Financial Review

In June 1997, SFAS No. 131, 'Disclosures about Segments of an Enterprise and Related Information', was issued. SFAS No. 131 changes the standards for reporting financial results by operating segments and related products and services, geographic areas, and major customers. The Company must adopt the standard no later than year-end 1998.

Quarterly Data

(Unaudited)	Quarter ended			
(Millions except for per share data)	Dec. 31	Sept. 30	June 30	Mar. 31
1997				
Net sales	$1,934	$1,931	$1,909	$1,789
Gross margin	546	541	538	482
Percent of sales	28%	28%	28%	27%
Income before extraordinary item	$ 183	$ 54	$ 126	$ 101
Extraordinary item	(54)			
Net income	$ 129	$ 54	$ 126	$ 101
Per Common Share				
Income before extraordinary item	$ 2.41	$ .70	$ 1.64	$ 1.31
Extraordinary item	(.71)			
Net income	$ 1.70	$ .70	$ 1.64	$ 1.31
Cash dividends paid	$ .44	$ .44	$ .44	$ .40
Market price				
High	103⅜	95¾	89⅞	75⅛
Low	85¼	81⅛	67⅛	67⅛
Per Common Share-assuming dilution				
Income before extraordinary item	$ 2.35	$ .69	$ 1.61	$ 1.29
Extraordinary item	(.69)			
Net income	$ 1.66	$ .69	$ 1.61	$ 1.29
1996				
Net sales	$1,724	$1,719	$1,782	$1,736
Gross margin	426	436	472	456
Percent of sales	25%	25%	26%	26%
Net income	66	85	103	95
Per Common Share				
Net income	$ .85	$ 1.11	$ 1.32	$ 1.23
Cash dividends paid	.40	.40	.40	.40
Market price				
High	70⅞	61⅞	62⅜	61⅞
Low	57¾	53	56⅜	50⅜
Per Common Share-assuming dilution				
Net income	$ .84	$ 1.09	$ 1.31	$ 1.22

Income in the fourth quarter of 1997 was increased by pretax gains of $91 million related to the sales of AIL Systems Inc. and the Appliance Controls business ($69 million aftertax, or $.90 per Common Share).

Income in the fourth quarter of 1997 was reduced by pretax restructuring charges of $24 million ($15 million aftertax, or $.19 per Common Share).

Net income in the fourth quarter of 1997 was reduced by a $54 million aftertax extraordinary loss for the redemption of debentures, or $.71 per Common Share.

Net income in the third quarter of 1997 was reduced by an $85 million write-off of purchased in-process research and development, with no income tax benefit, or $1.11 per Common Share.

Income in 1996 was reduced by pretax restructuring charges of $50 million ($32 million aftertax, or $.41 per Common Share). Of these restructuring charges, $29 million was recorded in the fourth quarter of 1996 and the remaining $21 million was recorded evenly throughout the first nine months of 1996.

In the fourth quarter of 1996, the effective income tax rate for full year 1996 was adjusted to 28.2% from 29.9%. This adjustment reduced income tax expense for the fourth quarter by $7 million, which relates to the first nine months of 1996.

In the third quarter of 1996, the estimated effective income tax rate for full year 1996 was adjusted to 29.9% from 31.6%. This adjustment reduced income tax expense for the third quarter by $5 million, which relates to the first half of 1996.

Business Segment and Geographic Region Information

Eaton is a global manufacturer of highly engineered products which serve the industrial, vehicle, construction, commercial and semiconductor markets with operations located in 28 countries. The major classes of products included in each business segment and other information follows.

Electrical and Electronic Controls

Industrial and Commercial Controls Electromechanical and electronic controls including motor starters, contactors, overloads and electric drives; programmable controllers, counters, man/machine interface panels and pushbuttons; photoelectric, proximity, temperature and pressure sensors; residential, molded case, hydraulic, air and vacuum circuit breakers; loadcenters; safety switches; lighting control systems; panelboards; switchboards; switchgear components; switchgear; dry type transformers; protective relays and metering; surge suppressors; busway; meter centers; crane controls; portable tool switches; commercial switches; relays; vacuum interrupters; illuminated pushbuttons and panels; annunciator panels; electrically actuated valves and actuators; pressure transducers and switches; and Navy motor control and power conversion systems.

Automotive and Appliance Controls Electromechanical and electronic controls including convenience, stalk and concealed switches; knock sensors; climate control components; speed controls; water valves; thermostats; temperature and humidity sensors; transmission valves; speed sensitive steering systems; tone generators and chimes; lighting controls; emission control valves; collision warning systems; remote keyless entry systems and remote actuated solenoids.

On December 1, 1997, the Company sold the Appliance Controls business which had sales of $418 million and $432 million in 1997 and 1996, respectively. The following products represent those included in the Appliance Controls business: timers, pressure switches, range controls, gas valves, and infinite switches.

Specialty Controls Ion implanters; photostabilizers; ozone and plasma ashers; thermal processing systems; flat panel display equipment; plastic and steel spring fasteners; retainer rings; clamps; golf grips; industrial rubber products; industrial clutches and brakes.