Hesston annual report

This annual report from the Hesston Corporation includes: financial highlights of the company and financial news to and from stockholders and employees. This publication funded by the National Historical Publications and Records Commission through the Kansas State Historical Records Advisory Board.

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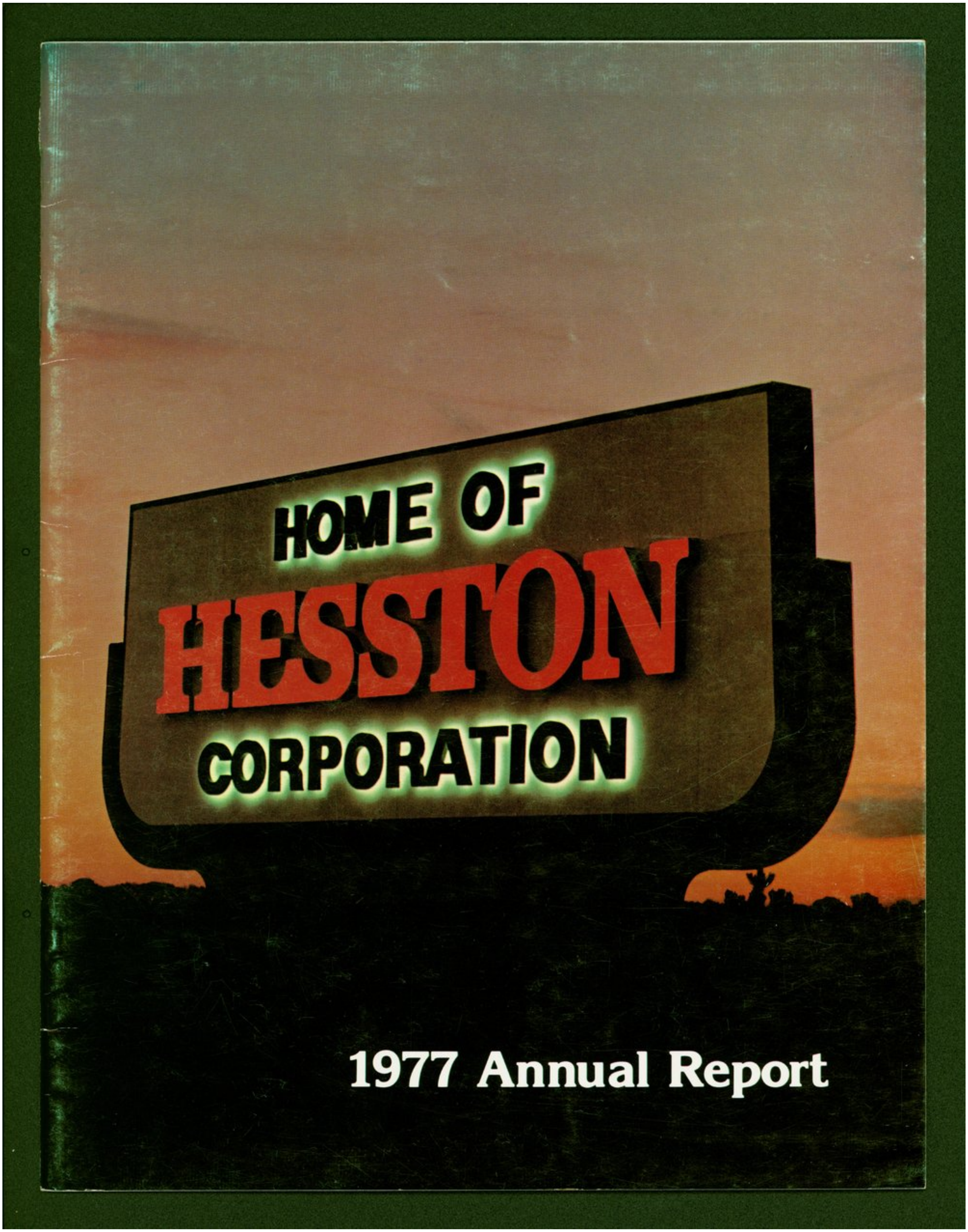
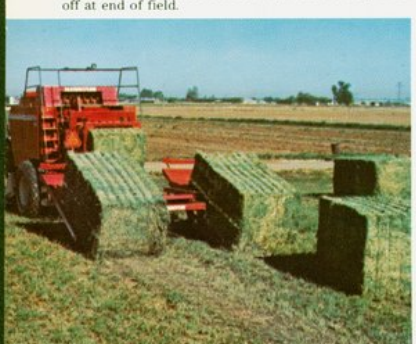

HOME OF
HESSTON
CORPORATION
1977 Annual Report

The new Model 4800 Big Square Baler is capable of packaging up to a ton of hay in a 4′×4′×8′ bale.

Big Bale Accumulator collects big bales to drop them off at end of field.



Big Bale Loader attachment stacks big bales on ground or transport vehicles.

Big Bale Processor loads and feeds two big bales as well as conventional small bales.

Hesston Corporation 1977 Annual Report

Financial Highlights

	For the years ended September 30, 1977	1976
Net Sales	**$142,245,000**	$187,194,000
Loss from continuing operations before income taxes	**$ (17,272,000)**	$ (4,007,000)
Provision for income taxes	**(7,956,000)**	121,000
Loss from continuing operations	**(9,316,000)**	(4,128,000)
Loss from discontinued operations	**—**	(2,024,000)
Net loss	**$ (9,316,000)**	$ (6,152,000)
Net loss per share	**$ (4.93)**	$ (3.50)
Common Shares Outstanding	**3,387,952**	1,987,952

Newest Way For One-Man Hay!

Hesston's new Model 4800 Big Square Baler System (opposite page) adds another dimension to one-man hay packaging systems. Now Hesston dealers can offer farmers and ranchers a choice from three models of Hesston StakHand® Systems, three models of Hesston Rounders® (big round bales), the conventional small square baler, and the new Model 4800.

The Annual Meeting of Stockholders of Hesston Corporation will be held at 1:30 p.m. local time on Wednesday, January 25, 1978, at the Hesston Corporation Communications Center, Hesston, Kansas.

A copy of Hesston Corporation's annual report to the Securities and Exchange Commission (Form 10-K) may be obtained by writing to: Hesston Corporation, Attention: Mr. Richard F. Hrdlicka, Secretary, Hesston, Kansas 67062.

New York Stock Exchange — HES, HES Pr

HESSTON CORPORATION
HESSTON, KANSAS 67062, Phone (316) 327-4000

Hydro Swing, StakHand, StakFeeder, StakProcessor, Round-Up and Rounder are registered trademarks of Hesston Corporation.

To Our Shareholders:

This letter may be summarized as a report on our recovery strategy which we outlined in last year's annual report.

In the 1976 report, we identified two major objectives. First, reduce inventory at dealer levels, which in turn reduces our heavy interest costs in floorplanned dealer inventory. Second, consolidate operations and dispose of excess plant capacity wherever possible. We had already made our major employment cutback in 1976, reducing the number of employees from 4,300 to 3,239 by year-end.

We made progress in these two areas. Dealer inventories in North America were reduced by $15 million. We consolidated our Field Queen operations into the Hesston Division and sold the facilities at Maize, Kansas. We also sold the Logan, Utah, facilities, including our potato harvesting line, which we closed in 1976 when we moved the sugar beet harvesting production to the Hesston Division plant. These actions further reduced excess plant capacity and overhead with a net reduction of 200 employees. Average employment in 1977 was 3,149, and at year-end the worldwide employment figure was 3,020.

These were achieved in North America in the face of a flat and sagging farm economy. On the international scene, the farm equipment market was more normal with Western Europe recovering from the severe drought in 1976. We had a significant reduction of factory inventory in Europe and increased sales to Eastern Bloc countries.

Our basic strategy for recovery continues to be a further reduction of dealer field inventories until they are in balance with retail demand. We have cut back our production and are holding shipments to dealers well below their retail sales. This has reduced our sales and placed a severe pressure on operating results and working capital. The lower level of production causes fixed costs to be higher in relationship to sales, since our factories worldwide are operating well below capacity, even though some factories, such as the Woods Division and the Danuser Division, are operating at a much better utilization level.

During our search this past year for improving our sales in international markets, we entered into discussions with Fiat Trattori, of Turin, Italy, to determine if there were some marketing compatibility between the two companies since we do not market tractors and Fiat does not market the kind of equipment we produce. Fiat Trattori is one of the major producers and marketers of farm tractors in the world.

At the time of these discussions, it became apparent that the pressure on our working capital might restrict our thrust in product development and in future growth. To overcome this financial problem, we were able to negotiate the sale of 1,400,000 shares of new-issue Hesston Common Stock and 600,000 shares of $.60 Cumulative Convertible Preferred Stock with voting privileges to Internazionale Holding Fiat, S.A. (IHF), a wholly-owned subsidiary of Fiat S.p.A. This issue was approved at a special stockholders meeting at Hesston on September 13, 1977. This transaction resulted in a net $19,678,000 increase to our equity and increased the outstanding shares to 3,387,952 shares of Common Stock, 499,800 shares of $1.60 Cumulative Convertible Preferred Stock and 600,000 shares of $.60 Cumulative Convertible Preferred Stock. It also gives IHF 50.2% of Hesston's outstanding voting securities.

At the September 13, 1977, stockholders meeting, all of the Board of Directors of the Company tendered their resignations and a new slate of directors was elected by the stockholders. Re-elected were Lyle E. Yost, Howard L. Brenneman, Richard F. Hrdlicka and Harold P. Dyck. New board members elected were Melvin H. Voth, Paolo Bernardelli, Pietro Quaglia, Fernando Negro, Evasio Sattanino, Stefano Decio, and Jonathan O'Herron.

The new Board voted to pay the $.40 per share quarterly dividend on the $1.60 Convertible Preferred Stock on December 1, 1977, to stockholders of record as of November 14, 1977.

With the completion of the stock transaction with IHF, we have added several new objectives to our recovery strategy. First, we want to strengthen our position in the worldwide marketplace. Intensive studies of our markets, on a country-by-country basis, are presently underway with Fiat Trattori to determine what synergy our two different, but compatible, product lines can generate. We fully anticipate that this will open the door for us in countries where we have not been able to establish adequate distribution. Second, we will continue to pursue our new product development, particularly entering new markets in the farm and light industrial field.

We believe we have a positive strategy for recovery and growth. The agricultural economy in North America will probably experience another difficult year, but there

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should be some improvement in the profitability of the beef and dairy sectors which should help bolster sales of hay and forage equipment. We anticipate a bottoming-out of the farm equipment downturn for the industry as a whole as dealers are able to work down much of their excess inventory.

Europe should have an improved farm economy but the weather patterns in Australia could present additional problems.

We anticipate 1978 to be the final year for Hesston's corrective measures. With the new thrust of a worldwide marketing basis and with new emphasis upon product development, we feel we will emerge a much stronger company with our direction clearly set in the growing worldwide farm and light industrial equipment markets.

We have had to make some tough management decisions during these past two years. However, these decisions have strengthened us and prepared us more adequately for the future. We appreciate your patience and confidence.

To our retiring directors, we express our appreciation for their support. And, to over 3,000 Hesston employees and managers who have had the confidence and desire to turn the company around, we say, "thank you."

Lyle E. Yost
Chairman

Howard L. Brenneman
President

Review of Operations

Fiscal 1977 can best be described as a year of consolidation and inventory reduction for Hesston Corporation. It can also easily be identified as the most difficult year in the Company's 30-year history. While there is still much to be done to make the turnaround a reality, the Company looks to 1978 as a year of restructuring for growth, strengthening of its distribution system worldwide and renewed enthusiasm for its product lines.

Hesston Division

The Hesston Division, responsible for the manufacturing and marketing of Hesston farm equipment in North America, entered the 1977 year on the heels of a sharp downturn in the farm economy and with an oversupply in dealer inventories. This inventory, at the close of the 1976 fiscal year, was equivalent to 85% of the reported retail for the year. Dramatic cutbacks in employment and production had already been made. Sugar beet harvesting equipment previously manufactured by the Logan (Utah) Division was transferred to Hesston Division to achieve better capacity utilization. The North American Farm Equipment Sales organization had been restructured so it could devote its efforts to the specific sales function, and the Product Management Group took on worldwide product development responsibilities to expedite entries of new products.

The anticipated gradual upturn in the farm economy didn't happen. Grain prices skidded and cattle prices stayed basically flat. Competition for the farm equipment dollar became intense but Hesston basically retained its share of market in most major product categories. By year end, the Hesston Division had reduced its dealer inventories by $15 million. This was a significant reduction in view of the obstacles. However, dealer inventories entering 1978 remain at unsatisfactory levels.

In another consolidation move, and to achieve greater efficiency and plant utilization, the operations of the Field Queen Division were moved to the main factory at Hesston and the Field Queen factory at Maize, Kansas, was sold. While Field Queen will maintain its direct distribution of self-propelled forage harvesters in most areas, Field Queen sales have become a responsibility of Hesston Marketing.

Contract manufacturing has also taken on new significance within the Hesston Division and has picked up some of the slack in manufacturing capacity. A substantial number of woodburning stoves are being manufactured for the licensees of Fisher International, Inc., of Eugene, Oregon.

Hesston Marketing has also taken on a new thrust with the establishment of a branch in Minneapolis. Others are located at Kansas City, Indianapolis, Denver and Calgary.

During 1977, the Hesston Division introduced its new Model 4500 baler. This is the Company's first entry into the conventional baler market and was initiated to lay the groundwork for more innovative products to be introduced to this market later, and to provide the Hesston dealer a broader line of hay products.

In 1978, Hesston will introduce the new Model 4800 Big Square Baler, which is capable of packaging up to a ton of hay in a 4′×4′×8′ bale, along with a total system of handling and feeding the giant bale (as described on the front cover of this report). While the initial production of these units will be modest during this introduction phase, the initial reaction during market testing was highly favorable. With this new big square baler system, Hesston dealers will now be able to offer farmers and ranchers the widest selection of one-man hay packaging systems and equipment in the world. They can select from three models of the Hesston StakHand systems, three models of Hesston Rounders that make the big round bales, and the conventional small square baler as well as the new big square baler.

In 1978, Hesston will also introduce a new Model 6610 self-propelled hydrostatic windrower and two new pull-type mower-conditioners, the Models 1070 and 1090. The Company will continue to broaden its new line of heavy-duty tillage equipment, which it introduced just a year ago. A new Model 7600 Field Queen self-propelled forage harvester has also been introduced. All in all, the Hesston farm equipment product line for 1978 stands as viable as any the Company has ever offered, ready for the challenge of a highly competitive industry.

With the problems of integration and consolidation of operations overcome, the Hesston Division can concentrate even more of its efforts on retail sales during the difficult 1978 sales year ahead, and in building the foundation for growth in the ensuing years.

Woods Division

The Woods Division continues to be the bright star in Hesston's Industrial Products group. Woods increased sales and gained market share in 1977 as the world's largest producer of tractor-mounted rotary mowers and shredders, while retaining its excellent profit margins. Rear-mounted mowers for backyard or garden-type tractors were the big contributors during 1977. A new version of the heavy-duty six-foot Model B-106 cutter is now being introduced. Woods also gained market share in rear-mounted blades and has made an entry into the box-scraper category.

Danuser Division

The Danuser Division achieved favorable results in 1977, breaking into the profit column for the first time in a number of years. Danuser is principally a producer of farm and industrial equipment for other original equipment manufacturers. The Division also manufactures the tillage equipment for the Hesston Division and backhoes for the Woods Division. They are developing an excellent plant organization and management team which is dedicated to

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Hesston offers three big-package hay stacking systems. StakHand® 10, 30-A and 60-A shown.

Hesston provides a complete line of movers for big stacks (StakMover 30 shown).

Hesston StakFeeder® models make winter feeding warm and easy (StakFeeder 60-A shown).

Hesston makes giant round bales in three sizes with Rounder® models 5800, 5500 and 5400.

Hesston Round Bale Movers handle bales one at a time, or four at a time (Model 5200 shown).

StakProcessor® 10 moves and feeds big bales and small stacks.

4500 Baler offers new wire-tying and bale-throwing features.

New 1978 Model 6610 Hydro-Static Windrower is for big-tonnage haying. Hesston offers three models of self-propelled windrowers.

Model 1090 is one of two all-new mower-conditioners for 1978.

The Model PT-7 (shown) and the Model PT-10 Mower-Conditioners are proven performers.

Model 1014 Hydro Swing® Windrower provides unmatched maneuverability for a pull-type machine. The Hydro Swing 1010 mower-conditioner is also available.

producing quality products, reaching defined objectives and achieving acceptable margins.

Hesco Division

The Hesco Division continues to show improvements in sales and in margins. Its brand-name line of quality, wood-crafted custom office furniture has become widely accepted. Custom-designed interior furnishings for franchised food chains contribute to the Division's revenue.

International Operations

When the full impact of the stock transaction with Internazionale Holding Fiat, S.A. is fully realized, the biggest beneficiary is anticipated to be Hesston's International Operations. The complementary aspects of the Fiat Trattori product lines perhaps will open the door for Hesston farm equipment in countries where Hesston has not been able to establish adequate distribution. However, the immediate goal of Hesston's International Operations is to improve margins and retail sales in all areas of the world where Hesston products are being aggressively sold.

European Region

Consolidation has also been going on in Europe and more will be accomplished in 1978. Sales in Europe showed an increase following a severe drought last year in Western Europe. The sales branch in France had an excellent year and the new sales operation in Germany made considerable progress. The new branches in the United Kingdom and Denmark also showed increases over 1976. A low level of the factory capacity of the Coex (France) Division was utilized during the year because of higher-than-normal inventories at the factory. Sales to dealers have relieved these inventories considerably.

Of significance in Europe were increased sales to Eastern Bloc countries, primarily Hungary and Bulgaria. In 1977, Hungary purchased self-propelled forage harvesters manufactured by the Coex Division and StakHand Hay Handling Systems produced at Hesston, Kansas. All together Hungary acquired nearly $2.5 million of Hesston products. Part of this transaction was on a cooperative contract whereby Hesston will buy Hungarian-produced products prior to 1982. Approximately $1.8 million of Hesston forage harvester components were sold to Agromachinaimpex, the state-owned manufacturer of farm equipment in Bulgaria.

Hesston-Europe introduced several new products in 1977 which have met with favorable acceptance; among these were the Model 5700 four-foot-wide Rounder, the Model 7050 pull-type forage harvester and the new Model 7650 250 h.p. self-propelled forage harvester.

Three Pull-Type Forage Harvesters meet the needs of any forage program.

Field Queen Model 7600 Self-Propelled provides big-capacity forage harvesting.

Hesston Beet Harvesters deliver a clean harvest. Choice of 3 models.

Hesston Slurry Manure Spreader (two models available) delivers one-man, tractor-seat handling of liquid waste.

Model 2210 Field Cultivator is built in widths up to 67 feet for big tractors.

2410 Single Disc is new for 1978...gives an old tillage concept a new life.

Hesston annual report

South Pacific Region

The Australian weather patterns present a clouded picture as to the prospects for immediate profit in this area of the world. Sales to dealers did show an increase over 1976 and the acceptance of the Hesston products was satisfactory during the Company's first full retail season in both Australia and New Zealand. The sales branch in Wagga Wagga, New South Wales, continues on an aggressive program of dealer development and product introductions. It has established itself in the marketplace and should be in an excellent position when the market conditions become more favorable.

Latin American Region

The agricultural economy in Latin America is anticipated to be one of the fastest growing of any in the world during the next decade and Hesston has been aggressively pursuing this market in countries where it has been practical and feasible. Unfortunately, the devaluation of the Mexican peso continues to affect sales in that country and the import restrictions in Brazil hamper sales efforts to farmers there. Hesston has done very well in the Central American countries and will continue to seek new opportunities throughout Latin America.

North Pacific Region

Hesston has established an excellent foothold in the Japanese market through the aggressive efforts of the distributor and the Company's regional sales personnel located there. This has proven to be a fine market for self-propelled and pull-type forage harvesters, Rounders, and the pull-type mower-conditioners. This market has just opened up and the acceptance of the Hesston products predicts a bright future in this area of the world.

Summary

As Hesston management and employees throughout the world have worked through this very difficult period in the Company's history, they have met and overcome many obstacles. Almost daily there has been a new set of circumstances to analyze and plans to execute. It has been a tempering experience, but one that has prepared the Company more adequately for the future as the agricultural and farm equipment industries go through their periodic cycles. The continued support and enthusiasm of our worldwide distribution system is gratifying and encouraging. With this kind of support, along with new products coming on-stream, others under development and the opportunities and potential which exist as a result of the Fiat Trattori relationship, the future for Hesston is, indeed, bright.

Woods RB700 Rear Scraper Blade is for ditching, scraping and grading.

Woods RM48 is a convenient 3-point mounted mower for small tractors.

Woods B106 heavy-duty rotary mower handles a 6′ swath.

Woods T310 Backhoe handles big digging jobs fast.

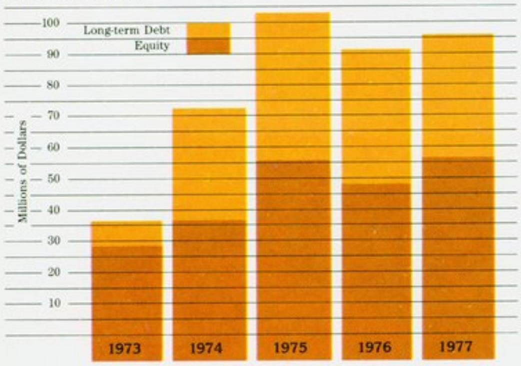
Hesston Model 5700 Rounder®, manufactured at Coex Division, makes a 4′ round bale for European markets.

Hesston 7650 Self-Propelled Forage Harvester, for big-capacity harvesting, is also a Coex-manufactured product.

Hesston Corporation

1977 Financial Review

TOTAL INVESTMENT



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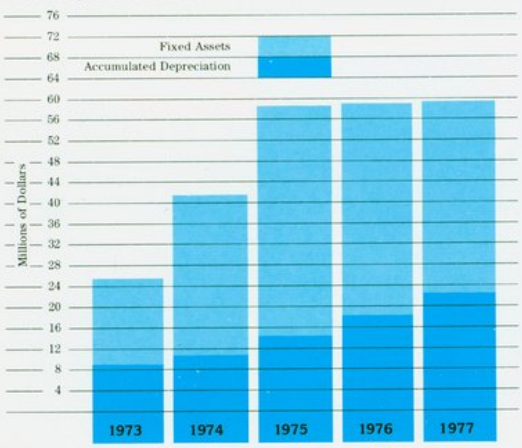
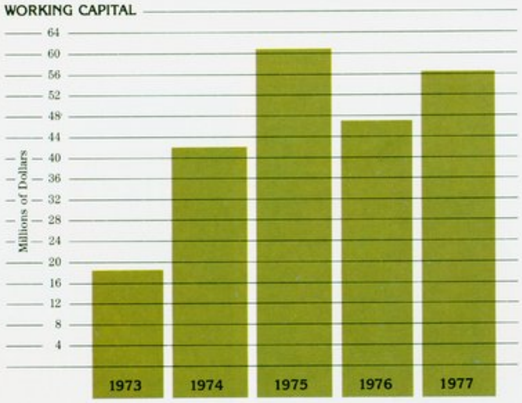


WORKING CAPITAL



Sales and Results of Operations

Consolidated net sales of Hesston Corporation for fiscal 1977 were $142,245,000 compared to $187,194,000 in 1976. The net loss for 1977 was $9,316,000 compared to a net loss of $6,152,000 ($4,128,000 from continuing operations) in 1976.

The decline in sales reflects lower shipments to dealers in North America. This decline was caused by a planned reduction in Hesston dealer inventory, as well as lower retail sales by dealers to farmers and ranchers, as was generally true throughout the farm equipment industry. The downturn in industry sales is related to the low prices for beef and grains and unfavorable weather conditions in several parts of North America. The amount of Hesston equipment at dealers declined by approximately $15,000,000. Sales outside North America increased to $32,649,000 in 1977 compared to $25,064,000 in 1976. This reflects an improvement in the agricultural markets of Europe and Australia relative to the prior year.

The increased loss from continuing operations of $5,188,000 experienced in 1977 is due primarily to the loss of gross profit associated with the lower sales.

Cost of Sales

Cost of sales increased to 71.3% of sales in 1977 compared to 67.1% in 1976. This increase is a result of giving larger sales discounts in 1977 and a decrease in production at two of our plants which caused fixed production costs to increase as a percentage of sales. Inventory write-down due to surplus and obsolescence was $2,060,000 in 1977 compared to $6,268,000 in 1976.

Operating Expenses

Operating expenses were $40,369,000 in 1977 compared to $47,547,000 in 1976. This decrease includes the reductions associated with the transfer of manufacturing from the Logan, Utah, and Maize, Kansas, plants to the Hesston, Kansas, plant in 1977. In addition, the Company was able to effect a general reduction in operating expenses. However, operating expenses were 28.4% of sales in 1977 compared to 25.4% in 1976. This increase as a percentage of sales was due to the inability to cut operating expenses in the same percentage as the sales decrease.

Interest and Finance Charges

Interest and finance charges decreased to $17,527,000 in 1977 compared to $19,388,000 in 1976. As is typical in the farm equipment industry, Hesston provides the floor plan and pays most of the financing cost for inventory at dealers. Accordingly, the cost to carry inventory for the period from shipment to the retail sale or payment by the dealer at maturity date is recognized at the time of sale. In 1977 interest and finance charges were 12.3% of sales compared to 10.4% in 1976.

Income Taxes

The effective tax benefit rate was 46.1% in 1977 compared to 23.3% in 1976. Most of the 1977 tax loss ocurred in countries where current year taxable loss could be carried back against prior year's taxable income. In 1976 a significant portion of the taxable loss could not be offset against prior year's income.

Capital Funds and Dividends

On September 14, 1977, Hesston Corporation sold 1,400,000 shares of Common Stock and 600,000 shares of \$.60 Cumulative Convertible Preferred Stock to Internazionale Holding Fiat S.A. ("IHF"). The sale price for both issues was \$10 per share which provided approximately \$19,678,000 of net proceeds to the Company. The funds were used to repay short-term borrowing and to supplement working capital. In 1977, the Company reduced long-term debt by \$4,666,000 compared to \$788,000 in 1976. In addition to the loss in 1977 which reduced retained earnings by \$9,316,000, cash dividends of \$800,000 were paid to holders of the \$1.60 Cumulative Convertible Preferred Stock. No dividend payments were made on Common Stock.

The Company is permitted under its long-term loan agreements to pay preferred dividends prior to October 1, 1982, provided tangible net worth exceeds \$42,500,000. At September 30, 1977, tangible net worth (as defined) was \$57,135,000. Cash dividends on Common Stock are permitted prior to October 1, 1982, provided that tangible net worth exceeds \$48,000,000 and net income for the period beginning October 1 in the fiscal year of the first common dividend payment exceeds cash dividends on all preferred and common stock for the period.

Capital Expenditures and Sale of Facilities

During 1977, expenditures for property, plant, and equipment totaled \$2,258,000 compared to \$5,854,000 in 1976. Depreciation in 1977 was \$4,979,000 compared to \$5,461,000 in the prior year. The Company completed the sale of the Logan, Utah, plant which was closed in 1976 and sold the Field Queen plant near Maize, Kansas, late in fiscal 1977. The net sales price of these fixed assets sold was \$2,833,000, which exceeded the net book value of \$2,335,000. In June 1977, the Company sub-leased to a third party, for a seven-year period, the Dewey, Oklahoma, plant, which was closed in 1976. This concludes the sale or lease of the unused facilities of the Company.

Sales Financing

In February 1977, Hesston Credit, Ltd. (HCL) was formed to provide floor plan financing for Hesston farm equipment dealers in Canada. An investment of \$600,000 by Hesston Industries Ltd. (HIL), a wholly owned consolidated subsidiary of the Company, was made in HCL.

In June 1977, the floor plan accounts receivable of Hesston Credit Corporation in the amount of \$4,836,000 were sold to an independent finance company. Notes payable to banks totaling \$2,600,000 were repaid and the balance of assets and liabilities were transferred to Hesston Corporation. No gain or loss resulted from the transaction.

The floor plan financing of dealer inventories in the U.S. continues to be provided by two independent finance companies. Such amounts outstanding with the independent finance companies for Hesston equipment were approximately \$47,608,000 at September 30, 1977 and \$62,639,000 at September 30, 1976.

Working Capital and Short-Term Debt

At September 30, 1977, working capital was \$56,470,000 representing an increase of \$9,247,000 over the prior year's \$47,223,000. Several components of working capital changed during the year. Short-term debt decreased from \$29,423,000 at the end of 1976 to \$14,613,000 at the current year end. This reduction was due in part to the proceeds of the \$19,678,000 sale of stock to IHF. Inventories were reduced by \$10,129,000 to \$59,530,000 at September 30, 1977 from \$69,659,000 one year earlier.

In February 1977, the Company and finance subsidiaries entered into revolving credit agreements with banks in the U.S. and Canada. A total of \$14,975,000 is available under these revolving credit agreements to Hesston Corporation and \$9,856,000 is available to Hesston Credit, Ltd. Lines of credit in Europe and Australia continue to be maintained as in the past and are approximately \$23,778,000.

The Company plans to renew the revolving credit agreements for 1978 as well as the foreign lines of credit.

Hesston Corporation

Consolidated Balance Sheet

September 30, 1977 and 1976	1977	1976
	(000's Omitted)	
Assets		
Current assets:		
Cash	$ 4,297	$ 2,708
Accounts receivable (Note 4)	23,469	29,486
Advance to unconsolidated credit subsidiary (Note 4)	8,264	
Refundable income taxes (Note 8)	7,200	2,500
Inventories:		
Finished goods	27,779	33,172
Parts	9,482	11,352
Work in process	9,845	11,470
Raw materials	12,424	13,665
	59,530	69,659
Other current assets (Notes 2 and 8)	4,826	6,322
Total current assets	107,586	110,675
Investment in unconsolidated credit subsidiaries (Note 4)	582	2,647
Assets held for resale (Note 2)	466	2,594
Other assets (Note 5)	4,452	1,190
Property, plant and equipment, at cost:		
Land	982	989
Buildings	26,833	27,260
Machinery and equipment	24,979	24,821
Office furniture and fixtures	3,309	3,233
Transportation equipment	3,249	2,376
	59,352	58,679
Less accumulated depreciation	22,403	18,315
Net property, plant and equipment	36,949	40,364
	$150,035	$157,470

Liabilities and Stockholders' Equity

	(000's Omitted) 1977	1976
Current liabilities:		
Notes payable to banks (Notes 4 and 6)	$ 14,613	$ 29,423
Accounts payable	10,643	9,879
Accrued sales discounts and allowances	12,523	9,413
Accrued payroll, profit-sharing and retirement contributions (Note 11)	3,427	3,125
Other accrued liabilities	5,277	7,430
Long-term debt payable within one year	4,633	4,182
Total current liabilities	51,116	63,452
Long-term debt payable after one year (Note 7)	37,978	43,095
Deferred income taxes and other (Note 8)	3,381	2,925
Contingencies (Note 12)		
Stockholders' equity (Notes 1, 7, 9 and 10):		
Preferred stock, $2 par value, 2,000,000 shares authorized:		
$1.60 cumulative convertible preferred stock, 499,800 shares outstanding, aggregate liquidation value $12,495,000	1,000	1,000
$.60 cumulative convertible preferred stock, 600,000 shares outstanding, aggregate liquidation value $6,000,000	1,200	
Common stock, $2 par value, 8,000,000 shares authorized, 3,387,952 shares outstanding (1,987,952 outstanding in 1976)	6,775	3,975
Capital in excess of par value	33,996	18,318
Retained earnings	14,589	24,705
Total stockholders' equity	57,560	47,998
	$150,035	$157,470

See summary of accounting policies and notes.

Hesston Corporation

Consolidated Statement of Operations

Years ended September 30, 1977 and 1976	1977 (000's Omitted)	1976 (000's Omitted)
Net sales	$142,245	$187,194
Cost of sales	101,419	125,560
Gross profit	40,826	61,634
Operating expenses:		
Marketing and selling	18,966	21,402
General and administrative	16,776	20,962
Engineering	4,627	5,183
	40,369	47,547
Operating profit	457	14,087
Other (income) deductions:		
Interest and finance charges	17,527	19,388
Net income of credit subsidiaries (Note 4)	(126)	(147)
Other — net (Note 3)	328	(1,147)
	17,729	18,094
Loss from continuing operations before income taxes	(17,272)	(4,007)
Provision for income taxes on continuing operations (Note 8):		
Current	(7,343)	1,952
Deferred	(613)	(1,831)
	(7,956)	121
Loss from continuing operations	(9,316)	(4,128)
Loss from discontinued operations (Note 2)		(2,024)
Net loss	$ (9,316)	$ (6,152)
Per common share:		
Loss from continuing operations	$(4.93)	$(2.48)
Loss from discontinued operations		(1.02)
Net loss	$(4.93)	$(3.50)

See summary of accounting policies and notes.

Hesston Corporation

Consolidated Statement of Stockholders' Equity

	(000's Omitted)					
Years ended September 30, 1977 and 1976	$1.60 Preferred stock, $2 par value	$.60 Preferred stock, $2 par value	Common stock, $2 par value	Capital in excess of par value	Retained earnings	Total
Balance, September 30, 1975	$1,000		$3,975	$18,318	$32,849	$56,142
Net loss					(6,152)	(6,152)
Less cash dividends:						
Common stock — $.60 per share					(1,192)	(1,192)
Preferred stock — $1.60 per share					(800)	(800)
Balance, September 30, 1976	1,000		3,975	18,318	24,705	47,998
Net loss					(9,316)	(9,316)
Preferred stock issued for cash — 600,000 shares (Note 1)		$1,200		4,703		5,903
Common stock issued for cash — 1,400,000 shares (Note 1)			2,800	10,975		13,775
Less cash dividends:						
Preferred stock — $1.60 per share					(800)	(800)
Balance, September 30, 1977	$1,000	$1,200	$6,775	$33,996	$14,589	$57,560

See summary of accounting policies and notes.

Hesston Corporation

Consolidated Statement of Changes in Financial Position

Years ended September 30, 1977 and 1976	(000's Omitted) 1977	1976
Source of funds:		
Issuance of common and preferred stock, net of issuance expenses of $322,000 (Notes 1 and 9)	$ 19,678	
Liquidation of Hesston Credit Corporation (Note 4)	2,646	
Sale of assets related to discontinued and transferred operations	2,335	
Other		$ 197
Total funds provided	24,659	197
Application of funds:		
Operations:		
Loss from continuing operations	(9,316)	(4,128)
Nonfund transactions:		
Depreciation	4,979	5,269
Noncurrent deferred income taxes and other	456	253
Undistributed loss (earnings) of credit subsidiaries	19	(147)
	(3,862)	1,247
Loss from discontinued operations (Note 2)		(2,024)
Nonfund transactions:		
Depreciation		192
Provision for loss on disposition of property, plant and equipment		595
		(1,237)
Funds consumed (provided) by operations	3,862	(10)
Investment in credit subsidiaries	600	2,500
Net additions to property, plant and equipment	2,665	4,821
Decrease in long-term debt	5,117	4,429
Dividends paid	800	1,992
Purchase commitment cash deposit (Note 5)	1,687	
Other	681	
Total funds consumed	15,412	13,732
Increase (decrease) in working capital	$ 9,247	$(13,535)
Increase (decrease) in components of working capital:		
Current assets:		
Cash	$ 1,589	$ (3,305)
Receivables and advances	6,947	7,705
Inventories	(10,129)	(13,610)
Other	(1,496)	3,824
	(3,089)	(5,386)
Current liabilities:		
Notes payable to banks	(14,810)	4,481
Accounts payable	764	(1,782)
Accrued liabilities	1,259	1,809
Long-term debt payable within one year	451	3,641
	(12,336)	8,149
Increase (decrease) in working capital	$ 9,247	$(13,535)

See summary of accounting policies and notes.

Hesston Corporation

Summary of Accounting Policies

September 30, 1977 and 1976

Principles of consolidation—The consolidated financial statements include the accounts of the Company and its subsidiaries, except for its credit subsidiaries, Hesston Credit Corporation (Note 4) and Hesston Credit, Ltd., which are reported on the equity method. All material intercompany accounts and transactions have been eliminated.

Inventories—Inventories are stated at the lower of cost (first-in, first-out basis) or market. Market represents replacement cost in the case of raw materials and net realizable value in the case of other inventories. Writedowns for surplus and obsolete inventories were about $2,060,000 and $6,268,000 in 1977 and 1976, respectively.

Property, plant and equipment—For financial reporting purposes substantially all plant and equipment are depreciated on a straight-line basis. For income tax purposes all plant and equipment are depreciated on an accelerated method. Estimated useful lives for purposes of depreciation are as follows:

Buildings	15-40 years
Machinery and equipment	3-15 years
Office furniture and fixtures	3-10 years
Transportation equipment	3- 8 years

Expenditures for property and equipment which substantially increase the useful life of the asset are capitalized. Maintenance, repairs and minor improvements are expensed as incurred. Upon sale or retirement of fixed assets, the asset cost and related accumulated depreciation are eliminated from the accounts and the gain or loss is recognized.

Income taxes—Deferred taxes are provided on all book-tax timing differences. Income taxes have not been provided on 50% of the income of the Company's Domestic International Sales Corporation since the Company intends to defer the distribution of such income (approximately $2,294,000 at September 30, 1977) indefinitely.

Investment tax credits are applied as a reduction of income taxes on the flow-through method.

Sales and sales discounts and allowances—Sales to dealers are recognized at the time of shipment (wholesale). Under terms of the Company's wholesale floorplan agreements, the Company incurs certain financing costs from date of wholesale to date of settlement by the dealer. Estimated financing costs and other discounts are accrued at the time of wholesale. Such estimates involve certain assumptions regarding carrying period and future interest rates which are reviewed and adjusted quarterly.

Loss per common share—Loss per share is based on the weighted average number of common shares outstanding during the period (2,053,157 and 1,987,839 in 1977 and 1976, respectively) after giving effect to the dividend requirements of the $1.60 and $.60 Cumulative Convertible Preferred Stock (Notes 1 and 9). Fully diluted per share amounts are not presented since conversion of the preferred stock or the exercise of the common stock options (Note 10) would have an antidilutive effect in 1977 and 1976.

ARTHUR YOUNG & COMPANY

TENMAIN CENTER
KANSAS CITY, MISSOURI 64105

The Board of Directors and Stockholders
Hesston Corporation

We have examined the accompanying consolidated balance sheet of Hesston Corporation at September 30, 1977 and the related consolidated statements of operations, stockholders' equity and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have previously made a similar examination of the financial statements for the prior year.

In our opinion, the statements mentioned above present fairly the consolidated financial position of Hesston Corporation at September 30, 1977 and 1976 and the consolidated results of operations and changes in financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis during the period.

November 14, 1977

Arthur Young & Company

Hesston Corporation

Notes to Consolidated Financial Statements

September 30, 1977 and 1976

1. Sale of Company stock

In September 1977, the Company sold a controlling interest (50.2%) comprised of 1,400,000 shares of previously unissued common stock and 600,000 shares of previously unissued, voting $.60 Cumulative Convertible Preferred Stock of the Company to Internazionale Holding Fiat S.A. (IHF), a wholly owned Swiss subsidiary of Fiat S.p.A. IHF also has an option to purchase an additional 615,000 shares of common stock at the current market price at the date of exercise. The stock was sold for $10 per share and the excess over par value of $15,678,000 (net of $322,000 issue expenses) was credited to capital in excess of par value. This transaction was approved by the stockholders at a special meeting in September 1977.

2. Discontinued and transferred operations

In March 1977, the Company decided to close the production facilities of its Field Queen division. All operations were transferred to the Company's plant in Hesston, Kansas and the land and buildings were sold in September 1977. Continuing operations for 1977 include approximately $250,000 gain on the disposition of this division.

In 1976, the Company discontinued operations of its Waste Equipment and Lawn Equipment divisions. The product lines of these divisions were sold and the Company commenced disposing of the remaining assets. The following is a summary of financial information relating to discontinued operations in 1976:

	(000's Omitted) 1976
Net sales	$ 3,783
Loss from operations	$(1,711)
Less income tax benefit	847
	(864)
Loss on disposal	(2,299)
Less income tax benefit	1,139
	(1,160)
Total loss from discontinued operations	$(2,024)

The loss on disposal includes the estimated loss associated with the sale of the assets of the businesses, together with provision for estimated operating losses subsequent to the decision to dispose of the divisions.

The Company also decided to close its Logan, Utah division in 1976. Production from this division was transferred to the Company's plant in Hesston, Kansas. Estimated expenses of $322,000 and $475,000 for closing the facility and transferring production materials and inventory to Hesston are included in the 1977 and 1976 loss from continuing operations.

The principal assets of these divisions are included in the consolidated balance sheet at September 30, 1977 and 1976, at their estimated realizable values. A summary of changes during 1977 affecting such assets and the accruals for costs to be incurred in the disposal period follows:

(000's Omitted)	Sept. 30, 1976	Current Closedowns	Recoveries (Expenditures)	Sept. 30, 1977
Assets held for resale:				
Land and buildings	$1,885	$ 514	$2,123	$276
Machinery and equipment	709	587	1,106	190
	$2,594	$1,101	$3,229	$466
Other current assets	$2,214		$2,214	
Accrued disposal costs	$1,038	$ 221	$ (856)	$403

Recoveries include sub-leased assets of $1,540,000 as more fully described in Note 5.

3. Foreign operations

The Company has subsidiaries located in Western Europe, Canada and Australia. The principal operations and assets are in Western Europe. Summarized combined financial information of these subsidiaries (excluding the Canadian subsidiary) is as follows:

(000's Omitted)	1977	1976
Current assets	$25,040	$22,119
Other	5,934	4,619
Total assets	30,974	26,738
Liabilities	28,253	21,440
Net assets	$ 2,721	$ 5,298
Sales	$29,597	$22,829
Cost and expenses	32,204	27,602
Net loss	$ (2,607)	$(4,773)

Included in the consolidated net loss are exchange losses of $465,000 in 1977 and exchange gains of $2,013,000 in 1976. Further, changes in currency exchange rates and translation of cost of sales using historic rather than current exchange rates decreased 1977 gross profit by $1,097,000.

4. Credit subsidiaries

In February 1977, Hesston Credit, Ltd. (HCL) was formed to provide floorplan financing for Hesston farm equipment dealers in Canada. An investment of $600,000 by Hesston Industries Ltd. (HIL), a wholly owned, consolidated subsidiary of the Company, was made in HCL. Prior to the establishment of HCL, Canadian dealer inventories were financed by HIL, which also engages in the sale of Hesston farm equipment. HCL purchased all of the floorplan receivables of HIL, $11,762,000, and assumed notes payable to banks of $10,793,000 at February 28, 1977. The consolidated financial statements at September 30, 1976 include HIL finance receivables of approximately $10,847,000 and notes payable to banks of $7,554,000.

In June 1977, the floorplan accounts receivable of Hesston Credit Corporation in the amount of $4,836,000 were sold to an independent finance company. Notes payable to banks totaling $2,600,000 were repaid and the balance of assets and liabilities were transferred to Hesston Corporation. No gain or loss resulted from the transaction. Condensed, combined financial information for the credit subsidiaries at September 30, 1977 and 1976 and for the twelve months then ended is as follows:

	(000's Omitted)	
FINANCIAL POSITION	1977	1976
Assets		
Cash	$ 13	$ 435
Finance receivables	8,908	4,083
Other assets	176	70
	$9,097	$4,588
Liabilities and equity		
Notes payable to banks	$ 233	$1,800
Advances from affiliates	8,264	
Other liabilities	18	141
Capital stock	601	2,500
Retained earnings (deficit)	(19)	147
	$9,097	$4,588
INCOME		
Interest and other income	$1,221	$ 448
Costs and expenses		
Interest	702	110
General and administrative	183	50
Other including translation loss	51	5
Income taxes	159	136
	1,095	301
Net income	$ 126	$ 147

Hesston Corporation guarantees all borrowings of HCL and makes loans and advances to HCL.

5. Other assets

The Company has deposited $1,900,000 as collateral for a bank guarantee on a purchase commitment made to a foreign trading company in Hungary commencing in 1978 for a four-year period. Specified portions of the restricted cash deposit will be released as performance conditions of the contract are met. Of this amount, $1,687,000 has been classified as a non-current asset at September 30, 1977.

A substantial portion of the remaining balance consists of property and equipment of the Waste Equipment division, having a net book value of $1,540,000, which has been leased to an independent party who has assumed the Company's obligations under the terms of the original lease agreement until May 1984.

6. Short-term bank borrowings and compensating balances

Prior to February 1977, Hesston Corporation and the credit subsidiaries, Hesston Credit Corporation (HCC) and Hesston Credit, Ltd. (HCL) had arranged lines of credit independently with a number of banks in the U.S. and Canada. The unused portion of these lines of credit could be withdrawn at the option of the banks. In February 1977, the Company's loan agreement with several banks (the Revolving Credit Agreement - Note 7) was amended to add a fixed maximum commitment, expiring December 31, 1977, covering short-term borrowings from participating banks. Similarly, in February 1977, HCC and HCL entered into Revolving Credit Agreements with the group of banks under similar terms as Hesston Corporation. Short-term borrowings under the Revolving Credit Agreement bear interest at the rate of 115% of prime. Terms for borrowing outside the U.S. and Canada have remained relatively unchanged.

The Company and its credit subsidiaries have informally agreed to maintain unrestricted average compensating balances with respect to domestic lines of credit and the Revolving Credit Agreement (Note 7). At September 30, 1977, the combined compensating balance requirements of the Company and its credit subsidiaries were: (1) 15% of the term portion of the Revolving Credit Agreement in the amount of $4,062,000 and (2) 10% of lines of credit aggregating $19,475,000, plus a ½% commitment fee on the unused portions of these lines of credit. The Company is not required to maintain compensating balances based on usage. At September 30, 1976, the compensating balance requirements were: (1) 15% of the Revolving Credit Agreement in the amount of $5,000,000; (2) 15% of informal lines of credit aggregating $6,475,000; and (3) 10% of informal lines of credit aggregating $17,500,000 plus 10% of average borrowings outstanding under these lines. Average compensating balances required during the year ended September 30, 1977, were $300,000 adjusted for average float of $3,200,000 and $1,800,000 for the year ended September 30, 1976, adjusted for average float of $2,000,000.

Hesston Corporation

Notes to Consolidated Financial Statements

September 30, 1977 and 1976

The following information relates to short-term bank borrowings for the respective periods:

(000's Omitted)

	Year ended Sept. 30, 1977		Year ended Sept. 30, 1976	
	Hesston Corporation	Unconsolidated credit subsidiaries	Hesston Corporation	Unconsolidated credit subsidiaries
At the balance sheet date:				
Lines of credit:				
Revolving credit agreement	$14,975	$ 9,856		
Subject to withdrawal by banks	23,778		$56,074	$ 4,500
	$38,753	$ 9,856	$56,074	$ 4,500
Short-term loans:				
Revolving credit agreement		$ 233		
Other	$14,613		$29,423	$ 1,800
Weighted-average interest rate	11.9%	9.8%	10.3%	7.0%
For the period ended at the balance sheet date:				
Maximum short-term borrowings outstanding at any month end ...	$35,030	$13,975	$34,631	$ 3,000
Average borrowings outstanding	26,475	6,186	29,131	1,560
Weighted-average interest rate	10.4%	8.3%	10.3%	7.0%

7. Long-term debt and restrictions

Long-term debt, including current maturities, outstanding at September 30, 1977 and 1976 is as follows:

(000's Omitted)

	1977	1976
10.75% promissory notes to insurance company, with annual payments of $2,700,000 which began September 30, 1977	$32,300	$35,000
Unsecured notes payable to U.S. banks, under Revolving Credit Agreement bearing interest at the prime rate, plus ½%, with quarterly payments of $312,500 which began as of March 31, 1977 ..	4,062	5,000
Obligations under capital leases, 7%-11%, payable in varying amounts to 1995	2,526	3,044
Other, 7%-13%, payable in varying annual amounts to 1989	3,723	4,233
	42,611	47,277
Portion due within one year ...	(4,633)	(4,182)
	$37,978	$43,095

The Company's loan agreement with the insurance company and the Revolving Credit Agreement with a number of banks were modified during the year. In February 1977, the Revolving Credit Agreement was amended to include $14,975,000 of short-term lines of credit expiring December 31, 1977. At that time the existing informal short-term lines of credit from the group of U.S. banks were terminated. The $312,500 quarterly installments due March 31, June 30, and September 30 were deferred until December 31, 1977. In March 1977, the $2,700,000 due September 30, 1977, to the insurance company was deferred to December 31, 1977. On September 30, 1977, the Company made term loan payments of $2,700,000 to the insurance company and $937,500 to the banks which were not due until December 31, 1977. Accordingly, the existing maturities follow the payment schedules that were in effect prior to the amendments made in February and March 1977. Long-term debt maturing in each of the next five fiscal years is: 1978 - $4,633,000, 1979 - $4,498,000, 1980 - $4,534,000, 1981 - $3,726,000 1982 - $3,258,000.

Concurrent with the sale of new stock in September 1977 (Note 1), the loan agreements with the insurance company and the banks were modified. The existing agreements contain restrictions and covenants relating to, among other things, payment of cash dividends, maintenance of working capital and net worth, additional borrowing, and acquisition of outstanding stock by the Company. These agreements permit payment of cash dividends on the $1.60 and $.60 Preferred Stock prior to October 1, 1982, provided tangible net worth (as defined) exceeds $42,500,000. At September 30,1977, tangible net worth was $57,135,000. Cash dividends on common stock are permitted prior to October 1, 1982, provided that tangible net worth exceeds $48,000,000 and net income for the period beginning October 1 in the fiscal year of the first common dividend payment exceeds cash dividends on all preferred and common stock for the period. Subsequent to October 1, 1982, cash dividends on common and preferred stock are subject to certain tests of cumulative net income or loss.

8. Income taxes

The components of income tax expense (benefit) are:

	1977 (000's Omitted)	1976 (000's Omitted)
Current:		
Federal	$(6,739)	$ 583
Foreign		113
State and other	(604)	113
	(7,343)	809
Deferred:		
Federal	(539)	(2,354)
Foreign		
State and other	(74)	(320)
	(613)	(2,674)
Total income tax (benefit)	$(7,956)	$(1,865)

Income tax expense (benefit) is included in the Consolidated Statement of Operations as follows:

	1977 (000's Omitted)	1976 (000's Omitted)
Continuing operations	$(7,956)	$ 121
Discontinued operations		(1,986)
	$(7,956)	$(1,865)

Other current assets include deferred tax benefits of $4,161,000 at September 30, 1977 and $4,306,000 at September 30, 1976. Deferred tax expense (benefit) results from differences in the timing of recognizing certain revenues and expenses for income tax and financial statement purposes. The sources of these differences in 1977 and 1976 and the tax effect of each were as follows:

	1977 (000's Omitted)	1976 (000's Omitted)
Tax over book gain from sale of fixed assets	$ (188)	$ (28)
Reserve for estimated field fix and bad debts	21	(526)
Reserve for discontinued operations	467	(902)
Excess of tax depreciation over book depreciation	271	530
Sales discounts and allowances in excess of amounts currently deductible	(476)	(799)
Provision for inventory writedowns in excess of amounts currently deductible	(482)	(671)
Other	(226)	(278)
	$ (613)	$(2,674)

Total tax benefit amounted to $7,956,000 (an effective rate of 46.1%) for 1977 and $1,865,000 (an effective rate of 23.3%) for 1976, which is less than the $8,290,000 and $3,848,000, respectively, computed by applying the federal income tax rate of 48% to loss before income taxes. The reasons for these differences are as follows:

	1977 (Percent of pretax income)	1976 (Percent of pretax income)
Computed "expected" income tax expense (benefit)	(48.0)%	(48.0)%
Investment tax credit	.4	(4.5)
Foreign losses for which no income tax benefit has been recognized	7.8	25.9
Other	(6.3)	3.3
	(46.1)%	(23.3)%

At September 30, 1977, several of the Company's foreign subsidiaries had net operating losses available to carry forward to offset future taxable income. Approximately $1,789,000, $599,000 and $373,000 of these operating loss carry-forwards will expire in 1981, 1982, and 1984, respectively, if not previously utilized, while about $1,906,000 may be carried forward indefinitely.

9. Preferred stock

As described in Note 1, 600,000 shares of voting, $.60 Cumulative Convertible Preferred Stock, par value $2.00, were sold to IHF. This class of preferred stock is convertible into common stock on a one-for-one basis and is redeemable on and after September 15, 1982 at $10 per share, plus in each case accrued dividends to the date of redemption.

In March 1975, the Company issued 500,000 shares of non-voting, $1.60 Cumulative Convertible Preferred Stock, par value $2.00. The preferred stock is convertible into common stock at the rate of 1.025 shares of common stock for each share of preferred stock. The preferred stock is redeemable all or in part at the option of the Company at $26.50 per share until 1980 and at prices declining at the rate of $.25 per year through 1985 and thereafter at $25.00 per share, plus in each case accrued dividends to the date of redemption.

The Company may not acquire shares of preferred stock or common stock, or pay dividends on common stock, unless all dividends on preferred stock for all past dividend periods have been paid or set apart for payment (also see Note 7).

10. Stock option plans

Under a qualified stock option plan, options to purchase 35,000 shares of common stock were granted on February 14, 1973, at an option price of $31.75 per share (market price at date of grant). Options were exercisable for 25% of the total grant from the second through the fifth years of the options, such rights being cumulative. At September 30, 1976, options for 26,250 shares were exercisable.

In January 1977, a new stock option plan (the "1976 plan") was approved by the stockholders. The maximum number of shares of common stock which may be issued and sold under the 1976 plan is 100,000. The option price for such shares will be fair market value at date of grant. Options may be exercised for 20% of the total grant at the end of the first through the fifth

Hesston Corporation

Notes to Consolidated Financial Statements

September 30, 1977 and 1976

years of the options, such rights being cumulative and expiring ten years after date of grant. On March 30, 1977, options to purchase 72,500 shares of common stock were granted at an option price of $8.25 per share. None of the options granted in 1977 have been exercised at September 30, 1977.

The options to purchase 26,250 shares of common stock, which were outstanding as of the approval date of the 1976 plan, were surrendered by the holders to the Company.

11. Profit-sharing and retirement plans

The Company and its subsidiaries have in effect several trusteed retirement profit-sharing plans, a deferred compensation plan and a cash bonus profit-sharing plan. The profit-sharing plans provide for annual contributions based on percentages of income (by operating division) in excess of certain minimum levels before any deduction for profit-sharing contributions, charitable contributions and income taxes. The plans may be amended or terminated at any time. Total charges against operations for the retirement plans were $872,000 and $802,000 in 1977 and 1976, respectively.

12. Contingencies

Under wholesale finance agreements, the Company has a contingent liability to repurchase equipment sold to dealers. Based on past experience, it is not anticipated that losses under these agreements or other credit losses will be material and therefore allowances for losses have not been provided.

The Company is contingently liable for $875,000 of Industrial Revenue Bonds associated with the Field Queen facility which was sold in September 1977 (Note 2).

13. Research and development

Research and development costs of approximately $4,028,000 in 1977 and $3,990,000 in 1976 were charged to operations.

14. Leases

In 1977, the Company changed its method of accounting for leases to comply with Statement of Financial Accounting Standards #13 issued in November 1976. This statement requires the asset and related obligation for capital leases, as defined, be recorded in the Company's balance sheet. The effect of this change in accounting principle was not material.

Property under capital leases included in property, plant and equipment; and other assets are as follows:

	(000's Omitted) September 30, 1977
Land and buildings	$2,208
Machinery and equipment	208
Transportation equipment	800
	3,216
Less accumulated amortization	397
	$2,819

Future minimum lease payments under capital leases together with the present value of the net minimum lease payments as of September 30, 1977 are as follows:

Fiscal year ending September 30:	(000's Omitted)
1978	$ 373
1979	363
1980	386
1981	365
1982	297
Later years	2,617
Total net minimum lease payments	4,401
Less amount representing interest	1,875
Present value of net minimum lease payments	$2,526

Future minimum rental payments required under operating leases that have initial or remaining non-cancelable lease terms in excess of one year at September 30, 1977 are as follows:

Fiscal year ending September 30,	Land and Buildings	Machinery and Equipment	Total
	(000's Omitted)		
1978	$ 554	$ 487	$1,041
1979	387	322	709
1980	258	180	438
1981	190	71	261
1982	186	26	212
Later years	404		404
	$1,979	$1,086	$3,065

Rents charged to costs and expenses for all operating leases were approximately $2,926,000 and $3,333,000 for the years ended September 30, 1977 and 1976, respectively.

15. Replacement cost information (Unaudited)

In compliance with the rules of the Securities and Exchange Commission (SEC), the Company has developed certain replacement cost information, as defined by the SEC, for its worldwide inventories, cost of sales and productive capacity which will be included in the Company's Annual Report Form 10-K.

The information indicates that replacement costs and related depreciation expense would be considerably higher than the historical amounts contained in the financial statements. Such data was derived based on numerous subjective and hypothetical assumptions. The Company has no intention of replacing any significant amount of these assets at this time and cautions that the actual cost and manner of replacing these assets in the future may differ substantially from these estimates.

The replacement cost data does not purport to represent the current value of the assets, and the Company makes no representation that this information is useful to the reader of these financial statements.

Hesston Corporation

Management's Discussion and Analysis of the Summary of Operations

for the year ended September 30, 1976

Sales and Results of Operations

Consolidated net sales of Hesston Corporation for fiscal 1976 were $187,194,000, 9% lower than the previous year's sales of $205,922,000. The net loss for 1976 was $6,152,000 compared to earnings of $8,275,000 before the cumulative effect of a change in accounting principle for fiscal 1975.

The decline in sales was a reflection of reduced shipments of Hesston farm equipment to dealers worldwide. In North America this was primarily the result of higher-than-normal dealer inventories at the beginning of the fiscal year, combined with lower-than-anticipated retail sales to farmers and ranchers by the dealers during the year. The economic conditions in several European countries, as well as the severe drought in Western Europe, seriously impaired sales in the international marketplace.

In addition to the loss of gross profit from reduced sales, the Company experienced higher fixed costs resulting from underutilization of production capacity. Interest and finance costs to carry excessive dealer inventories added to the loss. The cost of closing three divisions and selling three product lines during the year had an adverse effect upon earnings. Our first full year's operation in Australia resulted in a loss.

Cost of Sales

Cost of sales was 67.1% of net sales in 1976, compared to 63.3% of net sales in 1975, because production levels, much lower than capacity, caused fixed costs to be too high and a change in the product mix caused gross margin to be somewhat lower. The reduction in sales and production, particularly in the fourth quarter, and that anticipated for 1977, caused an abnormally high surplus and obsolescence write-down of inventories, particularly service parts and raw materials in 1976. The write-down was $6,268,000 in 1976 compared to $2,166,000 in 1975. In addition, higher sales discounts and allowances in 1976 increased the cost of sales percentage.

Operating Expenses

Operating expenses were 25.4% of net sales in 1976 and 21.1% in 1975. Marketing and selling expenses were higher due to increased dealer incentive programs and continued increased marketing efforts in Europe and Australia. Other operating expenses were approximately the same in 1976 as in 1975 since the lower sales volume was not anticipated until late in the third quarter.

Interest and Finance Charges

Interest expense and finance charges were $19,388,000 in 1976 and $16,840,000 in 1975. Substantially all of the increase is directly the result of higher levels of dealer inventory during the year.

Taxes

The effective tax rate was 23.3% in 1976 compared to 45.2% in 1975. The losses from foreign subsidiaries cannot be carried back to offset prior years' income and no tax benefit has been accrued.

Year ended September 30, 1977

Refer to the 1977 Financial Review on page 8.

Percentage of Net Sales by Product Line

(Each class of similar products which accounted for 10% or more of sales)

	1977	1976	1975	1974	1973
Hay Handling Equipment	**12%**	28%	38%	36%	35%
Windrowers	**37%**	33%	25%	24%	24%
Forage Harvesters	**23%**	16%	15%	15%	14%
Rotary Mowers	**16%**	12%	10%	11%	11%
Other Products	**12%**	11%	12%	14%	16%

Farm equipment products accounted for 96% of 1977 net sales and 100% of the loss from continuing operations before income taxes. The percentage of net sales applicable to farm equipment products for the past four years was as follows: 1976-99% 1975-96%, 1974-96%, 1973-96%. Eighty-six percent of the loss from continuing operations in 1976 and all of the income before income taxes for the three previous years was for farm equipment sales.

Price Range of Common and Preferred Stock

	Common Stock				$1.60 Preferred Stock			
	Fiscal 1977		Fiscal 1976		Fiscal 1977		Fiscal 1976	
	High	Low	High	Low	High	Low	High	Low
First Quarter	10	7¾	23⅝	17¼	17¾	15½	25½	21¼
Second Quarter	12	8¼	23⅝	17⅞	19¼	16¼	25½	22¼
Third Quarter	10½	8	22⅞	16⅞	18	16	24⅞	20½
Fourth Quarter	9	6⅞	19½	9½	17	14	23¾	16

Hesston Corporation

Ten Year Summary of Operations

(In Thousands of Dollars)	1977	1976	1975
Income Statement			
*Net Sales	$142,245	$187,194	$205,922
*Cost of Sales	101,419	125,560	130,434
*Operating Expenses	40,369	47,547	43,360
*Interest & Finance Charges	17,527	19,388	16,840
*Provision (Credit) for Income Taxes	(7,956)	121	7,266
Income (Loss) Before Other Credit (Charges)	(9,316)	(4,128)	8,907
Other Credits (Charges) to Income	—	(2,024)	665
Net Income (Loss)	(9,316)	(6,152)	9,572
Primary Earnings (Loss) Per Common Share	$(4.93)	$(3.50)	$4.60
Fully Diluted Earnings (Loss) Per Common Share	—	—	$4.23
Depreciation	4,979	5,461	4,263
*Earnings (Loss) as a % of Net Sales	(6.5%)	(2.2%)	4.3%
Dividends, Equity, Net Book Value			
Dividends:			
Common Stock	—	1,192	994
Per Share of Common Stock	—	$ .60	$ .50
Dividends:			
Preferred Stock	800	800	360
Per Share of Preferred Stock	$1.60	$1.60	$ .72
Total Equity	57,560	47,998	56,142
Book Value per Common Share	$11.30	$17.86	$21.96
Average Common Shares Outstanding	2,053,157	1,987,839	1,987,747
*Return on Average Equity	(17.7%)	(7.9%)	19.3%
Other Data			
Year-end Assets	150,035	157,470	161,641
Net Property, Plant and Equipment	36,949	40,364	44,193
Working Capital	56,470	47,223	60,758
Long-term Debt (excluding current maturities)	37,978	43,095	47,524
Current Ratio	2.1/1	1.7/1	2.1/1
Average Asset Turn	.93	1.17	1.50
Year-end Long-term Debt/Equity	.64	.90	.85
Stock Price Range-Common	12-6⅞	23⅝-9½	27⅞-14¼
Stock Price Range-Preferred	19¼-14	25½-16	30⅜-24⅛
Average Employment	3,149	3,850	4,581

*Amounts are from continuing operations

Note: Other Credits (Charges) to income include charges for discontinued operations for 1972-1976, as discussed in Note 2 of the Consolidated Financial Statements. The prior period effect of change in costing inventory in the amount of $1,297,000 is included in 1975. All computations of operating results have been made using Income (Loss) Before Other Credits (Charges). Proforma amounts computed as if the new inventory costing method had been applied retroactively are as follows:

	1975	1974
Net income	$8,275,000	$8,783,000
Primary earnings per common share	$3.95	$4.42

Proforma amounts have not been shown for other periods, as the effect would not be significant.

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975	1974	1973	1972	1971	1970	1969	1968
,922	$151,337	$ 96,431	$ 60,882	$ 44,955	$ 41,245	$ 38,490	$ 31,742
,434	96,534	60,050	38,213	27,970	27,439	25,247	22,746
,360	31,619	20,840	14,012	10,843	9,829	8,701	7,783
,840	7,159	3,355	2,778	2,717	1,953	1,358	948
,266	7,564	5,871	2,905	1,749	1,130	1,695	926
,907	8,659	6,466	3,050	—	—	—	—
665	(409)	(289)	(24)	—	—	—	—
,572	8,250	6,177	3,026	1,762	994	1,521	839
4.60	$4.15	$3.48	$1.85	$1.08	$ .61	$ .93	$ .64
4.23	—	—	—	—	—	—	—
,263	2,244	1,607	1,046	1,063	1,010	908	775
4.3%	5.7%	6.7%	5.0%	3.9%	2.4%	4.0%	2.6%
994	636	479	402	402	402	362	263
$ .50	$ .32	$ .28	$ .27	$ .27	$ .27	$ .27	$ .23
360	—	—	—	—	—	—	—
$ .72	—	—	—	—	—	—	—
,142	36,243	28,629	16,019	13,301	11,914	11,316	10,040
21.96	$18.23	$14.40	$9.78	$8.12	$7.27	$6.91	$7.70
7,747	1,987,747	1,775,829	1,637,747	1,637,747	1,637,747	1,637,747	1,304,262
9.3%	26.7%	29.0%	20.8%	13.9%	8.5%	14.0%	9.9%
1,641	115,201	57,379	35,753	27,166	27,748	21,770	18,793
4,193	30,870	17,049	9,150	6,686	6,950	6,142	5,652
0,758	41,867	18,789	14,191	13,351	10,765	9,860	8,530
7,524	37,060	7,781	8,069	7,094	6,084	4,941	4,352
2.1/1	2.0/1	1.9/1	2.2/1	3.0/1	2.1/1	2.8/1	2.8/1
1.50	1.79	2.11	1.95	1.64	1.67	1.90	1.76
.85	1.02	.27	.50	.53	.51	.44	.43
-14¼	36⅛-14¼	46¾-15½	26-11⅝	11¾-6⅛	10-4⅞	13½-7⅝	13⅞-9⅝
-24⅛	—	—	—	—	—	—	—
4,581	3,397	2,490	1,634	1,371	1,478	1,378	1,260

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Hesston Corporation

Directors

Paolo Bernardelli
Director of Marketing of Fiat Trattori S.p.A.

Howard L. Brenneman*
President and Chief Operating Officer of the Corporation

Stefano Decio*
Special Assistant to General Manager of Fiat Trattori S.p.A.

Harold P. Dyck
Consultant for the Mennonite Foundation, Inc. — Investments

Richard F. Hrdlicka
Senior Vice President — General Counsel and Secretary of the Corporation

Fernando Negro
Consultant to Fiat Trattori S.p.A.

Jonathan O'Herron
General Partner Lazard Freres & Co., investment bankers

Pietro Quaglia*
Vice President of Fiat U.S. Representative, Inc.

Evasio Sattanino*
Corporate Controller for Agricultural Tractor and Construction Machinery activities of Fiat

Melvin H. Voth
Vice President — Finance, Treasurer & Assistant Secretary of the Corporation

Lyle E. Yost*
Chairman of the Board and Chief Executive Officer of the Corporation

*Members of Executive Committee

Officers

Lyle E. Yost
Chairman -
Chief Executive Officer

Howard L. Brenneman
President -
Chief Operating Officer

Raymond C. Schlichting
Senior Vice President

Richard F. Hrdlicka
Senior Vice President -
General Counsel & Secretary

Raymond A. Adee
Vice President -
Product Planning

Max E. Bennett
Vice President -
Industrial Products Group

John Siemens, Jr.
Vice President -
Administration

Melvin H. Voth
Vice President -
Finance, Treasurer &
Assistant Secretary

Carl D. Wohlgemuth
Vice President -
Planning

Samuel W. White, Jr.
Vice President -
Marketing
Hesston Division

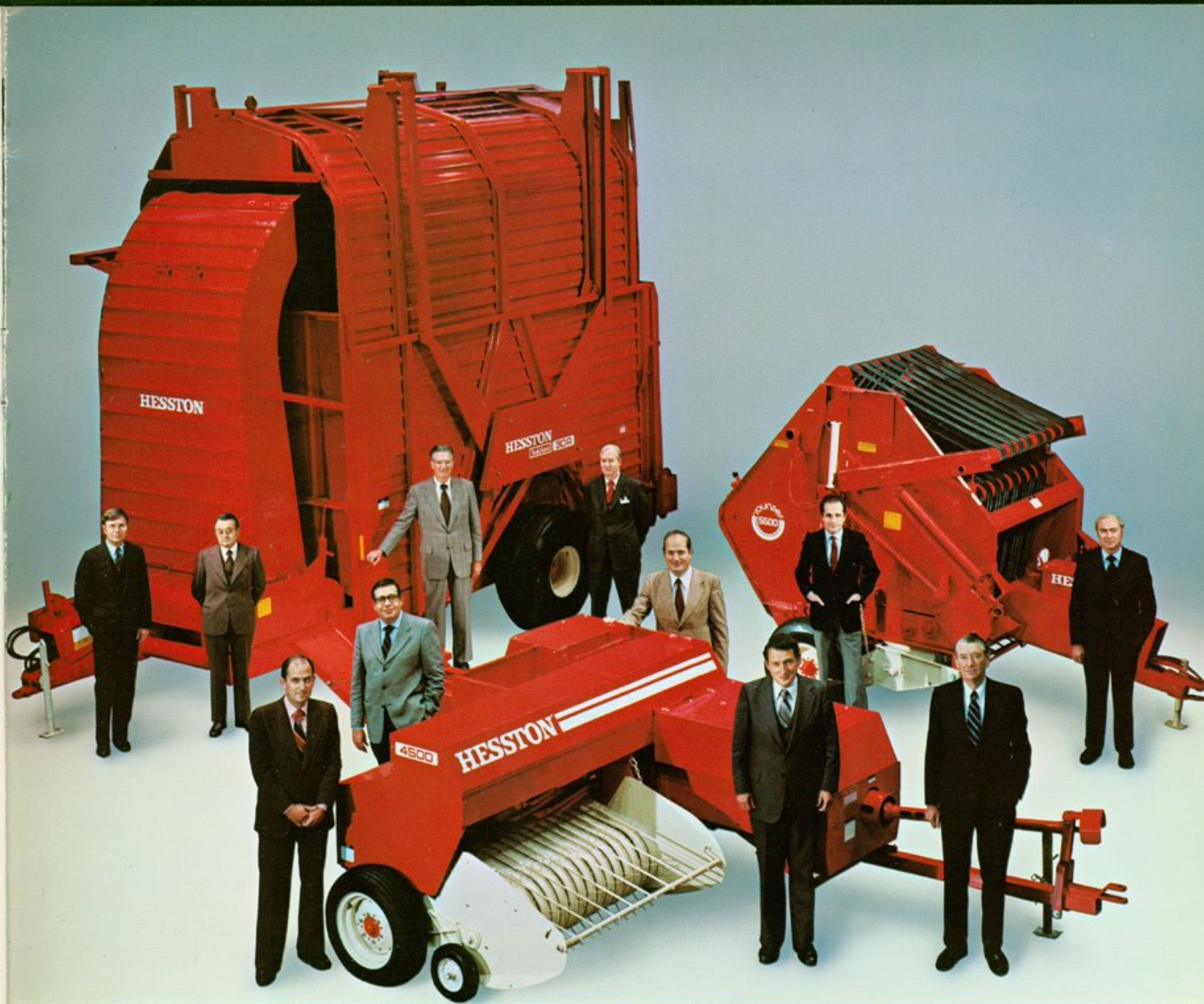
Robert D. Taylor
Assistant Treasurer

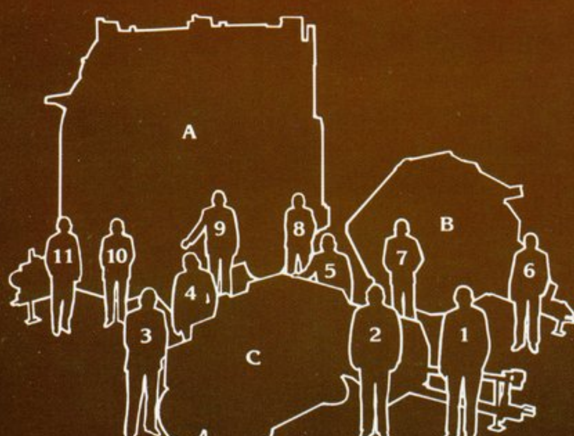
Transfer Agents
The Chase Manhattan Bank, N.A. New York, New York
The Fourth National Bank & Trust Company, Wichita, Kansas

Registrars
The Chase Manhattan Bank, N.A. New York, New York
The First National Bank in Wichita, Wichita, Kansas

HESSTON CORPORATION
Hesston, Kansas 67062

Hesston annual report





Hesston's Board of Directors surrounds some of the company's equipment that have made it first with a better way!

1. Lyle E. Yost
2. Howard L. Brenneman
3. Stefano Decio
4. Pietro Quaglia
5. Evasio Sattanino
6. Melvin H. Voth
7. Paolo Bernardelli
8. Jonathan O'Herron
9. Harold P. Dyck
10. Fernando Negro
11. Richard F. Hrdlicka

A. StakHand® 30-A one-man hay stacker
B. Model 5500 Rounder® Baler
C. Model 4500 Conventional Baler

Hesston Corporation. Corporate offices in the foreground, adjacent to the Hesston Division offices and factory.

HESSTON CORPORATION

Hesston Corporation, Hesston, Kansas 67062