

HARMON INDUSTRIES, INC.
SECOND QUARTER REPORT
SIX MONTHS ENDED JUNE 30, 1996



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Report to Shareholders

We continue to set records for sales and earnings. Our second quarter ended June 30, 1996, was our best quarter ever. Sales were \$39.1 million, 19 percent ahead of last year's second quarter. Strong showings from our systems business and asset management services operations were the major elements that produced our increased sales. Net earnings for the second quarter increased 29 percent to a new high of \$2.7 million compared with \$2.1 million a year earlier. Earnings per share were 39 cents versus 30 cents.

With two consecutive record breaking quarters in hand, the Company's six-month sales and earnings reached record highs also. Sales were \$77.5 million, up more than 24 percent from last year's six-month sales of \$62.3 million. Net earnings set a new record of \$4.7 million, up 71 percent from the \$2.8 million earned in the first six months last year. Earnings per share were 69 cents compared with 41 cents last year.

Incoming orders were \$35 million in the second quarter and \$36.1 million in the first quarter, a six-month performance roughly equal to that of last year.

Freight Railroad Activity

Our level of business activity with freight railroads remained steady. Orders from these customers were up approximately five percent for the six-month period

ended June 30, 1996. We believe this enhanced performance is due largely to our superior technology, our ability to deliver complete systems, our focus on customer service and our strategic thrust to provide innovative services. In fact, shortly after the close of this quarter, we reached an agreement with one of our major customers to provide an innovative turnkey signalling and crossing upgrade over a 150 mile segment of track. This project includes engineering, supply, delivery and installation of the entire signal systems. The project represents a significant step forward in creating effective partnerships with our customers.

Transit Outlook

Orders booked from the transit sector are numerous but still below those of last year, chiefly because we have not yet booked any major order this year. Sometime during the second half of this year, we expect to receive awards of several contracts where we are the apparent low bidder. These projects include a major award of a very large signalling contract in New Jersey, an extension of a contract in Southern California and several smaller signalling projects elsewhere.

Acquisition

We acquired United Kingdom-based Vaughan Systems on July 1, 1996. Vaughan is a software systems supplier

which produces custom-designed train describer and passenger information systems. Redesignated *Vaughan Harmon Systems Ltd.*, it is the industry leader in technology and market share for its market segment, and it stands to benefit greatly from the current resurgence in the UK rail market.

Vaughan's software capabilities and systems fit naturally with our advanced technologies in microprocessor-based interlockings and highway crossing systems. Our train control systems provide Vaughan with a high technology platform for expansion of its signal control systems within the U.K while their train describer and passenger information systems appear to have direct applicability to our entire office systems product line and our domestic transit market.

Shortly after we acquired Vaughan, it received a \$5.3 million order for a cab secure radio system from Railtrack. This order, its existing backlog and quotation activity indicate a strong demand for Vaughan's products in the U.K. and illustrates the timeliness of our acquisition.

Profit Margins

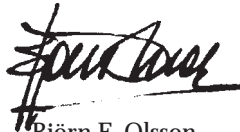
Profit margins at the six-month mark were higher than they were a year ago, chiefly because of increased sales and better efficiencies in the manufacture of certain products. Operating income, which includes a 40 percent *increase* in

research and development (R&D) expenditures, was 10.3 percent of sales for the first six months of 1996 compared with 7.8 percent a year earlier. A major factor in this improvement was a 2.2 percentage point reduction in SG&A expenses as a percentage of sales. Return on capital employed increased to 27.3 percent compared with 19.0 percent at mid-year 1995.

Harmon's balance sheet also showed considerable improvement with interest-bearing debt declining approximately \$6.3 million (51 percent) since the beginning of 1996.

Conclusion

Our excellent performance this year is the result of our technological strength and strong emphasis on customer service. Our focus on complete solutions, including engineering, products, just-in-time delivery and innovative services is directly in line with the expectations of our major customers and provides an excellent foundation for the remainder of 1996.



Björn E. Olsson
President and Chief Executive Officer

Blue Springs, Missouri
August 2, 1996

Consolidated Statements of Earnings (Unaudited)

(Dollars in thousands)

	Three months ended June 30,		Six months ended June 30,	
	1996	1995	1996	1995
Net sales	\$ 39,111	\$ 32,854	\$ 77,509	\$ 62,269
Cost of sales	26,141	21,971	53,366	43,279
Research and development expenditures	1,726	1,236	3,183	2,279
Gross profit	11,244	9,647	20,960	16,711
Selling, general and administrative expenses	6,560	5,990	12,724	11,602
Amortization of cost in excess of fair value of net assets acquired	137	133	274	266
Miscellaneous (income) expense—net	(14)	(7)	(30)	(32)
Operating income	4,561	3,531	7,992	4,875
Interest expense	(234)	(190)	(489)	(337)
Investment income	29	60	198	76
Earnings before income taxes	4,356	3,401	7,701	4,614
Income tax expense (benefit):				
Current	1,723	1,414	3,008	1,949
Deferred	(24)	(71)	(40)	(99)
	1,699	1,343	2,968	1,850
Net earnings	\$ 2,657	\$ 2,058	\$ 4,733	\$ 2,764
Net earnings per common share	\$ 0.39	\$ 0.30	\$ 0.69	\$ 0.41
Weighted average shares outstanding (000s)	6,840	6,824	6,835	6,819

Board of Directors

Robert E. Harmon
Chairman of the Board

Thomas F. Eagleton
*Attorney-at-Law
Thompson & Coburn
St. Louis, Missouri*

Bruce M. Flohr
*Chairman & CEO
RailTex, Inc., San Antonio, Texas*

Charles M. Foudree
*Executive Vice President—Finance,
Treasurer and Secretary*

Rodney L. Gray
*Chairman & CEO
Enron International, Inc.
Houston, Texas*

Herbert M. Kohn
*Attorney-at-Law
Bryan Cave, Kansas City, Missouri*

* Gary E. Ryker
*Executive Vice President
Marketing, Sales and Support*

Douglass Wm. List
*Management Consultant
Baltimore, Maryland*

Gerald E. Myers
*Management Consultant
Tempe, Arizona*

Björn E. Olsson
President and Chief Executive Officer

Donald V. Rentz
*Grant Leighton Associates of Texas, Inc.
Plano, Texas*

Judith C. Whittaker
*Vice President—Legal
Hallmark Cards, Inc.
Kansas City, Missouri*

* Denotes Advisory Director

Condensed Consolidated Balance Sheets (Unaudited)

(Dollars in thousands)

	June 30, 1996	Dec. 31, 1995
Assets		
Current assets	\$ 52,596	\$ 56,841
Net property, plant and equipment	15,771	14,177
Other assets	15,204	15,827
	\$ 83,571	\$ 86,845
Liabilities and Stockholders' Equity		
Current liabilities	\$ 20,729	\$ 21,827
Long-term liabilities	9,387	15,786
Stockholders' equity	53,455	49,232
	\$ 83,571	\$ 86,845

Management

Björn E. Olsson
President and Chief Executive Officer

Charles M. Foudree
*Executive Vice President—Finance,
Treasurer and Secretary*

Lloyd T. Kaiser
Executive Vice President—Systems

Gary E. Ryker
*Executive Vice President
Marketing, Sales and Support*

Ronald G. Breshears
Vice President—Human Resources

Richard A. Daniels
Vice President—Transit Sales

Robert E. Heggestad
Vice President—Technology

J. Randall John
Vice President—Services

John W. Johnson
Vice President—Domestic Sales

Raymond A. Rosewall
Vice President—Manufacturing

William J. Scheerer
*Vice President—Applications
Engineering*

Stephen L. Schmitz
Vice President—Controller

William L. Bush
Director—Research & Development

Jeffrey J. Utterback
Director—Quality Assurance

Domestic Operations

Riverside, California (4) †
Jacksonville, Florida
Atlanta, Georgia
Louisville, Kentucky
Lee's Summit, Missouri
Grain Valley, Missouri (3) †
Warrensburg, Missouri (2) †
Omaha, Nebraska
Hauppauge, New York

† Denotes number of locations

International Locations

Harmon Industries
Lausanne, Switzerland
Henkes-Harmon Industries, Pty. Ltd.
Mooroolbark, Victoria, Australia
Vale-Harmon Enterprises, Ltd.
Saint-Laurent, Quebec, Canada
Vaughan Harmon Systems Ltd.
Ware, England

Corporate Headquarters

1300 Jefferson Court
Blue Springs, Missouri 64015
☎ 816/229-3345
Telefax: 816/229-0556



1300 Jefferson Court
Blue Springs, Missouri 64015

Second Quarter Report to Shareholders