

# Financial Highlights

dollars in millions, except per share data	1998			1997		
	Amount	Per share		Amount	Per share	
		Basic	Diluted		Basic	Diluted
Net sales	\$2,530.1			\$2,340.6		
Income from continuing operations	\$ 208.5	\$ 1.59	\$ 1.57	\$ 213.6	\$ 1.51	\$ 1.48
Net income	\$ 208.5	\$ 1.59	\$ 1.57	\$ 343.0	\$ 2.43	\$ 2.38
Book value at end of year	\$1,514.1			\$1,734.3		
Book value per share at end of year	\$ 11.94			\$ 12.65		
Total debt to capitalization	13.3%			12.6%		

## Quarterly Financial Highlights (Unaudited)

in millions, except per share data	Fiscal year 1998				Fiscal year 1997			
	Three months ended				Three months ended			
	June 30 <sup>(4)</sup>	March 31	Dec. 31	Sept. 30	June 30	March 31	Dec. 31	Sept. 30
Net sales	\$ 603.4	\$ 660.5	\$ 664.9	\$ 601.3	\$ 614.9	\$ 638.5	\$ 564.2	\$ 523.0
Gross profit	189.5	209.0	213.0	192.5	199.9	208.0	179.5	172.9
Income from continuing operations before income taxes	55.6	94.6	90.9	84.7	83.4	100.6	79.2	70.6
Income from continuing operations	\$ 35.6	\$ 60.5	\$ 58.2	\$ 54.2	\$ 53.5	\$ 64.4	\$ 50.6	\$ 45.1
Income from discontinued operations, net of income taxes	—	—	—	—	13.4	44.9	37.5	33.6
Net income	\$ 35.6	\$ 60.5	\$ 58.2	\$ 54.2	\$ 66.9	\$ 109.3	\$ 88.1	\$ 78.7
Per share <sup>(1)</sup> :								
Basic income per share:								
Income from continuing operations	\$ .28	\$ .47	\$ .44	\$ .40	\$ .38	\$ .46	\$ .35	\$ .32
Income from discontinued operations	—	—	—	—	.11	.31	.27	.23
Net income	\$ .28	\$ .47	\$ .44	\$ .40	\$ .49	\$ .77	\$ .62	\$ .55
Diluted income per share:								
Income from continuing operations	\$ .28	\$ .46	\$ .44	\$ .39	\$ .37	\$ .45	\$ .35	\$ .31
Income from discontinued operations	—	—	—	—	.10	.31	.26	.23
Net income	\$ .28	\$ .46	\$ .44	\$ .39	\$ .47	\$ .76	\$ .61	\$ .54
Cash dividends per share <sup>(2)</sup>	\$ .12	\$ .12	\$ .12	\$ .12	\$ .12	\$ .15	\$ .15	\$ .15
Market price of common stock <sup>(3)</sup>								
High	\$33 <sup>1</sup> / <sub>8</sub>	\$34 <sup>7</sup> / <sub>16</sub>	\$35 <sup>7</sup> / <sub>8</sub>	\$35 <sup>3</sup> / <sub>4</sub>	\$ 42 <sup>7</sup> / <sub>8</sub>	\$ 44 <sup>3</sup> / <sub>8</sub>	\$ 43	\$ 39 <sup>3</sup> / <sub>4</sub>
Low	24 <sup>13</sup> / <sub>16</sub>	29 <sup>13</sup> / <sub>16</sub>	31 <sup>1</sup> / <sub>16</sub>	30 <sup>1</sup> / <sub>16</sub>	29 <sup>7</sup> / <sub>8</sub>	40	38 <sup>1</sup> / <sub>8</sub>	33 <sup>1</sup> / <sub>4</sub>

(1) Basic income per share has been calculated based on the average number of common shares outstanding. Diluted income per share includes average outstanding shares and common equivalent shares. Shares outstanding are for the company and the predecessor corporation (Old Morton). Refer to Spinoff and Basis of Presentation footnote.

(2) Cash dividends reflect total payments made by Old Morton through April 30, 1997, and by the company thereafter.

(3) The principal market is the New York Stock Exchange and prices are based on the Composite Tape (Ticker symbol MII). Stock prices after April 30, 1997 reflect the result of the Spinoff described in the Spinoff and Basis of Presentation footnote.

(4) Includes special charges of \$15.0 million pretax (\$9.6 million after tax or \$.07 per share). Refer to Special Charges footnote.

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Capital Expenditures in millions				
1994	1995	1996	1997	1998
\$ 125.0	\$ 126.4	\$ 124.4	\$ 117.4	\$ 136.8

Excluding the acquisition, salt sales would have declined by 4 percent and earnings would have decreased 7 percent.

During the year, the company was impacted by the weather effects of El Niño, which reduced ice control sales by 18 percent. Helping offset the dramatic decline were good performances from the rest of the salt product lines including water conditioning salt and grocery salt. Also benefiting salt results were operating margin improvements at Salins du Midi, which increased from 8 percent in fiscal year 1997 to 10 percent in fiscal year 1998.

North American non-ice control sales for fiscal 1998 ended 3 percent ahead of fiscal 1997 sales of \$414.9 million. The increase in sales was primarily generated by improved results in water conditioning, specialty and evaporated products. Sales of water conditioning products increased \$6.6 million or 5 percent to \$134.1 million. Sales of evaporated products increased 4 percent to \$107.1 million while sales of specialty products increased \$2.9 million or 10 percent.

Salt sales of \$155.7 million for the fourth quarter in fiscal 1998 were flat with year ago fourth quarter results of \$156.4 million. Operating earnings declined by 4 percent to \$19.3 million, as operating costs were slightly higher than in fiscal 1997.

In the fourth quarter of fiscal 1995, the company's Mines Seleine salt mine on the Magdalen Islands was shut down due to water intrusion into the production shaft. Production

was suspended at this mine with corresponding increased production at the company's remaining ice control mines. Operations at the mine resumed in August of fiscal 1998. Costs related to the efforts to save the mine have been recovered from insurance proceeds.

#### CORPORATE

During fiscal 1998, Morton bought back 11.1 million of its shares outstanding at a total cost of \$361.3 million. The total number of shares purchased since the spinoff in April 1997 is 14.3 million shares at a total cost of \$461.2 million. The company has approval to acquire an additional 5.7 million shares. The total share buyback program contributed approximately 4 cents per share to fiscal year 1998 results. Average shares outstanding for the fiscal year were 133.1 million versus 143.9 million at the end of fiscal 1997.

Corporate expenses decreased 15 percent during fiscal 1998 due to tight cost control, lower incentive pay and adjustment of accruals for certain stock option related supplemental cash payments. The incentive pay accruals were lower due to the actual results achieved for fiscal 1998. The supplemental cash payment accrual (refer to Incentive Plan footnote) was reduced to reflect the recent decline in Morton's stock price. Excluding these two items, corporate expenses declined 8 percent from the fiscal year ended June 30, 1997. The company's effective tax rate for continuing operations remained flat at 36 percent.

#### Comparison: Fiscal 1997 to Fiscal 1996

Boosted by strong fourth quarter volumes in chemicals and the recent acquisitions of Salins du Midi and Pulverlac, the company generated sales of \$2.34 billion, an increase of 6 percent from fiscal 1996 sales of \$2.22 billion. Income from continuing operations increased 20 percent to \$213.6 million. Fiscal 1996 income from continuing operations included special charges of \$23.9 million (\$29.2 million pretax), offset by \$15.1 million (\$24.1 million pretax) related to the settlement of several environmental insurance issues and \$9.4 million (\$15.0 million pretax) related to proceeds received for the formation of a joint venture. Income from discontinued operations, net of applicable income taxes, was \$129.4 million in fiscal 1997 versus \$155.5 million in 1996. Fiscal 1997 discontinued operations included 10 months of Morton Automotive Safety Products results versus a full

year in 1996. On an earnings per share basis, continuing operations increased from \$1.20 in fiscal 1996 to \$1.48 in fiscal 1997. Total earnings per share in fiscal 1997, including the results of Morton's Automotive Safety Products business for 10 months, was \$2.38 versus \$2.25 in fiscal 1996, an increase of 6 percent.

#### SPECIALTY CHEMICALS

For the full year 1997, Morton's specialty chemicals sales were up 4 percent to \$1.68 billion from \$1.61 billion in 1996. The increase in sales was mainly attributed to higher volumes and the Pulverlac acquisition which contributed \$35.4 million to 1997 sales.

Those product lines contributing most to the increase were industrial adhesives, thermoplastic polyurethanes, advanced materials, plastics additives, industrial coatings and powder coatings. These product lines contributed \$588.7 million or 35 percent of specialty chemicals full year sales. Year-over-year growth of the combined sales of these product lines was 10 percent, contributing approximately 76 percent of the year-over-year sales increase.

Operating earnings rose 21 percent to \$268.6 million during fiscal 1997 or 8 percent excluding the prior year \$27.1 million pretax special charge. Strong profit contributors included packaging adhesives, advanced materials, performance chemicals, plastics additives, industrial coatings and powder coatings. Automotive coatings results, excluding the impact of the creation of the joint venture in January 1996, were also up in fiscal 1997. Operating earnings of these product lines contributed \$188.4 million or 70 percent of specialty chemicals earnings in fiscal 1997. Combined, these product lines grew 20 percent from fiscal 1996 and contributed 51 percent to the year-over-year increase. Packaging adhesives achieved its 10 percent earnings growth despite a 4 percent decrease in sales from 1996. Improved manufacturing processes, tight cost controls and lower raw material costs were the main reasons for the year-to-year earnings increase.

The electronic materials, dyes and polymer systems product lines showed unfavorable year-to-year comparisons for both sales and earnings. Sales decreased 3 percent while earnings dropped 21 percent. All three of these product lines experienced strong competitive pricing pressures which led to decreased earnings. These product lines contributed 20 percent of specialty chemicals sales and 19 percent of fiscal 1997 earnings.

# Consolidated Statements of Income

in millions, except per share data	Year ended June 30		
	1998	1997	1996
Net sales	\$2,530.1	\$2,340.6	\$2,215.0
Interest, royalties and sundry income	44.3	47.6	73.2
	<u>2,574.4</u>	<u>2,388.2</u>	<u>2,288.2</u>
Deductions from income			
Cost of products sold	1,726.1	1,580.3	1,517.7
Selling, administrative and general expense	411.2	378.5	361.1
Research and development expense	60.9	58.8	60.2
Interest expense	23.3	25.6	24.4
Amortization of goodwill	12.1	11.2	10.3
Special charges	15.0	—	29.2
	<u>2,248.6</u>	<u>2,054.4</u>	<u>2,002.9</u>
Income from continuing operations before income taxes	325.8	333.8	285.3
Income taxes	117.3	120.2	106.6
Income from continuing operations	<u>208.5</u>	<u>213.6</u>	<u>178.7</u>
Income from discontinued operations, net of applicable income taxes	—	129.4	155.5
Net income	<u>\$ 208.5</u>	<u>\$ 343.0</u>	<u>\$ 334.2</u>
Basic income per share:			
Income from continuing operations	\$ 1.59	\$ 1.51	\$ 1.21
Income from discontinued operations	—	.92	1.06
Net income	<u>\$ 1.59</u>	<u>\$ 2.43</u>	<u>\$ 2.27</u>
Diluted income per share:			
Income from continuing operations	\$ 1.57	\$ 1.48	\$ 1.20
Income from discontinued operations	—	.90	1.05
Net income	<u>\$ 1.57</u>	<u>\$ 2.38</u>	<u>\$ 2.25</u>

See notes to consolidated financial statements.

# Consolidated Balance Sheets

in millions	June 30	
	1998	1997
<b>Assets</b>		
<i>Current Assets</i>		
Cash and cash equivalents	\$ 138.0	\$ 430.3
Receivables, less allowances of \$13.5 and \$11.7	468.6	466.4
Inventories	381.0	351.6
Prepaid expenses and other	125.4	141.7
Total Current Assets	1,113.0	1,390.0
<i>Other Assets</i>		
Cost in excess of net assets of businesses acquired, less amortization	357.4	338.4
Investments in affiliates	73.9	91.5
Miscellaneous	121.9	105.9
	553.2	535.8
<i>Property, Plant and Equipment</i>		
Land	94.9	102.5
Buildings and improvements	484.8	461.3
Machinery and equipment	1,101.9	1,061.7
Construction in progress	91.5	87.0
	1,773.1	1,712.5
Less allowances for depreciation	891.4	833.4
	881.7	879.1
	<u>\$2,547.9</u>	<u>\$2,804.9</u>
<b>Liabilities and Shareholders' Equity</b>		
<i>Current Liabilities</i>		
Notes payable and current portion of long-term debt	\$ 22.6	\$ 32.7
Accounts payable	215.6	255.9
Accrued salaries, wages and other compensation	52.1	58.4
Other accrued expenses	159.3	156.2
Income taxes	22.1	19.9
Total Current Liabilities	471.7	523.1
<i>Noncurrent Liabilities</i>		
Long-term debt, less current portion	222.5	224.1
Deferred income taxes	77.9	46.0
Accrued postretirement benefits other than pensions	157.9	156.0
Other noncurrent liabilities	103.8	121.4
Total Noncurrent Liabilities	562.1	547.5
<i>Shareholders' Equity</i>		
Preferred stock (par value \$1.00 per share)		
Authorized—25.0 shares, none issued		
Common stock (par value \$1.00 per share)		
Authorized—500.0 shares		
Issued—140.1 shares	140.1	140.1
Additional paid-in capital	—	.3
Retained earnings	1,840.3	1,706.0
Foreign currency translation adjustment and other	(36.9)	(16.8)
	1,943.5	1,829.6
Less cost of common stock in treasury—13.3 shares and 3.0 shares in 1998 and 1997	429.4	95.3
Total Shareholders' Equity	1,514.1	1,734.3
	<u>\$2,547.9</u>	<u>\$2,804.9</u>

See notes to consolidated financial statements.

# Consolidated Statements of Cash Flows

in millions	Cash provided (used) Year ended June 30		
	1998	1997	1996
<i>Operating Activities</i>			
Income from continuing operations	\$ 208.5	\$ 213.6	\$ 178.7
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	129.2	116.0	102.9
Deferred income taxes	(6.1)	5.8	2.7
Undistributed earnings of affiliates	.3	(7.5)	(4.8)
Special charges	15.0	—	29.2
Changes in operating assets and liabilities net of effects of businesses acquired:			
Receivables	(9.8)	(7.9)	(16.0)
Inventories and prepaid expenses	(23.1)	(15.6)	—
Accounts payable and accrued expenses	(66.4)	10.2	(27.0)
Income taxes	27.1	(15.7)	10.4
Other—net	(21.5)	(7.6)	(5.8)
Net cash provided by operating activities	<u>253.2</u>	<u>291.3</u>	<u>270.3</u>
<i>Investing Activities</i>			
Purchase of property, plant and equipment	(136.8)	(117.4)	(124.4)
Proceeds from property and other asset disposals	35.9	8.9	4.3
Net cash invested in businesses acquired	(18.1)	(309.5)	(.6)
Other	(4.7)	(2.2)	(1.7)
Net cash used for investing activities	<u>(123.7)</u>	<u>(420.2)</u>	<u>(122.4)</u>
<i>Financing Activities</i>			
Purchase of common stock for treasury	(361.3)	(234.9)	(242.3)
Net repayment of short-term borrowings	(4.8)	(23.1)	(1.1)
Repayment of long-term debt	(2.9)	(.1)	—
Stock option transactions	10.4	15.2	11.9
Dividends paid	(63.0)	(80.7)	(76.3)
Net cash used for financing activities	<u>(421.6)</u>	<u>(323.6)</u>	<u>(307.8)</u>
<i>Discontinued Operations</i>			
Net transfer from discontinued operations	—	806.8	141.8
Effect of foreign exchange rate changes on cash and cash equivalents	(.2)	7.1	(1.3)
(Decrease) increase in cash and cash equivalents	(292.3)	361.4	(19.4)
Cash and cash equivalents at beginning of year	430.3	68.9	88.3
Cash and cash equivalents at end of year	<u>\$ 138.0</u>	<u>\$ 430.3</u>	<u>\$ 68.9</u>

See notes to consolidated financial statements.

# Notes to Consolidated Financial Statements

## Spinoff and Basis of Presentation

On April 24, 1997, the shareholders of the current Morton International, Inc.'s predecessor ("Old Morton") approved the spinoff of its specialty chemicals and salt businesses (the "Spinoff") and the combination of Old Morton's automotive safety products business ("ASP") with the businesses of Autoliv AB (the "Combination"), pursuant to the Combination Agreement, dated as of November 25, 1996, by and among Old Morton, Autoliv AB, Autoliv, Inc., a newly formed corporation ("Autoliv"), and ASP Merger Sub, Inc. In connection with the Spinoff, Old Morton contributed its specialty chemicals and salt businesses and corporate operations, together with \$750 million of cash, to New Morton International, Inc. ("New Morton"), a newly formed subsidiary of Old Morton.

On April 30, 1997, all of the outstanding shares of New Morton were distributed to Old Morton shareholders on a basis of one New Morton share for each Old Morton share held by such shareholders. On May 1, 1997, the Combination became effective, and each outstanding Old Morton share was converted into the right to receive .341 of a share of Autoliv, a holding company which now holds ASP.

The net assets and results of operations of the ASP business are reflected in the accompanying financial statements prior to the Spinoff as discontinued operations.

## Nature of Operations

The company is an international organization engaged in the manufacture and marketing of specialty chemicals and salt. Specialty Chemicals is the largest segment, accounting for 69 percent of fiscal 1998 net sales. Its major markets include general industrial, packaging, construction, automotive, electronics, paper and printing, textiles and petroleum. Chemical products are sold primarily in North America and Europe but with some activity in Japan, Southeast Asia and South America. The Salt segment contributed 31 percent of 1998 net sales. It serves major North American and European salt markets with a complete line of products.

## Summary of Significant Accounting Policies

### *Principles of Consolidation*

Investments in 50 percent or less owned companies and joint ventures, where the company does not effectively control the entity, are carried on the equity basis. All intercompany accounts and transactions have been eliminated from the consolidated financial statements.

### *Cash Equivalents*

The company considers all highly liquid investment instruments purchased with a maturity of three months or less to be cash equivalents.

### *Inventories*

Inventories are stated at the lower of cost or market. The cost of domestic inventories (55 percent and 56 percent of consolidated inventories at June 30, 1998 and 1997) is determined by the last-in, first-out (LIFO) method, while the cost of foreign inventories is determined by the first-in, first-out (FIFO) method. If the FIFO method, which approximates replacement cost, had been used for all inventories, the total amount for inventories would have been increased by \$33.9 million and \$34.8 million at June 30, 1998 and 1997.

### *Intangible Assets*

Cost in excess of net assets of businesses acquired and other intangibles is being amortized on a straight-line basis over periods not exceeding 40 years. The amount of accumulated amortization related to intangibles, primarily goodwill, recorded as of June 30, 1998 and 1997 was \$161.3 million and \$145.6 million.

### *Property, Plant and Equipment*

The company provides for depreciation of property, plant and equipment, all of which are recorded at cost, by annual charges to income, computed primarily under the straight-line method.

### *Foreign Currency Translation*

All assets and liabilities in the balance sheet of foreign subsidiaries whose functional currency is other than the U.S. dollar are translated at year-end exchange rates except shareholders' equity, which is translated at historical rates. Translation gains and losses are accumulated as a separate component of shareholders' equity. Foreign currency transaction gains and losses are included in determining net income.

### *Foreign Exchange Contracts*

Neither foreign exchange contracts nor other financial instruments are held or issued for trading purposes. The company considers forward foreign exchange contracts primarily to offset the effects of foreign currency fluctuations related to firm and anticipated foreign denominated receivables and payables transactions, intercompany financing transactions and dividends from subsidiaries. The company may also use forward foreign exchange contracts to offset the currency fluctuation related to foreign currency denominated debt. The company nets its exposures before entering into hedge transactions. Generally, contracts do not exceed one year. Gains or losses on forward foreign exchange contracts that hedge an identifiable long term foreign currency commitment or exposure are deferred. All other forward foreign exchange contracts are marked to market at the current foreign exchange rates with unrealized gains and losses currently recognized in determining net income. Exchange gains (losses) recorded on forward contracts as an adjustment to general expense in 1998, 1997 and 1996 were \$(.2) million, \$1.2 million and \$1.6 million. Unrealized amounts related to foreign exchange contracts are included in current assets and liabilities.

## Notes to Consolidated Financial Statements *(continued)*

### *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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

### *Quarterly Results*

Quarterly results are presented on the inside front cover of the annual report.

### **Earnings Per Share**

In February 1997, the Financial Accounting Standards Board (FASB) issued Statement No. 128, "Earnings Per Share." Statement 128 replaced the calculation of primary and fully diluted earnings per share with basic and diluted earnings per share. Unlike primary earnings per share, basic earnings per share excludes any dilutive effects of options, warrants and convertible securities. Diluted earnings per share is very similar to the previously reported fully diluted earnings per share. All earnings per share amounts for all periods have been presented to conform to the Statement 128 requirements.

The numerators for the earnings per share disclosures on the accompanying Consolidated Statements of Income are the same as the income numbers shown on that Statement. Following is the computation of the denominator for the basic and diluted earnings per share calculations:

in millions	1998	1997	1996
Denominator for basic earnings per share—weighted average shares outstanding	131.2	141.4	146.9
Dilutive effect of employee stock options	<u>1.9</u>	<u>2.5</u>	<u>1.9</u>
Denominator for diluted earnings per share	<u>133.1</u>	<u>143.9</u>	<u>148.8</u>

### **Discontinued Operations**

As a result of the Spinoff, results for fiscal years 1997 and 1996 have been restated to reflect ASP as a discontinued operation. The results reported below include allocations of certain company assets (including pension assets), liabilities (including pension and postretirement benefits) and expenses relating to ASP that were transferred to ASP. The company also provided certain general administrative services including legal management, tax compliance, risk management and other corporate services to ASP. The cost of these services was not material and was not included in the cost and expenses of discontinued operations.

The operating results of the discontinued ASP business are as follows:

in millions	Ten months ended April 30, 1997	Year ended June 30, 1996
Net sales	\$1,249.2	\$1,397.5
Interest, royalties and sundry income (loss)	<u>(.9)</u>	<u>2.2</u>
	1,248.3	1,399.7
Cost of products sold	946.3	1,048.6
Selling, administrative and general expense	77.8	75.3
Research and development	12.5	20.0
Interest expense	<u>2.3</u>	<u>1.9</u>
	<u>1,038.9</u>	<u>1,145.8</u>
Income before income taxes	209.4	253.9
Income taxes	<u>80.0</u>	<u>98.4</u>
Net income	<u>\$ 129.4</u>	<u>\$ 155.5</u>

### **Acquisitions**

In December 1996, Morton signed a definitive agreement to acquire approximately two-thirds of the stock of Compagnie des Salins du Midi et des Salines de l'Est ("Salins du Midi"). A subsidiary of Morton acquired two-thirds of the stock in March 1997, made a public cash tender offer in France for the remaining shares, and as of June 30, 1997, owned 100 percent of Salins du Midi for a total cost of \$268.9 million. Salins du Midi is the leading independent salt producer in France. Based in Paris, Salins du Midi supplies salt for food and agricultural products, water treatment and ice/snow and industrial applications, and markets its products under the "La Baleine" label. Salins du Midi produces solar, rock and vacuum-processed salt at nine sites in France and at four sites in Spain as well as other locations.

In December 1996, rights to acquire 90 percent of the outstanding stock of Pulverlac S.p.A. ("Pulverlac"), an Italian powder coatings maker, were purchased for \$66.3 million. The remaining 10 percent was purchased in January 1998 for \$6.5 million. Pulverlac is a leader in the European powder coatings industry.

These acquisitions consisted principally of values for property, plant and equipment of \$151.5 million, working capital of \$55.2 million, and intangibles of \$90.7 million (primarily goodwill). The accounts and results of operations since acquisition of the companies have been included in the accompanying consolidated financial statements. Assuming the acquisitions had been effective as of July 1, 1995, unaudited pro forma data for the years ended June 30, 1997 and 1996 would not be materially different in relation to consolidated results presented herein.

### Special Charges

During the fourth quarter of fiscal 1998, the company recorded a special charge of \$15.0 million pretax (\$9.6 million after tax or \$.07 per share) for restructuring actions. These activities, which are expected to improve operating margins and enhance efficiency, relate to \$9.2 million for the closure of three chemical facilities and divestiture of several product lines, and \$5.8 million related to termination costs associated with the reorganization of the industrial coatings and adhesives and chemical specialties groups. These actions are expected to be completed primarily in fiscal 1999 and generate annual cost savings of approximately \$5.2 million.

During the fourth quarter of fiscal 1996, the company recorded special pretax charges of \$29.2 million (\$23.9 million after tax or \$.16 per share). The charges included amounts related to the early adoption of the accounting standard related to impairment of long-lived assets and the costs related to selected facility rationalizations and employee terminations resulting from the reorganization of the specialty chemicals operations.

During fiscal 1996, in applying the criteria of FASB Statement No. 121, "Accounting for the Impairment of Long-Lived Assets to be Disposed Of," the company determined that the significant reduction in the defense-related business of its chemical vapor deposition product line and the resulting negative impact on income in recent years were indicators of potential impairment. Accordingly, the company evaluated the ongoing value of long-lived assets associated with this product line in accordance with the provisions of Statement No. 121. Based on this evaluation, the company determined that an impairment did exist and recorded an impairment loss of \$15.8 million to write these assets down to their fair value. Fair value was based on estimated future cash flows to be generated by this product line, discounted at a rate commensurate with the risk involved. No tax benefit was recorded related to this charge.

During the fourth quarter of 1996, the company recorded a pretax charge of \$11.3 million for the planned closure of three domestic chemical facilities and a European sales office as well as the elimination of certain duplicate management and administrative positions. Operations at these facilities were transferred to other existing facilities.

Components of the one-time charge included \$3.0 million related to the disposal of the facilities mentioned above, \$4.9 million related to the write-down to net realizable value of certain manufacturing equipment and \$3.4 million related to employee termination costs. These actions were finalized in fiscal year 1998, and are expected to generate estimated annual savings of \$8.5 million.

In addition, in the fourth quarter of fiscal 1996 the company recorded a pretax charge of \$2.1 million to write down to current estimated realizable value certain corporate assets held for sale.

### Inventories

Components of inventories were as follows:

in millions	June 30	
	1998	1997
Finished products and work-in-process	\$294.6	\$271.8
Materials and supplies	86.4	79.8
	<u>\$381.0</u>	<u>\$351.6</u>

### Financing Arrangements

In May 1998, the company filed a shelf registration with the Securities and Exchange Commission for up to \$1 billion of debt securities. Should the sale of the debt securities occur, proceeds will be used for general corporate purposes which may include financing and re-financing of acquisitions, purchases of company stock, repurchases of outstanding long-term debt, capital expenditures, investments in subsidiaries, working capital and repayment of borrowings under credit facilities.

The company has committed credit agreements with banks that will expire in April 1999 and April 2002. In addition, lines of credit are available from domestic and foreign banks that generally do not have termination dates but are reviewed annually for renewal. Under these arrangements, the company may borrow upon such terms and conditions as the company and the banks may mutually agree. At June 30, 1998, such credit facilities amounted to approximately \$526.2 million, and the unused portions thereof were approximately \$507.2 million.

Long-term debt consisted of the following:

in millions	June 30	
	1998	1997
Credit Sensitive Debentures		
(net of unamortized discount of \$1.3)	\$198.7	\$198.7
Other	26.9	28.3
	225.6	227.0
Less current portion	3.1	2.9
	<u>\$222.5</u>	<u>\$224.1</u>

The Credit Sensitive Debentures ("Debentures") due June 1, 2020, are unsecured obligations of the company. The Debentures had an initial effective interest rate of 9.335 percent, subject to adjustment on the calendar day that certain changes in the debt rating of the Debentures occur, as determined by Standard & Poor's Corporation or Moody's Investor Service. No adjustment of the initial effective interest rate has occurred.

The aggregate maturities of long-term debt through June 30, 2003, total \$6.9 million. Interest paid on borrowings in 1998, 1997 and 1996 was \$23.1 million, \$26.6 million and \$24.0 million.

Notes payable at June 30, 1998 and 1997, reflected borrowings from banks at average interest rates of 7.4 percent and 5.5 percent.

## Notes to Consolidated Financial Statements *(continued)*

### Fair Values of Financial Instruments

The following methods were used by the company to estimate its fair value disclosures for financial instruments.

#### Cash and Cash Equivalents

The carrying amount reported in the balance sheet for cash and cash equivalents approximates its fair value.

#### Notes Payable and Long-Term Debt

The carrying amount of the company's borrowings in the form of notes payable approximates its fair value. The fair value of the company's long-term debt is estimated using discounted cash flow analyses, based on the company's current incremental borrowing rates for similar types of borrowing arrangements.

#### Foreign Currency Exchange Contracts

Forward foreign exchange contracts that hedge foreign currency exposures or transactions are valued at current foreign exchange rates.

The carrying or notional amounts and fair values of the company's financial instruments at June 30, 1998, were as follows:

in millions	Carrying or notional amount	Fair value
Notes payable	\$ 19.5	\$ 19.5
Long-term debt	225.6	293.3
Forward foreign exchange contracts	276.0	276.4

### Income Taxes

The provisions for income taxes for continuing operations were as follows:

in millions	1998	1997	1996
<b>Current:</b>			
Federal	\$ 49.6	\$ 55.3	\$ 55.2
State	12.9	12.0	11.6
Foreign	60.9	47.1	37.1
	<u>123.4</u>	<u>114.4</u>	<u>103.9</u>
<b>Deferred:</b>			
Federal	(4.7)	2.9	1.5
State	.5	1.4	.9
Foreign	(1.9)	1.5	.3
	<u>(6.1)</u>	<u>5.8</u>	<u>2.7</u>
	<u>\$117.3</u>	<u>\$120.2</u>	<u>\$106.6</u>

A reconciliation of the United States statutory rate to the effective income tax rate for continuing operations follows:

	1998	1997	1996
Statutory rate	35.0%	35.0%	35.0%
Effect of:			
State tax, net of federal tax benefit	2.7	2.6	2.8
Impairment loss on long-lived assets	—	—	1.9
Depletion	(1.8)	(1.9)	(2.1)
Other	<u>.1</u>	<u>.3</u>	<u>(.2)</u>
Effective rate	<u>36.0%</u>	<u>36.0%</u>	<u>37.4%</u>

Deferred income taxes reflect the impact of temporary differences between the valuation of assets and liabilities for financial reporting and their tax bases. Significant components of the company's deferred tax balances were as follows:

in millions	June 30	
	1998	1997
<b>Deferred tax benefits related to:</b>		
Postretirement and postemployment benefits	\$ 65.4	\$ 65.5
Accrual for environmental liabilities	14.1	15.0
Other	<u>65.2</u>	<u>67.1</u>
	<u>144.7</u>	<u>147.6</u>
<b>Deferred tax liabilities related to:</b>		
Tax over book depreciation	94.0	90.5
Pension	38.7	34.4
Other	<u>81.4</u>	<u>59.7</u>
	<u>214.1</u>	<u>184.6</u>
Net deferred tax liability	<u>\$ 69.4</u>	<u>\$ 37.0</u>

No individual item included in other deferred tax benefits or deferred tax liabilities above is material.

Total income tax payments related to the company (including ASP prior to the Spinoff) during fiscal 1998, 1997 and 1996 were \$106.3 million, \$167.4 million and \$189.2 million.

Components of the company's income from continuing operations before income taxes were as follows:

in millions	1998	1997	1996
Domestic	\$177.2	\$213.2	\$176.8
Foreign	<u>148.6</u>	<u>120.6</u>	<u>108.5</u>
	<u>\$325.8</u>	<u>\$333.8</u>	<u>\$285.3</u>

The Internal Revenue Service has completed its examination of Old Morton's consolidated federal income tax returns through fiscal 1992, and all issues, which were not significant individually or in the aggregate, have been settled.

## Notes to Consolidated Financial Statements *(continued)*

### Shareholders' Equity

Changes in shareholders' equity are summarized below:

in millions	Common stock		Additional paid-in capital	Retained earnings	Foreign currency translation adjustment and other	Treasury stock
	Shares	Amount				
Balance June 30, 1995	148.3	\$148.3	\$ 62.2	\$1,417.6	\$ 35.4	\$ —
Net income	—	—	—	334.2	—	—
Cash dividends paid, \$.52 per share	—	—	—	(76.3)	—	—
Exercise of stock options and related income tax benefits	.1	.1	(6.3)	—	—	24.3
Translation adjustment	—	—	—	—	(24.6)	—
Purchase of common stock for treasury	—	—	—	—	—	(242.3)
Other	—	—	—	—	.2	—
Balance June 30, 1996	148.4	148.4	55.9	1,675.5	11.0	(218.0)
Net income	—	—	—	343.0	—	—
Cash dividends paid, \$.57 per share	—	—	—	(80.7)	—	—
Exercise of stock options and related income tax benefits	.1	.1	(11.5)	—	(.3)	36.1
Translation adjustment	—	—	—	—	(26.4)	—
Purchase of common stock for treasury	—	—	—	—	—	(234.9)
Elimination of treasury stock <sup>(1)</sup>	(8.4)	(8.4)	(44.1)	(269.0)	—	321.5
Disposal of business operations <sup>(2)</sup>	—	—	—	37.2	(1.1)	—
Balance June 30, 1997	140.1	140.1	.3	1,706.0	(16.8)	(95.3)
Net income	—	—	—	208.5	—	—
Cash dividends paid, \$.48 per share	—	—	—	(63.0)	—	—
Exercise of stock options and related income tax benefits	—	—	(.3)	(11.2)	(.4)	27.2
Translation adjustment	—	—	—	—	(19.7)	—
Purchase of common stock for treasury	—	—	—	—	—	(361.3)
Balance June 30, 1998	140.1	\$140.1	\$ —	\$1,840.3	\$(36.9)	\$(429.4)

(1) In connection with the Spinoff, 8.4 million shares of treasury stock were canceled without payment of consideration therefor, resulting in reductions of common stock, additional paid-in capital and retained earnings, and the elimination of treasury stock.

(2) Retained earnings were decreased to reflect the divestiture of the net assets of ASP, increased by the cash received by the company as part of the Spinoff, and decreased to reflect the elimination of intercompany indebtedness of the ASP business and the liability for the company's portion of expenses in connection with the Spinoff.

In both April 1997 and December 1997, the company's Board of Directors authorized the repurchase of up to 10 million additional shares (20 million shares in aggregate) of the company's common stock. During fiscal 1997 and 1998, 3.2 million shares and 11.1 million shares were repurchased on the open market. In October 1995, Old Morton's Board of Directors authorized the repurchase of up to 10 million shares of Old Morton's common stock on the open market. During fiscal 1997 and 1996, 3.3 million shares and 6.7 million shares were repurchased.

In March 1997, the company declared a dividend distribution of one preferred share purchase right (the "Rights") for each outstanding common share, paid in connection with the Spinoff. Until exercisable, the Rights will not be transferable apart from the company's common stock. Each Right entitles its holder to buy one one-hundredth of a share of the company's Series A Junior Participating Preferred Stock at an exercise price of \$105 per one one-hundredth of a share of preferred stock.

The Rights will only become exercisable if a person or group acquires or makes an offer to acquire 20 percent or more of the company's common stock. In the event the company is acquired in a merger, each Right entitles the holder to purchase common stock of the surviving company having a market value of twice the exercise price of the Rights. In the event any person or group acquires 20 percent or more of the company's common stock (which the company's Board of Directors may reduce to 10 percent), each Right entitles the holder (other than such acquirer) to purchase common stock of the company having a market value of twice the exercise price of the Right. The Rights may be redeemed by the company at the price of one cent per Right prior to the acquisition of 20 percent of the outstanding shares of the company's common stock. At June 30, 1998, 1.6 million shares of preferred stock were reserved for future exercises of the Rights.