

The Riley Company

ANNUAL REPORT FOR THE
YEAR ENDED JUNE 30, 1977

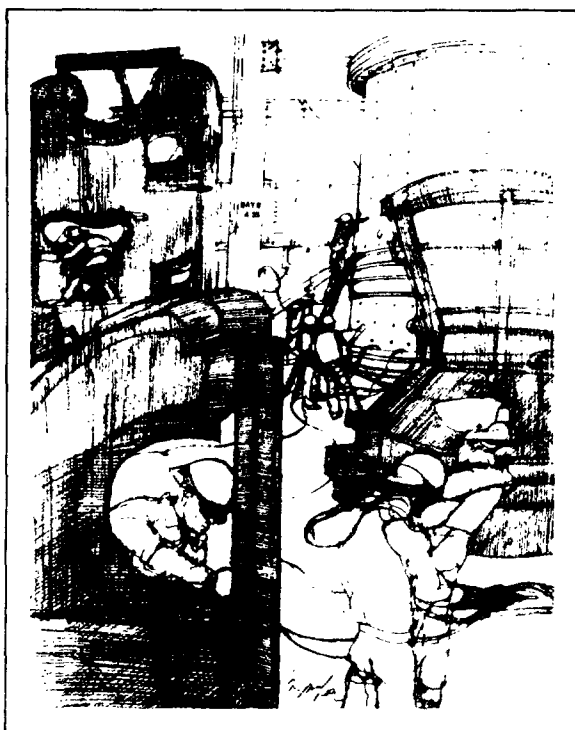
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My father

Financial Highlights

	Year Ended June 30	1977	1976	1975
Sales and contract revenues		\$242,726,899	\$210,153,452	\$188,373,910
Net income for the year		\$ 6,927,360	\$ 4,924,103	\$ 2,779,222
Net income per share		\$ 4.50	\$ 3.22	\$ 1.82
Average shares outstanding		1,510,199	1,513,392	1,515,357
Shares outstanding at June 30		1,511,273	1,508,783	1,515,357
Stockholders' investment		\$ 39,962,553	\$ 33,146,199	\$ 28,377,524
Stockholders' investment per share outstanding at year end		\$ 26.44	\$ 21.97	\$ 18.73
Working capital		\$ 29,633,088	\$ 25,341,796	\$ 20,373,805
Current ratio		1.2	1.3	1.4
Total backlog		\$372,000,000	\$416,000,000	\$329,000,000



The Front Cover

Skilled welders at work in The Riley Company's 700,000 square-foot Riley-Beaird facility in Shreveport, La., one of the largest and most modern metal fabrication and machining plants in the country where steel up to 17 inches thick is formed into cylinders. Products visible include the main drum of one of Riley's new ball tube mill pulverizers (rear), a gas turbine cylinder housing (right) and (left) the first compressor casings, among the largest in the world, ever fabricated from steel plate.

The Riley Company manufactures steam generators and associated equipment; exhaust scrubbers and other emission control systems; high pressure process vessels; fractionating towers and reactors for hydrocarbon processing; Maxim[®] industrial silencing, desalination and crude oil distillate equipment; instruments that monitor and control manufacturing processes and pipeline flows; control valves and regulators, and data accumulation and communications equipment.

Major customers are electric utilities and the petroleum, chemical and petro-chemical industries.

Riley employs 3,450 men and women in the United States, Canada and overseas and operates nine plants with a total manufacturing area of more than 1,400,000 square feet. The Company's stock is traded on the American Stock Exchange.

The Artist

The drawings for the 1977 annual report came from the sketch pad of the Chicago artist, Franklin McMahon. He was commissioned to capture on paper the feel of The Riley Company at work—its people, its products, its plants and laboratories, and typical installations of Riley equipment for utilities and industry.

Franklin McMahon's distinctively styled reportorial drawings have been featured in virtually every national magazine, in book form, and on television. In 1976 he won the George Foster Peabody award for two national television documentaries on the presidential election campaign.

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To Our Stockholders:

We are pleased to report that The Riley Company achieved a new record for sales and contract revenues in the fiscal year ended June 30, 1977, amounting to \$242,726,899, up 15 per cent over prior year's sales of \$210,153,452. Likewise, our net income of \$6,927,360, equal to \$4.50 per share primary, was up 41 per cent over the prior fiscal year, setting a new record high for our company.

A significant contribution to our net income after taxes comes from interest, dividends and realized gains from our investments in marketable securities where we have been investing our available resources. For the year ended June 30, 1977, \$4,987,695 of pre-tax income was realized from this source, equal to \$3,264,267 after taxes and \$2.12 per share. Our total investment portfolio of marketable securities, as of June 30, 1977, amounted to \$65,840,386 at cost; and, as of June 30, the market value of this portfolio exceeded our costs by \$1,546,000.

As a result of our continued policy of retaining the earnings of our company for growth, the stockholder equity in your company amounted to \$39,962,553, up 21 per cent over the prior year, and equal to \$26.44 per share outstanding at year end.

The backlog continues at a very high level even though it has declined 11 per cent to \$372,000,000 as of June 30, 1977. This compares to the record high backlog of \$416,000,000 which we had as of June 30, 1976. The decline resulted from the high level of sales and contract revenue coupled with the negligible amount of new utility boiler contracts awarded in the past fiscal year as a result of the uncertainties of our National Energy Program and the continued existence of excess peak electric generating capacity in the industry.

Our Riley Stoker subsidiary continued to reflect significant losses on

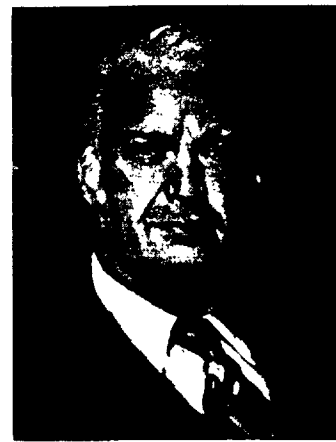
various older utility and industrial contracts which provided for only limited or no escalation. These operating losses in the year ended June 30, 1977, amounted to \$8,301,000, as compared to the \$10,004,000 loss from operations in the prior fiscal year. The completion of many of these older contracts in this past fiscal year causes us to be cautiously optimistic about the results of Riley Stoker in the forthcoming year.

Our Riley-Beaird subsidiary, engaged in the field of metal fabrication, contributed \$10,783,000 income from operations for the fiscal year ended June 30, 1977. The 19 per cent net income from operations contributed by Riley-Beaird on its sales in the fiscal year ended June 30, 1977, represents a significant achievement in a currently more competitive market climate for the types of products produced by Riley-Beaird.

Our Process Instruments Group contributed \$5,127,000 net from operations compared to \$3,905,000 in the prior fiscal year. This improved performance is due to substantial cost reductions of all product lines plus the earnings contribution of the Cashco valve facility relocated to Ellsworth, Kansas, last year.

Your company continues to be in a very liquid cash position. As of June 30, 1977, we had total cash and marketable securities amounting to approximately \$72,000,000. In addition, we have \$21,000,000 available under lines of credit from our banks which do not require any compensating balances, and under which we can borrow at prime rate, should the need for such borrowing arise.

Research and Development expenditures in the year ended June 30, 1977, amounted to a total of \$1,827,329, down from \$2,463,576 in the prior year. We are continuing our develop-



ment work on a marketable coal gasifier, however, at a reduced level of expenditures. In this past year our expenditures on this project dropped to \$344,177, which accounted for the decline in total R & D expenditures between years. With the continued regulation of natural gas prices, the demand for low BTU gas manufactured by coal gasification has not materialized. Therefore, we are continuing this project at a lower level of activity with the expectation of being ready with a marketable coal gasifier when national energy policy makes coal gasification a realistic economic energy alternative. The development work on a diesel fuel distillation unit for on-site direct distillation of diesel fuel in remote areas has been completed by our Riley-Beaird Group and we have commenced marketing this new product.

The progress made in recent years will become more apparent in the coming year. All of our facilities are in superb condition and with the dedication of our talented personnel we shall take every advantage of future opportunities. The moderation of the present economic recovery will put added pressure on margins but, nevertheless, we expect to continue to operate profitably and to grow in the present fiscal year.

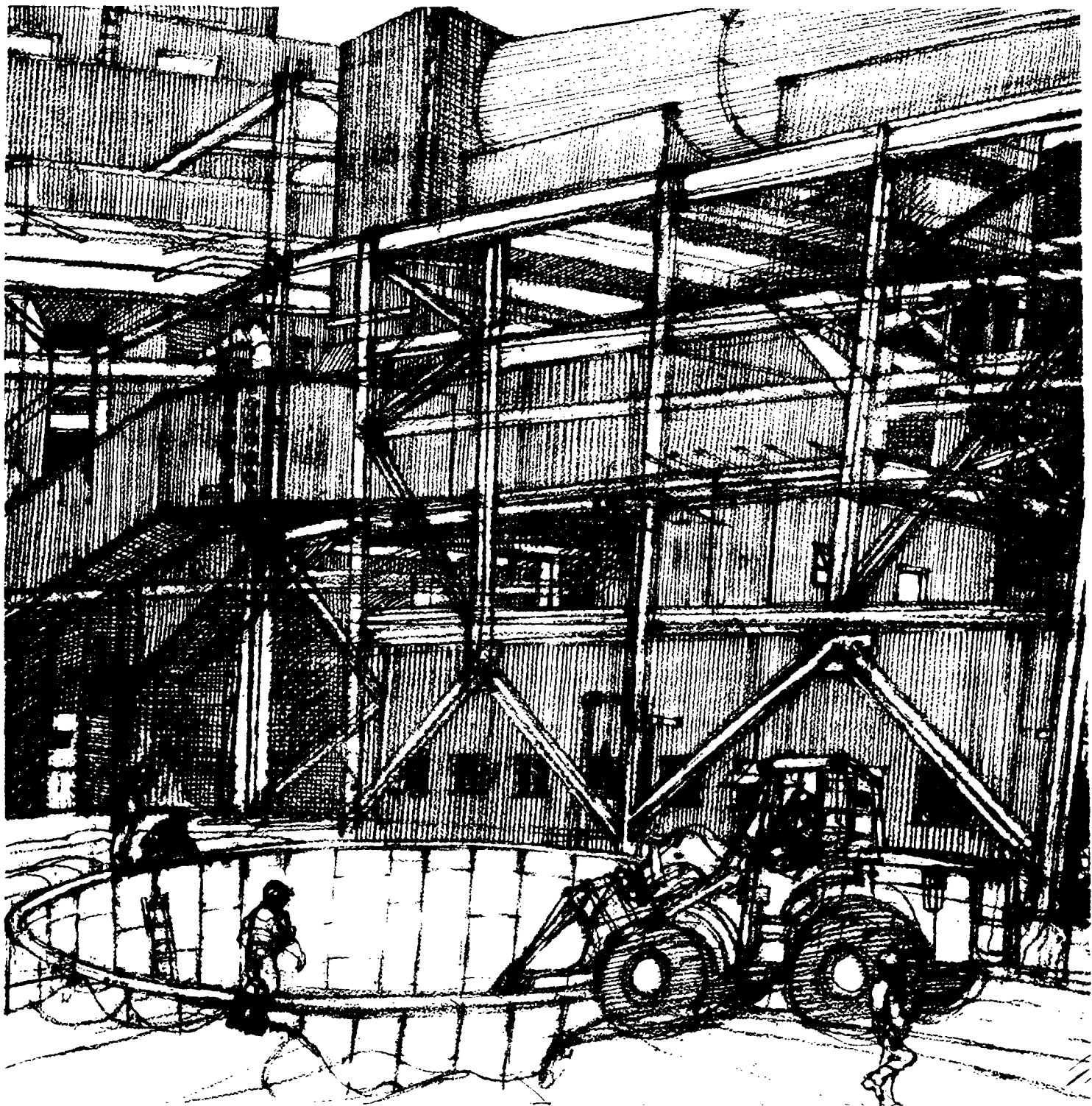
Sincerely,

H. C. Warren

H. C. Warren
Chairman

RS-002637
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August 31, 1977



The Riley-equipped Central Illinois Light Company's Duck Creek station, near Canton, Ill., which has a 400 megawatt Riley steam generating system and an Enviroengineering flue gas scrubbing system. The sulfur dioxide removal system is being installed in modules, the second of which is under construction (foreground). The Riley steam generator serving the station is capable of producing three million pounds of steam per hour.

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Riley Stoker Group

J. J. Farrell, *President*



The Riley Stoker Group major product line consists of steam generating systems for electric utility power plants and systems for process steam supply and steam for electric power generation in industrial plants. The Group designs the systems, manufactures the major components, and erects them at the user's installation site. The cycles on steam generating systems are long, ranging from two years for smaller systems to five years for the larger electric utility units.

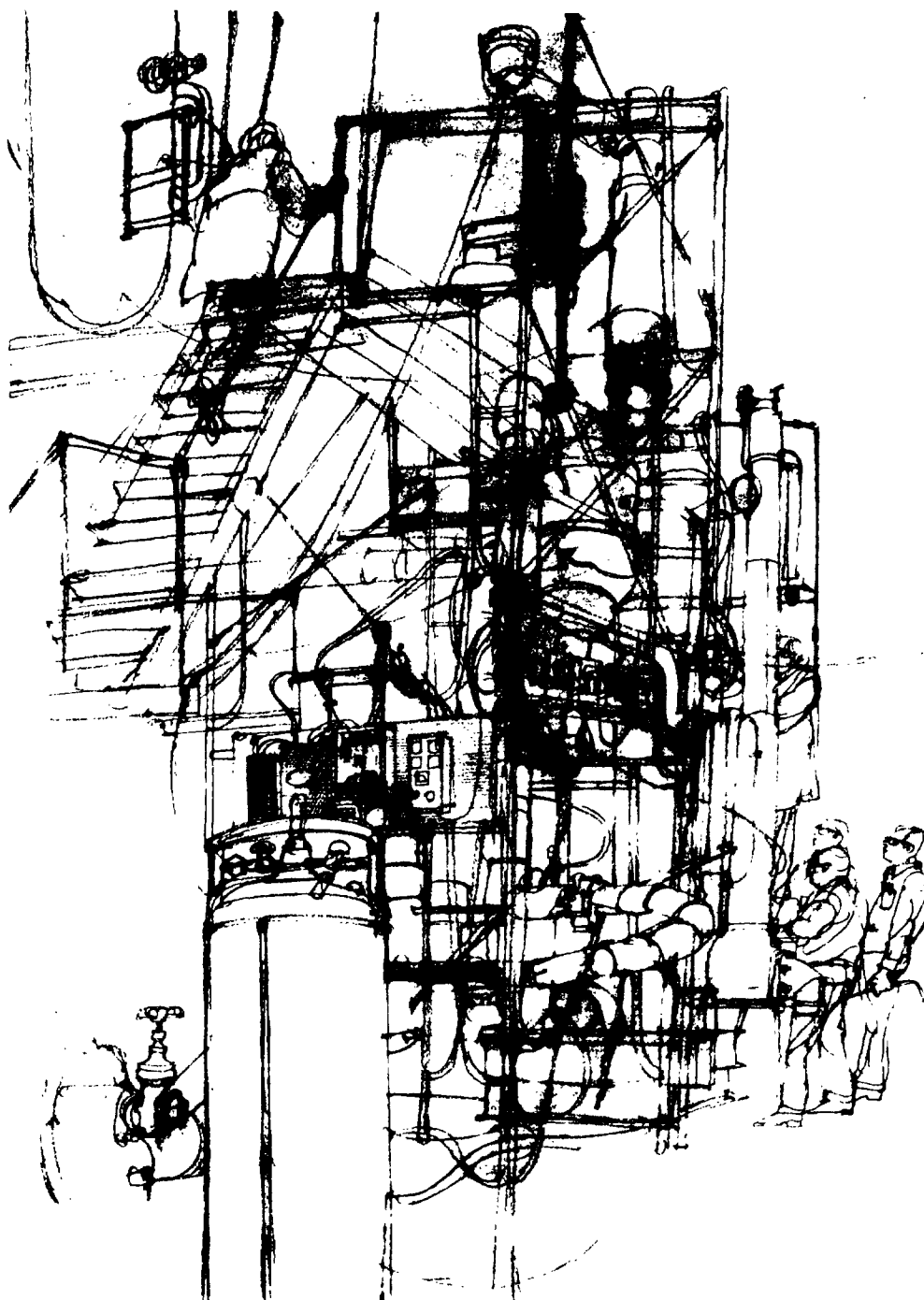
There is a considerable aftermarket associated with steam generating systems. The Group's Maintenance and Repair Division focuses on this aftermarket. The market includes maintenance, repairs and fuel conversion of steam generators and replacement parts. Fuel conversions are a particularly promising market segment, as the country shifts to coal from other fossil fuels. As coal becomes the dominant fossil fuel for new or converted boilers, the replacement parts market will grow at a faster rate than heretofore because of the inherent higher wear on contact parts caused by the use of coal as compared to oil or gas.

The Group, including Environeering, Inc., also participates in the growing market for flue gas desulfurization systems for electric utility and industrial boilers and particulate emission control systems for a wide variety of industrial process effluents.

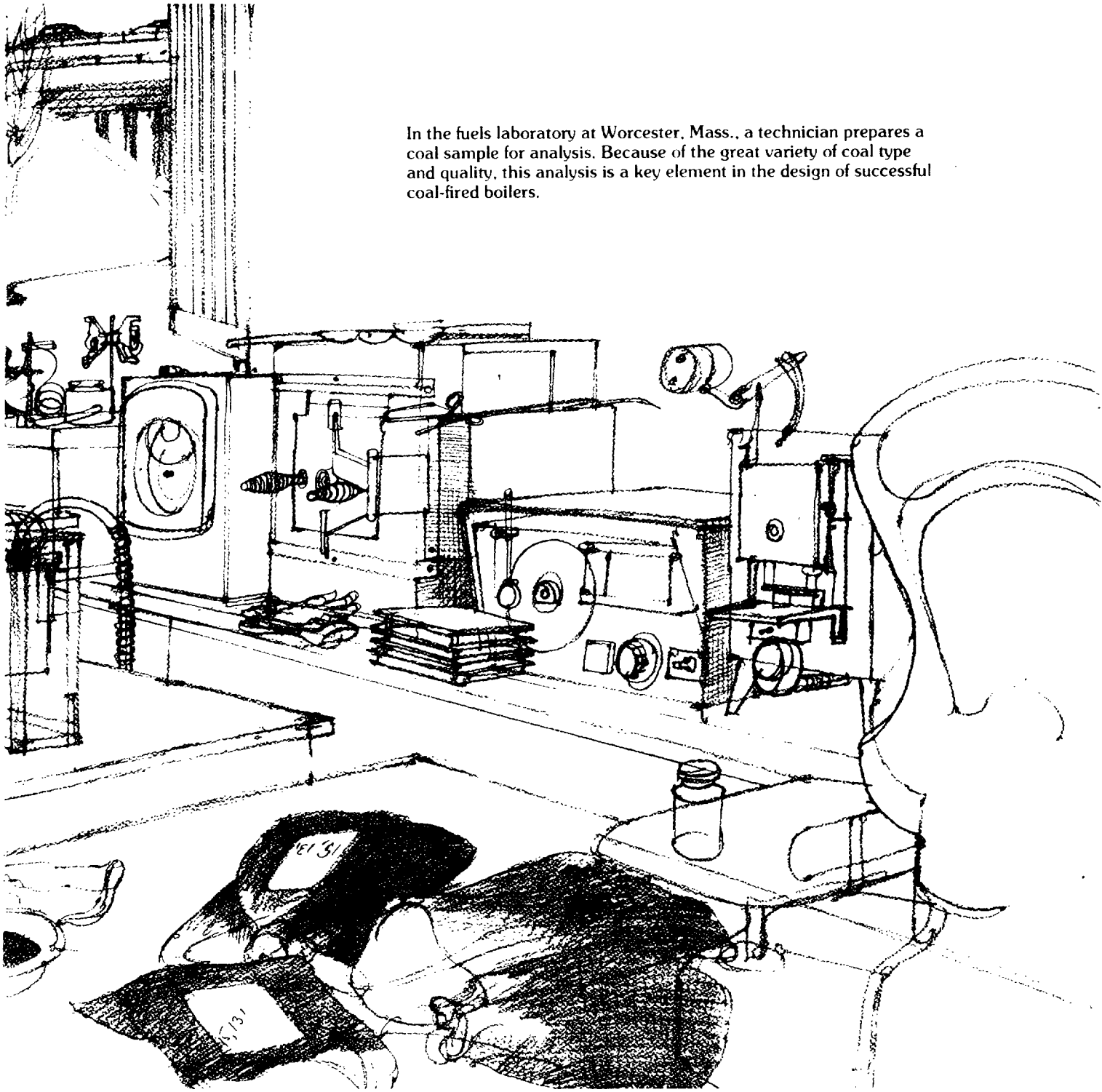
Electrical load growth in calendar year 1976 returned to its historical level of about 7 percent from the depressed years of 1974 and 1975, when load growth totaled only about 2 percent. However, even though load growth in 1976 returned to normal, existing reserve margins caused electric utilities to defer ordering new plants. Consequently, the orders placed for boilers in the last year have been at the lowest level in recent history. From among those few new orders placed during the 1977 fiscal year, the Group was

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1/17/02
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A laboratory development unit for the Riley-Morgan coal gasification process is shown in operation at the Riley Research and Development Center.



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In the fuels laboratory at Worcester, Mass., a technician prepares a coal sample for analysis. Because of the great variety of coal type and quality, this analysis is a key element in the design of successful coal-fired boilers.

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successful in securing an order from a southeastern utility for a 270 MW unit with an initial selling price of about \$25 million, subject to price escalation provisions.

The clear emphasis on coal in our National Energy Program is advantageous to the Group. Without having the drain of technical, human and financial resources for an

increasingly troubled nuclear business, we can concentrate our full effort on the field we know best—coal-burning boilers, either pulverized coal or stoker-fired. Coal-fired steam generators have a greater physical size than equivalent gas or oil-fired boilers and use more Group supplied auxiliary equipment. Therefore, even if the order rate in terms of physical

capacity is down from previous years, the drop is partially offset by the higher dollar content for a coal-fired steam generator system as compared to a gas or oil-fired boiler.

The industrial market was low, too, in fiscal 1977 as buyers of small steam generating systems for industrial application awaited direction from the anticipated National Energy Policy on

fuels and pollution control requirements. Although a clear policy has not yet been established by the Government for this sector, the need to provide steam capacity for expansion of production facilities became pressing and toward the close of the fiscal year orders were placed with the Group for seven major industrial boilers by a number of different customers

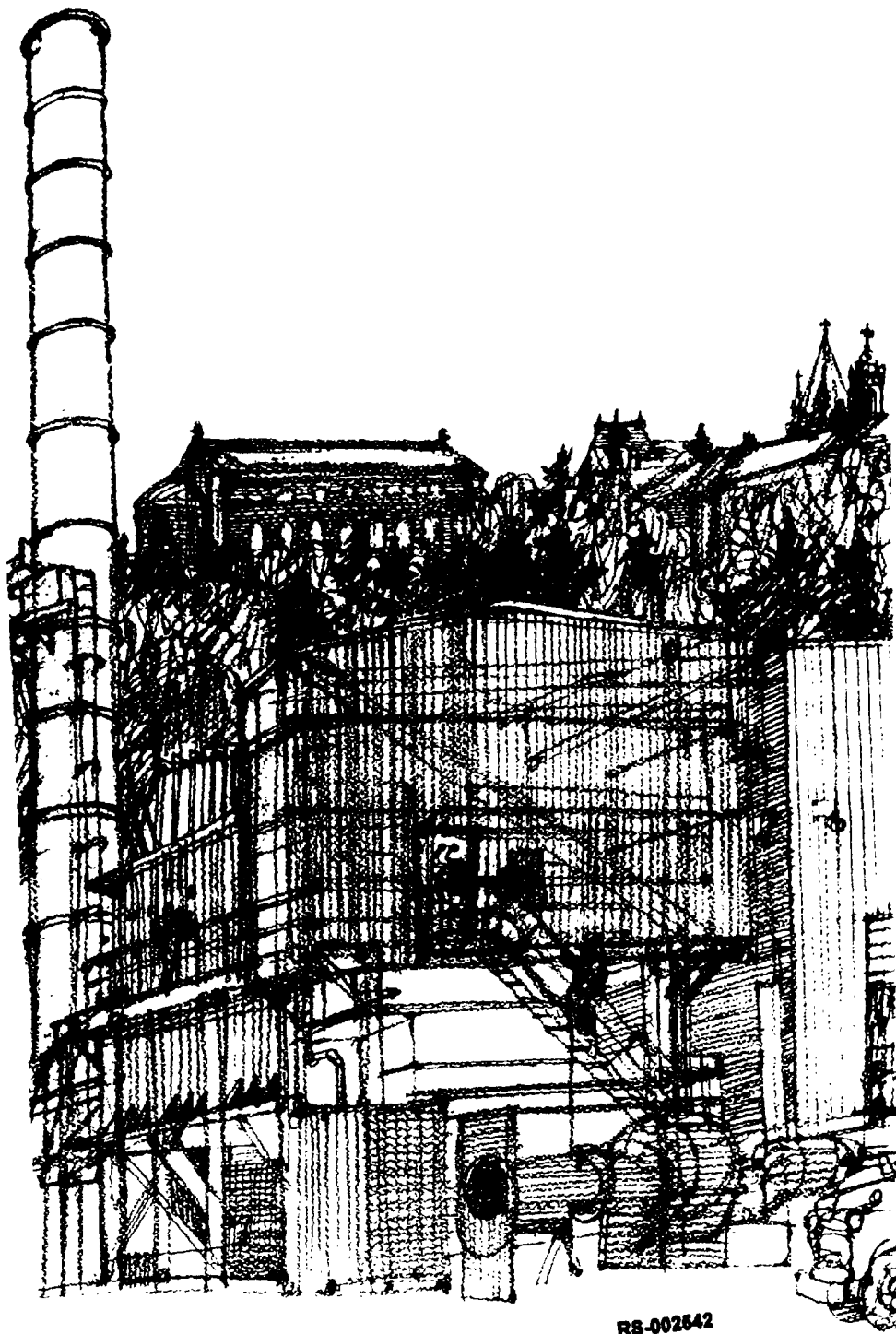
Increasingly, industrial boilers will be used for co-generation. Co-generation in this case means that the industrial firm which needs steam for its manufacturing processes will also use that steam to generate electricity for its own use or to be fed back into the transmission system of the electric utility serving the plant. Co-generation applications require larger, higher pressure boilers than would be required for process steam generation only.

The maintenance and repair business continued at a good pace, with an order rate well over the previous year.

Environeering assumed responsibility for flue gas desulfurization systems and systems for control of particulate emissions from boilers during the year. This move consolidated the emissions control systems business, which was formerly handled by Riley Stoker, with Environeering's traditional scrubber module business, into one organization.

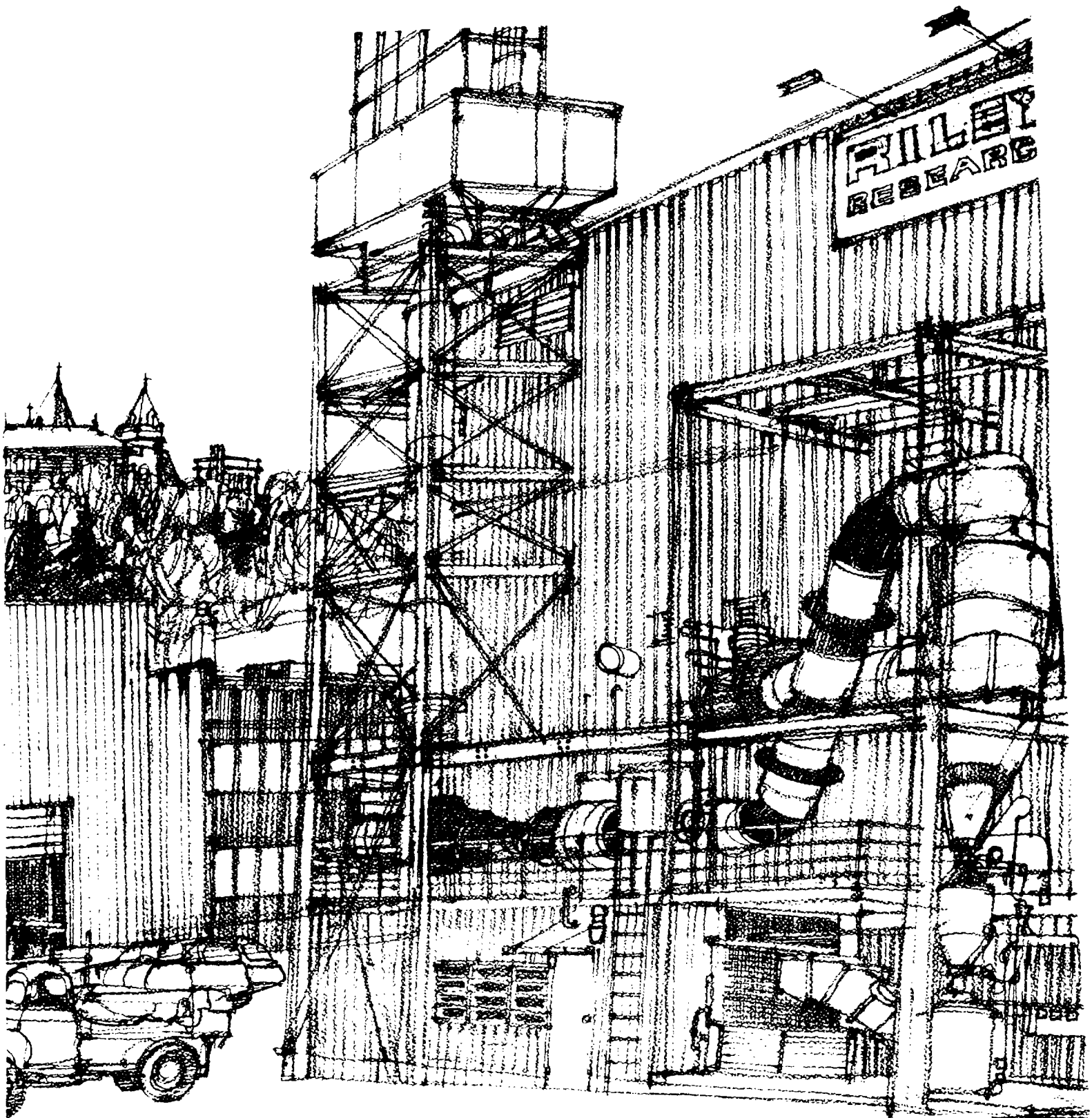
The market for Environeering-supplied systems and components is strong and is expected to grow as more stringent emission requirements are imposed upon electric utility and industrial boilers and many industrial processes.

During the year the first of the modern unique dry bottom coal-fired Riley Turbo[®] Furnace steam generating systems went into commercial operation. Two units in two different locations in the mid-West have entered service. Both are performing well and indicate the soundness of the design which is utilized in all of the large coal-fired

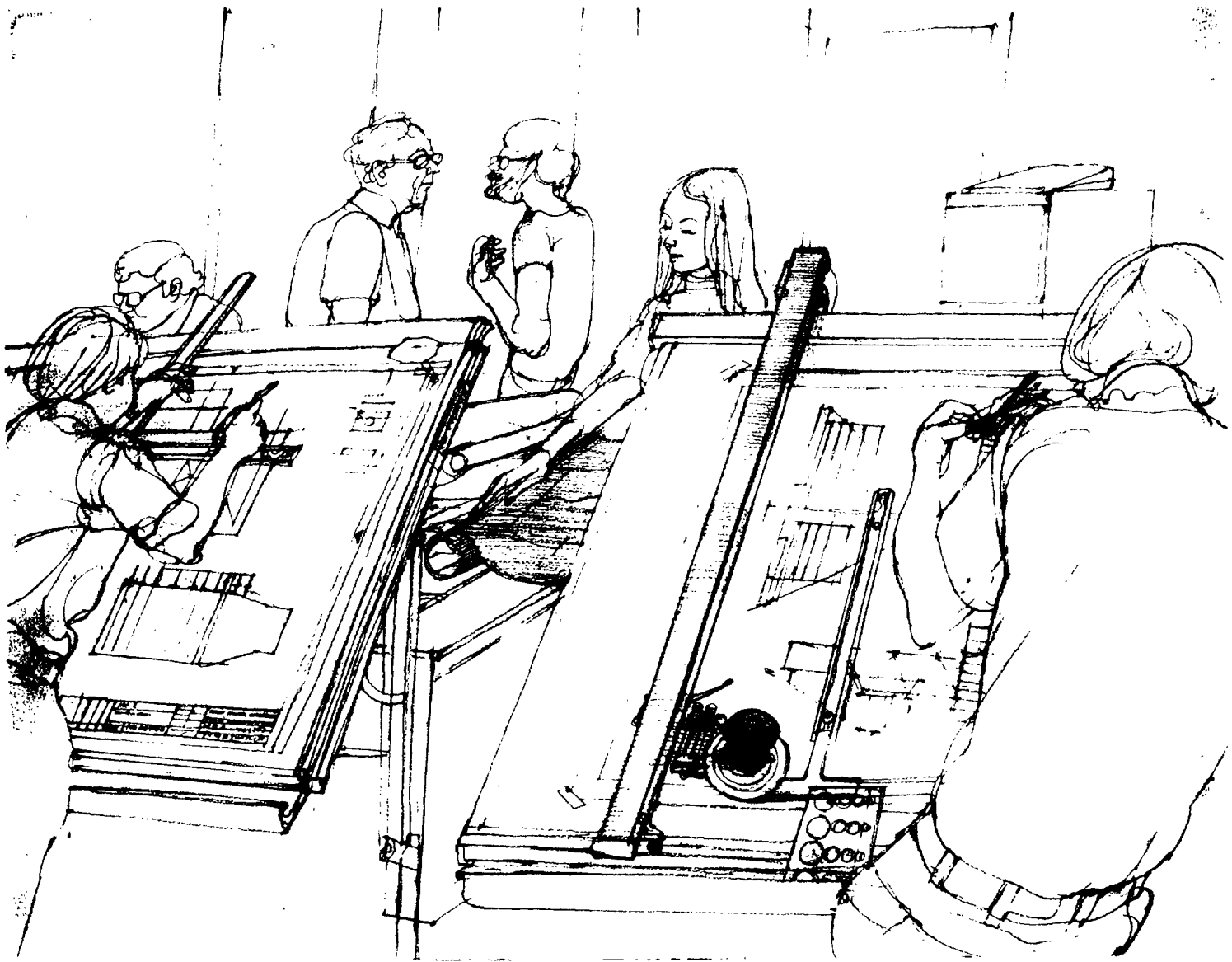


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At left, in this view of Riley's Research and Development Center at Worcester, Mass., is the 300 million BTU per hour, water-cooled test furnace for full scale testing of Riley burners. On the right is the Riley-Morgan coal gasification test unit.



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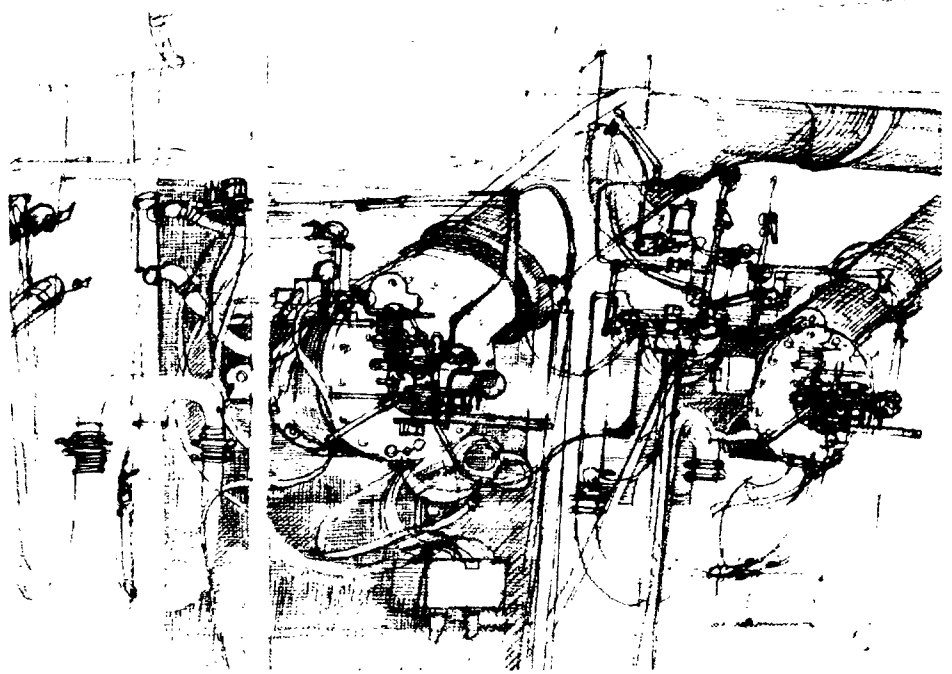


A corner of the design drafting room at the Riley Stoker Corporation, Worcester, Mass.

units being produced. The Turbo[®] Furnace design offers significant operating advantages, particularly in control of emissions of oxides of nitrogen. Successful operation of the first of these designs provides confidence in the design for others to follow.

Development and prototype testing of the new VESTA packaged water tube steam generating system was successfully completed. Initial orders have already been received. The VESTA boiler is a novel design in a single standard module configuration for installation as one unit, or in multiples, to provide steam capacity from 20,000 lbs. per hour to 100,000 lbs. per hour. The unit is designed for

This is the business end, the burner front, of the 300 million BTU test furnace at Worcester, Mass.



oil or gas firing and is of a size that will be allowed to continue to burn these fuels rather than coal. It is efficient and economical in terms of weight and floor space required. This new boiler is an important addition to the Group's product line and offers the opportunity to penetrate a market in which the Group has not been participating significantly.

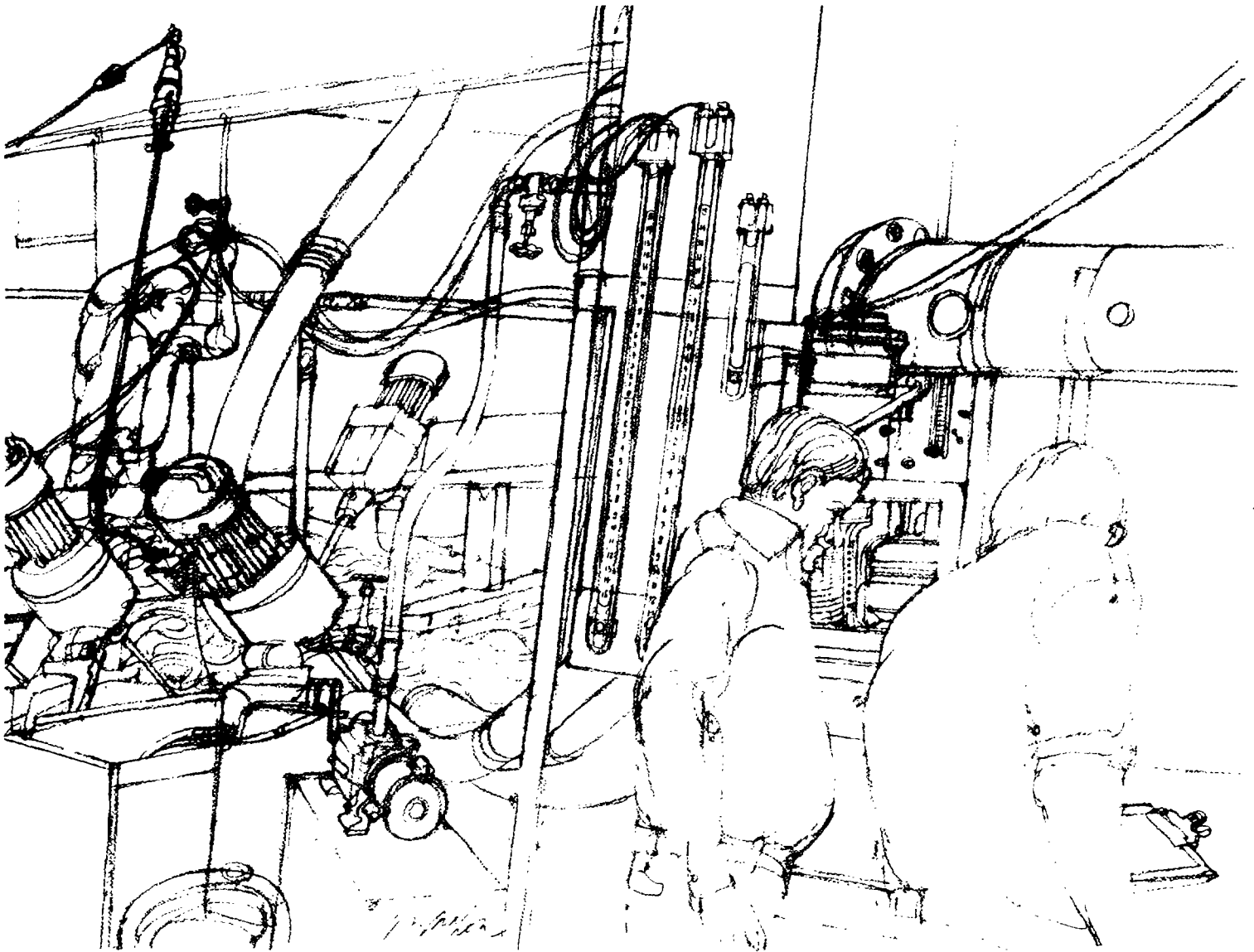
The initial commercial installations of the Group's new modular travelling grate spreader stoker were completed and operating tests performed. Performance of this new stoker design is excellent. With greater coal firing in industrial boilers, there will be a resurgence of stokers to facilitate

the use of coal. The Group is in a good position to capitalize on the increased use of stokers with its experience and with this modernized stoker having many customer advantages.

The Group's first major flue gas desulfurization system went into successful operation at a power plant of a mid-Western utility. This was an important milestone and provides a solid base for more aggressive participation in the growing market for scrubber systems for sulfur removal. The system is equipped with high-performance Ventri-Sorber® scrubber modules designed and manufactured by Enviroengineering.

Development work on coal gasification was paced to match the slower than previously anticipated development of the market. Progress continues to be made in developing a commercial coal gasification unit and in successful gasification of promising fuels such as lignite, which is plentiful in the West. The primary market for the Riley-Morgan low and intermediate BTU gasification unit will be industrial processes, where

Technicians in Enviroengineering's development laboratory, using the Company's Ventri-Sorber® scrubber, conduct tests in removal of sulfur dioxide from exhaust gases.



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1/17/02
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gas or oil are no longer available or are noneconomical, and where direct firing of gas is a process requirement.

The financial performance of the Group improved slightly this year over the prior fiscal year. However, older contracts, which suffered from significant cost inflation without commensurate price escalation, continued to generate losses, but less so than in previous years. These contracts are becoming a lesser factor in the overall mix of contracts in our backlog.

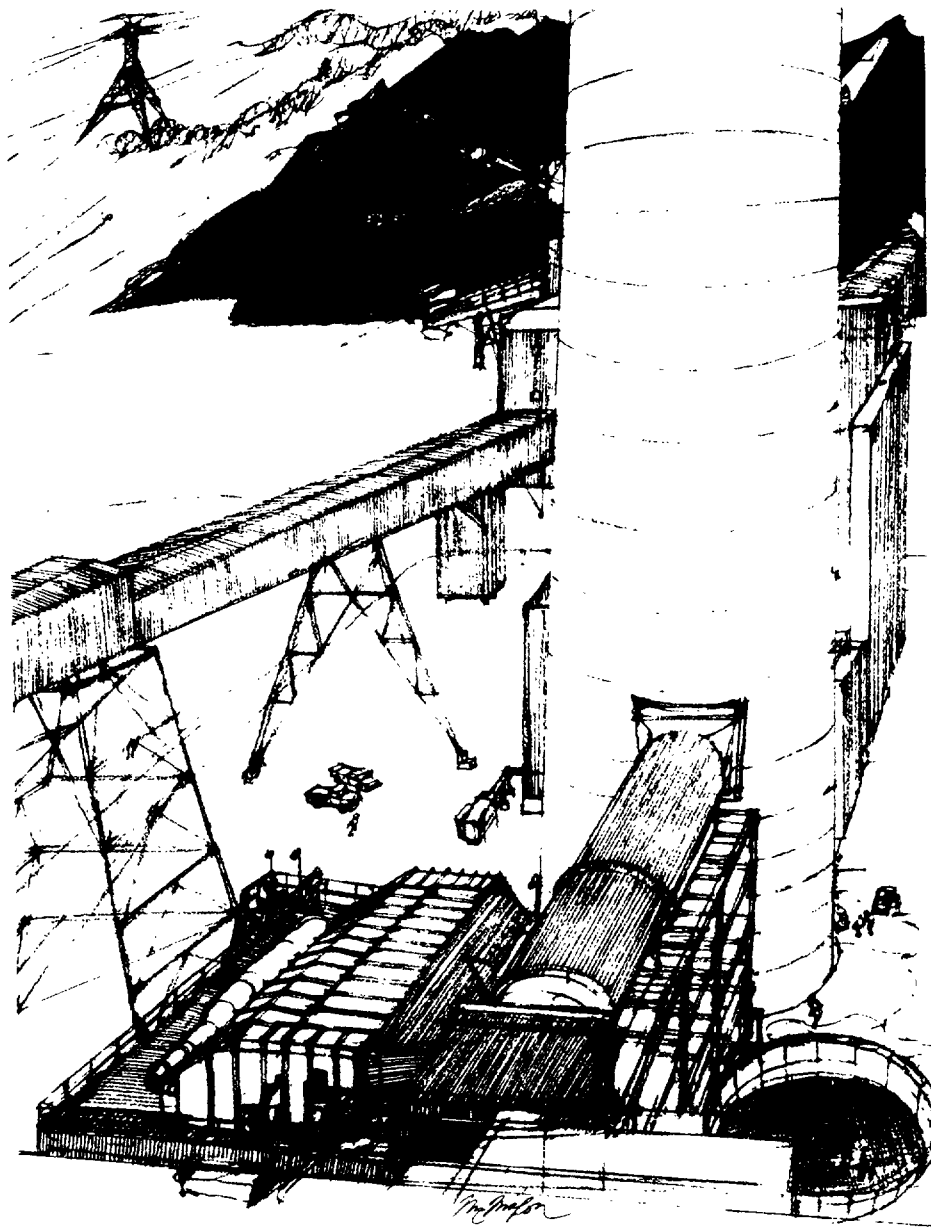
A new labor contract was negotiated at the Group's Erie Plant after a three-week work stoppage. The contract maintains important managerial rights. It does not include a cost-of-living adjustment, thereby providing known unit labor costs for the three-year term of the contract.

Progress was made in improving facilities and productivity in the Erie and Riley Southwest plants. Modern computer-controlled drafting equipment was put into full operation in Worcester Headquarters, resulting in important improvements in engineering and drafting productivity.

Work effort during the year was at a high level, particularly in the fabricating shops and construction division, as evidenced by our record revenues.

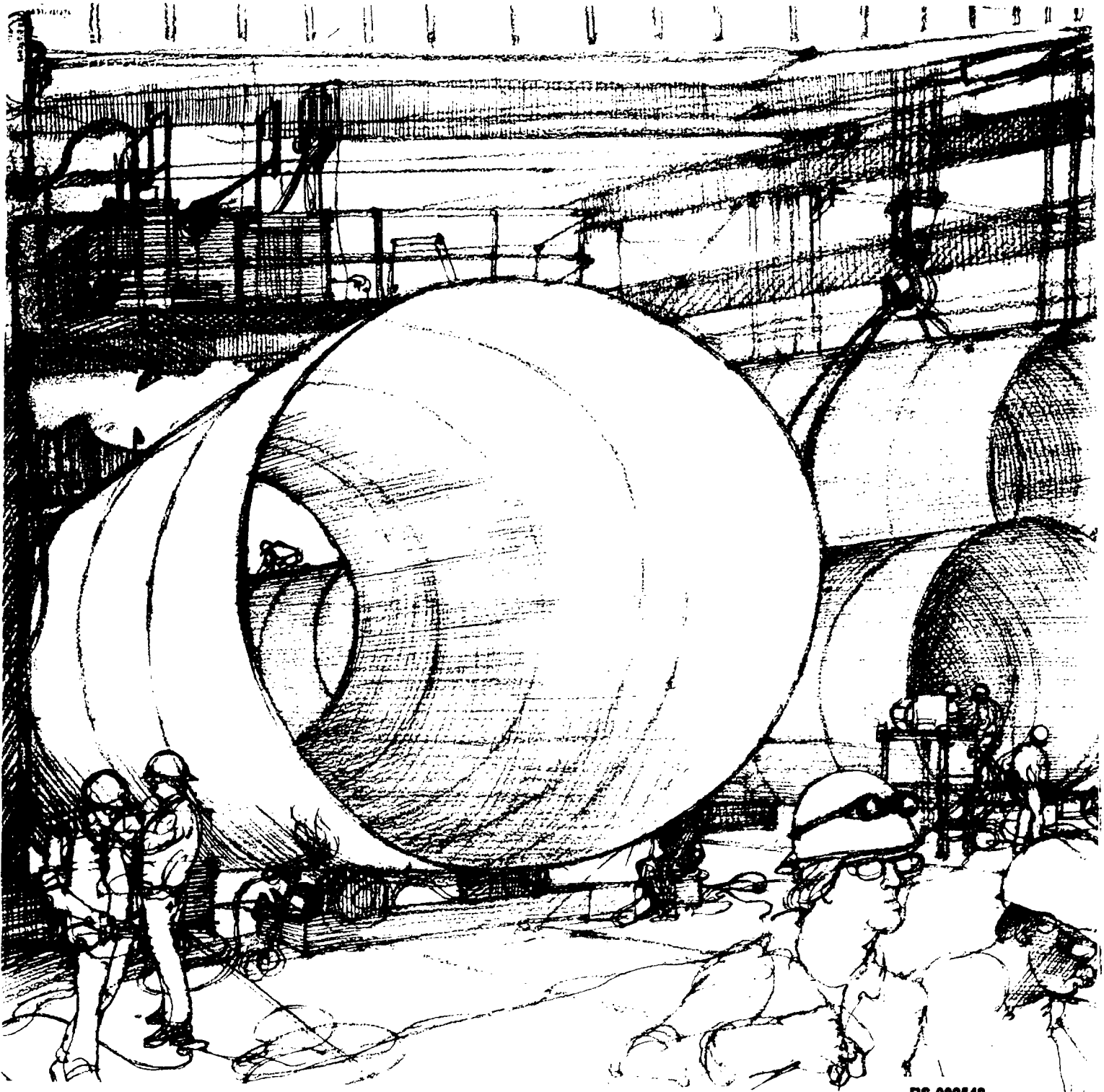
The market in fiscal year 1978 will continue to be very competitive, even though activity is expected to increase somewhat over last year's depressed market. With the emphasis on coal and air pollution control, the proven performance of the coal-fired Riley Turbo® Furnace design, important additions to the product line, and successful operation of a full-scale flue gas desulfurization system, the Group should be in a strong position to participate effectively as the market rebounds.

Newer contracts with better margins will continue to constitute an increasing percentage of our backlog mix as we proceed into and through the new fiscal year. Therefore, we expect to achieve a growing profit improvement of the Riley Stoker Group.



Shown in close-up is the first module of the four-module Environeering scrubbing system designed to remove sulfur dioxide from the Central Illinois Duck Creek power station. The first unit, capable of scrubbing 350,000 cubic feet of exhaust gas per minute, is in the left foreground. Gas from the scrubber passes through the large duct (center foreground) to the stack. In the right foreground is the excavation for the second module now under construction.

Thousands of LP-gas storage tanks from 30,000 to more than 100,000 gallons capacity are manufactured annually at Riley-Beaird, many of them in this high lift bay area with crane capacity which can easily handle 600-ton loads.



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1/17/02
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Riley-Beaird Group

W. E. Adams, *President*



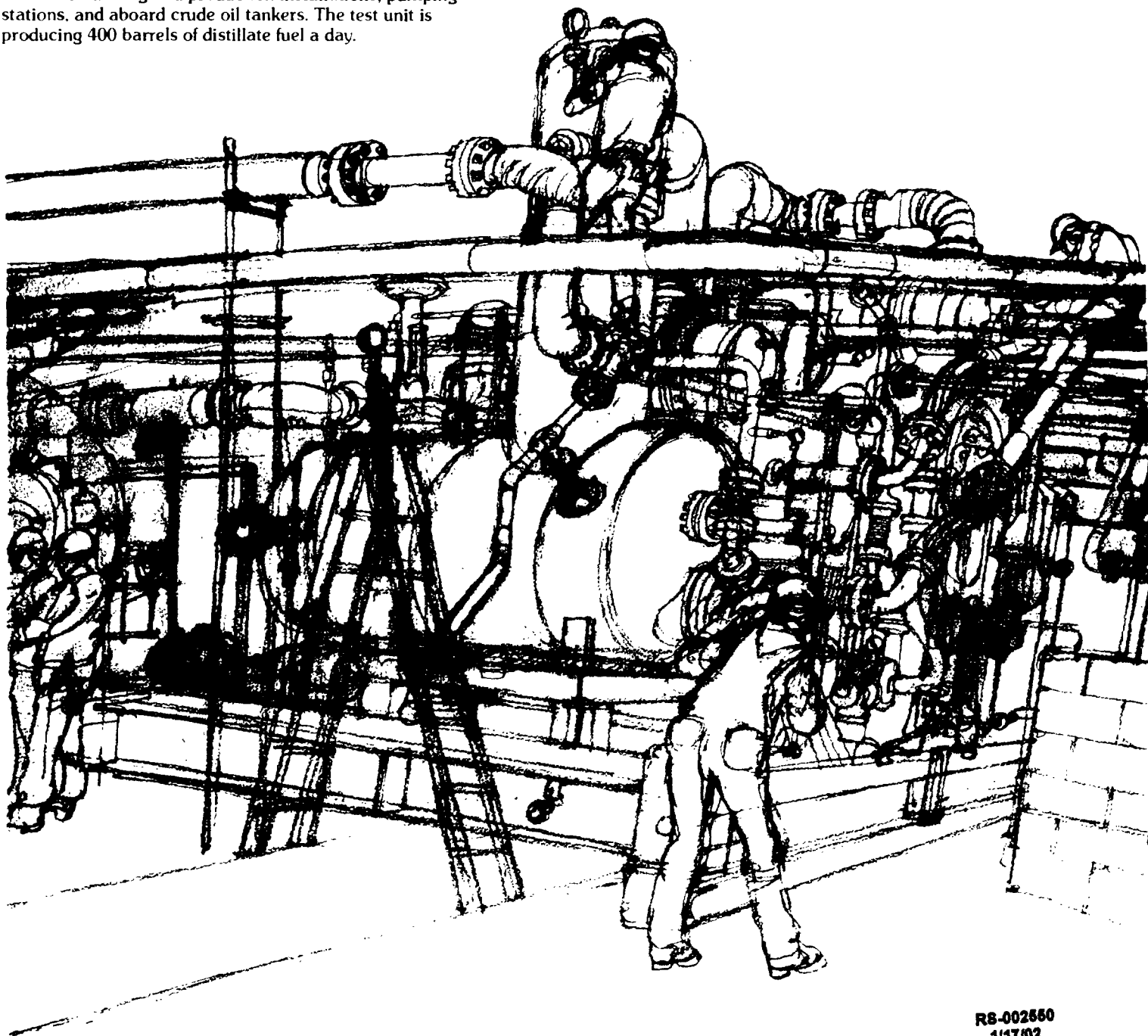
A flexible manufacturing capability, coupled with the company's ability to act and react quickly to market demands, contributed strongly to a successful year of Riley-Beaird operations. Profit for the unit substantially exceeded budgeted goals despite a slight decrease in total revenue.

Following the trend for the past several years, the Industrial and Contract profit centers of Riley-Beaird were responsible for a significant share of the total revenue and profit. The Maxim® Evaporator profit center had an exceptionally good year and Maxim® Silencers also continued their growth

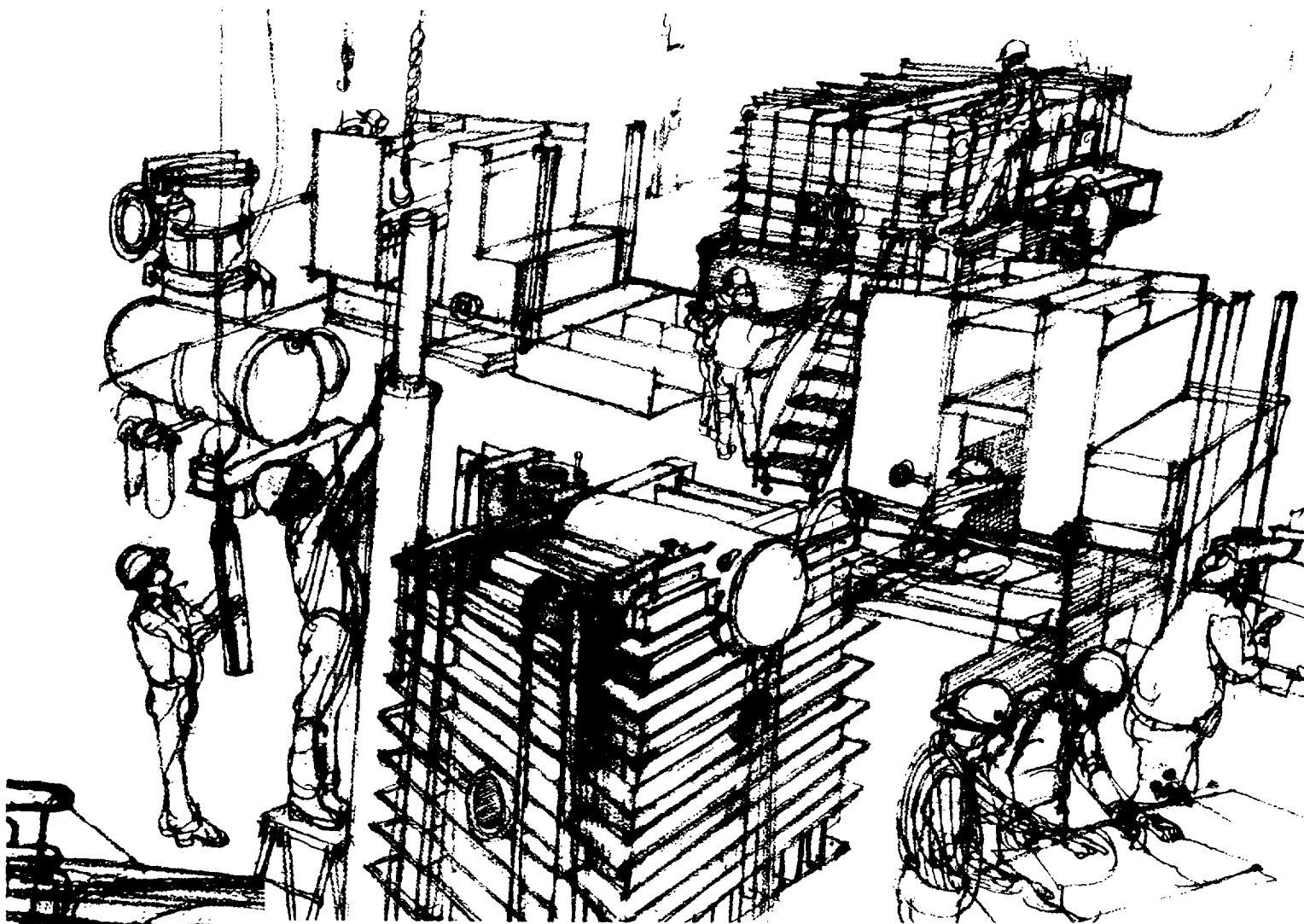
The physical plant was upgraded considerably. Heavy machine tools were rebuilt, many automatic welding machines were installed to improve both productivity and quality, large additional crane capacity was installed, and a 1,100-ton press was installed to supplement and enlarge our forming capability. Safety programs were emphasized, with a resulting decrease in accidents and increase in efficiency. A training facility was built and state university courses are now offered at this modern, convenient in-house facility. Manufacturing assembly line procedures were improved in many areas so as to make us more competitive in world markets.

Revenue and profit in the Industrial Group, serving the hydrocarbon processing industry, were reduced somewhat from the previous year. This reflects the lower level of U.S. expenditure for this segment of the capital goods market and greatly increased worldwide competition.

Shown in final stages of manufacture is Riley-Beaird's new distillation system which produces diesel fuel directly from crude oil. Revolutionary in design, it is easily transportable and can save the petroleum industry alone millions of dollars a year in costs to supply diesel fuel to remote sites such as oil drilling and production installations, pumping stations, and aboard crude oil tankers. The test unit is producing 400 barrels of distillate fuel a day.



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1/17/02
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Maxim® evaporators in various stages of manufacture at Riley-Beaird. Visible here are units designed for U.S. Navy and commercial vessels, with capacities up to 100,000 gallons of potable water per day. Also shown is a 72,000 gallon per day land-based evaporator under construction.

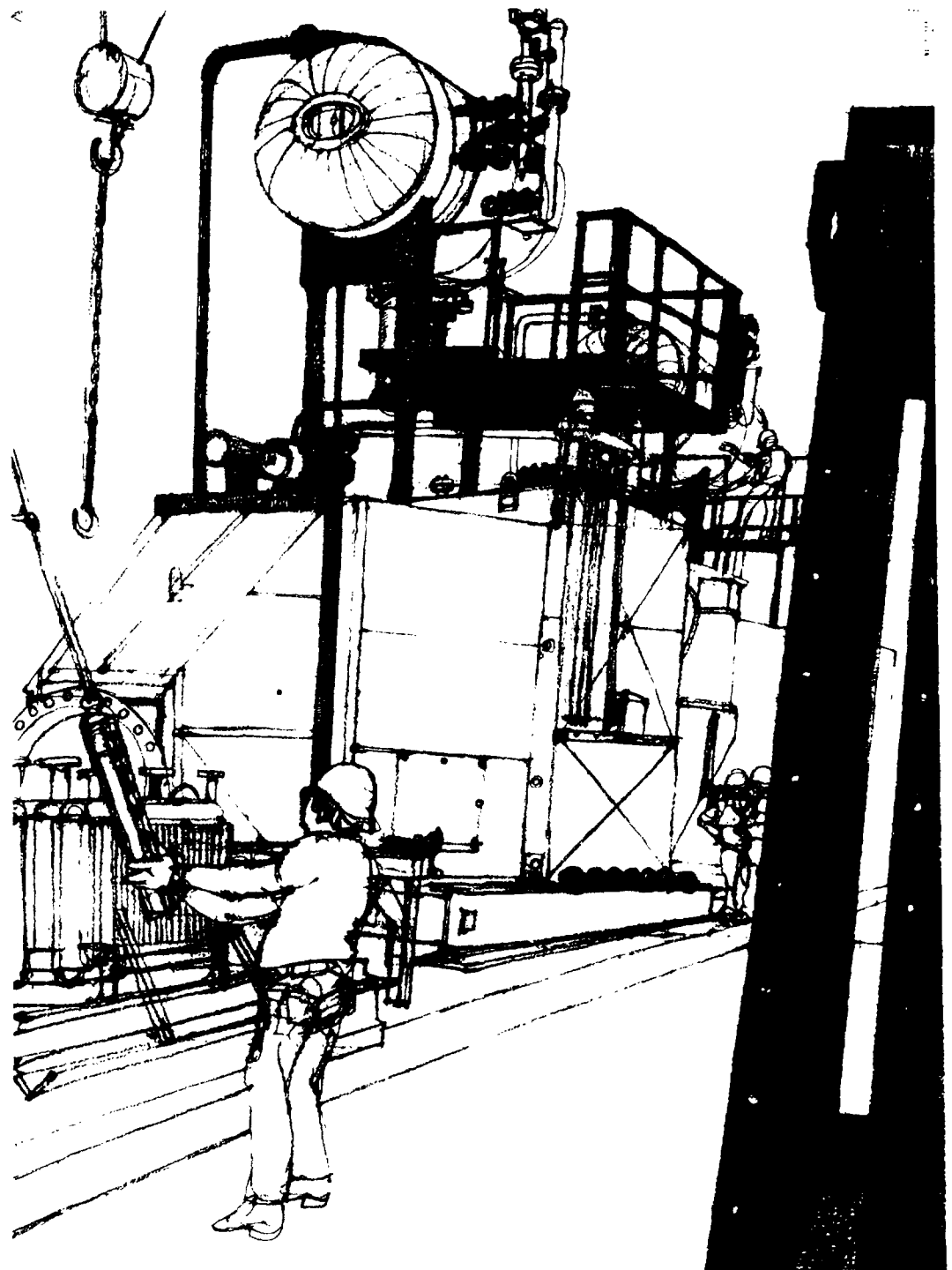
A heavy U.S. demand for propane storage for use as standby gas fuel for industrial plants provided an excellent base load for this profit center in the winter of 1976 and is continuing well in 1977. Small LPG systems (intended primarily for rural home use), a minor product line not contributing to bottom line profits, was discontinued at the close of this fiscal year.

Contract revenue was less than the previous year; however, profit was up over budgeted goals. Work in this profit center consists of large machined weldments manufactured for heavy capital equipment suppliers to the worldwide hydrocarbon processing industries. Water-wall

panels for steam generating plants, steam drums, and ball mills were handled by this profit center for our sister company, Riley Stoker Corporation in Worcester, Massachusetts. Backlogs continue into the early 1980's.

Maxim® Evaporators had exceptionally strong growth in fiscal year 1977. This growth was essentially across the entire line of Maxim® Evaporator products. Several repeat orders of large desalination plants for Indonesia were received and manufactured in fiscal year 1977. We have a solid backlog and good prospects for additional desalination

One of four Maxim* heat recovery silencer systems, being manufactured under special order for a refinery in Europe, is prepared for shipment from Shreveport. The units are designed for use with gas turbines.



plants both in the Mid-East and in many other worldwide markets needing fresh water. The continued buildup of the United States nuclear submarine fleet and a fleet of auxiliary oil tenders contributes to the backlog and revenue profit for this profit center. Standard heat recovery desalinators continue to expand their markets and contribute well to the growth of this center. Testing was successfully completed during the year on the new Distillate Fuel System which has the capability to produce

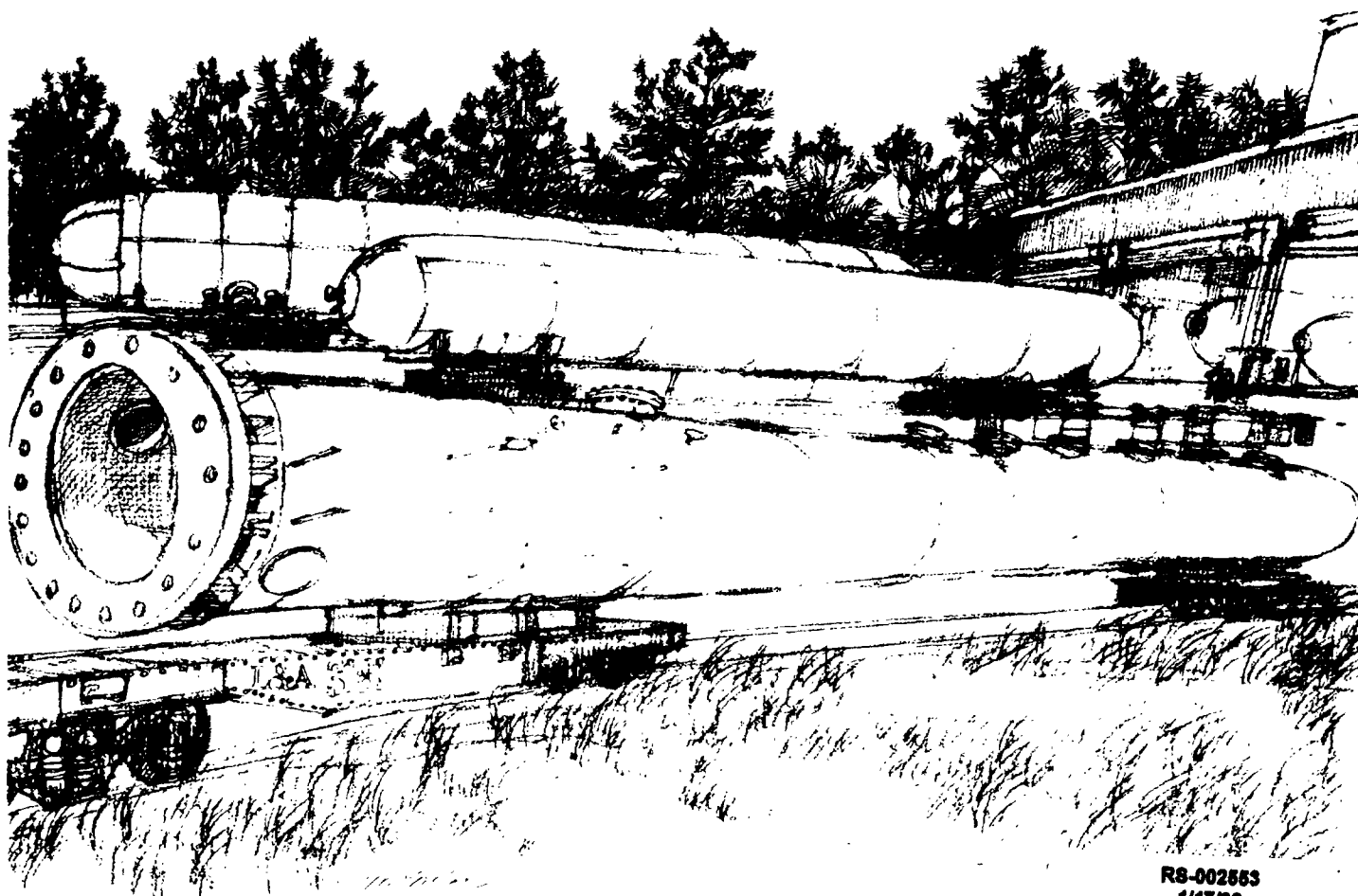
300 to 400 barrels of diesel fuel daily from crude oil. A commercial application will be made during the next year, on a carefully planned program of new product development.

Silencers and heat recovery equipment are handled by the Maxim* Silencer profit center. The line of silencers has been greatly expanded for existing markets with excellent market acceptance. Vent silencers, for control of noise from blowdown lines, have been expanded to a full product line with significant revenue.

profit. Maxim® waste heat recovery systems have also been further standardized. Increased business in the heat recovery field is attributed to both our increased national emphasis on energy recovery and our ability to react quickly with standardized catalogued equipment. The Maxim® silencer and heat recovery markets have strengthened both in the U.S. and in foreign locations. These needs are served by the main Shreveport plant and by foreign manufacturing licensees.

During the latter part of the year, profit margins narrowed in several product lines, reflecting increased competition for the business available from the relatively low rate of capital goods industry expansions which has taken place so far. Our manufacturing improvements, production line skills and a continued steady buildup in the capital goods industries as the economy improves should provide a good base for a successful operation by the Riley-Beaird unit in the next fiscal year.

When fractionating towers for petroleum, chemical and petrochemical plants and LP-gas tanks leave Riley-Beaird, they are ready for erection on site. Shipments from the Shreveport plant (shown here) make up some of the longest and heaviest loads ever hauled by American railroads, weighing more than 600 tons and over 260 feet long.

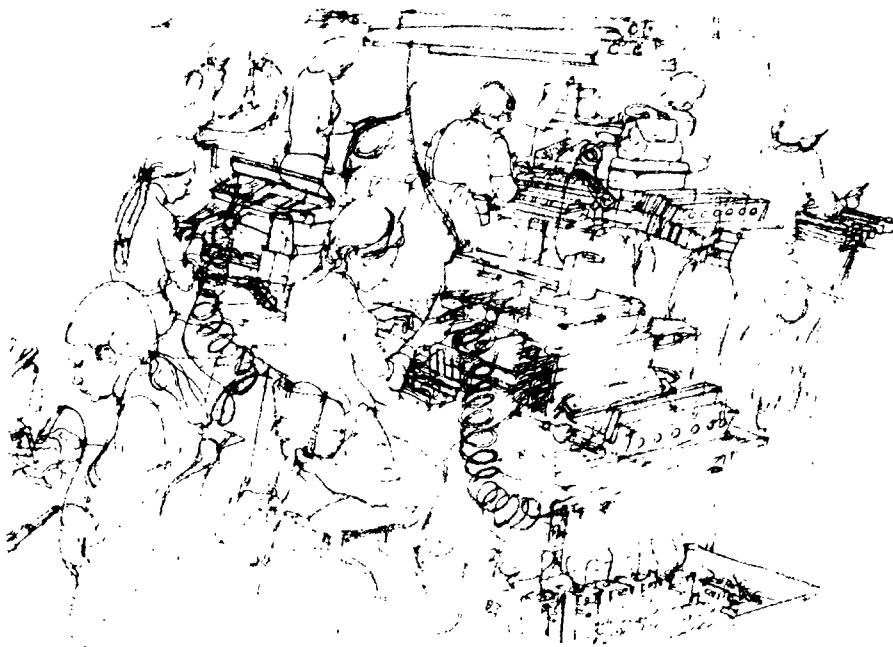
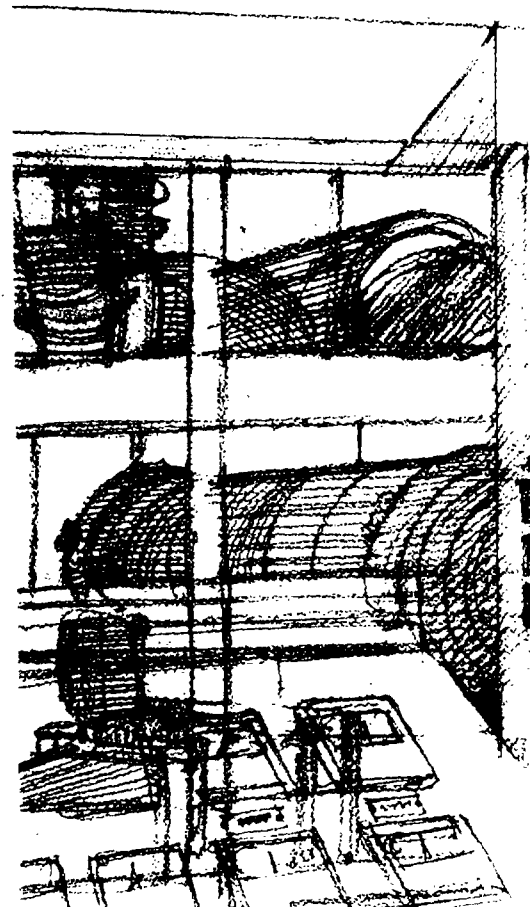


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Process Instruments Group

R. H. Garrett, *President*

Instrumentation from Riley's Panalarm Division is used extensively in the control room of the City of Chicago's new Southwest Supplementary Fuel Facility, better known as the world's largest cooperative (municipal-private industry) "trash to energy" plant. Residue from the more than two million pounds of garbage processed daily goes to the Commonwealth Edison Company which mixes it with coal for its steam generators. Panalarm's graphic display annunciator, the Panagraph[®] on the ceiling panel, monitors operations at key points of the process line, which is shown graphically. Directly below the Panagraph[®] is a second Panalarm[®] annunciator system.



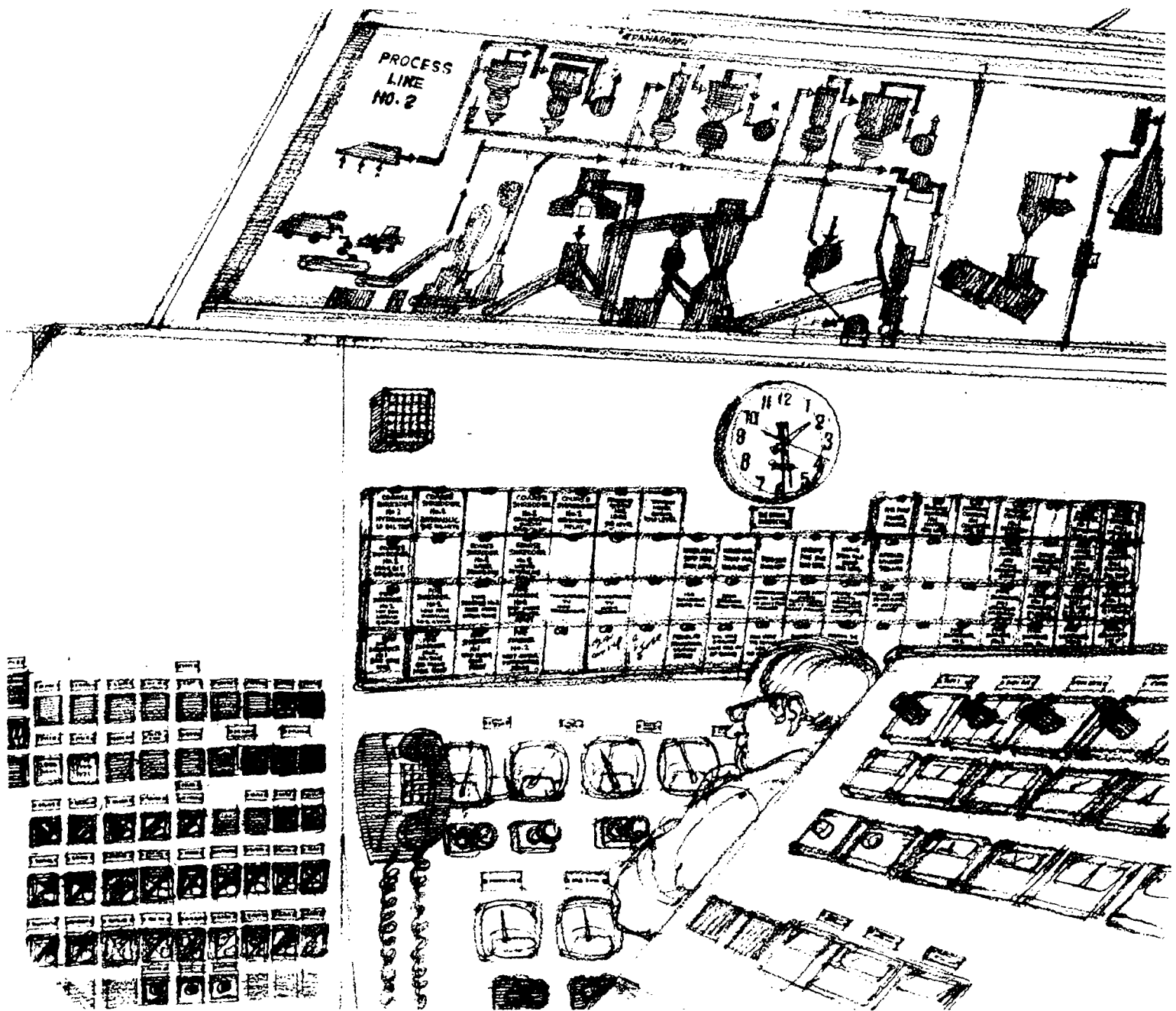
Solid state chassis components being wired and assembled at Panalarm's Skokie, Ill., plant.

Energy and Environment are words of the day. From a marketing standpoint, they call attention to many opportunities. As with other Riley operations, the Process Instruments Group is involved in numerous projects of energy and environmental origin.

Sale of the Group's products for purposes of making more energy available are international, with new geographic areas assuming important stature continually.

Projects relating to improving the environment are generally closer to

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1/17/02
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home (U.S.) but European and Far East interest in this field is increasing.

An interesting project that spans energy and environment, namely the City of Chicago's "Trash to Energy" facility, utilizes products of the Group's Panalarm® Division in three separate and different monitoring systems. The process converts solid waste, garbage, into heat-producing fuel which is used by Commonwealth Edison's Crawford Station to generate electricity. The graphic display, the temperature monitors, and the annunciators associated with this

projects are typical of the Panalarm® Division lines which serve to watch over all manner of plant and equipment variables to help keep them within prescribed limits.

The Panagraph® system utilized in the City of Chicago project combines annunciation alarms with a graphic or pictorial presentation of the process and plant. The operation, from incoming truckloads of waste through delivery of the resultant fuel, is portrayed simply and clearly. Alarm lights are spotted strategically within the display so that any process

abnormality is quickly identified and located. This graphic display further serves to orient new operating personnel and aids in describing the unique plant and process to visitors from other municipalities.

Sioc Limited, in Canada; Scama Limited, in the United Kingdom and Riley Panalarm, S.A. in Belgium, all manufacture monitoring products and systems identical to those of the Skokie, Illinois-based Panalarm® Division, thus giving the Process Instruments Group formidable stature in serving the international marketplace.

Water and waste plants have grown to very significant proportions over the past several years. In this field, Cashco® Incorporated valves and regulators as well as Panalarm® products and Panellit® Service Corporation technical expertise find interested customers. Cashco, now in production in its 125,000-square-foot plant in Ellsworth, Kansas, cuts across some of the same industry lines as Panalarm:® Petroleum, Petrochemical, Chemical, Pulp & Paper, Electric Utilities, Steel, Auto, Appliance, Cement, Food, and others are all considered prime targets of marketing opportunity.

While markets and marketing are given the most publicity, the Process Instruments Group never loses sight of the fact that product development and manufacturing efficiencies make the sales possible. Over the past fiscal year, the Group has introduced new and/or updated products on a continual basis including integral time delay alarm modules, optical isolated alarm modules, series contact monitors, graphic display, and balanced trim control valves, among others.

It is expected that the Process Instruments Group will experience an active and rewarding fiscal year 1978. Substantial sales volume, more than in previous years, will come as a result of projects destined for foreign countries. In spite of the Group's growing foreign subsidiaries, much of this foreign business will be placed with its U.S. sales force for manufacture in our U.S. plants. This anomaly is a direct result of the success of U.S.-based engineer-contractor firms in negotiating for prime contracts to build new plants in foreign countries, particularly in the Mid-East.



This control room of a typical utility power plant shows how Panalarm® industrial annunciators are installed in the ceiling panel.

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Consolidated Statements of Income

For the years ended June 30, 1977 and 1976

	1977	1976
Net sales and contract revenues (Notes 1 and 3).....	\$242,726,899	\$210,153,452
Cost of sales and work performed.....	214,297,986	180,245,927
Gross profit.....	\$ 28,428,913	\$ 29,907,525
Operating expenses—		
Selling.....	\$ 9,143,058	\$ 8,616,330
General and administrative.....	9,849,297	9,311,414
Research and development (Note 1).....	1,827,329	2,463,576
Total operating expenses.....	\$ 20,819,684	\$ 20,391,320
Income from operations.....	\$ 7,609,229	\$ 9,516,205
Other income and expense, net (Note 2).....	4,869,131	186,898
Income before income taxes.....	\$ 12,478,360	\$ 9,703,103
Provisions for income taxes (Notes 1 and 6).....	5,551,000	4,779,000
Net income for the year.....	\$ 6,927,360	\$ 4,924,103
Net income per share (Note 7)—		
Primary.....	\$ 4.50	\$ 3.22
Fully diluted.....	\$ 4.00	\$ 2.87

The accompanying notes are an integral part of these statements.

RS-002667
1/17/02
NUECES

Consolidated Balance Sheets

June 30, 1977 and 1976

Assets	<u>1977</u>	<u>1976</u>
CURRENT ASSETS:		
Cash.....	\$ 6,534,916	\$ 6,293,196
Certificates of deposit and U.S. Government obligations (Note 4).....	43,888,065	24,589,496
Marketable securities, at lower of cost or market (Note 4).....	21,952,321	6,120,013
Receivables, less reserves of \$196,440 in 1977 and \$190,000 in 1976 (Notes 3 and 13).....	52,843,309	41,011,639
Unbilled contract work (Notes 1 and 3).....	13,146,461	13,477,002
Inventories, at lower of cost (first-in first-out basis) or market (Note 1) —		
Work in process and finished products.....	10,166,191	15,141,438
Raw materials and purchased parts.....	8,981,257	8,728,227
Prepaid Federal income taxes (Notes 1 and 6).....	6,373,000	3,097,000
Prepaid expenses.....	281,252	589,441
Total current assets.....	<u>\$164,166,772</u>	<u>\$119,047,452</u>
 PLANT AND EQUIPMENT, at cost (Notes 1, 5 and 13):		
Land.....	\$ 589,554	\$ 589,849
Building and improvements.....	23,883,365	23,638,022
Machinery and equipment.....	23,564,044	20,922,650
	<u>\$ 48,036,963</u>	<u>\$ 45,150,521</u>
Less — Accumulated depreciation.....	(16,276,857)	(14,480,830)
Total plant and equipment, net.....	<u>\$ 31,760,106</u>	<u>\$ 30,669,691</u>
 OTHER ASSETS	<u>\$ 906,406</u>	<u>\$ 1,275,176</u>
	<u>\$196,833,284</u>	<u>\$150,992,319</u>

RS-002688
1/17/02
NUECES



Liabilities	<u>1977</u>	<u>1976</u>
CURRENT LIABILITIES:		
Current portion of long term debt and capitalized lease obligations	\$ 2,002,595	\$ 1,960,895
Accounts payable	20,739,293	13,224,191
Advances and deferred contract revenue (Notes 1 and 3)	94,305,024	68,394,388
Accrued expenses	11,428,426	8,696,759
Accrued income taxes (Notes 1 and 6)	6,058,346	1,429,423
Total current liabilities	<u>\$134,533,684</u>	<u>\$ 93,705,656</u>
LONG-TERM DEBT, less current portion (Note 5)	\$ 12,781,291	\$ 14,131,224
CAPITALIZED LEASE OBLIGATIONS, less current portion (Notes 1 and 5)	\$ 8,387,756	\$ 9,031,240
DEFERRED FEDERAL INCOME TAXES (Notes 1 and 6)	\$ 1,168,000	\$ 978,000
COMMITMENTS AND CONTINGENT LIABILITIES (Notes 1 and 6)		
STOCKHOLDERS' INVESTMENT:		
Preferred stock, no par value, 100,000 shares authorized; no shares issued	\$ —	\$ —
Common stock, \$1 par value; 1,900,000 shares authorized; 1,517,357 shares issued in 1977 and 1976 (Notes 5 and 8)	1,517,357	1,517,357
Additional paid-in capital	7,627,244	7,695,602
Retained earnings	30,997,784	24,070,424
	\$ 40,142,385	\$ 33,283,383
Less – Treasury stock, 6.084 common shares in 1977 and 8.574 shares in 1976	(179,832)	(137,184)
Total stockholders' investment	<u>\$ 39,962,553</u>	<u>\$ 33,146,199</u>
	<u>\$196,833,284</u>	<u>\$150,992,319</u>

The accompanying notes are an integral part of these balance sheets

R8-002559
1/17/02
NUECES

Consolidated Statements of Changes in Financial Position

For the years ended June 30, 1977 and 1976

	<u>1977</u>	<u>1976</u>
WORKING CAPITAL WAS OBTAINED FROM:		
Operations —		
Net income	\$ 6,927,360	\$ 4,924,103
Add (deduct)		
Provisions for depreciation and amortization	3,598,153	3,116,857
Deferred Federal income taxes	190,000	192,840
Total from operations	<u>\$ 10,715,513</u>	<u>\$ 8,233,800</u>
Decrease in cost of subsidiaries resulting from tax		
benefits of preacquisition loss carry-forwards	—	430,400
Sales and retirement of plant and equipment	738,057	215,508
Proceeds from stock options exercised	77,758	61,060
Other, net	245,847	245,228
Total funds obtained	<u>\$ 11,777,175</u>	<u>\$ 9,185,996</u>
WORKING CAPITAL WAS USED FOR:		
Additions to plant and equipment	\$ 5,303,702	\$ 2,798,838
Reduction in long-term debt and capitalized lease obligations	1,993,417	1,201,983
Purchase of treasury stock	188,764	217,184
Total funds used	<u>\$ 7,485,883</u>	<u>\$ 4,218,005</u>
INCREASE (DECREASE) IN WORKING CAPITAL	<u><u>\$ 4,291,292</u></u>	<u><u>\$ 4,967,991</u></u>
CHANGES IN WORKING CAPITAL:		
Increase (decrease) in current assets —		
Cash	\$ 241,720	\$ 1,328,953
Certificates of deposit and U.S. Government obligations	19,298,569	23,191,554
Marketable securities	15,832,308	5,575,865
Receivables	11,831,670	8,935,309
Inventories and unbilled contract work	(5,052,758)	4,364,159
Prepaid Federal income taxes and prepaid expenses	2,967,811	657,597
	<u>\$ 45,119,320</u>	<u>\$ 44,053,437</u>
(Increase) decrease in current liabilities —		
Current portion of long-term debt and capitalized lease obligations	\$ (41,700)	\$ 7,404,281
Accounts payable	(7,515,102)	315,603
Advances and deferred contract revenue	(25,910,636)	(46,631,750)
Accrued expenses	(2,731,667)	(237,585)
Accrued income taxes	(4,628,923)	64,005
	<u>\$ (40,828,028)</u>	<u>\$ 39,085,446</u>
INCREASE (DECREASE) IN WORKING CAPITAL	<u><u>\$ 4,291,292</u></u>	<u><u>\$ 4,967,991</u></u>

The accompanying notes are an integral part of these statements

RS-002560
1/17/02
NUECES



Consolidated Statements of Stockholders' Investment

For the years ended June 30, 1977 and 1976

	<u>Common Stock</u>		<u>Additional Paid-in Capital</u>	<u>Retained Earnings</u>	<u>Treasury Stock</u>	
	<u>Shares</u>	<u>Amount at Par Value</u>			<u>Shares</u>	<u>Amount</u>
Balance, June 30, 1975	1,515,357	\$1,515,357	\$7,715,846	\$19,146,321	—	\$ —
Net income for the year	—	—	—	4,924,103	—	—
Purchase of common stock for the treasury	—	—	—	—	13,574	217,184
Stock options exercised—						
Unissued stock	2,000	2,000	14,685	—	—	—
Treasury stock	—	—	(35,625)	—	(5,000)	(80,000)
Other	—	—	696	—	—	—
Balance, June 30, 1976	1,517,357	\$1,517,357	\$7,695,602	\$24,070,424	8,574	\$137,184
Net income for the year	—	—	—	6,927,360	—	—
Purchase of common stock for the treasury	—	—	—	—	6,510	188,764
Stock options exercised	—	—	(68,358)	—	(9,000)	(146,116)
Balance, June 30, 1977	<u>1,517,357</u>	<u>\$1,517,357</u>	<u>\$7,627,244</u>	<u>\$30,997,784</u>	<u>6,084</u>	<u>\$179,832</u>

The accompanying notes are an integral part of these statements

RS-002661
1/17/02
NUECES

Notes to Consolidated Financial Statements

(1) Summary of Major Accounting Policies:

Consolidation—

The consolidated financial statements include the accounts of the Company and all subsidiaries. The fiscal years of SIOC, Limited (Canada), as well as SIOC's wholly-owned subsidiary, SCAMA, Limited (England), end on March 31 and May 31, respectively. The fiscal year of Riley Panalarm, S.A. (Belgium), which began operations in fiscal 1977, also ends May 31. Accordingly, their financial statements, which are not material, have been included in the accompanying consolidated financial statements on the basis of their respective fiscal years. The accounts of foreign subsidiaries have been translated into U.S. dollars in accordance with Financial Accounting Standards Board Statement No. 8. Foreign translation gains or losses have not been material and are charged or credited to income currently. All significant intercompany transactions have been eliminated in consolidation.

Accounting for Long-Term Contracts—

Riley Stoker Corporation recognizes income on long-term contracts for electric utility steam generating systems on a percentage-of-completion method. In order to apply this method, total contract costs must be estimated. Certain contracts provide for the escalation of the sales price based on the future level of economic indices, as specified in the contract, and in such cases total contract revenue must also be estimated in applying the percentage-of-completion method. The percentage of completion is determined by relating the actual cost of work performed to date to the current estimated total cost of the respective contracts. When the estimate on a contract indicates a loss, the Company's practice is to record the entire loss. Unbilled contract work represents the excess of costs incurred and profits recognized to date on the percentage-of-completion accounting method over billings to date on certain contracts. Advances and deferred contract revenue represents the excess of billings to date over costs incurred and profits recognized to date on the percentage-of-completion accounting method on the remaining contracts (See Note 3).

Inventories—

Inventories are priced at the lower of cost (first-in, first-out basis) or market, and include materials, labor and manufacturing overhead.

The inventories used in the determination of cost of sales for the two years ended June 30, 1977, were as follows.

	Raw Materials and Purchased Parts	Work in Process and Finished Goods	Total
June 30—			
1975	\$12,696,706	\$ 9,228,038	\$21,924,744
1976	8,728,227	15,141,438	23,869,665
1977	8,981,257	10,166,191	19,147,448

Property, Depreciation and Maintenance and Repair Policies—

The Company follows the practice of providing depreciation on plant and equipment on the straight-line method for book purposes and on a combination of straight-line and accelerated methods for tax purposes. The estimated useful lives are 10 to 45 years for buildings and improvements and 3 to 20 years for machinery and equipment. Depreciation expense was:

1976	\$3,085,450
1977	\$3,475,230

Maintenance and repairs are charged to expense when incurred. The cost of major renewals or betterments is capitalized by charges to the appropriate property account. The cost of property retired or otherwise disposed of is removed from the property account, the accumulated depreciation is removed from the related reserve and the net gain or loss is credited or charged to income.

Income Taxes—

Income tax expense is based on reported earnings adjusted for differences that will never enter into the computation of taxes payable. Differences in the time certain income and expenses are recorded in consolidated earnings and when they are recognized for income tax purposes are reflected in the consolidated financial statements as deferred or prepaid income taxes. Investment credits are treated as a reduction of the current provision for income taxes.

Research and Development—

Research and development costs are charged to expense as incurred. Of the total research and development costs in 1977 and 1976, \$344,177 and \$865,267, respectively, were related to the Company's coal gasification research program.



Capitalized Lease Obligations—

Certain long-term lease transactions are accounted for as installment purchases of property and equipment. Accordingly, these facilities are capitalized and depreciated on a straight-line basis over their estimated useful life. The obligations represent the total present value of future rental payments discounted at interest rates implicit in the leases.

(2) Other Income and Expense

Other income and (expense), net is comprised of the following:

	1977	1976
Interest and dividends from marketable securities	\$4,098,435	\$1,176,864
Gain from sale of marketable securities	538,629	168,054
Security valuation allowance	350,631	(167,641)
Gain (loss) from sale of plant and equipment	917,039	(6,106)
Interest expense	(1,480,501)	(1,786,547)
Royalty income	708,700	580,878
Other income (expense), net	(263,802)	221,396
	<u>\$4,869,131</u>	<u>\$ 186,898</u>

(3) Long-Term Contracts:

Unbilled Contract Work and Advances and Deferred Contract Revenue—

Unbilled contract work includes the actual cost of work performed to date on long-term contracts and profits recognized to date in excess of billings to date on certain contracts.

The components of unbilled contract work are as follows:

	As of June 30,	
	1977	1976
Actual costs incurred	\$ 91,257,207	\$120,363,306
Related profits (losses) recognized	(2,417,694)	6,822,087
	<u>\$ 88,839,513</u>	<u>\$127,185,393</u>
Less-Billings to date	<u>75,693,052</u>	<u>113,708,391</u>
	<u>\$ 13,146,461</u>	<u>\$ 13,477,002</u>

Advances and deferred contract revenue represents the excess of billings to date over actual costs incurred and profits recognized on the remaining contracts.

The components of advances and deferred contract revenue are as follows:

	As of June 30,	
	1977	1976
Advance billings	\$547,495,036	\$376,799,607
Less-Related costs incurred and profits recognized	<u>453,190,012</u>	<u>308,405,219</u>
	<u>\$ 94,305,024</u>	<u>\$ 68,394,388</u>

The Company does not charge selling and general and administrative expenses to inventory or unbilled contract work.

Receivables—

Accounts receivable includes \$4,602,855 and \$5,012,229 at June 30, 1977 and 1976, respectively, representing amounts billed to customers, but not paid under retainage provisions of certain contracts. Substantially all retainages are due within one year.

(4) Marketable Securities

At June 30, 1977, the Company had an investment portfolio which was comprised of common and preferred stocks, obligations of the U.S. Government, banker's acceptances and overnight cash investments as follows (000's omitted):

	Unrealized				
	Cost	Market	Gains	Losses	Net Gains
U.S. Government obligations	\$43,888	\$44,104	\$ 270	\$ 55	\$ 215
Common stocks	17,209	18,376	1,320	152	1,168
Preferred stocks	2,121	2,284	167	4	163
Banker's acceptances and overnight investments	2,622	2,622	-	-	-
	<u>\$65,840</u>	<u>\$67,386</u>	<u>\$1,757</u>	<u>\$211</u>	<u>\$1,546</u>

During the fiscal year ended June 30, 1976 the Company charged \$167,641 against current operations increasing its marketable security valuation allowance to \$350,631 at June 30, 1976. As the result of the market appreciation in

value of the securities held during the fiscal year ended June 30, 1977, the security valuation allowance was eliminated and included in fiscal 1977 earnings.

During the fiscal years ended June 30, 1977 and 1976, the Company realized approximately \$539,000 and \$168,000, respectively, in gains from the sale of marketable securities. Subsequent to June 30, 1977, certain U.S. Government obligations with a cost basis of \$8,339,000 were sold at a gain of \$166,000. Other U.S. Government obligations were purchased to replace those sold at a cost of \$8,600,000.

(5) Long-Term Debt and Capitalized Lease Obligations:

At June 30, long-term debt consisted of the following:

	<u>1977</u>	<u>1976</u>
7½% notes payable \$1,100,000 annually through December 31, 1978, with a final payment of \$4,918,567 on December 31, 1979 (A)	\$ 7,118,568	\$ 8,218,568
8% note payable \$125,000 quarterly (including interest), with a final payment of \$3,614,950 on September 1, 1980 (B)	4,116,392	4,278,876
6% convertible subordinated notes, due in 1979 (C)	2,000,000	2,000,000
2% and 6½% first and second mortgages payable in monthly installments to 1984	529,111	590,292
Other	<u>376,333</u>	<u>384,903</u>
	\$14,140,404	\$15,472,639
Less current maturities	<u>1,359,113</u>	<u>1,341,415</u>
	<u>\$12,781,291</u>	<u>\$14,131,224</u>

(A) Secured by the common stock of Riley-Beard, Inc., held in escrow, and a lease on Beard's facilities.

(B) Fully subordinated to any other present or future indebtedness of the Company and secured by 41.7% of the common stock of Riley Stoker Corporation

(C) Convertible into 204,082 shares of the Company's common stock at \$9.80 per share at any time to maturity, which conversion price is subject to adjustment under certain conditions. The notes are subordinated to senior indebtedness outstanding or hereafter incurred. The notes are payable to Mr. Howard C. Warren, the Chairman of the Board and majority stockholder of the Company.

Scheduled aggregate maturities of long-term debt out-

standing at June 30, 1977, for the next five fiscal years are as follows:

1978	\$1,359,113
1979	1,378,500
1980	7,217,864
1981	3,642,770
1982	106,816

The three year revolving credit agreement dated November 30, 1973, which provided the Company with a maximum line of credit of \$12,000,000, expired on November 30, 1976, and was not renewed. In its place, the Company has obtained lines of credit from five banks totaling \$21,000,000 with interest at the minimum commercial lending rate. The Company is not required to maintain compensating balances under these lines of credit.

No borrowings were made under either the revolving credit agreement or lines of credit arrangements in fiscal 1977. In fiscal 1976, maximum borrowing during the year was \$9,000,000, and the average interest rate for such borrowings during the year was 7.9%.

The Company has capitalized lease obligations under leases of property, plant and equipment at three manufacturing facilities. These obligations mature at various dates through 1987, and represent the total present value of future rental payments discounted at interest rates of 4¼% to 6¼% implicit in the leases. Payments under the leases totaled \$619,480 in 1977 and \$631,444 in 1976 and will average \$700,000 over the next five years. Included in the current portion of long-term debt and capitalized lease obligations for 1977 and 1976, are \$643,482 and \$619,480, respectively, related to such leases.

(6) Income Taxes:

The provision for income taxes consists of the following (000's omitted):

	<u>1977</u>	<u>1976</u>
Federal -		
Current	\$7,938	\$3,763
Deferred (prepaid), net	(1,086)	(281)
Utilization of pre acquisition tax loss carry forwards	--	396
	<u>\$4,852</u>	<u>\$3,878</u>
Foreign	409	495
State	<u>290</u>	<u>406</u>
	<u>\$5,551</u>	<u>\$4,779</u>



The net credit for deferred (prepaid) income taxes results from the following sources (000's omitted):

	<u>1977</u>	<u>1976</u>
Long term contract losses not currently deductible	\$(2,498)	\$ (73)
Excess of tax over book profits on long-term contracts	(558)	(393)
Excess of tax over book depreciation	192	189
Other net	(222)	(4)
	<u>\$(3,086)</u>	<u>\$(281)</u>

The provision for income taxes is less than the amount computed by applying the U.S. Federal income tax rate of 48% to income before taxes by approximately \$439,000 in 1977 and exceeds this statutory amount by approximately \$121,000 in 1976. The difference arises from the following (000's omitted):

	<u>1977</u>	<u>1976</u>
Provision computed at statutory rate	\$5,990 48.0%	\$4,658 48.0%
State income taxes	151 1.2	195 2.0
Investment tax credit	(358) (2.9)	(119) (1.2)
Other, net	(232) (1.8)	45 .5
	<u>\$5,551 44.5%</u>	<u>\$4,779 49.3%</u>

The Company and its domestic subsidiaries file a consolidated income tax return. As of June 30, 1977, the Company and its subsidiaries have available capital loss carry-forwards of approximately \$600,000 which expire in 1980.

For financial statement reporting purposes, the utilization of pre-acquisition tax loss carry-forwards, related to periods prior to the Company's acquisition of a subsidiary under the purchase method of accounting, are recorded as a reduction in the cost of subsidiaries in excess of underlying assets. These tax loss carry-forwards have been substantially utilized as of June 30, 1976.

The Company's Riley Stoker subsidiary made a decision during the third quarter of 1977 to change to the completed contract method of accounting for income tax reporting only, with the approval of the Internal Revenue Service. This change, which would have no effect on net income, has been reconsidered and the Company has deferred its decision. Accordingly, the effects of such a change have not been reflected in the Company's balance sheet as of June 30, 1977.

(7) Earnings per Share:

Primary earnings per share for the two years ended June 30, 1977, have been determined based on the shares outstanding during the periods, after giving effect to common stock equivalents assuming the exercise of the Company's stock options under the treasury stock method where and to the extent such exercise would be dilutive. The average number of common shares and common share equivalents used in computing primary earnings per share were as follows: 1,539,360 (1977) and 1,530,165 (1976).

Fully diluted earnings per share have been determined assuming (1) the 6% convertible subordinated notes of Riley Stoker Corporation (Note 5) were converted and (2) all dilutive stock options (Note 8) were exercised under the treasury stock method. The average number of common shares and common share equivalents used in computing fully diluted earnings per share were as follows: 1,746,381 (1977) and 1,736,177 (1976).

(8) Stock Option Plans:

Under a 1968 qualified stock option plan, which expired on June 1, 1973, 3,000 shares of common stock are reserved for issuance for options outstanding to executives and key employees at June 30, 1977. An additional 77,000 shares of common stock are reserved for issuance for options outstanding to executives and key employees at June 30, 1977, under a similar qualified stock option plan adopted in October, 1973. Both plans provide that the option price be at least 100% of the fair market value of the stock at the date of grant, that options expire five years from date of grant and that certain other requirements be met. Options under the 1968 plan become exercisable two years from the date of grant and options under the 1973 plan become exercisable one year from date of grant.

A summary of the Company's stock options under these plans for the two years ended June 30, 1977, is as follows:

	Number of Shares	Option Price	
		Per Share	Aggregate
Options outstanding at June 30, 1975—	64,000	\$ 8.31-\$27.38	\$ 719,185
Granted	3,000	\$10.00	30,000
Exercised	(7,000)	\$ 8.31-\$ 8.88	(61,060)
Cancelled	(4,000)	\$ 8.31-\$27.38	(71,500)
Options outstanding at June 30, 1976—	56,000	\$ 8.38-\$27.38	\$ 616,625
Granted	36,000	\$14.50-\$16.75	561,750
Exercised	(9,000)	\$ 8.38-\$ 8.88	(77,875)
Cancelled	(3,000)	\$16.75-\$27.38	(71,500)
Options outstanding at June 30, 1977	<u>80,000</u>	<u>\$ 8.38-\$16.75</u>	<u>\$1,029,000</u>

Options for 47,000 shares at prices of \$8.38 to \$14.63 became exercisable in 1976 with an aggregate market value of \$527,625 at date exercisable. Options for 3,000 shares at price of \$10.00 became exercisable in 1977 with an aggregate market value of \$46,875 at date exercisable.

No accounting is made with respect to the Company's options until they are exercised, at which time the par value of shares issued is credited to common stock and the excess of proceeds over par value is credited to additional paid-in capital. For stock options issued from treasury stock, the difference between the option price received and the cost of the treasury stock, determined on a first-in, first-out cost basis, is charged or credited to additional paid-in capital.

(9) Pension Plans:

The Company has various pension plans covering substantially all of its employees. Pension expense included in the consolidated statement of income amounted to \$1,879,000 in 1977 and \$1,488,000 in 1976.

It is the Company's policy to fund the pension contributions as required and based on tax and other considerations. The assets of the plans exceed the actuarially computed value of vested benefits as of July 1, 1976, the date of the most recent actuarial review. The unfunded past-service costs as of July 1, 1976, were approximately \$4,800,000.

During fiscal 1977, the Company amended its pension plans to comply with the Employee Retirement Income Security Act of 1974. The effect of these changes on pension expense was not significant.

(10) Lease Commitments:

The Company has various lease agreements of more than one year duration expiring at various dates through 1995. Aggregate lease expense for 1977 and 1976 under these leases was \$599,816 and \$758,248, respectively, and future aggregate lease commitments are \$1,111,541. The Company has no significant non-capitalized financing leases. Reference is made to Note 5 for an explanation of capitalized rental obligations.

(11) Contingent Liabilities:

A lawsuit filed in August, 1973, against Environeering, Inc., and Riley Stoker seeking damages of not less than \$4,000,000, and Environeering's countersuit seeking recovery of \$325,000, were both settled during fiscal 1977. The settlements did not have a significant effect on the consolidated financial statements.

The Company and its subsidiaries have also been named as defendants in other lawsuits arising in the ordinary course of their business. In the opinion of Company management, none of the litigation will have a significant effect on the consolidated financial statements.

(12) Summary of Quarterly Earnings (Unaudited):

	Quarter Ended				Quarter Ended			
	Sept. 30, 1976	Dec. 31, 1976	March 31, 1977	June 30, 1977	Sept. 30, 1975	Dec. 31, 1975	March 31, 1976	June 30, 1976
(000's omitted)								
Net sales and contract revenue	\$54,785	\$58,391	\$59,600	\$69,950	\$46,206	\$51,617	\$55,976	\$56,354
Gross profit	\$ 6,511	\$ 7,321	\$ 7,934	\$ 6,663	\$ 6,800	\$ 8,396	\$ 8,977	\$ 5,734
Income before income taxes	\$ 2,248	\$ 2,891	\$ 3,991	\$ 3,348	\$ 1,835	\$ 3,196	\$ 3,386	\$ 1,286
Provision for income taxes	955	1,394	2,116	1,086(A)	936	1,549	1,776	518
Net Income	\$ 1,293	\$ 1,497	\$ 1,875	\$ 2,262	\$ 899	\$ 1,647	\$ 1,610	\$ 768
Earnings per share (Note 7)								
Primary	\$.85	\$.98	\$1.21	\$1.46	\$.59	\$1.07	\$1.05	\$.51
Fully diluted	\$.75	\$.87	\$1.08	\$1.30	\$.53	\$.96	\$.94	\$.44

(A) The reduced effective income tax rate of 32% in the fourth quarter, results principally from 1) realized capital gains from marketable securities which materialized in the quarter and which were applied against capital loss carry-forwards, 2) increases in dividends received from securities, 85% of which are non-taxable

**(13) Supplemental Information:
Property and Equipment—**

	Land	Buildings and Improvements	Machinery and Equipment
Cost—			
Balance, June 30, 1975	\$565,829	\$22,775,829	\$20,722,711
Additions, at cost	24,020	968,125	1,806,693
Sales and retirements	—	(196,209)	(1,516,477)
Transfers between accounts	—	90,277	(90,277)
Balance, June 30, 1976	\$589,849	\$23,638,022	\$20,922,650
Additions, at cost	—	321,248	4,982,454
Sales and retirements	(295)	(12,774)	(2,404,191)
Transfers between accounts	—	(63,131)	63,131
Balance, June 30, 1977	\$589,554	\$23,883,365	\$23,564,044
Accumulated Depreciation—		Buildings and Improvements	Machinery and Equipment
Balance, June 30, 1975		\$ 3,530,871	\$ 9,361,687
Provision charged to income		739,501	2,345,949
Sales and retirements		(194,457)	(1,302,721)
Balance, June 30, 1976		\$ 4,075,915	\$10,404,915
Provision charged to income		758,478	2,716,752
Sales and retirements		(1,739)	(1,677,464)
Balance, June 30, 1977		\$ 4,832,654	\$11,444,203

Reserve for Doubtful Accounts—

	1977	1976
Balance at beginning of year	\$ 190,000	\$ 192,300
Provision charged to income	39,582	66,156
Write off doubtful accounts	33,142	(68,456)
Balance at end of year	\$ 196,440	\$ 190,000

Supplementary Profit and Loss Information—

	1977	1976
Maintenance and repairs	\$ 2,828,499	\$ 2,588,530
Taxes, other than income taxes		
Payroll	4,313,507	3,935,074
Real estate and personal property	546,773	476,472
Franchise and other	295,892	147,768
Rents	721,952	892,987
Advertising	502,354	488,998

Auditors' Report

To the Stockholders and
Board of Directors of
The Riley Company

We have examined the consolidated balance sheets of THE RILEY COMPANY (a Delaware corporation) AND SUBSIDIARIES as of June 30, 1977 and June 30, 1976, and the related statements of income, stockholders' investment, and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements present fairly the financial position of The Riley Company and Subsidiaries as of June 30, 1977 and June 30, 1976, and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

ARTHUR ANDERSEN & CO.

Chicago, Illinois,
August 10, 1977

RS-002667
1/17/02
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The Riley Company Consolidated Summary of Earnings

(000's omitted)

	Year Ended June 30,				
	1977	1976	1975	1974	1973(C)
Net sales and contract revenues	\$242,726	\$210,153	\$188,374	\$169,664	\$112,310
Gross profit	28,429	29,908	27,269	28,740	19,542
Interest expense	1,481	1,787	1,814	2,056	1,540
Other income, net	6,350	1,973	936	966	1,091
Provision for income taxes	5,551	4,779	3,267	4,882	2,585
Income before extraordinary items	6,927	4,924	2,779	4,609	2,575
Extraordinary items	—	—	—	650(D)	—
Net income	6,927	4,924	2,779	5,259	2,575
Per share					
Primary—					
Before extraordinary items	\$4.50	\$3.22	\$1.82	\$3.04	\$1.70
Net income	4.50	3.22	1.82	3.47	1.70
Fully diluted—					
Before extraordinary items	\$4.00	\$2.87	\$1.63	\$2.71	\$1.54
Net income	4.00	2.87	1.63	3.09	1.54
Cash dividends	—	—	—	—	—
Average shares					
Average shares outstanding	1,510,199	1,513,392	1,515,357	1,515,357	1,507,280
Number of shares used in computing primary earnings per share (A)	1,539,360	1,530,165	1,526,753	1,516,968	1,513,908
Number of shares used in computing fully diluted earnings per share (B)	1,746,381	1,736,177	1,740,148	1,721,568	1,718,131

(A) The difference between average shares outstanding and the number of shares used in the computation of primary earnings per share represents common stock equivalents relating to dilutive stock options outstanding

(B) The difference between average shares outstanding and the number of shares used in the computation of fully diluted earnings per share represents common stock equivalents relating to dilutive stock options outstanding and

the assumed conversion of the convertible subordinated notes. (Note 7)

(C) Includes only six months of operations for Riley Beard, Inc., acquired on January 1, 1973

(D) Represents gain on sale of property held for sale, net of related income taxes

Management Discussion and Analysis of the Summary of Earnings

Net Sales and Contract Revenues: The Riley Company had record sales and contract revenues of \$242,726,899 in the fiscal year ended June 30, 1977. These sales were 15 percent higher than fiscal year 1976 sales of \$210,153,452, and 29 percent higher than fiscal year 1975 sales of \$188,373,910. Demand for the products of the Process Instruments Group and of the Riley-Beard Division continued at a strong level throughout fiscal 1977.

The Riley Stoker Group, which is essentially involved in the production of utility and industrial boilers for the generation of electric power and which are produced on long term contracts, realized greater revenues than the prior fiscal year. This increased revenue was, however, generated primarily from contracts booked in prior years. Sales and contract revenues generated by this Group in the fiscal year ended June 30, 1977, amounted to \$166,022,000 compared to \$131,204,000 in fiscal 1976 and \$115,922,000 in fiscal 1975.

A lower level of new orders received from utilities and industrial companies for fossil fuel boilers reflected the uncertainties of the national energy policy and thus was primarily responsible for the drop in The Riley Company's backlog of business from \$416,000,000 as of the end of June, 1976, to \$372,000,000 as of the end of June, 1977.

Demand for various pressure and process vessels produced by the

Riley-Beard subsidiary remained strong, however, highly competitive. In the fiscal year ended June 30, 1977, the sales of heavy metal fabrication products amounted to \$57,131,000 as compared to \$59,906,000 in the fiscal year ended June 30, 1976, a decrease of 5 percent. In fiscal 1975, sales of this Group amounted to \$53,053,000.

Sales and income contributed by the foreign subsidiaries of The Riley Company were not material in the fiscal year ended June 30, 1977, nor were they material in the prior two fiscal years.

Lines of Business: The Company and its subsidiaries are engaged primarily in the design, manufacture and servicing of steam generating and fuel burning equipment, annunciator components, and system related industrial monitoring control devices, and heavy metal fabrication for the petrochemical and other industries.

As of the end of June, 1977, the Company had a total backlog of business of \$372,000,000, down from \$416,000,000 as of June 30, 1976, but up from \$329,000,000 as of June 30, 1975. The primary portion of the Company's backlog of business as of June 30, 1977, of \$372,000,000 involves steam generating and fuel burning equipment, which generally have a three to five year order to delivery cycle.

The sales and contract revenues and operating income or (loss) attributable to each line of business for the last five fiscal years are as follows.

	(000's omitted) Year Ended June 30,				
	1977	1976	1975	1974	1973
Net Sales and Contract Revenues					
Electronic systems	\$ 19,574	\$ 19,043	\$ 19,399	\$ 16,966	\$ 13,477
Steam generators and fuel burning equipment	166,022	131,204	115,922	101,798	76,371
Heavy metal fabrication	57,131	59,906	53,053	50,900	22,462
Totals	\$242,727	\$210,153	\$188,374	\$169,664	\$112,310
Income from Operations					
Electronic systems	\$ 5,127	\$ 3,905	\$ 5,016	\$ 2,522	\$ 1,873
Steam generators and fuel burning equipment	(8,301)	(10,004)	(7,971)	2,157	1,961
Heavy metal fabrication	10,783	15,615	9,879	5,903	1,775
Totals	\$ 7,609	\$ 9,516	\$ 6,924	\$ 10,582	\$ 5,609
Other income and expense, net	4,869	187	(878)	(1,091)	(449)
Income before taxes and extraordinary items	\$ 12,478	\$ 9,703	\$ 6,046	\$ 9,491	\$ 5,160

*Includes only 6 months operations for Riley-Beard acquired January 1, 1973

Other income and expense, consisting primarily of income realized from interest earned, dividends and gains realized from the Company's portfolio of marketable securities and net of interest paid amounted to \$4,869,000 in the fiscal year ended June 30, 1977. The increase in this type of income as compared to prior fiscal years is entirely due to the availability of substantial cash resources in the fiscal year ended June 30, 1977, which have been temporarily invested in interest or dividend paying marketable securities, including U.S. Treasury Notes. In the fiscal year ended June 30, 1976, other income and expense, net, amounted to \$187,000 and in the year ended June 30, 1975, it amounted to \$(878,000) net.

Income from Operations: Income from operations in fiscal year ended June 30, 1977, amounted to \$7,609,229, as compared to \$9,516,205 in the fiscal year 1976 and \$6,924,374 in fiscal year 1975. The net reduction of \$1,907,000 in fiscal 1977 income is the net result of a) an increase of \$1,222,000 in income generated by the Process Instruments Group, b) a decrease in the net operating loss generated by the Riley Stoker Group amounting to \$1,703,000, and c) a decrease in operating income contributed by the Riley-Beaird Group of \$4,832,000 as compared to the prior fiscal year.

The increase in net operating income of the Process Instruments Group is the result of improved margins on all product lines, and also the resumption of profitable operations at the Cashco, Ellsworth, Kansas, facility after completion of the move from Decatur, Illinois, which had caused this subsidiary to suffer a substantial loss in the fiscal year ended June 30, 1976.

The Riley Stoker Group operating losses in the year ended June 30, 1977, are primarily due to the fact that older contracts having very low or no margins made no contribution to the absorption of general and administrative expenses.

The decrease in operating income contributed by the Riley-Beaird Group in fiscal 1977 is entirely due to the fact that pricing of its products became significantly more competitive, thus reducing the net margins generated by these products, as compared to the prior fiscal year.

Operating Expenses: Total selling expenses for The Riley Company in the fiscal year ended June 30, 1977, amounted to \$9,143,058 as compared to \$8,616,330 in the fiscal year ended June 30, 1976, and \$8,457,597 in the fiscal year ended June 30, 1975.

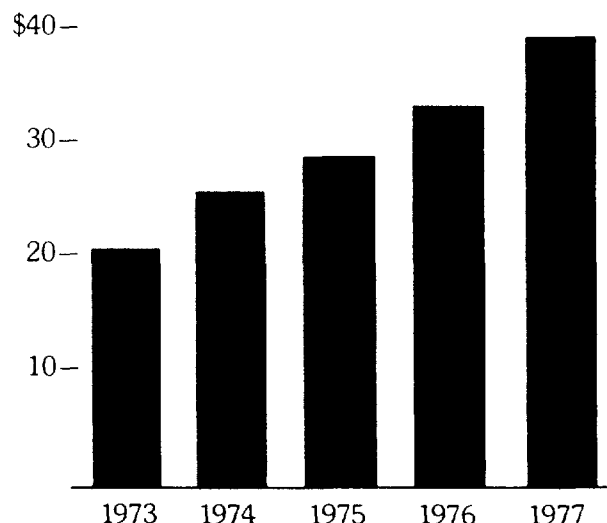
General and administrative expenses of \$9,849,297 in the year ended June 30, 1977, compared to \$9,311,414 in the year ended June 30, 1976, and \$8,445,607 in the year ended June 30, 1975. A substantial portion of the fiscal 1976 increase as compared to fiscal 1975 was due to the expenses incurred in the relocation of the Cashco valve manufacturing operations from Decatur, Illinois, (which was closed in April of 1976) to our new, modern, and enlarged facilities in Ellsworth, Kansas.

Research and Development Expenses: The Riley Company, continuing its policy of writing off all expenses incurred in the research and development programs, expended \$1,827,329 in the fiscal year ended June 30, 1977. In fiscal year 1976 the company had expended \$2,463,576 and in fiscal year 1975 the amount was \$3,441,487. The decline in R&D Expenditures both in fiscal 1977 and fiscal 1976 is the result of a reduced level of expenditures on coal gasification. In fiscal 1977 expenditures on this program amounted to \$344,177 as compared to \$865,267 in fiscal year 1976 and \$2,041,000 in fiscal year 1975. To date the Company has not received any orders for coal gasification units.

Research and development expense, as a percentage of sales and contract revenue, amounted to 0.8 percent in the fiscal year ended June 30, 1977, 1.2 percent in the fiscal year ended June 30, 1976, and 1.8 percent in the fiscal year ended June 30, 1975.

Stockholders' Equity

(In millions of dollars)



Summary of Quarterly Earnings

	1977	1976
	(000)	
First Quarter	\$1,293	\$ 899
Second Quarter	1,497	1,647
Third Quarter	1,875	1,610
Fourth Quarter	2,262	768

Summary of ASE Stock Prices

	1977		1976	
	High	Low	High	Low
First Quarter	17 ⁷ / ₈	13 ⁵ / ₈	19 ¹ / ₄	10 ³ / ₄
Second Quarter	16 ³ / ₈	14 ¹ / ₄	13	9 ³ / ₈
Third Quarter	27 ⁷ / ₈	15 ⁷ / ₈	17	10 ¹ / ₂
Fourth Quarter	33 ¹ / ₂	25 ¹ / ₂	18	14 ³ / ₄

The financial and other information contained in this annual report is in conformity with the Form 10-K annual report filed by the company with the S. E. C. A copy of the form 10-K, which contains additional information about the company, will be furnished to any stockholder upon written request to D. Knopf, Assistant Secretary, The Riley Company, 1500 Higgins Road, Park Ridge, Illinois 60068.

The Riley Company

1500 Higgins Road
Park Ridge, Illinois 60068

Directors

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President
Worcester Polytechnic Institute

C. O. NEWLIN
Vice President (Retired)
Continental Illinois National
Bank and Trust Company of Chicago

P. PEDERSEN
Secretary and General Counsel
The Riley Company

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Chairman of the Board
Riley Stoker Corporation

H. C. WARREN
Chairman and President
The Riley Company

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Chairman, President and Treasurer
The Riley Company

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Vice President, Finance
The Riley Company

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Riley-Beaird, Inc.

J. J. FARRELL
President
Riley Stoker Corporation

R. H. GARRETT
President
Process Instruments Group
Vice President
The Riley Company

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Secretary

D. KNOPF
Assistant Secretary

W. F. BERG
Controller

Transfer Agent and Registrar

First National Bank of Chicago
Chicago, Illinois

Auditors

Arthur Andersen & Co

Legal Counsel

Pedersen & Houpt