In 1995 — for the second year in a row — Eaton achieved record sales and profits as a result of the exceptional performance of most of the company's businesses in the face of difficult competitive and pricing pressures. Net income amounted to $399 million, or $5.13 per share on sales of $6.8 billion. This compares with 1994 net income of $333 million, or $4.40 per share, on sales of $6.1 billion.

Since 1991, sales have nearly doubled and net income has increased more than five-fold.

Strong demand in our key markets fueled 1995's performance. In most instances, though, Eaton's sales outpaced underlying market growth. Semiconductor Equipment sales were particularly noteworthy. On a year-to-year basis, they rose 80 percent. Semiconductor Equipment has now become a major Eaton operation.

Despite the fact that we were able to report record earnings, we did not achieve the full level of profits we would normally have expected, given our shipment increases. Some unpredictable external events, such as the economic crises in Mexico and Brazil, hurt demand in these countries. Internal performance shortfalls compounded our problems in meeting targeted earnings results. Our Cutler-Hammer unit did not achieve expected productivity levels following the consolidation of manufacturing facilities. Our Appliance Controls business was affected by the need to continue moving production out of Germany. Unexpected costs associated with major new product introductions penalized results in our worldwide Automotive Controls business, in Truck Components, and in some other units. While difficult to measure precisely, we estimate that these issues combined to reduce our 1995 results by about 30 cents per share.

Without minimizing these problems, it is important to note that none are fundamental in nature. In time, many of the underlying initiatives which drove up our costs in 1995 should provide the base for future profit growth.

During 1995, several strategically significant acquisitions were completed which we believe will also contribute to future growth. These include:

- The electrical switchgear and controls business of Emwest Products Pty. Limited, an Australian company. The purchase included operating facilities in Australia, New Zealand and the Philippines, which manufacture a wide range of electrical equipment, including circuit breakers, panelboards, contactors and switchgear. The business had annualized sales of $33 million in 1995.
- A Dutch automotive controls company, the IKU Group, with manufacturing facilities in Montfoort, The Netherlands; Three Rivers, Michigan; and Gdansk, Poland. IKU is a leading supplier of electric mirror actuators for automotive manufacturers and had annualized sales of $98 million in 1995.
- A leading golf grip manufacturer, Rubberon Technology Corporation, Ltd., located in Thailand, which serves the growing Asian market.
- The remaining 49 percent interest in Mallory Controles Ltda., located near Sao Paulo, Brazil. Eaton had bought a controlling interest in 1994. The new business entity, Eaton Controles Ltda., manufactures program timers, pressure switches and water valves for dishwashers, clothes dryers, washing machines and other major appliances.

We intend to continue these focused and disciplined acquisition efforts. From a financial point of view, we have completely digested the cost of the $1.1 billion investment in the electrical distribution and controls business unit purchased from Westinghouse in 1994. Increasingly, we will be looking for opportunities to use acquisitions to position Eaton in facets of our existing businesses which enjoy attractive, sustainable earnings growth prospects.

We also continued our heavy emphasis on research and development and capital spending programs in 1995. R&D reached $227 million, and spending on capital equipment totaled $399 million. This sizable rate of investment — which will continue in 1996 — speaks to the vitality and prospects of our key units.

As we look ahead, 1996 is already shaping up as a challenging year. Our economic assumptions are based on the expectation that physical volume in many of our product lines in North America reached cyclical peaks in the first half of 1995. Demand for heavy trucks in North America in 1996 is projected to fall 20 to 25 percent from the extraordinary level enjoyed in 1995. Perhaps the brightest prospect for year-to-year increases in sales is in our Semiconductor Equipment business, for which worldwide demand is expected to rise 40 percent in 1996. Virtually all of the world's largest semiconductor chip manufacturers use Eaton ion implantation equipment. Activity in our product lines in Europe and Japan is expected to strengthen somewhat, and we look for continued growth in the developing parts of the world. We believe that the worst effects of the recent economic problems in Mexico and Brazil are behind us.

If this economic outlook is accurate, our ability to report improved results in 1996 will be a function of our success in executing some key new product programs and in addressing some of our operational problems. We have already seen encouraging progress in our turnaround plans in Europe and in our truck axle business. That progress is expected to accelerate in 1996. Despite on-going moves to restructure some lagging operations, and plans to increase investment in promising growth initiatives, our goal is to outperform expectations based on the cyclical levels of our traditional automotive markets.