

1994

Eaton Corporation 1994 Annual Report

EAT•N

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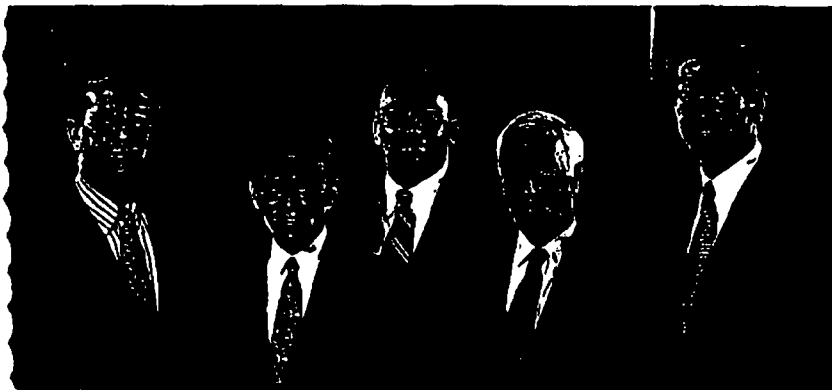
EATON CORPORATION
HIGHLIGHTS

For the year	1993	1992	1991
		or 1992 Excluding Acquisition Integration Charge	
Net sales	\$6,052	\$4,401	\$4,401
Income before income taxes	488	317	202
Income before extraordinary item	\$ 333	\$ 214	\$ 180
Extraordinary item		(7)	(7)
Net income	\$ 333	\$ 207	\$ 173
Per Common Share			
Income before extraordinary item	\$ 4.40	\$ 3.06	\$ 2.37
Extraordinary item		(.10)	(.10)
Net income	\$ 4.40	\$ 2.96	\$ 2.27
Cash dividends paid	\$ 1.20		\$ 1.15
Market price			
High	\$ 62 1/2		\$ 55
Low	43 3/8		38
Average number of Common Shares outstanding	75.6		69.5
At the year-end			
Working capital	\$ 744		\$ 679
Total debt	1,089		1,173
Shareholders' equity	1,680		1,105
Shareholders' equity per Common Share	\$21.54		\$15.50

Our Results for 1993 include an acquisition integration charge of \$55 million (\$34 million after income tax credits, or \$40 per Common Share) related to the 1992 purchase of the Distribution and Control Division Unit of Westinghouse Electric Corporation. The data excluding the charge is presented to demonstrate the results for the Company independent of that charge. Results for 1993 were also reduced by a \$7 million extraordinary loss for the redemption of debentures.

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Eaton's Senior Management Council includes, from left,

William E. Butler, chairman and chief executive officer;

Stephen R. Hardis, vice chairman and chief financial and administrative officer;

Gerald L. Gherlein, executive vice president and general counsel;

John S. Rodewig, president, chief operating officer - Vehicle Components, and Alexander M. Cutler, executive vice president, chief operating officer - Controls.

markets. These changes have affected the strategies of global companies and their decisions about where to source products. Eaton is participating in this trend and is a beneficiary of it.

There are three basic ways in which Eaton is expanding its sales and earnings: through internal development of new products, by expanding into global markets and by acquiring other companies or product lines. The prerequisite for all three, however, is what we call operational excellence - market leadership based on continuous improvement in quality and productivity. In 1994, for the third year running, productivity improvement exceeded 4 percent. This has allowed us to maintain our margins while pricing our products competitively in value-driven world markets.

Market leadership also helps Eaton generate superior rates of return on equity. In 1994, that return was 22.8 percent, which placed us among the top quartile of the S&P 400. Superior returns also produced the discretionary cash necessary to maintain existing market leadership and help finance additional growth. Capital investment in 1994 totaled nearly \$270 million, much of it devoted to improving the efficiency of our 150 factories around the world by providing better tools, equipment and working environment for our 51,000 employees. Capital spending in 1995 is projected to be \$350 million, the highest in the company's history. Some of these funds will be used to expand capacity in areas where current customer demand requires certain plants to operate at rates well beyond optimum efficiency, which penalizes earnings.

With operational excellence as a foundation, we continue to implement a three-pronged strategy for growth:

Internal Development

In 1994, investments in internal development - R & D and engineering - exceeded \$250 million. Increasingly, these funds are being used to make mechanical products "smart" by applying electronics, and to develop assemblies and subsystems instead of components. Electronic technology is becoming increasingly sophisticated and durable, and we are applying it in ways which add value for our customers by enabling them to differentiate from their competitors. Likewise, as major customers seek

to simplify their manufacturing and reduce suppliers, we are finding opportunities to provide full assemblies rather than components alone.

These strategies – simple to describe – are complex to execute. Increasingly, we are relying on multidisciplinary teams, including customers, to bring innovative products to market which will have noticeable impact on our sales. The process helps quicken the pace of product development, improves the efficiency of manufacturing and insures greater market acceptance.

Global Expansion

We are redoubling efforts to expand in Latin America and the Pacific Rim, regions expected to have the highest growth rates for the foreseeable future. We intend to leverage the success we have enjoyed in North America and Europe to these less developed regions which require so many of the products we produce. Eaton's reputation as a market leader is essential for this strategy – since business and government decision-makers in these developing economies look for trusted names with whom to forge partnerships. These regions already account for significant Eaton business, some of it not readily apparent. If exports from our U.S. plants and sales from joint ventures are added to consolidated sales in Latin America and the Pacific Rim, total revenue from these regions in 1994 was \$1.2 billion, up 76 percent in the past three years.

Acquisitions

Over the past 10 years, we have acquired 26 companies or product lines to strengthen our businesses and assure their world-class competitiveness. We have made solid progress in integrating the Westinghouse DCBU with our Cutler-Hammer business. During 1994, we closed 23 manufacturing, warehousing and distribution operations in order to eliminate excess capacity. We are consolidating product offerings and increasingly capitalizing on the product synergies we had anticipated. The projected dilution in 1994 earnings per share, originally forecast when we acquired the Westinghouse business, became, instead, a positive contribution to earnings. Successfully integrating such a large acquisition is strong evidence of the capability of our operating managers to undertake similar projects, if the value and strategic fit are right.

Two smaller acquisitions made in 1994 illustrate another facet of our acquisition strategy. In November, Eaton added Lectron Products, Inc., a manufacturer of automotive controls, and in December, we acquired a majority interest in a leading Brazilian appliance controls company, reinforcing our position in the growing Latin American market. Both illustrate the building of our automotive and appliance controls business. In 1980, it had less than \$175 million in sales,

mostly in the U.S. and Canada. Today, it is a global business with 33 manufacturing plants in 12 countries. Sales in 1995 are expected to be a billion dollars, more than 45 percent of which are outside North America.

Eaton's entire management is pledged to continue the profitable growth of the company, and the strategy to achieve it which is outlined in this report. That commitment is, I hope, as reassuring to you as it is to me, for I am retiring at the end of the year. Long after that date, however, my interest in Eaton's progress will continue, as will my pride in the accomplishments of our Eaton team.

We have no doubt that attaining the goal of high, sustainable earnings will translate directly into increased shareholder value. Our intent is to eliminate the discount at which Eaton shares trade below the average of the S&P 400. That change will proceed as the market perceives and then acknowledges that Eaton has, in fact, become a different and better company. We very much appreciate your continued support as we seek to enhance your investment.



William E. Butler
Chairman and Chief Executive Officer

February 28, 1995

Don Barnes, left, and Art Sandowal, assemble servo piston pumps at Eaton's plant in Hutchinson, Kansas. The pumps are



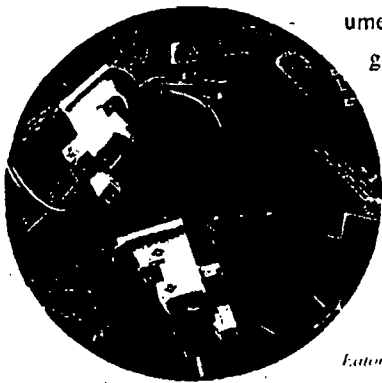
critical components in hydrostatic transmissions that propel such products as skid steer loaders, industrial sweepers and scrubbers, commercial lawn mowers and other equipment requiring from 1 to 80 horsepower.

MARKET LEADERSHIP

Operational excellence in today's fiercely competitive global arena demands market leadership that permits the economies of scale, product breadth and command of strategic imperatives to compete effectively.

By 1993, all but one of Eaton's businesses had achieved market leadership. The one exception — the industrial control and power distribution business marketed under the Cutler-Hammer name — overcame that hurdle in 1994 with the \$1 billion acquisition of Westinghouse product lines (discussed more fully under "Growth through Acquisitions" on pages 16 through 19). Today, Cutler-Hammer, with nearly \$1.5 billion in sales, has the size and product offerings to compete on a global basis.

Market leadership means that certain costs, such as product and market development, can be spread over larger sales to improve profit margins. It means better prices from suppliers through larger volume purchases. It means having a greater ability to build strategically for the future despite the vagaries of the marketplace. Each of Eaton's businesses now enjoys these substantial advantages.



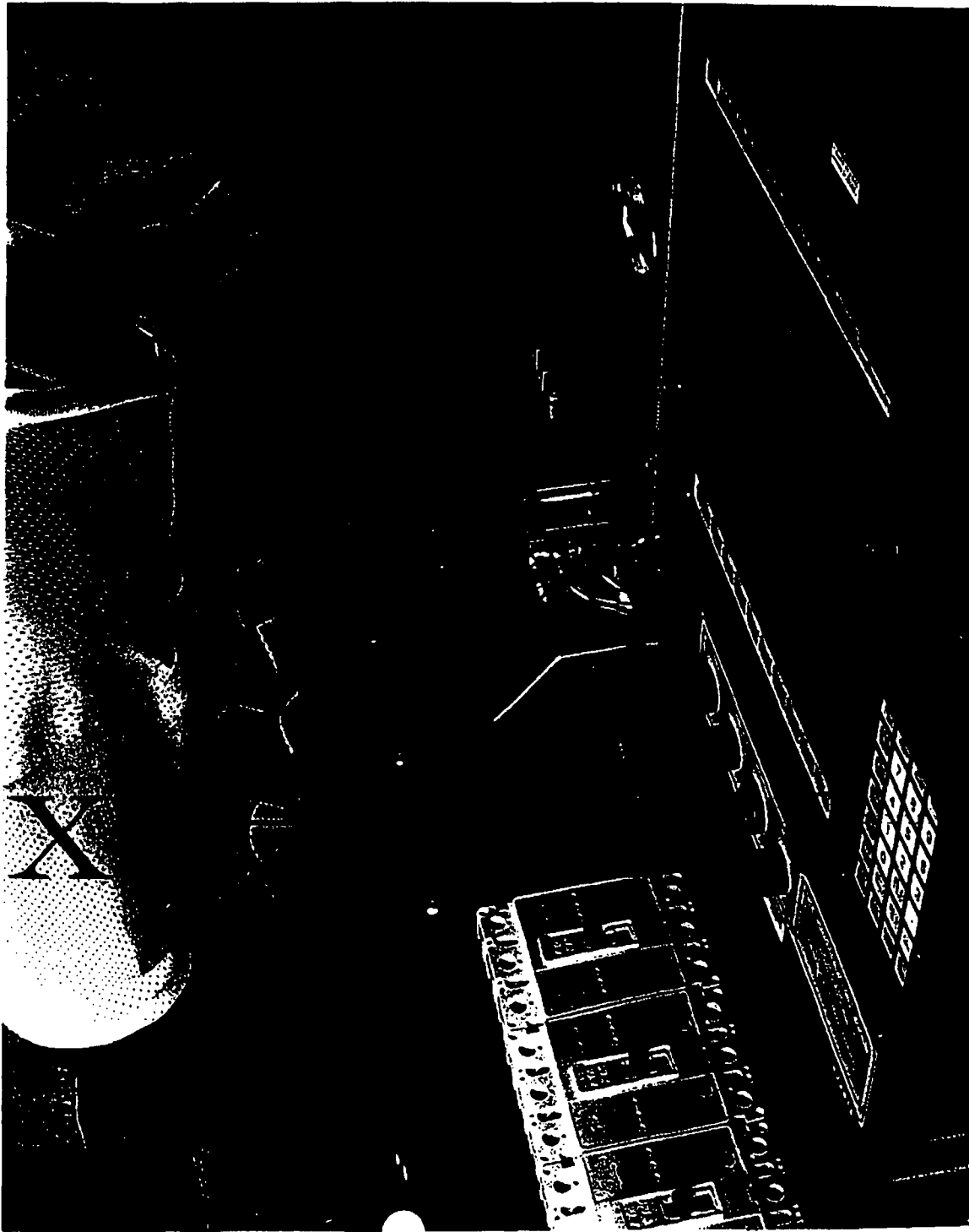
Eaton and Black & Decker work closely on the design and manufacture of switches for power tools. Eaton manufactures more than 20 million power tool switches

Eaton's return on common equity in 1994 was 22.8 percent, only the third time since 1950 that this figure has risen above 20 percent. Over the past two years, net cash provided by Eaton's operating activities approached \$1 billion. These funds are funneled into activities that sustain and build market leadership.

Boosting Factory Efficiency

Over the past 10 years, Eaton has invested more than \$1.8 billion in capital improvements, including nearly \$270 million in 1994. Much of this amount has been devoted to increasing operating efficiency at the company's 150 factories around the world. As demand for our products has surged since 1991, investments in modernization have paid off handsomely.

By the end of 1994, Eaton plants had earned more than 800 customer quality citations and certifications. Nearly 40 percent of Eaton's plants have already qualified for the international quality standard, ISO 9000, and many others will do so in 1995. In 1994, Eaton's plant in Salisbury, Maryland, which manufactures hydraulic-magnetic circuit breakers, was cited for its crucial support when a division of AT&T won both the Malcolm Baldrige Award, the U.S. national quality award, and the Deming Prize, Japan's national quality award.



ROLANDO CRUZ TESTS SERIES C, TYPE FS, MOLDED CASE
CIRCUIT BREAKERS AT THE CUTLER-HAMMER PLANT IN TOA BAJA, PUERTO RICO. THESE MICROPROCESSOR-CONTROLLED
BREAKERS MEET INTERNATIONAL ELECTRICAL STANDARDS AND ARE USED PRIMARILY FOR MOTOR PROTECTION. SERIES C MOLDED
CASE CIRCUIT BREAKERS ARE A LARGE FAMILY OF BREAKERS WITH RATINGS FROM 10 AMPS TO 2500 AMPS

GROWTH THROUGH OPERATIONAL EXCELLENCE

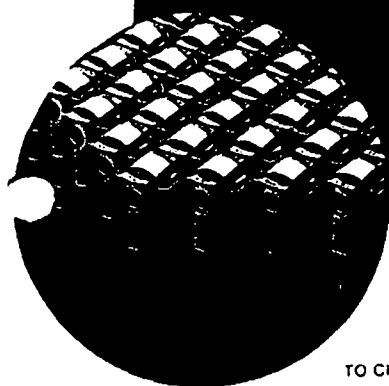


DYNAMOMETER TECHNICIAN BRIAN CARPENTER TESTS

EATON VALVES IN A 2.4 LITER CHRYSLER PROTOTYPE ENGINE. AS A PREFERRED SUPPLIER

FOR VALVES AND ROLLER LIFTERS (INSET), EATON CONTRIBUTES SIGNIFICANT TECHNOLOGICAL EXPERIENCE

TO CHRYSLER'S NEW ENGINE DESIGN AND DEVELOPMENT PROGRAMS.



Improving Productivity

For three years running, Eaton has achieved its corporate goal of at least 4 percent improved productivity annually. Inventory management, judged by annual turnover, has improved 25 percent in the last five years.

The spotlight on numbers does not obscure our clear and continuous focus on the customers who determine our success. Our goal is total customer support. We seek to anticipate their needs so completely that they are delighted by their association with Eaton. Here are a few of the ways Eaton's service translates into customer delight.

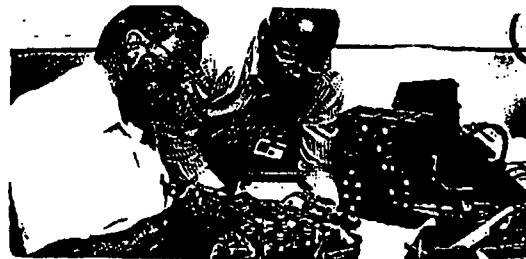
• Strategic alliances between Eaton and its customers are flourishing. Eaton and Cummins, the leading manufacturer of engines for heavy-duty trucks, now work jointly on valve train designs. This alliance gives Cummins access to Eaton's extensive technical expertise and gives Eaton the inside track on new business. Engineers at Black &

Decker, a company renowned for its power tools, routinely form cross-functional teams with their Eaton counterparts to design better, more versatile power tool switches.

• Total service is an everyday goal. Cutler-Hammer recently worked closely with Ford Motor Company and Lamb Technicon, an equipment manufacturer, to design a multiplexed, microprocessor-based system to control a transfer machine that processes engine parts at Ford's plant in Windsor, Ontario, Canada. Cutler-Hammer also worked hand-in-glove with Moore Electric Supply, Inc., its distributor in Charlotte, North Carolina, to win the multi-million dollar electrical contract for the new stadium where the National Football League's Carolina Panthers will play.

Generating New Business

• High quality and timely delivery often mean more orders. Since 1991, Eaton's business with Chrysler has grown four-fold and today Eaton is Chrysler's preferred supplier of valves and hydraulic roller lifters. Eaton is also a major supplier to Chrysler of automotive controls, including switches, cruise controls, air conditioning expansion valves and drier receivers.

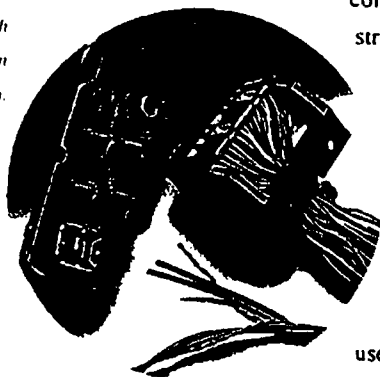


Robert E. Shandbrook, left, senior product development engineer, and Thomas M. Hall, manufacturing engineer, examine a high-power electrical load distribution module for the Apache helicopter. The units provide cost, weight and size savings and are extremely reliable and efficient in managing power aboard aircraft.

• Tackling tough problems builds goodwill. Boeing and Pratt & Whitney were delighted when Eaton designed problem-free hydraulic and differential pressure switches that resolved problems and enabled jet engines to perform at optimum efficiency.

The focus on customers is at the heart of operational excellence and the essence of good business – and of growing market leadership. But having market leadership – as Eaton does – is not enough. The challenge is to sustain and build on that leadership to steadily improve financial performance. The hard-won financial rewards of our success are being carefully reinvested to achieve this goal.

Eaton's new multiplexing system has an electronic control module linked to a single twisted pair of wires (at bottom in photo), which control numerous functions and replaces the cumbersome spaghetti-like cable laced with individual wires (right in photo) for each function.



MORE NEW PRODUCTS

At Eaton, internal development is focused on two things: (1) more new products, (2) in less time. The company has a carefully crafted strategy driving this vision. The long-term objective is 10 percent sustainable earnings growth annually.

As part of its strategic planning, Eaton prioritizes many opportunities for growth: new products, new technologies, new uses for old technology, and, to a thriving extent, the application of electronics to Eaton's traditional mechanical and electrical products. We are placing special emphasis on opportunities that will generate substantial sales and earnings within five years. We recognize that some of today's promising projects will fail; others, however, will generate growth far in excess of expectations.

A team of carefully selected business and technical experts shepherds each project. These Simultaneous Product and Process Development (SPPD) teams often have 25 to 30 members. They include many disciplines: product design, engineering, manufacturing, marketing and sales, as well as customer representatives with various areas of expertise. The teams address both product and process workflows, simplifying them to develop and introduce new products in less time.

The SPPD team devotes its time exclusively to the new project, employing the best practices and technology. Rigorous analysis by the company's senior managers gauges progress along the way. Funding is a critical issue, and Eaton dedicates funds to permit projects to succeed long-term.

Substantial Rewards Ahead

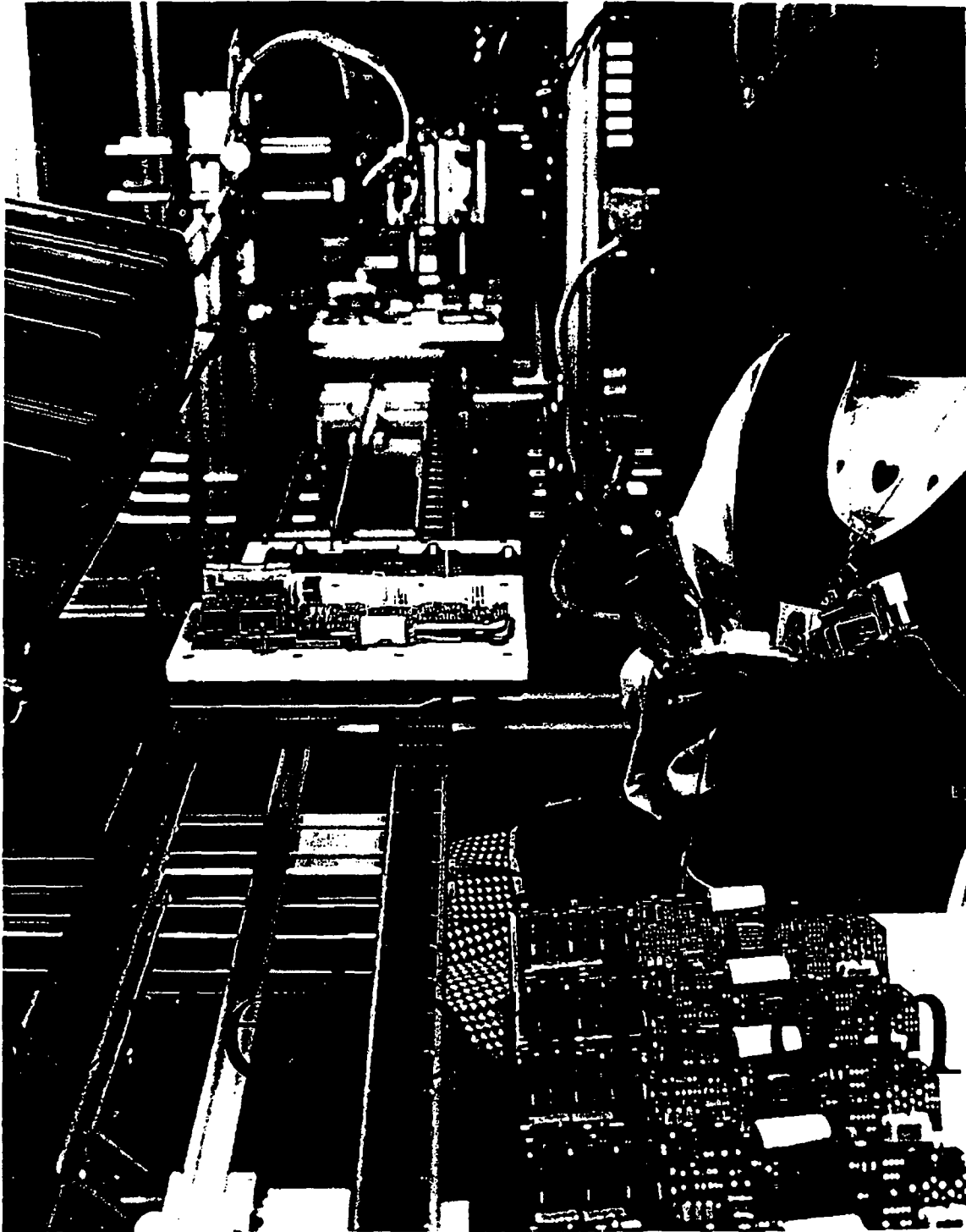
This strategy has already generated new sales, but the substantial rewards lie ahead as the strategy spreads throughout the company. Eaton SPPD teams have already had notable successes.

■ In 1995, Eaton will begin delivering multiplexing components to Chrysler that substantially reduce the wiring required in 1996 Jeep Grand Cherokees. Multiplexing permits electronic controls attached to vehicle components to communicate with one another via a single twisted pair of wires. This system reduces weight and lowers costs by eliminating the spaghetti-like wiring harness in vehicle doors and dashboards required to run individual wires to each switch. The sales potential is extraordinary if other automakers adopt the technology, and Eaton's leading-edge position provides outstanding growth opportunities.

Robert G. Neff makes headlamp adjusters at Eaton's new plant in Brunswick, Ohio. The adjusters fasten the headlamp to the vehicle and

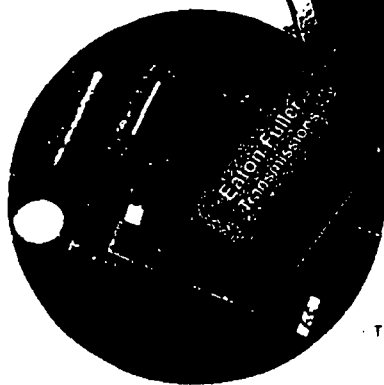


permit vertical and/or horizontal adjustment. Eaton manufactures 26 million headlamp adjusters annually for leading



VERONICA ROSAS PEREZ ASSEMBLES ELECTRONIC MODULES AT EATON'S PLANT IN MATAMOROS, MEXICO. THE MODULES ARE PART OF EATON'S NEW MULTIPLEXING SYSTEM FOR CHRYSLER'S 1996 JEEP GRAND CHEROKEES. MULTIPLEXED FUNCTIONS INCLUDE REMOTE KEYLESS ENTRY, SINGLE/ALL-DOOR LOCK, AUTO DOOR LOCK AT 15 MILES PER HOUR, HEATED MIRRORS AND DRIVER'S SIDE WINDOW EXPRESS-DOWN

GROWTH THROUGH INTERNAL DEVELOPMENT



MICHAEL J. CAMPBELL, QUALITY CONTROL TECHNICIAN

TESTS ELECTRONIC MODULES ON EATON'S NEW AUTOSHIFT TRANSMISSION

THE AUTOSHIFT IS A SEMI-AUTOMATED MODEL MARKETING PRIMARILY FOR BUSES AND COACHES. IT SUPPLIES MANY OF THE BENEFITS OF AUTOMATIC TRANSMISSIONS AT REDUCED COSTS

• Eaton's EC Timer – designed especially for European appliance makers – is modular, and customers can select their level of sophistication. Refinements to the timer's components have helped the company maintain its edge in an increasingly competitive European appliance controls market.

• Responding to the needs of vehicle manufacturers, Eaton designed an aluminum drier receiver that filters and dries air, thus greatly improving the efficiency of automotive air conditioning systems.

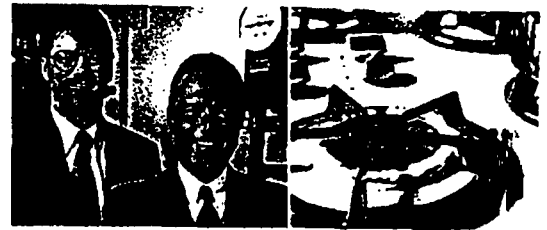
Enlarged Circuit Breaker Line

• Computer modeling resulted in the rapid development of a new circuit breaker that extends the company's leading medium voltage circuit breaker line to 38 kilovolts. The new circuit breaker, which is typically used in electrical substations, offers long life and trouble-free service.

• Eaton has also developed a new heavy-duty hydrostatic pump that incorporates an electronic circuit board, sensors and multiplexing to allow pump parameters to be monitored and adjusted to optimize performance. The pumps are smaller

and quieter than earlier models and are designed for use on combines, wheel loaders, lift trucks and similar agricultural and construction equipment. Eaton's share of the \$500 million worldwide market for heavy-duty hydrostatics is growing. The company intends to market the new electronic hydrostatic pump aggressively during 1995 in both North America and in Europe.

• In 1994, Eaton introduced the AutoShift, a semi-automated heavy-duty transmission primarily for buses and coaches. Based on the Eaton Fuller 10-speed mechanical transmission, the AutoShift has an electronic module that selects ideal shift points and shifts automatically. Among other advantages, AutoShift trims weight and cost and reduces complexity. A partially automated version, the AutoSelect, is being offered for heavy-duty trucks in North America.

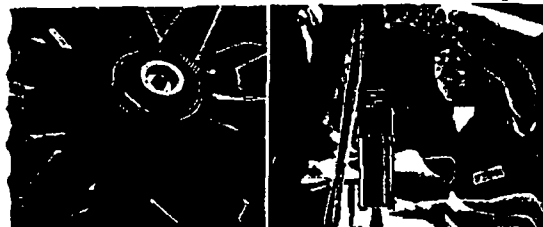


Mark Balcanas, right, manager of strategic planning and marketing, and Jim Pick, manager of range and refrigeration products group, are key members of a team that designed a new gas range system for Whirlpool. Designing and marketing sub-systems, in addition to individual components, offers Eaton attractive growth opportunities.

• Other truck projects include a lightweight, heavy-duty D404 tandem axle, now the benchmark of the industry; an extremely robust and reliable steer axle; extended service ("ES") brakes; a tire pressure control system that permits drivers to deflate and reinflate tires while the vehicle is moving. The tire pressure control system proved itself in Operation Desert Storm and in field testing with forestry customers such as Weyerhaeuser.

Through internal development, Eaton is meeting the challenge of extending the life of current products and developing new families upon which to build a future of growth and prosperity.

Eaton makes both fans and viscous fan drives at its plant in Markdorf, Germany, for customers in 20 countries in Europe, South America and Southeast Asia.



Renate Dummel is involved in final assembly of viscous fans and fan shrouds at Eaton's plant in Markdorf, Germany, where employees communicate in 10 languages.

WORLDWIDE OPPORTUNITIES

Eaton has 63 manufacturing plants outside the United States, including 26 in Europe and 21 in Latin America. Within the next few years, the number of facilities is expected to grow steadily as Eaton moves into developing markets, where global market leadership makes Eaton the partner of choice.

In 1994, a task force identified 10 countries with exceptional growth prospects as prime markets for Eaton products. Most are in the Far East and Latin America. In many of these developing markets, automakers and appliance manufacturers are vying to be the supplier of choice. As a component supplier to most of the world's passenger car and truck manufacturers and to every major U.S. and European appliance maker, Eaton is well-positioned to participate as growth opportunities develop.

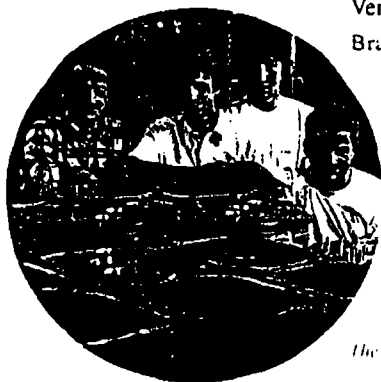
Cutler-Hammer is growing its electrical equipment business globally through wholly-owned subsidiaries in Canada, the United Kingdom, Venezuela, Mexico, Costa Rica, Brazil and Australia, and through export sales. Cutler-Hammer's broad product lines, including molded-case circuit breakers and vacuum breakers, meet all international electrical

standards. These products, along with photoelectric and proximity sensors, Freedom Series motor starters and contactors, and PanelMate video control panels, provide a substantial platform from which to grow the business internationally. (Cutler-Hammer is discussed more fully under "Growth through Acquisitions," on pages 16 through 19.)

Groundwork For Growth

In China, Eaton has had a licensing agreement for its 9-speed Roadranger transmissions since 1986. In 1993, Eaton formed Jining Eaton Hydraulics Company, a joint venture in China manufacturing hydraulic components, such as hydrostatic steering units and orbit motors. Eaton's chairman and other senior officers visited China last fall to lay the groundwork for other business ventures.

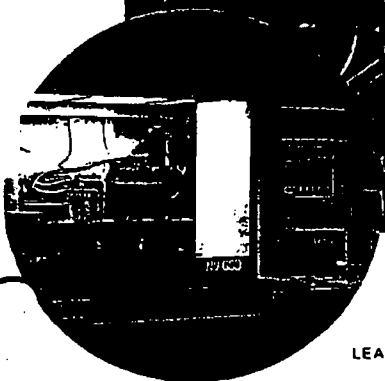
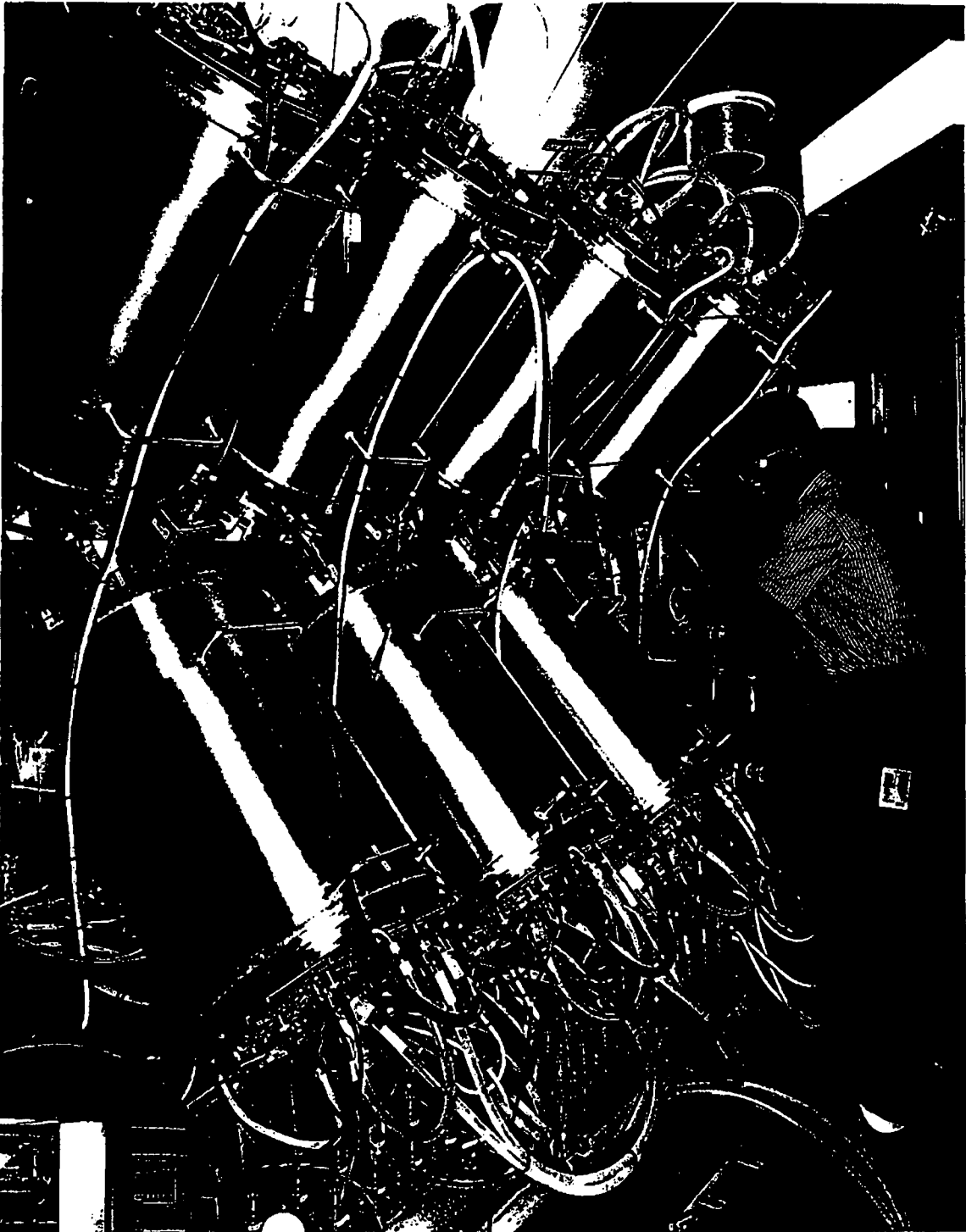
Perhaps the most successful of Eaton's international joint ventures is Sumitomo Eaton Nova (SEN), which manufactures ion implanters in Japan for worldwide markets. Eaton and SEN engineers work closely on the development of new products. The most recent result of



The team responsible for setting up the first assembly line for S-Series transmissions at St. Naucelle, France, includes, from left, Jean-Charles Cailhard, Luc Morin, Laurent Cochard, Jean-François



LAURENT LANUEL UNDERTAKES FINAL ASSEMBLY OF AN S-SERIES TRANSMISSION
AT EATON'S MANUFACTURING PLANT IN ST. NAZAIRE, FRANCE. THE FULLY SYNCHRONIZED S-SERIES WAS DEVELOPED BY TEAMS IN EUROPE
AND THE UNITED STATES AND DELIVERED TO MARKET IN JUST OVER TWO YEARS FROM CONCEPT TO MANUFACTURED PRODUCT



SON CHAU, ELECTRICAL/MECHANICAL ASSEMBLER, HELPS PREPARE ONE OF EATON'S LEADING-EDGE NV-GSD/HE ION IMPLANTERS, WHICH ARE DESIGNED, MANUFACTURED AND ASSEMBLED IN BEVERLY, MASSACHUSETTS. EATON WILL DELIVER CUSTOMERS MORE THAN 30 OF THE NEW UNITS IN 1995. INSET: THE FRONT OF THE NV-GSD/HE SHOWS THE IMPLANTER'S SOPHISTICATED WAFER-HANDLING SYSTEM.

their collaboration is Eaton's new high-energy ion implanter, introduced in 1994 to overwhelming market demand. Eaton and Sumitomo Electric each own 50 percent of the SEN joint venture. Eaton's high-current and medium-current implanters are in demand worldwide.

Successful Joint Ventures

Other joint ventures include Sumitomo Eaton Hydraulics Company (SEHYCO), a partnership with Sumitomo Heavy Industries of Japan that manufactures hydraulic components; Modern Molded Products Ltd., which manufactures Golf Pride golf grips in Taiwan; Nittan Valve of Japan, which has a major position as an Asian automotive valve supplier; and Japan Fawick, which manufactures Airflex clutches and brakes and markets Golf Pride golf grips. Eaton has one wholly-owned manufacturing plant in Asia, an assembly facility in Taiwan that manufactures commercial switches for Asian customers. Total Eaton-related sales in the Asia-Pacific region in 1994 were approximately \$750 million.

Among other areas identified for their exceptional growth prospects are Latin America and India. Eaton manufactures axles and assembles a variety of controls in Mexico, and is pursuing other investment opportunities. In Brazil, Eaton manufactures truck components, engine components, industrial control and power distribution equipment, and appliance controls. In India, the company participates in a joint venture that builds truck axles.



Eaton is also continuing to develop its extensive manufacturing and marketing base in Europe, where it has excellent market positions in automotive and appliance controls, engine components and truck components, and has growing positions in electrical equipment, commercial controls and hydraulics.

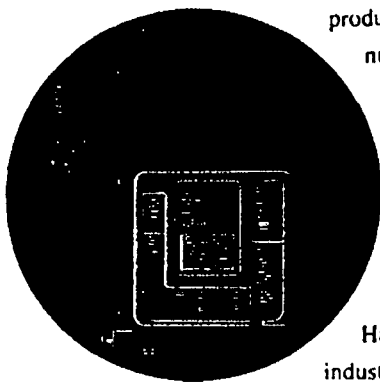


Engineers involved in manufacturing molded case circuit breakers in Tou Buja, Puerto Rico, include Ramon Ordoñez, product and process quality improvement engineer; Maridelly Rivera, manufacturing engineer; Rene Rey, manufacturing supervisor; and Larry Kupple, computer-integrated manufacturing engineer.

Eaton's Chairman William E. Butler, center; President John S. Rodewig, right; and Executive Vice President Alexander M. Cutler visited China in the fall of 1994 to evaluate business opportunities. Eaton has seven joint venture businesses in Asia.

EXPANDING OUR REACH

Over the last 10 years, Eaton has spent \$1.7 billion on acquisitions that sustain and build market leadership. As a result, more than 80 percent of Eaton's sales come from products that are number one or number two in the markets they serve.



This vacuum circuit breaker, rated 15,000 volts and weighing 350 pounds, is an integral part of Cutler-Hammer's medium-voltage switchgear, which is marketed globally

The acquisition of the Westinghouse Distribution and Controls Business Unit (DCBU) in 1994 merged two heavyweights – Cutler-Hammer, a major player in industrial controls, and DCBU, a leader in electrical distribution equipment – into one world-class franchise marketed as “The New Cutler-Hammer.” The combination created one of the broadest selections of electrical components available from a single supplier.

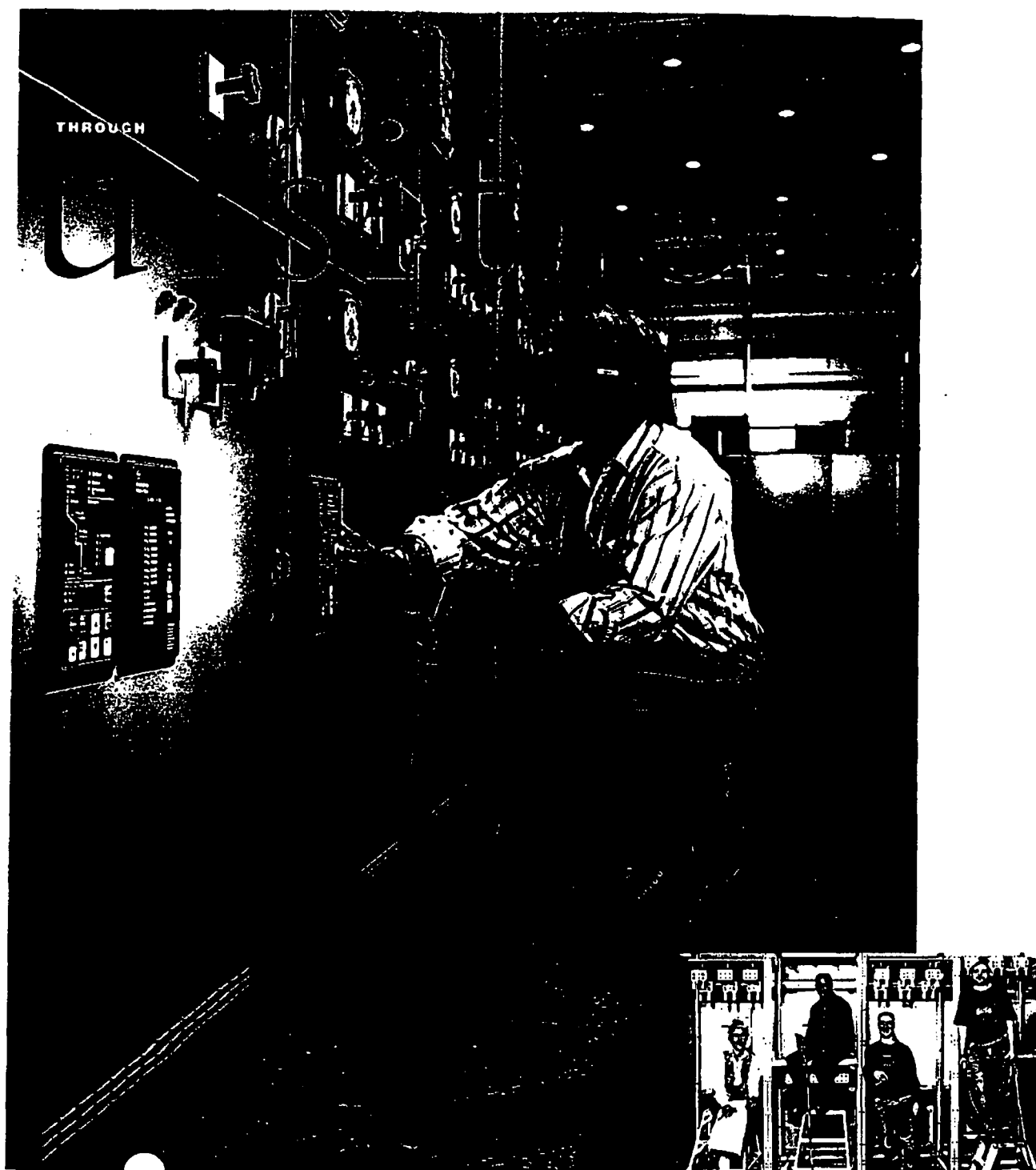
Cutler-Hammer sales in 1994 approached \$1.5 billion. These sales come from two broad categories of products:

- Industrial controls include contactors and motor starters, variable speed drives, photoelectric and proximity sensors, PanelMate video control panels, microprocessor-based control and protection devices, as well as pushbuttons and switches, all designed to enhance factory performance.
- Power distribution equipment includes the most complete family of circuit breakers in the industry, ranging from miniature breakers rated 120 volts up to world class vacuum breakers rated up to 38 kilovolts. These products are used

wherever there is a demand for electrical power – in residences, high-rise apartment and office buildings, commercial sites, hospitals and factories. The company's Series C molded case circuit breakers provide increased performance in less space than standard breakers and, like the vacuum breakers, meet all major international electrical standards. As a result, the company has high expectations of substantially improving export sales and sales at seven international subsidiaries.

Leading-Edge Products

Microprocessors are changing the electrical equipment industry, and Cutler-Hammer's leading-edge products provide substantial competitive advantages. The new Digitrip OPTIM programmable electronic trip unit uses microprocessors to monitor and adjust settings on installed circuit breakers, reducing downtime, increasing productivity and trimming costs. This technology, previously feasible only on large breakers, is now available on smaller molded case breakers. The OPTIM trip units perform optimally with the company's Series C molded case circuit breakers and



BILLY CANN, DRAFTER/TESTER, CHECKS MEDIUM-VOLTAGE SWITCHGEAR
AT THE COMPANY'S PLANT IN GREENWOOD, SOUTH CAROLINA INSET: AN ASSEMBLY
TEAM AT THE PLANT INCLUDES, FROM LEFT, DIANE GAFFNEY, OSCAR E. LATIMER, LINDA K. COBB AND GEORGE M. BALCHIN



SHERRI FRANKLIN PLACES A PRINTED CIRCUIT BOARD ONTO AN AUTOMATIC TRANSMISSION SOLENOID MANIFOLD AT EATON'S PLANT IN ROCHESTER HILLS, MICHIGAN.

ACQUIRED AS PART OF LECTRON PRODUCTS IN 1994, SOLENOIDS (INSET) ASSURE SMOOTH GEAR SHIFTING. LECTRON WILL ADD MORE THAN \$140 MILLION TO EATON'S ANNUAL SALES

low-voltage power circuit breakers to provide superior protection, diagnostics, monitoring and communications capability to protective applications.

Technological Innovation

Another new product is the IQ Analyzer, an outgrowth of the industry-leading family of IQ Electronic Meters. The IQ Analyzer monitors a full range of system parameters, including current, voltage, power and energy demand, among others. It also monitors the quality of power, noting voltage sags and harmonics, which can be harmful to electrical distribution systems. The IQ Analyzer, which features a user-friendly operator panel, makes system data easy to retrieve and available in a form that operators can readily interpret and use. As with all of the IQ family of products, it can also communicate information back to a personal computer over the Cutler-Hammer IMPACC system. The IQ Analyzer is ideally suited to locations such as computer facilities, commercial sites and industrial plants, where power quality is crucial.

More typical for Eaton than the Westinghouse DCBU purchase are niche acquisitions, smaller franchises that complement and bolster product lines. Eaton continued that trend in 1994 by acquiring Lectron Products, Inc., of Rochester Hills, Michigan. Lectron, Eaton's 26th niche acquisition since 1984, manufactures electro-mechanical and electronic controls for the automotive industry, including shift valves for electronically controlled automatic transmissions, speed-sensitive power steering control valves, keyless vehicle entry systems, daytime running lamps, chime warning modules and releases for trunk lids and fuel doors.

Strength in New Markets

During 1994, Eaton also acquired a 51 percent interest in Mallory Controles Ltda. of Sao Paulo, Brazil, with an option to acquire the remaining 49 percent. Mallory is the leading supplier of controls for major appliances in Brazil, and the acquisition reinforces Eaton's position with its global customers



Cutler-Hammer R-E breakers are readied for shipment at the company's plant in Beaver, Pennsylvania. Orders with one to five breakers are shipped next day, orders of six or more, shipped within five days.

in the growing Latin American market. The factory in Sao Paulo makes program timers, pressure switches and water valves for major appliances. These products complement others offered by Eaton's automotive and appliance controls business.

In 1980, Eaton's automotive and appliance controls business had less than \$175 million in sales, mostly in the U.S. and Canada. Today, it is a global business with 33 manufacturing plants in 12 countries. Sales in 1995 are expected to be \$1 billion, and more than 45 percent are in foreign markets.

As part of a long-range plan for building its businesses, Eaton remains alert for opportunities to reinforce basic business strengths, build product breadth and improve market leadership.

EATON CORPORATION

CONSOLIDATED BALANCE SHEETS

December 31	1994	1993
(Millions)		
Assets		
Current assets		
Cash	\$ 18	\$ 32
Short-term investments	23	268
Accounts receivable	889	550
Inventories	698	434
Deferred income taxes	151	127
Other current assets	67	55
	1,846	1,466
Property, plant and equipment		
Land	50	41
Buildings	539	486
Machinery and equipment	2,321	1,959
	2,910	2,486
Accumulated depreciation	(1,441)	(1,298)
	1,469	1,188
Excess of cost over net assets of businesses acquired	850	265
Deferred income taxes	158	112
Other assets	359	237
	<u>\$4,682</u>	<u>\$3,268</u>
Liabilities and Shareholders' Equity		
Current liabilities		
Short-term debt	\$ 14	\$ 14
Current portion of long-term debt	22	110
Accounts payable	449	266
Accrued compensation	163	106
Accrued income and other taxes	60	23
Other current liabilities	394	268
	1,102	787
Long-term debt	1,053	649
Postretirement benefits other than pensions	573	509
Other long-term liabilities	274	218
Shareholders' equity		
Common Shares (78.0 in 1994 and 71.3 in 1993)	39	36
Capital in excess of par value	806	535
Retained earnings	988	708
Foreign currency translation adjustments	(71)	(78)
Unallocated Employee Stock Ownership Plan shares	(82)	(96)
	1,680	1,105
	<u>\$4,682</u>	<u>\$3,268</u>

The Financial Review on pages 24 to 32 is an integral part of the consolidated financial statements.

EATON CORPORATION

STATEMENTS OF CONSOLIDATED INCOME

<i>Year ended December 31</i>	<i>1994</i>	<i>1993</i>	<i>1992</i>
<i>(Millions except for per share data)</i>			
Net sales	\$6,052	\$4,401	\$4,101
Costs and expenses			
Cost of products sold	4,397	3,284	3,134
Selling and administrative expense	882	591	578
Research and development expense	213	154	151
Acquisition integration charge		55	
	5,492	4,084	3,863
Income from operations	560	317	238
Other income and (expense)			
Interest expense	(91)	(75)	(89)
Interest income	7	8	9
Other income - net	12	12	23
	(72)	(55)	(57)
Income before income taxes	488	262	181
Income taxes	155	82	41
Income before extraordinary item and cumulative effect of accounting changes	333	180	140
Extraordinary item		(7)	
Cumulative effect of accounting changes			
Postretirement benefits other than pensions			(274)
Income taxes			6
Net income (loss)	\$ 333	\$ 173	\$ (128)
Per Common Share			
Income before extraordinary item and cumulative effect of accounting changes	\$ 4.40	\$ 2.57	\$ 2.03
Extraordinary item		(.10)	
Cumulative effect of accounting changes			
Postretirement benefits other than pensions			(3.97)
Income taxes			.09
Net income (loss)	\$ 4.40	\$ 2.47	\$ (1.85)
Cash dividends paid	\$ 1.20	\$ 1.15	\$ 1.10
Average number of Common Shares outstanding	75.6	69.8	68.9

The Financial Review on pages 24 to 32 is an integral part of the consolidated financial statements.

EATON CORPORATION

STATEMENTS OF CONSOLIDATED CASH FLOWS

<i>Year ended December 31</i>	<i>1994</i>	<i>1993</i>	<i>1992</i>
(Millions)			
<i>Operating activities</i>			
Income before extraordinary item and cumulative effect of accounting changes	\$ 333	\$ 180	\$ 140
Adjustments to reconcile to net cash provided by operating activities			
Depreciation	216	182	184
Amortization	35	14	16
Acquisition integration charge		55	
Deferred income taxes	35	(65)	(26)
Long-term liabilities	40	(6)	20
Other non-cash items in income	37		(39)
Changes in operating assets and liabilities, excluding acquisitions and divestitures of businesses			
Accounts receivable	(190)	40	58
Inventories	(115)	12	11
Other current assets	(12)	6	(5)
Accounts payable and other accruals	129	29	(8)
Accrued income and other taxes	10	(15)	(9)
Other – net	4	3	39
<i>Net cash provided by operating activities</i>	522	435	381
<i>Investing activities</i>			
Acquisitions of businesses, less cash acquired	(1,058)	(14)	(22)
Divestitures of businesses	61		18
Expenditures for property, plant and equipment	(267)	(227)	(186)
Purchases of short-term investments	(7)	(108)	(86)
Maturities and sales of short-term investments	252	22	
Other – net	9	8	18
<i>Net cash used in investing activities</i>	(1,010)	(319)	(258)
<i>Financing activities</i>			
Borrowings with original maturities of more than three months			
Proceeds	731		99
Payments	(609)	(98)	(151)
Borrowings with original maturities of less than three months – net	173	(14)	(15)
Proceeds from sale of Common Shares	252	62	
Proceeds from exercise of stock options	18	19	29
Cash dividends paid	(91)	(83)	(76)
<i>Net cash provided by (used in) financing activities</i>	474	(114)	(114)
<i>Total increase (decrease) in cash</i>	(14)	2	9
Cash at beginning of year	32	30	21
<i>Cash at end of year</i>	\$ 18	\$ 32	\$ 30

The Financial Review on pages 24 to 32 is an integral part of the consolidated financial statements.

EATON CORPORATION

STATEMENTS OF CONSOLIDATED SHAREHOLDERS' EQUITY

	Common Shares		Capital in excess of par value	Retained earnings	Foreign currency translation adjustments	Unallocated ESOP shares	Total shareholders' equity
	Shares	Amount					
(Shares in thousands, dollars in millions)							
Balance at January 1, 1992	34,069	\$17	\$418	\$838	\$ 2	\$(122)	\$1,153
Net loss				(128)			(128)
Cash dividends paid, net of Employee Stock Ownership Plan (ESOP) tax benefit				(74)			(74)
Issuance of shares under employee benefit plans, including tax benefit	598		34				34
Reduction of unallocated ESOP shares						12	12
Foreign currency translation adjustments					(49)		(49)
Balance at December 31, 1992	34,667	17	452	636	(47)	(110)	948
Net income				173			173
Cash dividends paid, net of ESOP tax benefit				(83)			(83)
Issuance of shares under employee benefit plans, including tax benefit	483		22				22
Two-for-one stock split	34,867	18		(18)			
Sale of shares	1,287	1	61				62
Reduction of unallocated ESOP shares						14	14
Foreign currency translation adjustments					(31)		(31)
Balance at December 31, 1993	71,304	36	535	708	(78)	(96)	1,105
Net income				333			333
Cash dividends paid, net of ESOP tax benefit				(89)			(89)
Issuance of shares under employee benefit plans, including tax benefit	503		21				21
Sale of shares	4,560	2	250				252
Acquisition of interests with Lectron Products, Inc.	1,600	1		25			26
Unrealized net gain on available-for-sale securities, net of income taxes				11			11
Reduction of unallocated ESOP shares						14	14
Foreign currency translation adjustments					7		7
Balance at December 31, 1994	77,967	\$39	\$806	\$988	\$(71)	\$ (82)	\$1,680

The Financial Review on pages 24 to 32 is an integral part of the consolidated financial statements.

ACCOUNTING POLICIES

Consolidation

The consolidated financial statements include accounts of the Company and all majority-owned subsidiaries. The equity method of accounting is used for investments where the Company has a 20% to 50% ownership interest.

Foreign Currency Translation

Financial statements for subsidiaries outside the United States, except those in highly inflationary economies, are translated into United States dollars at year-end exchange rates as to assets and liabilities and weighted average exchange rates as to revenues and expenses. The resulting translation adjustments are recorded in shareholders' equity. Financial statements for subsidiaries in highly inflationary economies are translated into United States dollars in the same manner except for inventories and property, plant and equipment-net, and related expenses, which are translated at historical exchange rates. The resulting translation adjustments are included in net income.

Short-Term Investments

Short-term investments are not considered to be cash equivalents for purposes of classification in the statements of consolidated cash flows.

Inventories

Inventories are carried at lower of cost or market. Inventories in the United States are generally accounted for using the last-in, first-out (LIFO) method. The remaining United States and all other inventories are accounted for using the first-in, first-out (FIFO) method.

Depreciation and Amortization

Depreciation and amortization are computed by the straight-line method for financial statement purposes. The cost of plant and equipment is depreciated over the useful lives of the various classes of assets. Identified intangible assets, principally patents, trademarks and tradenames are amortized over the useful life of the respective asset. Excess of cost over net assets of businesses acquired is amortized principally over forty years (accumulated amortization in millions was \$102 and \$78 at the end of 1994 and 1993, respectively). Excess of cost over net assets of businesses acquired is assessed for impairment when operating profit from the related business indicates that the carrying amount may not be recoverable.

Financial Instruments

The Company uses various financial instruments, including foreign exchange contracts and options, and interest rate swaps and caps, as part of foreign exchange and interest rate risk management programs. The Company does not buy and sell financial instruments solely for the purpose of earning a profit due to changes in the market price of the instruments, except for nominal amounts authorized under limited, controlled circumstances.

The Company has subsidiaries operating in Canada, Europe, Latin America and the Pacific region. In the normal course of business, these operations are exposed to fluctuations in related foreign currencies. The Company seeks to reduce exposure to foreign currency fluctuations, primarily the European and Canadian currencies, through the use of foreign currency forward exchange contracts and options.

Gains or losses on foreign currency forward exchange contracts and options which hedge net investments in consolidated subsidiaries outside the United States are accrued in shareholders' equity. Gains or losses on foreign currency forward exchange contracts and options which hedge specific transactions are recognized in net income, offsetting the underlying foreign currency transaction gains or losses. Premiums and discounts related to foreign currency forward exchange contracts and options are amortized to other income - net over the lives of the agreements.

In the normal course of business, the Company's operations are also exposed to fluctuations in interest rates. The Company seeks to reduce the cost of and exposure to interest rate fluctuations through the use of interest rate swaps and caps. Gains or losses on interest rate swaps and caps are included in interest expense since they hedge interest on debt. Premiums related to interest rate caps are amortized to interest expense over the lives of the agreements.

Counterparties to various hedging instruments are many major international financial institutions. While the Company may be exposed to credit losses in the event of nonperformance by these counterparties, no losses are anticipated due to control over the limit of positions entered into with any one party and the strong credit ratings of these institutions.

Net Income Per Common Share

Net income per Common Share is computed by dividing net income by the average month-end number of shares outstanding during each period. The dilutive effect of common stock equivalents, comprised solely of employee options for Common Shares, is not material.

ACQUISITIONS AND DIVESTITURES OF BUSINESSES

On January 31, 1994, the Company acquired the Distribution and Control Business Unit (DCBU) of Westinghouse Electric Corporation for an adjusted purchase price of \$1.050 billion. DCBU, a leading North American manufacturer of electrical distribution equipment and industrial controls, was combined with Eaton's Industrial Control and Power Distribution Operations (ICPDO) to form the new Cutler-Hammer business unit. The acquisition has been accounted for as a purchase and, accordingly, the statements of consolidated income include the results of DCBU beginning February 1, 1994. The acquired assets and liabilities assumed in the acquisition follow (in millions):

Fair value of assets acquired	\$ 742
Liabilities assumed	(298)
Excess of cost over net assets acquired	606
Purchase price, net of cash acquired	<u>\$1.050</u>

The excess of cost over net assets acquired is being amortized over forty years. Identified intangible assets of \$95 million are being amortized over an average life of sixteen years.

On an unaudited pro forma basis, assuming Eaton and DCBU had been combined as of the beginning of 1993, net sales would have increased \$1 billion whereas net income and net income per Common Share would not have been significantly different from reported amounts. On the same basis, results for 1994 would not have been significantly different from reported amounts.

In December 1993, in conjunction with the acquisition of DCBU, the Company recorded a \$55 million acquisition integration charge (\$34 million after income tax credits, or \$.49 per Common Share). Part of a comprehensive business plan, the charge addressed the costs of integrating the ICPDO product lines and manufacturing operations with DCBU, related workforce reductions and a \$9 million write-down of assets, largely in the United States. To date, expenditures and charges total \$20 million with the remaining \$35 million expected to occur primarily over the next three years. The remaining expenditures will be funded through cash flow from the combined operations.

On November 16, 1994, the Company acquired the common stock of Lectron Products, Inc. (Lectron) through the issuance of 1.6 million Common Shares. Lectron, a privately-held manufacturer of electronic and precision electromechanical controls for automotive manufacturers, had annual sales of \$128 million for the most recent fiscal year. This acquisition was accounted for as a pooling-of-interests. Financial statements for periods prior to the acquisition were not restated for the acquisition since the effect would not be material.

During 1994, in conjunction with the acquisition of DCBU, the Company sold certain DCBU operations to Thomas & Betts Corporation (T&B) in exchange for cash aggregating \$61 million and \$14 million of T&B common stock. These divestitures resulted in no gain or loss.

During 1994, 1993 and 1992, the Company acquired and divested other smaller operations.

EXTRAORDINARY ITEM

During 1993, the Company called for redemption \$74 million of 9% debentures and \$89 million of 8.5% debentures. The extraordinary loss on these redemptions, including the write-off of unamortized debt issuance costs, was \$11 million (\$7 million after income tax credits, or \$.10 per Common Share).

ACCOUNTING CHANGES

In 1992, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 106, "Employers' Accounting for Postretirement Benefits Other Than Pensions" and SFAS No. 109, "Accounting for Income Taxes."

SFAS No. 106 requires accrual of postretirement benefits other than pensions, primarily postretirement health care and life insurance for retirees in the United States, over the working lives of employees rather than recognition of expenses as claims are incurred. Net income for 1992 was reduced by the cumulative effect of this accounting change for prior years of \$442 million (\$274 million after income tax credits, or \$3.97 per Common Share). SFAS No. 106 has no effect on cash flows since claims will continue to be paid as incurred.

The adoption of SFAS No. 109 changed the method of accounting for income taxes to the liability method from the deferred method. The liability method requires recognition of deferred income taxes based on temporary differences between the financial reporting and income tax bases of assets and liabilities, using currently-enacted income tax rates and regulations. Net income for 1992 was increased by the cumulative effect of this accounting change for prior years of \$6 million, or \$.09 per Common Share. SFAS No. 109 has no effect on cash flows.

ACCOUNTS RECEIVABLE AND INVENTORIES

Accounts receivable are net of an allowance for doubtful accounts (in millions) of \$14 and \$10 at the end of 1994 and 1993, respectively.

The components of inventories at December 31 follow (in millions):

	1994	1993
Raw materials	\$213	\$141
Work in process	358	238
Finished goods	216	139
Gross inventories at FIFO	787	518
Excess of current cost over LIFO cost	(89)	(84)
Net inventories at LIFO	\$698	\$434

Gross inventories accounted for using the LIFO method (in millions) were \$367 and \$314 at the end of 1994 and 1993, respectively.

INVESTMENT IN LIFE INSURANCE

In 1993, the Company purchased company-owned life insurance policies insuring the lives of a portion of active United States employees. The policies accumulate asset values to meet future liabilities including the payment of employee benefits such as health care. At December 31, 1994 and 1993, the investment in the policies included in other assets (in millions) was \$10 and \$7, net of policy loans of \$226 and \$110, respectively. Net life insurance expense (in millions) of \$5 and \$2, including interest expense of \$15 and \$4 in 1994 and 1993, respectively, was included in selling and administrative expense.

DEBT AND OTHER FINANCIAL INSTRUMENTS

The Company's subsidiaries outside the United States have lines of credit, primarily short-term, aggregating \$115 million from various banks worldwide. Most of these arrangements are reviewed periodically for renewal. At December 31, 1994, the Company had \$19 million outstanding under these lines of credit with banks. The weighted average interest rate on short-term debt, excluding immaterial amounts for highly inflationary countries, at December 31, 1994 and 1993 was 6.8% and 8.1%, respectively.

Long-term debt at December 31, excluding the current portion, follows (in millions):

	1994	1993
Notes of Employee Stock Ownership Plan due through 1999	\$ 66	\$ 82
6-3/8% notes due 1999	100	
9% notes due 2001	100	100
8% debentures due 2006 (due 1996 at option of debenture holders)	86	86
8.9% debentures due 2006	100	100
7% debentures due 2011, net of unamortized discount of \$93 million in 1994 and \$95 million in 1993 (effective interest rate 14.6%)	107	105
8-7/8% debentures due 2019 (due 2004 at option of debenture holders)	38	38
5.1% debentures due 2022	100	100
7-5/8% debentures due 2024	100	
Unsecured notes (6% to 6.4%)	210	
Other	46	38
	<u>\$1,053</u>	<u>\$ 649</u>

To refinance a portion of the cost of the acquisition of DCBU, in April 1994, the Company sold \$100 million of 6-3/8% notes due 1999 and \$100 million of 7-5/8% debentures due 2024. Concurrent with the sale of the 6-3/8% notes and the 7-5/8% debentures, the Company terminated, and settled for cash, interest rate swap agreements with notional amounts totaling \$200 million which hedged the sale of the notes and debentures. The gain on the termination of the interest rate swap agreements is being amortized to interest expense over the life of the notes and debentures and effectively reduces the annual rate of the notes to 4.8% and the debentures to 7.1%.

In January 1994, in order to finance the acquisition of DCBU, the Company entered into a \$555 million 364-day revolving credit agreement and a \$555 million five-year revolving credit agreement. During 1994, as a result of the sale of \$200 million of notes and debentures, the sale of \$214 million of Common Shares and cash flow from operations, the Company canceled the 364-day revolving credit agreement and reduced the \$555 million five-year revolving credit agreement to \$300 million. The \$210 million of unsecured notes at December 31, 1994 relate to the acquisition of DCBU. These unsecured notes are classified as long-term debt because the Company intends, and has the ability under the five-year \$300 million revolving credit agreement, to refinance this debt on a long-term basis.

Notes of the Employee Stock Ownership Plan, which are guaranteed by the Company, consist of \$55 million at a floating interest rate (5.5% at December 31, 1994) based on LIBOR and \$26 million at a fixed interest rate of 7.6% (\$15 million of these notes are included in current portion of long-term debt). The Company has entered into a series of interest rate swaps, which expire ratably through 1999, and which change the interest rate on the \$26 million of fixed interest rate notes to fixed interest rates of 7.1% and 6.9% as to \$7 million and \$16 million, respectively, and to a floating interest rate (5.2% at December 31, 1994) based on LIBOR as to \$3 million.

In April 1994, the Company sold a five-year interest rate cap in exchange for a premium (cash) of \$1.5 million. This agreement effectively converts the \$100 million of 6-3/8% notes into floating rate debt at LIBOR minus 2.6% when LIBOR exceeds 9%.

At December 31, 1994, the Company had entered into interest rate caps commencing in January 1995 which effectively place a 5.5% ceiling on \$100 million of floating rate debt through November 1, 1995.

In 1994, the Company entered into two interest rate swaps aggregating \$50 million that expire in 2000, which partially offset the effect of a \$100 million 9% interest rate swap also expiring in 2000. The net effect of these swaps at December 31, 1994 was to convert \$50 million of floating rate debt to fixed rate debt at 9% and another \$50 million of floating rate debt to LIBOR plus 3.1%.

Aggregate mandatory sinking fund requirements and annual maturities of long-term debt are as follows (in millions): 1995, \$22; 1996, \$120; 1997, \$22; 1998, \$22; and 1999, \$323. The amount for 1996 includes \$86 million of 8% debentures due in 1996 at the option of the debenture holders. The amount for 1999 includes \$210 million of unsecured notes due to the expiration of the five-year revolving credit agreement in 1999.

Interest capitalized as part of acquisition or construction of major assets (in millions) was \$10, \$12, and \$8 in 1994, 1993 and 1992, respectively. Interest paid (in millions) was \$101, \$90 and \$94 in 1994, 1993 and 1992, respectively.

Effective January 1, 1994, the Company adopted SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities." As a result of the adoption of SFAS No. 115, the Company accrued the unrealized gain related to several available-for-sale securities. The cumulative effect of the accounting change for prior years was an \$8 million increase in the carrying value of the securities with an offsetting increase, after income taxes, of \$5 million in retained earnings in shareholders' equity.

The notional amounts, carrying amounts and fair values of financial instruments outstanding at December 31 follow (in millions):

	1994			1993		
	Notional amount	Carrying amount	Fair value	Notional amount	Carrying amount	Fair value
Cash and short-term investments		\$ 41	\$ 41		\$300	\$300
Marketable equity investments		51	51		27	34
Marketable debt securities		26	26		26	27
Short-term debt		(14)	(14)		(14)	(14)
Long-term debt and current portion of long-term debt		(1,075)	(1,114)		(759)	(941)
Foreign currency forward exchange contracts and options	\$189	1	(1)	\$227	6	7
Interest rate swaps						
Fixed to floating	76		(5)	31		3
Floating to fixed	123		(4)	327		(16)
Interest rate caps						
Purchased	100		2	500		
Sold	(100)	(1)	(2)			

The fair value of short-term investments, marketable equity investments and debt securities, short-term and long-term debt, and interest rate swaps and caps was principally based on quoted market prices. The fair value of foreign currency forward exchange contracts and options, which primarily mature in 1995, was estimated based on quoted market prices of comparable contracts, adjusted through interpolation where necessary for maturity differences.

PENSION PLANS

The Company has non-contributory defined benefit pension plans covering the majority of employees. Plans covering salaried and certain hourly employees provide benefits that are generally based on years of service and final average compensation. Benefits for other hourly employees are generally based on years of service. Company policy is to fund at least the minimum amount required by applicable regulations. In the event of a change in control of the Company, excess pension plan assets of North American operations may be dedicated to funding of health and welfare benefits for employees and retirees.

The components of pension (expense) income for the years ended December 31 follow (in millions):

	1994	1993	1992
Service cost - benefits earned during year	\$(55)	\$(42)	\$(39)
Interest cost on projected benefit obligation	(94)	(97)	(96)
Actual return on assets	36	155	203
Net amortization and deferral	99	(17)	(73)
	<u>\$(14)</u>	<u>\$ (1)</u>	<u>\$ (5)</u>

As a result of the DCBU acquisition, pension expense increased by \$7 million in 1994.

The pension asset (liability), by funded status, recognized in the balance sheet at December 31 follows (in millions):

	1994		1993	
	Over-funded	Under-funded	Over-funded	Under-funded
Accumulated pension benefit obligation				
Vested	\$ 950	\$ 147	\$ 979	\$ 136
Nonvested	62	8	53	10
	<u>1,012</u>	<u>155</u>	<u>1,032</u>	<u>146</u>
Value of future salary projections	135	10	143	10
Total projected pension benefit obligation	1,147	165	1,175	156
Fair value of plan assets	1,370	70	1,371	68
Plan assets in excess of or (less than) projected benefit obligation	223	(95)	196	(88)
Unamortized				
Initial net (asset) obligation	(40)	7	(48)	7
Net (gain) loss	(125)	(3)	(116)	3
Prior service cost	10	15	27	12
Adjustment to recognize minimum liability		(12)		(12)
	<u>\$ 68</u>	<u>\$ (88)</u>	<u>\$ 59</u>	<u>\$ (78)</u>

Measurement of the projected benefit obligation was based on a discount rate of 8.50%, 7.25%, and 8.25% in 1994, 1993 and 1992, respectively. The expected compensation growth rate was 5.95%, 4.95%, and 5.95% in 1994, 1993 and 1992, respectively. The expected long-term rate of return on assets was 10% in all three years. Plan assets are invested in equity and fixed income securities and other instruments. Underfunded plans are associated principally with operations outside the United States. The change in the discount rate to 8.50% at the end of 1994 had the effect of decreasing the accumulated pension benefit obligation by \$140 million with an offsetting increase in the unamortized net gain. This change will have an immaterial effect on future expense.

POSTRETIREMENT BENEFIT PLANS OTHER THAN PENSIONS

Generally, employees become eligible for postretirement benefits other than pensions, primarily health care and life insurance for retirees in the United States, when they retire. These benefits are payable for life, although the Company retains the right to modify or terminate the plans providing the benefits. The plans are contributory, with retiree contributions adjusted annually, and contain other cost-sharing features, including deductibles and co-payments. During 1993, certain plans were amended to limit the annual amount of the Company's future contributions towards employees' postretirement health care benefits. Company policy is to pay claims as they are incurred since, unlike pensions, there is no effective method to obtain a tax deduction for prefunding of these benefits under existing United States income tax regulations.

Expense for postretirement benefits other than pensions for the years ended December 31 follows (in millions):

	1994	1993	1992
Service cost - benefits earned during year	\$(13)	\$ (7)	\$(12)
Interest cost on projected benefit obligation	(43)	(37)	(44)
Net amortization and deferral	5	9	
	<u>\$(51)</u>	<u>\$(35)</u>	<u>\$(56)</u>

The liability for postretirement benefit plans other than pensions recognized in the balance sheets at December 31 follows (in millions):

	1994	1993
Accumulated postretirement benefit obligation		
Retirees	\$382	\$368
Eligible plan participants	44	38
Non-eligible plan participants	177	120
Unamortized		
Prior service cost	67	91
Net loss	(62)	(73)
	<u>\$608</u>	<u>\$544</u>

As a result of the DCBU acquisition, the expense and the liability for postretirement benefits other than pensions increased by \$6 million and \$51 million, respectively.

Measurement of the accumulated postretirement benefit obligation at December 31, 1994, was based on an 11% annual rate of increase in the per capita cost of covered health care benefits (12% for 1993). For 1994, the rate was assumed to decrease ratably to 7% through 1999 and decrease to 6.25% in 2000 and remain at that level thereafter (5% for 1993). The discount rate was 8.50% in 1994 and 7.25% for 1993. The changes in assumed rates had the effect of decreasing the accumulated postretirement benefit obligation (APBO) which offset increases in the APBO due to changes in plan provisions. These changes will have an immaterial effect on future expense. An increase of 1% in assumed health care cost trend rates would increase the accumulated postretirement benefit obligation as of December 31, 1994 by \$39 million and the net periodic cost for 1994 by \$3 million.

PROTECTION OF THE ENVIRONMENT

The Company has been named a potentially responsible party (PRP) under the Federal Superfund law at a number of waste disposal sites. Although this law technically imposes joint and several liability upon each PRP at each site, the extent of the Company's required financial contribution to the cleanup of these sites is expected to be limited based on the number and financial strength of the other named PRP's and the volumes of waste involved which might be attributable to the Company. The Company is also involved in remedial response and voluntary environmental cleanup expenditures at a number of other sites which are not the subject of any Superfund law proceeding, including certain currently-owned or formerly-owned plants.

Environmental exposures associated with the DCBU acquisition are limited by the purchase agreement with Westinghouse Electric Corporation. With respect to environmental conditions existing prior to the acquisition, Westinghouse agreed to retain certain responsibilities, to share the cost of others and to indemnify the Company for costs to the extent they exceed \$3.5 million annually. The obligation to share costs extends for ten years.

Although difficult to quantify, management estimates that there is a reasonable possibility that the remediation and other costs associated with all of these sites may range up to \$74 million, and that such costs would be incurred over a period of several years. The Company accrues for these costs when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. At December 31, 1994 and 1993, the balance sheet included an accrual for estimated remediation and other environmental costs (in millions) of approximately \$48 and \$18, respectively. The accrual for environmental costs at year-end 1994 includes \$13 million for environmental exposures associated with DCBU which was recorded as part of the allocation of the purchase price of DCBU. Actual costs to be incurred at identified sites in future periods may vary from the estimates, given inherent uncertainties in evaluating environmental exposures. Subject to the difficulty in estimating future environmental costs, the Company expects that any sum it may be required to pay in connection with environmental matters in excess of the amounts recorded or disclosed above will not have a material adverse effect on financial condition or results of operations.

The Company continues to modify, on an ongoing, regular basis, certain processes in order to reduce the impact on the environment. Efforts in this regard include the removal of many underground storage tanks and the reduction or elimination of certain chemicals and wastes in operations.

LEASE COMMITMENTS

Future minimum rental commitments as of December 31, 1994, under noncancelable operating leases, which expire at various dates and in most cases contain renewal options, are as follows (in millions): 1995, \$42; 1996, \$31; 1997, \$24; 1998, \$15; 1999, \$12; and after 1999, \$97.

Rental expense in 1994, 1993 and 1992 (in millions) was \$65, \$43 and \$45, respectively.

SHAREHOLDERS' EQUITY

At the 1994 Annual Meeting, shareholders adopted amended Articles of Incorporation which increased the number of authorized Common Shares from 150 million to 300 million. At December 31, 1994, 5.4 million Common Shares were reserved for exercise and grant of stock options. At the end of 1994, there were 14,834 holders of record of Common Shares. Additionally, 21,286 employees were shareholders through participation in the Share Purchase and Investment Plan.

In private placements, the Company sold 1.3 million Common Shares in December 1993 for aggregate net proceeds of \$62 million, and sold an additional 800,000 Common Shares in January 1994 for aggregate net proceeds of \$38 million. The proceeds from these private placements were used primarily to fund the redemption in January 1994 of \$89 million of 8.5% debentures.

In March 1994, in order to partially refinance the acquisition of DCBU, the Company sold 3.8 million Common Shares to the public for aggregate net proceeds of \$214 million.

In November 1994, the Company issued 1.6 million Common Shares in a pooling-of-interests with Lectron Products, Inc.

In May 1993, the Company's share purchase rights were redeemed at a price of 3-1/3 cents for each right, for a total payment of \$2 million.

The Company sponsors a Share Purchase and Investment Plan (SPIP) for United States operations under which eligible participating employees may choose to contribute up to 15% of their base pay to the SPIP. The Company matches employee contributions up to 6% of a participant's base pay as limited by United States income tax regulations. The matching contribution ranges from 25% to 100% of a participant's contribution and is invested in the Company's Common Shares. The matching contribution percentage is determined each quarter, based on net income per Common Share.

In 1989, the Company prefunded, through 1999, a portion of anticipated matching contributions to the SPIP by creating an Employee Stock Ownership Plan (ESOP) under the SPIP and selling 5 million Common Shares for \$150 million to the ESOP. The shares held by the ESOP have not yet been allocated to employee accounts and are included in shareholders' equity as "Unallocated ESOP Shares" and the notes payable of the ESOP are included in long-term debt. Shares in the ESOP are released at historical cost and allocated to the employee accounts based on the ratio of the annual principal payment on the notes payable compared to the original principal amount of the notes payable. Cash dividends paid on shares in the ESOP are charged against retained earnings and, along with Company contributions, are used to repay the principal and interest due on the notes payable. ESOP shares are considered as outstanding for purposes of computing net income per Common Share. Shares in the ESOP at the end of 1994 and 1993 (in millions) were 2.7 and 3.4, respectively. Compensation expense related to the SPIP match, including the effect of shares released by the ESOP at historical cost, (in millions) was \$15 in 1994, \$11 in 1993 and \$7 in 1992.

OPTIONS FOR COMMON SHARES

Options have been granted to certain employees, under various plans, to purchase the Company's Common Shares at prices equal to fair market value as of date of grant. These options expire ten years from date of grant. A summary of stock option activity follows:

	1994		1993	
	Average price per share	Shares	Average price per share	Shares
Outstanding, January 1	\$31.53	3,433,850	\$28.81	3,368,670
Granted	57.71	959,390	39.34	831,730
Exercised	28.12	(348,720)	27.28	(657,353)
Canceled	46.42	(45,361)	32.52	(109,197)
Outstanding, December 31	\$37.94	3,999,159	\$31.53	3,433,850
Shares exercisable				
January 1		2,401,683		2,334,758
December 31		2,839,095		2,401,683
Shares reserved for future grants				
January 1		2,133,630		2,856,882
December 31		1,218,477		2,133,630

INCOME TAXES

Income before income taxes for the years ended December 31 follows (in millions):

	1994	1993	1992
United States	\$396	\$214	\$147
Outside the United States	92	48	34
	<u>\$488</u>	<u>\$262</u>	<u>\$181</u>

Income taxes for the years ended December 31 follows (in millions):

	1994	1993	1992
Current			
United States:			
Federal	\$ 81	\$108	\$ 42
State and local	15	7	5
Outside the United States	44	30	20
	<u>140</u>	<u>145</u>	<u>67</u>
Deferred			
United States			
Increase in statutory tax rate		(5)	
Other Federal	24	(50)	(14)
State and local	1	(2)	(1)
Outside the United States			
Operating loss carryforwards	(8)	(7)	(11)
Reduction of valuation allowance for deferred tax assets	(3)	(5)	
Increase in statutory tax rate	(2)	(1)	
Other	3	7	
	<u>15</u>	<u>(63)</u>	<u>(26)</u>
	<u>\$155</u>	<u>\$ 82</u>	<u>\$ 41</u>

Significant components of current and long-term deferred income taxes at December 31 follow (in millions):

	1994		
	Current assets	Long-term assets	Long-term liabilities
Accruals and other adjustments			
Employee benefits	\$ 54	\$228	\$ (4)
Inventory	15		
Restructuring	20	13	
Depreciation and amortization		(142)	(17)
Other	46	7	
Operating loss carryforwards		78	1
Valuation allowance		(29)	
Other items	16	3	9
	<u>\$151</u>	<u>\$158</u>	<u>\$ (11)</u>

	1993		
	Current assets	Long-term assets	Long-term liabilities
Accruals and other adjustments			
Employee benefits	\$ 44	\$209	\$ (4)
Inventory	15		
Restructuring	15	13	
Depreciation and amortization		(140)	(15)
Other	38	5	
Operating loss carryforwards		50	2
Valuation allowance		(15)	
Other items	15	(10)	7
	<u>\$127</u>	<u>\$112</u>	<u>\$ (10)</u>

At December 31, 1994, certain subsidiaries outside the United States had tax loss carryforwards and tax credit carryovers (in millions) aggregating \$162 and \$15, respectively. Carryforwards of \$92 million have no expiration dates and the balance expire at various dates from 1995 through 2005. The tax credit carryovers expire at various dates from 1995 through 1999.

Reconciliations of income taxes at the United States Federal statutory rate to the effective income tax rate for the years ended December 31 follow (in millions):

	1994		1993	1992
	Amount	Rate	Rate	Rate
Income taxes at the United States statutory rate	\$171	35.0%	35.0%	34.0%
State and local income taxes	14	2.8	1.5	.9
Adjustment of worldwide tax liabilities	7	1.6	1.4	(6.0)
Possessions credit related to Puerto Rican operations	(26)	(5.2)		
Reduction of valuation allowance for deferred tax assets	(3)	(.6)	(2.1)	
Adjustment of deferred income taxes for change in statutory rates	(2)	(.4)	(2.3)	
Effective tax rate differential on earnings of consolidated subsidiaries and associate companies outside the United States	(6)	(1.3)	.1	(3.9)
Other - net			(2.1)	(2.2)
	<u>\$155</u>	<u>31.9%</u>	<u>31.5%</u>	<u>22.8%</u>

The Company has facilities in Puerto Rico that manufacture products for both domestic and foreign markets. These facilities operate under tax relief and other incentives that expire at various dates beginning in 2004 through 2013.

The parent company has not provided income taxes on undistributed earnings of consolidated subsidiaries outside the United States of \$353 million at December 31, 1994, since the earnings retained have been reinvested by the subsidiaries. If distributed, such remitted earnings would be subject to withholding taxes but substantially free of United States income taxes.

Worldwide income tax payments, including Federal and state income taxes in the United States, in 1994, 1993 and 1992 (in millions) were \$109, \$156 and \$71, respectively.

QUARTERLY DATA

(Unaudited)

	Quarter ended			
	Dec. 31	Sept. 30	June 30	Mar. 31
(Millions except for per share data)				
1994				
Net sales	\$1,605	\$1,531	\$1,545	\$1,371
Gross margin	442	411	429	373
Percent of sales	28%	27%	28%	27%
Net income	89	84	86	74
Per Common Share				
Net income	\$ 1.15	\$ 1.10	\$ 1.13	\$ 1.01
Cash dividends paid	.30	.30	.30	.30
Market price				
High	54%	54%	58%	62%
Low	43%	45%	49%	50%
1993				
Net sales	\$1,115	\$1,053	\$1,147	\$1,086
Gross margin	297	266	279	275
Percent of sales	27%	25%	24%	25%
Income before extraordinary item	30	44	53	53
Extraordinary item	(4)			(3)
Net income	26	44	53	50
Per Common Share				
Income before extraordinary item	\$.41	\$.63	\$.77	\$.76
Extraordinary item	(.05)			(.05)
Net income	.36	.63	.77	.71
Cash dividends paid	.30	.30	.275	.275
Market price				
High	55%	51%	47%	43%
Low	48	43	41%	38%

Results for 1994 reflect the acquisition of DCBU on January 31, 1994.

Results for the fourth quarter of 1993 were reduced by a \$55 million acquisition integration charge related to the purchase of DCBU (\$34 million after income tax credits, or \$.49 per Common Share).

The redemption of debentures in 1993 resulted in extraordinary losses of \$5 million and \$6 million in the first and fourth quarters, respectively (\$3 million and \$4 million after income tax credits, or \$.05 per Common Share in each quarter).

Gross margin for the second quarter of 1993 was reduced by a \$9 million charge for streamlining certain Vehicle Components operations in Europe.

BUSINESS SEGMENT AND GEOGRAPHIC REGION INFORMATION

Operations are classified among three business segments: Vehicle Components, Electrical and Electronic Controls and Defense Systems. The major classes of products included in each segment and other information follows.

Vehicle Components

Truck Components – Heavy and medium duty mechanical and automatic transmissions; power take-offs; drive, trailer and steering axles; brakes; anti-lock brake systems; locking differentials; engine valves; valve lifters; leaf springs; viscous fan drives; fans and fan shrouds; power steering pumps; tire pressure control systems; tire valves.

Passenger Car Components – Engine valves; hydraulic valve lifters; viscous fan drives; fans and fan shrouds; locking differentials; spring fluid dampers; superchargers; tire valves.

Off-Highway Vehicle Components – Mechanical and automatic transmissions; drive and steering axles; specialty axle products; brakes; engine valves; hydraulic valve lifters; gear and piston pumps and motors; transaxles and steering systems; gerotors; control valves and cylinders; forgings; central tire inflation systems; tire valves.

The principal market for these products is original equipment manufacturers of trucks, passenger cars and off-highway vehicles. Most sales of these products are made directly from the Company's plants to such manufacturers.

Electrical and Electronic Controls

Industrial and Commercial Controls – Electromechanical and electronic controls including motor starters, contactors, overloads and electric drives; programmable controllers, counters, man/machine interface panels and pushbuttons; photoelectric, proximity, temperature and pressure sensors; residential, molded case, air and medium voltage circuit breakers; loadcenters; safety switches; panelboards; switchboards; switchgear components; switchgear dry type transformers; busway; meter centers; portable tool switches; commercial switches; relays; vacuum interrupters; illuminated pushbuttons and panels; annunciator panels; electrically actuated valves and actuators; pressure transducers and switches.

Automotive and Appliance Controls – Electromechanical and electronic controls including convenience, stalk and concealed switches; knock sensors; climate control components; speed controls; timers; pressure switches; water valves; range controls; thermostats; gas valves; infinite switches; temperature and humidity sensors; transmission valves; speed sensitive steering systems; tone generators and chimes; lighting controls; emission control valves; remote keyless entry systems and remote actuated solenoids.

Specialty Controls – Ion implanters; engineered fasteners; golf grips; industrial clutches and brakes; automated material handling systems; automated guided vehicles and stacker cranes.

The principal markets for these products are industrial, construction, commercial, automotive, appliance, aerospace and government customers. Sales are made directly by the Company or indirectly through distributors and manufacturers' representatives.

Defense Systems

Strategic countermeasures; tactical jamming systems; electronic intelligence; electronic support measures and radar surveillance.

The principal market for these products is the United States Government.

Other Information

Operating profit represents net sales less operating expenses for each segment and geographic region and excludes interest expense and income, and general corporate expenses - net.

Identifiable assets for each segment and geographic region represent those assets used in operations, including excess of cost over net assets of businesses acquired, and exclude general corporate assets, which consist principally of short-term investments, deferred income taxes, investments carried at equity, property and other assets.

Net sales to divisions and subsidiaries of one customer, primarily from the Vehicle Components business segment (in millions), were \$623 in 1994, \$541 in 1993 and \$491 in 1992 (10% of sales in 1994, 12% in 1993 and 1992).

GEOGRAPHIC REGION INFORMATION

	United States	Canada	Europe	Latin America	Pacific Region	Eliminations	Totals
(Millions)							
1994							
Net sales	\$4,807	\$292	\$912	\$298	\$103	\$360	\$6,052
Operating profit	491	30	50	9	14		594
Identifiable assets	3,098	119	636	156	57	86	3,980
1993							
Net sales	\$3,404	\$183	\$769	\$202	\$ 81	\$238	\$4,401
Operating profit	275	21	17	9	10		332
Identifiable assets	1,726	101	548	103	48	60	2,466
1992							
Net sales	\$3,002	\$175	\$861	\$184	\$ 66	\$187	\$4,101
Operating profit	201	20	29	8	6		264
Identifiable assets	1,781	74	630	98	48	59	2,572

Results for 1994 reflect the acquisition of DCBU on January 31, 1994.

Operating profit in 1993 was reduced \$53 million in the United States and \$2 million in Canada by an acquisition integration charge related to the purchase of DCBU, and by a \$9 million charge for streamlining operations in Europe.

Geographic region information (table above) does not include results of associate companies and joint ventures in which the Company holds a 20%-50% ownership interest, which are accounted for by the equity method, and which had total sales as follows:

	United States	Europe	Latin America	Pacific Region	Totals
(Millions)					
1994	\$8	\$15	\$10	\$240	\$273
1993	7	13	15	169	204
1992	6	18	6	136	166

EATON CORPORATION
FINANCIAL REVIEW

BUSINESS SEGMENT INFORMATION

	1994	1993	1992
(Millions)			
<i>Net sales by classes of similar products</i>			
Vehicle Components			
Truck Components	\$1,798	\$1,504	\$1,244
Passenger Car Components	616	524	542
Off-Highway Vehicle Components	414	329	307
	2,828	2,357	2,093
Electrical and Electronic Controls			
Industrial and Commercial Controls	1,812	779	745
Automotive and Appliance Controls	839	735	723
Specialty Controls	437	338	308
	3,088	1,852	1,776
Defense Systems	136	192	232
	\$6,052	\$4,401	\$4,101
<i>Operating profit</i>			
Vehicle Components	\$ 354	\$ 247	\$ 170
Electrical and Electronic Controls			
(1993 reduced by the \$55 million acquisition integration charge)	239	83	85
Defense Systems	1	2	9
	594	332	264
Interest expense	(91)	(75)	(89)
Interest income	7	8	9
General corporate expenses - net	(22)	(3)	(3)
Income before income taxes	\$ 488	\$ 262	\$ 181
<i>Identifiable assets</i>			
Vehicle Components	\$1,359	\$1,230	\$1,194
Electrical and Electronic Controls	2,506	1,119	1,128
Defense Systems	115	117	250
	3,980	2,466	2,572
General corporate assets	702	802	648
Total assets	\$4,682	\$3,268	\$3,220
<i>Capital expenditures</i>			
Vehicle Components	\$ 149	\$ 124	\$ 93
Electrical and Electronic Controls	98	68	67
Defense Systems	5	7	14
Corporate	15	28	12
	\$ 267	\$ 227	\$ 186
<i>Depreciation and amortization</i>			
Vehicle Components	\$ 110	\$ 101	\$ 104
Electrical and Electronic Controls	114	69	71
Defense Systems	14	15	16
Corporate	13	11	9
	\$ 251	\$ 196	\$ 200

Results for 1994 reflect the acquisition of DCBU on January 31, 1994

Operating profit of the Electrical and Electronic Controls segment in 1993 was reduced by a \$55 million acquisition integration charge related to the purchase of DCBU. Operating profit of the Vehicle Components segment in 1993 was reduced by a \$9 million charge for streamlining certain vehicle components operations in Europe.

OVERVIEW

Strong sales in 1994 resulted in the Company reporting the highest net sales, net income and net income per Common Share in its history. The strength of the year was underscored by the results of each quarter in 1994 which represented the best in the Company's history.

On January 31, 1994, the Company purchased the Distribution and Control Business Unit (DCBU) from Westinghouse Electric Corporation, the largest acquisition in the Company's history. This acquisition, as discussed under "Acquisitions and Divestitures of Businesses" in the Financial Review, substantially bolstered the prospects for the Electrical and Electronic Controls segment by providing greater product depth with world class technology and by increasing product offering and distribution opportunities. This acquisition improves the balance of sales and earnings between the Electrical and Electronic Controls segment and the historically strong Vehicle Components segment.

The strong sales increase was broadly based with record sales achieved in both the Vehicle Components and the Electrical and Electronic Controls segments. Each product class of these segments experienced double-digit growth in 1994 as compared to 1993. Net income for the year rose to \$333 million in 1994. This represents a 92% increase compared to net income of \$173 million in 1993 which was reduced by a \$34 million after tax acquisition integration charge related to the purchase of DCBU and a \$7 million extraordinary loss on the redemption of debentures. Net income per Common Share increased to \$4.40 in 1994, a 78% increase over \$2.47 (after the charges noted above) in 1993. Net income per Common Share increased by a lesser percentage than net income due to an additional 6.7 million Common Shares outstanding at year-end 1994.

1994 COMPARED TO 1993

Net Sales

Net sales for 1994 increased 38% to \$6.1 billion from \$4.4 billion in 1993. The increase in sales was a reflection of the contributions of acquired businesses, as well as the improvement in North American transportation and capital goods markets. The Company expects that in 1995 the North American economy will continue to favor transportation and capital goods markets.

Sales improvements were also recorded by virtually all of the Company's operations outside the United States due in part to export of products to meet North American market demands. The economic recovery that began in the United Kingdom in the past year spread to the European continent as additional market strength was evident in Germany, France, Italy and other continental countries as indicated by the 19% sales increase in Europe over 1993. Expectations are that the Company's European businesses will continue to benefit as the recovery continues. The purchase of DCBU also expanded the Company's presence in Latin America. The combination of this acquisition and the growth in existing operations resulted in a 48% sales increase in Latin America over 1993.

The Vehicle Components segment continued to experience significant growth as net sales increased to \$2.8 billion for 1994, rising 20% over 1993's net sales of \$2.4 billion. Although the increase in sales was driven by unprecedented levels of production of heavy trucks in North America, each product class in this segment reported an increase in excess of 17% in 1994 as compared to 1993. The heavy truck market set industry records, with North American factory sales of 226,000 units, a 7% increase over the previous record levels of 1979 and a 21% increase over 1993. Order backlogs for heavy trucks reached an all time high of 212,000 units at year-end 1994.

Vehicle Components segment sales also reflect higher sales of components for sport utility vehicles, minivans and light trucks which markets showed a 20% increase in North American factory sales in 1994 over 1993. 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 in 1994 increased substantially over 1993 as the Company benefited from the 5% increase in factory sales of passenger cars in North America and also from improved market penetration. Additionally, sales of Off-Highway Vehicle Components showed marked improvement throughout the year as a result of strong demand for hydraulic components from agricultural, construction and industrial markets worldwide.

The positive outlook for the continued growth of the Vehicle Component product lines is based on increased use of heavy trucks in support of domestic manufacturing, consumer preference for minivans, light trucks and sport utility vehicles, increased production of multi-valve automobile engines, and strength of the construction and agricultural markets.

The Electrical and Electronic Controls segment's net sales in 1994 rose to \$3.1 billion, a 67% increase over 1993 net sales of \$1.9 billion. This segment now represents more than one-half of total sales. The DCBU acquisition was the principal cause for the increase in the Industrial and Commercial Controls product class, where sales more than doubled compared to 1993. Each of the remaining product classes in this segment reported an increase in excess of 14% in 1994 as compared to 1993. These increases were a reflection of strong growth experienced in the industrial, residential and commercial markets served by this segment.

Automotive and Appliance Controls sales in 1994 increased significantly over 1993 due to improved conditions in the passenger car and light truck markets served by the Company. The current strength of the North American household appliances market in comparison to previous years and positioning with appliance manufacturers also benefited the Company. Robust sales of semiconductor equipment, included in Specialty Controls, also contributed significantly to the 1994 sales increase for this segment. Sales have risen sharply over the past two years due to increased market penetration and worldwide demand for semiconductor equipment. Market leadership permitted the Company to benefit substantially from the industry's growth to the extent that order backlogs for ion implanters are at record levels. To meet this continuing demand, a new medium current ion implanter manufacturing

facility will be built in Austin, Texas in 1995. A new high energy ion implantation system was introduced in mid-year 1994, and market response, particularly in the Far East, exceeded expectations.

Several factors raise expectations for continuing growth in the Electrical and Electronic Controls product lines, including broad demand for technologically advanced controls for industrial and commercial markets, ongoing strength of the United States economy, high level of capacity utilization across many industries, recovering markets in Europe and new market initiatives in the Far East.

Operating Results

Income from operations increased 77% to \$560 million in 1994 over \$317 million in 1993, which was reduced by a \$55 million acquisition integration charge before income tax credits related to the purchase of DCBU. This increase reflects the higher level of sales described above, including the contributions of acquired businesses, results of continuous improvement initiatives and inventory controls, efforts to maintain and improve efficiency and productivity in the face of greatly increased marketplace demand, and benefits of recent capacity and workforce rationalizations.

Operating profit for the Vehicle Components segment was strong, rising 43% to \$354 million (13% of sales) in 1994 over \$247 million (10% of sales) in 1993. Increased profits were attributable largely to improved sales levels and also were a reflection of continuing stringent cost containment efforts as well as economies achieved through organizational rationalizations of certain businesses which better positioned operations to benefit from further growth and market opportunities in global vehicle markets. In 1993, operating profit was reduced by \$9 million as a result of streamlining certain Vehicle Components operations in Europe.

Operating profit for the Electrical and Electronic Controls segment significantly improved, rising 73% to \$239 million (8% of sales) from \$138 million (7% of sales) in 1993, before the effect of the \$55 million acquisition integration charge. The improvement in profits resulted from higher sales volumes, including contributions from acquired businesses, emphasis placed on containing and controlling costs and realization of benefits of earlier resizings.

Interest expense of \$91 million in 1994 increased from \$75 million in 1993. This increase was primarily caused by a higher average borrowing level due to the issuance of \$716 million of debt in 1994 to partially finance the acquisition of DCBU.

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

CHANGES IN FINANCIAL CONDITION

The Company's financial condition remained strong during 1994. Net working capital increased to \$744 million at year-end 1994 from \$679 million at year-end 1993, with a slight decrement in the current ratio to 1.7 from 1.9 at those dates, respectively.

The reduction of \$245 million in short-term investments at December 31, 1994 from the end of 1993 was primarily the result of the liquidation of \$170 million to partially fund the acquisition of DCBU. Additionally, the Company redeemed \$89 million of 8.5% debentures through the issuance of 1.3 million Common Shares in December 1993 for aggregate net proceeds of \$62 million and 800,000 Common Shares in January 1994 for aggregate net proceeds of \$38 million.

Accounts receivable increased by \$339 million at December 31, 1994 from the end of 1993 largely due to the acquisition of DCBU and increased sales levels. The acquisition of DCBU was also the principal cause of the substantial increases in inventories, deferred income taxes, property, plant and equipment, excess of cost over net assets of businesses acquired, other assets, and current and long-term liabilities at December 31, 1994 compared to the end of 1993.

Total debt, consisting of short-term, long-term and current portion of long-term debt, increased to \$1.1 billion at December 31, 1994 from the end of 1993, primarily due to debt issued to finance the acquisition of DCBU. The increase in total debt in 1994 was net of the redemption in January 1994 of \$89 million of 8.5% debentures. Throughout the year, cash provided by operating activities was partially used to repay debt related to business acquisitions.

As previously discussed, through a private placement, the Company sold 800,000 Common Shares in January 1994 for \$38 million. Beginning in April 1995, the holder of these shares has the right to require the Company to register the shares for public sale under the Federal securities law. The Company sold 3.8 million Common Shares to the public in March 1994 for aggregate net proceeds of \$214 million. In November 1994, the Company issued 1.6 million Common Shares, which are being registered under the Federal securities laws, in the pooling-of-interests with Lectron Products, Inc.

Capital expenditures for 1994 were a record \$267 million compared with \$227 million in 1993, reflecting the Company's ongoing investment program under long-range goals to achieve improvements in product quality, manufacturing productivity and business growth. Capital spending in 1995 is anticipated to be another all-time record in order to enable the Company to enhance product quality through technology improvements, to keep pace with the strength of orders in virtually all product lines, and to achieve long-term growth prospects.

Net cash provided by operating activities reached a record \$522 million in 1994 compared with \$435 million in 1993 and \$381 million in 1992. The improvement in cash flow from increased net income and other items exceeded cash requirements to satisfy increased working capital demands, primarily the substantial increase in accounts receivable. Net

cash provided by operating activities, supplemented by liquidation of short-term investments, funding from unsecured notes and other borrowings, proceeds from the sale of businesses and the issuance of Common Shares were used to fund business acquisitions, capital expenditures, cash dividends and repayment of debt.

As a result of the sale of the Common Shares, notes and debentures, as well as cash flow from operations, the Company canceled a \$555 million 364-day revolving credit agreement and \$255 million of a \$555 million five-year revolving credit agreement which had been entered into in January 1994 to provide interim financing for the acquisition of DCBU. The Company is maintaining the strength of the balance sheet and has now restored it to pre-acquisition standards in less than a year with the debt to capital ratio again below 40%. The Company believes capital resources available in the form of working capital on-hand, lines of credit and funds provided by operations will more than adequately meet anticipated requirements for capital expenditures and business expansion through niche acquisitions.

The combination of DCBU with the Company's Industrial Controls and Power Distribution Operations (ICPDO) strengthened the competitive position in the Electrical and Electronic Controls segment and will provide the opportunity for significant cost savings resulting from the complementary fit of the two businesses. Substantial efficiencies are beginning to be experienced due to the combination of the two operations. The Company has a comprehensive integration plan which is focused on rationalization of product lines and manufacturing operations, integration of sales and distribution functions and reduction of administrative expenses. The plan includes plant closures over the next few years to eliminate over-capacity. To date, the Company has closed and/or announced the closure of twenty-three facilities. The Company has also sold four facilities as a result of divestiture activities. It has also begun the relocation of several product lines as a result of the rationalization plan. The cost of the consolidation program for ICPDO locations was included in the 1993 \$55 million acquisition integration charge. To date, expenditures and charges total \$20 million with the remaining \$35 million expected to occur primarily over the next three years. Remaining expenditures will be funded through cash flow from combined operations. For actions related to the acquired locations, such costs have been considered in the allocation of the purchase price.

In the normal course of business, the Company is exposed to various financial risks including interest and foreign exchange rates. The Company has developed systems to continuously measure exposures to assure that exposures are evaluated comprehensively so that appropriate and timely action can be taken to reduce risk, if necessary. Monitoring of exposures and the evaluation of risks includes approval of derivative activities on a discrete basis by senior management. Oversight and review is performed monthly by senior management. In order to minimize the impact of potential defaults, the Company specifically limits counterparty credit exposure to prudent dollar limits. The Company's derivative activities are described in greater detail under "Debt and Other Financial Instruments" in the Financial Review

To reflect current market conditions, the discount rate used to measure the projected benefit obligations for pensions and postretirement benefits other than pensions was increased to 8.50% from 7.25%. This change had the effect of decreasing the accumulated pension benefit obligation by \$140 million with an offsetting increase in the unamortized net gain. The changes in assumed rates for postretirement benefits other than pensions had the effect of decreasing the accumulated postretirement benefit obligation which offset changes in other plan provisions. The effect of the change in the discount rates on future expense for pensions and postretirement benefits other than pensions will not be material.

At December 31, 1994 and 1993, the Company had net deferred income tax assets included in current and long-term assets. Management believes it is more likely than not that these tax benefits will be realized through the reduction of future taxable income. Significant factors considered by management in determination of the probability of realization of deferred tax assets include historical operating results of the Company, expectations of future earnings and the extended period of time over which the postretirement health care liability will be paid.

The Company has manufacturing operations in Mexico, none of which are significant to overall operations. The recent devaluation of the Peso in Mexico had an immaterial adverse effect on the Company's financial position and results of operations. The Company will continue to monitor the economic situation in Mexico.

Operations of the Company involve the use, disposal and clean-up of certain substances regulated under environmental protection laws, as further discussed under "Protection of the Environment" in the Financial Review. Subject to the difficulty in estimating future environmental costs, the Company expects that any sum it may have to pay in connection with environmental matters in excess of the amounts recorded or disclosed will not have a material adverse effect on financial condition.

To enhance shareholder value and to avoid dilution of earnings per share resulting from the exercise of stock options by employees, the Company's Board of Directors authorized the purchase of up to five million Common Shares. Under the Board's authorization, the Company may purchase the shares over a five year period; however, only a maximum of 1.5 million shares can be purchased in any one year.

1993 COMPARED TO 1992

Net Sales

Net sales for 1993 increased by 7% to \$4.4 billion from \$4.1 billion in 1992. The increase occurred principally in the United States and was largely due to a strengthened North American market for heavy and light trucks, vans and sport utility vehicles, responding to a United States economic recovery. The improvement in North America more than offset effects of the continued deep European recession. In North America, certain markets, which had been sluggish through most of 1993, showed sales improvements in the fourth quarter.

Vehicle Components segment net sales increased to \$2.4 billion for 1993, rising 13% over 1992 sales of \$2.1 billion. The improvement was largely due to significant growth in sales of truck components, following the best year for factory sales of heavy trucks in North America since 1979. Passenger car and light truck markets also showed improvement in 1993. Off-highway equipment markets, which had been down for several years, improved considerably. Strong sales growth in North America was partially offset by reduced sales in Europe where vehicle markets remain weak.

The Electrical and Electronic Controls segment showed a net sales increase of 4% in 1993 to \$1.9 billion compared to \$1.8 billion in 1992. The improvement was largely due to increased sales of industrial and commercial controls and specialty controls. Strong North American markets for automotive and appliance controls were largely offset, however, by continued weakness in corresponding European markets due to economic recession and the negative impact of foreign currency exchange rate fluctuations. Rising demand for portable tools, factory equipment and residential housing drove the increase in sales of industrial and commercial controls. Sales of industrial and power distribution equipment, which tend to lag any North American economic recovery, rose sharply in the fourth quarter. The semiconductor equipment business, included in specialty controls, experienced strong results throughout the year, with a 19% improvement in sales for 1993 over 1992.

Operating Results

Income from operations increased 33% to \$317 million in 1993 over \$238 million in 1992. This increase was due to significant sales growth as well as benefits achieved through ongoing cost containment and productivity improvements. This improvement was achieved in spite of a \$55 million acquisition integration charge related to the purchase of DCBU and a \$9 million charge, included in cost of products sold in 1993, for streamlining certain vehicle components operations in Europe.

The Vehicle Components segment operating profit rose to \$247 million (10% of sales) for 1993, a substantial improvement over \$170 million (8% of sales) for 1992 despite a \$9 million charge recorded in 1993 for streamlining certain European operations. The improvement was largely a result of improved markets in North America for heavy and light trucks, vans and sport utility vehicles. Other factors contributing to increased profits were continuing stringent cost containment efforts and economies achieved through capacity and workforce rationalizations of certain businesses, which better positioned operations to benefit from further growth in vehicle markets.

The Electrical and Electronic Controls segment operating profit significantly improved, before the effect of the \$55 million acquisition integration charge, rising 62% to \$138 million in 1993 (7% of sales) from \$85 million (5% of sales) in 1992. The improved segment profit picture was partially due to sales growth experienced in certain controls markets, but was also a clear reflection of continuing emphasis placed on containing and controlling costs and realization of anticipated benefits of earlier capacity and workforce rationalization efforts. The depressed European economy negatively impacted controls businesses, particularly automotive and appliance controls. Profit for this segment was reduced by a \$55 million pretax charge recorded in December 1993 for integration of ICPDO product lines and operations with DCBU to form the new Cutler-Hammer business unit.

Interest expense declined to \$75 million for 1993, the lowest level since 1986, from \$89 million for 1992 largely due to the reduction of higher interest rate debt, lower debt levels during 1993 and increased capitalized interest.

Other income – net was \$12 million in 1993, down from \$23 million in 1992, largely due to the \$11 million pretax gain on the sale of an interest in a limited partnership in 1992.

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

In 1992, new accounting standards for postretirement benefits other than pensions and for income taxes were adopted, which together reduced net income by \$268 million due to the recognition of the cumulative effect for prior years.

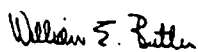
We have prepared the accompanying consolidated financial statements and related information included herein for each of the three years in the period ended December 31, 1994. The primary responsibility for the integrity of the financial information included in this annual report rests with management. Such information was prepared in accordance with generally accepted accounting principles appropriate in the circumstances, based on our best estimates and judgments and giving due consideration to materiality. The opinion of Ernst & Young LLP, the Company's independent auditors, on those financial statements is included herein.

Eaton maintains internal accounting control systems which provide reasonable assurance that assets are safeguarded from loss or unauthorized use and which produce reliable accounting records for preparation of financial information. There are limits inherent in all systems of internal accounting control based on the recognition that the cost of such systems should not exceed the benefits to be derived. We believe the Company's systems provide this appropriate balance.

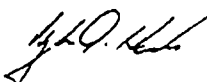
The systems and controls and compliance therewith are reviewed by an extensive program of internal audits and by our independent auditors. Their activities are coordinated to obtain maximum audit coverage with a minimum of duplicate effort and cost. The independent auditors receive copies of all reports issued by the internal auditors at the same time they are released to management and have access to all internal audit work papers.

The Company maintains high standards when selecting, training and developing personnel, to ensure that management's objectives of maintaining strong, effective internal accounting controls and unbiased, uniform reporting standards are attained. We believe our policies and procedures provide reasonable assurance that operations are conducted in conformity with law and with our Company's commitment to a high standard of business conduct.

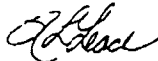
The Board of Directors pursues its responsibility for the quality of the Company's financial reporting primarily through its Audit Committee which is composed of four outside directors. The Audit Committee meets regularly with management, the internal auditors and independent auditors to ensure that they are meeting their responsibilities and to discuss matters concerning internal accounting control systems, accounting and financial reporting. The internal auditors and independent auditors have full and free access to senior management and the Audit Committee.



William E. Butler
Chairman and Chief
Executive Officer



Stephen R. Hardis
Vice Chairman and
Chief Financial and
Administrative Officer



Ronald L. Leach
Vice President -
Accounting

January 27, 1995

*To the Shareholders
Eaton Corporation*

We have audited the consolidated balance sheets of Eaton Corporation as of December 31, 1994 and 1993, and the related statements of consolidated income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1994, appearing on pages 20 to 32. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of Eaton Corporation at December 31, 1994 and 1993, and the consolidated results of its operations and its cash flows for each of the three years in the period ended December 31, 1994 in conformity with generally accepted accounting principles.

As described under "Accounting Changes" on page 25 in the Financial Review, in 1992 the Company changed its methods of accounting for postretirement benefits other than pensions and for income taxes.

Ernst & Young LLP

Cleveland, Ohio
January 27, 1995

EATON CORPORATION

FIVE-YEAR CONSOLIDATED FINANCIAL SUMMARY

<i>For the year</i>	<i>1994</i>	<i>1993</i>	<i>1992</i>	<i>1991</i>	<i>1990</i>
(Millions except for per share data)					
Net sales	\$6,052	\$4,401	\$4,101	\$3,659	\$4,083
Income before extraordinary item and cumulative effect of accounting changes	333	180	140	74	179
Extraordinary item		(7)			
Cumulative effect of accounting changes					
Postretirement benefits other than pensions			(274)		
Income taxes			6		
Net income (loss)	333	173	(128)	74	179
Per Common Share					
Income before extraordinary item and cumulative effect of accounting changes	\$ 4.40	\$ 2.57	\$ 2.03	\$ 1.09	\$ 2.53
Extraordinary item		(.10)			
Cumulative effect of accounting changes					
Postretirement benefits other than pensions			(3.97)		
Income taxes			.09		
Net income (loss)	4.40	2.47	(1.85)	1.09	2.53
Cash dividends paid	1.20	1.15	1.10	1.10	1.05
At the year-end					
Total assets	\$4,682	\$3,268	\$3,220	\$3,184	\$3,140
Long-term debt	1,053	649	833	795	755
Total debt	1,089	773	882	927	815
Shareholders' equity	1,680	1,105	948	1,153	1,140

Results for 1994 reflect the acquisition of DCBU on January 31, 1994.

Income in 1993 was reduced by a \$55 million acquisition integration charge related to the purchase of DCBU (\$34 million after income tax credits, or \$.49 per Common Share).

Income in 1993 was reduced by an extraordinary loss of \$11 million for the redemption of debentures (\$7 million after income tax credits, or \$.10 per Common Share).

Income in 1991 was reduced by a restructuring charge of \$39 million (\$25 million after income tax credits, or \$.38 per Common Share).

CORPORATE OFFICERS

SENIOR MANAGEMENT COUNCIL

WILLIAM E. BUTLER
Chairman and
Chief Executive Officer

JOHN S. RODEWIG
President
Chief Operating Officer -
Vehicle Components

STEPHEN R. HARDIS
Vice Chairman and Chief Financial
and Administrative Officer

ALEXANDER M. CUTLER
Executive Vice President
Chief Operating Officer - Controls

GERALD L. GHERLEIN
Executive Vice President
and General Counsel

STAFF OFFICERS

JOHN M. CARMONT
Vice President and Treasurer

SUSAN J. COOK
Vice President - Human Resources

ADRIAN T. DILLON
Vice President - Planning

PATRICK X. DONOVAN
Vice President - International

JOHN D. EVANS
Vice President

EARL R. FRANKLIN
Secretary and Associate
General Counsel

JOHN W. HUSHEN
Vice President - Corporate Affairs

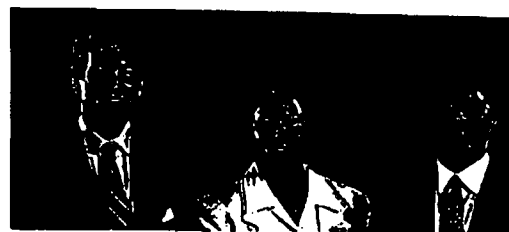
STANLEY V. JASKOLSKI
Vice President -
Technical Management

RONALD L. LEACH
Vice President - Accounting

WILLIAM T. MUIR
Vice President -
Manufacturing Technologies

DEREK R. MUMFORD
Vice President -
Information Technologies

BILLIE K. RAWOT
Vice President and Controller



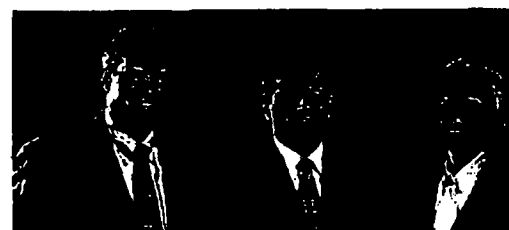
John M. Carmont Susan J. Cook Adrian T. Dillon



Patrick X. Donovan John D. Evans Earl R. Franklin



John W. Hushen Stanley V. Jaskolski Ronald L. Leach



William T. Muir Derek R. Mumford Billie K. Rawot

APPOINTED VICE PRESIDENTS

JOSEPH L. BECHERER
Vice President -
Operations/Cutler-Hammer

ALAN E. BEST
Vice President - Truck Components
Operations/North America

THOMAS W. CHISHOLM
Vice President -
Automotive Marketing

ANTE LUIIC
Vice President -
Automotive & Appliance Controls
Operations/Europe

ROBERT J. MCCLOSKEY
Vice President - Hydraulics &
General Products Operations

THOMAS W. O'BOYLE
Vice President - Truck Components
Operations/Worldwide

LARRY M. OMAN
Vice President - Engine Components
Operations/Worldwide

RANDALL R. PHILLIPS
Vice President -
Automotive & Appliance Controls
Operations/Worldwide

SAMUEL K. SCOVIL
Vice President -
Commercial & Military Controls
Operations/Worldwide

JERALD J. THEDER
Vice President -
Integration/Cutler-Hammer

JOAQUIN J. ZUZA
Vice President -
Truck Components Operations/Europe



DIRECTORS

Front row, from left

JOHN S. RODEWIG
President, Chief Operating Officer –
Vehicle Components, Eaton Corporation

WILLIAM E. BUTLER
Chairman and Chief Executive
Officer, Eaton Corporation

ALEXANDER M. CUTLER
Executive Vice President,
Chief Operating Officer – Controls,
Eaton Corporation

STEPHEN R. HARDIS
Vice Chairman and Chief Financial and
Administrative Officer, Eaton Corporation

Back row, from left

JOHN R. MILLER
President and Chief Executive Officer,
TBN Holdings Inc., Cleveland, Ohio,
an environmental company engaged
primarily in the resource recovery
and recycling business

A. WILLIAM REYNOLDS
Chairman, GenCorp Inc., Fairlawn,
Ohio, a technology-based company
with positions in aerospace, automo-
tive and polymer products

GARY L. TOOKER
Vice Chairman and Chief Executive
Officer, Motorola, Inc., a manufacturer
of electronics equipment

VICTOR A. PELSON
Executive Vice President and Chairman
of the Global Operations Team, AT&T,
providers of telecommunications

FURMAN C. MOSELEY
President, Simpson Investment
Company, holding company for
Simpson Paper Company and Simpson
Timber Company, all of Seattle,
Washington

CHARLES E. HUGEL
Former Chairman and Chief Executive
Officer, Combustion Engineering, Inc.,
Stamford, Connecticut, providers of
products and services for the power,
process, automation, environmental
control and other markets

HOOPER G. PATTILLO
Chairman of the Board and President,
Pattillo Construction Company, Inc.,
Decatur, Georgia, an industrial con-
struction and development company

NEIL A. ARMSTRONG
Former Chairman of Computing
Technologies for Aviation, Inc.,
Charlottesville, Virginia, a
computer systems company

PHYLLIS B. DAVIS
Former Senior Vice President,
Corporate Affairs, Avon Products, Inc.,
New York, a manufacturer and marketer
of cosmetics, toiletries and jewelry

COMMITTEES OF THE BOARD

EXECUTIVE COMMITTEE

Mr. Butler, as Chairman of the
Board's Executive Committee, serves
for the full 12-month term. Each of
the non-employee directors serves a
four-month term.

AUDIT COMMITTEE

Hooper G. Pattillo – Chairman
Phyllis B. Davis
Charles E. Hugel
A. William Reynolds

COMPENSATION COMMITTEE

Neil A. Armstrong – Chairman
Charles E. Hugel
John R. Miller
Furman C. Moseley
Victor A. Pelson

FINANCE COMMITTEE

Furman C. Moseley – Chairman
Neil A. Armstrong
Stephen R. Hardis
John R. Miller
Gary L. Tooker

ORGANIZATION AND NOMINATING COMMITTEE

Neil A. Armstrong – Chairman
William E. Butler
Charles E. Hugel
John R. Miller
Furman C. Moseley
Victor A. Pelson

PENSION REVIEW COMMITTEE

A. William Reynolds – Chairman
Phyllis B. Davis
Charles E. Hugel
Hooper G. Pattillo
Gary L. Tooker

SHAREHOLDER INFORMATION

ADDRESS

Eaton Corporation, Eaton Center
Cleveland, Ohio 44114-2584
216-523-5000

ANNUAL MEETING

The company's 1995 annual meeting of shareholders will be held at 10:30 a.m., local time, on Wednesday, April 26, 1995, at The Forum Conference and Education Center located within One Cleveland Center, 1375 East Ninth Street, Cleveland, Ohio 44114. Formal notice of the meeting, a proxy statement and proxy form will be mailed to each shareholder on or about March 16, 1995.

FORM 10-K REPORT

Any shareholder may, upon written request to the Office of the Secretary, obtain without charge a copy of Eaton's Form 10-K Report for 1994 as filed with the Securities and Exchange Commission. The report will be available after March 31, 1995.

COMMON SHARES

Listed for trading: New York, Chicago, Pacific and London stock exchanges
(Ticker Symbol: ETN)

TRANSFER AGENT, REGISTRAR, DIVIDEND DISBURSING AGENT AND DIVIDEND REINVESTMENT AGENT:

KeyCorp Shareholder Services, Inc.
P.O. Box 6477
Cleveland, Ohio 44101-1477
1-800-542-7792

DIVIDEND REINVESTMENT PLAN

A dividend reinvestment plan is available at no charge to record holders of Eaton common shares. Through the plan, record holders may buy additional shares by reinvesting their cash dividends or investing additional cash up to \$60,000 per year. Interested shareholders of record should contact KeyCorp Shareholder Services, Inc., above.

DIRECT DEPOSIT OF DIVIDENDS

Shareholders of record may have their dividends direct deposited to their bank accounts. Interested shareholders of record should contact KeyCorp Shareholder Services, Inc., above.

CHARITABLE CONTRIBUTIONS

A report of Eaton's charitable contributions is available upon written request to the Office of Community Affairs at the Eaton Corporation address shown above.

Trademarks of Eaton Corporation mentioned in this annual report include Eaton, AirFlex, AutoSelect, AutoShift, Customer Delight, Cutler Hammer, Digirip, ES, Freedom Series, Golf Pride, IMPACC, IQ Analyzer, Lecton, NV GSD III, PowerMate, Powerlonger, S Series

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