PGDM & PGDM (IB), 2019-21
Advanced Financial Statement Analysis
DM-311 /IB-312
Trimester –III, End-Term Examination: June 2020

Time allowed: 1 hrs and 30 mins Max Marks: 30

Roll No: ___________

Instruction: Students are required to write Roll No on every page of the question paper, writing anything except the Roll No will be treated as **Unfair Means.** All other instructions on the reverse of Admit Card should be followed meticulously. Please carry a non-programmable calculator.

Please refer the enclosed case **Harnischfeger Corporation.** Please attempt the following questions after carefully reading the case.

1. Identify all the accounting policy changes and accounting estimates that Harnischfeger made during 1984. Estimate, as accurately as possible, the effect of these changes on the company's 1984 reported profits. (10 marks)

2. What do you think are the motives of Harnischfeger's management in making the changes in its financial reporting policies? Do you think investors will 'see through' these changes? (10 marks)

3. Assess the company's future prospects given your insights from questions 1 and 2 and the information in the case on the company's turnaround policy. (10 marks)

Harnischfeger Corporation

In February 1985, Peter Roberts, the research director of Exeter Group, a small Boston-based investment advisory service specializing in turnaround stocks, was reviewing the 1984 annual report of Harnischfeger Corporation (**Exhibit 4**). His attention was drawn by the $1.28 per share net profit Harnischfeger reported for 1984. He knew that barely three years earlier the company had faced a severe financial crisis. Harnischfeger had defaulted on its debt and stopped dividend payments after reporting a hefty $7.64 per share net loss in fiscal 1982. The company's poor performance continued in 1983, leading to a net loss of $3.49 per share. Roberts was intrigued by Harnischfeger's rapid turnaround and wondered whether he should recommend the purchase of the company's stock (see **Exhibit 3** for selected data on Harnischfeger's stock).

Company Business and Products

Harnischfeger Corporation was a machinery company based in Milwaukee, Wisconsin. The company had originally been started as a partnership in 1884 and was incorporated in Wisconsin in 1910 under the name Pawling and Harnischfeger. Its name was changed to the present one in 1924. The company went public in 1929 and was listed on the New York Stock Exchange.

The company's two major segments were the P&H Heavy Equipment Group, consisting of the Construction Equipment and the Mining and Electrical Equipment divisions, and the Industrial Technologies Group, consisting of the Material Handling Equipment and the Harnischfeger Engineers divisions. The sales mix of the company in 1983 consisted of Construction Equipment, 32%; Mining and Electrical Equipment, 33%; Material Handling Equipment, 29%; and Harnischfeger Engineers, 6%.

Harnischfeger was a leading producer of construction equipment. Its products, bearing the widely recognized brand name P&H, included hydraulic cranes and lattice boom cranes. These were used in bridge and highway construction and for cargo and other material handling applications. Harnischfeger had market shares of about 20% in hydraulic cranes and about 30% in lattice boom cranes. In the 1980s the construction equipment industry in general was experiencing declining margins.

Electric mining shovels and excavators constituted the principal products of the Mining and Electrical Equipment Division of Harnischfeger. The company had a dominant share of the mining machinery market. The company's products were used in coal, copper, and iron mining. A significant part of the division's sales were from the sale of spare parts. Because of its large market share and the lucrative spare parts sales, the division was traditionally very profitable. Most of the company's future mining product sales were expected to occur outside the United States, principally in developing countries.

Professor Krishna Palepu prepared this case as the basis for class discussion rather than to illustrate either effective or ineffective handling of an administrative situation.

The Material Handling Equipment Division of Harnischfeger was the fourth-largest supplier of automated material handling equipment with a 9% market share. The division's products included overhead cranes, portal cranes, hoists, monorails, and components and parts. The demand for this equipment was expected to grow in the coming years as an increasing number of manufacturing firms emphasized cost reduction programs. Harnischfeger believed that the material handling equipment business would be a major source of its future growth.

Harnischfeger Engineers was an engineering services division engaged in design, custom software development, and project management for factory and distribution automation projects. The division engineered and installed complete automated material handling systems for a wide variety of applications on a fee basis. The company expected such automated storage and retrieval systems to play an increasingly important role in the "factory of the future."

Harnischfeger had a number of subsidiaries, affiliated companies, and licensees in a number of countries. Export and foreign sales constituted more than 50% of the total revenues of the company.

Financial Difficulties of 1982

The machinery industry experienced a period of explosive growth during the 1970s. Harnischfeger expanded rapidly during this period, growing from $205 million in revenues in 1973 to $644 million in 1980. To fund this growth, the company relied increasingly on debt financing, and the firm's debt/equity ratio rose from 0.88 in 1973 to 1.26 in 1980. The worldwide recession in the early 1980s caused a significant drop in demand for the company's products starting in 1981 and culminated in a series of events that shook the financial stability of Harnischfeger.

Reduced sales and the high interest payments resulted in poor profit performance leading to a reported loss in 1982 of $77 million. The management of Harnischfeger commented on its financial difficulties:

> *There is a persistent weakness in the basic industries, both in the United States and overseas, which have been large, traditional markets for P&H products. Energy-related projects, which had been a major source of business of our Construction Equipment Division, have slowed significantly in the last year as a result of lower oil demand and subsequent price decline, not only in the U.S. but throughout the world. Lack of demand for such basic minerals as iron ore, copper and bauxite have decreased worldwide mining activity, causing reduced sales for mining equipment, although coal mining remains relatively strong worldwide. Difficult economic conditions have caused many of our normal customers to cut capital expenditures dramatically, especially in such depressed sectors as the steel industry, which has always been a major source of sales for all P&H products.*

The significant operating losses recorded in 1982 and the credit losses experienced by its finance subsidiary caused Harnischfeger to default on certain covenants of its loan agreements. The most restrictive provisions of the company's loan agreements required it to maintain a minimum working capital of $175 million, consolidated net worth of $180 million, and a ratio of current assets to current liabilities of 1.75. On October 31, 1982, the company's working capital (after reclassification of about $115 million long-term debt as a current liability) was $29.3 million, the consolidated net worth was $142.2 million, and the ratio of current assets to current liabilities was 1.12. Harnischfeger Credit Corporation, an unconsolidated finance subsidiary, also defaulted on certain covenants of its loan agreements, largely due to significant credit losses relating to the financing of construction equipment sold to a large distributor. As a result of these covenant violations, the company's long-term debt of $124.3 million became due on demand, the unused portion of the bank revolving credit line of $25.0 million became unavailable, and the unused short-term bank credit lines of $12.0 million were canceled. In addition, the $25.1 million debt of Harnischfeger Credit Corporation also became immediately due. The company was forced to stop paying dividends and began negotiations with its lenders to restructure its debt to permit operations to continue. Price Waterhouse, the company's audit firm, qualified its audit opinion on Harnischfeger's 1982 annual report with respect to the outcome of the company's negotiations with its lenders.

Corporate Recovery Plan

Harnischfeger responded to the financial crisis facing the firm by developing a corporate recovery plan. The plan consisted of four elements: (1) changes in the top management, (2) cost reductions to lower the break-even point, (3) reorientation of the company's business, and (4) debt restructuring and recapitalization. The actions taken in each of these four areas are described below.

To deal effectively with the financial crisis, Henry Harnischfeger, then chairman and chief executive officer of the company, created the position of chief operating officer. After an extensive search, the position was offered in August 1982 to William Goessel, who had considerable experience in the machinery industry. Another addition to the management team was Jeffrey Grade, who joined the company in 1983 as senior vice president of finance and administration and chief financial officer. Grade's appointment was necessitated by the early retirement of the previous vice president of finance in 1982. The engineering, manufacturing, and marketing functions were also restructured to streamline the company's operations (see **Exhibits 1** and **2** for additional information on Harnischfeger's current management).

To deal with the short-term liquidity squeeze, the company initiated a number of cost reduction measures. These included (1) reducing the workforce from 6,900 to 3,800; (2) eliminating management bonuses and reducing of benefits and freezing wages of salaried and hourly employees; (3) liquidating excess inventories and stretching payments to creditors; and (4) permanent closure of the construction equipment plant at Escanaba, Michigan. These and other related measures improved the company's cash position and helped to reduce the rate of loss during fiscal 1983.

Concurrent with the above cost reduction measures, the new management made some strategic decisions to reorient Harnischfeger's business. First, the company entered into a long-term agreement with Kobe Steel, Ltd., of Japan. Under this agreement, Kobe agreed to supply Harnischfeger's requirements for construction cranes for sale in the United States as Harnischfeger phased out its own manufacture of cranes. This step was expected to significantly reduce the manufacturing costs of Harnischfeger's construction equipment, enabling it to compete effectively in the domestic market. Second, the company decided to emphasize the high technology part of its business by targeting for future growth the material-handling equipment and systems business. To facilitate this strategy, the Industrial Technologies Group was created. As part of the reoreintation, the company stated that it would develop and acquire new products, technology, and equipment, and would expand its abilities to provide computer-integrated solutions to handling, storing, and retrieval in areas hitherto not pursued—industries such as distribution warehousing, food, pharmaceuticals, and aerospace.

While Harnischfeger was implementing its turnaround strategy, it was engaged at the same time in complex and difficult negotiations with its bankers. On January 6, 1984, the company entered into agreements with its lenders to restructure its debt obligations into three-year term loans secured by fixed as well as other assets, with a one-year extension option. This agreement required, among other things, specified minimum levels of cash and unpledged receivables, working capital, and net worth.

> The company reported a net loss of $35 million in 1983, down from the $77 million loss the year before. Based on the above developments during the year, in the 1983 annual report the management expressed confidence that the company would return to profitability soon.

> *We approach our second century with optimism, knowing that the negative events of the last three years are behind us, and with a firm belief that positive achievements will be recorded in 1984. By the time the corporation celebrates its 100th birthday on December 1, we are confident it will be operating profitably and attaining new levels of market strength and leadership.*

During 1984 the company reported profits during each of the four quarters, ending the year with a pre-tax operating profit of $5.7 million, and a net income after tax and extraordinary credits of $15 million (see **Exhibit 4**). It also raised substantial new capital through a public offering of debentures and common stock. Net proceeds from the offering, which totaled $150 million, were used to pay off all of the company's restructured debt. In the 1984 annual report the management commented on the company's performance as follows:

> *1984 was the Corporation's Centennial year and we marked the occasion by rededicating ourselves to excellence through market leadership, customer service and improved operating performance and profitability.*

* * * * * *

> *We look back with pride. We move ahead with confidence and optimism. Our major markets have never been more competitive; however, we will strive to take advantage of any and all opportunities for growth and to attain satisfactory profitability. Collectively, we will do what has to be done to ensure that the future will be rewarding to all who have a part in our success.*

Exhibit 1 Board of Directors, Harnischfeger Corporation, 1984

		Director Since	Current Term	Shares Owned
Edward W. Duffy	Chairman of the Board and Chief Executive of United States Gypsum Company, manufacturer of building materials and products used in industrial processes, since 1983. Former Vice Chairman from 1981 to 1983; President and Chief Operating Officer from 1971 to 1981. Director American National Bank and Trust Company of Chicago, Walter E. Heller International Corporation, W. W. Grainger, Inc., and UNR Industries, Inc. Age 64.	1981	1985	100
Herbert V. Kohler, Jr.	Chairman, Chief Executive Officer, and Director of Kohler Company, manufacturer of plumbing and specialty products, engines and generators, since 1972; President since 1974. Age 44.	1973	1985	700
Taisuke Mori	Executive Vice Chairman and Director of Kobe Steel, Ltd., a Japanese manufacturer of steel and steel products, industrial machinery, construction equipment, aluminum, copper and alloy products, and welding equipment and consumables. Age 63.	1981	1985	None
William W. Goessel	President and Chief Operating Officer of the Corporation since 1982. Executive Vice President of Beloit Corporation from 1978, Director to 1982. Goulds Pumps, Inc. Age 56.	1982	1986	15,000
Henry Harnischfeger	Chairman of the Board and Chief Executive Officer of the Corporation since 1970; President from 1959 to 1982. Director, First Wisconsin Corporation and First Wisconsin National Bank of Milwaukee. Age 60.	1945	1986	611,362
Karl F. Nygren	Partner in Kirkland & Ellis, attorneys, since 1959. Age 56.	1964	1986	2,000
John P. Gallagher	Senior lecturer, Graduate School of Business, University of Chicago. Director, IC Industries, Inc., Stone Container Corporation, UNR Industries, Inc., American National Bank and Trust Company of Chicago, and Walter E. Heller International Corporation. Age 67.	1979	1987	500
Jeffrey T. Grade	Senior Vice President Finance and Administration and Chief Financial Officer of the Corporation since August 1, 1983. Vice President Corporate of IC Industries from 1981 to 1983; Assistant Vice President from 1976 to 1981. Age 40.	1983	1987	3,750
Donald Taylor	President, Chief Operating Officer, and Director of Rexnord, Inc., a major manufacturer of industrial components and machinery, since 1978. Director, Johnson Controls, Inc., Marine Corporation, and Marine Bank, N.A. Age 56.	1979	1987	100
Frank A. Lee	Director of Foster Wheeler Corporation since 1971; Chairman of the Board from 1981 to 1982; President and Chief Executive from 1978 to 1981. Director, Belco Pollution Control Corporation, International General Industries, Inc., and Banker's Life Insurance Co. Age 59.	1983	1987	None

Exhibit 2 Executive Compensation, Harnischfeger Corporation

The following table sets forth all cash compensation paid to each of the Corporation's five most highly compensated executive officers and to all executive officers as a group for services rendered to the Corporation and its subsidiaries during fiscal 1984.

Cash Compensation		
Henry Harnischfeger	Chairman of the Board and Chief Executive Officer	$ 364,004
William W. Goessel	President and Chief Operating Officer	280,000
C. P. Cousland	Senior Vice President and group executive, P&H Heavy Equipment	210,000
Jeffrey T. Grade	Senior Vice President Finance and Administration and Chief Financial Officer	205,336
Douglas E. Holt	President, Harnischfeger Engineers, Inc.	152,839
All persons who were executive officers during the fiscal year as a group (14 persons)		2,159,066

1985 Executive Incentive Plan

In December 1984, the board of directors established an Executive Incentive Plan for fiscal 1985 which provides an incentive compensation opportunity of 40% of annual salary for 11 senior executive officers only if the Corporation reaches a specific net after-tax profit objective and it provides an additional incentive compensation of up to 40% of annual salary for seven of those officers if the corporation exceeds the objective. The Plan covered the chairman, president, senior vice presidents; president, Harnischfeger Engineers, Inc.; vice president, P&H World Services; vice president, material Handling Equipment; and secretary. Awards made regarding fiscal year 1984 are included in the Compensation Table above.

Exhibit 3 Selected Stock Price and Market Data

A. Stock Prices

	Harnischfeger's Stock Price			S&P 400 Industrials Index		
	High	Low	Close	High	Low	Close
January 4, 1985	9 1/8	8 6/8	9	186.4	181.8	182.2
January 11, 1985	10 6/8	8 7/8	10 5/8	188.2	182.2	182.8
January 18, 1985	11	10	10 4/8	191.9	186.9	191.3
January 25, 1985	11 2/8	10 1/8	11	199.7	191.3	198.6
February 1, 1985	11 5/8	10 7/8	11 2/8	201.8	198.6	200.0

Harnischfeger's stock beta = 0.95 (Value Line estimate)

B. Market Data

	February 1985
Median P/E ratio of Dow Jones Industrials	10.9
Median P/E ratio of Value Line stocks	11.3
Median P/E ratio of machinery industry (construction and mining equipment)	10.0
Prime rate	10.5%
91-day Treasury bill rate	8.4%
30-year Treasury bond yield	11.4%
Moody's Aaa corporate bond yield	12.0%

Exhibit 4 1984 Annual Report—Edited

To Our Shareholders

The Corporation recorded gains in each quarter during fiscal 1984, returning to profitability despite the continued depressed demand and intense price competition in the world markets it serves.

For the year ended October 31, net income was $15,176,000 or $1.28 per common share, which included $11,005,000 or 93¢ per share from the cumulative effect of a change in depreciation accounting. In 1983, the Corporation reported a loss of $34,630,000 or $3.49 per share.

Sales for 1984 improved 24% over the preceding year, rising to $398.7 million from $321 million a year ago. New orders totaled $451 million, a $101 million increase over 1983. We entered fiscal 1985 with a backlog of $193 million, which compared to $141 million a year earlier.

All Divisions Improved

All product divisions recorded sales and operating improvements during 1984.

Mining equipment was the strongest performer with sales up over 60%, including major orders from Turkey and the People's Republic of China. During the year we began the implementation of the training, engineering and manufacturing license agreement concluded in November, 1983 with the People's Republic of China, which offers the Corporation long-term potential in modernizing and mechanizing this vast and rapidly developing mining market.

Sales of material handling equipment and systems were up 10% for the year and the increasingly stronger bookings recorded during the latter part of the year are continuing into the first quarter of 1985.

Sales on construction equipment products showed some signs of selective improvement. In the fourth quarter, bookings more than doubled from the very depressed levels in the same period a year ago, although the current level is still far below what is needed to achieve acceptable operating results for this product line.

Financial Stability Restored

In April, the financial stability of the Corporation was improved through a public offering of 2.15 million shares of common stock, $50 million of 15% notes due April 15, 1994, and $100 million of 12% subordinated debentures due April 15, 2004, with two million common stock purchase warrants.

Net proceeds from the offering totaled $149 million, to which we added an additional $23 million in cash, enabling us to pay off all of our long-term debt. As a result of the refinancing, the Corporation gained permanent long-term capital with minimal annual cash flow requirements to service it. We now have the financial resources and flexibility to pursue new opportunities to grow and diversify.

Furthermore, should we require additional funds, they will be available through a $52 million unsecured three-year revolving credit agreement concluded in June with ten U.S. and Canadian banks. An $80 million product financing capability was also arranged through a major U.S. bank to provide financing to customers purchasing P&H products.

Outlook

Throughout 1985 we believe we will see gradual improvements in most of our U.S. and world markets.

For our mining excavator product line, coal and certain metals mining are expected to show a more favorable long-term outlook in selected foreign requirements and our capability to source equipment from the U.S., Japan or Europe places us in a strong marketing position. In the U.S., we see only a moderate strengthening in machinery requirements for coal, while metals mining will remain weak.

Continuing shipments of the Turkish order throughout 1985 will help to stabilize our plant utilization levels and improve our operating results for this product line.

In our material handling and systems markets, particularly in the U.S., we are experiencing a moderately strong continuation of the improved bookings which we began to see in the third and fourth quarters of last year.

In construction lifting equipment markets, we expect modest overall economic improvement in the U.S., which should help to absorb the large numbers of idle lifting equipment that have been manufacturer, distributor and customer inventories for the last three years. As this overhang on the market is reduced we will see gradual improvement in new sales. Harnischfeger traditionally exports half of its U.S. -produced lifting products. However, as with mining equipment, the continued strength of the U.S. dollar severely restricts our ability to sell U.S. -built products in world markets.

In addition to the strong dollar and economic instability in many foreign nations, overcapacity in worldwide heavy equipment manufacturing remains a serious problem in spite of some exits from the market as well as consolidations within the industry.

The Corporation continues to respond to severe price competition through systematic cost reduction programs and through expanded sourcing of P&H equipment from our European operation and, most importantly, through our 30-year association with our Japanese partner, Kobe Steel, Ltd. P&H engineering and technology have established world standards for quality and performance for construction cranes and mining equipment, which customers can expect from every P&H machine regardless of its source. More than a dozen new models of foreign - sourced P&H construction cranes will be made available for the first time in the U.S. during 1985, broadening our existing product lines and giving competitive pricing to our U.S. distributors and customers.

To improve our future operating results, we restructured our three operating divisions into two groups. All construction and mining related activities are in the new "P&H Heavy Equipment Group." All material handling equipment and systems activities are now merged into the "Industrial Technologies Group." More information on these Groups is reported in their respective sections.

We are pleased to announce that John P. Moran was elected Senior Vice President and Group Executive, Industrial Technologies Group, and John R. Teitgen was elected Secretary and General Counsel.

In September Robert F. Schnoes became a member of our Board of Directors. He is President and Chief Executive Officer of Burgess, Inc. and of Ultrasonic Power Corporation, and a member of the Board of Signode Industries, Inc.

Beginning Our Second Century

1984 was the Corporation's Centennial year and we marked the occasion by rededicating ourselves to excellence through market leadership, customer service and improved operating performance and profitability.

Our first century of achievement resulted from the dedicated effort, support and cooperation of our employees, distributors, suppliers, lenders, and shareholders, and we thank all of them.

We look back with pride. We move ahead with confidence and optimism. Our major markets have never been more competitive; however, we will strive to take advantage of any and all opportunities for growth and to attain satisfactory profitability. Collectively, we will do what has to be done to ensure that the future will be rewarding to all who have a part in our success.

Henry Harnischfeger
Chairman of the Board

William W. Goessel
President

January 31, 1985

Management's Discussion & Analysis

Results of Operation

1984 Compared to 1983

Consolidated net sales of $399 million in fiscal 1984 increased $78 million or 24% over 1983. Sales increases were 62% in the Mining and Electrical Equipment Segment, and 10% in the Industrial Technologies Segment. Sales in the Construction Equipment Segment were virtually unchanged reflecting the continued low demand for construction equipment world-wide.

Effective at the beginning of fiscal 1984, net sales include the full sales price of construction and mining equipment purchased from Kobe Steel, Ltd. and sold by the Corporation, in order to reflect more effectively the nature of the Corporation's transactions with Kobe. Such sales aggregated $28.0 million in 1984.

The $4.0 million increase in Other Income reflected a recovery of certain claims and higher license and technical service fees.

Cost of Sales was equal to 79.1% of net sales in 1984 and 81.4% in 1983; which together with the increase in net sales resulted in a $23.9 million increase in gross profit (net sales less cost of sales). Contributing to this increase were improved sales of higher-margin replacement parts in the Mining Equipment and Industrial Technologies Segments and a reduction in excess manufacturing costs through greater utilization of domestic manufacturing capacity and economies in total manufacturing costs including a reduction in pension expense. Reductions of certain LIFO inventories increased gross profit by $2.4 million in 1984 and $15.6 million in 1983.

Product development selling and administrative expenses were reduced, due to the funding of R&D expenses in the Construction Equipment Segment pursuant to the October 1983 Agreement with Kobe Steel, Ltd., to reductions in pension expenses and provision for credit losses, and to the absence of the corporate financial restructuring expenses incurred in 1983.

Net interest expense in 1984 increased $2.9 million due to higher interest rates on the outstanding funded debt and a reduction in interest income.

Equity in Earnings (Loss) of Unconsolidated Companies included 1984 income of $1.2 million of Harnischfeger Credit Corporation, an unconsolidated finance subsidiary, reflecting an income tax benefit of $1.4 million not previously recorded.

The preceding items, together with the cumulative effect of the change in depreciation method described in Financial Note 2, were included in net income of $15.2 million or $1.28 per common share, compared with net loss of $34.6 million or $3.49 per share in 1983.

The sales orders booked and unshipped backlogs of orders of the Corporation's three segments are summarized as follows (in million of dollars):

Orders Booked	1984	1983
Industrial Technologies	$132	$106
Mining and Electrical Equipment	210	135
Construction Equipment	109	109
	$451	$350
Backlogs at October 31		
Industrial Technologies	$ 79	$ 71
Mining and Electrical Equipment	91	50
Construction Equipment	23	20
	$ 193	$ 141

1983 Compared to 1982

Consolidated net sales of $321 million in fiscal 1983 were $126 million or 28% below 1982. This decline reflected, for the second consecutive year, the continued low demand in all markets served by the Corporation's products, with exports even more severely depressed due to the strength of the dollar. The largest decline was reported in the Construction Equipment Segment down 34%; Mining and Electrical Equipment Segment, shipments were down 27%, and the Industrial Technologies Segment, 23%.

Cost of Sales was equal to 81.4% of net sales in 1983 and 81.9% in 1982. The resulting gross profit was $60 million in 1983 and $81 million in 1982, a reduction equal to the rate of sales decrease.

The benefits of reduced manufacturing capacity and economies in total manufacturing costs were offset by reduced selling prices in the highly competitive markets. Reductions of certain LIFO inventories increased gross profits by $15.6 million in 1983 and $7.2 million in 1982.

Product development, selling and administrative expenses were reduced as a result of expense reduction measures in response to the lower volume of business and undertaken in connection with the Corporation's corporate recovery program, and reduced provisions for credit losses, which in 1982 included $4.0 million in income support for Harnischfeger Credit Corporation.

Net interest expense was reduced $9.1 million from 1982 to 1983, due primarily to increased interest income from short-term cash investments and an accrual of $4.7 million in interest income on refundable income taxes not previously recorded.

The Credit for Income Taxes included a federal income tax benefit of $5 million, based upon the recent examination of the Corporation's income tax returns and refund claims. No income tax benefits were available for the losses of the U.S. operations in 1983.

The losses from unconsolidated companies recorded in 1983 included $0.5 million in Harnischfeger Credit Corporation; $2.1 million in Cranatex, Inc., a Corporation-owned distributorship in Texas; and $0.8 million in ASEA Industrial Systems Inc., then a 49%-owned joint venture between the Corporation and ASEA AB and now 19%-owned with the investment accounted for on the cost method.

The preceding items were reflected in a net loss of $34.6 million or $3.49 per share.

Liquidity and Financial Resources

In April 1984, the Corporation issued in public offerings 2,150,000 shares of Common Stock, $50 million principal amount of 15% Senior Notes due in 1994, and 100,000 Units consisting of $100 million principal amount of 12% Subordinated Debentures due in 2004 and 2,000,000 Common Stock Purchase Warrants.

The net proceeds from the sales of the securities of $149 million were used to prepay substantially all of the outstanding debt of the Corporation and certain of its subsidiaries.

During the year ended October 31, 1984, the consolidated cash balances increased $32 million to a balance of $96 million, with the cash activity summarized as follows (in million of dollars):

Funds provided by operations	$ 10
Funds returned to the Corporation upon restructuring of the Salaried Employees' Pension Plan	39
Debt repayment less the proceeds of sales of securities	(9)
Plant and equipment additions	(6)
All other changes - net	(2)
	$ 32

In the third quarter of fiscal 1984 the Corporation entered into a $52 million three-year revolving credit agreement with ten U.S. and Canadian banks. While the Corporation has adequate liquidity to meet its current working capital requirements, the revolver represents another step in the Corporation's program to strengthen its financial position and provide the required financial resources to respond to opportunities as they arise.

Consolidated Statement of Operations

(Dollar amounts in thousands except per share figures)

	Year Ended October 31		
	1984	1983	1982
Revenues			
Net sales	$398,708	$321,010	$447,461
Other income, including license and technical service fees	7,067	3,111	5,209
	405,775	324,121	452,670
Cost of sales	315,216	261,384	366,297
Operating Income	90,559	62,737	86,373
Less:			
Product development, selling and administrative expenses	72,196	85,795	113,457
Interest expense - net	12,625	9,745	18,873
Provision for plant closing	—	—	23,700
Income (Loss) before provision (credit) for income taxes, equity items and cumulative effect of accounting change	5,738	(32,803)	(69,657)
Provision (Credit) for income taxes	2,425	(1,400)	(1,600)
Income (Loss) before equity items and cumulative effect of accounting change	3,313	(31,403)	(68,057)
Equity items			
Equity in earnings (loss) of unconsolidated companies	993	(3,397)	(7,891)
Minority interest in (earnings) loss of consolidated subsidiaries	(135)	170	(583)
Income (loss) before cumulative effect of accounting change	4,171	(34,630)	(76,531)
Cumulative effect of change in depreciation method	11,005	—	—
Net income (loss)	$15,176	$(34,630)	$(76,531)
Earnings (loss) per common and common equivalent share:			
Income (loss) before cumulative effect of accounting change	$.35	$(3.49)	$(7.64)
Cumulative effect of change in depreciation method	.93	—	—
Net income (loss)	$1.28	$(3.49)	$(7.64)
Pro forma amounts assuming the changed depreciation method had been applied respectively:			
Net (loss)		$ (33,918)	$ (76,695)
(Loss) per common share		$ (3.42)	$ (7.65)

CONSOLIDATED BALANCE SHEET

(Dollar amounts in thousands except per share figures)

	October 31, 1984	October 31, 1983
Assets		
Current Assets		
Cash and temporary investments	$ 96,007	$ 64,275
Accounts receivable	87,648	63,740
Inventories	144,312	153,594
Refundable income taxes and related interest	1,296	12,585
Other current assets	5,502	6,023
Prepaid income taxes	14,494	14,232
	349,259	314,449
Investments and Other Assets		
Investments in and advances to:		
Finance subsidiary, at equity in net assets	8,849	6,704
Other companies	4,445	2,514
Other assets	13,959	6,411
	27,253	15,629
Operating Plants		
Land and improvements	9,419	10,370
Buildings	59,083	60,377
Machinery and equipment	120,949	122,154
	189,451	192,901
Accumulated depreciation	(93,259)	(107,577)
	96,192	85,324
	$472,704	$415,402
Liabilities and Shareholders' Equity		
Current Liabilities		
Short-term notes payable to banks by subsidiaries	$ 9,090	$ 8,155
Long-term debt and capitalized lease obligations payable within one year	973	18,265
Trade accounts payable	37,716	21,228
Employee compensation and benefits	15,041	14,343
Accrued plant closing costs	2,460	6,348
Advance payments and progress billings	20,619	15,886
Income taxes payable	1,645	3,463
Account payable to finance subsidiary	--	3,436
Other current liabilities and accruals	29,673	32,333
	117,217	123,457
Long-Term Obligations		
Long-term debt payable to:		
Unaffiliated lenders	128,550	139,092
Finance subsidiary	--	5,400
Capitalized lease obligations	7,870	8,120
	136,420	152,612
Deferred Liabilities and Income Taxes		
Accrued pension costs	57,611	19,098
Other deferred liabilities	5,299	7,777
Deferred income taxes	6,385	134
	69,295	27,009
Minority Interest	2,400	2,405
Shareholders' equity		
Preferred stock $100 par value --authorized 250,000 shares:		
Series A $7.00 cumulative convertible preferred shares: authorized, issued and outstanding 117,500 shares in 1984 and 100,000 shares in 1983	11,750	10,000
Common stock, $1 par value -- authorized 25,000,000 shares: issued and outstanding 12,283,563 shares in 1984 and 10,133,563 shares in 1983	12,284	10,134
Capital in excess of par value of shares	114,333	88,332
Retained earnings	19,901	6,475
Cumulative translation adjustments	(10,896)	(5,022)
	147,372	109,919
	$472,704	$415,402

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

(Dollar amounts in thousands)

	Year Ended October 31,		
	1984	1983	1982
Funds Were Provided by (Applied to):			
Operations:			
Income (loss) before cumulative effect of accounting change	$ 4,171	$ (34,630)	$ (76,531)
Cumulative effect of change in depreciation method	11,005	--	--
Net income (loss)	15,176	(34,630)	(76,531)
Add (deduct) --			
Items included not affecting funds:			
Depreciation	8,077	13,552	15,241
Unremitted (earnings) loss of unconsolidated companies	(993)	3,397	7,891
Deferred pension contributions	(500)	4,834	--
Deferred income taxes	6,583	(3,178)	1,406
Reduction in accumulated depreciation resulting from change in depreciation method	(17,205)	--	--
Other -- net	(2,168)	(67)	2,034
Decrease in operating working capital (see below)	7,039	11,605	72,172
Add (deduct) the effects on operating working capital of:			
Conversion of export and factored receivable sales to debt	--	23,919	--
Reclassification to deferred liabilities:			
Accrued pension costs	--	14,264	--
Other liabilities	--	5,510	--
Foreign currency translation adjustments	(6,009)	(1,919)	(5,943)
Funds provided by operations	10,000	37,287	16,270
Financing, Investment and Other Activities:			
Transactions in debt and capitalized lease obligations- Long-Term debt and capitalized lease obligations: Proceeds from sale of 15% Senior Notes and 12% subordinated debentures, net of issue costs	120,530	--	--
Other increases	1,474	--	25,698
Repayments	(161,500)	(760)	(9,409)
Restructured debt	--	158,058	--
Debt replaced, including conversion of receivable sales of $23,919, and short-term bank notes payable of $9,028	--	(158,058)	--
	(39,496)	(760)	16,289
Net increase (repayment) in short-term bank notes payable	2,107	(3,982)	(2,016)
Net increase (repayment) in debt and capitalized lease obligations	(37,389)	(4,742)	14,273
Issuance of:			
Common stock	21,310	--	449
Common stock purchase warrants	6,663	--	--
Salaried pension assets reversion	39,307	--	--
Plant and equipment additions	(5,546)	(1,871)	(10,819)
Advances to unconsolidated companies	(2,882)	--	--
Other -- net	269	1,531	848
Funds provided by (applied to) financing, investment and other activities	21,732	(5,082)	4,751
Increase in cash and temporary investments	$ 31,732	$ 32,205	$ 21,021
Cash Dividends	--	--	(2,369)
Increase in Cash and Temporary Investments	$ 31,732	$ 32,205	$ 18,652
Decrease (increase) in operating working capital (excluding cash items, debt and capitalized lease obligations):			
Accounts receivable	$ (23,908)	$ (5,327)	$ 42,293
Inventories	9,282	56,904	26,124
Refundable income taxes and related interest	11,289	(2,584)	(6,268)
Other current assets	259	10,008	(439)
Trade accounts payable	16,488	(1,757)	(3,302)
Employee compensation and benefits	698	(15,564)	(3,702)
Accrued plant closing costs	(3,888)	(14,148)	20,496
Other current liabilities	(3,181)	(15,927)	(3,030)
Decrease in operating working capital	$ 7,039	$ 11,605	$ 72,172

CONSOLIDATED STATEMENT OF SHAREHOLDERS' EQUITY

(Dollar amounts in thousands except per share figures)

	Preferred Stock	Common Stock	Capital in Excess of Par Value of Shares	Retained Earnings	Cumulative Translation Adjustments	Total
Balance at October 31, 1981	$ 10,000	$10,085	$87,932	$120,005	$ ---	$228,022
Cumulative translation adjustments through October 31, 1981					$ (1,195)	$ (1,195)
Issuance of Common Stock: 10,000 shares to Kobe Steel, Ltd.		10	91			101
38,161 shares under stock purchase and dividend reinvestment plans		39	309			348
Net (loss)				(76,531)		(76,531)
Cash dividends paid on: Preferred stock				(350)		(350)
Common stock $.20 per share				(2,019)		(2,019)
Translation adjustments, net of deferred income taxes of $128					(2,928)	(2,928)
Balance at October 31, 1982	10,000	10,134	88,332	41,105	(4,123)	145,448
Net (loss)				(34,630)		(34,630)
Translation adjustments, including deferred income taxes of $33					(899)	(899)
Balance at October 31, 1983	10,000	10,134	88,332	6,475	(5,022)	109,919
Issuance of:						
2,150,00 shares of common stock		2,150	19,160			21,310
2,000,000 common stock purchase warrants			6,663			6,663
17,500 shares of Series A $7.00 cumulative convertible preferred stock in discharge of dividends payable on preferred stock	1,750			(1,750)		---
Net income				15,176		15,176
Translation adjustments, net of deferred income taxes of $300					(5,874)	(5,874)
Other			178			178
Balance at October 31, 1984	$11,750	$12,284	$114,333	$19,901	$(10,896)	$147,372

Financial Notes

Note 1

Summary of Significant Accounting Policies

Consolidation - The consolidated financial statements include the accounts of all majority-owned subsidiaries except a wholly-owned domestic finance subsidiary, a subsidiary organized in 1982 as a temporary successor to a distributor, both of which are accounted for under the equity method, and a wholly-owned Brazilian subsidiary, which is carried at estimated net realizable value due to economic uncertainty. All related significant intercompany balances and transactions have been eliminated in consolidation.

Financial statements of certain consolidated subsidiaries, principally foreign, are included, effective in fiscal year 1984, on the basis of their fiscal years ending September 30; previously, certain of such subsidiaries had fiscal years ending July (See Note 2). Such fiscal periods have been adopted by the subsidiaries in order to provide for a more timely consolidation with the Corporation.

Inventories - The Corporation values its inventories at the lower of cost or market. Cost is determined by the last-in, first-out (LIFO) method for inventories located principally in the United States, and by the first-in, first-out (FIFO) method for inventories of foreign subsidiaries.

Operating Plants, Equipment and Depreciation - Properties are stated at cost. Maintenance and repairs are charged to expense as incurred and expenditures for betterments and renewals are capitalized. Effective in 1981, interest is capitalized for qualifying assets during their acquisition period. Capitalized interest is amortized on the same basis as the related asset. When properties are sold or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any gain or loss is included in income.

Depreciation of plants and equipment is provided over the estimated useful lives of the related assets, or over the lease terms of capital leases, using, effective in fiscal year 1984, the straight-line method for financial reporting , and principally accelerated methods for tax reporting purposes. Previously, accelerated methods, where applicable, were also used for financial reporting purposes (See Note 2). For U.S. income tax purposes, depreciation lives are based principally on the Class Life Asset Depreciation Range for additions, other than buildings, in the years 1973 through 1980, and on the Accelerated Cost Recovery System for all additions after 1980.

Discontinued facilities held for sale are carried at the lower of cost less accumulated depreciation or estimated realizable value, which aggregated $4.9 million and $3.6 million at October 31, 1984 and 1983, respectively, and were included in Other Assets in the accompanying Balance Sheet.

Pension Plans - The Corporation has pension plans covering substantially all of its employees. Pension expenses of the principal defined benefit plans consist of current service costs of such plans and amortization of the prior service costs and actuarial gains and losses over periods ranging from 10 to 30 years. The Corporation's policy is to fund at a minimum the amount required under the Employee Retirement Income Security Act of 1974.

Income Taxes - The consolidated tax provision is computed based on income and expenses recorded in the Statement of Operations. Prepaid or deferred taxes are recorded for the difference between such taxes and taxes computed for tax returns. The Corporation and its domestic subsidiaries file a consolidated federal income tax return. The operating results of Harnischfeger GmbH are included in the Corporation's U.S. income tax returns.

Additional taxes are provided on the earnings of foreign subsidiaries which are intended to be remitted to the Corporation. Such taxes are not provided on subsidiaries' unremitted earnings which are intended to be permanently reinvested.

Investment tax credits are accounted for under the flow-through method as a reduction of the income tax provision, if applicable, in the year the related asset is placed in service.

Reporting Format - Certain previously reported items have been conformed to the current year's presentation.

Note 2

Accounting Changes:

Effective November 1, 1983, the Corporation includes in its net sales products purchased from Kobe Steel, Ltd. and sold by the Corporation, to reflect more effectively the nature of the Corporation's transactions with Kobe. Previously only the gross margin on Kobe-originated equipment was included. During fiscal year 1984 such sales aggregated $28.0 million. Also, effective November 1, 1983, the financial statements of certain foreign subsidiaries are included on the basis of their fiscal years ended July 31. This change had the effect of increasing net sales by $5.4 million for the year ended October 31, 1984. The impact of these changes on net income was insignificant.

In 1984, the Corporation has computed depreciation expense on plants, machinery and equipment using the straight-line method for financial reporting purposes. Prior to 1984, the Corporation used principally accelerated methods for its U.S. operating plants. The cumulative effect of this change, which was applied retroactively to all assets previously subjected to accelerated depreciation, increased net income for 1984 by $11.0 million or $.93 per common and common equivalent share. The impact of the new method on income for the year 1984 before the cumulative effect was insignificant.

As a result of the review of its depreciation policy, the Corporation, effective November 1, 1983, has changed its estimated depreciation lives on certain U.S. plants, machinery and equipment and residual values on certain machinery and equipment, which increased net income for 1984 by $3.2 million or $.27 per share. No income tax effect was applied to this change.

The changes in accounting for depreciation were made to conform the Corporation's depreciation policy to those used by manufacturers in the Corporation's and similar industries and to provide a more equitable allocation of the cost of plants, machinery and equipment over their useful lives.

Note 3

Cash and Temporary Investments

Cash and temporary investments consisted of the following (in thousands of dollars):

	October 31,	
	1984	1983
Cash-in demand deposits	$2,155	$11,910
-in special accounts principally to support letters of credit	4,516	--
Temporary investments	89,336	52,365
	$ 96,007	$64,275

Temporary investments consisted of short-term U.S. and Canadian treasury bills, money market funds, time and certificates of deposit, commercial paper and bank repurchase agreements and bankers' acceptances. Temporary investments are stated at cost plus accrued interest, which approximates market value.

Note 4

Long-Term Debt, Bank Credit Lines and Interest Expense

Outstanding long-term debt payable to unaffiliated lenders was as follows (in thousands of dollars):

	October 31, 1984	1983
Parent Company:		
15% Senior Notes due April 15, 1994	$47,700	$ —
12% Subordinated Debentures, with an effective interest rate of 16.3%; sinking fund redemption payments of $7,500 due annually on April 15 in 1994-2003, and final payment of $25,000 in 2004	100,000	—
Term Obligations --		
Insurance company debt:		
9% Notes	—	20,000
9 7/8 Notes	—	38,750
8 7/8 Notes	—	40,500
Bank debt, at 105% of prime	—	25,000
Paper purchase debt, at prime or LIBOR, plus 1 1/4%	—	18,519
9.23% Mortgage Note due monthly to April, 1998	4,327	4,481
	152,027	147,250
Consolidated Subsidiaries		
Notes payable to banks in German marks	—	9,889
Contract payable in 1985-1989, in South African rands, with imputed interest rate of 12%	1,024	—
Other	—	36
	153,051	157,175
Less: Amounts payable within one year	644	17,799
Unamortized discounts	23,857	284
Long-Term Debt - excluding amounts payable within one year	$128,550	$139,092

Note 5

Harnischfeger Credit Corporation and Cranetex, Inc.

Condensed financial information of Harnischfeger Credit Corporation ("Credit"), an unconsolidated wholly-owned finance subsidiary, accounted for under the equity method, was as follows (in thousands of dollars):

Balance Sheet	**October 31, 1984**	**1983**
Assets		
Cash and temporary investments	$ 404	$ 19,824
Finance receivables - net	4,335	11,412
Factored account note and current account receivable from parent company	---	8,836
Other assets	4,181	661
	$ 8,920	$40,733
Liabilities and Shareholders' Equity		
Debt payable	$ ---	$ 32,600
Advances from parent company	950	---
Other liabilities	71	1,429
	1,021	34,029
Shareholders' equity	7,899	6,704
	$ 8,920	$40,733

Statement of Operations	**Year Ended October 31, 1984**	**1983**	**1982**
Revenues	$1,165	$2,662	$9,978
Less:			
Operating Expenses	1,530	3,386	14,613
Provision (credit) for income taxes	(1,560)	(222)	180
Net income (loss)	$1,195	$(502)	$(4,815)

Credit's purchases of finance receivables from the Corporation aggregated $1.1 million in 1984, $46.7 million in 1983 and $50.4 million in 1982. In 1982, Credit received income support of $4.0 million from the Corporation.

In 1982, the Corporation organized Cranetex, Inc. to assume certain assets and liabilities transferred by a former distributor of construction equipment, in settlement of the Corporation's and Credit's claims against the distributor and to continue the business on an interim basis until the franchise can be transferred to a new distributor. The Corporation recorded provisions of $2.5 million in 1983 and $2.3 million in 1982 and Credit recorded a provision of $6.7 million in 1982, for credit losses incurred in the financing of equipment sold to the former distributor.

The condensed balance sheet of Cranetex, Inc. was as follows (in thousand of dollars):

	October 31, 1984	October 31, 1983
Assets		
Cash	$ 143	$ 49
Accounts receivables	566	428
Inventory	2,314	3,464
Property and equipment	1,547	1,674
	$4,570	$5,615
Liabilities & Deficit		
Loans payable	$4,325	$6,682
Other liabilities	338	620
	4,663	7,302
Shareholders' (deficit), net of accounts and advances payable to parent company	(93)	(1,687)
	$4,570	$ 5,615

The net losses at Cranetex, Inc. of $.2 million in 1984, $2.1 million in 1983 and $1.0 million in 1982 were included in Equity in Earnings (loss) of Unconsolidated Companies in the Corporation's Statement of Operations.

Note 6

Transactions with Kobe Steel, Ltd. and ASEA Industrial Systems Inc.

Kobe Steel, Ltd. of Japan ("Kobe"), has been a licensee for certain of the Corporation's products since 1955, and has owned certain Harnischfeger Japanese construction equipment patents and technology since 1981. As of October 31, 1984, Kobe held 1,030,000 shares or 8.4% of the Corporation's outstanding Common Stock (See Note 13) Kobe also owns 25% of the capital stock of Harnischfeger of Australia Pty. Ltd., a subsidiary of the Corporation. This ownership appears as the minority interest on the Corporation's balance sheet.

Under agreements expiring in December, 1990 Kobe pays technical service fees on P&H mining equipment produced and sold under license from the Corporation, and trademark and marketing fees on sales of construction equipment outside of Japan. Net fee income received from Kobe was $4.3 million in 1984, $3.1 million in 1983, and $3.9 million in 1982; this income is included in Other Income in the accompanying Statement of Operations.

In October 1983, the Corporation entered into a ten-year agreement with Kobe under which Kobe agreed to supply the Corporation's requirements for construction cranes for sale in the United States as it phases out its own manufacture of cranes over the next several years, and to make the Corporation the exclusive distributor of Kobe-built cranes in the United States. The Agreement also involves a joint research and development program for construction equipment under which the Corporation agreed to spend at least $17 million over a three-year period and provided it does so, Kobe agreed to pay this amount to the Corporation. Sales of cranes outside the United States continue under the contract terms described in the preceding paragraph.

The Corporation's sales to Kobe, principally components for mining and construction equipment, excluding the R&D expenses discussed in the preceding paragraph, approximated $5.2 million, $10.5 million and $7.0 million during the three years ended October 31, 1984, 1983 and 1982, respectively. The purchases from Kobe of mining and construction equipment and components amounted to approximately $33.7 million, $15.5 million and $29.9 million during the three years ended October 31, 1984, 1983 and 1982, respectively, most of which were resold to customers (See Note 2).

The Corporation owns 19% of ASEA Industrial Systems Inc. ("AIS"), an electrical equipment company controlled by ASEA AB of Sweden. The Corporation's purchases of electrical components from AIS aggregated $11.2 million in 1984 and $6.1 million in 1983 and its sales to AIS approximated $2.6 million in 1984 and $3.8 million in 1983.

The Corporation believes that its transactions with Kobe and AIS were competitive with alternative sources of supply for each party involved.

Note 7

Inventories

Consolidated inventories consisted of the following (in thousand of dollars);

	October 31,	
	1984	**1983**
At lower of cost or market (FIFO method):		
Raw materials	$ 11,003	$ 11,904
Work in process and purchased parts	88,279	72,956
Finished goods	79,111	105,923
	178,393	190,783
Allowance to reduce inventories to cost on the LIFO method	(34,081)	(37,189)
	$144,312	$153,594

Inventories valued on the LIFO method represented approximately 82% of total inventories at both October 31, 1984 and 1983.

Inventory reductions in 1984, 1983 and 1982 resulted in a liquidation of LIFO inventory quantities carried at lower costs compared with the current cost of their acquisitions. The effect of these liquidations was to increase net income by 2.4 million or $.20 per common share in fiscal 1984, and to reduce the net loss by approximately $15.6 million or $1.54 per share in 1983, and by $6.7 million or $.66 per share in 1982; no income tax effect applied to the adjustment in 1984 and 1983.

Note 8

Accounts Receivable

Accounts receivable were net of allowances for doubtful accounts of $5.9 million and $6.4 million at October 31, 1984 and 1983, respectively.

Note 9

Research and Development Expense

Research and development expense incurred in the development of new products or significant improvements to existing products was $5.1 million in 1984 (net of amounts funded by Kobe Steel, Ltd.) $12.1 million in 1983 and $14.1 million in 1982.

Note 10

Foreign Operations

The net sales, net income (loss) and net assets of subsidiaries located in countries outside the United States and Canada and included in the consolidated financial statements were as follows (in thousands of dollars):

	Year Ended October 31,		
	1984	**1983**	**1982**
Net sales	$78,074	$45,912	$69,216
Net income (loss) after minority interests	828	(1,191)	3,080
Corporation's equity in total net assets	17,734	7,716	7,287

Foreign currency transaction losses included in Cost of Sales were $2.7 million in 1984, $1.2 million in 1983 and $1.3 million in 1982.

Note 11

Pension Plans and Other Postretirement Benefits

Pension expense for all plans of the Corporation and its consolidated subsidiaries was $1.9 million in 1984, $6.5 million in 1983 and $12.2 million in 1982.

Accumulated plan benefits and plan net assets for the Corporation's U.S. defined benefit plans, at the beginning of the fiscal years 1984 and 1983, with the data for the Salaried Employees' Retirement Plan as in effect on August 1, 1984, were as follows (in thousands of dollars):

	1984	1983
Actuarial present value of accumulated plan benefits:		
Vested	$52,639	$108,123
Nonvested	2,363	5,227
	$55,002	$113,350
Net assets available for benefits:		
Assets of the Pension Trusts	$45,331	$112,075
Accrued contributions not paid to the Trusts	16,717	12,167
	$62,048	$124,242

The Salaried Employees' Retirement Plan, which covers substantially all salaried employees in the U.S., was restructured during 1984 due to overfunding of the Plan. Effective August 1, 1984, the Corporation terminated the existing plan and established a new plan which is substantially identical to the prior plan except for an improvement in the minimum pension benefit. All participants in the prior plan became fully vested upon its termination. All vested benefits earned through August 1, 1984 were covered through the purchase of individual annuities at a cost aggregating $36.7 million. The remaining plan assets, which totaled $39.3 million, reverted to the Corporation in cash upon receipt of regulatory approval of the prior plan termination from the Pension Benefit Guaranty Corporation. For financial reporting purposes, the new plan is considered to be a continuation of the terminated plan. Accordingly, the $39.3 million actuarial gain which resulted from the restructuring is included in Accrued Pension Costs in the accompanying Balance Sheet and is being amortized to income over a ten-year period commencing in 1984. For tax reporting purposes, the asset reversion will be treated as a fiscal 1985 transaction. The initial unfunded actuarial liability of the new plan, computed as of November 1, 1983, of $10.3 million is also included in Accrued Pension Costs.

In 1982 and 1983, the Pension Trusts purchased certain securities with effective yields of 13% and 12%, respectively, and dedicated these assets to the plan benefits of a substantial portion of the retired employees and certain terminated employees with deferred vested rights. These rates, together with 9% for active employees in 1984, 8% in 1983 and 7 1/4% in 1982, were the assumed rates of return used in determining the annual pension expense and the actuarial present value of accumulated plan benefits for the U.S. plans.

The effect of the changes in the investment return assumption rates for all U.S. plans, together with the 1984 restructuring of the U.S. Salaried Employees' Plan, was to reduce pension expense by approximately $4.0 million in 1984 and $2.0 million in 1983, and the actuarial present value of accumulated plan benefits by approximately $60.0 million in 1984. Pension expense in 1983 was also reduced $2.1 million from the lower level of active employees. Other actuarial gains, including higher than anticipated investment results, more than offset the additional pension costs resulting from plan changes and interest charges on balance sheet accruals in 1984 and 1983.

The Corporation's foreign pension plans do not determine the actuarial value of accumulated benefits or net assets available for retirement benefits as calculated and disclosed above. For those plans, the total of the plans' pension funds and balance sheet accruals approximated the actuarially computed value of vested benefits at both October 31, 1984 and 1983.

The Corporation generally provides certain health care and life insurance benefits for U.S. retired employees. Substantially all of the Corporation's current U.S. employees may become eligible for such benefits upon retirement. Life insurance benefits are provided either through the pension plans or separate group insurance arrangements. The cost of retiree health care and life insurance benefits, other than the benefits provided by the pension plans, is expensed as incurred; such costs approximated $2.6 million in 1984 and $1.7 million in 1983.

Note 12

Income Taxes

Domestic and foreign income (loss) before income tax effects was as follows (in thousands of dollars):

	Year Ended October 31,		
	1984	1983	1982
Domestic	$1,578	$(35,412)	$(77,600)
Foreign			
Harnischfeger GmbH	432	(2,159)	(475)
All other	3,728	4,768	8,418
	4,160	2,609	7,943
Total income (loss) before income tax effects, equity items and cumulative effect of accounting change	$5,738	$(32,803)	$(69,657)

Provision (credit) for income taxes, on income (loss) before income tax effects, equity items and cumulative effect of accounting change, consisted of (in thousands of dollars):

	1984	1983	1982
Currently payable (refundable):			
Federal	$ ----	$(7,957)	$(9,736)
State	136	297	70
Foreign	2,518	3,379	5,376
	2,654	(4,281)	(4,290)
Deferred (prepaid):			
Federal	----	2,955	2,713
State and foreign	(229)	(74)	(23)
	(229)	2,881	2,690
Provision (credit) for income taxes	$2,425	$(1,400)	$(1,600)

Unremitted earnings of foreign subsidiaries which have been or are intended to be permanently reinvested were $19.1 million at October 31, 1984. Such earnings, if distributed, would incur income tax expense of substantially less than the U.S. income tax rate as a result of previously paid foreign income taxes, provided that such foreign taxes would become deductible as foreign tax credits. No income tax provision was made in respect of the tax-deferred income of a consolidated subsidiary that has elected to be taxed as a domestic international sales corporation. The Deficit Reduction Act of 1984 provides for such income to become nontaxable effective December 31, 1984.

At October 31, 1984, the Corporation had federal tax operating loss carry-forwards of approximately $70.0 million, expiring in 1998 and 1999, for tax return purposes, and $88.0 million for book purposes. In addition, the Corporation had for tax purposes, foreign tax credit carry-forwards of $3.0 million (expiring in 1985 through 1989), and investment tax credit carry-forwards of $1.0 million (expiring in 1997 through 1999). For book purposes, tax credit carry-forwards approximately $8.0 million. The carry-forward will be available for the reduction of future income tax provisions, the extent and timing of which are not determinable.

Differences in income (loss) before income taxes for financial and tax purposes arise from timing differences between financial and tax reporting and relate to depreciation, consolidating eliminations for inter-company profits in inventories, and provisions, principally, for warranty, pension, compensated absences, product liability and plant closing costs.

During 1983 an examination of the Corporation's 1977-1981 federal income tax returns and certain refund claims was completed by the Internal Revenue Service, and as a result, a current credit for federal income taxes of $8.0 million was recorded in 1983, $3.0 million of which was applied to the reduction of prepaid income taxes.

In 1984, tax credits fully offset any federal income tax otherwise applicable to the year's income, and in 1983 and 1982, the relationship of the tax benefit to the pre-tax loss differed substantially from the U.S. statutory tax rate due principally to losses from the domestic operations for which only a partial federal tax benefit was available in 1982. Consequently, an analysis of deferred income taxes and variance from the U.S. statutory rate is not presented

Report of Independent Accountants

Price Waterhouse
Milwaukee, Wisconsin
November 29, 1984

To the Directors and Shareholders of Harnischfeger Corporation

In our opinion, the financial statements, which appear on pages 18 to 34 of this report, present fairly the consolidated financial position of Harnischfeger Corporation and its subsidiaries at October 31, 1984 and 1983, and the results of their operations and the changes in their financial position for each of the three years in the period ended October 31, 1984, in conformity with generally accepted accounting principles consistently applied during the period except for the change, with which we concur, in the method of accounting for depreciation expense as described in Note 2 of this report. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Price Waterhouse