



August 26, 1998

Dear Shareholder:

Fiscal 1998 was not the good year we expected it to be. Net income was significantly less than we forecast at the beginning of the year. This was due primarily to the strong U.S. dollar, which reduced the revenue and gross profit we received from sales to European customers with whom we share currency risk, and a slower than hoped-for improvement in new plant efficiency. In fact, net income was higher for the year, but only because last year's results included a special charge for an early retirement opportunity. Excluding the special charge, earnings were down 16%. Also contributing to lower earnings were the cost of converting to emission-compliant engines, the cost of introducing several new models, expenses related to the conversion to new enterprise-wide software, and higher interest expense.

Favorable weather in most parts of the United States and Europe produced a very strong spring selling season. Demand for engines for walk-behind lawnmowers and power washers was particularly strong. In fact, demand for these small engines exceeded our ability to deliver. Demand for larger engines was not as strong, in part because of a major customer's successful efforts to reduce lawn tractor inventory. This unusual order pattern, combined with the effects of the strong U.S. dollar, reduced our average revenue per unit, so sales increased just 1% despite a 3% increase in unit shipments.

Net income for fiscal 1998 was \$70.6 million or \$2.85 per share. Net adjusted cash operating earnings were \$18.8 million more than the cost of capital. This measure of economic value added increased in fiscal 1998 despite lower cash operating earnings because of a lower cost of capital and less capital employed in the business. Return on average shareholders' investment increased to 21.2%. Dividends increased to \$1.12 per share.

Operating activities provided \$136 million of cash flow in fiscal 1998, compared with \$143 million in fiscal 1997. Earnings and depreciation provided \$118 million, while working capital decreased \$18 million. The working capital reduction was a consequence of the strong demand for small engines, which reduced year-end inventory. We used this cash flow plus \$28 million of cash reserves to fund \$45 million of capital expenditures, to reduce debt by \$14 million, to pay \$28 million of dividends, and to buy back common shares with a market value of \$77 million.

We acquired 1.8 million common shares in fiscal 1998, continuing the share buyback program we began last year. Through last year's dutch auction tender offer and subsequent open market purchases, we have reduced our shares outstanding 18%. We expect to complete the share buyback program in fiscal 1999.

During fiscal 1998 we reached agreements to form two joint ventures with companies in India, where our traditional approach to the market has not been successful. Kirloskar Briggs & Stratton, a joint venture with Kirloskar Oil Engines Ltd., a leading Indian manufacturer of diesel engines, will be responsible for sales and distribution of Briggs & Stratton engines and parts in India and will assemble and distribute products powered by Briggs & Stratton engines. Hero Briggs & Stratton, a joint venture with Hero Motors, will manufacture engines for two wheel vehicles. Hero Motors is part of the Hero Group, the world's largest manufacturer of bicycles and a leading manufacturer of scooters and mopeds. We and our joint venture partner believe that stricter exhaust emission regulations in India and other countries create an opportunity for 4 stroke engines in what has traditionally been a 2 stroke engine market.

Late in fiscal 1998 we reached agreements to sell the assets of two unprofitable activities – long life engines for residential heat pumps and computer software for dealer-based distribution systems. Neither was a core business. We believe that multi-language electronic commerce, parts look-up, and business system software will be important tools for development of our dealer network. However, we concluded that these products would have greater value as part of a software business with appropriate support capabilities.

Computer problems related to the year 2000 have been in the news. All companies are dealing with their old computer software's use of two digit dates and thus the software's inability to distinguish between the years 2000 and 1900. We are converting from old business software for a large mainframe computer to new year 2000 compliant enterprise-wide software for a network of smaller computers, a system that more closely matches our more decentralized organization. The actual conversion began in fiscal 1998 and should be completed by mid-fiscal 1999. Most of the expenses related to this conversion are behind us.

Our lawn and garden engine pricing has remained relatively static for the last few years. During this time we have incurred substantial costs to introduce new products with value-adding features, and we have made the extensive changes required to meet EPA exhaust emission standards without sacrificing engine performance. We are committed to capturing this added value in the marketplace and have communicated to our customers a modest 2% price increase for fiscal 1999.

In last year's annual report we discussed the rationale for our decision to start up three new engine plants in fiscal 1996 and the lingering consequences of that decision. Personnel at the new plants made progress in fiscal 1998, particularly later in the year. While the progress was less than we hoped for, it provides support for our belief that this problem is well on the way to being resolved.

Of all the engines we sell, approximately 80% are used to power lawn and garden equipment. As we have often explained, retail sales of lawn and garden equipment are very seasonal and depend to a great degree on weather. The seasonality of retail sales and the unpredictability of weather give this business a pattern. A late, cold or dry spring will postpone retail sales, perhaps even to the following year. Equipment manufacturers respond by delaying production for the next season, as they did in fiscal 1998. An early, warm, and wet spring – like this spring – will accelerate retail sales and produce product shortages. Equipment manufacturers respond by building earlier for the next season, as they are likely to do in fiscal 1999.

As usual, it is not possible to make a precise forecast for fiscal 1999. While we believe that equipment inventories at both the retail and manufacturer levels will be low at the end of the selling season, confirming data is not yet available. Some large retailers have not completed the process of selecting their suppliers and their product line for the 1999 season, but we are not aware of any changes in customer relationships that would significantly affect our business. Econometric forecasts indicate that retail sales next spring should be good if weather is normal. The effects of the strong U.S. dollar will linger into fiscal 1999, but the other factors that hurt fiscal 1998 should be less of an influence. Thus we expect improved operating results in fiscal 1999.



Chairman and
Chief Executive Officer



President and
Chief Operating Officer