

SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)  
OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended January 31, 1997  
-----

Commission file number 0-11254  
-----

COPYTELE, INC.  
-----

(Exact name of registrant as specified in its charter)

Delaware  
-----

11-2622630  
-----

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. employer  
identification no.)

900 Walt Whitman Road  
Huntington Station, NY  
-----

11746  
-----

(Address of principal executive offices)

(Zip Code)

(516) 549-5900  
-----

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Number of shares of common stock, par value \$.01 per share, outstanding as of March 10, 1997: 57,590,356 shares  
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Part I - FINANCIAL INFORMATION

Item 1. Financial Statements.

<TABLE>  
<CAPTION>

COPYTELE, INC.  
(Development Stage Enterprise)

CONDENSED BALANCE SHEETS (UNAUDITED)

| <S>  | January 31, 1997<br>-----<br><C> | October 31, 1996<br>-----<br><C> |
|--|----------------------------------|----------------------------------|
| ASSETS   |                                  |                                  |
| CURRENT ASSETS:  |                                  |                                  |
| Cash (including cash equivalents and interest bearing accounts of \$19,339,936 and \$21,921,133, respectively)                     | \$19,546,294                     | \$22,165,892                     |
| Accrued interest receivable  | 9,441                            | 49,306                           |
| Prepaid expenses and other current assets  | 1,484,782                        | 378,417                          |
|  | -----                            | -----                            |
|  | 21,040,517                       | 22,593,615                       |
| PROPERTY AND EQUIPMENT (net of accumulated depreciation and amortization of \$879,955 and \$816,651, respectively)                 | 880,054                          | 830,606                          |
| INVESTMENT IN JOINT VENTURE (Note 2)   | 989,540                          | 1,058,557                        |
| OTHER ASSETS   | 172,419                          | 227,642                          |
| DEFERRED TAX BENEFITS (net of valuation allowance of \$25,174,000 and \$25,308,000, respectively)                                  | -                                | -                                |
|  | -----                            | -----                            |
|  | \$23,082,530                     | \$24,710,420                     |
|  | =====                            | =====                            |
| LIABILITIES AND SHAREHOLDERS' EQUITY   |                                  |                                  |
| CURRENT LIABILITIES:   |                                  |                                  |
| Accounts payable and accrued liabilities   | \$ 1,472,407                     | \$ 1,960,147                     |
|  | -----                            | -----                            |
| SHAREHOLDERS' EQUITY:  |                                  |                                  |
| Preferred stock, par value \$100 per share; authorized 500,000 shares; no shares outstanding                                       | -                                | -                                |
| Common stock, par value \$.01 per share; authorized 120,000,000 shares; outstanding 57,478,656 and 57,404,656 shares, respectively | 574,787                          | 574,047                          |
| Additional paid-in capital   | 51,164,161                       | 50,934,606                       |
| Accumulated (deficit) during development stage   | (30,128,825)                     | (28,758,380)                     |
|  | -----                            | -----                            |
|  | 21,610,123                       | 22,750,273                       |
|  | -----                            | -----                            |
|  | \$23,082,530                     | \$24,710,420                     |
|  | =====                            | =====                            |

</TABLE>

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

<TABLE>  
<CAPTION>

COPYTELE, INC.  
(Development Stage Enterprise)  
CONDENSED STATEMENTS OF OPERATIONS (UNAUDITED)

| <S>  | For the three months<br>ended January 31,<br>-----<br>1997 |             | 1996<br>-----<br><C> | For the period from<br>November 5,1982<br>(inception) through<br>January 31, 1997<br>-----<br><C> |
|--|--|-------------|----------------------|---|
| SALES  | \$   | -           | \$                   | -   |
|  | -----  | -----       | -----                | -----   |
| SELLING, GENERAL AND ADMINISTRATIVE EXPENSES, (including research and development expenses of approximately \$898,000, \$767,000 and \$21,641,000, respectively) | 1,562,504  | 1,075,396   | 33,542,713           | 33,542,713  |
|  | -----  | -----       | -----                | -----   |
| LOSS FROM JOINT VENTURE  | 69,017   | 12,872      | 235,460              | 235,460   |
|  | -----  | -----       | -----                | -----   |
| INTEREST INCOME  | 261,076  | 116,949     | 3,649,348            | 3,649,348   |
|  | -----  | -----       | -----                | -----   |
| NET (LOSS)   | (\$1,370,445)  | (\$971,319) | (\$30,128,825)       | (\$30,128,825)  |
|  | =====  | =====       | =====                | =====   |
| NET (LOSS) PER SHARE OF COMMON STOCK   | (\$0.02)   | (\$0.02)    | (\$0.67)             | (\$0.67)  |
|  | =====  | =====       | =====                | =====   |

|   |            |            |            |
|---|------------|------------|------------|
| WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING | 57,423,102 | 52,335,450 | 45,277,367 |
|---|------------|------------|------------|

</TABLE>

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

<TABLE>  
<CAPTION>

COPYTELE, INC.  
(Development Stage Enterprise)  
CONDENSED STATEMENT OF SHAREHOLDERS' EQUITY  
FOR THE PERIOD FROM NOVEMBER 5, 1982 (INCEPTION) THROUGH JANUARY 31, 1997 (UNAUDITED)

|   | Common Stock |           | Additional      | Accumulated                        |
|---|--------------|-----------|-----------------|------------------------------------|
|   | Shares       | Par Value | Paid-in Capital | (Deficit) During Development Stage |
|   | -----        | -----     | -----           | -----                              |
| <S>   | <C>          | <C>       | <C>             | <C>                                |
| BALANCE, November 5, 1982 (inception)   | -            | \$ -      | \$ -            | \$ -                               |
| Sale of common stock, at par, to incorporators on November 8, 1982  | 1,470,000    | 14,700    | -               | -                                  |
| Sale of common stock, at \$.10 per share, primarily to officers and employees from November 9, 1982 to November 30, 1982  | 390,000      | 3,900     | 35,100          | -                                  |
| Sale of common stock, at \$2 per share, in private offering from January 24, 1983 to March 28, 1983   | 250,000      | 2,500     | 497,500         | -                                  |
| Sale of common stock, at \$10 per share, in public offering on October 6, 1983, net of underwriting discounts of \$1 per share  | 690,000      | 6,900     | 6,203,100       | -                                  |
| Sale of 60,000 warrants to representative of underwriters, at \$.001 each, in conjunction with public offering  | -            | -         | 60              | -                                  |
| Costs incurred in conjunction with private and public offerings   | -            | -         | (362,030)       | -                                  |
| Common stock issued, at \$12 per share, upon exercise of 57,200 warrants from February 5, 1985 to October 16, 1985, net of registration costs                                     | 57,200       | 572       | 630,845         | -                                  |
| Proceeds from sales of common stock by individuals from January 29, 1985 to October 4, 1985 under agreements with the Company, net of costs incurred by the Company               | -            | -         | 298,745         | -                                  |
| Restatement as of October 31, 1985 for three-for-one stock split  | 5,714,400    | 57,144    | (57,144)        | -                                  |
| Common stock issued, at \$4 per share, upon exercise of 2,800 warrants in December 1985   | 8,400        | 84        | 33,516          | -                                  |
| Sale of common stock, at market, to officers on January 9, 1987 and April 22, 1987 and to members of their immediate families on July 28, 1987                                    | 67,350       | 674       | 861,726         | -                                  |
| Restatement as of July 31, 1987 for five-for-four stock split   | 2,161,735    | 21,617    | (21,617)        | -                                  |
| Fractional share payments in conjunction with five-for-four stock split   | -            | -         | (1,345)         | -                                  |
| Sale of common stock, at market, to members of officers' immediate families from September 10, 1987 to December 4, 1990 and to officers on October 29, 1987 and February 26, 1989 | 628,040      | 6,280     | 6,124,031       | -                                  |
| Sale of common stock, at market, to senior level personnel on February 26, 1989   | 29,850       | 299       | 499,689         | -                                  |

Continued

</TABLE>

<TABLE>  
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COPYTELE, INC.  
(Development Stage Enterprise)  
CONDENSED STATEMENT OF SHAREHOLDERS' EQUITY  
FOR THE PERIOD FROM NOVEMBER 5, 1982 (INCEPTION) THROUGH JANUARY 31, 1997 (UNAUDITED)

Continued

|  | Common Stock |           | Additional      | Accumulated                        |
|--|--------------|-----------|-----------------|------------------------------------|
|  | Shares       | Par Value | Paid-in Capital | (Deficit) During Development Stage |
|  | -----        | -----     | -----           | -----                              |
| <S>  | <C>          | <C>       | <C>             | <C>                                |
| Sale of common stock, at market, to unrelated party on February 26, 1989 amended on March 10, 1989   | 35,820       | 358       | 599,627         | -                                  |
| Restatement as of January 31, 1991 for two-for-one stock split   | 11,502,795   | 115,028   | (115,028)       | -                                  |
| Sale of common stock, at market, to members of officers' immediate families from April 26, 1991 to October 27, 1992                              | 261,453      | 2,615     | 2,788,311       | -                                  |
| Common stock issued upon exercise of warrants by members of officers' immediate families on various dates from September 1993 through March 1996 | 579,800      | 5,798     | 2,651,462       | -                                  |
| Common stock issued upon exercise of stock options from December 16, 1992 to June 12, 1996   | 4,535,340    | 45,353    | 28,197,223      | -                                  |
| Restatement as of June 17, 1996 for two-for-one stock split  | 28,382,183   | 283,822   | (283,822)       | -                                  |
| Common stock issued upon exercise of warrants by   |              |           |                 |                                    |

|  |            |            |              |                |
|--|------------|------------|--------------|----------------|
| members of officers' immediate families on various dates in July and October, 1996   | 107,790    | 1,078      | 559,262      | -              |
| Common stock issued upon exercise of stock options from July 8, 1996 to January 31, 1997 under stock option plans, net of registration costs | 606,500    | 6,065      | 2,024,950    | -              |
| Accumulated (deficit) during development stage   | -          | -          | -            | (30,128,825)   |
| BALANCE, January 31, 1997  | 57,478,656 | \$ 574,787 | \$51,164,161 | (\$30,128,825) |

</TABLE>

The accompanying notes to condensed financial statements are an integral part of this statement.

<TABLE>  
<CAPTION>

COPYTELE, INC.  
(Development Stage Enterprise)  
CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

|   | For the three months ended<br>January 31, |              | For the period from<br>November 5, 1982<br>(inception) through<br>January 31, 1997 |
|---|---|--------------|--|
|   | 1997                                      | 1996         |  |
| <S>   | <C>                                       | <C>          | <C>  |
| CASH FLOWS FROM OPERATING ACTIVITIES:   |   |              |  |
| Payments to suppliers, employees and consultants  | (\$2,925,181)                             | (\$879,112)  | (\$33,032,914)   |
| Interest received   | 300,941                                   | 129,496      | 3,639,908  |
| Net cash (used in) operating activities   | (2,624,240)                               | (749,616)    | (29,393,006)   |
| CASH FLOWS FROM INVESTING ACTIVITIES:   |   |              |  |
| Payments for purchases of property and equipment  | (225,653)                                 | (4,453)      | (1,574,648)  |
| Disbursements to acquire certificates of deposit and corporate notes and bonds  | -   | -            | (12,075,191)   |
| Proceeds from maturities of investments   | -   | -            | 12,075,191   |
| Investment made in Joint Venture  | -   | (490,000)    | (1,225,000)  |
| Net cash (used in) investing activities   | (225,653)                                 | (494,453)    | (2,799,648)  |
| CASH FLOWS FROM FINANCING ACTIVITIES:   |   |              |  |
| Proceeds from sales of common stock and warrants, net of underwriting discounts of \$690,000 related to initial public offering in October 1983 | -   | -            | 17,647,369   |
| Proceeds from exercise of stock options and warrants, net of registration disbursements   | 230,295                                   | 2,557,714    | 34,156,209   |
| Proceeds from sales of common stock by individuals under agreements with the Company, net of disbursements made by the Company                  | -   | -            | 298,745  |
| Disbursements made in conjunction with sales of stock   | -   | -            | (362,030)  |
| Fractional share payments in conjunction with stock split   | -   | -            | (1,345)  |
| Net cash provided by financing activities   | 230,295                                   | 2,557,714    | 51,738,948   |
| NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS  | (2,619,598)                               | 1,313,645    | 19,546,294   |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD  | 22,165,892                                | 8,864,293    | -  |
| CASH AND CASH EQUIVALENTS AT END OF PERIOD  | \$19,546,294                              | \$10,177,938 | \$19,546,294   |

Continued

</TABLE>

<TABLE>  
<CAPTION>

COPYTELE, INC.  
(Development Stage Enterprise)  
CONDENSED STATEMENTS OF CASH FLOWS (UNAUDITED)

Continued

|  | For the three months ended<br>January 31, |      | For the period from<br>November 5, 1982<br>(inception) through<br>January 31, 1997 |
|--|---|------|--|
|  | 1997                                      | 1996 |  |

| <S>   | <C>           | <C>         | <C>            |
|---|---------------|-------------|----------------|
| RECONCILIATION OF NET (LOSS) TO NET CASH (USED IN)  |               |             |                |
| OPERATING ACTIVITIES:   |               |             |                |
| Net (loss)  | (\$1,370,445) | (\$971,319) | (\$30,128,825) |
| Loss from Joint Venture   | 69,017        | 12,872      | 235,460        |
| Depreciation and amortization   | 63,304        | 18,724      | 884,596        |
| Increase (Decrease) in accrued interest receivable  | 39,865        | 12,547      | (9,441)        |
| (Increase) in prepaid expenses and other current assets   | (1,106,365)   | (2,316)     | (1,484,782)    |
| (Increase) Decrease in other assets   | 55,223        | (86)        | (172,419)      |
| Increase (Decrease) in accounts payable and accrued liabilities related to operating activities | (374,839)     | 179,962     | 1,282,405      |
| Net cash (used in) operating activities   | (\$2,624,240) | (\$749,616) | (\$29,393,006) |

</TABLE>

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

COPYTELE, INC.  
(Development Stage Enterprise)  
NOTES TO CONDENSED FINANCIAL STATEMENTS  
JANUARY 31, 1997 (UNAUDITED)

(1) Summary of significant accounting policies and other disclosures:

The Company is a party to a joint venture located in Shanghai, China with Shanghai Electronic Components Corp. ("SECC") and Shanghai International Trade and Investment Developing Corp. ("SIT"). The Company owns a 55% interest in the capital, profits and losses of the joint venture, Shanghai CopyTele Electronics Co., Ltd. ("SCE" or "Joint Venture"). The remaining 45% is owned by two Chinese companies, SECC which owns 35% of the Joint Venture and SIT which owns 10%. (See Note 2, Investment in Joint Venture). The Company, pursuant to a Technology License Agreement, has licensed its flat panel application technology to the Joint Venture for exclusive use in China. The Company is solely authorized to market Joint Venture products outside China. Reference is made to "Management's Discussion and Analysis of Financial Condition and Results of Operations" for further discussion involving the Joint Venture. The Company and SECC have signed a Letter of Intent with respect to a second joint venture which would manufacture and sell electronic components and parts used in SCE's products and in products of other manufacturers (the "Second Joint Venture").

The Company has produced a telephone based multi-functional telecommunications product, incorporating the Company's flat panel and associated proprietary hardware and software technology called MAGICOM(R) 2000. The product can enable users to have a personal information center in a single unit which integrates voice communication, digital messaging, fax (transmission and paperless reception), copier, electronic handwriting, touch sensitive screen, data storage and transmission, and computer interfacing.

Reference is made to the October 31, 1996 audited financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 1996, for more extensive disclosures than contained in these condensed financial statements.

The Company, which controls four of the seven votes of SCE's board of directors, has reflected its investment in the Joint Venture under the equity method of accounting in the accompanying condensed financial statements. Under certain circumstances, decisions involving the Joint Venture require either a unanimous or two-thirds vote of SCE's board of directors.

The information contained herein for the three month periods ended January 31, 1997 and 1996 and for the period from November 5, 1982 (inception) through January 31, 1997 is unaudited, but in the opinion of the Company, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the results of operations for such periods have been included. The results of operations for interim periods may not necessarily reflect the annual operations of the Company.

The Company invests principally in short term highly liquid financial instruments with maturities of less than three months, which have been classified as cash equivalents in

the accompanying condensed balance sheets. The cost of these investments approximates market value.

The Company has adopted all recently issued accounting standards which have a material impact on its condensed financial statements. The Company has implemented Statement of Financial Accounting Standards

("SFAS") No. 123, "Accounting for Stock Based Compensation" as disclosed in Note 3.

(2) Investment in Joint Venture:

The Company has contributed \$1,225,000 in cash, and technology which has been valued for purposes of the Joint Venture at \$700,000. The Joint Venture does not reflect the \$700,000 in technology as an asset or equity investment in the condensed financial statements presented below. SECC and SIT have contributed cash aggregating \$1,575,000. The Company has reflected its investment in the Joint Venture under the equity method of accounting (see Note 1, Summary of significant accounting policies and other disclosures) and will recognize losses on the Joint Venture to the extent of its cash investment.

Condensed Balance Sheets for SCE at January 31, 1997 and October 31, 1996 and Condensed Statements of Operations for the three month periods ended January 31, 1997 and 1996 is as follows:

<TABLE>  
<CAPTION>

Condensed Balance Sheets

(Unaudited)

|                               | January 31, 1997 | October 31, 1996 |
|-------------------------------|------------------|------------------|
|                               | -----            | -----            |
|                               | <C>              | <C>              |
| Cash                          | \$ 75,260        | \$ 726,640       |
| Inventories                   | 1,057,397        | -                |
| Other current assets          | 54,622           | 266,409          |
| Land occupancy rights, net    | 303,586          | 308,516          |
| Fixed assets, net             | 915,730          | 145,643          |
| Construction in progress      | 840,486          | 878,533          |
| Restricted cash               | -                | 275,245          |
| Deposits                      | 237,035          | 184,601          |
|                               | -----            | -----            |
| Total Assets                  | \$3,484,116      | \$2,785,587      |
|                               | =====            | =====            |
| Notes payable                 | \$ 220,011       | \$ -             |
| Accounts payable              | 839,825          | -                |
| Accrued expenses              | 52,389           | 288,210          |
| Capital                       | 2,371,891        | 2,497,377        |
|                               | -----            | -----            |
| Total Liabilities and Capital | \$3,484,116      | \$2,785,587      |
|                               | =====            | =====            |

</TABLE>  
<TABLE>  
<CAPTION>

Condensed Statements of Operations

(Unaudited)

|                        | For the three months ended |                  |
|------------------------|----------------------------|------------------|
|                        | January 31, 1997           | January 31, 1996 |
|                        | -----                      | -----            |
|                        | <C>                        | <C>              |
| Net sales              | \$ -                       | \$ -             |
| Operating (loss)       | (129,653)                  | (26,793)         |
| Other income/(expense) | 4,167                      | 3,390            |
|                        | -----                      | -----            |
| Net (loss)             | (\$125,486)                | (\$23,403)       |
|                        | =====                      | =====            |

</TABLE>

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(3) Stock option plans:

The Company has two stock option plans, the 1987 Stock Option Plan, adopted by the Board of Directors on April 1, 1987 (the "1987 Plan"), and the CopyTele, Inc. 1993 Stock Option Plan, adopted by the Board of Directors on April 28, 1993 (the "1993 Plan").

Statement of Financial Accounting Standards ("SFAS") No. 123, "Accounting for Stock Based Compensation", encourages, but does not require companies to record compensation cost for stock-based employee compensation plans at fair value. The Company has chosen to continue to account for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board Opinion ("APB") No. 25, "Accounting for Stock Issued to Employees", and related interpretations. Compensation cost for stock options is measured as the excess, if any, of the quoted market price of the Company's stock at the date of grant over the amount an employee must pay to acquire the stock. Accordingly, under APB Opinion No. 25, no compensation cost has been recognized by the Company.

Had compensation cost for these plans been determined consistent with SFAS Statement No. 123, the Company's net loss and net loss per share would have increased to the following pro forma amounts:

<TABLE>  
<CAPTION>

For the Three Months Ended

For the Three Months Ended

|     |                                 | January 31, 1997<br>----- | January 31, 1996<br>----- |
|-----|---------------------------------|---------------------------|---------------------------|
| <S> |                                 | <C>                       | <C>                       |
|     | Net Loss: As Reported           | (\$1,370,445)             | (\$971,319)               |
|     | Pro Forma                       | (\$4,352,009)             | (\$2,156,712)             |
|     | Net Loss Per Share: As Reported | (\$0.02)                  | (\$0.02)                  |
|     | Pro Forma                       | (\$0.08)                  | (\$0.04)                  |

</TABLE>

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions used for grants for the three months ended January 31, 1997 and 1996, respectively: risk free interest rates of 6.24% and 5.62%; expected dividend yields of 0% and 0%; expected lives of 1.62 and 2.56 years; and expected stock price volatility of 73% and 69%. The weighted average fair value of options granted under Statement 123 for the three months ended January 31, 1997 and 1996 are \$2.27 and \$2.19, respectively.

Information regarding the 1987 Plan from October 31, 1996 to January 31, 1997, after adjustments for the two-for-one stock split declared in May 1996, is presented in the table and narrative below:

<TABLE>  
<CAPTION>

|     | Shares<br>-----                         | Current Weighted Average<br>Exercise Price Per Share<br>----- |
|-----|---|---|
| <S> | <C>                                     | <C>   |
|     | Shares under option at October 31, 1996 | 754,360 \$4.75  |
|     | Exercised                               | (25,000) \$2.75   |
|     | Shares under option at January 31, 1997 | 729,360 \$4.82  |
|     | Exercisable at January 31, 1997         | 729,360 \$4.82  |

</TABLE>

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The exercise price with respect to each option granted under the 1987 Plan from its inception was equal to at least the fair market value of the underlying common stock of the Company (the "Common Stock") on the date of grant. Upon the approval of the 1993 Plan by the Company's shareholders in July 1993, the 1987 Plan was terminated with respect to the grant of future options.

From February 1, 1997 through March 10, 1997, the Company received proceeds aggregating approximately \$76,100 relating to the exercise of options to purchase 23,200 shares of Common Stock pursuant to the 1987 Plan.

The 1993 Plan was amended as of May 3, 1995 and May 10, 1996 to, among other things, increase the number of shares of the Company's Common Stock available for issuance pursuant to grants thereunder from 6 million to 20 million, as adjusted for the two-for-one stock split declared in May 1996. Information regarding the 1993 Plan from October 31, 1996 to January 31, 1997 after adjustments for the two-for-one stock split declared in May 1996, is presented in the table and narrative below:

<TABLE>  
<CAPTION>

|     | Shares<br>-----                         | Current Weighted Average<br>Exercise Price Per Share<br>----- |
|-----|---|---|
| <S> | <C>                                     | <C>   |
|     | Shares under option at October 31, 1996 | 9,174,860 \$5.32  |
|     | Granted                                 | 1,785,500 \$4.72  |
|     | Exercised                               | (49,000) \$3.54   |
|     | Canceled                                | (13,000) \$5.17   |
|     | Shares under option at January 31, 1997 | 10,898,360 \$5.34   |
|     | Exercisable at January 31, 1997         | 5,767,860 \$5.34  |

</TABLE>

The exercise price with respect to each option granted under the 1993 Plan from its inception was equal to at least the fair market value of the underlying Common Stock on the date of grant. At January 31, 1997, 4,257,500 options were available for future grants under the 1993 Plan.

From February 1, 1997 through March 10, 1997, the Company received proceeds aggregating approximately \$374,407 relating to the exercise of options to purchase 88,500 shares of Common Stock pursuant to the 1993 Plan.

As of March 10, 1997, 5,679,360 of the options to purchase shares of Common Stock granted and outstanding under the 1993 Plan were exercisable.

(4) Warrants to purchase common stock:

Information from October 31, 1996 to January 31, 1997 regarding warrants previously issued by the Company, primarily to members of the immediate families of its Chairman of the Board and its President in conjunction with the sale of its Common Stock, after adjustments for anti-dilutive provisions and the two-for-one stock split declared in May 1996, is as follows:

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<TABLE>  
<CAPTION>

|  | Shares<br>----- | Current Weighted<br>Average Exercise<br>Price Per Share<br>----- |
|--|-----------------|--|
| <S>  | <C>             | <C>  |
| Shares covered by warrants at October 31, 1996 | 415,116         | \$ 5.11  |
| Warrants exercised                             | -               | \$ -   |
| Warrants expired                               | ( 97,296)       | \$ 4.50  |
|  | -----           |  |
| Shares covered by warrants at January 31, 1997 | 317,820         | \$ 5.27  |
|  | =====           |  |

</TABLE>

The exercise price of each warrant was equal to at least the fair market value of the underlying Common Stock on the date of issuance of such warrant. As of January 31, 1997, all of the warrants to purchase shares of Common Stock issued and outstanding were exercisable.

(5) Stock Split:

On May 24, 1996 the Company declared a two-for-one stock split, effected in the form of a 100% stock dividend, payable on June 17, 1996 to shareholders of record as of June 4, 1996. The weighted average number of shares outstanding and net loss per share amounts in the accompanying financial statements have been restated to reflect the stock split.

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.

The Company, which is a development stage enterprise, was incorporated on November 5, 1982 and has had no revenues to support its operations since its inception. The Company's principal activities are the development of telephone based multi-functional telecommunications products incorporating the Company's ultra-high resolution flat panel display, the further expansion of its overall flat panel technology, and the operations of SCE, the Company's 55% owned joint venture in China. The Company's interest in SCE is accounted for under the equity method of accounting (see Notes 1 and 2 to the Company's condensed financial statements). During 1996, the Company also increased its efforts to develop ultra-high resolution video and color capability for its overall flat panel display technology. There can be no assurance, however, that the Company's efforts in this area will be successful. There is also no assurance that the Company will generate significant revenues in the future, will have sufficient revenues to generate profits or that other products will not be produced by other companies that will render the products of the Company or SCE obsolete or unmarketable.

The Company has entered into marketing agreements with distributors in several countries throughout the world. These agreements are for terms of three years and provide for the purchase of the distributors' requirements of the Company's MAGICOM(R) 2000 product in their respective territories. The agreements provide for monthly purchase orders in increasing quantities, to be accompanied by irrevocable bank letters of credit furnished by the distributors.

The Company and SCE are in their initial stages of production and marketing. The eventual success and profitability of their product will depend upon many factors, including those normally associated with any new product. These factors include the capability of SCE to produce sufficient quantities of MAGICOM(R) 2000; the ability of the Company and SCE to maintain an acceptable pricing level to end-users for the product;

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long-term product performance and the capability of the Company, SCE



and its distributors to adequately service the product; the ability of distributors to market their contracted quantities of the product in their respective territories; political and economic stability in targeted marketing territories; and the possible development of competitive products that could render the product of the Company and SCE obsolete or unmarketable.

In reviewing Management's Discussion and Analysis of Financial Condition and Results of Operations, reference is made to the Company's Condensed Financial Statements and the notes thereto.

Safe Harbor Statement Under the Private Securities Litigation Reform Act of 1995 Except for the historical information contained herein, the matters discussed in this Quarterly Report on Form 10-Q are forward-looking statements relating to future events which involve certain risks and uncertainties, including those identified herein and in the Company's Annual Report on Form 10-K for the fiscal year ended October 31, 1996 (the "1996 10-K"). See "Business" and Note 1 to the Company's Financial Statements contained in the 1996 10-K for discussions regarding uncertainties that may significantly affect the results of operations, future liquidity and capital resources.

#### Results of Operations

Selling, general and administrative expenses for the three month periods ended January 31, 1997 and 1996 and for the period from November 5, 1982 (inception) through January 31, 1997 were approximately \$1,563,000, \$1,075,000, and \$33,543,000, respectively. These amounts include research, development and tooling costs of approximately \$898,000, \$767,000, and \$21,641,000, respectively, as well as normal operating expenses. The increase of approximately \$488,000 in selling, general and administrative expenses during the three months ended January 31, 1997 as compared to the same period in 1996 resulted primarily from increases in marketing expenses and compensation (and related costs) necessitated by the present phase of the Company's development program and related activities. Marketing costs increased during the fiscal 1997 period as a result of the opening and staffing of a marketing office, retention of public relations and advertising firms and the production of advertising materials. Compensation and related costs, rent and travel expenditures increased for the fiscal 1997 period as a result of the Company's adding personnel in marketing and engineering and increasing the size of its facilities. Professional fees, especially patent application preparation and filing fees, decreased during the fiscal 1997 period.

The Company's portion of SCE's loss during the fiscal 1997 period increased by approximately \$56,000, from approximately \$13,000 in the 1996 period, to approximately \$69,000 in the fiscal 1997 period, as a result of SCE's commencing the initial stages of production of MAGICOM(R) 2000.

Since November 1985, the Company's Chairman of the Board and its President have waived salary and related pension benefits for an undetermined period of time. Four other individuals, including a former officer and senior level personnel, waived salary and related pension benefits from January 1987 through December 1990. Commencing in January 1991, these four individuals waived such rights for an undetermined period of time and they did not receive salary or related pension benefits through December 1992. The Company's Chairman of the Board, its President and the three senior level personnel continued to waive such rights commencing in January 1993 for an undetermined period of time. One additional senior level employee also is currently waiving such salary and benefit rights for an undetermined period of time.

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The increase in interest income of \$144,000 during the three months ended January 31, 1997 as compared to the same period in 1996 primarily resulted from an increase in funds available for investment aided by slightly higher interest rates. Funds available for investment during the three month periods ended January 31, 1997 and 1996, on a monthly weighted average basis, were approximately \$20,204,000 and \$9,377,000, respectively. The investment instruments selected by the Company are principally money market accounts and commercial paper.

#### Liquidity and Capital Resources

Since its inception, the Company has met its liquidity and capital expenditure needs primarily from the proceeds of the sales of Common Stock in its initial public offering, in private placements, upon exercise of warrants issued in connection with the private placements and public offering, and upon exercise of stock options pursuant to the 1987 Plan and the 1993 Plan.

From November 1, 1996 to January 31, 1997, the Company received proceeds aggregating approximately \$242,000 relating to the exercise of options to purchase 74,000 shares of Common Stock under the 1987 and 1993 Plans. In addition, from February 1, 1997 to March 10, 1997, the Company received proceeds aggregating approximately \$451,000 relating to the exercise of options to purchase 111,700 shares of Common Stock under the 1987 and 1993 Plans.

SCE contemplates an initial investment of \$7,000,000, of which half is expected to be borrowed from banks, and capital investment of \$3,500,000. The Company has contributed \$1,225,000 in cash, and technology valued for the purposes of SCE at \$700,000, and SECC and SIT have contributed \$1,575,000 in cash to SCE (see Notes 1 and 2 to the

Company's condensed financial statements). The Joint Venture may require capitalization of up to \$25 million, depending upon the nature and extent of its business activities.

On April 17, 1996, the Company entered into a letter of intent for the formation of a second joint venture with SECC. The parties are presently discussing amendments to the letter of intent. As stipulated in the letter of intent, unless otherwise amended, the Second Joint Venture is expected to have an initial capitalization of approximately \$2,000,000, of which half would consist of bank borrowings. The Company would invest cash of approximately \$550,000 and SECC would contribute cash, equipment and technology collectively valued at \$450,000. The Second Joint Venture may require an ultimate capitalization of up to \$10 million depending on the nature and extent of its business activities which, if necessary, is expected to be financed through a combination of bank borrowings and equity investments contributed by the parties in proportion to their equity interests and on terms to be agreed upon.

The Company believes that without taking into consideration revenues from sales of MAGICOM(R) 2000 it will have sufficient funds through the first quarter of fiscal 2000 to maintain its present level of development efforts and to make its anticipated capital contribution of \$550,000 to the Second Joint Venture.

The Company's estimated funding capacity indicated above assumes, although there is no assurance, that the waiver of salary and pension benefits by the Chairman of the Board, the President and senior level personnel will continue. The Company anticipates that it may require additional funds in order to participate in the Joint Ventures following its initial capital contributions and to continue its research and development activities.

The National Association of Securities Dealers, Inc. ("NASD") requires that the Company maintain a minimum of \$4,000,000 of net tangible assets to maintain its

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NASDAQ - NMS listing. The Company anticipates that it will seek additional sources of funding, when necessary, in order to satisfy the NASD requirements.

The Company currently has no plans with respect to additional financing. There can be no assurance that adequate funds will be available to the Company, SCE, or the Second Joint Venture, including any future capital contribution, if any, beyond its initial capital contributions of \$1,225,000 to SCE and the anticipated capital contribution of \$550,000 to the Second Joint Venture, and its NASD funding requirements, or that, if available, the Company, SCE, or the Second Joint Venture, will be able to obtain such funds on favorable terms and conditions.

#### PART II - OTHER INFORMATION

##### Item 6. Exhibits and Reports on Form 8-K.

###### (a) Exhibits

- 10 - Contract Granting Land-Use Rights, dated October 11, 1995, between the Land Administration Bureau Songjiang County and Shanghai CopyTele Electronics Co., Ltd.
- 27 - Financial Data Schedule

###### (b) Reports on Form 8-K.

No reports on Form 8-K were filed for the Company during the quarter ended January 31, 1997.

#### SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CopyTele, Inc.

DENIS A. KRUSOS  
-----  
Denis A. Krusos  
Chairman of the Board,  
Chief Executive Officer  
and Director (Principal  
Executive Officer)

March 14, 1997

FRANK J. DISANTO  
-----  
Frank J. DiSanto  
President and Director

March 14, 1997

GERALD J. BENTIVEGNA  
-----  
Gerald J. Bentivegna  
Vice President - Finance and  
Chief Financial Officer and  
Director (Principal Financial  
and Accounting Officer)

March 14, 1997

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EXHIBIT INDEX

| Exhibit<br>----- | Description<br>-----   |
|------------------|--|
| 10 -             | Contract Granting Land-Use Rights, dated October 11, 1995, between the Land Administration Bureau Songjiang County and Shanghai CopyTele Electronics Co., Ltd. |
| 27 -             | Financial Data Schedule  |

CONTRACT

GRANTING LAND-USE RIGHTS

Song Tu (1995) Land-Use Rights Transfer Contract No. 59

THE LAND ADMINISTRATION BUREAU OF SONGJIANG COUNTY  
October 11, 1995

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CONTRACT GRANTING LAND-USE RIGHTS

CHAPTER I  
GENERAL PRINCIPLES

ARTICLE 1.

THIS CONTRACT is made by and between

Granter: THE LAND ADMINISTRATION BUREAU OF SONGJIANG COUNTY  
(hereinafter referred to as Party A)  
Legal representative: Wang Bingen  
Grantee: SHANGHAI COPYTELE ELECTRONICS CO., LTD.  
(hereinafter referred to as Party B)  
Legal representative: Lin Shenghe

In accordance with the "Law of the People's Republic of China on the Administration of Urban Real Estate" (hereinafter the "Administration Law"), the "Interim Regulations of the People's Republic of China Concerning the Assignment and Transfer of the Right to the Use of the State-Owned Land in the Urban Areas" (hereinafter the "Interim Regulations"), and "Measures of Shanghai Municipality on the Grant of Land Use Rights for Valuable Consideration" (hereinafter the "Measures").

CHAPTER II  
DEFINITIONS

ARTICLE 2.

The following are definitions of terms as used in this Contract:

1. "Songkai II-22A" means the piece of land described in Articles 3 and 4 of this Contract.

2. "Grant of Land-Use Rights for Valuable Consideration" (hereinafter "Grant") means a legal act on the part of Party A to provide the land of Shanghai Songjiang Industrial Area to Party B for its use with compensation within identified area, for a specified period, under specific conditions, and in conformity with a land development plan approved by the Government of the People's Republic of China. The State retains the ownership of the land, and the judicial authority, administrative authority and other authorities accorded by relevant law and

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regulations over the land, and other interests necessary for the protection of the interest of the public. During the term of this Grant, Party A shall have the right to monitor and examine the development, use, assignment, lease, mortgage and termination of the land-use rights to Songkai II-22A.

3. "Assignment of Land-Use Rights for Valuable Consideration" (hereinafter "Assignment") means a transfer in accordance with the provisions of this Contract, by Party B to a third person, of the land-use rights to all or any portion of Songkai II-22A granted hereunder by Party A to Party B.

4. "Buildings" refers to all buildings, structures and improvements for use in manufacturing, and the business operations and provisions of supporting services related to the manufactured products, and other structures with economic value located on Songkai II-22A.

5. "Off-Lot Infrastructure Facilities" refers to all the facilities for providing services of water, drainage/ sewage, electricity, telecommunications, fuel gas, road access to the boundary lines of Songkai II-22A as well as the leveling of the land in Songkai II-22A (up to 3.1 meters above sea level), as stipulated in Agreement on Provision of A Set of Municipal Facilities signed by Party B and Shanghai Songjiang Economy & Technology Construction General Co., the construction of which has been completed by Shanghai Songjiang Economy & Technology Development Construction General Co. at its sole expense.

6. "On-Lot Infrastructure Facilities" refers to all the facilities for providing services of water, drainage/ sewage, electricity, telecommunications, road access and levelling of the land in Songkai II-22A (to a level exceeding 3.1 meters above sea level), the construction of which shall be undertaken by Party B at its own expense.

7. "Lease" refers to any lease or sublease agreements entered into by Party B and a third party for the leasing or subleasing of all or any portion of Songkai II-22A.

8. "Lender" refers to any party which provides financing and is the holder of a Mortgage, as hereinafter defined.

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9. "Project" means the industrial project to be developed by Party B for manufacturing and the sales of multifunctional telecommunication products and all other activities necessary for and incidental to, such industrial project as approved by the government of the People's Republic of China.

10. "Construction Plan" means the construction plan for the Project which shall be submitted by Party B to Party A or other relevant government authorities for their examination and approval.

11. "Mortgage" refers to any mortgage, security agreement, deed of trust or other security instrument pursuant to which Party B grants a security interest in all or portions of Party B's rights and interests under this Contract and Party B's land-use rights in Songkai II-22A to a Lender for purposes of financing or refinancing development of all or part of Songkai II-22A.

CHAPTER III  
LOCATION AND MEASUREMENT OF Songkai II-22A  
AND TERM OF GRANT

ARTICLE 3.

Songkai II-22A (currently known as Songjiang Industrial Zone Lot No. Songkai II-22A) granted by Party A to Party B is located within the Shanghai Songjiang Industrial Zone, in an area north of Dongqu Avenue, west of Dongxing Rd., east of Songtao Textile Co., Ltd., south of Jiangtian Rd. (east), as shown on the Boundary Line Survey of Songkai II-22A provided by Party A, which is attached as Exhibit I to this Contract. Party A and Party have verified the area, location and the boundary lines of Songkai II-22A by signing the Boundary Line Survey in Exhibit 1.

ARTICLE 4.

Songkai II-22A described in Article 3 consists of Nine Thousand Nine Hundred Eighty Three (9983) square meters.

ARTICLE 5.

The term of the land-use rights under this Contract is fifty (50) years, and shall commence on the date, which is sixty eight (68) days after the signing of this Contract.

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The commencement date of the term of the land-use rights under this Contract shall be extended correspondingly if delay in possession of Songkai II-22A by Party B occurs due to no fault of Party B.

ARTICLE 6.

Party B may extend the term of the land-use rights by applying to Party A for such extension at least one (1) year prior to the expiration of the term. After approval of the extension by Party A, Party B shall complete the procedures for the grant of the land-use rights to Songkai II-22A.

CHAPTER IV  
FEES

ARTICLE 7.

Pursuant to the "Measures", Party B shall pay Party A a fee for the grant of the land-use rights to Songkai II-22A (hereinafter "Grant Fee"), a land administration registration fee, and a land-use fee.

ARTICLE 8.

The Grant Fee for Songkai II-22A shall be Twenty-One U.S. Dollars (\$21) per square meter. The total amount of the Grant Fee for the entire Songkai II-22A shall be Two Hundred and Nine Thousand Six Hundred Forty Three U.S. Dollars (\$209,643).

ARTICLE 9.

Within fifteen (15) days from the date this Contract is executed by both parties, Party B shall pay Party A a deposit in the amount of Twenty Thousand U.S. Dollars (\$20,000) (the "Deposit").

Party B shall pay Party A the Grant Fee no later than sixty (60) days after the date this Contract is executed by both parties. The amount of Deposit paid by Party B shall be credited against the total amount of the Grant Fee. In case Party B fails to pay the Grant Fee within sixty (60) days after this Contract is executed by both parties, Party A shall have the right to notify Party B in writing at any time of the deadline for Party B's full payment of the Grant Fee. If Party B fails to pay the Grant Fee prior to

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the deadline specified, Party A shall have the right to terminate this Contract and have the forfeited Deposit.

After the making of the payment of Grant Fee to Party A, Party B shall apply to Party A for the insurance of a Land-Use Certificate for Songkai II-22A. Within fifteen (15) days after receipt of Party B's application, Party A shall issue to Party B a Land-Use Certificate for Songkai II-22A, transferring the land-use rights to Songkai II-22A Party B free and clear of all liens, charges and encumbrances of any kind whatsoever. In case Party A fails to issue the Land-Use Certificate to Party B on time, Party B has the right to request Party A to return the Deposit and the Grant Fee to Party B, and pay Party B a penalty in the amount of Twenty Thousand U.S. Dollars (\$20,000) in addition to returning Deposit and Grant Fee to Party B.

After obtaining the Land-Use Certificate, Party B shall register its land-use rights with the Shanghai Real Estate Registry ("Municipal Registry").

ARTICLE 10.

The land-use fee for Songkai II-22A shall be One Yuan Renminbi (1 RMB) per square meter contained in Songkai II-22A per year, the first payment of which shall be made prior to October 15th of 1996, and therefore, payable prior to January 15th of each of the ensuing year.

ARTICLE 11.

Party B shall pay Party A the Grant Fee and Deposit in U.S. Dollar or in RMB. If Party B pays by RMB, it shall be calculated based on average of the buying and selling rates for U.S. Dollar published by the State Administration of Foreign Exchange Control Shanghai Branch, and in effect on the date of the signing of this Contact.

ARTICLE 12.

Party B shall pay the Grant Fee and Deposit on or before the due date as prescribed in this Contract by depositing with or remitting to Party A's account with the Shanghai Branch of the People's Construction Bank of China in accordance with the instructions to be provided by Party A to Party B.

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ARTICLE 13.

Party A shall notify Party B in writing of any changes in its bank and/or bank account within thirty (30) days of the change. Party B shall not be responsible for any late charges for delay in payment of fees caused by Party A's failure to give timely notice of such change.

CHAPTER V  
CONDITIONS FOR USE, AND PURPOSES

ARTICLE 14.

Songkai II-22A shall be developed and used mainly for the purpose of setting up and operating the Project. Service-oriented projects and facilities (including spaces for offices, cafeteria, conference center, exhibition area, retail centers, recreational facilities, and other administrative and commercial facilities) that serve the Project and the day-to-day needs and recreation of Chinese and foreign employees, residents and visitors involved in the Project are also permitted. Songkai II-22A shall be used under the following conditions: (1) Construction Density: no more than 50%; (2) Construction Capacity: no more than 1.0; (3) Green Areas: no less than 20%; and (4) Others: in accordance with the approved Construction Plan. The People's Government of Shanghai Municipality reserves the right to conduct city planning over Songkai II-22A. During the term of the land-use rights to Songkai II-22A granted hereunder, any reconstruction or renewal of the Buildings constructed to meet the conditions for use stipulated herein shall be in accordance with the conditions for use in effect at that time. The People's Government of Shanghai Municipality shall not be held liable for any negative effects which may be brought to Party B by any change in city planning.

ARTICLE 15.

Subject to the approval of Party A and the planning department of Songjiang County, Party B may change the use and purpose of Songkai II-22A as specified in this Contract. In the case of such change of the use and purpose of Songkai II-22A, the two parties shall enter into an agreement to modify this Contract or sign a new contract, and an appropriate fee shall be paid by Party B to Party A.

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ARTICLE 16.

Party B shall comply with relevant regulations of the State and Shanghai Municipality in connection with green areas, city appearance, environmental protection, sanitation, fire protection and safety, traffic management, design, construction, and other aspects of management of city construction.

ARTICLE 17.

Party B shall be responsible for any damages and destruction to the environment and facilities surrounding Songkai II-22A and any damages to the State or individuals that may be directly caused by any of Party B's activities conducted within Songkai II-22A.

ARTICLE 18.

Party B shall not, for any reasons, possess and use land surrounding Songkai II-22A without permission. If Party B is in need of possessing and using the land temporarily, Party B must obtain prior approval from Party A and other responsible authorities, and shall pay a fee for the use. Possession and use of land without prior approval shall be treated as unlawful possession of land.

CHAPTER VI  
CONSTRUCTION

ARTICLE 19.

Party B shall construct the Buildings on Songkai II-22A in accordance with the approved Construction Plan. Party B may amend the Construction Plan, and shall have control of the operation and maintenance of the Buildings and fixtures including, but not limited to, the design (including architectural, engineering and materials), financing, bidding, construction, leasing and repair and renovation of the Buildings and fixtures.

ARTICLE 20.



Party A represents and warrants that there is no building, structure, or improvement on Songkai II-22A. Party A also represents and warrants that there is no easement that may limit, restrict or interfere with Party B's planned use

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of Songkai II-22A; and that to Party A's knowledge, there is no such easement planned for Songkai II-22A during the term of this Contract.

ARTICLE 21.

Songkai II-22A shall be provided with Off-Lot Infrastructure Facilities to its boundary lines by Shanghai Songjiang Economy and Technology Development Construction General Co. (the "Development Company"). Such Off-Lot Infrastructure Facilities shall include water, drainage and storm sewage, electricity, fuel gas, telecommunications, and road access, as well as leveling of the land in Songkai II-22A up to 3.1 meters above sea level.

ARTICLE 22.

Within six months after Development Company has finished Off-Lot Infrastructure Facilities and delivered the Lot to Party B, Party B shall begin the construction on the Lot, and shall be responsible for completing the construction of all On-Lot Infrastructure Facilities and Buildings to a level necessary for and in accordance with the approved Construction Plan within two (2) years after the signing of this Contract. Party B shall construct the Buildings and On-Lot Infrastructure Facilities to meet the design and construction specification standards of "Regulations of Shanghai Municipality on City Planning and Technical Administration" and the engineering and design drawings submitted to and approved by Party A. Party B shall submit to Party A a set of engineering and design drawings no less than ten (10) days prior to starting the construction of the On-Lot Infrastructure Facilities and Buildings. After completion of the construction, Party B shall notify Party A to enable Party A to participate in the test and acceptance process.

ARTICLE 23.

All On-Lot Infrastructure Facilities and Buildings constructed by Party B shall be the property of and owned by Party B until expiration of the term, or earlier termination, of this Contract. Party B shall not, however, remove any On-Lot Infrastructure Facilities from Songkai II-22A nor waste, destroy or modify any On-Lot Infrastructure Facilities, except as permitted by this Contract.

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ARTICLE 24.

From time to time during the term of this Contract, Party B may, according to its needs, demolish, remove, replace, alter, modify, relocate, reconstruct or add to any Buildings, in whole or in part, and modify, change or alter the contour or grade, or both, of the land included within Songkai II-22A; provided, however, that any substantial replacements, alterations, relocations, reconstruction or additions to any such Buildings must be accomplished subject to the approval of Party A and relevant government authorities and in a manner consistent with the Construction Plan.

ARTICLE 25.

Party A agrees that Party A shall bear the responsibilities of providing Songkai II-22A combined with utility link-up points and related services sufficient for the setting up and operation of the Project as well as for the development of the On-Lot Infrastructure Facilities by Party B, including but not limited to water, drainage and storm sewage, electricity, telecommunications, and road access.

ARTICLE 26.

If Party B fails to complete the construction of the On-Lot Infrastructure Facilities and Buildings according to the schedule set forth in Article 22 of this Contract, Party B shall submit to Party A an application, giving sufficient reasons for the delay, for an extension of the time limit no later than six (6) months prior to the expiration of the time limit. No extension of the time limit shall exceed one (1) year.

Unless otherwise agreed to by Party A, if the period from the expiration of the time limits set for the completion of the construction of the On-Lot Infrastructure Facilities and Buildings in Article 22 of this Contract until the final completion of such construction exceeds six (6) months, Party B shall be responsible for paying to Party A a penalty in an amount equal to one percent (1%) of the Grant Fee; if the period falls between six (6) months to one (1) year, Party B shall be responsible for paying to Party A a penalty in an amount equal to three (3%) of the Grant Fee; if between one (1) year to two (2) years, seven percent (7%); if the period exceeds two (2) years, Party A shall have the right to confiscate the land-use rights to

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Songkai II-22A and all the On-Lot Infrastructure Facilities and Buildings on Songkai II-22A.

ARTICLE 27.

Party B and its delegated construction companies shall be responsible for repairing or rebuilding, at their own cost, any gutters, waterways, telecommunications lines, and other pipelines, facilities and structures located in the areas surrounding Songkai II-22A, which may be damaged by the construction in Songkai II-22A.

ARTICLE 28.

Party A shall put boundary stake at each corner of Songkai II-22A combined according to the Boundary Line Survey. Party B shall be responsible for taking effective measures for the protection of the boundary stakes to ensure that they will not be removed or damaged. If during the term of the land-use rights to Songkai II-22A, there occur removal of or damages to such stakes, Party B shall immediately report to Party A in writing, and apply for conducting a new survey of the boundary lines and installing new boundary stakes. Party B shall be responsible for all the expenses incurred as a result of the loss, damages, removal of the stakes, and for the new survey work and the installation of the new stakes.

CHAPTER VII  
ASSIGNMENT OF LAND-USE RIGHTS

ARTICLE 29.

After completion of the construction of at least twenty five percent (25%) of the Construction Plan Total Investment Amount on Songkai II-22A (not including Grant Fee and Demolishing Infrastructure Facilities Fee), Party B shall have the right, with Party A's approval, to divide into parts the land-use rights to portion of Songkai II-22A, and assign the divided land-use rights to different third parties. In the case of dividing the Buildings into parts and assigning accordingly, each assignee shall possess a corresponding but inseparable portion of the land-use rights. Party B must, however, specify the proportion of land-use rights to each assignee prior to such assignment, and formulate covenants for the use, management and main-

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tenance of the Buildings in accordance with regulations provided by Party A.

ARTICLE 30.

Party B shall ensure that its assignees register each assignment with the Municipal Registry for the transfer of title to the Buildings and the land use rights by providing a properly notarized assignment contract, and pay transfer fees to Party A and the Municipal Real Estate Bureau, and pay taxes in accordance with relevant Chinese tax law and regulations. An assignment without registration with the Municipal Registry is not a valid assignment.

ARTICLE 31.

After the effective date of any assignment made in accordance with the provisions of this Contract, Party B shall have no further rights or obligations under this Contract and all relevant registration documents with respect to that portion of the land-use rights assigned. As between Party A and Party B, Party B shall be considered to have assigned to the assignee all its rights and obligations arising under this contract and all relevant registration documents with respect to that portion of the land-use rights assigned.

CHAPTER VIII  
LEASES

ARTICLE 32.

Party B shall have the right at any time, and from time to time, to enter into one or more Leases covering all or any part of Songkai II-22A, the On-Lot Infrastructure Facilities and/or the Buildings, and to assign, extend or renew any such Lease. Party B shall provide Party A with full and complete copies of each Lease, including the name and address of each lessee. Lease shall be made subject to the term of this Contract.

Party A agrees, however, that so long as the lessee under a Lease is performing its obligations and duties under the Lease, Party A shall not disturb such lessee's continued use and possession of the portion of Songkai II-22A covered by the Lease, and the lessee may rely upon this provision of the Contract throughout the term of the Lease.

CHAPTER IX  
MORTGAGES

ARTICLE 33.

Party B shall the right, at any time, and from time to time, to grant Mortgages in favor of one or more Lenders using Songkai II-22A as collateral security for loans to or other obligations of Party B in accordance with the "Measures of Shanghai Municipality on Real Estate Mortgage". The respective rights and interests of Party B and Lenders under the Mortgages shall be stipulated in a mortgage contract. Each mortgage contract shall be subject to, and shall not violate, the provisions of this Contract. Lease arrangements of the Buildings existing before Mortgages shall continue to be in effect. When such land-use rights are so mortgaged, all Buildings on that portion of Songkai II-22A covered by the mortgage are simultaneously mortgaged. Conversely, when the Buildings are mortgaged, the land-use rights to the area of Songkai II-22A used by the Buildings are also mortgaged.

ARTICLE 34.

For those mortgage contracts signed in China, each shall be registered with the Municipal Registry within thirty (30) days from the date the mortgage contract takes effect. For those mortgage contracts signed in Hongkong, Macau, Taiwan or foreign countries, each shall be registered with the Municipal Registry within sixty (60) days from the date the mortgage contract takes effect. Mortgage registration shall be cancelled when the Mortgage is extinguished due to repayment of debts or other reasons. Party B shall register with the Municipal Registry for cancellation of Mortgage registration.

ARTICLE 35.

In the case where Party B fails to fulfil its obligations under the Mortgages or declares its dissolution or bankruptcy during the term of the Mortgages, Lenders shall be entitled to the disposal of the land-use rights to Songkai II-22A after a written notice to Party B, and to the lessee of the Building if a lease is in place.

The priority among Lenders shall be determined in the following order:

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- (1) Lenders with Mortgages registered within the required time period for registration have priority over Lenders with Mortgages registered after the required time period for registration has expired;
- (2) Among those Lenders with Mortgages registered within the required time period for registration, the lender under a mortgage with the earliest date of effectiveness has priority over the others; and
- (3) Among those Lenders with Mortgages registered after the required time period for registration has expired, the first to register has priority over the others.

ARTICLE 36.

Lenders may dispose of the land-use rights to Songkai II-22A, in accordance with relevant Chinese law and regulations, by transferring the rights to another party for valuable consideration, or through auctioning off the rights. In case of transfer for valuable consideration, the lessee of the Buildings, if a Lease is in place, shall have the first right of refusal to purchase the land-use rights. In case of an auction, the auction shall be discontinued if one of the following events occurs:

- (1) A dispute arises as to the ownership of the collateral being auctioned;
- (2) The Lender requests to discontinue the auction;
- (3) Party B requests to discontinue the auction because it is willing to repay the debt immediately or to provide the Lender with proof of its ability to repay the debt; and
- (4) Other events the occurrence of which requires the discontinuation of the auction under the "Measures of Shanghai Municipality on Real Estate Mortgage".

In the case of bankruptcy of Party B, Songkai II-22A shall not be deemed as the property of bankruptcy if Party B has granted Mortgages using the land-use rights to Songkai II-22A as collateral. The proceeds from the disposal of the land-use rights in excess of the amount due to Lender under

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the mortgage contracts, however, shall be deemed as the property of bankruptcy.

ARTICLE 37.

In case of disposal of the land-use rights to Songkai II-22A by Lenders under Mortgages granted by Party B, the proceeds from such disposal shall be distributed in the following order:

- (1) Expenses necessary for the disposal of the collateral;

- (2) Taxes due after the disposal of the collateral;
- (3) Payment for the amount of debt and penalty owed;
- (4) Remaining amount to Party B.

In case the proceeds are insufficient to pay for the amount of debt and penalty owed, Lenders shall be entitled to seek the deficiency from Party B.

ARTICLE 38.

A person who acquires the land-use rights to Songkai II-22A through a transfer with valuable consideration or an auction shall register with the Municipal Registry for the transfer of title for the acquired land-use rights to Songkai II-22A by providing a properly notarized mortgage contract, and pay transfer fees to Party A, and pay taxes to relevant government tax authorities.

#### CHAPTER X EXPIRATION OF TERM

ARTICLE 39.

Upon expiration of the term of the land-use rights, Party B shall go through the required procedures for returning Songkai II-22A to Party A, and Party A shall have the right to repossess without compensation the land-use rights to, together with all the Buildings and On-Lot Infrastructure Facilities thereupon, Songkai II-22A, and to cancel the Land-Use Certificates for Songkai II-22A.

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ARTICLE 40.

Upon expiration of the term of the land-use rights, Party B shall have the preemptive right to renew the land-use rights for all or portions of Songkai II-22A if Party B desires to make further use of Songkai II-22A, provided an application for renewal has been extended to Party A at least one (1) year prior to the expiration of the term. After approval of the application for renewal by Party A, Party B shall complete the procedures for the granting of the land-use rights to Songkai II-22A in accordance with relevant Chinese law and regulations.

#### CHAPTER XI FORCE MAJEURE

ARTICLE 41.

Neither party shall be liable for delay or failure of performance if occasioned by war, fire, flood, typhoon, storm, earthquake, or any other force majeure beyond the control of, and without fault of, the party. The party subject to a force majeure event shall take all reasonable steps under the circumstances to mitigate the loss caused by the event.

ARTICLE 42.

In case one party is unable to perform its obligations under this Contract due to force majeure as defined in Article 41, such party shall notify the other party in written form through certified mail or facsimile, and provide the other party with a detailed report of the event within thirty (30) days of the event, together with a complete statement of the reasons for its nonperformance or incomplete performance.

ARTICLE 43.

Unless otherwise expressly provided by State law itself, subsequent legislation or changes in law or changes in government policy shall not have

retroactive effect on this Contract. This Contract may be amended based on subsequent legislation or changes in law or changes in government policy upon application by Party B and approval by Party A.

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CHAPTER XII  
CONDEMNATION

ARTICLE 44.

Party A shall give a notice six (6) months in advance if it is in the public interest to take or acquire all or any part of Party B's land-use rights to Songkai II-22A through condemnation or power of eminent domain during the term of this Contract. If Party B's land-use rights to Songkai II-22A is so taken, then Party B shall be entitled to receive from Party A compensation equal to the true value of the land-use rights so taken or acquired and the On-Lot Infrastructure Facilities, and Buildings on Songkai II-22A, as determined by an entity responsible for real estate appraisals, using valuation methods, standards and procedures recognized internationally as commercially reasonable, but not taking into account any anticipated future profits. The purpose of such compensation shall be to place Party B in the same financial position as that in which Party B would have been if the condemnation had not taken place. All compensation shall be paid without unreasonable delay. If all of the On-Lot Infrastructure Facilities, Buildings and Party B's land-use rights are so taken or acquired through condemnation or power of eminent domain, then Party B shall have no further obligations under this Contract, effective as of the date of taking. If only a portion of the On-Lot Infrastructure Facilities, Buildings and Party B's land-use rights and other assets in Songkai II-22A are taken or acquired through condemnation or power of eminent domain, then the various fees payable by Party B to Party A under this Contract shall be reduced proportionately, effective from the date of taking.

Party B, and each Lender with a Mortgage, shall have the right to represent itself or themselves independently in the hearing or procedures involving any such taking or acquisition, including the valuation procedure. All sums due Party B hereunder shall be paid in cash promptly by Party A to Party B.

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CHAPTER XIII  
REMEDIES FOR BREACH OF CONTRACT

ARTICLE 45.

Unless otherwise provided hereunder, nonperformance or incomplete performance of Party A's obligations under this Contract due to Party A's own fault constitutes breach of the Contract if not remedied within sixty (60) days after notification by Party B. Party A shall be responsible for all the economic losses directly caused to Party B by its breach of this Contract or failure to fulfill the obligations stipulated under this Contract.

Unless otherwise provided hereunder, nonperformance or incomplete performance of Party B's obligations under this Contract due to Party B's own fault constitutes breach of the Contract if not remedied within sixty (60) days after notification by Party A. In case of breach of the Contract by Party B, Party A's rights are ranging from demand to cure within certain period of time, warning, payment of penalties, to confiscating a portion of or all of the land-user rights to Songkai II-22A and Buildings, according to the seriousness of the breach.

Each party hereby indemnifies and holds harmless the other party from and

against any and all claims, demands, damages and related costs and expenses incurred by or assessed against the indemnified party by reason of the indemnifying party's default under the terms of this Contract, including any damages or losses sustained by third parties in reliance upon the performance of each party's duties and obligations under this Contract.

CHAPTER XIV  
DISPUTE RESOLUTION

ARTICLE 46.

If any dispute shall arise under this Contract, or with respect to its validity, that cannot be resolved by normal business communications, the parties agree to send their authorized representative to participate in face-to-face negotiations for at least two (2) business days to resolve such dispute by amicable means. However, if such dispute cannot be resolved by face-to-face negotiations within thirty (30) days, then either party may submit the dispute

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to arbitration before a single arbitrator chosen by the parties. If the parties cannot agree on an arbitrator within thirty (30) days, then either party may submit the dispute to China International Economic and Trade Arbitration Commission for arbitration which shall be conducted in Shanghai by the Commission before a single arbitrator pursuant to the summary procedures of the Arbitration Law of the People's Republic of China. In either case, the arbitrator shall be a person with professional fluency in English. The decision of the arbitrator shall be issued in writing and shall be final and binding on the parties.

CHAPTER XV  
NOTICES

ARTICLE 47.

All notices and communications required or permitted to be given hereunder shall be in writing and will be effective when actually received, regardless of by what means transmitted, and may be served by depositing same in the mail, addressed to the party to be notified, postage prepaid, and registered or certified with return receipt requested, or by delivering to the same in person, or by prepaid telegram, telex or cable or facsimile. For the purpose of notices and communications, the addresses of the parties shall be:

Party A: THE LAND ADMINISTRATION BUREAU OF SONGJIANG  
COUNTY

Address: 327 Guyang Road North  
Songjiang, Shanghai  
People's Republic of China

Party B: SHANGHAI COPYTELE ELECTRONICS CO., LTD.

Address: 470 Bei Suzhou Road  
Shanghai

Either party may change its address for notices and communications referred to hereunder by providing notice to the other party of such new address within thirty (30) days of such change.

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CHAPTER XVI

SUPPLEMENTARY PROVISIONS

ARTICLE 48.

Party A and Party B shall cooperate with one another and grant such easements, access rights and rights of way as may be necessary to: (1) ensure continuing adequate vehicular access to and use of public roads connecting Songkai II-22A with the Industrial Zone and adjoining major transportation lines; (2) allow for construction, maintenance and repair of all On-Lot and Off-Lot Infrastructure Facilities; (3) ensure that personnel, emergency equipment and vehicles of the governments, public security organizations, fire protection departments and ambulance battalions may have access to Songkai II-22A for purposes of performing their public functions; and (4) allow the government to build lines and/or pipe lines for public utility services through Songkai II-22A. Party B shall have the right to seek remedies from relevant responsible government organizations for any damages that may be caused thereby to the On-Lot Infrastructure Facilities and Buildings.

ARTICLE 49.

All dates referred to herein are according to the Gregorian Calendar.

ARTICLE 50.

The Contract is to be signed in three (3) originals. One (1) original is provided to each of the parties to this Contract; and one original to the County Notary Public of Songjiang.

ARTICLE 51.

This Contract is written in both Chinese and English with equal legal effect.

ARTICLE 52.

This Contract, entered into between, and signed by, Party A and Party B, shall be duly notarized by the County Notary Office of Songjiang.

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ARTICLE 53.

Attachments to this Contract are incorporated herein as an integral part of the Contract.

CHAPTER XVII  
INTEGRATION

ARTICLE 54.

This Contract shall become legally binding upon both parties upon the issuance of the Land-Use Rights Certificate for Songkai II-22A by the People's Government of Songjiang County, and remain so until the expiration of the term of the land-use rights as specified in the Land-Use Rights Certificate. All prior understandings or agreements of the parties shall be deemed merged herein. This Contract may be amended or modified only in writing, signed by both parties.

ARTICLE 55.

This Contract is executed on this 11th day of October 1995 in Shanghai, the People's Republic of China.



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This Schedule contains summary financial information extracted from the financial statements contained in the body of the accompanying Form 10-Q and is qualified in its entirety by reference to such financial statements.

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