public offering ("IPO"), reduce interest expense to reflect the capital structure achieved with the Company's IPO, and record related income tax effects. A reconciliation of reported results to adjusted results follows in the table below.

	1996	1995
Net (loss) income available to common stockholders - as reported	$ (3,326)	$ 1,099
Adjustments:		
Eliminate revaluation of acquired inventory	(6,100)	(925)
Eliminate charge to SG&A for one-time acceleration of compensatory stock option vesting	–	(3,567)
Eliminate expensed in-process research and development related to the TAI acquisition	(19,300)	–
Eliminate management fee under agreement terminated in conjunction with the Company's IPO	–	(5,393)
Adjust interest expense to reflect financing associated with post-IPO capital structure	–	(11,494)
Adjust tax provision for items above	–	3,881
Eliminate extraordinary loss from early extinguishment of debt	(22,264)	(12,112)
Adjust preferred stock dividend and accretion to reflect Company's current capital structure	–	9
Total adjustments	47,664	29,601
Net income available to common stockholders - as adjusted	$ 44,338	$ 30,700

PRESIDENT'S LETTER

The year just concluded was successful not only financially for Waters, with sales growth of 17% and earnings growth of 37% (excluding nonrecurring items), but was a year of significant strategic progress for the company as well. First, in our core chromatography business, we launched a revolutionary new instrument platform, The Alliance™ System; and second, we acquired TA Instruments™ and its thermal analysis technology, providing Waters with a major new complementary growth opportunity.

The Alliance System debuted at The Pittsburgh Conference in March 1996, and has been quickly established as the HPLC performance leader. Customer response has been extremely positive and has driven HPLC growth rates to double-digit levels in the second half of 1996.

By July 1996, the Alliance System had been introduced in all regions of the world. Encouragingly, the Company's strong second-half performance was broad based with all major regions contributing equally to sales growth.

The success of the Alliance System underscores the real growth opportunity for us in our core markets. The Alliance System enables customers to improve their results through better chromatography. Customers clearly see this performance advantage and are encouraging us to continue to provide state-of-the-art HPLC solutions for their applications.

We intend to meet these customer needs by continuing to invest in our three major platform areas: our instrumentation, principally with the Alliance System; our software, with our market leading Millennium® Chromatography Manager Software; and chemistry, with a full range of consumable products, led by our novel Symmetry® product line.

No one is better positioned than Waters to provide a full range of state-of-the-art technologies in each of these important areas, and we intend to introduce important new products in each of these areas during 1997.

TA Instruments is the world leader in the field of thermal analysis — a technology complementary to HPLC which is particularly important for the analysis of polymers and plastics. We acquired TA Instruments in May 1996 for its technology and market leadership in a section of the analytical instrument marketplace where we had been underrepresented and where we saw opportunity. We were also attracted to TA Instruments by its culture and management which is very similar to Waters, with an emphasis on strong customer service, state-of-the-art products and application solutions for customers. TA Instruments' performance in 1996 exceeded our expectations, and ended 1996 with growth rates in the solid double digits. This business has a strong pipeline of new products in development, and we are optimistic about our opportunity to maintain and extend our competitive position. We believe that, with TA Instruments, we have a strengthened foundation in the industrial marketplace that can accelerate its growth by acquiring products and businesses which augment the base business.

We also made key investments to improve our infrastructure in 1996. We successfully converted legacy information systems in Europe and Asia to new state-of-the-art business systems based on software from SAP AG. These systems were delivered on time and on budget. Over the next 18 months, the United States and the remainder of our international operations will be converted as well. With these new systems in place, our information systems architecture will be ready to support our 21st century growth strategy.

As we look to 1997 and the future, the success we experienced and the investments we made in 1996 make us confident in our ability to sustain above-average performance in our very competitive industry. I'd like to thank our customers for their continued support and the worldwide Waters organization for its hard work and dedication in 1996, both of which made such a successful year possible.

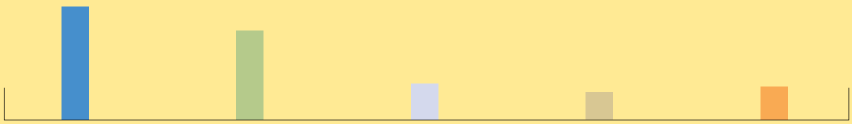
Sincerely,

Douglas Berthiaume

Douglas A. Berthiaume
Chairman, President, and
Chief Executive Officer

We gauge our results on an international basis

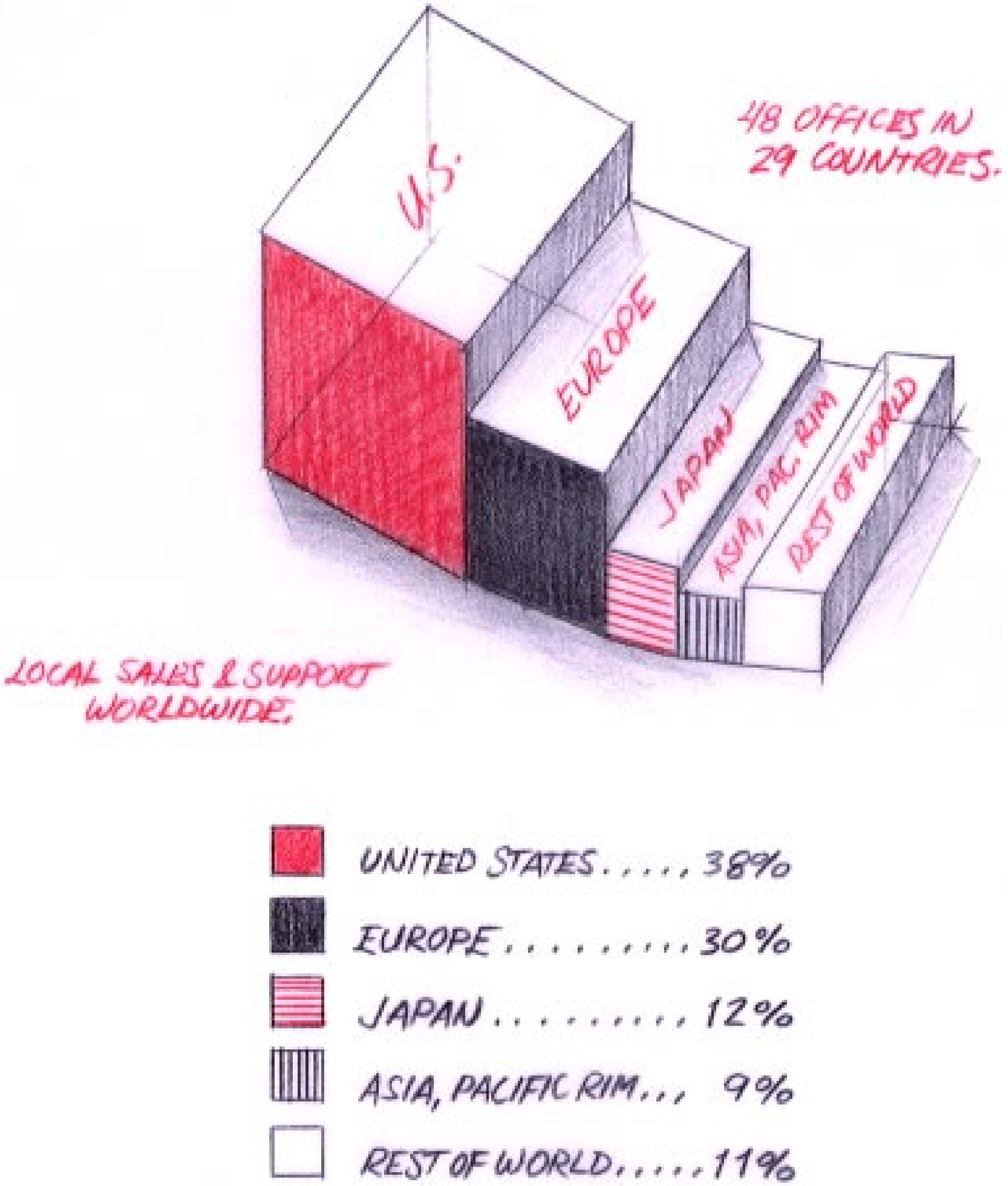
No matter how you measure it, the world is getting smaller. And that means Waters is an increasingly global corporation. Today, two thirds of our sales come from outside of the United States. While Japan and Europe remain our largest international markets, our fastest growth is expected to come from emerging markets—particularly in the Pacific Rim. But no matter where the customer is, our more than 2,000 employees throughout the world have been extremely successful at taking the Waters philosophy, fitting it to local needs, and delivering solutions that result in satisfied customers.



United States - 38% *Europe - 30%* *Japan - 12%* *Asia/Pacific Rim - 9%* *Rest of World - 11%*

Revenue by geography

REVENUE BY GEOGRAPHY

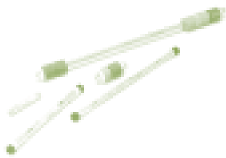


How do You Measure Achievement?

Alliance HPLC Systems — improving the quality of HPLC results

When it comes to Waters, one could argue that the most accurate way to measure success is with a High Performance Liquid Chromatography (HPLC) system. After all, that is precisely what we help our customers do every day, in every corner of the globe. For example, we're aiding customers in their quest to create and manufacture important new drugs. We're making sure that the taste quality of their food and beverage products is consistent. We're helping them comply with governmental regulations, keeping water cleaner. And we're providing knowledge that allows them to make major medical breakthroughs.

What is it that we do? In simple terms, we provide the tools that make analytical measurements, and then turn analytical data into usable information. In more complex terms, HPLC separates the individual chemical components of liquids (or chemical mixtures that can be converted into a liquid state), so they can be identified, purified or quantified. This helps chromatographers (analytical chemists, biochemists, materials scientists and other professionals) make smarter decisions faster. Or it gives them confidence that their chemical formulations are identical, batch after batch, year after year. It lets them know, with precision, if there is something in their product that does not belong there. Examples of industries where HPLC is employed include pharmaceutical, food, beverage and industrial chemical companies, as well as government agencies, universities and research institutes.


Symmetry HPLC Columns — a new standard for reproducibility

Shaped by the past, present and future. Waters pioneered HPLC, back in the 1960's. And today, the future of HPLC is bright, both in the short and long term. The size of the HPLC market is currently estimated at $1.9 billion. And, with a market share estimated to be twice that of our nearest competitor, Waters is the world's largest supplier of HPLC technologies.

Our customers include most Fortune 500 companies, in addition to major corporations all over the world. And their products are things you use every day. From cola to aspirin, from tires to perfume.

Reviewing our first year as a public company. While increases in orders, sales and profitability can be easily measured, other things, just as important to the success of a company, are more difficult to quantify. One such intangible is the spirit and culture of an organization. For Waters, 1996 was a year filled with enthusiasm and a sense of purpose. Based in large part on the successful launch of our Alliance HPLC system concept and excitement about the introduction of several new products in 1997, Waters employees have a heightened sense of pride and teamwork, and a dedication to maintaining their position as the industry's innovative leader.


Millennium Chromatography Software for HPLC and GC results management

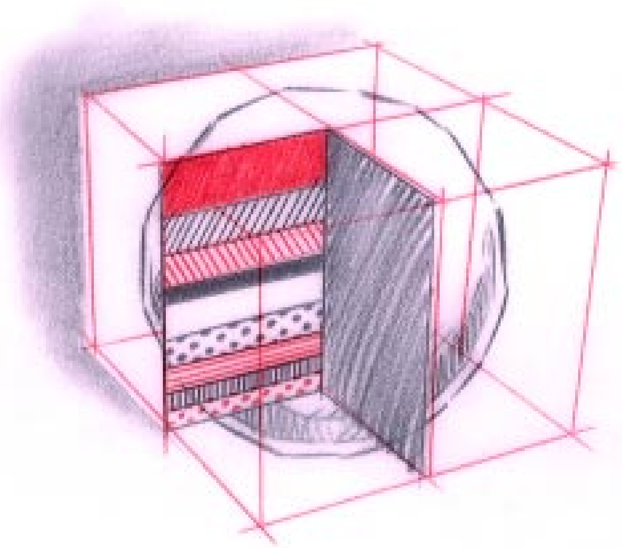
The sweet smell of success

The worldwide analytical instrument market size is estimated at $11.0 billion, and HPLC is the largest segment. From manufacturing the world's most sophisticated fragrances, to making motor oil, laboratories invest in numerous different technologies, depending on their analytical needs. HPLC, however, represents the single largest segment, since over 80% of compounds known to science can be characterized by HPLC. Complementary technologies like thermal analysis, which we acquired with the TA Instruments, Inc. purchase in 1996, give scientists additional means to characterize not only chemical mixtures but the associated physical properties of materials made of these mixtures, such as plastics, rubber and other highly engineered materials.

High performance liquid chromatography	Molecular spectroscopy	Molecular bioinstrumentation	Gas-phase chromatography	Surface sciences	Atomic spectroscopy	Other analytical techniques	Physical properties	Mass spectroscopy
$1.9	$1.6	$1.5	$1.4	$1.2	$1.1	$1.0	$0.9	$0.4

Estimated worldwide demand for analytical instrumentation (1996) - $US Billions

* EST. WORLDWIDE DEMAND FOR ANALYTICAL INSTRUMENTATION (1996)



TECHNIQUE:	U.S. BILLIONS $
HIGH PERFORMANCE LIQUID CHROMATOGRAPHY	$1.9
GAS PHASE CHROMATOGRAPHY	1.4
MOLECULAR BIOINSTRUMENTATION	1.5
MASS SPECTROSCOPY	0.4
MOLECULAR SPECTROSCOPY	1.6
ATOMIC SPECTROSCOPY	1.1
SURFACE SCIENCES	1.2
PHYSICAL PROPERTIES	0.9
OTHER	1.0
TOTAL:	11.0

* SOURCE: STRATEGIC DIRECTIONS INTERNATIONAL, LOS ANGELES, CA

The new standard by which all other HPLC systems will be measured

Alliance HPLC Systems: a bold new direction in HPLC

In March of 1996, Waters launched a new breed of HPLC instrument: The Alliance System. The importance of this introduction to Waters cannot be overemphasized. Not only was the technology judged an unqualified success by our customers, but it was also a shining example of the spirit of innovation and teamwork that defines the Waters work force worldwide.

To truly grasp the significance of the Alliance System concept, it is necessary to understand a few things about the HPLC industry. For years, major instrument suppliers had been marginally improving their HPLC systems. And fundamental system design had remained basically unchanged. The prevailing attitude was that maximum performance and reliability had been reached. Customers and equipment suppliers were satisfied with what they had. Waters challenged that attitude and, with the Alliance System, sent HPLC in a bold new direction. With technology that made results dramatically more accurate and reliable. And gave customers a reason to reevaluate what they should expect from an HPLC system.

Fundamental to the Alliance System concept was the industry's first system that combined solvent and sample management. The functional integration of a new design for solvent delivery with the world's most respected autosampler brought more consistent performance, enhanced reproducibility and higher quality results.

Reaction to the Alliance System was swift and clear. At Pittcon, the HPLC industry's biggest trade show, the Alliance System was the talk of the town. *American Laboratory* magazine called our Alliance System the "most impressive product introduction in HPLC" at Pittcon. *Instrument Business Outlook*, a major industry publication covering the show, noted "Alliance is a major step forward in HPLC instrumentation that will set a new standard for performance."

In October, a blue-ribbon panel of independent scientists, educators, and science journalists appointed by France's Institut National des Sciences Appliqueés (INSA) awarded our Alliance System its top innovation award at a ceremony at INSA LABO, one of Europe's most highly-regarded industry exhibitions.

But more important was the reaction of customers. Both ours and our competitors'. Orders for the Alliance System far exceeded our most optimistic forecasts. And because the worldwide launch was just completed in July, the full impact to the Waters bottom line is still being realized. Just as importantly, the Alliance System has greatly added to our ability to compete for new business in strategic accounts.

We believe the Alliance System concept is the most important new HPLC product in the past 15 years. Moreover, it will provide the basis for the Waters approach to HPLC for many years to come.

Integrity System for positive compound identification

And Alliance represents our commitment to developing the most innovative products and technologies.

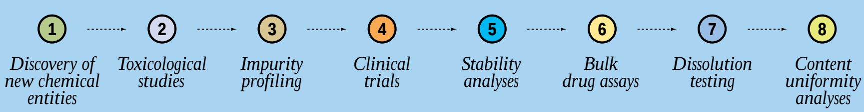
More Integrity Than Ever. Mass spectrometry is a powerful detection technique for HPLC. It provides much more sensitive and sophisticated information about HPLC samples. Until the launch of the Waters Integrity™ System in 1994, these instruments were extremely large, costly and difficult to use. The benchtop Integrity System changed everything, truly bringing mass spec to the masses.

In 1996, Waters brought the power of Alliance HPLC System performance to Integrity Systems and orders nearly doubled compared to the previous year.

During 1997, Waters plans to introduce a new mass spectrometry detector coupled with our Alliance System to take advantage of opportunities in the high-growth pharmaceutical analysis segment of the instrument market. Scientists will be able to generate higher-quality results in less time, helped by relational database technology to organize this increased productivity.

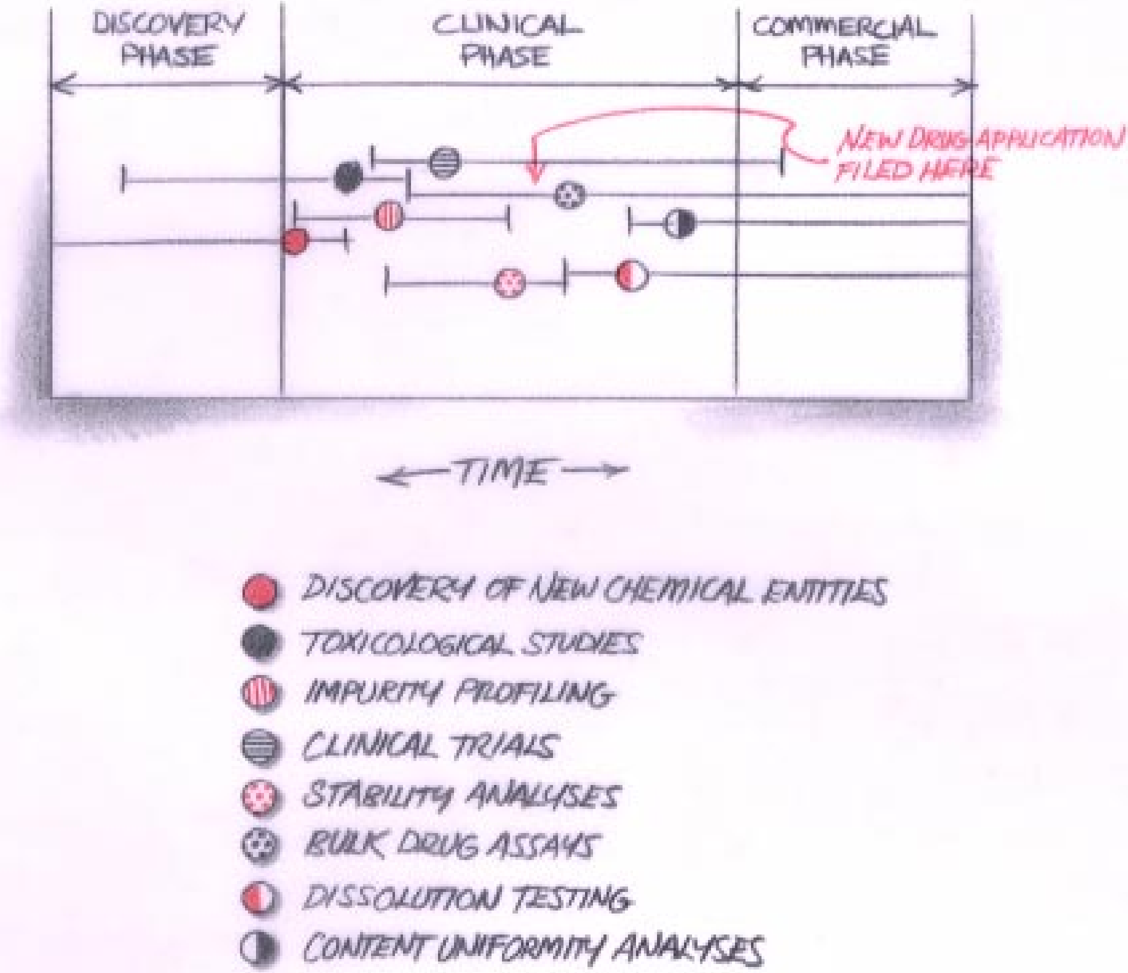
The business of making people feel better

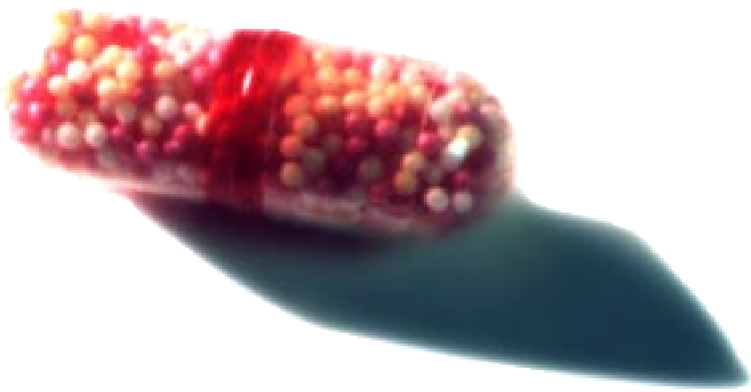
The pharmaceutical industry is our largest market. By all indications, 1996 was the best year ever for this important customer segment. According to the Pharmaceutical Research and Manufacturers of America, sales of ethical pharmaceuticals were expected to have topped $96 billion and research and development spending to have exceeded $15 billion, both new records. The number of new biotechnology drugs in production increased 21% in 1996. These factors significantly contributed to the overall growth of our core HPLC business in 1996.



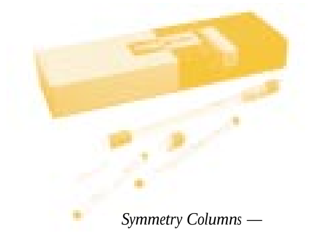
HPLC pharmaceutical applications

SIGNIFICANCE OF HPLC IN PHARMACEUTICAL RESEARCH, DEVELOPMENT AND QUALITY CONTROL





Analyzing the Analytical Column



Symmetry Columns — for improved run-to-run reproducibility

After the instrument itself, the second critical component of an HPLC system is the analytical column. The analytical column actually separates the sample's constituents from one another, so that their concentrations can be accurately measured.

Obviously, the success of any HPLC separation depends on the quality of the analytical column in which that separation takes place. What's more, the consistency of the column is critical, so that methods used can be repeated or transferred to other sites with exactly the same results.

With this in mind, Waters developed the Symmetry® line of columns, launched in late 1994. Our goal was to create the first world-class standard for columns to be used in the next generation of drug assays. We succeeded in bringing to market a product that is unsurpassed in performance, column-to-column reproducibility and durability.

In fact, much like our Alliance System is changing what customers expect from HPLC instruments, Symmetry columns have reset customer expectations in terms of analytical columns.

Today, many pharmaceutical companies around the world are using Symmetry columns in the research and development phases of various new, important drugs. And once a column is specified for a given drug, it becomes tied to a drug company's overall strategy for ensuring the quality of that product—meaning sales for the column continue as long as the drug is manufactured.

Oasis HLB Extraction Cartridges for HPLC sample preparation

In 1996, sales of Symmetry columns increased by almost 50%, exceeding our revenue projections. The vast majority of columns went to pharmaceutical accounts. Many of these columns were used in the development of products that will soon be coming to market. That means future sales of Symmetry columns should continue to grow strongly.

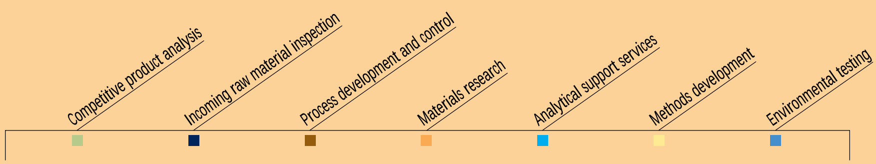
Broadening Our Product Line. The past year also saw the introduction of Oasis™ HLB single-use, disposable sample preparation cartridges. Launched in November at the annual meeting of the American Association of Pharmaceutical Scientists, Oasis HLB cartridges are based on a patented* polymeric sorbent technology that makes it faster and easier to prepare HPLC samples by eliminating all but the compounds of interest.

Oasis HLB cartridges are the industry's first product of its type, and the first from our new polymeric technology platform. And they represent one of Waters' most important new sample preparation product platforms ever, since they provide access to a $50 million market opportunity not addressed by Waters today.

*Patent pending

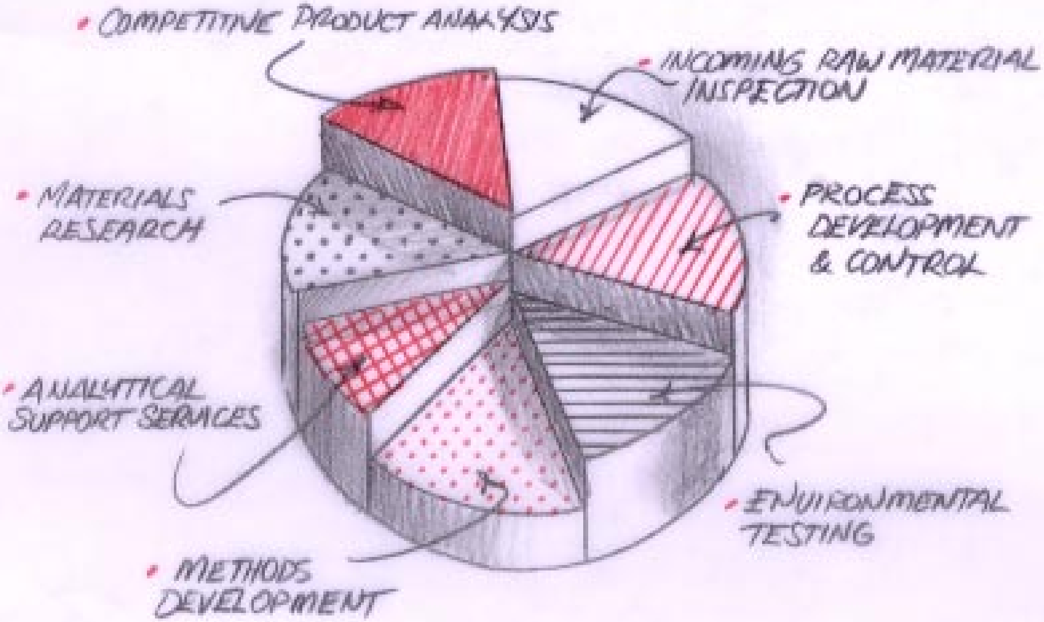
Good chemistry

As one might expect, Waters has many customers in the chemical and material industries. HPLC and thermal analysis come into play in the production of a diverse group of these products. From the coating on CDs to the waterproofing on coats. From semiconductors to semi-tractor tires, Waters technologies are an integral part of the development and manufacturing process.



Chemical industry applications

CHEMICAL INDUSTRY APPLICATIONS



- THOUSANDS OF LABORATORIES
  - HPLC ESSENTIAL
- TAI'S BIGGEST MARKET

Millennium Chromatography Software for HPLC results management

Generating reams of accurate, consistent results is one thing. Using them intelligently is another. Two initiatives that Waters began last year should have a substantial impact on helping customers employ their chromatography systems with greater intelligence than ever before. And these projects will also have a strong influence on the future of Waters for many years to come. The first of these is a new software system that makes it easier for chromatographers to manage information. The second makes conventional service and support obsolete, and draws upon Waters' unparalleled intellectual capital to help customers in new ways. Both initiatives also represent significant new areas for revenue growth and increased market penetration.

The New Millennium Comes Early. There are several reasons why managing information is important to the chromatography process. When customers use chromatography for research purposes, they need fast, flexible access to the data files for the myriad of tests they have run — which may number into the hundreds or thousands. And when applying for government approval of a drug, or after a drug is put into production, exact records are critical. Information management can also turn a difficult government audit into a much more manageable process.

Millennium software is the industry-leading, best-selling liquid chromatography software. More than 14,000 copies of Millennium software have been sold to date. That makes it the world's leading software platform for liquid chromatography data management. Millennium software is available in versions for individual computer workstations and for networked chromatography computer workstations. Orders for our Millennium networking products grew a robust 50% in 1996, as more companies adopt Millennium software as their data management software standard.

This year, Waters is scheduled to release the newest state-of-the-art version of Millennium software, to coincide with the migration of thousands of laboratories to Microsoft® Windows® 95 and Windows NT®. With a rich feature set and powerful capabilities, this new version of Millennium software will be one of the most sophisticated and powerful applications ever developed for the Windows environment.

The Right Connections. No other company has a longer history of HPLC innovation and experience than Waters. This is the basis of an exciting new approach to support and service: Waters Connections™ program. It represents an efficient new way to provide service for our customers, while improving overall responsiveness and emphasizing preventive maintenance. It also allows us to aggressively market a mix of service products better suited to individual client needs.

After-sale service and support is one of our fastest-growing areas of business.

Industry-leading Millennium Chromatography Software

The Connections suite of service products should make it only more so. Using our experienced technicians, as well as the Internet and CD-ROM, Connections service products will furnish customers with application information, education, performance assurance and regulatory compliance assistance.

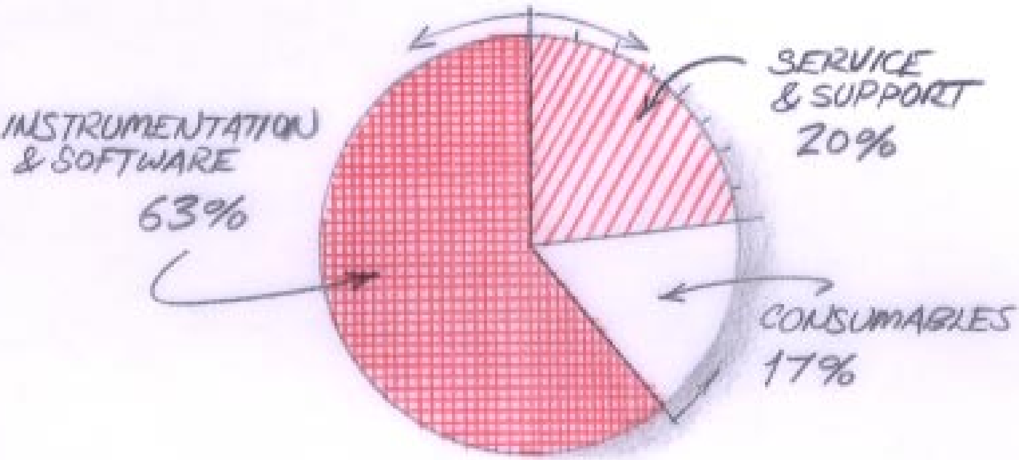
And, we will increase our emphasis on preventive maintenance; in the end that means more uptime and improved productivity for our customers, and more effectively managed business for us.

It's all important (and profitable)

Whether we're helping companies formulate or fortify a new fruit juice for their kiwi raspberry drink or develop a more powerful antacid, no other supplier of HPLC products has the depth and breadth of line that Waters offers. With leading-edge offerings in instrumentation, consumables and data management software, we offer a one-stop source for our customers. This focus, we believe, will continue to differentiate us from our major competition. And since all of our major product lines are still early in their life-cycle, the groundwork is set for strong performance for some time to come.

Revenue by product line

REVENUE BY PRODUCT LINE



INSTRUMENTATION & SOFTWARE:
- ALLIANCE HPLC SYSTEMS
- MILLENNIUM CHROMATOGRAPHY SOFTWARE
- THERMAL ANALYSIS SYSTEMS

SERVICE AND SUPPORT:
- CONNECTIONS PROGRAM

CONSUMABLES:
- SYMMETRY COLUMNS ← Over 50 thousand Sold!
- OASIS HLB CARTRIDGES

TA Instruments Dynamic Mechanical Analyzer for measuring the mechanical properties of materials

The largest market for HPLC products and services remains the pharmaceutical industry. While 1996 was perhaps the best year in history for sales to this market, 1997 looks even brighter. The Pharmaceutical Research and Manufacturers of America estimates that in 1997 R & D spending by pharmaceutical companies will exceed last year's total by 11%. Presently there are nearly 7,000 pharmaceuticals and biopharmaceuticals in development by more than 900 therapeutic drug companies worldwide.[1] There is also a renewed focus on streamlining the drug approval process. These are all factors which bode well for the use of HPLC. Since Waters' core technology is well-suited to this market, we are well positioned to capitalize on the anticipated growth.

One of the most significant events this past year was our acquisition of TA Instruments, Inc. (TAI). TAI is the world leader in thermal analysis, the most common measurement technique for characterizing polymers. Examples of polymers include rubber, plastics, proteins and starch. There are strong complementary relationships between the information obtained by our HPLC technology and thermal analysis. It is these relationships that we believe will bring new advantages to companies involved with the development, fabrication and quality control of high performance materials.

The worldwide market for thermal analysis and related products is close to $250 million, and many of TAI's current customers are also Waters' customers.

Consistent with our philosophy of adding complementary capabilities in other areas of expertise, TAI will strengthen our position in the very important chemical marketplace. Acquisitions of this type profitably expand and leverage our customer base.

New Allies. Also key to the future are new partnerships designed to create additional value for our customers. One example is our strategic partnership with Source for Automation, Inc. (Milford, Mass.). Together we are working to take their expertise in automated sample extraction and combine it with HPLC to establish an entirely new solution for automated content uniformity testing for pharmaceutical companies. A second partnership with Wyatt Technology Corp. (Santa Barbara, Calif.) strengthens our offering for polymer characterization by combining our Alliance System platform with their patented light-scattering detector technology.

Another example of new opportunity is software that links Millennium workstations or client/server systems to virtually any commercial Laboratory Information Management system allowing scientists to better track all analyses performed on their samples.

These and other alliances will give us new capabilities that will expand our marketplace.

It's all important. There are four keys to the success of an HPLC procedure. First, the instrument that performs the procedure must be accurate and reliable. Second, it is imperative that the analytical column, or the consumable element used for every test, be of high quality and consistency. Third, the data management software used for organizing, analyzing and storing results and methods must be flexible, powerful and easy to use. And finally, companies that employ HPLC must have access to service and support that help them get the most out of their applications. If just one of these elements is not up to par, the entire procedure is compromised.

Waters is the only company in the world that has industry-leading technology in all four of these areas. Moving forward, we intend to leverage each of them, and combine them more powerfully, to serve our customers more completely, and solidify our position as the definitive, single resource for HPLC solutions.

In short, as we look both back and ahead, one might sum up our first year as a public company stating that, by virtually any measure, 1996 was a successful year. Yet, we would like to think of it another way: as just the beginning.

1. Scrip Magazine, Review Issue of 1996, PJB Publications, London, England

A strong foundation for future growth

Waters' management team has the good fortune to lead an organization that is rich in intellectual capital, and that possesses a highly skilled work force. This combination of motivated and talented individuals will be instrumental in moving Waters to even greater profitability and productivity. Our management and employees are working together to implement new systems and technologies that will increase our competitive advantage, and lay the groundwork for future growth.

Philip S. Taymor
Senior Vice President
and Chief Financial Officer

Brian K. Mazar
Vice President, Human Resources
and Investor Relations

Devette W. Russo
Vice President,
Chromatography
Consumables Division

John R. Nelson
Senior Vice President
Research, Development,
and Engineering

Thomas W. Feller
Senior Vice President
Operations

Douglas A. Berthiaume
Chairman, President, and
Chief Executive Officer

Arthur G. Caputo
Senior Vice President
Worldwide Sales and Marketing

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OVERVIEW

Waters Corporation ("Waters" or the "Company") is the world's largest manufacturer, distributor and provider of high performance liquid chromatography ("HPLC") instruments, columns and other consumables, and related service. The Company has the largest HPLC market share in the United States, Europe and non-Japan Asia and has a leading position in Japan. HPLC, the largest product segment of the analytical instrument market, is utilized in a broad range of industries to detect, identify, monitor and measure the chemical, physical and biological composition of materials, and to purify a full range of compounds. With its acquisition of TA Instruments, Inc. ("TAI") in May 1996, Waters is also the world's leader in thermal analysis, a prevalent and complementary technique used in the analysis of polymers. Waters Corporation was established to acquire the predecessor Waters Chromatography Division ("Predecessor") of Millipore Corporation ("Acquisition") on August 18, 1994. Waters Corporation became a publicly traded company with its initial public offering ("IPO") in November 1995.

After sales growth of 8% in 1995, sales for the year ended December 31, 1996 grew by 17% over the comparable prior year period. Sales growth increased as a result of the introduction of new products, improvement in the HPLC market and the effect of the TAI acquisition. While some product prices have increased and others have decreased over the past three years, overall pricing has remained generally stable.

Waters has improved operating income levels in 1995 and 1996 on the strength of sales growth, significant cost reductions and operating leverage. In particular, as a result of measures taken in conjunction with the Acquisition and restructuring actions completed in late 1994, the Company reduced annual operating spending by over $20 million in 1995. These savings reduced cost of sales; selling, general and administrative expenses; and, to a lesser extent, research and development spending. The Company has continued to benefit from these cost reduction measures and has augmented them with new initiatives in 1996.

Excluding 1996 nonrecurring charges related to the purchase of TAI and 1995 nonrecurring charges related to the Company's IPO and purchase of Phase Separations Limited; operating income for the year ended December 31, 1996 was $71.2 million, a 26% increase over the $56.3 million generated in 1995. Excluding 1995 nonrecurring charges and 1994 nonrecurring charges related to the Acquisition of the Predecessor in August 1994; 1995 operating income represented a 72% increase over 1994 primarily as a result of the $20 million of spending reductions. Excluded 1996 nonrecurring charges were as follows: $6.1 million of revaluation of acquired inventory and $19.3 million of expensed in-process research and development. Excluded 1995 nonrecurring charges were as follows: $0.9 million of revaluation of acquired inventory, $5.4 million of management fees under a management services agreement terminated in conjunction with the Company's IPO and $3.6 million of expense included in selling, general and administrative expenses for the one-time acceleration of vesting of certain compensatory stock options in the fourth quarter. Excluded 1994 nonrecurring charges were as follows: $38.4 million of revaluation of inventory, $53.9 million of expensed in-process research and development, $0.6 million of management fees and $3.5 million of restructuring charges associated with the Acquisition of the Predecessor.

Based upon the re-engineering of its operations, the Company believes it can continue to leverage its infrastructure to support additional sales without a corresponding increase in costs.

During 1996, approximately 63% of the Company's combined net sales were derived from operations outside the United States. The Company believes that the geographic diversity of its sales reduces its dependence on any particular region. The U.S. dollar value of these revenues varies with currency exchange fluctuations, and such fluctuations can affect the Company's results from period to period. In 1996, each 1% average strengthening of the U.S. dollar would have decreased reported net sales by approximately $2.4 million while each 1% weakening of the dollar would have increased reported net sales by $2.4 million. The impact on net income and cash flow would have been significantly less as a result of local currency expenditures. Prior to the fourth quarter of 1995, the Company periodically entered into forward exchange contracts (which had initial maturities of 24 months or less) to economically hedge a significant portion of the U.S. dollar value of its anticipated future international cash flows. Generally accepted accounting principles required that those contracts outstanding at period end be valued at current market value with the resulting unrealized gain or loss reflected in the statements of operations for the period even though they economically hedged anticipated future cash flows. In the fourth quarter of 1995, the Company ceased to economically hedge anticipated future international cash flows and therefore liquidated those particular forward currency contracts. As of December 31, 1996, the Company's outstanding forward currency contracts amounted to $3.3 million and hedged the dollar value equivalent of specified customer commitments. The Company does not speculate in foreign currencies.

EFFECT OF ACQUISITION ON RESULTS OF OPERATIONS

The consummation of the Acquisition of the Predecessor affected the Company's results of operations following the Acquisition in certain significant respects. The Acquisition was structured as an asset purchase which created certain tax benefits from the revaluation of inventory, property, plant and equipment and intangible assets. The Company adjusted upward the historical book value of certain assets in accordance with generally accepted accounting principles. Consequently, depreciation and amortization expense related to goodwill and other intangibles increased subsequent to the Acquisition as did interest expense related to debt used to finance the Acquisition.

OPERATING INCOME DATA

Because of the revaluation of the assets and liabilities of the Predecessor and the related impact on cost of sales and expenses, the financial statements of the Predecessor for periods prior to August 19, 1994 are not strictly comparable to those of subsequent periods. However, the following table combines 1994 data for the Predecessor and Company in order to facilitate management's discussion of financial results.

	Company Year Ended December 31, 1996	Company Year Ended December 31, 1995	Combined Year Ended December 31, 1994
Net sales	$391,113	$332,972	$ 307,154
Cost of sales	145,254	126,216	123,186
Revaluation of acquired inventory[(A)]	6,100	925	38,424
Gross profit	239,759	205,831	145,544
SG&A expenses[(B)]	148,513	132,746	129,738
R&D expenses	20,898	17,681	20,189
Expensed in-process R&D[(A)]	19,300	–	53,918
Goodwill and purchased technology amortization[(C)]	5,219	3,629	1,227
Management fee[(A)]	–	5,393	552
Restructuring charge[(A)]	–	–	3,500
Operating income (loss)	**$45,829**	**$46,382**	**$(63,580)**

(A) Non-recurring charges.

(B) The year ended December 31, 1995 includes a $3,567 non-recurring charge for one-time acceleration of vesting of compensatory stock options.

(C) For the 1994 period, amount reflects amortization only for the period August 19, 1994 to December 31, 1994.

RECENT EVENTS

On May 1, 1996, the Company acquired all of the common stock of TAI for $84 million in cash, subject to certain adjustments, financed by drawings on the revolving credit facility under the New Bank Credit Agreement. As a result, the Company recorded nonrecurring charges for the revaluation of acquired inventory of $6.1 million and expensed in-process research and development of $19.3 million during the second and third quarters of 1996. TAI develops, manufactures, sells and services thermal analysis and rheology instrumentation which is used for the physical characterization of polymers and related materials. Thermal analysis and rheology are among the most prevalent techniques employed in the analysis of polymers and other organic/inorganic materials. TAI is the global market leader in the field of thermal analysis. Net sales for TAI were approximately $14 million through April 30, 1996 and $47 million in 1995.

On March 6, 1996, the Company increased the maximum availability under the New Bank Credit Agreement to $300 million in order to simplify its capital structure and provide additional financial flexibility. On March 7, 1996, the Company commenced a tender offer pursuant to which the $75 million in aggregate principal amount of Senior Subordinated Notes, which were not previously redeemed, were purchased on April 4, 1996. The Company recorded a $22.3 million extraordinary loss in the second quarter of 1996 due to the early extinguishment of its Senior Subordinated Notes.

COMPANY YEAR ENDED DECEMBER 31, 1996 COMPARED TO COMPANY YEAR ENDED DECEMBER 31, 1995

Net Sales

Net sales for 1996 were $391.1 million, compared with $333.0 million for the year ended December 31, 1995, an increase of 17%. Excluding the adverse effects of a stronger U.S. dollar, net sales increased by 20% in 1996. TAI accounted for 10% points of growth while the Company's core HPLC business grew by 10% points, excluding currency effects. HPLC growth was generally broad-based across geographies and end-user markets. The Company's international HPLC business sales increased by 11% and the U.S. HPLC business, which had been flat for the past several years, grew by 9% primarily from strong demand for its products in general and the impact of new product introductions. In particular, in March 1996, Waters successfully introduced its new family of Alliance™ HPLC systems which provide customers more accurate and consistent results and increased sample handling capacity, and are more compact and easier to maintain than conventional component systems.

Gross Profit

Gross profit for 1996 was $239.8 million compared to $205.8 million for 1995, an increase of $34.0 million or 17% over the comparable period of the prior year. Excluding nonrecurring charges for revaluation of acquired inventory related to purchase accounting for acquisitions ($6.1 million related to TAI in 1996 and $0.9 million related to Phase Separations Limited in 1995), gross profit increased by 19% in 1996. Gross profit as a percentage of sales excluding revaluation charges increased to 62.9% in 1996 from 62.1% in 1995 reflecting increased sales volume and improved manufacturing productivity.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for 1996 were $148.5 million, compared to $132.7 million for 1995. As a percentage of net sales, selling, general and administrative expenses decreased to 38% for 1996 from 39.9% for 1995, reflecting continued emphasis on expense controls. The $15.8 million or 12% increase in total expenditures primarily reflected the addition of TAI to the Company's operations.

Research and Development Expenses

Research and development expenses were $20.9 million for 1996 and $17.7 million for 1995, a $3.2 million or 18% increase from prior year levels. Current year spending increased with new HPLC product development programs and the addition of TAI's research and development expenses in the current year. In 1996, Waters introduced its new Alliance™ systems and a variety of other new products. The Company continues to invest significantly in the development of new and improved HPLC detection, consumable and data products, as well as newly acquired thermal analysis and rheology products.

Goodwill and Purchased Technology Amortization

Goodwill and purchased technology amortization for 1996 was $5.2 million, an increase of $1.6 million from the prior year. This increase was primarily related to the acquisition of TAI.

Expensed In-Process Research and Development

In 1996, the Company expensed $19.3 million of the purchase price for TAI related to acquired in-process research and development. Generally accepted accounting principles prohibit capitalization of research and development expenditures.

Management Fee

There were no management fees incurred during 1996. Until November 1995, the Company paid AEA Investors, Inc. ("AEA") and Bain Capital, Inc. ("Bain") an annual fee of $1.5 million plus out of pocket expenses for general management, financial and other corporate advisory services. The agreement was terminated for a one-time fee of $4.0 million in conjunction with the Company's IPO.

Operating Income

Operating income for 1996 was $45.8 million, a decrease of $0.6 million from the prior year. This decrease reflects $25.4 million of nonrecurring charges related to the TAI acquisition ($6.1 million of revaluation of acquired inventory and $19.3 million of expensed in-process research and development). Excluding revaluation of acquired inventory charges in 1996 and 1995, the 1996 expensed in-process research and development, the 1995 accelerated compensatory stock option vesting charge and the 1995 management fees under the terminated Management Services Agreement; operating income was $71.2 million for the year ended December 31, 1996 and represented a $14.9 million or 26% increase over 1995. Waters has improved operating income levels in 1996 on the strength of sales growth and continued focus on cost reduction in all operating areas.

Interest Expense, Net

Net interest expense decreased $15.6 million or 51%, from $30.3 million in 1995 to $14.7 million in 1996. Contemporaneously with the IPO, the Company retired $25 million of Senior Subordinated Notes, and retired all outstanding indebtedness under its senior credit facility dated August 18, 1994 ("Prior Bank Credit Agreement") with proceeds from the IPO and the New Bank Credit Agreement. In April 1996, the Company completed the successful tender for its then remaining $75 million of Senior Subordinated Notes, financing the repurchase with borrowings under the New Bank Credit Agreement. The current year interest expense decrease reflects the reduced debt levels and more favorable interest rates under the New Bank Credit Agreement.

Unrealized Losses (Gains) on Future Cash Flow Hedges

During 1995, the Company periodically entered into forward exchange contracts to economically hedge a significant portion of the U.S. dollar value of its anticipated future international cash flows. Generally accepted accounting principles required that those contracts outstanding at period end be valued at current market value with the resulting unrealized gain or loss reflected in the statement of operations for the period even though they economically hedged anticipated future international cash flows. For the year ended December 31, 1995, the Company reported unrealized losses of $1.1 million.

Realized (Gains) on Cash Flow Hedges

In the fourth quarter of 1995, the Company ceased to hedge anticipated future international cash flows and therefore liquidated those particular forward currency contracts. During 1995, the Company realized a $2.3 million gain on cash flow hedges.

Provision for Income Taxes

The Company's effective income tax rate for 1996, excluding nonrecurring, nondeductible charges, was 19.9% compared to 18.1% in 1995. Including these nonrecurring, nondeductible charges related to the purchase of TAI, the 1996 effective income tax rate was 36.1% in 1996. The Company continued to benefit from net operating loss carryforwards which substantially offset U.S. taxable income in 1996 and 1995.

Income from Continuing Operations

Income from continuing operations for 1996 was $19.9 million, compared to $14.1 million for 1995. Excluding nonrecurring charges in both years related to the revaluation of acquired inventory, 1996 expensed in-process research and development, 1995 management fees and the 1995 accelerated compensatory stock option vesting charge, the Company generated $45.3 million of income in 1996 compared to $24.0 million in 1995. The improvement over the prior year was a result of sales growth, continued focus on cost reductions in all operating areas, and interest expense reduction.

Early Extinguishment of Debt

In the second quarter of 1996, the Company recorded an extraordinary loss of $22.3 million related to the early extinguishment of debt in connection with the tender for its remaining $75 million of Senior Subordinated Notes. In the fourth quarter of 1995, the Company recorded an extraordinary loss of $12.1 million related to the early extinguishment of debt in connection with the IPO. The Company utilized the net proceeds from its IPO, its New Bank Credit Agreement and operating cash flow to retire $25 million of Senior Subordinated Notes and $81.4 million of principal outstanding under the Prior Bank Credit Agreement.

COMPANY YEAR ENDED DECEMBER 31, 1995 COMPARED TO COMBINED PREDECESSOR AND COMPANY YEAR ENDED DECEMBER 31, 1994

Net Sales

Net sales for 1995 were $333.0 million, compared with $307.2 million for the year ended December 31, 1994, an increase of 8%. Excluding the benefits of a weaker U.S. dollar, consolidated net sales for 1995 increased by 5% compared to the prior year period. The Company's international business benefited from improved market conditions and weakening of the U.S. dollar. International sales increased by 14% and growth was geographically broad-based. The U.S. business was flat with the prior year. On a worldwide basis, pharmaceutical customer demand, which accounted for over 40% of the Company's business, grew strongly in 1995. Company revenues reflected increased demand for new products introduced in 1994. In particular, the Company experienced strong demand for its consumable Symmetry® column products, which provide more accurate and reproducible chromatography results. Sales growth was also generated by the Company's new Integrity™ product, which combines the separation, quantification and detection capabilities of HPLC with the identification and characterization capabilities of benchtop MS detection.

Gross Profit

Gross profit for 1995 was $205.8 million, versus $145.5 million for 1994, an increase of $60.3 million or 41% over the comparable period of the prior year, due to significantly lower charges for revaluation of acquired inventory, higher sales volumes and productivity improvements. In the year ended December 31, 1994, the Company charged $38.4 million to cost of sales related to the revaluation of inventory acquired as part of the Acquisition. In the year ended December 31, 1995, the Company charged $0.9 million to cost of sales related to the revaluation of inventory acquired in conjunction with the July 1995 purchase of Phase Separations Limited. Moreover, the Company took various measures to reduce costs in conjunction with the Acquisition and as part of a restructuring in late 1994, including consolidating manufacturing plants and reducing the number of employees. Excluding revaluation of acquired inventory charges, gross profit for 1995 was $206.8 million, versus $184.0 million for 1994, an increase of 12% over the comparable period of the prior year and gross profit margins of 62.1% for 1995 exceeded 59.9% margins for 1994.

Selling, General and Administrative Expenses

Selling, general and administrative expenses for 1995 were $132.7 million, compared to $129.7 million for 1994. As a percentage of net sales, selling, general and administrative expenses decreased to 39.9% for 1995 from 42.2% for 1994. This decrease was primarily the result of re-engineering measures adopted in connection with the Acquisition and fourth quarter restructuring in 1994. The Company eliminated excess facilities, consolidated administrative operations, reduced staffing and replaced corporate overhead with a less costly stand-alone infrastructure. Cost reduction impacts were partly offset by the increased translated dollar value of international expenses due to the weak U.S. dollar and a $4.6 million charge for compensatory stock option expense, including a one-time charge of $3.6 million for the accelerated vesting of certain of these options.

Research and Development Expenses

Research and development expenses for 1995 were $17.7 million, $2.5 million below prior year levels due to three factors. First, 1994 results included particularly high spending levels related to the Company's Integrity™ HPLC-MS system. Research and development spending levels for 1994 were 9% higher than those of 1993. HPLC-MS spending has been reduced to levels typical after the completion of initial development. Second, the Company eliminated certain administrative and supervisory redundancies within its research and development organization by consolidating two research and development organizations into one after the Acquisition. Third, the Company modified its product development approach in 1995 and funded slightly fewer programs with more spending per program in order to shorten time to market and improve productivity.

The Company continued to invest in those programs important to its future, including benchtop mass spectrometry detection capabilities, a new solvent delivery module, network data products and new column chemistries.

Expensed In-Process Research and Development

In 1994, the Company wrote off $53.9 million of the Acquisition purchase price related to in-process research and development acquired from the Predecessor. Generally accepted accounting principles prohibit capitalization of research and development expenditures.

Goodwill and Purchased Technology Amortization

Goodwill and purchased technology amortization for 1995 was $3.6 million, an increase of $2.4 million from the prior period and primarily relates to the Acquisition on August 18, 1994.

Management Fee

For the year ended December 31, 1995, the Company incurred $5.4 million of expense for financial advice and consulting and other services from AEA and Bain, an increase of $4.8 million from the prior period under the professional services agreement dated August 18, 1994 among AEA, Bain, and the Company ("Management Services Agreement"). The increase was due primarily to a $4.0 million charge to terminate this agreement in connection with the Company's IPO in November 1995.

Operating Income

Operating income for 1995 was $46.4 million, an increase of $110.0 million from the prior year loss. $92.3 million of this operating income increase resulted from nonrecurring Acquisition related charges. Excluding revaluation of acquired inventory charges in 1994 and 1995, the 1995 accelerated compensatory stock option vesting charge, 1994 and 1995 management fees under the terminated Management Services Agreement and the 1994 expensed in-process research and development and restructuring charges; operating income of $56.3 million for the year ended December 31, 1995 was $23.5 million greater than that of the comparable period in 1994, a 72% increase.

Interest Expense, Net

Interest expense for 1995 was $30.3 million, an increase of $17.5 million as compared with $12.8 million for 1994. This increase was due to borrowings which financed the Acquisition on August 18, 1994.

Unrealized Losses (Gains) on Future Cash Flow Hedges

As discussed in the Overview above, until the fourth quarter of 1995, the Company periodically entered into forward exchange contracts to economically hedge the U.S. dollar value of a portion of its anticipated future international cash flows. The Company reported unrealized losses of $1.1 million in 1995 and unrealized gains of $0.9 million in 1994.

Realized (Gains) Losses on Cash Flow Hedges

In the fourth quarter of 1995, the Company liquidated all outstanding forward exchange contracts which hedged future cash flows. For the year ended December 31, 1995, the Company realized a $2.3 million gain on cash flow hedges contracted in prior periods to hedge its currency exposure.

Provision for Income Taxes

The Company's effective income tax rate for 1995 was 18.1%. The Predecessor's effective income tax rate for the period from January 1, 1994 to August 18, 1994 was 28.6%. The Company's 1995 tax rate was lower than the Predecessor's 1994 rate due to the benefit of net operating loss carryforwards from 1994 which substantially offset U.S. taxable income. The Company recorded a tax provision for the period from August 19 to December 31, 1994 while it reported operating losses as certain foreign subsidiaries generated taxable income.

Income from Continuing Operations

Income from continuing operations for 1995 was $14.1 million, compared to a loss of $77.9 million in the prior year comparable period. Nonrecurring charges related to the Acquisition depressed 1994 profit levels. In addition, 1995 improvements in operating profitability were offset by higher interest expense related to the Acquisition and nonrecurring charges primarily related to the Company's IPO.

Early Extinguishment of Debt

In the fourth quarter of 1995, the Company recorded an extraordinary loss of $12.1 million related to the early extinguishment of debt. The Company utilized the net proceeds from its IPO, its New Bank Credit Agreement and operating cash flow to retire $25.0 million of Senior Subordinated Notes and $81.4 million of principal outstanding under the Prior Bank Credit Agreement.

LIQUIDITY AND CAPITAL RESOURCES

Upon consummation of the Acquisition, liquidity requirements increased significantly due to debt service costs associated with borrowings.

On April 4, 1996, the Company consummated a tender offer ("Tender Offer") pursuant to which the remaining $75 million in aggregate principal amount of its 12.75% Senior Subordinated Notes ("Senior Subordinated Notes") were purchased. The aggregate purchase price paid by the Company in connection with the Tender Offer was $90.6 million. In the second quarter of 1996, the Company recorded an extraordinary loss of $22.3 million related to the early extinguishment of the Senior Subordinated Notes.

The Company's new bank credit agreement ("New Bank Credit Agreement") is a revolving credit facility with maximum availability of $300 million with the following principal terms. The loans under the New Bank Credit Agreement bear interest for each quarter at a per annum rate equal to, at the Company's option, (i) the Base Rate plus an amount which will vary between zero and 0.50% or (ii) Eurodollar Rate (as defined) plus an amount which will vary between 0.50% and 1.50%, based upon certain Company performance criteria for the previous four quarters. The availability under the New Bank Credit Agreement will decrease under certain circumstances such as in the event of asset sales and issuance of equity, will decrease by $45 million in each of the years 1998 and 1999, and will terminate in 2000. At December 31, 1996, the interest rate on the Company's New Bank Credit Agreement was approximately 6.6%. The New Bank Credit Agreement imposes certain restrictions on the Company and certain of its subsidiaries, including restrictions on its ability to incur indebtedness, pay dividends, make acquisitions, make investments, grant liens, sell its assets and engage in certain other activities. Indebtedness under the New Bank Credit Agreement is secured by substantially all of the assets of the Company. The Company's existing availability under the New Bank Credit Agreement was $87.5 million as of December 31, 1996. The Company was in compliance with all of its debt covenants under the New Bank Credit Agreement as of December 31, 1996.

The Company generated $53.2 million in cash from operating activities during 1996 primarily as a result of (i) $45.3 million in operating income before extraordinary items and non-cash charges for the revaluation of acquired inventory and expensed in-process research and development and (ii) $16.7 million of depreciation and amortization of intangible assets, offset by (iii) a $9.0 million increase in accounts receivable and changes in other net assets and liabilities.

Net cash of $93.1 million used in investing activities for 1996 primarily reflected (i) the $83.3 million used to acquire TAI and (ii) $10.1 million used for additions to property, plant and equipment.

Net cash of $34.7 million provided by financing activities reflected borrowings to finance the acquisition of TAI and the premium paid to tender for the Senior Subordinated Notes, offset by repayments made from the Company's operating cash flows.

In October 1996, the Company entered into a fifteen (15) month debt swap agreement with Credit Lyonnais - New York to hedge the U.S. dollar value of its investments in the net assets of certain European subsidiaries. The Company swapped $35.4 million in notional amount of floating rate LIBOR borrowings for equivalent notional amounts in six European currencies of borrowings at fixed interest rates averaging approximately 3.2% per annum. At representative interest rates and currency exchange rates in effect at October 29, 1996, the date of the transaction, the Company lowered its annual interest costs by approximately $1.1 million over the term of the swap agreement. The Company could also incur higher or lower principal payments over the term of the swap agreement depending on future related foreign currency rates. At currency exchange rates in effect on December 31, 1996, the principal repayment amount would have been $35.2 million.

In June 1996, the Company entered into a three-year debt swap agreement with Bankers Trust Company to hedge the U.S. dollar value of its investment in the net assets of TAI's Japanese subsidiary. The Company swapped $7.5 million in notional amount of floating rate LIBOR borrowings for 818 million Yen notional amount of borrowings at a fixed rate of 2.02%. At representative interest rates and currency exchange rates in effect at June 26, 1996, the effective date of the agreement, the Company lowered its annual interest costs by approximately $0.3 million over the term of the swap agreement. The Company could also incur higher or lower principal repayments over the term of the swap agreement depending on future currency rates for the Yen. At currency exchange rates in effect on December 31, 1996, the principal repayment amount would have been $7.1 million.

In March and April of 1996, the Company entered into several interest rate protection agreements. These agreements provide payments to the Company if the three month LIBOR rate, as defined, exceeds 6% in 1997 and 6.5% in 1998 and 1999 on aggregate borrowings of $183 million in 1997 and $70 million and $30 million in 1998 and 1999, respectively. At December 31, 1996, the fair value of these agreements was $0.7 million.

In January 1996, the Company entered into a three-year debt swap agreement with the Bank of Boston to hedge the U.S. dollar value of its investment in the net assets of its Japanese subsidiary. The Company swapped $22 million in notional amount of floating rate LIBOR borrowings for 2.3 billion Yen notional amount of borrowings at a fixed interest rate of 1.525% per annum. At representative interest rates and currency exchange rates in effect at January 23, 1996, the effective date of the agreement, the Company lowered its annual interest costs by approximately $0.9 million over the term of the swap. The Company could also incur higher or lower principal repayments over the term of the swap agreement depending on future currency rates for the Yen. At currency exchange rates in effect on December 31, 1996, the principal repayment amount would have been $20.1 million.

The Company believes that existing cash balances and cash flow from operating activities together with borrowings available under the New Bank Credit Agreement will be sufficient to fund future working capital needs, capital spending requirements and debt service requirements of the Company in the foreseeable future.

ENVIRONMENTAL MATTERS

The Company's facilities are subject to federal, state and local environmental requirements, including those relating to discharges to air, water and land, the handling and disposal of solid and hazardous waste and the cleanup of properties affected by hazardous substances. The Company does not currently anticipate any material adverse effect on its operations or financial condition as a result of its efforts to comply with, or its liabilities under, such requirements. The Company does not currently anticipate any material capital expenditures for environmental control facilities. Some risk of environmental liability is inherent in the Company's business, however, and there can be no assurance that material environmental costs will not arise in the future. In particular, the Company might incur capital and other costs to comply with increasingly stringent environmental laws and enforcement policies. Although it is difficult to predict future environmental costs, the Company does not anticipate any material adverse effect on its operations, financial condition or competitive position as a result of future costs of environmental compliance. In connection with the Acquisition, Millipore Corporation agreed to retain environmental liabilities resulting from pre-Acquisition operations of the Company's facilities.

RECENTLY ADOPTED ACCOUNTING STANDARDS

Accounting for Stock-Based Compensation

In 1996, the Company adopted the disclosure provisions of SFAS No. 123 which specifies a fair value based method of accounting for stock based compensation plans.

CAUTIONARY STATEMENT

Certain statements contained herein are forward looking. Many factors could cause actual results to differ from these statements, including loss of market share through competition, introduction of competing products by other companies, pressure on prices from competitors and / or customers, regulatory obstacles to new product introductions, lack of acceptance of new products by the HPLC or thermal analysis industries, changes in the healthcare market and the pharmaceutical industry, changes in distribution of the Company's products, and interest rate and foreign exchange fluctuations.

Report of Independent Accountants

To the Board of Directors and Stockholders of Waters Corporation:

We have audited the accompanying consolidated balance sheets of Waters Corporation and Subsidiaries as of December 31, 1996 and 1995 and the related consolidated statements of operations, stockholders' equity and cash flows for the years ended December 31, 1996 and December 31, 1995 and the period from August 19, 1994 to December 31, 1994. These financial statements are the responsibility of Waters Corporation management. Our responsibility is to express an opinion on these financial statements based on our audits. We have also audited the financial statements of the Waters Chromatography Division of Millipore Corporation ("Predecessor") for the period January 1, 1994 to August 18, 1994. Our report, dated February 10, 1995 includes an explanatory paragraph which describes certain costs and expenses presented in the financial statements which represent allocations and management's estimates of the cost of services provided to the Predecessor by Millipore Corporation.

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 financial statement 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 consolidated financial position of Waters Corporation and Subsidiaries as of December 31, 1996 and 1995, and the results of its operations and its cash flows for the years ended December 31, 1996 and 1995 and the period from August 19, 1994 to December 31, 1994 in conformity with generally accepted accounting principles.

Coopers & Lybrand L.L.P.

Coopers & Lybrand L.L.P.

Boston, Massachusetts
January 22, 1997

(In thousands, except per share data)	December 31, 1996	December 31, 1995
Assets		
Current assets:		
Cash and cash equivalents	$ 639	$ 3,233
Accounts receivable, less allowances for doubtful accounts of $1,712 and $1,513 at December 31, 1996 and 1995, respectively	88,112	76,087
Inventories	47,351	41,459
Other current assets	7,930	2,847
Net current assets of discontinued operations held for sale	–	3,694
Total current assets	144,032	127,320
Property, plant and equipment, net	74,777	70,261
Other assets	36,058	29,024
Goodwill, less accumulated amortization of $4,818 and $2,364 at December 31, 1996 and 1995, respectively	110,635	72,491
Net long term assets of discontinued operations held for sale	–	720
Total assets	$365,502	$299,816
Liabilities and Stockholders' Equity		
Current liabilities:		
Notes payable and current portion of long term debt	$ 1,736	$ 1,933
Accounts payable	17,509	16,757
Deferred revenue	10,491	6,945
Accrued retirement plan contributions	2,787	6,010
Accrued income taxes	1,700	2,494
Accrued other taxes	4,951	3,900
Other current liabilities	43,631	32,896
Total current liabilities	82,805	70,935
Long term debt	210,470	158,500
Redeemable preferred stock	7,153	6,232
Other liabilities	7,294	6,031
Total liabilities	307,722	241,698
Stockholders' Equity:		
Common stock, par value $0.01 per share 50,000 shares authorized, 28,923 and 28,796 shares issued and outstanding at December 31, 1996 and 1995, respectively	289	288
Additional paid-in capital	145,717	145,318
Deferred stock option compensation	(826)	(1,076)
Accumulated deficit	(87,808)	(85,403)
Translation adjustments	408	(605)
Minimum pension liability adjustment	–	(404)
Total stockholders' equity	57,780	58,118
Total liabilities and stockholders' equity	$365,502	$299,816

The accompanying notes are an integral part of the consolidated financial statements

(In thousands, except per share data)	Company Year Ended December 31, 1996	Company Year Ended December 31, 1995	Company August 19, 1994 to December 31, 1994	Predecessor January 1, 1994 to August 18, 1994
Net sales	$391,113	$332,972	$131,057	$176,097
Cost of sales	145,254	126,216	49,740	73,446
Revaluation of acquired inventory	6,100	925	38,424	–
Gross profit	239,759	205,831	42,893	102,651
Selling, general and administrative expenses	148,513	132,746	44,522	85,216
Research and development expenses	20,898	17,681	6,790	13,399
Goodwill and purchased technology amortization	5,219	3,629	1,227	–
Expensed in-process research and development	19,300	–	53,918	–
Management fee	–	5,393	552	–
Restructuring charge	–	–	3,500	–
Operating income (loss)	45,829	46,382	(67,616)	4,036
Interest expense, net	14,740	30,315	12,011	828
Unrealized losses (gains) on future cash flow hedges	–	1,142	(923)	–
Realized (gains) on cash flow hedges	–	(2,317)	–	–
Income (loss) from continuing operations before income taxes	31,089	17,242	(78,704)	3,208
Provision for income taxes	11,230	3,129	1,487	916
Income (loss) from continuing operations	19,859	14,113	(80,191)	2,292
Income (loss) from discontinued operations, net of tax effect	–	–	787	(448)
Estimated (loss) on disposal of discontinued operations	–	–	(8,000)	–
Income (loss) before extraordinary item	19,859	14,113	(87,404)	1,844
Extraordinary (loss) on early retirement of debt	(22,264)	(12,112)	–	–
Net (loss) income	(2,405)	2,001	(87,404)	$ 1,844
Less: accretion of and 6% dividend on Preferred stock	921	902	330	
Net (loss) income available to common stockholders	$ (3,326)	$ 1,099	$(87,734)	
(Loss) income per common share:				
Income (loss) per common share from continuing operations	$ .60	$ .54	$ (3.38)	
(Loss) per common share from discontinued operations	–	–	(.30)	
Extraordinary (loss) per common share	(.71)	(.49)	–	
Net (loss) income per common share	$ (.11)	$ .05	$ (3.68)	
Weighted average number of common shares	31,628	24,582	23,852	

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

(In thousands, except per share data)	Company Year Ended December 31, 1996	Company Year Ended December 31, 1995	Company August 19, 1994 to December 31, 1994	Predecessor January 1, 1994 to August 18, 1994
Cash flows from operating activities:				
Net (loss) income	$ (2,405)	$ 2,001	$ (87,404)	$ 1,844
Adjustments to reconcile net (loss) income to net cash provided by operating activities:				
Net (income) loss from discontinued operations	–	–	(787)	448
Unrealized losses (gains) on future cash flow hedges	–	1,142	(923)	–
Estimated loss on disposal of discontinued operations	–	–	8,000	–
Deferred income taxes	(4,200)	–	–	–
Depreciation and amortization	9,334	7,709	2,501	5,197
Amortization of capitalized software and intangible assets	7,375	6,065	1,893	1,126
Amortization of debt issuance costs	1,055	2,731	993	–
Compensatory stock option expense	250	4,565	–	–
Expensed in-process research and development	19,300	–	53,918	–
Extraordinary loss on early retirement of debt	22,264	12,112	–	–
Change in operating assets and liabilities:				
(Increase) decrease in accounts receivable	(8,981)	10,212	(38,127)	18,186
Decrease (increase) in inventories	5,430	5,583	44,324	(2,492)
(Increase) decrease in other current assets	(410)	(1,073)	970	(2,248)
Decrease (increase) in other assets	1,218	(1,277)	(568)	453
Increase (decrease) in accounts payable and other current liabilities	4,992	(1,661)	16,397	1,583
Increase (decrease) in deferred revenue	2,541	(32)	(317)	1,380
(Decrease) increase in accrued retirement plan contributions	(5,329)	1,637	109	(809)
Increase (decrease) in other liabilities	3,283	(4,511)	5,012	503
Net cash provided by continuing operations	55,717	45,203	5,991	25,171
Net cash provided by discontinued operations	–	1,039	1,418	478
Net cash provided by operating activities	55,717	46,242	7,409	25,649
Cash flows from investing activities:				
Additions to property, plant and equipment	(10,064)	(6,260)	(1,524)	(3,901)
Software capitalization and other intangibles	(3,758)	(3,618)	(667)	(2,034)
Payment to acquire predecessor net assets	–	–	(310,456)	–
Business acquisitions, net of cash acquired	(83,349)	(7,469)	–	–
Loans to officers	(425)	(2,062)	–	–
Realized loss on contracts hedging net asset value	–	(1,457)	–	–
Proceeds from sale of discontinued operations	4,497	6,477	–	–
Net cash (used in) investing activities by continuing operations	(93,099)	(14,389)	(312,647)	(5,935)
Net investing activities of discontinued operations	–	(154)	(594)	(508)
Net cash (used in) investing activities	(93,099)	(14,543)	(313,241)	(6,443)
Cash flows from financing activities:				
Proceeds from long term borrowings	–	84,286	275,813	–
Proceeds from issuance of common stock	–	86,152	66,628	–
Repayment (issuance) of notes and accrued interest	–	5,309	(5,055)	–
Net borrowings (repayment) of bank debt	126,902	(175,000)	–	–
Retirement of Senior Subordinated Notes	(91,219)	(28,188)	–	–
Transactions with parent company	–	–	–	(18,739)
Payments for debt issuance costs	(2,282)	(2,211)	(15,111)	–
Dividend paid	–	(16,195)	–	–
Proceeds from stock options exercised	1,322	–	–	–
Net cash provided by (used in) financing activities	34,723	(45,847)	322,275	(18,739)
Effect of exchange rate changes on cash and cash equivalents	65	642	(171)	–
(Decrease) increase in cash and cash equivalents	(2,594)	(13,506)	16,272	467
Cash and cash equivalents at beginning of period	3,233	16,739	467	–
Cash and cash equivalents at end of period	$ 639	$ 3,233	$ 16,739	$ 467
Supplemental cash flow information:				
Income taxes paid	$ 3,401	$ 1,924	$ 217	$ –
Interest paid	$ 15,941	$ 30,370	$ 7,247	$ –

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

(In thousands)	Common Stock	Additional Paid-in Capital	Deferred Stock Option Compensation	Warrants	Notes Receivable	Accumulated Deficit	Cumulative Translation Adjustments	Minimum Pension Liability Adjustment	Total
Initial capital contribution at August 19, 1994 (restated)	$215	$ 67,824	$ –	$ 3,200	$(4,925)	$ –	$ –	$ –	$ 66,314
Net loss for the period August 19, 1994 to December 31, 1994	–	–	–	–	–	(87,404)	–	–	(87,404)
Translation adjustment for the period August 19, 1994 to December 31, 1994	–	–	–	–	–	–	(1,120)	–	(1,120)
Accretion of preferred stock	–	(108)	–	–	–	–	–	–	(108)
Interest income on notes receivable	–	–	–	–	(130)	–	–	–	(130)
Dividend payable on preferred stock	–	(222)	–	–	–	–	–	–	(222)
Balance December 31, 1994	215	67,494	–	3,200	(5,055)	(87,404)	(1,120)	–	(22,670)
Net income for the year ended December 31, 1995	–	–	–	–	–	2,001	–	–	2,001
Translation adjustment for the year ended December 31, 1995	–	–	–	–	–	–	515	–	515
Proceeds from stock offering	63	86,089	–	–	–	–	–	–	86,152
Accretion of preferred stock	–	(301)	–	–	–	–	–	–	(301)
Interest income on notes receivable	–	–	–	–	(254)	–	–	–	(254)
Dividend payable on preferred stock	–	(600)	–	–	–	–	–	–	(600)
Repayment of notes receivable	–	–	–	–	5,309	–	–	–	5,309
Minimum pension liability adjustment	–	–	–	–	–	–	–	(404)	(404)
Warrants exercised	10	3,190	–	(3,200)	–	–	–	–	–
Compensatory stock options issued	–	5,641	(5,641)	–	–	–	–	–	–
Compensatory stock option expense	–	–	4,565	–	–	–	–	–	4,565
Dividend paid	–	(16,195)	–	–	–	–	–	–	(16,195)
Balance December 31, 1995	288	145,318	(1,076)	–	–	(85,403)	(605)	(404)	58,118
Net (loss) for the year ended December 31, 1996	–	–	–	–	–	(2,405)	–	–	(2,405)
Translation adjustment for the year ended December 31, 1996	–	–	–	–	–	–	1,013	–	1,013
Accretion of preferred stock	–	(321)	–	–	–	–	–	–	(321)
Dividend payable on preferred stock	–	(600)	–	–	–	–	–	–	(600)
Minimum pension liability adjustment	–	–	–	–	–	–	–	404	404
Compensatory stock option expense	–	–	250	–	–	–	–	–	250
Stock options exercised	1	1,320	–	–	–	–	–	–	1,321
Balance December 31, 1996	$289	$145,717	$ (826)	$ –	$ –	$(87,808)	$ 408	$ –	$ 57,780

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

1. DESCRIPTION OF BUSINESS

Organization and Basis of Presentation

Waters Corporation ("Waters" or the ''Company") is a holding company which owns all and only the common stock of Waters Technologies Corporation. Waters is the world's largest manufacturer, distributor and provider of high performance liquid chromatography ("HPLC") instruments, chromatography columns and other consumables, and related service. HPLC, the largest product segment of the analytical instrument market, is utilized in a broad range of industries to detect, identify, monitor and measure the chemical, physical and biological composition of materials, and to purify a full range of compounds. With its acquisition of TA Instruments, Inc. ("TAI") in May 1996, the Company is also the world's leader in thermal analysis instrumentation products which are used in a complementary fashion to analyze polymers.

In November 1995, the Company completed its initial public offering ("IPO"). Prior to this date, the Company was known as WCD Investors, Inc. and Waters Technologies Corporation was known as Waters Corporation. Waters acquired substantially all of the assets (''Acquisition") of the Waters Chromatography Division (''Predecessor") of Millipore Corporation (''Millipore") on August 18, 1994. Pursuant to the purchase method of accounting, acquired assets and liabilities were revalued to their fair market value. The excess of the purchase price over the fair market value of the net assets acquired was recorded as goodwill. Because of the revaluation of the assets and liabilities and its related impact on the statement of operations, the financial statements of the Predecessor for the periods prior to August 19, 1994 are not strictly comparable to those of the Company subsequent to that date. Therefore, Predecessor financial statements have been presented separately from Company financial statements.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Use of Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect (i) the reported amounts of assets and liabilities, (ii) disclosure of contingent assets and liabilities at the dates of the financial statements and (iii) the reported amounts of revenues and expenses during the reporting periods. Actual results could differ from those estimates.

Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its subsidiaries, most of which are wholly owned. All material inter-company balances and transactions have been eliminated.

Translation of Foreign Currencies

For most of the Company's foreign operations, assets and liabilities are translated into U. S. dollars at exchange rates prevailing on the balance sheet date while revenues and expenses are translated at average exchange rates prevailing during the period. Any resulting translation gains or losses are included in translation adjustments in the consolidated balance sheet.

Cash and Cash Equivalents

Cash equivalents primarily represent highly liquid investments, with original maturities of 90 days or less, in repurchase agreements and money market funds which are convertible to a known amount of cash and carry an insignificant risk of change in value. The Company has periodically maintained balances in various operating accounts in excess of federally insured limits.

Concentration of Credit Risk

The Company sells its products to a significant number of large and small customers throughout the world, with over 40% of 1996 net sales to the pharmaceutical industry. None of the Company's individual customers account for more than two percent of annual Company sales. The Company performs continuing credit evaluation of its customers and generally does not require collateral, but, in certain circumstances may require letters of credit. Historically, the Company has not experienced significant bad debt losses.

Inventory

The Company values all of its inventories at the lower of cost or market on a first-in, first-out basis (FIFO).

Income Taxes

Deferred income taxes are recognized for temporary differences between financial statement and income tax bases of assets and liabilities. Prior to the Acquisition, the Predecessor's operations were included in the consolidated tax returns of Millipore and all related income tax payments were made by Millipore.

Property, Plant and Equipment

Property, plant and equipment is recorded at cost. Expenditures for maintenance and repairs are charged to expense while the costs of significant improvements are capitalized. Depreciation is provided using straight line methods over the following estimated useful lives; leasehold improvements - lives of the related leases, buildings - 33 years, and production and other equipment - 5 to 10 years. Upon retirement or sale, the cost of assets disposed and the related accumulated depreciation are eliminated from the balance sheet and related gains or losses are reflected in income.

Software Development Costs

The Company capitalizes software development costs in accordance with Statement of Financial Accounting Standard No. 86. Capitalized costs are amortized to cost of sales on a straight-line basis over the estimated useful lives of the related software products, generally three to five years. Capitalized software included in other assets, net of accumulated amortization, was $10,379 and $8,418 at December 31, 1996 and 1995, respectively.

Purchased Technology and Goodwill

Purchased technology is recorded at its fair market value as of the acquisition date and is amortized over its estimated useful life, ranging from four to fifteen years for current purchased technology components. Goodwill is amortized on a straight-line basis over its useful life, 40 years for current goodwill components. Impairment of purchased technology and goodwill is measured on the basis of whether anticipated future undiscounted operating cash flows expected from the acquired business will recover the recorded respective intangible asset balances over the remaining amortization period. At December 31, 1996, no such impairment of assets was indicated. Purchased technology included in other assets was $6,805 and $8,667, net of accumulated amortization of $4,343 and $2,482, at December 31, 1996 and 1995, respectively.

Debt Issuance Costs

Debt issuance costs are amortized over the life of the related debt using the effective interest method. At December 31, 1996 and 1995, debt issuance costs included in other assets amounted to $3,551 and $7,874, net of accumulated amortization of $935 and $912, respectively.

Revenue Recognition

Sales of products and services are recorded based on product shipment and performance of service, respectively. Proceeds received in advance of product shipment or performance of service are recorded as deferred revenue in the balance sheet.

Product Warranty Costs

The Company provides for estimated warranty costs at the point of sale.

Field Service Expenses

All expenses of the Company's field service organization are included in selling, general and administrative expenses.

Reclassification

Certain amounts in previous years' financial statements have been reclassified to conform to current presentation.

Income (Loss) Per Share

Income (loss) per common share is based on the weighted average number of common shares and common share equivalents outstanding during the periods presented. Common share equivalents result from outstanding options and warrants to purchase common stock. Pursuant to Securities and Exchange Commission Staff Accounting Bulletin No. 83, using the treasury stock method until shares are actually issued, all common share equivalents issued and options granted by the Company at a price less than the IPO price during the twelve months preceding the IPO date in November 1995 have been included in computing income (loss) per common share for 1995 and 1994. Accretion of and cumulative dividends on preferred stock have been included in computing income (loss) per share.

Supplemental unaudited pro forma income (loss) per common share amounts, calculated as if the IPO had taken place at the beginning of the respective periods, were $0.35 and $(2.75) for the year ended December 31, 1995 and for the period August 19, 1994 to December 31, 1994, respectively. These calculations, required by APB Opinion No. 15 “Earnings per Share”, make supplemental pro forma adjustments to data as reported for the repayment of debt and common stock issued due to the IPO, and not for other nonrecurring items. The calculations are as follows:

	1995 (Unaudited)	1994 (Unaudited)
Net income (loss) available to common stockholders, as reported	$ 1,099	$(87,734)
Pro forma adjustments for interest expense, assuming that the IPO occurred at the beginning of the period	9,407	4,820
Net income (loss) used for supplemental pro forma income (loss) per common share calculation	$10,506	$(82,914)
Weighted average number of common shares outstanding, as reported	24,582	23,852
Adjustment necessary assuming shares issued in the IPO were outstanding for the full period	5,529	6,250
Weighted average common shares in supplemental pro forma income (loss) per common share calculation	30,111	30,102
Supplemental pro forma income (loss) per common share	$ .35	$ (2.75)

3. BUSINESS COMBINATIONS

In May 1996, the Company purchased TAI for $83,349 excluding transaction costs. The acquisition was financed through borrowings under the current bank credit agreement. TAI develops, manufactures, sells and services thermal analysis and rheology instruments which are used for the physical characterization of polymers and related materials. Thermal analysis and rheology are among the most prevalent techniques employed in the analysis of polymers and other organic/inorganic materials. TAI is the global market leader in the field of thermal analysis. Net sales for TAI were approximately $14,000 for the period from January 1, 1996 to April 30, 1996 and $47,000 in 1995. The acquisition was accounted for by the purchase method and the excess purchase price was allocated to the assets and liabilities of TAI based upon their estimated fair values. Principle components of this excess amount included the revaluation of certain inventories ($6,100), in-process research and development projects ($19,300) and goodwill ($43,780). The technological feasibility of in-process research and development projects had not yet been established at the date of acquisition and had no alternative future use.

The following unaudited Pro Forma results of operations for the years ended December 31, 1996 and December 31, 1995 give effect to the TAI acquisition as if the transaction had occurred at the beginning of each such period. The financial data are based on the historical consolidated financial statements for the Company and TAI and the assumptions and adjustments made upon the TAI acquisition. The Pro Forma results of operations exclude the 1996 charges for the revaluation of acquired inventory and expensed in-process research and development associated with the acquisition and do not (i) purport to represent what the Company’s results would have been if the TAI acquisition had occurred as of the beginning of the periods, or (ii) what such results will be for any future periods. The financial data are based upon assumptions that the Company believes are reasonable and should be read in conjunction with the Consolidated Financial Statements and accompanying notes thereto included elsewhere in this report.

	Pro Forma Results For the Year Ended	
	December 31, 1996	December 31, 1995
Net sales	$405,308	$379,569
Income from continuing operations	44,786	16,867
Net income	22,522	4,755
Income per common share from continuing operations	$ 1.39	$ 0.65
Net income per common share	$ 0.68	$ 0.16

In July 1995, the Company purchased Phase Separations Limited, a United Kingdom company, for approximately $7,500. Phase Separations Limited is a manufacturer of chromatography consumable products. This acquisition was also accounted for by the purchase method.

The total purchase price paid to acquire the Predecessor on August 18, 1994 was approximately $358,000, including related costs, and exceeded the historical book value of the net assets acquired. The Acquisition was accounted for by the purchase method and the excess purchase price was allocated to the assets and liabilities of the Predecessor based upon their estimated fair values. Principal components of this excess amount included the revaluation of certain inventories ($38,424), in-process research and development projects ($53,918), purchased technology ($10,748) and goodwill ($70,022). The technological feasibility of in-process research and development projects had not yet been established at the date of acquisition and had no alternative future use.

4. DISCONTINUED OPERATIONS

On December 31, 1994, the Company announced a plan to sell its process mass spectrometry business. The largest operation was sold in July 1995 for proceeds, net of associated costs, of approximately $6,500. Remaining operations were sold in January 1996 for proceeds, net of associated costs, of approximately $4,500. The results of this business prior to 1995 have been classified as discontinued operations in the consolidated statements of operations. A reserve of $8,000 was recorded in December 1994 for the estimated loss on disposition of this business. This reserve was reduced by actual losses for the year ended December 31, 1995 which aggregated $546. The net assets of the business had been segregated in the 1995 consolidated balance sheet.

5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment consist of the following:

	December 31, 1996	December 31, 1995
Land	$ 3,092	$ 3,092
Leasehold improvements	1,083	1,206
Buildings and improvements	29,171	28,653
Production and other equipment	53,414	43,499
Construction in progress	7,746	3,965
	94,506	80,415
Less: accumulated depreciation and amortization	(19,729)	(10,154)
Property, plant and equipment, net	$ 74,777	$ 70,261

6. INVENTORIES

Inventories are classified as follows:

	December 31, 1996	December 31, 1995
Raw material	$ 14,860	$ 10,719
Work in progress	6,180	4,201
Finished goods	26,311	26,539
Total inventories	$ 47,351	$ 41,459

7. DEBT

On August 18, 1994, the Company issued $100,000 of 12.75% Senior Subordinated Notes, series B due 2004 (“Senior Subordinated Notes”) and entered into an original bank credit agreement (“Prior Bank Credit Agreement”) which provided for term loans of up to $205,000. As required by the Prior Bank Credit Agreement, the Company also entered into an interest rate protection agreement on borrowing levels of $100,000 in September 1994. As explained below, all of these arrangements were subsequently terminated and refinanced.

Contemporaneously with the IPO, the Company retired all outstanding indebtedness under the Prior Bank Credit Agreement with net proceeds from the IPO and bank financing under a new bank credit agreement (“New Bank Credit Agreement”). The New Bank Credit Agreement is a revolving credit facility with maximum availability of $175,000 on the IPO date which was subsequently increased to $300,000 in March 1996. The loans under the New Bank Credit Agreement bear interest for each calendar quarter at a per annum rate equal to, at the Company’s option, (i) a floating rate based on the prime rate plus an amount which will vary between zero and 0.50% or (ii) the applicable Eurodollar rate plus an amount which will vary between 0.50% and 1.50%, based upon certain Company performance criteria for the previous four quarters. Amounts available under the New Bank Credit Agreement will decrease under certain circumstances and, in any case, by $45,000 in each of 1998 and 1999. The agreement terminates on November 22, 2000. Borrowings under the New Bank Credit Agreement are collateralized by substantially all of the Company’s assets.

On December 29, 1995, the Company redeemed $25,000 of Senior Subordinated Notes principal for a call premium of $3,188. In connection with the early retirement of the Prior Bank Credit Agreement and the $25,000 of Senior Subordinated Notes principal, the Company recorded a $12,112 extraordinary loss in 1995 for the write-off of associated unamortized debt issuance costs, the call premium and the associated interest rate protection premium.

On April 4, 1996, the Company consummated a tender offer (“Tender Offer”) to repurchase the remaining $75,000 in principal amount of 12.75% Senior Subordinated Notes. The aggregate purchase price paid by the Company in connection with the Tender Offer was $90,600. The Company funded this redemption through additional borrowings under the New Bank Credit Agreement. In the second quarter of 1996, the Company recorded an extraordinary loss of $22,264 related to the early extinguishment of the Senior Subordinated Notes.

Under its various loan agreements, the Company is required to meet certain covenants, including certain restrictions on dividend payments, none of which is considered restrictive to the operations of the Company. The Company was in compliance with all of its debt covenants under the New Bank Credit Agreement as of December 31, 1996.

At December 31, 1996, the Company had aggregate borrowings outstanding under the New Bank Credit Agreement of $212,460 and approximately $87,540 in additional borrowings available. The weighted average interest rate on the New Bank Credit Agreement borrowings was approximately 6.6% at December 31, 1996. At December 31, 1995, the interest rate on the $75,000 principal amount of Senior Subordinated Notes outstanding was fixed at 12.75% and the weighted average interest rate on the New Bank Credit Agreement borrowings was approximately 6.7%. The Company's foreign subsidiaries had available short-term lines of credit totaling $8,545 at December 31, 1996 and December 31, 1995. At December 31, 1996 and December 31, 1995, borrowings amounted to $1,990 at a weighted average interest rate of approximately 7.1% and $1,933 at a weighted average interest rate of approximately 4.0%, respectively.

In January 1996, the Company entered into a three-year debt swap agreement with the Bank of Boston to hedge the U.S. dollar value of its investment in the net assets of its Japanese subsidiary. The Company swapped $22,000 in notional amount of floating rate LIBOR borrowings for 2,300,000 Yen notional amount of borrowings at a fixed interest rate of 1.525% per annum. At representative interest rates and currency exchange rates in effect at January 23, 1996, the effective date of the agreement, the Company lowered its annual interest costs by approximately $900 over the term of the swap agreement. The Company could also incur higher or lower principal repayments over the term of the swap agreement. At currency exchange rates in effect on December 31, 1996, the principal repayment amount would have been $20,114.

In March and April 1996, the Company entered into several interest rate protection agreements. These agreements provide payments to the Company if the three month LIBOR rate, as defined, exceeds 6% in 1997 and 6.5% in 1998 and 1999 on aggregate borrowings of $183,000 in 1997 and $70,000 and $30,000 in 1998 and 1999, respectively. At December 31, 1996, the fair value of these agreements was $741.

In June 1996, the Company entered into a three-year debt swap agreement with Bankers Trust Company to hedge the U.S. dollar value of its investment in the net assets of TAI's Japanese subsidiary. The Company swapped $7,500 in notional amount of floating rate LIBOR borrowings for 817,500 Yen notional amount of borrowings at a fixed interest rate of 2.02% per annum. At representative interest rates and currency exchange rates in effect at June 26, 1996, the effective date of the agreement, the Company lowered its annual interest costs by approximately $266 over the term of the swap agreement. The Company could also incur higher or lower principal payments over the term of the swap agreement. At currency exchange rates in effect on December 31, 1996, the principal repayment amount would have been $7,057.

In October 1996 the Company entered into a fifteen (15) month debt swap agreement with Credit Lyonnais - New York to hedge the U.S. dollar value of its investments in the net assets of certain European subsidiaries. The Company swapped $35,400 in notional amount of floating rate LIBOR borrowings for equivalent notional amounts in six European currencies of borrowings at fixed interest rates averaging approximately 3.2% per annum. At representative interest rates and currency exchange rates in effect at October 29, 1996, the date of the transaction, the Company lowered its annual interest costs by approximately $1,100 over the term of the swap agreement. The Company could also incur higher or lower principal payments over the term of the swap agreement. At currency exchange rates in effect on December 31, 1996, the principal repayment amount would have been $35,229.

8. INCOME TAXES

Income tax data for 1996, 1995, and 1994 follow in the tables below:

	Company			Predecessor
(In thousands)	Year Ended December 31, 1996	Year Ended December 31, 1995	August 19, 1994 to December 31, 1994	January 1, 1994 to August 18, 1994
The components of income (loss) from continuing operations before income taxes were as follows:				
Domestic	$ 33,534	$ 18,322	$(77,320)	$ 15,953
Foreign	(2,445)	(1,080)	(1,384)	(12,745)
Total	$ 31,089	$ 17,242	$(78,704)	$ 3,208
The components of the current and deferred income tax provision on continuing operations were as follows:				
Current	$ 15,430	$ 3,129	$ 1,487	$ 916
Deferred	(4,200)	–	–	–
Total	$ 11,230	$ 3,129	$ 1,487	$ 916
The components of the provision for income taxes on continuing operations were as follows:				
Federal	$ 4,576	$ –	$ –	$ 916
State	900	300	129	–
Foreign	5,754	2,829	1,358	–
Total	$ 11,230	$ 3,129	$ 1,487	$ 916
The differences between income taxes computed at the United States statutory rate and the provision for income taxes are summarized as follows:				
Federal tax computed at U.S. statutory income tax rate	$ 10,881	$ 6,035	$(27,546)	$ 1,123
State income tax, net of federal income tax benefit	585	300	(5,156)	–
Deferred tax assets not benefited (benefited)	(16,823)	(6,271)	35,080	–
Net effect of foreign operations	7,339	2,858	–	–
Nondeductible acquisition costs	8,890	–	–	–
Other	358	207	(891)	(207)
Provision for income taxes	$ 11,230	$ 3,129	$ 1,487	$ 916
The tax effects of temporary differences and carryforwards which gave rise to deferred tax liabilities and deferred tax (assets) were as follows:				
Acquired net operating loss carryforwards	$ (3,995)	$ –	$ –	$ –
Estimated loss on disposal of discontinued operations	(991)	(1,900)	(3,200)	–
Goodwill amortization	(11,731)	(12,808)	(20,677)	–
Depreciation and capitalized software	3,919	3,357	–	77
Deferred financing	(146)	(2,569)	–	–
Deferred compensation	(2,344)	(1,840)	–	–
Tax credit carryforwards	(1,221)	(1,221)	–	–
Other	(3,610)	513	189	(77)
Net operating loss carryforward	(16,905)	(17,704)	(11,392)	–
Valuation allowance	32,824	34,172	35,080	–
Total deferred taxes	$ (4,200)	$ –	$ –	$ –

At December 31, 1996 the Company had a U.S. net operating loss carryforward of approximately $35,000 which begins to expire in the year 2009. The Company's ability to use the net operating loss carryforward is limited under Internal Revenue Code Section 382, however the company feels such limitation is not material. The Company had foreign net operating loss carryforwards of approximately $8,000, some of which begin to expire in the year 2000 and some of unlimited duration. The goodwill amortization represents the difference between the book and tax treatment for both goodwill and in-process research and development. The deferred tax asset of $4,200 is included as part of other current assets in the consolidated balance sheet. Realization of deferred tax assets is contingent upon future taxable income. The valuation allowance relates to the uncertainty of realizing the deferred tax assets. The tax benefit of the acquired net operating loss carryforwards of $9,986 will reduce goodwill but not tax expense when it is realized.

The Company's effective tax rate before the nondeductible acquisition related expenses for the twelve month period ended December 31, 1996 was 19.9%. The Company benefited from net operating loss carryforwards which offset U.S. taxable income in 1996.

9. LEASES

Lease agreements, expiring at various dates through 2019, cover buildings, office equipment and automobiles. Rental expense was approximately $6,474 in 1996, $5,684 in 1995 and $3,262 in 1994. In 1994, 1995 and 1996, the Company's rent expense included amounts previously allocated to and not classified as direct rent expense of the Predecessor. Future minimum rents payable as of December 31, 1996 under non-cancelable leases with initial terms exceeding one year were as follows:

1997	$5,824
1998	4,544
1999	3,352
2000	1,950
2001	1,388
thereafter	2,362

10. COMMON STOCK

Prior to the IPO, the authorized common stock of the Company consisted of 919 shares of Class A, 10 shares of Class B and 194 shares of Class C common stock. All general voting power was vested in the holders of the Class B common stock. The holders of the Class A, Class B and Class C common stock were entitled to receive dividends and distributions from the current and accumulated earnings and profits, as declared by the Board of Directors, in proportion to the number of shares of common stock held. In September 1995, the Company declared and paid a $16,195 distribution to its securityholders.

Contemporaneously with the IPO, the Company completed a reclassification in which each share of Class A, Class B, and Class C common stock was converted into a specified number of shares of a single class of Common Stock ("Reclassification"). At the same time, the authorized number of shares of common stock was increased to 50,000 shares with a par value of $.01 per share. Holders of Common Stock are entitled to one vote per share. In November 1995, the Company issued 6,250 shares of Common Stock in an IPO for net proceeds of $86,152.

11. REDEEMABLE PREFERRED STOCK

On August 18, 1994, as part of the consideration for the Acquisition, the Company authorized and issued one hundred shares of Redeemable Preferred Stock (''Preferred Stock") with a par value of $.01 per share to Millipore. The Preferred Stock has a liquidation value of $10,000 and earns an annual 6% cumulative dividend based upon the liquidation value. Any accumulated but unpaid dividends are added to the liquidation value. The Company may, at any time, redeem the Preferred Stock at the current liquidation value but in no event later than August 18, 2006. The Preferred Stock was recorded at its estimated fair value of $5,000 on the date of issuance. The excess of the liquidation value over the fair market value is being accreted by periodic charges to additional paid-in capital from the date of issue through August 18, 2006. During the years ended December 31, 1996, 1995, and 1994, $321, $301, and $108, respectively, were charged against additional paid-in capital to reflect the accretion from fair value to the liquidation value and $600, $600 and $222, respectively, were charged against additional paid-in capital for the accumulated but unpaid dividends. At December 31, 1996, the liquidation preference was $11,422.

12. STOCK COMPENSATION AND PURCHASE PLANS

The Company has four stock-based compensation plans, which are described below. The Company applies APB Opinion 25 and related Interpretations in accounting for its plans. Accordingly, no compensation cost has been recognized for its fixed stock option plans and its stock purchase plan under SFAS 123. In adopting SFAS 123 in 1996, the Company elected footnote disclosure only. Had compensation cost for the Company's four stock-based compensation plans been recorded based on the fair value of awards at grant date consistent with the method prescribed by SFAS 123, the Company's net income and earnings per share would have been changed to the pro forma amounts indicated below:

		1996	1995
Net (loss) income available to common stockholders	As reported	$(3,326)	$1,099
	SFAS 123 fair value, net of taxes	(1,174)	(487)
	APB 25 offset, net of taxes	176	493
	Pro forma	$(4,324)	$1,105
Net (loss) income per common share	As reported	$ (0.11)	$ 0.05
	SFAS 123 fair value, net of taxes	(0.04)	(0.02)
	APB 25 offset, net of taxes	0.01	0.02
	Pro forma	$ (0.14)	$ 0.05

The above initial phase-in period pro forma disclosures under SFAS 123 are not likely to be representative of the effects on reported net income for future years.

The fair value of each option grant under SFAS 123 is estimated on the date of grant using the Black-Scholes option-pricing model. The following table presents the annualized weighted-average values of the significant assumptions used to estimate the fair values of the options:

Options issued	358	663
Risk-free interest rate	6.4%	7.0%
Expected life in years	7.4	7.5
Expected volatility	0.674	0.6928
Expected dividends	0	0

The following table details the weighted-average exercise price and fair values of options on the date of grant where:

Option exercise prices are less than the market price		
Exercise price		$ 9.50
Fair value		$10.51
Option exercise prices are equal to the market price		
Exercise price		$ 4.07
Fair value		$ 3.07
Option exercise prices exceed the market price		
Exercise price	$34.21	$12.89
Fair value	$20.89	$ 2.16

The following table details the weighted-average remaining contractual life of options outstanding at December 31, 1996 by range of exercise prices:

Exercise Price Range	Number of Shares Outstanding	Exercise Price	Remaining Contractual Life of Options Outstanding
$ 0.00 to $ 5.00	1,077	$ 4.00	7.8 Years
$ 5.01 to $10.00	1,307	$ 9.50	7.9 Years
$10.01 to $20.00	2,520	$16.28	7.7 Years
$20.01 to $40.00	358	$34.21	9.3 Years
	5,262		

Stock Option Plans

On May 7, 1996, the Company's shareholders approved the 1996 Long-Term Incentive Plan ("1996 Plan"), which provides for the granting of 1,000 shares of Common Stock, consisting of stock options, stock appreciation rights ("SARs"), restricted stock, and other types of awards. Under the 1996 Plan, the exercise price for stock options may not be less than the fair market value of the underlying stock at the date of grant. The 1996 Plan is scheduled to terminate on May 7, 2006, unless extended for a period of up to five years by action of the Board of Directors. Options granted may be either incentive stock options or non-qualified options. Options generally will expire no later than ten years after the date on which they are granted and will become exercisable as directed by the Compensation Committee of the Board of Directors. An SAR may be granted alone or in conjunction with an option or other award. No SARs, restricted stock, or other types of awards were outstanding as of December 31, 1996.

The Company's 1994 Stock Option Plan (''1994 Plan") provided for the granting of 205 common stock options to certain key employees of Waters. Stock options under the 1994 Plan allowed the purchase of Class A Common Stock of the Company. Concurrent with the Reclassification, total options to purchase Class A Common Stock of the Company were converted into 5,035 options to purchase shares of Common Stock. The exercise price of the options is determined by a committee of the Board of Directors (''Board") of the Company. Options granted have a term of ten years and vest in five equal installments on the first five anniversaries after the grant.

On September 14, 1995, the Board amended certain existing stock option agreements as follows: (i) outstanding options for 971 and 129 shares granted in August 1994 and January 1995, respectively, which had a variable exercise price dependent on future events, were amended to fix the exercise price at $9.50 per share and (ii) outstanding options for 2,431 and 129 shares granted in August 1994 and January 1995, respectively, were amended to fix both the number of shares as originally granted and to fix the exercise price at $16.28 per share. On September 14, 1995, certain of these amended options had an exercise price below estimated fair value. Accordingly, the Company recorded $5,641 of deferred compensation expense to be recognized over the vesting period of the underlying options. In October 1995, the Board accelerated the vesting period of 1,100 outstanding stock options. Accordingly, the Company immediately charged $3,567 of noncash compensatory stock option expense to selling, general and administrative expenses in 1995.

Non-Employee Director Plans

On May 7, 1996, the Company's shareholders approved the 1996 Non-Employee Director Deferred Compensation Plan ("Deferred Compensation Plan") and the 1996 Non-Employee Director Stock Option Plan ("Director Stock Option Plan"). Under the Deferred Compensation Plan, outside directors may elect to defer their fees and credit such fees to either a cash account which earns interest at a market-based rate or to a common stock unit account, for which 100 shares of Common Stock have been reserved. Under the Director Stock Option Plan, each outside director will receive an option to purchase one thousand shares of Common Stock, and up to fifty thousand shares of Common Stock may be issued under such plan. On May 24, 1996 the Compensation Committee granted options to purchase six thousand shares of Common Stock under the Director Stock Option Plan. Options have a term of ten years and, with the exception of options granted in 1996, which vest in one year, vest in five equal installments on the first five anniversaries following the date of grant and have option prices no less than fair market value at the date of grant.

The following table summarizes stock option activity for the plans after giving effect to the Reclassification:

	Weighted Average Exercise Price	Number of Shares	Price Per Share
Granted	$ 12.06	4,372	$ 4.00 to $16.28
Outstanding at December 31, 1994	12.06	4,372	$ 4.00 to $16.28
Granted	9.76	663	$ 4.00 to $16.28
Outstanding at December 31, 1995	$ 11.76	5,035	$ 4.00 to $16.28
Granted	34.21	358	$34.21 to $34.50
Exercised	(10.48)	(128)	$ 4.00 to $16.28
Canceled	(34.21)	(3)	$ 34.21
Outstanding at December 31, 1996	$ 13.31	5,262	$ 4.00 to $34.50
Options exercisable at December 31, 1996	$ 11.30	2,439	
Available for grant at December 31, 1996		699	

Employee Stock Purchase Plan

On February 26, 1996, the Company adopted the 1996 Employee Stock Purchase Plan under which eligible employees may contribute up to 15% of their earnings toward the quarterly purchase of the Company's Common Stock. The plan makes available 250 shares of the Company's Common Stock commencing October 1, 1996. As of December 31, 1996, four thousand three hundred thirty six shares have been issued under the plan. Each plan period lasts three months beginning on January 1, April 1, and October 1 of each year. The purchase price for each share of stock is the lesser of 90% of the market price on the first day of the plan period or 100% of the market price on the last day of the plan period. No compensation expense is recorded in connection with the plan.

13. WARRANT

On August 18, 1994, the Company issued a warrant (''Warrant") to purchase 34 shares of Class A Common Stock and 10 shares of Class C Common Stock in connection with the Company's financing under the Prior Bank Credit Agreement. The Warrant had an exercise price of $.01 per share. The Company valued the Warrant based upon the difference between the fair market value of the Company's common stock as of the date of issuance and the exercise price of the Warrant. The fair market value of the Company's common stock was determined by the cash consideration per share paid by the original investors at the time of the Acquisition. The estimated fair market value of $3,200 for the Warrant was recorded as a component of stockholders' equity.

In connection with the Reclassification, the Warrant allowed for the purchase of 1,064 shares of the Common Stock at an exercise price of $.01 per share. In October 1995, the Company issued 1,064 shares of Common Stock upon the exercise of the Warrant.

14. FOREIGN CURRENCY CONTRACTS

The Company has periodically entered into forward exchange contracts to hedge the impact of foreign currency fluctuations on the U.S. dollar value of certain anticipated and specified future foreign cash flows and foreign net asset values. The unrealized gains and losses on outstanding contracts at period end which relate to anticipated future cash flows are recorded in unrealized gains (losses) on future cash flow hedges in the statements of operations. The realized gains and losses on these contracts and on those contracts relating to specified future foreign cash flows are recorded as realized gains (losses) on cash flow hedges. In December 1995, the Company liquidated those outstanding contracts which hedged anticipated future cash flows. Gains (losses) on contracts hedging net asset values generated a reduction in translation adjustments of $1,313 for the year ended December 31, 1995.

At December 31, 1996 and 1995, the Company had outstanding forward exchange contracts amounting to $3,342 and $3,400, respectively, which hedged the dollar value equivalent of specified future customer commitments. These contracts have an initial maturity of less than three months and mature in the period in which the local currency cash flow is expected.

15. RETIREMENT PLANS

Prior to the Acquisition, retirement benefits were provided to employees through the Millipore Corporation Employees' Participation and Savings Plan (''Millipore Participation Plan") and the Retirement Plan for Employees of Millipore Corporation (''Millipore Retirement Plan"). Subsequent to the Acquisition, the Company adopted two new retirement plans for employees effective August 19, 1994; the Waters Employee Investment Plan, a defined contribution plan, and the Waters Retirement Plan, a defined benefit cash balance plan, which supersede the aforementioned Millipore Corporation Participation and Retirement plans.

Waters employees' accumulated benefit balances in the Millipore Participation Plan were valued as of September 30, 1994 and transferred to the Waters Employee Investment Plan. Millipore and the Company have not yet agreed on the final valuation of the amount of benefits transferable from the Millipore Retirement Plan on behalf of Waters employees as of the Acquisition date. Upon agreement of a final valuation, Millipore will transfer the Waters employees' accumulated benefit balances to the Waters Retirement Plan.

Waters is currently asserting a claim against Millipore under procedures specified in the purchase and sale agreement for the Predecessor. Waters contends that Millipore has undervalued the amount of assets it is obligated to transfer from the Millipore Retirement Plan to the Waters successor plan. Waters believes it has meritorious arguments and should prevail, although the outcome is not certain. The Company believes that any outcome of the proceeding will not be material to the Company.

Employees hired prior to the Acquisition date were eligible to participate in the Waters Employee Investment Plan as of the Acquisition date. Employees hired after this date but before October 1, 1996 were eligible after one year of service. As of October 1, 1996, new or existing employees are eligible after one month of service. Employees may contribute from 1%-15% of eligible pay on a pre-tax basis. The Company makes a matching contribution of 50% for contributions up to 6% of eligible pay after one year of service. Employees are 100% vested in company matching contributions upon becoming eligible for the plan. For the years ended December 31, 1996 and December 31, 1995, the Company's matching contributions amounted to $1,318 and $1,280, respectively. Effective December 31, 1996, the TA Instruments, Inc. Savings and Investment Plan was merged into the Waters Employee Investment Plan. TAI's matching contributions from May 1, 1996 to December 31, 1996 were $127.

U.S. employees are eligible to participate in the Waters Retirement Plan after one year of service. The Company makes an annual contribution to each employee's account as a percentage of eligible pay based on years of service. In addition, each employee's account is credited for investment returns at the beginning of each year for the prior year at the average 12 month Treasury Bill rate plus 0.5%, limited to a minimum rate of 5% and a maximum rate of 10%. An employee does not vest until the completion of five years of service at which time the employee becomes 100% vested. Years of service under the Millipore Retirement Plan count toward participation and vesting under the Waters Retirement Plan. As of December 31, 1996, the TA Instruments, Inc. Employees' Pension Plan ("TAI Pension Plan") was merged into the Waters Retirement Plan. Participants in the TAI Pension Plan as of December 31, 1996 will have an opening account balance established equal to the present value of their December 31, 1996 accrued benefit under the TAI Pension Plan. TAI employees eligible for early retirement as of December 31, 1996 will continue to accrue benefits under the TAI formula to the extent that it provides a larger benefit than their cash balance account in the Waters Retirement Plan.

Summary data for the Waters Retirement Plan at December 31, 1996 and 1995 are presented in the following table. These amounts include the effect of the TAI acquisition as of December 31, 1996.

	Year Ended December 31, 1996	Year Ended December 31, 1995
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of $9,127 and $4,194, respectively	$ (9,305)	$(4,323)
Projected benefit obligation for service rendered to date	$(10,552)	$(4,424)
Estimated plan assets at fair value	13,988	2,087
Projected benefit obligation (in excess of) less than fair value of assets	3,436	(2,337)
Unrecognized prior service costs	(734)	273
Unrecognized net actuarial (gain) loss	(3,910)	505
Minimum pension liability adjustment	–	(677)
(Accrued) pension cost included in the financial statements	$ (1,208)	$(2,236)
Intangible asset	$ –	$ 273

	Year Ended December 31, 1996	Year Ended December 31, 1995	Year Ended December 31, 1994
Net periodic pension cost includes the following components:			
Service cost	$ 2,025	$1,780	$543
Interest cost	938	321	68
Return on plan assets	(700)	(137)	(60)
Amortization and deferral	(5)	(8)	(16)
Net periodic pension cost	$ 2,258	$1,956	$535
The projected benefit obligation was calculated using the following assumptions:			
Discount rate	7.75%	7.25%	8.75%
Return on assets	8.50%	8.50%	8.50%
Increases in compensation levels	4.75%	4.50%	5.00%

Millipore did not perform separate actuarial calculations for the Predecessor's portion of its Retirement Plan. As a result, data is not available for the plan for the period from January 1, 1994 to August 18, 1994.

16. POST-RETIREMENT BENEFITS OTHER THAN PENSIONS

The Company sponsors several unfunded defined benefit post-retirement plans covering U.S. employees. The plans provide medical insurance benefits and are, depending on the plan, either contributory or non-contributory.

Net periodic post-retirement benefit cost included the following components:

	Company			Predecessor
	Year Ended December 31, 1996	Year Ended December 31, 1995	August 19, 1994 to December 31, 1994	January 1, 1994 to August 18, 1994
Service cost-benefits attributed to service during the year				
Interest cost on accumulated post-retirement benefit obligation	$ 95	$ 82	$ 37	257
Net amortization and deferral	69	64	35	174
Net periodic post-retirement benefit cost	(83)	(83)	(21)	(29)
	$ 81	$ 63	$ 51	$ 402

Summary information on the Company's plan at December 31, 1996, and 1995 is presented in the following table:

	Year Ended December 31, 1996	Year Ended December 31, 1995
Accumulated post-retirement benefit obligation:		
Retirees	$ 137	$ 152
Fully eligible active plan participants	229	45
Other active plan participants	682	608
Unrecognized amounts:		
Prior service costs	1,348	1,556
Net loss (gain)	33	16
Accrued post retirement benefit cost	$2,429	$2,377

The Company's accrued post-retirement benefit obligation was $2,429 and $2,377 at December 31, 1996 and 1995, respectively, and is included in other liabilities in the balance sheet. This obligation pertains only to active employees of the Company at the time of the Acquisition and employees hired subsequent to the Acquisition. The obligation to fund post retirement benefits for retired employees prior to the Acquisition has been retained by Millipore.

The discount rate used in determining the accumulated post-retirement benefit obligation was 7.75%, and 7.25% as of December 31, 1996 and 1995, respectively. Increases in the health care cost trend rate do not result in any additional costs to the Company.

17. RELATED PARTY TRANSACTIONS

In 1996 and 1995, the Company made loans to certain executive officers of the Company. The loans are collateralized by a pledge of shares of common stock held by these executive officers. The 1995 loans bear interest at 5.83% per annum and mature on December 1, 2000. The additional loans made in 1996 bear interest at 5.65% per annum and mature on January 8, 2001. Loans receivable of $2,487 at December 31, 1996 and $2,062 at December 31, 1995 are included in other assets in the balance sheet at December 31, 1996 and December 31, 1995, respectively.

In connection with the consummation of the Acquisition, the Company and Millipore entered into a Transition Support and Service Agreement (''Transition Agreement") whereby Millipore agreed to (i) lease office space, (ii) transfer certain personnel, (iii) provide management information systems, administrative, distribution and facilities management support, (iv) provide access to its telephone network, and (v) supply professional support services. The Company believes that the costs incurred under the Transition Agreement are representative of the charges that would be levied by independent third parties for similar services. The Company incurred net expenses pursuant to this agreement of $4,165, $5,210 and $5,621 for the years ended December 31, 1996 , 1995, and 1994, respectively.

During the years ended December 31, 1996, 1995, and 1994, the Company sold product and services totaling $86, $104, and $203, respectively, to Millipore.

In conjunction with the Acquisition, the Company assumed a deferred compensation liability of $4,925 from Millipore to certain key executives of Waters. The liability incurred interest at an annual rate of 7.05%. This liability plus accrued interest was paid to the executives on September 14, 1995. Interest expense for the years ended December 31, 1995 and 1994 was $254 and $130, respectively.

In connection with the Acquisition, the Company entered into a ten-year Management Services Agreement with AEA Investors, Inc. and Bain Capital, Inc. pursuant to which they agreed to pay AEA Investors, Inc. and Bain Capital, Inc. an aggregate annual management fee of $1,500, plus out-of-pocket expenses. Pursuant to the Management Services Agreement, AEA Investors, Inc. and Bain Capital, Inc. provided general management, financial and other corporate advisory services to the Company. Pursuant to this agreement, AEA Investors, Inc. and Bain Capital, Inc. received a cash financial advisory fee of $8,000 at the closing of the Acquisition. The management fee for the period August 19, 1994 to December 31, 1994 was $552. In connection with the IPO, the Management Services Agreement was terminated for a fee of $4,000. Management fees excluding the termination fee were $1,393 for the year ended December 31, 1995.

On August 18, 1994, the Company issued common stock at fair market value to senior management in exchange for notes receivable in the amount of $4,925. The notes receivable earned interest at an annual interest rate of 7.05%. Interest income on the notes receivable for the year ended December 31, 1995 was $254. The notes receivable were collateralized by the shares of common stock owned by senior management of the Company. Accordingly, the notes receivable were recorded as a reduction of stockholders' equity during the period they were outstanding. On September 14, 1995, the notes were repaid in full.

18. BUSINESS SEGMENT INFORMATION

The Company operates in one business segment and in the geographical segments indicated in the table below. Sales are reflected in the segment from which the sales are made. The United States segment includes Puerto Rico. The other international segment includes Canada, South America, Australia, India, Eastern Europe and countries in the former Soviet Union. Transfer sales between geographical areas are generally made at a discount from list price.

Company, 1996

	United States	Europe	Japan	Asia	Other Int'l	Elimination	Total
Sales:							
Unaffiliated sales	$145,578	$118,433	$48,876	$34,828	$37,230	$ –	$384,945
Unaffiliated export sales to Asia	283	–	–	–	–	–	283
Unaffiliated export sales to Other Int'l	5,885	–	–	–	–	–	5,885
Transfers between areas	122,575	–	–	–	–	(122,575)	–
Total sales	$274,321	$118,433	$48,876	$34,828	$37,230	$(122,575)	$391,113
Income from operations	$ 45,748	$ 67	$ 672	$ (221)	$ 423	(860)	$ 45,829
Total assets	$385,891	$108,111	$23,507	$ 9,655	$17,889	$(179,551)	$365,502

Company, 1995

	United States	Europe	Japan	Asia	Other Int'l	Elimination	Total
Sales:							
Unaffiliated sales	$116,065	$103,144	$47,941	$26,787	$33,749	$ –	$327,686
Unaffiliated export sales to Asia	464	–	–	–	–	–	464
Unaffiliated export sales to Other Int'l	3,947	875	–	–	–	–	4,822
Transfers between areas	107,506	–	–	–	–	(107,506)	–
Total sales	$227,982	$104,019	$47,941	$26,787	$33,749	$(107,506)	$332,972
Income from operations	$ 44,780	$ 1,610	$ 2,422	$ (1,416)	$ (1,014)	–	$ 46,382
Total assets	$343,768	$ 75,464	$20,537	$11,010	$18,402	$(169,365)	$299,816

Company, August 19, 1994 to December 31, 1994

	United States	Europe	Japan	Asia	Other Int'l	Elimination	Total
Sales:							
Unaffiliated sales	$ 47,663	$ 39,203	$17,095	$10,450	$13,359	$ –	$127,770
Unaffiliated export sales to Asia	1,072	–	–	–	–	–	1,072
Unaffiliated export sales to Other Int'l	2,022	193	–	–	–	–	2,215
Transfers between areas	43,881	–	–	–	–	(43,881)	–
Total sales	$ 94,638	$ 39,396	$17,095	$10,450	$13,359	$ (43,881)	$131,057
Loss from operations pre-restructuring	$ (63,973)	$ 240	$ 789	$ (1,204)	$ 32	$ –	$ (64,116)
Restructuring charge	(498)	(960)	(1,660)	(320)	(62)	–	(3,500)
Loss from operations post-restructuring	$ (64,471)	$ (720)	$ (871)	$ (1,524)	$ (30)	$ –	$ (67,616)
Total assets	$331,113	$ 79,291	$21,503	$12,058	$18,640	$(131,007)	$331,598

Predecessor, January 1, 1994 to August 18, 1994

	United States	Europe	Japan	Asia	Other Int'l	Elimination	Total
Sales:							
Unaffiliated sales	$ 70,101	$ 47,373	$26,242	$10,711	$17,253	$ –	$171,680
Unaffiliated export sales to Asia	1,441	–	–	–	–	–	1,441
Unaffiliated export sales to Other Int'l	2,717	259	–	–	–	–	2,976
Transfers between areas	65,064	–	–	–	–	(65,064)	–
Total sales	$139,323	$ 47,632	$26,242	$10,711	$17,253	$ (65,064)	$176,097
Income from operations	$ 16,781	$ (8,109)	$ (706)	$ (2,045)	$ (1,885)	$ –	$ 4,036

The Company's (Predecessor's) unaudited quarterly results are summarized below (In thousands except per share data):

1996	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Net sales	$85,313	$ 95,965	$98,414	$111,421	$391,113
Cost of sales	32,114	35,199	36,631	41,310	145,254
Revaluation of acquired inventory	–	2,440	3,660	–	6,100
Gross profit	53,199	58,326	58,123	70,111	239,759
Selling, general and administrative expenses	33,429	35,963	38,360	40,761	148,513
Research and development expenses	4,668	5,074	5,544	5,612	20,898
Goodwill and purchased technology amortization	931	1,431	1,615	1,242	5,219
Expensed in-process research and development	–	19,300	–	–	19,300
Operating income (loss)	14,171	(3,442)	12,604	22,496	45,829
Interest expense, net	3,954	3,480	3,706	3,600	14,740
Unrealized loss on future cash flow hedges	–	–	–	–	–
Income (loss) from continuing operations before income taxes	10,217	(6,922)	8,898	18,896	31,089
Provision (credit) for income taxes	2,042	2,932	2,502	3,754	11,230
Income (loss) from continuing operations	8,175	(9,854)	6,396	15,142	19,859
Extraordinary item - (loss) on early retirement of debt	–	(22,264)	–	–	(22,264)
Net income (loss)	8,175	(32,118)	6,396	15,142	(2,405)
Less: accretion of and dividend on Preferred Stock	229	229	231	232	921
Net loss available to common stockholders	$ 7,946	$(32,347)	$ 6,165	$ 14,910	$ (3,326)
Per share information:					
Income from continuing operations	$ .26	$ (.32)	$ .19	$ .47	$ .60
Extraordinary (loss) per common share	–	(.70)	–	–	(.71)
Net (loss) per common share	$. 26	$ (1.02)	$ .19	$ .47	$ (.11)
Weighted average number of common shares outstanding	30,925	31,782	31,888	31,919	31,628

1995	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Total
Net sales	$77,554	$ 84,328	$80,634	$ 90,456	$332,972
Cost of sales	30,282	31,275	30,761	33,898	126,216
Revaluation of acquired inventory	–	–	371	554	925
Gross profit	47,272	53,053	49,502	56,004	205,831
Selling, general and administrative expenses	31,823	32,593	33,259	38,700	136,375
Management fee	387	383	389	4,234	5,393
Research and development expenses	4,096	4,418	4,346	4,821	17,681
Operating income (loss)	10,966	15,659	11,508	8,249	46,382
Interest expense, net	8,119	7,955	7,614	6,627	30,315
Foreign currency contracts losses (gains)	3,886	2,461	(6,669)	(853)	(1,175)
(Loss) Income from continuing operations before income taxes	(1,039)	5,243	10,563	2,475	17,242
(Credit) provision for income taxes	(199)	876	1,993	459	3,129
(Loss) before extraordinary item	(840)	4,367	8,570	2,016	14,113
Extraordinary item - (loss) on early retirement of debt	–	–	–	(12,112)	(12,112)
Net income (loss)	(840)	4,367	8,570	(10,096)	2,001
Less: accretion of and dividend on Preferred Stock	222	226	227	227	902
Net loss available to common stockholders	$(1,062)	$ 4,141	$ 8,343	$ (10,323)	$ 1,099
Per share information:					
(Loss) income from continuing operations	$ (.04)	$ .17	$ .35	$ .07	$ .54
Extraordinary (loss) per share	–	–	–	(.45)	(.49)
Net (loss) income per share	$ (.04)	$ .17	$ .35	$ (.38)	$ .05
Weighted average number of common shares outstanding	23,852	23,852	23,852	26,774	24,582

	The Company			Predecessor Business		
	Year Ended December 31, 1996	Year Ended December 31, 1995	August 19 to December 31, 1994	January 1 to August 18, 1994	Year Ended December 31, 1993	Year Ended December 31, 1992
Statement of Operations Data:						
Net sales	$391,113	$332,972	$131,057	$176,097	$304,927	$309,287
Cost of sales	145,254	126,216	49,740	73,446	124,387	123,342
Revaluation of acquired inventory	6,100	925	38,424	–	–	–
Gross profit	239,759	205,831	42,893	102,651	180,540	185,945
Selling, general and administrative expenses	148,513	132,746	44,522	85,216	132,452	138,318
Research and development expenses	20,898	17,681	6,790	13,399	18,525	19,142
Goodwill and purchased technology amortization	5,219	3,629	1,227	–	–	–
Expensed in-process research and development	19,300	–	53,918	–	–	–
Management fee	–	5,393	552	–	–	–
Restructuring charge	–	–	3,500	–	13,000	–
Operating income (loss)	45,829	46,382	(67,616)	4,036	16,563	28,485
Interest expense, net (1)	14,740	30,315	12,011	828	2,072	2,107
Unrealized losses (gains) on future cash flow hedges	–	1,142	(923)	–	–	–
Realized (gains) on cash flow hedges	–	(2,317)	–	–	–	–
Income (loss) from continuing operations before income taxes	31,089	17,242	(78,704)	3,208	14,491	26,378
Provision for income taxes	11,230	3,129	1,487	916	4,169	6,180
Income (loss) from continuing operations	19,859	14,113	(80,191)	2,292	10,322	20,198
Income (loss) from discontinued operations, net of tax	–	–	787	(448)	(9)	108
Estimated (loss) on disposal of discontinued operations	–	–	(8,000)	–	–	–
Income (loss) before extraordinary item	19,859	14,113	(87,404)	1,844	10,313	20,306
Extraordinary item-(loss) on early retirement of debt	(22,264)	(12,112)	–	–	–	–
Income (loss) before cumulative effect of change in accounting principal	(2,405)	2,001	(87,404)	1,844	10,313	20,306
Cumulative effect of change in accounting principle (2)	–	–	–	–	–	(2,228)
Net income (loss)	$ (2,405)	2,001	(87,404)	$ 1,844	$ 10,313	$ 18,078
Less: accretion of and dividend on Preferred Stock	921	902	330			
Net income (loss) available to common stockholders	$ (3,326)	$ 1,099	$ (87,734)			
Income (loss) per common share:						
Income (loss) per common share from continuing operations	$ .60	$ .54	$ (3.38)			
Loss per common share from discontinued operations	–	–	(.30)			
Extraordinary loss per common share	(.71)	(.49)	–			
Net income (loss) per common share	$ (.11)	$ 05	$ (3.68)			
Weighted average number of common shares	31,628	24,582	23,852			
Balance Sheet Data (at period end):						
Working capital	$ 61,227	$ 56,385	$ 87,357		$ 100,528	$ 112,905
Total assets	365,502	299,816	331,598		189,592	199,513
Long-term debt, including current maturities (1)	210,470	158,500	275,000		–	–
Redeemable preferred stock	7,153	6,232	5,330		–	–
Stockholders' equity (deficit)/parent company investment	57,780	58,118	(22,670)		149,095	163,157

(1) Interest expense through August 18, 1994 was an allocation of Millipore's worldwide net interest expense based upon the ratio of the Predecessor's net assets to Millipore's net assets. No debt obligations of Millipore were reflected on the Predecessor's balance sheets.

(2) In 1992, the Company recorded an after tax charge to income of $2.2 million for the adoption of the provisions of SFAS No. 106, Employers' Accounting for Postretirement Benefits Other Than Pensions.

DIRECTORS

Douglas A. Berthiaume
Chairman, President,
and Chief Executive Officer
Waters Corporation

Joshua Bekenstein
Managing Director
Bain Capital, Inc.

Philip Caldwell
Senior Managing Director
Lehman Brothers Inc.
and Retired Chairman and
Chief Executive Officer,
Ford Motor Company

Edward Conard
Managing Director
Bain Capital, Inc.

Thomas P. Salice
Managing Director
AEA Investors, Inc.

Marc Wolpow
Managing Director
Bain Capital, Inc.

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and Chief Executive Officer

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Senior Vice President
Worldwide Sales
and Marketing

Thomas W. Feller
Senior Vice President
Operations

John R. Nelson
Senior Vice President
Research and Development

Philip S. Taymor
Senior Vice President
Finance and Administration
and Chief Financial Officer

Brian K. Mazar
Vice President
Human Resources
and Investor Relations

Devette W. Russo
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STOCKHOLDERS' MEETING

Date:	May 6, 1997, 11 a.m.
Place:	Waters Corporation 34 Maple Street Milford, Massachusetts
Directions:	Call 800-252-4752 Ext. 3314

STOCKLIST SYMBOL

NYSE: WAT

FORM 10K

A copy of the Company's 10K, filed with the Securities and Exchange Commission, is available without charge upon written request to:

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Waters

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