

# HILLENBRAND INDUSTRIES

## 1998 Annual Report



**Caring for people, creating shareholder value**





## OUR PURPOSE

**Hillenbrand Industries is dedicated to the creation of value for our customers, wealth for our shareholders and great opportunities for our associates who deliver exceptional results.**

**Together, we will build highly profitable companies that are niche market leaders serving the health and death needs of individuals.**

**We will do this through highly focused business units that deliver exceptional value to our customers with highly differentiated products and services. These products and services provide value to our customers which is clearly superior to that offered by our competitors.**

## The leadership brands of Hillenbrand Industries

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**Hill-Rom®**  
Patient Care Products

**Batesville®**  
Burial Caskets and Cremation Products

**Forethought®**  
Funeral Planning

### On the Cover:

*At Hillenbrand Industries, the bottom line is about caring for people. In our Health Care Group, we focus on providing innovative and caring solutions for patients and their caregivers. For example, infants get a good start in life with our high-technology incubators. In our Funeral Services Group, we focus on providing personalized funeral products that ease the grief of people in their time of need. The more than 10,000 Hillenbrand associates worldwide are proud to provide products and services that care for people when they need it most and keep shareholder value growing.*

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## AT A GLANCE

**Hillenbrand Industries, Inc.**  
700 State Route 46 East  
Batesville, Indiana 47006-8835  
Investor Relations: (812) 934-8400  
www.hillenbrand.com  
Gus Hillenbrand, President and CEO

**Hillenbrand Industries, Inc. (NYSE:HB) is a publicly traded holding company for three diversified, wholly owned and autonomously managed operating companies. The operating companies are organized into the Health Care and Funeral Services Groups and are the leader in the markets they serve.**

### *Group*

### *Operating Company*

### *Products & Services*

#### **Health Care**



**Hill-Rom Company**  
1069 State Route 46 East  
Batesville, Indiana 47006-9167  
www.hill-rom.com  
Walter M Rosebrough, Jr., President and CEO

Hill-Rom Company is a leading manufacturer of patient care products, and a leading provider of specialized therapy rental products and related services. Hill-Rom® products are designed to improve patient outcomes and reduce total delivery costs.

#### **Funeral Services**



**Batesville Casket Company**  
One Batesville Boulevard  
Batesville, Indiana 47006-7798  
www.batesville.com  
David J. Hirt, President and CEO

Batesville Casket Company is a leading manufacturer of burial caskets, cremation urns and caskets, and related support services.



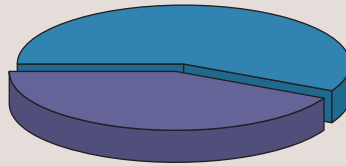
**Forethought Financial Services, Inc.**  
Forethought Center  
Batesville, Indiana 47006-4826  
www.forethought.com  
Frederick W. Rockwood, President and CEO  
Richard N. Coffin, Executive Vice President and COO

Forethought Financial Services is a leading provider of funeral planning financial products and marketing services in the United States and Canada.

## 1998 NET REVENUES

(dollars in millions)

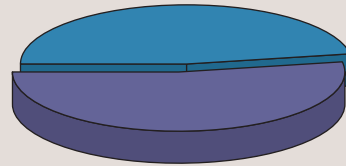
■ Health Care - \$1,151  
■ Funeral Services - \$850



## 1998 OPERATING PROFIT

(dollars in millions)

■ Health Care - \$151  
■ Funeral Services - \$170

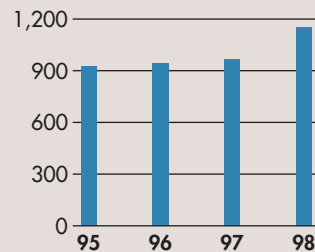


## Customers & Markets

Hill-Rom serves acute, ambulatory and long-term health care facilities and home care patients worldwide.

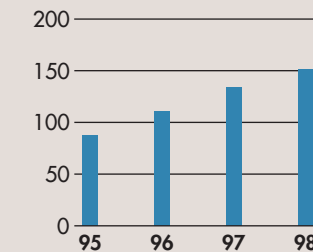
### HEALTH CARE GROUP REVENUES

(dollars in millions)



### HEALTH CARE GROUP PROFITS

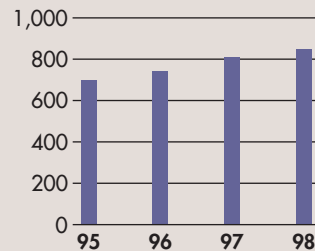
(dollars in millions)



Batesville Casket serves funeral directors operating licensed funeral homes in North America and selected export markets.

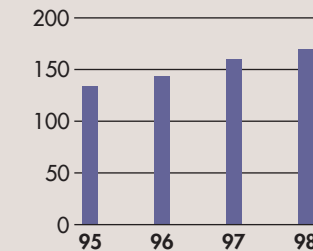
### FUNERAL SERVICES GROUP REVENUES

(dollars in millions)



### FUNERAL SERVICES GROUP PROFITS

(dollars in millions)



Forethought® funeral planning is marketed and sold by funeral homes throughout North America.

All years presented in the above pie charts and graphs exclude unusual items.

## Disclosure Regarding Forward-Looking Statements

From time to time, the Company makes oral and written statements that may constitute “forward-looking statements” as defined in the *Private Securities Litigation Reform Act of 1995* (the “Act”) or by the SEC in its rules, regulations and releases. The Company desires to take advantage of the “safe harbor” provisions in the Act for forward-looking statements made from time to time, including, but not limited to, the forward-looking statements relating to the future performance of the Company contained in Management’s Discussion and Analysis and the Notes to Consolidated Financial Statements and other statements made in this annual report.

The Company cautions readers that any such forward-looking statements are based on assumptions that the Company believes are reasonable, but are subject to a wide range of risks, and there is no assurance that actual results may not differ materially. Important factors that could cause actual results to differ include but are not limited to: differences in anticipated and actual product introduction dates, the ultimate success of those products in the marketplace, the success of cost control and restructuring efforts, and the integration of acquisitions, among other things. Realization of the Company’s objectives and expected performance can also be adversely affected by the outcome of pending litigation and rulings by the Internal Revenue Service on certain tax positions taken by the Company.

# FINANCIAL HIGHLIGHTS

Hillenbrand Industries, Inc. and Subsidiaries

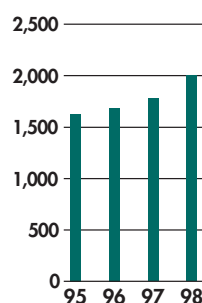
	Fiscal Year			Percent Change	
(Dollars in millions except per share data)	1998	1997	1996	1998/97	1997/96
Net revenues:					
Health Care	\$1,151	\$ 966	\$ 941	19%	3%
Funeral Services	850	810	743	5%	9%
Total net revenues	2,001	1,776	1,684	13%	5%
Operating profit:					
Health Care (b)	81	134	111	(40%)	21%
Funeral Services	170	160	144	6%	11%
Total operating profit	251	294	255	(15%)	15%
Other items (a) (c)	42	(35)	(22)	(220%)	59%
Income taxes (b) (c)	109	102	93	7%	10%
Net income	\$ 184	\$ 157	\$ 140	17%	12%
Basic and diluted net income per common share	\$ 2.73	\$ 2.28	\$ 2.02	20%	13%
Dividends per common share	\$ 0.72	\$ 0.66	\$ 0.62	9%	6%
Return on average equity	20.6%	19.6%	19.3%	N/A	N/A
Average shares outstanding (000's)	67,578	68,796	69,474	(2%)	(1%)
Shareholders	24,500	24,000	24,000	2%	0%
Employees	10,400	9,800	9,800	6%	0%

See Notes to Consolidated Financial Statements

- (a) Results in 1998 reflect a gain of \$75 million (\$47 million after tax) related to the sale of Medeco Security Locks, Inc.
- (b) Results in 1998 reflect a \$42 million, net of tax, charge due to the write-off of goodwill, other asset impairment charges and other closing costs related to the discontinuance of manufacturing operations at Hill-Rom facilities in Germany and Austria; tax benefits related to the write-off of the Company's investments in Germany and Austria; and provisions for certain income tax exposures.
- (c) Results in 1996 reflect a gain of \$3 million (\$2 million after tax) and a related income tax benefit of \$6 million on the sale of Block Medical.

## NET REVENUES

(millions of dollars)

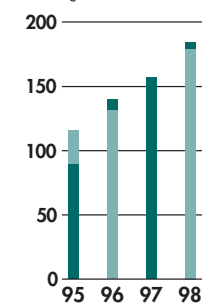


Net revenues have grown at a compounded annual rate of 7% over the past three years.

## NET INCOME

(millions of dollars)

■ excluding unusual items  
■ including unusual items

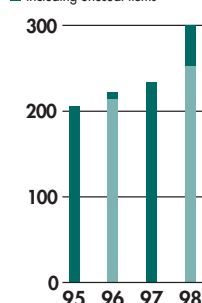


Excluding these unusual items, net income has grown at a compounded annual rate of 16% over the past three years.\*

## GROSS CASH FLOW

(millions of dollars)

■ excluding unusual items  
■ including unusual items

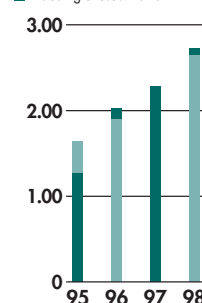


Excluding unusual items, gross cash flow has grown at a compounded annual rate of 7% over the past three years.\*\*

## EARNINGS PER SHARE

(dollars)

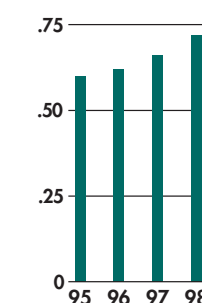
■ excluding unusual items  
■ including unusual items



Earnings per share have grown at a compounded annual rate of 17% over the past three years.\*\*\*

## DIVIDENDS PER SHARE

(dollars)



Dividends per share have grown at a compounded annual rate of 6% over the past three years.

\* The year 1998 includes income of \$47 million relative to the sale of Medeco Security Locks, Inc., offset by unusual charges totaling \$42 million, net of a tax benefit, relating to the write-off of goodwill, other asset impairment charges and other closing costs related to the discontinuance of certain Hill-Rom manufacturing operations in Europe. The year 1996 includes gains and tax benefits totaling \$8 million on the sale of Block Medical. The year 1995 includes a \$26 million charge for write-down of goodwill at Block Medical and other items.

\*\* Hillenbrand Industries has generated over \$950 million in gross cash over the past four years. The year 1998 includes a gain totaling \$47 million (after tax) on the sale of Medeco Security Locks, Inc. The year 1996 includes gains and tax benefits totaling \$8 million on the sale of Block Medical.

\*\*\* The year 1998 includes income of \$.70 per share relative to the sale of Medeco Security Locks, Inc., offset by unusual charges totaling \$.62 per share, net of a tax benefit, relating to the write-off of goodwill, other asset impairment charges and other closing costs related to the discontinuance of certain Hill-Rom manufacturing operations in Europe. The year 1996 includes gains and tax benefits totaling \$.12 per share on the sale of Block Medical. The year 1995 includes a \$.37 per share charge for the write-down of goodwill at Block Medical and other items.

# TO OUR SHAREHOLDERS, CUSTOMERS AND ASSOCIATES:

***Year of Growth*** — In 1998, your Company had another year of consistent growth and its best-ever financial performance.

- Consolidated net revenues increased 13% to more than \$2 billion.
- Net income grew 17% to \$184 million.
- Earnings per share were \$2.73, a 20% increase over 1997.
- The Company achieved a 21% return on average shareholders' equity in 1998.

***Executing Our Three Growth Strategies*** —

We continued to create shareholder value by focusing on our three growth strategies: 1) growth through customer-driven new product development; 2) growth through the acquisition and creation of new businesses that complement our existing ones; and 3) growth through Continuous Improvement. Our future success rests on our ability to aggressively execute these three growth strategies to keep shareholder value increasing.

***Health Care Trends*** — Market conditions continue to provide both challenges and exciting growth opportunities for our Health Care Group. In North America, market demand for our core capital equipment products such as high-technology beds, furniture, stretchers, architectural products, maternity and infant care products and communications systems continues to grow.

Overall, our acute care, long-term care and rental businesses continue to have a positive revenue trend. However, the industry is beginning to see a decline in rental revenues in long-term care due to revised Medicare reimbursement laws. Over time, however, we expect these revenues to return. In other trends, payers, providers and manufacturers continue to consolidate.

***Health Care Group Results*** — Our Health Care Group consists of our Hill-Rom subsidiary and, for part of the year, Medeco Security Locks, Inc. Medeco, which was profitable, was sold to Assa Abloy AB in July, allowing us to focus on our core health and funeral service businesses.

This Group delivered record revenues of \$1.2 billion, 19% over 1997. Operating profit grew 13% to \$151 million, excluding unusual charges. The health care segment of our business accounted for 58% of consolidated net revenues. Increased sales and rentals in virtually all of Hill-Rom's strategic business units fueled our Health Care Group's financial performance.



*From left: Gus Hillenbrand, President and Chief Executive Officer, and Dan Hillenbrand, Chairman of the Board.*

***European Health Care Restructuring*** — We are closing two European manufacturing facilities to align operations with market demand. Meanwhile, we are consolidating manufacturing for the bulk of our European sales into one plant and are restructuring our overall European operations. We are not abandoning these markets. Quite the opposite, we will introduce more new products specially designed for the needs of each European market we serve. Our lower cost structure in Europe will significantly increase profitability and offer exciting opportunities for growth.

***Health Care Business Development*** — Last year we acquired Air-Shields, Inc., a global leader in the manufacture and supply of infant incubators and warmers. We also acquired MEDÆS Holdings, Inc., a leading manufacturer of patient headwalls and

## **Our future success rests on our ability to aggressively execute our three growth strategies to keep shareholder value increasing.**

medical gas delivery equipment. Late in the year, we acquired Fisher Berkeley Corp., a maker of nurse call and locating equipment. These and other acquisitions have provided increased revenues and growth opportunities in their respective markets.

***Funeral Service Trends*** — Consumers are becoming more knowledgeable about funerals and their expectations have increased accordingly. Batesville Casket Company and Forethought Financial Services believe they are uniquely positioned to help their customer, the independent funeral director, meet the growing demands of the consumer.

The cornerstone of our death care business, both today and in the future, is with the independent, family-owned funeral home. We are intensely committed to providing independent funeral directors the superior products, effective merchandising systems and support services they need to compete and achieve profitability. We are absolutely dedicated to the success of the independent funeral director. They have been, are and will continue to be, the heart of our funeral service business.

***Personalization of Funeral Services*** — When it comes to personalizing caskets, no one offers more consumer-driven themes and styles than Batesville Casket Company. Our newest innovation is a proprietary, high-tech system for laser engraving caskets with meaningful text and designs. These personalized caskets are available the day after they are ordered in a growing number of United States markets. Helping people find meaning in a difficult life experience is good for families and for the profitability of funeral service providers.

***Forethought Financial Services*** — Forethought Financial Services is a leading provider of insurance and trust-based products that assist people with pre-arranging a personalized funeral. In May, Forethought Financial Services established a new financial institution, the Forethought Federal Savings Bank. The savings bank will facilitate and expand our ability to provide pre-need funeral trust services to customers nationwide.

***Funeral Services Group Results*** — Our Funeral Services Group, consisting of Batesville Casket Company and Forethought Financial Services, found opportunities in this changing industry. Revenues for this Group totaled \$850 million, 5% over 1997. Operating profit grew 6% over 1997 to \$170 million. This segment of our business accounted for 42% of Hillenbrand Industries' 1998 consolidated net revenues.

While Batesville Casket's net revenues declined slightly, we increased unit sales and continued to gain market share. For the fifth consecutive year, the Options cremation division of Batesville Casket Company continued to deliver exceptional growth. Forethought Financial Services increased revenues by growing the number of

**Hillenbrand Industries remains dedicated to creating value for customers, wealth for shareholders and great opportunities for our people who deliver exceptional results.**

pre-need insurance policies in-force and investment income on insurance reserves. The Funeral Services Group will continue to capture market share and grow revenues by offering new, innovative and high-quality products and services to meet the growing consumer desire for personalized funeral services.

***Continuous Improvement*** — Our Continuous Improvement (CI) efforts permit us to lower our cost structure so we can profitably gain share in low-growth markets. It also helps us develop products faster than our competition and integrate acquisitions sooner while lowering their cost structure. In 1998, we developed an Advanced Management Continuous Improvement Program (AMCIP). This program enhances our leaders' knowledge of the CI process and their ability to apply it on the job as an ongoing business strategy to reduce costs while increasing productivity, quality and safety.

***Our Corporate Mission***—Hillenbrand Industries remains dedicated to creating value for customers, wealth for shareholders and great opportunities for our people who deliver exceptional results. For 1999, we are working nonstop to uncover new platforms that drive growth. We will remain true to our Five Guiding Principles: Niche Market Leadership, Total Customer Satisfaction, Continuous Improvement, Individual Worth and Management for Cash Flow. By listening to customers' ideas, monitoring market opportunities and encouraging employee creativity, we are positioned to grow shareholder value to new levels. To our shareholders, associates, customers and suppliers, thank you for your support and continued investment in the growing businesses of Hillenbrand Industries.



**Daniel A. Hillenbrand**  
*Chairman of the Board*



**W August Hillenbrand**  
*President and Chief Executive Officer*

# Strategies for Growing Shareholder Value

We continue to create shareholder value in increasingly complex and competitive markets by focusing on our three growth strategies:

1. New Product Development
2. Acquisitions & New Business Development
3. Continuous Improvement

New product development is key to our future growth. We listen to and incorporate customer ideas to retain our position as the leading innovator in the industries we serve.



*Seasons™ sundial urn*



*TotalCare® hospital bed*



*Orthodox casket-  
all wood construction*

**T**he secret of our success in new product development is our fervor for listening. Each year thousands of customers visit our Batesville, Indiana and European showrooms and factories. Funeral directors and health care professionals alike meet directly with our product development teams to provide valuable ideas for new products and services.

Our customers have great suggestions for improving the design of existing products. Last year we logged more than 4,000 new ideas from customers. Our vision is to turn their ideas into more than 125 products over the next three years. By listening to ideas, we ensure our existing and new product lines are constantly driving growth.

**Health Care Group** — The **Acute Care** strategic business unit (SBU) provides products and services to acute-care facilities in North America and

## **By listening to new ideas, we ensure our existing and new product lines are constantly driving growth.**

internationally. Revenues were driven by steady growth in the sales of beds, support surfaces, furniture, chairs, stretchers, operating room equipment and equipment rentals. Sales continue to be strong and growing for the award-winning TotalCare® bed system. This is the first general-purpose bed that allows a single caregiver to place functionally immobile patients into a full-chair position at the touch of a button.

In Hill-Rom's **Architectural** products business, sales were led by the Integris® 1000 and 2000 headwall systems that deliver lighting, electric, data, medical gases and other related services to the point of care. Also contributing to this business' growth was the EpiCare™ ceiling arm that provides centralized but flexible electrical, communication and medical gas services in surgical settings. This market should continue to have strong future orders as service providers restructure and renovate facilities.

The year 1998 was the biggest sales year ever for our **Maternal/Infant Care** business' Affinity® II birthing bed. New incubators, warmers and other infant-care products are set for market release in 1999. We increased our expertise in this market by acquiring and integrating Air-Shields, Inc., a global leader in the manufacture and supply of infant incubators and warmers. This business will help identify industry trends that will shape new product design and drive new sales.

The Hill-Rom **NetLinx** information and communication technology business drove its sales in 1998 with its COMposer® patient-nurse communications system. This product quickly and efficiently routes patient calls to a caregiver's location to reduce overhead pages and ensure that caregivers don't waste time trying to locate each other. Also increasing revenues was the WatchChild™ obstetrical patient data-management system. This computer-based charting technology eliminates redundant reporting and charting requirements while promoting hospital-wide standards. With several new products being introduced in 1999, we expect significant revenue growth from this business over the next several years.

**Long Term Care** SBU results included a slight increase in total sales, increased market share, expanded product lines and big steps toward becoming a full-line provider in this market. Sales of the Resident® long-term care bed increased revenues in this SBU. The new TransLift™ series marked our entrance into the lift product category. For 1999, we will introduce new therapy surfaces and clinical programs, as well as a broader line of capital equipment, to outfit the long-term care resident environment. Our vision is to bring Hill-Rom long-term care customers the most complete package of capital equipment and therapeutic products in the industry today.

Hill-Rom's innovative **Home Care** SBU continues to provide therapy to patients in their own homes. Significant revenues were generated by patient support surfaces such as the Silkair® low airloss therapy product and the Clinitron At-Home® air fluidized therapy unit. The VICAIR®\* academy dry air support system seat cushions were also introduced in 1998. The 1999 outlook is for steady revenue growth as we further penetrate the support surface and elderly seating markets with new products.

Hill-Rom's **Europe** SBU introduced in 1998 a new DUO™ therapy surface that provides both static and alternating pressure options. The DUO™ therapy surface is extremely successful throughout Europe and is now being introduced into our world export operations. We also have high expectations for European sales of more technologically advanced specialty North American products such as our new TotalCare® hospital bed system. Adding sales specialists to support these products will result in improved sales and profitability for Hill-Rom Europe.

**Funeral Services Group** — Our Funeral Services Group is a leading innovator in the death care industry. We are extending that lead by providing funeral directors new products and services that create meaningful funeral and memorialization experiences for client families. Our ability to quickly customize and deliver products makes our company the front-runner in the industry's emerging personalization trend. By providing the industry's best selection in personalization options, our products help families find special meaning when experiencing one of life's most difficult events.

**Batesville Casket Company** offers a complete selection in metal caskets including bronze, copper, stainless steel and carbon steel. Our beautiful wood caskets are made of mahogany, walnut, cherry, maple, oak, pecan, poplar and distinctive pine.

Batesville Casket has long been known for high-quality protective metal caskets, featuring a special gasket and closure system to prevent gravesite elements such as earth and water from entering the casket. To meet growing consumer demand, Batesville continues to enter new market segments with products such as non-protective metal caskets, all-wood constructed models for the Jewish Orthodox community, cloth-covered and crematable caskets.

Batesville's vast casket selection, combined with new personalization options, provides families endless possibilities for customizing their funeral experience. For example, funeral directors are excited about Batesville's newest innovation, a proprietary system for producing customized laser-engraved caskets. With this technology, families can have the name of a loved one, special designs or emblems engraved on the casket top. In the case of a fallen firefighter, police officer or armed service personnel, a service badge or military emblem can be engraved.

*Superior patient care,  
caregiver safety and  
shareholder value is  
what Hill-Rom's  
TotalCare® bed is all  
about. Sales continue to  
be strong for this award-  
winning product that  
features one-button chair  
and easy egress positions,  
allowing patients to  
achieve mobility sooner  
with minimal risk of  
injury to themselves  
and/or caregivers.*

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We also offer custom casket corner designs, custom-embroidered cap panels and a variety of casket interior colors. These easy-to-add options featuring a variety of themes and styles allow consumers to personalize their product of choice. Themes include religious, armed services, leisure, floral patterns, ethnic offerings and more. At Batesville Casket, we realize that funerals are for the living, and family selection is an important part of personalizing a funeral.

Batesville Casket has the most extensive distribution system in the casket industry. Our fully synchronized manufacturing and distribution system allows us to do what no other casket distributor can. Seven distribution hubs and more than 70 local customer service centers ensure that funeral directors anywhere, whether in large cities or the most remote rural towns, receive personalized Batesville products on time, every time. In a growing number of markets, we can take an order today, personalize a casket tonight and have the casket at the funeral home for tomorrow's service. That's the Batesville advantage.

We also pioneered merchandising systems that help ease the product selection process for grieving families. Our Meaningful Memories™ merchandising system allows funeral directors to display products and services in a way that helps families select and personalize their funeral. Batesville Casket Company's expanding product line, personalization options, superior distribution system and customer-focused merchandising systems make us the preferred supplier to funeral directors nationwide.

New product innovation continues to be a dominating factor in the success of **Options by Batesville**, accounting for nearly half of the division's revenue growth for 1998. Options pioneered a new category of urns with its introduction of the Garden Series™ memorial products, including a memorial sundial, fountain and wind chimes. Other product successes include the Starfish™ cast bronze keepsake urn and the Flora Maple Memento™ chest. Specialty themes and the ability to personalize were key factors in the success of Options' new product offerings in 1998. Options will continue to use research and customer input to focus its innovations and drive aggressive growth.

**Forethought Financial Services** remains the leading provider of insurance and trust-based products for pre-planning a personalized funeral service. In 1998, Forethought Life Insurance Company introduced its new Coverage Plus™ policy, a higher growth product. Also, Forethought National TrustBank continued to expand and refine its trust-based funeral planning products. The Forethought companies have built upon the success of the Total Casket Protection® program, a joint offering with Batesville Casket that freezes the wholesale price paid by funeral homes for Batesville caskets delivered in conjunction with a Forethought pre-need insurance or trust product. In 1998, the Total Casket Protection® program was expanded to include certain Options® cremation products.

*Looking to the future, Hillenbrand Industries and our subsidiaries will continue to build shareholder value by listening to customers' needs and monitoring market trends. We'll create new products and services that keep our companies growing.*

***B**atesville's products  
and options allow people  
to truly personalize a  
funeral service. A  
personal funeral service  
is more meaningful and  
helps people cope with  
one of life's most difficult  
experiences. Our newest  
personalization  
innovation is distinctive  
laser-engraved casket  
tops that can feature a  
variety of designs or  
emblems.*

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We will create  
shareholder  
value and  
growth by  
acquiring and developing  
new businesses  
that complement  
our existing  
business units.



*Isolette® infant incubator*



*MEDES® Vacuum Pump IDR*

**A**t Hillenbrand Industries, we use a concentric growth model to target acquisitions and new business development initiatives. Following this model, we look for new business opportunities related to or complementary with growing market segments we are already serving. This strategy follows our philosophy of being the market leader in all our business segments. We believe we are number one or two in many of the markets we serve.

To implement this strategy, we break our companies into narrowly focused business units. These small business units allow us to focus on profitable niche markets, aggressively grow market share, develop new products more quickly, instill a philosophy of continuous improvement in all operations, control costs, reduce bureaucracy, speed

## **We look for new business opportunities related to or complementary of growing market segments we are already serving.**

decision making and develop new leaders. Each business unit operates with a significant degree of autonomy and is responsible for its product development, profitability and contribution to growing shareholder value.

**Health Care Group** — At the beginning of our 1998 fiscal year, our **Acute Care** strategic business unit announced the completion of the acquisition of certain of Vickers PLC's medical businesses, notably Air-Shields, Inc. Now called **Hill-Rom Air-Shields, Inc.**, this company is a global leader in the manufacture and supply of infant incubators and warmers. Air-Shields is a good fit within our existing Hill-Rom **Maternal/Infant Care** business. This acquisition has increased revenues and market share, making Hill-Rom a leader in this market segment.

In February, we announced the acquisition of **MEDÆS Holdings, Inc.** MEDÆS is a leading manufacturer of medical, architectural and engineered systems that include patient headwalls and medical gas delivery equipment. This acquisition provides our Hill-Rom **Architectural** products business new channels of distribution both in North America and internationally. It expands Hill-Rom into the medical gas delivery market as an industry leader.

These acquisitions exemplify how we intend to grow Hillenbrand Industries. We will grow our existing businesses by seeking out and investing in companies that provide access to new products, services and markets. Our business development and planning staffs are working closely with our business unit leaders to identify and evaluate acquisition candidates and new business development opportunities to meet our concentric growth criteria.

For example, our **Home Care** SBU signed an agreement with Vicair B.V. to offer the VICAIR® academy dry air support system seat cushions, allowing us to enter the elderly seating market in 1998. In October, our Hill-Rom **NetLinx** communications

business acquired Fisher Berkeley Corp., a manufacturer of nurse-call systems. This acquisition will increase the number of products available to our communications customers, allow us to enter the long-term care communications market in 1999 and improve our position in proprietary technology.

Also in 1998, we purchased as part of the Air-Shields acquisition, **Narco Medical Services, Inc.**, a leading regional provider of monitoring, respiratory and infusion product rentals, sales and biomedical services. In 1998, Narco Medical achieved strong product sales in the anesthesia and critical care markets. In 1999, Narco will introduce a new Clinical Equipment Management Program to meet the unmet needs of customers with biomedical departments.

Also purchased as part of the Air-Shields acquisition was Medical Industrial Equipment, Ltd., **MIE**, a manufacturer of anesthesia equipment and accessory items. The company received FDA approval to sell its primary anesthesia products, the Hawk Induction System and the Falcon Anesthesia System.

**Funeral Services Group** — Our Funeral Services Group has also been busy evaluating acquisition and new business development opportunities. To support our commitment to independently owned funeral homes, we made two acquisitions. In September, we acquired the assets of **International Funeral Associates , Inc.**(IFA), a membership-based association of independent funeral homes. IFA provides buying services for a range of funeral service products, in addition to business resources such as accounts receivables management, pre-need marketing and property/casualty insurance.

In 1998, we also acquired **Applied Retail Systems** (ARS) a premier supplier of casket selection room display fixtures. Batesville Casket has worked with ARS extensively in the past on projects such as our Partnership Marketing Program™ (PMP) and, most recently, the Meaningful Memories™ program. The acquisition of ARS will further our goal to provide funeral directors the best in merchandising and display systems.

In May, we established a new financial institution, the **Forethought Federal Savings Bank**. The savings bank will facilitate and expand Forethought® pre-need funeral trust services to customers nationwide.

In 1999, Forethought Financial Services will continue to evaluate acquisitions and join the entire Funeral Services Group in exploring entry into European markets.

*By closely following the markets we serve, we are confident our continuous efforts to apply our concentric growth model will produce acquisition and new business development opportunities to keep shareholder value growing.*

*We are focused on looking for acquisitions that complement and increase market share in the niche markets we already serve. In 1998, for example, we acquired Air-Shields, Inc., a global leader in infant incubators and warmers. Now Hill-Rom Air-Shields, Inc., this company is an excellent fit with our existing maternal/infant care business.*

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Everything we  
do-*everything*-  
can be improved.



*Affinity® II birthing bed*



*Advance® bed*

We invest  
creativity before  
capital and use



*Flora Maple Memento™ chest*



*Eagle Corner casket hardware*

Continuous  
Improvement  
to grow shareholder  
value.

**O**ur corporate-wide commitment to **Continuous Improvement** (CI) is increasing our profitability and capacity to grow our businesses with lower capital expenditures. We use a very disciplined CI process developed by the world's leading experts. We foster a corporate-wide mindset of process measurement, standardization and creative problem solving that reaches into each business unit and staff function, and touches each associate. Simply, we believe there are always better, faster, more accurate, higher quality and lower cost ways to do business. CI eliminates non-value-added activities, and the savings go straight to our customers and the bottom line.

Our efforts have freed up hundreds of thousands of square feet of factory floor space. In certain areas, CI events have increased productivity more than 25%; reduced inventory 30%; increased quality 50%; enhanced safety and ergonomics 200%; and shortened new product development cycle times. These CI successes are the reason we

**Simply, we believe there are always better, faster,  
more accurate, higher quality and lower cost ways to do business.**

continue to gain market share in flat, declining, consolidating and changing markets. Moreover, it is how we sustain profitability in increasingly price-competitive markets. The people of Hillenbrand Industries realize the importance of listening to each other for the best ideas that keep shareholder value growing.

In April, we began an **Advanced Management Continuous Improvement Program (AMCIP)** as part of our CI commitment. Designed specifically for the leaders of Hillenbrand Industries, this new program enhances their knowledge of the CI process and ability to apply it on the job as an ongoing business strategy. This program complements the commitment large numbers of Hillenbrand employees make to hundreds of ongoing factory and administrative area improvement events held across the corporation each year.

Here is how the program works. At various times during the next several years, selected key leaders will leave their present positions for three months and dedicate 100% of their time to learning and applying CI. They will work in and with the Hillenbrand Industries CI Department. AMCIP will speed up our use of CI as a strategic edge over our present and future competitors. It provides a great opportunity to develop our leaders. And, more specifically, it will give our key leaders the skills and experience to apply CI in their operations when they return from AMCIP.

This special program is unique to Hillenbrand Industries. We know of no other company in the world extending this level of commitment to the CI process. AMCIP is now a vital part of our efforts to achieve our three growth strategies.

**Health Care Group** — In 1998, our Hill-Rom **Long Term Care** SBU used CI to develop new products, improve product design and manufacturing, and streamline billing and collection processes. In **Home Care**, CI was used to gain process improvements in billing, field sales, field operations and new product development. In

**Maternal/Infant Care**, with the assistance of CI, all products are now built to customer order, significantly reducing finished goods inventory. We also improved the reliability and lowered the production costs of key products.

At our Ritter Plant in Batesville, Indiana, CI has helped us implement focused product cells in our health care furniture department, which reduced manufacturing lead time from three days to less than eight hours. We also implemented paced assembly lines to improve productivity, flexibility and teamwork. Our new Ritter factory floor measurement system is driving quality, cost, delivery and safety improvements.

In the **Europe** SBU, CI is being employed to consolidate three manufacturing facilities into one, dramatically improving labor productivity and freeing up space for the addition of new products.

**Funeral Services Group** — In our Funeral Services Group, **Batesville Casket Company** used CI to streamline production processes and free up floor space in our manufacturing plants. The free space in one of the plants is now a distribution hub. This accomplishment is even more remarkable considering this plant is also producing more caskets than ever before. Additional CI efforts enabled Batesville Casket to condense a molding and plating process, produce parts just in time, and close a support facility.

Employee dedication, teamwork and new ideas characterize the Funeral Services Group approach to CI. We are always interested in the better way and are using CI to shorten manufacturing time to further reduce the time from when a product is ordered to its delivery. We are also using CI to eliminate stored goods waiting for trucks. Products are now loaded and delivered on demand. With the help of CI, Batesville

## **All over Hillenbrand Industries, we are using CI to work smarter. Everyone has a voice. Everyone listens to new ideas.**

Casket now manufactures products in the order they are loaded into our trucks. Beginning in 1999, thanks in part to CI, Batesville can begin supplying the largest funeral service provider in the world without having to invest in any additional manufacturing equipment. That's amazing. That's CI at work.

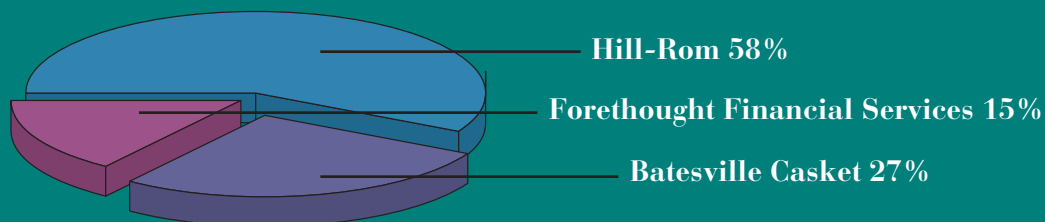
Great strides were made in CI to spur the aggressive growth of the **Options by Batesville** division. Options used CI to maximize efficiency and quality from its new manufacturing facility. In 1998, Options took CI to a new level by working with customers to apply its principles in the funeral firm to improve their service, quality and performance.

**Forethought Financial Services** used CI to refine administrative processes with emphasis on same-day delivery and increased quality. We believe we have the shortest product delivery time in the industry. These efforts freed up 3,500 square feet of space in our material storage and shipping area.

*All over Hillenbrand Industries, we are using CI to work smarter. Everyone has a voice. Everyone listens to new ideas. And we don't just make suggestions; we make changes that keep shareholder value growing.*

# Our Diverse Line of Products and Services Keeps Shareholder Value Growing

Percentage of Revenues by Operating Companies



## OUR DIVERSE PRODUCT LINE



**T**he COMposer® patient-nurse communications system is a comprehensive communication and information management system designed to enhance the quality of care. System features include on-screen patient information, direct room-to-room communications, an automatic and specific locating system that eliminates noisy overhead pages, activity reporting and more. The COMposer® system helps create a quieter hospital environment for caregivers and patients, while increasing caregiver productivity.



**B**atesville Casket Company's stainless steel casket product line offers great eye appeal, has been very well received by the marketplace and is growing quickly. Our Millennium™ stainless steel casket received news media coverage across the United States, including *The Wall Street Journal* and *ABC World News Tonight*. Its hand-polished, mirror-like finish is accentuated with vase-shaped, round-end corners, gold-tinted hardware and a fluted handle bar. The Millennium™ casket has achieved a distinctive look never before seen in the industry.



**T**he DUO™ mattress system is a new therapy product offered by Hill-Rom in Europe. The DUO™ mattress system is revolutionary in that it offers two clinically accepted pressure-sore therapy modalities in one mattress product.



**M**ounted securely to the ceiling, the EpiCare™ ceiling column is the solution when a centralized service for electrical, communications and medical gases is important. A product of Hill-Rom's Architectural business, the EpiCare™ column provides flexibility in an ever-changing surgical environment.

# FORE THOUGHT

FEDERAL SAVINGS BANK



Just as starfish are so often reminders of happy times spent at the beach, the **Starfish™ keepsake urn** is a personal memorial for someone who enjoyed recreation at the seashore. **Options®** miniature keepsake urns are designed to hold a small portion of cremated remains. They are ideal when several family members desire personal memorials or when either scattering or burial is selected for final disposition. We offer many distinctive designs that truly personalize cremation services.

**F**orethought Financial Services provides funeral planning insurance and trust products to make it easier for families to prepare for, personalize, experience and cope with the death of a loved one. Forethought Financial Services is a leading provider of insurance and trust-based products to assist people with pre-arranging a personalized funeral. In May, Forethought Financial Services established a new financial institution, the **Forethought Federal Savings Bank**. The savings bank will facilitate and expand our ability to provide pre-need funeral trust services to consumers nationwide.



**B**y combining features usually found only in multiple products, **Hill-Rom's Procedural Recliner** can be a chair, a recliner, a flat exam/procedure surface and much more. An optional hydraulic high-low pedal permits positioning of the recliner from a low position of 21" to a high position of 32 1/2" to provide access to the patient and facilitate patient egress and ingress. These are only some of the features of this example of Hill-Rom innovative product designs and engineering.



**T**he **TRANS-LIFT™ resident sling lift** is designed to help caregivers avoid the risk associated with manual lifting of immobile residents. Its simple design ensures ease of use with minimal training of staff, and the thoughtfully designed sling and lift provide maximum comfort and security for the resident. It's another example of how Hill-Rom products focus on producing favorable outcomes for both the patient and caregiver.

## Officers

### **W August Hillenbrand, 58**

President and Chief Executive Officer since 1989. During a 30-plus year Hillenbrand career, has been chief operating officer and executive vice president, Hill-Rom Company president, vice president, operations and assistant to the president.

### **Donald G. Barger, Jr., 56**

Vice President and Chief Financial Officer since 1998. Formerly vice president and chief financial officer of Worthington Industries.

### **Tom E. Brewer, 60**

Senior Vice President, Finance since 1998. Formerly senior vice president and chief financial officer from 1983. Also formerly vice president and treasurer of The Firestone Tire and Rubber Company.

### **George E. Brinkmoeller, 63**

Vice President, Corporate Services since 1980. During his career, he has been director of corporate services and manager of affiliated operations. Formerly manager of Sheraton Hotel Corporation.

### **Michael L. Buettner, 41**

Vice President, Corporate Development since 1995. Formerly with Bausch & Lomb as staff vice president, corporate development; vice president, business development, personal products; director, corporate business development; assistant to corporate controller and manager, acquisition analysis.

### **Mark R. Lanning, 44**

Vice President and Treasurer since 1995. Formerly assistant treasurer and joined Hillenbrand in 1988 as manager, corporate audit. Prior experience was with Ernst & Whinney, now Ernst & Young, LLP, as senior manager.

### **Mark R. Lindenmeyer, J.D., M.D., 52**

Vice President, General Counsel and Secretary since 1991. Joined Hillenbrand in 1986 as litigation and medical/legal specialist. Previously in the University of Rochester medical internship and residency program. Before that, a partner with Greeman, Kellerman & Lindenmeyer, and a U.S. Army judge advocate officer.

### **J. Cameron Moss, 42**

Vice President, Corporate Planning since 1996. Formerly with McKinsey & Company as senior engagement manager and with Robert Bosch Corporation as account manager.

### **David L. Robertson, 53**

Named Vice President, Human Resources in 1998. Formerly senior vice president, human resources for Rubbermaid, Inc.

### **Robert J. Tennison, 52**

Vice President, Continuous Improvement since 1996. Formerly with Donnelly Corporation as senior vice president, operations and with Hennessy Industries as president.

### **James D. Van De Velde, 52**

Vice President, Controller, since 1991. Joined Hillenbrand in 1980 as tax director. Formerly tax manager with Price Waterhouse, now PricewaterhouseCoopers, LLP.

## Operating Company Presidents

### **Richard N. Coffin, 52**

Executive Vice President and Chief Operating Officer, Forethought Financial Services since 1997. Previously vice president, finance and chief financial officer. Has been with Hillenbrand since 1979.

### **David J. Hirt, 52**

President and Chief Executive Officer, Batesville Casket Company since 1989. Previously senior vice president of sales and marketing for Batesville Casket Company and has been with Hillenbrand since 1968.

### **Frederick W. Rockwood, 51**

President and Chief Executive Officer, The Hillenbrand Funeral Services Group, Inc. since 1997 and Forethought Financial Services since 1985. Has been with Hillenbrand since 1977. Previously with Bain and Company and The Boston Consulting Group.

### **Walter M Rosebrough, Jr., 44**

President and Chief Executive Officer, Hill-Rom Company since 1995 and Support Systems International since 1988. Has been with Hillenbrand since 1982. Previously with General Motors.

## Board of Directors

**Daniel A. Hillenbrand, 75**

Chairman of the Board  
Hillenbrand Industries  
Batesville, IN  
Board Member Since 1969 1, 2, 3, 4, 5

**Lawrence R. Burtschy, 62**

Chairman  
L.R. Burtschy & Co.  
Charleston, SC  
Board Member Since 1970 1, 2

**Peter F. Coffaro, 70**

Chairman of the Board  
PABCO Fluid Power Co.,  
Ohio Valley Flooring,  
Anchor Flange Company  
Cincinnati, OH  
Board Member Since 1987 3, 4, 5

**Edward S. Davis, Esq., 67**

Partner  
Hughes Hubbard & Reed  
Attorneys-at-Law  
New York, NY  
Board Member Since 1974 3, 4, 5

**Leonard Granoff, 72**

President  
Granoff Associates  
Providence, RI  
Board Member Since 1978

**John C. Hancock, 69**

Consultant  
Fort Myers, FL  
Board Member Since 1980 4, 5

**George M. Hillenbrand, II, 59**

Personal Investments  
Batesville, IN  
Board Member Since 1986 1, 2

**John A. Hillenbrand, II, 67**

Personal Investments  
Batesville, IN  
Board Member Since 1972 1, 2

**Ray J. Hillenbrand, 64**

Personal Investments  
Rapid City, SD  
Board Member Since 1970 1, 2

**W August Hillenbrand, 58**

President and Chief Executive Officer  
Hillenbrand Industries  
Batesville, IN  
Board Member Since 1972 1, 2, 4

1. Executive Committee
2. Finance Committee
3. Audit Committee
4. Compensation Committee
5. Performance Compensation Committee

# GLOSSARY

**ACUTE CARE**—The health care market that is most commonly referred to as “hospitals,” but would include any primary care site offering birthing, medical/surgical, cardiac, critical, disease, emergency/trauma and intensive care.

**AIR FLUIDIZED THERAPY** (See Clinitron® Air Fluidized Therapy)

**ARCHITECTURAL PRODUCTS**—Hill-Rom® capital products that include modular headwall systems, ceiling-mounted equipment for surgery centers and lighting and cabinetry for patient environments.

**CAPITAL**—Hill-Rom® products that are primarily sold to and purchased by health care facilities, as opposed to those Hill-Rom® products that are rented on a per diem basis, such as many specialized therapy rental products.

**CAREGIVER**—An individual who cares for a patient/resident in the acute, long-term and home-care environments. Participation varies from simple patient/resident care tasks requiring little or no training to expert professional techniques and nursing skills necessary in life-threatening situations that require specialized education, training and a license.

**CLINITRON® AIR FLUIDIZED THERAPY UNIT**—A Hill-Rom® therapy unit consisting of a tub-like tank filled with thousands of round ceramic microspheres (glass beads) with the consistency of a very fine sand. The spheres are put in motion (agitated) and suspended by a continual flow of warm air pumped from the bottom of the tank. This creates a buoyant surface that feels like a liquid but is completely dry. The patient “floats” on a monofilament sheet covering the gently “bubbling” surface and the even distribution of weight makes the bed particularly useful in treating severe burns, wounds and pressure ulcers. (Also known as a “bead bed.”)

**CREMATION**—The process by which human remains are reduced to their original elements by the application of intense heat.

**DEATH CARE**—A term coined by the professional investment community to describe the funeral and cemetery services industry and its sub-industries, including: funeral home, crematorium and cemetery acquisition; burial casket, cremation product, embalming product, funeral garment and grave marker manufacturing; and pre-need funeral planning. Batesville Casket and Forethought Financial Services serve only the casket, cremation and pre-need markets as Hillenbrand Industries’ Funeral Services Group.

**FUNERAL SERVICES GROUP**—Hillenbrand Industries’ business group consisting of wholly owned subsidiaries Batesville Casket Company, Forethought Financial Services and other subsidiaries.

**HEADWALL SYSTEMS**—The Hill-Rom Architectural Products line of attractive and modular wall and ceiling systems that organize and facilitate the convenient delivery of electrical

power, lighting and medical gases to the patient bed; they also provide support for patient monitoring, life support and medication equipment.

**HEALTH CARE GROUP**—Hillenbrand Industries’ business group consisting of the wholly owned subsidiary, Hill-Rom, Inc. and its subsidiaries.

**HOME CARE**—The primary care of patients in the home.

**LONG-TERM CARE**—The health care market that provides care to persons requiring ongoing institutional, post-acute medical treatment, nursing care or a high degree of personal assistance with activities of daily living.

**LOW AIRLOSS THERAPY**—A sleep surface with air-filled cushions separated into integrated zones that prevent and treat pressure ulcers by reducing pressure over the entire body contact area. Air pressure is automatically adjusted whenever the patient changes positions. Carefully placed micro air vents on the cushions allow just enough air to escape (low airloss) to keep the patient dry and comfortable.

**MEDICARE**—A federal government insurance program to assist those age 65 and over and the disabled with medical and hospital expenses.

**MEDICAL-SURGICAL**—The traditional acute care hospital’s medical or surgical units. Patients and equipment located on this floor are commonly referred to as “Med-Surg.”

**PRESSURE ULCER**—Any lesion caused by unrelieved pressure resulting in damage to the underlying body tissue; usually located over bony prominences.

**PROCEDURAL**—Relating to medical and surgical procedures performed on patients.

**PROTECTIVE METAL CASKET**—A burial casket designed to prevent the entry of grave site elements, such as water, air, soil, insects, etc. Batesville Casket Company provides protective caskets made from bronze, copper, stainless steel and carbon steel.

**PULMONARY**—Of, relating to, or affecting the lungs.

**RENTAL THERAPY PRODUCTS**—Hill-Rom® wound and pulmonary care specialized therapeutic products that are rented in acute care, long-term care and home-care markets.

**TOTAL CASKET PROTECTION® PROGRAM**—An innovative program offered to funeral directors by Forethought Financial Services that guarantees the wholesale price to the funeral director of a Batesville® casket specified in a Forethought® funeral plan regardless of when the contract is fulfilled. Developed and marketed jointly by Batesville Casket Company and Forethought Financial Services. A similar program is available for Options® cremation products.

# 1998 FINANCIAL REPORT

HILLENBRAND INDUSTRIES, INC. AND SUBSIDIARIES

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# ELEVEN YEAR SUMMARY

HILLENBRAND INDUSTRIES, INC. AND SUBSIDIARIES

(Dollars in millions except per share data)

	Ten Year Compounded Annual Growth Rate	1998	1997	1996
<b>Results of Operations</b>				
Net revenues	10%	<b>\$2,001</b>	1,776	1,684
Operating expenses	10%	<b>\$1,707</b>	1,512	1,448
Unusual charges (a)		<b>\$ 66</b>	—	—
Operating profit	7%	<b>\$ 228</b>	264	236
Other income (expense), net (d)		<b>\$ 65</b>	(5)	(3)
Income from continuing operations before income taxes	11%	<b>\$ 293</b>	259	233
% of net revenues		<b>14.6</b>	14.6	13.8
Income taxes	10%	<b>\$ 109</b>	102	93
% effective rate		<b>37.0</b>	39.4	39.9
Income from continuing operations	12%	<b>\$ 184</b>	157	140
% of net revenues		<b>9.2</b>	8.8	8.3
Other items (b)		<b>\$ —</b>	—	—
Net income	11%	<b>\$ 184</b>	157	140
% average shareholders' equity		<b>20.6</b>	19.6	19.3
<b>Per Share Data</b>				
Income from continuing operations	13%	<b>\$ 2.73</b>	2.28	2.02
Net income	12%	<b>\$ 2.73</b>	2.28	2.02
Cash dividends	14%	<b>\$ 0.72</b>	0.66	0.62
Earnings retained and reinvested	11%	<b>\$ 2.01</b>	1.62	1.40
Book value	12%	<b>\$14.25</b>	12.94	11.44
Average shares outstanding (000's)	(1%)	<b>67,578</b>	68,796	69,474
<b>Financial Position</b>				
Current assets	11%	<b>\$ 858</b>	821	694
Current liabilities	9%	<b>\$ 375</b>	359	320
Working capital	12%	<b>\$ 483</b>	462	374
Current ratio		<b>2.3</b>	2.3	2.2
Equipment leased to others and property, net	0%	<b>\$ 302</b>	329	346
Total assets	18%	<b>\$4,280</b>	3,828	3,396
Long-term debt	10%	<b>\$ 303</b>	203	204
Shareholders' equity	11%	<b>\$ 952</b>	886	787
<b>Other Data</b>				
Capital expenditures	(3%)	<b>\$ 88</b>	85	92
Depreciation, amort. and write-down of goodwill	8%	<b>\$ 149</b>	102	99
Gross cash flow (c)	8%	<b>\$ 301</b>	235	223
Employees	3%	<b>10,400</b>	9,800	9,800
Shareholders	11%	<b>24,500</b>	24,000	24,000
Stock price range — high and low		<b>64<sup>11</sup>/<sub>16</sub>-44<sup>9</sup>/<sub>16</sub></b>	48 <sup>5</sup> / <sub>8</sub> -33 <sup>7</sup> / <sub>8</sub>	40 <sup>1</sup> / <sub>4</sub> -31 <sup>7</sup> / <sub>8</sub>
Price/earnings ratio — high and low		<b>28-19</b>	25-18	29-19

(a) Write-down of goodwill and other assets in 1998 and 1995; settlement of a patent infringement suit in 1994; and write-down of goodwill in 1993.

(b) Income (loss) from discontinued operation in 1987-1993; gain on the sale of discontinued operation in 1993; and the cumulative effect of the change in accounting principle in 1992.

(c) Excluding insurance operations, the sum of net income from continuing operations, income (loss) from discontinued operation, depreciation, amortization and write-down of goodwill.

(d) Reflects a gain of \$75 million in 1998 on the sale of Medeco Security Locks, Inc.

1995	1994	1993	1992	1991	1990	1989	1988
1,625	1,577	1,448	1,303	1,084	982	872	783
1,420	1,336	1,202	1,109	928	852	750	669
26	85	14	—	—	—	—	—
179	156	232	194	156	130	122	114
(9)	(11)	(11)	(16)	(9)	(10)	(13)	(12)
170	145	221	178	147	120	109	102
10.5	9.2	15.3	13.7	13.6	12.2	12.5	13.0
80	55	89	67	57	48	45	42
47.1	37.9	40.3	37.6	38.8	40.0	41.3	41.2
90	90	132	111	90	72	64	60
5.5	5.7	9.1	8.5	8.3	7.3	7.3	7.7
—	—	14	5	(1)	4	7	6
90	90	146	116	89	76	71	66
12.7	13.4	25.2	23.1	19.7	18.2	19.5	20.3
1.27	1.26	1.86	1.55	1.23	.97	.86	.79
1.27	1.26	2.04	1.62	1.22	1.02	.96	.88
.60	.57	.45	.35	.29	.28	.25	.20
.67	.69	1.59	1.27	.93	.74	.71	.68
10.54	9.78	8.98	7.65	6.76	5.96	5.35	4.68
70,758	71,278	71,407	71,915	72,885	73,971	74,377	75,117
640	566	595	556	397	409	345	308
301	259	311	277	240	193	153	156
339	307	284	279	157	216	192	152
2.1	2.2	1.9	2.0	1.7	2.1	2.3	2.0
367	359	327	307	297	314	338	311
3,070	2,714	2,291	1,958	1,545	1,277	1,048	835
206	209	108	185	104	108	113	118
746	693	640	548	491	436	397	349
103	100	113	98	59	76	130	118
127	97	113	118	97	96	82	70
207	179	231	227	183	171	155	142
9,800	10,000	9,800	10,700	10,500	9,500	9,000	8,000
30,000	29,000	27,000	21,500	11,000	9,800	9,500	9,000
33⅓-27	43⅓-26⅔	48⅓-36½	43⅓-29¼	30⅓-17⅔	24-15⅔	21½-13¼	17⅔-11½
30-17	24-13	32-21	34-25	27-17	23-15	22-14	23-15

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

*HILLENBRAND INDUSTRIES, INC. AND SUBSIDIARIES*

The following discussion and analysis should be read in conjunction with the Company's consolidated financial statements and accompanying notes. Hillenbrand Industries is organized into two business segments. The Health Care Group consists of Hill-Rom. Results for Block Medical, which was sold on July 22, 1996, and Medeco Security Locks which was sold on July 1, 1998, are included in this segment through these respective dates. The Funeral Services Group consists of Batesville Casket Company and Forethought Financial Services (Forethought).

## RESULTS OF OPERATIONS 1998 Compared with 1997

### Summary

Consolidated net revenues of \$2,001 million increased \$225 million, or 13%, in 1998. Operating profit of \$228 million was down 14%. Net income increased 17% to \$184 million, and earnings per share increased 20% to \$2.73.

Third quarter 1998 results reflect income of \$47 million, net-of-tax, (\$.70 per share) relative to the sale of Medeco Security Locks, Inc. The Company also recorded several unusual charges which total \$42 million, net-of-tax, (\$.62 per share). The charges include the write-off of goodwill, other asset impairment charges and other closing costs related to the discontinuance of manufacturing operations at Hill-Rom facilities in Germany and Austria; tax benefits related to the write-off of the Company's investments in Germany and Austria; and provisions for certain income tax exposures. Excluding these items, operating profit increased 13%, net income increased 14% and earnings per share increased 16%.

### Net Revenues

Health Care sales of \$748 million increased \$160 million, or 27%, due to the effect of acquisitions and good market acceptance of the TotalCare® bed and increased unit volume of architectural, communications, procedural and maternal/infant care products in Hill-Rom's U.S. acute care market. Shipments of the Resident® LTC bed also increased as it continues to experience good market acceptance. Unit volume and revenues increased slightly in Hill-Rom's European market, partially offset by unfavorable currency adjustments. Excluding the sales effect from the purchases of Air-Shields, Inc., and MEDÆS Holdings, Inc., and the sale of Medeco Security Locks, Inc., Health Care sales increased 11%. Medeco (for which seven months and twelve months of sales are reflected in 1998 and 1997 results) did not contribute significantly to the overall sales of the Health Care Group.

Health Care rental revenue grew \$25 million, or 7%. In the U.S. long-term care market, rental revenues were down slightly year over year mainly due to the effect of a change in Medicare Part A patient reimbursement practices effective July 1, 1998. Overall, higher volume was offset by lower rates and product mix in the long-term care market. The U.S. home care market experienced slightly higher revenues as unit growth from new and higher end products was partially offset by lower overall rates. In the U.S. acute care market, rental revenues were up year over year due to higher

volume from new products which was partially offset by lower rates and product mix. Rental revenues in Europe increased slightly in nearly all markets, but were largely offset by unfavorable currency adjustments.

Funeral Services sales decreased \$4 million, or 1% due to lower product mix partially offset by increased shipments of hardwood and cremation products. Unit volume growth was accomplished in a market that is currently flat for casketed deaths.

Insurance revenues grew \$44 million or 17%. Investment income accounted for approximately \$18 million of the increase while earned premium revenue accounted for about \$14 million. Investment income grew mainly because of the increased size of the investment portfolio. Earned premium revenue increased due primarily to increased policies in force year over year. Policy sales declined nearly 9% in 1998 due to slowed growth as Forethought's entry into targeted jurisdictions is nearly complete and due to increased competition. Since premium revenues are earned over the life of the policyholder, current year sales will primarily affect revenues and earnings in future years. Forethought's trust business did not have a significant revenue impact in 1998.

### Gross Profit

Gross profit on Health Care sales increased \$54 million, or 20%, to \$320 million, due primarily to increased shipments in Hill-Rom's U.S. markets. As a percentage of sales, gross profit declined from 45% in 1997 to 43% in 1998 primarily due to the integration of Air-Shields and MEDÆS which have lower margins compared to other Health Care sales products. Shipments of higher value products, continued improvements in direct material, labor and overhead costs, leveraging of fixed manufacturing expenses in the United States and decreased shipments of lower margin European products helped to partially offset the lower gross profit margins of Air-Shields and MEDÆS.

Gross profit on Health Care rentals of \$162 million was up \$19 million, or 13%. As a percentage of sales, gross profit improved to 40% in 1998 compared to 38% in 1997. This increase reflects the increased unit volume experienced in all U.S. markets, continued process improvements and cost control.

Gross profit on Funeral Services sales of \$260 million decreased \$4 million, or 2%, in 1998. As a percentage of sales, gross profit remained essentially unchanged at 48%. This comparison reflects the mix change in Funeral Services sales year to year discussed above. Even with increased unit volume and lower overall pricing, gross profit as a percent of sales remained unchanged due to process improvements and cost controls.

Profit before other operating expenses in insurance operations increased \$20 million, or 36%, in 1998 due to higher investment income (with minimal corresponding direct cost), profits earned on the larger base of policies in force, net gains on the sale of investments and continued control of direct administrative expenses. These items were partially offset by an increase in death benefits paid and reserved due to the larger base of policies in force.

### Other Operating Expenses

These expenses, consisting of selling, marketing, distribution

and general administrative costs, increased \$59 million, or 12% in 1998. As a percentage of consolidated revenues, these expenses remained essentially unchanged at 27% in 1997 and 1998. This is a result of continued cost control and process improvement throughout the Company.

### Operating Profit

Operating profit in the Health Care Group decreased \$53 million, or 40%, to \$81 million. This decrease is mainly due to a \$70 million charge for the write-off of goodwill, other asset impairment charges and other closing costs related to the discontinuance of manufacturing operations at Hill-Rom facilities in Germany and Austria. Excluding this charge, operating profit would have been \$151 million in 1998, or a 13% increase, due to increased sales of higher value products in the U.S. acute care market and an increase in rental revenues partially offset by higher incentive compensation and commission expenses.

Operating profit in the Funeral Services Group of \$170 million increased \$10 million, or 6%, from 1997. At Batesville Casket, operating profit decreased slightly in 1998 as increased casket and cremation volume was offset by lower pricing on an unfavorable product mix. Operating expenses remained essentially unchanged. At Forethought, higher investment income, increased capital gains and cost control helped to increase operating profit.

Consolidated operating profit of \$228 million decreased \$36 million, or 14%. Excluding unusual charges discussed above, consolidated operating profit would have been \$298 million, a 13% increase. A decrease in corporate expenses in 1998 contributed to the growth in operating profit.

### Other Income and Expense

Interest expense increased due to additional long-term debt associated with the addition of \$100 million in debentures issued in December 1997. Investment income grew slightly due to a higher earnings rate on investments partially offset by lower levels of cash and equivalents. Excluding the gain

of \$75 million on the sale of Medeco, other income and expense, net was unchanged year-to-year.

### Income Taxes

The effective income tax rate in 1998 was 37.0% compared to 39.4% in 1997. Excluding one-time events affecting 1998 financial results, the effective income tax rate was essentially unchanged compared to 1997.

## 1997 Compared with 1996

### Summary

Consolidated net revenues increased \$92 million, or 5%, in 1997. Operating profit of \$264 million was up 12%, net income of \$157 million was up 12% and earnings per share of \$2.28 increased 13%. Excluding the gain on the sale of Block Medical (\$8 million or \$.12 per share) in the third quarter of 1996, net income and earnings per share increased 19% and 20%, respectively, in 1997.

### Net Revenues

Health Care sales increased \$20 million, or 4%, due to higher shipments of Advance® series beds, stretchers, architectural equipment and communications products in Hill-Rom's U.S. acute care market and good market acceptance of the Resident® LTC bed in the long-term care market. In Hill-Rom's European markets, lower shipments in Germany and unfavorable currency adjustments were partially offset by increased shipments in France. The German market continued to be negatively affected by health care reform and general economic conditions. Sales at Medeco were up due to higher shipments of door security products, partially offset by lower demand in route management (primarily pay telephone business). Medeco and Block (for which eight months of sales were reflected in 1996 results) did not contribute significantly to the overall sales of the Health Care Group.

Health Care rental revenue grew \$5 million, or 1%. In the U.S. long-term care market, increased units in use and

## Consolidated Income Statement Comparison

	Fiscal Year			Percent Change		
(Dollars in millions)	1998	1997	1996	1998/97	1997/96	1996/95
Net revenues:						
Health Care sales	\$ 748	\$ 588	\$ 568	27%	4%	2%
Health Care rentals	403	378	373	7%	1%	1%
Funeral Services sales	541	545	524	(1%)	4%	2%
Insurance revenues	309	265	219	17%	21%	18%
Total revenues	\$2,001	\$1,776	\$1,684	13%	5%	4%
Gross profit:						
Health Care sales	\$ 320	\$ 266	\$ 234	20%	14%	12%
Health Care rentals	162	143	140	13%	2%	15%
Funeral Services sales	260	264	246	(2%)	7%	4%
Insurance revenues	92	72	57	28%	26%	27%
Total gross profit	834	745	677	12%	10%	10%
Other operating expenses	540	481	441	12%	9%	8%
Unusual charges	(66)	—	—	N/A	N/A	N/A
Operating profit	228	264	236	(14%)	12%	32%
Other income (expense), net	65	(5)	(3)	N/A	(67%)	67%
Income before income taxes	293	259	233	13%	11%	37%
Income taxes	109	102	93	7%	10%	16%
Net income	\$ 184	\$ 157	\$ 140	17%	12%	56%

higher rates were partially offset by a shift toward greater use of lower cost products. In the U.S. home care market, unit growth and increased rates generated from higher-featured new products were partially offset by lower Medicare reimbursement rates. Acute care rental revenues were down year over year due to cost and competitive pressures and lower product mix, largely offset by increased units in use. Rental revenues in Europe were down due to softness in the German therapy market and unfavorable currency adjustments.

Funeral Services sales increased \$21 million, or 4%. Unit volume growth of traditional caskets and cremation products in an essentially flat death market was partially offset by lower casket product mix. The effect of price increases was mostly offset by rebates and discounts.

Insurance revenues were up \$46 million, or 21%. Earned premium revenue increased \$22 million due primarily to increased policies in force year over year. Investment income grew \$16 million, reflecting a larger investment portfolio, partially offset by marginally lower yields. Policy sales were up over 16% in 1997. Since premium revenues are earned over the life of the policyholder, current year sales will primarily affect revenues and earnings in future years. Realized net gains on the sale of investments were \$8 million in 1997 compared with a net of zero in 1996. The trust business did not have a significant effect on Forethought's operations in 1997 and prior years.

#### **Gross Profit**

Gross profit on Health Care sales of \$266 million was up \$32 million, or 14%, reflecting the increased shipments in Hill-Rom's U.S. markets. As a percentage of sales, gross profit improved from 41% in 1996 to 45% in 1997 due to increased shipments of higher margin products, continued improvements in direct material, labor and overhead costs and leveraging of fixed manufacturing expense in the United States. Decreased shipments of lower margin European products also contributed to the overall improvement in margins.

Gross profit on Health Care rentals increased \$3 million, or 2%, to \$143 million and, as a percentage of revenues, was essentially unchanged at 38%. This comparison reflects the issues generating the year-to-year change in rental revenues discussed above. Field service costs continued to improve.

Gross profit on Funeral Services sales of \$264 million was up \$18 million, or 7%, in 1997. As a percentage of sales, it increased from 47% in 1996 to 48% in 1997, reflecting productivity improvements and leveraging of fixed manufacturing costs, partially offset by lower casket product mix.

Profit before other operating expenses in insurance operations increased \$19 million, or 51%, due to higher investment income (with minimal corresponding direct cost), profits earned on the larger base of policies in force, net gains on the sale of investments and continued control of direct administrative expenses. These items were partially offset by an increase in the crediting rate (the interest rate that Forethought uses to increase the face amount on insurance policies to have the benefit grow).

#### **Other Operating Expenses**

These expenses, consisting of selling, marketing, distribution and general administrative costs, increased \$40 million, or 9%, in 1997. As a percentage of consolidated revenues, they grew from 26% in 1996 to 27% in 1997. This growth

primarily reflected higher incentive compensation and commissions on improved operating performance and costs associated with product and market development efforts. Continued process improvements and cost control throughout the Company mitigated the effect of these increases.

#### **Operating Profit**

Operating profit in the Health Care Group increased \$23 million, or 21%, in 1997 due to higher shipments and profitability in Hill-Rom's U.S. markets, reduced operating losses in Europe and marginal growth in rental revenue and profits.

Operating profit in the Funeral Services Group of \$160 million was up \$16 million, or 11%, from 1996. At Batesville Casket, growth in sales and gross profit was partially offset by higher incentive compensation expense. Forethought's operating profit growth was driven primarily by higher investment income.

Consolidated operating profit of \$264 million increased \$28 million, or 12%. The growth in the Health Care and Funeral Services Groups was partially offset by higher corporate expenses.

#### **Other Income and Expense**

Interest expense was down slightly due to lower debt associated with European operations. Interest income increased due to higher levels of cash and equivalents, partially offset by lower interest earned on other investments. Other income, net, in 1996 included the \$3 million pre-tax gain on the sale of Block Medical.

#### **Income Taxes**

The effective income tax rate in 1997 declined marginally to 39.4% from 39.9% in 1996. Excluding the tax benefit of \$6 million on the book and tax differences in the basis of Block, the effective rate was 42.5% in 1996. The lower rate in 1997 was due primarily to reduced operating losses in Europe.

### **LIQUIDITY AND CAPITAL RESOURCES**

#### **Cash Flows**

Net cash flows from operating activities and selected borrowings represent the Company's primary sources of funds for growth of the business, including capital expenditures and acquisitions. Cash and cash equivalents (excluding investments of insurance operations) decreased \$67 million to \$297 million at the end of 1998.

#### **Operating Activities**

Net cash generated by operating activities of \$173 million in 1998 decreased compared to \$246 million in 1997. Higher earnings and an increase in depreciation, amortization and write-down of goodwill were offset by the gain from the sale of Medeco, due to the sale being a non-operating activity, and adverse changes in working capital.

The increase in depreciation, amortization and write-down of goodwill is due to the unusual charge of \$43 million to write-off the goodwill associated with the discontinuance of manufacturing facilities in Germany and Austria. The adverse changes in working capital are partially due to strong fourth quarter shipments at Hill-Rom and slower collections from Medicare intermediaries and insurance, which resulted in higher receivables. This also caused days revenues outstanding to increase to 84 in 1998 compared to 80 in 1997. Hill-Rom believes this trend is endemic to the industry and is aggressively managing these accounts.

Excluding the effect of acquisitions, current liabilities decreased mainly due to lower compensation accruals in 1998.

### Investing Activities

Net cash used in investing activities increased from \$339 million to \$446 million. This increase is primarily due to acquisitions made in 1998.

Forethought's insurance operation invests the cash proceeds from insurance premiums predominantly in U.S. treasuries and agencies and high-grade corporate bonds with fixed maturities. The Company's objective is to purchase investment securities with maturities that match the expected cash outflows of policy benefit payments. The investment portfolio is periodically realigned to better meet this objective, as reflected in the relatively large amount of sales prior to maturity. Sales prior to maturity in 1998 and 1997 resulted in net gains with 1996 reflecting essentially a breakeven position.

On December 31, 1998, subsequent to the end of fiscal year 1998, Forethought Life Insurance Company acquired the stock of Arkansas National Life Insurance Company for a cash payment of \$31 million.

### Financing Activities

The Company's long-term debt-to-equity ratio was 32% at year end 1998 compared with 23% at year end 1997. This increase was primarily due to the Company's issuance of \$100 million in debentures in December 1997 partially offset by the increase in equity during 1998. Payments on short-term debt were relative to European operations.

Quarterly cash dividends per share were \$.155 in 1996, \$.165 in 1997 and \$.18 in 1998. An additional increase to \$.195 per quarter was approved in January 1999.

In 1998, the Company repurchased 1,768,100 shares of its common stock at a cost of \$85 million.

### Insurance Assets and Liabilities

Insurance assets of \$2,833 million grew 13% over the past year. Cash and invested assets of \$2,204 million constitute 78% of the assets. The investments are concentrated in U.S. treasuries and agencies and high-grade corporate bonds.

The invested assets are more than adequate to fund the insurance reserves and other liabilities of \$1,886 million. Statutory reserves represent 61% of the face value of insurance in force. Forethought Life Insurance Company declared a \$14 million dividend to Hillenbrand Industries in the fourth quarter of 1998, paid in December 1998, and made \$12 million and \$11 million dividend payments in 1997 and 1996, respectively. The statutory capital and surplus as a percent of statutory liabilities of Forethought Life Insurance Company was 8% at December 31, 1998 and 1997. The non-current deferred tax benefit relative to insurance operations results from differences in recognition of insurance policy revenues and expenses for financial accounting and tax reporting purposes. Financial accounting rules require ratable recognition of insurance product revenues over the lives of the respective policyholder. These revenues are recognized in the year of policy issue for tax purposes. This results in a deferred tax benefit. Insurance policy acquisition expenses must be capitalized and amortized for both financial accounting and tax purposes, although under different methods and amounts. Financial accounting rules require a greater amount to be capitalized and amortized than for tax reporting. This results in a deferred tax cost, which partially offsets the deferred tax benefit. Excluding the tax effect of adjusting the investment portfolio to fair value, the net deferred tax benefit remained essentially unchanged in 1998, compared to a \$6 million increase in 1997.

### Shareholders' Equity

Cumulative treasury stock acquired in open market transactions increased to 15,067,167 shares in 1998, up from 13,299,067 shares in 1997. The Company currently has Board of Directors' authorization to repurchase up to a total of 19,289,067 shares. Repurchased shares are to be used for general business purposes. From the cumulative shares acquired, 16,050 shares, net of shares converted to cash to pay withholding taxes, were reissued in 1998 to individuals under the provisions of the Company's various stock-based compensation plans.

### Key Financial Data

	1998	1997	1996	1995	1994
<b>Income Statement</b>					
% Pretax, preinterest expense, income to revenues	16	16	15	12	11
% Net income to revenues	9	9	8	6	6
% Income taxes to pretax income	37	39	40	47	38
<b>Balance Sheet</b>					
% Long-term debt to total capital	24	19	21	22	23
% Total debt to total capital	29	24	28	26	26
Current assets/current liabilities (a)	2.3	2.3	2.2	2.1	2.2
Working capital turnover (a)	3.5	3.3	3.9	4.2	4.6
<b>Profitability</b>					
% Return on total capital	15	14	14	9	10
% Return on average shareholders' equity	21	20	19	13	13
<b>Asset Turnover</b>					
Revenues/inventories (a)	16.1	19.1	15.3	12.9	13.7
Revenues/receivables (a)	4.3	4.5	5.1	4.6	4.7
<b>Stock Market</b>					
Year-end price/earnings (P/E)	21	20	18	25	23
Year-end price/book value	4.1	3.4	3.3	3.1	3.0

(a) Excludes insurance operations.

## OTHER ISSUES

### Accounting Standards

Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income," was issued in June 1997. This standard requires that the Company disclose, either in the income statement or in a separate financial statement, net income as currently reported and other components of comprehensive income. Comprehensive income is defined as the change in shareholders' equity during a period resulting from transactions and other events and circumstances from non-owner sources. The Company is required to adopt this standard not later than the first quarter of 1999. Implementation of this standard will not affect the Company's financial position or results of operations.

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," was issued in June 1997. This standard defines segments of an enterprise as the components of the company whose operations are reviewed regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. It requires disclosures about products and services, geographic areas and major customers. The Company is required to adopt this standard not later than the issuance of its 1999 annual report. Implementation of this standard will not affect the Company's financial position or results of operations.

In February 1998, SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," was issued. This standard revises current disclosure requirements for employers' pensions and other retiree benefits. The Company is required to adopt this standard not later than the issuance of its 1999 annual report. Implementation of this standard will not affect the Company's financial position or results of operations.

The Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", in June 1998. This standard establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities and requires that all derivatives be recognized on the balance sheet at fair value. Changes in fair values of derivatives will be accounted for based upon their intended use and designation. Since the Company's holdings in such instruments are minimal, adoption of this standard is not expected to have a material effect on the financial statements. The Company is required to adopt the standard not later than the first quarter of fiscal 2000.

### Unusual Charges

On August 17, 1998, the Board of Directors of the Company approved a plan to restructure Hill-Rom's direct and support operations in Germany and Austria that will permit the Company to more efficiently meet the needs of its customers and improve profitability. Market demand has not met expectations and remains far below estimates established at the time the German and Austrian businesses were acquired in 1994. Changes in local market conditions, health care reform and increased competitive pressures have greatly extended the time required for the Company to achieve profitability and significantly reduced management's projections of future cash flows from operations in these countries.

Under this plan, the Company will reduce its fixed costs and align manufacturing, distribution, sales and administrative functions with anticipated demand. This alignment will result in the closing of manufacturing facilities in Germany and Austria and relocating certain manufacturing and business processes to other European locations. The Company will continue to serve and support the German and Austrian markets through a direct sales and service organization with products manufactured specifically for these markets by its other operations. Approximately 250 production and administrative employees are affected by this plan.

The restructuring plan necessitated the provision of a \$73 million asset impairment and restructuring charge in the third quarter. The non-cash component of this charge included a \$43 million write-off of German subsidiary goodwill, \$7 million for the write-down of property, plant and equipment held for sale and \$3 million for obsolete inventory resulting from the realignment of operations. Asset impairment charges were determined based upon projected cash flows, independent appraisals and market assessments for goodwill, land and buildings, and management estimates of losses to be incurred upon the disposition of surplus equipment and inventories. Property, plant and equipment to be disposed of have an adjusted fair market value of approximately \$4 million, not including costs of disposal, as of November 28, 1998. The restructuring plan also included additional charges for severance and employee benefit costs of \$11 million and other estimated plant closing costs of \$9 million which includes legal, lease and contract termination, warranty, environmental, purchase commitment and related shutdown costs. None of these individual cost categories are material relative to the total. In addition to the costs accrued under the plan, additional costs of an estimated \$4 million will be incurred to relocate certain manufacturing and business processes to other European locations. These costs will be expensed as incurred as required by generally accepted accounting principles.

As of November 28, 1998, the German and Austrian manufacturing facilities were still in operation, with depreciation expense on assets to be sold reflected for the full fiscal year. In the fourth quarter, changes in the estimates of costs to be incurred under the plan reduced the overall level of the asset impairment and restructuring charge recorded in the third quarter by \$3.5 million. With the exception of the write-down in inventory, which is reflected as a component of Health Care cost of goods sold, the remaining charge is classified within the separate Unusual charge line of the Statement of Consolidated Income. As of the end of the year less than \$1 million of the restructuring related costs had been paid. In December 1998, manufacturing operations were discontinued in Germany. The Austrian manufacturing operations are expected to be discontinued in the second quarter of 1999. Substantially all employee related costs associated with the restructuring are expected to be paid in fiscal 1999. The disposition of property, plant and equipment, along with excess and discontinued inventories, is targeted to be completed within the next twelve months, but could take longer.

## Environmental Matters

Hillenbrand Industries is committed to operating all of its businesses in a way that protects the environment. The Company has voluntarily entered into remediation agreements with environmental authorities, and has been issued Notices of Violation alleging violations of certain permit conditions. Accordingly, the Company is in the process of implementing plans of abatement in compliance with agreements and regulations. The Company has also been notified as a potentially responsible party in investigations of certain offsite disposal facilities. The cost of all plans of abatement and waste-site cleanups in which the Company is currently involved is not expected to exceed \$5 million. The Company has provided adequate reserves in its financial statements for these matters. These reserves have been determined without consideration of possible loss recoveries from third parties. Compliance with other current governmental provisions relating to protection of the environment are not expected to materially affect the Company's capital expenditures, earnings or competitive position. Recent changes in environmental law might affect the Company's future operations, capital expenditures and earnings. The cost of complying with these provisions is not known.

## Factors that May Affect Future Results

New legislation phased in beginning July 1, 1998 established Resource Utilization Groups for Medicare Part A patients within long-term care facilities. Reimbursement will now be on a prospective fee basis as opposed to the previous cost plus basis. This change will have a dampening effect on the Company's rental revenues in the long-term care market. Restructuring and reform in the health care industry, including consolidation of providers and payers, growth of managed care and expansion of the home care and long-term care markets, continues. Growth in the Company's acute care capital markets has improved dramatically over the past three years and the order pattern entering the first quarter of 1999 remains strong. While continued growth is not a certainty, the Company believes that its innovative products and services designed to improve patient outcomes and reduce total delivery cost, will enable it to maintain its leadership role in this and the other markets it serves.

The market for casketed deaths is expected to remain flat for the foreseeable future. Batesville Casket has been able to increase its share of this market, as well as the growing cremation market, by providing innovative products and marketing programs for its funeral director customers.

While Forethought's growth has slowed as its entry into targeted jurisdictions winds down, it will work to maintain and strengthen its leadership position in the life insurance-based funeral planning market through on-going product enhancements. Its entry into the trust-based funeral planning market is not expected to have a material effect on the Company's financial results for the next several years.

## Year 2000 Date Conversion

Many existing computer programs use only two digits to identify years. These programs were designed without consideration for the affect of the upcoming change in century, and if not corrected, could fail or create erroneous results by or at the year 2000. Essentially all of the Company's information technology based systems, as well as many non-information technology based systems, are potentially affected by the Year 2000 issue. Technology

based systems reside on mainframes, servers and personal computers in the U.S. and in the foreign countries where the Company has operations. Specific systems include accounting, payroll, financial reporting, product development, inventory tracking and control, business planning, tax, accounts receivable, accounts payable, purchasing, distribution, and numerous word processing and spreadsheet applications. The Company's financial services business utilizes life insurance, accounting and actuarial systems that are also affected. Non-information technology based systems include equipment and services containing imbedded microprocessors, such as building management systems, manufacturing process control systems, clocks, security systems and products sold or leased to customers. All of the Company's businesses have relationships with numerous third parties, including material suppliers, utility companies, transportation companies, insurance companies, banks and brokerage firms, that may be affected by the Year 2000 issue.

## The Company's State of Readiness

Remediation plans have been established for all major systems potentially affected by the Year 2000 issue. The primary phases and current status of the plans for information technology based systems are summarized as follows:

1. *Identification of all applications and hardware with potential Year 2000 issues.* To the best of the Company's knowledge, this phase has been completed.
2. *For each item identified, perform an assessment to determine an appropriate action plan and timetable for remediation of each item. A plan may consist of replacement, code remediation, upgrade or elimination of the application and includes resource requirements.* This phase has been completed with the exception of certain systems in Hill-Rom's recently acquired operations and a small business unit within Hill-Rom, which should be complete in the first quarter of 1999.
3. *Implementation of the specific action plan.* Specific action plans have been started and should be completed for nearly all known mission-critical systems as of the end of the first quarter of 1999. Action plans for remaining systems should begin by the second quarter of 1999.
4. *Test each application upon completion.* Testing is in process or has been completed for all systems for which the remediation plan has been completed. Testing of the remaining systems should be completed by the third quarter of 1999.
5. *Place the new process into production.* Many applications and systems have been put into production. These include servers, personal computers and various software programs. Applications and systems are being put into production once they have been tested. All affected applications and systems should be in production by the third quarter of 1999 with the exception of certain systems in Hill-Rom's European operations which should be placed into production by the fourth quarter of 1999.

The Company is in the process of identifying all non-information technology based systems. Appropriate remediation plans are being developed, implemented and tested when each affected system is identified. Identification should be completed by the end of the first quarter of 1999, and plans should be developed and implemented by the end of the third quarter of 1999.

The Company is in the process of identifying all products sold or leased to customers which are affected by the Year 2000 issue. Once a Year 2000 affected product is identified, remediation plans are developed, implemented and tested, if deemed appropriate. A product listing is available to customers on the Company's Hill-Rom web page depicting Year 2000 compliance ([www.hill-rom.com](http://www.hill-rom.com)). Assessment of all affected products should be completed by the end of the first quarter of 1999, and corrective actions, if required, should be completed by the end of the third quarter of 1999.

One small subsidiary, Narco Medical Services, Inc., distributes medical devices manufactured by third parties. Each supplier has been surveyed to determine its readiness. Customers have been referred to manufacturers for Year 2000 readiness information. Contingency plans are being developed to address any resulting issues.

Identification of areas of potential third party risk is nearly complete and, for those areas identified to date, remediation plans are being developed. Identification and assessment should be completed in the first quarter of 1999, and plans should be developed and implemented by the end of the third quarter of 1999.

#### ***The Costs Involved***

The total cost to the Company of achieving Year 2000 compliance is not expected to exceed \$7 million and will consist primarily of the utilization of internal resources. Spending to date totals approximately \$3.5 million. Costs relating to internal systems' Year 2000 compliance are included in the Information Systems budget and are immaterial as a percentage of that budget. All costs related to achieving Year 2000 compliance are based on management's best estimates. There can be no guarantee that actual results will not differ from estimates.

#### ***Risks and Contingency Plan***

The Company is in the process of determining the risks it would face in the event certain aspects of its Year 2000 remediation plan failed. It is also developing contingency plans for all mission-critical processes. Under a "worse case" scenario, the Company's manufacturing operations would be unable to build and deliver product due to internal system failures and/or the inability of vendors to deliver raw materials and components. Alternative suppliers are being identified and inventory levels of certain key components may be temporarily increased. While virtually all internal systems can be replaced with manual systems on a temporary basis, the failure of any mission-critical system will have at least a short-term negative effect on operations. The failure of national and worldwide banking information systems or the loss of essential utilities services due to the Year 2000 issue could result in the inability of many businesses, including the Company, to conduct business. Risk assessment should be completed by the end of the first quarter and contingency plans should be completed in the third quarter.

## **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company is exposed to various market risks, including fluctuations in interest rates, mismatches in funding obligations and receipts and variability in currency exchange rates. The Company has established policies, procedures and internal processes governing its management of market risks and the use of financial instruments to manage its exposure to such risks.

The Company's insurance operation is subject to fluctuations in interest rates on its investment portfolio and, to a lesser extent, prepayment and equity pricing risks. The investment portfolio is concentrated in high-grade corporate bonds and U.S. agencies and treasuries with predominantly fixed interest rates. The portfolio is managed in accordance with the Company's objective to substantially match investment durations with policy liability durations and within applicable insurance industry regulations. Investments may be liquidated prior to maturity in order to meet the matching objective and manage fluctuations in interest rates and prepayments. They are, accordingly, classified as "available for sale" and are not purchased for trading purposes. The Company uses various techniques, including duration analysis, to assess the sensitivity of the investment portfolio to interest rate fluctuations, prepayment activity, equity price changes and other risks. The insurance operation also performs and reports results for asset adequacy analysis as required by the National Association of Insurance Commissioners. Based on the duration of the investment portfolio at November 28, 1998 and November 29, 1997, a hypothetical 10% increase in weighted average interest rates could reduce the market value of the investment portfolio approximately \$77 and \$76 million, respectively, over a twelve-month period. The Company believes its investment policy minimizes the risk of adverse fluctuation in surplus value. In addition, the long-term fixed nature of portfolio assets reduces the effect of short-term interest rate fluctuations on earnings.

The Company is subject to variability in foreign currency exchange rates primarily in its European operations. Exposure to this variability is managed primarily through the use of natural hedges, whereby funding obligations and assets are both managed in the local currency. The Company, from time to time, enters into currency exchange agreements to manage its exposure arising from fluctuating exchange rates related to specific transactions. The sensitivity of earnings and cash flows to variability in exchange rates is assessed by applying an appropriate range of potential rate fluctuations to the Company's assets, obligations and projected results of operations denominated in foreign currencies. Based on the Company's overall currency rate exposure at November 28, 1998, movements in currency rates would not materially affect the financial position of the Company.

# STATEMENTS OF CONSOLIDATED INCOME

HILLENBRAND INDUSTRIES, INC. AND SUBSIDIARIES

(Dollars in millions except per share data)

Year Ended	November 28, 1998	November 29, 1997	November 30, 1996
<b>Net Revenues</b>			
Health Care sales	\$ 748	\$ 588	\$ 568
Health Care rentals	403	378	373
Funeral Services sales	541	545	524
Insurance revenues	309	265	219
Total revenues	2,001	1,776	1,684
<b>Cost of Revenues</b>			
Health Care cost of goods sold	428	322	334
Health Care rental expenses	241	235	233
Funeral Services cost of goods sold	281	281	278
Insurance cost of revenues	217	193	162
Total cost of revenues	1,167	1,031	1,007
Other operating expenses	540	481	441
Unusual charges (Note 4)	(66)	—	—
<b>Operating Profit</b>	228	264	236
Other income (expense), net:			
Interest expense	(27)	(21)	(22)
Investment income, net	19	18	17
Other (Note 3)	73	(2)	2
<b>Income Before Income Taxes</b>	293	259	233
Income taxes	109	102	93
<b>Net Income</b>	\$ 184	\$ 157	\$ 140
<b>Basic and Diluted Net Income per Common Share</b>	\$ 2.73	\$ 2.28	\$ 2.02
<b>Dividends per Common Share</b>	\$ .72	\$ .66	\$ .62
<b>Average Number of Common Shares Outstanding</b>	67,577,803	68,796,439	69,474,266

See Notes to Consolidated Financial Statements.

# CONSOLIDATED BALANCE SHEET

HILLENBRAND INDUSTRIES, INC. AND SUBSIDIARIES

(Dollars in millions)

	November 28, 1998	November 29, 1997
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 297	\$ 364
Trade accounts receivable, less allowances of \$27 in 1998 and \$25 in 1997	392	333
Inventories	105	79
Other	64	45
Total current assets	858	821
<b>Equipment Leased to Others</b>	288	280
Less accumulated depreciation	207	189
Equipment leased to others, net	81	91
<b>Property</b>	632	651
Less accumulated depreciation	411	413
Property, net	221	238
<b>Other Assets</b>		
Intangible assets at amortized cost:		
Patents and trademarks	20	19
Excess of cost over net asset values of acquired companies (Note 2)	164	96
Other	14	11
Deferred charges and other assets	89	51
Total other assets	287	177
<b>Insurance Assets (Note 12)</b>		
Investments	2,204	1,934
Deferred acquisition costs	536	473
Deferred income taxes	34	43
Other	59	51
Total insurance assets	2,833	2,501
<b>Total Assets</b>	\$ 4,280	\$ 3,828

	November 28, 1998	November 29, 1997
<b>LIABILITIES</b>		
<b>Current Liabilities</b>		
Short-term debt (Notes 5 and 8)	\$ 60	\$ 60
Current portion of long-term debt (Notes 5 and 8)	1	1
Trade accounts payable	69	71
Income taxes payable (Note 10)	27	27
Accrued compensation	73	63
Other	145	137
Total current liabilities	375	359
<b>Long-Term Debt (Notes 5 and 8)</b>	<b>303</b>	<b>203</b>
<b>Other Long-Term Liabilities (Note 6)</b>	<b>86</b>	<b>75</b>
<b>Deferred Income Taxes (Notes 1 and 10)</b>	<b>4</b>	<b>7</b>
<b>Insurance Liabilities (Note 12)</b>		
Benefit reserves	1,856	1,667
Unearned revenue	674	605
General liabilities	30	26
Total insurance liabilities	2,560	2,298
<b>Total Liabilities</b>	<b>3,328</b>	<b>2,942</b>
<b>Commitments and Contingencies (Note 14)</b>		
<b>SHAREHOLDERS' EQUITY (Notes 6 and 7)</b>		
Common stock — without par value:		
Authorized — 199,000,000 shares		
Issued — 80,323,912 shares in 1998 and 1997	4	4
Additional paid-in capital	15	14
Retained earnings (Note 5)	1,221	1,085
Accumulated unrealized gain on investments	52	34
Foreign currency translation adjustment	(7)	(3)
Treasury stock, at cost: 1998 — 13,564,793 shares; 1997 — 11,812,743 shares	(333)	(248)
<b>Total Shareholders' Equity</b>	<b>952</b>	<b>886</b>
<b>Total Liabilities and Shareholders' Equity</b>	<b>\$ 4,280</b>	<b>\$ 3,828</b>

See Notes to Consolidated Financial Statements.

# STATEMENTS OF CONSOLIDATED CASH FLOWS

HILLENBRAND INDUSTRIES, INC. AND SUBSIDIARIES

(Dollars in millions)

Year Ended	November 28, 1998	November 29, 1997	November 30, 1996
<b>Operating Activities</b>			
Net income	\$ 184	\$ 157	\$ 140
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation, amortization and write-down of goodwill	149	102	99
Change in noncurrent deferred income taxes	(3)	(12)	(6)
Gain on sale of business	(75)	—	(3)
Change in working capital excluding cash, current debt, acquisitions and dispositions:			
Trade accounts receivable	(36)	(46)	24
Inventories	(2)	17	15
Other current assets	2	—	(1)
Trade accounts payable	(12)	21	(21)
Accrued expenses and other liabilities	(14)	32	5
Change in insurance deferred policy acquisition costs	(63)	(67)	(67)
Change in other insurance items, net	48	35	40
Other, net	(5)	7	15
Net cash provided by operating activities	173	246	240
<b>Investing Activities</b>			
Capital expenditures	(88)	(85)	(92)
Proceeds on disposal of fixed assets and equipment leased to others	10	1	2
Acquisitions of businesses, net of cash acquired	(188)	—	(6)
Other investments	(11)	(4)	(3)
Proceeds on sale of business	64	—	15
Insurance investments:			
Purchases	(746)	(721)	(437)
Proceeds on maturities	168	112	78
Proceeds on sales	345	358	126
Net cash used in investing activities	(446)	(339)	(317)
<b>Financing Activities</b>			
Additions to short-term debt	39	10	119
Reductions to short-term debt	(13)	(15)	(81)
Additions to long-term debt	101	—	—
Reductions to long-term debt	(1)	(2)	(3)
Payment of cash dividends	(48)	(45)	(43)
Treasury stock acquired	(85)	(13)	(51)
Insurance premiums received	495	514	459
Insurance benefits paid	(282)	(256)	(227)
Net cash provided by financing activities	206	193	173
Effect of Exchange Rate Changes on Cash	—	(2)	(1)
<b>Total Cash Flows</b>	(67)	98	95
<b>Cash and Cash Equivalents</b>			
At beginning of year	364	266	171
At end of year	\$ 297	\$ 364	\$ 266

See Notes to Consolidated Financial Statements.

# STATEMENTS OF CONSOLIDATED SHAREHOLDERS' EQUITY

HILLENBRAND INDUSTRIES, INC. AND SUBSIDIARIES

(Dollars in millions)

Year Ended	November 28, 1998	November 29, 1997	November 30, 1996
<b>Common Stock</b>	\$ 4	\$ 4	\$ 4
<b>Additional Paid-in Capital</b>			
Beginning of year	14	14	14
Fair market value over cost on reissuance of treasury shares (1998 — 16,050; 1997 — 15,284; 1996 — 33,996)	1	—	—
Other	—	—	—
End of year	15	14	14
<b>Retained Earnings</b>			
Beginning of year	1,085	973	876
Net income	184	157	140
Dividends	(48)	(45)	(43)
End of year	1,221	1,085	973
<b>Accumulated Unrealized Gain on Investments</b>			
Beginning of year	34	21	23
Net unrealized holding gain (loss)	18	13	(2)
End of year	52	34	21
<b>Foreign Currency Translation Adjustment</b>			
Beginning of year	(3)	10	14
Translation adjustment	(4)	(13)	(4)
End of year	(7)	(3)	10
<b>Treasury Stock</b>			
Beginning of year	(248)	(235)	(185)
Shares acquired (1998 — 1,768,100; 1997 — 290,395; 1996 — 1,425,100)	(85)	(13)	(51)
Shares reissued	—	—	1
End of year	(333)	(248)	(235)
<b>Total Shareholders' Equity</b>	\$ 952	\$ 886	\$ 787

See Notes to Consolidated Financial Statements.

# NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

HILLENBRAND INDUSTRIES, INC. AND SUBSIDIARIES

(Dollars in millions except per share data)

## 1. Summary of Significant Accounting Policies

Accounting policies specific to insurance operations are summarized in Note 12.

### Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries, except for several small subsidiaries which provide ancillary services to the Company and the public. These subsidiaries are not consolidated because of their materiality and are accounted for by the equity method. Their results of operations appear in the income statement, net of income taxes, under the caption "Other income (expense), net." Material intercompany accounts and transactions have been eliminated in consolidation.

The Company's fiscal year is the 52 or 53 week period ending the Saturday nearest November 30.

### Nature of Operations

Hillenbrand Industries is organized into two segments — the Health Care Group and the Funeral Services Group. The Health Care Group consists of Hill-Rom, Block Medical and Medeco Security Locks were included in this segment prior to their sale in 1996 and 1998, respectively. Hill-Rom is a leading manufacturer of patient care products and leading provider of specialized rental therapy products designed to assist in managing the complications of patient immobility. Its products and services are marketed to acute and long-term health care facilities and home care patients primarily in North America and Europe. The Health Care segment generated 58% of Hillenbrand's revenues in 1998. The Funeral Services Group consists of Batesville Casket Company and Forethought Financial Services (Forethought). Batesville Casket Company is a leading producer of protective metal and hardwood burial caskets, cremation urns and caskets and marketing support services. Its products are marketed to licensed funeral directors operating licensed funeral homes primarily in North America. Batesville generated 27% of Hillenbrand's revenues in 1998. Forethought provides funeral homes in 42 U.S. states, the District of Columbia, Puerto Rico and six Canadian provinces with life insurance policies and marketing support for preneed, inflation-protected funeral planning. It entered the preneed trust market in 1997. Forethought generated 15% of Hillenbrand's revenues in 1998.

### Use of 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 certain assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expense during the reporting period. Actual results could differ from those estimates.

### Cash and Cash Equivalents

The Company considers investments in marketable securities and other highly liquid instruments with a maturity of three months or less at date of purchase to be cash equivalents.

### Inventories

Inventories are valued at the lower of cost or market. Inventory costs are determined by the last-in, first-out (LIFO) method for approximately 56% and 71% of the Company's inventories at November 28, 1998 and November 29, 1997, respectively. The decline in the percentage of inventories on LIFO is related to the acquisitions completed in the current year (see Note 2). Costs for other inventories have been determined principally by the

first-in, first-out (FIFO) method. Inventories at November 28 consist of the following:

	1998	1997
Finished Products	\$ 58	\$44
Work in Process	32	24
Raw Materials	15	11
Total	\$105	\$79

If the FIFO method of inventory accounting, which approximates current cost, had been used for all inventories, they would have been approximately \$9 million and \$10 million higher than reported at November 28, 1998 and November 29, 1997, respectively.

### Equipment Leased to Others

Equipment leased to others primarily represents therapy rental units, which are recorded at cost and depreciated on a straight-line basis over their estimated economic life. The majority of these units are leased on a day-to-day basis.

### Property

Property is recorded at cost and depreciated over the estimated useful life of the assets using principally the straight-line method for financial reporting purposes. Generally, when property is retired from service or otherwise disposed of, the cost and related amount of depreciation or amortization are eliminated from the asset and reserve accounts, respectively. The difference, if any, between the net asset value and the proceeds is charged or credited to income. The major components of property at the end of 1998 and 1997 were:

	1998	1997
Land	\$ 18	\$ 22
Buildings and building equipment	142	144
Machinery and equipment	472	485
Total	\$632	\$651

### Intangible and Other Non-current Assets

Intangible assets are stated at cost and amortized on a straight-line basis over periods ranging from 3 to 40 years. The Company reviews goodwill and other non-current assets for impairment whenever events or changes in circumstances indicate that the carrying value may not be recoverable. If the undiscounted expected future cash flows from use of the asset are less than the carrying value, an impairment loss is recognized. The amount of the impairment loss is determined by comparing the discounted expected future cash flows with the carrying value.

Goodwill related to Hill-Rom's German subsidiary was written off in the third quarter of 1998 resulting in a \$43 million charge. See Note 4 for additional information.

Accumulated amortization of intangible assets was \$150 million and \$156 million as of November 28, 1998, and November 29, 1997, respectively.

### Environmental Liabilities

Expenditures that relate to an existing condition caused by past operations, and which do not contribute to current or future revenue generation, are expensed. A reserve is established when it is probable that a liability has been incurred and the amount of the loss can be reasonably estimated. These reserves are determined without consideration of possible loss recoveries from

third parties. More specifically, each quarter, financial management, in consultation with its environmental engineer, estimates the range of liability based on current interpretation of environmental laws and regulations. For each site in which a Company unit is involved, a determination is made of the specific measures that are believed to be required to remediate the site, the estimated total cost to carry out the remediation plan and the periods in which the Company will make payments toward the remediation plan. The Company does not make an estimate of general or specific inflation for environmental matters since the number of sites is small, the magnitude of costs to execute remediation plans are not significant and the estimated time frames to remediate sites are not believed to be lengthy.

Specific costs included in environmental expense are site assessment, development of a remediation plan, clean-up costs, post-remediation expenditures, monitoring, fines, penalties and legal fees. The reserve represents the expected undiscounted future cash outflows.

Expenditures that relate to current operations are charged to expense.

### Revenue Recognition

Sales are recognized upon shipment of products to customers. Rental revenues are recognized when services are rendered.

### Cost of Revenues

Health Care and Funeral Services cost of goods sold consist primarily of purchased material costs, fixed manufacturing expense, and variable direct labor and overhead costs. Health Care rental expenses are those costs associated directly with rental revenue, including depreciation and service of the Company's therapy rental units, service center facility and personnel costs, and regional sales expenses.

### Earnings Per Common Share

The Company adopted SFAS No. 128, "Earnings per Share," in the first quarter of 1998. SFAS No. 128 requires disclosure of basic and diluted earnings per share in place of primary and fully diluted earnings per share as required by APB No. 15. Basic earnings per share is calculated based upon weighted-average number of outstanding common shares for the period. Diluted earnings per share is calculated based upon weighted-average number of outstanding common shares, plus the effect of dilutive stock options.

### Stock-Based Compensation

The Financial Accounting Standards Board issued SFAS No. 123, "Accounting for Stock-Based Compensation" in October 1995. SFAS No. 123 encourages companies to adopt a fair value approach to valuing stock-based compensation that would require compensation cost to be recognized based on the fair value of the stock-based instrument granted. The Company has elected, as permitted by the standard, to continue to follow its intrinsic value based method of accounting for its stock-based compensation plans consistent with the provisions of APB No. 25. Under the intrinsic method, compensation cost for stock-based compensation is measured as the excess, if any, of the quoted market price of the instrument at the measurement date over the exercise price. The Company has provided the pro forma disclosure provisions of SFAS No. 123 in Note 6.

### Retirement Plans

The Company and its subsidiaries have several defined benefit retirement plans covering the majority of employees, including certain employees in foreign countries. The Company contributes funds to trusts as necessary to provide for current service and for any unfunded projected future benefit obligation over a reasonable period. The benefits for these plans are based primarily on years of service and the employee's level of compensation during specific periods of employment.

The components of net pension expense in the United States are as follows:

	1998	1997	1996
Service expense-benefits earned during the year	\$ 8	\$ 8	\$ 7
Interest expense on projected benefit obligation	10	9	8
Actual return on plan assets	(16)	(10)	(7)
Net amortization and deferral	6	—	(1)
Net pension expense	\$ 8	\$ 7	\$ 7

The funded status of plans in the United States is shown in the table below:

	November 28, 1998	November 29, 1997
Actuarial present value of benefit obligations:		
Accumulated benefit obligation, including vested benefits of \$98 in 1998 and \$85 in 1997	\$(104)	\$ (91)
Projected benefit obligation for service rendered to date	\$(161)	\$(135)
Plan assets at fair value, primarily U.S. Government obligations, corporate bonds and notes, and common stock issued by the Company. The value of this common stock at date of acquisition by the plans was \$3 and the current market value was \$26 in 1998 and \$20 in 1997.	144	124
Plan assets less than projected benefit obligation	(17)	(11)
Unrecognized net gain from past experience different from that assumed	(10)	(15)
Unrecognized prior service cost	3	2
Unrecognized net asset at year-end being recognized over 14 to 22 years from the initial compliance date of December 1, 1985	(1)	(1)
Unfunded accrued expenses included in liabilities	\$ (25)	\$ (25)

The assumptions used in accounting for the domestic plans are as follows:

	1998	1997	1996
Discount rate used to determine the projected benefit obligation	7.25%	7.5%	7.5%
Rate of increase in future compensation levels used to determine the projected benefit obligation	5.5%	5.5%	5.5%
Expected long-term rate of return on assets used to determine net periodic pension cost	8.0%	8.0%	8.0%

In addition to the above plans, the Company assumed the unfunded liabilities of a defined benefit plan in the acquisition of Arnold in 1994. The unfunded accumulated benefit obligation of this plan, included in accrued expenses, was \$11 million on November 28, 1998 and November 29, 1997 and \$13 million on November 30, 1996. Pension expense was negligible in 1998 and was \$1 million in 1997 and 1996.

The Company also sponsors several defined contribution plans covering certain of its employees. Employer contributions are made to these plans based on a percentage of employee compensation. The cost of these defined contribution plans was \$6 million in 1998 and \$5 million in 1997 and 1996.

### **Income Taxes**

The Company and its eligible domestic subsidiaries file a consolidated U.S. income tax return. Foreign operations file income tax returns in a number of jurisdictions. Deferred income taxes are computed in accordance with SFAS No. 109, "Accounting for Income Taxes." Deferred income taxes reflect the net tax effects of temporary differences between the financial reporting carrying amounts of assets and liabilities and the income tax amounts.

### **Foreign Currency Translation**

Assets and liabilities of foreign operations are primarily translated into U.S. dollars at year-end rates of exchange and the income statements are translated at the average rates of exchange prevailing during the year. Adjustments resulting from translation of the financial statements of foreign operations into U.S. dollars are excluded from the determination of net income and included as a separate caption in shareholders' equity. Foreign currency gains and losses resulting from foreign currency transactions are included in results of operations and are not material.

### **Accounting Standards**

Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income," was issued in June 1997. This standard requires that the Company disclose, either in the income statement or in a separate financial statement, net income as currently reported and other components of comprehensive income. Comprehensive income is defined as the change in shareholders' equity during a period resulting from transactions and other events and circumstances from non-owner sources. The Company is required to adopt this standard not later than the first quarter of 1999. Implementation of this standard will not affect the Company's financial position or results of operations.

SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," was issued in June 1997. This standard defines segments of an enterprise as the components of the company whose operations are reviewed regularly by the chief operating decision-maker in deciding how to allocate resources and in assessing performance. It requires disclosures about products and services, geographic areas and major customers. The Company is required to adopt this standard not later than the issuance of its 1999 annual report. Implementation of this standard will not affect the Company's financial position or results of operations.

In February 1998, SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," was issued. This standard revises current disclosure requirements for employers' pensions and other retiree benefits. The Company is required to adopt this standard not later than the issuance of its 1999 annual report. Implementation of this standard will not affect the Company's financial position or results of operations.

The Financial Accounting Standards Board issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities", in June 1998. This standard establishes accounting

and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities and requires that all derivatives be recognized on the balance sheet at fair value. Changes in fair values of derivatives will be accounted for based upon their intended use and designation. Since the Company's holdings in such instruments are minimal, adoption of this standard is not expected to have a material effect on the financial statements. The Company is required to adopt the standard not later than the first quarter of fiscal 2000.

## **2. Acquisitions**

On December 18, 1997, Hill-Rom acquired the stock of Air-Shields, Inc., a manufacturer and supplier of infant incubators and warmers, and certain other businesses of Vickers PLC for \$98 million, net of cash acquired and including costs of acquisition, and the assumption of certain liabilities totaling \$29 million. This acquisition has been accounted for as a purchase, and the results of the operations of the acquired business have been included in the consolidated financial statements since the date of acquisition. The excess of the purchase price over the fair value of net assets acquired was approximately \$68 million and has been recorded as goodwill which is being amortized on a straight-line basis over 20 years. Hill-Rom is continuing to negotiate the final purchase price for this acquisition with the seller, which when resolved, is expected to result in a reduction of goodwill.

On February 9, 1998, Hill-Rom acquired the stock of MED-ES Holdings, Inc., a manufacturer of medical architectural systems for \$62 million including costs of acquisition and the assumption of certain liabilities totaling \$17 million. This acquisition was accounted for as a purchase, and the results of operations have been included in the consolidated financial statements since the date of acquisition. The excess of the purchase price over the fair value of net assets acquired was approximately \$51 million and has been recorded as goodwill which is being amortized on a straight-line basis over 20 years.

On June 4, 1998, Forethought Financial Services purchased Chrysler Life Insurance Company, for approximately \$14 million, including costs of acquisition. This acquisition has been accounted for as a purchase, and the results of operations of the acquired business have been included in the consolidated financial statements since the acquisition date. The excess of the purchase price over the fair value of net assets acquired, which were primarily state insurance licenses, was approximately \$4 million which is being amortized on a straight-line basis over 40 years.

Hill-Rom, Batesville Casket and the Company each acquired one small company during 1998 in addition to those outlined above. The combined purchase price of these companies was approximately \$14 million, net of cash acquired.

Assuming all fiscal 1998 acquisitions had occurred December 1, 1996, unaudited fiscal 1997 pro forma consolidated net revenue would have increased by approximately \$150 million, and net income and earnings per share would have decreased by less than 5%. Unaudited fiscal 1998 pro forma revenue, net income and earnings per share would not have been materially different from reported amounts. Such unaudited consolidated pro forma information is not necessarily indicative of the combined results that would have occurred had the acquisitions taken place on those dates, nor is it indicative of the results that may occur in the future.

In 1996, the Company's subsidiaries, Batesville Casket and Hill-Rom, each acquired two small companies. The combined purchase price was \$6 million.

Acquisitions occurring subsequent to November 28, 1998 are discussed in Note 15.

### 3. Disposition

On July 1, 1998, the Company sold its high security and access control business, Medeco Security Locks, Incorporated, to Assa Abloy AB. The Company recorded an after tax gain of approximately \$47 million in the third quarter. Results for Medeco were included in the Health Care Group through the date of disposition and did not have a material effect on the results of that group or the Company's consolidated earnings, cash flows and financial position. The gain on the sale of Medeco is classified within the Other line under Other income (expense), net in the Statement of Consolidated Income.

On July 22, 1996, the Company sold the assets of Block Medical for cash and stock totaling \$17 million. The Company recorded a gain on the sale of \$3 million (\$2 million after income taxes) and a related income tax benefit of approximately \$6 million realized from book and tax differences in the basis of the business.

### 4. Unusual Charges

On August 17, 1998, the Board of Directors of the Company approved a plan to restructure Hill-Rom's direct and support operations in Germany and Austria that will permit the Company to more efficiently meet the needs of its customers and improve profitability. Market demand has not met expectations and remains far below estimates established at the time the German and Austrian businesses were acquired in 1994. Changes in local market conditions, health care reform and increased competitive pressures have greatly extended the time required for the Company to achieve profitability and significantly reduced management's projections of future cash flows from operations in these countries.

Under this plan, the Company will reduce its fixed costs and align manufacturing, distribution, sales and administrative functions with anticipated demand. This alignment will result in the closing of manufacturing facilities in Germany and Austria and relocating certain manufacturing and business processes to other European locations. The Company will continue to serve and support the German and Austrian markets through a direct sales and service organization with products manufactured specifically for these markets by its other operations. Approximately 250 production and administrative employees are affected by this plan.

The restructuring plan necessitated the provision of a \$73 million asset impairment and restructuring charge in the third quarter. The non-cash component of this charge included a \$43 million write-off of German subsidiary goodwill, \$7 million for the write-down of property, plant and equipment held for sale and \$3 million for obsolete inventory resulting from the realignment of operations. Asset impairment charges were determined based upon projected cash flows, independent appraisals and market assessments for goodwill, land and buildings, and management estimates of losses to be incurred upon the disposition of surplus equipment and inventories. Property, plant and equipment to be disposed of have an adjusted fair market value of approximately \$4 million, not including costs of disposal, as of November 28, 1998. The restructuring plan also included additional charges for severance and employee benefit costs of \$11 million and other estimated plant closing costs of \$9 million which includes legal, lease and contract termination, warranty, environmental, purchase commitment and related shutdown costs. None of these individual cost categories are material relative to the total. In addition to the costs accrued under the plan, additional costs of an estimated \$4 million will be incurred to relocate certain manufacturing and business processes to other European locations. These costs will be expensed as incurred as required by generally accepted accounting principles.

As of November 28, 1998, the German and Austrian manufacturing facilities were still in operation, with depreciation

expense on assets to be sold reflected for the full fiscal year. In the fourth quarter, changes in the estimates of costs to be incurred under the plan reduced the overall level of the asset impairment and restructuring charge recorded in the third quarter by \$3.5 million. With the exception of the write-down in inventory, which is reflected as a component of Health Care cost of goods sold, the remaining charge is classified within the separate Unusual charge line of the Statement of Consolidated Income. As of the end of the year less than \$1 million of the restructuring related costs had been paid. In December 1998, manufacturing operations were discontinued in Germany. The Austrian manufacturing operations are expected to be discontinued in the second quarter of 1999. Substantially all employee related costs associated with the restructuring are expected to be paid in fiscal 1999. The disposition of property, plant and equipment, along with excess and discontinued inventories, is targeted to be completed within the next twelve months, but could take longer.

### 5. Financing Agreements

The Company's various financing agreements contain no restrictive provisions or conditions relating to dividend payments, working capital or additional indebtedness.

Long-term debt consists of the following:

	November 28, 1998	November 29, 1997
Unsecured 8½% debentures due on December 1, 2011	\$100	\$100
Unsecured 7% debentures due on February 15, 2024	100	100
Unsecured 6¾% debentures due on December 15, 2027	100	—
Government sponsored bond with an interest rate of 5.0% and maturities to 2008	2	2
Other	2	2
Total	304	204
Less current portion	1	1
Total long-term debt	\$303	\$203

Scheduled payments on long-term debt as of November 28, 1998 total less than \$1 million in each of the years 1999 through 2003.

Short-term debt consists of borrowings under various lines of credit maintained for foreign subsidiaries. The weighted average interest rate on all short-term borrowings outstanding as of November 28, 1998 and November 29, 1997 was approximately 4.0%.

At November 28, 1998, the Company had uncommitted credit lines totaling \$93 million available for its operations. These agreements have no commitment fees, compensating balance requirements or fixed expiration dates.

### 6. Stock-Based Compensation

At November 28, 1998, the Company has three active stock-based compensation plans; the Senior Executive Compensation Program, the Performance Compensation Plan, and the 1996 Stock Option Plan, which are described below. These three plans are administered by the Compensation Committee of the Board of Directors. All shares issued under these plans are valued at market trading prices.

The Company's Senior Executive Compensation Program, initiated in fiscal year 1978, provides long-term performance

share compensation, which contemplates annual payments of common stock of the Company to participants contingent on their continued employment and upon achievement of pre-established financial objectives of the Company over succeeding three-year periods. A total of 1,097,205 shares of common stock of the Company remain reserved for issuance under the program. Total tentative performance shares payable through November 28, 1998, were 360,132. In addition, the Senior Executive Compensation Program mandates and or provides for participants to defer payment of long-term performance shares earned in prior years. A total of 183,900 shares are deferred of which 177,741 are vested and payable as of November 28, 1998.

Under the Performance Compensation Plan key employees are awarded tentative performance shares based upon achievement of performance targets. A total of 1,290,028 shares of common stock remain reserved for issuance under this plan as of November 28, 1998. In 1993, 386,096 shares were earned based on the Company's performance. A total of 1,125 deferred shares are payable as of November 28, 1998 under this plan. The plan will terminate on November 30, 2001.

Under the 1996 Stock Option Plan key employees and directors are granted the opportunity to acquire the Company's common stock. Under the terms of the plan, options may be

either incentive or non-qualified. Stock appreciation rights may be awarded in conjunction with either an incentive stock option or non-qualified stock option. The exercise price per share shall be the average fair market price of the common stock on the date of the grant. Options granted to employees vest one-third on each of the first three anniversaries of the date of grant. Options granted to directors vest entirely on the first anniversary of the date of grant. All options have a maximum term of ten years. Three million shares of common stock have been reserved for issuance under this plan and options were initially granted in 1997. As of November 28, 1998 there were 2,253,663 shares of common stock available for future grants. The fair value for each option grant is estimated on the date of the grant using the Black-Scholes option pricing model. The weighted average fair value of options granted was \$14.19 and \$13.22 per share in 1998 and 1997, respectively. The following weighted average assumptions were used:

	1998	1997
Risk-free interest rate	5.63%	6.83%
Dividend yield	1.49%	1.44%
Volatility factor	.1926	.1903
Weighted average expected life	5.98 years	5.97 years

The following table summarizes the transactions of the Company's stock option plan:

	1998		1997	
	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Unexercised options outstanding — beginning of year	283,500	\$44.3125	N/A	N/A
Options granted	499,000	\$52.9793	290,500	\$44.3125
Options exercised	(10,339)	\$44.3125	N/A	N/A
Options cancelled	(36,163)	\$47.4575	(7,000)	\$44.3125
Unexercised options outstanding — end of year	735,998	\$50.0340	283,500	\$44.3125
Exercisable options — end of year	96,535	\$44.3125	None	N/A

The following table summarizes information about stock options outstanding at November 28, 1998:

Range of Exercise Prices	OPTIONS OUTSTANDING			OPTIONS EXERCISABLE	
	Number Outstanding	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price	Number Exercisable	Weighted Average Exercise Price
\$44.3125 - \$44.3125	251,498	8.36	\$44.3125	96,535	\$44.3125
\$52.1563 - \$52.1563	430,500	9.14	\$52.1563	0	\$ —
\$57.0938 - \$57.0938	20,000	9.66	\$57.0938	0	\$ —
\$59.1250 - \$59.2188	16,000	9.31	\$59.1719	0	\$ —
\$63.2500 - \$63.2500	18,000	9.36	\$63.2500	0	\$ —
\$44.3125 - \$63.2500	735,998	8.90	\$50.0340	96,535	\$44.3125

Under the restricted stock plan key employees were granted restricted shares of the Company's stock. As of November 28, 1998 there were 17,371 shares which remain deferred under this program. No awards were made in fiscal 1998 and the plan has been terminated.

The amount charged to expense for all stock-based compensation plans was \$8 million, \$4 million and \$2 million in 1998, 1997 and 1996, respectively.

The pro forma effect on net income for all stock-based compensation plans if accounted for under SFAS No. 123 is less

than \$1 million of additional compensation expense in 1998, 1997, and 1996, respectively.

Members of the Board of Directors may elect to defer fees earned and invest them in common stock of the Company. A total of 10,064 deferred shares are payable as of November 28, 1998 under this program.

## 7. Shareholders' Equity

One million shares of preferred stock, without par value, have been authorized and none have been issued.

The Board of Directors has authorized the repurchase, from time to time, of up to 19,289,067 shares of the Company's stock in the open market. The purchased shares will be used for general corporate purposes. As of November 28, 1998, a total of 15,067,167 shares had been purchased at market trading prices, of which 13,564,793 shares remain in treasury.

On December 1, 1997, the Company purchased 990,000 shares of its common stock from a trust established by a founder of the Company to facilitate the payment of the trust's federal and state taxes upon the death of the founder's widow. The purchase, totaling \$42 million, was a private transaction at a discount from market determined by an investment bank to be fair to the Company.

## 8. Financial Instruments

The following methods and assumptions were used to estimate the fair value of each class of financial instruments (other than Insurance investments which are described in Note 12) for which it is practicable to estimate that value:

The carrying amounts of cash and cash equivalents, trade accounts receivable, other current assets, trade accounts payable, and accrued expenses approximate fair value because of the short maturity of those instruments.

The fair value of the Company's debt is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities. The estimated fair values of the Company's debt instruments are as follows:

	<b>November 28, 1998</b>	
	Carrying Amount	Fair Value
Short-term debt	<b>\$ 60</b>	<b>\$ 60</b>
Long-term debt	<b>\$304</b>	<b>\$340</b>

The Company has only limited involvement with derivative financial instruments and does not use them for trading purposes. They are used to manage well-defined foreign currency risks. The Company occasionally enters into foreign currency forward contracts to hedge exposure to adverse exchange risk related to certain assets and obligations denominated in foreign currencies. The gains or losses arising from these contracts offset foreign exchange gains or losses on the underlying assets or liabilities and are recognized as offsetting adjustments to the carrying amounts. The Company had no material derivative financial instruments on November 28, 1998 and November 29, 1997.

## 9. Segment Information

### Industry Information

The Health Care Group consists of Hill-Rom. Block Medical and Medeco Security Locks were in this segment prior to their sale in 1996 and 1998, respectively. Hill-Rom produces and sells electric hospital beds, patient room furniture, patient handling equipment and medical architectural products designed to meet the needs of acute care, long-term care, home care and perinatal

providers. It also provides rental therapy units to health care facilities and the home care market for wound therapy, the management of pulmonary complications associated with critically ill patients and incontinence management.

The Funeral Services Group consists of Batesville Casket Company and Forethought Financial Services. Batesville manufactures and sells a variety of metal and hardwood caskets and a line of urns and caskets used in cremation. Batesville's products are sold to licensed funeral directors operating licensed funeral homes. Forethought Financial Services' subsidiaries, Forethought Life Insurance Company, Forethought National TrustBank, Forethought Federal Savings Bank, Forethought Life Assurance Company and The Forethought Group, Inc., provide funeral planning professionals with marketing support for Forethought® funeral plans funded by life insurance policies and trust products. Note 12 contains additional information regarding financial services.

Product transfers between industry segments are not material.

Financial information regarding the Company's industry segments is presented below:

Year Ended	<b>November 28, 1998</b>	November 29, 1997	November 30, 1996
Net revenues:			
Health Care	<b>\$1,151</b>	\$ 966	\$ 941
Funeral Services	<b>850</b>	810	743
Consolidated	<b>\$2,001</b>	\$1,776	\$1,684
Operating profit:			
Health Care (a)	<b>\$ 81</b>	\$ 134	\$ 111
Funeral Services	<b>170</b>	160	144
Corporate and other	<b>(23)</b>	(30)	(19)
Consolidated	<b>228</b>	264	236
Interest expense	<b>(27)</b>	(21)	(22)
Investment income	<b>19</b>	18	17
Other income (expense), net (b) (c)	<b>73</b>	(2)	2
Income before income taxes	<b>\$ 293</b>	\$ 259	\$ 233
Identifiable assets:			
Health Care	<b>\$ 801</b>	\$ 679	\$ 647
Funeral Services	<b>3,087</b>	2,750	2,421
Corporate and other	<b>392</b>	399	328
Consolidated	<b>\$4,280</b>	\$3,828	\$3,396
Capital expenditures:			
Health Care	<b>\$ 53</b>	\$ 68	\$ 69
Funeral Services	<b>29</b>	15	21
Corporate and other	<b>6</b>	2	2
Consolidated	<b>\$ 88</b>	\$ 85	\$ 92
Depreciation and amortization:			
Health Care	<b>\$ 125</b>	\$ 76	\$ 72
Funeral Services	<b>22</b>	23	24
Corporate and other	<b>2</b>	3	3
Consolidated	<b>\$ 149</b>	\$ 102	\$ 99

(a) Reflects a \$70 million charge in 1998 for the write-off of goodwill, other asset impairment charges and other closing costs related to the discontinuance of manufacturing operations at Hill-Rom facilities in Germany and Austria.

(b) Reflects a gain of \$75 million in 1998 on the sale of Medeco Security Locks.

(c) Reflects a gain of \$3 million in 1996 on the sale of Block Medical.

## Geographic Information

Sales between geographic areas are at transfer prices which approximate market value.

	United States	Europe <i>(a)</i>	Other International	Corporate and Other	Eliminations	Consolidated
<b>1998:</b>						
Net revenues:						
To unaffiliated customers	<b>\$1,758</b>	<b>\$ 178</b>	<b>\$ 65</b>	<b>\$ —</b>	<b>\$ —</b>	<b>\$2,001</b>
Transfers to other geographic areas	<b>36</b>	<b>—</b>	<b>—</b>	<b>—</b>	<b>(36)</b>	<b>—</b>
Total net revenues	<b>\$1,794</b>	<b>\$ 178</b>	<b>\$ 65</b>	<b>\$ —</b>	<b>\$ (36)</b>	<b>\$2,001</b>
Operating profit (loss)	<b>\$ 322</b>	<b>\$ (79)</b>	<b>\$ 8</b>	<b>\$ (23)</b>	<b>\$ —</b>	<b>\$ 228</b>
Identifiable assets	<b>\$3,779</b>	<b>\$ 211</b>	<b>\$ 41</b>	<b>\$ 392</b>	<b>\$ (143)</b>	<b>\$4,280</b>
<b>1997:</b>						
Net revenues:						
To unaffiliated customers	\$1,560	\$ 157	\$ 59	\$ —	\$ —	\$1,776
Transfers to other geographic areas	37	—	—	—	(37)	—
Total net revenues	\$1,597	\$ 157	\$ 59	\$ —	\$ (37)	\$1,776
Operating profit (loss)	\$ 305	\$ (14)	\$ 3	\$ (30)	\$ —	\$ 264
Identifiable assets	\$3,261	\$ 298	\$ 30	\$ 399	\$ (160)	\$3,828
<b>1996:</b>						
Net revenues:						
To unaffiliated customers	\$1,447	\$ 188	\$ 49	\$ —	\$ —	\$1,684
Transfers to other geographic areas	37	—	—	—	(37)	—
Total net revenues	\$1,484	\$ 188	\$ 49	\$ —	\$ (37)	\$1,684
Operating profit (loss)	\$ 284	\$ (31)	\$ 2	\$ (19)	\$ —	\$ 236
Identifiable assets	\$2,869	\$ 355	\$ 24	\$ 328	\$ (180)	\$3,396

*(a) Reflects a \$70 million charge in 1998 for the write-off of goodwill, other asset impairment charges and other closing costs related to the discontinuance of manufacturing operations at Hill-Rom facilities in Germany and Austria.*

## 10. Income Taxes

Income taxes are computed in accordance with SFAS No. 109. The significant components of the consolidated income tax provision are as follows:

	<b>1998</b>	1997	1996
Income (loss) before income taxes:			
Domestic	<b>\$370</b>	\$272	\$267
Foreign	<b>(77)</b>	(13)	(34)
Total	<b>\$293</b>	\$259	\$233
Provision for income taxes:			
Current items:			
Federal	<b>\$ 90</b>	\$ 99	\$ 85
State	<b>19</b>	13	13
Foreign	<b>4</b>	3	1
Total current items	<b>113</b>	115	99
Deferred items:			
Federal	<b>(4)</b>	(11)	(6)
State	<b>—</b>	—	—
Foreign	<b>—</b>	(2)	—
Total deferred items	<b>(4)</b>	(13)	(6)
Provision for income taxes	<b>\$109</b>	\$102	\$ 93

The differences between the amounts recorded for income taxes for financial statement purposes and the amounts computed by applying the Federal statutory tax rate to income before taxes are explained as follows:

	1998		1997		1996	
	Amount	% of Pretax Income	Amount	% of Pretax Income	Amount	% of Pretax Income
Federal income tax (a)	\$103	35.0	\$90	35.0	\$81	35.0
State income tax (b)	12	4.1	9	3.5	9	3.8
Foreign income tax (c)	30	10.3	6	2.3	12	5.1
Adjustment of estimated income tax accruals	19	6.5	—	—	—	—
Utilization of foreign net operating losses	(47)	(16.1)	—	—	—	—
Sale of Block Medical	—	—	—	—	(6)	(2.6)
Other, net	(8)	(2.8)	(3)	(1.4)	(3)	(1.4)
Provision for income taxes	\$109	37.0	\$102	39.4	\$93	39.9

(a) At statutory rate.

(b) Net of Federal benefit.

(c) Federal tax rate differential.

The tax effect of temporary differences that give rise to significant portions of the deferred tax balance sheet accounts were as follows:

	November 28, 1998		November 29, 1997	
	Non-insurance	Insurance	Non-insurance	Insurance
Deferred tax assets:				
Current:				
Inventories	\$ 3	\$ —	\$ 2	\$ —
Employee benefit accruals	3	—	3	—
Self insurance accruals	10	—	10	—
Litigation accruals	2	—	3	—
Other, net	20	5	7	4
Long-term:				
Employee benefit accruals	23	1	21	1
Deferred policy revenues	—	236	—	212
Foreign loss carryforwards	9	—	67	—
Foreign acquisition reserves	—	—	2	—
Other, net	9	—	7	—
Total assets	79	242	122	217
Deferred tax liabilities:				
Current:				
Inventories	2	—	2	—
Other, net	2	—	2	—
Long-term:				
Depreciation	34	3	34	—
Amortization	2	—	—	—
Unrealized gain on investments	—	28	—	18
Benefit reserves	—	12	—	11
Deferred acquisition costs	—	160	—	140
Foreign asset step up	—	—	4	—
Other, net	—	5	1	5
Total liabilities	40	208	43	174
Less valuation allowance for foreign loss carryforwards	(9)	—	(65)	—
Net asset	\$30	\$ 34	\$ 14	\$ 43

Foreign loss carryforwards approximated \$161 million at November 29, 1997, the majority of which related to operations in Germany, Austria and France. With the announced discontinuance of manufacturing operations in Germany and Austria during 1998, the Company was able to recognize a tax benefit of approximately \$47 million for substantially all of the German and Austrian operating losses. In regards to the Company's remaining foreign operations, unutilized loss carryforwards of approximately \$25 million exist as of November 28, 1998.

There is not currently sufficient positive evidence as required by SFAS No. 109 to support recognition of the tax benefit associated with these operating losses. Accordingly, a full valuation allowance of \$9 million has been recorded. It is reasonably possible that the Company's operating results could improve in the future thereby allowing recognition of the tax benefits associated with the operating losses.

Certain expenses associated with the Company's corporate-owned life insurance program have been questioned by the

Internal Revenue Service (IRS). At the end of 1997, the Company and the IRS had pending with the IRS' national office a request for technical advice with respect to the tax benefits of this program. During 1998, an unfavorable response to the request for technical advice was received. The Company continues to believe all tax benefits relative to this program were taken in full compliance with existing and prior tax law. However, it is likely that the IRS will disallow some portion of the tax benefits associated with this program.

The Company does not believe that the ultimate outcome of tax positions taken by the Company, including those related to the corporate-owned life insurance program, will have a material adverse effect on its financial condition, results of operations or cash flows.

## 11. Supplementary Information

The following amounts were (charged) or credited to income in the year indicated:

	1998	1997	1996
Rental expense	<b>\$ (21)</b>	\$ (16)	\$ (16)
Research and development costs	<b>\$ (42)</b>	\$ (49)	\$ (42)
Investment income, net (a)	<b>\$ 19</b>	\$ 18	\$ 17

(a) Excludes insurance operations.

The table below indicates the minimum annual rental commitments (excluding renewable periods) aggregating \$37 million, used for warehouses and office space, under noncancellable operating leases.

1999	\$14
2000	\$10
2001	\$ 6
2002	\$ 4
2003	\$ 2
2004 and beyond	\$ 1

The table below provides supplemental information to the statements of consolidated cash flows.

	1998	1997	1996
Cash paid for:			
Income taxes	<b>\$113</b>	\$109	\$92
Interest	<b>\$ 24</b>	\$ 23	\$16
Non-cash investing and financing activities:			
Liabilities assumed from/incurred for the acquisition of businesses	<b>\$ 47</b>	\$ —	\$ 1
Treasury stock issued under stock compensation plans	<b>\$ —</b>	\$ —	\$ 1
Accrued treasury stock acquisition	<b>\$ —</b>	\$ 13	\$ —

## 12. Financial Services

Forethought Financial Services, through its subsidiaries, Forethought Life Insurance Company, Forethought National TrustBank, Forethought Federal Savings Bank, Forethought Life Assurance Company and The Forethought Group, Inc., serves funeral planning professionals with life insurance policies, trust products and marketing support for Forethought® funeral planning. Forethought entered the preneed trust market in 1997. This business did not materially affect the financial results of Forethought or Hillenbrand Industries in 1998. The life insurance policies sold by Forethought Life Insurance Company are limited to long-duration, whole-life policies, and, as such, are accounted for under SFAS No. 97. The benefits under these policies increase based on external inflationary indices and management's discretion. Premiums received are allocated to benefit reserves and unearned revenue. Unearned revenues are recog-

nized over the actuarially determined life of the contract. Policy acquisition costs, consisting of commissions, policy issue expense and premium taxes, are deferred and amortized consistently with unearned revenues. Liabilities equal to policyholder account balances and amounts assessed against these balances for future insurance charges are established on the insurance contracts issued by Forethought Life Insurance Company.

Investments are predominantly U.S. treasuries and agencies and high-grade corporate bonds with fixed maturities and are carried on the balance sheet at fair value. The Company's objective is to purchase investment securities with maturities that match the expected cash outflows of policy benefit payments. The investment portfolio is constantly monitored to insure assets match the expected payment of the liabilities. Securities are also sold in other carefully constrained circumstances such as concern about the credit quality of the issuer. Otherwise, it is management's intent that these investments be held to maturity. Cash (unrestricted as to use) is held for future investment.

In accordance with the provisions of SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," the Company has classified the investments in debt and equity securities of its insurance subsidiary as "available for sale" and reported them at fair value on the balance sheet. Unrealized gains and losses are charged or credited to a separate component of shareholders' equity and the insurance deferred tax asset adjusted for the income tax effect. The fair value of each security is based on the market value provided by brokers/dealers.

The amortized cost and fair value of investment securities available for sale at November 28, 1998 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	<b>\$ 639</b>	<b>\$17</b>	<b>\$ 5</b>	<b>\$ 651</b>
Corporate securities	<b>1,274</b>	<b>69</b>	<b>13</b>	<b>1,330</b>
Mutual funds	<b>37</b>	<b>13</b>	<b>—</b>	<b>50</b>
Preferred stocks	<b>3</b>	<b>—</b>	<b>—</b>	<b>3</b>
Total (a)	<b>\$1,953</b>	<b>\$99</b>	<b>\$18</b>	<b>\$2,034</b>

The amortized cost and fair value of investment securities available for sale at November 29, 1997 were as follows:

	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
U.S. Treasury securities and obligations of U.S. government corporations and agencies	<b>\$ 645</b>	<b>\$11</b>	<b>\$ 6</b>	<b>\$ 650</b>
Corporate securities	<b>1,129</b>	<b>40</b>	<b>5</b>	<b>1,164</b>
Mutual funds	<b>40</b>	<b>13</b>	<b>—</b>	<b>53</b>
Preferred stocks	<b>4</b>	<b>—</b>	<b>—</b>	<b>4</b>
Total (a)	<b>\$1,818</b>	<b>\$64</b>	<b>\$11</b>	<b>\$1,871</b>

(a) Does not include the amortized cost of other investments carried on the balance sheet in the amount of \$170 million at November 28, 1998, and \$63 million at November 29, 1997, the carrying value of which approximates fair value.

The amortized cost and fair value of investment securities available for sale at November 28, 1998, by contractual maturity, are shown below. Expected maturities will differ from contractual maturities because borrowers may have the right to call or repay obligations with or without call or prepayment penalties.

	Amortized Cost	Fair Value
Due in one year or less	\$ 38	\$ 38
Due after 1 year through 5 years	234	241
Due after 5 years through 10 years	303	310
Due after 10 years	726	770
Mortgage-backed securities	612	622
Mutual funds	37	50
Preferred stocks	3	3
Total	\$1,953	\$2,034

The cost used to compute realized gains and losses is determined by specific identification. Proceeds and realized gains and losses from the sale of investment securities available for sale were as follows:

	1998	1997	1996
Proceeds	\$345	\$358	\$126
Realized gross gains	\$ 24	\$ 12	\$ 1
Realized gross losses	\$ 4	\$ 4	\$ 1

### 13. Unaudited Quarterly Financial Information

1998 Quarter Ended	2/28/98	5/30/98	8/29/98	11/28/98	Total Year
Net revenues	\$479	\$508	\$483	\$531	\$2,001
Gross profit	197	212	193	232	834
Net income	43	45	42	54	184
Basic and diluted net income per common share	.64	.66	.63	.80	2.73
1997 Quarter Ended	3/01/97	5/31/97	8/30/97	11/29/97	Total Year
Net revenues	\$446	\$426	\$429	\$475	\$1,776
Gross profit	184	177	179	205	745
Net income	39	37	35	46	157
Basic and diluted net income per common share	.56	.54	.51	.67	2.28

### 14. Contingencies

On August 16, 1995, Kinetic Concepts, Inc., and Medical Retro Design, Inc. (collectively, the “plaintiffs”), filed suit against Hillenbrand Industries, Inc., and its subsidiary Hill-Rom Company, Inc., in the United States District Court for the Western District of Texas, San Antonio Division. The plaintiffs allege violation of various antitrust laws, including illegal bundling of products, predatory pricing, refusal to deal and attempting to monopolize the hospital bed industry. They seek monetary damages totaling in excess of \$269 million, trebling of any damages that may be allowed by the court, and injunctions to prevent further alleged unlawful activities. The Company believes that the claims are without merit and is aggressively defending itself against all allegations. Accordingly, it has not recorded any loss provision relative to damages sought by the plaintiffs. On November 20, 1996, the Company filed a Counterclaim to the above action against Kinetic Concepts, Inc. (KCI) in the U.S. District Court in San Antonio, Texas. The Counterclaim alleges, among other things, that KCI has attempted to monopolize the therapeutic bed market, interfere with the Company’s and Hill-Rom’s business relationships by conducting a campaign of anticompetitive conduct, and abused the legal process for its own advantage.

The Company has voluntarily entered into remediation agreements with environmental authorities, and has been issued Notices of Violation alleging violations of certain permit conditions. Accordingly, the Company is in the process of implement-

Summarized financial information of insurance operations included in the statement of consolidated income is as follows:

	1998	1997	1996
Investment income	\$138	\$120	\$104
Earned premium revenue	151	137	115
Net gain on sale of investments	20	8	—
Total net revenues	309	265	219
Benefits paid	71	63	56
Credited interest	123	111	97
Deferred acquisition costs amortized	39	35	29
Other operating expenses	23	21	13
Income before income taxes	\$ 53	\$ 35	\$ 24

Statutory data at December 31 includes:

	1998 (unaudited)	1997	1996
Net income	\$ 35	\$ 32	\$ 29
Capital and surplus	\$153	\$144	\$129

ing plans of abatement in compliance with agreements and regulations. The Company has also been notified as a potentially responsible party in investigations of certain offsite disposal facilities. The cost of all plans of abatement and waste-site cleanups in which the Company is currently involved is not expected to exceed \$5 million. The Company has provided adequate reserves in its financial statements for these matters. These reserves have been determined without consideration of possible loss recoveries from third parties. Changes in environmental law might affect the Company’s future operations, capital expenditures and earnings. The cost of complying with these provisions is not known.

The Company is subject to various other claims and contingencies arising out of the normal course of business, including those relating to commercial transactions, product liability, safety, health, taxes, environmental and other matters. Management believes that the ultimate liability, if any, in excess of amounts already provided or covered by insurance, is not likely to have a material adverse effect on the Company’s financial condition, results of operations or cash flows.

### 15. Subsequent Events

On December 31, 1998, Forethought Life Insurance Company, a wholly owned subsidiary of Forethought Financial Services, Inc., acquired the stock of Arkansas National Life Insurance Company for a cash payment of \$31 million.

## REPORT OF MANAGEMENT

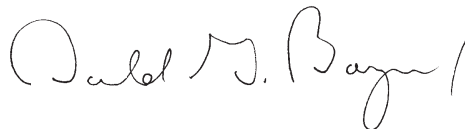
HILLENBRAND INDUSTRIES, INC. AND SUBSIDIARIES

Management of Hillenbrand Industries is responsible for the preparation, fairness, and integrity of the Company's financial statements and other information included in this annual report. The financial statements have been prepared in accordance with generally accepted accounting principles applied on a materially consistent basis. Where necessary, management has made informed judgments and estimates of the outcome of events and transactions, with due consideration given to materiality.

Management believes that the Company's policies, procedures and internal control systems provide reasonable assurance that assets are safeguarded and transactions are properly recorded and executed in accordance with its authorization. The Company also maintains a program of internal auditing to examine and evaluate the adequacy and effectiveness of these policies, procedures and internal controls.

The Company engages independent public accountants who are responsible for performing an independent audit of the financial statements. Their report, which appears below, states their opinion on the fairness of the Company's financial statements.

The Audit Committee of the Board of Directors meets regularly with the independent accountants, the internal auditors and financial management to assure that each is meeting its responsibilities.



Donald G. Barger, Jr.  
Vice President and  
Chief Financial Officer



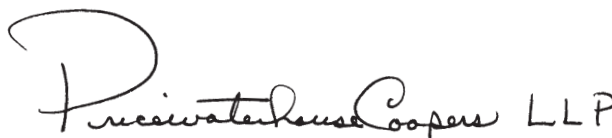
James D. Van De Velde  
Vice President and Controller

## REPORT OF INDEPENDENT ACCOUNTANTS

To the Shareholders and  
Board of Directors of  
Hillenbrand Industries, Inc.

In our opinion, the accompanying consolidated balance sheets and the related statements of consolidated income, consolidated shareholders' equity and consolidated cash flows present fairly, in all material respects, the financial position of Hillenbrand Industries, Inc. and its subsidiaries at November 28, 1998 and November 29, 1997, and the results of their operations and their cash flows for each of the three years in the period ended November 28, 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  
Indianapolis, Indiana  
January 11, 1999

# SHAREHOLDER INFORMATION

## Stock Exchange

Hillenbrand Industries common stock is traded on the New York Stock Exchange (NYSE) under the ticker symbol "HB." The newspaper stock table listings are "Hillenbrnd," "Hillenbd" or "Hilenbd."

## Dividends

Hillenbrand Industries has paid cash dividends on its common stock every quarter since the first public offering in 1971, and those dividends have increased each year since 1972. Dividends are paid near the end of February, May, August and November to shareholders of record near the end of January, April, July and October.

## Direct Stock Service

This program enables current shareholders to transfer their Hillenbrand stock certificates into electronic accounts in their own names (similar to mutual funds) on the books of the transfer agent, Harris Trust and Savings Bank. In contrast with physical certificates (which can be misplaced or stolen), these uncertificated accounts provide a cost-free safekeeping facility, as well as a convenient way to make gifts or other transfers of stock—with or without the issuance of certificates. In addition, non-shareholders may make initial investments in Hillenbrand stock through the program. The program also includes other options, such as reinvesting dividends and purchasing and selling stock. For more information about the plan and to obtain a program brochure and enrollment form, call toll free (888) 665-9611.

## Transfer Agent, Registrar and Dividend Disbursing Agent

Inquiries and transactions related to the transfer and registration of stock certificates or cash dividends should be directed to:

Harris Trust and Savings Bank  
311 West Monroe Street  
P.O. Box A3504  
Chicago, Illinois 60690-3504  
(312) 461-3309

## Annual Meeting

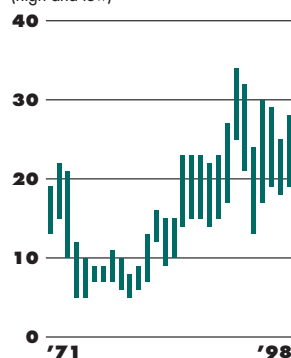
The annual shareholders' meeting of Hillenbrand Industries, Inc. will be held on Tuesday, April 13, 1999, at 10:00 a.m. (EST), at:

The Sherman House  
35 South Main Street  
Batesville, Indiana 47006-0067  
(812) 934-7264

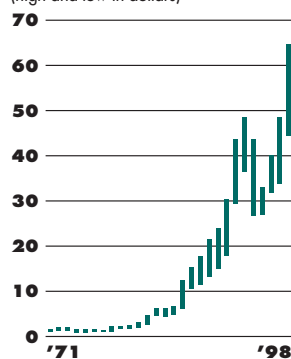
## Corporate Site on the World Wide Web

[www.hillenbrand.com](http://www.hillenbrand.com)

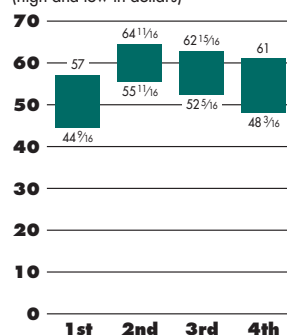
### Price/Earnings Ratio (high and low)



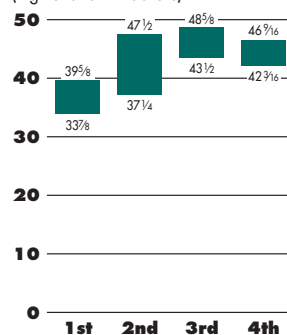
### Stock Price Range (high and low in dollars)



### 1998 Quarterly Stock Performance (high and low in dollars)



### 1997 Quarterly Stock Performance (high and low in dollars)



## Company Contacts

### Investor Relations

Requests for the Hillenbrand Industries Annual Report on Form 10-K or other information on the Company should be directed in writing to:

Mark R. Lanning  
Vice President and Treasurer  
Hillenbrand Industries, Inc.  
700 State Route 46 East  
Batesville, Indiana 47006-8835  
(812) 934-8400  
[mark.lanning@hillenbrand.com](mailto:mark.lanning@hillenbrand.com)

### Corporate Communications

General questions and comments about Hillenbrand Industries and its operations should be directed to:

Christopher P. Feeney  
Director, Corporate Communications  
Hillenbrand Industries, Inc.  
700 State Route 46 East  
Batesville, Indiana 47006-8835  
(812) 934-8197  
[christopher.feeney@hillenbrand.com](mailto:christopher.feeney@hillenbrand.com)

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Cincinnati, Ohio

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Aurora, Indiana

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For more information about Hillenbrand Industries or its subsidiaries,  
Batesville Casket Company, Forethought Financial Services and Hill-Rom,  
please visit one of our sites on the Internet.

[www.hillenbrand.com](http://www.hillenbrand.com)



[www.hill-rom.com](http://www.hill-rom.com)



[www.forethought.com](http://www.forethought.com)



[www.batesville.com](http://www.batesville.com)

## HILLENBRAND INDUSTRIES

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