

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollar amounts in thousands unless indicated)

Note 1

Significant Accounting Policies

BASIS OF PRESENTATION: The consolidated financial statements and related notes give retroactive effect to the merger on November 29, 1994 with Joy Technologies Inc. (“JTI”) for all periods presented, accounted for as a pooling of interests. The Consolidated Statement of Income has also been reclassified to reflect the Company’s divestiture in 1998 of the P&H Material Handling (“Material Handling”) segment, and in 1995 of the Systems Group and Joy Environmental Technologies (“JET”), all accounted for as discontinued operations (See Note 16 — Discontinued Operations.) The term “Company” as used in these consolidated financial statements refers to Harnischfeger Industries, Inc. and its subsidiaries.

PRINCIPLES OF CONSOLIDATION: The consolidated financial statements include the accounts of all majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

USE OF ESTIMATES: The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Ultimate realization of assets and settlement of liabilities in the future could differ from those estimates.

INVENTORIES: Inventories are stated at the lower of cost or market value. Cost is determined by the last-in, first-out (LIFO) method for substantially all domestic inventories and by the first-in, first-out (FIFO) method for the inventories of foreign subsidiaries.

REVENUE RECOGNITION: Revenue on long-term contracts is generally recorded using the percentage-of-completion method for financial reporting purposes. Contracts for pulp and papermaking machinery and certain mining equipment are included. Losses, if any, are recognized in full as soon as identified. Sales of other products and services are recorded as products are shipped or services are rendered.

PROPERTY, PLANT AND EQUIPMENT: Property, plant and equipment is stated at historical cost. Expenditures for major renewals and improvements are capitalized, while maintenance and repairs which do not significantly improve the related asset or extend its useful life are charged to expense as incurred. For financial reporting purposes, plant and equipment is depreciated primarily by the straight-line method over the estimated useful lives of the assets. Depreciation claimed for income tax purposes is computed by accelerated methods.

CASH EQUIVALENTS: The Company considers all highly liquid debt instruments with a maturity of three months or less at the date of purchase to be cash equivalents.

FOREIGN EXCHANGE CONTRACTS: Any gain or loss on forward contracts designated as hedges of commitments is deferred and included in the measurement of the related foreign currency transaction, except that permanent losses are recognized immediately.

FOREIGN CURRENCY TRANSLATION: The majority of the assets and liabilities of the Company’s international operations are translated at year-end exchange rates; income and expenses are translated at average exchange rates prevailing during the year.

For operations whose functional currency is the local currency, translation adjustments are accumulated in a separate section of shareholders’ equity. Transaction gains and losses, as well as translation adjustments relating to operations whose functional currency is the U.S. dollar, are reflected in income. Pre-tax foreign exchange losses included in operating income (loss) were \$(2,150), \$(811) and \$(983) in 1998, 1997 and 1996, respectively.

GOODWILL AND INTANGIBLE ASSETS: Goodwill represents the excess of the purchase price over the fair value of identifiable net assets of acquired companies and is amortized on a straight-line basis over periods ranging up to 40 years. Consistent with Statement of Financial Accounting Standard (“SFAS”) No. 121, “Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to be Disposed of”, the Company annually evaluates whether the projected earnings and undiscounted cash flows of the acquired companies are sufficient to recover the carrying value of the net investment, including goodwill, in order to determine if an impairment has occurred. Other intangible assets are amortized over the shorter of their legal or economic useful lives ranging from 5 to 20 years. Accumulated amortization was \$100,679 and \$95,033 at October 31, 1998 and 1997, respectively.

INCOME TAXES: Deferred income taxes are recognized for the tax consequences of “temporary differences” by applying enacted statutory tax rates applicable to future years to differences between the financial statement carrying amounts and the tax bases of existing assets and liabilities and for tax basis carryforwards. A valuation allowance is provided for deferred tax assets where it is considered more likely than not that the Company will not realize the benefit of such assets (See Note 6 — Income Taxes.)

RESEARCH AND DEVELOPMENT EXPENSES: Research and development costs are expensed as incurred. Such costs incurred in the development of new products or significant improvements to existing products amounted to \$49,131, \$38,725 and \$34,152 in 1998, 1997 and 1996, respectively. Certain capital expenditures used in research activities, such as the construction of a pilot paper machine used in research and for customer tests, are capitalized and depreciated over their expected useful lives.

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EARNINGS PER SHARE: In the first quarter of fiscal 1998, the Company adopted SFAS No. 128, "Earnings Per Share". This statement establishes revised standards for computing and presenting earnings per share. All prior periods have been restated (See Note 17 — Earnings Per Share.) Shares in the Stock Employee Compensation Trust ("SECT") are not considered outstanding for purposes of computing earnings per share.

FUTURE ACCOUNTING CHANGES: In June, 1997, the Financial Accounting Standards Board ("FASB") issued SFAS No. 130, "Reporting Comprehensive Income". The standard requires that certain items recognized under accounting principles as components of comprehensive income be reported in a financial statement that is displayed with the same prominence as other financial statements. The Company will adopt the standard in fiscal 1999.

In June, 1997, the FASB issued SFAS No. 131, "Disclosures About Segments of an Enterprise and Related Information". This standard establishes new requirements for the reporting of segment information by public entities. All prior periods will be required to be restated. The Company will adopt this standard in fiscal 1999.

In February, 1998, the FASB issued SFAS No. 132, "Employers' Disclosures about Pensions and Other Post-retirement Benefits". This standard's objective is to improve pension and other postretirement benefits disclosure. The Company will adopt the standard in fiscal 1999.

In June, 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities". This standard addresses the accounting for derivative instruments including certain derivative instruments embedded in other contracts, and hedging activities. The Company will adopt this standard in fiscal 2000.

It is not expected that SFAS No. 130, 131, 132, or 133 will result in significant changes to the Company's disclosures or financial results.

Note 2

Acquisitions

On March 19, 1998, the Company completed the acquisition of Horsburgh & Scott ("H&S") for a purchase price of \$40,192. H&S is a manufacturer of gears and gear cases, and is also involved in the distribution of parts and service to the mining industry. The acquisition was accounted for as a purchase transaction, with the purchase price allocated to the fair value of specific assets acquired and liabilities assumed. Resultant goodwill is being amortized over 40 years.

In fiscal 1996, the Company completed the acquisition of Dobson Park Industries plc ("Dobson") for a purchase price of approximately \$330,000, including acquisition costs, plus the assumption of net debt of approximately \$40,000.

The Company has substantially integrated Longwall's (the main subsidiary of Dobson) operations, thus enabling Joy Mining Machinery ("Joy") to offer integrated underground longwall mining systems to the worldwide mining industry. As a result of this integration, the Company established purchase accounting reserves to provide for the estimated costs of this effort. The reserves related primarily to the closure of selected manufacturing and service facilities, severance and relocation costs approximated \$71,000.

As part of the Dobson acquisition, several non-mining businesses were designated as businesses held for sale. At October 31, 1998, all of the businesses had been sold for slightly more than \$100,000, the original amount recorded on the Consolidated Balance Sheet.

On March 27, 1996, Beloit Corporation ("Beloit") purchased the assets of the Pulp Machinery Division of Ingersoll-Rand Company ("IMPCO") for \$119,230, including acquisition costs. The acquisition was accounted for as a purchase transaction with the purchase price allocated to the fair value of specific assets acquired and liabilities assumed. Resultant goodwill is being amortized over 40 years.

Note 3

Restructuring Charge

In the second quarter of fiscal 1998, Beloit recorded a \$65,000 restructuring charge (\$31,900 after tax and minority interest). The charge includes costs related to severance for approximately 1,000 people worldwide, facility closures, and disposal of machinery and equipment. Closure of a pulping-related manufacturing facility in Sherbrooke, Quebec, Canada has been completed, and closure of a similar facility in Dalton, Massachusetts will be complete in the first quarter of fiscal 1999. The paper-related manufacturing facility in the United Kingdom is being converted to a center of excellence responsible for rolls, while the Italian operation is expected to be converted from a full-line manufacturing operation to a MillProSM aftermarket center for central and southern Europe. The cash and noncash elements of the restructuring charge approximated \$32,500 and \$32,500, respectively. Management anticipates that the reserves will be substantially utilized within the next year. As of October 31, 1998, approximately 670 employees have been terminated in accordance with this plan. Details of this restructuring charge are as follows:

	Original Reserve	Reserve Utilized	10/31/98 Reserve
Employee severance	\$25,800	\$(10,486)	\$15,314
Facility closures	33,300	(12,477)	20,823
Machinery and equipment dispositions	5,900	(2,512)	3,388
Pre-tax charge	\$65,000	\$(25,475)	\$39,525

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In the fourth quarter of fiscal 1996, Beloit recorded a restructuring charge of \$43,000 (\$21,830 after tax and minority interest.) The restructuring was designed to provide for severance of approximately 500 employees worldwide, disposition of machinery and equipment, closure of certain facilities and the sale of certain capital intensive businesses. At October 31, 1998, all activity related to this restructuring was substantially completed.

Note 4

Accounts Receivable

Accounts receivable at October 31 consisted of the following:

	1998	1997
Trade receivables	\$337,003	\$438,591
Unbilled receivables	365,212	405,897
Allowance for doubtful accounts and contract losses	(9,889)	(8,319)
	<u>\$692,326</u>	<u>\$836,169</u>

The amount of trade receivables due beyond one year is not significant (See Note 18 — Beloit APP Contracts.)

Note 5

Inventories

Inventories at October 31 consisted of the following:

	1998	1997
Finished goods	\$366,346	\$274,391
Work in process and purchased parts	198,765	247,568
Raw materials	96,920	132,980
	<u>662,031</u>	<u>654,939</u>
Less excess of current cost over stated LIFO value	(51,553)	(60,178)
	<u>\$610,478</u>	<u>\$594,761</u>

Inventories valued using the LIFO method represented approximately 66% and 54% of consolidated inventories at October 31, 1998 and 1997, respectively.

Note 6

Income Taxes

The components of income (loss) for the Company's domestic and foreign operations for the years ended October 31 were as follows:

	1998	1997	1996
Domestic	\$(343,780)	\$ 94,666	\$ 57,189
Foreign	(44,856)	86,462	91,710
Pre-tax income (loss) from continuing operations	<u>\$(388,636)</u>	<u>\$181,128</u>	<u>\$148,899</u>

The consolidated provision (benefit) for income taxes included in the Consolidated Statement of Income for the years ended October 31 consisted of the following:

	1998	1997	1996
Current provision (benefit):			
Federal	\$ 2,081	\$ (5,048)	\$ 4,957
State	4,633	1,618	2,288
Foreign	5,998	24,691	36,474
Total current	<u>12,712</u>	<u>21,261</u>	<u>43,719</u>
Deferred provision (benefit):			
Federal	(108,564)	44,784	13,409
State and foreign	(17,193)	(236)	6,472
Total deferred	<u>(125,757)</u>	<u>44,548</u>	<u>19,881</u>
Total consolidated income tax provision (benefit)	<u>\$(113,045)</u>	<u>\$65,809</u>	<u>\$63,600</u>

The income tax provision (benefit) is included in the Consolidated Statement of Income as follows:

	1998	1997	1996
Continuing operations	\$(160,300)	\$61,555	\$52,098
Income from and net gain on sale of discontinued operation	47,255	12,920	11,502
Extraordinary item — retirement of debt	—	(8,666)	—
	<u>\$(113,045)</u>	<u>\$65,809</u>	<u>\$63,600</u>

The difference between the federal statutory tax rate and the effective tax rate on continuing operations for the years ended October 31 are as follows:

	1998	1997	1996
Federal statutory tax rate	(35.0)%	35.0%	35.0%
Goodwill amortization not deductible for tax purposes	0.9	1.9	2.3
Differences in foreign and U.S. tax rates	1.0	11.3	4.2
Differences in Foreign Sales Corporation and U.S. tax rate	(1.0)	(0.9)	(0.8)
State income taxes, net of federal tax impact	0.7	1.0	2.2
General business and foreign tax credits utilized	(1.0)	(17.5)	(11.1)
Resolution of various tax audits	(2.7)	—	—
Benefit related to capital transaction	(4.5)	—	—
Other items — net	0.4	3.2	3.2
Effective tax rate	<u>(41.2)%</u>	<u>34.0%</u>	<u>35.0%</u>

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Temporary differences and carryforwards which gave rise to the net deferred tax asset (liability) at October 31 are as follows:

	1998	1997
Inventories	\$ (7,021)	\$(16,788)
Reserves not currently deductible	62,041	5,757
Depreciation and amortization in excess of book expense	(31,422)	(41,926)
Employee benefit related items	30,507	15,319
Tax credit carryforwards	41,718	28,300
Tax loss carryforwards	147,845	65,032
Other — net	(77,663)	(65,618)
Valuation allowance	(47,038)	(34,895)
Net deferred tax asset (liability)	\$118,967	\$(44,819)

This net asset (liability) is included in the Consolidated Balance Sheet in the following captions:

	1998	1997
Prepaid income taxes	\$ 74,186	\$ 33,852
Deferred income taxes	44,781	(78,671)
	\$118,967	\$(44,819)

At October 31, 1998, the Company had general business tax credits of \$23,794 expiring in 2007–2013, foreign tax credit carryforwards of \$8,377 expiring in 2002–2003, and alternative minimum tax credit carryforwards of \$9,547 which do not expire. In addition, tax loss carryforwards consisted of foreign carryforwards of \$40,283 with various expiration dates, federal carryforwards of \$78,020 (pre-tax of \$222,900) expiring in 2018, and state carryforwards of \$29,542 with various states and expiration dates. The carryforwards will be available for the reduction of future income tax liabilities; a valuation allowance has been recorded against certain of these carryforwards for which utilization is uncertain.

U.S. income taxes, net of foreign taxes paid or payable, have been provided on the undistributed profits of foreign subsidiaries, except in those instances where such profits are expected to be permanently reinvested. Such unremitted earnings of subsidiaries which have been or are intended to be permanently reinvested were \$202,200 at October 31, 1998. If for some reason not presently contemplated, such profits were to be remitted or otherwise become subject to U.S. income tax, the Company expects to incur tax at substantially less than the U.S. income tax rate as a result of foreign tax credits that would be available.

Income taxes paid were \$45,039, \$11,809 and \$30,205 for 1998, 1997 and 1996, respectively.

Note 7

Long-Term Obligations, Bank Credit Facilities and Interest Expense

Long-term obligations at October 31 consisted of the following:

	1998	1997
10¼% Senior Notes, due 2003	\$ —	\$ 7,730
8.9% Debentures, due 2022	75,000	75,000
8.7% Debentures, due 2022	75,000	75,000
7¼% Debentures, due 2025 (net of discount of \$1,233 and \$1,247)	148,767	148,753
67⁄8% Debentures, due 2027 (net of discount of \$106 and \$111)	149,894	149,889
Senior Notes, Series A through D, at interest rates of between 8.9% and 9.1%, due 1999 to 2006	69,546	71,364
Australian Term Loan Facility, due 2000	56,169	—
Revolving Credit Facility	375,000	150,000
Industrial Revenue Bonds, at interest rates of between 5.9% and 8.8%, due 1999 to 2017	32,820	33,400
Other	19,377	14,057
	1,001,573	725,193
Less: Amounts due within one year	(38,776)	(11,727)
	\$ 962,797	\$713,466

On October 7, 1997, JTI issued a fixed-spread tender offer to purchase any and all of its 10¼% Senior Notes. This offer expired on October 21, 1997 with \$180,650 being repurchased under the offer. In 1997, as a result of the 10¼% Senior Note repurchases, the Company recorded an extraordinary loss on debt retirement, net of applicable income taxes, of \$(12,999), or \$(0.27) per basic share, consisting primarily of unamortized financing costs and purchase premiums. Debt purchased was funded through available cash and credit facilities.

The 10¼% Senior Notes were callable on or after September 1, 1998 at 105.125%. The Company called the remaining notes on September 1, 1998 for \$7,730 plus interest and premium of \$792.

The 7¼% debentures were issued on December 19, 1995 at a price of 99.153%. The debentures mature on December 15, 2025, are not redeemable prior to maturity and are not subject to any sinking fund requirements.

In 1996, the Company filed a shelf registration with the Securities and Exchange Commission for the sale of up to \$200,000 of debt securities. On February 25, 1997, \$150,000 of 67⁄8% debentures were issued at a price of 99.925%. Proceeds were used for repayment of short-term indebtedness. The debentures mature on February 15, 2027, are not redeemable by the Company prior to maturity and are not subject to any sinking fund requirements. Each holder of

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the debentures has the right to require the Company to repay the holders, in whole or in part, on February 15, 2007, at a repayment price equal to 100% of the aggregate principal amount thereof plus accrued and unpaid interest.

The Senior Notes, Series A through D, are privately placed and unsecured. The Series D Notes provide for eleven equal annual repayments of principal plus accrued interest beginning in 1996; Series A through C Notes are due at maturity in 1999, 1999, and 2001, respectively.

One of the Company's Australian subsidiaries maintains a committed three-year \$90,000 Australian dollar (\$56,169 U.S. dollar) term loan facility with a group of four banks at rates expressed in relation to Australian dollar-denominated Bank Bills of Exchange. A commitment fee is payable on any unused portions of the loan. As of October 31, 1998, the loan was fully utilized.

The Company maintains a committed Revolving Credit Facility Agreement with certain domestic and foreign financial institutions that allows for borrowings of up to \$500,000 at rates expressed in relation to LIBOR and other rates and which expires in October, 2002. A facility fee is payable on the Revolving Credit Facility. At October 31, 1998, direct outstanding borrowings under the facility were \$375,000 and commercial paper borrowings, considered a utilization of the facility, were \$5,610.

The terms of certain of the debt agreements place limits on the amount of additional long-term debt the Company may issue and require maintenance of a minimum consolidated net worth, as defined. Additional funded debt may be incurred if immediately thereafter consolidated funded debt does not exceed 50% of consolidated total tangible assets, as defined.

In February, 1998, the Company filed a shelf registration with the Securities and Exchange Commission for \$200,000 of debt securities. To date, no securities have been issued under this registration. The Company also has \$50,000 of debt securities remaining from a shelf registration filed in 1996.

Installments payable to holders of the outstanding long-term obligations of the Company are due as follows:

1999	\$ 38,776
2000	70,805
2001	22,645
2002	383,637
2003	2,437

At October 31, 1998, short-term bank credit lines of foreign subsidiaries were approximately \$164,173. The outstanding borrowings were \$51,937 with a weighted average interest rate of 12.96%. There were no compensating balance requirements under these lines of credit. Domestic credit facilities other than the revolving credit agreement were approximately \$40,000 of which \$36,000 has been utilized. The weighted average interest rate for these loans was 6.42%.

Net interest expense consisted of the following:

	1998	1997	1996
Interest income	\$ 8,509	\$ 3,309	\$ 6,505
Interest expense	(89,849)	(75,454)	(68,518)
Interest expense — net	\$(81,340)	\$(72,145)	\$(62,013)

Interest paid was \$86,380, \$76,378 and \$65,161 in 1998, 1997 and 1996, respectively.

Note 8

Pensions and Other Employee Benefits

The Company and its subsidiaries have a number of defined benefit, defined contribution and government mandated pension plans covering substantially all employees. Benefits from these plans are based on factors which include various combinations of years of service, fixed monetary amounts per year of service, employee compensation during the last years of employment and the recipient's social security benefit. The Company's funding policy with respect to its qualified plans is to contribute annually not less than the minimum required by applicable law and regulation nor more than the amount which can be deducted for income tax purposes. The Company also has a nonqualified senior executive supplemental pension plan, which is based on credited years of service and compensation during the last years of employment.

Certain foreign plans, which supplement or are coordinated with government plans, many of which require funding through mandatory government retirement or insurance company plans, have pension funds or balance sheet accruals which approximate the actuarially computed value of accumulated plan benefits as of October 31, 1998 and 1997.

The Company recorded an additional minimum pension liability and intangible asset of \$4,513 and \$5,600 in 1998 and 1997, respectively, to recognize the unfunded accumulated benefit obligation of certain plans. Pension expense for all plans of the Company was \$18,347 in 1998, \$20,953 in 1997 and \$19,132 in 1996. Net periodic pension costs for U.S. plans and plans of subsidiaries outside the United States for which SFAS No. 87, "Employers' Accounting for Pensions," has been adopted included the following components:

	1998	1997	1996
Service cost benefits			
earned during the year	\$ 25,185	\$ 23,602	\$ 22,892
Interest cost on projected benefit obligation	65,038	62,722	56,792
Actual gain on plan assets	(77,112)	(115,397)	(98,003)
Net amortization and deferral	(15)	43,277	33,832
Net periodic pension cost	\$ 13,096	\$ 14,204	\$ 15,513

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The discount rate used for U.S. plans was 7.0% in 1998, 7.5% in 1997 and 8.0% in 1996 and for non-U.S. plans ranged from 6.0%-15.0%. The assumed rate of increase in future compensation of U.S. salaried employees was 4.0% in 1998, 4.5% in 1997 and 5.0% in 1996 and for non-U.S. salaried employees ranged from 2.0% to 12.0%. Benefits under the

hourly employee plans are generally not based on wages. The expected long-term rate of return on assets for U.S. plans was 10.0% and for non-U.S. plans ranged from 10.0% to 16.0%. The assumptions for non-U.S. plans were developed on a basis consistent with that for U.S. plans, adjusted to reflect prevailing economic conditions and interest rate environments.

The following table sets forth the plans' funded status at October 31:

	1998		1997	
	Plans With Assets Exceeding Accumulated Benefits	Plans With Accumulated Benefits Exceeding Assets	Plans With Assets Exceeding Accumulated Benefits	Plans With Accumulated Benefits Exceeding Assets
Actuarial present value of:				
Vested benefits	\$598,598	\$249,612	\$715,967	\$ 30,043
Accumulated benefits	634,248	269,288	757,050	35,492
Projected benefits	704,658	277,511	827,474	42,903
Net assets available for benefits	687,058	224,660	864,281	9,836
Plans' assets greater (less) than projected benefits	(17,600)	(52,851)	36,807	(33,067)
Unrecognized (asset) obligation existing at adoption	(6,497)	1,939	(5,328)	663
Unrecognized prior service cost	3,189	44,763	33,657	1,801
Unrecognized net (gain) loss	49,248	2,350	(18,341)	9,272
Net pension asset (liability)	\$ 28,340	\$ (3,799)	\$ 46,795	\$(21,331)

Pension plan assets consist primarily of trust funds with diversified portfolios of primarily equity and fixed income investments.

The Company has a profit sharing plan which covers substantially all domestic employees except certain employees covered by collective bargaining agreements and employees of subsidiaries with separate defined contribution plans. Payments to the plan are based on the Company's EVA performance. Profit sharing expense was \$0 in 1998, \$9,957 in 1997 and \$10,783 in 1996.

Note 9

Postretirement Benefits Other Than Pensions

The Company generally provides certain health care and life insurance benefits under various plans for U.S. employees who retire after attaining early retirement eligibility, subject to the plan amendments discussed below.

The weighted average discount rate used in determining the postretirement benefit obligation was 7.0%, 7.5% and 8.0% at October 31, 1998, 1997 and 1996, respectively.

The following table sets forth the plans' funded status and amounts recognized in the Company's Consolidated Balance Sheet as of October 31:

	1998	1997
Accumulated postretirement benefit obligation:		
Retirees	\$45,885	\$53,531
Fully eligible active plan participants	1,681	2,052
Other active plan participants	3,164	3,182
Total	50,730	58,765
Plan assets at fair value	—	—
Accumulated postretirement benefit obligation in excess of plan assets	50,730	58,765
Unrecognized prior service credit	—	11,903
Unrecognized gain (loss)	(11,040)	2,590
Accrued postretirement benefit liability	39,690	73,258
Less: Current portion	5,503	17,056
Total	\$34,187	\$56,202

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For measurement purposes, an assumed annual rate of increase in the per capita cost of covered health care benefits ranged from 5.9% to 8.0% for non-Medicare eligible participants (a range of 5.3% to 7.6% was used for Medicare eligible participants). These rates were assumed to decrease gradually to 5.0% for most participants by 2001 and remain at that level thereafter. The health care cost trend rate assumption has an effect on the amounts reported. A one percentage point increase in the assumed health care cost trend rates each year would increase the accumulated postretirement benefit obligation as of October 31, 1998 by \$3,900 and the aggregate service cost and interest cost components of the net periodic postretirement benefit cost for the year by \$400. Postretirement life insurance benefits have a minimal effect on the total benefit obligation.

In 1993, the board of directors of the Company approved a general approach that would culminate in the elimination of all Company contributions towards postretirement health care benefits. Increases in costs paid by the Company were capped for certain plans beginning in 1994 extending through 1998 and Company contributions will be eliminated on January 1, 1999 for most employee groups, excluding Joy. For Joy, based upon existing plan terms, future eligible retirees will participate in a premium cost-sharing arrangement which is based upon age as of March 1, 1993 and position at the time of retirement. Active employees under age 45 as of March 1, 1993 and any new hires after April 1, 1993 will be required to pay 100% of the applicable premium.

Net periodic postretirement benefit cost includes the following components:

	1998	1997	1996
Service cost	\$ 173	\$ 163	\$ 327
Interest cost on accumulated postretirement benefit obligation	3,850	4,743	5,632
Amortization of prior service (credit)	(11,903)	(12,810)	(10,780)
Net amortization and deferral	(6,738)	(2,943)	(2,624)
Net periodic postretirement benefit cost	<u>\$(14,618)</u>	<u>\$(10,847)</u>	<u>\$ (7,445)</u>

Note 10

Shareholders' Equity and Stock Options

The Company's authorized common stock amounts to 150,000,000 shares. A Preferred Stock Purchase Right is attached to each share of common stock which entitles a shareholder to exercise certain rights in the event a person or group acquires or seeks to acquire 15% or more of the outstanding common stock of the Company.

In September, 1997, the Company announced that the board of directors had authorized the purchase of up to ten million shares of the Company's common stock. As of October 31, 1998, the Company had repurchased 1,772,900 shares through open-market transactions at a cost of approximately \$68,263. No shares were repurchased under this program during the latter part of 1998.

In May, 1998, the Emerging Issues Task Force ("EITF") issued EITF 97-14 which addresses the accounting for deferred compensation arrangements where amounts earned by an employee are invested in the employer's stock and placed in a "rabbi trust". In September, 1998, 621,149 shares in the Company's Deferred Compensation Trust were distributed including 479,302 shares distributed to the Company to fund withholding tax liabilities. Shares not distributed and remaining in the Company's Deferred Compensation Trust (145,251 shares) relate to the Directors Plan and to inactive employees and are considered as treasury stock with an offset to compensation liability. Consistent with the EITF, since the plan permits diversification for settlement in cash, Company shares or diversified assets, the Company will mark to market the liability to reflect the market value of the shares remaining in the Trust.

In fiscal 1997, the Company adopted the disclosure requirements of SFAS No. 123, "Accounting for Stock-Based Compensation," but elected to continue to measure compensation cost using the intrinsic value method, in accordance with Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation cost for stock options has been recognized. If compensation cost had been determined based on the estimated fair value of options granted in 1996, 1997, and 1998 consistent with the methodology in SFAS No. 123, the pro forma effects on the Company's net income and earnings per share would not have been material.

The fair value of each option granted in 1996, 1997 and 1998 was estimated using the Black-Scholes option-pricing method with the following weighted average assumptions:

	1998	1997	1996
Expected stock price volatility	30.45%	29.45%	29.45%
Risk-free interest rate	4.6%	6.5%	6.5%
Expected life of options	7 years	7 years	7 years
Expected dividends	\$0.40 per share	\$0.40 per share	\$0.40 per share

In 1997, the Company established a new long-term incentive compensation plan which covers a limited number of key senior executives of the Company. The plan, which replaces traditional stock options for these participants, consists of

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awards of up to an aggregate of 1,200,000 shares based upon achievement of pre-established stock price improvement factors. The base stock price was set at \$40.87 per share.

The minimum requirements of the plan call for a portion of the shares to be awarded if a 30% increase in stock price occurs within three years. The shares shall be fully awarded if the stock price increases 50% within three years or 70% within five years. As the stock price has declined since inception of the plan, no compensation expense was recorded in fiscal 1998 or 1997.

In 1998, addressing concerns expressed by certain shareholders with the cliff vesting feature of the plan, the Company modified the plan to include a change-of-control feature. In the event of a change of control, awards would be made at prices below the minimum prices stated in the plan.

At the April 9, 1996 annual meeting, shareholders approved a new Stock Incentive Plan. This plan provides for the granting, up to April 9, 2006, of qualified and non-qualified options, stock appreciation rights, restricted stock and performance units to key employees for not more than 2,000,000 shares of common stock. Non-qualified options covering 1,133,302 shares were granted under the plan in 1998, including 479,302 shares which were granted in connection with the EITF 97-14 distribution described above.

The Company's 1988 Incentive Stock Plan provides for the granting of qualified and non-qualified options, stock appreciation rights and restricted stock to key employees for not more than 3,600,000 shares of common stock. In fiscal 1996, non-qualified options and restricted stock covering 4,000 and 347,857 shares, respectively, were granted under this plan. The restricted stock was issued in connection with the cancellation of the employment contracts of certain senior executive officers, and provided that shares would be forfeited if the officer voluntarily terminated employment before age 55. During 1997, the shares were surrendered in exchange for comparable payment rights based on stock held in the Company's Deferred Compensation Trust. These shares were distributed in 1998 in connection with the EITF 97-14 distribution discussed above, subject to the restriction that the recipients would not sell the shares as long as they remain employees of the Company. Following shareholder approval of the 1996 Stock Incentive Plan, the 1988 Incentive Stock Plan terminated for the granting of future awards.

Since the inception of the 1978 and 1988 Incentive Stock Plans and the 1996 Stock Incentive Plan, options for the purchase of 5,293,707 shares have been granted at prices ranging from \$6.75 to \$47.00 per share. At October 31, 1998, 2,111,030 of the options were outstanding, 1,962,842 had been exercised and 1,219,835 had expired. Generally, the options become exercisable in cumulative installments of one-fourth of the shares in each year beginning six months from the date of the grant.

Certain information regarding stock options is as follows:

	Number of Shares	Weighted Average Price Per Share
Outstanding at		
October 31, 1995	1,444,286	\$23.88
Granted	494,900	37.83
Exercised	(320,172)	20.97
Canceled or expired	(120,680)	23.86
Outstanding at		
October 31, 1996	1,498,334	29.11
Granted	30,000	43.29
Exercised	(301,072)	23.80
Canceled or expired	(67,491)	30.37
Outstanding at		
October 31, 1997	1,159,771	30.78
Granted	1,133,302	17.73
Exercised	(61,767)	21.33
Canceled or expired	(120,276)	34.52
Outstanding at		
October 31, 1998	2,111,030	23.84
Exercisable at		
October 31, 1998	1,239,052	\$20.76

The weighted average contractual life of options outstanding at October 31, 1998 is 8.41 years with exercise prices ranging from \$6.85 to \$44.50.

Following a "Dutch auction" self-tender offer in May, 1993, the Company purchased for cash 2,500,000 shares of common stock, or approximately 9% of shares of common stock outstanding at that time, at \$19 $\frac{5}{8}$ per share, in conjunction with the establishment of the Harnischfeger Industries, Inc. Stock Employee Compensation Trust ("SECT"). Concurrent with the purchase, the Company sold 2,547,771 shares of common stock held in treasury to the SECT, amounting to \$50,000 at \$19 $\frac{5}{8}$ per share. The purchase of the treasury shares reduced shareholders' equity. The sale of the treasury shares to the SECT had no impact on such equity. Shares in the SECT are being used to fund future employee benefit obligations under plans that currently require shares of Company common stock.

Shares owned by the SECT are accounted for as treasury stock until issued to existing benefit plans; they are reflected as a reduction to shareholders' equity. Shares owned by the SECT are valued at the closing market price each period, with corresponding changes in the SECT balance reflected in capital in excess of par value. Shares in the SECT are not considered outstanding for computing earnings per share.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 11

Operating Leases

The Company leases certain plant, office and warehouse space as well as machinery, vehicles, data processing and other equipment. Certain of the leases have renewal options at reduced rates and provisions requiring the Company to pay maintenance, property taxes and insurance. Generally, all rental payments are fixed. The Company's assets and obligations under capital lease arrangements are not significant.

Total rental expense under operating leases, excluding maintenance, taxes and insurance, was \$24,468, \$23,973 and \$25,570 in 1998, 1997 and 1996, respectively.

At October 31, 1998, the future payments for all operating leases with remaining lease terms in excess of one year, and excluding maintenance, taxes and insurance, were as follows:

1999	\$28,271
2000	20,437
2001	14,478
2002	11,546
2003	10,340
2004 and thereafter	71,823

Note 12

Commitments, Contingencies and Off-Balance-Sheet Risks

At October 31, 1998, the Company was contingently liable to banks, financial institutions and others for approximately \$479,000 for outstanding letters of credit securing performance of sales contracts and other guarantees in the ordinary course of business. The Company may also guarantee performance of its equipment at levels specified in sales contracts without the requirement of a letter of credit.

The Company is a party to litigation matters and claims which are normal in the course of its operations. Also, as a normal part of their operations, the Company's subsidiaries undertake certain contractual obligations, warranties and guarantees in connection with the sale of products or services. Although the outcome of these matters cannot be predicted with certainty and favorable or unfavorable resolution may affect income on a quarter-to-quarter basis, management believes that such matters will not have a materially adverse effect on the Company's consolidated financial position. Beloit may on occasion enter into arrangements to participate in the ownership of or operate pulp or papermaking facilities in order to satisfy contractual undertakings or resolve disputes.

One of the claims against Beloit involves a lawsuit brought by Potlatch Corporation that alleges pulp line washers supplied by Beloit for less than \$15,000 failed to perform satisfactorily (See Note 19 — Potlatch for additional information.)

The Company and its senior executives have been named as defendants in three purported class action suits, entitled Great Neck Capital Appreciation Investment Partnership, L.P. v. Jeffery T. Grade, et al., C. William Carter v. Harnischfeger Industries, Inc. et al., and Norman Ellison v. Jeffery T. Grade, et al., filed on June 5, 1998, June 11, 1998 and July 21, 1998, respectively, in the United States District Court for the Eastern District of Wisconsin. These actions, which have now been consolidated, seek damages in an unspecified amount on behalf of an alleged class of purchasers of the Company's common stock, based principally on allegations that the Company's disclosures with respect to the Indonesian contracts of Beloit (discussed in Note 18 — Beloit APP Contracts) violated the federal securities laws.

The Company's ability to realize the unbilled receivables is discussed in Note 18 — Beloit APP Contracts.

The Company is also involved in a number of proceedings and potential proceedings relating to environmental matters. Although it is difficult to estimate the potential exposure to the Company related to these environmental matters, the Company believes that these matters will not have a materially adverse effect on its consolidated financial position or results of operations.

The Company has entered into various foreign currency exchange contracts with major international financial institutions designed to minimize its exposure to exchange rate fluctuations on foreign currency transactions. These contracts are used to hedge known cash receipts and disbursements in the ordinary course of business. At October 31, 1998, the outstanding net U.S. dollar face amounts of contracts to cover sales and purchase activity totaled approximately \$43,000. In addition, at October 31, 1998, the Company had outstanding foreign exchange contracts totaling \$11,785 to cover interest and borrowing obligations. The difference between contract and estimated fair values at October 31, 1998 was not significant. It is the Company's policy not to enter into highly leveraged transactions or other "derivative" instruments.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 13

Disclosure About Fair Value of Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments for which it is practicable to estimate that value:

CASH AND CASH EQUIVALENTS: The carrying value approximates fair value because of the short maturity of those instruments.

LONG-TERM OBLIGATIONS: The fair value of the Company's long-term obligations has been based on prevailing market quotations and by discounting cash flows using current market yields quoted on similar issues.

The estimated fair values of the Company's financial instruments at October 31, 1998 and 1997 are as follows:

1998	Carrying Value	Fair Value
Cash and Cash Equivalents	\$ 30,012	\$ 30,012
Long-Term Obligations	(1,001,573)	(1,042,130)
<hr/>		
1997	Carrying Value	Fair Value
Cash and Cash Equivalents	\$ 29,383	\$ 29,383
Long-Term Obligations	(725,193)	(769,361)

Note 14

Transactions With Affiliated Companies

Mitsubishi Heavy Industries, Ltd. ("Mitsubishi") owns a 20% interest in Beloit. In connection with this ownership interest, Mitsubishi entered into certain agreements that provide it with the right to designate one of Beloit's five directors. The agreements also place certain restrictions on the transfer of Beloit stock. In the event of change in control of the Company to someone engaged in the pulp and paper machinery business, Mitsubishi has the right to sell its 20% interest back to the Company for the greater of \$60,000 or the book value of its equity interest.

Transactions with related parties for the years ending October 31 were as follows:

	1998	1997	1996
Sales	\$ 3,449	\$ 3,965	\$1,267
Purchases	14,091	39,413	223
Receivables	7,017	8,291	6,306
Payables	5,092	18,994	41
License Income	4,666	7,831	7,127

The Company believes that its transactions with related parties were competitive with alternate sources of supply for each party involved.

Note 15

Segment Information

The Company designs, manufactures, markets and services products structured into two industry segments. The "Mining Equipment Segment" consists of P&H Mining Equipment and Joy. P&H Mining Equipment designs, manufactures and markets electric mining shovels, electric and diesel-electric draglines, buckets, large rotary blasthole drilling equipment and related replacement parts for the surface mining and quarrying industries. Joy designs, manufactures and distributes continuous miners, longwall shearers, roof supports, face conveyors, shuttle cars and flexible conveyor train continuous haulage systems for use in the underground extraction of coal and other minerals. In addition, Joy engineers, manufactures and markets worldwide a highwall mining system for the extraction of coal from exposed surface seams in the walls of surface coal mines, trenches and mountainside benches. It also rebuilds and services installed equipment and sells spare parts for the equipment it manufactures.

The "Pulp and Paper Machinery Segment" (Beloit Corporation) designs, manufactures, services and markets papermaking machinery and allied equipment for the pulp and paper industries. Sales to a Pacific Rim customer in this segment approximated 5% and 15% of the Company's consolidated net sales for fiscal 1998 and 1997, respectively, and the related accounts receivable from this customer approximated 26% and 25% of consolidated accounts receivable at October 31, 1998 and October 31, 1997, respectively.

Intersegment sales are not significant. Corporate assets include principally cash, cash equivalents, and administration facilities.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Segments of Business by Industry

	Total Sales	Operating Income (Loss)	Depreciation and Amortization	Capital Expenditures	Identifiable Assets
1998					
Mining Equipment	\$1,212,307	\$ 81,984	\$ 43,015	\$ 53,459	\$1,407,193
Pulp and Paper Machinery	829,753	(368,689) ⁽¹⁾	42,371	80,289	1,326,722
Total continuing operations	2,042,060	(286,705)	85,386	133,748	2,733,915
Corporate	—	(20,591)	1,374	177	53,344
Consolidated total	\$2,042,060	\$(307,296)	\$ 86,760	\$133,925	\$2,787,259

1997					
Mining Equipment	\$1,467,341	\$ 201,803	\$ 41,231	\$ 61,004	\$1,371,484
Pulp and Paper Machinery	1,267,847	76,485 ⁽²⁾	45,122	53,616	1,240,764
Total continuing operations	2,735,188	278,288	86,353	114,620	2,612,248
Discontinued operation	—	—	—	—	232,559
Corporate	—	(25,015)	1,108	11,781	79,728
Consolidated total	\$2,735,188	\$ 253,273	\$ 87,461	\$126,401	\$2,924,535

1996					
Mining Equipment	\$1,405,936	\$ 183,141	\$ 44,051	\$ 23,938	\$1,362,435
Pulp and Paper Machinery	1,134,779	48,511 ⁽³⁾	38,788	39,769	1,023,819
Total continuing operations	2,540,715	231,652	82,839	63,707	2,386,254
Discontinued operation	—	—	—	—	204,412
Corporate	—	(20,740)	538	12,848	99,363
Consolidated total	\$2,540,715	\$ 210,912	\$ 83,377	\$ 76,555	\$2,690,029

(1) After anticipated losses on contracts of \$127,400, settlement of a contract dispute of \$37,000 and a restructuring charge of \$65,000.

(2) After anticipated losses on contracts of \$27,600.

(3) After restructuring charge of \$43,000.

Geographical Segment Information

	Total Sales	Interarea Sales	Sales to Unaffiliated Customers	Operating Income (Loss)	Identifiable Assets
1998					
United States	\$1,555,951	\$(400,889)	\$1,155,062	\$(259,319)	\$2,149,597
Europe	439,286	(137,181)	302,105	(38,941)	615,290
Other Foreign	675,539	(90,646)	584,893	(30,563)	397,881
Interarea Eliminations	(628,716)	628,716	—	42,118	(428,853)
	\$2,042,060	\$ —	\$2,042,060	\$(286,705)	\$2,733,915

1997					
United States	\$1,915,675	\$(280,314)	\$1,635,361	\$ 187,838	\$1,651,129
Europe	661,159	(161,063)	500,096	107,967	632,465
Other Foreign	609,306	(9,575)	599,731	47,787	412,283
Interarea Eliminations	(450,952)	450,952	—	(65,304)	(83,629)
	\$2,735,188	\$ —	\$2,735,188	\$ 278,288	\$2,612,248

1996					
United States	\$1,646,964	\$(212,543)	\$1,434,421	\$ 131,377	\$1,333,461
Europe	734,780	(155,323)	579,457	78,838	655,073
Other Foreign	551,479	(24,642)	526,837	47,917	442,618
Interarea Eliminations	(392,508)	392,508	—	(26,480)	(44,898)
	\$2,540,715	\$ —	\$2,540,715	\$ 231,652	\$2,386,254

Exports of U.S.-produced products were approximately \$302,000, \$480,000 and \$304,000 in 1998, 1997 and 1996, respectively.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 16

Discontinued Operations

On March 30, 1998, the Company completed the sale of approximately 80% of the common stock of the Company's Material Handling segment to Chartwell Investments, Inc. in a leveraged recapitalization transaction. As such, the accompanying financial statements have been reclassified to reflect Material Handling as a discontinued operation. The Company retained approximately 20% of the outstanding common stock and 11% of the outstanding voting securities of Material Handling and holds one board of director seat in the new company. In addition, the Company has licensed Material Handling to use the "P&H" trademark on existing Material Handling-produced products on a worldwide basis for periods specified in the agreement for a royalty fee payable over a ten year period. The Company reported a \$151,500 after-tax gain on the sale of this discontinued operation in the second quarter of fiscal 1998. Proceeds consisted of \$341,000 in cash and \$4,800 in preferred stock with a 12.25% Payment-in-Kind

dividend; \$7,200 in common stock was not reflected in the Company's balance sheet or gain calculations due to the nature of the leveraged recapitalization transaction. Taxes on the sale amounted to \$45,000. Net assets disposed of in the sale aggregated \$139,300.

Operating results of the discontinued operation as of October 31 were as follows:

	5 months		
	1998	1997	1996
Net sales	\$130,546	\$353,350	\$323,216
Income before income taxes	6,631	38,001	32,862
Minority interest	—	(18)	(45)
Income tax provision	(2,255)	(12,920)	(11,502)
Net income	\$ 4,376	\$ 25,063	\$ 21,315

Note 17

Earnings Per Share

In the first quarter of fiscal 1998, the Company adopted SFAS No. 128, "Earnings Per Share". Following is the reconciliation of the numerators and denominators used to calculate the basic and diluted earnings per share:

For the Years Ended October 31,

Basic Earnings Per Share

Income (loss) from continuing operations
Income from discontinued operation
Gain on sale of discontinued operation
Extraordinary loss on retirement of debt
Net income (loss)

Average common shares outstanding

Income (loss) from continuing operations
Income from and net gain on sale of discontinued operation
Extraordinary loss on retirement of debt
Net income (loss)

Diluted Earnings Per Share

Income (loss) from continuing operations
Income from discontinued operation
Gain on sale of discontinued operation
Extraordinary loss on retirement of debt
Net income (loss)

Average common shares outstanding :

Common stock
Options

Income (loss) from continuing operations
Income from and net gain on sale of discontinued operation
Extraordinary loss on retirement of debt
Net income (loss)

	1998	1997	1996
Income (loss) from continuing operations	\$(174,409)	\$113,217	\$ 92,902
Income from discontinued operation	4,376	25,063	21,315
Gain on sale of discontinued operation	151,500	—	—
Extraordinary loss on retirement of debt	—	(12,999)	—
Net income (loss)	\$ (18,533)	\$125,281	\$114,217
Average common shares outstanding	46,445	47,827	47,196
Income (loss) from continuing operations	\$ (3.75)	\$ 2.37	\$ 1.97
Income from and net gain on sale of discontinued operation	3.35	0.52	0.45
Extraordinary loss on retirement of debt	—	(0.27)	—
Net income (loss)	\$ (0.40)	\$ 2.62	\$ 2.42
Income (loss) from continuing operations	\$(174,409)	\$113,217	\$ 92,902
Income from discontinued operation	4,376	25,063	21,315
Gain on sale of discontinued operation	151,500	—	—
Extraordinary loss on retirement of debt	—	(12,999)	—
Net income (loss)	\$ (18,533)	\$125,281	\$114,217
Average common shares outstanding :			
Common stock	46,445	47,827	47,196
Options	—	434	369
	46,445	48,261	47,565
Income (loss) from continuing operations	\$ (3.75)	\$ 2.35	\$ 1.95
Income from and net gain on sale of discontinued operation	3.35	0.51	0.45
Extraordinary loss on retirement of debt	—	(0.27)	—
Net income (loss)	\$ (0.40)	\$ 2.59	\$ 2.40

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 18

Beloit APP Contracts

In fiscal 1997 and 1996, Beloit received orders for four fine paper machines from Asia Pulp & Paper Co. Ltd. ("APP") for a total of approximately \$600,000. During the second quarter of fiscal 1998, the Company identified \$155,000 of additional estimated contract costs at Beloit related to these contracts. The additional costs primarily related to non-proprietary equipment, installation and erection, freight and other site construction costs, and overruns resulting from changes in estimates of costs to complete related to these complex, large-scale projects.

Based on its review of the \$155,000, the Company, with the assistance of its outside auditors, determined that \$27,600 of this charge was properly allocated to the fourth quarter of fiscal 1997 as it related to isolated costs for piping which were inadvertently overlooked. Income for that period and the full fiscal year of 1997 was restated to reflect this charge.

The first two machines have been substantially paid for and installed at the APP facilities in Indonesia. The Company has sold approximately \$44,000 of its receivables from APP on these first two machines to a financial institution. The machines are currently in the start-up/optimization phase and are required to meet certain contractual performance tests. The contracts call for the potential of liquidated damages, including performance damages, in certain circumstances. The Company is currently in negotiation with APP on certain claims and back charges on the first two machines.

The two remaining machines have been substantially manufactured, are in Beloit's possession and are carried on the Consolidated Balance Sheet at October 31, 1998 as unbilled receivables approximating \$180,000. This amount has been reduced by a \$46,000 down payment received from APP and \$19,000 of receivables that were sold to a financial institution. The Company has issued letters-of-credit in the amount of the initial down payment. To date, APP has been unable to secure financing for these two machines.

On December 15, 1998, the Company declared APP in default on the contracts for the two remaining machines, concluding that APP has not acted in good faith and is unwilling to pay its obligations or is incapable of securing financing for these two paper machines. Consequently, on December 15, 1998, the Company filed for arbitration in Singapore for the full payment from APP for the second two machines as well as at least \$125,000 in damages and delay costs.

On December 16, 1998, APP filed a notice of arbitration in Singapore against Beloit seeking a full refund of approximately \$46,000 paid to Beloit for the second two machines, claiming that Beloit breached an obligation under the purchase contracts to secure financing, thus resulting in termination. APP also seeks recovery of other damages alleged by APP caused by Beloit's claimed breaches. In addition, APP seeks a declaration in the arbitration that it has no liability under certain promissory notes. The Company will vigorously defend against all of APP's assertions that it is entitled to a return of payments under the contracts and also will proceed without delay to mitigate APP's obligations for damages by finding other customers for these world-class machines.

The Company intends to vigorously pursue its rights under the contracts and expects to be fully compensated for these two machines from APP. However, in the event that the Company is unsuccessful in arbitration and to mitigate APP's damages, the Company is pursuing selling these two machines to other customers.

Proceeds from the ultimate sale of these paper machines, if required, are expected to be sufficient to substantially recover the carrying value of the receivable. In the event the Company is unsuccessful in arbitration and/or is unable to sell these paper machines to another customer, it may have a materially adverse effect on its consolidated financial position or results of operations.

Note 19

Potlatch

A claim against Beloit involves a lawsuit brought by Potlatch Corporation that alleges pulp line washers supplied by Beloit for less than \$15,000 failed to perform satisfactorily. In June, 1997, a Lewiston, Idaho jury awarded Potlatch \$95,000 in damages in the case which, together with fees, costs and interest to October 31, 1998, approximate \$116,000. Beloit has appealed this award to the Idaho Supreme Court. The appeal was heard by the Court on September 10, 1998 with a decision anticipated in the first half of fiscal 1999. The Company considers the eventual outcome of the Potlatch case not to be estimable. Reserves in the October 31, 1998 Consolidated Balance Sheet are less than the sales price of the washers. The possible ultimate cost to the Company of this case could be materially higher than the reserves. In the event the Company is unsuccessful in its request for a new trial in this matter, it may have a material adverse effect on its consolidated financial position or results of operations.

REPORT OF INDEPENDENT ACCOUNTANTS



To The Directors and Shareholders of Harnischfeger Industries, Inc.

In our opinion, the consolidated financial statements appearing on pages 27 to 43 of this report present fairly, in all material respects, the financial position of Harnischfeger Industries, Inc. and its subsidiaries (the "Company") at October 31, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended October 31, 1998, in conformity with generally accepted accounting principles. These financial statements are the responsibility of the Company's management; our responsibility is to express an opinion on these financial statements based on our audits. We conducted our audits of these statements in accordance with generally accepted auditing standards which require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining,

on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

A handwritten signature in black ink that reads "PricewaterhouseCoopers LLP". The signature is written in a cursive, flowing style.

Milwaukee, Wisconsin
December 8, 1998, except as to Note 18,
which is as of December 16, 1998

UNAUDITED QUARTERLY FINANCIAL DATA AND STOCK PRICES

(Dollar amounts in thousands except per share and market price amounts)

	Fiscal Quarter				1998
	First	Second	Third	Fourth	Year
Net Sales	\$557,844	\$ 477,839	\$503,169	\$503,208	\$2,042,060
Gross Profit	53,244	42,985	59,173	37,163	192,565
Operating (Loss)	(34,583)	(136,438)	(54,311)	(81,964)	(307,296)
(Loss) from Continuing Operations	(24,971)	(72,826)	(38,604)	(38,008)	(174,409)
Income from Discontinued Operation	3,404	972	—	—	4,376
Gain on Sale of Discontinued Operation	—	151,500	—	—	151,500
Net Income (Loss)	\$ (21,567)	\$ 79,646	\$ (38,604)	\$ (38,008)	\$ (18,533)
Earnings Per Share — Basic					
(Loss) from continuing operations	\$ (0.53)	\$ (1.57)	\$ (0.83)	\$ (0.82)	\$ (3.75)
Income from and net gain on sale of discontinued operation	0.07	3.28	—	—	3.35
Net Income (Loss)	\$ (0.46)	\$ 1.71	\$ (0.83)	\$ (0.82)	\$ (0.40)
Earnings Per Share — Diluted					
(Loss) from continuing operations	\$ (0.53)	\$ (1.57)	\$ (0.83)	\$ (0.82)	\$ (3.75)
Income from and net gain on sale of discontinued operation	0.07	3.28	—	—	3.35
Net Income (Loss)	\$ (0.46)	\$ 1.71	\$ (0.83)	\$ (0.82)	\$ (0.40)
Market price of common stock:					
High	\$ 40	\$ 35 ¹⁵ / ₁₆	\$ 32	\$ 24 ⁷ / ₈	\$ 40
Low	32 ⁵ / ₃₂	27	24 ¹³ / ₁₆	6 ¹ / ₈	6 ¹ / ₈

	Fiscal Quarter				1997
	First	Second	Third	Fourth	Year
Net Sales	\$619,429	\$697,506	\$704,212	\$714,041	\$2,735,188
Gross Profit	152,584	165,524	163,990	145,143	627,241
Operating Income	60,304	80,918	66,586	45,465	253,273
Income from Continuing Operations	26,332	38,128	30,072	18,685	113,217
Income from Discontinued Operation	4,526	6,843	5,818	7,876	25,063
Extraordinary Loss on Retirement of Debt	—	—	—	(12,999)	(12,999)
Net Income	\$ 30,858	\$ 44,971	\$ 35,890	\$ 13,562	\$ 125,281
Earnings Per Share — Basic					
Income from continuing operations	\$ 0.55	\$ 0.80	\$ 0.63	\$ 0.39	\$ 2.37
Income from discontinued operations	0.10	0.14	0.12	0.16	0.52
Extraordinary loss on retirement of debt	—	—	—	(0.27)	(0.27)
Net Income	\$ 0.65	\$ 0.94	\$ 0.75	\$ 0.28	\$ 2.62
Earnings Per Share — Diluted					
Income from continuing operations	\$ 0.55	\$ 0.79	\$ 0.62	\$ 0.39	\$ 2.35
Income from discontinued operations	0.09	0.14	0.12	0.16	0.51
Extraordinary loss on retirement of debt	—	—	—	(0.27)	(0.27)
Net Income	\$ 0.64	\$ 0.93	\$ 0.74	\$ 0.28	\$ 2.59
Market price of common stock:					
High	\$ 50	\$ 49 ¹ / ₄	\$ 43 ⁷ / ₈	\$ 44 ¹³ / ₁₆	\$ 50
Low	39 ¹ / ₂	40	38 ⁷ / ₈	37 ¹⁵ / ₁₆	37 ¹⁵ / ₁₆

FIVE-YEAR REVIEW OF SELECTED FINANCIAL DATA

(Dollar amounts in thousands except per share amounts)

Years Ended October 31,	1998	1997	1996	1995	1994
Revenues					
Net Sales	\$2,042,060	\$2,735,188	\$2,540,715	\$1,912,197	\$1,442,299
Other Income	12,052	27,181	21,026	28,442	22,678
	2,054,112	2,762,369	2,561,741	1,940,639	1,464,977
Cost of Sales, including anticipated losses on contracts					
	1,849,495	2,107,947	1,919,378	1,488,440	1,115,518
Product Development, Selling and Administrative Expenses					
	446,913	401,149	388,451	293,684	261,391
Restructuring Charge					
	65,000	—	43,000	—	—
Operating Income (Loss)					
	(307,296)	253,273	210,912	158,515	88,068
Interest Expense — Net					
	(81,340)	(72,145)	(62,013)	(40,513)	(47,231)
Income (Loss) Before Joy Merger Costs, Gain on Sale of Measurex Investment, (Provision) Benefit For Income Taxes and Minority Interest					
	(388,636)	181,128	148,899	118,002	40,837
Joy Merger Costs					
	—	—	—	(17,459)	—
Gain on Sale of Measurex Investment (Provision) Benefit for Income Taxes					
	160,300	(61,555)	(52,098)	(45,572)	(11,599)
Minority Interest					
	53,927	(6,356)	(3,899)	(7,230)	(2,224)
Income (Loss) from Continuing Operations					
	(174,409)	113,217	92,902	77,398	27,014
Income (Loss) from and Net Gain (Loss) on Sale of Discontinued Operations, net of applicable income taxes					
	155,876	25,063	21,315	(16,513)	5,597
Extraordinary Loss on Retirement of Debt, net of applicable income taxes					
	—	(12,999)	—	(3,481)	(4,827)
Cumulative Effect of Accounting Change, net of applicable income taxes and minority interest					
	—	—	—	—	(81,696)
Net Income (Loss)					
	\$ (18,533)	\$ 125,281	\$ 114,217	\$ 57,404	\$ (53,912)
Earnings Per Share — Basic					
Income (loss) from continuing operations					
	\$ (3.75)	\$ 2.37	\$ 1.97	\$ 1.67	\$ 0.62
Income (loss) from and net gain (loss) on sale of discontinued operations					
	3.35	0.52	0.45	(0.35)	0.13
Extraordinary loss on retirement of debt					
	—	(0.27)	—	(0.08)	(0.11)
Cumulative effect of accounting change					
	—	—	—	—	(1.87)
Net income (loss) per common share					
	\$ (0.40)	\$ 2.62	\$ 2.42	\$ 1.24	\$ (1.23)
Earnings Per Share — Diluted					
Income (loss) from continuing operations					
	\$ (3.75)	\$ 2.35	\$ 1.95	\$ 1.66	\$ 0.62
Income (loss) from and net gain (loss) on sale of discontinued operations					
	3.35	0.51	0.45	(0.35)	0.13
Extraordinary loss on retirement of debt					
	—	(0.27)	—	(0.08)	(0.11)
Cumulative effect of accounting change					
	—	—	—	—	(1.87)
Net income (loss) per common share					
	\$ (0.40)	\$ 2.59	\$ 2.40	\$ 1.23	\$ (1.23)
Average Shares Outstanding					
Basic					
	46,445	47,827	47,196	46,218	43,716
Diluted					
	46,445	48,261	47,565	46,659	43,716
Dividends Per Common Share					
	\$ 0.40	\$ 0.40	\$ 0.40	\$ 0.40	\$ 0.40
Bookings					
	\$1,997,035	\$2,762,246	\$2,675,888	\$1,988,692	\$1,499,242

FIVE-YEAR REVIEW OF SELECTED FINANCIAL DATA

(Dollar amounts in thousands except per share amounts)

Years Ended October 31,	1998	1997	1996	1995	1994
Working Capital:					
Current assets	\$1,463,144	\$1,588,712	\$1,410,250	\$1,213,390	\$1,043,401
Current liabilities	1,026,280	1,180,497	1,077,127	723,303	612,076
Working capital	\$ 436,864	\$ 408,215	\$ 333,123	\$ 490,087	\$ 431,325
Current ratio	1.4	1.3	1.3	1.7	1.7
Plant and Equipment					
Net properties	\$ 631,328	\$ 657,100	\$ 634,045	\$ 487,656	\$ 490,237
Capital expenditures	133,925	126,401	76,555	67,875	46,907
Depreciation expense	66,769	67,156	63,342	53,008	56,105
Total Assets	\$2,787,259	\$2,924,535	\$2,690,029	\$2,040,767	\$1,981,953
Debt and Capitalized					
Lease Obligations					
Long-term obligations ⁽¹⁾	\$1,001,573	\$ 725,193	\$ 662,137	\$ 462,991	\$ 571,054
Short-term notes payable	117,607	214,126	45,261	18,921	14,419
	\$1,119,180	\$ 939,319	\$ 707,398	\$ 481,912	\$ 585,473
Minority Interest	\$ 43,838	\$ 97,724	\$ 93,652	\$ 89,611	\$ 85,570
Debt to Capitalization Ratio ⁽²⁾	61.2%	52.6%	48.0%	42.6%	49.9%
Shareholders' Equity	\$ 666,850	\$ 749,660	\$ 673,485	\$ 559,276	\$ 502,365
Book value per share	\$ 14.52	\$ 15.93	\$ 14.15	\$ 11.98	\$ 11.04
Common shares outstanding ⁽³⁾	45,915,942	47,046,328	47,598,340	46,693,061	45,503,451
Number of (End of Year):					
Employees	13,700	17,700	17,100	14,000	14,900
Common Shareholders of Record	2,100	1,861	1,972	2,114	2,261

(1) Includes amounts classified as current portion of long-term obligations

(2) Total debt to total debt, minority interest and shareholders' equity

(3) As of end of year, excluding SECT shares