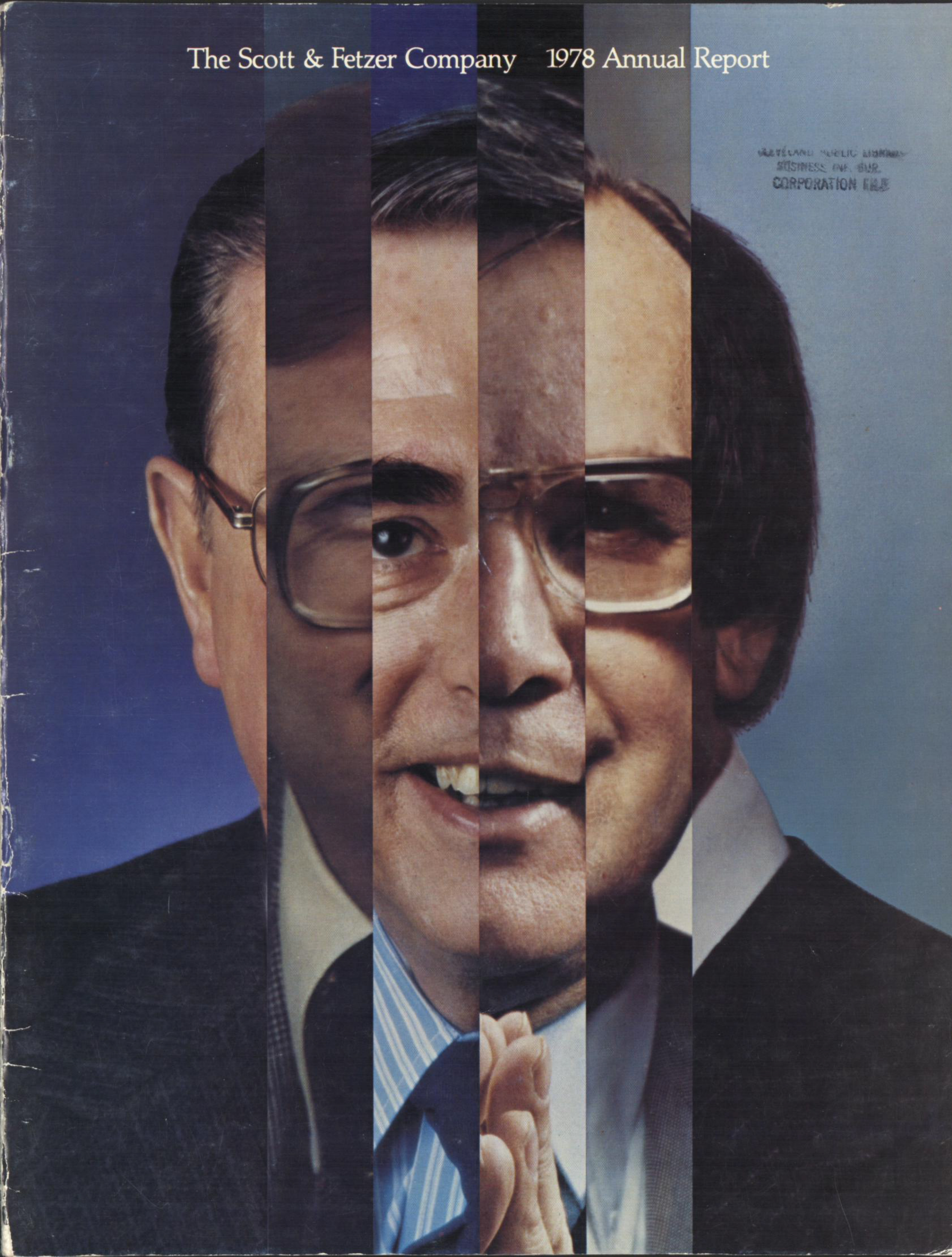
The Scott & Fetzer Company 1978 Annual Report



The Corporate Management

The six officers who form the Scott & Fetzer senior management group are shown in the composite on the front cover. On page five are their full pictures together with a statement of the group's responsibilities.

Contents

The Scott & Fetzer Company

Corporate Office

14600 Detroit Avenue
Lakewood, Ohio 44107
Telephone: 216/228-6200

Annual Meeting

The annual meeting of shareholders will be held on Tuesday, March 27, 1979, at 10:30 a.m. at the Lakewood City Hall Auditorium, 12650 Detroit Avenue, Lakewood, Ohio.

Form 10-K Report

Copies of Scott & Fetzer's Form 10-K report, filed with the Securities and Exchange Commission, are available without charge upon written request to Robert C. Weber, Secretary of the company.

Transfer Agent and Registrar

The Cleveland Trust Company
P.O. Box 6477
Cleveland, Ohio 44101

Common Stock

Scott & Fetzer common shares are traded on the New York Stock Exchange, the Midwest Stock Exchange, and the Pacific Stock Exchange. The ticker symbol for the shares is SFZ.

A Description of the Company

The Scott & Fetzer Company is a diversified marketing-oriented manufacturing company selling products in the cleaning systems, educational & household products, fluid transmission, equipment & accessories, power & energy, and measurement & control markets. The company has 20 operating units composed of independent businesses, most of which were acquired subsequent to 1963. The operating units are organized and managed as separate decentralized profit centers within Scott & Fetzer. The company was founded in 1914 and was incorporated under the laws of the State of Ohio on November 30, 1917.

The Year at a Glance

(Dollars in Thousands Except Per Share Data)

	1976	1977	**1978**	Per Cent Change 1978 vs. 1977
Net Sales	$301,918	$351,187	**$478,222**	36%
Income Before Taxes —				
Continuing Operations	42,367	56,108	**60,807**	8%
Per cent to Sales	14.0%	16.0%	**12.7%**	
Net Income —				
From Continuing Operations	$ 21,103	$ 26,802	**$ 30,176**	13%
From Discontinued Operations	1,618	(496)	**71**	
Total	$ 22,721	$ 26,306	**$ 30,247**	15%
Per cent to Sales —				
Continuing Operations	7.0%	7.6%	**6.3%**	
Per Share Earnings —				
From Continuing Operations	$ 2.78	$ 3.63	**$ 4.10**	13%
From Discontinued Operations	.21	(.07)	**.01**	
Total	$ 2.99	$ 3.56	**$ 4.11**	15%
Dividends Per Share	$ 1.17	$ 1.30	**$ 1.50**	15%
Book Value Per Share	$ 16.26	$ 18.23	**$ 20.85**	14%
Total Assets	$215,277	$225,411	**$337,977**	50%
Shares Outstanding (000's)	7,577	7,317	**7,338**	
Number of Shareholders	9,377	8,852	**8,439**	

Common Stock Market Price and Dividend Information

	Market Price of Common Stock				Dividends Per Share	
	1978		1977			
Fiscal Quarter	**High**	**Low**	High	Low	1978	1977
First	**$27¾**	**$23**	$28	$23⅞	$ .35	$ .30
Second	**32½**	**23¼**	27⅛	22¾	.35	.30
Third	**36⅛**	**30⅜**	29	22⅞	.40	.35
Fourth	**35⅜**	**25⅜**	28	24⅞	.40	.35
Closing price on December 29, 1978	**$25⅞**					

To the Shareholders

1978 was a year of significant progress and accomplishment for Scott & Fetzer since we achieved the principal objectives that had been established for the year. In our 1977 annual report, we identified several major priorities for 1978, all of which were realized. Some of the highlights of 1978 were:

- Record sales, net income, earnings per share and dividends paid to shareholders.
- The acquisition of World Book-Childcraft International, Inc., which makes Scott & Fetzer one of the largest direct-selling companies in the world.
- The acquisition of Wayne Home Equipment Company, the market leader in oil and gas power burners used in home hot water, steam and warm air furnaces and water system pumps for the home and industrial markets.
- Completed the sale of the remaining two divisions, Humphreys Leather Goods and Dek/Electro, which were classified as discontinued businesses in our 1977 report.
- Further consolidated several smaller divisions which were, in some instances, product lines rather than free-standing divisions.

By the end of 1979, we plan to have no more than four divisions with net income less than $1 million per division. It is our long-term goal for all operating units to have net income of $1 million or more; however, some of our promising businesses need more time to reach that objective. In addition, smaller divisions provide opportunities to develop some of our best young management teams. Having fewer but larger divisions enables us to devote more time to and work more closely with the management teams in the growth of their respective businesses. Larger divisions also enable us to attract superior talent at all levels of management.

- Initiated a program to expand our core manufacturing and engineering capabilities in component products which will help us achieve further vertical integration of our principal product lines. This is a major step in becoming the low-cost producer in our major product lines. Core capability is planned for such products as die castings, plastic products, electrical components including motors and switches, metal fabrication and screw machine products.
- Substantially increased our investment in land, buildings, and equipment in order to improve our efficiency and productivity and further our goal of being the low-cost producer in our major product lines.
- Purchased several product lines to strengthen our engineering and marketing capabilities in selected growth market areas. We acquired the Filtrex product lines of vacuum cleaner parts and accessories in order to give our Klevac division a more diversified group of replacement products; the Accu-Trol line of automatic and manual precision compressed gas crossover manifold systems and the Superior line of precision compressed gas regulators for the Western Enterprises division; and the Fan Clutch product line which provided additional vertical integration for our Valley Industries division.
- Introduced a comprehensive marketing program, including a new distributor agreement, at the Kirby group designed to strengthen the entire Kirby marketing operation.
- Installed and implemented a corporate computer data bank with an extensive data base programmed to facilitate the monitoring and control of all operating units without encroaching upon the decentralized responsibilities of the operating unit managements.
- Worked closely with each operating unit management team to develop long-range strategies which place much greater emphasis upon internally generated growth.
- Initiated an overall corporate strategy to guide both the corporation and the various operating units in achieving our long-term objectives.

In summary, Scott & Fetzer management can look back over 1978 with pride and satisfaction as it was a memorable year. Some of these developments are discussed in more detail in subsequent sections of this report.

Results of Operations. Our sales and earnings for 1978 include those of the Wayne Home Equipment division for 10 months (acquired in February, 1978) and World Book-Childcraft for three months (acquired September 1, 1978). Scott & Fetzer's consolidated sales for 1978 were $478.2 million, 36% above the $351.2 million for 1977. Net income increased 15% to $30.2 million from $26.3 million in 1977. Earnings per share were $4.11, up 15% versus the $3.56 earned in the prior year. The return on shareholders' equity was 19.8% for 1978 compared with 19.7% last year.

The record sales and earnings for 1978 reflected the improved operating results of 13 of the 19 previously existing operating units, the absence of operating losses from discontinued operations, and the two acquisitions.

Dividends. The quarterly dividend rate was raised to 40 cents per share from 35 cents, effective with the payment made on August 31, 1978. For 1978, dividend payments totalled $1.50 per share, 15% above the $1.30 per share paid during 1977. This was a payout of 36% of the 1978 total earnings per share. As we have stated previously, it is our Directors' intention to increase dividend payments consistent with our earnings growth and to pay out approximately 35-40% of average earnings over a three-year period.

Acquisitions. As I stated in the 1977 annual report, one of our principal objectives was to acquire one or more major business enterprises which would accomplish two purposes: first, strengthen our long-term earnings base by having less dependency upon a single business segment; second, provide entry to markets outside Scott & Fetzer's traditional consumer product areas. In February, 1978, we accomplished both of these objectives in purchasing Wayne Home Equipment. At that time, it was Scott & Fetzer's largest acquisition. Wayne, located in Fort Wayne, Indiana, has an excellent history of profitable growth. It is the market leader in oil and gas power burners used in home hot water, steam and warm air furnaces and water system pumps for the home and industrial markets. With our plans for future growth and experience in the fluid transmission markets, Wayne was a very strategic addition to Scott & Fetzer.

Because of Scott & Fetzer's long experience in direct door-to-door selling through the Kirby group, we had searched for a number of years for another direct-selling business. In periods of economic stress, direct selling can provide excellent balance to Scott & Fetzer's more traditional manufacturing and marketing operations. Although we had examined several direct-selling companies, none met our criteria. In early 1978, we became aware that Field Enterprises, Inc., a private holding company for the Field family, had decided, for a number of valid reasons, to sell World Book-Childcraft, a subsidiary. World Book met a primary acquisition requirement. It is the market leader with high quality products, an excellent direct-selling organization and an unblemished record for ethical selling practices. Although it is a consumer products company, World Book provides a substantial earnings base with potential for appreciable future growth in earnings. Through this acquisition, which was completed September 1, 1978, Scott & Fetzer obtained another major direct-selling business comparable to Kirby. In addition, World Book has substantial experience in direct-mail marketing and extensive international operations. We also obtained a captive life insurance company and a captive consumer finance company. These affiliated World Book operations will significantly broaden Scott & Fetzer's corporate capabilities.

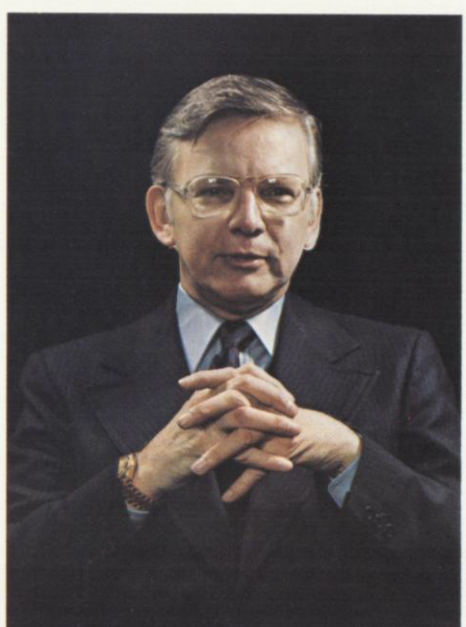
We are continuing to search for major acquisitions in the measurement & control, the power & energy, and the cleaning systems markets. We believe that these fields offer Scott & Fetzer substantial future growth opportunities. When these future objectives are achieved, no single operating unit will account for more than 25% of our net income.

We believe it must be a high priority of management to reduce the risks associated with major dependence upon a single unit as a source of earnings.

In 1979, our consolidated sales should approach $700 million with about one-half of the sales and earnings coming from Kirby's and World Book's direct-selling and affiliated operations.

While direct selling contributes to our earnings stability in periods of economic stress, it is nevertheless our goal to add other non-consumer businesses with the dual objectives of reaching a balance between consumer and non-consumer products, and deriving an increased percentage of our total earnings from non-consumer products.

Dispositions and Consolidations. At the end of 1977, we completed the sale of three divisions (Virden Lighting, Rembrandt Lamp, and Atlas Lighting), with two more divisions classified as discontinued businesses. The dispositions of the Humphreys Leather Goods and Dek/Electro divisions were completed in early 1978. With the dispositions of these five divisions, Scott & Fetzer had 19 operating units prior to the acquisition of Wayne Home Equipment and World Book-Childcraft. At the end of 1978, the Klevac and Cardinal divisions were combined to form a new Klevac division. With the dispositions, acquisitions, and consolidations, we now have 20 operating units.



Management Changes. Mr. John Bebbington, 53, and Mr. Walter A. Rajki, 53, who formerly were group vice presidents, were promoted to the newly created position of senior vice president. With the increasing size of Scott & Fetzer, these two experienced operating executives will assist me with the planning and growth of our operating units. Mr. Kenneth J. Semelsberger, 41, formerly president of the Stahl division, and Mr. Kearney K. Kier, 42, formerly president of the Klevac division, were named group vice presidents. Mr. Donald Mitchell, 38, joined Scott & Fetzer as president of the American-Lincoln division. Previously, Mr. Mitchell was president of Lester Engineering Company, a manufacturer of plastic die casting and injection molding equipment, and earlier was executive vice president of Van Dorn Plastic Machinery Company.

Mr. Kenneth D. Hughes, 57, was elected a vice president and continues as Scott & Fetzer's treasurer and controller. Theodore C. Bliss, 38, was promoted to assistant treasurer. John E. Frere, 31, joined Scott & Fetzer as assistant controller. Previously, Mr. Frere was associated with the public accounting firm of Coopers & Lybrand, most recently as audit manager.

Capital Expenditures. 1978 capital expenditures were $12.9 million vs. $8.8 million in 1977. More importantly, we authorized in excess of $14 million for four additional plants: a building in Leitchfield, Kentucky which will enable the Campbell-Hausfeld group to expand its manufacturing and customer service capabilities; and three buildings in Tennessee, two for the France division and one for a new plastic injection molding plant as part of our core capability discussed earlier. Our 1979 capital program which may exceed $20 million has placed major emphasis on two objectives:

- Reducing the unit cost of production, and

- Providing facilities for the expansion of existing operating units because of the response of our managers to the emphasis on internally generated growth.

Future Strategy. With the dispositions largely completed and the two major acquisitions consummated during 1978, we have the foundation to continue to build the company. It is one of our management objectives to build Scott & Fetzer into a significant long-term business enterprise with leadership positions in the principal markets we serve. We believe that Scott & Fetzer has the management resources, marketing skills, and significant market position in our major business areas to achieve continuing profitable growth.

We also expect to achieve a minimum earnings increase of 10% annually, primarily from internal growth, and maintain a superior return on shareholders' equity of approximately 20% after taxes. With the steps taken in the last three years, we are now prepared to aggressively pursue Scott & Fetzer's many opportunities. We are currently expanding and improving our manufacturing facilities. New product programs are a major objective of each of our operating units. We are adding product lines to existing marketing channels and expect to expand our major market positions with some carefully selected acquisitions.

As we enter 1979 and look to the 1980's, Scott & Fetzer is in a strong position with excellent financial resources to achieve its long-term goals. Each of our operating unit management groups, as well as the corporate senior management, is committed to the principle of growing each of the business units into a significant size and leadership position. This offers Scott & Fetzer the greatest base for survival and sustained profitable growth.

1979 Outlook. We enter 1979 a stronger and more broadly-based company than at any time in our history. We believe that management will be challenged more this year than has been the case since 1974-75. While our present business outlook is reasonably optimistic, economic conditions are becoming less predictable and the prospects of a recession have increased. Our contingency plans are well developed and firmly established in each operating unit.

With the inclusion of World Book-Childcraft and Wayne Home Equipment in our consolidated results for a full year, in addition to the planned growth in our other operating units, we expect that Scott & Fetzer will achieve another record year in 1979 even with a relatively flat economy and continuing high inflation and interest rates.

An area of great uncertainty, however, is the government's "voluntary" wage and price guidelines. As good corporate citizens, we want to cooperate and comply, but it is a fact that the economy and our businesses do not function efficiently with this type of arbitrary restraint. It is conceivable that these voluntary guidelines could evolve into some form of mandatory wage and price controls or a restrictive credit policy. These artificial constraints will bring new pressures on managements to maintain margins and overall profitability.

While we cannot anticipate all of the possibly adverse external developments that could have an impact on 1979 operations, we are prepared to aggressively control our operating costs and manage our resources. In each of our operating units we are committed to a policy to be the low-cost producer.

1978 was a great year for Scott & Fetzer. I want to express publicly my appreciation and that of my associates in the corporate management for the continuing advice and counsel of our dedicated and committed outside directors. I want to pay particular tribute to the operating and staff management teams for the excellence of their individual efforts and their continuing personal growth as entrepreneurially-oriented business managers. They have responded magnificently to the challenge of becoming growth-oriented, problem-solving managers who aggressively and wisely make their own opportunities.

We are indebted for the contributions of our many fine employees who helped make 1978 our best year in business.

I would like to express my gratitude to another outstanding group of extraordinary people—the independent Kirby and World Book-Childcraft marketing and selling organizations—for their effort and achievements during the year. One of my personal satisfactions in 1978 was my increased association with more of these wonderful people, giving me an opportunity to know many of them much better.

All of us at Scott & Fetzer recognize the loyalty and support of our many fine customers, dependable suppliers and other outside organizations that contributed so much to our 1978 record year. We will do our utmost to continue justifying their cooperation.

To all of our shareholders, we are committed to making your investment in Scott & Fetzer a profitable one.

Ralph Schey

RALPH SCHEY
President and
Chief Executive Officer

February 12, 1979

The Corporate Management

Six officers form Scott & Fetzer's senior management group: the president and chief executive officer, executive vice president-finance, two senior vice presidents and two group vice presidents.

These officers have the overall responsibility to formulate Scott & Fetzer's long-term business philosophy and objectives and develop the corporate strategy. Corporate management has the prime responsibility for monitoring all operations, controlling the allocation of Corporate resources and assisting the various group and division management teams in developing their business objectives and strategies.

Scott & Fetzer's fundamental philosophy is to provide an environment and incentives, including compensation, to the operating unit management teams "to grow a business." The Corporate management group, individually and collectively, functions as an informal board of directors to assist the group and the division presidents in achieving their goals.

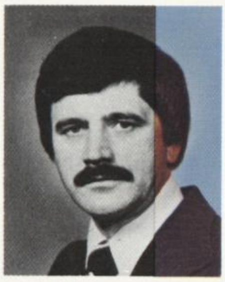
JOHN BEBBINGTON
Senior Vice President

KEARNEY K. KIER
Group Vice President

J. F. BRADLEY
Executive Vice President — Finance

RALPH SCHEY
President and Chief Executive Officer

WALTER A. RAJKI
Senior Vice President



KENNETH J. SEMELSBERGER
Group Vice President

Cleaning Systems

The Kirby Group

Until 1964, Kirby was Scott & Fetzer's only product line. The Kirby Home Sanitation System is a premium, high quality product and is regarded by customers as the "Cadillac" of upright vacuum cleaners. The product has always been, and will continue to be, sold by the direct door-to-door marketing method by a highly motivated direct-selling organization. Today, the Kirby distributing organization is international in scope and comprised of independent men and women from all walks of life who want to be in business for themselves yet belong to an exclusive group of similarly dedicated and motivated sales people.

Kirby Vacuum Cleaner

Kirby is a leader in both the vacuum cleaner and direct-selling industries. There have been many contributing factors, including outstanding individuals, both past and present, who have built a direct-selling organization that would be hard to duplicate today, and the Kirby products which are designed, engineered and manufactured to exacting standards of quality and performance. The Kirby converts easily to nine separate units to perform 80 or more tasks in and around the home.

ADRIAN E. BUDLONG, JR.
President, Kirby Group

Kirby products are manufactured in plants located in Cleveland, Ohio and Andrews, Texas, and sold in 18 countries. Products are shipped to distributors from both plants, through five warehouses in the United States, one warehouse in England and through Kirby of Canada located in Whitby, Ontario. The Kirby direct-selling organization comprises 825 independent authorized factory distributors, over 1,200 area distributors, and approximately 11,000 independent full- and part-time sales people.

The Kirby group is committed to high quality products and total concern for customer satisfaction. To improve still further the independent marketing organization's selling and service practices, a new comprehensive market program was introduced in May, 1978. The new program's objectives were to assure: that all Kirby customers are provided convenient and qualified installation and service; and, that the independent distributors are compensated for the obligation to service all Kirby products in their primary marketing area.

The new marketing program, which necessitated some changes in the field organization, adversely affected Kirby's sales, particularly in the second and third quarters. In addition, 1978 sales were impacted by the severe weather early in the year and generally weaker consumer demand.

Kirby's 1979 outlook has improved and, unless there is a severe tightening of consumer credit, unit volume, sales and earnings should increase over the 1978 levels.

Kirby Rug Renovator

KEARNEY K. KIER
Group Vice President

In addition to the Kirby group, the Cleaning Systems segment includes the American-Lincoln division and the recently consolidated Klevac division.

With increasing attention being given to improving the cleanliness of commercial and industrial work environments, the market for labor-saving cleaning equipment is growing. The American-Lincoln line includes power-driven floor sweepers, scrubbers, polishers and other equipment for the cleaning and care of all types of surfaces, both interior and exterior.

In mid-year, American-Lincoln introduced an all-hydraulic, heavy duty rider-sweeper that received favorable reception and should help the division gain in market share. Other new products are being readied for introduction this year to reach new markets.

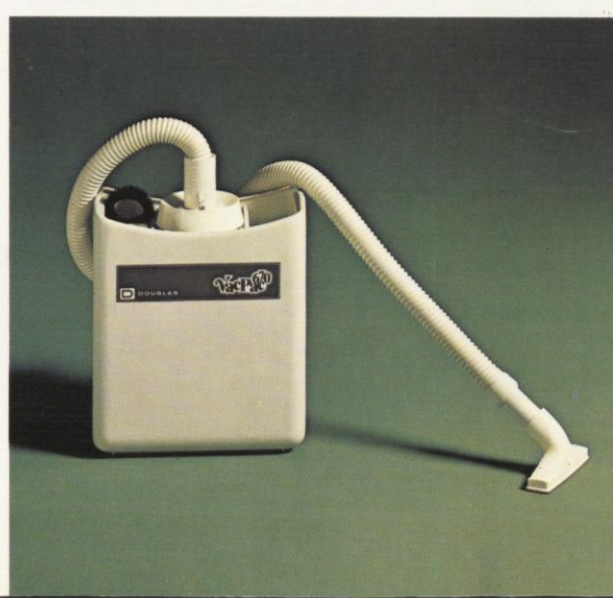
Near year end, the Klevac and Cardinal operations were combined into a new Klevac division to maximize its technical, manufacturing and marketing capabilities through stronger product and service programs for customers. Klevac products include the Douglas line of vacuum cleaners, replacement vacuum cleaner parts and accessories, and chemical cleaning specialties. Some products are manufactured by Klevac for the original equipment market and for other Scott & Fetzer operating units.

The "Vac Pac," a compact, portable vacuum cleaner announced early in the year, is designed for limited space applications, such as mobile home, boat, and recreational vehicle interiors. Response to this new product indicates an even larger potential than anticipated. Also early in 1978, the "Filtrex" line of disposable vacuum cleaner bags and other replacement parts was acquired. This line complements other products in the Cleaning Systems segment of our business and provides entry into additional markets.

Scrubmobile/**American-Lincoln division**

Vacuum cleaner replacement parts/**Klevac division**

Chemical cleaning specialties/ **Klevac division**



Douglas Vac Pac portable vacuum cleaner/**Klevac division**

Educational & Household Products

World Book-Childcraft International, Inc.

The acquisition of World Book-Childcraft International, Inc. in September, 1978 marked the accomplishment of a principal Scott & Fetzer objective: the addition of another major direct-selling business to strengthen the long-term earnings base. The purchase of WBCI not only provided an opportunity to build upon the company's considerable expertise in the consumer direct-sales area, but through WBCI's mail order, finance and insurance subsidiaries, the overall base of corporate capabilities was greatly expanded.

For over 60 years, World Book-Childcraft has been a leader in the educational publishing field, serving both institutional — school and libraries — and consumer markets, domestically and internationally. To a significant degree, WBCI's success has been built around the highly acclaimed World Book Encyclopedia, an authoritative 22-volume reference set. While World Book's ownership share is about 32%, its annual market share is the highest among those encyclopedias sold on a door-to-door basis.

While suitable for all family members, World Book gives the academic needs of elementary and junior high school children special attention. The editorial excellence of World Book is recognized by both consumers and the academic community and the annual updating procedures are considered among the most extensive in the industry.

Childcraft, a 15-volume collection of well-illustrated children's books, is the second major product in the line. In the last decade, Childcraft has experienced rapid sales growth, and claims an ever-increasing share of company unit sales. Other products include the two-volume World Book Dictionary and Cyclo-teacher, a teaching machine based on the concept of programmed instruction.

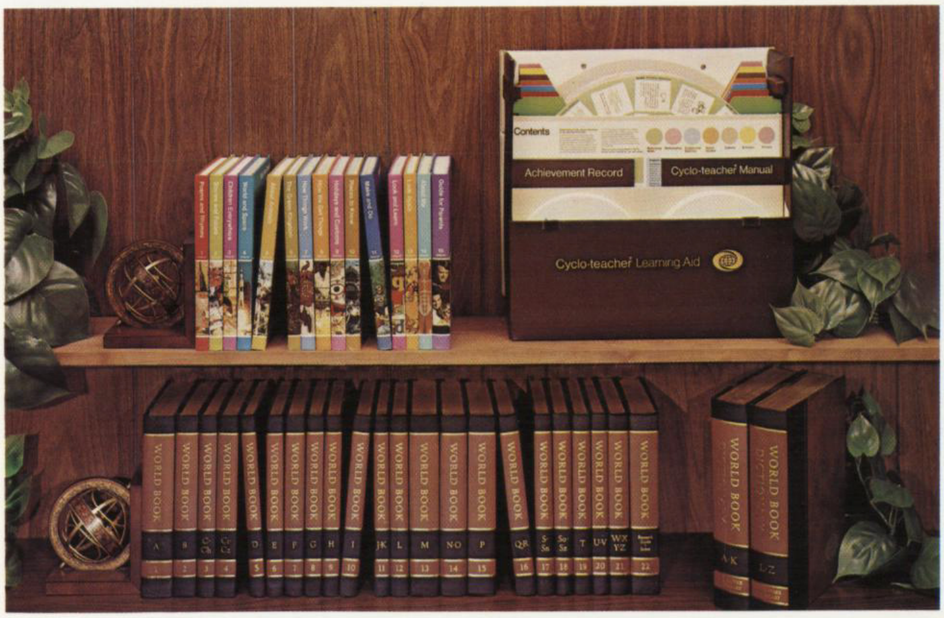
WBCI has taken a more aggressive posture in new product/venture activities in recent years. A new party plan organization, Discovery by World Book, was launched on a test basis in 1976. Discovery markets a variety of educationally-oriented books, toys, and games for children. Results to date have been somewhat below expectations but gains in recent months have been encouraging.

In the direct-sales area, following a successful regional test market, the Childcraft Dictionary was introduced nationally in late 1978. Sales are proceeding according to plan and it is anticipated that annual volume objectives will be met. At least one additional new product is planned for test marketing in 1979.

Domestic Direct Sales. Representing the largest of World Book's operations, the direct-sales operation markets products through an extensive part-time sales organization. The sales force exceeds 40,000 representatives, relying heavily on the part-time efforts of housewives and teachers. While most encyclopedias are marketed on a door-to-door basis, World Book's position of dominance may be attributed largely to high quality products and the unique nature of its massive part-time sales force. Further expansion of the sales organization is a primary objective in 1979.

WILLIAM T. BRANHAM
Chairman
World Book-Childcraft International, Inc.

DONALD G. MILNE
President
World Book-Childcraft International, Inc.



World Book Encyclopedia, Childcraft reference set, World Book Dictionary, and Cyclo-teacher Learning Aid

International Direct Sales. WBCI currently maintains sales organizations in Australia, France, Japan, the British Isles and the Caribbean. These subsidiaries and branches represent the primary source of revenue and income for the international operation. Major products are made available in other countries, not serviced by these subsidiaries and branches, through distributor and licensing agreements.

Volatile foreign currencies and uncertain economic conditions in general have depressed international sales in recent years. Longer-term growth opportunities are, however, viewed as favorable.

Annuals and Mail Order. WBCI currently markets three annual publications: The World Book Year Book, Science Year, and the Childcraft Annual. Each is sold exclusively by mail to previous customers of the direct-sales operation. The 1978 combined sales of the three annuals exceeded 3.8 million units.

Mail order has, since 1976, expanded beyond the traditional reliance on the World Book mailing lists. New lists are now being tested and implemented on a continuing basis, and proprietary products in the areas of books and other mail order merchandise are being developed. Through syndications and other agreements, new markets are being developed for these proprietary products through alternate channels of distribution.

Insurance Operations. In 1967, the World Book Life Insurance Company was founded with the principal objective of marketing children's life insurance by mail to owners of WBCI products. Over the years since its founding, World Book Life has enjoyed steady growth while specializing in juvenile coverage, but plans are currently in progress to broaden marketing efforts to include other forms of insurance, other markets, and other distribution channels.

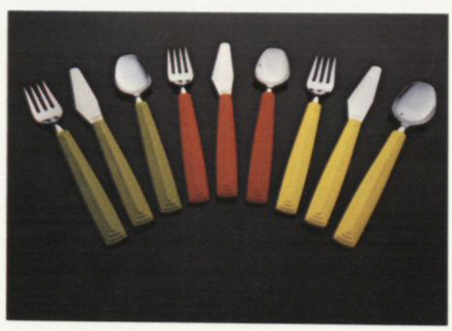
Consumer Installment Financing. For many years, WBCI has financed internally its consumer installment receivables. At the date of acquisition by Scott & Fetzer, a separate finance subsidiary — World Book Finance, Inc. — was formed to conduct these domestic financing activities. The finance company was initially capitalized with $26 million in equity and $75 million of medium- and long-term debt. At the end of the 1978 fiscal year, World Book Finance had $96 million of net installment receivables.

Water system fixtures/**Streamway division**

Household Products

Four other product lines, all of which have been a part of Scott & Fetzer for many years, are now in the Educational & Household Products segment. They are Quikut division's cutlery, Streamway division's water system fixtures, the Ja-Son line of scissors, and the Cardinal line of plastic containers. All are established lines that reach consumers directly or indirectly.

Primarily a manufacturer of cutlery for sale to large users of premiums, Quikut is heavily marketing-oriented. Makers of soap products, breakfast foods, petroleum and other high-volume consumer products are principal customers. Quikut has a 50-year history of success in the premium industry. The recent transfer of this division's plastic molding operations to the Western Enterprises division will enable Quikut to concentrate its development and marketing efforts on cutlery products and will strengthen the in-company source for molded plastic components.


Cutlery for premium use/**Quikut division**

Streamway manufactures water system fixtures—faucets, valves, shower heads, and other fittings—for both the original equipment market, such as motor homes, recreational vehicles, and pre-fabricated homes, and the traditional wholesaler-to dealer-to consumer market for new and replacement installations. Both markets have been growing rapidly. Streamway has responded with a broadened and improved line, with the "AquaStream" faucet its latest innovation, giving sales special impetus in 1978. Other similar products are in development.

Stainless steel scissors/
Powerwinch/Ja-Son division

Millions of school children have begun their cut-and-paste careers with Ja-Son's "Penguin Pete" scissors. Ja-Son, in business since 1945 and with Scott & Fetzer since 1973, is one of only a few manufacturers of cold forged steel scissors and shears. Stainless steel scissors, an industry first, were developed by Ja-Son and introduced during 1978. This highly desirable product should give added thrust to the entire line this year. Ja-Son offers a wide range of hand scissors for the home, school, office and shop.

Plastic containers/**Klevac division**

Plastic containers have been Cardinal's principal product line since 1948 and have continued their growth since being acquired by Scott & Fetzer in 1971. Ice cream makers, pickle packers, and other food companies represent steady customers for this line.

Fluid Transmission

JOHN BEBBINGTON
Senior Vice President

Steadily increasing emphasis on product engineering, design innovations, and new product introductions were the principal activities in 1978 of the three operating units in this segment — Campbell-Hausfeld, Wayne Home Equipment, and Western Enterprises. Ongoing programs to raise the technological superiority of major market share lines, together with marketing initiatives, have helped establish stable growth patterns for all three units which should continue in 1979 and beyond. Improvement in production management and the addition of new processing techniques, particularly in plastics, are strengthening Scott & Fetzer's low-cost-producer position in major lines.

During 1978, Campbell-Hausfeld, long the largest U.S. manufacturer of single stage air compressors, reported record sales and earnings, in spite of having experienced the beginning of what will amount to a sizable reduction in sales to its largest customer. While this major customer and Campbell-Hausfeld remain substantial partners in the single stage compressor business, changes in strategy on both sides will result in lowering Campbell-Hausfeld's volume with this customer. Growth in other markets served by Campbell-Hausfeld, as well as product improvement and new product introductions, enabled the division to offset this drop and still achieve increases in both sales and earnings for the year. These programs are expected to continue growth in 1979.

A new valving system, developed by Campbell-Hausfeld for use on five- and ten-horsepower two stage compressors, offers customers substantially improved operating efficiencies and lower maintenance costs. Users of the airless paint spray equipment now enjoy greater ease and lower cost of maintenance due to the development of cartridge valving to control the flow of highly abrasive latex paints.

To improve customer service and provide for continued growth, Campbell-Hausfeld has acquired a 235,000-square-foot plant in Leitchfield, Kentucky which will be producing air compressor tanks as well as single and two stage compressors by the fall of 1979.

Wayne Home Equipment, which was founded in 1928 and is the world's largest manufacturer of oil burners and water disposal pumps, was acquired in February, 1978. The Wayne acquisition brings to Scott & Fetzer two additional leading market share lines, as well as a number of promising lesser lines. As a part of Scott & Fetzer, Wayne gains direct access to sources of supply for a number of key components for both the pump and burner lines. In supplying Wayne, other Scott & Fetzer divisions will benefit from the resulting increased utilization of facilities, and the added sharing of technological skills and other knowledge will benefit all operations.

Long the leading supplier of oil burners to original equipment furnace and boiler manufacturers, Wayne this year entered the replacement burner market with a complete line of burner kits designed to replace outmoded units with modern fuel-saving new burners. Also, Wayne will add a consumer item to its pump line in 1979. A new portable submersible unit designed for removing water from basements, bilges or other low points will be the first in a series offered for the home and farm owner.

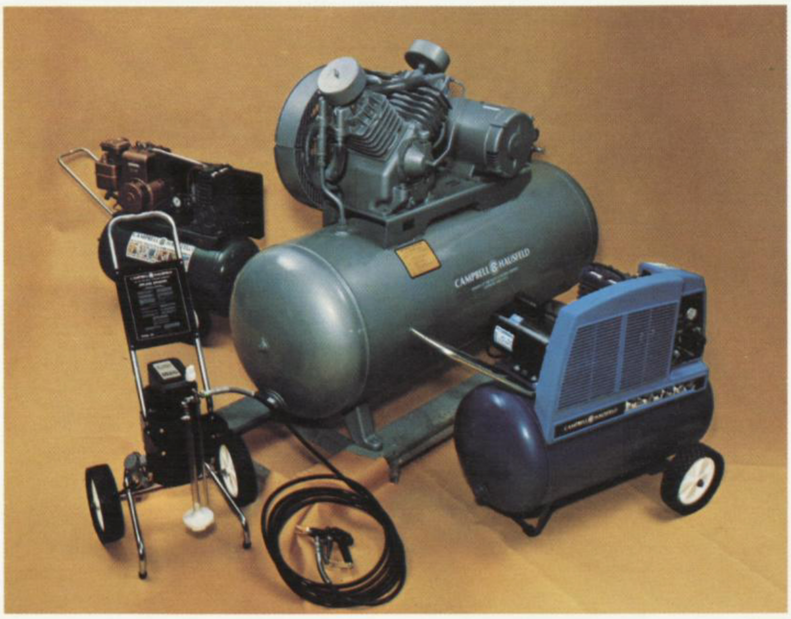
Wayne has focused its primary burner engineering efforts on the development of small, low-input units, offering advantages of lower cost, quiet operation, and reduced electric power use. A number of these units are being tested by major customers and show promise for use in the mobile home and small house market. Early this year Wayne entered into a license agreement for a highly advanced ultrasonic atomizing burner that can be fired at varying rates of oil input. With this added capability, the new Wayne small burner line will reach new heights in the efficient use of oil heat in small space and water heating installations.

Western Enterprises has long been the largest U.S. manufacturer of compressed gas fittings for the transmission of welding and medical gases. During 1978, Western increased sales of its established products to record levels, and in addition introduced two significant new lines. Early in the year, the Accu-Trol line of precision crossover manifolds was offered to the Western distribution network. This new product fills a growing need for a dependable gas manifolding system which insures full utilization of the gas product in cylinder banks before switching demand to a secondary supply. Later in 1978, Western introduced a new line of precision gas pressure regulators which offer the better performance of two stage regulators at costs approaching those of the more economical single stage units in use throughout the Western compressed gas fittings market.

At the close of 1978, Western assumed responsibility for the plastic molding activity formerly part of the Quikut division.

During 1978, an engineering study was completed and a manufacturing development program involving the use of injection molded glass-filled thermosetting polyester plastic materials was begun. This recently introduced material produces parts such as motor or pump housings by molding to finished dimensions rather than the casting and machining involved with commonly used metal parts. The resulting piece is stable and dense, has high impact strength, and has excellent insulating qualities. By the end of 1979 numerous product lines should be supplied with high-performing, cost-saving components from this new material.

A 50,000-square-foot plant has been started in Portland, Tennessee, to increase Western's capacity to supply plastic components to Kirby, Campbell-Hausfeld, Wayne, Streamway and other operating units.

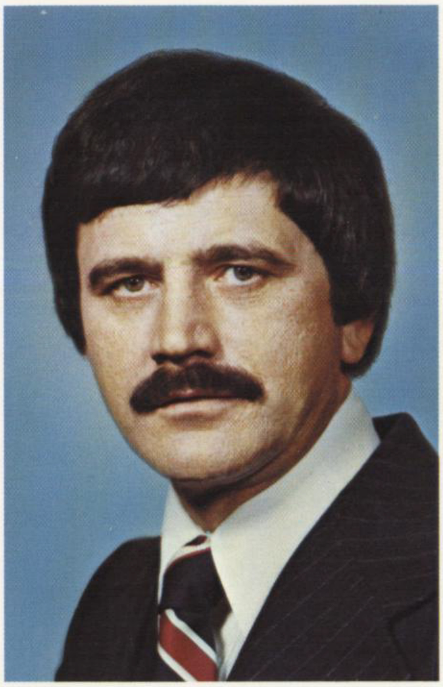


Air compressors and airless paint sprayer/**Campbell-Hausfeld group**

Manifold systems and accessories/
Western Enterprises division

Water pumps and oil power burners/
Wayne Home Equipment division

Equipment & Accessories



KENNETH J. SEMELSBERGER
Group Vice President

The Equipment & Accessories segment comprises four divisions—Carefree of Colorado, Douglas, Stahl, and Valley Industries—and the winch and hoist line of the Powerwinch/Ja-Son division. All are long-established operations and have been part of Scott & Fetzer for several years.

Each division has core product lines that provide both continued growth and a base for future diversification. Each has experienced strong growth in recent years, chiefly through marketing and operating skills.

Carefree is a leading producer of awnings, screen enclosures, and accessories for recreational vehicles and is best known for its retractable roll-up awning, which it pioneered. Carefree markets its line through independent distributors in the United States and Canada, supported by an aggressive merchandising program and product diversification.

Douglas manufactures metal components for the truck and heavy equipment industry and the military, and has built an excellent reputation for product quality through superior engineering and manufacturing. Hydraulic cylinders and valves, steering columns and couplers, and track links for military vehicles are the division's main products. Douglas sells directly to customers and works closely with them in development programs. This liaison with mobile equipment producers keeps Douglas in the forefront of industry requirements. With the growing demand for trucks and heavy equipment, Douglas is positioned to serve its customers and share in the growth.

Stahl is a major supplier of truck bodies to electric, gas and telephone utilities and to the service industries—plumbers, carpenters, electricians, cable TV, and others. The division also manufactures accessory products for pickup trucks, rescue vehicles, ambulances, and towable street sweepers. Ongoing product innovations, including the first utility service van with compartmentalized interior, and a solid distribution system have contributed to Stahl's steady growth. The stability of the truck equipment market affords Stahl the opportunity for greater market penetration and long-term growth.

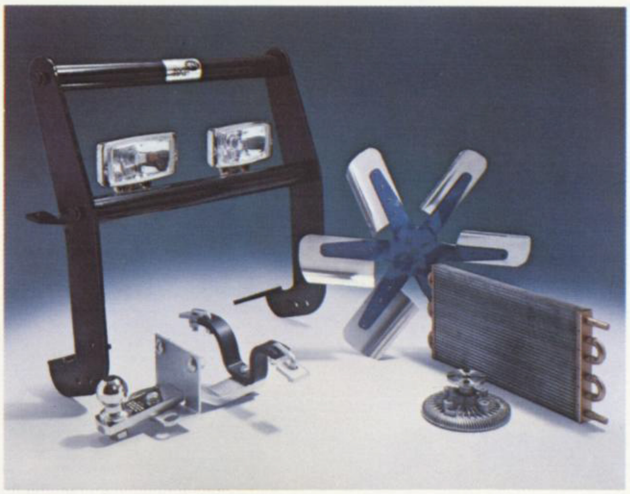
Valley Industries division is the largest manufacturer of recreational trailering accessories in the United States. Valley makes hitches, balls and couplers, sway bars and related towing accessories. In 1978, the introduction of automotive fan clutch and auxiliary cooler product lines cornerstoned Valley's entrance into the automotive accessories market. Valley sells through automotive, recreational equipment, and marine distributors; mass merchandisers; national chain stores; and to original equipment manufacturers. Over the past five years, Valley's sales have doubled, and America's lifestyle patterns portend a continuation of this trend.

Powerwinch/Ja-Son division holds a leadership position in the marine accessories aftermarket and in 1978 enhanced this standing by introducing the "Big Boat" 6,000-pound electric winch. Powerwinch manufactures an extensive line of electric and mechanical winches and markets primarily through marine and automotive distributors.

Recreational vehicle awning/
Carefree of Colorado division

Steering column assembly for heavy duty truck/**Douglas division**

Utility service body/**Stahl division**



Trailering accessories, oil cooling fan and fan clutch products/
Valley Industries division

"Big Boat" electric winch/
Powerwinch/Ja-Son division

Power & Energy

WALTER A. RAJKI
Senior Vice President

Scott & Fetzer has been directly involved with energy industries since 1964 when the company made its first acquisition—PLM Products. Subsequent acquisitions and internal growth have broadened the Power & Energy and Measurement & Control segments.

One of the long-term influences on these two segments is the passing of the era of cheap energy. This is evident from the rising costs of oil, gas, coal and uranium. Moreover, exploration and development costs for new energy resources, as well as costs of oil refineries and electric power generating plants, probably will continue to rise.

In addition to rising costs for traditional energy, the uncertainties of fuel sources have accelerated probing into such alternates as geothermal, solar, wind, and wood and waste products. With these complex and interrelated shifts will come changes in the market and also growth opportunities for Scott & Fetzer. Paralleling the growth of electricity as the principal end-use form of energy will be demand for related products in our Power & Energy and Measurement & Control segments.

This year the five divisions in these segments—Adalet-PLM, France, Halex, Northland and Meriam Instrument—will increase their research and product development expenditures by 40% over 1978. Responding to the growth potential in the industries served by these divisions, our engineering and laboratory facilities have been expanded. The high-voltage and environmental laboratory facilities have been relocated and enlarged by adding a section with electronic products capability. The transformer products development facility was enlarged, and this year the control products engineering facility will be doubled in size.

To achieve the divisions' goals of above average growth requires the development and introduction of new and profitable products. These products, while technologically innovative, will be based on related technology now in place in Scott & Fetzer.

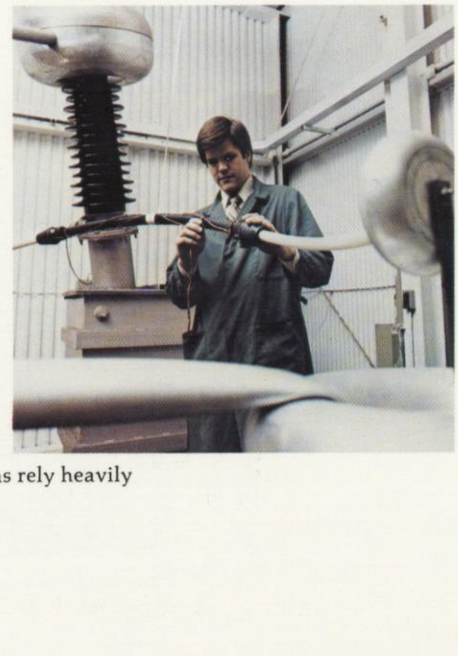
Measurement & Control

Manufacturing capacity at the France division is being increased, with the construction of a new plant in Livingston, Tennessee, and by an additional plant in our Fairview, Tennessee location. Electrical and electronic controls will be made in both plants to meet the rising demand for these products.

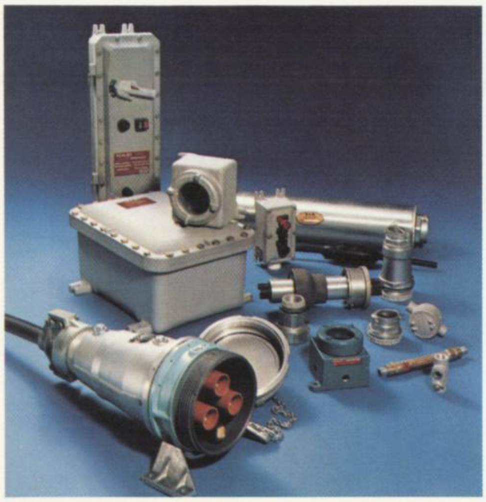
Adalet-PLM has expanded its line of motor control and electrical distribution products. This division recently introduced an electrical temperature control system that will be used in continuous process industries, such as petrochemicals, oil refining, and food, where the closely regulated temperature of the flowing material is essential to the process. Customer response indicates a promising future for this product.

Northland division, which manufactures fractional horsepower motors, introduced new, high performance motors with material and installation labor-saving features to meet changing customer requirements. Halex division, maker of die cast zinc electrical fittings, added a line of liquid-tight conduit fittings.

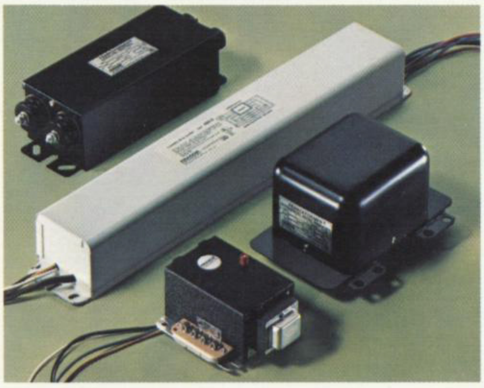
Meriam Instrument division, a leading producer of manometric and differential pressure flow measuring instruments, introduced a line of flow recorders for applications where the precise measurement of fluids or gases is required.



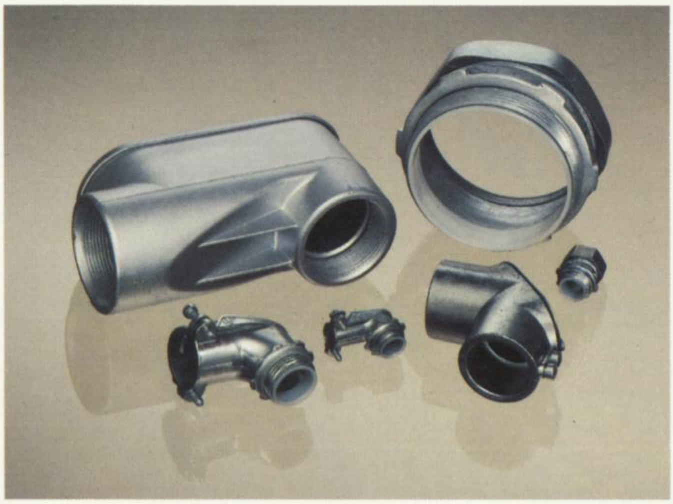
Product development and improvement programs rely heavily on our engineering test facilities.



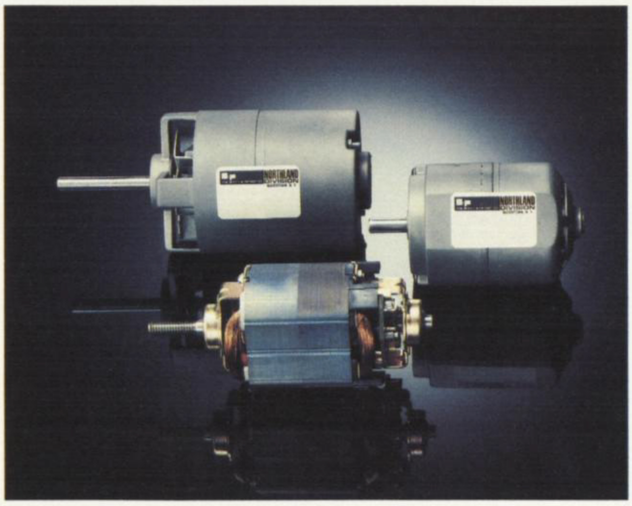
Electrical products for energy-related markets/**Adalet-PLM division**



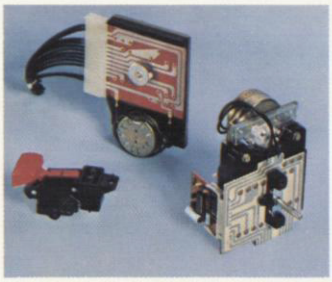
Electrical and electronic controls/**France division**



Electrical conduit fittings/**Halex division**



Fractional horsepower motors/**Northland division**



Controls for automatic laundry equipment/**France division**

Mechanical differential pressure recorder for any process fluid/**Meriam Instrument division**

Summary of Operations

The Scott & Fetzer Company and Subsidiary Companies

(Dollars in Thousands Except Per Share Data)

	Years Ended November 30				
	1978	1977	1976	1975	1974
Net sales	**$478,222**	$351,187	$301,918	$247,249	$247,539
Cost of goods sold	**318,897**	249,521	222,225	185,742	192,186
Interest expense, capitalized leases	**1,093**	1,056	1,117	1,142	960
Interest expense, other	**4,230**	2,904	2,941	2,625	2,532
Interest income	**5,044**	2,881	2,859	1,305	132
Income taxes	**30,631**	29,306	21,264	14,491	11,126
Net income	**$ 30,247**	$ 26,306	$ 22,721	$ 16,908	$ 13,559
Per share					
Earnings per common and common equivalent share	**$ 4.11**	$ 3.56	$ 2.99	$ 2.24	$ 1.80
Dividends	**1.50**	1.30	1.17	1.02	1.00
Average number of common equivalent shares (000's)	**7,354**	7,384	7,594	7,559	7,553

Management's Discussion and Analysis of the Summary of Operations

1978 VERSUS 1977

Consolidated net sales and other revenues were up 36% from 1977. Of this percentage increase, 29% was contributed by the combined sales and revenues of World Book Childcraft International (three months) and Wayne Home Equipment (10 months) which were acquired in 1978 and accounted for as purchases.

The significant changes in cost of goods sold, when expressed as a per cent of sales, reflects the difference in cost structure of World Book from that of other Scott & Fetzer operations. Manufacturing costs relating to the products sold by World Book constitute a significantly lower percentage of its sales dollar than that experienced in the other manufacturing operations of the company. Conversely, the administrative, selling and distribution costs are proportionately higher in their channels of distribution.

Net interest costs for the year were down to $279,000 from $1,079,000 the previous year. Higher interest rates on short-term investments plus interest earned by World Book effected this reduction.

Other expense, net, was below the 1977 level which had large one-time, non-recurring expenses relating primarily to goodwill write-offs and the sale of discontinued businesses.

State and local income taxes remained at a rate of 5.6% of income before taxes. The effective rate of federal and foreign taxes on income dropped to 47.4% from 49.4% the previous year. The principal factor contributing to this lower rate was a reduction in the provision for federal income taxes for 1978 associated with the purchase of Wayne Home Equipment.

1977 VERSUS 1976

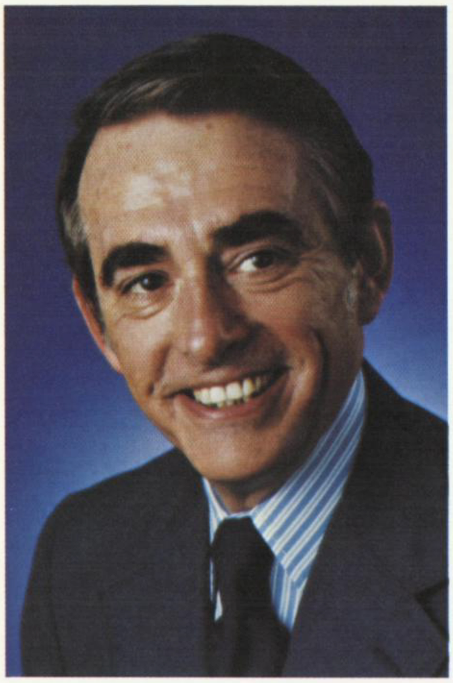
Consolidated net sales for 1977 were up 16% over restated 1976, reflecting price increases and higher unit volume in most product lines.

Cost of goods sold as a per cent of sales declined to 71.1% from the previous year's 73.6%, the result of improved operating performance and cost reductions.

Provision for income taxes increased 38% over last year, reflecting the increased income before taxes of the U.S. operations and a pre-tax loss incurred by a Canadian subsidiary with no offsetting tax relief.

The 16% gain in net income for 1977 is attributable to volume growth and lower operating costs, partially offset by a higher effective income tax rate. The increase in earnings per share of 19% was higher than the percentage increase in net income as a result of the company's purchase of 267,308 shares of its stock in January of 1977.

Business and Financial Review



J. F. BRADLEY
Executive Vice President — Finance

Consolidated sales, net income, earnings per share and dividends paid to shareholders were at record highs for 1978. Scott & Fetzer's 1978 financial statements include 10 months' results of Wayne Home Equipment Company, which was acquired in February, 1978, and three months' results of World Book-Childcraft International, Inc., acquired in September, 1978. These acquisitions significantly affected Scott & Fetzer's financial statements, adding approximately $103 million to sales and a net 10 cents to earnings per share. The five business segments that had been used during 1978 to categorize sales and earnings have been expanded to six segments for year end and future financial reports. To accommodate World Book-Childcraft, the previous Cleaning Systems & Household Products segment has been separated into two new segments: Cleaning Systems, and Educational & Household Products. The results for 1978 and restated figures for the previous years are shown on page 21.

For 1978, consolidated sales were $478.2 million, $127 million or 36% above the $351.2 million from continuing operations recorded in 1977. Income before taxes increased to $60.8 million from $56.1 million in the previous year. Net income, including the results of discontinued operations, amounted to $30.2 million, or $4.11 per share, a growth of 15% compared with the $26.3 million and $3.56 per share earned in 1977. The net profit margin for 1978 was 6.3%, down from 7.5% in the prior year. Return on shareholders' equity was 19.8% versus 19.7% a year earlier.

The statement of results by the six business segments has been expanded this year, in conformity with the new accounting rules, to include for each segment the identifiable assets, depreciation and capital expenditures for new facilities and equipment. Sales in all segments except Cleaning Systems showed an increase over 1977, with the largest gains coming in Educational & Household Products due to the World Book-Childcraft acquisition, and in Fluid Transmission as a result of the acquisition of Wayne Home Equipment. Excluding the effects of the acquisitions, the Measurement & Controls and Equipment & Accessories product segments had the largest growth during 1978.

Cleaning Systems. Sales totalled $99.9 million, slightly below the year-earlier level. Income before taxes declined 10% to $21.8 million from $24.1 million in the previous year and accounted for 36% of total earnings compared with 43% last year. The Kirby group, the largest operating unit in this segment, experienced moderately lower sales and earnings as a result of severe weather conditions during 1978's first quarter, weaker consumer markets, and the introduction of a new Kirby marketing program that affected sales, particularly in the second and third quarters. These results were partially offset by significantly improved sales and earnings in the new Klevac division (formerly the Klevac and Cardinal divisions).

Educational & Household Products. For 1978 this segment reflected the results of World Book-Childcraft for three months and will have a much greater impact in future years. Also a part of the segment are other consumer household products, including water system fixtures, scissors and cutlery, plastic containers and lighting products. For 1978, including World Book-Childcraft for three months, sales were $84.6 million compared with $22.4 million in the prior year. Income before taxes amounted to $2.5 million, up from $781,000 in 1977. With World Book-Childcraft included for a full year in 1979, this will be Scott & Fetzer's largest sales segment. Excluding World Book-Childcraft's three-month results, the volume of the other product lines in this segment approximated the 1977 levels while earnings improved.

Business and Financial Review (continued)

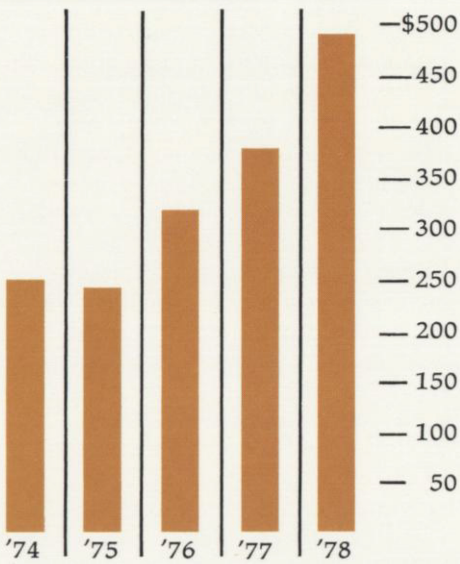
Fluid Transmission. Including the results of Wayne Home Equipment for 10 months, sales for 1978 increased to $140.9 million from $95.9 million a year earlier. Income before taxes rose to $17.5 million from $12.7 million in the prior year. This segment in 1978 accounted for 29% of total sales and earnings. The large increase in both sales and earnings resulted primarily from the addition of Wayne. The Campbell-Hausfeld group had moderately improved results while sales and earnings for the Western Enterprises division were substantially higher. Campbell-Hausfeld was affected during the first quarter of 1978 by severe weather conditions as well as a change, later in the year, in the merchandising policies and selection of a second source supplier by a major customer.

Equipment & Accessories. Sales increased 18% to $91.4 million from $77.8 million last year. Income before taxes rose 28% to $14.2 million from $11.1 million in 1977. This segment accounted for 19% of total sales and 23% of earnings. All divisions achieved substantially higher sales and earnings records for 1978. The Douglas and Stahl divisions enjoyed strong demand in the automotive and truck equipment markets. Additionally, the Valley Industries, Carefree of Colorado and Powerwinch divisions recorded sharp sales and earnings growth reflecting strength in recreational markets.

Power & Energy. Sales were $56.1 million, 11% above the $50.7 million for 1977. Income before taxes increased slightly to $10.2 million from $9.9 million last year. All product lines recorded at least moderate volume growth. The percentage growth in earnings was less than for sales, due to an earnings decline in the Northland division and moving and new plant startup costs at the France division. Division headquarters of France were moved from Westlake, Ohio to Tennessee where the division is in the process of building two new plants.

Measurement & Control. Sales volume of these product lines for 1978 increased 25% to $18.6 million from $14.9 million in the prior year. Income before taxes amounted to $3.6 million, 19% above the $3 million earned last year. The France and Meriam divisions enjoyed substantial volume gains, reflecting excellent customer demand. Earnings growth for the France division, while substantial, did not match the sales increase due to the moving costs and new plant preparation expenses discussed in the Power & Energy segment.

Net Sales (millions)



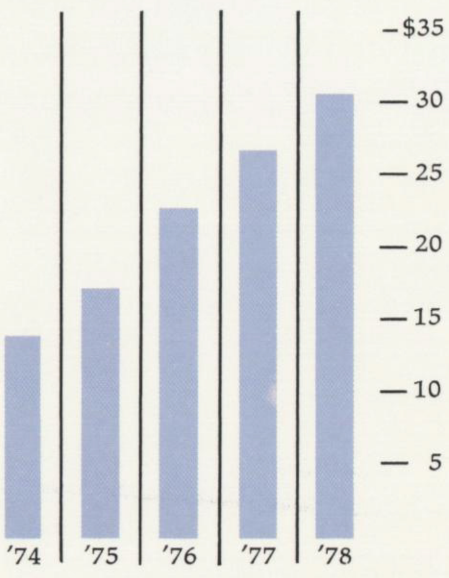
Analysis of Earnings. Income before taxes from continuing operations increased 8% to $60.8 million from $56.1 million earned in 1977. The operating earnings for 1978 were affected by the substantial expenses associated with the acquisition of Wayne Home Equipment and World Book-Childcraft. Other deductions from operating earnings declined from $3 million last year to $2.2 million for 1978, reflecting substantially lower net interest costs (interest income versus interest expense), as a result of sharply higher interest rates earned on short-term investments during 1978.

Income Taxes. As shown on the Profit and Loss Statement on page 23, the provisions for state, local, federal, and foreign income taxes were $30.6 million or 50.4% of income before taxes for 1978 compared with the $29.3 million or 52.2% of income before taxes last year. The table below shows the principal factors affecting the tax provisions ($000's):

	1978	1977
Income before taxes	$60,807	$56,108
Less state and local	3,433	3,164
Income before federal and foreign taxes	$57,374	$52,944
Income taxes at 48% statutory rate	$27,540	$25,413
Adjustments: Add (Deduct)		
Foreign tax effect	770	993
Acquisition transaction	(690)	—
Investment tax credits	(383)	(300)
Export "DISC" credit	(330)	(286)
All other, net	291	322
Provision for federal and foreign income taxes	$27,198	$26,142

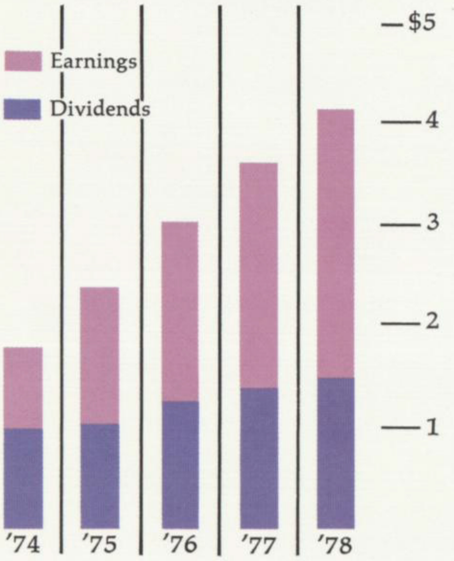
The additional provision for foreign corporate income taxes in both years is due to the operating losses incurred in the Canadian Lighting division which are included in pre-tax income with no tax relief currently available. The higher Canadian provision in 1977 reflected a goodwill write-off that was not deductible for tax purposes. The reduction in 1978 of $690,000 in U.S. income taxes was associated with the purchase of Wayne Home Equipment. The 1978 investment tax credit was higher than in 1977 due to larger capital expenditures in 1978.

Net Income (millions)



Net Income and Earnings Per Share. Net income after taxes for 1978 increased 15% to $30.2 million from $26.3 million in the prior year. This included, for both years, the results of the discontinued operations. $71,000 of net income for 1978 reflected the operating results of Humphreys Leather Goods and Dek/Electro divisions for a brief period prior to their disposition. Earnings per share also

Earnings and Dividends per Share



rose 15% to $4.11 per share from $3.56 last year. The table below shows the significant factors affecting net income and earnings per share for 1978 compared with 1977:

	Net Income ($000's)	Earnings Per Share
1977 — as reported ...	$26,306	$3.56
Increase (Decrease) in 1978 from:		
Operations	1,658	.24
Acquisitions, net .	743	.10
Net interest costs .	526	.07
Lower effective tax rate	447	.06
Effect of discontinued operations	567	.08
Net change ..	3,941	.55
1978 — as reported ...	$30,247	$4.11

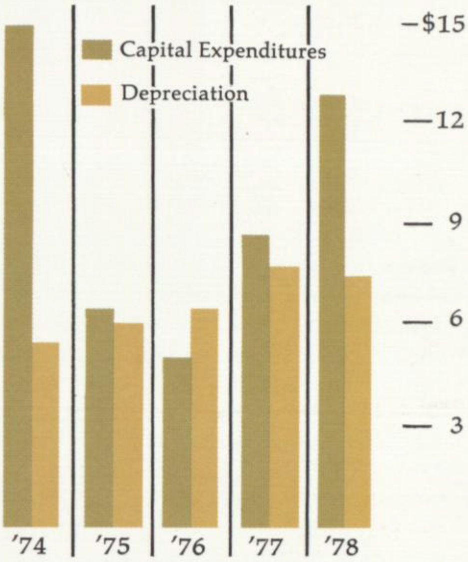
For 1978, the continuing operations had a net growth in earnings of $1.7 million or 24 cents per share. The acquisitions of Wayne Home Equipment and World Book-Childcraft contributed an incremental $.7 million or 10 cents per share to earnings. Since these were cash purchases, the net contribution to earnings reflected the tax savings less deduction of the acquisition expenses and interest income (after taxes) that Scott & Fetzer would have earned had the cash used in the purchases been invested in short-term securities.

The net interest costs (interest expense versus interest income) decreased by $526,000 (after tax effect) and contributed seven cents to earnings per share during 1978. Net income and earnings per share also were favorably affected by the lower effective tax rate during 1978, adding $447,000 or six cents per share. The discontinued operations lost $496,000 or seven cents a share in 1977. The results of the two remaining discontinued divisions (which were sold in early 1978) and the effect of the sale transactions contributed $71,000 or one cent per share in 1978. The favorable change from 1977 of the discontinued operations was a contribution of $567,000 or eight cents per share. The total of these various factors is $3.9 million, or an increase of 55 cents per share from the 1977 earnings level.

Financial Position. The consolidated balance sheet shown on pages 24-25 reflects some significant changes for 1978 compared with 1977. The acquisitions of Wayne Home Equipment and World Book-Childcraft constitute the major contributing factors to the year-to-year variations in Scott & Fetzer's balance sheet.

Total assets at year-end 1978 were $338 million, up $112.6 million for the year. Most of this increase was due to the addition of World Book-Childcraft and Wayne Home Equipment. Current assets increased to $229.6 million from $171.5 million a year earlier. Cash and short-term investments totalled $54.9 million, down from $60.3 million at year-end 1977. The cash position at the end of 1978 would have been substantially higher except for the two cash purchase acquisitions. Trade receivables rose to $60.3 million from $44.1 million, an increase of $16.2 million, and inventories totalled $83.9 million, up $22.7 million. The two acquisitions resulted in receivables and inventories being higher by $11.7 million and $27.2 million, respectively. Installment receivables, a new item on Scott & Fetzer's balance sheet, reflects the customer balances due on installment sales of World Book-Childcraft's foreign operations. The domestic customer installment balances are part of World Book Finance, Inc., an unconsolidated captive finance subsidiary.

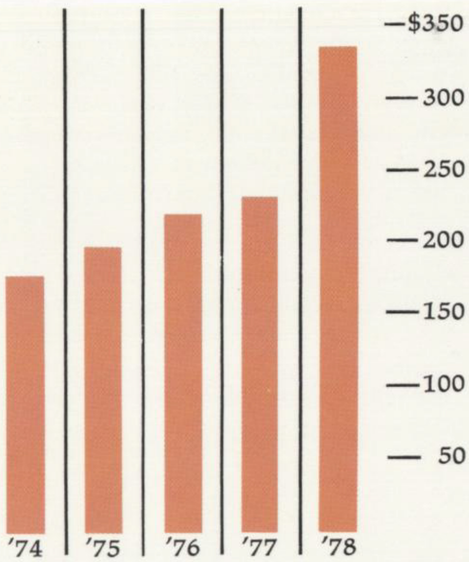
Capital Expenditures and Depreciation (millions)



Another new item appearing on the balance sheet for the first time is "Investment In Unconsolidated Subsidiaries" of $32.8 million. This is Scott & Fetzer's net equity investment in the finance companies created in connection with the acquisition of World Book and World Book Life Insurance Company, which are unconsolidated subsidiaries.

Net property, plant and equipment increased $12.1 million to $62.2 million, primarily as a result of the acquisitions. The "Excess Cost Over Fair Value of Assets Acquired," was $2.8 million higher as a result of the Wayne acquisition. This intangible is being amortized over 40 years. Other assets totalled $10.4 milllion, $6.8 million above year-end 1977. The increase was due to the long-term notes received in connection with the sale of the Humphreys Leather Goods and Dek/Electro divisions and other non-current assets obtained in the Wayne and World Book acquisitions.

Total Assets (millions)

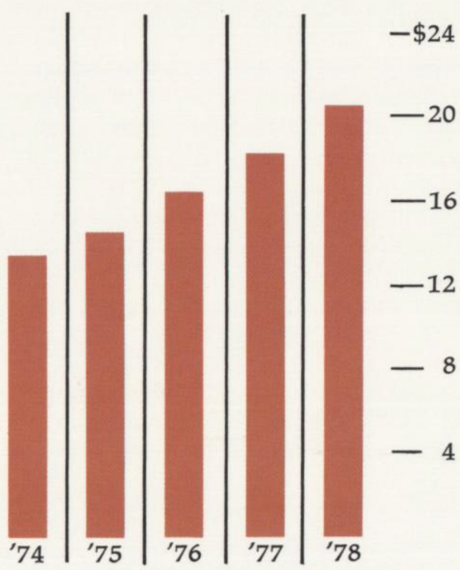


Current liabilities, at year-end 1978, were $131 million, $84.7 million above the year-earlier level. Of this increase, $32.3 million is World Book deferred income taxes on installment sales contracts. Under Internal Revenue Service regulations, income from installment sales contracts is taxable upon collection rather than when the sale is recorded for accounting purposes. The notes payable to banks of $7.1 million at November 30, 1978, reflect borrowings of World Book's foreign operations from six banks. The increases in the other various current liabilities largely result from the addition of the two acquisitions.

Other long-term debt was $4.8 million, up from $1.1 million at the end of 1977. The increase of $3.7 million reflects the notes payable to former shareholders of Wayne Home Equipment. The other deferred credits of $3.6 million represent the company's net liability under various previously-existing deferred compensation plans of World Book-Childcraft.

Total shareholders' equity rose to $153 million from $133.4 million a year earlier. This was equivalent to a book value of $20.85 per share at November 30, 1978, up 14% from the $18.23 per share at the prior year end.

Book Value per Share



Business Segment Information

The Company operates in six principal industry segments consisting of:

Cleaning Systems: Vacuum cleaners, other commercial and industrial cleaning equipment; shampoos, polishes and cleaners; and replacement parts for vacuum cleaners.

Educational & Household Products: Encyclopedias, and other educational and learning products; scissors; plastic containers; water system fixtures; cutlery and other products for the home.

Fluid Transmission: Air compressors, paint spray equipment; oil and gas burners; sump and water system pumps; and compressed gas connector fittings and transmission products.

Equipment & Accessories: Hitching and towing equipment; awnings and accessories for recreational vehicles; mechanical winches and electrical power winches and hoists for boats and trailers; truck bodies and bumpers; tank track links; hydraulic valves and steering column components; and telephone exchange mounting frames.

Power & Energy: High voltage electrical cable fittings and couplers; explosion-proof housings; conduit fittings; transformers; and fractional horsepower motors.

Measurement & Control: Precision flow measurement instruments; bellows differential pressure gauges; flow elements, specialized tachometers and Pitot probes; and timers for laundry equipment and other appliances.

Financial information by segments is presented below:

(Dollars in Thousands)

	Year ended November 30				
	1978	1977	1976	1975	1974
NET SALES					
Cleaning Systems	**$ 99,944**	$100,309	$ 86,269	$ 72,328	$ 72,840
Educational & Household Products	**84,645**	22,442	20,764	16,123	19,356
Fluid Transmission	**140,949**	95,881	82,849	60,817	56,230
Equipment & Accessories	**91,413**	77,761	64,620	60,318	57,034
Power & Energy	**56,148**	50,716	46,776	36,460	41,059
Measurement & Control	**18,570**	14,887	11,615	9,708	10,201
Eliminations	**(13,447)**	(10,809)	(10,975)	(8,505)	(9,181)
	$478,222	$351,187	$301,918	$247,249	$247,539
INCOME BEFORE TAX					
Cleaning Systems	**$ 21,763**	$ 24,150	$ 19,233	$ 15,501	$ 12,248
Educational & Household Products	**2,479**	781	2,136	1,523	1,736
Fluid Transmission	**17,490**	12,665	4,569	1,707	5,449
Equipment & Accessories	**14,186**	11,137	9,330	8,046	2,384
Power & Energy	**10,241**	9,866	10,357	6,982	6,165
Measurement & Control	**3,603**	3,024	1,976	1,518	1,194
Operating Earnings	**69,762**	61,623	47,601	35,277	29,176
Corporate Expenses and Net Interest	**(8,955)**	(5,515)	(5,234)	(5,096)	(5,590)
	$ 60,807	$ 56,108	$ 42,367	$ 30,181	$ 23,586

Business Segment Information (continued)

	Year ended November 30				
	1978	1977	1976	1975	1974
IDENTIFIABLE ASSETS BY SEGMENT					
Cleaning Systems	**$ 44,013**	$ 40,929	$ 27,664	$ 26,982	$ 30,635
Educational & Household Products	**115,342**	12,016	12,071	8,947	9,714
Fluid Transmission	**66,539**	44,737	51,243	42,335	42,051
Equipment & Accessories	**40,466**	34,340	31,907	27,844	32,254
Power & Energy	**22,847**	20,506	19,206	16,910	21,155
Measurement & Control	**8,741**	6,854	5,886	5,643	5,681
Corporate and Other	**40,029**	66,029	67,300	64,258	30,736
Total Assets	**$337,977**	$225,411	$215,277	$192,919	$172,226

(Dollars in Thousands)

	DEPRECIATION Year Ended November 30		CAPITAL EXPENDITURES Year Ended November 30	
	1978	1977	**1978**	1977
Cleaning Systems	**$ 1,115**	$ 1,034	**$ 1,348**	$ 1,427
Educational & Household Products	**1,255**	443	**1,245**	333
Fluid Transmission	**2,438**	1,552	**4,747**	1,184
Equipment & Accessories	**929**	972	**1,730**	923
Power & Energy	**673**	605	**1,244**	659
Measurement & Control	**201**	188	**330**	369
Corporate and Other	**830**	2,749	**2,242**	3,921
	$ 7,441	$ 7,543	**$12,886**	$ 8,816

Consolidated Statement of Income

The Scott & Fetzer Company and Subsidiary Companies

(Dollars in Thousands Except Per Share Data)

	Year Ended November 30	
	1978	1977
NET SALES AND OTHER REVENUE	$478,222	$351,187
Cost of goods sold	318,897	249,521
Gross profit	159,325	101,666
Selling, general and administrative expenses	96,303	42,534
Operating profit	63,022	59,132
Other income (deductions):		
Charges for services of finance subsidiaries (Note 12)	(2,803)	—
Income from unconsolidated subsidiaries before income taxes	898	—
Interest expense, capitalized leases (Note 5)	(1,093)	(1,056)
Interest expense, other	(4,230)	(2,904)
Interest income	5,044	2,881
Other, net	(31)	(1,945)
	(2,215)	(3,024)
Income from continuing operations before income taxes	60,807	56,108
Provision for income taxes:		
State and local	3,433	3,164
Federal and foreign		
Current	26,810	25,464
Deferred	388	678
Total taxes	30,631	29,306
Income from continuing operations	30,176	26,802
Income (loss) from discontinued operations (Note 2)	71	(496)
NET INCOME	$ 30,247	$ 26,306
EARNINGS PER SHARE		
From continuing operations	$ 4.10	$ 3.63
From discontinued operations	.01	(.07)
Total earnings per common and common equivalent share	$ 4.11	$ 3.56
DIVIDENDS PER SHARE	$ 1.50	$ 1.30
Average number of common and common equivalent shares outstanding (000's)	7,354	7,384

The accompanying Notes to Financial Statements and Summary of Accounting Policies are integral parts of these financial statements.

Consolidated Balance Sheet

The Scott & Fetzer Company and Subsidiary Companies

(Dollars in Thousands)

ASSETS	November 30 1978	1977
CURRENT ASSETS:		
Cash	$ 2,158	$ 7,279
Certificates of deposit	34,370	24,404
Short-term investments	18,376	28,611
Trade receivables, less allowance for doubtful accounts 1978 — $1,984 1977 — $793	60,286	44,114
Installment receivables (including accounts due after one year), less unearned finance charges of $683 and allowances for doubtful accounts of $4,088	20,290	—
Other receivables	6,097	1,826
Inventories (Note3):		
Raw materials and supplies	37,830	30,684
Work in process	26,504	16,295
Finished goods	19,571	14,221
	83,905	61,200
Prepaid expenses	4,091	4,054
TOTAL CURRENT ASSETS	229,573	171,488
INVESTMENT IN UNCONSOLIDATED SUBSIDIARIES (Note 12)	32,766	—
PROPERTY, PLANT AND EQUIPMENT (Note 5):		
Land and land improvements	2,597	1,526
Buildings	14,860	11,998
Machinery and equipment	63,909	58,042
Capitalized leases	16,723	15,097
	98,089	86,663
Accumulated depreciation	35,853	36,487
TOTAL PROPERTY, PLANT AND EQUIPMENT	62,236	50,176
EXCESS COST OVER FAIR VALUE OF ASSETS ACQUIRED (Note 1)	2,966	144
OTHER ASSETS	10,436	3,603
	$337,977	$225,411

The accompanying Notes to Financial Statements and Summary of Accounting Policies are integral parts of these financial statements.

LIABILITIES	November 30 1978	1977
CURRENT LIABILITIES:		
Notes payable, banks (Note 4)	$ 7,115	$ —
Current portion of long-term debt	2,459	1,233
Accounts payable, trade	31,730	20,571
Accounts payable, other	9,820	1,261
Accrued taxes, other	3,471	2,747
Accrued liabilities	34,080	12,537
Income taxes	10,031	7,952
Deferred income taxes	32,330	—
TOTAL CURRENT LIABILITIES	131,036	46,301
LONG-TERM DEBT (Notes 4 & 5):		
9¼ % Notes due 1985	30,000	30,000
Other long-term debt	4,765	1,102
Capitalized leases	11,271	10,736
TOTAL LONG-TERM DEBT	46,036	41,838
DEFERRED INCOME TAXES	4,295	3,907
OTHER DEFERRED CREDITS	3,596	—
TOTAL LIABILITIES	184,963	92,046
SHAREHOLDERS' EQUITY		
SERIAL PREFERENCE STOCK:		
Authorized 1,000,000 shares, without par value; none issued		
COMMON STOCK:		
Authorized 15,000,000 shares without par value (Notes 6 & 9)		
Stated value of issued shares: $1.25 per share		
1978 — 7,576,924 less 239,334 in treasury		
1977 — 7,576,924 less 260,371 in treasury	9,172	9,146
ADDITIONAL CAPITAL (Note 9)	6,238	5,863
RETAINED EARNINGS (Note 4)	137,604	118,356
TOTAL SHAREHOLDERS' EQUITY	153,014	133,365
	$337,977	$225,411

Consolidated Statement of Changes in Financial Position

The Scott & Fetzer Company and Subsidiary Companies

(Dollars in Thousands)

	Year Ended November 30	
	1978	1977
SOURCE OF FUNDS		
From continuing operations:		
Income after taxes	$ 30,176	$ 26,802
Depreciation and amortization	7,124	5,499
Writedown of intangible assets	—	654
Earnings from unconsolidated subsidiaries	(431)	—
Deferred federal income taxes	388	678
	37,257	33,633
From discontinued operations:		
Income (loss) after taxes	71	(496)
Depreciation and amortization	317	2,044
Writedown of intangible assets and provision for future costs	300	919
Deferred federal income taxes	—	(671)
	688	1,796
Total from operations	37,945	35,429
Proceeds from disposition of divisions, less non-current notes receivable of $1,925 and $2,762 in 1978 and 1977, respectively	9,400	5,783
Long-term financing arising from capitalized lease obligations	1,471	486
Increase in long-term debt for acquisition	3,716	—
Sale of common stock under stock options	401	91
Disposal of property, plant and equipment	362	1,662
Other, net	324	102
	53,619	43,553
APPLICATION OF FUNDS		
Property, plant and equipment, intangibles, and other non-current assets of companies acquired in 1978, less non-current liabilities assumed of $3,840 (excluding working capital acquired of $29,565)	48,484	—
Cash dividends	10,999	9,510
Disposals of net current assets of discontinued divisions	6,667	7,309
Additions to property, plant and equipment	12,886	8,816
Decrease in long-term debt	1,233	1,384
Acquisition of treasury stock	—	6,750
	80,269	33,769
INCREASE (DECREASE) IN WORKING CAPITAL	$ (26,650)	$ 9,784

Consolidated Statement of Changes in Financial Position (continued)

(Dollars in Thousands)

	Year Ended November 30 1978	Year Ended November 30 1977
INCREASE (DECREASE) IN COMPONENTS OF WORKING CAPITAL		
Current assets:		
Cash and certificates of deposit	$ 4,845	$ 4,696
Short-term investments	(10,235)	8,167
Trade and other receivables	40,733	(2,110)
Inventories	22,705	(180)
Prepaid expenses	37	99
	58,085	10,672
Current liabilities:		
Notes payable, banks	7,115	—
Current portion of long-term debt	1,226	120
Trade and other payables	20,442	(720)
Accrued liabilities, including taxes	23,622	1,488
Deferred income taxes	32,330	—
	84,735	888
INCREASE (DECREASE) IN WORKING CAPITAL	$ (26,650)	$ 9,784

Consolidated Statement of Retained Earnings

The Scott & Fetzer Company and Subsidiary Companies

(Dollars in Thousands)

	Year Ended November 30 1978	Year Ended November 30 1977
Retained earnings, beginning of year	$118,356	$107,765
Net income	30,247	26,306
	148,603	134,071
Cash dividends	10,999	9,510
Excess of cost of treasury stock over amount allocated to common stock and additional capital — 260,371 shares	—	6,205
	10,999	15,715
Retained earnings, end of year	$137,604	$118,356

The accompanying Notes to Financial Statements and Summary of Accounting Policies are integral parts of these financial statements.

Notes to Financial Statements

1. Acquisitions

In February, 1978, the Company acquired for cash and notes totaling $23,550,000 all of the outstanding stock of Wayne Home Equipment Company, a manufacturer of oil and gas power burners and water system pumps. The transaction has been accounted for as a purchase as of February 1, 1978, and, accordingly, the results of operations of Wayne have been included in the consolidated statement of earnings since that date. The purchase price in excess of the fair value of net assets acquired of $2,891,000 is being amortized over a 40-year period.

As of September 1, 1978, the Company acquired all of the outstanding stock of World Book-Childcraft International, Inc., which publishes the World Book Encyclopedia and other educational, learning and reference materials. The initial transaction involved a cash purchase price of approximately $49,000,000 plus the payment of an outstanding term loan of $37,500,000. The initial transaction excluded the Canadian subsidiary and the Insurance Company as the requisite governmental approvals had not been granted at the purchase date.

Subsequently, on November 8, 1978, the State of Illinois approved the sale of World Book Life Insurance to the Company for a cash price of $5,733,000. It is anticipated that the Canadian subsidiary will be purchased in 1979 for approximately $6,000,000.

As part of the World Book-Childcraft acquisition, Scott & Fetzer formed a new subsidiary—World Book Finance, Inc. This unconsolidated subsidiary finances the domestic consumer installment sales of World Book, through borrowings without parent company guarantees. (See Note 12.)

The World Book acquisition has been accounted for as a purchase as of September 1, 1978 and, accordingly, the results of operations have been included in the consolidated statement of earnings since that date, except for World Book Life Insurance which has been accounted for as an unconsolidated subsidiary since its acquisition as of October 31, 1978.

The following table summarizes, on an unaudited pro forma basis, the sales, net income and earnings per common share of the Company as though Wayne Home Equipment and World Book-Childcraft had been acquired on December 1, 1976:

	1978	1977
Net Sales	$652,781,000	$607,183,000
Net Income (continuing operations)	$ 35,940,000	$ 31,674,000
Earnings Per Share	$ 4.89	$ 4.29

2. Discontinued Operations

On November 30, 1977, the Company completed the sale of its domestic lighting divisions (Atlas, Virden and Rembrandt) for cash and notes receivable. During the first quarter ended February 28, 1978 the Company completed the sale of two additional divisions (Dek/Electro and Humphreys Leather Goods), which were also determined to be discontinued as of November 30, 1977, for cash and notes receivable.

Income and expenses related to discontinued divisions have been removed from the appropriate categories in the statement of income and net results therefrom show as "income (loss) from discontinued operations." Net sales were $2,986,000 and $43,550,000, with operating costs and expenses of $2,829,000 and $42,814,000, and net income (loss) of $71,000 and ($496,000) for the years ended November 30, 1978 and 1977, respectively.

3. Inventories

If current costs had been used for those inventories presently valued using the last-in, first-out method, inventories presently in the balance sheet would have been $14,491,000 and $10,099,000 higher than reported at November 30, 1978 and 1977, respectively.

Inventories for continuing operations used in the computation of cost of goods sold, which include progress payments of $7,500,000 for printing contracts at November 30, 1978, were as follows (dollars in thousands):

November 30, 1976	$52,123
November 30, 1977	55,730
November 30, 1978	83,905

4. Short- and Long-Term Borrowings

The short-term notes payable, banks, represent outstanding loans to the foreign affiliates of World Book-Childcraft International, Inc., as of September 30, 1978. The maximum borrowing under existing arrangements is $12,705,000. The weighted average interest rate for the one-month period was 11.86%. At November 30, 1978, the company maintained guarantees of $14,516,000 for foreign debt. Subsequent to November 30, 1978, a guarantee of $10,470,000 for debt of a foreign finance subsidiary was assumed by World Book Finance, Inc.

Other long-term debt at November 30, 1978 and 1977 consisted of the following:

	1978	1977
Mortgage notes — 5½% to 8% maturities to 1982	$ 105,200	$ 202,000
Insurance company loan — 6% maturities to 1980	700,000	900,000
Former shareholders of Wayne Home Equipment — 8% maturities to 1987	3,715,800	—
Unsecured debentures — 7% $172,000 due in 1980 and $72,000 in 1981	244,000	—
	$4,765,000	$1,102,000

Effective August 31, 1978, an indenture for the principal amount of $30,000,000, dated May 15, 1975, and due May 15, 1985 with interest at 9%, was amended by a majority consent of the note holders. The amendment provided for an increase in the annual interest rate to be paid on the unpaid principal amount of the notes from 9% to 9¼%. Also, certain definitions in the indenture were revised, including the definition of Restricted and Unrestricted Subsidiaries, as they apply to the covenants of the note agreement. The indenture continues to maintain provisions regarding increases in debt, minimum asset-to-debt ratios, and the extent to which dividends may be paid. At November 30, 1978, retained earnings unrestricted for the payment of dividends amounted to $74,383,000.

On August 31, 1978, the Company completed a privately-placed 9½%, twenty-year financing agreement with a major institutional lender for $40,000,000 with delayed delivery arrangements. One-half of the financing was received on December 28, 1978, the balance to be received in February, 1979.

The Company has domestic unused lines of credit amounting to $16,000,000. Although withdrawal is not legally restricted, the Company is expected to, and does, maintain compensating balances equal to 10% of the lines of credit.

Aggregate maturities of long-term debt during the five-year period November 30, 1979, through November 30, 1983 are $2,433,800, $2,573,000, $3,304,000, $2,724,000, and $1,493,000, respectively.

For continuing operations, interest and debt expenses on long-term debt were $4,397,000 and $3,906,000 for the years ended November 30, 1978 and 1977, respectively.

5. Long-Term Leases

The Company leases certain production and warehouse facilities for terms ranging from 8 to 40 years. The majority of facility leases are for 15 years or more and contain certain renewal options, generally for 15 years. In addition, the Company leases transportation and other equipment, substantially all for three- to five-year terms. A substantial portion of the equipment leases contain purchase options. In accordance with Financial Accounting Standards Board Statement No. 13, the Company has capitalized all leases in effect since November 30, 1976 which meet criteria for classification as capital leases as defined in the Statement. Financial statements for years prior to 1977 have been restated to apply the new method of accounting retroactively. Leases for property, plant and equipment acquired with the proceeds from industrial revenue bonds have been consistently capitalized. Capital leases are accounted for and depreciated as Company-owned capital assets and were included in property, plant and equipment at November 30 as follows (dollars in thousands):

	1978	1977
Land and land improvements	$ 333	$ 449
Buildings	11,593	12,506
Machinery and equipment	4,797	2,142
	16,723	15,097
Less accumulated depreciation	5,913	4,708
	$10,810	$10,389

Future minimum lease payments under noncancelable leases at November 30, 1978 are summarized below (dollars in thousands):

Years Ending November 30	Capitalized Leases	Operating Leases
1979	$ 2,448	$ 4,680
1980	2,279	4,333
1981	2,648	3,860
1982	2,495	3,736
1983	2,429	3,704
Later years	6,309	15,561
Total minimum lease payments	18,608	35,874
Less minimum sublease rents	—	161
Net minimum lease payments	18,608	$35,713
Less estimated executory costs	59	
Less amount representing interest	6,065	
Present value of net minimum lease payments under capital leases	$12,484	

Net rent expense for noncancelable operating leases for the years ended November 30, 1978 and 1977 amounted to $3,264,000 and $2,992,000, after deducting sublease rents of $101,400 and $95,000, respectively.

6. Stock Options

The Company adopted a common stock option plan in 1973 for which 191,363 shares were reserved for issuance under outstanding options at November 30, 1978. Shares reserved for future grants at November 30, 1978 and 1977 were 375,313 and 371,938, respectively.

The 1973 stock option plan provides for the granting of either qualified or nonqualified options to officers and key employees to purchase shares of common stock at a price not less than 100% of the fair market value of the stock on the date options are granted. Options are exercisable one-fourth each year commencing one year after date of grant and expire five years after grant for qualified options, and 10 years after grant for nonqualified options.

The plan also permits the granting of stock appreciation rights to optionees. As of November 30, 1978, no stock appreciation rights had been granted.

Information relating to options is set forth below:

	Number of Shares	Option Price: Average Per Share	Option Price: Total	Market Price: Average Per Share	Market Price: Total
Options granted:					
1977	94,975	$24.88	$2,363,240	$24.88	$2,363,240
1978	56,500	25.75	1,454,875	25.75	1,454,875
Options becoming exercisable:					
1977	38,834	24.06	934,262	26.01	1,009,987
1978	47,248	21.54	1,017,864	24.53	1,159,026
Options exercised:					
1977	6,937	13.06	90,584	25.67	178,041
1978	21,037	19.07	401,102	27.98	588,662
Options outstanding:					
1977	215,775	25.78	5,562,622	25.78	5,562,622
1978	191,363	23.59	4,514,027	23.59	4,514,027

Certain options granted under the plan have corresponding contingent options which may be exercised only upon the lapsing of existing options. During 1978, 1,250 shares of such existing options lapsed.

During 1978 and 1977, options for 61,125 shares and 37,963 shares, respectively, were cancelled. The Company has made no charge against income with respect to options.

7. Pension and Retirement Plans

The majority of the Company's employees are covered by various non-contributory trusteed pension and profit-sharing plans. The Company also has non-funded deferred compensation agreements with certain of its officers and other senior management employees. Contributions under the plans charged to continuing operations were $3,581,000 and $2,268,000 for the years ended November 30, 1978 and 1977, respectively. These include, as to certain of the plans, amortization of prior service costs over periods ranging from 24 to 40 years. The amount required to fund prior service cost is estimated at $20,100,000. The Company's policy is to fund pension costs accrued. The aggregate actuarially computed value of vested benefits exceeded the total pension fund assets and balance sheet accruals by approximately $2,758,000 at November 30, 1978.

8. Contingent Liabilities

Any liability that may result from lawsuits and other claims pending against the Company will not be material in the opinion of management of the Company.

9. Capital Stock

Changes in the common stock and additional capital accounts during the two years ended November 30, 1978 and 1977 were as follows (dollars in thousands):

	Common Stock: Treasury Shares	Common Stock: Issued Shares	Common Stock: Stated Value	Additional Capital
Balance, November 30, 1976	—	7,576,924	$9,471	$5,992
Purchase of stock	(267,308)	—	(334)	(211)
Sale of stock under options	6,937	—	9	82
Balance, November 30, 1977	(260,371)	7,576,924	9,146	5,863
Sale of stock under options	21,037	—	26	375
Balance, November 30, 1978	(239,334)	7,576,924	$9,172	$6,238

10. Quarterly Earnings Data (Unaudited)
The unaudited summary of quarterly earnings for years ended November 30, 1978 and 1977 is presented as follows (dollars in thousands except per share data):

	1978 Fiscal Year by Quarter			
	First	Second	Third	Fourth
Net sales	$87,021	$121,859	$105,690	$163,652
Gross profit	23,038	34,322	28,474	73,491
Income from continuing operations	5,851	10,132	7,615	6,578
Income from discontinued operations	71	—	—	—
Net Income	$ 5,922	$ 10,132	$ 7,615	$ 6,578
Earnings per share				
From continuing operations	$ .80	$1.38	$1.03	$ .89
From discontinued operations	.01	—	—	—
Total	$ .81	$1.38	$1.03	$ .89

	1977 Fiscal Year by Quarter			
	First	Second	Third	Fourth
Net sales	$80,009	$ 98,147	$ 88,331	$ 84,700
Gross profit	22,446	27,881	24,585	26,754
Income from continuing operations	5,945	8,342	6,489	6,026
Income from discontinued operations	(329)	(904)	350	387
Net Income	$ 5,616	$ 7,438	$ 6,839	$ 6,413
Earnings per share				
From continuing operations	$ .79	$1.14	$ .88	$ .82
From discontinued operations	(.04)	(.13)	.05	.05
Total	$ .75	$1.01	$ .93	$ .87

11. Business Segment Information
Information with respect to the Company's business segments is contained on pages 21 and 22 of this report.

Intersegment sales are accounted for at prices which generally approximate market. Operating profit is total revenue less operating expenses, excluding interest, general corporate expenses, income taxes and earnings of unconsolidated subsidiaries.

12. Investments in Unconsolidated Subsidiaries
The investments in unconsolidated subsidiaries which are wholly-owned are carried on the equity basis and at November 30, 1978, were as follows (dollars in thousands):

	Equity in Net Assets
World Book Finance, Inc.	$ 26,432
World Book Life Insurance	5,733
Foreign finance subsidiary	601
	$ 32,766

Accounts payable in the accompanying balance sheet include amounts due to unconsolidated subsidiaries of $2,740,000 at November 30, 1978.

World Book Finance, Inc., (WBFI) provides funds principally to finance the domestic installment receivables of World Book. The Company is obligated under an operating agreement to make available to WBFI amounts sufficient so that earnings, as defined, are at least 150% of fixed charges (primarily interest). The amount provided in 1978 was $2,803,000.

The condensed balance sheet of WBFI at November 30, 1978 was as follows (dollars in thousands):

Assets	
Cash	$ 4,697
Finance receivables (net of allowance for credit losses)	96,119
Receivables from affiliated companies	2,434
Total Assets	$103,250
Liabilities and Shareholders' Equity	
Accounts payable and other liabilities	$ 1,818
Long-term indebtedness due to unsecured outside parties	75,000
Total Liabilities	76,818
Shareholders' equity, September 1, 1978 — date of inception	26,001
Net income	431
Shareholders' equity, end of period	26,432
Total Liabilities and Shareholders' Equity	$103,250

Notes to Financial Statements (continued)

13. Current Replacement Costs (Unaudited)
The Company is required to report to the Securities and Exchange Commission in its Form 10K certain information relating to current replacement cost of productive capacity (primarily buildings, machinery and equipment), replacement cost of inventories at year end, and the effect during the year on Cost of Goods Sold, if costs were used that were in effect at the time of sale. This information basically is intended to show the effects of inflation on current operations and the future effects of replacing productive capacity at current costs and should be looked upon only as an indication of the state of the general economy as it relates to the Company at the present time. It does not purport to show the future operating performance of the Company, since productive capacity would not be replaced at one time and future costs are dependent on ever-changing economic conditions and management control of all economic factors affecting the Company.

Management is constantly aware of the effects of inflation on production costs and the ability to maintain and improve productive capacity and is continually taking steps to reduce costs and upgrade its productive assets to take advantage of technological improvements and innovations in order to maintain modern, efficient manufacturing operations.

The calculation of the current replacement cost data was based on estimates and various assumptions. The value of this analysis is limited to the validity of the estimates and assumptions and is of minimal usefulness to the Company.

A copy of the annual report to the Securities and Exchange Commission on Form 10K, which includes the complete replacement cost analysis for fiscal 1978, may be obtained from the Company upon request.

Summary of Accounting Policies

The following is a summary of significant accounting policies followed in the preparation of these financial statements. The policies conform to generally acccepted accounting principles and have been consistently applied in the preparation of the financial statements.

Principles of Consolidation — The consolidated financial statements include the accounts of the Company and its domestic and foreign subsidiaries, except for the finance and insurance subsidiaries which are included on an equity basis. The foreign subsidiaries associated with the World Book-Childcraft subsidiary are included, based on their fiscal years ended September 30. Intercompany balances, transactions and stockholdings have been eliminated in consolidation.

Short-Term Investments— Short-term investments are carried at cost, which approximates market value.

Inventory Valuations — The last-in, first-out method of inventory valuation is used for a majority of domestic inventories. The remaining inventory is valued principally at average standard cost. Inventory valuations are at the lower of cost or market.

Property, Plant and Equipment — Items capitalized as part of land, buildings and equipment, including significant betterments to existing facilities, are valued at cost. When property is retired or is otherwise disposed of, the cost and accumulated depreciation are removed from the appropriate accounts and any gain or loss included in current income. Maintenance, repair and ordinary renewals are charged to expense as incurred.

Income Taxes — Deferred taxes on income are provided for timing differences between financial and tax reporting, principally for income recognized from installment accounts receivable (classified as current), depreciation and capital lease costs.

Investment Tax Credits — These credits are handled by the "flow through" method, reducing the provision for federal income taxes in the year they arise.

Installment Accounts Receivable — In accordance with industry practice, total installment receivables are included in current assets. The portions of such accounts due after one year from the balance sheet date amounted to $10,680,000 at November 30, 1978.

Profits on installment sales are credited to income at the time of sale. Monthly finance charges levied on substantially all domestic accounts are credited to income over the lives of the installment contracts, after deducting a provision for estimated uncollectible charges.

No separate finance charges are levied on installment sales of foreign subsidiaries or on mail order sales payable over a term of more than 12 months. The portion of the sales price deemed to represent finance charges is deferred at the time of the sale and is taken into income over the life of the installment contract.

Earnings Per Share — Earnings per common share are determined by dividing net income by the weighted average number of shares of common stock outstanding plus common share equivalents (shares issuable for certain stock options granted).

Foreign Currencies — Foreign currency amounts are translated into United States dollars, in accordance with Financial Accounting Standards Board Statement No. 8, generally at remittance exchange rates, as follows: inventories, prepaid and deferred items, property, plant and equipment and related cost of goods sold, amortization and depreciation — at historical rates; all other assets and liabilities — at rates in effect at the end of the year; income and all other expenses — at average exchange rates during the year. Foreign currency exchange gains and losses, which are not material, are included in the determination of net income.

Excess Cost Over Fair Value of Assets Acquired — The excess of cost of investment over assets acquired is being amortized on a straight-line basis over a 40-year period.

Depreciation — Straight-line and accelerated methods are used in the computation of depreciation for financial reporting purposes, the straight-line method being used for the majority of the assets.

Report of Independent Certified Public Accountants

To the Stockholders and Board of Directors
The Scott & Fetzer Company:

We have examined the consolidated balance sheets of The Scott & Fetzer Company and subsidiary companies as at November 30, 1978 and 1977, and the related consolidated statements of income, retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the consolidated financial position of The Scott & Fetzer Company and subsidiary companies at November 30, 1978 and 1977, the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

In addition, we have read the financial information included in "The Year at a Glance" on page 1, "Business and Financial Review" on pages 17 through 20, the "Summary of Operations" on page 16 and "Historical Review" on page 35 of this annual report, have compared it to data taken from the audited financial statements, subjected it to audit procedures, and verified its mathematical accuracy. In our opinion, such data is fairly stated in relation to the audited financial statements taken as a whole.

Coopers & Lybrand

Cleveland, Ohio
January 18, 1979

Report of the Board of Directors' Audit Committee

As in past years, Scott & Fetzer's Audit Committee comprises four members, all outside directors. In our judgment, the corporate senior management has the responsibility for the integrity and objectivity of the company's financial statements. We believe it is the Audit Committee's function, acting for the board of directors, to review the company's published financial statements, monitor the effectiveness of the internal financial control system and meet regularly with senior management, the public auditors — Coopers & Lybrand, and the internal audit group. During 1978, the Audit Committee met four times to fulfill these responsibilities.

We have received the full cooperation of all personnel involved in the financial control system, and the committee is generally satisfied with the current management and financial controls. Where we have recommended improvements or refinements, corporate senior management has cooperated with our requests. Currently, the company is working to develop and expand the computerized management information systems — particularly inventory accountability and more sophisticated cost systems.

The Audit Committee also monitors regularly the company's control programs to prevent conflicts of interest and improper payments of any kind. External and internal auditors report that they are satisfied that these control procedures are adequate and being effectively used by management, and the Audit Committee concurs.

We believe that Scott & Fetzer's published financial statements are based on conservative accounting policies which have been consistently followed and factually present the company's current operating results and financial position.

The Audit Committee appreciates the cooperation and efforts of all personnel, within the company and externally, who have assisted us.

For the Audit Committee

J. T. Bailey

Joseph T. Bailey,
Chairman

Cleveland, Ohio
January 23, 1979

Historical Review

(Dollars in Thousands Except Per Share Data)

AS REPORTED	1978	1977	1976	1975	1974
Net Sales	**$478,222**	$351,187	$343,043	$284,020	$291,258
Income Before Taxes	**60,807**	56,108	45,855	32,791	25,931
Net Income	**30,247**	26,306	22,861	17,048	13,696
Cash Dividends	**10,999**	9,510	8,864	7,706	7,554
Per cent Payout of Net Income	**36.4**	36.2	38.8	45.2	55.2
Earnings Retained and Reinvested	**19,248**	16,796	13,997	9,342	6,142
Capital Expenditures	**12,886**	8,816	4,636	6,064	12,473
Working Capital	**98,537**	125,187	116,180	100,602	84,496
Long-Term Debt	**46,036**	41,838	34,350	34,772	27,424
Total Assets	**337,977**	225,411	207,223	184,177	162,729
Shareholders' Equity	**153,014**	133,365	123,804	109,496	100,137
Per cent Return on Shareholders' Equity	**19.8**	19.7	18.5	15.6	13.7
Per Share					
Earnings	**4.11**	3.56	3.01	2.26	1.81
Dividends	**1.50**	1.30	1.17	1.02	1.00
Book Value	**20.85**	18.23	16.34	14.49	13.25
Market Price Range	**36⅛-23**	29-22¾	29⅜-17⅝	22-8⅛	25⅝-8⅜
Price/Earnings Ratio	**9-6**	8-6	10-6	10-4	14-5
Year-End Data					
Shares Outstanding (000's)	**7,338**	7,317	7,577	7,556	7,555
Number of Shareholders of Record	**8,439**	8,852	9,377	10,105	9,896
Number of Employees	**17,425**	7,255	7,500	7,084	7,481
RESULTS RESTATED*					
Net Sales	**$478,222**	$351,187	$301,918	$247,249	$247,539
Income Before Taxes	**60,807**	56,108	42,367	30,181	23,586
Per cent to Sales	**12.7**	16.0	14.0	12.2	9.5
Income from Continuing Operations	**30,176**	26,802	21,103	15,690	12,460
Per cent to Sales	**6.3**	7.6	7.0	6.3	5.0
Income (Loss) from Discontinued Operations	**71**	(496)	1,618	1,218	1,099
Net Income	**$ 30,247**	$ 26,306	$ 22,721	$ 16,908	$ 13,559
Earnings Per Share:					
From Continuing Operations	**$ 4.10**	$ 3.63	$ 2.78	$ 2.08	$ 1.65
From Discontinued Operations	**.01**	(.07)	.21	.16	.15
Total	**$ 4.11**	$ 3.56	$ 2.99	$ 2.24	$ 1.80

* *"Results Restated" for 1976 and prior years reflects a change in accounting for leases and the net sales and income before taxes of continuing operations.*

Operating Units

CLEANING SYSTEMS

AMERICAN-LINCOLN DIVISION
1100 Haskins Road
Bowling Green, Ohio 43402

KLEVAC DIVISION*
815 E. Tallmadge Avenue
Akron, Ohio 44310

KIRBY GROUP
1920 W. 114th Street
Cleveland, Ohio 44102

WESTERN ENTERPRISES DIVISION*
33672 Pin Oak Parkway
Avon Lake, Ohio 44012

EDUCATIONAL & HOUSEHOLD PRODUCTS

CANADA LIGHTING DIVISION
19 Curity Avenue
Toronto M4B 1X6, Ontario, Canada

KLEVAC DIVISION*
815 E. Tallmadge Avenue
Akron, Ohio 44310

POWERWINCH/JA-SON DIVISION*
217 Long Hill Cross Road
Shelton, Connecticut 06484

QUIKUT DIVISION
1100 Napoleon Street
Fremont, Ohio 43420

STREAMWAY DIVISION
835 Sharon Drive
Westlake, Ohio 44145

WORLD BOOK-CHILDCRAFT INTERNATIONAL, INC.
Merchandise Mart Plaza
Chicago, Illinois 60654

FLUID TRANSMISSION

CAMPBELL-HAUSFELD GROUP
Production Drive
Harrison, Ohio 45030

WAYNE HOME EQUIPMENT DIVISION
801 Glasgow Avenue
Fort Wayne, Indiana 46803

WESTERN ENTERPRISES DIVISION*
33672 Pin Oak Parkway
Avon Lake, Ohio 44012

EQUIPMENT & ACCESSORIES

CAREFREE OF COLORADO DIVISION
2760 Industrial Lane
Broomfield, Colorado 80020

DOUGLAS DIVISION
141 Railroad Street
Bronson, Michigan 49028

POWERWINCH/JA-SON DIVISION*
217 Long Hill Cross Road
Shelton, Connecticut 06484

STAHL DIVISION
4750 West 160th Street
Cleveland, Ohio 44135

VALLEY INDUSTRIES DIVISION
1313 S. Stockton Street
Lodi, California 95240

POWER & ENERGY

ADALET-PLM DIVISION
4799-4801 W. 150th Street
Cleveland, Ohio 44135

FRANCE DIVISION*
Two Maryland Farms
Brentwood, Tennessee 37027

HALEX DIVISION
23901 Aurora Road
Bedford Heights, Ohio 44146

NORTHLAND DIVISION
968 Bradley Street
Watertown, New York 13601

MEASUREMENT & CONTROL

FRANCE DIVISION*
Two Maryland Farms
Brentwood, Tennessee 37027

MERIAM INSTRUMENT DIVISION
10920 Madison Avenue
Cleveland, Ohio 44102

** Under more than one business segment*

Corporate Management

RALPH SCHEY
Chairman, President and Chief Executive Officer

J. F. BRADLEY
Executive Vice President — Finance

JOHN BEBBINGTON
Senior Vice President

WALTER A. RAJKI
Senior Vice President

KEARNEY K. KIER
Group Vice President

KENNETH J. SEMELSBERGER
Group Vice President

KENNETH D. HUGHES
Vice President, Treasurer and Controller

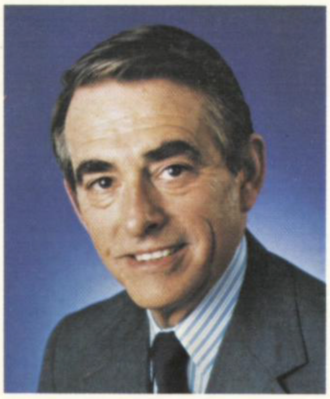
ROBERT C. WEBER
Secretary and General Counsel

THEODORE C. BLISS
Assistant Treasurer

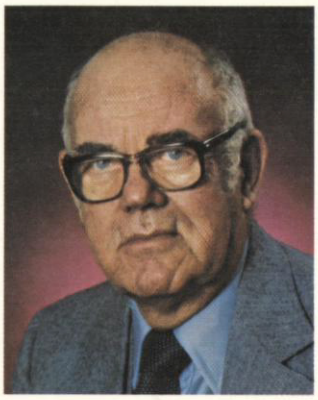
JOHN E. FRERE
Assistant Controller

Directors

JOSEPH T. BAILEY
Chairman and Chief Executive Officer, The Warner & Swasey Co.,
Manufacturer of machine tools, construction equipment, and textile machinery
Audit Committee, chairman; Compensation and Organization Committee

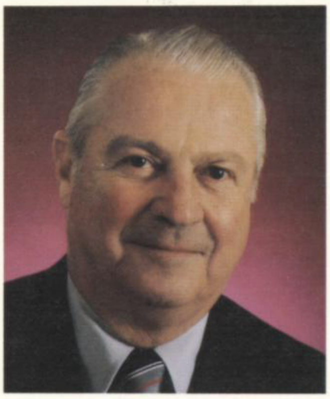


J. F. BRADLEY
Executive Vice President-Finance
Investment Committee, chairman; Executive Committee



NILES H. HAMMINK
Formerly Chairman and Chief Executive Officer, The Scott & Fetzer Co.
Executive Committee, chairman; Investment Committee

JAMES A. HUGHES
Chairman, First Union Realty Investments,
Real estate investment trust
Audit Committee; Compensation and Organization Committee

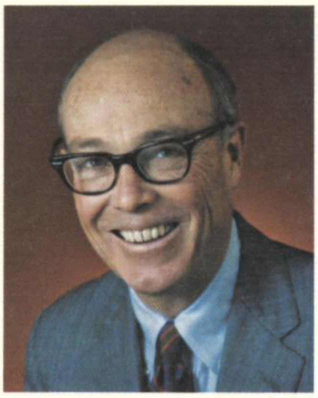


LAWRENCE C. JONES
Chairman and President, Van Dorn Company
Manufacturer of special purpose containers and plastic injection molding machinery, and heat treating of steel
Audit Committee, Investment Committee

DELMAR W. KARGER
Professor of Management, Emeritus, Rensselaer Polytechnic Institute
Compensation and Organization Committee

RALPH SCHEY
Chairman, President and Chief Executive Officer
Executive Committee

THOMAS W. SMITH
Private Investor
Compensation and Organization Committee, chairman; Audit Committee



ROBERT L. SWIGGETT
President, Kollmorgen Corporation,
Manufacturer of printed circuits, direct current motors and control systems, color and photometry instruments, and electro-optional systems
Investment Committee

The Scott & Fetzer Company
14600 Detroit Avenue
Lakewood, Ohio 44107

0
APT 205
112

Printed in U.S.A.