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BERKSHIRE HATHAWAY INC.

1976

ANNUAL REPORT TO THE STOCKHOLDERS

Berkshire Hathaway Inc.

1976 Annual Report to the Stockholders

BUSINESS OF THE COMPANY

The Company is engaged directly and through subsidiaries in the manufacture and sale of woven textiles in the United States and through a subsidiary in the sale of textile products in Canada. Through subsidiaries collectively referred to in this annual report as the Insurance Group, the Company is engaged in the underwriting of fire and casualty insurance throughout the United States. In January 1976, a newly formed subsidiary of the Company acquired the assets comprising a relatively smaller business engaged in the manufacture of branded (K & W) chemical products distributed nationwide for use in the automotive aftermarket. The Company owns approximately 98% of The Illinois National Bank & Trust Co. of Rockford, Illinois which is engaged in the commercial banking business. The Company and subsidiary members of the Insurance Group have significant holdings in Blue Chip Stamps, a California corporation — the businesses of which are more fully described herein.

CONTENTS

Berkshire Hathaway Inc.

To the Stockholders of Berkshire Hathaway Inc.:

After two dismal years, operating results in 1976 improved significantly. Last year we said the degree of progress in insurance underwriting would determine whether our gain in earnings would be "moderate" or "major". As it turned out, earnings exceeded even the high end of our expectations. In large part, this was due to the outstanding efforts of Phil Liesche's managerial group at National Indemnity Company.

In dollar terms, operating earnings came to $16,073,000, or $16.47 per share. While this is a record figure, we consider return on shareholders' equity to be a much more significant yardstick of economic performance. Here our result was 17.3%, moderately above our long-term average and even further above the average of American industry, but well below our record level of 19.8% achieved in 1972.

Our present estimate, subject to all the caveats implicit in forecasting, is that dollar operating earnings are likely to improve somewhat in 1977, but that return on equity capital may decline a bit from the 1976 figure.

Textile Operations

Our textile division was a significant disappointment during 1976. Earnings, measured either by return on sales or by return on capital employed, were inadequate. In part, this was due to industry conditions which did not measure up to expectations of a year ago. But equally important were our own shortcomings. Marketing efforts and mill capabilities were not properly matched in our new Waumbec operation. Unfavorable manufacturing cost variances were produced by improper evaluation of machinery and personnel capabilities. Ken Chace, as always, has been candid in reporting problems and has worked diligently to correct them. He is a pleasure to work with – even under difficult operating conditions.

While the first quarter outlook is for red ink, our quite tentative belief is that textile earnings in 1977 will equal, or exceed modestly, those of 1976. Despite disappointing current results, we continue to look for ways to build our textile operation and presently have one moderate-size acquisition under consideration. It should be recognized that the textile business does not offer the expectation of high returns on investment. Nevertheless, we maintain a commitment to this division – a very important source of employment in New Bedford and Manchester – and believe reasonable returns on average are possible.

Insurance Underwriting

Casualty insurers enjoyed some rebound from the disaster levels of 1975 as rate increases finally outstripped relentless cost increases. Preliminary figures indicate that the stockholder-owned portion of the property and casualty industry had a combined ratio of 103.0 in 1976, compared to 108.3 in 1975. (100 represents a break-even position on underwriting – and higher figures represent underwriting losses.) We are unusually concentrated in auto lines where stock companies had an improvement from 113.5 to 107.4. Our own overall improvement was even more dramatic, from 115.4 to 98.7.

Our major sector in insurance, the traditional auto and general liability business of National Indemnity Company, had an outstanding year, achieving profit levels significantly better than the industry generally. Credit for this performance must be given to Phil Liesche, aided particularly by Roland Miller in Underwriting and Bill Lyons in Claims.

Volume at National Indemnity Company grew rapidly during 1976 as competitors finally reacted to the inadequacy of past rates. But, as mentioned in last year's annual report, we are concentrated heavily in lines that are particularly susceptible to both economic and social inflation. Thus present rates, which are adequate for today, will not be adequate tomorrow. Our opinion is that before long, perhaps in 1978, the industry will fall behind on rates as temporary prosperity produces unwise competition. If this happens, we must be prepared to meet the next wave of inadequate pricing by a significant reduction in volume.

Reinsurance underwriting has lagged the improvement in direct business. When mistakes are made in the pricing of reinsurance, the effects continue for even longer than when similar mistakes are made in direct underwriting. George Young, an outstanding manager, has worked tirelessly to achieve his goal of profitable underwriting, and has cancelled a great many contracts where appropriate rate adjustments were not obtainable. Here, as in the direct business, we have had a concentration in casualty lines which have been particularly hard hit by inflationary conditions. The near term outlook still is not good for our reinsurance business.

Our "home state" operation continues to make substantial progress under the management of John Ringwalt. The combined ratio improved from 108.4 in 1975 to 102.7 in 1976. There still are some excess costs reflected in the combined ratio which result from the small size of several operations. Cornhusker Casualty Company, oldest and largest of the home state companies, was the winner of the Chairman's Cup in 1976 for achievement of the lowest loss ratio among the home state companies. Cornhusker also achieved the lowest combined ratio in its history at 94.4, marking the fifth time in its six full years of existence that a ratio below 100 has been recorded. Premium growth was 78% at the home state companies in 1976, as market position improved significantly. We presently plan a new home state operation later this year.

Our Home and Automobile Insurance Company subsidiary, writing primarily automobile business in the Cook County area of Illinois, experienced a strong recovery in 1976. This is directly attributable to John Seward who, in his first full year, has revamped significantly both rating methods and marketing. The auto business has been shifted to a six month direct bill policy, which permits a faster reaction time to underwriting trends. Our general liability business at Home and Automobile has been expanded significantly with good results. While it remains to be proven that we can achieve sustained underwriting profitability at Home and Auto, we are delighted with the progress John Seward has achieved.

Overall, we expect a good year in insurance in 1977. Volume is high and present rate levels should allow profitable underwriting. Longer term, however, there are significant negatives in the insurance picture. Auto lines, in particular, seem highly vulnerable to pricing and regulatory problems produced by policital and social factors beyond the control of individual companies.

Insurance Investments

Pre-tax investment income in 1976 improved to $10,820,000 from $8,918,000 as invested assets built up substantially, both from better levels of profitability and from gains in premium volume.

In recent reports we have noted the unrealized depreciation in our bond account, but stated that we considered such market fluctuations of minor importance as our liquidity and general financial strength made it improbable that bonds would have to be sold at times other than those of our choice. The bond market rallied substantially in 1976, giving us moderate net unrealized gains at yearend in the bond portfolios of both our bank and insurance companies. This, too, is of minor importance since our intention is to hold a large portion of our bonds to maturity. The corollary to higher bond prices is that lower earnings are produced by the new funds generated for investment.

On balance, we prefer a situation where our bond portfolio has a current market value less than carrying value, but more attractive rates are available on issues purchased with newly-generated funds.

Last year we stated that we expected 1976 to be a year of realized capital gains and, indeed, gains of $9,962,000 before tax, primarily from stocks, were realized during the year. It presently appears that 1977 also will be a year of net realized capital gains. We now have a substantial unrealized gain in our stock portfolio as compared to a substantial unrealized loss several years ago. Here again we consider such market fluctuations from year to year relatively unimportant; unrealized appreciation in our equity holdings, which amounted to $45.7 million at yearend, has declined by about $5 million as this is written on March 21st.

However, we consider the yearly business progress of the companies in which we own stocks to be very important. And here, we have been delighted by the 1976 business performance achieved by most of our portfolio companies. If the business results continue excellent over a period of years, we are certain eventually to achieve good financial results from our stock holdings, regardless of wide year-to-year fluctuations in market values.

Our equity holdings with a market value of over $3 million on December 31, 1976 were as follows:

No. of Shares	*Company*	*Cost*
141,987	California Water Service Company	$ 3,608,711
1,986,953	Government Employees Insurance Company Convertible Preferred	19,416,635
1,294,308	Government Employees Insurance Company Common Stock	4,115,670
395,100	Interpublic Group of Companies	4,530,615
562,900	Kaiser Industries, Inc.	8,270,871
188,900	Munsingwear, Inc.	3,398,404
83,400	National Presto Industries, Inc.	1,689,896
170,800	Ogilvy & Mather International	2,762,433
934,300	The Washington Post Company Class B	10,627,604
	Total	$58,420,839
	All other Holdings	16,974,375
	Total Equities	$75,395,214

You will notice that our major equity holdings are relatively few. We select such investments on a long-term basis, weighing the same factors as would be involved in the purchase of 100% of an operating business: (1) favorable long-term economic characteristics; (2) competent and honest management; (3) purchase price attractive when measured against the yardstick of value to a private owner; and (4) an industry with which we are familiar and whose long-term business characteristics we feel competent to judge. It is difficult to find investments meeting such a test, and that is one reason for our concentration of holdings. We simply can't find one hundred different securities that conform to our investment requirements. However, we feel quite comfortable concentrating our holdings in the much smaller number that we do identify as attractive.

Our intention usually is to maintain equity positions for a long time, but sometimes we will make a purchase with a shorter expected time horizon such as Kaiser Industries. Here a distribution of securities and cash from the parent company is expected to be initiated in 1977. Purchases were made in 1976 after the announcement of the distribution plan by Kaiser management.

Banking

Eugene Abegg, Chief Executive of Illinois National Bank and Trust Company of Rockford, Illinois, our banking subsidiary, continues to lead the parade among bankers — just as he has ever since he opened the bank in 1931.

Recently, National City Corp. of Cleveland, truly an outstandingly well-managed bank, ran an ad stating "the ratio of earnings to average assets was 1.34% in 1976 which we believe to be the best percentage for any major banking company." Among the really large banks this *was* the best earnings achievement but, at the Illinois National Bank, earnings were close to 50% better than those of National City, or approximately 2% of average assets.

This outstanding earnings record again was achieved while:

(1) paying maximum rates of interest on all consumer savings instruments (time deposits now make up well over two-thirds of the deposit base at the Illinois National Bank),

(2) maintaining an outstanding liquidity position (Federal funds sold plus U. S. Government and Agency issues of under six months' duration presently are approximately equal to demand deposits), and

(3) avoiding high-yield but second-class loans (net loan losses in 1976 came to about $12,000, or .02% of outstanding loans, a very tiny fraction of the ratio prevailing in 1976 in the banking industry).

Cost control is an important factor in the bank's success. Employment is still at about the level existing at the time of purchase in 1969 despite growth in consumer time deposits from $30 million to $90 million and considerable expansion in other activities such as trust, travel and data processing.

Blue Chip Stamps

During 1976 we increased our interest in Blue Chip Stamps, and by yearend we held about 33% of that company's outstanding shares. Our interest in Blue Chip Stamps is of growing importance to us. Summary financial reports of Blue Chip Stamps are contained in the footnotes to our attached financial statements. Moreover, shareholders of Berkshire Hathaway Inc. are urged to obtain the current and subsequent annual reports of Blue Chip Stamps by requesting them from Mr. Robert H. Bird, Secretary, Blue Chip Stamps, 5801 South Eastern Avenue, Los Angeles, California 90040.

Miscellaneous

K & W Products has performed well in its first year as a subsidiary of Berkshire Hathaway Inc. Both sales and earnings were up moderately over 1975.

We have less than four years remaining to comply with the requirement that our bank be divested by December 31, 1980. We intend to accomplish such a divestiture in a manner that minimizes disruption to the bank and produces good results for our shareholders. Most probably this will involve a spin-off of bank shares in 1980.

We also hope at some point to merge with Diversified Retailing Company, Inc. Both corporate simplification and enhanced ownership position in Blue Chip Stamps would be benefits of such a merger. However, it is unlikely that anything will be proposed in this regard during 1977.

Warren E. Buffett, Chairman

March 21, 1977

PEAT, MARWICK, MITCHELL & CO.

CERTIFIED PUBLIC ACCOUNTANTS

KIEWIT PLAZA

OMAHA, NEBRASKA 68131

The Board of Directors and Stockholders
Berkshire Hathaway Inc.:

We have examined the consolidated balance sheets of Berkshire Hathaway Inc. and consolidated subsidiaries as of January 1, 1977 and January 3, 1976, the balance sheets of the Berkshire Hathaway Inc. - Insurance Group as of December 31, 1976 and 1975, and the related consolidated statements of earnings and retained earnings and changes in financial position of Berkshire Hathaway Inc. for the 52 weeks ended January 1, 1977 and the 53 weeks ended January 3, 1976 and the statements of income and unassigned surplus and changes in financial position of the Berkshire Hathaway Inc. - Insurance Group for the years ended December 31, 1976 and 1975. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Blue Chip Stamps, an investee of the Company. The Company's investment in Blue Chip Stamps at January 1, 1977 and January 3, 1976 was $27,304,491 and $18,777,479, respectively, and its equity in net earnings of Blue Chip Stamps was $3,365,946 and $2,002,652 for the years 1976 and 1975, respectively. The financial statements of Blue Chip Stamps were examined by other auditors whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for Blue Chip Stamps, is based upon the report of the other auditors.

In our report dated March 26, 1976, our opinion on the financial statements for the year ended January 3, 1976 was qualified for the effect of such adjustments if any, as might have been determined to be necessary had the financial statements of Blue Chip Stamps been audited for the nine months ended November 29, 1975. As indicated above, we have now been furnished with the report dated April 12, 1976 of the auditors who examined the financial statements of Blue Chip Stamps for the year ended February 28, 1976. Accordingly, our present opinion on the January 3, 1976 financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, based upon our examination and the report of other auditors, the aforementioned consolidated financial statements present fairly the financial position of Berkshire Hathaway Inc. and consolidated subsidiaries at January 1, 1977 and January 3, 1976 and the Berkshire Hathaway Inc. - Insurance Group at December 31, 1976 and 1975 and the results of their operations and the changes in their financial position for the respective years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

March 11, 1977

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS	Jan. 1, 1977	Jan. 3, 1976
Cash	$ 3,436,996	$ 6,044,526
Investments, other than affiliates (notes 3 and 4):		
U. S. Treasury Bills and other short-term obligations, at cost which approximates market	15,489,052	16,175,265
Bonds, at amortized cost	89,215,773	78,760,945
Preferred stocks, at cost	22,286,948	2,558,275
Common stocks of unaffiliated companies, at cost	53,108,266	39,341,135
Total investments, other than affiliates	180,100,039	136,835,620
Investments in affiliates (notes 5 and 6):		
Common stock of Blue Chip Stamps	27,304,491	18,777,479
Unconsolidated bank subsidiary	24,731,779	23,424,329
Other unconsolidated subsidiaries	879,602	1,120,333
Total investments in affiliates	52,915,872	43,322,141
Recoverable Federal income taxes	–	4,400,000
Accounts receivable from customers, agents and others, net (note 7)	23,730,027	19,710,105
Inventories (note 8)	9,301,321	8,135,615
Real estate, equipment, furniture and leasehold improvements, at cost less allowance for depreciation and amortization (note 9)	5,051,699	3,722,242
Deferred insurance premium acquisition costs	6,820,000	2,950,000
Other assets	1,685,315	621,168
	$283,041,269	$225,741,417
LIABILITIES AND STOCKHOLDERS' EQUITY		
Losses and loss adjustment expenses	$ 85,152,259	$ 73,033,492
Unearned premiums	36,736,618	22,344,290
Funds held under reinsurance treaties	3,783,169	2,939,462
Amounts due for purchase of securities	839,495	679,990
Accounts payable and accrued expenses	7,259,034	5,790,070
Income taxes:		
Current	3,346,111	178,546
Deferred	4,677,301	2,518,786
7½% debentures due 1987 (note 10)	464,260	505,820
Sundry installment promissory notes (note 11)	4,522,326	3,602,480
8% senior notes due 1993 (note 12)	20,000,000	20,000,000
Excess of net assets of consolidated subsidiaries over cost of investment	579,070	579,070
Other liabilities	388,493	679,219
	167,748,136	132,851,225
Stockholders' equity (note 12):		
Common stock of $5 par value. Authorized 1,100,000 shares; issued 979,569 shares	4,897,845	4,897,845
Retained earnings	110,827,343	87,992,347
	115,725,188	92,890,192
Less 6,647 shares of common stock in treasury at cost	432,055	–
Total stockholders' equity	115,293,133	92,890,192
Commitment and contingent liability (notes 14 and 17)		
	$283,041,269	$225,741,417

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

	Year ended Jan. 1, 1977	Jan. 3, 1976
Income items:		
Insurance premiums earned	$ 80,780,074	$ 58,335,706
Net sales of manufactured products	47,173,989	32,833,372
Interest and dividend income	10,820,148	8,918,240
Real estate income	293,693	287,314
	139,067,904	100,374,632
Cost and expense items:		
Insurance losses and loss adjustment expenses	55,376,421	47,237,737
Cost of manufactured products sold	41,573,438	28,234,179
Insurance underwriting expenses	24,694,390	21,744,891
Selling, administrative and other expenses	4,949,424	4,192,399
Interest expense	2,028,106	1,845,396
	128,621,779	103,254,602
Earnings (loss) from insurance and manufacturing operations before applicable income taxes	10,446,125	(2,879,970)
Income tax (expense) credit applicable to operating earnings or loss (note 13)	(1,488,659)	4,140,910
Earnings before equity in net earnings of other companies and realized investment gains or losses	8,957,466	1,260,940
Equity in net earnings of bank subsidiary	3,750,000	3,450,000
Equity in net earnings of Blue Chip Stamps (note 5)	3,365,946	2,002,652
Earnings before realized investment gains or losses	16,073,412	6,713,592
Realized investment gains (losses)	9,961,584	(2,888,062)
Applicable income tax (expense) credit	(3,200,000)	866,035
Net realized investment gains or (losses)	6,761,584	(2,022,027)
Net unrealized appreciation in market value of preferred and common stocks of unaffiliated companies of $45,388,000 in 1976 and $17,148,000 in 1975 have not been included in the determination of net earnings.		
Net earnings	22,834,996	4,691,565
Retained earnings at beginning of year	87,992,347	83,300,782
Retained earnings at end of year	$110,827,343	$ 87,992,347
Earnings per share of common stock, based on weighted average outstanding shares:		
Earnings before realized investment gains or losses	$16.47	$ 6.85
Realized investment gains (losses)	6.93	(2.06)
Net earnings	$23.40	$ 4.79

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.

AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended Jan. 1, 1977	Jan. 3, 1976
Funds provided:		
From operations:		
Net earnings	$22,834,996	$ 4,691,565
Charges (credits) to earnings not requiring (providing) funds:		
Equity in undistributed earnings of bank subsidiary	(1,307,450)	(1,007,450)
Equity in undistributed earnings of Blue Chip Stamps	(3,255,762)	(1,853,481)
Accretion of discount on bonds	(1,033,805)	(384,278)
Depreciation and amortization	618,024	536,632
(Increase) decrease in deferred insurance premium acquisition costs	(3,832,608)	1,450,000
Decrease (increase) in recoverable income taxes	4,400,000	(1,599,266)
Increase in accounts receivable from customers, agents and others	(3,589,461)	(32,731)
(Increase) decrease in inventories	(892,738)	507,771
Increase in unpaid losses and loss adjustment expenses	10,970,214	272,395
Increase in unearned premiums	13,992,841	639,423
Increase in funds held under reinsurance treaties	843,707	82,178
Increase in accounts payable and accrued expenses	1,312,783	378,721
Increase (decrease) in liability for income taxes	5,305,080	(510,277)
Other, net	(585,938)	45,309
	22,944,887	(1,475,054)
Funds provided from operations	45,779,883	3,216,511
Dividends received from unconsolidated subsidiaries	224,000	82,000
Proceeds from issuance of long-term debt	1,218,473	1,150,000
Decrease in cash	2,885,944	—
	$50,108,300	$ 4,448,511
Funds used:		
Net assets of acquired businesses:		
Cash	$ 278,414	$ 210,577
Investments	3,734,736	—
Accounts receivable	430,461	1,786,147
Inventories	272,968	2,643,834
Real estate and equipment	626,600	—
Other assets	646,822	46,680
Notes payable	—	(1,665,000)
Other liabilities	(1,725,221)	(1,361,913)
	4,264,780	1,660,325
Additions to real estate, equipment, furniture and leasehold improvements	1,320,881	345,401
Repayment of debt	340,187	536,917
Purchase of treasury stock	432,055	—
Cost of net purchase (sale) of investments:		
U. S. Treasury Bills	(1,773,574)	5,067,102
Bonds	8,685,226	6,846,016
Preferred stocks	19,728,673	(296,910)
Common stocks of unaffiliated companies	11,855,553	(11,328,730)
Common stock of Blue Chip Stamps	5,271,250	—
Unconsolidated subsidiaries	(16,731)	15,000
Net purchase of investments	43,750,397	302,478
Increase in cash	—	1,603,390
	$50,108,300	$ 4,448,511

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

January 1, 1977 and January 3, 1976

(1) Summary of Significant Accounting Policies and Practices

(a) Basis of Presentation

The accounts of Berkshire Hathaway Inc., the parent Company, are consolidated with the accounts of wholly-owned subsidiaries engaged in manufacturing businesses, and the accounts of subsidiary insurance companies (The "Insurance Group"), wholly-owned by Berkshire Hathaway Inc.

The parent Company's investment in The Illinois National Bank & Trust Co. of Rockford is accounted for on the equity basis.

Immaterial subsidiaries are not consolidated and investments therein are carried at cost less dividends received from such subsidiaries.

The accounts of the parent Company and of textiles manufacturing subsidiaries are maintained on the basis of a fiscal year ending on the Saturday nearest to December 31, while the accounts of other subsidiaries, primarily the Insurance Group, are maintained on the basis of the calendar year.

(b) Investment in Securities, Other than Affiliates

Investments in bonds are stated at amortized cost; investments in preferred and common stocks other than affiliates are carried at the lower of aggregate cost or market value.

(c) Investment in Blue Chip Stamps

The investment in Blue Chip Stamps ("Blue Chip") is accounted for on the equity basis. Deferred income taxes are provided for with respect to undistributed earnings of Blue Chip under the assumption that such earnings will be distributed as taxable dividends. Through February 1976, Blue Chip determined income on the basis of a fiscal year ending on or about February 28, and through 1975 Berkshire Hathaway Inc. reflected its equity in Blue Chip's earnings on the basis of that company's twelve months ending on or about November 30. In December 1976, Blue Chip changed its 52-53 week fiscal year-end from approximately February 28 to approximately December 31. Accordingly, for 1976, Berkshire Hathaway Inc. determined its equity in Blue Chip's earnings based on that company's calendar year 1976 results. This change in fiscal year reporting in determining equity in Blue Chip's earnings did not have a material effect on the 1976 net earnings of Berkshire Hathaway Inc. (See note 5.)

(d) Insurance Premiums

Insurance premiums are recognized as revenues ratably over the term of the policies. Unearned premiums are computed on the monthly pro rata basis and are stated after deduction for reinsurance placed with reinsurers in the amount of $4,281,000 at December 31, 1976 and $2,885,610 at December 31, 1975. Premium acquisition costs such as commissions, premium taxes and certain other underwriting expenses are, pursuant to statutory insurance accounting rules, charged against income when incurred. However, for financial statement purposes, a portion of such costs are deferred and charged against income as the related premiums are earned.

(e) Losses and Loss Adjustment Expenses

The Insurance Group provides for losses and loss adjustment expenses based upon (1) aggregate case basis estimates for losses reported, in respect to direct premiums written, (2) estimates of unreported losses based upon past experience, (3) estimates received relating to assumed reinsurance, and (4) deduction of amounts for reinsurance placed with reinsurers in the amount of $8,619,481 at December 31, 1976 and $6,094,384 at December 31, 1975.

(f) Real Estate, Equipment, Furniture and Leasehold Improvements

These items of property (including significant betterments and renewals) are carried at cost depreciated over their useful lives estimated at the date of acquisition. The double-declining balance method is used to calculate depreciation of new items of textile properties acquired after 1965; the straight-line method is

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

applied for other items. Maintenance, repairs and renewals of a minor nature are generally charged to operations as incurred.

(g) *Inventories*

Inventories relate to manufacturing operations and are stated at cost, determined for the parent Company under the last-in, first-out method. Inventories of manufacturing subsidiaries are stated at the lower of cost or market, determined under the first-in, first-out method.

(h) *Income Taxes*

A consolidated Federal income tax return is filed by the parent Company and its eligible subsidiaries. Amounts included in the consolidated balance sheets for Federal income taxes payable or recoverable include the apportioned Federal tax amounts of the companies whose accounts are consolidated.

A provision for deferred taxes is made in recognition of timing differences created by the manner in which the Insurance Group accounts for certain income and expense items for financial reporting purposes and the accounting treatment of these items for income tax purposes.

Investment tax credits on qualifying property and equipment acquisitions are applied as a reduction of income tax expense in the year realized.

(2) Acquired Businesses

In January 1976, the Company acquired net assets valued at approximately $2.1 million comprising a business engaged in the manufacture and sale of branded chemical products used in the automotive after market. Manufacturing facilities of this business are located in Los Angeles, California and Bloomington, Indiana. The assets were acquired through a newly formed subsidiary; the acquisition has been accounted for as a purchase and 1976 results of the operations are included in the consolidated statements of earnings. Promissory notes aggregating $1,218,473 were issued by the Company as part of the purchase transaction.

In a related transaction on the same date, an insurance subsidiary of the Company purchased for approximately $2.2 million cash, all of the outstanding capital stock of a small reinsurance operation, the business of which had previously been conducted with and through the Company's Insurance Group. 1976 results of this acquired subsidiary are included in the statements of income of the Insurance Group and in the consolidated statements of earnings.

On April 28, 1975, the Company purchased all of the outstanding capital stock of Waumbec Mills Incorporated ("Waumbec"), Manchester, New Hampshire. Waumbec is engaged in manufacturing, distributing and selling woven fabrics. A wholly-owned subsidiary of Waumbec engages at the same location in the finishing of textile fabrics. The acquisition of Waumbec has been accounted for as a purchase, and results of operations from date of acquisition are included in the consolidated statements of earnings.

The cost of Waumbec to the Company, including direct acquisition costs, was $1,660,325; installment promissory notes of principal amount of $1,150,000, which bear interest at 8% per annum, were issued by the parent Company in partial consideration of the purchase price with the balance paid in cash.

The net book value of assets less liabilities of Waumbec was in excess of the purchase price; such excess was applied in accordance with the Accounting Principles Board Opinion No. 16 to eliminate the net property, plant and equipment accounts of Waumbec and its subsidiary as they existed at the purchase date. As a result of that acquisition adjustment, no depreciation expense with respect to the acquired properties (which as to Waumbec's prior basis of accountability amounted to $310,000 in 1976 and $239,000 during the period of the Company's ownership in 1975), has been charged to earnings, nor will such depreciation be chargeable to future consolidated earnings.

Waumbec and its subsidiary as of the date of acquisition had unused net operating loss carryovers, as defined by the Internal Revenue Code, of approximately $2.6 million. To the extent that future tax benefits are derived from such carryovers, they will be accounted for as "negative goodwill" to be amortized into consolidated income in future periods which will not coincide with the periods in which benefits, if any, are realized. Such benefits will arise only if Waumbec and its subsidiary have future taxable income, and then only to the extent that such income exceeds aggregate net losses for tax purposes, if any, of other members of the consolidated group. No such tax benefits were

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

realized in 1976; management of Berkshire Hathaway Inc. believes some tax benefits might be realized, though their effect on income in any given future accounting period would not be material in amount.

Had the purchase of these businesses been consummated on the same basis at the beginning of the year prior to their actual execution, certain items in the consolidated statement of earnings for 1975 on a pro forma basis would have been as follows:

Insurance premiums earned	$59,366,000
Net sales of manufactured products	38,328,000
Earnings before equity in net earnings of other companies and realized investment gains or losses	734,000
Net earnings	4,165,000
Net earnings per share	4.25

(3) Bonds and Common Stocks Deposited with Others

Bonds and common stocks were deposited in trust with various regulatory authorities or others as follows:

	December 31, 1976	December 31, 1975
Common stocks — at cost	$ 7,199,764	$ 2,619,268
Bonds — at amortized cost	18,606,648	20,911,305

(4) Investment in Securities of Unaffiliated Companies

A summary of the aggregate cost and approximate market value of investments in securities of unaffiliated companies at December 31, 1976 and 1975 is as follows:

	1976		1975	
	Cost	*Market*	*Cost*	*Market*
Bonds	$89,215,773	$ 90,425,187	$78,760,945	$74,487,055
Equity securities:				
Preferred stocks	22,286,948	32,732,520	2,558,275	2,886,871
Common stocks	53,108,266	88,318,145	39,341,135	39,280,357
	$75,395,214	$121,050,665	$41,899,410	$42,167,226

At December 31, 1976, with respect to equity securities, gross unrealized gains were $46,301,783 and gross unrealized losses, $636,332. Net realized gains of $9,961,584 on the sale of securities were included in the determination of net income for 1976. The cost of securities sold is generally determined on a first-in, first-out basis.

(5) Investment in Blue Chip Stamps

The Company's consolidated investment in Blue Chip Stamps ("Blue Chip") remained at 25.6% during 1975 but increased during 1976 to 33.2% at January 1, 1977. The investment is accounted for by the equity method.

Equity in net earnings of Blue Chip reflects the following for the past two years.

	1976	1975
Dividends received	$ 378,982	$ 318,056
Equity in undistributed earnings	3,354,381	2,027,603
Provision for current income taxes	(27,282)	(22,900)
Provision for deferred income taxes	(241,515)	(145,986)
Amortization of net excess of cost of investment over underlying net asset values	(98,620)	(174,121)
	$3,365,946	$2,002,652

Equity in 1975 earnings was based on the fifty-two weeks operations of Blue Chip ended November 29, 1975. Blue Chip changed from a February 28 year-end reporting basis to a calendar year reporting basis for 1976 and, accordingly, equity in 1976 earnings is based on the fifty-three weeks operations of Blue Chip ended on January 1, 1977. Equity in

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

calendar year 1976 earnings so computed is approximately $400,000 greater than if it were computed with regard to Blue Chip's operations for the fifty-two weeks ended in November 1976. This result obtains primarily from the fact that the Company's consolidated holdings of Blue Chip shares was approximately 30% greater in December 1976 than in December 1975; had Blue Chip retained its previous fiscal year, the Company's equity in earnings attributable to its increased holdings in December 1976 would not have been reflected until the first quarter of 1977.

Amortization of the difference between the Company's cost of Blue Chip shares and approximate underlying net asset values at dates of acquisition has been computed on the basis that such difference would be extinguished by January 1, 1981. At 1976 year-end the Company's carrying value of its consolidated holdings of Blue Chip shares amounting to $27,304,491 is $1,259,279 less than underlying net asset value on that date while such net asset value was approximately $452,000 less than carrying value of Blue Chip shares held by the Insurance Group. Beginning in 1977, it is the Company's intention to amortize the 1976 year-end difference between carrying value and underlying net asset value over seven years, the resulting credit (charge, in the case of the Insurance Group) will not be significant in any given year.

Blue Chip Stamps, a California corporation, and its subsidiaries are engaged in four lines of business: (1) See's Candy Shops, Incorporated, a 99%-owned subsidiary, produces candy and other confectionery products of the highest quality in two fully equipped kitchens in California. See's is believed to be one of the largest candy manufacturers distributing through its own chain of retail shops; it now has 173 in nine western states including Hawaii. (2) Blue Chip Stamps provides a trading stamp service to retail merchants and their customers in California and Nevada. Stamp service revenues have declined significantly in recent years from a peak of $124,180,000 in the fiscal year ended February 28, 1970 to $17,208,000 for the fiscal year ended January 1, 1977. Over the past five years Blue Chip has reduced the number of redemption stores from a peak of 90 to 44 at present. (3) Blue Chip operates a separate "incentives division" on a nationwide basis, tailoring for businesses programs designed to perform motivational functions. (4) Wesco Financial Corporation, now an 80%-owned subsidiary, owns all of the outstanding stock of Mutual Savings and Loan Association which operates at sixteen locations in Southern California.

In February 1977 Blue Chip agreed to buy the newspaper assets of the Buffalo Evening News, Inc., publisher of a successful daily newspaper in Buffalo, New York.

The financial statements of Blue Chip as of January 1, 1977 and for the 53 weeks then ended, and as of February 28, 1976 and for the 52 weeks then ended reflect the following:

BLUE CHIP STAMPS
Consolidated Balance Sheets

	($000 omitted)	
Assets	*Jan 1, 1977*	*Feb. 28, 1976*
Cash and short-term investments	$ 14,162	$ 26,727
Marketable securities, at cost January 1, 1977 (market — $73,240); at market February 28, 1976 (cost — $61,690)	63,143	56,712
Inventories	6,493	7,295
Property, fixtures and equipment, net	8,417	8,290
Investment in Wesco Financial Corporation	38,661	28,588
Excess of cost over equity in net assets of consolidated subsidiary	15,128	15,487
Other assets	21,133	22,356
	$167,137	$165,455
Liabilities and Stockholders' Equity		
Liability for unredeemed trading stamps	$ 66,867	$ 71,135
6½% subordinated debentures due 1978	4,287	6,392
Other liabilities	9,995	17,787
Stockholders' equity	85,988	70,141
	$167,137	$165,455

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

BLUE CHIP STAMPS
Consolidated Earnings Summaries

	($000 omitted) 53 weeks ended Jan. 1, 1977	52 weeks ended Feb. 28, 1976
Candy sales	$ 56,333	$ 51,342
Stamp service revenues	17,208	20,361
Merchandise promotions and incentive sales	8,888	15,210
Dividends and interest	5,211	4,913
Other revenues	682	818
Total revenues	$ 88,322	$ 92,644
Earnings before securities gains or losses	$ 11,780	$ 9,045
Per share	2.27	1.75
Net earnings	11,703	9,053
Per share	2.26	1.75

(6) Investments in Unconsolidated Subsidiaries

The investment in the unconsolidated bank subsidiary represents approximately 98% of the outstanding stock of The Illinois National Bank & Trust Co. of Rockford. The equity method is used in accounting for this investment. See note 14 regarding divestiture of this investment. Financial statements of The Illinois National Bank & Trust Co. of Rockford and subsidiary are presented elsewhere herein.

The carrying values of $25,611,381 at January 1, 1977 and $24,544,662 at January 3, 1976 for all unconsolidated subsidiaries were approximately $2,500,000 in excess of the parent Company's equity in the net assets as reflected in the financial statements of the subsidiaries at those dates. The major portion of this excess cost originated prior to November 1, 1970 and is not being amortized since it is considered by management to have continuing value over an indefinite period.

(7) Receivables

Accounts receivable from customers, agents and others was made up of the following:

	December 31, 1976	December 31, 1975
Insurance Group:		
Agents' balances and premiums in course of collection	$ 7,861,366	$ 6,949,958
Investment income due and accrued	2,005,335	1,649,292
Reinsurance recoverable on loss payments	5,221,214	4,520,912
Amounts due from sale of securities	135,601	23,084
	15,223,516	13,143,246
Textile business trade accounts receivable (less allowance for doubtful accounts, 1976 – $434,785; 1975 – $362,095)	8,101,575	6,566,859
Automotive chemicals business trade accounts receivable	404,936	—
	$23,730,027	$19,710,105

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(8) Inventories

A summary of inventories follows:

	Jan. 1, 1977	Jan. 3, 1976
Textile business:		
Raw materials and supplies	$ 1,966,793	$ 1,717,825
Stock in process	2,488,847	2,987,238
Griege and finished cloth	4,520,086	3,430,552
	8,975,726	8,135,615
Automotive chemicals business	325,595	—
	$ 9,301,321	$ 8,135,615

Inventories of the parent Company are determined by the last-in, first-out ("LIFO") method. Inventories of subsidiaries are stated at the lower of cost or market, determined under the first-in, first-out ("FIFO") method. Cost using FIFO for all inventories would have exceeded balance sheet carrying amounts by $1,542,744 at January 1, 1977 and $1,261,642 at January 3, 1976, respectively.

(9) Real Estate, Equipment, Furniture and Leasehold Improvements

The composition of plant and equipment is shown below:

January 1, 1977	*Properties of manufacturing operations*	*Properties of Insurance Group*	*Total*
Land	$ 251,360	$ 128,847	$ 380,207
Buildings	2,792,915	1,365,863	4,158,778
Machinery and equipment	14,033,720	—	14,033,720
Furniture and fixtures and leasehold improvements	821,803	1,271,184	2,092,987
	17,899,798	2,765,894	20,665,692
Less accumulated depreciation and amortization	14,484,374	1,129,619	15,613,993
	$ 3,415,424	$1,636,275	$ 5,051,699
January 3, 1976			
Land	$ 84,860	$ 83,847	$ 168,707
Buildings	2,409,214	1,260,989	3,670,203
Machinery and equipment	13,035,988	—	13,035,988
Furniture and fixtures and leasehold improvements	772,810	1,141,562	1,914,372
	16,302,872	2,486,398	18,789,270
Less accumulated depreciation and amortization	14,106,876	960,152	15,067,028
	$ 2,195,996	$1,526,246	$ 3,722,242

(10) 7½% Subordinated Debentures

Debentures bear interest at the rate of 7½% payable February 1 and August 1 and will be due on August 1, 1987. The debentures are not secured by any lien and are not convertible; they are subordinated to senior indebtedness which includes indebtedness of the parent Company for money borrowed. The debentures may be redeemed at par at the Company's option. The indenture under which the debentures were issued requires the parent Company to redeem $42,800 principal amount of the debentures, through a sinking fund, annually on August 1 through 1986.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(11) Sundry Installment Promissory Notes

This caption includes the following:

	1976	*1975*
Parent Company:		
8% note issued May 1974, repayable in monthly installments of $13,071 including interest, through February 1988	$1,155,797	$1,217,480
8% notes issued April 1975, repayable in annual installments of $287,500 plus interest, in each of the years 1977 through 1980	1,150,000	1,150,000
9% notes issued January 1976, $100,000 principal amount, with interest on such amount from date of issue, payable in each of the years 1979 through 1987; final principal payment of $173,341, with interest thereon from date of issue, payable January 6, 1988	1,073,341	—
9% notes issued January 1976, $10,000 principal amount, with interest on such amount from date of issue, payable in each of the years 1977 through 1982; final principal payment of $8,469, with interest thereon from date of issue, payable January 6, 1983	68,469	—
9% notes issued January 1976, repayable in monthly installments of $1,000 including interest, through March 1985	69,719	—
Obligations of subsidiary:		
6% note issued 1973, repayable in semiannual installments of $80,000 plus interest through August 1, 1978	320,000	480,000
Notes issued 1973, principal repayable in annual installments of $70,000 through May 1, 1983, plus interest at 5% through April 30, 1978 and 6% thereafter*	490,000	560,000
8% note issued in April 1975 with a fixed due date of April 30, 1980, contingently due eariler*	195,000	195,000
	$4,522,326	$3,602,480

*Guaranteed by parent Company.

(12) 8% Senior Notes due 1993

The parent Company in 1973 issued $20,000,000 8% Senior notes with final maturity March 1, 1993. The notes call for mandatory annual prepayments of $1,143,000 on March 1 in each of the years from 1979 to 1992, inclusive. Optional prepayments are permitted without premium up to the amount of the required prepayments in each of the years 1979 to 1992; this right is not cumulative. Additionally, the parent Company may also prepay the notes at any time, in full or in part, at a premium declining ratably from the current rate of approximately 6.3% to par in 1992. The parent Company agreed it will not affect any optional prepayment prior to March 1, 1983 from proceeds of any refunding operation involving the incurring of any indebtedness at an effective annual interest rate of less than 8%.

In the note instruments the parent Company agreed, among other things, as to both the parent Company and restricted subsidiaries, as defined, to limitations as to permissible outstanding funded debt and subordinated funded debt and to a limitation on mortgage debt except as to after-acquired property. Further, the parent Company covenanted that it would not make "restricted payments", which term includes dividends or other equity distributions plus investment in unrestricted subsidiaries (those not bound by the terms of the loan agreement), in excess of stated formula amounts. Retained earnings of approximately $40,000,000 as of January 1, 1977 are unrestricted by this provision; the remainder is restricted.

The loan agreement also contains limiting terms relating to sales of the Company's assets, mergers and consolidations, and allows the noteholders to demand prepayment, at par, within 60 days of notice that, during the lifetime of Warren E. Buffett, stock ownership in the parent Company by Warren E. Buffett and the members of his immediate family, including certain trusts and charitable organizations, has decreased to less than 15% of the outstanding capital stock of the parent Company.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(13) Income Taxes

Income tax expense for 1976 represents current expense of $2,819,941 and deferred expense of $2,137,515, composed of the following:

	U.S. Federal	*Foreign, state and local*	*Total*
Totals:			
Applicable to operating earnings	$1,263,270	$225,389	$1,488,659
Applicable to equity in earnings of Blue Chip Stamps	268,797	—	268,797
Applicable to realized investment gains	3,200,000	—	3,200,000
	$4,732,067	$225,389	$4,957,456
Current expense (credit) applicable to:			
Current ordinary income (loss) for tax purposes	$ (845,448)	$225,389	$ (620,059)
Realized investment gains	3,440,000	—	3,440,000
	2,594,552	225,389	2,819,941
Deferred expense (credit) applicable to:			
Change in deferred insurance premium acquisition costs	1,836,000	—	1,836,000
Discount on bonds currently accreted	300,000	—	300,000
Undistributed income of Blue Chip Stamps	241,515	—	241,515
Cumulative accreted discount on bonds sold	(240,000)	—	(240,000)
	2,137,515	—	2,137,515
Total tax expense	$4,732,067	$225,389	$4,957,456

Total net income before taxes was $27,792,451. A reconciliation of income tax expense at the statutory 48% rate to total income taxes as shown above follows:

	Amount
Tax expense at 48% statutory rate	$13,340,000
Decreases (increases) resulting from:	
Tax-exempt interest income	(2,021,000)
100% exclusion relating to equity in earnings of the Illinois National Bank	(1,800,000)
85% dividends received credit:	
On dividends from unaffiliated companies	(1,301,000)
On equity in earnings of Blue Chip Stamps	(1,523,000)
Long-term capital gains rate differential	(1,721,000)
Credit to unconsolidated subsidiary	237,000
Difference in tax basis of assets	(149,000)
Other, net	(104,544)
Total income tax expense	$ 4,957,456

Berkshire Hathaway Inc.
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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

Net recoverable income taxes credited to 1975 earnings represent a current credit of $4,313,045 and a deferred credit of $525,014, composed of the following:

	U.S. Federal	*Foreign, state and local*	*Total*
Totals:			
Credit (expense) applicable to operating loss	$4,272,431	$(131,521)	$4,140,910
(Charge) applicable to equity in earnings of Blue Chip Stamps	(168,886)	—	(168,886)
Credit applicable to realized investment losses	866,035	—	866,035
	$4,969,580	$(131,521)	$4,838,059
Current credit (expense) applicable to:			
Ordinary loss for tax purposes	$3,834,790	$(131,521)	$3,703,269
Realized investment losses	609,776	—	609,776
	4,444,566	(131,521)	4,313,045
Deferred credit (expense) applicable to:			
Change in deferred insurance premium acquisition costs	696,000	—	696,000
Accreted discount on bonds	(281,259)	—	(281,259)
Undistributed income of Blue Chip Stamps	(145,986)	—	(145,986)
Cumulative accreted discount on bonds sold	104,185	—	104,185
Benefit of capital loss carryover	152,074	—	152,074
	525,014	—	525,014
Total credit (expense)	$4,969,580	$(131,521)	$4,838,059

A before tax net loss of $146,494 was realized in 1975. A reconciliation of the tax credit from such net loss at the statutory rate to the above credit follows:

	Amount
Tax credit at 48% statutory rate	$ 70,000
Increases (decreases) resulting from:	
Tax-exempt interest income	2,137,000
85% dividends received credit:	
On dividends from unaffiliated companies	978,000
On equity in earnings of Blue Chip Stamps	957,000
100% exclusion relating to equity in earnings of The Illinois National Bank	1,656,000
Long-term capital loss rate differential	(520,000)
Tax benefit to unconsolidated subsidiary	(319,000)
Other, net	(120,941)
Total tax credits	$4,838,059

As of December 31, 1976, unused net operating loss carryovers in acquired subsidiaries exist in the approximate amount of $2,600,000 expiring in 1977, 1978 and 1979. These can only be offset against taxable income earned by the acquired subsidiaries, and any tax benefits realized therefrom would be accounted for as a reduction of purchase price resulting in their amortization into income over a period not to exceed forty years.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(14) "One-Bank Holding Company" Status

The Company is a bank holding company under Federal legislation enacted in 1970. It has filed with the Federal Reserve Board an irrevocable election to divest of its holdings in The Illinois National Bank & Trust Co. of Rockford prior to January 1, 1981. No determination has been made as to how it will effect such divestiture, and so long as the Company controls the bank it is subject to the restrictions imposed upon it by the Bank Holding Company Act.

(15) "Savings and Loan Holding Company" Status

The Company, as a result of its investment in Blue Chip Stamps which in turn holds controlling interest in a California savings and loan association, is a savings and loan holding company under the Savings and Loan Holding Company Amendments of 1967. As such, the Company is subject to the restrictions and regulatory requirements imposed upon it by the Savings and Loan Holding Company Act.

(16) Transactions with Affiliates

Members of the Insurance Group in 1976 and 1975 engaged in transactions in the ordinary course of business with Columbia Insurance Company ("Columbia"), a subsidiary of Diversified Retailing Company, Inc. ("Diversified"). Warren E. Buffett, Chairman of the Board of the Company, is also Chairman of the Boards of Columbia and Diversified. At the end of 1976, Mr. Buffett owned more than 50% of the outstanding shares of Diversified. In 1976 and 1975, in connection with reinsurance business, gross premiums of $5,777,098 and $2,066,155, respectively, were ceded to Columbia by insurance subsidiaries of the Company. National Indemnity Company performs all of Columbia's bookkeeping and other administrative services. For these services Columbia pays to National Indemnity Company as part of its ceding commissions an amount ordinarily equal to one-half of the customary originating brokerage commissions. The amount of ceding commissions representing fees for bookkeeping and administrative services paid by Columbia to National Indemnity Company was $35,334 in 1976 and $12,850 in 1975. Reinsurance transactions with Columbia are effected at rates comparable to rates in similar transactions conducted at arm's length with unrelated parties, except as to that portion of the ceding commissions representing fees as to which there are no similar transactions with unrelated parties; management believes that Columbia's capacity to accept cessions of reinsurance from the Company's Insurance Group contributes an element of marketing strength to the Group.

(17) Litigation

The Company, together with a number of subsidiaries, officers, directors and employees of the Company and certain subsidiaries, was named as a defendant in a lawsuit filed in mid 1975 alleging numerous causes of action and seeking damages of several million dollars. Since the filing of the complaint, interrogatories have been served upon the plaintiff but the plaintiff has refused to answer such interrogatories, has refused to testify in pretrial proceedings relating to performance of certain of its obligations, and has conducted no discovery in this matter. In the opinion of counsel for the Company, the Company will not be affected materially by the final outcome of the proceeding.

(18) Compensating Balance

In accordance with the terms of a line of credit with a bank, the Company has verbally agreed to maintain an average cash compensating balance of 10% of the unused line of credit, based upon the bank's ledger records without adjustment for uncollected funds. During 1976 the average compensating balance required to be maintained under the line of credit amounted to approximately $570,000. The line of credit was not utilized at December 31, 1976 or 1975 and has an expiration date of October 22, 1977. The approximate average amount of short-term debt outstanding during the year, using month-end balances, was $300,000 with a related interest rate of 6.75%. The maximum amount of short-term debt outstanding at any month-end was $1,200,000 during 1976 and none during 1975.

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BALANCE SHEETS

	December 31, 1976	December 31, 1975
ASSETS		
Investments — other than investments in affiliates (notes 3 and 4)		
Bonds, at amortized cost	$ 89,215,773	$ 78,760,945
Preferred stocks — at cost	22,286,948	2,558,275
Common stocks — at cost	53,108,266	39,341,135
U. S. Treasury Bills — at cost which approximates market	14,992,494	13,912,843
Total investments — other than investments in affiliates	179,603,481	134,573,198
Cash	2,592,562	2,000,940
Investment in Blue Chip Stamps (note C)	17,740,283	15,400,558
Accrued investment income	2,005,335	1,649,292
Premiums receivable and agents' balances	7,861,366	6,949,956
Reinsurance recoverable on paid losses	5,221,214	4,520,912
Property and equipment, at cost less accumulated depreciation (note 9)	1,636,275	1,526,246
Deferred premium acquisition costs	6,820,000	2,950,000
Recoverable Federal income taxes	—	4,100,000
Other assets	903,814	387,403
	$224,384,330	$174,058,505
LIABILITIES, CAPITAL STOCK AND SURPLUS		
Losses and loss adjustment expenses	$ 85,152,259	$ 73,033,492
Unearned premiums	36,736,618	22,344,290
Funds held under reinsurance treaties	3,783,169	2,939,462
Amounts due for purchase of securities	839,495	679,990
Current income taxes	2,560,922	—
Deferred income taxes	4,536,139	2,472,002
Other liabilities	2,313,187	1,642,099
	135,921,789	103,111,335
Capital stock and surplus:		
Common stock of National Indemnity Company of $10 par value. Authorized 750,000 shares; issued 550,000 shares	5,500,000	5,500,000
Common stock of National Fire & Marine Insurance Company of $100 par value. Authorized 50,000 shares; issued 25,000 shares	2,500,000	2,500,000
Paid-in surplus	20,601,250	20,601,250
Unassigned surplus (note D)	59,861,291	42,345,920
Total capital stock and surplus	88,462,541	70,947,170
	$224,384,330	$174,058,505

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
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STATEMENTS OF INCOME AND UNASSIGNED SURPLUS

	Year Ended December 31, 1976	Year Ended December 31, 1975
Underwriting income:		
Premiums written	$94,772,915	$58,975,130
Increase in unearned premiums	(13,992,841)	(639,424)
Premiums earned	80,780,074	58,335,706
Losses and claims	44,609,702	39,285,324
Loss adjustment expenses	10,766,719	7,952,413
Underwriting expenses (note E)	24,694,390	21,744,891
	80,070,811	68,982,628
Underwriting gain (loss)	709,263	(10,646,922)
Investment income:		
Interest on bonds	7,412,730	6,036,808
Dividends on stocks of unaffiliated companies	3,130,747	2,456,103
Real estate income	293,693	287,314
	10,837,170	8,780,225
Less investment expenses	399,355	338,918
Net investment income	10,437,815	8,441,307
Other expense	177,199	121,451
Income (loss) before income taxes and items below	10,969,879	(2,327,066)
Applicable tax (expense) credit (note F)	(1,134,822)	3,924,410
Income before items below	9,835,057	1,597,344
Equity in earnings of Blue Chip Stamps (note C)	1,637,465	1,140,953
Income before realized gain or loss on investments	11,472,522	2,738,297
Realized gain (loss) on investments	10,242,849	(2,888,062)
Applicable income tax (expense) credit (note F)	(3,200,000)	866,035
Net realized gain (loss) on investments (note G)	7,042,849	(2,022,027)
Net unrealized appreciation in market values of preferred and common stocks of unaffiliated companies of $45,388,000 in 1976 and $17,148,000 in 1975 have not been included in the determination of net income.		
Net income	18,515,371	716,270
Unassigned surplus at beginning of year	42,345,920	41,629,650
Dividends paid to stockholder	(1,000,000)	—
Unassigned surplus at end of year	59,861,291	42,345,920

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended December 31, 1976	1975
Funds provided:		
From operations:		
Net income	$ 18,515,371	$ 716,270
Charges (credits) to income not requiring (providing) funds:		
Equity in undistributed earnings of Blue Chip Stamps	(1,561,912)	(1,029,578)
Accretion of discount on bonds	(1,033,805)	(384,278)
Depreciation	162,972	152,155
Increase in unpaid losses and loss expense	10,970,214	272,395
Increase in unearned premiums	13,992,841	639,423
Increase in funds held under reinsurance treaties	843,707	82,178
Decrease (increase) in agents' balances and premiums in course of collection	(858,928)	2,633,813
Increase in reinsurance recoverable on loss payments	(700,302)	(2,061,819)
(Increase) decrease in deferred acquisition costs	(3,832,608)	1,450,000
Decrease (increase) in recoverable income taxes	4,100,000	(1,499,266)
Increase (decrease) in liability for income taxes	4,604,059	(561,998)
Increase in accrued investment income	(356,043)	(210,800)
Other, net	306,919	381,172
	26,637,114	(136,603)
Funds provided from operations	45,152,485	579,667
Net sale of investments	—	5,444
	$ 45,152,485	$ 585,111
Funds used:		
Subsidiary acquired:		
Bonds	735,797	—
Common stocks	1,911,578	—
U. S. Treasury Bills	887,361	—
Cash	126,204	—
Other assets and deferred charges	94,430	—
Unpaid losses and loss adjustment expenses	(1,148,553)	—
Unearned premiums	(399,487)	—
Other liabilities	(32,818)	—
	2,174,512	—
Purchase of real estate, furniture and equipment	273,001	97,807
Net purchase of investments	41,239,554	—
Dividend paid	1,000,000	—
Increase in cash	465,418	487,304
	$ 45,152,485	$ 585,111
Net purchase (sale) of investments:		
U. S. Treasury Bills	192,290	4,774,180
Bonds	8,685,226	6,846,016
Preferred stocks	19,728,673	(296,910)
Common stocks of unaffiliated companies	11,855,553	(11,328,730)
Common stock of Blue Chip Stamps	777,812	—
Net cost of investments (sold) purchased	$ 41,239,554	$ (5,444)

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS
December 31, 1976 and 1975

(A) Note References

Numerical note references are to the notes to consolidated financial statements of Berkshire Hathaway Inc. and consolidated subsidiaries. Note 1 to such statements includes a summary of significant accounting policies and practices of the Insurance Group.

(B) Basis of Presentation

The financial statements of Berkshire Hathaway Inc. — Insurance Group include the accounts of wholly-owned subsidiaries of Berkshire Hathaway Inc. which are engaged in fire and casualty insurance underwriting. The statements are presented on a combined basis with significant intercompany transactions and balances eliminated, and in accordance with generally accepted accounting principles (GAAP) which differ in some respects from principles prescribed or permitted by insurance regulatory authorities (statutory method) in accordance with which the companies maintain their records. A reconciliation of the aggregate capital stock and surplus ("Surplus as regards Policyholders") as determined under the statutory method to that determined and reported herewith in accordance with GAAP is as follows:

	December 31,	
	1976	*1975*
Statutory surplus as regards policyholders	$123,569,209	$55,406,942
Excess of NAIC market valuations over cost valuations of investments in equity securities (excluding stock of Blue Chip Stamps)	(45,655,447)	(267,819)
Excess of NAIC market valuations over amortized cost of bonds	(281,646)	—
Excess of carrying value of investment in Blue Chip Stamps (determined under GAAP pursuant to the equity method) over NAIC market valuation	35,072	9,216,289
Deferred insurance premium acquisition costs	6,820,000	2,950,000
Excess statutory liability loss reserves	1,283,560	756,343
Net recoverable from unauthorized reinsurers	4,214,238	2,426,692
Sundry nonadmitted assets	2,313,694	2,930,725
Income tax effect and adjustments	(3,836,139)	(2,472,002)
Capital stock and surplus per accompanying financial statements	$ 88,462,541	$70,947,170

Statutory net income is reconciled to GAAP net income as follows:

	1976	*1975*
Statutory net income	$14,293,893	$ 1,814,693
Increase (decrease) in deferred acquisition costs	3,832,608	(1,450,000)
Equity in undistributed earnings of Blue Chip Stamps, net of amortization of excess cost	1,561,912	1,029,579
Subsidiary acquisition cost adjustment	170,095	—
Income tax effects and adjustments	(1,343,137)	(678,002)
Net income per accompanying financial statements	$16,515,371	$ 716,270

Continued

NOTES TO FINANCIAL STATEMENTS, *Continued*

(C) Investment in Blue Chip Stamps

The investment in Blue Chip Stamps (Blue Chip) by the companies comprising the Insurance Group represented approximately 20% of that company's outstanding shares at December 31, 1976, increased from approximately 19% at December 31, 1975. The investment is accounted for by the equity method.

Equity in net earnings of Blue Chip reflects the following for the past two years:

	1976	1975
Dividends received	$ 239,966	$ 237,476
Equity in undistributed earnings	2,043,575	1,513,907
Provision for current income taxes	(17,276)	(17,100)
Provision for deferred income taxes	(147,137)	(109,002)
Amortization of excess of cost of investment over underlying net asset values	(481,663)	(484,328)
	$1,637,465	$1,140,953

See also notes 1(c) and 5 to consolidated financial statements of Berkshire Hathaway Inc. and consolidated subsidiaries.

(D) Stockholders' Equity

Surplus is restricted for dividend purposes by the insurance departments of the states in which the companies do business.

(E) Underwriting Expenses

The following expenses comprise underwriting expenses:

	1976	1975
Commissions and brokerage	$20,490,844	$13,512,566
Salaries and other compensation	3,325,212	3,027,683
Taxes, licenses and fees	2,011,322	1,508,145
Other underwriting expenses	2,699,620	2,246,497
Total statutory underwriting expenses	28,526,998	20,294,891
(Increase) decrease in deferred acquisition costs	(3,832,608)	1,450,000
	$24,694,390	$21,744,891

(F) Federal Income Taxes

Federal income tax (expense) credits are made up of the following

	1976	1975
Totals		
(Expense) credit applicable to operating earnings	$ (1,134,822)	$3,924,410
(Expense) applicable to equity in earnings of Blue Chip Stamps	(164,413)	(126,102)
(Expense) credit applicable to realized investment gains or losses	(3,200,000)	866,035
	$ (4,499,235)	$4,664,343

For 1976, current income tax expense was $2,456,098 and deferred tax expense was $2,043,137. For 1975, current income tax credits were $4,102,345 and deferred income tax credits were $561,998. Deferred tax (expense) credits related to:

	1976	1975
Change in deferred premium acquisition costs	$ (1,836,000)	$ 696,000
Equity in undistributed earnings of Blue Chip Stamps	(147,137)	(109,002)
Bond discount currently accreted, not currently taxed	(300,000)	(281,259)
Cumulative accreted discount on bonds sold	240,000	104,185
Benefit of capital loss carryforward	—	152,074
Total deferred tax (expense) credit	$ (2,043,137)	$ 561,998

Continued

Berkshire Hathaway Inc.

INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS, *Continued*

1976 income tax expense is reconciled to the Federal 48% statutory rate as follows:

	Amount
Income tax expense at statutory rate	$11,047,000
(Decreases) increases resulting from:	
Tax-exempt interest	(2,021,000)
85% dividends received credit relating to:	
Dividends received from unaffiliated companies	(1,277,000)
Equity in earnings of Blue Chip Stamps	(931,000)
Nondeductible amortization	231,000
Benefits from affiliates	(680,000)
Long-term capital gain rate differential	(1,772,000)
Other, net	(97,765)
Total 1976 Federal income tax expense	$ 4,499,235

1975 Federal income tax credits are reconciled to the total credit at the Federal 48% statutory rates as follows:

	Amount
Credit at statutory rate	$ 1,895,000
Increases (decreases) resulting from:	
Tax-exempt interest	2,137,000
85% dividends received credit relating to:	
Dividends received from unaffiliated companies	978,000
Equity in earnings of Blue Chip Stamps	715,000
Nondeductible amortization	(232,000)
Benefit to affiliates	(319,000)
Long-term capital loss rate differential	(520,000)
Other net	10,343
Total 1975 Federal income tax credit	$ 4,664,343

(G) Investment Gains and Losses

A summary of realized and unrealized investment gains (losses) for 1976 and 1975 is as follows:

	1976			
	Net gains	*Applicable income taxes*	*Net gains less income taxes*	*Net unrealized gain*
Bonds	$ 1,155,684	$ (346,699)	$ 808,985	$ —
Preferred stocks	441,613	(132,484)	309,129	10,117,000
Common stocks	8,645,572	(2,720,817)	5,924,755	35,271,000
	$10,242,849	$ (3,200,000)	$ 7,042,849	$45,388,000

	1975			
	Net gains (losses)	*Applicable income taxes*	*Net gains (losses) less income taxes*	*Net unrealized gain*
Bonds	$ 239,041	$ (71,712)	$ 167,329	$ —
Preferred stocks	28,450	(8,535)	19,915	1,044,000
Common stocks	(3,155,553)	946,282	(2,209,271)	16,104,000
	$ (2,888,062)	$ 866,035	$ (2,022,027)	$17,148,000

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
206 WEST STATE STREET, SUITE 700
ROCKFORD, ILLINOIS 61101

The Board of Directors
The Illinois National Bank &
Trust Co. of Rockford:

We have examined the consolidated balance sheets of the Illinois National Bank & Trust Co. of Rockford and subsidiary as of December 31, 1976 and 1975 and the related consolidated statements of earnings, changes in stockholders' equity and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of the Illinois National Bank & Trust Co. of Rockford and subsidiary at December 31, 1976 and 1975 and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

January 14, 1977

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

	December 31, 1976	December 31, 1975
ASSETS		
Cash and due from banks	$ 10,868,111	$ 18,797,271
Investment securities (note 2):		
United States Government obligations	30,337,817	24,181,462
United States Government agencies	160,792	15,576,778
Obligations of states and political subdivisions	54,002,192	46,959,481
Federal Reserve Bank stock	300,000	300,000
Other securities	6,629,054	4,053,154
Federal funds sold	32,000,000	—
Loans (notes 3 and 6)	56,188,346	58,081,252
Bank premises and equipment (note 4)	895,977	966,626
Accrued interest receivable	1,545,707	2,040,487
Other assets	464,520	514,603
	$193,392,516	$171,471,114
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Demand deposits	$ 54,874,671	$ 53,477,577
Time deposits	113,461,996	93,501,325
Total deposits	168,336,667	146,978,902
Federal funds purchased	—	1,000,000
Accrued taxes and other liabilities (note 5)	1,628,082	1,411,487
Total liabilities	169,964,749	149,390,389
Stockholders' equity:		
Common stock of $20 par value. Authorized and issued 250,000 shares	5,000,000	5,000,000
Surplus	5,000,000	5,000,000
Undivided profits	12,124,955	10,771,923
Reserve for contingencies	1,302,812	1,308,802
Total stockholders' equity	23,427,767	22,080,725
	$193,392,516	$171,471,114

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF EARNINGS

	Years ended December 31,	
	1976	*1975*
Operating income:		
Interest and fees on loans	$ 5,092,525	$ 5,711,826
Income on Federal funds sold	225,353	213,649
Interest and dividends on:		
United States Government obligations	1,075,950	701,175
United States Government agencies	1,415,317	913,791
Obligations of states and political subdivisions	3,255,184	2,853,496
Time deposits with other banks	—	203,531
Federal Reserve Bank stock	18,000	18,000
Other securities	501,162	252,596
Total interest income	11,583,491	10,868,064
Trust fees	546,501	503,178
Service charges on deposit accounts	149,217	133,645
Other	635,253	583,229
Total operating income	12,914,462	12,088,116
Operating expenses:		
Interest on deposits	5,879,505	5,190,802
Interest on borrowed money	4,266	3,795
Total interest expense	5,883,771	5,194,597
Salaries	1,675,744	1,642,956
Employee benefits (note 7)	349,331	292,981
Occupancy, net (note 4)	259,455	246,770
Furniture and equipment (note 4)	233,017	246,233
Provision for loan losses (note 6)	12,000	11,900
Other	837,857	766,203
Total operating expenses	9,251,175	8,401,640
Earnings before income taxes and securities gains	3,663,287	3,686,476
…able income taxes, net (note 5)	108,068	172,092
Earnings before securities gains	3,555,219	3,514,384
…ities gains, net of related taxes of $142,437 in 1976 and $2,185 in 1975 (note 5)	291,823	52,430
Net earnings	$ 3,847,042	$ 3,566,814
…rnings per share:		
Earnings before securities gains	$14.22	$14.06
Securities gains	1.17	.21
Net earnings	$15.39	$14.27

See accompanying notes to consolidated financial statements of bank subsidiary

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

	Common stock	*Surplus*	*Undivided profits (note 6)*	*Reserve for contingencies*
Balance, December 31, 1974, as previously reported	$5,000,000	$5,000,000	$ 9,940,669	$1,001,000
Accretion of discount through December 31, 1974, net of tax of $72,474	—	—	72,242	—
Reclassification — contingency portion of allowance for loan losses	—	—	(313,742)	313,742
Balance, December 31, 1974, as restated	5,000,000	5,000,000	9,699,169	1,314,742
Net earnings	—	—	3,566,814	—
Cash dividends — $10 per share	—	—	(2,500,000)	—
Transfer from reserve for contingencies — loan loss provision	—	—	5,940	(5,940)
Balance, December 31, 1975	5,000,000	5,000,000	10,771,923	1,308,802
Net earnings	—	—	3,847,042	—
Cash dividends — $10 per share	—	—	(2,500,000)	—
Transfer from reserve for contingencies — loan loss provision	—	—	5,990	(5,990)
Balance, December 31, 1976	$5,000,000	$5,000,000	$12,124,955	$1,302,812

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford
AND SUBSIDIARY

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Years ended December 31 *1976*	*1975*
Funds provided:		
From operations:		
Net earnings	$ 3,847,042	$ 3,566,814
Depreciation (including direct leased equipment)	213,979	210,303
Provision for loan losses	12,000	11,900
Deferred income taxes	(202,529)	89,223
Discount accretion	(132,375)	(71,066)
Provided from operations	3,738,117	3,807,174
Increase in:		
Deposits	21,357,765	8,281,864
Federal funds purchased	—	1,000,000
Decrease in:		
Loans	1,880,906	12,040,472
Federal funds sold	—	5,000,000
Cash and due from banks	7,929,160	2,746,306
Other, net	900,121	283,376
Total funds provided	$35,806,069	$33,159,192
Funds used:		
Increase in earning assets:		
Federal funds sold	32,000,000	—
Investment securities	226,605	30,536,264
Additions to bank premises and equipment, net	33,728	79,428
Increase in direct leased equipment	45,736	43,500
Cash dividends	2,500,000	2,500,000
Decrease in Federal funds purchased	1,000,000	
Total funds used	$35,806,069	$33,159,192

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1976 and 1975

(1) Significant Accounting Policies

The accounting policies of The Illinois National Bank & Trust Co. of Rockford (a 97.7% owned subsidiary of Berkshire Hathaway Inc.) and its wholly-owned subsidiary, Brown Building Corporation, conform to generally accepted accounting principles and to general practice within the banking industry. The following is a description of the more significant accounting policies:

Consolidation

The consolidated financial statements include those of the Bank and its wholly-owned subsidiary. All significant intercompany transactions are eliminated in consolidation.

Investment Securities

Investment securities are stated at cost, adjusted for amortization of premium and accretion of discount. Prior to 1976, accretion of discount was not recorded. During the current year accretion was recorded, including the cumulative amounts applicable to securities owned which were acquired in prior years. The effect of 1975 net income and the cumulative and pro forma effect on prior years of changing to the method of accreting discount is not material. However, to comply with reporting requirements promulgated by supervisory authorities, the prior year financial statements have been restated to reflect the change to include accretion income, net of tax. Gains or losses on sales of investment securities are recognized only upon realization and are shown separately in the statements of earnings.

Consumer Credit Loans

Consumer credit loans are generally made on a discount basis. Unearned discount is taken into earnings over the terms of the respective loans using a method that approximates straight-line.

Bank Premises and Equipment

Bank premises and equipment are stated at cost less accumulated depreciation. Depreciation is computed on the straight-line method for building and automobiles, and on an accelerated method for improvements and other equipment. Rates of depreciation are based on the following: buildings, 40 years; improvements and other equipment, 3-8 years.

Costs of major additions and improvements are capitalized. Expenditures for maintenance and repairs are charged against operations as incurred.

Income Taxes

The Bank utilizes the accrual method of accounting for financial reporting purposes, but files its income tax returns on a cash basis. Investment tax credits are treated as a reduction of the provision for Federal income taxes in the year realized.

Provision for Loan Losses

The provision for loan losses is based on past loan loss experience, management's evaluation of the loan portfolio under current economic conditions, and such other factors as in management's best judgment, deserve current recognition in estimating loan losses.

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(2) Investment Securities

A summary of investments by major classifications is as follows:

	Dec. 31, 1976 (in thousands)			*Dec. 31, 1975 (in thousands)*		
	Par value	*Book value*	*Market value*	*Par value*	*Book value*	*Market value*
U. S. Government—direct	$30,455	$30,338	$30,343	$24,565	$24,181	$24,456
U. S. Government—agencies	160	161	165	15,550	15,577	15,605
State and local municipalities	55,104	54,002	56,090	47,680	46,959	44,474
Other	8,259	6,629	7,027	4,730	4,053	3,952
	$93,978	$91,130	$93,625	$92,525	$90,770	$88,487

Investment securities with a par value of $7,801,000 and $7,551,000 at December 31, 1976 and 1975, respectively, were pledged to secure public deposits for other purposes.

(3) Loans

A summary of the major classifications of loans at December 31, 1976 and 1975 is as follows:

	1976	*1975*
Commercial loans	$25,663,661	$27,331,810
Consumer credit loans (less unearned discount of $2,345,401 in 1976 and $2,286,776 in 1975)	11,675,781	12,179,579
Floor plan loans	5,426,337	5,701,588
Real estate loans	14,129,615	13,576,010
	56,895,394	58,788,987
Less allowance for loan losses	707,048	707,735
	$56,188,346	$58,081,252

(4) Bank Premises and Equipment

Bank premises and equipment are recorded at cost less accumulated depreciation of $1,945,559 and $1,994,524 at December 31, 1976 and 1975, respectively. Depreciation expense totaled $104,377 for 1976 and $109,324 for 1975.

(5) Income Taxes

Accrued taxes and other liabilities in the accompanying balance sheets include deferred taxes of $502,037 and $704,566 at December 31, 1976 and 1975, respectively. Such deferred taxes result from timing differences arising from reporting taxable income on the cash basis. The Bank and its subsidiary join in the filing of a consolidated Federal income tax return with the parent company, Berkshire Hathaway Inc. The tax benefit of deductions by the parent has been passed to the Bank, as shown in the following schedules.

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

Taxes applicable to net earnings were as follows:

	1976	1975
Tax provision applicable to earnings before securities gains	$270,420	$467,257
Tax provision applicable to securities gains	217,021	25,867
	487,441	493,124
Less tax benefit from parent corporation applicable to:		
Earnings before securities gains	162,352	295,165
Securities gains	74,584	23,682
	236,936	318,847
Applicable income taxes, net	$250,505	$174,277

The components of consolidated income tax expense are as follows:

	1976	1975
Current income taxes:		
Federal	$631,551	$314,523
Less tax benefit from parent applicable to:		
Taxes currently payable	236,936	314,523
Recovery of prior taxes paid through net operating loss carryback	—	4,324
Total benefit from parent	236,936	318,847
	394,615	(4,324)
State	58,419	89,378
Total current income taxes	453,034	85,054
Deferred income taxes:		
Federal	(209,725)	93,264
State	7,196	(4,041)
Total deferred income taxes	(202,529)	89,223
Applicable income taxes, net	$250,505	$174,277

The sources of timing differences resulting in deferred income taxes and the tax effect of each were as follows:

	1976	1975
Accrued earnings and expense not reported for income tax purposes until collected or paid, net	$(196,519)	$ 95,183
Loan loss deductions for tax purposes less than that provided for financial reporting purposes	(6,010)	(5,960)
	$(202,529)	$ 89,223

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

The total income tax expense for 1976 amounted to $250,505, an effective rate of 6.1% ($174,277 and 4.6% in 1975). The reasons for the difference between the effective tax rate and the corporate Federal income tax rate of 48% are as follows:

	1976		1975	
	Amount	*Percent of pretax earnings*	*Amount*	*Percent of pretax earnings*
Tax expense at statutory rate	$1,966,823	48.0%	$1,795,724	48.0%
Increase (reduction) in taxes resulting from:				
Tax-exempt interest, net of discount accretion	(1,523,483)	(37.2)	(1,341,705)	(35.9)
State income taxes, net of Federal income tax benefits	34,120	.8	44,374	1.1
Tax benefit from parent	(236,936)	(5.7)	(318,847)	(8.5)
Other—net	9,981	.2	(5,269)	(.1)
Actual tax expense	$ 250,505	6.1%	$ 174,277	4.6%

It is not expected that the cash outlay for income taxes for any year through 1979 will exceed the income tax expense for such year.

(6) Allowances for Loan Losses

The following is a summary of activity in the allowance for loan losses:

	1976	1975
Balance at beginning of year	$707,735	$719,918
Recoveries on loans previously charged off	14,360	27,179
Provision for loan losses	12,000	11,900
	734,095	758,997
Less loans charged off	27,047	51,262
Balance at end of year	$707,048	$707,735

(7) Pension and Profit-Sharing Plan

The Bank has a noncontributory pension plan and a profit-sharing plan for all officers and employees with one full year of service. Based upon the most recent actuarial report available (as of December 31, 1975), the pension fund assets exceeded the actuarial computed value of vested benefits and there was no unfunded past service cost liability. The Bank's policy is to fund pension costs as accrued. The total pension and profit-sharing expense was $180,163 for 1976 and $159,351 for 1975.

LINES OF BUSINESS

Sources of Revenues:

Revenues reflected in the consolidated financial statements include those from (1) premium earnings and investment income of the Insurance Group, (2) sales revenues from the textile business plus a minor amount of investment income of the parent Company, plus, in 1976 (3) sales revenues from the automotive chemicals business. The following table summarizes the total revenues derived from these categories for the past five years, in thousands of dollars:

	1972	1973	1974	1975	1976
Insurance Business	$66,556	$60,526	$ 68,776	$ 67,116	$ 91,617
Textile Business	27,772	33,479	32,706	33,259	44,921
Automotive Chemicals Business	—	—	—	—	2,530
	$94,328	$94,005	$101,482	$100,375	$139,068

Sources of Net Earnings:

The unconsolidated bank subsidiary and the investment in Blue Chip Stamps represent additional significant sources of income for the Company. Sources of total net earnings on a pre-tax basis with total tax effects to the Company and its consolidated subsidiaries reflected as a separate item, were as follows for the past five years:

	(Thousands of Dollars)				
	1972	1973	1974	1975	1976
Insurance	$10,701	$10,249	$ 892	$ (2,327)	$10,970
Textiles	1,697	2,837	2,660	1,290	1,148
Automotive Chemicals	—	—	—	—	518
Unconsolidated bank subsidiary	2,700	2,782	4,093	3,450	3,750
Blue Chip Stamps	142	1,124	1,164	2,172	3,635
Interest and corporate administrative expenses, less parent Company interest income	(770)	(1,966)	(2,324)	(1,843)	(2,190)
Realized investment gain (loss)	1,359	1,331	(1,908)	(2,888)	9,962
Total pre-tax income (loss)	15,829	16,357	4,577	(146)	27,793
Less: Total income taxes (credits)	3,703	3,497	(2,466)	(4,838)	4,958
Net Earnings	$12,126	$12,860	$ 7,043	$ 4,692	$22,835

Berkshire Hathaway Inc.

FIVE YEAR SUMMARY OF OPERATIONS

	1972	1973	1974	1975	1976
	(Dollars in thousands, except per share amounts)				
Insurance premiums written	$57,950	$50,372	$60,997	$58,975	$94,773
Insurance premiums earned	59,627	52,929	60,574	58,336	80,780
Net sales of manufactured products	27,742	33,411	32,592	32,883	47,174
Interest and dividend income	6,648	7,378	8,030	8,918	10,820
Insurance underwriting gain (loss)	4,284	3,319	(6,892)	(10,647)	709
Gross profit from sales of manufactured products	4,087	5,105	5,163	4,599	5,600
Interest expense	584	1,605	1,718	1,845	2,028
Income taxes (credit) applicable to insurance and manufacturing operations	3,241	2,979	(2,010)	(4,141)	1,489
Net earnings from insurance and manufacturing operations	8,387	8,141	3,239	1,261	8,957
Equity in net earnings of bank subsidiary	2,700	2,782	4,093	3,450	3,750
Equity in net earnings of Blue Chip Stamps	111	1,008	1,052	2,003	3,366
Earnings before realized investment gains or losses	11,198	11,931	8,383	6,714	16,073
Realized investment gains (losses) net of income taxes	928	929	(1,340)	(2,022)	6,762
Net earnings	$12,126	$12,860	$ 7,043	$ 4,692	$22,835
Average shares outstanding	979,569	979,569	979,569	979,569	975,693
Per share:					
Earnings before realized investment gains or losses	$11.43	$12.18	$8.56	$6.85	$16.47
Net earnings	12.38	13.13	7.19	4.79	23.40

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

Insurance Premiums Earned and Insurance Underwriting Gain (Loss)

Combined loss and expense ratios (which are the sum of the ratio of losses and loss expenses incurred to premiums earned plus the ratio of underwriting expenses, on a statutory basis, to premiums written) have been as follows for the Insurance Group for the past five years.

	NET PREMIUMS		*RATIOS*		
	Written *(In thousands)*	*Earned*	*Losses and Loss Adj. Exp./ Earned Prem.*	*Underwriting Expenses/ Written Prem.*	*Combined Loss and Expense Ratio*
1972	$57,950	$59,627	62.0	29.7	91.7
1973	50,372	52,929	62.0	32.5	94.5
1974	60,997	60,574	77.8	32.0	109.8
1975	58,975	58,336	81.0	34.4	115.4
1976	94,773	80,780	68.6	30.1	98.7

The combined loss and expense ratio is the traditional measure of underwriting results of property and casualty companies. In any year when that ratio exceeds 100, it generally indicates that unprofitable business has been underwritten.

The following table sets forth the net premiums written and earned by the Insurance Group in each of the past three years:

Operational Area		*1974*	*1975*	*1976*
		(Thousands of Dollars)		
Specialized Auto, General Liability and Other(1)	Written	$36,738	$37,860	$60,860
	Earned	34,436	38,144	52,550
Reinsurance(2)	Written	12,204	9,893	15,823
	Earned	12,938	10,188	13,792
Urban Auto & Casualty(3)	Written	6,613	3,072	3,463
	Earned	7,902	3,332	3,380
Home State Companies(4)	Written	5,442	8,150	14,627
	Earned	5,298	6,672	11,058
Totals	Written	$60,997	$58,975	$94,773
	Earned	$60,574	$58,336	$80,780

(1) National Indemnity Company and National Fire & Marine Insurance Company less the Reinsurance Department of National Indemnity.

(2) Reinsurance Department of National Indemnity.

(3) Home and Automobile Insurance Company.

(4) Corporations organized in the jurisdictions of Nebraska, Minnesota, Texas and Iowa underwriting standard and preferred classes of fire and casualty insurance in those states.

The total underwriting gain or loss for the Insurance Group for the past three years is shown in the following table:

	(Thousands of Dollars)					
	1974		1975		1976	
	Statutory	GAAP	Statutory	GAAP	Statutory	GAAP
Specialized auto, general liability and other	$(2,119)	$(1,939)	$(5,201)	$ (6,728)	$ 923	$ 3,956
Reinsurance	(1,470)	(2,068)	(1,955)	(2,194)	(2,374)	(2,585)
Urban Auto & Casualty	(1,761)	(2,183)	(941)	(848)	(103)	(61)
Home State	(702)	(702)	(1,100)	(877)	(1,569)	(601)
	$(6,052)	$(6,892)	$(9,197)	$(10,647)	$(3,123)	$ 709

The only difference between the Statutory and GAAP underwriting results is the change in amount of premium acquisition costs (underwriting expense, i.e., commissions, etc.) which is deferred under GAAP. In both 1974 and 1975, the amount deferred at year-end decreased from the preceding year-end, generally in expectation of unfavorable underwriting results from certain portions of the in-force book of business. Deferred acquisition costs were increased significantly in 1976, though full deferral of eligible costs was not made at 1976 year end, particularly for the Reinsurance business for which no acquisition costs were deferred at December 31, 1976.

The very poor underwriting results experienced by National Indemnity and National Fire and Marine (Subgroup 1 above) in 1974 and 1975 resulted in substantial premium rate increases for business written by these operations in the last half of 1975; further rate increases were affected in 1976. Since premiums written are taken into the income account at the later point in time at which they are earned, there is a delay between the time rate adjustments are effected and the time at which they reflect in income. Results of rate adjustments are partially reflected in their 1976 income and their 1976 underwriting results were significantly improved over those of the prior two years.

The Reinsurance business has sustained significant losses in each of the past three years; increased rates failed to compensate for increased losses. This business is heavily concentrated in casualty lines which have been more negatively impacted by inflation, both monetary and social, than have property lines because of the greater elapsed time between the writing of coverages and settlement of claims. Additionally, the risks in Berkshire's Reinsurance business tend to be more concentrated than in other areas of Berkshire's insurance business, so that the effects from one or two contracts can, and have, significantly effected overall underwriting results of this segment.

The extremely high underwriting loss in 1974 of Home and Automobile Insurance Company resulted from that Company's ill-advised and ill-executed venture into the Florida market. In its traditional Cook County, Illinois business, Home & Auto effected rate increases in 1974 and in 1975 with the result that premium volume declined significantly from previous levels, but loss ratios did not improve. Their management, rates, and underwriting practices were restructured in late 1975. A strong recovery was experienced in 1976. The automobile business has been shifted to a six month direct bill policy which permits a faster reaction time to underwriting trends. Their general liability business has been expanded significantly with good results.

Operations of the Home State Companies in total have to date yielded only underwriting losses. Their combined ratio has improved for each of the past two years, their volume has become meaningful, and management believes that the concepts underlying the formation of these companies remain sound.

MANAGEMENT'S DISCUSSION, *Continued*

Manufacturing Business Revenues and Gross Profits

The revenues and gross profits of the manufacturing businesses are summarized for the past three years as follows:

	(in thousands of dollars) 1974	1975	1976
Revenues:			
Berkshire operation	$32,592	$23,521	$30,887
Waumbec operation	—	9,312	13,757
K & W operation	—	—	2,530
	$32,592	$32,833	$47,174
Gross Profits:			
Berkshire operation	$ 5,163	$ 2,972	$ 3,583
Waumbec operation	—	1,627	579
K & W operation	—	—	1,438
	$ 5,163	$ 4,599	$ 5,600

The traditional Berkshire textile operation results improved in 1976 compared to 1975. However, 1975 was not, on balance, a satisfactory year, as evidenced by comparison to the better 1974 results. Textile profit results in 1976 deteriorated from quarter-to-quarter, particularly in the Waumbec operation, where manufacturing cost variances significantly decreased both the rate and dollar amount of gross profits from those of 1975.

The Waumbec operation was purchased April 28, 1975 and the above sales and gross profit figures reflect those of that operation from date of purchase. 1975 full year sales of Waumbec were $12,444,000. 1975 revenues of K & W (which were prior to purchase of the business by the Company) were $2,363,000.

Interest and Dividend Income

Interest and dividend income is earned almost entirely by the Insurance Group. The continuing increase in this category of income has been primarily the result of increased investments; in 1975 and 1976, the average yield on investments also increased. Interest and dividend income is related to average investments for the past five years in the following table, which excludes the investment in and dividends received from Blue Chip Stamps, accounted for by the equity method.

	Average Investments at cost	*Interest and Dividend Income*	*Average Per Cent Earned*
	(Amounts in Thousands)		
1972	$103,217	$ 6,648	6.44
1973	117,516	7,378	6.28
1974	131,347	8,030	6.11
1975	136,500	8,918	6.53
1976	158,468	10,820	6.83

The average per cent earned declined in 1973 and 1974 as a result of the increase in those years in the average investments in preferred and common stocks relative to the average investment in bonds; the income yield on the bonds tends to exceed that on stocks.

MANAGEMENT'S DISCUSSION, *Continued*

Investments for the past five years are categorized in the following table, at the average of their carrying values at the beginning and end of each year:

	Bonds, Treasury bills and other short-term obligations	*Preferred and common stocks*	*Total*
		(in thousands of dollars)	
1972	$87,175	$16,042	$103,217
1973	81,311	36,205	117,516
1974	78,557	52,790	131,347
1975	88,787	47,713	136,500
1976	99,821	58,647	158,468

Income Taxes (Credit) Applicable to Insurance and Textile Operations

Each year there is a significant difference between pre-tax income reported in the financial statements and income subject to tax. The difference arises principally from certain dividends received credits and from the fact that a considerable portion of income of the Insurance Group is produced by tax exempt bonds. Berkshire Hathaway Inc. and its includible subsidiaries join in the filing of a consolidated Federal income tax return. Income tax expense for 1976 and credit for 1975 are detailed, summarized and reconciled to the statutory 48% rate in the footnotes to the financial statements.

Equity in Net Earnings of Bank Subsidiary

Berkshire's equity in net earnings of the Illinois National Bank and Trust Co. of Rockford ("the bank") represent approximately 98% of the bank's earnings. Financial statements of the bank are included elsewhere herein.

A financial summary of the bank's operations for the last three years is summarized below, in thousands of dollars:

	1974	*1975*	*1976*
Interest income	$11,043	$10,868	$11,583
Interest expense	4,969	5,195	5,884
Net interest earnings	6,074	5,673	5,699
Non-interest income	1,133	1,220	1,331
	7,207	6,893	7,030
Non-interest expenses	2,915	3,207	3,367
Earnings before income taxes and before securities gains	$ 4,292	$ 3,686	$ 3,663
Net earnings	$ 4,215	$ 3,567	$ 3,847

Figures for 1974 and 1975 have been restated by a minor amount to include in income, net of tax, accreted discount on bonds as explained in Note 1 to the Financial Statements of the Bank.

1975 Compared to 1974

Outstanding loans declined in 1975, resulting in less total interest income than in 1974. Interest bearing time deposits increased so that interest expense was greater in 1975 than in 1974. The combination resulted in a decline of $401,000 in net interest earnings in 1975 from the prior year.

A non-recurring credit of $554,000 against property tax expense in 1974, reflected above as a reduction of "non-interest expenses" for that year, more than explains the increase in that category of expense from 1974 to 1975.

MANAGEMENT'S DISCUSSION, *Continued*

Income taxes applicable to operating earnings of the bank in both 1974 and 1975 were partially offset in each year by after-tax gain from disposition of securities, so that final Net Earnings were slightly less than Earnings before those items.

1976 Compared to 1975

Earnings before income taxes and before securities gains were approximately the same for 1976 as for the prior year. This result was achieved despite the fact that 1976 commercial and industrial loan demand was less than vigorous, and the rate of return on loans declined steadily throughout the year. Interest income on securities, the funds for which were secured through increased deposits, more than offset the decline in loan interest. Interest paid on increased time deposits caused the increase in interest expense. Operating expenses were closely controlled in 1976, as they have been historically.

1976 income taxes of the bank were more than offset by securities gains so that final Net Earnings increased $280,000 over 1975.

Equity in Net Earnings of Blue Chip Stamps

Berkshire's equity in net earnings of Blue Chip Stamps ("Blue Chip") computed by the equity method for each of the past three years has been as follows:

	1974	*1975*	*1976*
Equity in net earnings	$1,548	$2,346	$3,733
Applicable income taxes	(112)	(169)	(269)
Amortization of excess of cost over equity in net assets	(384)	(174)	(98)
	$1,052	$2,003	$3,366

Equity in 1974 and 1975 earnings were based on the twelve month operations of Blue Chip ended on or about November 30 of those years. Blue Chip changed to a calendar year reporting basis for 1976, and Berkshire equity in 1975 earnings is, accordingly, based on Blue Chip's 1976 calendar year results.

The average number of shares of Blue Chip owned by Berkshire has increased from the prior year in each of the past three years. Average shares owned in 1974, 1975 and 1976 were, respectively, 1,144,670, 1,325,233 and 1,579,090. At 1976 year end, Berkshire's ownership of Blue Chip shares had increased to 1,720,709, representing approximately 33% of Blue Chip's outstanding shares.

Realized Investment Gains (Losses)

Realization of investment gains or losses is determined by prevailing investment strategy as applied under changing economic conditions. Net results for the past three years were as follows, in thousands of dollars.

	1974	*1975*	*1976*
Realized gains (losses)	$ (1,908)	$ (2,888)	$ 9,962
Applicable income tax (expense) credits	568	866	(3,200)
Realized gains (losses) after taxes	$ (1,340)	$ (2,022)	$ 6,762

Berkshire Hathaway Inc.

DIRECTORS AND EXECUTIVE OFFICERS

WARREN E. BUFFETT, *Director and Chairman of the Board*
Chief Executive Officer of the Company

KENNETH V. CHACE, *Director*
President of the Company and Chief Operating Officer of the Textile Operations of the Company

MALCOLM G. CHACE, JR., *Director*
Retired, Former Chairman of the Board of Directors of the Company

J. VERNE McKENZIE, *Director*
Vice President, Secretary and Treasurer of the Company

COMMON STOCK PRICES

The common stock of Berkshire Hathaway Inc. is traded in the over the counter market. The high and low bid prices for the stock in each quarter of 1975 and 1976 is set forth in the following table. The quotations represent prices between dealers and do not include retail markup, markdown or commission. They do not represent actual transactions.

		High	*Low*
1975	1st Quarter	51	38
	2nd Quarter	51	45
	3rd Quarter	60	41
	4th Quarter	43	38
1976	1st Quarter	56	38
	2nd Quarter	63	59
	3rd Quarter	73	61
	4th Quarter	95	66

The Company did not pay a dividend in 1975 or 1976.

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