

SECURITIES AND EXCHANGE COMMISSION  
Washington, D. C. 20549

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FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended: September 27, 1998, Commission File No. 0-7647

HAWKINS CHEMICAL, INC.

-----  
(Exact Name of Registrant as specified in its Charter)

MINNESOTA

41-0771293

-----  
(State of Incorporation)

-----  
(I.R.S. Employer Identification No.)

3100 East Hennepin Avenue, Minneapolis, Minnesota

55413

-----  
(Address of Principal Executive Offices)

-----  
(Zip Code)

(612) 331-6910

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(Registrant's Telephone Number, Including Area Code)

Securities registered pursuant to Section 12(b) of the Act: NONE  
Securities registered pursuant to Section 12(g) of the Act: COMMON STOCK, PAR  
VALUE \$.05 PER SHARE

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding twelve months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days.      Yes      X      No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K / X /.

The aggregate market value of voting stock held by nonaffiliates of the Registrant on November 30, 1998, was \$90,567,442 (based upon the last reported sale price on that date as reported by The Nasdaq Stock Market), excluding all shares held by officers and directors of the Registrant and by the Trustees of the Registrant's Employee Stock Ownership Plan and Money Purchase Pension Plan were deemed to be shares held by affiliates. The number of shares outstanding of the Registrant's common stock on November 30, 1998 was 11,355,430.

DOCUMENTS INCORPORATED BY REFERENCE

Part II of this Annual Report on Form 10-K incorporates by reference information (to the extent specific pages are referred to herein from the Registrant's Annual Report to Shareholders for the year ended September 27, 1998. Part III of this Annual Report on Form 10-K incorporates by reference information (to the extent specific sections are referred to herein) from the Registrant's Proxy Statement for its 1999 Annual Meeting of Shareholders to be held February 24, 1999.

CAUTIONARY STATEMENT REGARDING  
FUTURE RESULTS AND FORWARD-LOOKING STATEMENTS

THE FUTURE RESULTS OF THE COMPANY, INCLUDING RESULTS REFLECTED IN ANY FORWARD-LOOKING STATEMENT MADE BY OR ON BEHALF OF THE COMPANY, WILL BE IMPACTED BY A NUMBER OF IMPORTANT FACTORS. WORDS SUCH AS "MAY," "WILL," "EXPECT," "BELIEVE," "ANTICIPATE," "ESTIMATE," OR "CONTINUE" OR COMPARABLE TERMINOLOGY ARE INTENDED TO IDENTIFY FORWARD-LOOKING STATEMENTS.

FORWARD-LOOKING STATEMENTS, BY THEIR NATURE, INVOLVE SUBSTANTIAL RISKS AND UNCERTAINTIES.

PART I

ITEM 1. BUSINESS.

(a) GENERAL DEVELOPMENT OF THE BUSINESS. The Registrant was incorporated under the laws of the State of Minnesota in 1955. In the past year the Registrant merged three of its former subsidiaries, Feed-Rite Controls, Inc., Mon-Dak Chemical, Inc., Dakota Chemical, Inc. and its Arrowhead Chemical Division together to form a single wholly owned subsidiary known as Hawkins Water Treatment Group, Inc. ("HWTG"). In fiscal 1999, the Registrant plans to merge HWTG into the Registrant.

(b) FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS. Although the Registrant operates through several divisions, its principal business is the formulation, blending and distribution of bulk specialty chemicals. Throughout its operations the Registrant provides related products and services which share similar raw materials, production methods and distribution channels. In the judgment of the Registrant, therefore, it is operating in a single industry segment.

(c) NARRATIVE DESCRIPTION OF THE BUSINESS.

(i) PRODUCTS AND MARKETS. The Registrant's business is conducted throughout the nine-state area of Minnesota, Wisconsin, Iowa, North Dakota, South Dakota, Montana, Nebraska, Michigan and Wyoming through its wholly-owned subsidiary and three divisions described below:

(A) HAWKINS WATER TREATMENT GROUP. This division specializes in providing water and waste-water treatment equipment and chemicals and in services relating to the testing of water samples in Minnesota, Wisconsin, Iowa, North Dakota, South Dakota, Nebraska and Wyoming. It also operates as a distributor of the Registrant's products, and a regional distributor of laundry, dry cleaning, and janitorial supplies in Montana, Wyoming, the Dakotas, Minnesota, northern Wisconsin and the upper peninsula of Michigan.

(B) HAWKINS TERMINAL DIVISION. This division receives, stores and distributes various chemicals in bulk, including liquid caustic soda, phosphoric acid and aqua ammonia; manufactures sodium hypochlorite (bleach); repackages liquid chlorine; and performs custom blending of certain chemicals for customers according to customer formulas. Approximately 80% of the business of the Hawkins Terminal Division is related to liquid caustic soda. Hawkins Terminal Division operates a liquid caustic soda barge terminal to receive

-2-

shipments during the period the Mississippi River is open to barge traffic (approximately April 1 through November 15). During the remainder of the year the Division relies on stockpiles, as well as supplies shipped in by railroad tank car. Pursuant to operating agreements it has with other chemical companies, the Registrant also receives, stores and ships liquid caustic soda and other chemicals at both the Hawkins "Terminal 1" location and its "Terminal 2" site which is located across the river and downstream from Terminal 1.

Since 1963, flooding of the Mississippi River has required the Hawkins Terminal Division to temporarily shift its operations out of its buildings three times, the most recent being in April 1997. No substantial interruptions to sales resulted from the floods because railroad tank cars were successfully used as an alternative means of supply. Although the use of tank cars resulted in additional costs, results of operations were not materially impacted. For approximately two weeks in 1997, the areas around the Registrant's terminal operations were flooded, preventing shipments to and from these locations. The terminals themselves were not flooded as the facilities were adequately protected by dikes. All shipments were made from alternate locations. The additional costs incurred as a result of the flooding did not materially impact the Registrant's results of operations for fiscal 1997. No assurance can be given that flooding will not recur or that there will not be material damage or interruption to the business of the Registrant's Hawkins Terminal Division in the future.

(C) INDUSTRIAL CHEMICAL AND EQUIPMENT DIVISION. This division was created in 1993 when the Registrant acquired the assets of Industrial Chemical & Equipment Co. It specializes in sales to the plating and electronic industries, and relies on a specially trained sales staff which works directly with customers on their plating and other processes.

(D) HAWKINS SALES DIVISION. The Hawkins Sales Division is a sales distribution center for industrial chemicals, laboratory chemicals and laboratory supplies. Bulk industrial chemicals are generally repackaged and sold in smaller quantities to the Registrant's customers. Sales are concentrated primarily in western Wisconsin, Minnesota, northern Iowa and North and South Dakota. Among the principal chemicals handled by the Sales Division are water purification and pollution control chemicals (such as chlorine) and industrial chemicals (such as anhydrous ammonia, aluminum sulphate, hydrofluosilicic acid, soda ash, phosphates, muriatic acid, aqua ammonia, sulfuric acid and liquid caustic soda).

(ii) STATUS OF NEW PRODUCTS. The Registrant began shipping its Cheese-Phos-Registered Trademark- product (discussed below) in late calendar 1995. Sales of this product through fiscal 1998 were not material to the Registrant's results of operations for the period.

(iii) RAW MATERIALS. The Registrant has approximately 450 suppliers, including many of the major chemical producers in the United States, of which approximately 20 account for a majority of the purchases made by the Registrant. The Registrant typically has written distributorship agreements or supply contracts with its suppliers that are renewed from time to time. Although there is no assurance that any contract or understanding with any supplier will not be terminated in the foreseeable future, most of the basic chemicals purchased by the Registrant can be obtained from alternative sources should existing relationships be terminated.

-3-

(iv) PATENTS, TRADEMARKS, LICENSES, FRANCHISES, AND CONCESSIONS. There are no patents, trademarks, licenses, franchises or concessions that are currently material to the successful operation of the Registrant's business. The Registrant has, however, obtained a patent on a liquid form of sodium phosphate for use in the processed food industry, as described below; the patent was granted on October 17, 1995, and will expire on November 8, 2013.

Process cheese producers are increasingly moving away from dry forms of sodium ortho phosphates to liquid versions. The advantages of the liquid form include delivery by pumping, greater measurement accuracy and consistency in finished product, and the elimination of undissolved chemical, dust, and the disposal of empty chemical bags. The major drawback of the liquid sodium phosphates currently being used in the cheese processing industry is that it must be stored at between 130 and 160 degrees Fahrenheit to prevent crystallization. Expensive heat storage and steam heated piping is necessary to maintain required temperatures. Back-up generators must also be installed as safeguards against product cooling and solidifying in case of a plant power outage.

The Registrant's patented Cheese-Phos-Registered Trademark- liquid sodium phosphate, which can be stored at room temperature, offers all the advantages of a liquid sodium phosphate product, but eliminates the need for high-heat delivery systems. Although it is not currently possible to project the effect of Cheese-Phos-Registered Trademark- on the Registrant's results of operations for future periods, the Registrant does not currently expect this product to add materially to the Registrant's revenues and profits.

(v) SEASONAL ASPECTS. The sale of water treatment chemicals used in municipal water treatment facilities tends to reach a higher level during the summer months, which are part of the Registrant's third and fourth fiscal quarters.

(vi) WORKING CAPITAL ITEMS. As a bulk distributor of chemicals, the Registrant is required to carry significant amounts of inventory to meet rapid delivery requirements of customers. Working capital requirements vary on a seasonal basis as a result of the seasonality of the water treatment business.

(vii) DEPENDENCE ON LIMITED NUMBER OF CUSTOMERS. No one customer represents more than approximately four percent of the Registrant's sales, but the loss of its four largest customers could have a material adverse effect on the Registrant's results of operations.

(viii) BACKLOG. Backlog is not material to an understanding of the Registrant's business.

(ix) GOVERNMENT CONTRACTS. No material portion of the Registrant's business is subject to renegotiation of profits or termination of contracts at the election of any state or federal governmental subdivision or agency.

(x) COMPETITIVE CONDITIONS. The Registrant operates in a competitive industry and competes with producers, distributors and sales agents offering chemicals equivalent to all of the products handled by the Registrant. Many such producers and distributors have substantially more business and are substantially larger than the Registrant. No one competitor, however, is dominant in Registrant's market. Price and service are the principal methods of competition in the industry.

-4-

(xi) RESEARCH AND DEVELOPMENT. The Registrant does not have a formal research and development function; employees are assigned to research and development projects as the need arises. During the past fiscal year, expenditures for research and development were negligible and not material to Registrant's business.

(xii) ENVIRONMENTAL MATTERS. The Registrant is primarily a compounder and distributor, rather than a manufacturer, of chemical products. As such, compliance with current federal, state and local provisions regarding discharge of materials into the environment, or otherwise relating to the protection of the environment, is not anticipated to have any material effect upon the capital expenditures, earnings or competitive position of the Registrant. The Registrant does not currently anticipate making any material capital expenditures for environmental control facilities during fiscal 1999.

(xiii) EMPLOYEES. The number of persons employed by the Registrant and its subsidiaries as of September 27, 1998 was 156.

(d) FINANCIAL INFORMATION ABOUT FOREIGN AND DOMESTIC OPERATIONS AND EXPORT SALES. Because the Registrant deals in only one geographic area of the United States, a breakdown of revenue, profitability or assets attributable to different geographic areas is not meaningful to an understanding of Registrant's business.

ITEM 2. PROPERTIES.

The Registrant's principal location consists of approximately eleven acres of land in Minneapolis, Minnesota, with six buildings containing a total of 160,000 square feet of office and warehouse space. The Registrant's principal office, out of which the Hawkins Sales Division operates, is located in one of these buildings, at 3100 East Hennepin Avenue. The other buildings are used by the Registrant, its Hawkins Water Treatment Group subsidiary, and its Industrial Chemical and Equipment division. The Registrant's warehouse facilities in Minneapolis have been retrofitted with sprinklers for fire protection; this process was completed in the second quarter of calendar 1996. The Registrant carries insurance covering the replacement of property damaged by fire or flood.

Information about the Registrant's other principal facilities is presented below. These facilities, as well as those described above, are adequate and suitable for the purposes they serve. Unless noted, each facility is owned and is fully utilized by the Registrant or its subsidiary.

-5-

Subsidiary or Division	Location	Primary Use	Approx. Square Feet
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Hawkins Terminal Division	St. Paul, MN(1)	Office, Warehouse and Garage	32,000
Hawkins Water Treatment Group	Fargo, ND(2)	Office and Warehouse	22,800
	Fond du Lac, WI(3)	Warehouse	20,300
	Washburn, ND	Office and Warehouse	14,000
	Billings, MT	Office and Warehouse	6,000
	Sioux Falls, SD(4)	Warehouse	18,000
	Rapid City, SD	Warehouse	3,600
	Superior, WI	Office and Warehouse	17,000

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(1) The Hawkins Terminal Division operation, located at two sites on opposite sides of the Mississippi River, is made up of three buildings, nine outside storage tanks with a total capacity of approximately 8,900,000 gallons for the storage of liquid caustic soda, as well as numerous smaller tanks for storing and mixing chemicals. The land on which the Hawkins Terminal Division buildings and storage tanks are located is leased by the Registrant from the Port Authority of the City of St. Paul, Minnesota for a basic rent plus an amount based on the tonnage unloaded at both sites each year. The applicable leases run until December 31, 1998, at which time the Registrant has an option to renew the leases for an additional five-year period on the same terms and conditions. The Registrant has exercised its option to renew these leases. The Registrant also has options to renew these leases for three additional successive five-year renewal periods (extending until 2018) for which the rent may be adjusted pursuant to the rental renegotiation provisions contained in the leases.

(2) This facility is occupied by Hawkins Water Treatment Group (17,800 square feet) and leased to a third party (5,000 square feet).

(3) In addition to the space in this building being used by Hawkins Water Treatment Group, 10,000 square feet of space is being leased by the Registrant to third parties.

(4) The Sioux Falls facility is occupied by Hawkins Water Treatment Group (12,000 square feet) and leased to a third party (6,000 square feet).

The Registrant and its subsidiary also own several trucks, tractors, trailers, and vans.

-6-

ITEM 3. LEGAL PROCEEDINGS.

As of the date of this filing, neither the Registrant nor its subsidiary were involved in any pending legal proceeding to which the Registrant or its subsidiary was a party or of which any property of the Registrant or its subsidiaries were the subject other than ordinary routine litigation incidental to their business, except as follows:

LYNDE COMPANY WAREHOUSE FIRE. On March 1, 1995, the Registrant and its former subsidiary The Lynde Company were named as defendants in an action entitled DONNA M. COOKSEY, ET AL. V. HAWKINS CHEMICAL, INC. AND THE LYNDE COMPANY ("COOKSEY"). This action was certified as a partial class action in state district court in Hennepin County, Minnesota. The plaintiffs sought damages for personal injury and other damages alleged to have been caused by the alleged release of hazardous substances as a result of a fire at an office/warehouse facility used by The Lynde Company. The Registrant has entered into a class settlement agreement with the class, pursuant to which the Registrant has agreed to pay certain of the class' costs and expenses as well as certain compensation to the class pursuant to a Matrix and Plan of Distribution which form a part of the settlement agreement (the "Settlement Agreement"). The district court has given final approval of the settlement.

The Registrant's primary and umbrella insurers had denied a tender of the defense of the lawsuit and had denied any obligation to indemnify the Registrant for damages claimed by third parties in connection with the fire. On July 7, 1995, the Registrant commenced suits against The North River Insurance Company and the Westchester Fire Insurance Company, the primary and umbrella insurers, respectively, in the United States District Court for the District of Minnesota. On October 6, 1996, the Court entered an Order for Judgment against the two insurers declaring that they each owed the Registrant a duty to defend the Cooksey action, that the insurers had breached their duty to defend and that the Registrant was entitled to judgment against North River in the amount of \$890,174 and against Westchester in the amount of \$90,868 for fees and expenses incurred by the Registrant through October of 1996 in defending against the Cooksey action and in prosecuting the action against the two insurers. The two insurers appealed the judgments to the Eighth Circuit Court of Appeals, which affirmed the lower court judgments.

During fiscal 1995, the Registrant recorded \$750,000 to cover expected legal and settlement costs for this litigation and an additional \$1,771,439 in fiscal 1997. Subsequent to the end of fiscal 1998, the Registrant has been reimbursed for substantially all of its settlement and litigation expenses. In addition, any claims remaining under the Settlement Agreement will be covered by the umbrella insurer as to cost of defense and payment of claims.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matter was submitted to a vote of security holders during the fourth quarter of fiscal 1998.

-7-

ITEM 4A. EXECUTIVE OFFICERS OF THE REGISTRANT.

The executive officers of the Company, their ages and offices held, as of December 15, 1998 are set forth below:

Name ----	Age ---	Office -----
Dean L. Hahn	65	Chairman of the Board and Chief Executive Officer
Donald L. Shipp	63	Vice Chairman
John R. Hawkins	47	President and Secretary
Howard M. Hawkins	54	Vice President and Treasurer
Jon C. Eaton	55	Vice President, Terminal Operations
Kurt R. Norman	43	Vice President, Hawkins Water Treatment Group

DEAN L. HAHN has been the Chairman of the Board and Chief Executive Officer of the Company since 1996 and he was the President of the Company from 1983 to 1996.

DONALD L. SHIPP has been the Vice Chairman of the Board since December 1998. He was the President of the Company from 1996 to December 1998, Executive Vice President from 1983 to 1996 and the President of Feed-Rite Controls, Inc., a subsidiary of the Company, from 1967 to 1996.

HOWARD M. HAWKINS has been a Vice President of the Company since 1996 and the Company's Treasurer since 1973.

JOHN R. HAWKINS has been the Company's President since December 1998 and its Secretary since 1991. He was an Executive Vice President from 1997 to December 1998 and Vice President of Sales from 1987 to 1997.

JON C. EATON has been the Vice President of Terminal Operations for the Company since 1988.

KURT R. NORMAN has been the Vice President of the Hawkins Water Treatment Group since 1996 and he was General Manager from 1988 to 1996.

-8-

## PART II

### ITEM 5. MARKET FOR THE REGISTRANT'S COMMON EQUITY AND RELATED STOCKHOLDER MATTERS.

The information under the caption "Quarterly Stock Data" on page 21 of the 1998 Annual Report is incorporated herein by this reference.

### ITEM 6. SELECTED FINANCIAL DATA.

The information under the caption "Selected Financial Data" on page 19 of the 1998 Annual Report is incorporated herein by this reference.

### ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS.

The information under the caption "Management's Discussion and Analysis" on pages 8 through 11 of the 1998 Annual Report is incorporated herein by this reference.

### ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK.

The information under the caption "Management's Discussion and Analysis" on pages 8 through 11 of the 1998 Annual Report is incorporated herein by this reference.

### ITEM 8. FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA.

The Consolidated Financial Statements of the Company and the Independent Auditors' Report therefor on pages 12 through 18 of the 1998 Annual Report are incorporated herein by this reference.

### ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE.

No changes in accountants or disagreements between the Registrant and its accountants regarding accounting principles or financial statement disclosure have occurred during the Registrant's two most recent fiscal years or any subsequent interim period.

-9-

## PART III

### ITEM 10. DIRECTORS AND EXECUTIVE OFFICERS OF THE REGISTRANT.

The information under the captions "Election of Directors" and "Section 16(a) Beneficial Ownership Reporting Compliance" in the 1999 Proxy Statement is incorporated herein by this reference.

### ITEM 11. EXECUTIVE COMPENSATION.

The information under the caption "Compensation of Executive Officers and Directors" in the 1999 Proxy Statement is incorporated herein by this reference.

### ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

The information under the caption "Security Ownership of Management and Beneficial Ownership" in the 1999 Proxy Statement is incorporated herein by this reference.

### ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS.

The information under the captions "Election of Directors" and "Related Party Transactions" in the 1999 Proxy Statement is incorporated herein by this reference.

PART IV

ITEM 14. EXHIBITS, FINANCIAL STATEMENT SCHEDULES, AND REPORTS ON FORM 8-K.

(a) (1) FINANCIAL STATEMENTS OF REGISTRANT.

The following consolidated financial statements of Hawkins Chemical, Inc. and subsidiary, together with the Independent Auditors' Report, found under appropriate headings in the Registrant's 1998 Annual Report, are hereby incorporated by reference in this Annual Report on Form 10-K.

Consolidated Balance Sheets at September 27, 1998 and September 28, 1997.

Consolidated Statements of Income for the Years Ended September 27, 1998, September 28, 1997 and September 29, 1996.

Consolidated Statements of Shareholders' Equity for the Years Ended September 27, 1998, September 28, 1997 and September 29, 1996.

-10-

Consolidated Statements of Cash Flows for the Years Ended September 27, 1998, September 28, 1997 and September 29, 1996.

Notes to Consolidated Financial Statements.

Independent Auditors' Report.

(a) (2) FINANCIAL STATEMENT SCHEDULES OF REGISTRANT.

The additional financial data listed below is included as a schedule to this Annual Report on Form 10-K and should be read in conjunction with the consolidated financial statements presented in Part II, Item 8. Schedules not included with this additional financial data have been omitted because they are not required or the required information is included in the financial statements or the notes.

Independent Auditors' Report on Schedule.

Schedule for the Years Ended September 27, 1998, September 28, 1997 and September 29, 1996:

Schedule II - Valuation and Qualifying Accounts

Condensed financial information of the Registrant is not presented because no restrictions exist on the transfer of funds or assets between the Registrant and its subsidiary.

(a) (3) EXHIBITS.

The exhibits to this Annual Report on Form 10-K are listed on the Exhibit Index on page 15.

A copy of any of the exhibits listed or referred to above will be furnished at a reasonable cost to any person who was a shareholder of the Company as of December 28, 1998, upon receipt from any such person of a written request for any such exhibit. Such request should be sent to Hawkins Chemical, Inc., 3100 East Hennepin Avenue, Minneapolis, Minnesota, 55413, Attn: Secretary.

There are no management contracts or compensatory plans or arrangements required to be filed as an exhibit to this Annual Report on Form 10-K pursuant to Item 14(a)(3).

(b) REPORTS ON FORM 8-K.

None.

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HAWKINS CHEMICAL, INC.

By /s/ Dean L. Hahn

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Dean L. Hahn, Chairman  
of the Board of Directors

Dated: December 28, 1998.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has also been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

By /s/ Dean L. Hahn Dated: December 28, 1998

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Dean L. Hahn, Chief Executive  
Officer, Director

By /s/ Howard J. Hawkins Dated: December 28, 1998

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Howard J. Hawkins, Chairman  
Emeritus, Director

By /s/ Donald L. Shipp Dated: December 28, 1998

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Donald L. Shipp, Vice Chairman,  
Director

By /s/ John R. Hawkins Dated: December 28, 1998

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John R. Hawkins, President and  
Secretary, Director

By /s/ Howard M. Hawkins Dated: December 28, 1998

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Howard M. Hawkins, Treasurer  
(Chief Financial and Accounting  
Officer), Director

By /s/ Carl J. Ahlgren Dated: December 28, 1998

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Carl J. Ahlgren, Director

By /s/ Norman P. Anderson Dated: December 28, 1998

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Norman P. Anderson, Director

By /s/ John S. McKeon Dated: December 28, 1998

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John S. McKeon, Director

By /s/ Duane M. Jergenson Dated: December 28, 1998

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Duane M. Jergenson, Director

INDEPENDENT AUDITORS' REPORT ON SCHEDULE

We have audited the consolidated financial statements of Hawkins Chemical, Inc. and subsidiary (the "Company") as of September 27, 1998 and September 28, 1997, and for each of the three years in the period ended September 27, 1998, and have issued our report thereon dated December 3,

1998; such consolidated financial statements and report are included in the 1998 Annual Report to Shareholders and are incorporated herein by reference. Our audits also included the consolidated financial statement schedule of the Company, listed in Item 14(a)(2). This consolidated financial statement schedule is the responsibility of the Company's management. Our responsibility is to express an opinion based on our audits. In our opinion, this consolidated financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly in all material respects the information set forth therein.

DELOITTE & TOUCHE LLP  
 Minneapolis, Minnesota  
 December 3, 1998

SCHEDULE II

HAWKINS CHEMICAL, INC. AND SUBSIDIARY

VALUATION AND QUALIFYING ACCOUNTS

FOR THE YEARS ENDED SEPTEMBER 27, 1998, SEPTEMBER 28, 1997 AND SEPTEMBER 29, 1996

DESCRIPTION	BALANCE AT BEGINNING OF YEAR	ADDITIONS		DEDUCTIONS WRITE-OFFS	BALANCE AT END OF YEAR
		CHARGED TO COSTS AND EXPENSES	CHARGED TO OTHER ACCOUNTS		
Reserve deducted from asset to which it applies - allowance for doubtful accounts:					
YEAR ENDED: September 27, 1998	\$361,830	\$32,700	\$ ---	\$15,804	\$378,726
YEAR ENDED: September 28, 1997	\$344,002	\$31,200	\$ ---	\$13,372	\$361,830
YEAR ENDED: September 29, 1996	\$347,871	\$68,046	\$ ---	\$71,915	\$344,002

INDEX TO EXHIBITS

Exhibit No.	Description of Exhibit	Method of Filing
3.1	Amended and Second Restated Articles of Incorporation as amended through February 28, 1989.	Incorporated by reference to Exhibit 3D to the Registrant's Quarterly Report on Form 10-Q for the quarter ended March 31, 1989.
3.2	Second Amended and Superseding By-Laws as amended through February 15, 1995.	Incorporated by reference to Exhibit 3.2 to the Registrant's Annual Report on Form 10-K for the year ended October 1, 1995.
4	See Exhibits 3.1 and 3.2 above.	
13.1*	Portions of Annual Report to Security Holders for period ended September 27, 1998.	Filed herewith electronically.

21.1*	Subsidiaries of Registrant.	Filed herewith electronically.
23.1*	Independent Auditors' Consent.	Filed herewith electronically.
27.1*	Financial Data Schedule.	Filed herewith electronically.

\* Denotes previously unfiled documents.

## MANAGEMENT'S DISCUSSION AND ANALYSIS

THE INFORMATION CONTAINED IN THIS ANNUAL REPORT INCLUDES FORWARD-LOOKING STATEMENTS AS DEFINED IN SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934, AS AMENDED. THESE FORWARD-LOOKING STATEMENTS INVOLVE A NUMBER OF RISKS AND UNCERTAINTIES, INCLUDING DEMAND FROM MAJOR CUSTOMERS, COMPETITION, CHANGES IN PRODUCT OR CUSTOMER MIX OR REVENUES, CHANGES IN PRODUCT COSTS AND OPERATING EXPENSES, AND OTHER FACTORS DISCLOSED THROUGHOUT THIS ANNUAL REPORT AND THE COMPANY'S OTHER FILINGS WITH THE SECURITIES AND EXCHANGE COMMISSION. THE ACTUAL RESULTS THAT THE COMPANY ACHIEVES MAY DIFFER MATERIALLY FROM ANY FORWARD-LOOKING STATEMENTS DUE TO SUCH RISKS AND UNCERTAINTIES. THE COMPANY UNDERTAKES NO OBLIGATION TO REVISE ANY FORWARD-LOOKING STATEMENT IN ORDER TO REFLECT EVENTS OR CIRCUMSTANCES THAT MAY ARISE AFTER THE DATE OF THIS REPORT. READERS ARE URGED TO CAREFULLY REVIEW AND CONSIDER THE VARIOUS DISCLOSURES MADE BY THE COMPANY IN THIS REPORT AND IN THE COMPANY'S OTHER REPORTS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION THAT ATTEMPT TO ADVISE INTERESTED PARTIES OF THE RISKS AND UNCERTAINTIES THAT MAY AFFECT THE COMPANY'S FINANCIAL CONDITION, RESULTS OF OPERATIONS OR CASH FLOWS.

### OVERALL SUMMARY

Net sales in fiscal 1998 increased 8.0% to \$94,722,511 from \$87,745,980 in fiscal 1997. Net income in fiscal 1998 increased 5.4% to \$8,213,869 from \$7,790,487 in fiscal 1997. Basic and diluted earnings per share in fiscal 1998 were \$.71 compared to \$.67 in fiscal 1997. Return on average shareholders' equity was 16.0% for 1998, compared to 16.9% for 1997. Book value per share at September 27, 1998 was \$4.67 compared to \$4.22 one year ago.

### RESULTS OF OPERATIONS

The general economic environment in our markets has improved slightly with the overall improvement in the economy. While this improvement had a favorable impact on earnings, management will continue to focus efforts on programs aimed at improving profitability and controlling costs.

#### NET SALES

For the year ended September 27, 1998, sales increased \$6,976,531, an 8.0% increase from 1997, due to an increase in the volume and selling price (and the cost) of caustic soda and to increasing business in food grade products and pharmaceutical chemicals, which accounted for slightly more than one-half of the increase. The remaining increase came from overall volume increases in all divisions. For the year ended September 28, 1997, sales increased \$6,859,918, an 8.5% increase from 1996, due to volume increases of caustic soda, increasing business in food grade products and pharmaceutical chemicals and overall volume increases in all divisions and subsidiaries.

#### GROSS MARGINS

Gross margin, as a percentage of sales, was 23.6% in 1998, 24.3% in 1997 and 22.4% in 1996. The 1998 decrease was due to lower profit margins on a major product line while the cost and selling price of the product line was increasing throughout the year. The Company attempts to maintain relatively constant dollar margins as the cost of this product line increases and decreases. The cost of this product is normally subject to fluctuations and such fluctuations are expected to continue in future periods. By maintaining relatively stable dollar margins, the gross margin percentage will decrease when the cost of the product is increasing and increase when the cost of the product is decreasing. The 1997 increase was due mainly to better profit margins on a portion of the sales volume increase and the Company's ability to maintain relatively constant dollar profit margins on this major product line while the cost of the materials decreased. The Company has also generally been able to, and expects to continue to, adjust its selling prices as the cost of materials and other expenses change, thereby maintaining relatively stable gross margins.

The Company's caustic soda operations are located on the Mississippi River, enabling the Company to receive caustic soda through barge transportation. When the river has flooded, the Company has been able to receive caustic soda by tank cars. Although the use of tank cars has resulted

in additional costs, results of operations have not been materially impacted. Based on this experience, the Company does not expect any future flooding to have a material impact on the Company's financial condition, results of operations, or cash flows.

#### SELLING, GENERAL AND ADMINISTRATIVE

Selling, general and administrative expenses increased 7.1% and 7.3% in 1998 and 1997, respectively, over the previous year. The 1998 increase was due to increases in employee salaries and benefits cost and to costs related to upgrading the computer and phone systems. The 1997 increase was due to increasing the sales staff, which resulted in higher employee salaries and benefits costs and to general inflation in all other areas.

#### LITIGATION AND SETTLEMENT COSTS RELATED TO 1995 FIRE

The charges of \$1,771,439 in 1997 and \$750,000 in 1995 were recorded to cover legal fees and settlement costs in connection with the Company's defense of a lawsuit filed against it in Minnesota. The lawsuit resulted from a fire at an office/warehouse facility occupied by The Lynde Company, formerly a wholly owned subsidiary of the Company. Through September 27, 1998, the Company had paid \$2,728,000 in settlement and legal costs relating to the fire. Most of the claimants have now been paid under the Settlement Agreement.

The Company's primary and umbrella insurers denied coverage and refused to defend the lawsuit. Subsequent to the end of fiscal 1998, the Company has prevailed in its claims against its insurers and has been reimbursed \$2.7 million for substantially all of its settlement and legal expenses. In addition, the Company anticipates that the claims remaining under the Settlement Agreement will be covered by the umbrella insurer as to the cost of defense and claims payment.

#### OTHER INCOME

Interest income was up 7.3% in 1998 as compared to the previous year due to a higher rate of return on the cash available for investments. Interest income was up 15.9% in 1997 as compared to 1996 due to more cash available for investment and to additional interest earned on the notes receivable relating to the sale of The Lynde Company. Interest expense decreased in 1998 and 1997 as compared to the previous year. Most of the interest expense is the result of the Company issuing a note payable to the seller in connection with the acquisition of the assets of Industrial Chemical & Equipment Company in 1993. The gain on the sale of The Lynde Company relates to the Company's sale of the subsidiary on May 29, 1997. Other miscellaneous income decreased in 1998 and 1997 as compared to the previous years due to the gain on the sale of land in 1997 and to the gain on the sale of a building in 1996.

#### PROVISION FOR INCOME TAXES

The effective income tax rate was 38.9% for the year ended September 27, 1998, 38.8% for the year ended September 28, 1997 and 38.0% for the year ended September 29, 1996. The differences are due mainly to variations in tax-free income on investments in municipal bonds.

#### INFLATION

Inflation has not had a significant impact on the Company, as selling prices have generally been adjusted as the cost of materials and other expenses have changed. On occasion, however, slight fluctuations in the cost of a single, large-volume product have not been reflected in the selling price of that product.

#### FINANCIAL CONDITION

##### LIQUIDITY

Cash provided by operations in fiscal 1998 was \$6,127,052 compared with \$5,675,264 in fiscal 1997 and \$7,241,783 in fiscal 1996. The increase in fiscal 1998 over 1997 was due primarily to the increase in net income. The decrease in fiscal 1997 over 1996 was due primarily to an increase in trade receivables caused by the sales increase, an increase in inventories to meet expected future sale increases, and to a decrease in accounts payable caused by the timing of year-end purchases.

Cash and investments available-for-sale decreased by \$2,304,155 to \$17,740,944 at the end of fiscal 1998. The Company is investing excess cash primarily in conservative investments. Cash equivalents consist of bank certificates of deposit having a maturity of three months or less. Investments

consist of investment contracts with high-rated, stable insurance companies and marketable securities consisting of variable rate municipal bonds carried at fair value which approximates cost. Cash equivalents and investments are highly liquid and are available upon demand generally with only a minor penalty.

On May 29, 1997, the Company sold the inventory and operations of The Lynde Company, a wholly owned subsidiary which specialized in swimming pool chemicals, for \$2,590,000, effective March 1, 1997. The Company recorded a gain on the sale of approximately \$1.3 million. At closing, the Company received \$500,000 cash and a note receivable for the balance. The note receivable is due over the next five years plus interest at 8%.

Subsequent to fiscal 1998, the Company received \$2.7 million from a litigation settlement (see Note 10). These proceeds will be used for future working capital requirements.

#### CAPITAL EXPENDITURES

Capital expenditures in fiscal years 1998, 1997 and 1996 were \$5,051,641, \$4,017,543 and \$4,299,071, respectively. Of the 1998 capital expenditures, the new food chemical production facility and truck wash area accounted for approximately \$1.6 million, improvements to the outside storage tanks at Terminal I amounted to approximately \$.5 million, transportation equipment additions accounted for \$.6 million and building additions and the installation of automatic sprinkling systems at out-state locations accounted for \$.7 million. Other building improvements and additions amounted to \$.7 million and other warehouse, laboratory and office machinery and equipment accounted for \$1 million.

#### COMMON STOCK REPURCHASES

During fiscal year 1998, the Company acquired and retired 153,000 shares of common stock for \$1,568,296.

#### OUTLOOK

Management does not anticipate the need for stock or debt issuances in the short or long-term, as cash, investments and cash flows from operations have been adequate to fund working capital, capital investments, dividend needs and common stock repurchases. If the need for additional financing arises, however, management will consider issuance of debt or equity if such financing can be obtained on favorable terms. Although management continually looks for companies to acquire and for ways to modernize its warehouse facilities and equipment, no material commitments for acquisitions or capital expenditures currently exist.

Other than as discussed above, management is not aware of any matters or trends that have materially affected the results of operations for fiscal 1998 that are not expected to have either short or long-term implications, nor is it aware of any trends or other matters that have not materially affected results in fiscal 1998 but are expected to have a material effect on future periods.

#### YEAR 2000 READINESS

As generally known, the Year 2000 issue pertains to the inability of some computer hardware and software and other electronic devices to operate properly as January 1,

2000 approaches, and beyond. The Company has taken, and will continue to take, actions intended to minimize the impact of the Year 2000 issue, although it is impossible to eliminate these risks entirely.

The Company's major information technology (IT) systems and infrastructure have been upgraded or replaced in the ordinary course of business over the last two years. Approximately \$450,000 has been spent through September 27, 1998 to upgrade the Company's primary IT systems, IT infrastructure and security systems, and to replace the telephone, voicemail, and timekeeping systems to Year 2000 compliant systems. The Company will continue to invest in technology to accommodate the Company's future growth, with such improvements intended to achieve Year 2000 compliance as a byproduct of the upgrades.

The Company is currently implementing a Year 2000 compliance testing program of its hardware, software and equipment. Testing will include, but is

not limited to, corporate IT systems, IT infrastructure, security systems, telephone systems, manufacturing and laboratory equipment, and timekeeping systems. Although the Company does not expect that costs necessary to replace non-compliant systems will have a material impact on the Company's results of operations, liquidity, or financial condition, it is not possible to estimate the total expected cost associated with achieving Year 2000 readiness.

The Company relies on computer processing for its business activities and the Year 2000 issue creates risk for the Company from unforeseen problems in the Company's systems and from third parties with whom the Company does business. The failure of the Company's systems and/or third party systems could have a material adverse effect on the Company's results of operations, liquidity, and financial condition. Year 2000 readiness of third parties with whom the Company does business, particularly suppliers of critical products and providers of utility and communication services, could impair the Company's ability to deliver products and services and could cause system failures or errors, business interruptions and, in a worst case scenario, the inability to engage in normal business practices for an unknown length of time. This worst case scenario, if it should occur, could have a material adverse effect on the Company's operations, liquidity or financial condition, particularly if the disruption continues for a significant length of time. While third party risk related to the Year 2000 issues is difficult to quantify or control, the Company is taking steps to try to minimize the potential adverse effect that could arise. The Company has sent Year 2000 surveys to its suppliers asking for the compliance status of suppliers' products and internal operations. The responses received by the Company to date indicate that most of its suppliers expect to be Year 2000 compliant in a timely manner. The Company plans to develop third party contingency plans as it identifies partners evidencing inadequate Year 2000 preparations. Contingency plans may include plans to accumulate extra inventory and/or establish alternative sources of supply and channels of distribution. However, even with diligent planning, third party providers pose an uncertain risk that cannot be entirely eliminated.

Due to the general uncertainty inherent in the Year 2000 issue, resulting in part from the uncertainty of the Year 2000 issue readiness of third-party suppliers and customers,

the Company is unable to determine at this time whether the consequences of Year 2000 issue failures will have a material impact on the Company's results of operations, liquidity, or financial condition.

#### MARKET RISK

At the end of fiscal 1998, the Company had an investment portfolio of fixed income securities, excluding \$17,171,214 of those classified as cash and cash equivalents and variable rate securities, of \$2,418,573. These securities, like all fixed income instruments, are subject to interest rate risk and will decline in value if market interest rates increase. However, the Company has the ability to hold its fixed income investments until maturity and therefore the Company would not expect to recognize an adverse impact in income or cash flows.

#### ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 130, "Reporting Comprehensive Income," which establishes standards for reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income will include all changes in shareholders' equity except those resulting from investments by and distributions to owners. The Company will be required to adopt SFAS No. 130 in fiscal 1999. Such adoption is not expected to have a material impact on the Company.

In June 1997, the FASB also issued SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information." SFAS No. 131 redefines how operating segments are determined and requires disclosures of certain financial and descriptive information about a company's operating segments. The Company has not yet determined the effects SFAS No. 131 will have on the financial statements. The Company will be required to adopt SFAS No. 131 in fiscal 1999.

In June 1998, the FASB issued SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities." SFAS No. 133 requires companies to record derivatives on the balance sheet as assets and liabilities, measured at fair value. Gains or losses resulting from changes in the values of those derivatives

would be accounted for depending on the use of the derivative and whether it qualifies for hedge accounting. SFAS No. 133 is effective for fiscal years beginning after June 15, 1999, with earlier adoption encouraged. Management has not yet determined the effects SFAS No. 133 will have on its financial position or the results of its operations.

CONSOLIDATED BALANCE SHEETS

	September 27, 1998	September 28, 1997
-----		
ASSETS		
CURRENT ASSETS:		
Cash and cash equivalents .....	\$ 3,197,015	\$ 8,065,021
Investments available-for-sale .....	14,543,929	11,980,078
Trade receivables - less allowance for doubtful accounts: 1998, \$378,726; 1997, \$361,830 .....	11,436,690	11,117,991
Notes receivable .....	271,027	222,946
Inventories .....	10,816,460	8,580,705
Prepaid expenses and other .....	1,848,662	1,912,325
	-----	-----
Total current assets .....	42,113,783	41,879,066
PROPERTY, PLANT AND EQUIPMENT:		
Land .....	645,194	655,194
Buildings and improvements .....	17,593,650	14,716,226
Machinery and equipment .....	7,302,134	6,173,501
Transportation equipment .....	5,211,745	5,051,518
Office furniture and equipment .....	1,978,677	1,668,849
	-----	-----
Less accumulated depreciation .....	32,731,400	28,265,288
	14,307,911	12,777,743
	-----	-----
Net property, plant and equipment .....	18,423,489	15,487,545
OTHER ASSETS:		
Intangible assets - less accumulated amortization: 1998, \$393,015; 1997, \$329,917 .....	664,199	727,297
Investments held-to-maturity .....	1,848,843	1,750,658
Notes receivable - noncurrent .....	3,302,923	3,639,712
	-----	-----
Other .....	182,238	168,338
	-----	-----
Total other assets .....	5,998,203	6,286,005
	-----	-----
TOTAL ASSETS .....	\$66,535,475	\$63,652,616
	-----	-----
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Accounts payable - trade .....	\$ 4,970,341	\$ 5,729,584
Current portion of long-term debt .....	89,123	59,928
Dividends payable .....	1,147,090	1,044,351
Accrued payroll and employee benefits .....	3,245,815	2,452,746
Container deposits .....	1,503,889	1,539,585
Other accruals .....	664,347	2,389,123
	-----	-----
Total current liabilities .....	11,620,605	13,215,317
LONG-TERM DEBT .....	423,402	512,525
DEFERRED INCOME TAXES .....	1,011,500	983,000
COMMITMENTS AND CONTINGENCIES (NOTES 4, 6 AND 8).....		
SHAREHOLDERS' EQUITY:		
Common stock - authorized: 15,000,000 shares of \$.05 par value; issued and outstanding: 1998 - 11,450,895 shares; 1997 - 11,603,895 shares .....	572,545	580,195
Additional paid-in capital .....	41,960,535	42,517,455
Retained earnings .....	10,946,888	5,844,124
	-----	-----
Total shareholders' equity .....	53,479,968	48,941,774
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY .....	\$66,535,475	\$63,652,616
	-----	-----

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF INCOME

For the Fiscal Years Ended

	September 27, 1998	September 28, 1997	September 29, 1996
Net sales .....	\$ 94,722,511	\$ 87,745,980	\$ 80,886,062
Cost of sales .....	72,380,576	66,413,954	62,789,554
Gross profit .....	22,341,935	21,332,026	18,096,508
Selling, general and administrative expenses .....	10,170,255	9,499,558	8,853,319
Litigation and settlement costs relating to 1995 fire .....		1,771,439	
Income from operations .....	12,171,680	10,061,029	9,243,189
Other income (deductions):			
Interest income .....	1,237,789	1,153,322	995,012
Interest expense .....	(43,516)	(47,439)	(53,170)
Gain on sale of The Lynde Company .....		1,324,827	
Miscellaneous .....	83,084	234,518	262,020
Total other income, net .....	1,277,357	2,665,228	1,203,862
INCOME BEFORE INCOME TAXES .....	13,449,037	12,726,257	10,447,051
Provision for income taxes .....	5,235,168	4,935,770	3,970,641
NET INCOME .....	\$ 8,213,869	\$ 7,790,487	\$ 6,476,410
WEIGHTED AVERAGE NUMBER OF SHARES OUTSTANDING .....	11,594,752	11,603,895	11,603,895
BASIC AND DILUTED EARNINGS PER SHARE .....	\$ 0.71	\$ 0.67	\$ 0.56

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

	COMMON STOCK		ADDITIONAL PAID-IN CAPITAL	RETAINED EARNINGS
	SHARES	AMOUNT		
BALANCE AT OCTOBER 1, 1995 .....	10,525,772	\$ 526,289	\$ 34,235,623	\$ 3,356,710
Stock dividend .....	525,918	26,296	4,444,007	(4,470,303)
Cash dividend .....				(1,729,200)
Income tax savings from dividends paid on ESOP shares .....				149,300
Net income .....				6,476,410
BALANCE AT SEPTEMBER 29, 1996 .....	11,051,690	552,585	38,679,630	3,782,917
Stock dividend .....	552,205	27,610	3,837,825	(3,865,435)
Cash dividend .....				(2,041,623)
Income tax savings from dividends paid on ESOP shares .....				177,778
Net income .....				7,790,487
BALANCE AT SEPTEMBER 28, 1997 .....	11,603,895	580,195	42,517,455	5,844,124
Cash dividend .....				(2,307,479)
Stock acquired and retired .....	(153,000)	(7,650)	(556,920)	(1,003,726)
Income tax savings from dividends paid on ESOP shares .....				200,100
Net income .....				8,213,869
BALANCE AT SEPTEMBER 27, 1998 .....	11,450,895	\$ 572,545	\$ 41,960,535	\$ 10,946,888

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the Fiscal Years Ended		
	September 27, 1998	September 28, 1997	September 29, 1996
CASH FLOWS FROM OPERATING ACTIVITIES:			
Net income .....	\$ 8,213,869	\$ 7,790,487	\$ 6,476,410
Gain on sale of The Lynde Company .....		(1,324,827)	
Litigation and settlement costs relating to 1995 fire .....	(1,083,866)	1,175,286	
Reconciliation to cash flows:			
Depreciation and amortization .....	1,993,112	1,686,622	1,477,228
Deferred income taxes .....	750,894	(307,800)	230,511
Earnings on other assets .....	(112,084)	(91,076)	(81,093)
Loss (gain) from property disposals .....	20,992	(110,807)	(160,212)
Changes in operating accounts (requiring) providing cash:			
Trade receivables .....	(318,699)	(1,377,706)	771,975
Inventories .....	(2,235,755)	(1,221,750)	79,925
Accounts payable .....	(759,243)	(979,850)	(1,981,770)
Accrued liabilities .....	116,463	383,058	(262,185)
Other .....	(458,631)	53,627	690,994
Net cash provided by operating activities .....	6,127,052	5,675,264	7,241,783
CASH FLOWS FROM INVESTING ACTIVITIES:			
Additions to property, plant and equipment .....	(5,051,641)	(4,017,543)	(4,299,071)

Purchase of investments .....	(2,563,852)	(1,475,475)	(3,183,787)
Sale of investments .....			647,945
Proceeds from property disposals .....	164,691	191,946	198,069
Cash received on sale of assets and business of The Lynde Company .....		500,000	
Payments received on notes receivable .....	288,708	196,120	55,293
Net cash used in investing activities .....	(7,162,094)	(4,604,952)	(6,581,551)
CASH FLOWS FROM FINANCING ACTIVITIES:			
Debt repayment .....	(59,928)	(56,008)	(52,344)
Cash dividends paid .....	(2,204,740)	(1,881,408)	(1,581,870)
Acquisition and retirement of stock .....	(1,568,296)		
Net cash used in financing activities .....	(3,832,964)	(1,937,416)	(1,634,214)
Net decrease in cash and cash equivalents .....	(4,868,006)	(867,104)	(973,982)
Cash and cash equivalents at beginning of year .....	8,065,021	8,932,125	9,906,107
CASH AND CASH EQUIVALENTS AT END OF YEAR .....	\$ 3,197,015	\$ 8,065,021	\$ 8,932,125
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:			
Note receivable on sale of land and building .....			\$ 1,100,000
Note receivable on sale of The Lynde Company .....		\$ 2,090,083	
Cash paid during the year for:			
Interest .....	\$ 47,711	\$ 51,359	\$ 56,834
Income taxes .....	\$ 5,739,297	\$ 4,334,567	\$ 3,942,596

SEE ACCOMPANYING NOTES TO CONSOLIDATED FINANCIAL STATEMENTS.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### 1. NATURE OF BUSINESS AND SIGNIFICANT ACCOUNTING POLICIES

#### NATURE OF BUSINESS

Hawkins Chemical, Inc. and its wholly owned subsidiary, Hawkins Water Treatment Group, Inc., are engaged in the wholesale trade of chemicals and chemical feeding and control equipment and the formulating and blending of specialty chemicals.

#### BASIS OF CONSOLIDATION

The financial statements include the consolidated accounts of Hawkins Chemical, Inc. and its wholly owned subsidiary (the Company). All significant inter-company transactions and balances have been eliminated. The Company's fiscal year is a 52/53-week year ending on the Sunday closest to September 30.

#### CASH EQUIVALENTS

Cash equivalents include all liquid debt instruments (primarily cash funds and certificates of deposit) purchased with an original maturity of three months or less. Cash equivalents are carried at cost, which approximates market value.

#### INVESTMENTS AVAILABLE-FOR-SALE

Investments classified as available-for-sale securities consist of insurance contracts and variable rate marketable securities (primarily municipal bonds and annuity contracts) that will be held for indefinite periods of time, including securities that may be sold in response to changes in market interest or prepayment rates, needs for liquidity or changes in the availability or yield of alternative investments. These securities are carried at market value which approximates cost.

#### INVENTORIES

Inventories, consisting primarily of finished goods, are primarily valued at the lower of cost or net realizable value, with cost being determined using the last-in, first-out (LIFO) method. One division values its inventory using the first-in, first-out (FIFO) cost method (See Note 2).

#### PROPERTY, PLANT AND EQUIPMENT

Property is stated at cost and depreciated over the lives of the assets using both straight-line and declining-balance methods. Estimated lives are: 10 to 50 years for buildings and improvements; 3 to 15 years for machinery and equipment; 3 to 10 years for transportation equipment; and 3 to 10 years for office furniture and equipment.

#### INTANGIBLES

The excess of the purchase price and related costs over the fair value of

the net assets acquired is being amortized over 15 or 40 years.

#### INVESTMENTS HELD-TO-MATURITY

Held-to-maturity securities consist of Minnesota municipal bonds which the Company has the intent and ability to hold to maturity, and are valued at amortized historical cost, increased for accretion of discounts and reduced by amortization of premiums, computed by the constant-yield method.

#### RECOVERABILITY OF LONG-LIVED ASSETS

The Company reviews its long-lived assets whenever events or changes in circumstances indicate the carrying amount of the assets may not be recoverable. The Company determines potential impairment by comparing the carrying value of the assets with expected net cash flows expected to be provided by operating activities of the business or related products. Should the sum of the expected future net cash flows be less than the carrying value, the Company would determine whether an impairment loss should be recognized. An impairment loss would be measured by comparing the amount by which the carrying value exceeds the fair value of the asset based on market value that is based on the discounted cash flows expected to be generated by the asset.

#### INCOME TAXES

The Company utilizes Statement of Financial Accounting Standard (SFAS) No. 109, "Accounting for Income Taxes." Under SFAS No. 109, the deferred tax assets and liabilities are recognized based on differences between the financial statements and the tax bases of assets and liabilities using presently enacted tax rates.

#### REVENUE RECOGNITION

The Company recognizes revenues upon shipment of the product.

#### EARNINGS PER SHARE

Effective December 15, 1997, the Company adopted Statement of Financial Accounting Standard (SFAS) No. 128, "Earnings Per Share." Per share amounts for the fiscal years ended September 28, 1997 and September 29, 1996 have been restated for the adoption of SFAS No. 128. The per share amounts reported under SFAS No. 128 are not materially different than those calculated and presented under Accounting Principles Board Opinion No. 15. Basic and diluted earnings per share are computed by dividing net income by the weighted average number of common shares outstanding.

#### CONCENTRATION OF CREDIT RISK

Financial instruments which potentially subject the Company to a concentration of credit risk principally consist of cash, investments available-for-sale and trade receivables. The Company sells its principal products to a large number of customers in many different industries. To reduce credit risk, the Company routinely assesses the financial strength of its customers. The Company invests its excess cash balances in certificates of deposit at a single financial institution. At September 27, 1998, the Company had certificates of deposit in excess of federally insured limits of approximately \$3,100,000.

At the end of fiscal 1998, the Company had an investment portfolio of fixed income securities, excluding \$17,171,214 of those classified as cash and cash equivalents and variable rate securities, of \$2,418,573. These securities, like all fixed income instruments, are subject to interest rate risk and will decline in value if market interest rates increase. However, the Company has the ability to hold its fixed income investments until maturity and therefore the Company would not expect to recognize an adverse impact in income or cash flows.

#### ESTIMATES

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

#### RISK AND UNCERTAINTIES

There are no concentrations of business transacted with a particular

customer or supplier nor concentrations of revenue from a particular service or geographic area that would severely impact the Company in the near term.

ACCOUNTING PRONOUNCEMENTS

In June 1997, the Financial Accounting Standards Board (FASB) issued SFAS No. 130, "Reporting Comprehensive Income," which establishes standards for reporting and display of comprehensive income and its components in a full set of general purpose financial statements. Comprehensive income will include all changes in shareholders' equity except those resulting from investments by and distributions to owners. The Company will be required to adopt SFAS No. 130 in fiscal 1999. Such adoption is not expected to have a material impact on the Company.

In June 1997, the FASB also issued SFAS No. 131, "Disclosure about Segments of an Enterprise and Related Information." SFAS No. 131 redefines how operating segments are determined and requires disclosures of certain financial and descriptive information about a company's operating segments.

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2. INVENTORIES

Inventories consist of the following:

	September 27, 1998	September 28, 1997
Finished goods (FIFO basis) .....	\$ 12,841,114	\$ 9,025,817
LIFO reserve .....	(2,024,654)	(445,112)
Net inventory .....	\$ 10,816,460	\$ 8,580,705

Inventories valued under the LIFO method for the fiscal years ended September 27, 1998 and September 28, 1997, were approximately \$12,238,000 and \$7,796,000, respectively. The balance of the inventory was valued under the FIFO method.

In fiscal 1998, the LIFO reserve increased by \$1,579,542. As a result, the ending LIFO cost was less than the ending cost determined using the first-in, first-out (FIFO) method by \$2,024,654. The increase in the LIFO reserve was caused by a significant increase in the cost of a single, large-volume component of inventory.

3. NOTES RECEIVABLE

At September 27, 1998 and September 28, 1997, the net balance outstanding on the note receivable from the sale of Tessman Seed was \$615,091 and \$733,432, respectively. On March 1, 1996, the balance of the note receivable was refinanced at the request of the borrower. The note receivable is due in equal installments of \$146,466 with interest at 8%.

During 1996, the Company sold a building and realized a gain of approximately \$142,000 on the sale. The Company received a \$1,100,000 note receivable and cash of \$108,188 at the time of the sale. The note receivable is secured by the building and is due in monthly installments of \$9,201 including interest at 8%

through January 1, 2004, when the remaining balance of \$849,985 is due. At September 27, 1998 and September 28, 1997, the balance outstanding was \$1,033,629 and \$1,060,186, respectively.

In 1997, the Company sold the inventory and operations of The Lynde Company (Lynde), a wholly owned subsidiary which specialized in swimming pool chemicals, for approximately \$2,590,000. The Company recorded a gain on the sale of \$1,324,827. At closing, the Company received \$500,000 cash and a note receivable for the balance. The note receivable requires principal payments through March 2002 plus interest at 8%. At September 27, 1998 and September 28, 1997, the balance outstanding on the note receivable was \$1,925,230 and \$2,069,040, respectively. Revenues from Lynde for the fiscal years ended September 28, 1997 and September 29, 1996 were \$725,500 and \$3,413,200, respectively. Lynde recorded a net loss in 1997 of \$19,600 through the effective date of the sale and net income for the year ended September 29, 1996 of \$195,300.

#### 4. LONG-TERM DEBT

Long-term debt at September 27, 1998 and September 28, 1997 is summarized as follows:

	1998	1997
-----		
Note payable, due in annual installments to 2002 .....	\$ 512,525	\$ 572,453
Less current portion .....	89,123	59,928
	-----	
Total .....	\$ 423,402	\$ 512,525
-----		

Long-term debt maturities for the five fiscal years subsequent to 1998 are: 1999 - \$89,123, 2000 - \$95,362, 2001 - \$102,037, 2002 - \$109,180 and 2003 - \$116,823.

#### 5. SHAREHOLDERS' EQUITY

The stock dividends in 1997 and 1996 were accounted for by transferring the fair value of the issued stock from retained earnings to the categories of permanent capitalization as common stock (par value) and additional paid-in capital. During 1998, the Company acquired and retired 153,000 shares of common stock for \$1,568,296.

#### 6. LEASES

The Company has various operating leases for land and buildings on which some of its operations are located. Total rental expense for the years ended September 27, 1998, September 28, 1997 and September 29, 1996 was \$47,612, \$46,003 and \$60,955, respectively. Future minimum lease payments due under operating leases with an initial term of one year or more at September 27, 1998 are \$8,596 in 1999.

#### 7. PENSION AND EMPLOYEE STOCK OWNERSHIP PLANS

The Company has a defined contribution pension plan covering substantially all of its non-union employees. Pension expense for the years ended September 27, 1998, September 28, 1997 and September 29, 1996 was \$545,650, \$459,367 and \$425,398, respectively. The Company's cost for the pension plan is determined as 7% of each employee's covered compensation. Amounts charged to pension expense and contributed to union multi-employer pension plans (not included in the above amounts) were not material. It is the Company's policy to fund all pension costs accrued.

The Company has an employee stock ownership plan covering substantially all of its non-union employees. Contributions are made at the discretion of the Board of Directors subject to a maximum amount allowed under the Internal Revenue Code. Contributions for the years ended September 27, 1998, September 28, 1997 and September 29, 1996 were \$984,455, \$889,979 and \$824,955, respectively. The Company does not currently offer any post-retirement benefits, deferred stock or stock-based compensation plans.

8. CONTINGENCIES

During 1995, the Company had a fire in the office/warehouse of The Lynde Company, a former wholly owned subsidiary. Charges of \$1,771,439 in 1997 and \$750,000 in 1995 were recorded to cover legal fees and settlement costs in connection with the Company's defense of a lawsuit filed against it as a result of the fire. As of September 27, 1998, the Company has paid approximately \$2,728,000 in settlement and legal costs. Most of the claimants have now been paid under a settlement agreement and the Company believes those claims remaining will be covered by the Company's umbrella insurer as to the cost of defense and claims payment. The Company's insurer denied coverage and refused to defend the lawsuit. At September 27, 1998 the Company was in litigation against its insurers to recover the legal and settlement costs (see Note 10).

In addition, the Company is involved in various legal actions arising from the normal course of business. Management is of the opinion that any judgement or settlement resulting from pending or threatened litigation would not have a material adverse effect on the financial position, results of operations or cash flows of the Company.

9. INCOME TAXES

The provisions (benefits) for income taxes are as follows:

	1998	1997	1996
Federal - current	\$3,316,868	\$4,143,883	\$3,011,755
States - current	1,167,300	1,099,687	799,010
Deferred	751,000	(307,800)	159,876
Total	\$5,235,168	\$4,935,770	\$3,970,641

A reconciliation of the provision for income taxes, based on income from continuing operations, to the applicable federal statutory income tax rate of 35% is as follows:

	1998	1997	1996
Statutory federal income tax	\$ 4,707,163	\$ 4,454,190	\$ 3,656,468
State income taxes, net of federal deduction	770,418	687,454	549,531
Tax-exempt income	(122,876)	(108,856)	(97,325)
Other, net	(119,537)	(97,018)	(138,033)
Total	\$ 5,235,168	\$ 4,935,770	\$ 3,970,641

The tax effects of items comprising the Company's net deferred tax asset (liability) are as follows:

	1998	1997
Current deferred taxes:		
Trade receivables	\$ 150,000	\$ 154,000
Inventory	411,000	750,000
Accruals	164,500	544,000
Total*	\$ 725,500	\$ 1,448,000

Noncurrent deferred taxes:

Gain on sale of		
The Lynde Company	\$ (399,500)	\$ (456,000)
Property basis difference	(612,000)	(527,000)
	-----	-----
Total	\$ (1,011,500)	\$ (983,000)
	-----	-----

\*Included in prepaid expenses and other on the consolidated balance sheets.

10. SUBSEQUENT EVENT

Subsequent to the end of fiscal 1998, the Company has prevailed against its insurers in connection with the 1995 warehouse fire at The Lynde Company, a former wholly owned subsidiary. The Company has received payment of \$2,728,000, which covers substantially all of its settlement and legal costs from 1995 through September 27, 1998. The Company's results of operations for its first fiscal quarter of 1999 will include \$2,728,000 associated with this settlement.

INDEPENDENT AUDITORS' REPORT

To the Shareholders of Hawkins Chemical, Inc.:

We have audited the accompanying consolidated balance sheets of Hawkins Chemical, Inc. and its subsidiary (the Company) as of September 27, 1998 and September 28, 1997 and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended September 27, 1998. These consolidated 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 audits.

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 financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Hawkins Chemical, Inc. and its subsidiary at September 27, 1998 and September 28, 1997 and the results of their operations and their cash flows for each of the three years in the period ended September 27, 1998 in conformity with generally accepted accounting principles.

DELOITTE & TOUCHE LLP  
 Minneapolis, Minnesota  
 December 3, 1998

SELECTED FINANCIAL DATA

Year Ended September	1998	1997	1996	1995	1994
Sales from continuing operations	\$ 94,722,511	\$ 87,745,980	\$ 80,886,062	\$ 83,332,624	\$ 71,423,471
Income from continuing operations	8,213,869	7,790,487	6,476,410	5,723,963	5,044,410
Basic and diluted earnings per common share from continuing operations	.71	.67	.56	.49	.44
Cash dividends declared per common share	.20	.18	.15	.19	.11
Cash dividends paid per common share	.19	.16	.14	.19	.11
Total assets	66,535,475	63,652,616	56,487,356	53,690,814	45,974,984
Long-term debt	423,402	512,525	572,453	628,461	680,805

All per share data has been restated to reflect the 5% stock dividends in 1997, 1996 and 1994 and the 10% stock dividend in 1995.

SECURITIES MARKET MAKERS - Herzog, Heine, Geduld, Inc., New York, NY; John G. Kinnard and Company, Inc., Minneapolis, MN; S.J. Wolfe and Co., Dayton, OH

SUMMARY OF OPERATIONS BY QUARTER (UNAUDITED)

(DOLLARS IN THOUSANDS EXCEPT PER SHARE DATA)	First Quarter		Second Quarter		Third Quarter		Fourth Quarter		Total Year	
	1998	1997	1998	1997	1998	1997	1998	1997	1998	1997
Net sales	\$22,667	\$19,936	\$22,316	\$20,673	\$25,720	\$23,867	\$24,020	\$23,270	\$94,723	\$87,746
Gross profit	5,116	4,165	4,890	4,426	6,182	5,900	6,154	6,841	22,342	21,332
Net income	1,898	1,456	1,717	1,478	2,229	2,963	2,370	1,893	8,214	7,790
Basic and diluted earnings per share	.16	.13	.15	.13	.19	.26	.20	.16	.71	.67

QUARTERLY STOCK DATA

	High	Low
Fiscal 1998		
4th Quarter	\$12 1/8	\$ 9 7/8
3rd Quarter	14	11 1/4
2nd Quarter	11 3/8	9 3/4
1st Quarter	12 3/4	9 1/2
Fiscal 1997		
4th Quarter	10 1/4	7 7/8
3rd Quarter	9	6 1/2
2nd Quarter	7	6
1st Quarter	8	5 1/2

The common stock of Hawkins Chemical, Inc. is as quoted on the NASDAQ National Market System. The price information represents closing sale prices reported in the NASDAQ/NMS Monthly Statistical Report. There were 786 common shareholder accounts on September 27, 1998. The prices are adjusted to reflect the 5% stock dividend that occurred on April 11, 1997.

EXHIBIT 21.1

The following is a wholly owned subsidiary of the Registrant:

SUBSIDIARY	STATE IN WHICH ORGANIZED
Hawkins Water Treatment Group, Inc.	Minnesota

The financial statements of the predecessors of Hawkins Water Treatment Group, Inc., Feed-Rite Controls, Inc., Mon-Dak Chemical, Inc., and Dakota Chemical, Inc. (which predecessors were merged into a single entity now known as Hawkins Water Treatment Group, Inc. following the end of fiscal 1997), are consolidated with those of the Registrant.

Subsequent to September 27, 1998, Hawkins Water Treatment Group is being merged into Registrant and will continue to operate as a division of Registrant.

EXHIBIT 23.1

INDEPENDENT AUDITORS' CONSENT

We consent to the incorporation by reference in Registration Statement No. 33-41323 of Hawkins Chemical, Inc. and subsidiary (the "Company") on Form S-8 of our report dated December 3, 1998 incorporated by reference in the Annual Report on Form 10-K for the Company for the year ended September 27, 1998.

DELOITTE & TOUCHE LLP

Minneapolis, Minnesota  
December 24, 1998

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