The decline in earnings was caused by several factors. Start-up costs at two freight car wheel plants were high during the first quarter and sufficient sales volume was not obtained to fully utilize the expanded capacity throughout the year.

Unusual expenses were incurred in several areas of our hydraulics business. The Aerospace Division, created in mid-1962, was engaged in moving production of servovalves to the Oxnard, California plant. The costs of consolidating manufacturing activities, and engineering and field service organizations were charged to the year's operations.

In the Denison Division, start-up costs were incurred at the new Marysville, Ohio plant which went into production early in the year.

During the year, Jarry Hydraulics completed moving its main manufacturing facilities into a modern building in Montreal. Moving and rearranging expenses, interruptions in manufacturing, and development costs in connection with certain military contracts were all high.

Competition has been severe in all markets served and, as a consequence, the rate of profit on many products was low. Increased selling prices have been possible only in limited product areas and we anticipate that similar conditions will prevail throughout this year. Consequently, vigorous cost control will be maintained, and studies to effect better manufacturing and marketing methods will have the continuous attention of division management people.

ORDERS AND BACKLOG

Total orders received in 1963 increased to $221,700,000, slightly exceeding shipments. The backlog of orders at the end of the year was $56,100,000 compared with $49,100,000 a year previously. Approximately 50 per cent of the year-end backlog was for hydraulic products, which ordinarily take a longer lead time from order to shipment.

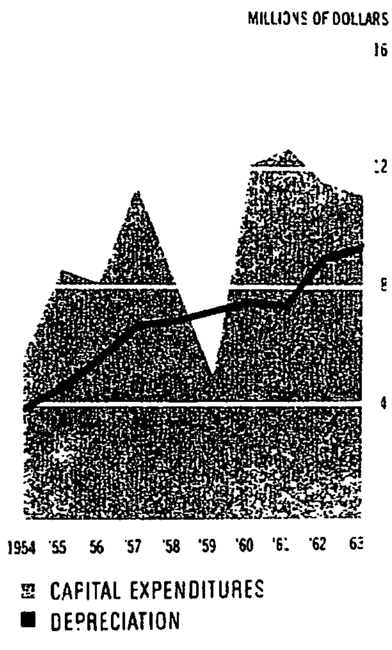
CAPITAL EXPENDITURES

Capital expenditures for 1963 were $11,124,000 compared to $11,568,000 in 1962. Depreciation charges and amortization amounted to $9,646,000 for the year 1963.

A major portion of capital expenditures was for cost reduction programs and necessary replacement of equipment throughout the company.

In January 1963, the company purchased for $3,000,000 the net assets of a company in Hilden, West Germany which was

CAPITAL EXPENDITURES AND DEPRECIATION



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