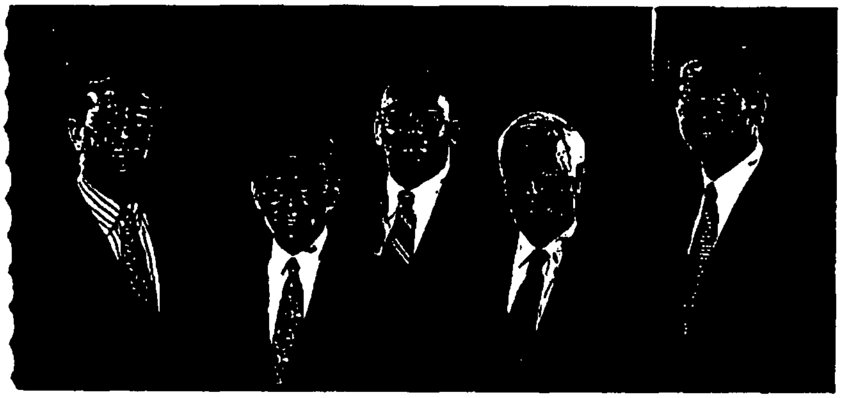

Eaton's Senior Management Council includes, from left, William E. Butler, chairman and chief executive officer; Stephen R. Hardis, vice chairman and chief financial and administrative officer; Gerald L. Gherlein, executive vice president and general counsel; John S. Rodewig, president, chief operating 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