OVERVIEW

Buoyed by strength of the United States and European economies, strong sales momentum that began in late 1993 continued in 1995 resulting in Eaton achieving the highest net sales, net income and net income per Common Share in the Company's history. This marks the second consecutive year of record results. The strength of the year was underscored by the results of each quarter in 1995 when sales exceeded $1.6 billion and net income equaled or exceeded $90 million in every quarter for the first time in the Company's history.

Each product class and most major geographic regions in the Vehicle Components and Electrical and Electronic Controls segments experienced sales growth in 1995 as compared to 1994. The higher sales reflect positive contributions from the Company's existing operations, improved industrial economic market conditions worldwide, geographic expansion and business acquisitions. Net income and net income per Common Share increased 20% and 17%, respectively, in 1995 over 1994. These improvements largely reflect the increased sales levels.

During 1995, the Company took actions intended to enhance shareholder value, approving a 33% increase in the quarterly dividend and a new Preferred Share Purchase Rights Plan, and initiating a share repurchase program to avoid dilution of earnings per share from exercise of stock options.

995 COMPARED TO 1994

Net Sales Net sales rose 13% in 1995 over 1994. The improvement in sales was broadly based and primarily attributable to higher unit volumes in both the Vehicle Components and the Electrical and Electronic Controls segments. During 1995, the Company benefited from the diversity of its product lines as well as from its global markets. In 1995, the North American economy continued to favor the transportation and capital goods markets served by the Company which was the principal reason for the 11% sales increase in North America in 1995 over 1994. The European economic recovery that began in 1994 continued in 1995 and coupled with the recently acquired IKU Group resulted in a 26% sales increase in that region in 1995 over 1994. Despite the continued recession in Japan, sales in the Pacific Region rose 32% in 1995 over 1994, due in part to the recently acquired Emwest electrical switchgear and controls business. In Latin America, economic weakness in Mexico, Brazil and Argentina caused an 11% sales decline in 1995 over 1994. The weakness in Mexico, Brazil and Argentina was partially offset by sales from the recently acquired Mallory Controles Ltda.

The Vehicle Components segment continued its trend of increased net sales, with 1995 showing an increase of 9% over 1994. Truck Components sales rose 9% in 1995 over 1994. The North American market for heavy-duty trucks set industry records again in 1995, with Class 8 truck sales reaching 245,000 units, 9% above the previous record set in 1994. However, the soft landing of the United States economy in the second half of 1995 negatively impacted sales of heavy-duty trucks in the fourth quarter of 1995. Fourth quarter 1995 heavy-duty truck production declined 6% in response to the sharp drop in orders. Slowing growth in industrial output since the first quarter of 1995 affected truck tonnage hauled; as a result, the rush to add fleet capacity, which was at a frenzied pace in 1994 and early 1995, slowed during the second half of 1995. In the third quarter of 1995, though production and retail sales of heavy-duty trucks remained high, net orders were negative as canceled orders exceeded new incoming orders. In the fourth quarter of 1995, orders rebounded somewhat but remained well below the levels experienced earlier in the year. Backlog, which is at 114,000 units at year-end 1995, remains high by historical standards.

The Vehicle Components segment also reflects higher sales of components for sport utility vehicles, minivans and light trucks. North American factory sales in 1995 were comparable with strong 1994 sales. These vehicles, where the Company's component sales are particularly strong, now account for nearly half of the domestic vehicle unit sales of United States-based automobile manufacturers. Passenger Car Components sales rose 9% in 1995 over 1994 despite a 2% decline in North American production of passenger cars and a modest 4% rise in Europe. Sales benefited from the continued trend to multivalve engines and particular strength in Europe. The continuing demand for hydraulic components from the agricultural, construction and industrial markets enabled Off-Highway Vehicle Components sales to remain strong, showing an 11% increase in 1995 over 1994.

The Electrical and Electronic Controls segment continued its trend of significant growth in net sales, with 1995 showing an increase of 17% over 1994, nearly doubling the sales of just two years ago. Sales for 1995 reflect twelve months from the former Distribution and Control Business Unit (DCBU) versus eleven months in 1994.

An increase in industrial and nonresidential construction, partially offset by decreases in both residential construction and sales to the United States Government, resulted in Industrial and Commercial Controls sales rising 9% in 1995 over 1994. The 27% increase in sales of Automotive and Appliance Controls in 1995 over 1994 was due in part to the acquisitions of Lectron Products, Inc., Mallory Controles Ltda. and the IKU Group as well as increased penetration on several new automotive platforms.

Worldwide demand for the Company's semiconductor capital equipment continues to be extraordinarily strong. Sales of the Company's ion implanters in 1995 were at an all-time high, rising 80% over 1994 and more than doubling the sales of just two years ago. This demand was the primary contributor to Specialty Controls' 31% sales increase in 1995 over 1994. Sales of the joint venture related to this business, which are not included in the Company's consolidated sales, also benefited significantly from this increased demand, rising 61% over 1994. The Company is experiencing surging markets as well as market share gains throughout its entire ion implanter product line. Based on industry capital spending plans, semiconductor capital equipment sales are expected to rise significantly again in 1996. A new manufacturing facility in Austin, Texas, currently under construction, will significantly expand the Company's capacity to serve this growing market.