CHANGES IN FINANCIAL CONDITION

Net working capital increased to $822 million at year-end 1995 from $744 million at year-end 1994, while the current ratio of 1.7 was consistent for both year-ends. The Company remains in a strong financial position and has the capital resources available in the form of working capital, lines of credit and funds provided by operations for reinvestment in existing operations, strategic acquisitions and managing the capital structure.

Although sales in 1995 reached a record level, accounts receivable and inventories at the end of 1995 only increased slightly from 1994. The accounts receivable and inventory turnover rates of seven times in 1995 were consistent with 1994. Accounts receivable days sales outstanding and days of inventory on-hand showed slight increases at year-end 1995 from 1994. The acquisitions of the IKU Group and Emwest, as discussed under 'Acquisitions and Divestitures of Businesses' in the Financial Review, were the principal cause of the increase in excess of cost over net assets of businesses acquired from the prior year-end.

Total debt, consisting of short-term and long-term debt and the current portion of long-term debt, increased slightly from December 31, 1994, the result of the issuance in June 1995 of $150 million 6½% debentures due 2025, which was partially offset by payments on certain borrowings. In 1995, the Company entered into a $500 million five-year revolving credit agreement as discussed under 'Debt and Other Financial Instruments' in the Financial Review.

Reflecting the Company's ongoing investment program under long-range goals to achieve improvements in product quality, manufacturing productivity and business growth, capital expenditures for 1995 were a record. Over the past five years, the Company has spent more than $1 billion on capital expenditures to increase productivity, reduce costs and, selectively, to add capacity. Capital spending in 1996 is anticipated to be another all-time record in order to enable the Company to enhance product quality through technology improvements and to help achieve long-term growth prospects.

During 1994, the Company purchased DCBU, as discussed under 'Acquisitions and Divestitures of Businesses' in the Financial Review. The Company has been actively progressing on the comprehensive integration plan which was established for the combination of DCBU with the Company's Industrial Controls and Power Distribution Operations. To date, the Company has closed and/or announced the closure of twenty-six facilities and sold six facilities as a result of divestiture activities.

At December 31, 1995, the Company had net deferred income tax assets reported as both 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.

In the normal course of business, the Company is exposed to various financial risks including changes in interest and foreign exchange rates. The Company has developed systems to continuously measure and assure that these 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 of exposures and derivative activities 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 effect of financial instruments on the Company's financial condition and results of operations is not material. 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 and other rate assumptions used to measure the projected benefit obligations for pensions and postretirement benefits other than pensions was reduced in 1995, as further discussed under 'Pension Plans' and 'Postretirement Benefit Plans Other Than Pensions' in the Financial Review.

Operations of the Company involve the use and disposal of certain substances regulated under environmental protection laws. The Company continues to modify, on an ongoing, regular basis, certain processes in order to reduce the impact on the environment, including the reduction or elimination of certain chemicals used in and wastes generated from operations. The Company's liabilities related to environmental matters are further discussed under 'Protection of the Environment' in the Financial Review.

Due to a strong balance sheet and cash flow from operations, strength of the Company's markets and a commitment to enhancing ongoing shareholder value, the Company raised the quarterly dividend from 30 cents to 40 cents, effective with the second quarter 1995 dividend. This represented a 33% increase and was the second increase in dividend rates in less than two years. The Company has paid dividends on Common Shares annually since 1923. Cash dividends paid in 1995 were a record. In addition, a dividend of one Preferred Share Purchase Right on each outstanding Common Share was declared as discussed under 'Preferred Share Purchase Rights' in the Financial Review.

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 has authorized the purchase of up to five million outstanding Common Shares. Under the Board's authorization, the Company may purchase these shares over a five year period; however, only a maximum of 1.5 million shares can be purchased in any one year. Through December 31, 1995, the Company had repurchased 766,000 shares at an aggregate purchase price of $40 million, or an average price of $52 per share.

The Company continues to generate substantial cash from operations. The Company's earnings growth and emphasis on asset management generated record operating cash flow in 1995, compared with the previous record in 1994. The improvement in cash flow resulting from increased net income and other items exceeded the cash requirements to fund increased working capital. Net cash provided by operating activities, supplemented by commercial paper and other borrowings, was used to fund the purchase price of business acquisitions, the record levels of capital expenditures and cash dividends, the repayment of debt and repurchase of Common Shares.