



Twin Disc 1998 Annual Report

About the cover:
The Liwa all-wheel-drive wildfire-fighting vehicle represents a demanding new application for Twin Disc's rugged, proven 1175 Series Automatic Transmission System.

Twin Disc, Incorporated is an international manufacturer and distributor of heavy-duty off-highway power transmission equipment. Company engineers work hand-in-hand with customers and engine manufacturers to design products with characteristics unique to their specific applications. ■ Twin Disc supplies the commercial, pleasure craft and military segments of the marine market with transmissions, surface and waterjet drives and electronic controls. Its off-highway transmission products are used in agricultural, all-terrain specialty vehicle and military applications. Twin Disc also sells industrial products such as power take-offs, mechanical, hydraulic, and modulating clutches and control systems to the agricultural, environmental and energy and natural resources markets. ■ The Corporation, which is a multi-national organization headquartered in Racine, Wisconsin, currently has a diverse shareholder base with approximately one-third of the outstanding shares held by management, active and retired employees and other long-term investors.



Lanier Racing is turning heads on the Super Boat Association offshore racing circuit with its 41' super unlimited catamaran hulls powered by twin Eickert 960 hp engines driving Arneson ASD 8 Surface Drives to speeds of 130 mph.

This new Ziegler 6x6 ARFF (Aircraft Rescue Fire Fighting) vehicle is ready to move into action at Münster Osnabrück Airport, equipped with a Mercedes 1025 hp engine driving through a Twin Disc TD-61-2619 Fully Automatic Transmission featuring an 8-MLW-1856 Torque Converter.

Financial Highlights



	1998	1997	1996
Net Sales	\$ 202,643	\$ 189,942	\$ 176,657
Net Earnings	9,363	7,729	6,559
Basic Earnings Per Share	3.30	2.78	2.36
Diluted Earnings Per Share	3.24	2.75	2.34
Dividends Per Share	.76	.70	.70
Average Shares Outstanding For The Year	2,833,663	2,781,174	2,777,805
Fully Diluted Shares Outstanding For The Year	2,886,209	2,808,226	2,805,123

Sales and Earnings by Quarter

1998	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Year
Net Sales	\$47,880	\$53,994	\$49,029	\$51,740	\$202,643
Gross Profit	9,936	12,250	12,810	15,132	50,128
Net Earnings	1,356	2,116	2,384	3,507	9,363
Basic Earnings Per Share	.48	.75	.84	1.23	3.30
Diluted Earnings Per Share	.47	.73	.82	1.21	3.24
Dividends Per Share	.19	.19	.19	.19	.76
Stock Price Range (High-Low)	30% - 28%	34% - 29%	33% - 29 ¹⁵ / ₁₆	33% - 32 ¹ / ₁₆	34% - 28%

1997	1st Qtr.	2nd Qtr.	3rd Qtr.	4th Qtr.	Year
Net Sales	\$40,941	\$45,496	\$49,204	\$54,301	\$189,942
Gross Profit	8,687	10,980	11,724	12,428	43,819
Net Earnings	1,132	1,742	1,916	2,939	7,729
Basic Earnings Per Share	.41	.63	.69	1.05	2.78
Diluted Earnings Per Share	.40	.62	.68	1.04	2.75
Dividends Per Share	.175	.175	.175	.175	.70
Stock Price Range (High-Low)	23% - 21%	22% - 21%	25% - 21%	28% - 23%	28% - 21%

Based on average shares outstanding for the period.
In thousands of dollars except per share and stock price range statistics.

To Our Shareholders

We are pleased that fiscal 1998 was an outstanding year for Twin Disc.

Net earnings rose 21 percent resulting in a five year compound growth rate of 29 percent. Fiscal 1998 earnings increased to \$9.4 million, or \$3.30 per share, from \$7.7 million, or \$2.78 per share, a year earlier.

Net sales surpassed the \$200 million mark two years ahead of the goals set forth in our Growth Challenge. Net sales for the year totaled \$202.6 million, an increase of 7 percent from \$189.9 million for the prior year.

Return On Net Assets Employed (RONAE) improved 4.5 percentage points to 16.1 percent and is on track with our challenge to exceed our cost of capital consistently which, in terms of RONAE, now stands at 18 percent.

As a result of the Company's strong operating performance, the Board of Directors on July 31, 1998, raised the dividend 11% to an annual rate of \$.84 per share.

The growth strategies and operational initiatives we have implemented in the last several years have produced a trend of improved financial results that is expected to continue in the years ahead.

Operations Review

DOMESTIC

Our domestic business was excellent as net sales increased 12 percent to \$147.8 million from \$131.8 million last year. We experienced strong demand for pleasure boat transmissions and industrial products that more than offset the midyear completion of a transmission contract.

Pre-tax earnings of our domestic operations advanced 32 percent to \$7.9 million from \$6.0 million the previous year. While the increase in earnings is partly the result of higher sales, the better performance also reflects improved margins through greater productivity.

OVERSEAS

Net sales of our overseas operations, however, declined 6 percent to \$54.8 million from \$58.1 million last year. The downturn was related primarily to softer demand in Asian commercial marine markets, while European sales remained steady.

Pre-tax earnings of our overseas operations increased 21 percent to \$8.1 million from \$6.7 million a year ago. Although sales in our overseas markets were down, production volume at our Belgian subsidiary was up significantly due to robust demand for smaller pleasure craft marine transmissions in North America.

CASH FLOW AND FINANCIAL CONDITION

Our cash from operating activities totaled \$7.0 million, down from \$20.5 million last year, largely because of the prepayment of a pension obligation. We expect to continue to generate positive operating cash flow in fiscal 1999 and beyond.

Capital expenditures were \$7.2 million in fiscal 1998, up from \$4.7 million last year. We expect capital expenditures to exceed depreciation in the next few years as manufacturing cell configurations are refined. Also during the year we invested \$1.0 million in a new subsidiary. Finally, dividends totaling \$2.2 million were paid compared with \$1.9 million a year ago.

At June 30, 1998, long-term debt totaled \$19.9 million equal to 24 percent of equity and 20 percent of capitalization. Our financial condition remains strong and ample to finance future growth opportunities.

Strategic Initiatives

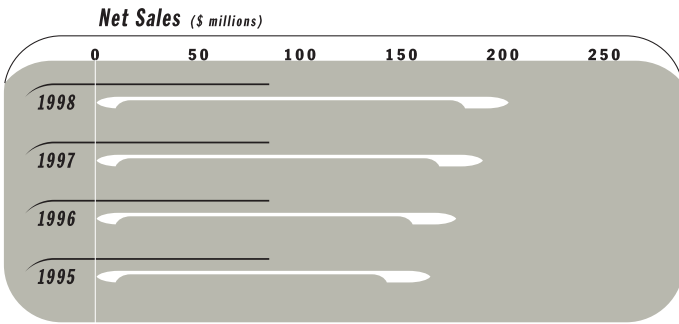
GROWTH

As previously mentioned, we are pleased to report that our first Growth Challenge—to achieve revenues of \$200 million by fiscal year 2000—was attained two years ahead of schedule. This accomplishment was reached primarily by internal product development and improving market demand.

Looking ahead, we have established a new Growth Challenge to attain revenues of \$300 million by fiscal year 2003. To achieve the incremental volume, we are presently working on growth initiatives totaling over \$200 million; of course not all projects will materialize nor maintain their expected timetables. These initiatives include internal product development programs as well as acquisitions. We are actively pursuing acquisitions that will complement our industrial products, marine and off-highway transmission businesses. In addition, we are seeking opportunities that will add a fourth major operating unit related to our core businesses.

PEOPLE

By far our most important resource is people. To succeed in today's fast-paced and highly competitive world economy, Twin Disc needs well-trained and flexible employees—from the corporate office to the shop floor—that can respond effectively to changing customer and market needs. We believe that we have excellent employees who will provide the capability to carry us forward successfully into the next millennium. Our salaried staff worldwide benchmarks well against updated job standards and participates in a Performance and Competency Measurement Program. A variety of training programs have been developed to update employees on the latest techniques and technologies as well as reach required competencies.



Our domestic hourly employees also participate in annual performance reviews as a part of their pay-for-skills compensation program. This incentive for cross-training has directly improved productivity.

QUALITY

Our commitment to quality is more than just ensuring that we are manufacturing a world-class product. Twin Disc and its employees are striving to achieve complete customer satisfaction.

Twin Disc is recognized around the world for our durable designs and quality manufacturing. Our engineers utilize the latest techniques and technologies as well as rigorous laboratory and field testing before our products are introduced to the marketplace. Our manufacturing facilities have been certified ISO 9001 and our cellular manufacturing process ensures consistent quality. In addition, most of our marketing subsidiaries have qualified for ISO 9002 status.

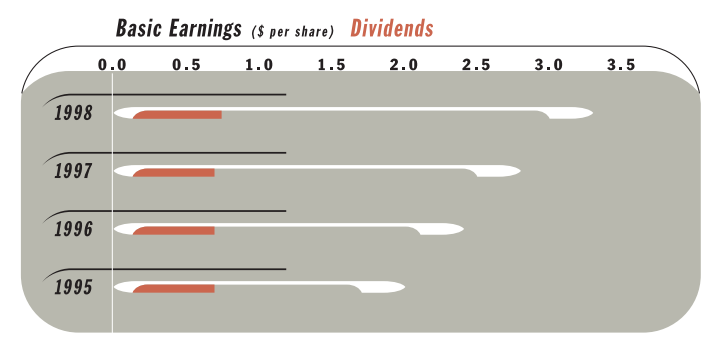
Yet to achieve total customer satisfaction, we must still provide predictable and timely delivery. Our challenge has been to achieve 95 percent on-time delivery by fiscal year 1998. While this challenge was not attained on schedule, significant improvement was made during the year. We expect to make further strides in the year ahead.

PERFORMANCE

Our primary focus is to enhance shareholder value. To accomplish this objective, we seek to increase market share and provide consistently improved earnings as well as returns in excess of our cost of capital. Specifically, we seek to grow earnings per share by a minimum of 10 percent annually over a three-year period and to generate a minimum return on net assets employed (RONAE) equivalent to our cost of capital of 18 percent.

Over the past three years, basic earnings per share increased at a 28 percent compound rate. Attention is being focused on growing volume as well as increasing operating efficiency and productivity.

RONAE increased to 16.1 percent from 11.6 percent during the last year. While not yet at our target rate, the improving trend is the result of better margins and better working capital management. We remain optimistic about our prospects to achieve consistent returns in excess of our cost of capital.



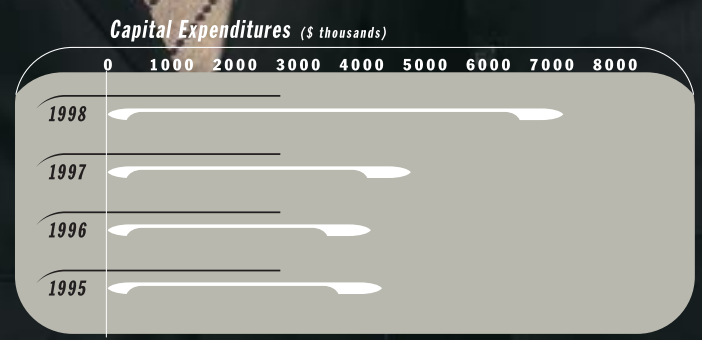
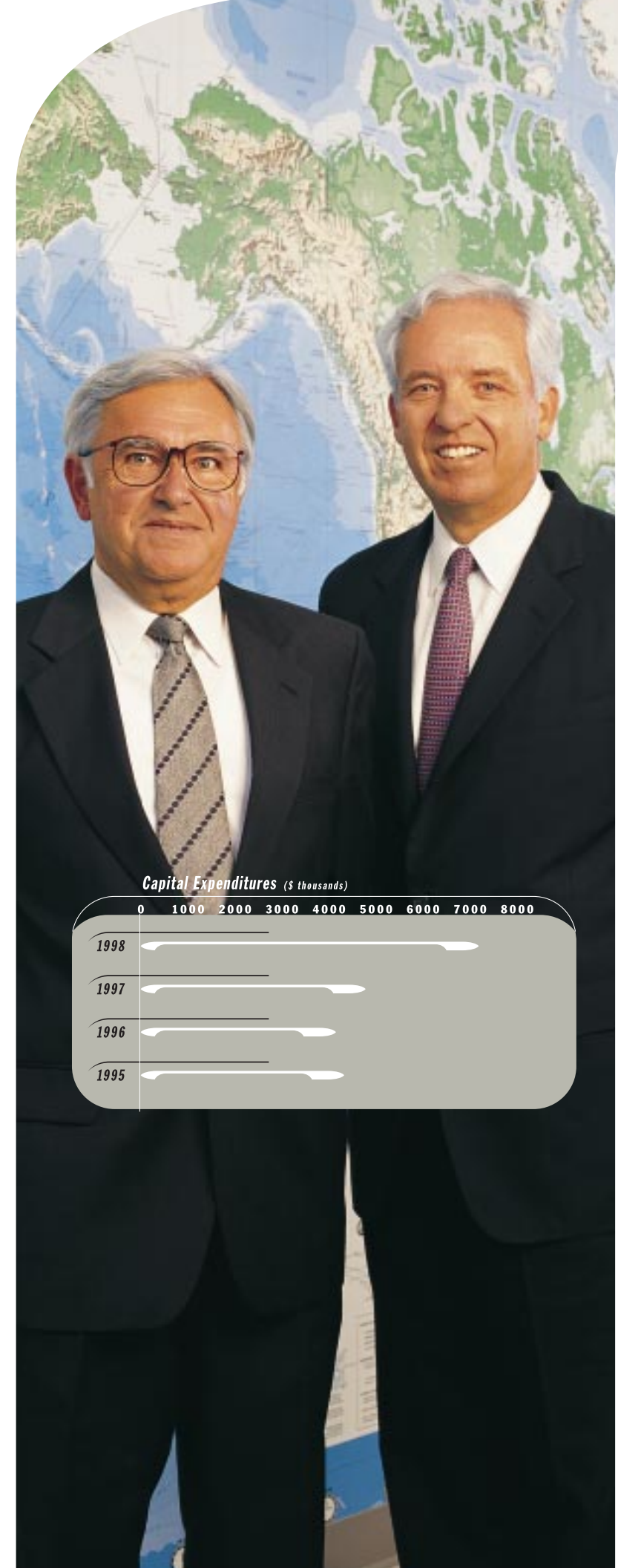
DIRECTOR RETIREMENT AND NOMINATION

Pursuant to the terms of our corporate policy, Stuart W. Tisdale will retire from the Board at the 1998 Annual Meeting. First elected as a director in 1980, Stu has been a solid and consistent contributor to the Company's growth and welfare over the past 18 years. His business acumen and constructive advice will be missed by his fellow directors and management.

To fill the vacancy created by the retirement, the Board has nominated Mr. John A. Mellowes, Chairman and Chief Executive Officer of Charter Manufacturing, to a three-year term. Charter Manufacturing is an integrated producer of steel and fastener products for the automotive industry. John brings to Twin Disc a successful career of growing manufacturing operations in a highly competitive environment.

OUTLOOK

Near-term our backlog of orders to be shipped within the next six months totaled \$54 million at June 30, 1998, down 29 percent from June 1997. The decline from a year ago reflects the completion of a transmission contract as well as a recent softening in demand in the Pacific Rim.



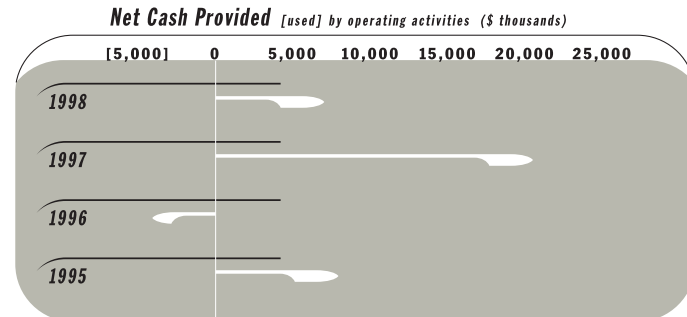
With the absence of the transmission contract and slower orders, the first six months of the new fiscal year will return to more historical levels. However, we anticipate sales to pick up in the second half as the result of more new business.

Longer-term, the outlook for Twin Disc is optimistic. As indicated previously, we are working on projects totaling over \$200 million that should add \$100 million in incremental volume over the next five years. The combination of internal product development and acquisitions should keep the Company on a growth curve that will outpace our markets.

We are very pleased with our financial results for fiscal 1998, and while we expect slower demand for the first six months of fiscal 1999, we anticipate higher sales and earnings in the longer term as a result of product demand and our strategies to achieve our Growth Challenges. In closing, we would like to thank our shareholders, customers, suppliers and employees for their support—without whom our continued growth would not be possible.

Michael E. Batten
Michael E. Batten
 Chairman, Chief Executive Officer

Michael H. Joyce
Michael H. Joyce
 President, Chief Operating Officer



*Excludes the impact of the adoption of FASB Statements 106 and 109.

Application diversity creates specialized market opportunities.

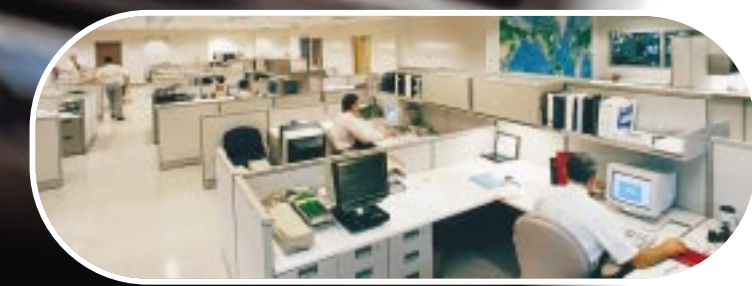


What will we think of next?



Our extensive knowledge of power transmission expands with each application. Though the physics remain basically the same, the implementation of those physics requires specialized engineering skills combined with proven transmission technology. We have the building blocks to deliver successful new products faster than ever before. The remarkable 3600 off-road transporter transmission system was designed in just seven months. And a combined Twin Disc/NICO team delivered the initial six models of the MG-6000 series marine transmission in less than sixteen months.

Through our ability to design, engineer, manufacture and sell and support to varied installations across the world, Twin Disc is recognized globally as a resource for proprietary transmission knowledge. This expanding engineering expertise combined with our evolving product line is our leverage to future growth. The only question is, what will we think of next?



In a sophisticated automatic power transmission system helping to propel a 1000 horsepower fire truck weighing 30 tons up to 50 miles per hour in 30 seconds, one thing leads to another. Thousands of parts interact in precise sequences, electronically actuated, to transmit power under optimum traction to the wheels.

As a company, Twin Disc is an intricately designed, sturdily built machine performing a sequence of events that ultimately makes possibilities of performance into realities of productivity. With our proven design, engineering and manufacturing components, we focus our energies on specific markets and customers requiring unique transmission solutions. Many of the challenges today involve programable transmission systems that electronically adapt to changing terrain or work environments, such as experienced by off-road transporters.

Improved manufacturing skills give us tremendous options in the global arena.



THE LONDON INTERNATIONAL
Boat Show 98

personnel. We instituted a pay-for-skills compensation plan to encourage shop floor personnel to increase their flexibility through cross-training to develop and learn new skills. And our Operations Planning System has streamlined all inter-departmental activities. The success of these commitments is amply evident in our Racine manufacturing plant, where we've doubled sales per employee in the last four years.

About two years ago the company completed ISO 9001 certification for its U.S. and European manufacturing facilities. Then we deployed our global business system to advance consistent training and performance standards throughout

our operations. These measures have taken positive effect. Lead times have been reduced. Quality has been improved. Costs have been contained. While these remain ongoing challenges, the Company is in better condition than ever to deliver its goods.

We've proven to ourselves and our customers that we have evolved to a world-class manufacturing entity. The success of this past year reflects it. The challenges of tomorrow will demand it.

Our products are complex and require sophisticated manufacturing capabilities and a skilled, motivated workforce. The last five years, Twin Disc has engaged in a number of rigorous programs to improve its manufacturing abilities. The world market expects world-class manufacturing quality and delivery.

We've made significant investments in new manufacturing equipment, updating plants in the United States and Europe, and training and expanding the flexibility of our manufacturing



We've built the machine that will manufacture our future.



From native intelligence to brainware to machines, we have what it takes.

Twin Disc has the engineering expertise to anticipate the power transmission challenges a vehicle or machine will face, and the resources to develop a specific product or system solution to meet those challenges.

Using disciplines such as computerized systems modeling, torsional vibration analysis and finite element analysis, we can design a system for optimum efficiency.

We then can show proof of concept in our fully automated test facility, where we run accelerated endurance tests around the clock, speeding development and customer response time.

Many of our transmission systems, both vehicular and marine, incorporate electronic controls. Many more will, as control of power differentiates transmission systems more than the gear boxes. Twin Disc designs, develops and supplies electronic components for its products.



Sea Ray continues its tradition of offering its customers imaginative, elegant layouts and top-of-the-line performance with its new 560 Sedan Bridge, powered by twin Caterpillar engines through Twin Disc Marine Transmissions and Twin Disc EC-200 Electronic Controls.

When a product reaches the manufacturing stage, Twin Disc's cell-based manufacturing facilities and skilled personnel can adapt quickly to production level requirements. Evidence of the effectiveness of Twin Disc's unique combination of core competencies is the 3600 Series electronically controlled, modulated hydraulic clutch systems for vehicles, and the new MG-6000 marine

transmissions incorporating special valve systems for the new generation of electronic engines. Only total design through manufacturing could so quickly and efficiently advance such products.

Beyond the physical development of a product, the sales and aftermarket support are critical, because of the essential nature of our products to a vehicle or machine's performance. Twin Disc's regional sales offices and vast worldwide distribution network put Twin Disc products and support services on-site virtually anywhere in the world they're needed.



Core competencies make ideas happen.

intelligence





These catamarans built by Stingray Marine in Durbanville, South Africa, achieve 40-plus knots via dual 435 hp Caterpillar engines driving Arneson ASD 10 Surface Drives through Twin Disc MG-5085A Marine Transmissions to help the Israeli Navy patrol and protect coastal waters.

Product Activity

Marine Propulsion Products

MARINE TRANSMISSIONS

Twin Disc Marine Transmission sales were up in both Europe and the United States, with the aggressive market for large and mid-size pleasure boats. Good momentum was established with initial shipments early in the year of the 6000 Series world-class transmission for high performance pleasure craft and high speed military and commercial applications. These transmissions can be assembled at multiple Twin Disc manufacturing facilities around the world thus providing



The Ft. Morgan Ferry makes the 4-mile trip across the mouth of Mobile Bay between Dolphin Island and Ft. Morgan, Alabama, sixteen times a day. It uses two Detroit Diesel 12V71 360 hp engines and two Twin Disc MG-514 Marine Transmissions, one set each mounted fore and aft, to push and pull the boat simultaneously.



Sub Sea Systems *Nautilus 100*, powered by two Caterpillar V-8 engines working through Twin Disc MG-5062V Marine Transmissions, gives visitors to Grand Cayman an upfront and personal look at the Caribbean underwater world.



Radar Blue, a 62' Salthouse charter gamefish yacht built in Auckland, New Zealand, is a marvel of luxury and technology. It's powered by twin 660 hp Caterpillar engines driving through Twin Disc MG-5114A Marine Transmissions via Twin Disc EC-200 with three-station electronic controls.



Azimut combines substance and flair in its new 58' cruiser equipped with Twin Disc MG-5114V Marine Transmissions.



To fully demonstrate the speed, maneuverability and safety of a waterjet, the Twin Disc Propulsion Group equipped this nimble 28' hull with a Twin Disc TDJ110 Waterjet driven by a Yanmar 350 hp engine driving through an MG-507-1 Marine Transmission controlled by an EC-200WJ Electronic Control.

consistent quality and product availability. Our Belgian subsidiary, Twin Disc International S.A., also saw significantly increased orders for lower horsepower pleasure boat transmissions in Europe as well as shipments to the U.S. Pacific Rim boat building was down from last year because of the declining Asian economy.



Midstream Fuel Service's 60' tug *Annie Jeanne*, with Caterpillar 3412s driving through Twin Disc MG-5202 Marine Transmissions, pushes petroleum barges along the Intercoastal from the Mississippi River to St. Marks, Florida.



Tasmanian Bluefin Pty Ltd has brought high-concept, impressive speed and amazing fuel efficiency to long line fishing with its original design 85' *Ocean Dawn*, powered by Detroit Diesel engines driving through Twin Disc MG-514M Marine Transmissions.

The 176' container ship *Coastal Sea*, equipped with a Caterpillar 3512 generating 1500 horsepower through a Twin Disc MG-5600 Marine Transmission, picks up and delivers a variety of cargo from Seattle to the Aleutian Islands.



Pershing Boats offer their customers unparalleled performance with Arneson Surface Drives and Twin Disc Marine Electronic Controls.

Commercial marine transmissions experienced moderately improved sales over last year with transmission orders for inland waterway tugs, pushboats and towboats remaining fairly constant, especially in repowering applications. There was modest building activity in fishing boats as well as a mix of small orders for lift boats, small crew boats, passenger boats, and patrol boats. Gulf Coast offshore supply vessel construction business has diminished because of low oil import costs. Fishing and workboat activity in the northwest remained stable.



Twin Disc's new EC-200 Electronic Controls featuring an additional remote hand-held station give *Price's Waterhouse 71'* cruiser precise control whether underway or pulling into the dock.



ELECTRONIC CONTROLS

Twin Disc electronic controls continue to show acceptance in pleasure craft and commercial applications. The EC-200's newly designed streamlined control head and waterproof housing introduced at the Miami International Boat Show in February have garnered a lot of attention throughout the boating industry.

The first installation of the new handheld remote controlled unit was completed on a Seattle area luxury yacht. This remarkable extension of the EC-200 allows a boat operator to literally walk around his boat or even on the dock while maneuvering it into its berth. This is especially handy when docking a large boat in a tight spot.

The superior technology, aesthetics, weather resistance and installation ease of Twin Disc electronic controls should prove attractive to all types of boat builders, from large luxury boats to sport fishermen to houseboats to runabouts.

Tarrab Yachts, built in Buenos Aires, Argentina, brings luxury and performance to the American market with its 90' cockpit motor yacht, powered by twin Caterpillar 3412 engines each generating 1350 horsepower through Twin Disc MG-6557A Down-Angle Marine Transmissions.



ARNESON SURFACE DRIVES

Arneson Drives are being well received by boat builders in Italy and the United Kingdom as well as in the U.S. Our Belgian subsidiary showed very strong sales of Arneson drives. These surface piercing propeller systems offer superior speed and handling as well as improved fuel economy. Their racing heritage was exemplified in major offshore races in the U.S. during the year. This cutting-edge performance reinforces "consumer" sales and applications in high speed patrol and interdiction boats around the world.

WATERJETS

Twin Disc believes the performance and safety benefits of waterjets will lead them to inevitably become a major propulsion consideration in both pleasure craft and commercial vessels. This year Twin Disc underscored its commitment to waterjet potential. The company equipped a demonstration boat to show boat builders and customers how efficient, practical and safe water jets are over conventional prop systems.



Equipped with two Twin Disc Marine Control Drives powered by Deutz engines, firefighting tug *Costante Neri* protects shipping activity in Livorno harbor.

MARINE CONTROL DRIVES (MCDs)

Twin Disc International showed strong sales of these unique variable speed drives to tugboat builders in Europe. MCDs provide the boat operator with the capability to split and control engine power between propulsion and other critical activities—bow thrusters, fire pumps, winches. This makes the boat more responsive and productive while using a single engine, thus saving construction costs.



Honker Cut Marine out of San Diego is showing some decisive wins on the American Power Boat Association circuit with its specially prepared 38' offshore boat equipped with twin 920 hp, 510 cubic inch Oldsmobile engines driving ASD 8 Arneson Surface Drives.



The *Ulu*, a 32' all-aluminum Bristol Bay Gillnetter made by Stambaugh has the advantage of speed, maneuverability, precise control and no propeller to snag nets, thanks to a Twin Disc TDJ130 Waterjet powered by a Luger 425 diesel and controlled by a two-station Twin Disc EC-200 Marine Electronic Control System.



The Tatra RV20 Recovery Vehicle depends on the proven TD-61-1175 Fully Automatic Transmission System to provide the power and traction to extract disabled military vehicles and mobile weapons from rugged terrain and battlefield conditions.



Thomas-Sides, French manufacturer of airport fire trucks shipped all over Europe, continues its use of Twin Disc Automatic Transmission Systems with this new vehicle equipped with a TD-61-1090.

Off-Highway Vehicle Transmissions

Twin Disc power-shift and fully automatic transmission systems continue to attract major specialty vehicle OEMs in the U.S. and Europe. As in most marketing arenas, there are a handful of major manufacturers here and abroad. In the all-wheel drive specialty vehicle market, Twin Disc is either already working with the leading players or in the process of establishing relationships.

This year the Company made significant penetration into new North American customers with confirmed projects in development. In addition, a loyal customer base of fire truck manufacturers in Europe continued to order Twin Disc transmission systems.

Such customers have found that Twin Disc automatic transmission systems not only offer superior performance in terms of propulsion and pump and roll capability, they are uniquely integrated into the driveline architectures of these vehicles.

The exotic suspension systems of these critical vehicles must accommodate difficult on- and off-road situations while protecting the driver and equipment. The transmission system becomes a major consideration in terms of placement and fit relative to the suspension system. Twin Disc is recognized as having the engineering expertise and product line to meet difficult design criteria.



Emergency One's Titan HPE™ 8x8 with its 1000 hp Detroit Diesel engine and Twin Disc TD-61-2619 Automatic Transmission System can carry up to 4,227 gallons of water and 405 gallons of foam concentrate and still go from 0 to 50 mph in under 30 seconds.

Aircraft Rescue Fire Fighting (ARFF) vehicles represent high-ticket opportunities for the Company. While individual orders may range from five to fifty units, the total dollar volume for these valuable suspension systems can be very significant.

NEW DEVELOPMENTS

In July, Twin Disc hosted a major demonstration of a new wildfire fighting vehicle. The demonstration, held at the Nevada Automotive Test Center, invited brush and forest fire fighters from across the country to see this 8x8 33-ton vehicle in action. This new off-road fire truck has raised the standard for a rugged, agile, fast and capable firefighting vehicle.



A New Holland Versatile® 4WD tractor brings productivity down to earth using a Cummins 310 hp engine working through a Twin Disc TD-122-1402 Power-Shift Transmission.

FARM TRACTORS

Twin Disc enjoyed a successful year in farm tractor transmission sales in the U.S. Power-shift transmissions shipped for large 4-wheel-drive tractors were up over last year, which showed respectable improvement from the previous year. The growth reflects pent-up demand and large capital investments in bigger, more productive tractors for larger farms here and in Europe. Twin Disc Power-Shift Transmissions are easily integrated into these tractor geometries and provide extraordinary power, durability and control—all resulting in more productivity. While the backlog of orders currently is subsiding, Twin Disc continues to cultivate its strong reputation in the global large tractor market.

This Holmer Maschinenbau 4x4 agricultural tractor puts Mercedes 400 horsepower power to work through a Twin Disc TD-124-1402 Automatic Transmission System.



Tatra HET (Heavy Equipment Transport) equipped with TD-101-3600 Automatic Transmission System.

**THE TRANSMISSION
MAKES THE DIFFERENCE.**

The Liwa firefighting vehicle is built on a Twin Disc transmission system that's earned an incomparable reputation for durability, driver efficiency and equipment effectiveness in all-terrain military vehicles. This all-wheel drive, fully automatic transmission with engine-mounted modulated clutch torque converter, PTO and electronic control makes possible unparalleled off-road performance. Tried and proven on military vehicles for more than three years, the Twin Disc 1175 Transmission System is standard issue on certain heavy equipment transports destined for rugged desert operations.

This firefighting vehicle has the power to carry large fire extinguishing payloads through, around and over obstacles that would stop most vehicles, let alone fire trucks. It can do this, in part, because of its four drive axles providing eight-wheel traction, a unique suspension system that affords the vehicle a strong, rigid drive train and high ground clearance, and independently sprung axles that can negotiate torturous terrain.



The transmission can precisely control power so the truck can track cautiously through a boulder field while providing full pumping power.

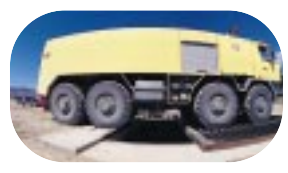


But the catalyst is the Twin Disc automatic transmission system. It manages the power of this vehicle for propulsion and firefighting duties, permitting a single-operator to control both.

Such performance characteristics of the transmission are only relevant if the transmission system can fit into the unique suspension architecture of the truck. The transmission system has to be both streamlined and strong. It must adhere to the ground clearance criteria, nestle compactly in the chassis, yet transfer power smoothly and reliably under demanding conditions. To accomplish all this, the Twin Disc transmission system is literally built into the suspension system. In fact, it's a load-bearing component of the system.



Tatra Liwa wildfire-fighting vehicle with its 536 horsepower driving and pumping through a Twin Disc Fully Automatic Transmission System takes impressive firefighting capabilities to fires other vehicles can't even reach.



1650

Fully loaded with nearly 3,000 gallons of water, the 30-plus ton vehicle can climb a 40% grade in soft dirt.



It can do this because it doesn't require a drop box and the versatile configuration allows it to fit within chassis space limitations.

So, Twin Disc has produced a transmission system that has spawned a new breed of heavy-duty off-road vehicle. One that can take heavy payloads where no other vehicles have previously gone, then with a single engine put that payload to work pumping, drilling, spraying—whatever requires propulsion and auxiliary power. Without the Twin Disc transmission, such a vehicle would not be possible.

The power splitting capability of the transmission along with the integral PTO allows high pressure spraying on the move to douse crown fires in treetops.

Because the automatic transmission provides precise power to the wheels for optimum traction the vehicle can step axle-by-axle over a two meter wide, one meter deep trench without grounding out or getting hung up.

3250

9250

2970



NLB Corporation's Ultra-Clean 36° ultra high pressure pumping unit uses a Twin Disc SP211HP3 PTO to apply 36,000 psi of water pressure to cleaning operations.



Pool Energy Services facilitates drilling California oil wells with this portable high pressure mud pump driven by a General Engine power package consisting of a Detroit Diesel 700 hp 1292 DDEC engine working through a Twin Disc TD-51-2000 Transmission with Type-8 18" Torque Converter.

Stationary Equipment

POWER TAKE-OFFS

Power Take-Off sales increased thanks to a variety of applications such as irrigation pumps, recycling machines, high pressure sprayers and oil field mud pumps and workover rigs. To meet equipment manufacturers' continually changing demands for size, power and machine configurations, Twin Disc continues to develop new products to expand its already extensive line of clutches and PTOs.



The Indian Queens Power Station in County Cornwall in southwest England helps the national grid meet peak electric power demands by generating 140,000 kW using a General Electric Gas Turbine with a frame 9E starting system featuring a Twin Disc 4-LUGP-2620 Torque Converter.



This R.E. Clancy Verticle Shaft Impactor uses a rugged Twin Disc Inline SP318IL PTO to crush limestone in a northern Michigan quarry.

GAS TURBINE STARTING DRIVES

Our torque converters are designed, assembled and packaged in starting drives and shipped to gas turbine electric generator customers all over the world. Twin Disc torque converters play an integral role in the startup of the generator by overcoming the immense torque required to spin the massive turbine up to firing speed. This reduces wear on the equipment and allows faster and more reliable turbine ignition.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS

NET SALES, NEW ORDERS AND BACKLOG

Revenues increased in both fiscal 1997 and 1998; fiscal 1998 represented the sixth consecutive year of higher sales. Greater demand for our traditional products, which was relatively stable during fiscal 1997, provided most of the improvement in the recently completed year. Order rates softened in selected markets as the year progressed, and this trend, combined with the completion of a major truck transmission contract, led to a 29 percent decline in backlog by year-end.

Net sales for fiscal 1998 were \$203 million, an increase of 7 percent over the \$190 million reported in fiscal 1997, and 14 percent above the \$177 million for fiscal 1996. Most of the fiscal 1997 improvement resulted from a new business opportunity with the initial shipments of automatic transmissions for a major vehicle contract. Though some softness in demand for the lower horsepower marine transmissions occurred at the middle of fiscal 1997, shipments to our principal markets for the twelve months generally were good and provided a solid base of sales comparable with the previous year. The transmission contract was completed in January, but growth in other product markets provided the bridge to another year of sales improvement in fiscal 1998. The markets providing most of the growth were the pleasure craft marine market, supplied primarily from our Belgian operation, and a variety of applications for power take-offs and clutches such as irrigation, recycling, and oil field.

The changes in shipping levels of our distribution

companies, marketing and service subsidiaries around the world, varied by region; in most cases fiscal 1998 differed from 1997. Domestic distribution sales, which were off in fiscal 1997, recovered in fiscal 1998 as a result of greater demand for marine transmissions, general industrial products, and service work. European distribution shipments increased between 15 and 20 percent each year, with Arneson surface drives representing the major component of the improvement. Elsewhere in the world, primarily the Pacific Basin, the fiscal 1997 sales increase, spurred by boat building activity, was reversed in fiscal 1998 because of the declining Asian economy and the strong U.S. dollar.

The U.S. dollar, after a year of relative stability in 1996, strengthened in 1997 and 1998. The currencies of the countries in which Twin Disc operates on average were off approximately 6 percent in fiscal 1997 and an additional 10 percent in fiscal 1998. Overall, the impact of currency translation on revenues was a relatively minor reduction of 2 percent and 3 percent in fiscal 1997 and fiscal 1998, respectively. Price increases, implemented selectively in each year, raised revenues by approximately the rate of inflation.

At the beginning of fiscal 1997, the backlog of orders scheduled for shipment during the next six months was \$66 million, 10 percent of which was attributable to the automatic truck transmission contract that extended through the first half of fiscal 1998. Order rates improved early in fiscal 1997 and, although modest softening was experienced in selected markets by mid-year, the backlog at June 30, 1997, was up 16 percent from the prior year.

MARGINS, COSTS AND EXPENSES

Manufacturing operations have been cellularized and improvements in process time, machine capability, and utilization continue to be provided by evolutionary refinements to the cells. In 1996, we also initiated a pay-for-skills program in our domestic plant that motivated manufacturing associates to learn new machine operating skills and increase production flexibility and efficiency. Delivery times were reduced, particularly during the latter half of fiscal 1998, as the Company has more fully utilized the scheduling capabilities of recently installed computer systems.

The steady improvement in gross margin that began in fiscal 1991 was maintained in fiscal 1997 with a minimal increase. Solid year-to-year increases in domestic gross margins through each of the quarters were countered by lower profitability at the Belgian operation in the second half of the year. That decline in Europe was caused by a temporary drop in orders, leading to short workweeks and reduced productivity.

In fiscal 1998, improved productivity at our domestic plant, coupled with greater volume in the first half of the year, provided for higher domestic margins. Production volume at our Belgian subsidiary rose during the second quarter with the increased demand for marine transmissions, favorably impacting productivity and margins. Additionally, with sales denominated in the strong U.S. dollar, the Belgian margin showed a significant increase for the year.

Marketing, engineering, and administrative (MEA) expense in terms of dollars increased by almost 9 percent for fiscal 1997 but rose only slightly as a percentage of sales. The increase occurred at the Company's domestic operations and consisted mainly of salary expense for an added number of marketing and engineering personnel, a one-time expense associated with an accelerated product development program, and a salaried associate bonus payment not made in the previous year.

A propulsion products marketing group also was established in 1997 to focus on development of markets for a full line of marine propulsion products

transmissions, Arneson drives, water jets, and electronic controls.

In fiscal 1998, MEA rose 9 percent, again slightly outpacing the sales increase. The principal components of the increase were the write-off of a loss on the bankruptcy restructuring of a customer in South Africa, marketing and domestic engineering personnel additions, and the expenses associated with a mid-year acquisition.

INTEREST, TAXES AND NET EARNINGS

Virtually all of the short-term debt required to finance working capital needs in fiscal 1996 was repaid by the end of fiscal 1997, and interest expense declined by about 8 percent in that year. Short-term borrowings remained very low in fiscal 1998 and, as a result, interest expense declined about 15 percent from the prior year.

The effective income tax rates have remained relatively consistent throughout the three-year period with minor variations between years caused by a fluctuation in the proportion of foreign earnings which are generally taxed at a higher rate. Also, in fiscal 1998, an additional accrual of taxes for prior years added to the effective rate.

LIQUIDITY AND CAPITAL RESOURCES

The net cash provided by operating activities in fiscal 1997 was a record \$20.5 million. Higher earnings and depreciation were supplemented by reductions in accounts receivable and inventory as receivable days outstanding (DSO) and inventory turnover ended fiscal 1997 at their best levels since 1990. After lowering the rate on most of the Company's debt through a private placement in 1996, the Company focused on improving cash flow in fiscal 1997 and reduced short-term borrowing, primarily domestic, by \$7 million. In fiscal 1998, the positive cash flows from earnings, depreciation, and a further reduction in accounts receivable DSO were partially offset by inventory increases necessary to satisfy the level of

demand at our Belgian subsidiary and by the prepayment of the current year domestic pension contribution. The result was a \$7 million operating cash flow after the \$8 million reduction for prepaid pension expense.

For several years prior to fiscal 1998, fixed asset purchases were less than depreciation as manufacturing cells were established and existing machinery was rearranged. Expenditures for capital equipment exceeded depreciation by about \$2 million in fiscal 1998 as experience helped identify the equipment needed to further improve cell performance. We expect capital spending will continue to exceed depreciation as individual cell structures are refined.

Working capital and the current ratio declined in fiscal 1998 after increasing during both of the preceding two years. In fiscal 1997 working capital increased \$5.7 million, reflecting higher balances of cash and short-term investments and reduced short-term borrowings. The decline in working capital of \$4.3 million at the end of fiscal 1998 was nearly equivalent to the reduction in accounts receivable, as the inventory increase was offset by a decline in cash. The current ratio of 3.2 at June 30, 1998, was down slightly from the 3.3 reported at the previous year-end.

The Company believes the capital resources available in the form of existing cash, lines of credit (described in Footnote F to the consolidated financial statements) and funds provided by operations will be adequate to meet anticipated capital expenditures and other foreseeable business requirements in the future.

OTHER MATTERS

YEAR 2000 READINESS

The Company has assessed the potential impact of the Year 2000 date change on its business systems and operations. With the change to a new information system for domestic operations in late 1995 and a similar update currently being implemented at its Belgian manufacturing subsidiary, the Company's systems will be prepared to handle the century date

change. Testing of these systems will occur in fiscal year 1999. Network systems and other affected equipment throughout the Company and its subsidiaries either are already capable of handling the date change or will be as updates are completed during the next six months. In addition, suppliers and service providers are being contacted to ensure they are actively involved in a program to address the Year 2000 issue and provide uninterrupted service to Twin Disc. The remaining costs of complying with the Year 2000 requirements are not expected to be significant. The Company believes, based on currently available information, that it will be able to manage its Year 2000 transition without material adverse effect on the Company's future consolidated results of operations, liquidity and capital resources.

ENVIRONMENTAL MATTERS

The Company is involved in various stages of investigation relative to hazardous waste sites on the United States EPA National Priorities List. It is not possible at this time to determine the ultimate outcome of those matters; but, as discussed further in Footnote N to the consolidated financial statements, they are not expected to affect materially the Company's operations, financial position or cash flows.

RECENT FINANCIAL REPORTING PRONOUNCEMENTS

The Financial Accounting Standards Board recently issued Statement of Financial Accounting Standards (FAS) 130, "Comprehensive Income," FAS 131, "Disclosures about Segments of an Enterprise and Related Information," FAS 132, "Employers' Disclosure about Pensions and Other Postretirement Benefits," and FAS 133, "Accounting for Derivative Instruments and Hedging Activities," which are addressed in Footnote A to the consolidated financial statements.

CONSOLIDATED BALANCE SHEETS

JUNE 30, 1998 AND 1997

(Dollars in thousands)	1998	1997
ASSETS		
Current assets:		
Cash and cash equivalents.....	\$ 5,087	\$ 8,983
Trade accounts receivable, net	28,320	32,428
Inventories	53,280	47,844
Deferred income taxes	1,987	3,491
Other	4,906	5,216
Total current assets.....	93,580	97,962
Property, plant and equipment, net	35,728	34,249
Investments in affiliates	10,356	10,880
Deferred income taxes.....	1,241	4,559
Intangible pension asset	4,082	4,779
Other assets.....	15,967	6,326
	<u>\$160,954</u>	<u>\$158,755</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Notes payable	\$ 276	\$ 169
Accounts payable	9,917	12,834
Accrued liabilities.....	19,360	16,618
Total current liabilities.....	29,553	29,621
Long-term debt.....	19,949	19,944
Accrued retirement benefits.....	29,457	35,393
	78,959	84,958
Shareholders' equity:		
Common shares authorized: 15,000,000; issued: 3,643,630; no par value	11,653	11,653
Retained earnings	84,738	77,424
Foreign currency translation adjustment	3,418	6,060
Minimum pension liability adjustment.....	(661)	(3,708)
	99,148	91,429
Less treasury stock, at cost.....	17,153	17,632
Total shareholders' equity	81,995	73,797
	<u>\$160,954</u>	<u>\$158,755</u>

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

CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE YEARS ENDED JUNE 30, 1998, 1997 AND 1996

(In thousands, except per share data)	1998	1997	1996
Net sales	\$202,643	\$189,942	\$176,657
Cost of goods sold	152,515	146,123	135,780
Gross profit	50,128	43,819	40,877
Marketing, engineering and administrative expenses	34,092	31,219	28,706
Earnings from operations	16,036	12,600	12,171
Other income (expense):			
Interest income	550	1,335	121
Interest expense	(1,505)	(1,781)	(1,942)
Equity in earnings of affiliates	651	307	45
Other, net	313	219	512
	9	80	(1,264)
Earnings before income taxes.....	16,045	12,680	10,907
Income taxes	6,682	4,951	4,348
Net earnings	<u>\$ 9,363</u>	<u>\$ 7,729</u>	<u>\$ 6,559</u>
Earnings per share data:			
Basic earnings per share	\$ 3.30	\$ 2.78	\$ 2.36
Diluted earnings per share	3.24	2.75	2.34
Shares outstanding data:			
Average shares outstanding	2,834	2,781	2,777
Dilutive stock options.....	52	27	28
Diluted shares outstanding	<u>2,886</u>	<u>2,808</u>	<u>2,805</u>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

FOR THE YEARS ENDED JUNE 30, 1998, 1997 AND 1996

(In thousands)	1998	1997	1996
Cash flows from operating activities:			
Net earnings	\$ 9,363	\$ 7,729	\$ 6,559
Adjustments to reconcile to net cash provided (used) by operating activities:			
Depreciation and amortization	5,607	5,489	5,233
Gain on sale of plant assets	(402)	(127)	(26)
Equity in earnings of affiliates	(651)	(307)	(45)
Provision for deferred income taxes	2,873	1,481	1,646
Dividends received from affiliate.....	495	300	548
Changes in operating assets and liabilities:			
Trade accounts receivable, net.....	3,361	1,267	(6,055)
Inventories	(5,673)	2,882	(3,926)
Other assets.....	(7,842)	(954)	(987)
Accounts payable	(2,695)	3,463	(3,513)
Accrued liabilities.....	2,777	(391)	(3,982)
Deferred retirement plan.....	(244)	(345)	415
Net cash provided (used) by operating activities ...	<u>6,969</u>	<u>20,487</u>	<u>(4,133)</u>
Cash flows from investing activities:			
Proceeds from sale of plant assets.....	574	501	18
Acquisitions of plant assets	(7,154)	(4,734)	(4,140)
Investment in subsidiary	(1,021)	-	-
Payment for license agreement	(1,515)	-	(2,402)
Net cash used by investing activities	<u>(9,116)</u>	<u>(4,233)</u>	<u>(6,524)</u>
Cash flows from financing activities:			
Increases (decreases) in notes payable, net.....	112	(7,182)	5,076
Proceeds from long-term debt.....	-	4	19,914
Principal payments on long-term debt.....	-	-	(14,000)
Acquisition of treasury stock	(1,314)	-	-
Proceeds from exercise of stock options	1,904	188	35
Dividends paid	(2,160)	(1,947)	(1,943)
Net cash provided (used) by financing activities ...	<u>(1,458)</u>	<u>(8,937)</u>	<u>9,082</u>
Effect of exchange rate changes on cash	(291)	(377)	(123)
Net change in cash and cash equivalents	(3,896)	6,940	(1,698)
Cash and cash equivalents:			
Beginning of year.....	8,983	2,043	3,741
End of year.....	<u>\$ 5,087</u>	<u>\$ 8,983</u>	<u>\$ 2,043</u>
Supplemental cash flow information:			
Cash paid during the year for:			
Interest	\$ 1,505	\$ 1,822	\$ 1,802
Income taxes	4,698	3,318	4,946

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

CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS' EQUITY

FOR THE YEARS ENDED JUNE 30, 1998, 1997 AND 1996

(In thousands)	1998	1997	1996
Common stock			
Balance, June 30	\$ 11,653	\$ 11,653	\$ 11,653
Retained earnings			
Balance, July 1	77,424	71,658	67,054
Net earnings	9,363	7,729	6,559
Cash dividends.....	(2,160)	(1,947)	(1,943)
Stock options exercised.....	111	(16)	(12)
Balance, June 30	<u>84,738</u>	<u>77,424</u>	<u>71,658</u>
Foreign currency translation adjustment			
Balance, July 1	6,060	10,326	14,081
Current adjustment.....	(2,642)	(4,266)	(3,755)
Balance, June 30	<u>3,418</u>	<u>6,060</u>	<u>10,326</u>
Minimum pension liability adjustment, net			
Balance, July 1	(3,708)	(620)	(284)
Current adjustment, net of related income taxes (\$1,948 in 1998, \$1,975 in 1997 and \$215 in 1996)	3,047	(3,088)	(336)
Balance, June 30	<u>(661)</u>	<u>(3,708)</u>	<u>(620)</u>
Treasury stock, at cost			
Balance, July 1	(17,632)	(17,836)	(17,882)
Shares acquired.....	(1,314)	-	-
Stock options exercised.....	1,793	204	46
Balance, June 30	<u>(17,153)</u>	<u>(17,632)</u>	<u>(17,836)</u>
Shareholders' equity balance, June 30	<u>\$ 81,995</u>	<u>\$ 73,797</u>	<u>\$ 75,181</u>

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

A. SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting policies followed in the preparation of these financial statements:

CONSOLIDATION PRINCIPLES—The consolidated financial statements include the accounts of Twin Disc, Incorporated and its subsidiaries, all of which are wholly owned. Certain foreign subsidiaries are included based on fiscal years ending May 31, to facilitate prompt reporting of consolidated accounts. All significant intercompany transactions have been eliminated.

TRANSLATION OF FOREIGN CURRENCIES—Substantially all foreign currency balance sheet accounts are translated into United States dollars at the rates of exchange prevailing at year-end. Revenues and expenses are translated at average rates of exchange in effect during the year. Foreign currency translation adjustments are recorded as a component of shareholders' equity. Gains and losses from foreign currency transactions are included in earnings.

CASH EQUIVALENTS—The Company considers all highly liquid marketable securities purchased with a maturity date of three months or less to be cash equivalents.

RECEIVABLES—Trade accounts receivable are stated net of an allowance for doubtful accounts of \$647,000 and \$538,000 at June 30, 1998 and 1997, respectively.

FAIR VALUE OF FINANCIAL INSTRUMENTS—The carrying amount reported in the consolidated balance sheets for cash and cash equivalents, accounts receivable, accounts payable and short-term debt approximates fair value because of the immediate short-term maturity of these financial instruments. The carrying amount reported for long-term debt approximates fair value because the underlying instrument bears interest at a current market rate.

DERIVATIVE FINANCIAL INSTRUMENTS—Derivative financial instruments (primarily forward foreign exchange contracts) may be utilized by the Company to hedge foreign exchange rate risk. The Company has established policies and procedures for risk assessment and the approval, reporting and monitoring of derivative financial instrument activities. The Company does not enter into financial instruments for trading or speculative purposes. For financial reporting purposes, forward foreign exchange contracts used to hedge the currency fluctuations on transactions denominated in foreign currencies are marked-to-market and the resulting gains and losses, together with the offsetting losses and gains on hedged transactions, are recorded in the "Other income (expense)" caption in the statement of operations. At June 30, 1998 and 1997, the Company had outstanding forward foreign exchange contracts to purchase \$5,000,000 and \$3,000,000, respectively, of Belgian francs with a weighted average maturity of 56 days and 34 days, respectively.

INVENTORIES—Inventories are valued at the lower of cost or market. Cost has been determined by the last-in, first-out (LIFO) method for parent company inventories, and by the first-in, first-out (FIFO) method for other inventories.

PROPERTY, PLANT AND EQUIPMENT AND DEPRECIATION—Assets are stated at cost. Expenditures for maintenance, repairs and minor renewals are charged against earnings as incurred. Expenditures for major renewals and betterments are capitalized and amortized by depreciation charges. Depreciation is provided on the straight-line method over the estimated useful lives of the assets for financial reporting and on accelerated methods for income tax purposes. The lives assigned to buildings and related improvements range from 10 to 40 years, and the lives assigned to machinery and equipment range from 5 to 15 years. Upon disposal of property, plant and equipment, the cost of the asset and the related accumulated depreciation are removed from the accounts and the resulting gain or loss is reflected in earnings. Fully depreciated assets are not removed from the accounts until physical disposition.

INVESTMENTS IN AFFILIATES—The Company's 25% investments in affiliates are stated at cost, adjusted for equity in undistributed earnings since acquisition.

REVENUE RECOGNITION—Revenues are recognized when products are shipped.

INCOME TAXES—The Company recognizes deferred tax liabilities and assets for the expected future income tax consequences of events that have been recognized in the Company's financial statements. Under this method, deferred tax liabilities and assets are determined based on the temporary differences between the financial statement carrying amounts and the tax bases of assets and liabilities using enacted tax rates in effect in the years in which the temporary differences are expected to reverse.

The Company does not provide for taxes which would be payable if undistributed earnings of its foreign subsidiaries or its foreign affiliate were remitted because the Company either considers these earnings to be invested for an indefinite period or anticipates that if such earnings were distributed, the U.S. income taxes payable would be substantially offset by foreign tax credits.

MANAGEMENT ESTIMATES—The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Actual amounts could differ from those estimates.

RECENTLY ISSUED ACCOUNTING STANDARDS—During the second quarter of 1998, the Company adopted Statement of Financial Accounting Standards (FAS) 128 "Earnings Per Share," which establishes new standards for reporting earnings per share. The earnings per share computations for prior periods have been restated to conform with the provisions of FAS 128.

During 1997, the Financial Accounting Standards Board (FASB) issued FAS 130 "Comprehensive Income" and FAS 131 "Disclosures about Segments of an Enterprise and Related Information," and during 1998 the FASB issued FAS 132 "Employers' Disclosure about Pensions and Other Postretirement Benefits" and FAS 133 "Accounting for Derivative Instruments and Hedging Activities." FAS 130, 131, and 132 are effective for the Company's 1999 fiscal year and FAS 133 is effective for the Company's 2000 fiscal year. A brief description of each standard and the potential effect on the Company's financial statements follows:

FAS 130 establishes standards for reporting and display of comprehensive income and its components in the financial statements. FAS 130 requires financial statement disclosures for prior periods to be restated. The Company is in the process of determining its preferred disclosure format.

FAS 131 establishes new standards for the way that public companies report information about operating segments in annual financial statements. FAS 131 also establishes standards for related disclosures about products and services, geographic areas, and major customers and requires financial statement disclosure for prior periods to be restated. The Company's reporting under FAS 131 will disclose required information about two operating segments, Manufacturing and Distribution.

FAS 132 establishes standards for disclosing information about pensions and other postretirement benefits in the financial statements and requires disclosure for prior periods to be restated. The Company is evaluating the extent to which its disclosures may be affected by FAS 132.

FAS 133 establishes standards for accounting for derivatives and hedging activities. The Company is evaluating the extent to which its accounting for derivative and hedging activities may be affected by FAS 133.

B. INVENTORIES

The major classes of inventories at June 30 were as follows:

(In thousands)	1998	1997
Finished parts	\$ 43,848	\$ 38,713
Work-in-process.....	5,524	5,997
Raw materials	3,908	3,134
	<u>\$ 53,280</u>	<u>\$ 47,844</u>

Inventories stated on a LIFO basis represent approximately 33% and 42% of total inventories at June 30, 1998 and 1997, respectively. The approximate current cost of the LIFO inventories exceeded the LIFO cost by \$18,252,000 and \$17,526,000 at June 30, 1998 and 1997, respectively.

C. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment at June 30 were as follows:

(In thousands)	1998	1997
Land.....	\$ 1,295	\$ 1,335
Buildings.....	19,065	18,708
Machinery and equipment.....	92,309	87,832
	112,669	107,875
Less accumulated depreciation.....	76,941	73,626
	<u>\$ 35,728</u>	<u>\$ 34,249</u>

D. INVESTMENTS IN AFFILIATES

The Company's investments in affiliates consists of 25% interests in Niigata Converter Company, Ltd., Japan (a manufacturer of power transmission equipment), and Palmer Johnson Distributors, LLC (a domestic distributor of Twin Disc products).

Undistributed earnings of the affiliates included in consolidated retained earnings approximated \$3,283,000 and \$3,127,000 at June 30, 1998 and 1997, respectively.

Combined condensed financial data of the above-listed affiliates are summarized as follows:

(In thousands)	1998	1997
Current assets	\$ 78,214	\$ 87,375
Other assets.....	40,171	43,582
	<u>\$ 118,385</u>	<u>\$ 130,957</u>
Current liabilities.....	\$ 83,066	\$ 85,479
Other liabilities.....	412	8,479
Shareholders' equity	34,907	36,999
	<u>\$ 118,385</u>	<u>\$ 130,957</u>

	1998	1997	1996
Net sales	\$152,558	\$166,171	\$183,487
Gross profit.....	20,897	19,911	23,436
Net earnings	2,606	1,228	181

E. ACCRUED LIABILITIES

Accrued liabilities at June 30 were as follows:

(In thousands)	1998	1997
Salaries and wages	\$ 6,871	\$ 5,983
Retirement benefits.....	2,930	2,150
Other	9,559	8,485
	<u>\$ 19,360</u>	<u>\$ 16,618</u>

F. DEBT

Short-term notes payable consists of amounts borrowed under unsecured line of credit agreements. Unused lines of credit total \$18,370,000 at June 30, 1998. These lines of credit are available predominately at the LIBOR interest rate and may be withdrawn at the option of the banks. The weighted average interest rate of short-term lines outstanding at June 30, 1998 and 1997, was 6.8% and 7.3%, respectively.

Included in long-term debt is \$20 million of 7.37% ten-year unsecured notes, net of \$69,000 unamortized debt issuance costs at June 30, 1998. These notes contain certain covenants, including the maintenance of a current ratio of not less than 1.5. Principal payments of \$2,857,000 are due in the years 2000 through 2005, with the remaining balance due on June 1, 2006. Also included in long-term debt is \$18,000 of debt related to a foreign subsidiary.

G. LEASE COMMITMENTS

Approximate future minimum rental commitments under noncancellable operating leases are as follows (in thousands):

Fiscal Year	
1999.....	\$ 2,414
2000.....	1,736
2001.....	1,260
2002.....	925
2003.....	596
Thereafter.....	241
	<u>\$ 7,172</u>

Total rent expense for operating leases approximated \$2,571,000, \$2,254,000 and \$2,109,000 in 1998, 1997 and 1996, respectively.

H. SHAREHOLDERS' EQUITY

At June 30, 1998 and 1997, treasury stock consisted of 810,646 and 856,456 shares of common stock, respectively. The Company issued 86,850 and 9,900 shares of treasury stock in 1998 and 1997, respectively, to fulfill its obligations under the stock option plans. The difference between the cost of treasury shares issued and the option price is credited to retained earnings. The Company acquired 41,040 shares of treasury stock in 1998.

Cash dividends per share were \$.76 in 1998 and \$.70 in 1997 and 1996.

In 1998, the Company's Board of Directors established a Shareholder Rights Plan and distributed to shareholders, one preferred stock purchase right for each outstanding share of common stock. Under certain circumstances, a right may be exercised to purchase one one-hundredth of a share of Series A Junior Preferred Stock at an exercise price of \$160, subject to certain anti-dilution adjustments. The rights become exercisable ten (10) days after a public announcement that a party or group has either acquired at least 15% (or at least 25% in the case of existing holders who currently own 15% or more of the common stock), or commenced a tender offer for at least 25%, of the Company's common stock. Generally, after the rights become exercisable, if the Company is a party to certain merger or business combination transactions, or transfers 50% or more of its assets or earnings power, or certain other events occur, each right will entitle its holders, other than the acquiring person, to buy a number of shares of common stock of the Company, or of the other party to the transaction, having a value of twice the exercise price of the right. The rights expire June 30, 2008, and may be redeemed by the Company for \$.05 per right at any time until ten (10) days following the stock acquisition date. The Company is authorized to issue 200,000 shares of preferred stock, none of which have been issued. The Company has designated 50,000 shares of the preferred stock for the purpose of the Shareholder Rights Plan.

I. BUSINESS SEGMENTS AND FOREIGN OPERATIONS

The Company and its subsidiaries are engaged in one line of business, the manufacture and sale of power transmission equipment. Transfers among geographic areas are made at established intercompany selling prices. Principal products include industrial clutches, hydraulic torque converters, fluid couplings, power-shift transmissions, marine transmissions, universal joints, power take-offs, and reduction gears. The Company sells to both domestic and foreign customers in a variety of market areas, principally construction, industrial, government, marine, energy and natural resources and agricultural.

Two customers each accounted for approximately 11%, 11% and 10% of consolidated net sales in 1998, 1997 and 1996, respectively.

Information about the Company's operations in different geographic areas is summarized as follows:

	1998	1997	1996
Sales to unaffiliated customers:			
United States	\$ 147,819	\$ 131,844	\$ 120,137
Foreign:			
Europe	35,418	34,332	34,206
Other.....	19,406	23,766	22,314
Total	<u>\$202,643</u>	<u>\$189,942</u>	<u>\$176,657</u>
Transfers between geographic areas:			
United States	\$ 28,994	\$ 28,716	\$ 30,230
Foreign:			
Europe	21,778	16,398	23,130
Other.....	378	415	322
Total	<u>\$ 51,150</u>	<u>\$ 45,529</u>	<u>\$ 53,682</u>
Net sales:			
United States	\$ 176,813	\$ 160,560	\$ 150,367
Foreign:			
Europe	57,196	50,730	57,336
Other.....	19,784	24,181	22,636
Eliminations	(51,150)	(45,529)	(53,682)
Total	<u>\$202,643</u>	<u>\$189,942</u>	<u>\$176,657</u>
Earnings before income taxes:			
United States	\$ 7,944	\$ 6,009	\$ 2,821
Foreign:			
Europe	7,000	4,378	6,126
Other.....	1,101	2,293	1,960
Total	<u>\$ 16,045</u>	<u>\$ 12,680</u>	<u>\$ 10,907</u>
Identifiable assets at June 30:			
United States	\$ 117,024	\$ 115,973	\$ 117,552
Foreign:			
Europe	37,125	33,329	36,356
Other.....	11,438	12,947	12,794
Eliminations	(4,633)	(3,494)	(4,003)
Total	<u>\$160,954</u>	<u>\$158,755</u>	<u>\$162,699</u>

Net earnings of the foreign subsidiaries were \$4,428,000, \$3,840,000 and \$4,758,000 in 1998, 1997 and 1996, respectively. The net assets of the foreign subsidiaries were \$31,515,000 and \$31,517,000 at June 30, 1998 and 1997, respectively. Undistributed earnings of foreign subsidiaries, on which no provisions for United States income taxes have been made, aggregated approximately \$21,335,000 (including \$54,000 translation component) at June 30, 1998. Included in earnings are foreign currency transaction gains (losses) of \$(343,000), \$334,000 and \$409,000 in 1998, 1997 and 1996, respectively.

J. STOCK OPTION PLANS

The Company has a non-qualified stock option plan for officers, key employees and directors to purchase up to 125,000 shares of common stock, and an incentive stock option plan for officers and key employees to purchase up to 225,000 shares of common stock. The plans are administered by the Executive Selection and Compensation Committee of the Board of Directors which has the authority to determine which officers and key employees will be granted options. The grant of options to non-employee directors is fixed and based on such directors' seniority. Except as described in the following sentence, all options allow for exercise prices not less than the grant date fair market value, immediate vesting and expire ten years after the date of grant. For options under the incentive stock option plan, if the optionee owns more than 10% of the total combined voting power of all classes of the Company's stock, the price will be not less than 110% of the grant date fair market value and the options expire five years after the grant date.

Shares available for future options as of June 30 were as follows:

	1998	1997
Non-qualified stock option plan	10,850	23,950
Incentive stock option plan.....	30,550	53,400

Stock option transactions under the plans during 1998 and 1997 were as follows:

	1998	Weighted Average Price	1997	Weighted Average Price	1996	Weighted Average Price
Non-qualified stock option plan:						
Options outstanding at beginning of year	94,150	\$21.71	95,350	\$21.69	81,450	\$21.21
Granted	13,100	28.75	15,100	21.88	13,900	24.50
Cancelled	—	—	(10,400)	23.32	—	—
Exercised (\$14.00–\$29.63 per share)	(26,750)	22.81	(5,900)	19.03	—	—
Options outstanding at June 30	<u>80,500</u>	<u>\$22.50</u>	<u>94,150</u>	<u>\$21.71</u>	<u>95,350</u>	<u>\$21.69</u>
Options price range (\$14.00–\$20.00)						
Number of shares		34,300				
Weighted average price		\$19.06				
Weighted average remaining life		5.91 years				

Options price range (\$20.01–\$29.63)	
Number of shares	46,200
Weighted average price	\$25.05
Weighted average remaining life	6.33 years

	1998	Weighted Average Price	1997	Weighted Average Price	1996	Weighted Average Price
Incentive stock option plan:						
Options outstanding at beginning of year	161,550	\$21.60	151,450	\$21.52	132,050	\$20.78
Granted	29,900	29.18	24,250	22.05	25,050	24.89
Cancelled	(7,050)	20.15	(10,150)	22.57	(3,400)	23.60
Exercised (\$14.00–\$19.50 per share)	(60,100)	21.53	(4,000)	18.81	(2,250)	15.29
Options outstanding at June 30	<u>124,300</u>	<u>\$23.57</u>	<u>161,550</u>	<u>\$21.60</u>	<u>151,450</u>	<u>\$21.52</u>
Options price range (\$14.00–\$20.00)						
Number of shares		36,600				
Weighted average price		\$18.71				
Weighted average remaining life		5.63 years				
Options price range (\$20.01–\$29.63)						
Number of shares		87,700				
Weighted average price		\$25.59				
Weighted average remaining life		6.18 years				

The Company accounts for its stock option plans under the guidelines of Accounting Principles Board Opinion No. 25. Accordingly, no compensation cost has been recognized in the statement of operations. Had the Company recognized compensation expense based on the fair value at the grant date for awards under the plans, consistent with the method prescribed by FAS 123, the net earnings and earnings per share would have been as follows (in thousands, except per share amounts):

	1998	1997	1996
Net earnings			
As reported.....	\$9,363	\$7,729	\$6,559
Pro forma.....	9,125	7,554	6,365
Basic earnings per share			
As reported.....	\$ 3.30	\$ 2.78	\$ 2.36
Pro forma.....	3.22	2.72	2.29
Diluted earnings per share			
As reported.....	\$ 3.24	\$ 2.75	\$ 2.34
Pro forma.....	3.16	2.69	2.27

The above pro forma net earnings and earnings per share were computed using the fair value of options at the date of grant (for options granted after June 1995) as calculated by the Black-Scholes option-pricing method and the following assumptions: 20% volatility, 3% annual dividend yield, interest rates based on expected terms and grant dates, a 5-year term and an exercise price equal to the fair market value on the date of grant except for incentive options granted to greater than 10% shareholders which are calculated using a 3-year term and an exercise price equal to 110% of the fair market value on the date of grant. For those options granted during 1998, 1997 and 1996 with exercise prices equal to the grant date fair market value, the exercise prices and weighted average fair values of the options were \$28.75 and \$5.81 in 1998, \$21.88 and \$4.61 in 1997 and \$24.50 and \$5.23 in 1996, respectively. For those options granted with exercise prices greater than the grant date fair market value, the exercise prices and weighted average fair values of the options were \$31.63 and \$3.26 in 1998, \$24.06 and \$2.69 in 1997 and \$26.95 and \$3.04 in 1996, respectively.

K. ENGINEERING AND DEVELOPMENT COSTS

Engineering and development costs include research and development expenses for new products, development and major improvements to existing products, and other charges for ongoing efforts to refine existing products. Research and development costs charged to operations totaled \$3,104,000, \$3,050,000 and \$2,457,000 in 1998, 1997 and 1996, respectively. Total engineering and development costs were \$8,833,000, \$8,288,000 and \$6,998,000 in 1998, 1997 and 1996, respectively.

L. RETIREMENT PLANS

The Company has noncontributory, qualified defined benefit pension plans covering substantially all domestic employees and plans covering certain foreign employees. Domestic plan benefits are based on years of service, and for salaried employees on average compensation for benefits earned prior to January 1, 1997, and on a cash balance plan for benefits earned after January 1, 1997. The Company's funding policy for the plans covering domestic employees is to contribute an actuarially determined amount which falls between the minimum and maximum amount that can be contributed for federal income tax purposes. Domestic plan assets consist principally of listed equity and fixed income securities.

In addition, the Company has unfunded, non-qualified retirement plans for certain management employees and directors. Benefits are based on final average compensation and vest at retirement from the Company.

Net pension expense for the Company's domestic defined benefit plans consists of the following components:

(In thousands)	1998	1997	1996
Service cost-benefits earned during the year	\$ 1,248	\$ 1,636	\$ 1,529
Interest cost on projected benefit obligation	7,056	7,056	6,823
Actual return on plan assets.....	(20,405)	(5,198)	(9,956)
Net amortization and deferral	14,548	(188)	5,304
Net pension cost.....	<u>\$ 2,447</u>	<u>\$ 3,306</u>	<u>\$ 3,700</u>

The following table sets forth the Company's domestic defined benefit plans' funded status and the amounts recognized in the Company's balance sheets as of June 30:

(In thousands)	1998 Plan Assets Exceed Obligations	1998 Obligations Exceed Plan Assets	1997 Obligations Exceed Plan Assets
Actuarial present value of benefit obligations:			
Vested benefit obligation.....	\$49,932	\$ 37,940	\$ 76,030
Non-vested benefit obligation	3,048	7,592	12,451
Accumulated benefit obligation	52,980	45,532	88,481
Effect of projected future compensation levels	—	2,963	552
Projected benefit obligation.....	52,980	48,495	89,033
Plan assets at fair value	(55,845)	(42,477)	(76,097)
Plan assets (less than) in excess of projected benefit obligations	(2,865)	6,018	12,936
Unrecognized net loss	(3,094)	(955)	(7,012)
Unrecognized prior service cost.....	1,007	(4,846)	(3,427)
Unrecognized transitional net asset (liability).....	73	(476)	(535)
Adjustment required to recognize additional minimum liability	—	5,165	10,858
(Prepaid) accrued retirement cost at June 30.....	<u>\$ (4,879)</u>	<u>\$ 4,906</u>	<u>\$ 12,820</u>

Assumptions used in accounting for the retirement plans are as follows:

	1998	1997
Discount rate	7.25%	8.00%
Rate of increase in compensation levels.....	4.50%	4.50%
Expected long-term rate of return on plan assets.....	9.00%	9.00%

Total accrued (prepaid) retirement costs at June 30 are summarized as follows:

(In thousands)	1998	1997
Current:		
Domestic defined benefit plans	\$ 179	\$ (493)
Foreign benefit plans	315	446
	494	(47)
Long-term:		
Domestic defined benefit plans:		
Prepaid costs.....	(8,030)	—
Accrued costs	7,878	13,313
	(152)	13,313
	<u>\$ 342</u>	<u>\$13,266</u>

Effective as of January 1, 1997, the Twin Disc, Incorporated Retirement Plan for Salaried Employees was amended to freeze the benefit formula in effect prior to January 1, 1997, and to change the formula for benefit accruals to a cash balance pension plan. The effect of this change was to decrease the unrecognized prior service cost by \$4.2 million.

Retirement plan expense for the Company's foreign plans was \$661,000, \$667,000 and \$837,000 in 1998, 1997 and 1996, respectively.

The Company sponsors defined contribution plans covering substantially all domestic employees. These plans provide for employer contributions based primarily on employee participation. The total expense under the plans was \$1,227,000, \$1,023,000 and \$903,000 in 1998, 1997 and 1996, respectively.

In addition to providing pension benefits, the Company provides health care and life insurance benefits for certain domestic retirees. All employees retiring after December 31, 1992, and electing to continue coverage through the Company's group plan, are required to pay 100% of the premium cost.

The Company recognized \$2,379,000, \$2,293,000 and \$2,680,000 in non-pension postretirement benefit expense in 1998, 1997 and 1996, respectively, which consists primarily of interest cost.

The following table sets forth the status of the postretirement benefit programs (other than pensions) and amounts recognized in the Company's consolidated balance sheet at June 30:

	(In thousands)	1998	1997
Accumulated postretirement benefit obligation:			
Retirees.....		\$27,813	\$25,998
Fully eligible active plan participants.....		423	440
Other active participants.....		383	504
		<u>28,619</u>	<u>26,942</u>
Unamortized net amount resulting from changes in plan experience and actuarial assumptions.....		(4,397)	(2,665)
Accrued postretirement benefit obligation.....		<u>\$24,222</u>	<u>\$24,277</u>

The current portion of the accumulated postretirement benefit obligation of \$2,643,000 and \$2,197,000 is included in accrued liabilities at June 30, 1998 and 1997, respectively.

The assumed weighted average discount rate used in determining the actuarial present value of the accumulated postretirement benefit obligation was 7.25% and 8.00% at June 30, 1998 and 1997, respectively. The assumed weighted average health care cost trend rate was 7% in fiscal year 1998 and will decrease to 6% in fiscal year 1999 and remain constant thereafter. A 1% increase in the assumed health care trend would increase the accumulated postretirement benefit obligation by approximately \$1.9 million and the interest cost by approximately \$133,000.

M. INCOME TAXES

United States and foreign earnings before income taxes were as follows:

	(In thousands)	1998	1997	1996
United States.....		\$ 7,944	\$ 6,009	\$ 2,821
Foreign.....		8,101	6,671	8,086
		<u>\$16,045</u>	<u>\$12,680</u>	<u>\$10,907</u>

The provision (credit) for income taxes is comprised of the following:

	(In thousands)	1998	1997	1996
Currently payable:				
Federal.....		\$ 154	\$ 913	\$ 829
State.....		114	100	78
Foreign.....		3,541	2,457	1,925
		<u>3,809</u>	<u>3,470</u>	<u>2,832</u>
Deferred:				
Federal.....		2,582	1,559	388
State.....		183	(51)	(54)
Foreign.....		108	(27)	1,182
		<u>2,873</u>	<u>1,481</u>	<u>1,516</u>
		<u>\$ 6,682</u>	<u>\$ 4,951</u>	<u>\$ 4,348</u>

The components of the net deferred tax asset as of June 30, were as follows:

	(In thousands)	1998	1997
Deferred tax assets:			
Retirement plans and employee benefits.....		\$ 8,074	\$ 11,605
Other.....		3,039	3,078
Alternative minimum tax credit carryforwards.....		143	1,143
Foreign tax credit carryforwards.....		250	—
		<u>11,506</u>	<u>15,826</u>
Deferred tax liabilities:			
Property, plant and equipment.....		5,488	5,634
Other.....		2,790	2,142
		<u>8,278</u>	<u>7,776</u>
Total net deferred tax assets.....		<u>\$ 3,228</u>	<u>\$ 8,050</u>

Following is a reconciliation of the applicable U.S. federal income tax rate to the effective tax rates reflected in the statements of operations:

	1998	1997	1996
U.S. federal income tax rate.....	34.0%	34.0%	34.0%
Increases (reductions) in tax rate resulting from:			
Foreign tax items.....	1.2	.2	4.2
Accrual for prior years.....	4.4	3.7	—
Other, net.....	2.0	1.1	1.7
	<u>41.6%</u>	<u>39.0%</u>	<u>39.9%</u>

N. CONTINGENCIES

The Company is involved in various stages of investigation relative to hazardous waste sites, two of which are on the United States EPA National Priorities List (Superfund sites). The Company's assigned responsibility at each of the Superfund sites is less than 2%. The Company has also been requested to provide administrative information related to two other potential Superfund sites but has not yet been identified as a potentially responsible party. Additionally, the Company is subject to certain product liability matters.

At June 30, 1998, the Company has accrued approximately \$1,350,000, which represents management's best estimate available for possible losses related to these contingencies. This amount has been provided over the past several years. Based on the information available, the Company does not expect that any unrecorded liability related to these matters would materially affect the consolidated financial position, results of operations or cash flows.

REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders
Twin Disc, Incorporated
Racine, Wisconsin

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, changes in shareholders' equity and cash flows present fairly, in all material respects, the financial position of Twin Disc, Incorporated and Subsidiaries at June 30, 1998 and 1997, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 1998, in conformity with generally accepted accounting principles. 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 of these statements in accordance with generally accepted auditing standards which 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, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for the opinion expressed above.

PricewaterhouseCoopers LLP
Milwaukee, Wisconsin
July 24, 1998

TWIN DISC, INCORPORATED AND SUBSIDIARIES

TEN YEAR FINANCIAL SUMMARY

(In thousands of dollars, except where noted)	1998	1997	1996	1995	1994	1993	1992	1991	1990	1989
STATEMENT OF OPERATIONS										
Net sales.....	\$202,643	\$189,942	\$176,657	\$164,232	\$141,193	\$139,403	\$136,255	\$152,990	\$163,021	\$187,347
Costs and expenses, including marketing, engineering and administrative.....	186,607	177,342	164,486	154,347	136,244	135,284	134,242	155,395	159,178	172,014
Earnings (loss) from operations.....	16,036	12,600	12,171	9,885	4,949	4,119	2,013	(2,405)	3,843	15,333
Other income (expense).....	9	80	(1,264)	(1,301)	18	(95)	(162)	(721)	511	1,868
Earnings (loss) before income taxes.....	16,045	12,680	10,907	8,584	4,967	4,024	1,851	(3,126)	4,354	17,201
Income taxes (credits).....	6,682	4,951	4,348	2,912	578	1,362	810	(711)	1,679	6,574
Net earnings (loss).....	9,363	7,729	6,559	5,672	4,389	2,662	1,041	(2,415)	2,675	10,627
Overseas operations										
Net sales.....	54,824	58,098	56,520	55,625	45,862	44,766	45,668	54,200	52,814	53,904
Net earnings (loss).....	4,428	3,840	4,758	2,480	2,365	1,673	(478)	(1,514)	2,248	5,574
BALANCE SHEET										
<i>Assets</i>										
Cash and cash equivalents.....	5,087	8,983	2,043	3,741	4,166	2,903	2,987	2,288	4,159	1,614
Receivables, net.....	28,320	32,428	34,917	29,247	25,682	25,106	26,026	24,567	27,107	31,288
Inventories.....	53,280	47,844	51,083	47,157	41,569	42,562	36,686	40,913	38,268	44,030
Other current assets.....	6,893	8,707	8,597	10,345	8,993	6,961	4,521	5,886	3,662	2,765
Total current assets.....	93,580	97,962	96,640	90,490	80,410	77,532	70,220	73,654	73,196	79,697
Investments and other assets.....	31,646	26,544	30,344	30,463	26,830	21,813	10,554	9,648	10,142	9,318
Fixed assets less accumulated depreciation.....	35,728	34,249	35,715	37,348	36,676	37,560	38,724	42,877	40,119	32,946
Total assets.....	160,954	158,755	162,699	158,301	143,916	136,905	119,498	126,179	123,457	121,961
Net assets overseas.....	31,515	31,517	30,671	32,368	29,580	28,059	30,477	32,063	36,104	28,246
<i>Liabilities and Shareholders' Equity</i>										
Current liabilities.....	29,553	29,621	34,002	36,852	32,710	31,252	35,694	38,785	28,188	32,342
Long-term debt.....	19,949	19,944	19,938	14,000	11,500	13,000	—	4,309	5,251	—
Deferred liabilities.....	29,457	35,393	33,578	32,827	34,309	31,244	7,365	8,463	10,137	8,377
Shareholders' equity.....	81,995	73,797	75,181	74,622	65,397	61,409	76,439	74,622	79,881	81,242
Total liabilities and shareholders' equity.....	160,954	158,755	162,699	158,301	143,916	136,905	119,498	126,179	123,457	121,961
<i>Comparative Financial Information</i>										
Per share statistics:										
Basic earnings (loss).....	3.30	2.78	2.36	2.03	1.57	.95	.37	(.85)	.93	3.57
Diluted earnings (loss).....	3.24	2.75	2.34	2.02	1.56	.95	.37	(.85)	.93	3.57
Dividends.....	.76	.70	.70	.70	.70	.70	.70	.85	.90	.80
Shareholders' equity.....	28.94	26.48	27.07	26.75	23.36	21.93	27.10	26.42	27.89	27.32
Return on equity.....	11.4%	10.5%	8.7%	7.6%	6.7%	4.3%	1.4%	(3.2)%	3.3%	13.1%
Return on assets.....	5.8%	4.9%	4.0%	3.6%	3.0%	1.9%	.9%	(1.9)%	2.2%	8.7%
Return on sales.....	4.6%	4.1%	3.7%	3.5%	3.1%	1.9%	.8%	(1.6)%	1.6%	5.7%
Average shares outstanding.....	2,833,663	2,781,174	2,776,805	2,790,111	2,799,390	2,799,603	2,820,513	2,824,815	2,864,526	2,973,950
Diluted shares outstanding.....	2,886,209	2,808,226	2,805,123	2,812,703	2,809,390	2,806,603	2,823,885	2,826,123	2,864,526	2,973,950
Number of shareholder accounts.....	774	845	913	996	1,058	1,139	1,214	1,271	1,349	1,441
Number of employees.....	1,078	1,081	1,080	1,097	1,099	1,114	1,221	1,483	1,676	1,651
Additions to plant and equipment.....	7,154	4,734	4,140	4,290	4,216	4,684	4,390	8,218	7,084	9,440
Depreciation.....	5,205	5,141	5,071	4,792	4,670	4,958	5,452	5,568	5,207	4,628
Net working capital.....	64,027	68,341	62,638	53,638	47,700	46,280	34,526	34,869	45,008	47,355

1993 Net Earnings data and Return percentages reflect operating earnings before the effect of adopting Financial Accounting Standards 106 and 109. The cumulative effect of their adoption was a net loss of \$14.44 million or \$5.16 per share.

DIRECTORS

MICHAEL E. BATTEN
Chairman, Chief Executive Officer

MICHAEL H. JOYCE
President, Chief Operating Officer

JAMES O. PARRISH
Vice President-Finance & Treasurer

PAUL J. POWERS
Chairman, President-Chief Executive Officer
Commercial Intertech Corp.
(Manufacturer of Hydraulic Components,
Fluid Purification Products, Pre-Engineered
Buildings and Stamped Metal Products)
Youngstown, Ohio

RICHARD T. SAVAGE
President-Chief Executive Officer
Modine Manufacturing Company
(Manufacturer of Heat Exchange Equipment)
Racine, Wisconsin

DAVID L. SWIFT
Retired Chairman, President-Chief
Executive Officer
Acme-Cleveland Corporation
(Manufacturer of Diversified Industrial Products)
Pepper Pike, Ohio

STUART W. TISDALE
Retired Chairman-Chief Executive Officer
WICOR, Inc.
(Parent Company of Wisconsin Gas Company,
Sta-Rite Industries, Shurflo Pump Manufacturing
and Hypro Corporation)
Milwaukee, Wisconsin

GEORGE E. WARDEBERG
Chairman-Chief Executive Officer
WICOR, Inc.
(Parent Company of Wisconsin Gas Company,
Sta-Rite Industries, Shurflo Pump Manufacturing
and Hypro Corporation)
Milwaukee, Wisconsin

DAVID R. ZIMMER
Executive Vice President
United Dominion Industries
(Manufacturer of Proprietary Engineered Products)
Charlotte, North Carolina

OFFICERS

MICHAEL E. BATTEN
Chairman, Chief Executive Officer

MICHAEL H. JOYCE
President, Chief Operating Officer

JAMES O. PARRISH
Vice President-Finance & Treasurer

PHILIPPE PECRIAUX
Vice President-Europe

JAMES MCINDOE
Vice President-International Marketing

LANCE J. MELIK
Vice President-Corporate Development

FRED H. TIMM
Corporate Controller & Secretary

PAUL A. PELLIGRINO
Vice President-Engineering

JOHN W. SPANO
Vice President-Sales & Marketing

ARTHUR A. ZINTEK
Vice President-Human Resources

CORPORATE DATA

ANNUAL MEETING

Roma Lodge
Racine, Wisconsin
2:00 P.M.
October 16, 1998

SHARES TRADED

New York Stock Exchange: Symbol TDI

ANNUAL REPORT ON SECURITIES AND EXCHANGE COMMISSION FORM 10-K

Single copies of the Company's 1998 Annual Report on Securities and Exchange Commission Form 10-K will be provided without charge to shareholders after September 30, 1998, upon written request directed to the Secretary, Twin Disc, Incorporated, 1328 Racine Street, Racine, Wisconsin 53403.

TRANSFER AGENT & REGISTRAR

Firststar Trust Company
Milwaukee, Wisconsin

INDEPENDENT ACCOUNTANTS

PricewaterhouseCoopers L.L.P.
Milwaukee, Wisconsin

GENERAL COUNSEL

von Briesen, Purtell, & Roper, s.c.
Milwaukee, Wisconsin

CORPORATE OFFICES

Twin Disc, Incorporated
Racine, Wisconsin 53403
Telephone: (414) 638-4000

WHOLLY-OWNED SUBSIDIARIES

Twin Disc International S.A.
Nivelles, Belgium
Twin Disc Spain, S.A.
Madrid, Spain
Twin Disc Italia S.R.L.
Viareggio, Italy
Twin Disc (Pacific) Pty. Ltd.
Brisbane, Queensland, Australia
Twin Disc (Far East) Ltd.
Singapore
Twin Disc (South Africa) Pty. Ltd.
Johannesburg, South Africa

Mill-Log Equipment Co., Inc.
Coburg, Oregon
Southern Diesel Systems Inc.
Miami, Florida
TD Electronics, Inc.
Loves Park, Illinois

PARTIALLY-OWNED

AFFILIATE COMPANY

Niigata Converter Company, Ltd.
Kamo, Omiya and Tokyo, Japan
Palmer Johnson Distributors, LLC
Sturgeon Bay, Wisconsin

MANUFACTURING FACILITIES

Racine, Wisconsin
Nivelles, Belgium
Kamo and Omiya, Japan

SALES OFFICES

Domestic
Racine, Wisconsin
Coburg, Oregon
Seattle, Washington
Miami, Florida
Jacksonville, Florida
Overseas
Nivelles, Belgium
Brisbane and Perth, Australia
Singapore
Johannesburg, South Africa
Madrid, Spain
Viareggio, Italy
Affiliate Company
Tokyo, Japan
Sturgeon Bay, Wisconsin

MANUFACTURING LICENSES

Niigata Converter Company, Ltd.
Tokyo, Japan
Transfluid S.R.L.
Milan, Italy
Nakamura Jico Co. Ltd.
Tokyo, Japan
Hindustan Motors, Ltd.
Madras, India

