Operating Results Income from operations increased 16% in 995 over 1994, reflecting a 9% return on sales for both years. This increase was primarily a result of the higher sales volumes described above, as well as the impact of the Company's continued emphasis on cost reduction efforts and productivity improvement programs. These improvements have enabled the Company to maintain its margins while pricing products competitively in value-driven world markets.

Operating profit for the Vehicle Components segment continued to be strong, improving 17% in 1995 over 1994 and reflecting a 13% return on sales for both years. While the improvement in profits was primarily attributable to improved sales volumes, other contributing factors included ongoing cost reduction efforts and productivity improvement programs, and economies achieved through organizational rationalizations of certain businesses which have better positioned operations to benefit from further growth and market opportunities in global vehicle markets. One such example is the demand in Europe for the Company's new heavy-duty synchronized transmission which has exceeded expectations. Despite the initial costs of bringing this new product to market, which decreased margins in the third quarter of 1995, it is now a positive contributor to margins.

Operating profit for the Electrical and Electronic Controls segment continued to be strong, improving 20% in 1995 over 1994 and reflecting an 8% return on sales for both years. The improvement in profits was primarily attributable to improved sales volumes, but also included added contributions from recently acquired businesses, continued stringent ~~st containment efforts and the realization of benefits from earlier re-~~ings. On the negative side, transitional plant integration difficulties, effects of two September hurricanes in Puerto Rico and unanticipated program launch costs on several new automotive platforms reduced margins in the last half of 1995. The Company expects to correct the operational difficulties in Cutler-Hammer and the program launch issues in the automotive controls business in 1996. Investments in systems and infrastructure for the Company's semiconductor equipment operations also reduced margins in 1995, but will help Eaton take full advantage of the growth opportunities in this profitable business in 1996 and beyond.

Increased income from associate companies, a payment received related to a dividend from a foreign subsidiary and reduced foreign currency exchange losses primarily caused the increase in Other income — net in 1995 over 1994.

An analysis of changes in income taxes and the effective income tax rate is presented under 'Income Taxes' in the Financial Review.

As the sales momentum in many of the Company's markets changed markedly over the course of 1995, with earlier booming demand giving way to more mixed conditions as 1995 ended, the Company anticipates 1996 will be a challenging year. During 1996, the Company expects to continue to benefit from the diversity of its product lines as well as from its global markets. The North American heavy-duty truck market is expected to decline between 20% to 25% from the unprecedented levels experienced in the last two years. The Company expects production of light vehicles to be flat, with passenger cars declining slightly and light trucks modestly higher. The United States capital spending boom, while maturing, is expected to show sustained, moderate growth, with semiconductor capital equipment expected to rise another 40% in 1996.

The success of the Vehicle Components segment is closely linked to increased use of heavy-duty trucks in support of domestic manufacturing. Other significant factors include enduring consumer preference for light trucks, particularly minivans and sports utility vehicles; increasing production of multivalve engines for enhanced performance and economy in light motor vehicles worldwide; declining market share for imports in North America; and demand for off-highway vehicles.

Several factors raise expectations for continued growth in the Electrical and Electronic Controls segment, including continued surging worldwide demand for semiconductor capital equipment, broad based demand for technologically advanced controls to serve industrial and commercial markets, ongoing strength of the United States and European economies, high level of capacity utilization across many industries and new market initiatives the Company has undertaken in the Far East and Latin America.

The Company's long-term goal of building sustainable earnings growth throughout the economic cycle is being accomplished through continued emphasis on the development of new products, increased expansion into global markets, and acquisition of businesses and product lines to complement the Company's existing operations.

To enhance Eaton's existing portfolio of products as well as to develop the products of tomorrow, the Company spent a record amount in 1995 in research and development. The Company is providing increased value added to global customers through investment in internal product development by applying electronics to make mechanical products 'smart' and developing assemblies and subsystems rather than the more traditional individual components.

The Company continues to be active in pursuing growth through acquisitions as well as through investments in 20% to 50% owned associate companies. Over the past decade, the Company has acquired thirty companies or product lines and invested in eleven associate companies with an orientation towards strengthening existing businesses and assuring their world-class competitiveness. Each of the Company's major North American business lines is a leader in the market it serves. The 1994 acquisition of DCBU tripled the size of Eaton's Cutler-Hammer business. The Company has increased its efforts to expand in the Pacific Region and Latin America, areas expected to have the highest growth rates for the foreseeable future. Eaton intends to leverage its strong established presence in North America and Europe to these developing regions. Recent examples of this expansion are the acquisition of Mallory Controles Ltda., a leading Brazilian appliance and automotive controls company, and the purchase of an additional minority interest in the Company's majority-owned Mexican truck manufacturing operations. Pacific Region acquisitions include Rubberon, a leading golf grip manufacturer, and the Emwest electrical switchgear and controls business. The Company's associate companies are predominately located in the Pacific Region and Latin America.