

HARMON INDUSTRIES, INC.
THIRD QUARTER REPORT
NINE MONTHS ENDED SEPTEMBER 30, 1996



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Report to Shareholders

Our performance for the third quarter established new records. Sales were \$42 million, 10 percent ahead of the same quarter a year ago. Net earnings were \$2.5 million, nine percent above last year's third quarter. Earnings per share were 36 cents versus 33 cents.

With three consecutive record breaking quarters in hand, the Company's nine-month sales and earnings accordingly reached record highs also. Sales were \$119.5 million, up more than 19 percent from last year's nine-month sales of \$100.3 million. Cumulative nine-month net earnings were up 43 percent, establishing a new record of \$7.2 million compared with \$5.0 million earned in the first nine months last year. Earnings per share were \$1.06 compared with \$0.74.

Incoming Orders at Record Levels

We booked \$57 million in new orders in the third quarter. This is more than double last year's third quarter order level. Year-to-date orders are \$128 million, about 30 percent ahead of last year. Our freight market accounted for the major portion of this year's orders, which included the largest turnkey railroad signaling system and crossing upgrade for a Class I railroad in our history. International orders increased

appreciably from last year and accounted for roughly 10 percent of this year's bookings. Our transit business has been slow, having booked just \$3.9 million since the start of the year. Transit orders should improve shortly, however, as we expect to receive a major contract later this month.

Acquisitions

The timing of our acquisition in July of Great Britain-based Vaughan Systems Ltd. (now Vaughan Harmon Systems Ltd.) was fortuitous as it is already making a significant contribution to our overall sales volume. During the third quarter, it booked orders of \$8.4 million, an amount greater than its annual sales of recent years.

On the domestic front, we acquired two contract engineering companies in Jacksonville, Florida, last month, thereby continuing to enhance and solidify our position as a signal and engineering design company within the railroad supply industry.

Profit Margins

Profit margins at the nine-month mark were up over those of a year ago, chiefly because of manufacturing efficiencies that traditionally accompany higher sales. Operating income, which includes

a 24.3 percent *increase* in research and development expenditures, was 10.1 percent of sales for the first nine months of 1996 compared with 8.2 percent a year earlier.

Improved cash flows enabled us to reduce borrowings by \$1.6 million for this year's third quarter compared to the third quarter of 1995, thus reducing our third quarter interest expense about 37 percent from that of a year ago. At quarter's end, interest-bearing debt had declined to \$6.7 million, a drop of roughly \$5.8 million since the beginning of 1996.

High Speed Train Demonstration

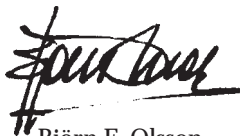
On October 11, CNN's "Headline News" carried the story of our ITCS high speed train demonstration in Michigan. Amtrak tested our high speed train control system at 101 mph over a distance of 20 miles. It was a successful demonstration of our technology, which provides a cost-effective means of improving safety and reducing travel times, a critical step in making high-speed passenger trains attainable. The goal of the project, which is expected to be completed in about a year, is to reduce the trip time from Detroit to Chicago to about 3.5 hours or less. The success of this demonstration has

prompted interest in similar demonstrations from the international markets.

Conclusion

Our continued focus on providing customers with leading edge technology and service has enabled Harmon to grow substantially at a time when much of the rail-supply industry is experiencing difficulties.

We are pleased with our results, not only because sales and earnings are growing, but also for the underlying reasons that caused them. This performance, which is an exception to the general tone of the railroad supply industry, is clear evidence that our overall business strategy is working. In short, our strategy of adapting and anticipating our customers' buying methods are the principal reasons for our excellent year to date and the source of our confidence for the remainder of 1996.



Björn E. Olsson
President and Chief Executive Officer

Blue Springs, Missouri
November 1, 1996

Consolidated Statements of Earnings (Unaudited)

(Dollars in thousands)

	Three months ended September 30,		Nine months ended September 30,	
	1996	1995	1996	1995
Net sales	\$41,957	\$38,026	\$119,465	\$100,296
Cost of sales	29,721	26,954	83,086	70,254
Research and development expenditures	1,492	1,503	4,676	3,761
Gross profit	10,744	9,569	31,703	26,281
Selling, general and administrative expenses	6,491	5,464	19,216	17,067
Amortization of cost in excess of fair value of net assets acquired	154	144	428	410
Miscellaneous (income) expense—net	(14)	(13)	(45)	(45)
Operating income	4,113	3,974	12,104	8,849
Interest expense	(123)	(197)	(612)	(534)
Investment income	28	4	226	80
Earnings before income taxes	4,018	3,781	11,718	8,395
Income tax expense (benefit):				
Current	1,554	1,524	4,561	3,473
Deferred	(24)	(23)	(64)	(122)
	1,530	1,501	4,497	3,351
Net earnings	\$ 2,488	\$ 2,280	\$ 7,221	\$ 5,044
Net earnings per common share	\$ 0.36	\$ 0.33	\$ 1.06	\$ 0.74
Weighted average shares outstanding (000s)	6,844	6,837	6,838	6,825

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)

	Sept. 30, 1996	Dec. 31, 1995
Assets		
Current assets	\$ 61,801	\$ 56,841
Net property, plant and equipment	17,190	14,177
Other assets	15,678	15,827
	\$ 94,669	\$ 86,845
Liabilities and Stockholders' Equity		
Current liabilities	\$ 28,965	\$ 21,827
Long-term liabilities	9,603	15,786
Stockholders' equity	56,101	49,232
	\$ 94,669	\$ 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

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Harmon
INDUSTRIES

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Blue Springs, Missouri 64015

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