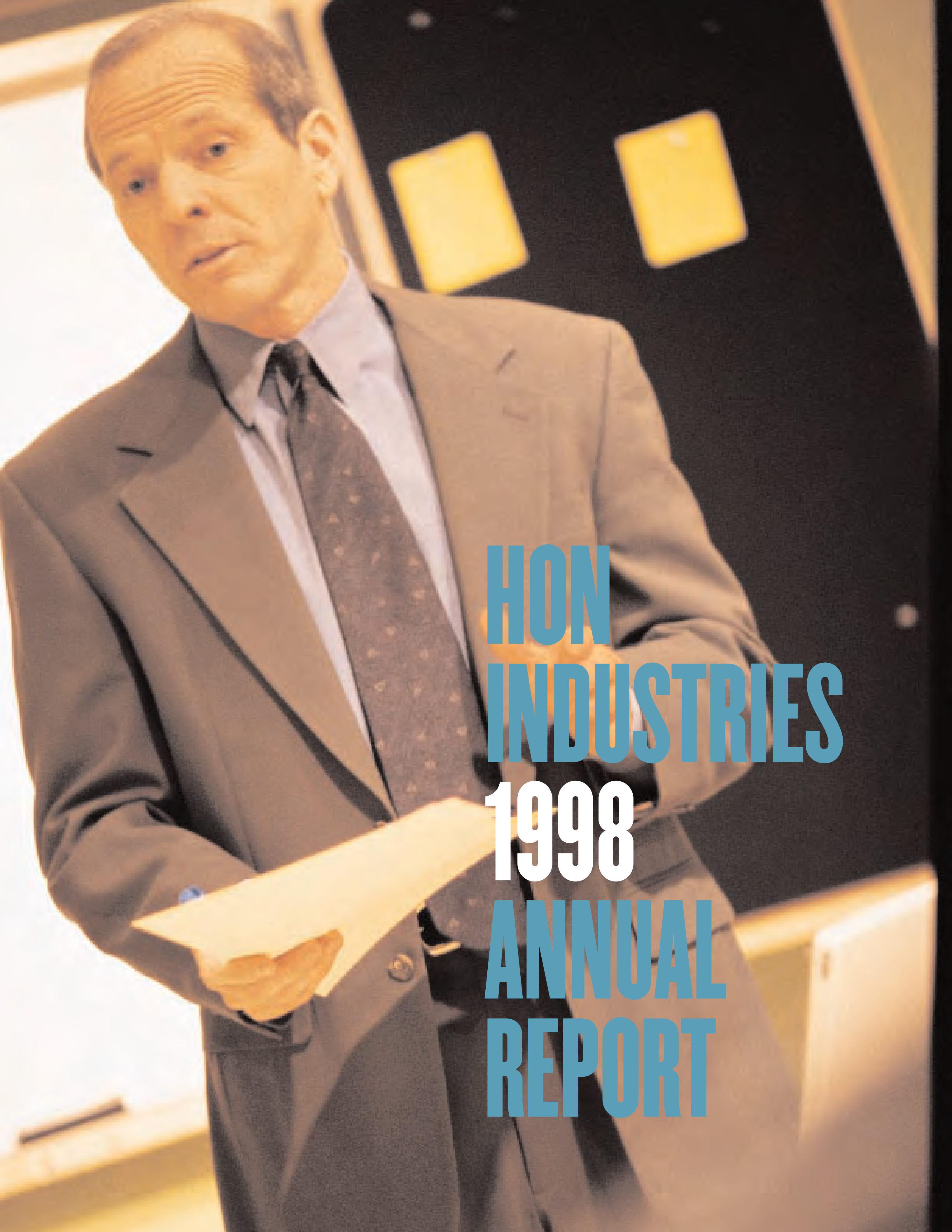


HON INDUSTRIES 1998 ANNUAL REPORT

“WELCOME TO MY OFFICE.”

For many working Americans, going to work means going to the office. Yet large or small, in a high-rise or a home, offices are not what they used to be. In little more than a decade, new technologies, new organizational structures, increased diversity, changing demographics, outsourcing, downsizing, and a host of other factors have revolutionized the office landscape. Rather than simply being a place to work, offices have become a place for people—and technology—to work together. Environments that once simply pushed people to work harder now aim to help them be more creative, more comfortable, more open, more human. No longer are offices just about making a living, they're about making a difference, and sometimes, achieving your dreams. And the revolution continues.

No one knows more about today's offices than HON INDUSTRIES. We have equipped America's changing offices for half a century, and we have grown to become a leader in our industry. Our furniture and panel systems are found just about everywhere people work, across the country. Our distribution channels put our products within easy reach of end users, and our innovative solutions offer the benefits and value that business people need to do their best work and to grow.

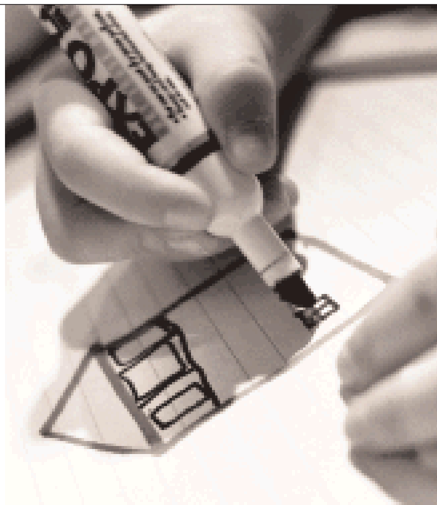
So welcome to our offices. One of them just might be your office too.

“THERE’S SOMETHING NICE ABOUT SHARING AN OFFICE WITH A SIX YEAR OLD.”

In the home office

About 30 percent of the workforce, more than 40 million people, spend at least some of their working hours at home. Perhaps they have joined the ranks of telecommuters, whose numbers have doubled since the early 1990s. Perhaps they have started new companies, the majority of which are begun at home. Others are among the growing number of professionals who seek a better balance between work and family—and less time stuck in traffic.

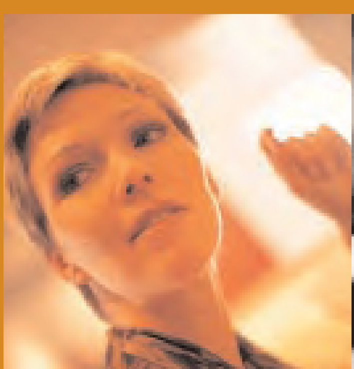
For these and other reasons, nearly one-quarter of all households now have a home office, and the number is growing rapidly. HON INDUSTRIES is leading—and benefiting—from this trend. We’re a leading supplier to the superstores, warehouse clubs, and office furniture dealers where many people equip their home offices, and our extensive distribution network assures that they can find the products they want when they want them. What’s more, our products are known for being durable and functional, the two benefits that home office workers value the most. That’s why, for home offices, it’s home sweet HON.

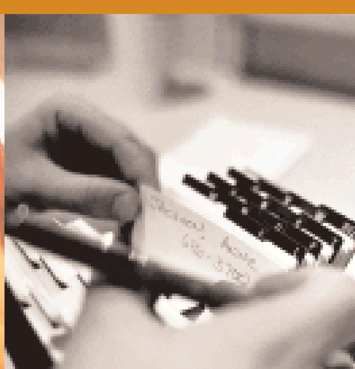


In the small office

In the U.S., new business start-ups continue to rise year after year. Small businesses drive the nation's economic growth. The estimated 23 million small businesses in the U.S. employ more than half of the private workforce, generate more than half of the nation's gross domestic product, and are the principal source both of new jobs and of innovation.

HON INDUSTRIES offers innovative solutions to the needs of small business. Our Rapid Continuous Improvement program has helped us become one of the lowest-cost, highest-quality manufacturers in our industry, so we can meet the same high standards as premium-priced furniture and tight budgets too. What's more, our furniture and systems are flexible and adaptable, so they can grow with growing companies. Because we know that in every small business, someone is thinking big.





“FIRST WE’LL PUT MONEY INTO THE BUSINESS. THEN WE’LL PUT IT INTO OUR OFFICES.”

In the branch office

In the past 15 years, the team has come to dominate the American workplace. To speed the introduction of new products, improve productivity, reduce costs, and achieve their strategic objectives, companies are knocking down the walls between functions and bringing people together. Rigid hierarchy has given way to flexible groups. Command and control has been replaced by give and take.

HON INDUSTRIES gives teamworkers the home-field advantage. Applying the lessons learned in developing our own cross-functional teams, our open office furniture and systems streamline information flow and promote interaction. Spaces can grow or shrink to adapt to new requirements—today's conference room can become tomorrow's workstations—while products such as height-adjustable tables give individuals the freedom to make themselves comfortable and productive. Meanwhile, complete, on-time deliveries, backed by one of the most extensive distribution networks in our industry, help assure that new offices can be up and running quickly. It's one more example of how our team works—for yours.

“WE WANT PEOPLE TO SEE THAT WE’RE COMMITTED TO QUALITY.”

In the corporate office

At a time of rapid change, when entire industries can rise and fall overnight, companies can survive only by attracting and motivating the best people — at every level. The right offices can help a company demonstrate its concern for its workers' well-being and help it retain a workforce that is increasingly demanding, mobile, and diverse. The best offices engage the eyes, minds, and emotions of the people who use them to create an environment that fosters success.

HON INDUSTRIES' offices get the job done. We combine rich details and outstanding fit and finish with the ability to handle all of the demands of the wired workplace. Our high quality office environments help companies show, not simply say, that achievement is appreciated—and rewarded. Enduring, classic designs reflect a long-term perspective and strong values. And with a comprehensive portfolio of premium-quality products, as well as our value-priced products and systems, we can deliver single-source solutions to all of a company's furniture needs. No matter where people work, we're working with them.

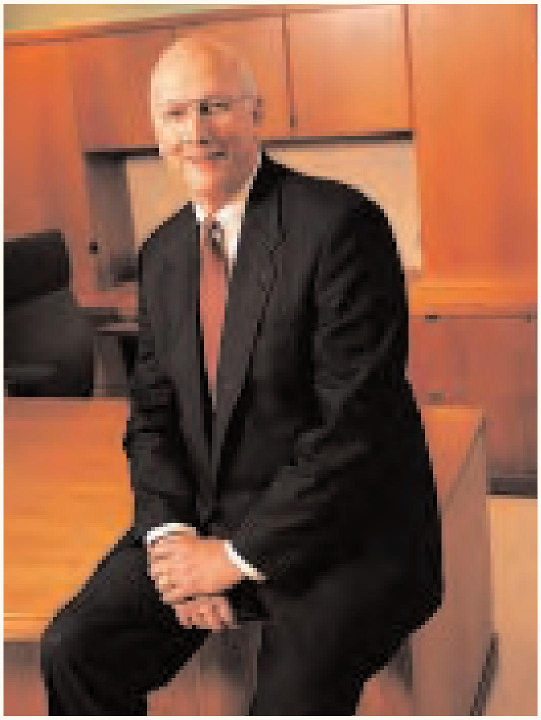
Away from the office

At the end of the day, the warm glow of a fire relaxes and inspires. It's no wonder that fireplaces rank among the most desired amenities found in homes or that they bring a substantial return on investment.

HON INDUSTRIES' hearth products are designed to offer homeowners years of enjoyment while they help builders and dealers increase sales and profitability. Innovative, energy-efficient designs allow fireplaces to be installed almost anywhere, and their proven performance reduces service calls and improves customer satisfaction. Our Heat-N-Glo, Heatilator, and Aladdin brands encompass every distribution channel and price point and allow us to apply our expertise in manufacturing steel products to another attractive — and growing — market. HON INDUSTRIES makes the office more productive and rewarding. And then we welcome you home.

"I DO SOME OF MY BEST WORK WHEN I'M NOT AT THE OFFICE."





JACK D. MICHAELS
Chairman, President and CEO

A LETTER TO OUR SHAREHOLDERS

The Standard of Performance
As I write from "My Office" to yours, I'm pleased to report that HON INDUSTRIES achieved another record year. We strengthened our leading positions in both office furniture and hearth products. And we are prepared to do even better in the future.

By every measure, our gains were exceptional:
> Our net sales rose over 24 percent to an all-time high of $1.7 billion, as all six of our operating companies reported record sales.
> Operating income grew 23 percent to $179 million.
> Net income increased 22 percent to $106 million.
> Earnings per share rose to $1.72, an increase of nearly 19 percent.

Our performance has not gone unrecognized—we appear on the list of *Fortune*'s "Most Admired" companies and on *Forbes*' "Platinum List" for excellence in growth and profitability. However, we are underappreciated on Wall Street. Fears of a general economic slowdown and anticipated slower rates of growth in our industry drove the price of our stock down by 17 percent from the first of the year to year-end, and down significantly from the yearly high. Our continued growth and superior financial performance ultimately should bring us the valuation we think we deserve. In the meantime, we displayed our confidence in the Company by repurchasing more than half a million shares of our common stock. As of year-end, we had $62.5 million remaining from our board of directors-approved stock repurchase authorization. Also, we expect our move to the New York Stock Exchange to increase awareness of the Company, along with our performance and, most of all, our prospects for profitable growth.

Our objective is clear: We want to double our earnings every five years. We have exceeded that goal. We are the market leader in the high quality, value segment of the office furniture industry and in wood- and gas-burning fireplaces and stoves and we consistently outpace the growth of our industries. In 1998, we grew three times faster than the office furniture industry as a whole, to become the third largest office furniture manufacturer in North American sales. The hearth products industry grew approximately 10 percent in 1998. Our hearth product sales grew by 20 percent. Both industries are very strong. Office furniture, for example, has had only two down growth years in the past 25 years.

It is equally clear that our strategies work. We have grown by rapidly introducing innovative, high quality products, by expanding our position with our distributor partners, by continually improving productivity, and by pursuing strategic, profitable acquisitions. We are confident that these strategies will bring us even more growth.

Innovation

New products are the lifeblood of our success. We respond to end users' emerging needs through the aggressive introduction of new products. Engineered to be easier to manufacture, new products allow us to offer a broad selection, with more features, greater performance, and higher quality, at attractive prices.

In 1998, 44 percent of our sales came from products introduced in the past three years, surpassing our 40 percent goal. Cross-functional teams practice concurrent product development, tackling design, materials and manufacturing processes at the same time to reduce costs, provide higher quality products with greater performance, and quickly bring to market new products that solve customer needs. Examples of our new offerings include a new "best in class" desk, new lines of seating, enhanced systems furniture, and storage solutions with added features. Our Hearth Technologies business has the largest number of patents in its industry and also rapidly introduces new products. Innovation and technology, especially in gas heating products, drive our success in this business. The new outdoor division we established late in 1998 will bring our technological expertise to an entirely new family of products, such as weatherproof fireplaces, and will expand the markets we serve. *(See a selected list of new products on page 41.)*

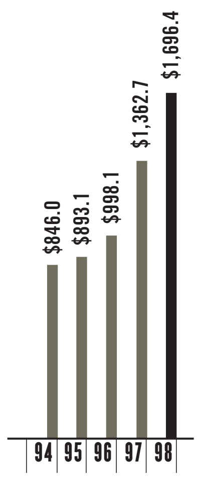
Distribution

Our distributors are our direct customers, and we have a strong presence in nearly every major distribution channel. We are the number one or number two supplier to the nation's largest office furniture dealers, warehouse clubs, wholesalers, and superstores and in most channels account for more than half of the furniture pages in their catalogs. Our extensive distribution network puts us close to our customers and allows us to combine quick delivery with low freight costs. Our new dealer partner program adds even more value to our relationships by helping our distributors increase their sales to the contract segment of the office furniture market.

In hearth products, our partners are residential builder distributors, retail distributors, manufactured housing distributors, and home improvement centers. We meet the needs of builders by supplying innovative products that are easy to install and that add to the value and appeal of their homes. A broad selection of high quality, realistic looking, state-of-the-art products help retail distributors win the hearts of their customers. Also, quick-ship programs and complete-and-on-time delivery allow our distributors to meet customers' demands during peak selling seasons without requiring large investments in inventories. In the home improvement centers, there is a new opportunity in the do-it-yourself market with the direct-vent gas fireplace.

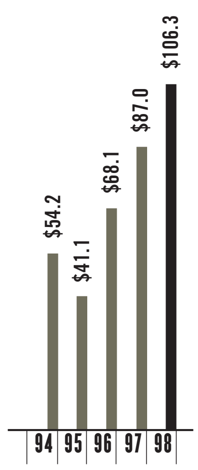
NET SALES

(MILLIONS OF DOLLARS)

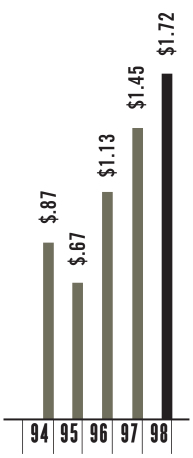


NET INCOME

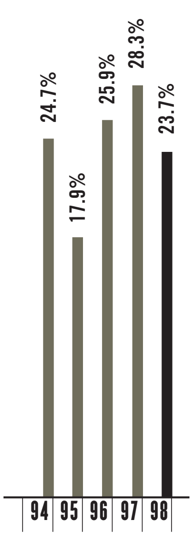
(MILLIONS OF DOLLARS)



EARNINGS PER SHARE
(DOLLARS)



RETURN ON BEGINNING ASSETS EMPLOYED
(PERCENT)



Lean Manufacturing

We know what our customers want: durable, high quality, innovative solutions, at attractive prices, with quick, complete, and on-time delivery. Our 52-year tradition of leadership and pride in manufacturing excellence—and the formal introduction of our Rapid Continuous Improvement (RCI) program in 1992—help us meet their requirements. Over the past six years, improving productivity and eliminating waste have become a way of life. We have increased customer satisfaction significantly, increased our sales per employee by 50 percent, and shortened our lead times to some of the lowest in the industry. In 1998, we continued our progress. Inventory turns increased to 18.4. From order to delivery, we now can deliver selected products to our customers in as little as four days. In an industry that has been known for its long lead times, our deliveries of mixed products to exact customer specifications is approaching two weeks and we plan to decrease this lead time even further. We continue to leverage our manufacturing expertise across our office furniture and hearth products. We have made substantial gains in lowering costs.

While we're proud of the gains we've made, there's plenty of room for improvement. In the first quarter of 1999, we announced an intensified cost-savings initiative to increase our long-term profitability, save $11.6 million annually, and achieve the best possible return on our assets. There will be a one-time impact on pre-tax earnings estimated at approximately $19.7 million, which translates to roughly $0.20 per diluted share in the first quarter of 1999. To further strengthen our position as a low-cost producer and improve service to our customers, we are closing three U.S. plants and consolidating their operations with other plants in this country. We are building a new plant in Mexico to provide the best products with the lowest cost and the fastest lead times to our retail channel of distribution.

Strategic Acquisitions

Acquisitions expand our product offerings and our customer base, increase our economies of scale, and allow us to introduce new products to our distribution channels. In 1998, we acquired Aladdin Steel Products, Inc. to improve our position in the retail stove segment of our hearth products. We also worked to integrate the three furniture companies we acquired in 1997 into our operations. We added new products to their lines, increased production at their facilities, and achieved dramatic gains in their profitability. The continued implementation of our lean manufacturing practices will bring additional improvements in their margins.

The Power of People

Plans and strategies are no more effective than the people who carry them out. At HON INDUSTRIES, those people think and act like owners of the Company, because they are. All of our employees—long regarded as members of this organization—are shareholders. A strong sense of ownership and shared responsibility are part of our culture and drive our continuing efforts to improve our performance and exceed the expectations of our customers. Our members also are members of the communities in which we do business and they get involved to make a positive difference. Just as we try to make offices better places to work, so we try to make our communities better places to live. One way is through our commitment to protecting the environment. Some examples of how we do this include recycling programs, using materials in creating our products that would otherwise end up in landfills, and continuously working to eliminate emissions at their source.

In all of our efforts, we benefit from the counsel of an outstanding board of directors. We deeply appreciate the dedication and service of our retiring directors. We also are pleased to welcome the new members to our board. Their insights and experience, gained at some of America's most well known companies, will be invaluable as we continue to grow in an increasingly complex and challenging marketplace.

Looking Ahead

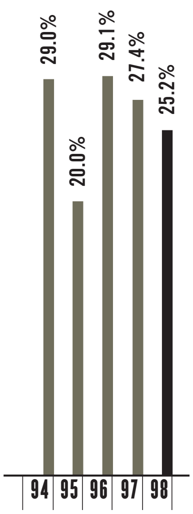
It's an exciting time to be in the furniture business. New technologies and changing lifestyles are revolutionizing the way that people work—and their offices as well. The phenomenal rise in new business start-ups, telecommuting, and home offices, combined with the growing interest in office ergonomics, demand new solutions and open new opportunities as customers seek greater value in solving their work needs. At the same time, high-quality low-cost manufacturing and efficient distribution are no longer simply strategic advantages, but imperatives for success.

We have what it takes. Our low-price, high quality products are especially appealing to the small and mid-sized businesses that lead the nation's economic growth, and to other customers as well. Our innovation, extensive distribution capabilities, lean manufacturing, acquisitions and, most of all, our people, will set us apart and enable us to continue to set the standard of performance for our industries.

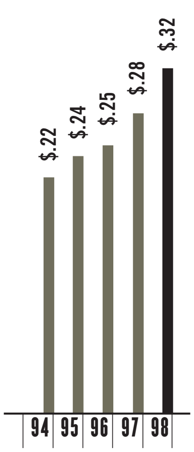
We expect another year of outstanding performance in 1999. Office furniture order rates are encouraging as we enter the year. Hearth product orders remain at record levels. Our strong balance sheet and the investments we have made create a solid base for future growth. Capital expenditures, higher in 1998 as we invested in new product development and added distribution capacity, are anticipated to be lower in 1999. A steady stream of new products and ongoing profit-enhancing initiatives will help us increase our share of our markets and answer increased competition from other manufacturers. An active share repurchase program will help build the value of our stock. I look forward to sharing more good news from this office in the months—and years—ahead.

JACK D. MICHAELS
Chairman, President and CEO

RETURN ON AVERAGE SHAREHOLDERS' EQUITY
(PERCENT)



CASH DIVIDENDS PER COMMON SHARE
(DOLLARS)



Financial Highlights

	1998	1997	1998 vs. 1997
Income Statement Data			
Net sales	$1,696,433,000	$1,362,713,000	24.5%
Gross profit	523,436,000	429,556,000	21.9%
Selling and administrative expenses	344,259,000	284,397,000	21.0%
Operating income	179,177,000	145,159,000	23.4%
Net income	106,313,000	86,955,000	22.3%
Net income as a % of:			
Net sales	6.3%	6.4%	
Average shareholders' equity	25.2%	27.4%	
Per common share:			
Net income	$ 1.72	$ 1.45	18.6%
Book value	7.54	6.19	21.8%
Cash dividends	.32	.28	14.3%
Balance Sheet Data			
Current assets	$ 290,329,000	$ 295,150,000	(1.6)%
Total assets	864,469,000	754,673,000	14.5%
Current liabilities	217,438,000	200,759,000	8.3%
Current ratio	1.34	1.47	
Long-term debt and capital lease obligations	$ 135,563,000	$ 134,511,000	0.8%
Debt/capitalization ratio	22.7%	26.1%	
Shareholders' equity	$ 462,022,000	$ 381,662,000	21.1%
Average shareholders' equity	421,842,000	317,030,000	33.1%
Working capital	72,891,000	94,391,000	(22.8)%
Other Data			
Capital expenditures — net	$ 149,717,000	$ 85,491,000	75.1%
Cash flow from operations	146,792,000	141,385,000	3.8%
Weighted-average shares outstanding during year	61,649,531	59,779,508	3.1%
Price/earnings ratio at year-end	14	20	
Number of shareholders at year-end	5,877	5,399	8.9%
Members (employees) at year-end	9,824*	9,390*	

*** Includes acquisitions completed during year.**

All appropriate common share and per common share amounts above have been retroactively restated to reflect a March 1998, two-for-one stock split in the form of a 100% stock dividend.

Financial Review

Our Vision:

HON INDUSTRIES and its members are dedicated to achieving excellence through the pursuit of a philosophy, strategies, and day-to-day actions aimed at achieving rapid continuous improvement. We continuously strive to develop a culture where members, customers, suppliers, shareholders, and the public experience fairness and respect in their relations with the Company.

Achieving excellence depends on individual and collective integrity and the relentless pursuit of the following long-standing beliefs.

HON INDUSTRIES shall

> *be profitable*

> *be economically sound*

> *pursue sound growth*

> *supply quality products and services*

> *be a good place to work*

> *be a responsible corporate citizen*

When the Company is appreciated by its members, favored by its customers, supported by its suppliers, respected by the public, and admired by its shareholders, this vision is fulfilled.

HON INDUSTRIES INC. AND SUBSIDIARIES

Selected Financial Data — Eleven-Year Summary

	1998	1997	1996	1995
Per Common Share Data				
Income from Continuing Operations	$ 1.72	$ 1.45	$ 1.13	$ .67
Income from Discontinued Operations	—	—	—	—
Cumulative Effect of Accounting Changes	—	—	—	—
Gain on Sale of Discontinued Operations	—	—	—	—
Net Income	1.72	1.45	1.13	.67
Cash Dividends	.32	.28	.25	.24
Book Value	7.54	6.19	4.25	3.56
Net Working Capital	1.19	1.53	.89	1.07
Operating Results (Thousands of Dollars)				
Net Sales	$1,696,433	$1,362,713	$998,135	$893,119
Cost of Products Sold	1,172,997	933,157	679,496	624,700
Gross Profit	523,436	429,556	318,639	268,419
Interest Expense	10,658	8,179	4,173	3,569
Income from Continuing Operations before Income Taxes	170,109	139,128	105,267	65,517
Income before Income Taxes as a % of Net Sales	10.03%	10.21%	10.55%	7.34%
Federal and State Income Taxes	$ 63,796	$ 52,173	$ 37,173	$ 24,419
Effective Tax Rate for Continuing Operations	37.50%	37.50%	35.31%	37.27%
Income from Continuing Operations	$ 106,313	$ 86,955	$ 68,094	$ 41,098
Income from Continuing Operations as a % of Net Sales	6.27%	6.38%	6.82%	4.60%
Income before Cumulative Effect of Accounting Changes	$ 106,313	$ 86,955	$ 68,094	$ 41,098
Income from Discontinued Operations	—	—	—	—
Net Income	106,313	86,955	68,094	41,098
Cash Dividends and Share Purchase Rights Redeemed	19,730	16,736	14,970	14,536
Addition to (Reduction of) Retained Earnings	86,583	37,838	33,860	18,863
Net Income Applicable to Common Stock	106,313	86,955	68,094	41,098
% Return on Average Shareholders' Equity	25.20%	27.43%	29.06%	20.00%
Depreciation and Amortization	$ 52,999	$ 35,610	$ 25,252	$ 21,416
Distribution of Net Income				
% Paid to Shareholders	18.56%	19.25%	21.98%	35.37%
% Reinvested in Business	81.44%	80.75%	78.02%	64.63%
Financial Position (Thousands of Dollars)				
Current Assets	$ 290,329	$ 295,150	$205,527	$194,183
Current Liabilities	217,438	200,759	152,553	128,915
Working Capital	72,891	94,391	52,974	65,268
Net Property, Plant, and Equipment	444,177	341,030	234,616	210,033
Total Assets of Continuing Operations	864,469	754,673	513,514	409,518
Total Assets of Discontinued Operations — Net	—	—	—	—
Total Assets	864,469	754,673	513,514	409,518
% Return on Beginning Assets Employed	23.74%	28.27%	25.93%	17.91%
Long-Term Debt and Capital Lease Obligations	$ 135,563	$ 134,511	$ 77,605	$ 42,581
Shareholders' Equity	462,022	381,662	252,397	216,235
Retained Earnings	351,786	265,203	227,365	193,505
Current Ratio	1.34	1.47	1.35	1.51
Current Share Data				
Number of Shares Outstanding at Year-End	61,289,618	61,659,316	59,426,530	60,788,674
Weighted-Average Shares Outstanding During Year	61,649,531	59,779,508	60,228,590	60,991,284
Number of Shareholders of Record at Year-End	5,877	5,399	5,319	5,479
Other Operational Data				
Capital Expenditures — Net (Thousands of Dollars)	$ 149,717	$ 85,491	$ 44,684	$ 53,879
Members (Employees) at Year-End	9,824*	9,390*	6,502*	5,933

**Includes acquisitions completed during year.*

1994	1993	1992	1991	1990	1989	1988
$ .87	$ .69	$ .59	$ .51	$ .65	$ .39	$ .34
—	—	—	—	—	—	.02
—	.01	—	—	—	—	—
—	—	—	—	—	—	.11
.87	.70	.59	.51	.65	.39	.47
.22	.20	.19	.18	.15	.12	.10
3.17	2.83	2.52	2.32	2.03	1.88	1.98
1.27	1.23	1.23	1.07	.82	.83	1.29
$845,998	$780,326	$706,550	$607,710	$663,896	$602,009	$532,456
573,392	537,828	479,179	411,168	458,522	409,942	366,599
272,606	242,498	227,371	196,542	205,374	192,067	165,857
3,248	3,120	3,441	3,533	3,611	3,944	4,188
86,338	70,854	61,893	52,653	69,085	44,656	41,919
10.21%	9.08%	8.76%	8.66%	10.41%	7.42%	7.87%
$ 31,945	$ 26,216	$ 23,210	$ 19,745	$ 25,907	$ 17,193	$ 16,139
37.00%	37.00%	37.50%	37.50%	37.50%	38.50%	38.50%
$ 54,393	$ 44,638	$ 38,683	$ 32,908	$ 43,178	$ 27,463	$ 25,780
6.43%	5.72%	5.47%	5.42%	6.50%	4.56%	4.84%
$ 54,393	$ 44,638	$ 38,683	$ 32,908	$ 43,178	$ 27,463	$ 25,780
—	—	—	—	—	—	9,515
54,156	45,127	38,683	32,908	43,178	27,463	35,295
13,601	12,587	12,114	11,656	9,931	8,298	7,956
13,563	17,338	26,569	18,182	(11,952)	(17,444)	20,986
54,156	45,127	38,683	32,908	43,178	27,463	35,295
28.95%	26.35%	24.75%	23.41%	33.24%	19.92%	25.77%
$ 19,042	$ 16,631	$ 15,478	$ 14,084	$ 13,973	$ 12,866	$ 11,860
25.11%	27.89%	31.32%	35.42%	23.00%	30.22%	22.54%
74.89%	72.11%	68.68%	64.58%	77.00%	69.78%	77.46%
$188,810	$188,419	$171,309	$150,901	$146,591	$162,576	$175,367
111,093	110,759	91,780	82,275	93,465	106,104	78,787
77,717	77,660	79,529	68,626	53,126	56,472	96,580
177,844	157,770	145,849	125,465	124,603	114,116	94,339
372,568	352,405	322,746	280,893	276,984	284,322	275,928
—	—	—	—	—	—	—
372,568	352,405	322,746	280,893	276,984	284,322	275,928
24.72%	22.14%	22.18%	19.66%	24.00%	16.32%	18.46%
$ 45,877	$ 45,916	$ 50,961	$ 32,734	$ 37,250	$ 36,996	$ 37,863
194,640	179,553	163,009	149,575	131,612	128,203	147,549
174,642	161,079	143,741	117,172	98,990	110,942	128,386
1.70	1.70	1.87	1.83	1.57	1.53	2.23
61,349,206	63,351,692	64,737,912	64,417,370	64,769,794	68,194,176	74,647,164
62,435,450	64,181,088	65,517,990	64,742,976	66,220,810	69,632,100	74,853,672
5,556	4,653	4,534	4,466	4,331	4,124	4,134
$ 35,005	$ 27,541	$ 26,626	$ 13,907	$ 20,709	$ 12,807	$ 10,299
6,131	6,257	5,926	5,599	6,073	6,385	5,423

Management's Discussion and Analysis of Financial Condition and Results of Operations

THE FOLLOWING DISCUSSION OF THE COMPANY'S HISTORICAL RESULTS OF OPERATIONS AND OF ITS LIQUIDITY AND CAPITAL RESOURCES SHOULD BE READ IN CONJUNCTION WITH THE CONSOLIDATED FINANCIAL STATEMENTS OF THE COMPANY AND RELATED NOTES.

Results of Operations

The following table sets forth the percentage of consolidated net sales represented by certain items reflected in the Company's statements of income for the periods indicated.

Fiscal	1998	1997	1996
Net sales	100.0%	100.0%	100.0%
Cost of products sold	69.1	68.5	68.1
Gross profit	30.9	31.5	31.9
Selling and administrative expenses	20.3	20.9	21.6
Gain on sale of subsidiary	—	—	0.3
Operating income	10.6	10.6	10.6
Interest expense (net)	.5	.4	.1
Income before income taxes	10.1	10.2	10.5
Income taxes	3.8	3.8	3.7
Net income	6.3%	6.4%	6.8%

The Company has two reportable core operating segments: office furniture and hearth products. The "Operating Segment Information" note included in the notes to consolidated financial statements provides more detailed financial data with respect to these two segments.

Fiscal Year Ended January 2, 1999, Compared to Fiscal Year Ended January 3, 1998

Net Sales

Net sales, on a consolidated basis, increased by 24% to $1.7 billion in 1998 from $1.36 billion in the prior year even though fiscal year 1998 was a normal 52-week year compared to 1997 being a 53-week year. The Company increased sales in both core operating segments due to the continued focus on superior customer service, rapid introduction of new innovative and compelling value products, and acquisitions. Office furniture net sales increased 25% in 1998 to $1.5 billion from $1.16 billion in 1997. Net sales of hearth products increased 20% to $245.1 million in 1998 from $204.5 million in 1997. Both core operating segments experienced another year of strong growth during 1998. The office products industry reported an annual growth rate of 7.8% and hearth products an estimated 10%. The Company's most recent five-year compounded annual growth rate is 17% in net sales.

Gross Profit

Gross profit increased 22% to $523.4 million in 1998 from $429.6 million in the prior year. Gross margin decreased to 30.9% for 1998 compared to 31.5% for 1997. This decrease was due to selling price reductions on select products to increase sales volume, which were only partially offset by productivity gains, and the adverse impact of the Allsteel acquisition not achieving the Company's margin standards as rapidly as projected.

Selling and Administrative Expenses

Selling and administrative expenses increased by 21% to $344.3 million from $284.4 million in the prior year. Selling and administrative expenses, as a percentage of net sales, decreased to 20.3% in 1998 from 20.9% in 1997. Management places major emphasis on controlling and reducing selling and administrative expenses. The Company expects to leverage these costs as sales grow, however, increased costs to meet competitive conditions offset a portion of the efficiency and leveraging gains.

Selling and administrative expenses include freight expense to the customer, product development costs and amortization expenses of intangible assets. The "Selling and Administrative Expenses" note included in the notes to consolidated financial statements provides further information regarding the comparative expense levels for these major expense items.

Operating Income

Operating income increased by 23% to $179.2 million in 1998 from $145.2 million in 1997. The increase is due to increased sales and lower selling and administrative expenses as a percent of sales.

Net Income

Net income increased by 22% to $106.3 million in 1998 from $87.0 million in 1997. This increase is a result of the higher operating income being partially offset by an increase in interest expense associated with acquisition and capital expenditures.

Net income per common share increased by 19% to $1.72 in 1998 from $1.45 in 1997. Average shares outstanding increased to 61.6 million in 1998 from 59.8 million in 1997 as a result of the weighting of the October 1997 primary stock offering.

Fiscal Year Ended January 3, 1998, Compared to Fiscal Year Ended December 28, 1996

Net Sales

Net sales, on a consolidated basis, increased by 37% to $1.36 billion in 1997 from $998.1 million in the prior year. The Company increased net sales in both core segments by offering compelling value products through a combination of broad selection, features, quality, price, and service. Office furniture products net sales increased 31% in 1997 to $1.16 billion from $887.3 million in 1996 due in part from the Company's acquisitions of Allsteel Inc., Bevis Custom Furniture, Inc., and Panel Concepts, Inc. Hearth products net sales increased 84% in 1997 to $204.5 million from $110.8 million in 1996 due in part to the Company's October 1996 acquisition of Heat-N-Glo Fireplace Products, Inc. Both core industry segments experienced strong growth during 1997. The office products industry reported an annual growth rate of 15% and hearth products an estimated 10%. The Company's compounded annual growth rate for the five-year period of 1993 to 1997 was 14% in net sales while the overall office furniture industry's sales growth rate was 8%. No comparable industry growth data is available for the hearth products industry.

Gross Profit

Gross profit increased by 35% to $429.6 million in 1997 from $318.6 million in the prior year. Gross margin decreased to 31.5% for 1997 compared to 31.9% for 1996. This lower margin is due to the combination of productivity gains and cost control initiatives being more than offset by strategic selling price reductions on select products to increase market share and the impact of lower operating margins for certain 1997 acquisitions.

Selling and Administrative Expenses

Selling and administrative expenses increased by 32% to $284.4 million from $215.6 million in the prior year. Selling and administrative expenses, as a percentage of net sales, decreased to 20.9% in 1997 from 21.6% in 1996. This decrease was a result of continued commitment to develop more efficient business processes which have improved member productivity, stringent control of expenses, and increased efficiencies associated with higher net sales. However, these results were partially offset by increased freight costs due to growth of unit volume, increased distribution costs for new warehouse capacity and product handling technologies that facilitate providing a higher level of service to customers, and the ongoing commitment to developing and marketing new products.

This expense category, in addition to freight expense to the customer, also includes major costs related to product development and amortization expense of intangible assets. The "Selling and Administrative Expenses" note included in the notes to consolidated financial statements provides further information regarding the comparative expense levels for these major expense items.

Operating Income

Operating income increased by 41% to $145.2 million in 1997 from $103.0 million, excluding a nonrecurring pre-tax gain on the sale of a subsidiary of $3.2 million in 1996. The increase is due to controlling operating costs and leveraging incremental sales.

Net Income

Net income increased by 32% to $87.0 million in 1997 from $66.1 million in 1996, excluding the $2.0 million nonrecurring after-tax gain on the sale of a subsidiary. This increase is a result of the higher operating income being partially offset by an increase in interest expense associated with acquisitions and the resumption of a more normal effective income tax rate. The effective tax rate was 37.5% for 1997 compared to 35.3% for 1996. The rate for 1996 was favorably impacted by nonrecurring income tax credits of $2.1 million, or $0.04 per share, recorded in the third quarter of 1996.

Net income per common share increased by 32% to $1.45 in 1997 from $1.10, excluding a nonrecurring after-tax gain of $0.03 per share in 1996. Average common shares outstanding decreased to 59.8 million in 1997 from 60.2 million in 1996.

Fiscal Year Ended December 28, 1996 Compared to Fiscal Year Ended December 30, 1995

Net Sales

Net sales, on a consolidated basis, increased by 12% to $998.1 million in 1996 from $893.1 million in the prior year. The increase in net sales for both core business segments was due to the Company's offering of an ongoing stream of innovative and quality new products and a commitment to manufacturing excellence. Office furniture products net sales increased 8% in 1996 to $887.3 million from $818.9 million in 1995. Hearth products net sales increased 49% in 1996 to $110.8 million from $74.2 million in 1995 due in part to the Company's October 1996 acquisition of Heat-N-Glo Fireplace Products, Inc.

Gross Profit

Gross profit increased by 19% to $318.6 million in 1996 from $268.4 million in the prior year. The increase in gross profit is primarily attributable to the Company's sales growth in both operating segments, which has been driven by unit sales growth as opposed to pricing growth. Gross profit margin increased to 31.9% for 1996 compared to 30.1% for 1995. This increase was a result of the elimination of production inefficiencies associated with two operations closed during 1995 and increased production unit volume, productivity improvements, and effective cost control efforts, partially offset by continued price reductions on many of the Company's products.

Selling and Administrative Expenses

Selling and administrative expenses increased by 7% to $215.6 million in 1996 from $201.7 million in the prior year. Selling and administrative expenses as a percentage of net sales decreased to 21.6% in 1996 from 22.6% in 1995. This decrease was a result of continued implementation of the Company's rapid continuous improvement process, which led to more efficient business processes and increased efficiencies associated with higher net sales. These decreases were partially offset by increases in marketing programs, greater use of cooperative advertising programs, freight costs escalating at a more rapid rate than product price increases, and additional costs of pursuing a proactive acquisition strategy.

Operating Income
Operating income increased by 54% to $103.0 million (excluding a nonrecurring pre-tax gain on the sale of a subsidiary of $3.2 million) in 1996 from $66.7 million in 1995. The increase is a result of the increase in gross profit and lower selling and administrative expenses as a percentage of net sales.

Net Income
Net income, excluding the $2.0 million nonrecurring after-tax gain on the sale of a subsidiary, increased by 61% to $66.1 million in 1996 from $41.1 million in the prior year. This increase is primarily attributable to increased operating income, lower net interest expense and a lower effective income tax rate. The effective tax rate was 35.3% for 1996 compared to 37.3% for 1995. The rate for 1996 was favorably impacted by non-recurring income tax credits of $2.1 million, or $0.04 per share, recorded in the third quarter of 1996.

Net income per common share increased by 64% to $1.10 (excluding a nonrecurring after-tax gain of $0.03 per share) in 1996 from $0.67 for 1995. The Company's net income per share performance for 1996 benefited from the Company's common stock repurchase program.

During 1995 and 1996, the Company closed, consolidated, and sold several operations in an effort to concentrate further on its core strengths. In addition, the Company resolved several litigation uncertainties, reduced its workforce, addressed several asset realization concerns, and benefited from special tax credits. The net effect of these nonrecurring business events was to reduce annual net income by $3.3 million, or $0.05 per share, in 1996, and $4.8 million, or $0.08 per share, in 1995.

Liquidity and Capital Resources

During 1998, cash from operations was $146.8 million which provided the funds necessary to meet working capital needs, help finance acquisitions, invest in capital improvements, repay long-term debt, and pay increased dividends.

Cash Management
Cash, cash equivalents, and short-term investments totaled $17.7 million compared to $46.3 million at the end of 1997 and $32.7 million at the end of 1996. These funds, coupled with cash from future operations and additional long-term debt, if needed, are expected to be adequate to finance operations, planned improvement, and internal growth.

The Company places special emphasis on the management and reduction of its working capital with a particular focus on trade receivables and inventory levels. The success achieved in managing receivables is in large part a result of doing business with quality customers and maintaining close communications with them. Trade receivable days outstanding have averaged about 36 days over the past three years. Inventory levels and turns continue to improve as a function of reducing production cycle times. Inventory turns have been in the 17 to 18 range over the past three years with 1998 reaching 18.4 turns.

The Company had a cash infusion during the fourth quarter of 1997 from its primary offering of 2,300,000 shares of common stock at an offering price of $26 per share. This transaction netted the Company approximately $56.8 million which was used to finance acquisitions and to repay a portion of debt associated with acquisitions.

Capital Expenditure Investments
Capital expenditures, net of disposals, were $149.7 million in 1998, $85.5 million in 1997, and $44.7 million in 1996. Expenditures during 1998, 1997, and 1996 have been consistently focused on machinery and equipment and facility expansion needed to support new products, process improvements, cost-saving initiatives, and creating additional production and warehousing capacity.

Acquisitions
In February 1998, the Company completed the acquisition of Aladdin Steel Products, Inc. for a purchase price of approximately $10.2 million. This acquisition allowed the Company to strengthen its position in the hearth products market. During 1997, the Company completed three office furniture acquisitions: Allsteel Inc. in June, Bevis Custom Furniture, Inc. in November, and Panel Concepts, Inc. in December for a combined purchase price of approximately $119.5 million. In October 1996, the Company acquired Heat-N-Glo Fireplace Products, Inc., a leading hearth products manufacturer, for a purchase price of approximately $79 million. These acquisitions were accounted for under the purchase method of accounting and financed by a combination of cash and long-term debt.

Long-Term Debt

Long-term debt, including capital lease obligations, was 23% of total capitalization at January 2, 1999, 26% at January 3, 1998, and 24% at December 28, 1996. The Company does not expect future capital resources to be a constraint on planned growth. Significant additional borrowing capacity is available through a revolving bank credit agreement in the event cash generated from operations should be inadequate to meet future capital needs.

Cash Dividends

Cash dividends were $0.32 per common share for 1998, $0.28 for 1997, and $0.25 for 1996. Further, the Board of Directors announced an 18.8% increase in the quarterly dividend from $0.08 to $0.095 per common share effective with the March 1, 1999, dividend payment. The previous quarterly dividend increase was from $0.07 to $0.08, effective with the February 28, 1998, dividend payment. A cash dividend has been paid every quarter since April 15, 1955, and quarterly dividends are expected to continue. The average dividend payout percentage for the most recent three-year period has been 26% of prior year earnings.

Stock Split

On February 11, 1998, the Board of Directors announced a two-for-one stock split in the form of a 100 percent stock dividend that was paid on March 27, 1998, to shareholders of record on March 6, 1998. Shareholders received one share of common stock for each share held on the record date.

Common Share Repurchases

During 1998, the Company repurchased 529,284 shares of its common stock at a cost of approximately $12.2 million, or an average price of $23.04. As of January 2, 1999, approximately $62.5 million of the $70.0 million authorized for repurchases remained unspent. During 1997, the Company repurchased 183,154 shares at a cost of approximately $4.1 million, or an average price of $22.30. During 1996, the Company repurchased 1,507,600 shares at a cost of approximately $21.9 million, or an average price of $14.54.

Litigation and Uncertainties

The Company is involved in various legal actions arising in the course of business. These uncertainties are referenced in the "Contingencies" note included in the notes to consolidated financial statements.

Year 2000 Issue

The Company is actively working a comprehensive Year 2000 (Y2K) readiness plan. The primary mission of the plan is to maintain business continuity by giving priority remediation and resolution to any Year 2000 issue, whether internally or externally based, that may disrupt or compromise normal business operations.

The project is focused on three business fronts: (1) information technology (IT), which encompasses traditional computer hardware, software and related networks; (2) operations, which encompass material suppliers and embedded chips used by facility, production, and distribution machinery, equipment, and support processes; and (3) customers and other non-operational service providers.

Remediation progress achieved to date has been primarily in the information technology area, which has benefited from having the earliest start. The other two focus areas are in various stages of identifying potential remediation targets, solutions, and confirmation procedures.

The IT issues addressed to date have been minor. Potential operational issues have been identified and are being aggressively pursued. None appear at this time to constitute a serious threat to the Company's Y2K business continuity mission. Customers and other non-operational service providers represent a unique challenge inasmuch as the Company must rely primarily on individual Year 2000 readiness disclosures. In most instances, the Company is unable to independently confirm readiness. However, no customer or service provider has been identified as constituting a serious threat to the business continuity mission. Total incremental out-of-pocket project remediation-related costs incurred through January 2, 1999, were less than $100,000. Internal project costs were negligible.

All three project focus areas are on schedule to be completed during the second and third quarter of 1999, leaving the fourth quarter of 1999 primarily for follow-up compliance testing and contingency planning as needed. The Company is estimating its total incremental out-of-pocket project costs will not exceed the $1 million range, including some costs that, because of their nature, will be capitalized. All costs associated with this project are being expensed or capitalized in the period incurred.

While the Company at this time does not expect any material business interruptions due to Year 2000 issues, even with the best of plans and the best follow-through efforts, there may be a variety of potential business risks. Management believes these business risks include, but are not necessarily limited to the following: higher than expected remediation costs, exclusion of coverage by insurers for losses/damages attributable to Year 2000 issues, loss of production, loss of sales, and litigation risk.

Report of Independent Public Accountants

To the Board of Directors of HON INDUSTRIES Inc.

We have audited the accompanying consolidated balance sheets of HON INDUSTRIES Inc. and subsidiaries as of January 2, 1999, January 3, 1998, and December 28, 1996, and the related consolidated statements of income, shareholders' equity, and cash flows for the fiscal years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall consolidated financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of HON INDUSTRIES Inc. and subsidiaries as of January 2, 1999, January 3, 1998, and December 28, 1996, and its results of its operations and its cash flows for the fiscal years then ended, in conformity with generally accepted accounting principles.

Arthur Andersen LLP

Chicago, Illinois

February 1, 1999

Management's Responsibility for Financial Statements

Management is responsible for the preparation, integrity, and objectivity of the consolidated financial statements and other financial information presented in this report. The accompanying consolidated financial statements and related notes were prepared in accordance with generally accepted accounting principles, applying certain estimates and judgments as required.

HON INDUSTRIES' internal controls are designed to provide reasonable assurance as to the integrity and reliability of the financial statements and to adequately safeguard, verify, and maintain accountability of assets. Such controls are based on established written policies and procedures, are implemented by trained, skilled personnel with an appropriate segregation of duties, and are monitored through a comprehensive internal audit program. These policies and procedures prescribe that the Company and all its members are to maintain the highest ethical standards and that its business practices are to be conducted in a manner which is above reproach.

Arthur Andersen LLP, independent public accountants, is retained to audit HON INDUSTRIES' financial statements. Their accompanying report is based on audits conducted in accordance with generally accepted auditing standards, which includes the consideration of the Company's internal controls to establish a basis for reliance thereon in determining the nature, timing, and extent of audit tests to be applied.

The Board of Directors exercises its responsibility for these financial statements through its Audit Committee, which consists entirely of independent nonmanagement board members. The Audit Committee meets periodically with the independent public accountants and with the Company's internal auditors, both privately and with management present, to review accounting, auditing, internal controls, and financial reporting matters.

Jack D. Michaels
Chairman, President and
Chief Executive Officer

David C. Stuebe
Vice President and
Chief Financial Officer

Consolidated Statements of Income

For the Years	1998	1997	1996
Net sales	$1,696,433,000	$1,362,713,000	$998,135,000
Cost of products sold	1,172,997,000	933,157,000	679,496,000
Gross Profit	523,436,000	429,556,000	318,639,000
Selling and administrative expenses	344,259,000	284,397,000	215,646,000
Gain on sale of subsidiary	—	—	3,200,000
Operating Income	179,177,000	145,159,000	106,193,000
Interest income	1,590,000	2,148,000	3,247,000
Interest expense	10,658,000	8,179,000	4,173,000
Income Before Income Taxes	170,109,000	139,128,000	105,267,000
Income taxes	63,796,000	52,173,000	37,173,000
Net Income	$ 106,313,000	$ 86,955,000	$ 68,094,000
Net Income Per Common Share	$ 1.72	$ 1.45	$ 1.13

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Balance Sheets

As of Year-End	1998	1997	1996
Assets			
Current Assets			
Cash and cash equivalents	$ 17,500,000	$ 46,080,000	$ 31,196,000
Short-term investments	169,000	260,000	1,502,000
Receivables	183,576,000	158,408,000	109,095,000
Inventories	67,225,000	60,182,000	43,550,000
Deferred income taxes	12,477,000	14,391,000	9,046,000
Prepaid expenses and other current assets	9,382,000	15,829,000	11,138,000
Total Current Assets	290,329,000	295,150,000	205,527,000
Property, Plant, and Equipment	444,177,000	341,030,000	234,616,000
Goodwill	108,586,000	98,720,000	51,213,000
Other Assets	21,377,000	19,773,000	22,158,000
Total Assets	$864,469,000	$754,673,000	$513,514,000
Liabilities and Shareholders' Equity			
Current Liabilities			
Accounts payable and accrued expenses	$193,859,000	$183,738,000	$127,910,000
Income taxes	1,921,000	8,133,000	2,574,000
Note payable and current maturities of long-term debt	15,769,000	2,545,000	16,244,000
Current maturities of other long-term obligations	5,889,000	6,343,000	5,825,000
Total Current Liabilities	$217,438,000	$200,759,000	$152,553,000
Long-Term Debt	128,069,000	123,487,000	71,285,000
Capital Lease Obligations	7,494,000	11,024,000	6,320,000
Other Long-Term Liabilities	18,067,000	18,601,000	20,183,000
Deferred Income Taxes	31,379,000	19,140,000	10,726,000
Minority Interest in Subsidiary	—	—	50,000
Commitments and Contingencies			
Shareholders' Equity			
Common stock	61,290,000	61,659,000	29,713,000
Paid-in capital	48,348,000	55,906,000	360,000
Retained earnings	351,786,000	265,203,000	227,365,000
Receivable from HON Members Company Ownership Plan	—	(1,099,000)	(5,041,000)
Accumulated other comprehensive income	598,000	(7,000)	—
Total Shareholders' Equity	462,022,000	381,662,000	252,397,000
Total Liabilities and Shareholders' Equity	$864,469,000	$754,673,000	$513,514,000

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Shareholders' Equity

	Common Stock	Additional Paid-in Capital	Receivable from Co. ESOP	Retained Earnings	Accumulated Other Comprehensive Income	Total Shareholders' Equity
Balance, December 30, 1995	$30,394,000	$ 550,000	$(8,214,000)	$193,505,000	$ —	$216,235,000
Comprehensive income:						
Net income				68,094,000		68,094,000
Other comprehensive income						—
Comprehensive income						68,094,000
Cash dividends				(14,970,000)		(14,970,000)
Common shares — treasury:						
Shares purchased	(754,000)	(1,896,000)		(19,264,000)		(21,914,000)
Shares issued under Members Stock Purchase Plan and stock awards	73,000	1,706,000				1,779,000
Principal repaid by HON Members Company Ownership Plan			3,173,000			3,173,000
Balance, December 28, 1996	29,713,000	360,000	(5,041,000)	227,365,000	—	252,397,000
Comprehensive income:						
Net income				86,955,000		86,955,000
Other comprehensive income					(7,000)	(7,000)
Comprehensive income						86,948,000
Cash dividends				(16,736,000)		(16,736,000)
Stock split effected in the form of a 100% stock dividend	30,830,000			(30,830,000)		—
Common shares — treasury:						
Shares purchased	(92,000)	(2,441,000)		(1,551,000)		(4,084,000)
Shares issued through public stock offering	1,150,000	55,616,000				56,766,000
Shares issued under Members Stock Purchase Plan and stock awards	58,000	2,371,000				2,429,000
Principal repaid by HON Members Company Ownership Plan			3,942,000			3,942,000
Balance, January 3, 1998	61,659,000	55,906,000	(1,099,000)	265,203,000	(7,000)	381,662,000
Comprehensive Income:						
Net income				106,313,000		106,313,000
Other comprehensive income					605,000	605,000
Comprehensive income						106,918,000
Cash dividends				(19,730,000)		(19,730,000)
Common shares — treasury:						
Shares purchased	(529,000)	(11,672,000)				(12,201,000)
Shares issued under Members Stock Purchase Plan and stock awards	160,000	4,114,000				4,274,000
Principal repaid by HON Members Company Ownership			1,099,000			1,099,000
Balance, January 2, 1999	$61,290,000	$ 48,348,000	—	$351,786,000	$598,000	$462,022,000

The accompanying notes are an integral part of the consolidated financial statements.

Consolidated Statements of Cash Flows

For the Years	1998	1997	1996
Net Cash Flows From (To) Operating Activities:			
Net income	$ 106,313,000	$ 86,955,000	$ 68,094,000
Noncash items included in net income:			
Depreciation and amortization	52,999,000	35,610,000	25,252,000
Gain on sale of subsidiary, net of tax	—	—	(2,016,000)
Other postretirement and postemployment benefits	1,529,000	1,397,000	1,398,000
Deferred income taxes	13,816,000	7,128,000	5,103,000
Other — net	8,000	(35,000)	252,000
Changes in working capital, excluding acquisition and disposition:			
Receivables	(24,238,000)	(15,169,000)	(5,085,000)
Inventories	(4,286,000)	3,134,000	184,000
Prepaid expenses and other current assets	6,517,000	(1,574,000)	(2,613,000)
Accounts payable and accrued expenses	3,895,000	16,789,000	998,000
Accrued facilities closing and reorganization expenses	64,000	(256,000)	(1,147,000)
Income taxes	(7,419,000)	6,881,000	(3,971,000)
Increase in other liabilities	(2,406,000)	525,000	6,860,000
Net cash flows from (to) operating activities	146,792,000	141,385,000	93,309,000
Net Cash Flows From (To) Investing Activities:			
Capital expenditures — net	(149,717,000)	(85,491,000)	(44,684,000)
Acquisition spending, net of cash acquired	(11,470,000)	(121,424,000)	(79,136,000)
Net proceeds from sale of subsidiary	—	—	7,336,000
Principal repaid by HON Members Company Ownership Plan	1,099,000	3,942,000	3,173,000
Short-term investments — net	91,000	442,000	12,392,000
Other — net	80,000	1,792,000	(976,000)
Net cash flows from (to) investing activities	(159,917,000)	(200,739,000)	(101,895,000)
Net Cash Flows From (To) Financing Activities:			
Purchase of HON INDUSTRIES common stock	(12,206,000)	(4,085,000)	(21,912,000)
Proceeds from public offering of HON INDUSTRIES common stock	—	56,766,000	—
Proceeds from long-term debt	73,237,000	100,238,000	51,072,000
Payments of note and long-term debt	(60,079,000)	(64,374,000)	(8,416,000)
Proceeds from sale of HON INDUSTRIES common stock to members	3,323,000	2,429,000	1,777,000
Dividends paid	(19,730,000)	(16,736,000)	(14,970,000)
Net cash flows from (to) financing activities	(15,455,000)	74,238,000	7,551,000
Net increase (decrease) in cash and cash equivalents	(28,580,000)	14,884,000	(1,035,000)
Cash and cash equivalents at beginning of year	46,080,000	31,196,000	32,231,000
Cash and cash equivalents at end of year	$ 17,500,000	$ 46,080,000	$ 31,196,000
Supplemental Disclosures of Cash Flow Information:			
Cash paid during the year for:			
Interest	$ 10,867,000	$ 8,404,000	$ 3,334,000
Income taxes	$ 56,787,000	$ 38,246,000	$ 36,318,000

The accompanying notes are an integral part of the consolidated financial statements.

Notes to Consolidated Financial Statements

Nature of Operations

HON INDUSTRIES Inc., with its subsidiaries (the Company), is a national manufacturer and marketer of office furniture and hearth products. Both industries are reportable segments; however, the Company's office furniture business is its principal line of business. Refer to the "Operating Segment Information" note for further information. Office furniture products are sold through a national system of dealers, wholesalers, mass merchandisers, warehouse clubs, retail superstores, end-user customers, and to federal and state governments. Dealer, wholesaler, and retail superstores are the major channels based on sales. Hearth products include wood-, pellet-, and gas-burning factory-built fireplaces, fireplace inserts, stoves, and gas logs. These products are sold through a national system of dealers, wholesalers, and large regional contractors. The Company's products are marketed predominantly in the United States and Canada. The Company exports select products to a limited number of markets outside North America, principally Latin America and the Caribbean, through its export subsidiary; however, based on sales, it is not significant.

Summary of Significant Accounting Policies

Principles of Consolidation and Fiscal Year-End

The consolidated financial statements include the accounts and transactions of the Company and its subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

The Company follows a 52/53-week fiscal year which ends on the Saturday nearest December 31. Fiscal year 1998 ended on January 2, 1999; 1997 ended on January 3, 1998; and 1996 ended on December 28, 1996. The financial statements for fiscal year 1997 are based on a 53-week period, fiscal years 1998 and 1996 are on a 52-week basis.

Cash and Cash Equivalents

Cash and cash equivalents generally consist of cash and commercial paper. These securities have original maturity dates not exceeding three months from date of purchase.

Short-Term Investments

Short-term investments are classified as available-for-sale and are highly liquid debt and equity securities. These investments are stated at cost which approximates market value.

Receivables

Accounts receivable are presented net of an allowance for doubtful accounts of $2,816,000, $3,277,000, and $1,830,000 for 1998, 1997, and 1996, respectively.

Inventories

Inventories are valued at the lower of cost or market, determined principally by the last-in, first-out (LIFO) method.

Property, Plant, and Equipment

Property, plant, and equipment are carried at cost. Depreciation has been computed by the straight-line method over estimated useful lives: land improvements, 10–20 years; buildings, 10–40 years; and machinery and equipment, 3–12 years. The Company capitalized interest costs of $22,000 and $95,000 in 1997 and 1996, respectively.

Goodwill and Patents

Goodwill represents the excess of cost over the fair value of net identifiable assets of acquired companies. Goodwill is being amortized on a straight-line basis predominantly over 30 years. Patents are being amortized on a straight-line basis over their estimated useful lives, which range from 7 to 16 years. Patents are reported by the Company as "Other Assets."

The carrying value of goodwill and patents is reviewed by the Company whenever significant events or changes occur which might impair recovery of recorded costs. Based on its most recent analysis, the Company believes no material impairment of these intangible assets exists at January 2, 1999.

(In thousands)	1998	1997	1996
Goodwill	$113,812	$100,667	$52,051
Patents	16,450	16,450	16,060
Less accumulated amortization	8,570	3,781	838
	$121,692	$113,336	$67,273

Product Development Costs

Product development costs relating to the development of new products and processes, including significant improvements and refinements to existing products, are expensed as incurred. The amounts charged against income were $15,707,000 in 1998, $15,371,000 in 1997, and $10,423,000 in 1996.

Stock-Based Compensation

The Company accounts for its stock option plan using Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," which results in no charge to earnings when options are issued at fair market value. The Company has adopted the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation."

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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

New Accounting Standards

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income," SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information," and SFAS No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," as of January 4, 1998, the beginning of its 1998 fiscal year; SFAS No. 128, "Earnings Per Share," and SFAS No. 129, "Disclosure of Information about Capital Structure," as of January 3, 1998, year-end 1997; and SFAS No. 121, "Accounting for the Impairment of Long-Lived Assets to be Disposed Of," in the first quarter of 1996. Their adoption had no material effect on financial condition or results of operations.

Earnings Per Share

Net income per common share is based on the weighted-average number of shares of common stock outstanding during each year including allocated and unallocated ESOP shares. The Company adopted Statement of Financial Accounting Standards (SFAS) No. 128, "Earnings Per Share," and SFAS No. 129, "Disclosure of Information about Capital Structure," as of January 3, 1998, which is the end of its 1997 fiscal year. The effect of adoption was immaterial.

Comprehensive Income

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income," as of January 4, 1998, the beginning of its 1998 fiscal year. SFAS No. 130 establishes new rules for the reporting and display of comprehensive income and its components; however, the adoption of this Statement had no impact on the Company's net income or shareholders' equity. The Company's comprehensive income consists of an unrealized holding gain on equity securities available-for-sale under SFAS No. 115, "Accounting for Certain Investments in Debt and Equity Securities," and nominal foreign currency adjustments. Prior years' financial statements have been reclassified to conform to these requirements.

Reclassifications

Certain prior year information has been reclassified to conform to the current year presentation.

Business Combinations

The Company acquired Aladdin Steel Products, Inc. on February 20, 1998. Aladdin is a manufacturer of wood-, pellet-, and gas-burning stoves and inserts. Aladdin is being operated by Hearth Technologies Inc., the Company's hearth products subsidiary. The transaction was accounted for under the purchase method. The cash purchase price and preliminary allocation is shown below:

(In millions)	
Purchase Price	$10.2
Preliminary Allocation of Purchase Price:	
Working capital, other than cash	.2
Property, plant, and equipment	1.8
Goodwill	8.2

The Company completed three office furniture business acquisitions during fiscal year 1997. Allsteel Inc. was a stock purchase acquired on June 17, 1997, from ACI America Holdings Inc., a subsidiary of BTR plc, for approximately $66 million. It manufactures and markets a line of quality, mid-priced office furniture with manufacturing and distribution facilities in Jackson and Milan, Tennessee; Verona, Mississippi; and West Hazleton, Pennsylvania. Bevis Custom Furniture, Inc. was an asset purchase acquired on November 13, 1997, from Hunt Manufacturing Co. for approximately $45.1 million. It manufactures and markets a line of affordably priced office furniture with a manufacturing operation located in Florence, Alabama. Allsteel and Bevis operate as part of the Company's division, The HON Company. Panel Concepts, Inc. was a stock purchase acquired December 1, 1997, from Standard Pacific Corp. for approximately $8.4 million. It manufactures and markets innovative panel-based office systems with a manufacturing plant located in Santa Ana, California. Panel Concepts operates as part of the Company's subsidiary, BPI Inc. Each of the transactions was accounted for under the purchase method of accounting and all were financed by a combination of cash and long-term debt. Assuming the acquisitions of Heat-N-Glo Fireplace Products, Inc., Allsteel Inc., Bevis Custom Furniture, Inc., and Panel Concepts, Inc. had occurred on December 31, 1995, the beginning of the Company's 1996 fiscal year, instead of the actual dates, the Company's pro forma consolidated net sales would have been approximately $1.5 billion and $1.3 billion for 1997 and 1996, respectively. Pro forma consolidated net income and net income per share for 1997 and 1996 would not have been materially different than the reported amounts.

In October 1996, the Company acquired Heat-N-Glo Fireplace Products, Inc., located in Savage, Minnesota, for a combination of cash and debt totaling approximately $79 million. The transaction was accounted for under the purchase method. The Company merged Heat-N-Glo into Heatilator Inc., which changed its name to Hearth Technologies Inc. Both Heatilator and Heat-N-Glo are engaged in the manufacturing and marketing of quality hearth products and operate as divisions of Hearth Technologies Inc.

Assuming this transaction had occurred as of the beginning of fiscal year 1995, the Company's pro forma consolidated net sales would have been approximately $1.07 billion and $971.6 million in 1996 and 1995, respectively.

Assuming the acquisition of Heat-N-Glo Fireplace Products, Inc., Allsteel Inc., Bevis Custom Furniture, Inc., Panel Concepts, Inc., and Aladdin Steel Products, Inc. had occurred on December 29, 1996, the beginning of the Company's 1997 fiscal year, instead of the actual dates reported above, the Company's pro forma consolidated net sales would have been approximately $1.7 billion and $1.5 billion for 1998 and 1997, respectively. Pro forma consolidated net income and net income per share for 1998 and 1997 would not have been materially different than the reported amounts.

Business Disposition

On January 24, 1996, the Company sold the outstanding stock of Ring King Visibles, Inc., a wholly owned subsidiary, for $8.0 million in cash and the forgiveness of intercompany receivables of approximately $2.0 million. The sale resulted in an approximate $3.2 million pre-tax gain for the Company (an after-tax gain of $2.0 million, or $0.03 per share) which was recorded in the first quarter of fiscal year 1996.

Inventories

(In thousands)	1998	1997	1996
Finished products	$ 24,955	$ 26,352	$ 20,303
Materials and work in process	53,320	48,186	36,184
LIFO allowance	(11,050)	(14,356)	(12,937)
	$ 67,225	$ 60,182	$ 43,550

Property, Plant, and Equipment

(In thousands)	1998	1997	1996
Land and land improvements	$ 12,156	$ 10,059	$ 9,114
Buildings	144,559	111,387	92,509
Machinery and equipment	411,238	333,216	231,780
Construction and equipment installation in progress	85,782	60,832	42,507
	653,735	515,494	375,910
Less allowances for depreciation	209,558	174,464	141,294
	$444,177	$341,030	$234,616

Accounts Payable and Accrued Expenses

(In thousands)	1998	1997	1996
Trade accounts payable	$ 75,895	$ 76,623	$ 44,762
Compensation	6,789	6,339	6,331
Profit sharing and retirement expense	20,355	15,013	11,736
Vacation pay	11,751	10,879	8,064
Marketing expenses	45,833	38,096	36,550
Casualty self-insurance expense	6,271	5,201	3,787
Other accrued expenses	26,965	31,587	16,680
	$193,859	$183,738	$127,910

Long-Term Debt

(In thousands)	1998	1997	1996
Industrial development revenue bonds, various issues, payable through 2018 with interest at 3.44–8.125% per annum	$ 25,293	$ 23,549	$24,063
Note payable to bank, term loan payable in 2001 with interest at 7.11% per annum	—	—	27,200
Note payable to bank, revolving credit agreement with interest at a variable rate (5.25–5.8125% at year-end 1998)*	95,000	80,000	—
Convertible debenture payable to individuals, due in 1999 with interest at 7.0% per annum	—	12,000	12,000
Other notes and amounts	7,776	7,938	8,022
	$128,069	$123,487	$71,285

* *The revolving bank credit agreement is payable in the year 2002 with a maximum borrowing limit of $200,000,000.*

Aggregate maturities of long-term debt are as follows (in thousands):

1999	$12,574
2000	3,282
2001	3,207
2002	95,710
2003	833
Thereafter	25,037

The note and convertible debenture payable to individuals are payable to the former owners of a business acquired by the Company in 1996. These individuals continue as officers of a subsidiary of the Company following the merger. The convertible debenture is convertible into shares of common stock of Hearth Technologies Inc., a subsidiary of the Company, representing 10% of the current issued and outstanding stock of Hearth Technologies Inc.

Certain of the above borrowing arrangements include covenants which limit the assumption of additional debt and lease obligations. The fair value of the Company's outstanding long-term debt obligations at year-end 1998 approximates the recorded aggregate amount.

Property, plant, and equipment, with net carrying values of approximately $54,227,000 at the end of 1998, are mortgaged.

Selling and Administrative Expenses

(In thousands)	1998	1997	1996
Freight expense to customer	$ 96,258	$ 73,261	$ 51,662
Amortization of intangible assets	4,789	2,943	838
Product development costs	15,707	15,371	10,423
General selling and administrative expense	227,505	192,822	152,723
	$344,259	$284,397	$215,646

Income Taxes

Significant components of the provision for income taxes are as follows:

(In thousands)	1998	1997	1996
Current:			
Federal	$44,525	$38,989	$27,958
State	5,363	4,695	3,932
	49,888	43,684	31,890
Deferred	13,908	8,489	5,283
	$63,796	$52,173	$37,173

A reconciliation of the statutory federal income tax rate to the Company's effective income tax rate is as follows:

	1998	1997	1996
Federal statutory tax rate	35.0%	35.0%	35.0%
State taxes, net of federal tax effect	2.6	2.6	2.7
Federal and state tax credits	(.1)	(.2)	(2.2)
Other — net	—	.1	(.2)
Effective tax rate	37.5%	37.5%	35.3%

The Company recognized one-time federal and state research and development and new jobs tax credits totaling $2.1 million, or $0.04 per share, in 1996 related to prior tax years.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets are as follows:

(In thousands)	1998	1997	1996
Net long-term deferred tax liabilities:			
Tax over book depreciation	$(33,118)	$(25,743)	$(17,584)
OPEB obligations	3,305	3,920	2,947
Other — net	(1,566)	2,683	3,911
Total net long-term deferred tax liabilities	(31,379)	(19,140)	(10,726)
Net current deferred tax assets:			
Workers' compensation, general, and product liability accruals	2,315	2,054	1,548
Vacation accrual	2,531	892	1,855
Inventory obsolescence reserve	1,026	2,631	580
Other — net	6,605	8,814	5,063
Total net current deferred tax assets	12,477	14,391	9,046
Net deferred tax (liabilities) assets	$(18,902)	$ (4,749)	$ (1,680)

Shareholders' Equity and Earnings Per Share

	1998	1997	1996
Common Stock, $1 Par Value			
Authorized	200,000,000	100,000,000	100,000,000
Issued and outstanding	61,289,618	61,659,316	59,426,530
Preferred Stock, $1 Par Value			
Authorized	1,000,000	1,000,000	1,000,000
Issued and outstanding	—	—	—

On February 11, 1998, the Company's Board of Directors declared a two-for-one stock split in the form of a 100% stock dividend paid on March 27, 1998, to shareholders of record on the close of business on March 6, 1998. In May 1998, shareholders authorized an increase of capital stock of the Company from 101,000,000 shares to 201,000,000 shares, consisting of 200,000,000 shares of common stock, $1.00 par value, and 1,000,000 shares of preferred stock, $1.00 par value.

The Company purchased 529,284; 183,154; and 1,507,600 shares of its common stock during 1998, 1997, and 1996, respectively. The par value method of accounting is used for common stock repurchases. The excess of the cost of shares acquired over their par value is allocated to Paid-In Capital with the excess charged to Retained Earnings.

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income," as of January 4, 1998, the beginning of its 1998 fiscal year. The Company has changed the format of its consolidated statements of shareholders' equity to present comprehensive income.

Components of other comprehensive income (loss) consists of the following:

(In thousands)	1998	1997	1996
Foreign currency translation adjustments — net of tax	$ 42	$ (7)	$—
Change in unrealized gains on marketable securities — net of tax	563	—	—
Other comprehensive income (loss)	$605	$ (7)	$—

The Company filed a Registration Statement with the Securities and Exchange Commission in September 1997 for a primary offering of 2,000,000 shares of its common stock which was combined with a secondary offering of 4,790,000 shares of Company stock by Bandag, Incorporated, a major shareholder. The combined public offering was priced at $26.00 per share on October 23, 1997, and closed on October 29, 1997. The Company granted the underwriters an option to purchase 1,018,500 additional shares at the same price to cover over-allotments, if any, of which 300,000 shares were subsequently purchased. The Company's net proceeds from the sale of its 2,300,000 shares were used to finance acquisitions and to repay debt associated with acquisitions.

In May 1997, the Company registered 400,000 shares of its common stock under its 1997 Equity Plan for Non-Employee Directors which was approved by shareholders at the May 1997 annual shareholders' meeting. This plan permits the Company to issue to its non-employee directors options to purchase shares of Company common stock, restricted stock of the Company, and awards of Company stock. The plan also permits non-employee directors to elect to receive all or a portion of their annual retainers and other compensation in the form of shares of Company common stock. During 1998 and 1997, 4,250 and 5,400 shares of Company common stock were issued under the plan, respectively.

Cash dividends declared and paid per share for each year are:

(In dollars)	1998	1997	1996
Common shares	$.32	$.28	$.25

Pursuant to the 1994 Members Stock Purchase Plan, 1,000,000 shares of the Company's common stock were registered for issuance to participating members. Members who have one year of employment eligibility and work a minimum of 20 hours per week have rights to purchase stock on a quarterly basis. The price of the stock purchased under the plan is 85% of the closing price on the applicable purchase date. No member may purchase stock under the plan in an amount which exceeds the lesser of 20% of his or her gross earnings or 4,000 shares, with a maximum fair market value of $25,000 in any calendar year. An additional 419,460 shares were available for issuance under the plan at January 2, 1999. The effect of the application of adopting Financial Accounting Standards Board Statement No. 123, "Accounting for Stock-Based Compensation," was not material to the Company. Shares of common stock were issued in 1998, 1997, and 1996 pursuant to a members stock purchase plan as follows:

	1998	1997	1996
Shares issued	101,108	84,552	122,740
Average price per share	$23.58	$20.77	$12.45

The Company has a shareholders rights plan which will expire August 20, 2008. The plan becomes operative if certain events occur involving the acquisition of 20% or more of the Company's common stock by any person or group in a transaction not approved by the Company's Board of Directors. Upon the occurrence of such an event, each right entitles its holder to purchase an amount of common stock of the Company with a market value of $400 for $200, unless the Board authorizes the rights be redeemed. The rights may be redeemed for $0.01 per right at any time before the rights become exercisable. In certain instances, the right to purchase applies to the capital stock of the acquirer instead of the common stock of the Company. The Company has reserved preferred shares necessary for issuance should the rights be exercised.

The Company has entered into change in control employment agreements with corporate officers and certain other key employees. According to the agreements, a change in control occurs when a third person or entity becomes the beneficial owner of 20% or more of the Company's common stock or when more than one-third of the Company's Board of Directors is composed of persons not recommended by at least three-fourths of the incumbent Board of Directors. Upon a change in control, a key employee is deemed to have a two-year employment with the Company, and all his or her benefits are vested under Company plans. If, at any time within two years of the change in control, his or her position, salary, bonus, place of work, or Company-provided benefits are modified, or employment is terminated by the Company for any reason other than cause or by the key employee for good reason, as such terms are defined in the agreement, then the key employee is entitled to receive a severance payment equal to two times annual salary and the average of the prior two years' bonuses.

Stock Options

Under the Company's 1995 Stock-Based Compensation Plan, as amended and restated effective May 13, 1997, the Company may award options to purchase shares of the Company's common stock and grant other stock awards to executives, managers, and key personnel. The Plan is administered by the Human Resources and Compensation Committee of the Board of Directors. Stock options awarded under the Plan must be at exercise prices equal to or exceeding the fair market value of the Company's common stock on the date of grant. Stock options are generally subject to four-year cliff vesting and must be exercised within ten years from the date of grant.

The Company accounts for executive stock options issued under this Plan using Accounting Principles Board Opinion No. 25, which results in no charge to earnings when options are issued at fair market value. The Company has elected the disclosure requirements of Statement of Financial Accounting Standards (SFAS) No. 123, "Accounting for Stock-Based Compensation."

If compensation costs had been determined based on the fair value at the grant dates for awards under this Plan, consistent with SFAS No.123, the impact on net earnings and earnings per share would be less than one-cent per share. The weighted-average fair value of options granted during 1998 and 1997 estimated on the date of grant using the Black-Scholes option-pricing model was $15.51 and $11.85, respectively. The fair value of 1998 and 1997 options granted is estimated on the date of grant using the following assumptions: dividend yield of 0.90% to 1.31%, expected volatility of 30.90% to 31.40%, risk-free interest rate of 5.53% to 6.71%, and an expected life of 10 years depending on grant date.

The status of the Company's stock option plans is summarized below:

	Number of Shares	Weighted-Average Exercise Price
Outstanding at December 28, 1996	—	—
Granted	156,000	$24.74
Exercised	—	—
Forfeited	—	—
Outstanding at January 3, 1998	156,000	24.74
Granted	20,000	32.50
Exercised	—	—
Forfeited	—	—
Outstanding at January 2, 1999	176,000	25.62
Options exercisable at:		
January 2, 1999	—	
January 3, 1998	—	

The following table summarizes information about fixed stock options outstanding at January 2, 1999:

Options Outstanding				Options Exercisable
Range of Exercise Prices	Number Outstanding	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Number Exercisable at January 2, 1999
$24.50 – $28.25	156,000	8.5 years	$24.74	0
$32.50	20,000	9.1 years	$32.50	0

Retirement Benefits

The Company has defined contribution profit-sharing plans covering substantially all employees who are not participants in certain defined benefit plans. The Company's annual contribution to the defined contribution plans is based on employee eligible earnings and results of operations and amounted to $20,101,000, $14,558,000, and $11,118,000 in 1998, 1997, and 1996, respectively.

The Company sponsors defined benefit plans which include a limited number of salaried and hourly employees at certain subsidiaries. The Company's funding policy is generally to contribute annually the minimum actuarially computed amount. The Company adopted Statement of Financial Accounting Standards (SFAS) No. 132, "Employer's Disclosures about Pensions and Other Postretirement Benefits," as of January 4, 1998, the beginning of its 1998 fiscal year. Net pension costs relating to these plans were $-0-, $93,000, and $146,000 for 1998, 1997, and 1996, respectively. The actuarial present value of obligations, less related plan assets at fair value, is not significant.

The Company also participates in a multiemployer plan, which provides defined benefits to certain of the Company's union employees. Pension expense for this plan amounted to $306,000, $327,000, and $275,000 in 1998, 1997, and 1996, respectively.

In 1992, the Company established a trust to administer a leveraged employee stock ownership plan (ESOP), the HON Members Company Ownership Plan. Company contributions based on employee eligible earnings and dividends on the shares are used to make loan interest and principal payments. As the loan is repaid, shares are distributed to the ESOP trust for allocation to participants. During 1998, the final shares in the Plan were allocated to participants, and the Plan was subsequently merged into the Company's defined contribution profit-sharing plan. Selected financial data pertaining to the ESOP is as follows:

(In thousands, except share data)	1998	1997	1996
Company contribution to ESOP	$ 656	$3,735	$3,348
Dividend income of ESOP	533	487	446
Company interest expense on ESOP loan	—	—	555
Shares of common stock allocated to ESOP participant accounts	96,304	351,574	305,466
Shares held in suspense (unallocated) by ESOP as of year-end	—	96,304	447,878
Fair value of shares held in suspense by ESOP as of year-end	—	$2,757	$7,264
Closing market price of common stock as of year-end	$23.94	$28.63	$16.22

Postretirement Health Care

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 132, "Employers' Disclosures about Pensions and Other Postretirement Benefits," as of January 4, 1998. The Company adopted SFAS No. 106, "Employers' Accounting for Postretirement benefits Other Than Pensions," as of January 3, 1993, and recorded the cumulative effect of the accounting change on the deferred recognition basis.

The following table sets forth the funded status of the plan, reconciled to the accrued postretirement benefits cost recognized in the Company's balance sheet at:

(In thousands)	1998	1997	1996
Reconciliation of benefit obligation			
Obligation at beginning of year	$ 15,409	$ 15,259	$ 21,559
Service cost	419	480	810
Interest cost	1,045	1,115	1,629
Benefit payments	(974)	(796)	(865)
Actuarial (gains) losses	1,442	(649)	(7,874)
Obligation at end of year	$ 17,341	$ 15,409	$ 15,259
Funded status			
Funded status at end of year	$ 17,341	$ 15,409	$ 15,259
Unrecognized transition obligation	(10,075)	(10,788)	(11,501)
Unrecognized prior-service cost	(2,484)	(2,630)	(2,776)
Unrecognized gain (loss)	4,031	6,586	6,919
Net amount recognized	$ 8,813	$ 8,577	$ 7,901
Net periodic postretirement benefit cost include:			
Service cost	$ 419	$ 480	$ 810
Interest cost	1,045	1,115	1,629
Amortization of transition obligation over 20 years	713	713	713
Amortization of prior service cost	146	146	146
Amortization of (gains) and losses	(767)	(922)	—
Net periodic postretirement benefit cost	$ 1,556	$ 1,532	$ 3,298

The discount rates at fiscal year-end 1998, 1997, and 1996 were 6.75%, 7.0%, and 7.5%, respectively. The pre-65 1999 gross trend rates begin at 10% for the medical and prescription drug coverages and grade down to 5% in eight years and remain at this level for all future years. The post-64 gross trend rates begin at 8% for the medical coverage and decrease until the maximum Company subsidy (cap) is reached in 2003. For the prescription drug coverage, the 1999 gross trend rates begin at 10% and decrease until the cap is reached in 2003. Assumed health care cost trend rates have a significant effect on the amounts reported for the health care plans. A 1% change in assumed health care cost trend rates would have the following effects:

(In thousands)	1% Increase	1% Decrease
Effect on total of service and interest cost components of net periodic postretirement health care benefit cost	$ 136	$(109)
Effect on the health care component of the accumulated postretirement benefit obligation	$1,954	$(414)

Leases

The Company leases certain warehouse and plant facilities and equipment. Commitments for minimum rentals under noncancellable leases at the end of 1998 are as follows:

(In thousands)	Capitalized Leases	Operating Leases
1999	$ 4,210	$ 9,915
2000	3,757	8,048
2001	2,398	6,569
2002	1,078	5,269
2003	211	3,896
Thereafter	1,646	4,036
Total minimum lease payments	13,300	$37,733
Less amount representing interest	2,611	
Present value of net minimum lease payments, including current maturities of $3,195,000	$10,689	

Property, plant, and equipment at year-end include the following amounts for capitalized leases:

(In thousands)	1998	1997	1996
Buildings	$ 3,299	$ 3,299	$ 3,299
Machinery and equipment	15,805	15,805	8,419
	19,104	19,104	11,718
Less allowances for depreciation	8,978	6,139	4,854
	$10,126	$12,965	$ 6,864

Rent expense for the years 1998, 1997, and 1996 amounted to approximately $10,150,000, $7,555,000, and $6,788,000, respectively. The Company has operating leases for office and production facilities with annual rentals totaling $578,000 with the former owners of a business acquired in 1996. These individuals continue as officers of a subsidiary of the Company following the merger. Contingent rent expense under both capitalized and operating leases (generally based on mileage of transportation equipment) amounted to $596,000, $581,000, and $353,000 for the years 1998, 1997, and 1996, respectively.

Contingencies

The Company is involved in various legal actions which have arisen in the course of business. Management believes the outcome of these matters will not have a material effect on the financial condition or results of operations of the Company.

Operating Segment Information

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 131, "Disclosures about Segments of an Enterprise and Related Information," effective with its 1998 fiscal year beginning January 4, 1998. This segment disclosure is essentially unchanged from the format used by the Company historically in complying with SFAS No. 14, "Financial Reporting for Segments of a Business Enterprise," and SFAS No. 30, "Disclosures of Information about Major Customers." That is, management views the Company as being in two operating segments: office furniture and hearth products, with the former being the principal segment.

The office furniture segment manufactures and markets a broad line of metal and wood commercial and home office furniture which includes file cabinets, desks, credenzas, chairs, storage cabinets, tables, bookcases, freestanding office partitions and panel systems, and other related products. The hearth products segment manufactures and markets a broad line of manufactured gas-, pellet-, and wood-burning fireplaces and stoves, fireplace inserts, gas logs, and chimney systems principally for the home.

The Company's October 2, 1996, acquisition of Heat-N-Glo Fireplace Products, Inc., resulted in hearth products becoming a reportable segment. Prior to this acquisition, the Company had only one reportable segment, office furniture. Refer to the "Business Combinations" note for additional information regarding this acquisition.

The Company's two operating segments are somewhat seasonal with the third (July-September) and fourth (October-December) fiscal quarters historically having higher sales than the prior quarters. In fiscal 1998, 51% of the Company's consolidated net sales of office furniture were generated in the third and fourth quarters and 55% of consolidated net sales of hearth products were generated in the third and fourth quarters.

For purposes of segment reporting, intercompany sales transfers between segments are not material, and operating profit is income before income taxes exclusive of certain unallocated corporate expenses. These unallocated corporate expenses include the net costs of the Company's corporate operations, interest income, and interest expense. Management views interest income and expense as corporate financing costs and not as an operating segment cost. In addition, management applies an effective income tax rate to its consolidated income before income taxes so income taxes are not reported or viewed internally on a segment basis. Identifiable assets by segment are those assets applicable to the respective industry segments. Corporate assets consist principally of cash and cash equivalents, short-term investments, and corporate office real estate and related equipment.

No geographic information for revenues from external customers or for long-lived assets is disclosed inasmuch as the Company's primary market and capital investments are concentrated in the United States.

Reportable segment data reconciled to the consolidated financial statements for the years ended 1998, 1997, and 1996 is as follows:

(In thousands)	1998	1997	1996
Net sales:			
Office furniture	$1,451,328	$1,158,228	$887,299
Hearth products	245,105	204,485	110,836
	$1,696,433	$1,362,713	$998,135
Operating profit:			
Office furniture	$ 165,314	$ 139,710	$106,824
Hearth products	31,478	24,817	14,155
Total operating profit	196,792	164,527	120,979
Unallocated corporate expenses	(26,683)	(25,399)	(15,712)
Income before income taxes	$ 170,109	$ 139,128	$105,267
Identifiable assets:			
Office furniture	$ 660,626	$ 551,120	$330,575
Hearth products	154,817	128,361	122,037
General corporate	49,026	75,192	60,902
	$ 864,469	$ 754,673	$513,514
Depreciation and amortization expense:			
Office furniture	$ 42,562	$ 27,633	$ 21,140
Hearth products	9,120	6,590	2,813
General corporate	1,317	1,387	1,299
	$ 52,999	$ 35,610	$ 25,252
Capital expenditures — net:			
Office furniture	$ 128,482	$ 73,659	$ 41,186
Hearth products	18,162	13,055	4,060
General corporate	3,073	(1,223)	(562)
	$ 149,717	$ 85,491	$ 44,684

One office furniture customer accounted for approximately 12% of consolidated net sales in 1998, 1997, and 1996.

Summary of Unaudited Quarterly Results of Operations

The following table presents certain unaudited quarterly financial information for each of the past twelve quarters. In the opinion of the Company's management, this information has been prepared on the same basis as the consolidated financial statements appearing elsewhere in this report and includes all adjustments (consisting only of normal recurring accruals) necessary to present fairly the financial results set forth herein. Results of operations for any previous quarter are not necessarily indicative of results for any future period.

(In thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year-End 1998: (a)				
Net sales	$418,263	$401,417	$448,679	$428,074
Cost of products sold	291,571	278,107	309,080	294,239
Gross profit	126,692	123,310	139,599	133,835
Selling and administrative expenses	88,563	83,213	88,162	84,321
Operating income	38,129	40,097	51,437	49,514
Interest income (expense) — net	(2,172)	(2,691)	(2,025)	(2,180)
Income before income taxes	35,957	37,406	49,412	47,334
Income taxes	13,484	14,027	18,530	17,755
Net income	$ 22,473	$ 23,379	$ 30,882	$ 29,579
Net income per common share	$ .36	$ .38	$ .50	$ .48
Weighted-average common shares outstanding	61,648	61,663	61,691	61,596
As a Percentage of Net Sales				
Net sales	100.0%	100.0%	100.0%	100.0%
Gross profit	30.3	30.7	31.1	31.3
Selling and administrative expenses	21.2	20.7	19.6	19.7
Operating income	9.1	10.0	11.5	11.6
Income taxes	3.2	3.5	4.1	4.1
Net income	5.4	5.8	6.9	6.9
Year-End 1997: (b)				
Net sales	$282,859	$296,567	$391,348	$391,939
Cost of products sold	194,194	200,969	268,147	269,847
Gross profit	88,665	95,598	123,201	122,092
Selling and administrative expenses	60,453	64,303	80,641	79,000
Operating income	28,212	31,295	42,560	43,092
Interest income (expense) — net	(1,142)	(1,141)	(2,209)	(1,539)
Income before income taxes	27,070	30,154	40,351	41,553
Income taxes	10,152	11,307	15,132	15,582
Net income	$ 16,918	$ 18,847	$ 25,219	$ 25,971
Net income per common share	$ .28	$ .32	$ .43	$ .42
Weighted-average common shares outstanding	59,400	59,384	59,356	61,011
As a Percentage of Net Sales				
Net sales	100.0%	100.0%	100.0%	100.0%
Gross profit	31.3	32.2	31.5	31.2
Selling and administrative expenses	21.4	21.7	20.6	20.2
Operating income	10.0	10.6	10.9	11.0
Income taxes	3.6	3.8	3.9	4.0
Net income	6.0	6.4	6.4	6.6

(In thousands, except per share data)	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Year-End 1996: (c)				
Net sales	$233,477	$219,260	$255,254	$290,144
Cost of products sold	160,006	150,227	176,403	192,860
Gross profit	73,471	69,033	78,851	97,284
Selling and administrative expenses	49,846	49,507	53,605	62,688
Gain on sale of subsidiary	3,200	—	—	—
Operating income	26,825	19,526	25,246	34,596
Interest income (expense) — net	(119)	(8)	91	(890)
Income before income taxes	26,706	19,518	25,337	33,706
Income taxes	9,881	7,222	7,430	12,640
Net income	$ 16,825	$ 12,296	$ 17,907	$ 21,066
Net income per common share	$ .28	$ .20	$ .30	$ .35
Weighted-average common shares outstanding	60,690	60,340	60,126	59,758
As a Percentage of Net Sales				
Net sales	100.0%	100.0%	100.0%	100.0%
Gross profit	31.5	31.5	30.9	33.5
Selling and administrative expenses	21.3	22.6	21.0	21.6
Operating income	11.5	8.9	9.9	11.9
Income taxes	4.2	3.3	2.9	4.4
Net income	7.2	5.6	7.0	7.3

(a) First quarter 1998 includes partial quarterly results of operation of Aladdin Steel Products, Inc. acquisition acquired February 20, 1998.

(b) Third quarter 1997 represents 14 weeks of business activity compared to 13 weeks for the same quarter in 1996 and 1995. In addition, the quarter includes the first quarterly results of the Allsteel Inc. acquisition acquired June 17, 1997. Fiscal year 1997 similarly represents 53 weeks compared to 52 weeks in 1998 and 1996. Fourth quarter includes partial quarterly results of operation of two acquisitions: Bevis Custom Furniture, Inc., acquired November 13, 1997, and Panel Concepts, Inc., acquired December 1, 1997.

(c) First quarter 1996 includes $3,200,000 pre-tax gain on the sale of Ring King Visibles, Inc. (after-tax gain of $2,000,000, or $0.03 per share). Third quarter includes one-time federal and state income tax credits of $2,100,000, or $0.04 per share. Fourth quarter includes the results of operation of Heat-N-Glo Fireplace Products, Inc., acquired October 2, 1996.

Subsequent Events

On February 11, 1999, the Company announced a cost savings initiative to increase long-term profitability. It will close three office furniture manufacturing operations and consolidate substantially all production into other U.S. manufacturing operations that have created capacity primarily through ongoing rapid continuous improvement initiatives. The operations will close following an orderly transition of production to other facilities which is expected to be completed during the second and third quarters of 1999. A charge to pre-tax earnings of approximately $19.7 million, or $0.20 per diluted share, will be taken in the first quarter of 1999 in connection with this consolidation.

Common Stock Market Prices and Dividends (Unaudited)
Quarterly 1998 – 1997

1998 by Quarter	High	Low	Dividends per Share
1st	$37 3/16	$27 3/4	$.08
2nd	36 1/2	26 1/4	.08
3rd	32 7/8	21 1/2	.08
4th	28 1/4	20	.08
Total Dividends Paid			$.32

1997 by Quarter	High	Low	Dividends per Share
1st	$21 1/2	$15 7/8	$.07
2nd	27 1/8	17 1/2	.07
3rd	32 1/8	22 1/8	.07
4th	31	23 13/16	.07
Total Dividends Paid			$.28

Common Stock Market Price and Price/Earnings Ratio (Unaudited)
Fiscal Years 1998 – 1988

	Market Price*			Price/Earnings Ratio	
Year	High	Low	Earnings per Share*	High	Low
1998	37 3/16	20	1.72	22	12
1997	32 1/8	15 7/8	1.45	22	11
1996	21 3/8	9 1/4	1.13	19	8
1995	15 5/8	11 1/2	.67	23	17
1994	17	12	.87	20	14
1993	14 5/8	10 3/4	.70	21	15
1992	11 3/4	8 1/4	.59	20	14
1991	10 1/4	6 5/8	.51	20	13
1990	11 1/2	6 3/4	.65	18	10
1989	9 5/16	4 3/8	.39	25	11
1988	5 1/8	3 15/16	.47	11	8
Eleven-Year Average				20	12

**Adjusted for the effect of stock splits*

THANK YOU TO OUR NEARLY 10,000 MEMBER-OWNERS WHO WITH THEIR STRONG COMMITMENT TO EXCELLENCE MADE 1998 ANOTHER OUTSTANDING YEAR.

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Baker & McKenzie

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Adviser/Consultant

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Consumer and Office Markets Group
3M

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Chairman, SC Companies, Inc.
Chairman, Stanley Consultants, Inc.

BRIAN E. STERN
President,
Xerox Technology Enterprises
Xerox Corporation

LORNE R. WAXLAX
Retired Executive Vice President
The Gillette Company

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PUBLIC POLICY AND CORPORATE GOVERNANCE
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Marketing and International

WILLIAM F. SNYDACKER
Treasurer

DAVID W. STROHL
Vice President, Technical Development

DAVID C. STUEBE
Vice President and CFO

Division

The HON Company
GEORGE J. KOENIGSAECKER III
President

Subsidiaries

BPI Inc.
JEAN M. REYNOLDS
President

The Gunlocke Company
JOHN M. STEVENS
President

Hearth Technologies Inc.
DANIEL C. SHIMEK
President
BRADLEY D. DETERMAN
President, Heat-N-Glo Division
DAVID B. CRIBB
President, Heatilator Division
ALAN J. TRUSLER
President,
Aladdin Hearth Products Division

Holga Inc.
BRIAN R. OKEN
President

Investor Information

Schedule of Quarterly Results

The Company operates on a fiscal year ending on the Saturday nearest December 31. Quarterly results are typically announced within 20 days after the end of each quarter, and audited results are typically announced within 40 days after year-end.

Fiscal 1999 Quarter-End Dates

First Quarter >Saturday, April 3
Second Quarter >Saturday, July 3
Third Quarter >Saturday, October 2
Fourth Quarter >Saturday, January 1, 2000

Annual Meeting

The Company's annual shareholders' meeting will be held at 10:30 a.m. on Tuesday, May 11, 1999, at the Holiday Inn, Highways 61 & 38 North, Muscatine, Iowa. Shareholders and other interested investors are encouraged to attend the meeting.

10-K Report

A copy of the Company's annual report filed with the Securities and Exchange Commission on Form 10-K is available, without charge, upon written request to David C. Stuebe, Vice President and CFO, at the Company's corporate headquarters address.

Corporate Headquarters
HON INDUSTRIES Inc.
414 East Third Street
P.O. Box 1109
Muscatine, IA 52761-0071
Telephone: 319-264-7400
Fax: 319-264-7217
Website: *www.honi.com*

Independent Public Accountants

Arthur Andersen LLP
33 West Monroe Street
Chicago, IL 60603-5385

Financial Information and Inquiries

Shareholders or other interested investors are welcome to call or write with questions or requests for additional information. Inquiries should be directed to:

David C. Stuebe,
Vice President and CFO
or Elizabeth P. Coronelli,
Investor Relations Manager

HON INDUSTRIES Inc.
P. O. Box 1109
Muscatine, IA 52761-0071
Telephone: 319-264-7400
Fax: 319-264-7655

Year 2000 Readiness Disclosure

The Company maintains an electronic copy of its latest Year 2000 Readiness Disclosure at its website location at *www.honi.com* or a paper copy is available, without charge, upon written request to David C. Stuebe, Vice President and CFO, at the Company's corporate headquarters address.

Common Stock

HON INDUSTRIES common stock trades on the New York Stock Exchange under the symbol: HNI. Stock price quotations can be found in major daily newspapers and *The Wall Street Journal.*

Transfer Agent

Shareholders may report a change of address or make inquiries by writing or calling:

Harris Trust and Savings Bank
P. O. Box A3504
Chicago, IL 60690-3504
Telephone: 312-360-5346

Safe Harbor Statement

Statements in this annual report that are not strictly historical, including statements as to plans, objectives, and future financial performance, are "forward-looking" statements that are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements involve known and unknown risks, which may cause the Company's actual results in the future to differ materially from expected results. These risks include, among others, competition within the office furniture and fireplace industries; the relationship between supply and demand for value-priced office products, as well as direct vent gas and wood fireplaces; the effects of economic conditions; issues associated with the acquisition and integration of acquisitions; operating risks; the ability of the Company to realize cost savings and productivity improvements; the ability of the Company's distributors to successfully market and sell the Company's products; and the availability of capital to finance planned growth, as well as the risks, uncertainties, and other factors described from time to time in the Company's filings with the Securities and Exchange Commission.

Corporate Overview

>HON INDUSTRIES is the third largest office furniture manufacturer in North American sales, with the number one position in the value-priced segment of the market, and the nation's leading manufacturer of gas- and wood-burning fireplaces.

>The HON Company is America's leader in value-priced office furniture. The company offers a complete line of office furnishings, including panel systems, seating, desks, tables, and files, under the brands HON®, Allsteel®, and Bevis®.

>BPI specializes in panel systems products and services, a market that represents approximately 35 percent of the total office furniture industry. BPI and Panel Concepts brand products offer a full range of features and price points.

>The Gunlocke Company handcrafts high-quality, natural wood office furniture. It offers executive case goods and a wide range of seating, lounge furniture, and conference tables as well as custom products built to designer specifications.

>Holga manufactures high-density storage, shelving, and mobile filing systems, as well as steel case goods. Sales are made to end users through a network of commercial and high-density storage dealers.

>Hearth Technologies is the leader in gas- and wood-burning fireplaces and participates in the electric fireplace, stove, and gas log markets. Its Heat-N-Glo, Heatilator, and Aladdin Hearth Products divisions serve the residential construction and home improvement markets.

>The HON INDUSTRIES International Group markets HON INDUSTRIES' products on a worldwide basis.

Selected 1998 New Product Introductions and Redesigns

The HON Company
Concensys®, Terrace® Plus, and Inter|change® Systems Furniture; Trooper™, Tiempo™, and Talbot™ Seating; Steel Desk Series; Expectations™ Commercial Computer Furniture

BPI
Parallel™ Cantilevered Systems Furniture, TL2™ Floor to Ceiling Systems Furniture, BPI® Lateral Files, and BPI® Conference Tables

The Gunlocke Company
Prism™ Systems Furniture, Harlow™ and Credentials™ Seating, and additional product offerings in Mosaic™ and Medley™ Executive Wood Case Goods

Holga
OptiStor™ Rotating Cabinet, FourFlex® Shelving System, and SmartSpace™ Filing System

Hearth Technologies

Heat-N-Glo
7000 Series Upper-end Direct Vent Gas Fireplaces, CFX-36T Top Vent Gas Fireplaces (ceramic fiber), CFX-ZC Direct Vent Gas Inserts (ceramic fiber), 32E-XL Electric Fireplaces, SlimLine™ Builder Series Gas Fireplaces, and Patio Campfire™ Gas Log Set

Heatilator
Accelerator™ Series Wood Fireplaces, Caliber™ Classic Direct Vent Gas Fireplaces, Simplicity Gas Fireplaces, Night Fire™ Outdoor Gas Fueled Campfire, X Burn Upgrade for Novus Heaters, and Electric Series Fireplaces

Aladdin Hearth Products
Arrow® DVI25 and DVI35 Gas Inserts, Dovre® DV450 Gas Stove, and Quadra-Fire® DV40 Step Top Gas Stove

DESIGN: *Cagney + McDowell, Chicago* PHOTOGRAPHY: *Tom Maday, Chicago*