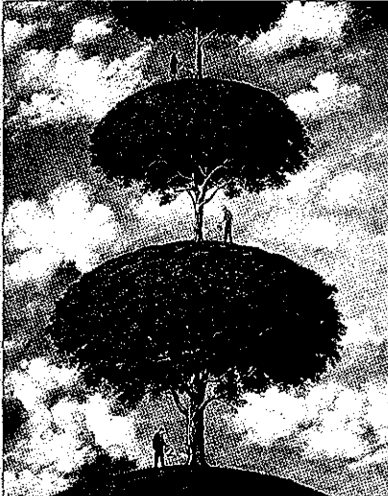
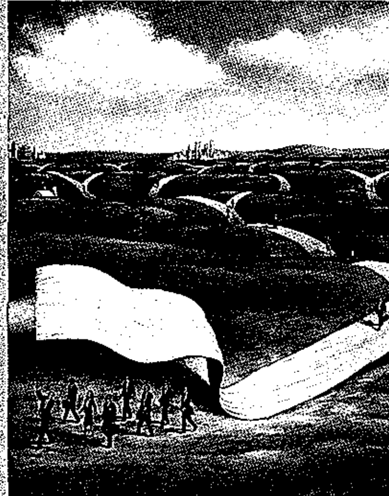
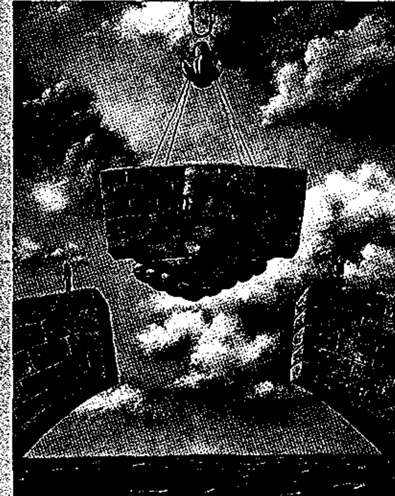
Becoming the Global Supplier of Choice



GROWTH

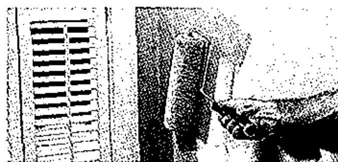
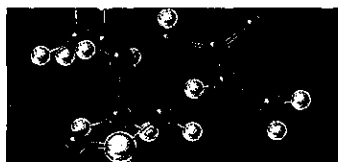
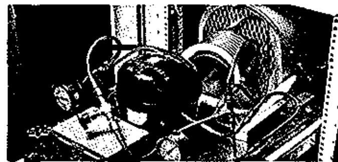


FRANCHISE

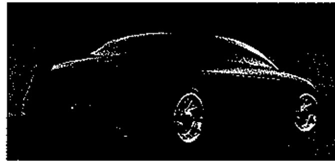
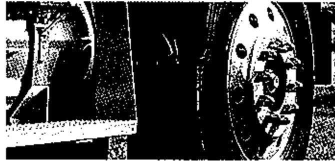
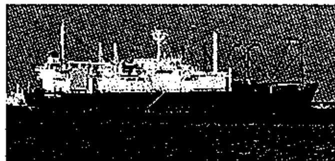
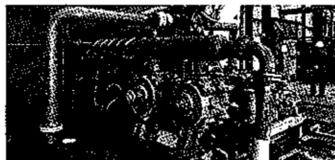


STRUCTURE

The Lubrizol Corporation • 1997 Annual Report

End-Use Markets		Lubrizol Products
ANTIWEAR HYDRAULIC FLUIDS		Additive packages to prevent wear, rust, oxidation, corrosion and viscosity loss in functional fluids meeting the requirements of hydraulic pump, valve and cylinder manufacturers.
METALWORKING FLUIDS		Chemistry to control acidity, foam, mist, metal staining, friction, tool breakage, odor and oxidation in fluids used in metalworking machinery.
FUEL PRODUCTS		Additive packages for fuels to control deposits, wear, lubricity, emissions, rust and foam in gasoline and diesel engines. Also, additives to ensure storage stability and cold weather flow of gasoline and diesel fuels.
PAINTS, COATINGS & INKS		Additive technology for industrial coatings, paints and inks to improve physical properties, such as sag resistance, scratch and abrasion resistance, color development and adhesion.
FIBER DYE, WATER TREATMENT CHEMICALS, PERSONAL CARE PRODUCTS		Sulfonic acid acrylic monomers that impart hydrophilicity, stability and lubricity to a wide variety of products, including acrylic fiber, premium water treatment chemicals, personal care products and conductive gels for medical applications.
EMISSION CONTROL		Catalyst and filter systems for bus engines to help buses meet clean air standards in retrofit and rebuild applications. Also, exhaust aftertreatment systems for mining, materials handling, construction and highway equipment.
REFINERY AND OIL FIELD PRODUCTS		Specialty chemicals to improve combustion and flow, prevent deposits and fouling, regenerate catalysts, inhibit corrosion and scale and enhance oil field operations.
COMPRESSOR LUBRICANTS		Synthetic based compressor lubricants for use with non-CFC refrigerants in air conditioning systems and air compressor applications.
PRECISION METERING		Blending and additive injection metering equipment for bulk fluid loading, mining, water and sewage treatment, chemical manufacturing and oil refining applications.
MINING EXPLOSIVES		Specialty surfactant technology that provides superior stability in water-in-oil invert emulsions used in a variety of applications worldwide. Compatible with vegetable, synthetic and mineral oils.

PRODUCTS & APPLICATIONS

End-Use Markets		Lubrizol Products
PASSENGER CAR MOTOR OILS		Additive packages to improve fuel economy and control deposits, sludge, varnish, rust, corrosion, wear, viscosity, oxidation and cold temperature flow in oils meeting industry and original equipment manufacturers specifications worldwide.
HEAVY-DUTY ENGINE OILS		Performance chemistry to control piston deposits, lacquer, soot, oxidation, sludge, wear and oil consumption in oils meeting industry and original equipment manufacturers specifications worldwide.
TWO-STROKE ENGINE OILS		Technology to protect against piston and cylinder scuffing, ring stick, exhaust port blocking, preignition and rust in oils meeting worldwide industry and original equipment manufacturers specifications.
MARINE DIESEL ENGINE OILS		Additives for cylinder, crosshead and trunk piston oils that neutralize acids and control scuffing, deposits, wear, lacquer, ring sticking, sludge, oxidation and rust in meeting the requirements of major engine builders.
STATIONARY GAS ENGINE OILS		Performance chemistry to prevent deposits, wear, valve recession, ring sticking, plug fouling, catalyst masking, port blocking, oxidation, nitration and rust in oils meeting the requirements of major engine builders worldwide.
AUTOMATICTRANSMISSION FLUIDS		Technology to maintain shift quality and prevent wear, deposits, oxidation, viscosity loss and foam in automatic transmission fluids meeting specifications issued by major automotive manufacturers around the world.
AUTOMOTIVE & INDUSTRIAL GEAR OILS		Chemistry for manual transmissions, rear axles and industrial gearboxes to prevent wear, pitting, spalling, scoring, tooth breakage, deposits, oxidation, rust, copper corrosion, foam and water retention.
TRACTOR FLUIDS		Additives to control wear, deposits, oxidation, friction, brake squawk, foaming, rust and corrosion in farm tractor transmissions, final drives, wet brakes, clutches and hydraulic systems.
OFF-HIGHWAY EQUIPMENT		Additive chemistry for the engine oils, gear lubricants, hydraulic fluids and diesel fuels meeting the specifications of heavy-duty equipment builders worldwide.
GREASES		Thickeners, rust inhibitors, extreme pressure agents and antioxidants used in greases to meet the specifications of industry organizations and original equipment manufacturers around the world.

About the Company

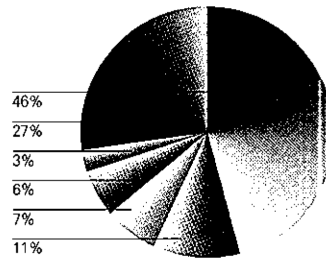
The Lubrizol Corporation is a leading full-service supplier of performance chemicals to diverse markets worldwide. These specialty chemical products are created through application of advanced chemical and mechanical technologies to enhance the performance, quality and value of the products in which they are used.

Founded in 1928, the company operates manufacturing and blending facilities, laboratories and offices staffed by 4,300 employees around the world.

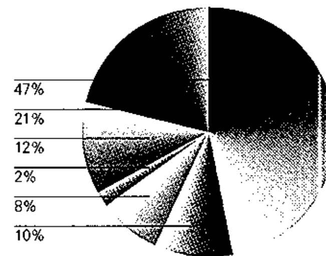
In 1997, Lubrizol pursued three corporate strategies to grow the business, improve its structure and build the franchise. These strategies strengthened Lubrizol's position as a global leader in the development, manufacturing and distribution of performance chemistry. They also enhanced the company's ability to produce products that meet the needs of transportation and industrial customers worldwide, and to supply consistent, high-quality products anywhere in the world.

Lubrizol is a recognized leader in specialty additive systems for lubricating oils used in gasoline and diesel engines, automatic transmissions, gear drives, marine engines and tractors. The company also supplies specialty products for industrial fluids, fuel additives, process chemicals and coating additives. In addition, Lubrizol markets equipment and performance chemicals for other specialized markets.

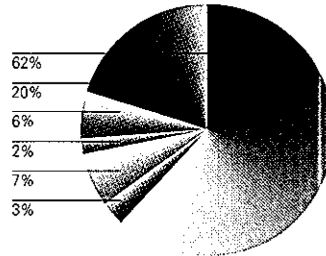
NORTH AMERICA
$655.9 Million in Revenues



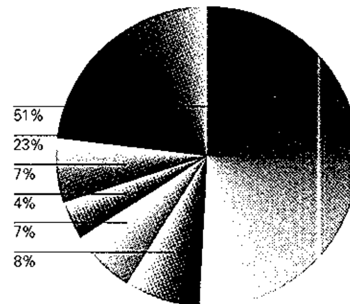
EUROPE
$498.9 Million in Revenues

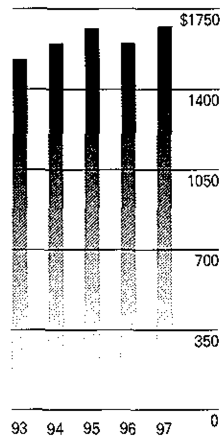


ASIA-PACIFIC, LATIN AMERICA, MIDDLE EAST
$519.0 Million in Revenues



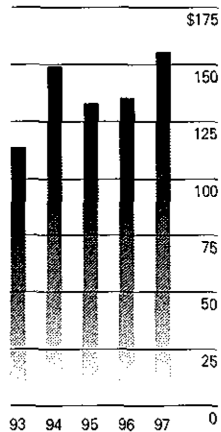
WORLDWIDE
$1,673.8 Million in Revenues





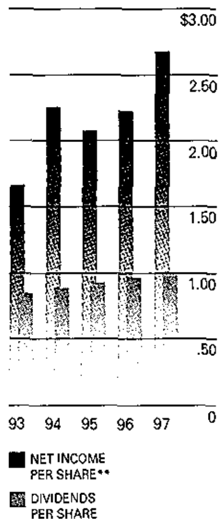
Financial Highlights

(In Millions Except Per Share and Employee Data)	1997	1996	Increase (Decrease)
OPERATIONS:			
Revenues	$1,673.8	$1,597.6	5%
Net income	154.9	169.8	(9%)
Net income before gain on investments	154.9	135.2	15%
Net income per share	2.68	2.80	(4%)
Net income per share before gain on investments	2.68	2.23	20%
Dividends per share	1.01	.97	4%
Cash provided from operating activities	234.4	231.0	1%
Return on shareholders' equity before gain on investments	19%	16%	
FINANCIAL POSITION:			
Total assets	$1,462.3	$1,402.1	4%
Shareholders' equity	815.4	819.4	
Debt as a percent of capitalization	21%	20%	
OTHER:			
Capital expenditures	$ 100.7	$ 94.3	7%
Shares outstanding at December 31	57.0	58.5	(3%)
Number of employees	4,291	4,358	(2%)



COMMON SHARE PRICE HISTORY

	1997		1996	
	High	Low	High	Low
1st quarter	$36	$30½	$31	$26⅝
2nd quarter	42⅛	30⅜	30½	27¼
3rd quarter	44⅞	41 15/16	30½	27⅞
4th quarter	46 15/16	34⅞	32⅜	28½



To Our Shareholders:

Lubrizol had a very good year in 1997. The company made visible progress to grow its business, improve its structure and build its franchise. Revenues increased 5 percent as product shipments increased 17 percent and market share grew. Cost of sales rose less than 4 percent and other operating expenses declined 1 percent. Cash flow remained strong and the company repurchased 1.8 million of its shares. Net income per share for the year increased 20 percent to a record level from operations, despite the effects of the stronger U.S. dollar, which depressed earnings by about 6 percent, or $.17 per share. At the same time, Lubrizol was successful in expanding its franchise through the acquisition of several smaller businesses expected to contribute total annual revenues of more than $70 million.

All of this progress in 1997 is helping Lubrizol become the global supplier of choice in performance chemicals. This annual report describes many of the initiatives and accomplishments of 1997 in the areas of growth, structure and franchise.

1997 Results

Consolidated revenues for 1997 were $1.67 billion, an increase of 5 percent over 1996. Worldwide additive shipments increased 17 percent. Consolidated net income in 1997 was $154.9 million, or $2.68 per share. Consolidated net income in 1996 was $169.8 million, or $2.80 per share, which included after-tax gains of $34.6 million, or $.57 per share, from gains on investments. Excluding these gains, net income per share in 1997 increased 20 percent over 1996.

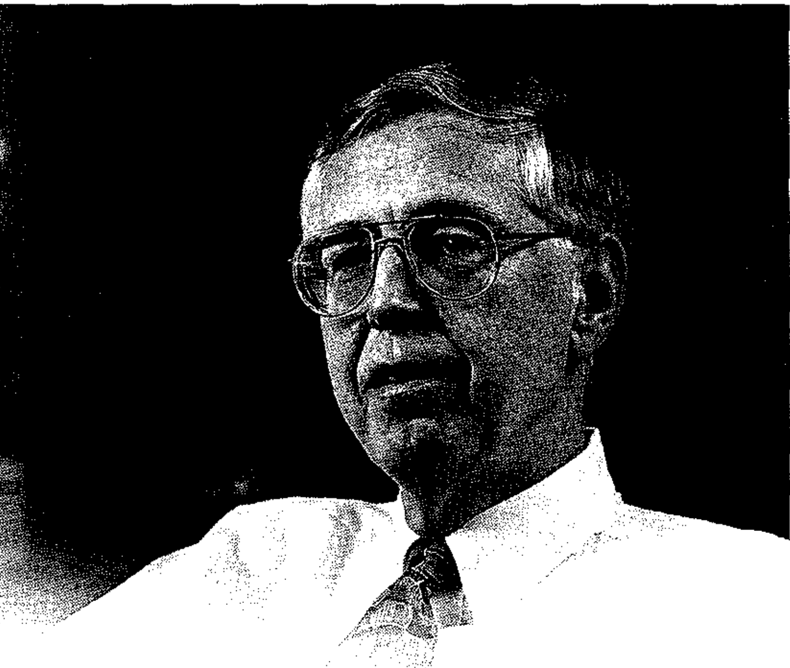
Last year, we said that the challenges in our industry would continue in 1997, but that Lubrizol's opportunities for growth and profitability had been enhanced by steps taken in 1996 to improve the company's competitiveness. This proved to be the case. Increased sales to selected customers, geographic expansion and growth in certain market segments all contributed to revenue and earnings improvement. However, this progress was achieved under difficult market conditions. Weak worldwide demand for lubricant additives and industry overcapacity have created very competitive conditions, putting pressure on product prices and margins. A more efficient cost structure, put into place in 1996, helped offset these pressures and provided additional leverage to the improved top-line results. Steps continued during 1997 to better position Lubrizol to operate effectively in this competitive market environment.

Quarterly dividends were increased 4 percent in the fourth quarter, yielding an annualized rate of $1.04 per share. This was the 14th consecutive year in which dividends were raised. Dividends paid in 1997 were $58.4 million.

Lubrizol repurchased 1.8 million of its outstanding shares for $70 million in 1997. At the end of the year, 4.7 million shares remained in the current repurchase authorization.

Recent Events

In December 1996, the company acquired CPI Engineering Services, Inc., a formulator of specialty synthetic lubricants used by original equipment manufacturers (OEMs) in air and refrigeration compressors.



W. G. Bares

In May, Lubrizol acquired Gateway Additive Company, a supplier of performance additives to the metalworking fluids and industrial lubricants markets.

In July, the company acquired Hyrolec Management Limited, which specializes in additive injection and monitoring systems for bulk liquid terminals.

In January 1998, the company acquired Carl Becker Chemie GmbH and Co., a leading supplier of specialty additives to the metalworking fluid and industrial markets in Germany.

Also in January, Lubrizol acquired the Brazilian coating additives business of BetzDearborn Brasil, Ltda.

Directors and Officers

In April, Thomas C. MacAvoy retired as a Director after 14 years of service.

In April, Forest J. Farmer, Sr. was elected a Director at the Annual Meeting of Shareholders. Mr. Farmer is President and Chief Executive Officer of Bing Manufacturing, Inc.

In June, M. Thomas Moore was appointed a Director to fill a vacancy. Mr. Moore is retired Chairman and Chief Executive Officer of Cleveland-Cliffs Inc.

In April, Leslie M. Reynolds was elected Assistant Secretary.

In January 1998, William R. Jones retired as Treasurer after 25 years of service with the company.

1998 Challenges

The initiatives begun in 1997, which are described in this report, must be advanced in 1998. This will not be easy. Market forces, competitive pressures and economic uncertainty in Asia present a new set of challenges to Lubrizol. Resources will be committed to accomplish what is needed for the longer term, although in 1998, progress may be less visible than last year.

Beyond 1998, we envision a leaner business infrastructure that is less complex and more efficient. We expect greater contributions to earnings to come from new market segments and business development opportunities. Lubrizol will become a broader-based specialty chemical company through both internal growth and acquisitions.

Our long-standing goals, however, are unchanged: to remain the market leader in our industry, to be the global supplier of choice to our customers, to grow earnings per share by an average of 10 percent per year and to deliver a 20 percent return on shareholders' equity. Achieving these goals will increase returns for our shareholders.

W. G. Bares

W. G. Bares
Chairman, President and
Chief Executive Officer

March 18, 1998

Growing the Business

- Increase Sales at Selected Accounts
- Expand Geographically
- Grow Selected Market Segments

Lubrizol's primary strategy for 1997 was to grow the business. The worldwide industry growth rate for lubricating additives has slowed to about 1 percent per year, which contributed to the company's relatively flat volumes and revenues during the last several years. In 1997, three initiatives were used to put Lubrizol's growth strategy into place.

Increasing sales at selected accounts was the primary means through which Lubrizol grew in 1997. Successful implementation of this initiative resulted in a significant increase in shipment volumes, a 5 percent increase in revenues and a 3 percentage point increase in market share. Perhaps more important, Lubrizol has become a more valuable partner with the customer, enabling both companies to grow and prosper.

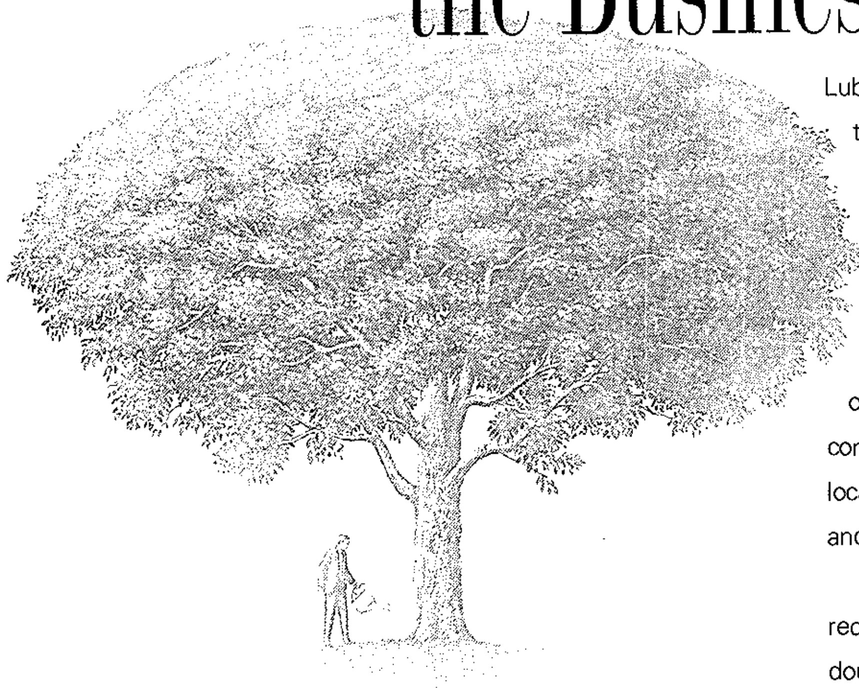
In today's changing and competitive markets, customers and suppliers have mutual responsibility to create the maximum values for the business. Both must understand and anticipate needs. Full benefit can be realized only if each meets commitments to the other.

In 1997, Lubrizol focused on working with customers to find ways to reduce complexity in all parts of the relationship: technology, operations, logistics, marketing and services. The sharing of ideas and identification of opportunities was a joint initiative between Lubrizol and its customers. As complexity was reduced, costs were lowered and these savings were shared. Customers contributed to the relationship by committing a greater portion of their business to Lubrizol for a longer period of time. This type of relationship creates more value for both parties than with the traditional vendor/buyer transaction.

Lubrizol expects to build on these successful relationships and to continue to grow its market share.

Expanding geographically is not new to Lubrizol. Global supply is a core competency and has been practiced by the company for more than 50 years. Approximately 60 percent of revenues are derived from sales outside North America in 107 countries on 7 continents. As part of the company's strategy for growth, geographic expansion became an area of renewed focus and results in 1997. Lubrizol's worldwide shipment volumes grew 17 percent. This growth rate was exceeded in Asia-Pacific, Eastern Europe, the Middle East and Latin America.

Growing the Business



Despite the recent uncertainty about Asian financial markets, economic growth in the region will continue, and Lubrizol continues to focus on strategies to participate in this growth. In 1997, the company and its partner, Sinopec Lanzhou Petroleum Processing Complex, started blending operations in Tianjin and Lanzhou, China. These joint ventures provide Lubrizol an important supply base to service the needs of the expanding Chinese economy. They complement other Lubrizol production facilities located in Japan, Singapore, Australia and India, and a technical center in Japan.

The company continues to evaluate resource requirements for the region with the goal of doubling its Asia-Pacific business by 2005. To do this, Lubrizol is building on its current market leadership by focusing on global and regional customer relationships.

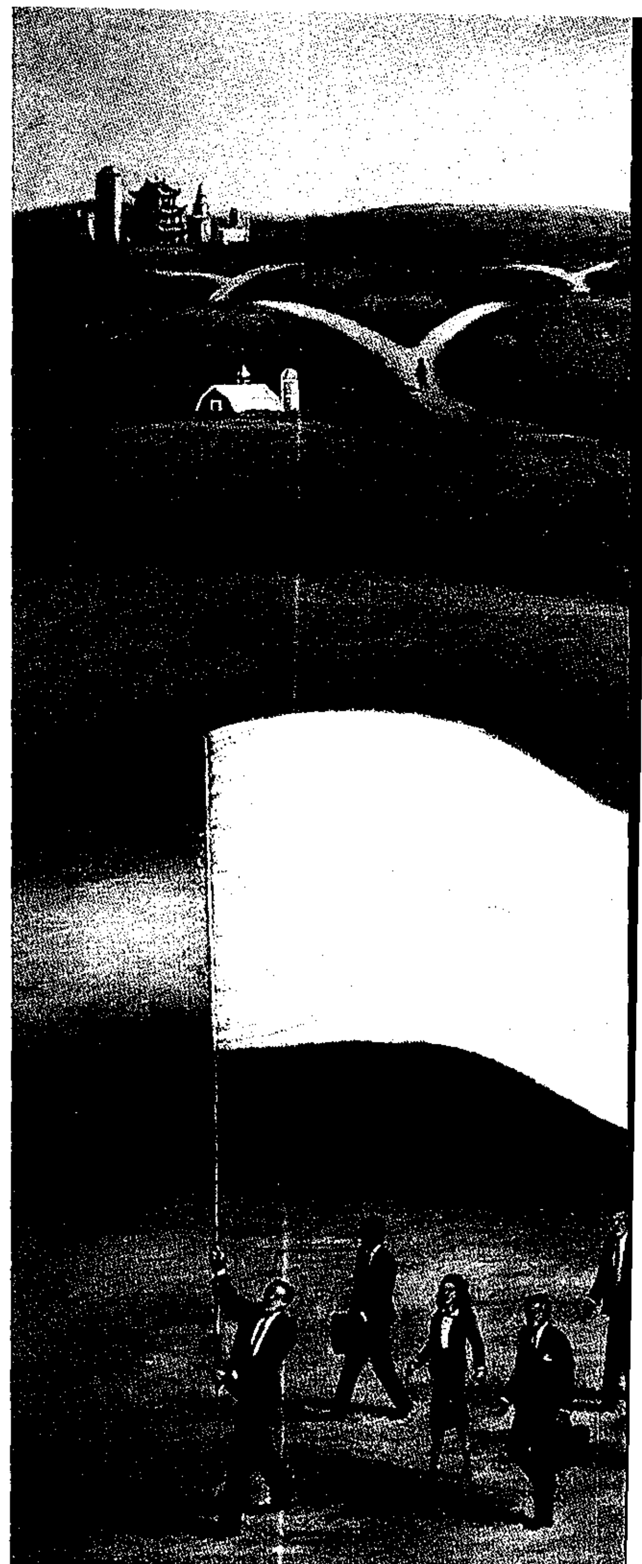
The company will also be investing in opportunities to improve its service capabilities in the Asia-Pacific region. For example, negotiations are under way to obtain management control of the company's joint venture in India. In 1998, Lubrizol will also focus on growth opportunities in Latin America.

Selected market segments were another growth area in 1997. Lubrizol sells products into more than 20 different end-use markets, such as engine oils, transmission fluids, gear oils, coatings and greases. Three of these market segments were targeted for particular emphasis in 1997: metalworking additives, viscosity modifiers and fuel products.

Lubrizol has set a goal to become the global leader in metalworking additives. Acquisitions represent an important element of this growth initiative. In 1997, the company acquired the Gateway Additive Company, located in Spartanburg, South Carolina. Gateway, with annual sales of $12 million, specializes in the development and supply of performance additives to the metalworking fluids and industrial lubricants markets. Early in 1998, Lubrizol also acquired the business assets of Carl Becker Chemie GmbH and Co., located in Hamburg, Germany. Becker Chemie, with annual sales of $15 million, is a leading supplier of specialty additives to the metalworking fluids and industrial lubricants markets in Germany and throughout the European Union. These two acquisitions, which bring strong water-based technology, will be combined with Lubrizol's strong oil-based business into a new metalworking additives division. Sales of this division are approximately $50 million and are expected to grow to more than $100 million in several years.

Lubrizol's efforts to increase sales of viscosity modifiers were particularly successful in 1997. These products are manufactured under exclusive contracts by world-class polymer producers who, under Lubrizol's direction, modify the performance characteristics of the polymers. The company markets these viscosity modifiers in combination with its detergent/inhibitor additives to provide the lowest cost total formulation to customers. This combined approach adds value to customers' businesses by providing a single source for all their additive needs and by ensuring product integrity using a total systems approach for supply. In 1997, Lubrizol increased its shipments of viscosity modifiers more than 30 percent.

Fuel products, while a relatively small portion of Lubrizol's total sales, are an important adjunct to the company's lubricant additives business. The interrelationship between fuel and lubricant additives in engine equipment is an area of growing technical interest. As the world's largest additives supplier, Lubrizol is committed to maintaining technical leadership in this important area. The company continues to invest in personnel and equipment, as well as new technology, to meet the needs for fuel additives tomorrow and beyond. The company is making progress in growing its share of the fuel additives market.



Building the Franchise

Long-term growth for Lubrizol depends upon the ability of the company and its management to continually renew and revitalize the business. While maintaining a sharp focus on its traditional markets and customers, the company also has been carefully developing skills and evaluating opportunities to build the franchise for the future.

Lubrizol has been moving into new markets where it can use the company's competencies of problem solving, combining components and global supply. Although this effort is not new, it has become more focused over the past several years. For example, the coating additives industry is consolidating globally, and Lubrizol has the ability to become a market leader. With sales of nearly $40 million in this area, the company has been expanding resources and technology to become a larger participant in this global market. The sales and distribution base has been expanded in Asia and Latin America, new rheology control products are being introduced to customers and Lubrizol is working more closely with powder coating manufacturers developing specialized new products. In 1997, Lubrizol entered into a partnership agreement with EFKA Chemicals B.V. of Hillegom, Netherlands, to be the exclusive distributor and technical service representative for EFKA products for paints, coatings and inks in North America. Early in 1998, Lubrizol acquired the Brazilian coating additives business of BetzDearborn Brasil, Ltda., which includes a product line of defoamers, dispersants and biocides. The company is continuing to evaluate other acquisition opportunities in coating additives and is planning to grow this business to at least $100 million in sales over the next several years.

- Move into New Markets
- Redefine the Role of Technology
- Create a Culture for Success

Higher performance and environmental standards for fuels and lubricants are providing opportunities to integrate fluid monitoring, precision metering, automated maintenance and emission control with traditional additive technology. This performance system market segment is a promising area of new growth for Lubrizol.

In 1997, Lubrizol acquired Hyrolec Management Limited of Fareham, Hampshire, England, which specializes in additive injection and monitoring systems for bulk liquid terminals. Lubrizol will operate Hyrolec as a separate subsidiary establishing a European base for Lubrizol's equipment-related business. Also in 1997, Lubrizol acquired Unikat AB of Malmo, Sweden, which manufactures emission control systems in the growing Scandinavian and European markets. These acquisitions complement the company's existing performance system businesses—Gate City Equipment Company, Inc. and Engine Control Systems, Ltd. They will increase Lubrizol's capability to provide integrated equipment solutions to both OEMs and terminal operators and form a market core for the development of products related to fluids, fluid management and emission control. These businesses, with total revenues of $30 million, are expected to grow to more than $50 million within several years.

A third new market is refrigeration lubricants for non-CFC refrigerants. Late in 1996, Lubrizol acquired CPI Engineering Services, Inc., which supplies specialty industrial lubricants and refrigerant lubricants to OEMs in several niche markets. During 1997, Lubrizol's own synthetic refrigerant lubricant business was assimilated into CPI Engineering Services. Sales of $30 million should exceed $50 million within several years.

Building the franchise also involves redefining the role of technology for the future. Beginning in 1996, it was recognized that the traditional model for technology investment, which had served the company well for nearly 70 years, was becoming less effective. In 1997, this model was challenged and revised in order to increase the competitive advantage resulting from technology expenditures.

Today, the opportunities pursued by Lubrizol are more closely reviewed to ensure that the risks and technical costs are matched with opportunities for adequate financial return. Complexity of product performance testing had led to an increase in technical spending as a percent of sales. Given the growth characteristics of Lubrizol's traditional business, this level of spending was not sustainable. A balanced portfolio of projects aligned with the business strategy is now being used to select and prioritize technology investment opportunities.

In 1995, technical spending was 12 percent of sales. By 1997, technical spending was reduced to about 8 percent of sales without compromising support for the business.

Selecting new chemistry as the first option to solve problems can also be costly and time-consuming. This can limit the ability to meet customers' needs in price, quality and service. Today, Lubrizol is using its capabilities in formulation, process control and testing before selecting new chemical options to solve problems. This allows a quicker response to opportunities at a lower cost.

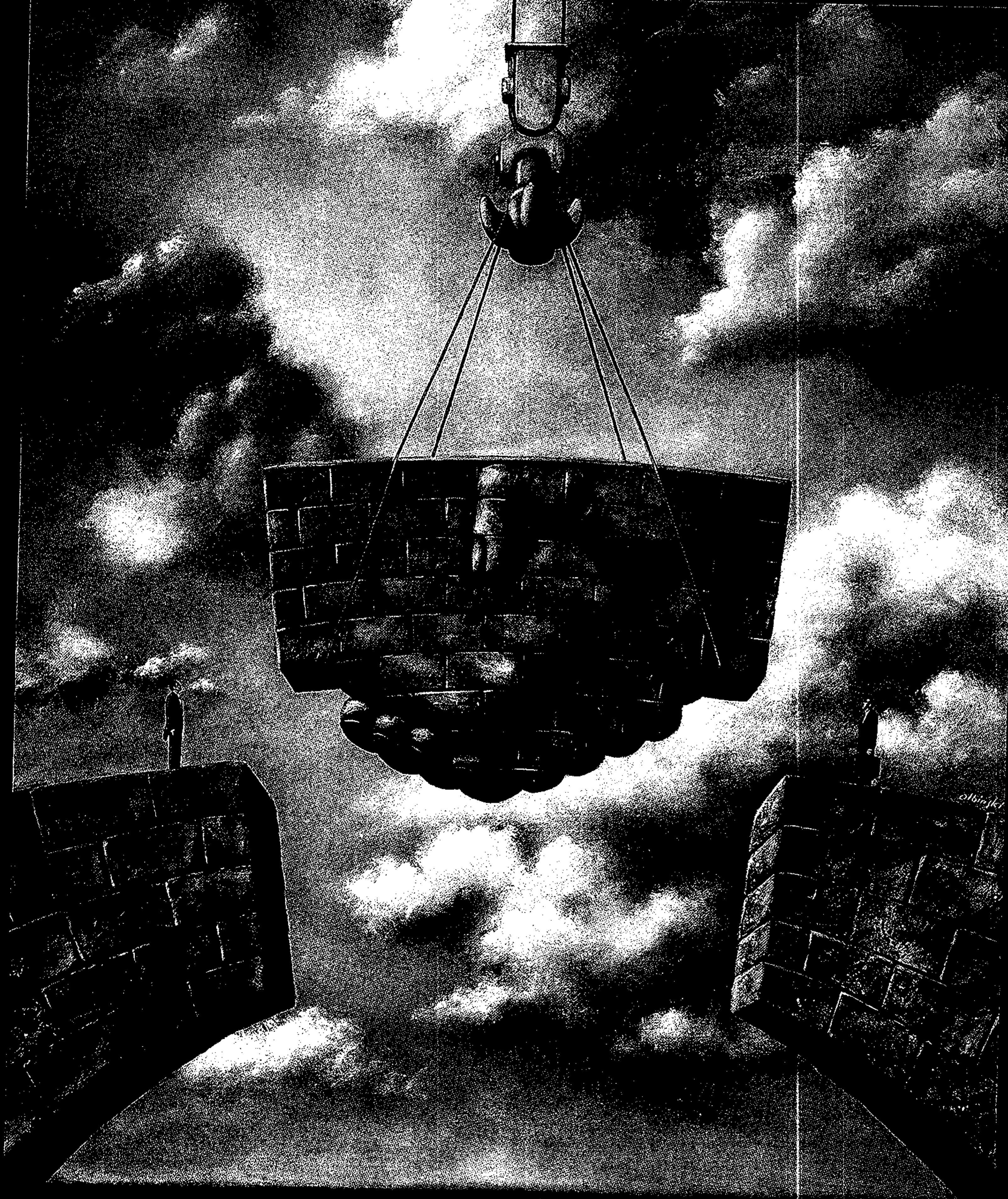
Building the Franchise

Building the franchise requires the proper culture for success. For Lubrizol, this culture includes leadership, ethics, compensation and change-management.

Leadership characteristics underpin everything. In 1997, the company completed a leadership development model for personal and organizational growth. It uses existing tools, such as performance planning and succession planning, along with new concepts related to adaptability to change, team performance and goal alignment. Built upon this leadership base is a very strong commitment to ethical values. Lubrizol insists upon doing the right things the right way and requires a shared accountability for ethics. This philosophy is in place and audited worldwide.

Aligning reward strategies with business strategies was an important area for cultural focus in 1997. Significant changes in executive and key manager compensation strategy were implemented during the year. Systems were put into place aligning expectations and behaviors with identified rewards and consequences.

Finally, change-management is a skill that is vital for a successful culture in today's business environment. Economic and technical change is putting pressure on people and organizations to adapt to new conditions faster and more frequently. Responding to these conditions, Lubrizol has developed a change-leadership process to help employees as they learn to adapt to the culture required to build the company's franchise.



Improving the Structure

- Reduce Complexity
- Reduce Conversion Costs
- Improve the Process

In 1997, Lubrizol continued to improve the way work is performed in the company. This is an essential strategy to provide customers more value for less cost.

Reducing complexity is a requirement to compete in rapidly changing, highly competitive markets. The company can no longer afford the high costs associated with product complexity. Lubrizol offers approximately 1,100 products using 280 components and 450 raw materials. These products are manufactured in more than 100 component production units and require extensive performance approvals using multiple, customized testing programs. Overall, complexity contributes significantly to operating costs.

The company is improving control of these costs through a complexity reduction initiative, which has two parts: complexity avoidance in product development and complexity removal in the current product portfolio. This initiative must be balanced with the need to maintain and continue to grow a healthy business.

To avoid complexity, Lubrizol is using a product platform concept. A platform is a family of products formulated from a common group of components that meet market needs and customer requirements. The platform concept provides a technology-driven framework for product line management using a new, disciplined development process. More emphasis is being placed on complexity avoidance earlier in the product development cycle. This results in fewer new components and increases formulating discipline, which increases usage of existing components that meet the needs of different market segments. The net result is fewer platforms, products and components.

Removing complexity from the current product portfolio represents an immediate opportunity to lower costs. Hundreds of current products account for, in aggregate, only 1 percent of gross profit. To eliminate these products, Lubrizol is using product substitutions and encouraging customers to consider alternative products.

Complexity reduction at Lubrizol is a three- to five-year effort. Progress is being made using rigorous product line management, enhanced formulating discipline, product substitutions and selective price increases. Lubrizol and industry-initiated product upgrades will also provide opportunities to reduce existing product complexity. The company intends to reduce product platforms more than 30 percent and finished products more than 40 percent by 2001. In 1997, significant progress was made toward these goals with platforms and products each being reduced 10 percent.

In 1997, Lubrizol achieved a 17 percent increase in product shipments while holding manufacturing conversion costs essentially flat. **Reducing conversion costs** has contributed strongly to the company's improved financial performance over the past two years. Economy of scale and increased product throughput have helped lower production costs per ton. Lubrizol's global manufacturing system has been restructured to accommodate increased shipment volumes and faster customer service. Throughput at the company's largest plants in Texas, France and Singapore has been optimized to keep overall costs low. Manufacturing process improvements, such as in-line blending, continuous process units and distributive control systems, have helped increase productivity. Reduction of complexity has helped lower conversion costs.

Reducing conversion costs is more than just the production process itself. For example, through supplier-managed inventories, Lubrizol is able to have more efficient control of the supply chain to its customers. Likewise, the company is working more closely with its own suppliers to improve raw material quality and processing yields. Outsourcing of production or services, such as product drumming, is being embraced as another way to hold down costs for processes that can be better performed by third parties.

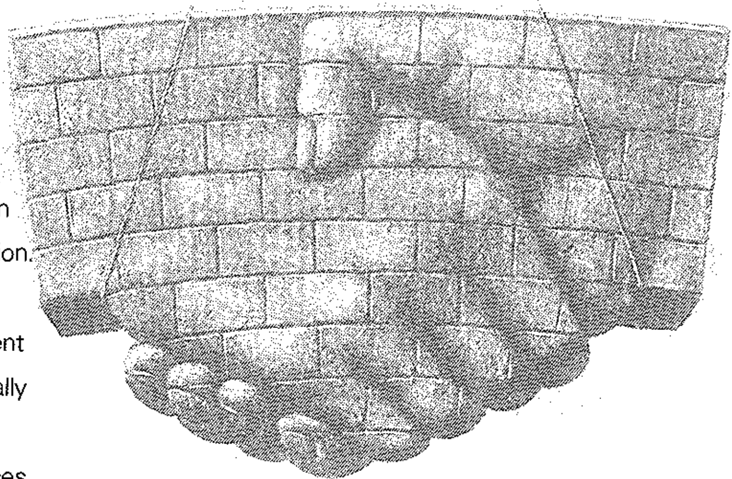
Conversion costs also have been reduced as a result of the company's commitment to Responsible Care® Pollution prevention reduces waste at the source and identifies opportunities to recycle by-products, thereby increasing product yields and eliminating disposal costs. In addition, system reliability is improved, which increases production capacity.

Customer demands are increasing in the areas of price, quality and service, which is directly impacting the need for product uniformity. Quality management practices and ISO-9000 certifications have helped the company evolve new computerized process modeling and predictive tools to increase equipment utilization and process yields. All of these efforts have contributed to a 13 percent reduction in manufacturing conversion costs per ton achieved in 1997.

Improving the Structure

To improve the process of how Lubrizol operates globally, the company committed in 1997 to implement the Lubrizol Integrated Knowledge Systems (LINKS). This is an initiative to increase worldwide standardization and integration of information systems. This globally integrated information system consists of two parts: a new product approval process and a new enterprise resource planning system based upon SAP R/3 software. The implementation of LINKS is a multiyear project with the system becoming operational in the U.S. in the first half of 1998, in Europe by mid-1999 and in the rest of the world thereafter.

LINKS supports the corporate strategy to improve the company's structure by reducing complexity and increasing efficiency. By simplifying and standardizing our systems, our customers will benefit from the ease and speed of doing business with Lubrizol. This improved flow of information is critical for Lubrizol's global alliances with customers. LINKS will provide immediate, worldwide access to information so that resources will be shared, and processes and information will be integrated across global sites. LINKS will bring a more cross-functional, cross-national approach to Lubrizol's business.



System design and preparation for LINKS was a major focus of the company in 1997. Capital costs associated with the U.S. installation of SAP R/3 amounted to approximately $28 million. Similar expenditures are anticipated in 1998. The company expects a return on this investment in terms of lower costs beginning in 1999. Equally important, as a result of LINKS, Lubrizol will improve its ability to deliver products and services cost-effectively to customers, on time, worldwide.

Management's Discussion and Analysis of Financial Condition and Results of Operations

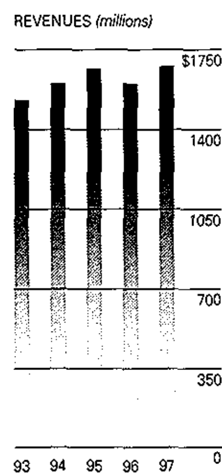
The Lubrizol Corporation is a full-service supplier of performance chemicals and products to diverse markets worldwide. Principally, the company develops, produces and sells specialty additive packages used in transportation and industrial finished lubricants such as gasoline and diesel engine lubricating oils, automatic transmission fluids, gear oils, marine and tractor lubricants, fuel products and industrial fluids. The company's additive packages are generally produced in shared manufacturing facilities and sold largely to a common customer base. These specialty chemical products are created through the application of advanced chemical and mechanical technologies to enhance the performance, quality and value of the products in which they are used. The company also produces and supplies coatings additives, refinery and oil field chemicals, specialty monomers, process chemicals, synthetic refrigerant compressor lubricants, fluid metering devices and particulate emission trap devices.

The company estimates the growth rate of the lubricant additive industry is approximately 1% per year. This aggregate growth rate includes mature markets such as North America and Europe, where the majority of the company's business is located, and faster growing markets such as Asia-Pacific and Latin America. The overall growth rate has declined in recent years due to market forces such as improved engine design, longer drain intervals and product specification changes. In addition, customers continue to search for stronger, longer-term relationships with a few key suppliers for help in improving the quality and performance of their products and services and reducing overall costs. These factors, along with excess production capacity within the lubricant additive industry, are causing a more competitive marketplace in certain product lines and continuing pressure on selling prices for the company's products. The company expects this competitive marketplace to continue in 1998.

The company has been responding to these challenges. It has entered into and will continue to actively pursue strategic relationships with its customers, the finished lubricant suppliers, in order to increase its share of its customers' business, eliminate redundant costs and jointly pursue growth in developing regions of the world. The company also has various short-term and long-term initiatives relating to its cost structure, such as further consolidation of intermediate production and continuing simplification of its product lines, to further enhance its competitiveness and market leadership position. Progress on these initiatives has resulted in a more cost-efficient organization, and the company believes it is well positioned to compete in the current industry environment and gain additional market share from these opportunities. In addition to growth through market share gains in its traditional business, the company has continued to pursue growth opportunities in certain selected markets. Business growth has been achieved in these markets through acquisitions and application of technologies.

1997 RESULTS OF OPERATIONS

In 1997, the company made significant progress with each of its strategies to grow its business, improve its cost structure and build its franchise. During 1997, revenues increased 5% as product shipments increased 17% over 1996 and the company's market share grew. The company continued its focus to improve its cost structure as operating expenses were flat versus 1996, even with significantly higher production throughput. Net income per share in 1997 increased 20%, after excluding from 1996 the gain on investments. This record performance was achieved despite the unfavorable effect on earnings of the stronger U.S. dollar.

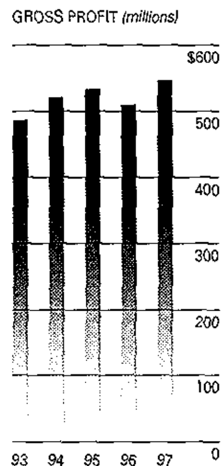


In 1997, the company had record revenues of $1.67 billion, an increase of $76.2 million over 1996. Increased revenues resulted from a 17% increase in specialty chemical shipment volumes (contributing a 15% increase in consolidated revenues), partially offset by a 10% decline in the average selling price. Although the average selling price stabilized during the second half of the year, the full-year decline for 1997 was attributable approximately 50% to changing product mix, 30% to unfavorable currency effects and 20% to lower product pricing. The unfavorable product mix effect resulted from volume gains in product lines having lower than the overall average selling price. On balance, the company's acquisition/divestiture activity did not significantly affect 1997 annual revenues as recent acquisitions offset a prior year disposition. However, acquisitions contributed one-fourth, or $11.4 million, of the 13% increase in consolidated revenues for the fourth quarter of 1997 compared with the fourth quarter of 1996.

A primary strategy of the company in 1997 was to grow its business. The company is having success building global and regional alliances with targeted customers and is actively pursuing additional strategic relationships with finished lubricant suppliers. As compared with 1996, sales volume increased throughout the year. Higher sales volumes were realized in all geographic zones and across a broad customer base. In 1997, sales volume increased 14% to North American customers and 18% to international customers, primarily in Asia-Pacific, Western Europe and Latin America. The growth in sales volume was derived principally from market share gains within established markets rather than overall industry growth.

The company believes the steps it has taken over the past several years have improved its competitive position and led to strong growth in sales volume during 1997. However, the market forces, competitive pressures and economic uncertainty in Asia will continue to present challenges in 1998. In late 1997, currency devaluations, market downturns and general financial uncertainties in Asia have caused economic growth forecasts for this region to be significantly revised for 1998. Although the company believes the economic fundamentals throughout most of the region remain positive for the longer-term, the still developing situation could dampen demand within the region for finished lubricant additives in 1998. The company believes all of these challenging conditions will likely reduce the rate of sales volume growth in 1998.

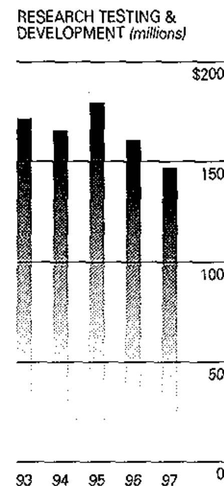
Cost of sales reflects the higher sales volume as well as lower average raw material costs and level manufacturing costs. Compared with the respective prior year periods, average material costs, including favorable currency effects and the impact of less expensive product mix, were 10% lower in the first half of 1997, 6% lower in the second half of 1997 and 8% lower for the year. The company's manufacturing costs do not fluctuate significantly with changes in production volume. The effects of the company's ongoing manufacturing rationalization program and other cost management initiatives have improved manufacturing efficiency as the company is operating fewer manufacturing units at higher capacity levels. Manufacturing costs, aided by currency effects, were flat in 1997 compared with 1996, even though production activity was significantly higher in 1997 and the company resumed pay increases following the salary freeze in effect during 1996.



Gross profit (sales less cost of sales) increased $36.2 million, or 7%, in 1997 compared with 1996. This improvement in gross profit amount was after unfavorable currency effects of $20 million, which occurred evenly over the four quarters. Acquisition/divestiture activity contributed $13.0 million to the increase in gross profit for 1997. Gross profit improved to 32.7% of sales in 1997 compared with 32.0% in 1996 as manufacturing efficiencies, lower material costs and the effect of acquisition/divestiture activities more than offset the effect of lower average selling price. Gross profit was 31.4% during the second half of 1997 due to sequentially lower average selling price, higher material costs and the effect of asset impairment losses of $4.4 million principally in the fourth quarter. The company believes the gross profit percentage for the full year 1998 will be approximately the same as the full year 1997.

Selling and administrative expenses increased $12.6 million, or 8%, in 1997 compared with 1996. These expenses, which were higher in the second half of the year compared with the first half, increased primarily due to higher patent-related litigation expenses, the effect of acquisitions, incremental expenses related to the implementation of the new enterprise-wide management information system and increased variable compensation as a result of higher earnings.

During 1997, research, testing and development expense (technology expense) decreased $14.3 million, or 9%, from 1996. Product standards change periodically as engine and transmission designs are improved by the equipment manufacturers to meet new emissions, efficiency, durability and other performance factors. These changes influence the timing and amount of the company's technology expense. The lower spending level in 1997 was due to the timing of testing programs particularly within the engine oil and gear oil product lines, greater internalization of testing activity that reduced outside testing requirements and workforce reductions. The company's technology expense in 1997 includes some costs related to new performance specifications for heavy-duty engine oils which are expected to become effective during 1998 and new performance specifications for passenger car engine oils expected to become effective during 2000. The company expects its technology expense in 1998 will be slightly higher than in 1997.



As discussed in Note 17 to the financial statements, in 1997, the company provided $9.4 million for the impairment of long-lived assets. These charges related to a shutdown of an intermediate manufacturing system and the write-off of certain computer equipment and legacy software systems that will be disposed of due to the computer equipment standardization project and the new enterprise-wide management information system being implemented.

Primarily as a result of these factors, consolidated revenues increased $37.7 million more than the increase in total costs and expenses in 1997.

Interest income in 1997 was lower than in 1996 as proceeds from the 1996 sale of investments (discussed below) were temporarily invested in interest-bearing instruments until used in the company's share repurchase program. Interest expense in 1997 was level with 1996. The average daily balance of total debt outstanding during 1997 was $195 million as compared with $188 million in 1996.

The company transacts business in over 100 countries and has a number of operating facilities in countries outside of the United States. As a result, the company is subject to business risks inherent in non-U.S. activities, including political and economic uncertainty, import and export limitations, exchange controls and currency fluctuations. The company believes risks related to its foreign operations are mitigated due to the political and economic stability of the countries in which its largest foreign operations are located. While changes in the dollar value of foreign currencies will affect earnings from time to time, the longer term economic effect of these changes should not be significant given the company's net asset exposure, currency mix and pricing flexibility. As the U.S. dollar strengthens or weakens against other international currencies in which the company transacts business, the financial results of the company will be affected. The principal currencies, other than the U.S. dollar, in which the company

transacts business are the French franc, German deutsche mark, British pound sterling and Japanese yen. The U.S. dollar continued to strengthen during 1997, causing an unfavorable effect on net income of approximately $10 million, or $.17 per share.

As a result of the factors discussed above and after excluding from 1996 the gain on investments, income before income taxes increased 17%, or $33.8 million, from 1996. The company adjusted its tax provision in the third quarter of 1997 to reflect a legislated increase in the statutory tax rate applicable to its earnings in France, where the company has significant operations. This adjustment resulted in an effective tax rate of 33.0% for the full year 1997 as compared with 31.5% in 1996, after excluding the 1996 gain on investments on which a 35% tax rate applied. The higher effective tax rate reduced net income by $3.5 million, or $.06 per share in 1997. The company anticipates that the 1998 consolidated effective tax rate will increase to approximately 34.5%.

Net income in 1997 was $154.9 million, or $2.68 per share. In 1996, net income was $169.8 million, or $2.80 per share, which included investment gains. After excluding from 1996 the non-recurring gains, net income in 1997 was 15% higher than the $135.2 million for 1996. On this same basis, net income per share was 20% higher than the $2.23 per share for 1996, reflecting the company's share repurchase program.

1996 RESULTS OF OPERATIONS

In 1996, management of the company took action early in the year to improve its cost structure as part of its continuing efforts to enhance its efficiency as an additive supplier. Although revenues in 1996 declined 4% from 1995, this was offset by the effects of aggressive cost management and management's focus on strengthening of customer and supplier relationships. In addition, lower working capital, significantly reduced capital expenditures and the sale of non-strategic investments resulted in improved cash flow and enabled the company to repurchase 7% of its common shares outstanding during 1996. As a result, the company was able to grow net income and net income per share, despite unfavorable currency effects.

Consolidated revenues were $1.60 billion in 1996, a decrease of $66 million, or 4%, from record 1995 levels. Volume in 1996 was equal with 1995 despite the introduction of a new industry specification discussed below. Revenues decreased 2% due to price/mix effects and 1% due to unfavorable currency effects. In addition, the sale of the specialty vegetable oil business in September 1996 reduced consolidated revenues by 1% as compared with 1995.

During 1996, new passenger car engine oil additives were introduced to meet a new U.S. industry specification. Most of the company's customers converted to this new specification by September 1996. This new specification required approximately 10% less additive than the prior specification, and the company estimates that it negatively impacted annual sales volume in North America by 2% in 1996 (1% worldwide). However, other volume gains, primarily in heavy duty engine oils, more than offset the impact from the new specification and overall volume in North America increased 1% over 1995. Internationally, volume declined 1%, as growth in Asia-Pacific was offset by lower volume in Western Europe.

Gross profit of $509.5 million was $13.5 million, or 3%, lower in 1996 compared with 1995. Excluding the effects of the $9.5 million asset impairment in 1995 (discussed below), gross profit in 1996 was $23.0 million lower than in 1995. Unfavorable currency effects accounted for one-half of this decline with the balance attributable to lower revenues. However, the company aggressively managed its procurement costs of raw materials and continued its cost management efforts under the manufacturing rationalization initiative discussed below. These efforts lowered the cost of production to maintain 1996 gross profit as a percent of sales at 32.0%, compared to 32.1% in 1995 (excluding asset impairment).

The company continued to lower its operating costs through aggressive cost management. This included a worldwide freeze on salary increases and hiring throughout all of 1996 and the manufacturing rationalization and organizational realignment initiatives that began in 1993. Employee levels, excluding acquisitions and divestitures during the year, were reduced by nearly 6% at December 31, 1996, compared with December 31, 1995, as retiring or departing employees were not replaced. The company's manufacturing costs and selling, administrative and technology expenses in 1996 were each lower than in 1995 and, in the aggregate, declined nearly 6%, or $40 million (excluding the effects of the 1995 asset impairment). Currency had a favorable effect on costs and accounted for approximately 25% of this reduction.

Technology expense decreased 10% in 1996 compared with 1995. In addition to the effects of cost management strategies discussed above, the decrease was due to reduced testing requirements for product specifications primarily within driveline and engine oils. The effect of currency on technology expenses was not significant.

Primarily as a result of the above factors, total costs and expenses declined $75.0 million in 1996 from 1995 ($65.5 million excluding the asset impairment), offsetting the revenue decline for the year.

During 1996, the company completed the divestiture of substantially all of its agribusiness assets comprised of its equity investment in Mycogen Corporation and the assets of the company's wholly-owned subsidiary, SVO Specialty Products, Inc. (SVO). These transactions generated cash proceeds of $149.0 million and, after losses on other investment activity, resulted in the $53.3 million ($34.6 million, or $.57 per share after taxes) gain on investments. (See Note 8 to the financial statements.) The company has substantially liquidated its non-strategic investments.

As discussed previously, the company conducts a significant amount of its business outside of the United States and is subject to certain related risks including currency fluctuations. The U.S. dollar strengthened during 1996 as compared with exchange rates in effect during 1995, particularly against the French franc, German deutsche mark and Japanese yen, causing an unfavorable effect on 1996 net income of $4.9 million, or $.08 per share.

Interest expense, net of interest income, declined $2.4 million in 1996 compared with 1995. Proceeds collected from the sale of investments were used to temporarily reduce commercial paper borrowings and acquire short-term investments until used in the company's share repurchase program. The average daily balance of total debt outstanding during 1996 was $188 million as compared with $203 million in 1995.

As a result of the factors discussed above, 1996 net income was $169.8 million, an increase of 12% or $18.2 million from 1995. Net income per share for 1996 was $2.80, or 18% higher than in 1995 and reflected the impact of the company's share repurchase program. Excluding the gains on investments from both years and the provision for asset impairment in 1995, net income increased to $135.2 million from $132.8 million in 1995, a 2% increase. The corresponding net income per share of $2.23 in 1996 was a 7% increase from the $2.08 earnings per share in 1995.

1995 RESULTS OF OPERATIONS

In 1995, the company grew revenues but, despite a strong first half, annual earnings declined compared with 1994. As discussed below, the primary factors contributing to the 1995 results were lower demand for engine oil additives particularly during the second half of 1995, the U.S. Government trade restrictions regarding sales to certain customers in the Middle East and the inability to maintain profit margins during a period of rising raw material costs.

Consolidated revenues were $1.66 billion, an increase of $64.6 million, or 4%, in 1995 compared with 1994. Price increases implemented in early 1995 and a more favorable product mix increased 1995 revenues by 3% and the translation of various international currencies, which strengthened during the period when compared with the U.S. dollar, increased revenues by 3%. Volume declined 2% from the 1994 level. Sequentially, revenues in the second half of 1995 were 5% lower than the first half due to lower volume (3%) and unfavorable price/product mix (2%).

For the year, sales volume declined in 1995 compared with 1994, principally in international markets. North American volume declined less than 1% from 1994. International volume declined 3% mainly because of the cessation of spot business with certain customers in the Middle East due to a U.S. Presidential Order restricting such trade. Excluding from the comparison this 1994 spot business, which occurred during the first half of the year, international volume increased 1%, and worldwide volume in 1995 was even with 1994. Sequentially, volume declined 3% in North America and 4% internationally in the second half compared with the first half of 1995 as demand for engine oil lubricants in North America and Europe weakened, causing lower additive shipment volumes.

Gross profit increased slightly to $522.9 million in 1995 from $520.7 million in 1994. Cost of sales in 1995 included a provision for asset impairment of $9.5 million recorded in the fourth quarter of 1995. This charge related primarily to an intermediate processing unit that became permanently impaired due to a change in product formulation caused by a new industry-wide product specification. Excluding the effect of this asset impairment, the amount of gross profit increased in 1995, despite lower volume, as higher average selling prices, aided by favorable currency and mix, more than offset an increase in average material cost of 9%, over half of which was due to the effects of currency and mix. However, gross profit as a percent of sales declined to 32.1% (excluding the asset impairment) in 1995 from 32.7% in 1994 as raw material costs increased faster than selling prices and, combined with slightly higher manufacturing costs and lower volumes, negatively impacted margin percentage. Sequentially, gross profit percentage declined to 30.5% (excluding the asset impairment) in the second half of 1995 compared with 33.6% in the first half due to the effect of unfavorable price/mix, less favorable currency, higher raw material costs and lower volume.

The company's manufacturing rationalization and organizational realignment initiatives have slowed the rate of increase in the company's cost and expenses. The company's manufacturing expenses (excluding the asset impairment), as well as its selling and administrative expenses, increased 3% in 1995 as compared with 1994. Excluding increases in expenses due to currency translation and an acquisition made during 1995, manufacturing costs and selling and administrative expenses were each level with the 1994 amounts.

Technology expenses increased 9% to $179.6 million. Technology expenses increased, as anticipated, due to worldwide testing programs for the engine oils, driveline oils and fuel products areas together with a greater emphasis on longer-term strategic research.

Primarily as a result of the above factors, total cost and expenses increased $16.5 million ($7.0 million excluding the asset impairment loss) more than the increase in total revenues in 1995.

The company sold all of its remaining shares of Genentech, Inc. common stock during the first half of 1995 and realized a pretax gain of $38.5 million ($.39 per share after taxes). During 1994, the company had a pretax gain on the sale of Genentech common stock of $41.2 million ($.41 per share after taxes).

Other income – net was $7.1 million in 1995 compared with $7.3 million in 1994 (see Note 9 to the financial statements). Other income was impacted by equity losses recognized from the company's investment in Mycogen Corporation and by other transactions involving Mycogen. The company recorded equity losses from Mycogen of $5.4 million in 1995 compared with equity losses of $.1 million in 1994. In late 1995, the company recognized a noncash gain of $4.5 million, representing an increase in the value of the company's ownership interest in the net assets of Mycogen, when Mycogen issued new common shares to another investor.

Interest expense increased $7.2 million in 1995 over 1994 as a result of higher average debt outstanding to meet the requirements of the capital expenditure and share repurchase programs. The average daily balance of total debt outstanding during 1995 was $203 million as compared with $111 million in 1994.

As discussed previously, the company conducts a significant amount of its business outside of the United States and is subject to certain related risks including currency fluctuations. During 1995, the U.S.

dollar weakened, primarily against the French franc, German deutsche mark and Japanese yen, when compared with exchange rates in effect during the year 1994. This resulted in 1995 net income being favorably impacted by approximately $.20 per share.

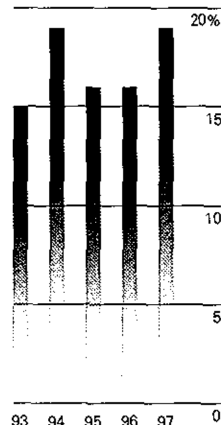
As a result of the factors discussed above, income before income taxes decreased 10%, or $25.9 million, from 1994. The company's 1995 effective tax rate was 32.8% as compared with the 1994 rate of 30.2%, which was lower than normal due to charitable donations of appreciated securities made by the company in 1994. After application of the 1995 higher effective tax rate, net income was $151.6 million in 1995, a decrease of 14% or $24.0 million from 1994.

Excluding the gains realized from sale of Genentech common stock in 1995 and 1994 and the provision for asset impairment in 1995, net income decreased 11% to $132.8 million in 1995 compared with $148.8 million in 1994. The corresponding earnings per share of $2.08 in 1995 declined 8% compared with $2.26 in 1994.

RETURN ON AVERAGE SHAREHOLDERS' EQUITY

Return on average shareholders' equity was 19% in 1997, 20% in 1996 (16% excluding gains on investments) and 18% in 1995.

RETURN ON EQUITY* *(percent)*
(Before Investment Gains, the 1995 provision for Asset Impairment and the 1993 Special Charge and Accounting Changes.)

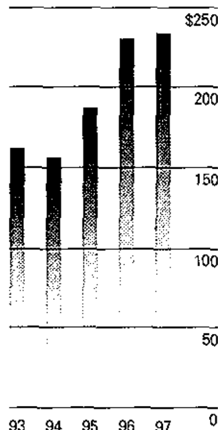


WORKING CAPITAL, LIQUIDITY AND CAPITAL RESOURCES

The company's cash flows for the years 1995 through 1997 are presented in the consolidated statements of cash flows. Cash provided from operating activities during 1997 was $234.4 million, a slight increase compared with $231.0 million in 1996 and a significant improvement over the $187.4 million in 1995. This improvement was primarily attributable to the benefits of the company's programs to modify its cost structure and reduce operating costs. In 1997, cash of $13.6 million was used to fund an increase in working capital, primarily receivables and inventory, to support the company's business growth during the year. During 1997 inventory turns improved significantly as inventory quantities remained flat compared with the prior year period even with higher sales volumes. Receivable balances increased in line with the higher revenues of the fourth quarter of 1997 versus the fourth quarter of 1996. The 1997 increase in accounts payable and accrued expenses reflects the increased operating activity between the comparative fourth quarters. In 1996, working capital changes generated cash from operating activities of $16.2 million, including approximately $24 million resulting from management efforts to reduce specialty chemical inventory levels and approximately $22 million related to liquidating inventories and receivables prior to the sale of the company's former specialty vegetable oil (SVO) business in September 1996.

Over the past several years the company has divested its marketable securities and its non-strategic assets, primarily agribusiness assets. The after-tax proceeds from these activities have generally been used in the company's share repurchase program discussed below.

CASH PROVIDED FROM OPERATING ACTIVITIES *(millions)*

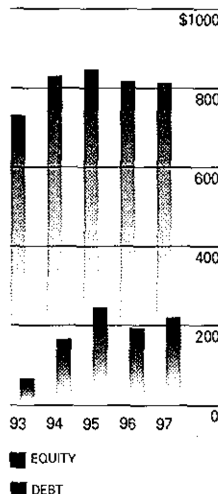


Proceeds from the sale of investments received during 1997 reflect $9.6 million from the sale of a non-strategic investment and $2.5 million collected on a promissory note from the 1996 sale of certain SVO technology rights. Proceeds from the sale of investments during 1996 were principally comprised of $126.2 million from the sale of Mycogen and $22.8 million from the sale of SVO assets. Proceeds from the sale of investments in 1995 were from the sale of Genentech common stock. (See Note 8 to the financial statements.)

The company has begun to implement a global enterprise-wide management information system and is standardizing its computer equipment among all of its major facilities. This project supports the company's strategy to improve its cost structure by reducing complexity and increasing efficiency. The project was initiated in 1996, and the company estimates it will require approximately four years to implement the system globally. This system, when fully implemented, will provide immediate, worldwide access to information so that resources will be shared and processes will be standardized and integrated across global sites. During 1997, the principal focus was to design and configure this system for the U.S. implementation. The company expects the system to become operational in the first half of 1998 at its major U.S. facilities, in mid-1999 at its major European facilities and subsequently at its other worldwide facilities. The return on this investment is expected to be realized, beginning in 1999, by reducing costs and delivering products and services more cost-effectively to the company's customers.

Capital expenditures in 1997 were $100.7 million compared with $94.3 million in 1996. Approximately 50% of 1997 (65% of 1996) capital expenditures pertained to manufacturing plants to enhance or maintain production capabilities, including maintaining facilities in compliance with environmental and safety regulations. Capital spending for environmental and safety projects totaled $7 million in 1997, $8 million in 1996 and $37 million in 1995. Approximately one-fourth of the 1997 capital expenditures pertained to the new enterprise-wide management information system being implemented by the company (as discussed above). Capital expenditures during 1995 were abnormally high as the company completed several large construction projects to enhance or maintain production and technical capabilities and expand its corporate administrative facilities. The company estimates capital expenditures for 1998 will approximate the 1997 amounts, including a similar amount for the continuation of the multi-year project to implement the new enterprise-wide management information system.

CAPITALIZATION *(millions)*



During 1997, the company invested $21.5 million in several acquisitions in the company's existing business areas of metalworking additives and performance systems. In December 1996, the company acquired a formulator of specialty synthetic lubricants used by original equipment manufacturers in air and refrigeration compressors, for $24.6 million. In addition, the company invested $2.1 million and $2.7 million in 1997 and 1996, respectively, in joint ventures in China.

The company maintains an active share repurchase program, and in June 1997 the company's Board of Directors authorized an additional 4 million shares under the program. During 1997, the company repurchased 1.8 million common shares, or 3% of its common shares outstanding at the beginning of the year, for $70.1 million. There were 4.7 million common shares remaining under the company's repurchase authorization at December 31, 1997. In 1996, the share repurchase program was increased to utilize the after-tax proceeds from the sale of investments as the company repurchased 4.5 million, or 7%, of its outstanding shares for $135.2 million. The company intends to repurchase approximately $80 million of its common shares during 1998.

Debt increased during 1997 primarily to finance several acquisitions and the increase in working capital. During 1996, improved cash flow and lower capital expenditures enabled the company to have net repayments of short- and long-term debt of $43.6 million. In June 1995, the company publicly issued $100 million of 7.25%, 30-year debentures and used the net proceeds to repay a portion of the commercial paper borrowings then outstanding. Debt as a percent of capitalization (shareholders' equity plus short- and long-term debt) was 21% at December 31, 1997, compared with 20% at December 31, 1996. The company believes its percentage of debt to capitalization will increase to 25% to 30% during 1998 in order to fund possible acquisitions and its share repurchase program.

The company's financial position continues to be strong with a ratio of current assets to current liabilities of 2.5 to 1 at December 31, 1997, compared with 2.6 to 1 at December 31, 1996. At December 31, 1997, the company had unused revolving credit agreements and other credit lines aggregating $95 million. As described in Note 5 to the financial statements, the company has the ability to refinance up to $56.6 million of its outstanding commercial paper on a long-term basis under existing revolving credit agreements. The company believes its credit facilities, internally generated funds and ability to obtain additional financing, if desired, will be sufficient to meet its future capital needs.

The company is involved in patent litigation with Exxon Corporation in various countries. Refer to Note 18 to the financial statements for further discussion regarding this litigation.

The company relies on its computer-based management information systems, as well as computer-based systems used for other purposes, in conducting its normal business activities. Certain of these computer-based programs may not have been designed to function properly with respect to the application of dating systems relating to the Year 2000. The company has a global "Year 2000" compliance strategy designed so that all of its computer-based systems, including process control, testing and laboratory equipment and embedded systems, will function without disruption with respect to dating system applications relating to the Year 2000. Implementation of the new enterprise-wide management information system is a key component of the company's strategy for its operation of particular computer-based systems without disruption in the Year 2000. In addition, the company is in the process of assessing the actions to be taken with respect to all of its other systems in order to avoid Year 2000-related disruptions and is targeting completion of all remedial activities by mid-1999. The company's compliance strategy includes obtaining assurance from other entities critical to its business, such as suppliers and customers, regarding their ability to operate their systems in the Year 2000. Except for expenditures related to the new enterprise-wide management information system (as discussed above), the company is not yet able to estimate the total costs of conducting its Year 2000 remedial activities. However, based upon information developed to date, the company believes it has adequate liquidity and capital resources to fund all remediation activities, and that (except for those costs related to the new enterprise-wide management information system) the total costs of Year 2000 remediation activities will not be material to the company's results of operations or financial condition. The company expects to complete its Year 2000 activities within a time frame that will enable its computer-based systems to function without significant disruption in the Year 2000.

CAUTIONARY STATEMENT FOR "SAFE HARBOR" PURPOSES UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This report, including Management's Discussion and Analysis of Financial Condition and Results of Operations and the letter "To Our Shareholders" from W. G. Bares, Chairman, President and Chief Executive Officer of the company, contains forward-looking statements within the meaning of the federal securities laws. As a general matter, forward-looking statements are those focused upon future plans, objectives or performance as opposed to historical items and include statements of anticipated events or trends and expectations and beliefs relating to matters not historical in nature. Such forward-looking statements are subject to uncertainties and factors relating to the company's operations and business environment, all of which are difficult to predict and many of which are beyond the control of the company, that could cause actual results of the company to differ materially from those matters expressed in or implied by such forward-looking statements.

The company believes that the following factors, among others, could affect its future performance and cause actual results of the company to differ materially from those expressed or implied by forward-looking statements made by or on behalf of the company:

- the overall demand for lubricant additives on a worldwide basis, which has a slow growth rate in mature markets such as North America and Europe;
- the lubricant additive demand in Asia-Pacific and Latin America, which has been growing at significantly higher rates than mature markets, along with lubricant additive demand in developing regions such as China and India, which geographic areas are an announced focus of the company's activities;

- the effect on the company's business resulting from the economic uncertainty within certain countries of the Asia-Pacific region;
- technology developments that affect longer-term trends for lubricant additives, such as: improved engine design, fuel economy, longer oil drain intervals and emission system compatibility;
- the company's success at continuing to develop proprietary technology to meet or exceed new industry performance standards and individual customer expectations;
- the frequency of change in industry performance standards, which affects the level and timing of the company's technology costs, the product life cycles and the relative quantity of additives required for new specifications;
- the rate of progress in continuing to reduce complexities and conversion costs and in modifying the company's cost structure to maintain and enhance its competitiveness;
- the success of the company in strengthening and retaining relationships with lubricant additive customers, growing sales at targeted accounts, and expanding geographically;
- the extent to which the company is successful in expanding beyond its core lubricant additives businesses;
- the recoveries, judgments, costs and future impact of legal proceedings, including those relating to intellectual property litigation with Exxon Corporation and its affiliates;
- the potential impact of consolidation among lubricant additive manufacturers;
- the relative degree of price pressure for lubricant additives;
- the cost, availability and quality of raw materials, including petroleum-based products, required for the manufacture of lubricant additives;
- the effects of fluctuations in currency exchange rates upon the company's reported results from its international operations, together with non currency risks of investing in and conducting significant operations in foreign countries, including those relating to political, social, economic, and regulatory factors;
- the ability to achieve and timing of cost efficiencies resulting from the multi-year program to implement the new enterprise-wide management information system;
- the ability of the company to operate its computer-based systems without significant disruption due to dating systems application in the Year 2000; and
- changes in significant government regulations affecting environmental compliance.

Independent Auditors' Report

Deloitte & Touche LLP

TO THE SHAREHOLDERS AND BOARD OF DIRECTORS OF THE LUBRIZOL CORPORATION

We have audited the accompanying consolidated balance sheets of The Lubrizol Corporation and its subsidiaries as of December 31, 1997 and 1996, and the related consolidated statements of income, shareholders' equity, and cash flows for each of the three years in the period ended December 31, 1997. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of The Lubrizol Corporation and its subsidiaries at December 31, 1997 and 1996, and the results of their operations and their cash flows for each of the three years in the period ended December 31, 1997 in conformity with generally accepted accounting principles.

Deloitte + Touche LLP

Cleveland, Ohio
February 5, 1998

Consolidated Statements of Income

(In Thousands of Dollars Except Per Share Data)	Year Ended December 31		
	1997	1996	1995
Net sales	$1,669,251	$1,592,877	$1,657,821
Royalties and other revenues	4,531	4,685	5,773
Total revenues	1,673,782	1,597,562	1,663,594
Cost of sales	1,123,602	1,083,394	1,134,875
Selling and administrative expenses	171,244	158,633	163,493
Research, testing and development expenses	146,678	160,978	179,649
Total cost and expenses	1,441,524	1,403,005	1,478,017
Gain on investments		53,280	38,459
Other income – net	5,104	6,012	7,150
Interest income	4,588	7,714	4,764
Interest expense	(10,803)	(10,955)	(10,376)
Income before income taxes	231,147	250,608	225,574
Provision for income taxes	76,278	80,806	73,959
Net income	$ 154,869	$ 169,802	$ 151,615
Net income per share	$2.68	$2.80	$2.37
Net income per share, diluted	$2.66	$2.79	$2.37
Dividends per share	$1.01	$ .97	$ .93

The accompanying notes to financial statements are an integral part of these statements.

Consolidated Balance Sheets

(In Thousands of Dollars)	December 31 1997	December 31 1996
ASSETS		
Cash and short-term investments	$ 86,504	$ 55,073
Receivables	273,505	238,401
Inventories	260,118	251,905
Other current assets	36,949	39,720
Total current assets	657,076	585,099
Property and equipment – at cost	1,513,824	1,529,187
Less accumulated depreciation	821,147	821,873
Property and equipment – net	692,677	707,314
Investments in nonconsolidated companies	25,904	29,821
Other assets	86,635	79,881
TOTAL	$1,462,292	$1,402,115
LIABILITIES AND SHAREHOLDERS' EQUITY		
Short-term debt and current portion of long-term debt	$ 38,095	$ 40,871
Accounts payable	127,347	99,676
Income taxes and other current liabilities	96,488	86,563
Total current liabilities	261,930	227,110
Long-term debt	182,165	157,628
Postretirement health care obligation	105,962	105,463
Noncurrent liabilities	42,878	47,284
Deferred income taxes	53,909	45,254
Total liabilities	646,844	582,739
Contingencies and commitments		
Preferred stock without par value – unissued		
Common shares without par value – outstanding 56,966,894 shares in 1997 and 58,522,676 shares in 1996	82,669	78,534
Retained earnings	773,184	744,310
Accumulated other comprehensive income (loss)	(40,405)	(3,468)
Total shareholders' equity	815,448	819,376
TOTAL	$1,462,292	$1,402,115

The accompanying notes to financial statements are an integral part of these statements.

Consolidated Statements of Cash Flows

(In Thousands of Dollars)	Year Ended December 31		
	1997	1996	1995
CASH PROVIDED FROM (USED FOR):			
OPERATING ACTIVITIES:			
Net income	$ 154,869	$ 169,802	$ 151,615
Adjustments to reconcile net income to cash provided by operating activities:			
Depreciation and amortization	87,217	80,964	74,247
Deferred income taxes	8,585	23,074	16,899
Provision for asset impairments	9,360		9,489
Gain on investments		(53,280)	(38,459)
Change in current assets and liabilities, net of acquisitions and dispositions:			
Receivables	(47,313)	9,834	(386)
Inventories	(16,919)	46,658	(7,885)
Accounts payable and accrued expenses	46,524	(38,693)	(3,768)
Other current assets	4,101	(1,610)	(175)
Change in noncurrent liabilities	(169)	(1,317)	(2,486)
Other items – net	(11,889)	(4,430)	(11,729)
Total operating activities	234,366	231,002	187,362
INVESTING ACTIVITIES:			
Proceeds from sale of investments	12,117	149,603	40,160
Capital expenditures	(100,700)	(94,297)	(189,259)
Acquisitions and investments in nonconsolidated companies	(23,636)	(27,309)	(3,521)
Other – net	5,164	4,357	3,654
Total investing activities	(107,055)	32,354	(148,966)
FINANCING ACTIVITIES:			
Short-term borrowing (repayment)	26,772	(52,890)	(18,676)
Long-term borrowing	5,572	28,425	100,064
Long-term repayment	(4,159)	(19,141)	(2,746)
Dividends paid	(58,469)	(59,033)	(59,414)
Common shares purchased, net of options exercised	(63,391)	(133,926)	(64,792)
Total financing activities	(93,675)	(236,565)	(45,564)
Effect of exchange rate changes on cash	(2,205)	(2,297)	1,368
Net increase (decrease) in cash and short-term investments	31,431	24,494	(5,800)
Cash and short-term investments at the beginning of year	55,073	30,579	36,379
Cash and short-term investments at the end of year	$ 86,504	$ 55,073	$ 30,579

The accompanying notes to financial statements are an integral part of these statements.

Consolidated Statements of Shareholders' Equity

(Dollars in Thousands)	Number of Shares Outstanding	Shareholders' Equity: Common Shares	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Total
BALANCE, DECEMBER 31, 1994	64,844,560	$84,059	$ 734,533	$ 13,447	$ 832,039
Comprehensive income:					
Net income 1995			151,615		151,615
Other comprehensive income (loss)				(10,465)	(10,465)
Comprehensive income					141,150
Cash dividends			(59,414)		(59,414)
Common shares – treasury:					
Shares purchased	(1,982,969)	(2,604)	(63,987)		(66,591)
Shares issued upon exercise of stock options	89,697	1,799			1,799
BALANCE, DECEMBER 31, 1995	62,951,288	83,254	762,747	2,982	848,983
Comprehensive income:					
Net income 1996			169,802		169,802
Other comprehensive income (loss)				(6,450)	(6,450)
Comprehensive income					163,352
Cash dividends			(59,033)		(59,033)
Common shares – treasury:					
Shares purchased	(4,496,427)	(5,982)	(129,206)		(135,188)
Shares issued upon exercise of stock options	67,815	1,262			1,262
BALANCE, DECEMBER 31, 1996	58,522,676	78,534	744,310	(3,468)	819,376
Comprehensive income:					
Net income 1997			154,869		154,869
Other comprehensive income (loss)				(36,937)	(36,937)
Comprehensive income					117,932
Cash dividends			(58,469)		(58,469)
Common shares – treasury:					
Shares purchased	(1,812,841)	(2,538)	(67,526)		(70,064)
Shares issued upon exercise of stock options	257,059	6,673			6,673
BALANCE, DECEMBER 31, 1997	56,966,894	$82,669	$ 773,184	$(40,405)	$ 815,448

The accompanying notes to financial statements are an integral part of these statements.

Notes To Financial Statements

(In Thousands of Dollars Unless Otherwise Indicated)

NOTE 1 – NATURE OF OPERATIONS

The Lubrizol Corporation is a full-service supplier of performance chemicals and products to diverse markets worldwide. Principally, the company develops, produces and sells specialty additive packages used in transportation and industrial finished lubricants such as gasoline and diesel engine lubricating oils, automatic transmission fluids, gear oils, marine and tractor lubricants, fuel products and industrial fluids. The company's additive packages are generally produced in shared manufacturing facilities and sold largely to a common customer base. These specialty chemical products are created through the application of advanced chemical and mechanical technologies to enhance the performance, quality and value of the products in which they are used. The company also produces and supplies coatings additives, refinery and oil field chemicals, specialty monomers, process chemicals, synthetic refrigerant compressor lubricants, fluid metering devices and particulate emission trap devices.

The company's sales and receivables are concentrated in the oil and chemical industries. The company's additive customers consist primarily of oil refiners and independent oil blenders and are located in more than 100 countries. Approximately 40% of the company's sales are made to customers in North America, 30% in Europe and 30% in Asia-Pacific, the Middle East and Latin America. The ten largest customers, most of which are international oil companies and a number of which are groups of affiliated entities, comprised approximately 44% of consolidated sales in 1997, 1996 and 1995. The largest single customer, including its affiliated entities, in each year accounted for 10% of sales in 1997, 1996 and 1995.

NOTE 2 – ACCOUNTING POLICIES

CONSOLIDATION – The consolidated financial statements include the accounts of The Lubrizol Corporation and its subsidiaries where ownership is 50% or greater and the company has effective controlling financial interest. For nonconsolidated companies (affiliates), the equity method of accounting is used when ownership, unless temporary, exceeds 20% and when the company has the ability to exercise significant influence over the policies of the investee.

ESTIMATES – The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions pending completion of related events. These estimates and assumptions affect the amounts reported at the date of the financial statements for assets, liabilities, revenues and expenses and the disclosure of contingencies. Actual results could differ from those estimates.

CASH EQUIVALENTS – The company generally invests its excess cash in short-term investments with various banks and financial institutions. Short-term investments are cash equivalents, as they are part of the cash management activities of the company and are comprised primarily of investments having maturities of three months or less when purchased.

INVENTORIES – Inventories are stated at cost which is not in excess of market. Cost of inventories is determined by the first-in, first-out (FIFO) method except for chemical inventories within the United States, which use the last-in, first-out (LIFO) method.

DEPRECIATION AND AMORTIZATION – Accelerated depreciation methods are used in computing depreciation on certain machinery and equipment which comprise approximately 25% of the depreciable assets. The remaining assets are depreciated using the straight-line method. The estimated useful lives are 10 to 40 years for buildings and land improvements and range from 3 to 20 years for machinery and equipment. Amortization of intangible and other assets is on a straight-line method over periods ranging from 5 to 25 years.

RESEARCH, TESTING AND DEVELOPMENT – Research, testing and development costs are expensed as incurred. Research and development expenses, excluding testing, were $88.4 million, $93.4 million and $104.9 million in 1997, 1996 and 1995, respectively.

FOREIGN CURRENCY TRANSLATION – The assets and liabilities of non-U.S. subsidiaries are translated into U.S. dollars at exchange rates in effect at the balance sheet date. Operating results are translated at weighted average exchange rates in effect during the period. Net unrealized translation gains (losses) are recorded as a component of other comprehensive income.

PER SHARE AMOUNTS – Net income per share is computed by dividing net income by average common shares outstanding during the period. Net income per share, diluted, includes the dilution effect resulting from outstanding stock options and stock awards. In February 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Standards (SFAS) 128 – Earnings Per Share, which became effective for the company's December 31, 1997, financial statements. Per share amounts determined in accordance with SFAS 128, which did not significantly affect previously reported amounts, are computed as follows:

	1997	1996	1995
Numerator:			
Net income available to common shareholders	$154,869	$169,802	$151,615
Denominator:			
Weighted average common shares outstanding	57,843	60,694	63,840
Dilutive effect of stock options and awards	386	109	221
Denominator for net income per share, diluted	58,229	60,803	64,061
Net income per share	$2.68	$2.80	$2.37
Net income per share, diluted	$2.66	$2.79	$2.37

SHARE REPURCHASES – The company has an active program to repurchase its common shares and utilizes the par value method of accounting for its treasury shares. Under this method, the cost to reacquire shares in excess of paid-in capital related to those shares is charged against retained earnings.

DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION – Under currently effective accounting standards, the company operates in a single reportable segment. Information regarding the industry in which the company operates, its customers and geographic areas is presented in Notes 1 and 14. In June 1997, the FASB issued SFAS 131 – Disclosures About Segments of an Enterprise and Related Information, which becomes effective for the company in 1998. SFAS 131 redefines how operating segments are determined and requires disclosure of certain financial and descriptive information about a company's operating segments. The company has not yet completed its analysis of SFAS 131 and accordingly has not yet determined what effect, if any, it may have on future financial statement disclosures.

NOTE 3 – INVENTORIES

	1997	1996
Finished products	$ 94,010	$ 88,176
Products in process	67,246	77,910
Raw materials	81,079	66,590
Supplies and engine test parts	17,783	19,229
	$260,118	$251,905

Inventories on the LIFO method were 29% and 25% of consolidated inventories at December 31, 1997 and 1996, respectively. The current replacement cost of these inventories exceeded the LIFO cost at December 31, 1997 and 1996, by $43.7 million and $49.1 million, respectively.

NOTE 4 – INVESTMENTS IN NONCONSOLIDATED COMPANIES

	1997	1996
Investments carried at equity	$25,039	$22,551
Investments available-for-sale		6,234
Investments carried at cost	865	1,036
	$25,904	$29,821

At December 31, 1996, the company held an investment in securities of a publicly traded company which was classified as available-for-sale and whose market value approximated its costs. In early 1997, these securities were sold, and the realized pretax gain on sale of these investments of $3.4 million was included in other income.

NOTE 5 – SHORT-TERM AND LONG-TERM DEBT

	1997	1996
Long-term debt consists of:		
7.25% debentures, due 2025	$100,000	$100,000
Debt supported by long-term banking arrangements:		
Commercial paper at weighted average rates of 6.4%	35,000	
6.5% Marine terminal refunding revenue bonds, due 2000	18,375	18,375
Term loans:		
Dollar denominated, at 5.0%, due 2000	5,544	
Yen denominated, at 2.0% to 5.8%, due 1998 - 2002	19,450	26,232
Deutsche mark denominated, at 4.9% due 1999	14,460	16,884
Other 4.3%, due 2004 - 2008	366	403
	193,195	161,894
Less current portion	(11,030)	(4,266)
	$182,165	$157,628
Short-term debt consists of:		
Commercial paper at weighted average rates of 6.4% and 6.0%	$ 18,900	$ 34,200
Other short-term debt at weighted average rates of 1.4% and 3.3%	8,165	2,405
Current portion of long-term debt	11,030	4,266
	$ 38,095	$ 40,871

The company publicly issued debentures in June 1995 in the aggregate principal amount of $100 million. These debentures are unsecured, senior obligations of the company that mature on June 15, 2025, and bear interest at an annualized rate of 7.25% payable semiannually on June 15 and December 15 of each year. The debentures are not redeemable prior to maturity and are not subject to any sinking fund requirements.

Commercial paper debt is due within one year. The company has credit facilities, which were unused at December 31, 1997, aggregating $95 million, including $75 million in committed revolving credit agreements which would permit the company to borrow at or below the U.S. prime rate. These facilities permit the company to refinance for a period beyond one year the amount due under the Marine Terminal Refunding Revenue Bonds, whose bondholders have the right to put the bonds back to the company, and up to $56.6 million of commercial paper borrowings. Accordingly, the company classified the portion of commercial paper borrowings expected to remain outstanding throughout the following year as long-term at each balance sheet date.

Amounts due on long-term debt are $11.0 million in 1998, $19.0 million in 1999, $26.2 million in 2000, $1.4 million in 2001, $35.4 million in 2002 and $100.2 million thereafter.

The company has an interest rate swap agreement that effectively converts variable rate interest payable on $18.4 million of Marine Terminal Refunding Revenue Bonds due July 1, 2000, to a fixed rate of 6.5%. The company also has interest rate swap agreements, which expire in March 2005, that exchange variable rate interest obligations on a $50 million notional principal amount for a fixed payment obligation of 7.6% (see Note 15).

Interest paid, net of amounts capitalized, amounted to $10.9 million, $10.4 million and $9.8 million during 1997, 1996 and 1995, respectively. The company capitalizes interest on qualifying capital projects. The amount of interest capitalized during 1997, 1996 and 1995 amounted to $2.1 million, $3.0 million and $4.3 million, respectively.

NOTE 6 – OTHER BALANCE SHEET INFORMATION

Receivables:	1997	1996
Customers	$243,232	$213,308
Affiliates	7,727	6,582
Other	22,546	18,511
	$273,505	$238,401

Receivables are net of allowance for doubtful accounts of $1.4 million in 1997 and $1.2 million in 1996.

Property and Equipment:	1997	1996
Land and improvements	$ 102,831	$ 105,071
Buildings and improvements	270,237	274,420
Machinery and equipment	1,059,575	1,081,850
Construction in progress	81,181	67,846
	$1,513,824	$1,529,187

In 1996, the company began a multi-year project to implement a new enterprise-wide management information system to support its global information processing and access needs. Costs were expensed as incurred during the assessment and preliminary project design stages of this project. Direct internal and external costs for qualifying activities during the application development and implementation stages of this project are capitalized as property and equipment. Capitalized costs relating to this project were $26.0 million in 1997 and $2.3 million in 1996. Capitalized costs will be amortized over the estimated useful life of seven years beginning when each respective site installation is complete and ready for its intended use.

Depreciation and amortization of property and equipment was $82.7 million in 1997, $78.7 million in 1996 and $71.8 million in 1995.

Other Assets:	1997	1996
Goodwill and other intangibles	$58,066	$46,585
Deferred income taxes	2,061	4,149
Other	26,508	29,147
	$86,635	$79,881

During 1997, 1996 and 1995, the company made cash acquisitions of, or investments in, several companies. These acquisitions were recorded under the purchase method of accounting, including recognizing goodwill for amounts paid in excess of the fair value of identifiable assets acquired. The acquired companies have not had a material effect on the company's consolidated results of operations during 1997, 1996 or 1995. Accumulated amortization of intangible and other assets was $16.3 million and $12.2 million at December 31, 1997 and 1996, respectively.

Income Taxes and Other Current Liabilities:	1997	1996
Employee compensation	$34,757	$35,463
Income taxes	25,509	12,914
Taxes other than income	12,105	10,893
Other	24,117	27,293
	$96,488	$86,563

Noncurrent Liabilities:	1997	1996
Employee benefits	$27,867	$33,239
Other	15,011	14,045
	$42,878	$47,284

NOTE 7 – SHAREHOLDERS' EQUITY

The company has 147 million authorized shares consisting of 2 million shares of serial preferred stock, 25 million shares of serial preference shares and 120 million common shares, each of which is without par value. Common shares outstanding exclude common shares held in treasury of 29,229,000 and 27,673,218 at December 31, 1997 and 1996, respectively.

The company has a shareholder rights plan under which one right to buy one-half common share has been distributed for each common share held. The rights may become exercisable under certain circumstances involving actual or potential acquisitions of 20% or more of the common shares by a person or affiliated persons who acquire such stock without complying with the requirements of the company's articles of incorporation. The rights would entitle shareholders, other than such person or affiliated persons, to purchase common shares of the company or of certain acquiring persons at 50% of then current market value. At the option of the directors, the rights may be exchanged for common shares, and may be redeemed in cash, securities or other consideration. The rights will expire in 2007 unless earlier redeemed.

In June 1997, FASB issued SFAS 130 – Reporting Comprehensive Income, which becomes effective in 1998; however, earlier application is permitted. SFAS 130 requires presentation of comprehensive income (net income plus all other changes in net assets from non owner sources) and its components in the financial statements. The company elected to early adopt SFAS 130 and has changed the format of its consolidated statements of shareholders' equity to present comprehensive income.

Components of other comprehensive income (loss) consists of the following:

	1997	1996	1995
Foreign currency translation adjustments	$(36,941)	$ (6,663)	$ 12,957
Change in unrealized gains on marketable securities			(35,645)
Income tax benefit	4	213	12,223
Other comprehensive income (loss)	$(36,937)	$ (6,450)	$(10,465)

The change in unrealized gain on marketable securities during 1995 includes reclassification adjustments for $38.5 million of gains realized in income from the sale of the securities. The 1995 income tax benefit includes a benefit of $12.5 million related to the change in unrealized gain (including $13.5 million for reclassification of realized gains). Accumulated other comprehensive income or loss shown in the consolidated statements of shareholders' equity at December 31, 1997, 1996 and 1995 is solely comprised of the accumulated foreign currency translation adjustment, net of tax effects.

NOTE 8 – GAIN ON INVESTMENTS

In 1996, the company sold its investments in Mycogen Corporation and Agrigenetics, Inc., for cash of $126.2 million. The company also sold certain rights to its SVO oilseed technology for $8.0 million, of which $2.0 million was collected in 1996, $2.5 million collected in 1997 and $3.5 million collected in January 1998. Also, in September 1996, the company sold substantially all the remaining assets of SVO for cash of $20.8 million. These transactions resulted in pretax gains of $57.3 million. Losses on other investment activity reduced the gain on investments to $53.3 million. On an after-tax basis, these gains contributed $.57 to 1996 net income per share.

During the first half of 1995, the company sold all of its remaining shares of Genentech Inc. common stock and received proceeds of $40.2 million, generating gross realized gains of $38.5 million. On an after-tax basis these gains contributed $.39 to 1995 net income per share. The company determined the gross realized gains using the average cost method.

The investment in Genentech was reported at fair value in the company's balance sheets, until sold, as investments available-for-sale, with changes in unrealized gains recorded as a component of other comprehensive income in shareholders' equity.

NOTE 9 – OTHER INCOME

Other income – net consists of the following:

	1997	1996	1995
Equity earnings (losses) of nonconsolidated companies	$ 4,804	$ 4,350	$ (2,081)
Gain on investee stock issuance			4,530
Other – net	300	1,662	4,701
	$ 5,104	$ 6,012	$ 7,150

Other income in 1995 reflects equity losses from Mycogen of $5.4 million and preferred dividend income of $1.5 million. Gains on investee stock issuance represents a noncash gain, from the increase in the value of the company's ownership interest in the net assets of Mycogen, due to Mycogen's issuance of new shares at a price in excess of the company's carrying value per share.

NOTE 10 – INCOME TAXES

The provision for income taxes is based upon income before tax for financial reporting purposes. Deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the tax bases of assets and liabilities and their carrying values for financial reporting purposes. In estimating future tax consequences, the company considers anticipated future events, except changes in tax laws or rates, which are recognized when enacted.

Income before income taxes consists of the following:

	1997	1996	1995
United States	$154,589	$196,390	$136,801
Foreign	76,558	54,218	88,773
Total	$231,147	$250,608	$225,574

The provision for income taxes consists of the following:

	1997	1996	1995
Current:			
United States	$35,556	$39,688	$28,294
Foreign	32,137	18,044	28,766
	67,693	57,732	57,060
Deferred:			
United States	8,784	16,842	8,334
Foreign	(199)	6,232	8,565
	8,585	23,074	16,899
Total	$76,278	$80,806	$73,959

Foreign taxes include withholding taxes. The United States tax provision includes the U.S. tax on foreign income distributed to the company. The company increased its 1997 tax provision by approximately $3.5 million primarily to reflect a legislated increase in the statutory tax rate applicable to its earnings in France, where the company has significant operations. The differences between the provision for income taxes at the U.S. statutory rate and the tax shown in the consolidated statements of income are summarized as follows:

	1997	1996	1995
Tax at statutory rate of 35%	$80,901	$87,713	$78,951
Foreign sales corporation earnings	(4,704)	(3,477)	(4,389)
Equity income	(2,775)	(1,324)	(856)
Other – net	2,856	(2,106)	253
Provision for income taxes	$76,278	$80,806	$73,959

The tax effects of temporary differences that give rise to significant portions of deferred tax assets and liabilities at December 31 are as follows:

	1997	1996
Deferred tax assets:		
Accrued compensation and benefits	$ 43,251	$ 39,522
Intercompany profit in inventory	13,223	13,107
Net operating losses carried forward	15,217	13,131
Other	4,045	4,949
Total gross deferred tax assets	75,736	70,709
Less valuation allowance	(4,179)	(4,239)
Net deferred tax assets	71,557	66,470
Deferred tax liabilities:		
Depreciation and other basis differences	90,151	75,869
Undistributed foreign equity income	3,626	4,672
Inventory basis differences	2,588	3,920
Other	4,657	3,804
Total gross deferred tax liabilities	101,022	88,265
Net deferred tax assets (liabilities)	$(29,465)	$(21,795)

At December 31, 1997, certain foreign subsidiaries have net operating loss carryforwards of $40.6 million for income tax purposes, of which $8.8 million expires in years 2000 through 2004 and $31.8 million has no expiration. After evaluating tax planning strategies and historical and projected profitability, a valuation allowance has been recognized to reduce the deferred tax assets related to those carryforwards to the amount expected to be realized. The net change in the total valuation allowance for the years ended December 31, 1997, 1996 and 1995, was a decrease of $.1 million, an increase of $.7 million and an increase of $3.6 million, respectively.

U.S. income taxes or foreign withholding taxes are not provided on undistributed earnings of foreign subsidiaries, which are considered to be indefinitely reinvested in the operations of such subsidiaries. The amount of such earnings was approximately $376.8 million at December 31, 1997. Determination of the net amount of unrecognized U.S. income tax with respect to these earnings is not practicable.

Income taxes paid during 1997, 1996 and 1995 amounted to $53.0 million, $55.0 million and $56.9 million, respectively.

NOTE 11 – PENSION AND PROFIT SHARING PLANS

The company has noncontributory defined benefit pension plans covering most employees. Pension benefits under these plans are based on years of service and the employee's compensation. The company's funding policy in the United States is to contribute amounts to satisfy the Internal Revenue Service funding standards and elsewhere to fund amounts in accordance with local regulations. Several defined benefit plans are unfunded. Plan assets are invested principally in marketable equity securities and fixed income instruments.

Net periodic pension cost of defined benefit plans consists of:

	1997	1996	1995
Service cost – benefits earned during period	$ 10,270	$ 11,097	$ 10,089
Interest cost on projected benefit obligation	17,704	17,690	17,804
Actual return on plan assets	(45,407)	(33,585)	(47,965)
Net amortization and deferral	23,835	14,229	31,833
Net periodic pension cost	$ 6,402	$ 9,431	$ 11,761

The weighted average assumptions used at December 31 were:

	1997	1996	1995
Discount rate for determining funded status	6.9%	7.5%	7.3%
Compensation increase	4.0%	4.5%	4.8%
Return on plan assets	8.8%	8.9%	8.8%

The funded status of such defined benefit pension plans and the amounts recognized in the consolidated balance sheets at December 31 are as follows:

	1997		1996	
	Assets Exceed Accum. Benefits	Accum. Benefits Exceed Assets	Assets Exceed Accum. Benefits	Accum. Benefits Exceed Assets
Fair value of plan assets	$291,885	$ 6,245	$264,949	$ 6,431
Projected benefit obligation	(228,764)	(25,497)	(217,173)	(31,448)
Plan assets in excess of (less than) projected benefit obligation	63,121	(19,252)	47,776	(25,017)
Unrecognized net transition obligation (asset)	(10,093)	3,242	(11,833)	3,882
Unrecognized net loss (gain)	(45,239)	2,410	(28,162)	845
Unrecognized prior service cost	9,022	1,792	10,091	2,689
Minimum liability adjustment	(54)	(2,005)		(1,699)
Accrued pension asset (liability)	$ 16,757	$(13,813)	$ 17,872	$(19,300)
Accumulated benefit obligation	$171,388	$ 19,104	$155,071	$ 24,702
Vested benefits	$164,411	$ 15,177	$149,318	$ 20,442

The company also has defined contribution retirement plans, principally involving profit sharing plans and a 401(k) savings plan, covering most employees in the United States and at certain non-U.S. subsidiaries. Expense for all defined contribution plans was $9.9 million in 1997, $10.2 million in 1996 and $8.9 million in 1995.

NOTE 12 – POSTRETIREMENT HEALTH CARE

The company provides certain postretirement benefits other than pensions, primarily health care and life insurance plans, for retired employees. Currently, substantially all of the company's full-time employees in the U.S. become eligible for these benefits after attaining specified years of service and age 55 at retirement. Participants contribute a portion of the cost of such benefits. The company's postretirement health care plans are not funded.

The status of the U.S. postretirement health care and life insurance plans at December 31 is as follows:

	1997	1996
Accumulated postretirement benefit obligations:		
Retirees	$ 29,709	$ 29,794
Fully eligible active plan participants	12,658	14,385
Other active plan participants	16,319	19,776
Total accumulated postretirement benefit obligation	58,686	63,955
Unrecognized net gain	9,816	652
Unrecognized net reduction in prior service costs	33,838	37,056
Accrued postretirement health care costs	$102,340	$101,663

Unrecognized net reduction in prior service costs results from plan amendments. These reductions in prior service costs do not immediately reduce the accrued postretirement liability, but are amortized as a reduction of expense over the participant's average future service period to full eligibility (remaining amortization period at December 31, 1997, of approximately 11 years). The company revised its assumed ultimate health care cost trend rate from 6% to 5% during 1997. This revision reduced the accumulated postretirement benefit obligation at December 31, 1997, by $8.9 million. This gain will be amortized beginning in 1998 over the average remaining service period of participants.

The assumed health care cost trend rate used in measuring the accumulated postretirement benefit obligation at December 31, 1997, was 8.25% (9.00% at December 31, 1996), with subsequent annual decrements of .75% to an ultimate trend rate of 5%. A one-percentage-point increase in the assumed health care cost trend rate for each year would increase the accumulated postretirement benefit obligation by approximately 15% and the aggregate of the service and interest cost components of net postretirement health care cost by approximately 19%. Discount rates of 7.25% and 7.50%, respectively, were used in determining the accumulated postretirement benefit obligations at December 31, 1997 and 1996.

Net postretirement benefit cost consists of the following components for the company's U.S. plans:

	1997	1996	1995
Service cost – benefits earned during the year	$ 1,350	$ 1,501	$ 1,361
Interest cost on accumulated postretirement benefit obligation	4,800	4,817	6,066
Amortization of unrecognized net gains	(3,218)	(3,218)	(1,766)
Net postretirement health care cost	$ 2,932	$ 3,100	$ 5,661

The company also provides postretirement health care benefits at several of its international locations. Accumulated benefits and net postretirement health care costs for these locations were not significant.

NOTE 13 – LEASES

The company has commitments under operating leases primarily for office space, terminal facilities, land, railroad tank cars and various computer and office equipment. Rental expense was $13.8 million in 1997, $16.9 million in 1996 and $19.5 million in 1995. Future minimum rental commitments under operating leases having initial or remaining noncancelable lease terms exceeding one year are $14.5 million in 1998, $11.1 million in 1999, $9.4 million in 2000, $5.8 million in 2001, $5.3 million in 2002 and $20.8 million thereafter.

NOTE 14 – OPERATIONS IN GEOGRAPHIC AREAS

Financial data by geographic area, based on the location of the subsidiary which shipped and billed the product, is as follows:

	1997	1996	1995
Revenues from customers:			
United States	$ 735,315	$ 711,781	$ 722,879
Europe	462,356	480,250	533,920
Far East	275,407	229,659	225,773
Other	200,704	175,872	181,022
	1,673,782	1,597,562	1,663,594
Intercompany transfers:			
United States	343,120	318,492	319,671
Europe	34,214	26,364	37,556
Far East	206	182	301
Other	21,678	22,507	30,905
	399,218	367,545	388,433
Gross revenues	2,073,000	1,965,107	2,052,027
Less: Intercompany transfers	(399,218)	(367,545)	(388,433)
Consolidated revenues	$1,673,782	$1,597,562	$1,663,594
Operating profit:			
United States	$ 195,177	$ 162,090	$ 128,909
Europe	23,918	27,746	51,172
Far East	12,679	9,078	9,731
Other	18,243	13,178	17,476
Eliminations	1,241	(671)	(2,555)
	251,258	211,421	204,733
General corporate expenses	(19,000)	(16,864)	(19,156)
Gain on investments		53,280	38,459
Other income – net	5,104	6,012	7,150
Interest – net	(6,215)	(3,241)	(5,612)
Income before income taxes	$ 231,147	$ 250,608	$ 225,574
Identifiable assets:			
United States	$ 841,547	$ 796,154	$ 804,045
Europe	374,234	400,639	395,053
Far East	151,826	151,015	154,992
Other	101,141	91,768	82,708
Eliminations	(111,462)	(114,546)	(82,310)
	1,357,286	1,325,030	1,354,488
Corporate assets	105,006	77,085	137,532
Total assets	$1,462,292	$1,402,115	$1,492,020

Notes:

A. Intercompany transfers are made at prices comparable to normal unaffiliated customer sales for similar products.

B. Affiliated companies are not allocated to geographic segments.

C. Corporate assets consist of short-term investments and investments in affiliated companies.

Export sales from the United States to customers, primarily in Asia and Latin America, were $132 million, $144 million and $138 million during 1997, 1996 and 1995, respectively.

Net assets of non-U.S. subsidiaries at December 31, 1997 and 1996, were $488 million and $487 million, respectively. Net income of these subsidiaries was $43 million in 1997, $29 million in 1996 and $52 million in 1995; and dividends received from the subsidiaries were $7 million, $18 million and $7 million, respectively.

NOTE 15 – FINANCIAL INSTRUMENTS

The company has various financial instruments, including cash and short-term investments, investments in nonconsolidated companies, foreign currency forward contracts, interest rate swaps and short- and long-term debt. The company has determined the estimated fair value of these financial instruments by using available market information and generally accepted valuation methodologies. The use of different market assumptions or estimation methodologies could have a material effect on the estimated fair value amounts. The estimated fair value of the company's debt instruments at December 31, 1997, approximates $227.5 million compared with the carrying value of $220.3 million. The company believes the carrying values of its other financial instruments approximate their fair values, except for certain interest rate swap agreements discussed below. The company uses derivative financial instruments only to manage well-defined foreign currency and interest rate risks. The company does not use derivative financial instruments for trading purposes.

The company is exposed to the effect of changes in foreign currency rates on its earnings and cash flow as a result of doing business internationally. In addition to working capital management, pricing and sourcing, the company selectively uses foreign currency forward contracts to lessen the potential effect of currency changes. Such contracts are generally in connection with transactions with maturities of less than one year. The maximum amount of foreign currency forward contracts outstanding at any one time was $58.4 million in 1997, $41.2 million in 1996 and $16.6 million in 1995. At December 31, 1997, the company had short-term forward contracts to sell currencies at various dates during 1998 for $38.9 million. Realized and unrealized gains or losses on these contracts are recorded in the statement of income, or in the case of transactions designated as hedges of net foreign investments, in the foreign currency translation adjustment account in other comprehensive income. Additionally, foreign currency forward contract gains and losses on certain future transactions may be deferred until the future transaction is recorded. Deferred currency gains on foreign exchange contracts at December 31, 1997, were not significant.

The company is exposed to market risk from changes in interest rates. The company's policy is to manage interest rate cost using a mix of fixed and variable rate debt. To manage this mix in a cost-efficient manner, the company may enter into interest rate swaps, in which the company agrees to exchange, at specified intervals, the difference between fixed and variable interest amounts calculated by reference to an agreed upon notional principal amount. The company has entered into interest rate swap agreements to convert variable rate debt to fixed rates (see Note 5). Interest payments receivable and payable under the terms of the interest rate swap agreements are accrued over the period to which the payment relates and the net difference is treated as an adjustment of interest expense related to the underlying liability. Changes in the underlying market value of the remaining swap payments are recognized in income when the underlying liability being hedged is extinguished or partially extinguished to a level less than the notional amount of the interest rate swaps. Consequently, market value losses of $1.0 million and $1.1 million were recognized in 1997 and 1996, respectively. The company would have paid approximately $6.3 million, including accrued interest of $.8 million, if it had terminated these interest rate swap agreements at December 31, 1997.

NOTE 16 – STOCK COMPENSATION PLANS

The 1991 Stock Incentive Plan provides for granting of restricted and unrestricted shares and options to buy common shares intended either to qualify as "incentive stock options" under the Internal Revenue Code or "non-statutory stock options" not intended to so qualify, up to an amount equal to 1% of the outstanding common shares at the beginning of any year, plus any unused amount from prior years. Under the 1991 Plan, options generally become exercisable 50% one year after grant, 75% after two years, 100% after three years, and expire up to ten years after grant. "Reload options," which are options to purchase additional shares if a grantee uses already-owned shares to pay for an option exercise, are granted automatically under the 1991 Plan and may be granted at the discretion of the administering committee under the 1985 Employee Stock Option Plan. The 1991 Plan generally supersedes the 1985 Plan, although options outstanding under the 1985 Plan remain exercisable until the expiration dates. The option price under both plans is the fair market value of the shares on the date of grant. Both plans permit or permitted the granting of stock appreciation rights in connection with the grant of options. In addition, the 1991 Plan provides to each outside director of the company an automatic annual grant of an option to purchase 2,000 common shares, with terms generally comparable to employee stock options.

Under the 1991 Stock Incentive Plan, the company granted to certain executive officers 65,000 performance share stock awards in March 1997, all of which are outstanding at December 31, 1997. Common shares equal to the number of performance share stock awards granted will be issued if the market price of the company's common stock reaches $45.00 per common share for ten consecutive trading days or after six years from date of grant, whichever occurs first. The

market value of the company's common shares at date of grant of the performance share stock awards was $33.75 per share. The company accrues compensation expense related to performance share stock awards ratably over the projected vesting period. Compensation costs accrued for performance share stock awards was $.5 million in 1997.

SFAS 123 encourages the fair-value based method of accounting for stock compensation plans under which the value of stock-based compensation is estimated at the date of grant using valuation formulas, but permits the continuance of intrinsic-value accounting. The company accounts for its stock compensation plans using the intrinsic-value accounting method (measured as the difference between the exercise price and the market value of the stock at date of grant). If the fair value method to measure compensation cost for the company's stock compensation plans had been used, the company's net income would have been reduced by $2.6 million in 1997, $2.0 million in 1996 and $1.7 million in 1995 with a corresponding reduction in net income per share of $.05 in 1997 and $.03 for both 1996 and 1995.

Disclosures under the fair value method are estimated using the Black-Scholes option-pricing model with the following weighted-average assumptions for grants of stock options in the following years:

	1997	1996	1995
1985 Plan:			
Risk-free interest rate	5.7%	6.6%	7.1%
Dividend yield	2.7%	3.4%	3.4%
Volatility	20%	23%	23%
Expected life (years)	3.1	3.7	8.6
1991 Plan:			
Risk-free interest rate	5.8%	6.3%	7.0%
Dividend yield	2.7%	3.4%	3.4%
Volatility	22%	23%	23%
Expected life (years)	9.9	8.8	8.2

The fair value of the performance share stock awards granted in 1997 was $31.80 per share using the following assumptions: risk-free interest rate of 5.7%; volatility of 20%; and expected life of three years. Dividends do not accumulate on performance share stock awards.

Information regarding these option plans, excluding the performance share stock awards, follows:

	Shares	Weighted-Average Exercise Price
Outstanding, January 1, 1997	3,248,113	$30.93
Granted	417,561	35.07
Exercised	(361,179)	25.85
Forfeited	(92,338)	35.88
Outstanding, December 31, 1997	3,212,157	$31.88
Options exercisable, December 31, 1997	2,590,556	$31.67
Weighted-average fair value of options granted during the year		$ 9.37
Outstanding, January 1, 1996	2,958,416	$30.70
Granted	497,566	29.96
Exercised	(99,427)	18.25
Forfeited	(108,442)	31.86
Outstanding, December 31, 1996	3,248,113	$30.93
Options exercisable, December 31, 1996	2,574,762	$30.57
Weighted-average fair value of options granted during the year		$ 8.05
Outstanding, January 1, 1995	2,583,721	$29.28
Granted	528,210	35.12
Exercised	(148,887)	21.57
Forfeited	(4,628)	34.56
Outstanding, December 31, 1995	2,958,416	$30.70
Options exercisable, December 31, 1995	1,975,878	$28.77
Weighted-average fair value of options granted during the year		$10.05

The following table summarizes information about stock options outstanding at December 31, 1997:

	Options Outstanding			Options Exercisable	
Range of Exercise Prices	Number Outstanding at 12/31/97	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at 12/31/97	Weighted-Average Exercise Price
$13 – $19	78,423	2.1 Years	$16.66	78,423	$16.66
19 – 25	89,375	1.3	21.91	89,375	21.91
25 – 31	1,205,571	4.7	28.89	1,013,029	28.69
31 – 38	1,772,454	5.3	34.70	1,343,395	34.93
38 – 45	66,334	2.7	42.09	66,334	42.09
	3,212,157	4.8	$31.88	2,590,556	$31.67

NOTE 17 – ASSET IMPAIRMENT AND SPECIAL CHARGE

In 1997, the company provided $9.4 million for the impairment of long-lived assets. This included $6.3 million to reduce the carrying value of certain computer equipment and software made obsolete prior to expiration of their original estimated useful lives due to new systems being implemented. Also, during the fourth quarter the company decided to utilize a toll processor, beginning in 1998, rather than to produce an intermediate internally. This decision resulted in the permanent impairment of a production unit, and a provision of $3.1 million was recorded to reduce the asset carrying value to its estimated fair value. Fair value was determined by estimating the present value of future cash flows. These impairment losses are reflected in the consolidated statements of income for the year ended December 31, 1997, as follows: cost of sales – $4.4 million; research, testing and development expenses – $.9 million; selling and administrative expenses – $1.8 million and other income (net) – $2.3 million.

During the fourth quarter of 1995, the company recorded a provision of $9.5 million for the write-down of assets to their fair value. This charge was primarily related to an intermediate processing unit that became permanently impaired due to product formulation changes caused by a new industry-wide specification. This charge, originally presented as a separate line on the 1995 consolidated statement of income, has been reclassified to cost of sales, in order to be consistent with the form of presentation used for the year ended December 31, 1997.

In 1993, the company recorded an $86.3 million special charge related to its manufacturing rationalization and organizational realignment initiatives. It was originally estimated that these initiatives would take approximately three years to fully implement and would reduce the number of the company's production units by up to one-third and the number of employees by approximately 5%. Originally, 30% of the special charge was for employee reductions; 55% was for asset write-downs primarily related to manufacturing assets and Agribusiness investments; and 15% was for tank cleaning and dismantling, lease exit costs and other transitional costs.

The company substantially completed its planned activities under the special charge initiatives by December 31, 1996. The total number of production units was reduced by nearly 30%, and comparable worldwide employment was reduced by approximately 9%, or over 400 employees, through early retirements, separations and attrition. Although there was no change in the aggregate amount of the special charge, certain components were revised as actual costs to implement became known. Approximately 45% of the special charge related to employee separations; 40% to asset write-downs and 15% to other areas. Costs for employee reductions were greater than originally estimated due to the greater number of employee separations. Asset write-offs decreased due to lower than originally estimated net book values of the assets removed from service. Cash outlays for the special charge were approximately $50 million, including $4 million in 1997, $9 million in 1996 and $14 million in 1995.

NOTE 18 – LITIGATION

The company has filed claims against Exxon Corporation and/or its affiliates relating to various commercial matters, including alleged infringements by Exxon of certain of the company's patents. These suits are pending in the United States (in Ohio), Canada and the United Kingdom.

The company has prevailed in a case brought in Canada against Exxon's Canadian affiliate, Imperial Oil, Ltd., for infringement of the company's patent pertaining to dispersants, the largest additive component used in motor oils. A 1990 trial court verdict in favor of the company regarding the issue of liability was upheld by the Federal Court of Appeals of Canada in December 1992, and in October 1993, the Supreme Court of Canada dismissed Imperial Oil's appeal of the Court of Appeals' decision. The case has been returned to the trial court for an assessment of compensation damages, but no date has been set for a determination of such damages. In October 1994, the trial court judge determined that Imperial Oil had violated an earlier injunction for the manufacture or sale of the dispersant which is the subject of this case. The determination of penalty damages, if any, on account of this violation will be made after the compensation damages for patent infringement have been determined by the court.

In November 1996, a patent trial court in London declared a Lubrizol United Kingdom patent invalid, which patent is the subject of litigation brought by the company against Exxon in that country. The company is appealing this decision, which appeal is expected to be heard in March 1998. Although the trial court decision does not involve any damage payments, the court awarded Exxon its recoverable legal costs in the case, as is customary under U.K. practice. Exxon has filed with the court a request for legal costs of approximately $12 million. The determination of which of those costs may be recoverable will be subject to a separate proceeding. The company has obtained a stay of this separate proceeding pending the outcome of the appeal of the trial court decision. As a court-ordered condition to obtain the stay, the company made a $3.0 million contingent payment to Exxon in July 1997. This amount was fully expensed in 1997. Management believes that the November 1996 trial court decision will not be upheld in its present form on appeal, in which case the recoverable legal costs would be reduced or eliminated, and amounts paid contingently by the company could be refunded in whole or in part.

A reasonable estimation of the company's potential recovery relating to the Exxon litigation referenced above can not be made at this time, and no recovery amounts have been recorded in the company's financial statements.

Quarterly Financial Data (Unaudited)

	Three Months Ended			
	March 31	June 30	Sept. 30	Dec. 31
	(In Thousands of Dollars Except Per Share Data)			
1997				
Net sales	$387,749	$432,556	$426,824	$422,122
Gross profit	129,642	149,543	136,540	129,924
Net income	38,861	46,900	38,652	30,456
Net income per share	$.66	$.81	$.67	$.53
Net income per share – diluted	$.66	$.80	$.66	$.53
1996				
Net sales	$405,412	$420,531	$392,114	$374,820
Gross profit	131,817	132,007	124,931	120,728
Gain on investments (net of tax)	34,632			
Net income	71,236	38,070	31,733	28,763
Net income per share	$1.14	$.63	$.53	$.49
Net income per share – diluted	$1.14	$.62	$.53	$.48

Historical Summary

(In Millions, Except Shareholders, Employees and Per Share Data)	1997	1996	1995
OPERATING RESULTS:			
Revenues	$1,673.8	$1,597.6	$1,663.6
Total cost and expenses	1,441.5	1,403.0	1,478.0
Other income (charges)	(1.1)	56.1	40.0
Net income	154.9	169.8	151.6
– Before unusual items and accounting changes	154.9	135.2	132.8
Net income per share	2.68	2.80	2.37
– Before unusual items and accounting changes	2.68	2.23	2.08
FINANCIAL RATIOS:			
Gross profit percentage	32.7	32.0	31.5
Percent of revenues:			
Selling and administrative expenses	10.2	9.9	9.8
Research and testing expenses	8.8	10.1	10.8
Return on average shareholders' equity (%)	19.0	20.4	18.0
– Before unusual items and accounting changes (%)	19.0	16.2	15.8
Debt to capitalization (%)	21.3	19.5	22.5
Current ratio	2.5	2.6	2.4
OTHER INFORMATION:			
Dividends declared per share	$ 1.01	$ .97	$ .93
Average common shares outstanding	57.8	60.7	63.8
Capital expenditures	$ 100.7	$ 94.3	$ 189.3
Depreciation expense	82.7	78.7	71.8
At Year End:			
Total assets	$1,462.3	$1,402.1	$1,492.0
Total debt	220.3	198.5	247.1
Total shareholders' equity	815.4	819.4	849.0
Shareholders' equity per share	14.31	14.00	13.48
Common share price	36.88	31.00	27.75
Number of shareholders	5,661	5,764	6,304
Number of employees	4,291	4,358	4,601

1994	1993	1992	1991	1990	1989	1988	1987
$1,599.0	$1,525.5	$1,552.2	$1,476.3	$1,452.7	$1,227.9	$1,125.7	$1,022.3
1,397.0	1,362.2	1,390.5	1,308.7	1,288.4	1,109.7	1,009.9	916.4
49.4	(43.6)	15.4	10.5	106.9	19.5	69.9	23.3
175.6	45.6	124.6	123.7	190.0	94.0	140.0	81.3
148.8	113.5	124.6	123.7	133.5	94.0	88.4	73.7
2.67	.67	1.81	1.79	2.67	1.26	1.81	1.03
2.26	1.67	1.81	1.79	1.87	1.26	1.14	.94
32.7	32.0	31.7	32.4	30.3	29.2	29.9	29.6
10.0	10.4	11.7	11.7	10.9	10.8	10.5	10.8
10.3	11.2	10.0	9.8	8.5	9.2	9.6	9.1
22.5	5.9	15.4	16.2	27.2	14.2	21.8	13.6
19.0	14.6	15.4	16.2	18.0	14.2	13.7	12.0
16.8	8.7	5.6	7.9	8.3	8.5	8.4	10.1
2.5	2.5	2.9	2.7	2.7	3.0	3.1	3.0
$ .89	$ .85	$ .81	$ .77	$ .73	$ .69	$ .65	$ .61
65.7	67.7	69.0	69.3	71.1	74.7	77.4	79.1
$ 160.5	$ 127.9	$ 95.8	$ 82.4	$ 77.4	$ 64.7	$ 54.6	$ 42.0
63.9	59.6	58.4	54.6	54.0	48.7	46.6	47.2
$1,394.4	$1,182.6	$1,127.1	$1,171.7	$1,114.6	$ 960.2	$ 970.7	$ 939.4
167.9	69.6	48.4	67.8	66.6	61.2	60.8	69.7
832.0	732.2	819.4	794.5	736.2	663.3	664.3	621.6
12.83	11.00	11.97	11.51	10.61	8.96	8.74	7.98
33.88	34.13	27.25	28.25	23.63	18.75	17.75	16.44
6,494	6,616	6,822	6,767	6,692	7,370	7,782	8,335
4,520	4,613	4,609	5,299	5,169	5,030	4,781	4,817

Board of Directors

W. G. Bares
Chairman of the Board, President and Chief Executive Officer

Edward F. Bell
Retired President and Chief Executive Officer of Ameritech Ohio, which provides telephone, data transmission and telecommunications services in Ohio.

L. E. Coleman
Retired Chairman and Chief Executive Officer of The Lubrizol Corporation.

Peggy Gordon Elliott
President of South Dakota State University.

Forest J. Farmer, Sr.
President and Chief Executive Officer of Bing Manufacturing, Inc., a company that provides sequencing and value-added subassemblies to the automotive industry.

Gordon D. Harnett
Chairman, President and Chief Executive Officer of Brush Wellman Inc., the world's largest producer of beryllium and beryllium-containing engineered products.

Victoria F. Haynes
Vice President–Research and Development and Chief Technical Officer of The BFGoodrich Company, a specialty chemicals and aerospace company.

David H. Hoag
Chairman and Chief Executive Officer of The LTV Corporation and Chief Executive Officer of LTV Steel Company, a metals company engaged in the production of flat rolled carbon steel.

William P. Madar
Chairman of the Board of Nordson Corporation, a company which manufactures and markets industrial equipment.

Ronald A. Mitsch
Vice Chairman and Executive Vice President–Industrial and Consumer Markets and Corporate Services of 3M, a manufacturer of products for industrial, commercial, health care and consumer markets.

M. Thomas Moore
Retired Chairman and Chief Executive Officer of Cleveland-Cliffs Inc., an iron ore producer.

Corporate Information

Transfer Agent, Registrar and Dividend Disbursing Agent

American Stock Transfer & Trust Company
40 Wall Street
New York, NY 10005
(212) 936-5100 (800) 937-5449

Annual Meeting

The Annual Meeting of Shareholders will be held at the Clarion Hotel & Conference Center, Eastlake, Ohio, on April 27, 1998.

Form 10-K

The Form 10-K Annual Report to the Securities and Exchange Commission will be available March 31, 1998. A copy may be obtained without charge upon written request to the Secretary of the Corporation or from the Lubrizol web site.

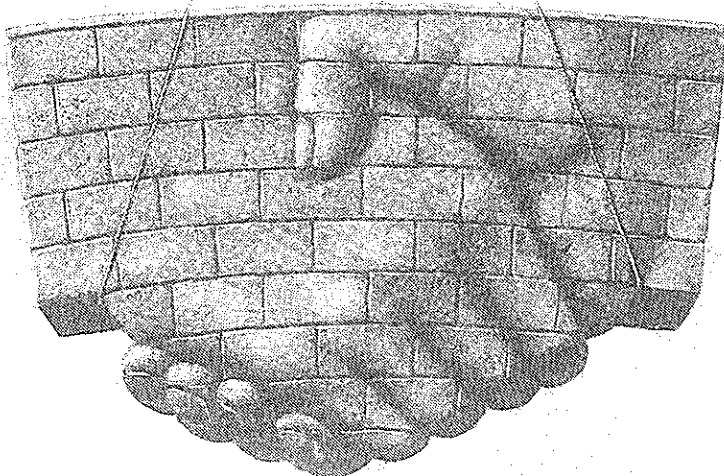
Shareholder Information

The Common Shares of The Lubrizol Corporation are listed on the New York Stock Exchange under the symbol LZ. The number of shareholders of record of Common Shares was 5,717 as of February 10, 1998.

Lubrizol shareholders of record may purchase additional shares of stock through a dividend reinvestment program. Interested shareholders should contact our transfer agent, American Stock Transfer & Trust Company, at the address and telephone number listed above.

Internet Web Site

Company and investor information is available at the Internet web site: http://www.lubrizol.com.



Officers

W. G. Bares
Chairman, President and Chief Executive Officer

George R. Hill
Senior Vice President

Ray A. Andreas
Vice President and Chief Financial Officer

Joseph W. Bauer
Vice President and General Counsel

Stephen A. Di Biase
Vice President

Joe E. Hodge
Vice President

K. H. Hopping
Vice President and Secretary

S. F. Kirk
Vice President

Yannick Le Couédic
Vice President

Mark W. Meister
Vice President

Richard D. Robins
Vice President

J. Alun Thomas
Vice President

Gregory P. Lieb
Controller—Accounting and Financial Reporting

Leslie M. Reynolds
Assistant Secretary

29400 Lakeland Boulevard
Wickliffe, Ohio 44092-2298
(440) 943-4200
http://www.lubrizol.com

Principal Subsidiaries and Branches

Lubrizol Australia
Lubrizol do Brasil Aditivos, Ltda.
Lubrizol Canada Limited
Lubrizol de Chile Limitada
Lubrizol China, Inc.
Lubrizol Coating Additives Company GmbH (Germany)
Lubrizol Española, S.A.
Lubrizol Europe B.V. (The Netherlands)
Lubrizol France S.A.
Lubrizol Gesellschaft m.b.H. (Austria)
Lubrizol GmbH (Germany)
Lubrizol International Inc.
Lubrizol International Management Corporation
Lubrizol Italiana, S.p.A.
Lubrizol Japan Limited
Lubrizol Korea
Lubrizol Limited (England)
Lubrizol Metalworking Additives Company, Inc.
Lubrizol de Mexico S. de R.L.
Lubrizol de Mexico Comercial S. de R.L. de C.V.
Lubrizol Overseas Trading Corporation
Lubrizol S.A. (Belgium)
Lubrizol Scandinavia AB
Lubrizol Servicios Tecnicos S. de R.L. (Mexico)
Lubrizol South Africa (Pty.) Limited
Lubrizol Southeast Asia (Pte.) Ltd. (Singapore)
Lubrizol de Venezuela C.A.
CPI Engineering Services, Inc.
Engine Control Systems, Ltd. (Canada and England)
Gate City Equipment Company, Inc.
Gateway Additive Company
Hyrolec Technical Services Limited (England)

Affiliates

Industrias Lubrizol S.A. de C.V. (Mexico)
Lanzhou Lubrizol – Lanlian Additive Co., Ltd. (China)
Lubrizol India Limited
Lubrizol Transarabian Company Limited (Saudi Arabia)
Solub Limited (Russia)
Tianjin Lubrizol – Lanlian Additive Co., Ltd. (China)

Manufacturing Plants

Painesville, Ohio
Bayport, Texas
Deer Park, Texas
Houston, Texas
Atlanta, Georgia
Sydney, Australia
Rio de Janeiro, Brazil
Newmarket, Canada
Niagara Falls, Canada
Bromborough, England
LeHavre, France
Rouen, France
Mourenx, France
Hamburg, Germany
Ritterhude, Germany
Mumbai, India
Kinuura, Japan
Apodaca, Mexico
Yanbu, Saudi Arabia
Jurong, Singapore
Durban, South Africa

Technical Centers

Atsugi, Japan
Hazelwood, England
Wickliffe, Ohio