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BERKSHIRE HATHAWAY INC.

1977

ANNUAL REPORT TO THE STOCKHOLDERS

Berkshire Hathaway Inc.

1977 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, 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.

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Berkshire Hathaway Inc.

To the Stockholders of Berkshire Hathaway Inc.:

Operating earnings in 1977 of $21,904,000, or $22.54 per share, were moderately better than anticipated a year ago. Of these earnings, $1.43 per share resulted from substantial realized capital gains by Blue Chip Stamps which, to the extent of our proportional interest in that company, are included in our operating earnings figure. Capital gains or losses realized directly by Berkshire Hathaway Inc. or its insurance subsidiaries are not included in our calculation of operating earnings. While too much attention should not be paid to the figure for any single year, over the longer term the record regarding aggregate capital gains or losses obviously is of significance.

Textile operations came in well below forecast, while the results of the Illinois National Bank as well as the operating earnings attributable to our equity interest in Blue Chip Stamps were about as anticipated. However, insurance operations, led again by the truly outstanding results of Phil Liesche's managerial group at National Indemnity Company, were even better than our optimistic expectations.

Most companies define "record" earnings as a new high in earnings per share. Since businesses customarily add from year to year to their equity base, we find nothing particularly noteworthy in a management performance combining, say, a 10% increase in equity capital and a 5% increase in earnings per share. After all, even a totally dormant savings account will produce steadily rising interest earnings each year because of compounding.

Except for special cases (for example, companies with unusual debt-equity ratios or those with important assets carried at unrealistic balance sheet values), we believe a more appropriate measure of managerial economic performance to be return on equity capital. In 1977 our operating earnings on beginning equity capital amounted to 19%, slightly better than last year and above both our own long-term average and that of American industry in aggregate. But, while our operating earnings per share were up 37% from the year before, our beginning capital was up 24%, making the gain in earnings per share considerably less impressive than it might appear at first glance.

We expect difficulty in matching our 1977 rate of return during the forthcoming year. Beginning equity capital is up 23% from a year ago, and we expect the trend of insurance underwriting profit margins to turn down well before the end of the year. Nevertheless, we expect a reasonably good year and our present estimate, subject to the usual caveats regarding the frailties of forecasts, is that operating earnings will improve somewhat on a per share basis during 1978.

Textile Operations

The textile business again had a very poor year in 1977. We have mistakenly predicted better results in each of the last two years. This may say something about our forecasting abilities, the nature of the textile industry, or both. Despite strenuous efforts, problems in marketing and manufacturing have persisted. Many difficulties experienced in the marketing area are due primarily to industry conditions, but some of the problems have been of our own making.

A few shareholders have questioned the wisdom of remaining in the textile business which, over the longer term, is unlikely to produce returns on capital comparable to those available in many other businesses. Our reasons are several: (1) Our mills in both New Bedford and Manchester are among the largest employers in each town, utilizing a labor force of high average age possessing relatively non-transferable skills. Our workers and unions have exhibited unusual understanding and effort in cooperating with management to achieve a cost structure and product mix which might allow us to maintain a viable operation. (2) Management also has been energetic and straightforward in its approach to our textile problems. In particular, Ken Chace's efforts after the change in corporate control took place in 1965 generated capital from the textile division needed to finance the acquisition and expansion of our profitable insurance operation. (3) With hard work and some imagination regarding manufacturing and marketing configurations, it seems reasonable that at least modest profits in the textile division can be achieved in the future.

Insurance Underwriting

Our insurance operation continued to grow significantly in 1977. It was early in 1967 that we made our entry into this industry through the purchase of National Indemnity Company and National Fire and Marine Insurance Company (sister companies) for approximately $8.6 million. In that year their premium volume amounted to $22 million. In 1977 our aggregate insurance premium volume was $151 million. No additional shares of Berkshire Hathaway stock have been issued to achieve any of this growth.

Rather, this almost 600% increase has been achieved through large gains in National Indemnity's traditional liability areas plus the starting of new companies (Cornhusker Casualty Company in 1970, Lakeland Fire and Casualty Company in 1971, Texas United Insurance Company in 1972, The Insurance Company of Iowa in 1973, and Kansas Fire and Casualty Company in late 1977), the purchase for cash of other insurance companies (Home and Automobile Insurance Company in 1971, Kerkling Reinsurance Corporation, now named Central Fire and Casualty Company, in 1976, and Cypress Insurance Company at yearend 1977), and finally through the marketing of additional products, most significantly reinsurance, within the National Indemnity Company corporate structure.

In aggregate, the insurance business has worked out very well. But it hasn't been a one-way street. Some major mistakes have been made during the decade, both in products and personnel. We experienced significant problems from (1) a surety operation initiated in 1969, (2) the 1973 expansion of Home and Automobile's urban auto marketing into the Miami, Florida area, (3) a still unresolved aviation "fronting" arrangement, and (4) our Worker's Compensation operation in California, which we believe retains an interesting potential upon completion of a reorganization now in progress. It is comforting to be in a business where some mistakes can be made and yet a quite satisfactory overall performance can be achieved. In a sense, this is the opposite case from our textile business where even very good management probably can average only modest results. One of the lessons your management has learned — and, unfortunately, sometimes re-learned — is the importance of being in businesses where tailwinds prevail rather than headwinds.

In 1977 the winds in insurance underwriting were squarely behind us. Very large rate increases were effected throughout the industry in 1976 to offset the disastrous underwriting results of 1974 and 1975. But, because insurance policies typically are written for one-year periods, with pricing mistakes capable of correction only upon renewal, it was 1977 before the full impact was felt upon earnings of those earlier rate increases.

The pendulum now is beginning to swing the other way. We estimate that costs involved in the insurance areas in which we operate rise at close to 1% per month. This is due to continuous monetary inflation affecting the cost of repairing humans and property, as well as "social inflation", a broadening definition by society and juries of what is covered by insurance policies. Unless rates rise at a comparable 1% per month, underwriting profits must shrink. Recently the pace of rate increases has slowed dramatically, and it is our expectation that underwriting margins generally will be declining by the second half of the year.

We must again give credit to Phil Liesche, greatly assisted by Roland Miller in Underwriting and Bill Lyons in Claims, for an extraordinary underwriting achievement in National Indemnity's traditional auto and general liability business during 1977. Large volume gains have been accompanied by excellent underwriting margins following contraction or withdrawal by many competitors in the wake of the 1974-75 crisis period. These conditions will reverse before long. In the meantime, National Indemnity's underwriting profitability has increased dramatically and, in addition, large sums have been made available for investment. As markets loosen and rates become inadequate, we again will face the challenge of philosophically accepting reduced volume. Unusual managerial discipline will be required, as it runs counter to normal institutional behavior to let the other fellow take away business — even at foolish prices.

Our reinsurance department, managed by George Young, improved its underwriting performance during 1977. Although the combined ratio (see definition on page 12) of 107.1 was unsatisfactory, its trend was downward throughout the year. In addition, reinsurance generates unusually high funds for investment as a percentage of premium volume.

At Home and Auto, John Seward continued to make progress on all fronts. John was a battlefield promotion several years ago when Home and Auto's underwriting was awash in red ink and the company faced possible extinction. Under his management it currently is sound, profitable, and growing.

John Ringwalt's homestate operation now consists of five companies, with Kansas Fire and Casualty Company becoming operational late in 1977 under the direction of Floyd Taylor. The homestate companies had net premium volume of $23 million, up from $5.5 million just three years ago. All four companies that operated throughout the year achieved combined ratios below 100, with Cornhusker Casualty Company, at 93.8, the leader. In addition to actively supervising the other four homestate operations, John Ringwalt manages the operations of Cornhusker which has recorded combined ratios below 100 in six of its seven full years of existence and, from a standing start in 1970, has grown to be one of the leading insurance companies operating in Nebraska utilizing the conventional independent agency system. Lakeland Fire and Casualty Company, managed by Jim Stodolka, was the winner of the Chairman's Cup in 1977 for achieving the lowest loss ratio among the homestate companies. All in all, the homestate operation continues to make excellent progress.

The newest addition to our insurance group is Cypress Insurance Company of South Pasadena, California. This Worker's Compensation insurer was purchased for cash in the final days of 1977 and, therefore, its approximate $12.5 million of volume for that year was not included in our results. Cypress and National Indemnity's present California Worker's Compensation operation will not be combined, but will operate independently utilizing somewhat different marketing strategies. Milt Thornton, President of Cypress since 1968, runs a first-class operation for policyholders, agents, employees and owners alike. We look forward to working with him.

Insurance companies offer standardized policies which can be copied by anyone. Their only products are promises. It is not difficult to be licensed, and rates are an open book. There are no important advantages from trademarks, patents, location, corporate longevity, raw material sources, etc., and very little consumer differentiation to produce insulation from competition. It is commonplace, in corporate annual reports, to stress the difference that people make. Sometimes this is true and sometimes it isn't. But there is no question that the nature of the insurance business magnifies the effect which individual managers have on company performance. We are very fortunate to have the group of managers that are associated with us.

Insurance Investments

During the past two years insurance investments at cost (excluding the investment in our affiliate, Blue Chip Stamps) have grown from $134.6 million to $252.8 million. Growth in insurance reserves, produced by our large gain in premium volume, plus retained earnings, have accounted for this increase in marketable securities. In turn, net investment income of the Insurance Group has improved from $8.4 million pre-tax in 1975 to $12.3 million pre-tax in 1977.

In addition to this income from dividends and interest, we realized capital gains of $6.9 million before tax, about one-quarter from bonds and the balance from stocks. Our unrealized gain in stocks at yearend 1977 was approximately $74 million but this figure, like any other figure of a single date (we had an unrealized loss of $17 million at the end of 1974), should not be taken too seriously. Most of our large stock positions are going to be held for many years and the scorecard on our investment decisions will be provided by business results over that period, and not by prices on any given day. Just as it would be foolish to focus unduly on short-term prospects when acquiring an entire company, we think it equally unsound to become mesmerized by prospective near term earnings or recent trends in earnings when purchasing small pieces of a company; i.e., marketable common stocks.

A little digression illustrating this point may be interesting. Berkshire Fine Spinning Associates and Hathaway Manufacturing were merged in 1955 to form Berkshire Hathaway Inc. In 1948, on a pro forma combined basis, they had earnings after tax of almost $18 million and employed 10,000 people at a dozen large mills throughout New England. In the business world of that period they were an economic powerhouse. For example, in that same year earnings of IBM were $28 million (now $2.7 billion), Safeway Stores, $10 million, Minnesota Mining, $13 million, and Time, Inc., $9 million. But, in the decade following the 1955 merger aggregate sales of $595 million produced an aggregate loss for Berkshire Hathaway of $10 million. By 1964 the operation had been reduced to two mills and net worth had shrunk to $22 million, from $53 million at the time of the merger. So much for single year snapshots as adequate portrayals of a business.

Equity holdings of our insurance companies with a market value of over $5 million on December 31, 1977 were as follows:

No. of Shares	*Company*	*Cost*	*Market*
		(000's omitted)	
220,000	Capital Cities Communications, Inc.	$ 10,909	$ 13,228
1,986,953	Government Employees Insurance Company Convertible Preferred	19,417	33,033
1,294,308	Government Employees Insurance Company Common Stock	4,116	10,516
592,650	The Interpublic Group of Companies, Inc.	4,531	17,187
324,580	Kaiser Aluminum & Chemical Corporation	11,218	9,981
1,305,800	Kaiser Industries, Inc.	778	6,039
226,900	Knight-Ridder Newspapers, Inc.	7,534	8,736
170,800	Ogilvy & Mather International, Inc.	2,762	6,960
934,300	The Washington Post Company Class B	10,628	33,401
	Total	$ 71,893	$139,081
	All Other Holdings	34,996	41,992
	Total Equities	$106,889	$181,073

We select our marketable equity securities in much the same way we would evaluate a business for acquisition in its entirety. We want the business to be (1) one that we can understand, (2) with favorable long-term prospects, (3) operated by honest and competent people, and (4) available at a very attractive price. We ordinarily make no attempt to buy equities for anticipated favorable stock price behavior in the short term. In fact, if their business experience continues to satisfy us, we welcome lower market prices of stocks we own as an opportunity to acquire even more of a good thing at a better price.

Our experience has been that pro-rata portions of truly outstanding businesses sometimes sell in the securities markets at very large discounts from the prices they would command in negotiated transactions involving entire companies. Consequently, bargains in business ownership, which simply are not available directly through corporate acquisition, can be obtained indirectly through stock ownership. When prices are appropriate, we are willing to take very large positions in selected companies, not with any intention of taking control and not foreseeing sell-out or merger, but with the expectation that excellent business results by corporations will translate over the long term into correspondingly excellent market value and dividend results for owners, minority as well as majority.

Such investments initially may have negligible impact on our operating earnings. For example, we invested $10.9 million in Capital Cities Communications during 1977. Earnings attributable to the shares we purchased totaled about $1.3 million last year. But only the cash dividend, which currently provides $40,000 annually, is reflected in our operating earnings figure.

Capital Cities possesses both extraordinary properties and extraordinary management. And these management skills extend equally to operations and employment of corporate capital. To purchase, directly, properties such as Capital Cities owns would cost in the area of twice our cost of purchase via the stock market, and direct ownership would offer no important advantages to us. While control would give us the opportunity – and the responsibility – to manage operations and corporate resources, we would not be able to provide management in either of those respects equal to that now in place. In effect, we can obtain a better management result through non-control than control. This is an unorthodox view, but one we believe to be sound.

Banking

In 1977 the Illinois National Bank continued to achieve a rate of earnings on assets about three times that of most large banks. As usual, this record was achieved while the bank paid maximum rates to savers and maintained an asset position combining low risk and exceptional liquidity. Gene Abegg formed the bank in 1931 with $250,000. In its first full year of operation, earnings amounted to $8,782. Since that time, no new capital has been contributed to the bank; on the contrary, since our purchase in 1969, dividends of $20 million have been paid. Earnings in 1977 amounted to $3.6 million, more than achieved by many banks two or three times its size.

Late last year Gene, now 80 and still running a banking operation without peer, asked that a successor be brought in. Accordingly, Peter Jeffrey, formerly President and Chief Executive Officer of American National Bank of Omaha, has joined the Illinois National Bank effective March 1st as President and Chief Executive Officer.

Gene continues in good health as Chairman. We expect a continued successful operation at Rockford's leading bank.

Blue Chip Stamps

We again increased our equity interest in Blue Chip Stamps, and owned approximately 36½% at the end of 1977. Blue Chip had a fine year, earning approximately $12.9 million from operations and, in addition, had realized securities gains of $4.1 million.

Both Wesco Financial Corp., an 80% owned subsidiary of Blue Chip Stamps, managed by Louis Vincenti, and See's Candies, a 99% owned subsidiary, managed by Chuck Huggins, made good progress in 1977. Since See's was purchased by Blue Chip Stamps at the beginning of 1972, pre-tax operating earnings have grown from $4.2 million to $12.6 million with little additional capital investment. See's achieved this record while operating in an industry experiencing practically no unit growth. Shareholders of Berkshire Hathaway Inc. may obtain the annual report of Blue Chip Stamps by requesting it from Mr. Robert H. Bird, Blue Chip Stamps, 5801 South Eastern Avenue, Los Angeles, California 90040.

Warren E. Buffett, Chairman

March 14, 1978

Berkshire Hathaway

	1968	1969	1970	1971	
		(Dollars in thousands, except per share amounts)			
Insurance premiums written	$22,620	$28,776	$45,086	$66,455	$5
Net sales of manufactured products .	46,002	40,427	24,569	26,011	:
Interest and dividend income . . .	1,972	2,133	2,942	5,043	
Net earnings from insurance and manufacturing operations	2,488	2,699	1,893	4,712	
Equity in net earnings of bank subsidiary	—	1,165	2,973	2,192	
Equity in net earnings of Blue Chip Stamps	—	—	—	63	
Earnings before realized investment gains or losses	2,488	3,864	4,866	6,967	1
Realized investment gains (losses) net of income taxes	2,174	4,089	(301)	719	
Net earnings	$ 4,662	$ 7,953	$ 4,565	$ 7,686	$1
Average shares outstanding	985,482	985,000	979,715	979,569	97
Per share:					
Earnings before realized investment gain or loss	$ 2.52	$ 3.92	$ 4.97	$ 7.11	$
Realized investment gain (loss) . .	2.21	4.15	(.31)	.74	
Net earnings	$ 4.73	$ 8.07	$ 4.66	$ 7.85	$
Stockholders' equity at year end . .	$36.74	$44.83	$49.49	$57.34	$

Year Summary

1974	1975	1976	1977	
(Dollars in thousands, except per share amounts)				
$60,997	$58,975	$94,773	$151,083	Insurance premiums written
32,592	32,833	47,174	48,189	Net sales of manufactured products
8,030	8,918	10,820	12,549	Interest and dividend income
3,239	1,261	8,957	12,615	Net earnings from insurance and manufacturing operations
4,093	3,450	3,750	3,550	Equity in net earnings of bank subsidiary
1,052	2,003	3,366	5,739	Equity in net earnings of Blue Chip Stamps
8,383	6,714	16,073	21,904	Earnings before realized investment gains or losses
(1,340)	(2,022)	6,762	4,820	Realized investment gains (losses) net of income taxes
$ 7,043	$ 4,692	$22,835	$ 26,724	Net earnings
979,569	979,569	975,693	971,600	Average shares outstanding
				Per share:
$ 8.56	$ 6.85	$ 16.47	$ 22.54	Earnings before realized investment gain or loss
(1.37)	(2.06)	6.93	4.96	Realized investment gain (loss)
$ 7.19	$ 4.79	$ 23.40	$ 27.50	Net earnings
$90.04	$94.83	$118.50	$146.07	Stockholders' equity at year end

Berkshire Hathaway Inc.

MANAGEMENT'S DISCUSSION

A ten year summary is presented on pages 8 and 9. Supplementary data relative to elements of "net earnings from insurance and manufacturing operations" for the past five years is as follows:

	1973	*1974*	*1975*	*1976*	*1977*
			(in thousands)		
Insurance underwriting gain (loss)	$3,319	$(6,892)	$(10,647)	$ 709	$6,184
Gross profit from sales of manufactured products	5,105	5,163	4,599	5,600	4,453
Interest expense	1,605	1,718	1,845	2,028	2,075
Income taxes (credit) applicable to insurance and manufacturing operations	2,979	(2,010)	(4,141)	1,489	2,914

Note (3) to the consolidated financial statements sets forth certain information regarding sources of revenue and operating profits plus additional data with respect to total year-end assets for the past five years. That note should be read in conjunction with these comments.

The following discussion deals with items in the ten year summary or in the above table which reflect a change of 10% or more in 1977 or 1976 from the prior year which are not fully dealt with elsewhere herein.

Insurance Premium Written

In both 1976 and 1977, in each of the separately identifiable areas of our insurance business, premium volume has increased over the preceding year's total, as follows:

	1975	*1976*	*1977*
Specialized Auto and General Liability (1)	$37,986	$58,337	$ 87,146
Workers Compensation (2)	2,947	5,986	18,467
Reinsurance (3)	9,893	15,823	22,252
Home State Companies (4)	8,150	14,627	23,218
	$58,976	$94,773	$151,083

(1) National Indemnity Company and National Fire and Marine Insurance Company less departments of National Indemnity dealing with (a) Workers' Compensation and (b) Reinsurance, plus underwritings by Home and Automobile Insurance Company in the urban Chicago area.

(2) Workers' Compensation departments of National Indemnity.

(3) Reinsurance department of National Indemnity.

(4) Corporations organized in the jurisdictions of Nebraska, Minnesota, Texas, Iowa and Kansas underwriting multiple line fire and casualty insurance in those states.

The traditional specialized automobile and general liability business of National Indemnity Company and National Fire & Marine Insurance Company has always tended to be highly cyclical. These operations have reflected significant volume increases following years which have been unprofitable for the industry, and this phase of the cycle simply recurred in 1976 and 1977. Their increased premium volume reflects significant necessary rate increases, but a greater contributing factor to their increased volume, particularly in 1976, was an increased volume of covered risks. Competition in the industry diminished significantly after the horrendous results suffered by the industry in 1974 and 1975; National Indemnity, National Fire, as well as Home & Auto in lesser volume, had both the capacity and the underwriting skills to market their specialized products in areas from which conventional underwriting organizations tended to withdraw.

MANAGEMENT'S DISCUSSION, *Continued*

Workers' compensation insurance was a relatively insignificant element of our insurance business prior to 1976. In that year, a branch office of National Indemnity in Los Angeles began aggressively marketing this coverage, and in 1977 that operation produced a volume of business that merits its being called out as a separate and distinct aspect of the business of our Insurance Group. We expect that the addition to the Group at the end of 1977 of Cypress Insurance Company, a California workers' compensation underwriter, will make this line of insurance even more significant to the Group in coming years.

The increased premium volume of the Reinsurance Department of National Indemnity is reflective of a combination of necessary increased rates plus an increased volume of insured risks.

The Home State Company operations continued to increase their market penetration in each of the states in which they are licensed. The new Kansas operation was formed late in 1977 and therefore its production by year-end was virtually nil.

Net Sales of Manufactured Products

Sales from the businesses comprising the manufacturing segments of the Company were as follows for the past three years.

	1975	*1976*	*1977*
Berkshire textile operation	$23,521	$30,887	$35,554
Waumbec textile operation	9,312	13,757	9,944
K & W automotive chemicals	—	2,530	2,691
	$32,833	$47,174	$48,189

Some increases in prices, changes in product mix and a 15% increase in unit sales and production combined to result in an increase in dollar sales from the Berkshire operation of about 30% in 1976 over 1975. In 1977, both unit sales and dollar sales increased about 15% from the prior year. Goods manufactured by others were purchased and resold in 1977 to account for the increased unit sales; total production at the New Bedford mill was near capacity level in both 1977 and 1976.

Sales from Waumbec textile operation for the full year 1975 were $12,444,000. Sales from that operation reflected in the above table reflect only those from the April 28, 1975 date of the Company's purchase of the business. In 1977, sales were significantly depressed and well below levels necessary to maintain reasonable production schedules.

Interest and Dividend Income

In the following table, interest and dividend income is related to average investments for the past three years. Investments are shown at the average of their carrying values at the beginning and end of each year:

(thousands of dollars)

	Average Investments, at cost				
	Bonds, Treasury bills and other short term obligations	*Preferred and Common Stocks*	*Total*	*Interest and Dividend Income*	*Average Percent Earned*
1975 . . .	$ 88,787	$47,713	$136,500	$ 8,918	6.53
1976 . . .	99,821	58,647	158,468	10,820	6.83
1977 . . .	117,512	90,706	208,218	12,549	6.03

MANAGEMENT'S DISCUSSION, *Continued*

Interest and dividend income is earned almost entirely by the Insurance Group. The basic reason for the increase in this category of income is increased invested funds. Rates earned on taxable bonds and short term obligations were significantly higher in 1976 than in either 1975 or 1977. The greater proportionate increase in 1977 in investments in stocks further reduced the average yield earned in this most recent year, since the income yield on such investments tends to be less than on bonds.

Insurance underwriting gain (loss)

Insurance underwriting results are most commonly measured by the "combined ratio". Such term represents the sum of the ratio of losses and loss adjustment expenses to premiums earned plus the ratio of underwriting expenses to premiums written. In the computation, underwriting expenses on a statutory basis are used, that is, no adjustment is made for the change in deferred acquisition costs as is required under generally accepted accounting principles. A combined ratio below 100 indicates an underwriting profit; above 100 indicates an underwriting loss. The combined ratio for the Insurance Group for the past three years has been as follows:

	NET PREMIUMS		*RATIOS*		
	Written	*Earned*	*Losses and Loss Adj. Exp./ Earned Prem.*	*Underwriting Expenses/ Written Prem.*	*Combined Loss and Expense Ratio*
	(in thousands)				
1975 . . .	58,975	58,336	81.0	34.4	115.4
1976 . . .	94,773	80,780	68.6	30.1	98.7
1977 . . .	151,083	136,890	66.9	27.9	94.8

Insurance underwriting profit (loss) stated in dollars on the basis of generally accepted accounting principles have resulted as follows for the Insurance Group for the past 3 years.

	1975	*1976*	*1977*
		(in thousands)	
Specialized auto and general liability . . .	$ (7,443)	$5,077	$8,240
Workers Compensation	(133)	(1,182)	(1,369)
Reinsurance	(2,194)	(2,585)	(1,442)
Home State Companies	(877)	(601)	755
	$(10,647)	$ 709	$6,184

The combined ratio for the Workers Compensation business (which excludes volume in that line written by the multiple line Home State Companies) was 107.1 in 1977. We referred previously to our aggressive marketing of Workers Compensation in California in 1976 and 1977. The enthusiasm for volume led to the writing of coverages at inadequate rates; some of this business is still on the books and we expect continuing losses therefrom over the near term. We believe that this business if properly managed can ultimately eliminate underwriting losses, although probably not in 1978, while generating significant sums for investment.

The losses in reinsurance are diminishing; management is cautiously optimistic that they will be further diminished and possibly eliminated in the near future.

MANAGEMENT'S DISCUSSION, *Continued*

Manufacturing business gross profits

Gross profits of the manufacturing businesses are summarized for the past three years as follows:

	(in thousands of dollars)		
	1975	*1976*	*1977*
Berkshire textile operation	$2,972	$3,583	$2,951
Waumbec textile operation	1,627	579	(48)
K & W automotive chemicals	—	1,438	1,550
	$4,599	$5,600	$4,453

Berkshire textile operation: Volume and price increases in 1976 resulted in improved gross profits over 1975; the total achieved in 1976 was, however, less than satisfactory. Prices deteriorated somewhat in 1977 from the less than satisfactory 1976 level, while manufacturing costs continued to increase; this combination resulted in $632,000 less gross profits in 1977 than in 1976 on increased sales.

Waumbec textile operation: Unfavorable manufacturing cost variances were experienced in the Waumbec operation in 1976 and these persisted in 1977. Further, in 1977, production curtailments were made at this operation to the extent that approximately 50% of capacity was not utilized. In the last quarter of 1977, an increased order rate and slightly improved prices were noted. Management expects greater utilization of Waumbec capacity for 1978, at least some gross profit contribution, and possibly a net profit contribution.

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:

	1975	*1976*	*1977*
Equity in net earnings	$2,346	$3,733	$5,977
Applicable income taxes	(169)	(269)	(430)
Amortization of difference between cost and equity in net asets	(174)	(98)	192
	$2,003	$3,366	$5,739

Equity in 1977 net earnings of Blue Chip includes $1,494,000 representing equity in Blue Chip's realized securities gains. Applicable Berkshire income taxes on such amount were approximately $108,000, so that Berkshire's 1977 net earnings were enhanced $1,386,000, or $1.43 per outstanding Berkshire share, as a result of such securities gains of Blue Chip.

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 1975, 1976, and 1977 were, respectively, 1,325,233, 1,579,090, and 1,781,033. At 1977 year end, Berkshire's ownership of Blue Chip shares had increased to 1,889,903, representing approximately 36.5% of Blue Chip's outstanding shares.

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 December 31, 1977 and January 1, 1977, the balance sheets of the Berkshire Hathaway Inc. - Insurance Group as of December 31, 1977 and 1976, and the related consolidated statements of earnings and retained earnings and changes in financial position of Berkshire Hathaway Inc. for the 52 weeks ended December 31, 1977 and January 1, 1977 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, 1977 and 1976. Our examinations were 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 December 31, 1977 and January 1, 1977 was $35,773,558 and $27,304,491, respectively, and its equity in net earnings of Blue Chip Stamps was $5,738,694 and $3,365,946 for the years 1977 and 1976, 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 opinion, based upon our examinations and the report of other auditors, the aforementioned consolidated financial statements present fairly the financial position of Berkshire Hathaway Inc. and consolidated subsidiaries at December 31, 1977 and January 1, 1977 and the Berkshire Hathaway Inc. - Insurance Group at December 31, 1977 and 1976 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 17, 1978

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS	Dec. 31, 1977	Jan. 1, 1977
Cash	$ 4,920,576	$ 3,436,996
Investments, other than affiliates (note 5):		
U. S. Treasury Bills and other short-term obligations, at cost which approximates market	18,635,379	15,489,052
Bonds, at amortized cost	127,324,424	89,215,773
Preferred stocks, at cost	23,231,882	22,286,948
Common stocks of unaffiliated companies, at cost	83,656,835	53,108,266
Total investments, other than affiliates	252,848,520	180,100,039
Investments in affiliates (notes 4 and 6):		
Common stock of Blue Chip Stamps	35,773,558	27,304,491
Unconsolidated bank subsidiary	25,839,229	24,731,779
Other unconsolidated subsidiaries	1,612,102	879,602
Total investments in affiliates	63,224,889	52,915,872
Accounts receivable from customers, agents and others, net (note 7)	31,203,596	23,730,027
Inventories (note 8)	10,008,048	9,301,321
Real estate, equipment, furniture and leasehold improvements, at cost less allowance for depreciation and amortization (note 9)	5,580,507	5,051,699
Deferred insurance premium acquisition costs	9,810,000	6,820,000
Other assets	1,644,746	1,685,315
	$379,240,882	$283,041,269

LIABILITIES AND STOCKHOLDERS' EQUITY

Losses and loss adjustment expenses	$133,591,629	$ 85,152,259
Unearned premiums	52,190,714	36,736,618
8% Senior Notes due 1993 (note 11)	20,000,000	20,000,000
Promissory notes and debentures (note 10)	4,342,647	4,986,586
Notes payable to bank (note 17)	2,000,000	—
Accounts payable, accrued expenses, and other liabilities	17,215,634	12,849,261
Income Taxes:		
Current	1,524,036	3,346,111
Deferred	6,587,819	4,677,301
	237,452,479	167,748,136
Stockholders' equity (note 11):		
Common stock of $5 par value. Authorized 1,100,000 shares; issued 979,569 shares	4,897,845	4,897,845
Retained earnings	137,551,775	110,827,343
	142,449,620	115,725,188
Less common stock in treasury at cost (8,891 shares December 31, 1977; 6,647 shares January 1, 1977)	661,217	432,055
Total stockholders' equity	141,788,403	115,293,133
Commitment and contingent liability (notes 13 and 16)		
	$379,240,882	$283,041,269

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

	Year ended Dec. 31, 1977	Year ended Jan. 1, 1977
Income items:		
Insurance premiums earned	$136,890,470	$ 80,780,074
Net sales of manufactured products	48,189,227	47,173,989
Interest and dividend income	12,548,889	10,820,148
Real estate income	287,927	293,693
	197,916,513	139,067,904
Cost and expense items:		
Insurance losses and loss adjustment expenses	91,585,058	55,376,421
Cost of manufactured products sold	43,736,247	41,573,438
Insurance underwriting expenses	39,121,500	24,694,390
Selling, administrative and other expenses	5,868,864	4,949,424
Interest expense	2,075,158	2,028,106
	182,386,827	128,621,779
Earnings from insurance and manufacturing operations before applicable income taxes	15,529,686	10,446,125
Income tax expense applicable to operating earnings (note 12)	2,914,432	1,488,659
Earnings before equity in net earnings of other companies and realized investment gains	12,615,254	8,957,466
Equity in net earnings of bank subsidiary	3,550,000	3,750,000
Equity in net earnings of Blue Chip Stamps (note 4)	5,738,694	3,365,946
Earnings before realized investment gains	21,903,948	16,073,412
Realized investment gains	6,870,484	9,961,584
Applicable income tax expense	2,050,000	3,200,000
Net realized investment gains	4,820,484	6,761,584
Net unrealized appreciation in market value of preferred and common stocks of unaffiliated companies of $28,528,000 in 1977 and $45,388,000 in 1976 has not been included in the determination of net earnings.		
Net earnings	26,724,432	22,834,996
Retained earnings at beginning of year	110,827,343	87,992,347
Retained earnings at end of year	$137,551,775	$110,827,343
Earnings per share of common stock, based on weighted average outstanding shares:		
Earnings before realized investment gains	$22.54	$16.47
Realized investment gains	4.96	6.93
Net earnings	$27.50	$23.40

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended Dec. 31, 1977	Year ended Jan. 1, 1977
Funds provided:		
From operations:		
Net earnings	$26,724,432	$22,834,996
Charges (credits) to earnings not requiring (providing) funds:		
Equity in undistributed earnings of bank subsidiary	(1,107,450)	(1,307,450)
Equity in undistributed earnings of Blue Chip Stamps	(5,740,739)	(3,255,762)
Accretion of discount on bonds	(890,266)	(1,033,805)
Depreciation and amortization	734,463	618,024
Increase in deferred insurance premium acquisition costs	(2,990,000)	(3,832,608)
Decrease in recoverable income taxes	–	4,400,000
Increase in accounts receivable from customers, agents and others	(5,371,423)	(3,589,461)
Increase in inventories	(706,727)	(892,738)
Increase in unpaid losses and loss adjustment expenses	35,632,125	10,970,214
Increase in unearned premiums	14,192,666	13,992,841
Increase in liability for income taxes	10,130	5,305,080
Other, net	2,968,704	1,570,552
	36,731,483	22,944,887
Funds provided from operations	63,455,915	45,779,883
Dividends received from unconsolidated subsidiaries	50,000	224,000
Proceeds from issuance of debt	2,000,000	1,218,473
Decrease in cash	–	2,885,944
	$65,505,915	$50,108,300
Funds used:		
Net assets of acquired businesses:		
Cash	$ 462,140	$ 278,414
Investments	15,526,994	3,734,736
Accounts receivable	2,102,146	430,461
Inventories	–	272,968
Real estate and equipment	186,346	626,600
Other assets	–	646,822
Loss and loss adjustment expenses	(12,807,245)	(1,148,553)
Unearned premium	(1,261,430)	(399,487)
Other liabilities	(1,516,551)	(177,181)
	2,692,400	4,264,780
Additions to real estate, equipment, furniture and leasehold improvements	1,076,925	1,320,881
Repayment of debt	643,939	340,187
Purchase of treasury stock	229,162	432,055
Cost of net purchase (sale) of investments:		
U. S. Treasury bills	3,146,327	(1,773,574)
Bonds	22,562,607	8,685,226
Preferred stocks	73,718	19,728,673
Common stocks of unaffiliated companies	30,548,569	11,855,553
Common stock of Blue Chip Stamps	2,728,328	5,271,250
Unconsolidated subsidiaries	782,500	(16,731)
Net purchase of investments	59,842,049	43,750,397
Increase in cash	1,021,440	–
	$65,505,915	$50,108,300

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1977 and January 1, 1977

(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.

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

The accounts of the parent Company and its consolidated 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.

(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 $5,268,090 at December 31, 1977 and $4,281,000 at December 31, 1976. 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 $8,532,954 at December 31, 1977 and $8,619,481 at December 31, 1976.

(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 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.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(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

On December 23, 1977, an insurance subsidiary of the Company purchased for approximately $2.7 million cash all of the outstanding capital stock of Cypress Insurance Company, South Pasadena, California. That company is engaged in the underwriting of Workers' Compensation insurance in the state of California. The acquired assets are included in the December 31, 1977 balance sheet of the Insurance Group, which is included in the year-end consolidated balance sheet of the Company. No operations of Cypress are reflected in the statements of earnings. The pro forma effect of this acquisition on 1977 earnings, assuming ownership of Cypress throughout all of the year, while not deemed material, would have been to increase consolidated net earnings by approximately 50¢ per share.

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 acquisition was accounted for as a purchase and results of the operations are included in the 1976 and 1977 consolidated statements of earnings. In a related transaction on the same date, an insurance subsidiary of the Company purchased for approximately $2.2 million 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 and 1977 results of this acquired subsidiary are included in the statements of income of the Insurance Group and the consolidated statements of earnings.

(3) Business Segments

FASB Statement No. 14 requires inclusion of the data in this note as to 1977. Information for earlier years is presented to satisfy certain disclosure requirements of the Securities and Exchange Commission.

Major business segments of the Company are the manufacturing and sale of woven textiles and the underwriting of property and casualty insurance. Products of the textile business are principally sheer curtain fabrics of synthetic materials. To a lesser degree, the Company deals in heavier textile fabrics marketed in part to the home furnishings trade and in part to the womenswear trade, plus fabrics marketed for use as menswear lining materials. The insurance business (a) underwrites automobile and general liability risks (b) provides Workers' Compensation coverages (c) reinsures risks assumed from other insurers and (d) writes multiple line fire and casualty coverages in domiciliary states of its "Homestate" companies.

In the following tables, revenues of the insurance business include investment income of subsidiaries comprising the Insurance Group. Operating profit is total revenue less total expense identified with each segment. In computing operating profit identified with segments, none of the following items has been added or deducted: equity in income from unconsolidated subsidiary and investee, realized investment gains, general corporate expenses and interest expense. Neither depreciation nor capital expenditures are significant to either of the major business segments.

Identifiable assets by industry are those used in the operations in each industry except that the insurance business has a significant investment in Blue Chip Stamps which has been excluded from assets identified with the insurance industry; this exclusion is in line with exclusion from income and operating profit of the insurance industry of income relating to such investment.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

	1977	1976	1975	1974	1973
Sources of Revenue					
Insurance	$149,710	$ 91,617	$ 67,116	$ 68,776	$ 60,526
Textiles	45,498	44,644	32,833	32,592	33,410
Other	2,709	2,807	426	114	69
Total Revenue	$197,917	$139,068	$100,375	$101,482	$ 94,005
Operating Profit					
Identified with segments:					
Insurance	$ 18,166	$ 10,970	$ (2,327)	$ 892	$ 10,249
Textiles	(620)	1,148	1,289	2,660	2,837
Other	593	796	426	114	69
Segments Operating Profit (Loss)	18,139	12,914	(612)	3,666	13,155
Not identified with segments:					
Equity in net earnings of bank subsidiary	3,550	3,750	3,450	4,093	2,782
Equity in net earnings of Blue Chip Stamps	6,169	3,635	2,172	1,164	1,124
Realized investment gains (losses)	6,870	9,962	(2,888)	(1,908)	1,331
General corporate expenses	(534)	(439)	(422)	(723)	(433)
Interest expense	(2,075)	(2,029)	(1,846)	(1,715)	(1,602)
Income (loss) before taxes	$ 32,119	$ 27,793	$ (146)	$ 4,577	$ 16,357
Identifiable Assets at Year End					
Identified with segments:					
Insurance	$291,534	$206,644	$158,657	$157,967	$144,121
Textiles	22,480	20,621	17,821	13,282	14,786
Other	1,852	1,973	—	—	—
	315,866	229,238	176,478	171,249	158,907
Not identified with segments:					
Corporate cash and short-term investments	150	887	5,942	4,437	1,171
Investment in Illinois National Bank & Trust Co.	25,839	24,732	23,424	22,417	21,003
Investment in Blue Chip Stamps	35,774	27,304	18,777	16,924	13,717
Investment in unconsolidated subsidiaries	1,612	880	1,120	1,187	1,334
	63,375	53,803	49,263	44,965	37,225
Total Consolidated Assets	$379,241	$283,041	$225,741	$216,214	$196,132

(4) Blue Chip Stamps

The Company's consolidated investment in Blue Chip Stamps ("Blue Chip") was 25.6% at January 3, 1976, 33.2% at January 1, 1977 and increased to 36.5% at December 31, 1977. The investment is accounted for by the equity method.

At year end 1977 the Company's carrying value of its consolidated holdings of Blue Chip shares amounted to $35,773,558 which is $1,350,639 less than underlying net asset value. Underlying net asset value with respect to Blue Chip shares held by the Insurance Group was $230,343 less than carrying value at December 31, 1977.

Blue Chip Stamps, a California corporation, and its subsidiaries are engaged in five 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 179 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 $15,723,000 for the fiscal year ended December 31, 1977. Over the past six years Blue Chip has reduced the number of redemption stores from a peak of 90 to 42 at present. (3) Blue Chip operates a separate "motivation division" on a nationwide basis, tailoring for businesses programs designed to perform motivational functions. (4) Wesco Financial Corporation, an 80%-owned subsidiary, owns all of the outstanding stock of Mutual Savings and Loan

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

Association which operates at sixteen locations in Southern California. (5) Buffalo Evening News, a 100% owned subsidiary purchased in April 1977, publishes a daily newspaper in Buffalo, New York.

The balance sheets of Blue Chip as of December 31, 1977 and January 1, 1977 are summarized as follows:

BLUE CHIP STAMPS
Consolidated Balance Sheets

Assets	*($000 omitted)* Dec. 31, 1977	Jan. 1, 1977
Cash and short-term investments	$ 16,559	$ 14,162
Marketable securities, at market December 31, 1977 (cost — $55,186); at cost January 1, 1977 (market — $73,240)	53,010	63,143
Inventories	7,332	6,493
Property, fixtures and equipment, net	40,414	8,417
Investment in Wesco Financial Corporation	43,892	38,661
Excess of cost over equity in net assets of consolidated subsidiaries	15,439	15,128
Other assets	23,460	21,133
	$200,106	$167,137
Liabilities and Stockholders' Equity		
Liability for unredeemed trading stamps	$ 66,209	$ 66,867
6¾% subordinated debentures due 1978	2,168	4,287
Note payable to bank	13,500	—
Other liabilities	18,978	9,995
Stockholders' equity	99,251	85,988
	$200,106	$167,137

A footnote accompanying the 1977 financial statements of Blue Chip Stamps stated that Buffalo Evening News, Inc., a subsidiary of Blue Chip, was engaged in certain legal proceedings, with counsel for Blue Chip unable at this time to express any opinion as to the likely outcome of the action. Blue Chip's investment in such subsidiary represented approximately one-third of its total shareholders' equity at December 31, 1977.

Earnings of Blue Chip for the past two years are summarized below:

BLUE CHIP STAMPS
Consolidated Earnings Summaries

	($000 omitted) 52 weeks ended Dec. 31, 1977	53 weeks ended Jan. 1, 1977
Revenues:		
Candy	$ 62,886	$56,333
Newspapers	31,786	—
Stamp service	15,723	17,208
Merchandise promotion and motivation service	2,485	8,888
Other	4,293	5,893
Total revenues	$117,173	$88,322
Earnings before securities gains or losses	$ 12,893	$11,780
Per share	2.49	2.27
Net earnings	16,993	11,703
Per share	3.28	2.26

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

The Company's equity in net earnings of Blue Chip reflects the following for the past two years.

	1977	*1976*
Dividends received	$ 428,311	$ 378,982
Equity in undistributed earnings	5,548,893	3,354,381
Provision for current income taxes	(30,838)	(27,282)
Provision for deferred income taxes	(399,518)	(241,515)
Amortization of difference between cost of investment and underlying net asset values	191,846	(98,620)
	$5,738,694	$3,365,946

(5) 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, 1977 and 1976 is as follows:

	1977		*1976*	
	Cost	Market	Cost	Market
Bonds	$127,324,424	$131,179,864	$89,215,773	$ 90,425,187
Equity securities:				
Preferred stocks	23,231,882	37,070,565	22,286,948	32,732,520
Common stocks	83,656,835	144,001,968	53,108,266	88,318,145
	$106,888,717	$181,072,533	$75,395,214	$121,050,665

At December 31, 1977, with respect to equity securities, gross unrealized gains were $76,962,278 and gross unrealized losses, $2,778,459. Net realized gains of $6,870,484 on the sale of securities were included in the determination of net income for 1977. The cost of securities sold is generally determined on a first-in, first-out basis.

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

	December 31,	
	1977	*1976*
Bonds — at amortized cost	$30,421,453	18,606,648
Common stocks — at cost	5,399,300	7,199,764

(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 13 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 $27,451,331 at December 31, 1977 and $25,611,381 at January 1, 1977 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.

Berkshire Hathaway Inc.

AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(7) Receivables

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

	December 31, 1977	December 31, 1976
Insurance Group:		
Agents' balances and premiums in course of collection	$12,733,598	$ 7,861,366
Investment income due and accrued	2,786,138	2,005,335
Reinsurance recoverable on loss payments	5,837,052	5,221,214
Amounts due from sale of securities	286,641	135,601
	21,643,429	15,223,516
Textile business trade accounts receivable (less allowance for doubtful accounts, 1977 — $492,176; 1976 — $434,785)	9,168,579	8,101,575
Automotive chemicals business trade accounts receivable	391,588	404,936
	$31,203,596	$23,730,027

(8) Inventories

A summary of inventories follows:

	Dec. 31, 1977	*Jan. 1, 1977*
Textile business:		
Raw materials and supplies	$ 1,448,498	$ 1,966,793
Stock in process	2,514,368	2,488,847
Griege and finished cloth	5,802,982	4,520,086
	9,765,848	8,975,726
Automotive chemicals business	242,200	325,595
	$10,008,048	$ 9,301,321

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 $1,976,635 at December 31, 1977 and $1,542,744 at January 1, 1977, respectively.

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

The composition of plant and equipment is shown below:

December 31, 1977	*Properties of manufacturing operations*	*Properties of Insurance Group*	*Total*
Land	$ 251,360	$ 143,247	$ 394,607
Buildings	2,823,580	1,604,709	4,428,289
Machinery and equipment	14,504,402	—	14,504,402
Furniture and fixtures and leasehold improvements	841,891	1,783,980	2,625,871
	18,421,233	3,531,936	21,953,169
Less accumulated depreciation and amortization	15,004,459	1,368,203	16,372,662
	$ 3,416,774	$2,163,733	$ 5,580,507

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

(10) Promissory Notes and Debentures

Promissory notes and debentures payable represent unsecured debt obligations payable at various dates through 1988 at interest rates varying from 6% to 9%. Maturities and debenture sinking fund requirements are as follows:

Year	*Amount*
1978	$ 644,784
1979	597,555
1980	799,896
1981	325,358
1982	330,866
1983-1988	1,644,188
	$4,342,647

(11) 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 5.9% 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 $81,000,000 as of December 31, 1977 are restricted by this provision.

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.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(12) Income Taxes

Income tax expense for 1977 represents current expense of $3,484,270 and deferred expense of $1,910,518 composed of the following:

	U.S. Federal	*Foreign, state and local*	*Total*
Totals:			
Applicable to operating earnings	$2,847,272	$67,160	$2,914,432
Applicable to earnings of Blue Chip Stamps	430,356	–	430,356
Applicable to realized investment gains	2,050,000	–	2,050,000
	$5,327,628	$67,160	$5,394,788
Current expense applicable to:			
Current ordinary income for tax purposes	$1,207,110	$67,160	$1,274,270
Realized investment gains	2,210,000	–	2,210,000
	3,417,110	67,160	3,484,270
Deferred expense (credit) applicable to:			
Change in deferred insurance premium acquisition costs	1,436,000	–	1,436,000
Discount on bonds currently accreted	235,000	–	235,000
Undistributed income of Blue Chip Stamps	399,518	–	399,518
Cumulative accreted discount on bonds sold	(160,000)	–	(160,000)
	1,910,518	–	1,910,518
Total tax expense	$5,327,628	$67,610	$5,394,788

Total net income before taxes was $32,119,220. 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	$15,417,226
Decreases resulting from:	
Tax-exempt interest income	(2,136,000)
100% exclusion relating to equity in earnings of the Illinois National Bank	(1,704,000)
85% dividends received credit:	
On dividends from unaffiliated companies	(2,103,000)
On equity in earnings of Blue Chip Stamps	(2,439,000)
Long-term capital gains rate differential	(1,161,000)
Credit from unconsolidated subsidiary	(227,000)
Other, net	(252,438)
	$ 5,394,788

As of December 31, 1977, unused net operating loss carryovers in acquired subsidiaries exist in the approximate amount of $2,500,000 of which approximately $850,000 expires in 1978. 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.

(12) Income Taxes (continued)

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

(13) "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.

(14) "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.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(15) Transactions with Affiliates

Members of the Insurance Group in 1977 and 1976 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 1977, Mr. Buffett owned more than 50% of the outstanding shares of Diversified. In 1977 and 1976, in connection with reinsurance business, gross premiums of $7,293,705 and $5,777,098, 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 $59,340 in 1977 and $35,334 in 1976. 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.

(16) 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.

(17) Compensating Balance

In accordance with the terms of a $6 million line of credit with a bank, the Company has agreed to maintain an average cash compensating balance of 10% of the line of credit plus 10% of the amount of borrowing under the line that may be outstanding from time to time, based upon the bank's ledger records without adjustment for uncollected funds. The average compensating balances required to be maintained under this agreement were approximately $750,000 in 1977 and $630,000 in 1976. The approximate average amount of short-term debt outstanding during 1977 and 1976, using daily balances, were $1,485,000 and $300,000, respectively. Average interest cost on borrowings under the line in 1977 was 6.86%; in 1976, 6.75%. The maximum amount of short-term debt outstanding at any month-end was $5,000,000 during 1977 and $1,200,000 during 1976. At December 31, 1977, $2,000,000 was outstanding under the line of credit.

Berkshire Hathaway Inc.
INSURANCE GROUP

BALANCE SHEETS

	December 31, 1977	December 31, 1976
ASSETS		
Investments — other than investments in affiliates (note 5):		
Bonds, at amortized cost	$127,324,424	$ 89,215,773
Preferred stock, at cost	23,231,882	22,286,948
Common stock, at cost	83,656,835	53,108,266
U. S. Treasury Bills — at cost which approximates market	18,635,379	14,992,494
Total investments — other than investments in affiliates	252,848,520	179,603,481
Cash	4,532,113	2,592,562
Investment in Blue Chip Stamps (note C)	21,697,062	17,740,283
Accrued investment income	2,786,138	2,005,335
Premiums receivable and agents' balances	12,733,598	7,861,366
Reinsurance recoverable on paid losses	5,837,052	5,221,214
Property and equipment, at cost less accumulated depreciation (note 9)	2,163,733	1,636,275
Deferred premium acquisition costs	9,810,000	6,820,000
Other assets	823,082	903,814
	$313,231,298	$224,384,330
LIABILITIES, CAPITAL STOCK AND SURPLUS		
Losses and loss adjustment expenses	$133,591,629	$ 85,152,259
Unearned premiums	52,190,714	36,736,618
Funds held under reinsurance treaties	5,030,020	3,783,169
Amounts due for purchase of securities	1,338,425	839,495
Current income taxes	909,946	2,560,922
Deferred income taxes	6,276,889	4,536,139
Other liabilities	4,023,714	2,313,187
	203,361,337	135,921,789
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)	81,268,711	59,861,291
Total capital stock and surplus	109,869,961	88,462,541
	$313,231,298	$224,384,330

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

STATEMENTS OF INCOME AND UNASSIGNED SURPLUS

	Year Ended December 31, 1977	1976
Underwriting income:		
Premiums written	$151,083,136	$ 94,772,915
Increase in unearned premiums	(14,192,666)	(13,992,841)
Premiums earned	136,890,470	80,780,074
Losses and claims	76,762,779	44,609,702
Loss adjustment expenses	14,822,279	10,766,719
Underwriting expenses (note E)	39,121,500	24,694,390
	130,706,558	80,070,811
Underwriting gain	6,183,912	709,263
Investment income:		
Interest on bonds	7,376,481	7,412,730
Dividends on stocks of unaffiliated companies	5,155,060	3,130,747
Real estate income	287,927	293,693
	12,819,468	10,837,170
Less investment expenses	537,938	399,355
Net investment income	12,281,530	10,437,815
Other expenses	298,899	177,199
Income before income taxes and items below	18,166,543	10,969,879
Applicable tax expense (note F)	2,713,612	1,134,822
Income before items below	15,452,931	9,835,057
Equity in earnings of Blue Chip Stamps (note C)	3,134,005	1,637,465
Income before realized gain on investments	18,586,936	11,472,522
Realized gain on investments	6,870,484	10,242,849
Applicable income tax expense (note F)	2,050,000	3,200,000
Net realized gain on investments (note G)	4,820,484	7,042,849
Net unrealized appreciation in market values of preferred and common stocks of unaffiliated companies of $28,528,000 in 1977 and $45,388,000 in 1976 has not been included in the determination of net income.		
Net income	23,407,420	18,515,371
Unassigned surplus at beginning of year	59,861,291	42,345,920
Dividends paid to stockholder	(2,000,000)	(1,000,000)
Unassigned surplus at end of year	$ 81,268,711	$ 59,861,291

See accompanying notes to financial statements.

Berkshire Hathaway Inc.

INSURANCE GROUP

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended December 31, 1977	1976
Funds provided:		
From operations:		
Net income	$ 23,407,420	$ 18,515,371
Charges (credits) to income not requiring (providing) funds:		
Equity in undistributed earnings of Blue Chip Stamps	(3,130,476)	(1,561,912)
Accretion of discount on bonds	(890,266)	(1,033,805)
Depreciation	198,179	162,972
Increase in unpaid losses and loss expense	35,632,125	10,970,214
Increase in unearned premiums	14,192,666	13,992,841
Increase in funds held under reinsurance treaties	1,246,851	843,707
Increase in agents' balances and premiums in course of collection	(3,146,300)	(858,928)
Increase in reinsurance recoverable on loss payments	(594,050)	(700,302)
Increase in deferred acquisition costs	(2,990,000)	(3,832,608)
Decrease in recoverable income taxes	—	4,100,000
Increase in liability for income taxes	11,461	4,604,059
Increase in accrued investment income	(577,417)	(356,043)
Other, net	1,002,991	306,919
	40,955,764	26,637,114
Funds provided from operations	$ 64,363,184	$ 45,152,485
Funds used:		
Subsidiary acquired:		
Bonds	$ 14,655,778	$ 735,797
Preferred and common stocks	871,216	1,911,578
U. S. Treasury Bills	—	887,361
Cash	462,140	126,204
Other assets and deferred charges	2,288,492	94,430
Unpaid losses and loss adjustment expenses	(12,807,245)	(1,148,553)
Unearned premiums	(1,261,430)	(399,487)
Other liabilities	(1,516,551)	(32,818)
	2,692,400	2,174,512
Purchase of real estate, furniture and equipment	539,291	273,001
Net purchase of investments	57,654,082	41,239,554
Dividend paid	2,000,000	1,000,000
Increase in cash	1,477,411	465,418
	$ 64,363,184	$ 45,152,485
Net purchase of investments:		
U. S. Treasury Bills	3,642,885	192,290
Bonds	22,562,607	8,685,226
Preferred stocks	73,718	19,728,673
Common stocks of unaffiliated companies	30,548,569	11,855,553
Common stock of Blue Chip Stamps	826,303	777,812
Net cost of investments purchased	$ 57,654,082	$ 41,239,554

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS
December 31, 1977 and 1976

(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, 1977	December 31, 1976
Statutory surplus as regards policyholders	$169,748,004	$123,569,209
Excess of NAIC market valuations over cost valuations of investments in equity securities (excluding stock of Blue Chip Stamps)	(74,183,816)	(45,655,447)
Excess of NAIC market valuations over amortized cost of bonds	(1,943,796)	(281,646)
Excess of carrying value of investment in Blue Chip Stamps (determined under GAAP pursuant to the equity method) over NAIC market valuation	3,667,891	35,072
Deferred insurance premium acquisition costs	9,810,000	6,820,000
Excess statutory liability loss reserves	3,076,480	1,283,560
Net recoverable from unauthorized reinsurers	2,875,379	4,214,238
Sundry nonadmitted assets	2,621,708	2,313,694
Income tax effects and adjustments	(5,801,889)	(3,836,139)
Capital stock and surplus per accompanying financial statements	$109,869,961	$ 88,462,541

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

	1977	1976
Statutory net income	$ 19,252,694	$ 14,293,893
Increase in deferred acquisition costs	2,990,000	3,832,608
Equity in undistributed earnings of Blue Chip Stamps, net of amortization of excess cost	3,130,476	1,561,912
Subsidiary acquisition cost adjustment	—	170,095
Income tax effects and adjustments	(1,965,750)	(1,343,137)
Net income per accompanying financial statements	$ 23,407,420	$ 18,515,371

Continued

Berkshire Hathaway Inc.
INSURANCE GROUP

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 21% of that company's outstanding shares at December 31, 1977, increased from approximately 20% at December 31, 1976. The investment is accounted for by the equity method.

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

	1977	*1976*
Dividends received	$ 251,378	$ 239,966
Equity in undistributed earnings	3,190,980	2,043,575
Provision for current income taxes	(18,099)	(17,276)
Provision for deferred income taxes	(229,750)	(147,137)
Amortization of excess of cost of investment over underlying net asset values	(60,504)	(481,663)
	$3,134,005	$1,637,465

See also notes 1(c) and 4 to consolidated financial statements of Berkshire Hathaway Inc. and consolidated subsidiaries.

(D) Stockholders' Equity

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

(E) Underwriting Expenses

The following expenses comprise underwriting expenses:

	1977	*1976*
Commissions and brokerage	$31,380,265	$20,490,844
Salaries and other compensation	4,284,910	3,325,212
Taxes, licenses and fees	2,911,441	2,011,322
Other underwriting expenses	3,534,884	2,699,620
Total statutory underwriting expenses	42,111,500	28,526,998
Increase in deferred acquisition costs	(2,990,000)	(3,832,608)
	$39,121,500	$24,694,390

(F) Federal Income Taxes

Federal income tax expense is made up of the following:

	1977	*1976*
Totals applicable to:		
Operating earnings	$2,713,612	$1,134,822
Equity in earnings of Blue Chip Stamps	247,849	164,413
Realized investment gains	2,050,000	3,200,000
	$5,011,461	$4,499,235

For 1977, current income tax expense was $3,270,711 and deferred tax expense was $1,740,750. For 1976 current income tax expense was $2,456,098 and deferred income tax expense was $2,043,137. Deferred tax expense (credits) related to:

	1977	*1976*
Change in deferred premium acquisition costs	$1,436,000	$1,836,000
Equity in undistributed earnings of Blue Chip Stamps	229,750	147,137
Bond discount currently accreted, not currently taxed	235,000	300,000
Cumulative accreted discount on bonds sold	(160,000)	(240,000)
Total deferred tax expense	$1,740,750	$2,043,137

Continued

Berkshire Hathaway Inc.

INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS, *Continued*

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

	1977	1976
Income tax expense at statutory rate	$13,641,063	$11,047,000
(Decreases) increases resulting from:		
Tax-exempt interest	(2,136,000)	(2,021,000)
85% dividends received credit relating to:		
Dividends received from unaffiliated companies	(2,103,000)	(1,277,000)
Equity in earnings of Blue Chip Stamps	(1,404,000)	(931,000)
Benefits from affiliates	(1,717,000)	(680,000)
Long-term capital gain rate differential	(1,161,000)	(1,772,000)
Other, net	(108,602)	133,235
	$ 5,011,461	$ 4,499,235

(G) Investment Gains and Losses

A summary of realized and unrealized investment gains for 1977 and 1976 is as follows:

	1977			
	Net realized gains	*Applicable income taxes*	*Net realized gains less income taxes*	*Net unrealized gains*
Bonds	$ 1,556,033	$ 466,810	$ 1,089,223	$ –
Preferred stocks	97,205	29,162	68,043	3,393,000
Common stocks	5,217,246	1,554,028	3,663,218	25,135,000
	$ 6,870,484	$ 2,050,000	$ 4,820,484	$28,528,000
	1976			
Bonds	$ 1,155,664	$ (346,699)	$ 808,965	$ –
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

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, 1977 and 1976 and the related consolidated statements of earnings, changes in stockholders' equity and changes in financial position for the years then ended. Our examinations were 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, 1977 and 1976 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 20, 1978

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

December 31, 1977 and 1976

ASSETS	1977	1976
Cash and due from banks	$ 20,973,276	$ 10,868,111
Investment securities (notes 2 and 9):		
United States Treasury obligations	566,558	30,337,817
United States Government agency obligations	41,553,063	160,792
Obligations of states and political subdivisions	58,696,192	54,002,192
Other securities	6,053,613	6,629,054
Federal Reserve Bank stock	300,000	300,000
Federal funds sold	7,000,000	32,000,000
Loans (note 3)	62,267,886	56,188,346
Bank premises and equipment (note 4)	1,021,747	895,977
Other assets	2,719,924	2,010,227
	$201,152,259	$193,392,516

LIABILITIES AND STOCKHOLDERS' EQUITY	1977	1976
Liabilities:		
Demand deposits	$ 56,978,240	$ 54,874,671
Time deposits	117,890,119	113,461,996
Total deposits (note 5)	174,868,359	168,336,667
Accrued taxes and other liabilities (note 6)	1,716,594	1,628,082
Total liabilities	176,584,953	169,964,749
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	13,266,149	12,124,955
Reserve for contingencies (note 8)	1,301,157	1,302,812
Total stockholders' equity	24,567,306	23,427,767
	$201,152,259	$193,392,516

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, 1977 and 1976

	1977	1976
Operating income:		
Interest and fees on loans	$ 5,479,848	$ 5,092,525
Income on Federal funds sold	287,622	225,353
Interest and dividends on:		
United States Treasury obligations	172,484	1,075,950
United States Government agency obligations	2,098,230	1,415,317
Obligations of states and political subdivisions	3,848,051	3,255,184
Other securities	576,652	501,162
Federal Reserve Bank stock	18,000	18,000
Total interest income	12,480,887	11,583,491
Trust fees	636,939	546,501
Service charges on deposit accounts	116,375	149,217
Other	577,087	635,253
Total operating income	13,811,288	12,914,462
Operating expenses:		
Interest on deposits	6,600,325	5,879,505
Interest on Federal funds purchased	1,981	4,266
Total interest	6,602,306	5,883,771
Salaries and employee benefits (note 7)	2,096,796	2,025,075
Occupancy, net (note 4)	269,442	259,455
Furniture and equipment (note 4)	215,021	233,017
Provision for possible loan losses (note 3)	16,000	12,000
Other	811,709	837,857
Total operating expenses	10,011,274	9,251,175
Earnings before income taxes and securities gains	3,800,014	3,663,287
Income taxes, net (note 6)	429,493	108,068
Earnings before securities gains	3,370,521	3,555,219
Securities gains, net of related taxes of $11,209 in 1977 and $142,437 in 1976 (note 6)	269,018	291,823
Net earnings	$ 3,639,539	$ 3,847,042
Earnings per share:		
Earnings before securities gains	$13.48	$14.22
Securities gains	1.08	1.17
Net earnings	$14.56	$15.39

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

Years ended December 31, 1977 and 1976

	Common stock	*Surplus*	*Undivided profits (note 6)*	*Reserve for contingencies (note 8)*
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
Net earnings	—	—	3,639,539	—
Cash dividends — $10 per share	—	—	(2,500,000)	—
Transfer from reserve for contingencies — loan loss provision	—	—	1,655	(1,655)
Balance, December 31, 1977	$5,000,000	$5,000,000	$13,266,149	$1,301,157

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, 1977 and 1976

	1977	1976
Funds provided:		
From operations:		
Net earnings	$ 3,639,539	$ 3,847,042
Depreciation	96,192	104,377
Provision for loan losses	16,000	12,000
Deferred income taxes	(376,620)	(202,529)
Discount accretion	(169,835)	(132,375)
Other	78,101	109,602
Provided from operations	3,283,377	3,738,117
Increase in deposits	6,531,692	21,357,765
Decrease in:		
Loans	—	1,880,906
Federal funds sold	25,000,000	—
Cash and due from banks	—	7,929,160
Other, net	40,455	900,121
Total funds provided	$34,855,524	$35,806,069
Funds used:		
Increase in earning assets:		
Federal funds sold	—	32,000,000
Investment securities	15,569,736	226,605
Loans	6,095,540	—
Additions to bank premises and equipment, net	221,962	33,728
Cash dividends	2,500,000	2,500,000
Increase in cash and due from banks	10,105,165	—
Decrease in Federal funds purchased	—	1,000,000
Other, net	363,121	45,736
Total funds used	$34,855,524	$35,806,069

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1977 and 1976

(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 1976 accretion was recorded, including the cumulative amounts applicable to securities owned which were acquired in prior years. 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 Possible Loan Losses

The provision for possible 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

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(2) Investment Securities

A summary of investments by major classifications is as follows:

	Dec. 31, 1977 (in thousands) Par value	Book value	Market value	Dec. 31, 1976 (in thousands) Par value	Book value	Market value
U. S. Government:						
Treasury	$ 565	$ 566	$ 557	$30,455	$30,338	$30,343
Agencies	41,550	41,553	41,616	160	161	165
State and political subdivisions	59,301	58,696	61,985	55,104	54,002	56,090
Other	7,345	6,054	6,415	8,259	6,629	7,027
	$108,761	$106,869	$110,573	$93,978	$91,130	$93,625

Investment securities with a par value of $8,001,000 and $7,801,000 at December 31, 1977 and 1976, respectively, were pledged to secure public deposits and for other purposes.

(3) Loans

A summary of the major classifications of loans at December 31, 1977 and 1976 is as follows:

	1977	1976
Real estate loans	$14,935,184	$14,129,616
Loans to financial institutions	—	439,000
Loans for purchasing or carrying securities	5,000	23,000
Commercial and industrial loans	33,837,853	28,797,400
Loans to individuals	12,697,237	12,235,762
All other loans	1,492,694	1,270,616
Total net of unearned discount	62,967,968	56,895,394
Less allowance for possible loan losses	(700,082)	(707,048)
Net loans	$62,267,886	$56,188,346

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

	1977	1976
Balance at beginning of year	$707,048	$707,735
Recoveries on loans previously charged off	9,471	14,360
Provision for loan losses	16,000	12,000
	732,519	734,095
Less loans charged off	32,437	27,047
Balance at end of year	$700,082	$707,048

(4) Bank Premises and Equipment

Bank premises and equipment are recorded at cost less accumulated depreciation of $2,031,918 and $1,945,559 at December 31, 1977 and 1976, respectively. Depreciation expense totaled $96,192 for 1977 and $104,377 for 1976.

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(5) Deposits

A summary of deposits by major classifications at December 31, 1977 and 1976 is as follows:

	1977	*1976*
Demand deposits of individuals, partnerships and corporations	$ 52,720,561	$ 49,105,982
Time and savings deposits of individuals, partnerships and corporations	115,603,809	110,165,314
Deposits of U.S. Government	1,659,050	938,158
Deposits of states and municipalities	2,799,656	4,017,368
Deposits of commercial banks	236,735	284,494
Certified and official checks	1,848,548	3,825,351
Total deposits	$174,868,359	$168,336,667

(6) Income Taxes

Accrued taxes and other liabilities in the accompanying balance sheets include deferred income taxes of $878,657 and $502,037 at December 31, 1977 and 1976, respectively. Such deferred income taxes result primarily 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 benefits to and from the parent have been recorded by the Bank, as shown in the reconciliation which follows.

Taxes applicable to net earnings were as follows:

	1977	*1976*
Tax provision applicable to earnings before securities gains	$ 73,771	$ 270,420
Tax provision applicable to securities gains	140,336	217,021
	214,107	487,441
Add (deduct) tax benefit to (from) parent corporation applicable to:		
Earnings before securities gains	355,722	(162,352)
Securities gains	(129,127)	(74,584)
	226,595	(236,936)
Income taxes	$ 440,702	$ 250,505

The components of consolidated income tax expense are as follows:

	1977	*1976*
Current income taxes:		
Federal	$ (226,595)	$ 631,551
Add (deduct) tax benefit to (from) parent applicable to taxes currently payable	226,595	(236,936)
	—	394,615
State	64,082	58,419
Total current income taxes	64,082	453,034
Deferred income taxes:		
Federal	369,861	(209,725)
State	6,759	7,196
Total deferred income taxes	376,620	(202,529)
Income taxes	$ 440,702	$ 250,505

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

	1977	*1976*
Accrued earnings and expense not reported for income tax purposes until collected or paid, net	$ 374,961	$ (196,519)
Loan loss deductions for tax purposes more (less) than that provided for financial reporting purposes	1,659	(6,010)
	$ 376,620	$ (202,529)

The total income tax expense for 1977 amounted to $440,702, an effective rate of 10.8% ($250,505 and 6.1% in 1976). The reasons for the difference between the effective tax rate and the corporate Federal income tax rate of 48% are as follows:

	1977		*1976*	
	Amount	*Percent of pretax earnings*	*Amount*	*Percent of pretax earnings*
Tax expense at statutory rate	$1,958,516	48.0%	$1,966,823	48.0%
Increase (reduction) in taxes resulting from:				
Tax-exempt interest, net of discount accretion	(1,790,903)	(43.9)	(1,523,483)	(37.2)
State income taxes, net of Federal income tax benefits	36,837	.9	34,120	.8
Tax benefit to (from) parent, net	226,595	5.6	(236,936)	(5.7)
Other – net	9,657	.2	9,981	.2
Actual tax expense	$ 440,702	10.8%	$ 250,505	6.1%

(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, 1976), 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 $213,665 for 1977 and $180,163 for 1976.

(8) Reserve for Contingencies

Included in the reserve for contingencies is the portion of the reserve for bad debts for tax purposes, which exceeds the valuation reserve for financial statement purposes and the applicable deferred income taxes. This amounted to $300,157 and $301,812 for December 31, 1977 and 1976, respectively. The remaining portion of the reserve for contingencies ($1,001,000 for both 1977 and 1976) is not attributable to any specific contingency of the Bank.

(9) Investment Securities Write-down

The regulatory reporting requirements by the Office of the Comptroller of the Currency required the Bank to remove from the bank investment account, the value of the stock conversion privilege on convertible debentures of the Bank's investment holdings during the year 1977. However, the necessary accounting revision of these amounts was

Berkshire Hathaway Inc.

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The Illinois National Bank & Trust Co. of Rockford

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

determined not to be in accordance with generally accepted accounting principles. As a result, the Bank received permission from the Comptroller of the Currency to report to shareholders, totals which do not contain any write-down or revisions, which is in accordance with generally accepted accounting principles. The reports for calendar year 1977 that are submitted to the Comptroller of the Currency comply with the Comptroller's ruling and exclude the conversion privilege value on debentures not sold or matured prior to December 31, 1977.

The reconciliation between the report to the Comptroller and the accompanying financial statements at December 31, 1977 and for the year then ended is as follows:

	Per financial statements	*Per comptroller report*	*Net effect of the security write-down*
Balance Sheet Accounts			
Investments	$106,869,426	$106,237,253	$632,173
Undivided profits	$ 13,266,149	$ 12,633,976	$632,173
Statement of Earnings Accounts			
Operating income:			
Interest and dividends on other securities	$ 576,652	$ 588,816	$ (12,164)
Operating expenses — other	$ 811,709	$ 1,456,046	644,337
Net earnings	$ 3,639,539	$ 3,007,366	$632,173

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 1976 and 1977 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*
1976	1st Quarter	56	38
	2nd Quarter	63	59
	3rd Quarter	73	61
	4th Quarter	95	66
1977	1st Quarter	97	85
	2nd Quarter	100	95
	3rd Quarter	107	100
	4th Quarter	139	107

The Company did not pay a dividend in 1976 or 1977.

BERKSHIRE HATHAWAY INC.

Executive Offices — 97 Cove Street, New Bedford, Massachusetts 02744