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BERKSHIRE HATHAWAY INC.

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1978
ANNUAL REPORT TO THE STOCKHOLDERS

Berkshire Hathaway Inc.
1978 Annual Report to the Stockholders

At December 30, 1978, Diversified Retailing Company, Inc. was merged into Berkshire Hathaway Inc. A result of the merger was a combining of the historic accounts of the two companies as if they had always been one merged company. The information in this 1978 Annual Report accordingly reflects such result.

See the Business Segment Information on pages 35 to 37 for a description of the businesses in which Berkshire Hathaway Inc. and its subsidiaries are engaged.

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PURDUE UNIVERSITY
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Berkshire Hathaway Inc.

To the Shareholders of Berkshire Hathaway Inc.:

First, a few words about accounting. The merger with Diversified Retailing Company, Inc. at yearend adds two new complications in the presentation of our financial results. After the merger, our ownership of Blue Chip Stamps increased to approximately 58% and, therefore, the accounts of that company must be fully consolidated in the Balance Sheet and Statement of Earnings presentation of Berkshire. In previous reports, our share of the net earnings only of Blue Chip had been included as a single item on Berkshire's Statement of Earnings, and there had been a similar one-line inclusion on our Balance Sheet of our share of their net assets.

This full consolidation of sales, expenses, receivables, inventories, debt, etc. produces an aggregation of figures from many diverse businesses — textiles, insurance, candy, newspapers, trading stamps — with dramatically different economic characteristics. In some of these your ownership is 100% but, in those businesses which are owned by Blue Chip but fully consolidated, your ownership as a Berkshire shareholder is only 58%. (Ownership by others of the balance of these businesses is accounted for by the large minority interest item on the liability side of the Balance Sheet.) Such a grouping of Balance Sheet and Earnings items — some wholly owned, some partly owned — tends to obscure economic reality more than illuminate it. In fact, it represents a form of presentation that we never prepare for internal use during the year and which is of no value to us in any management activities.

For that reason, throughout the report we provide much separate financial information and commentary on the various segments of the business to help you evaluate Berkshire's performance and prospects. Much of this segmented information is mandated by SEC disclosure rules and covered in "Management's Discussion" on pages 29 to 34. And in this letter we try to present to you a view of our various operating entities from the same perspective that we view them managerially.

A second complication arising from the merger is that the 1977 figures shown in this report are different from the 1977 figures shown in the report we mailed to you last year. Accounting convention requires that when two entities such as Diversified and Berkshire are merged, all financial data subsequently must be presented as if the companies had been merged at the time they were formed rather than just recently. So the enclosed financial statements, in effect, pretend that in 1977 (and earlier years) the Diversified-Berkshire merger already had taken place, even though the actual merger date was December 30, 1978. This shifting base makes comparative commentary confusing and, from time to time in our narrative report, we will talk of figures and performance for Berkshire shareholders as historically reported to you rather than as restated after the Diversified merger.

With that preamble it can be stated that, with or without restated figures, 1978 was a good year. Operating earnings, exclusive of capital gains, at 19.4% of beginning shareholders' investment were within a fraction of our 1972 record. While we believe it is improper to include capital gains or losses in evaluating the performance of a single year, they are an important component of the longer term record. Because of such gains, Berkshire's long-term growth in equity per share has been greater than would be indicated by compounding the returns from operating earnings that we have reported annually.

For example, over the last three years — generally a bonanza period for the insurance industry, our largest profit producer — Berkshire's per share net worth virtually has doubled, thereby compounding at about 25% annually through a combination of good operating earnings and fairly substantial capital gains. Neither this 25% equity gain from all sources nor the 19.4% equity gain from operating earnings in 1978 is sustainable. The insurance cycle has turned downward in 1979, and it is almost certain that operating earnings measured by return on equity will fall this year. However, operating earnings measured in dollars are likely to increase on the much larger shareholders' equity now employed in the business.

In contrast to this cautious view about near term return from operations, we are optimistic about prospects for long term return from major equity investments held by our insurance companies. We

Frank DeNardo came with us in the spring of 1978 to straighten out National Indemnity's California Worker's Compensation business which, up to that point, had been a disaster. Frank has the experience and intellect needed to correct the major problems of the Los Angeles office. Our volume in this department now is running only about 25% of what it was eighteen months ago, and early indications are that Frank is making good progress.

George Young's reinsurance department continues to produce very large sums for investment relative to premium volume, and thus gives us reasonably satisfactory overall results. However, underwriting results still are not what they should be and can be. It is very easy to fool yourself regarding underwriting results in reinsurance (particularly in casualty lines involving long delays in settlement), and we believe this situation prevails with many of our competitors. Unfortunately, self-delusion in company reserving almost always leads to inadequate industry rate levels. If major factors in the market don't know their true costs, the competitive "fall-out" hits all — even those with adequate cost knowledge. George is quite willing to reduce volume significantly, if needed, to achieve satisfactory underwriting, and we have a great deal of confidence in the long term soundness of this business under his direction.

The homestate operation was disappointing in 1978. Our unsatisfactory underwriting, even though partially explained by an unusual incidence of midwestern storms, is particularly worrisome against the backdrop of very favorable industry results in the conventional lines written by our homestate group. We have confidence in John Ringwalt's ability to correct this situation. The bright spot in the group was the performance of Kansas Fire and Casualty in its first full year of business. Under Floyd Taylor, this subsidiary got off to a truly remarkable start. Of course, it takes at least several years to evaluate underwriting results, but the early signs are encouraging and Floyd's operation achieved the best loss ratio among the homestate companies in 1978.

Although some segments were disappointing, overall our insurance operation had an excellent year. But of course we should expect a good year when the industry is flying high, as in 1978. It is a virtual certainty that in 1979 the combined ratio (see definition on page 31) for the industry will move up at least a few points, perhaps enough to throw the industry as a whole into an underwriting loss position. For example, in the auto lines — by far the most important area for the industry and for us — CPI figures indicate rates overall were only 3% higher in January 1979 than a year ago. But the items that make up loss costs — auto repair and medical care costs — were up over 9%. How different than yearend 1976 when rates had advanced over 22% in the preceding twelve months, but costs were up 8%.

Margins will remain steady only if rates rise as fast as costs. This assuredly will not be the case in 1979, and conditions probably will worsen in 1980. Our present thinking is that our underwriting performance relative to the industry will improve somewhat in 1979, but every other insurance management probably views its relative prospects with similar optimism — someone is going to be disappointed. Even if we do improve relative to others, we may well have a higher combined ratio and lower underwriting profits in 1979 than we achieved last year.

We continue to look for ways to expand our insurance operation. But your reaction to this intent should not be unrestrained joy. Some of our expansion efforts — largely initiated by your Chairman — have been lackluster, others have been expensive failures. We entered the business in 1967 through purchase of the segment which Phil Liesche now manages, and it still remains, by a large margin, the best portion of our insurance business. It is not easy to buy a good insurance business, but our experience has been that it is easier to buy one than create one. However, we will continue to try both approaches, since the rewards for success in this field can be exceptional.

Insurance Investments

We confess considerable optimism regarding our insurance equity investments. Of course, our enthusiasm for stocks is not unconditional. Under some circumstances, common stock investments by insurers make very little sense.

We get excited enough to commit a big percentage of insurance company net worth to equities only when we find (1) businesses we can understand, (2) with favorable long-term prospects, (3) operated by honest and competent people, and (4) priced very attractively. We usually can identify a small number of potential investments meeting requirements (1), (2) and (3), but (4) often prevents action. For example, in 1971 our total common stock position at Berkshire's insurance subsidiaries amounted to only $10.7 million at cost, and $11.7 million at market. There were equities of identifiably excellent companies available — but very few at interesting prices. (An irresistible footnote: in 1971, pension fund managers invested a record 122% of net funds available in equities — at full prices they couldn't buy enough of them. In 1974, after the bottom had fallen out, they committed a then record low of 21% to stocks.)

The past few years have been a different story for us. At the end of 1975 our insurance subsidiaries held common equities with a market value exactly equal to cost of $39.3 million. At the end of 1978 this position had been increased to equities (including a convertible preferred) with a cost of $129.1 million and a market value of $216.5 million. During the intervening three years we also had realized pre-tax gains from common equities of approximately $24.7 million. Therefore, our overall unrealized and realized pre-tax gains in equities for the three year period came to approximately $112 million. During this same interval the Dow-Jones Industrial Average declined from 852 to 805. It was a marvelous period for the value-oriented equity buyer.

We continue to find for our insurance portfolios small portions of really outstanding businesses that are available, through the auction pricing mechanism of security markets, at prices dramatically cheaper than the valuations inferior businesses command on negotiated sales.

This program of acquisition of small fractions of businesses (common stocks) at bargain prices, for which little enthusiasm exists, contrasts sharply with general corporate acquisition activity, for which much enthusiasm exists. It seems quite clear to us that either corporations are making very significant mistakes in purchasing entire businesses at prices prevailing in negotiated transactions and takeover bids, or that we eventually are going to make considerable sums of money buying small portions of such businesses at the greatly discounted valuations prevailing in the stock market. (A second footnote: in 1978 pension managers, a group that logically should maintain the longest of investment perspectives, put only 9% of net available funds into equities — breaking the record low figure set in 1974 and tied in 1977.)

We are not concerned with whether the market quickly revalues upward securities that we believe are selling at bargain prices. In fact, we prefer just the opposite since, in most years, we expect to have funds available to be a net buyer of securities. And consistent attractive purchasing is likely to prove to be of more eventual benefit to us than any selling opportunities provided by a short-term run up in stock prices to levels at which we are unwilling to continue buying.

Our policy is to concentrate holdings. We try to avoid buying a little of this or that when we are only lukewarm about the business or its price. When we are convinced as to attractiveness, we believe in buying worthwhile amounts.

Equity holdings of our insurance companies with a market value of over $8 million on December 31, 1978 were as follows:

No. of Shares	*Company*	*Cost*	*Market*
		(000's omitted)	
246,450	American Broadcasting Companies, Inc.	$ 6,082	$ 8,626
1,294,308	Government Employees Insurance Company Common Stock	4,116	9,060
1,986,953	Government Employees Insurance Company Convertible Preferred	19,417	28,314
592,650	Interpublic Group of Companies, Inc.	4,531	19,039
1,066,934	Kaiser Aluminum and Chemical Corporation	18,085	18,671
453,800	Knight-Ridder Newspapers, Inc.	7,534	10,267
953,750	SAFECO Corporation	23,867	26,467
934,300	The Washington Post Company	10,628	43,445
	Total	$ 94,260	$163,889
	All Other Holdings	39,506	57,040
	Total Equities	$133,766	$220,929

In some cases our indirect interest in earning power is becoming quite substantial. For example, note our holdings of 953,750 shares of SAFECO Corp. SAFECO probably is the best run large property and casualty insurance company in the United States. Their underwriting abilities are simply superb, their loss reserving is conservative, and their investment policies make great sense.

SAFECO is a much better insurance operation than our own (although we believe certain segments of ours are much better than average), is better than one we could develop and, similarly, is far better than any in which we might negotiate purchase of a controlling interest. Yet our purchase of SAFECO was made at substantially under book value. We paid less than 100¢ on the dollar for the best company in the business, when far more than 100¢ on the dollar is being paid for mediocre companies in corporate transactions. And there is no way to start a new operation — with necessarily uncertain prospects — at less than 100¢ on the dollar.

Of course, with a minor interest we do not have the right to direct or even influence management policies of SAFECO. But why should we wish to do this? The record would indicate that they do a better job of managing their operations than we could do ourselves. While there may be less excitement and prestige in sitting back and letting others do the work, we think that is all one loses by accepting a passive participation in excellent management. Because, quite clearly, if one controlled a company run as well as SAFECO, the proper policy also would be to sit back and let management do its job.

Earnings attributable to the shares of SAFECO owned by Berkshire at yearend amounted to $6.1 million during 1978, but only the dividends received (about 18% of earnings) are reflected in our operating earnings. We believe the balance, although not reportable, to be just as real in terms of eventual benefit to us as the amount distributed. In fact, SAFECO's retained earnings (or those of other well-run companies if they have opportunities to employ additional capital advantageously) may well eventually have a value to shareholders greater than 100¢ on the dollar.

We are not at all unhappy when our wholly-owned businesses retain all of their earnings if they can utilize internally those funds at attractive rates. Why should we feel differently about retention of earnings by companies in which we hold small equity interests, but where the record indicates even better prospects for profitable employment of capital? (This proposition cuts the other way, of course, in industries with low capital requirements, or if management has a record of plowing capital into projects of low profitability; then earnings should be paid out or used to repurchase shares — often by far the most attractive option for capital utilization.)

The aggregate level of such retained earnings attributable to our equity interests in fine companies is becoming quite substantial. It does not enter into our reported operating earnings, but we feel it well may have equal long-term significance to our shareholders. Our hope is that conditions continue to prevail in securities markets which allow our insurance companies to buy large amounts of underlying earning power for relatively modest outlays. At some point market conditions undoubtedly will again preclude such bargain buying but, in the meantime, we will try to make the most of opportunities.

Banking

Under Gene Abegg and Pete Jeffrey, the Illinois National Bank and Trust Company in Rockford continues to establish new records. Last year's earnings amounted to approximately 2.1% of average assets, about three times the level averaged by major banks. In our opinion, this extraordinary level of earnings is being achieved while maintaining significantly less asset risk than prevails at most of the larger banks.

We purchased the Illinois National Bank in March 1969. It was a first-class operation then, just as it had been ever since Gene Abegg opened the doors in 1931. Since 1968, consumer time deposits have quadrupled, net income has tripled and trust department income has more than doubled, while costs have been closely controlled.

Our experience has been that the manager of an already high-cost operation frequently is uncommonly resourceful in finding new ways to add to overhead, while the manager of a tightly-run operation usually continues to find additional methods to curtail costs, even when his costs are already well below those of his competitors. No one has demonstrated this latter ability better than Gene Abegg.

We are required to divest our bank by December 31, 1980. The most likely approach is to spin it off to Berkshire shareholders some time in the second half of 1980.

Retailing

Upon merging with Diversified, we acquired 100% ownership of Associated Retail Stores, Inc., a chain of about 75 popular priced women's apparel stores. Associated was launched in Chicago on March 7, 1931 with one store, $3200, and two extraordinary partners, Ben Rosner and Leo Simon. After Mr. Simon's death, the business was offered to Diversified for cash in 1967. Ben was to continue running the business — and run it, he has.

Associated's business has not grown, and it consistently has faced adverse demographic and retailing trends. But Ben's combination of merchandising, real estate and cost-containment skills has produced an outstanding record of profitability, with returns on capital necessarily employed in the business often in the 20% after-tax area.

Ben is now 75 and, like Gene Abegg, 81, at Illinois National and Louie Vincenti, 73, at Wesco, continues daily to bring an almost passionately proprietary attitude to the business. This group of top managers must appear to an outsider to be an overreaction on our part to an OEO bulletin on age discrimination. While unorthodox, these relationships have been exceptionally rewarding, both financially and personally. It is a real pleasure to work with managers who enjoy coming to work each morning and, once there, instinctively and unerringly think like owners. We are associated with some of the very best.

Warren E. Buffett, Chairman

March 26, 1978

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 30, 1978 and December 31, 1977 and the related consolidated statements of earnings, 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. We did not examine the financial statements of Blue Chip Stamps, a consolidated subsidiary, which statements reflect total assets constituting 25 percent and 28 percent and total revenues constituting 32 percent and 32 percent of the consolidated totals for 1978 and 1977, respectively. These statements 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 solely 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 30, 1978 and December 31, 1977 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, after restatement for the merger of Diversified Retailing Company, Inc. and the consolidation of Blue Chip Stamps, with which we concur, as explained in note 1 to the consolidated financial statements.

Peat, Marwick, Mitchell & Co.

March 28, 1979

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(in thousands of dollars)

ASSETS	Dec. 30, 1978	Dec. 31, 1977 (Restated)
Cash (notes 11 and 12)	$ 13,001	$ 13,996
Investments, other than investments in affiliates:		
Bonds, at amortized cost (note 5)	157,651	132,929
Marketable equity securities, at cost (note 5)	196,161	163,294
Invested cash, U.S. Treasury Bills and other short-term investments, at cost which approximates market	61,056	35,730
Total investments, other than affiliates	414,868	331,953
Investments in affiliates:		
The Illinois National Bank & Trust Co. of Rockford (note 6)	27,146	25,839
Wesco Financial Corporation (note 7)	49,370	43,892
Other unconsolidated subsidiaries	1,477	1,627
Total investments in affiliates	77,993	71,358
Accounts receivable from customers, agents and others (note 8)	45,283	38,009
Inventories (note 9)	23,029	23,776
Real estate, equipment, furniture and leasehold improvements, at cost less allowance for depreciation and amortization (note 10)	47,877	47,106
Deferred insurance premium acquisition costs	13,846	10,852
Other assets	34,691	35,093
	$670,588	$572,143

LIABILITIES AND STOCKHOLDERS' EQUITY

Losses and loss adjustment expenses	$180,870	$139,461
Unearned premiums	69,368	57,128
Liability for unredeemed trading stamps	66,832	66,209
Accounts payable, accruals and other liabilities	33,983	35,466
Note payable to bank	—	2,000
Current income taxes	10,768	6,492
Deferred income taxes	9,885	7,793
Term loan payable to bank (note 12)	13,500	13,500
Senior notes payable (note 13)	27,000	27,000
Other notes and debentures payable (note 14)	16,571	14,604
Minority shareholders' interest	48,579	47,926
	477,356	417,579
Stockholders' equity:		
Common stock of $5 par value. Authorized 1,250,000 shares; issued 1,214,286 shares	6,071	6,071
Capital in excess of par value	3,517	3,517
Retained earnings (note 13)	195,515	156,273
	205,103	165,861
Less common stock in treasury, at cost (187,138 shares December 30, 1978; 183,606 shares December 31, 1977)	11,871	11,297
Total stockholders' equity	193,232	154,564
Commitment and contingent liability (notes 6, 17 and 19)		
	$670,588	$572,143

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.

AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS

(in thousands of dollars)

	Year ended Dec. 30, 1978	Year ended Dec. 31, 1977 (Restated)
Income items:		
Insurance premiums earned	$186,073	$143,087
Net sales and operating revenues of manufacturing, merchandising and service operations	235,576	203,752
Interest and dividend income	24,293	16,796
	445,942	363,635
Cost and expense items:		
Insurance losses and loss adjustment expenses	132,263	96,869
Cost of products and services sold	151,521	130,647
Insurance underwriting expenses	50,810	40,417
Selling, general and administrative expenses	71,172	60,698
Interest and financing costs	5,058	4,789
	410,824	333,420
Earnings from consolidated operations including minority interests, before applicable income taxes, equity in earnings of unconsolidated subsidiaries and realized investment gain	35,118	30,215
Income taxes applicable to above (note 16)	10,442	9,487
Earnings from consolidated operations including minority interests, before equity in earnings of unconsolidated subsidiaries and realized investment gain	24,676	20,728
Minority interest in above	2,709	3,489
Earnings before equity in earnings of unconsolidated subsidiaries and realized investment gain	21,967	17,239
Equity of Berkshire Hathaway Inc. in earnings of unconsolidated subsidiaries:		
The Illinois National Bank & Trust Co. of Rockford	4,242	3,550
Wesco Financial Corporation	3,775	2,683
Earnings before realized investment gain	29,984	23,472
Realized investment gain	13,987	13,310
Applicable income taxes	(4,416)	(4,448)
Applicable minority interest	(313)	(1,941)
Realized investment gain, net of income taxes and minority interest	9,258	6,921
Net unrealized appreciation in market value of marketable equity securities amounting to $14,665 in 1978 and $12,964 in 1977 has not been included in the determination of net earnings.		
Net earnings	$ 39,242	$ 30,393
Earnings per share of common stock based on weighted average outstanding shares:		
Earnings before realized investment gain	$ 29.15	$ 22.62
Realized investment gain	9.00	6.67
Net earnings	$ 38.15	$ 29.29

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(in thousands of dollars)

	Common stock	Capital in excess of par value	Retained earnings	Treasury stock	Total
Balance, January 1, 1977 — as previously reported	$4,898	—	$110,827	$(432)	$115,293
Restatement effects of merger with Diversified Retailing Company, Inc.*	1,173	3,517	15,053	(9,389)	10,354
Balance, January 1, 1977 — as restated	6,071	3,517	125,880	(9,821)	125,647
Net earnings for 1977 (Restated)	—	—	30,393	—	30,393
Purchases of treasury stock, 13,758 shares	—	—	—	(1,476)	(1,476)
Balance, December 31, 1977 — as restated	6,071	3,517	156,273	(11,297)	154,564
Net earnings for 1978	—	—	39,242	—	39,242
Purchases of treasury stock, 3,532 shares	—	—	—	(574)	(574)
Balance, December 30, 1978	$6,071	$3,517	$195,515	$(11,871)	$193,232

*Stockholders equity of Diversified at the beginning of 1977	$27,120
Deduct:	
Carrying value to Diversified of common shares of The Company held by Diversified at the beginning of 1977, less deferred taxes considered applicable thereto	(16,761)
Cash paid in merger in lieu of issuance of fractional shares	(5)
Restatement effect on total stockholders equity of merger with Diversified	$10,354

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION
(in thousands of dollars)

	Year ended Dec. 30, 1978	Year ended Dec. 31, 1977 (Restated)
Funds provided:		
From operations:		
Net earnings	$ 39,242	$ 30,393
Minority interest in earnings	6,371	8,255
Earnings including minority interest	45,613	38,648
Charges (credits) to earnings not requiring (providing) funds:		
Equity in undistributed earnings of unconsolidated subsidiaries, net of dividends received	(6,712)	(1,107)
Accretion of discount on bonds	(1,000)	(929)
Depreciation and amortization of property, plant and equipment, including leaseholds	4,602	3,308
Increase in deferred insurance premium acquisition costs	(2,994)	(3,659)
Increase in accounts receivable	(7,274)	(2,654)
Decrease (increase) in inventories	747	(1,319)
Increase in unpaid insurance losses and loss adjustment expenses	41,409	36,875
Increase in unearned insurance premiums	12,240	15,617
Increase in income tax liability	6,368	1,884
Increase (decrease) in liability for unredeemed trading stamps	623	(658)
Increase (decrease) in accounts payable	(1,001)	7,207
Other	(339)	435
	46,669	55,000
Funds provided from operations	92,282	93,648
Proceeds from issuance of debt	4,791	39,000
Decrease in cash	995	—
	$ 98,068	$132,648
Funds used:		
Net assets of acquired businesses:		
Investments	—	15,527
Property, plant and equipment (of Buffalo Evening News)	—	31,900
Other assets	—	10,663
Loss and loss adjustment expenses	—	(12,807)
Other liabilities	—	(7,761)
	—	37,522
Additions to property, plant and equipment, net of disposals	5,450	3,906
Repayment of debt	4,824	23,275
Purchase of treasury stock	574	1,476
Dividends paid to minority stockholders	564	613
Cost of net purchases of investments:		
U.S. Treasury Bills and short-term obligations	25,326	5,016
Bonds	23,722	24,656
Marketable equity securities	32,867	22,630
Common stock of Blue Chip Stamps	4,891	2,728
Unconsolidated subsidiaries	(150)	5,978
Total purchase of investments	86,656	61,008
Increase in cash	—	4,848
	$ 98,068	$132,648

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 30, 1978 and December 31, 1977
(dollars in thousands)

(1) Merger of Diversified Retailing Company, Inc.

At December 30, 1978 Diversified Retailing Company, Inc. ("Diversified") was merged into Berkshire Hathaway Inc. ("The Company") in a transaction accounted for as a combination of companies under common control. Under such accounting, the basis of accountability for the assets and liabilities of the parties to the merger is unchanged from that of the parties prior to the merger. The accompanying financial statements as of December 30, 1978 and for the year then ended give effect to the combination of the accounts of Diversified and The Company, and all prior financial statements have been restated on a comparable, combined basis.

Prior to the merger of The Company and Diversified, each had an ownership interest in Blue Chip Stamps ("Blue Chip"); for which each accounted pursuant to the equity method of accounting. The combination, resulting from the merger, of these interests in Blue Chip caused Blue Chip to become a subsidiary of the combined company, and accordingly, at December 30, 1978 and December 31, 1977 and for the years then ended, the accompanying consolidated financial statements reflect the consolidation of the accounts of Blue Chip and its consolidated subsidiaries. Net earnings determined by consolidation of Blue Chip are unchanged from net earnings determined by using the equity method of accounting for the investment in Blue Chip. Prior to 1977, the combined holdings in Blue Chip by The Company and by Diversified represented less than a majority of Blue Chip's outstanding shares and accordingly, the equity method of accounting remains applicable for periods prior to 1977.

Diversified was a holding company; operations were conducted through wholly-owned subsidiaries, one of which is in the business of retailing of women's and children's apparel and others of which are engaged in the property and casualty insurance business.

Accounts of Diversified and its retailing subsidiary were previously maintained on the basis of a fiscal year ending with respect to January 31, figures for 1978 for those corporations included in the consolidated totals represent operations for the eleven months from February 1, 1978 through December 30, 1978. The effect of conforming their fiscal year to that of Berkshire is not material.

Total income items reflect the following for entities combined and consolidated in the statements of earnings for the past two years:

	1978	*1977*
Revenues of The Company	$254,885	$197,628
Revenues of Diversified	47,471	48,834
Combined	302,356	246,462
Revenues of Blue Chip, consolidated as a result of the merger	143,586	117,173
Total income items, combined and consolidated	$445,942	$363,635

Net earnings for the past two years represent a combination of earnings of The Company and Diversified (including the equity of each in earnings of Blue Chip) as follows:

	1978	*1977*
The Company	$37,033	$26,724
Diversified (excluding equity in earnings of The Company attributable to common shares of The Company owned by Diversified)	2,209	3,669
Net earnings, combined	$39,242	$30,393

There were 970,678 shares of common stock of The Company oustanding during 1978 prior to the merger; the increase resulting from the merger was 56,470 shares; after giving effect to the merger, outstanding shares of The Company were 1,027,148.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

(2) Summary of Significant Accounting Policies and Practices

(a) Basis of Presentation

As indicated in the preceding note, the consolidated accounts of The Company have been combined with the consolidated accounts of Diversified in the accompanying consolidated financial statements and, as a further result of the merger, the accounts of Blue Chip Stamps and its consolidated subsidiaries have also been included. The resulting financial statements thus reflect accounts of companies engaged in a number of businesses, a disaggregation of the operations of these several businesses is accomplished in the business segment information on pages 35 to 37 of this annual report.

The Company's investment in The Illinois National Bank & Trust Co. of Rockford ("Illinois National Bank") and Blue Chip's investment in Wesco Financial Corporation ("Wesco"), a savings and loan holding company, are accounted for by the equity method of accounting.

Subsidiaries which in the aggregate are insignificant have not been consolidated and investments therein are carried at cost less dividends received from such subsidiaries.

Accounts of The Company, its textile manufacturing and sales subsidiaries, a retailing subsidiary, Blue Chip, and its candy business subsidiaries are maintained on the basis of a 52-53 week fiscal year ending with respect to December 31; the accounts of other subsidiaries (including members of 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 aggregate market value.

(c) Insurance Premiums

Insurance premiums are recognized as revenues ratably over the terms 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 $1,311 at December 31, 1978 and $1,672 at December 31, 1977. 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.

(d) 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 $7,137 at December 31, 1978 and $5,199 at December 31, 1977.

(e) Stamp Service Accounting

Blue Chip recognizes stamp service revenues upon issuance of its trading stamps and provides a liability account for unredeemed trading stamps consisting of estimates of the cost of merchandise and related redemption service expenses. Factors affecting the estimated cost of future redemptions are periodically evaluated by management of Blue Chip and, when considered warranted, revisions are made of the total estimated number of stamps expected to be redeemed and the provision for future redemption costs per stamp. The most recent change in these estimates occurred in 1976, no change was made during 1977 or 1978. Currently, the total number of stamps expected to be redeemed is estimated to be approximately 97% of the stamps issued before March 1974 and approximately 93% of those issued thereafter.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

(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, and selected new items acquired by other businesses; 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 are stated at cost, determined for The Company and for Blue Chip's newspaper subsidiary under the last-in, first-out method. Inventories of other members consolidated are stated at the lower of cost or market, with cost determined under the first-in, first-out or average cost methods.

(h) *Income Taxes*

A consolidated Federal income tax return is filed by The Company and its eligible (over 80% owned domestic) subsidiaries. Blue Chip and its eligible subsidiaries file a consolidated tax return. Amounts included in the consolidated balance sheets for Federal income taxes payable or recoverable include the direct or apportioned Federal tax amounts of the companies whose accounts are consolidated. Prepaid and deferred tax accounts are maintained in recognition of timing differences created by accounting for certain income and expense items for financial reporting purposes differently from the accounting for the items for income tax purposes. A provision for deferred taxes is also provided with respect to equity of The Company and its consolidated subsidiaries (other than Blue Chip) in current undistributed earnings of Blue Chip, on the assumption that such earnings will eventually be distributed, taxable as dividend income.

(3) Acquired Businesses

On December 23, 1977, an insurance subsidiary of The Company purchased for approximately $2,700 cash all of the outstanding capital stock of Cypress Insurance Company ("Cypress"), South Pasadena, California. Cypress is engaged in the underwriting of workers' compensation insurance in the state of California. The acquired assets were included in the December 31, 1977 balance sheet of the Insurance Group, which is included in the related consolidated balance sheet of The Company. Operations of Cypress were not reflected in the statement of earnings for 1977. 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 that year. Operations of Cypress are included in the statement of earnings for 1978.

Effective April 15, 1977, Blue Chip acquired the newspaper assets, subject to certain liabilities, of the Buffalo (New York) Evening News ("the News"), for approximately $34,000 in cash plus assumption of certain pension obligations. The acquisition was accounted for by the purchase method, and the cost of net assets acquired exceeded their fair value by $1,080. The results of operations of the News have been included in the accompanying consolidated statements of earnings with those of Blue Chip since the date of acquisition.

Had the newspaper operations been included for the entire 1977 fiscal year, unaudited pro forma consolidated revenues would have increased approximately $10,600 and unaudited pro forma consolidated net income would have been reduced approximately 25¢ per outstanding share. The pro forma figures reflect, among other things, additional Blue Chip financing costs and depreciation, net of applicable income tax benefits, and amortization of the excess of Blue Chip's cost of net assets acquired over underlying value.

(4) Business Segments

Information with respect to business segments appears at pages 35 to 37 of this report and is an integral part of these financial statements.

(dollars in thousands)

(5) Investments in Bonds and Marketable Equity Securities

A summary of the aggregate cost and aggregate approximate market value of investments in bonds and marketable equity securities is as follows:

	Dec. 30, 1978		Dec. 31, 1977	
	Cost	Market	Cost	Market
Bonds	$157,651	$155,541	$132,929	$137,193
Marketable equity securities:				
Preferred stocks	24,080	32,757	23,366	37,225
Common stocks	172,081	250,428	139,928	198,427
	$196,161	$283,185	$163,294	$235,652

The excess of the aggregate market value over aggregate cost of marketable equity securities represented unrealized gains less unrealized losses as follows:

	Dec. 30, 1978	Dec. 31, 1977
Unrealized gains	$91,315	$79,746
Unrealized losses	4,291	7,388
Net excess of market over cost	$87,024	$72,358

In addition to the investments summarized above, at both December 30, 1978 and December 31, 1977, there is included in other assets the $4,163 cost of an investment by Blue Chip in nonvoting stock of Pinkerton Holding Corporation ("PHC") for which there is no trading market. PHC's principal assets are equity securities of Pinkerton's, Inc. ("PI"). Blue Chip's indirect holdings (through PHC), plus its direct holdings in nonvoting stock of PI (included in the above summary) represent a beneficial ownership of approximately 32% of the equity of PI at December 30, 1978. (The Company's economic interest in the equity of PI, reduced by the minority interest in Blue Chip which is outstanding, was approximately 19% at December 30, 1978.) Blue Chip does not account for its investment in PI under the equity method inasmuch as Blue Chip's management considers its influence at PI to be insignificant because it has no vote as a stockholder and only one representative on the eleven-member Board of Directors.

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

	Dec. 30, 1978	Dec. 31, 1977
Bonds, at amortized cost	$46,680	$31,604
Marketable equity securities, at cost	3,494	11,604

(6) Investment in The Illinois National Bank & Trust Co. of Rockford

The investment of The Company in The Illinois National Bank represents approximately 98% of that commercial bank's outstanding stock. The equity method is used in accounting for this investment. Carrying value of the investment at December 30, 1978 exceeds underlying book value by approximately $1,836. The difference is not being amortized since it originated prior to 1970 and is considered by management to have continuing value.

As a result of its ownership of The Illinois National Bank, The Company is a bank holding company under Federal legislation enacted in 1970. The Company has filed with the Federal Reserve Board an irrevocable election to divest of its holdings in The Illinois National Bank prior to January 1, 1981; management presently contemplates that the required divestiture will be accomplished sometime in 1980 by means of a spin-off of either the bank shares or the shares of a company to be formed which will hold the bank shares.

(dollars in thousands)

(7) Investment in Wesco Financial Corporation

Wesco is a savings and loan holding company, approximately 80% owned by Blue Chip at December 30, 1978 and December 31, 1977. The investment in Wesco is stated at Blue Chip's cost plus Blue Chip's equity in Wesco's undistributed earnings since date of acquisition. The unamortized excess of Blue Chip's equity in net assets of Wesco over its carrying value at December 30, 1978 and December 30, 1977 was, respectively, $21,101 and $21,725. This excess is being amortized by Blue Chip over 40 years.

A significant minority interest is outstanding with respect to Blue Chip; the equity of The Company and subsidiaries, other than Blue Chip, in Wesco's earnings after taking into account that minority interest, is significantly less than Blue Chip's equity in Wesco's earnings. To appropriately reflect the amount of consolidated net earnings represented by equity of The Company in Wesco's earnings, the latter is reflected in the accompanying consolidated statements of earnings net of the Blue Chip minority interest therein and less the provision for income taxes of The Company with respect thereto. This is summarized as follows for the past two years:

	1978	1977
Wesco's net earnings	$8,481	$6,449
Blue Chip's equity in Wesco's net earnings	6,793	5,166
Blue Chip amortization of excess of equity over cost	624	549
	7,417	5,715
Blue Chip minority interest	(3,349)	(2,824)
Provision for income taxes	(293)	(208)
Equity of The Company in earnings of Wesco	$3,775	$2,683

Summarized consolidated financial information of Wesco and its subsidiaries for the past two years follows:

ASSETS	Dec. 30, 1978	Dec. 31, 1977
Cash and marketable securities	$143,101	$162,098
Loans receivable, less unearned loan fees, unrealized profit and loans in process	477,597	394,125
Other assets	25,596	24,871
	$646,294	$581,094
LIABILITIES AND STOCKHOLDERS' EQUITY		
Savings deposits	$488,328	$459,908
Other liabilities	70,497	39,777
Total liabilities	558,825	499,685
Stockholders' equity, partially appropriated	87,469	81,409
	$646,294	$581,094
Total revenues	$ 51,019	$ 44,423
Net income	$ 8,481	$ 6,449

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

Wesco's appropriated retained earnings at December 31, 1978 include approximately $50,349 of reserves on which no provision for Federal income taxes has been made. If in the future these appropriations are used for any purpose other than to absorb bad debt losses, Federal income taxes will be imposed at the then applicable rates. The Federal Savings and Loan Insurance Corporation, in connection with the insurance of savings deposits, requires savings and loan associations to maintain certain reserves which may be used only for the purpose of absorbing losses. In addition, associations must maintain certain reserves under California law. Such reserve requirements were met as of December 31, 1978.

(8) Receivables

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

	Dec. 31, 1978	Dec. 31, 1977
Insurance Group:		
Agents' balances and premiums in course of collection	$18,896	$13,042
Investment income due and accrued	4,425	2,891
Reinsurance recoverable on loss payments	5,413	5,837
Amounts due from sales of securities	—	287
	28,734	22,057
Trade accounts receivable of other businesses:		
Textile business	10,109	9,661
Retailing business	541	237
Candy business	1,119	1,065
Newspaper business	4,149	4,027
Trading stamps and motivation businesses	899	1,169
Other	379	391
	17,196	16,550
Less allowance for doubtful accounts	647	598
	16,549	15,952
Total receivables	$45,283	$38,009

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

(9) Inventories

A summary of inventories follows:

	Dec. 30, 1978	Dec. 31, 1977
Textile business:		
Raw materials and supplies	$ 1,292	$ 1,449
Stock in process	3,564	2,514
Greige and finished cloth	4,917	5,803
Retailing business	4,880	6,436
Candy business	4,098	3,650
Newspaper business	617	1,058
Trading stamps and motivation businesses	3,245	2,624
Other	416	242
	$23,029	$23,776

Textile inventories of The Company are determined by the last-in, first-out (LIFO) method, as are the paper and ink inventories of the newspaper business. Other inventories are stated at the lower of cost or market with cost determined by the first-in, first-out method or the average cost method. Replacement cost of inventories determined by the LIFO method exceeded their carrying value by $1,884 at December 30, 1978 and $1,955 at December 31, 1977.

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

The composition of property, plant and equipment is shown below:

	Dec. 30, 1978	Dec. 31, 1977
Land	$ 3,778	$ 3,794
Buildings	16,907	16,071
Machinery and equipment	55,032	52,348
Furniture, fixtures and leasehold improvements	7,073	6,151
	82,790	78,364
Less accumulated depreciation and amortization	34,913	31,258
	$47,877	$47,106

(11) Compensating Balance Arrangements with Banks

The Company has a $6,000 line of credit with a bank for which it has agreed to maintain average balances with the bank of 10% of the line plus 10% of outstanding borrowings under the line. The approximate daily average amount of borrowings under the line in 1978 was $1,910. The average annual interest cost of the borrowings was 8.21%. The maximum short-term borrowings under the line at any month end in 1978 was $3,500, with no outstanding borrowings thereunder at December 30, 1978. In 1977, under the same arrangement, The Company paid 6.86% interest with respect to $1,485 average borrowings, the maximum borrowings at any month-end were $5,000, and $2,000 was outstanding at December 31, 1977.

Blue Chip has a line of credit arrangement with another bank providing for borrowings of up to $5,000 for which it has agreed to maintain compensating balances of $500 plus 10% of any amounts borrowed under the line. Short-term borrowings from this bank by Blue Chip are required to be collateralized by securities with a market value of at least 150% of the amount of the borrowings. Blue Chip's maximum outstanding short-term borrowings were $8,000 in 1978 and $6,000 in 1977, including amounts in addition to the credit line arrangement. Blue Chip's daily average short-term borrowings were $1,432 in 1978 and $2,014 in 1977, at average annual interest rates, respectively, of 10.5% and 6.9%. Blue Chip had no short-term borrowings outstanding at the end of either 1978 or 1977.

In addition to maintaining compensating balances for its short-term borrowings, Blue Chip maintained additional average balances with the same bank equal to at least 10% of its term loan outstanding through April 1978 and 15% thereafter. (See note 12.)

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

(12) Term Loan Payable to Bank

In April 1977 Blue Chip borrowed $30,000 from a bank. As a result of prepayments, the loan has been reduced to $13,500 at December 30, 1978, repayable $3,500 on April 30, 1981, and $5,000 each on April 30, 1982 and 1983. Interest is payable monthly at rates increasing from the present one-quarter percent above prime (which was 12% at December 30, 1978) to one-half percent above prime beginning in May 1980. The loan currently requires compensating balances of 15% of the average outstanding principal amount, increasing to 20% in May 1979. All of Blue Chip's shares of See's and the News are pledged as collateral.

(13) Senior Notes Payable

8% Senior Notes Due 1993

The Company in 1973 issued $20,000 8% Senior notes with final maturity March 1, 1993, the total principal amount of which remained outstanding at December 30, 1978. The notes call for mandatory annual prepayments of $1,143 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 Company may prepay the notes at any time, in full or in part, at a premium declining ratably from the current rate of approximately 5.4% to par in 1992. The 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 Company agreed, among other things, as to both The 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 $157,075 as of December 30, 1978 are restricted by this provision, $38,440 are unrestricted.

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.

9¼% Senior Notes Due 1993

In December 1977, Associated borrowed $7,000 from institutional investors, evidenced by its 9¼% collateralized promissory notes in that aggregate principal amount. This debt was originally guaranteed by Diversified; as part of the merger of The Company and Diversified, The Company issued its substitute notes in exchange for the Associated obligations and release by the obligees of the collateral; the substitute notes, bearing 9¼% interest, became senior note obligations of The Company, ranking *parri passu* with the 8% Senior notes discussed above. Interest on these notes is payable March 1st and September 1st; principal payments of $777 annually are required commencing March 1, 1985; final maturity is March 1, 1993. An event of default under The Company's 8% Senior notes is considered an event of default under these notes.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

(14) Other Notes and Debentures Payable

This caption is comprised of the following obligations:

	Dec. 30, 1978	Dec. 31, 1977
Obligations of The Company:		
8% debentures due 1985, issued by Diversified in 1967, with fixed interest payable semiannually on May 1st and November 1st. Additional participating interest (1% maximum) is payable annually on November 1st contingent upon adjusted consolidated earnings, as defined, for the previous fiscal year. (Participating additional interest of $66 was paid November 1, 1978 with respect to 1977 and is payable November 1, 1979 with respect to 1978)	$ 6,600	$ 6,600
7½% debentures issued 1967, interest payable semiannually on February 1st and August 1st redeemable through 1986 through the operation of a sinking fund, final payment due August 1, 1987	384	421
Various notes bearing interest at 8% or 9%, as stated in the obligations, payable in installments or at fixed maturity dates through 1992	4,295	4,640
	11,279	11,661
Obligations of wholly-owned subsidiary of The Company:		
Notes issued 1973, annual principal payment of $70 required through May 1, 1983. 6% interest payable annually after April 30, 1978, 5% prior thereto. This obligation is guaranteed by The Company.	350	420
8% note issued 1975 due April 30, 1980, contingently due earlier. This obligation is guaranteed by The Company.	195	195
6% note matured August 1, 1978	—	160
Obligations of Blue Chip:		
6¾% debentures matured December 1, 1978	—	2,168
Obligation of See's:		
9⅝% mortgage note payable in monthly installments of $41, including interest; final payment December 1, 2006. Secured by mortgage of obligor's manufacturing and warehousing facilities.	4,747	—
	$16,571	$14,604

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

(15) Debt Maturities

Future principal payments on debt, including sinking fund requirements, with respect to notes and debentures outstanding at December 30, 1978 are required as follows:

	Term loan payable to bank	*Senior notes*	*Other notes and debentures*	*Total debt maturities*
1979	$ —	$ 1,143	$ 645	$ 1,788
1980	—	1,143	851	1,994
1981	3,500	1,143	684	5,327
1982	5,000	1,143	1,032	7,175
1983	5,000	1,143	391	6,534
Thereafter	—	21,285	12,968	34,253
	$13,500	$27,000	$16,571	$57,071

(dollars in thousands)

(16) Income Taxes

Income tax expense of The Company and its consolidated subsidiaries for 1978 represents current expense of $13,270 plus deferred expense of $2,093, less an increase of $212 in the amount of Federal income taxes considered by Blue Chip to be prepaid.

	U.S. Federal	*Foreign, state and local*	*Total*
The total represents the following:			
Applicable to:			
Operating earnings	$ 8,762	$1,680	$10,442
Equity of The Company in earnings of Wesco	293	—	293
Realized investment gain	4,363	53	4,416
Total income tax expense	$13,418	$1,733	$15,151
Current expense is applicable to:			
Current ordinary income for tax purposes	7,015	1,680	8,695
Realized investment gain	4,522	53	4,575
	11,537	1,733	13,270
Deferred expense is applicable to:			
Increase in deferred insurance premium acquisition costs	1,437	—	1,437
Discount on bonds currently accreted	266	—	266
Cumulative accreted discount on bonds sold	(159)	—	(159)
Equity of The Company in earnings of Wesco	293	—	293
Undistributed earnings of Blue Chip less amount deemed to represent earnings of Wesco	229	—	229
Other timing differences	27	—	27
	2,093	—	2,093
The decrease (increase) in prepaid income taxes of Blue Chip relate to timing differences with respect to:			
Stamp redemption expense	(712)	—	(712)
State income taxes and other	500	—	500
	(212)	—	(212)
Total income tax expense	$13,418	$1,733	$15,151

(dollars in thousands)

Total 1978 net income, including interest of minority therein, before income taxes was $60,764. A reconciliation of income tax expense at the statutory Federal tax rate of 48% applied to total income follows:

Tax expense, at 48% statutory rate	$29,167
Decreases resulting from:	
Tax-exempt interest income	(2,652)
100% exclusion relating to equity in earnings of:	
The Illinois National Bank	(2,036)
Wesco	(3,561)
85% dividends received credit	(4,829)
Long-term capital gain rate differential	(2,433)
Increases resulting from:	
State income taxes, less Federal income tax benefit	911
Provision by The Company and consolidated subsidiaries (other than Blue Chip) for income taxes with respect to their equity in earnings of Blue Chip	571
Other	13
	$15,151

Income tax expense of The Company and its consolidated subsidiaries for 1977 represents current expense of $12,121 plus deferred expense of $2,417, less an increase of $395 in the amount of Federal income taxes considered by Blue Chip to be prepaid.

	U.S. Federal	*Foreign, state and local*	*Total*
The total represents the following:			
Applicable to:			
Operating earnings	$ 7,827	$1,660	$ 9,487
Equity of The Company in earnings of Wesco	208	—	208
Realized investment gain	4,153	295	4,448
Total income tax expense	$12,188	$1,955	$14,143
Current expense is applicable to:			
Current ordinary income for tax purposes	5,853	1,660	7,513
Realized investment gain	4,313	295	4,608
	10,166	1,955	12,121
Deferred expense is applicable to:			
Change in deferred insurance premium acquisition costs	1,758	—	1,758
Discount on bonds currently accreted	235	—	235
Cumulative accreted discount on bonds sold	(160)	—	(160)
Equity of The Company in earnings of Wesco	208	—	208
Undistributed earnings of Blue Chip less amount deemed to represent earnings of Wesco	376	—	376
	2,417	—	2,417
The decrease (increase) in prepaid income taxes of Blue Chip relate to timing differences with respect to:			
Stamp redemption expense	(324)	—	(324)
State income taxes and other	(71)	—	(71)
	(395)	—	(395)
Total income tax expense	$12,188	$1,955	$14,143

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

Total 1977 net income, including interest of minority therein, before income taxes was $52,790. A reconciliation of income tax expense at the Federal statutory rate of 48% to the total income taxes as shown above follows:

Tax expense, at 48% statutory rate	$25,339
Decreases resulting from:	
Tax-exempt interest income	(2,266)
100% exclusion relating to equity in earnings of:	
The Illinois National Bank	(1,704)
Wesco	(2,743)
85% dividends received exclusion	(3,447)
Long-term capital gain rate differential	(2,353)
Credit from unconsolidated subsidiary	(227)
Other	(69)
Additions resulting from:	
State income taxes, less Federal income tax benefit	984
Provision by The Company and consolidated subsidiaries (other than Blue Chip) for income taxes with respect to their equity in earnings of Blue Chip	629
	$14,143

(17) Lease Commitments

The Company's retailing subsidiary (Associated) and Blue Chip and its subsidiaries had significant lease commitments outstanding at December 30, 1978, the minimum rentals under which were as follows at December 30, 1978:

Year	*Associated*	*Blue Chip*	*Total*
1979	$ 1,664	$ 2,555	$ 4,219
1980	1,576	2,056	3,632
1981	1,519	1,584	3,103
1982	1,195	1,356	2,551
1983	980	1,269	2,249
Thereafter	3,657	4,557	8,214
	$10,591	$13,377	$23,968

Leases of The Company and its consolidated subsidiaries in effect at December 30, 1978 are classified as operating leases; there were no capital lease commitments pertaining to real property; any such commitments with respect to equipment leases entered into are considered immaterial. Total rental expense charged to consolidated net earnings was $7,486 for 1978 and $7,136 for 1977, including contingent real estate rentals in excess of stated minimum amounting to $2,157 for 1978 and $2,040 for 1977.

(18) Pension Plans

Employees of The Company and its consolidated subsidiaries who meet certain eligibility requirements are covered under either employer-sponsored or union-sponsored pension, profit-sharing or savings plans. Total pension expense charged to consolidated earnings was $2,587 for 1978 and $2,135 for 1977, which includes, as to certain of the plans, amortization of prior service costs over a 30-year period. The Company and its subsidiaries generally fund pension costs accrued. Based on the most recent actuarial valuations, the market value of the assets of certain employer-sponsored pension plans was $1,900 less than the actuarially computed value of vested benefits under those plans; however, the aggregate market value of the assets of all employer-sponsored plans, plus amounts accrued for contributions thereto, exceeded the aggregate of vested benefits at the valuation dates by approximately $2,300. Unamortized past service costs with respect to certain of the plans approximated $6,250.

(19) Litigation

On October 28, 1977, the Buffalo Courier-Express, Inc. a principal competitor of the Buffalo Evening News (published by Blue Chip's subsidiary, Buffalo Evening News, Inc.) in the Buffalo metropolitan area, filed an action against such subsidiary in the United States District Court under Federal antitrust laws seeking to enjoin certain practices allegedly engaged in by the News in connection with the proposed initiation of a Sunday edition in place of its Saturday weekend edition and publication of Saturday and holiday editions, thus providing competition for the existing Sunday edition of the Courier-Express. In addition to seeking an injunction, the complaint seeks treble damages in an unspecified amount, attorneys' fees and costs. On November 9, 1977, the District Court issued a preliminary order granting in part and denying in part a motion for preliminary injunction. Among other things, the order required the News to maintain its proposed subscription pricing structure, to shorten a proposed promotional subscription pricing plan, to withdraw certain circulation guarantees and to limit free sampling. The order is subject to modification as circumstances may warrant pending trial, and is not final on any of the issues raised in the litigation. A motion by the plaintiff (1) to have defendant held in contempt for alleged violations of the preliminary injunction and (2) for modification of the preliminary injunction to impose further restrictions was denied by the District Court except for one finding that a News advertising salesman made a prediction to two advertisers regarding future circulation without full basis as required by the preliminary injunction; the issue of damages, if any, attributable to this alleged action by an advertising salesman, was deferred. The News also made a motion to modify the preliminary injunction to reduce restrictions, which was likewise denied. The News is appealing the granting of the preliminary injunction, the denial of its motion for modification thereof, and the one contempt holding, to the Court of Appeals for the Second Circuit. Additional motions filed by the plaintiff are pending in the trial court alleging that the News is in contempt of various aspects of the injunction. No hearing dates have been set with respect to these motions. In the main action in the trial court, the defendant has filed an answer and counterclaim denying all liability and seeking affirmative relief of treble damages in an unspecified amount, injunction, attorneys' fees and costs against plaintiff on the ground, among others, that plaintiff seeks to monopolize the Sunday newspaper business in the Buffalo metropolitan area in violation of the Federal antitrust laws. If the plaintiff is successful in obtaining the kind of permanent injunctions it is seeking, the News probably will be forced to cease operations and liquidate; however, with discovery incomplete, the outcome of the action and defendant's potential exposure, if any, are uncertain.

It is the opinion of management of Berkshire Hathaway Inc. that the ultimate outcome of this litigation will not have a materially adverse effect on the consolidated financial position of Berkshire Hathaway Inc., notwithstanding its potentially severe impact upon the News.

Berkshire Hathaway Inc.

SUMMARY OF OPERATIONS FOR THE PAST 5 YEARS

The following Consolidated Summary of Operations of the Company and its consolidated subsidiaries for the 5 years ended December 30, 1978 should be read in conjunction with the consolidated financial statements of the Company and the related notes thereto included elsewhere in this Report. See Note (A) to this Summary for information as to the bases for presentation used in its preparation.

	1974	*1975*	*1976*	*1977*	*1978*
	(in thousands of dollars except share amounts)				
Insurance premiums written	$64,172	$61,688	$101,111	$158,704	$198,313
Sales of textile mill products	32,592	32,833	44,644	45,498	52,674
Retail sales of apparel	33,977	35,082	38,892	41,686	40,719
Candy sales	—	—	—	62,886	73,653
Newspaper revenues	—	—	—	31,786	44,674
Trading stamps and motivation service revenues	—	—	—	18,208	20,322
Interest and dividend income	8,444	9,363	11,340	16,796	24,293
Insurance underwriting gain (loss)	$ (7,362)	$(11,350)	$ 248	$ 5,801	$ 3,001
Gross profit from sales of goods and services	18,259	18,477	20,910	73,105	84,055
Interest expense	2,395	2,559	3,055	4,789	5,058
Income taxes (credit) applicable to operations	(1,703)	(3,652)	2,071	9,486	10,442
Earnings from insurance, manufacturing, merchandising and service operations (including earnings applicable to minority interest)	$ 3,641	$ 1,765	$ 9,686	$ 20,729	$ 24,676
Equity in net earnings of:					
Blue Chip Stamps	1,911	2,923	4,700	—	—
Illinois National Bank	4,093	3,450	3,750	3,550	4,242
Wesco Financial Corporation	—	—	—	5,507	7,124
Realized investment gain (loss) net of income taxes	(1,550)	(2,017)	6,830	8,862	9,571
Minority shareholders' interest in earnings	—	—	—	8,255	6,371
Net earnings	8,163	6,121	24,966	30,393	39,242
Average shares outstanding	1,169,988	1,150,521	1,069,899	1,037,705	1,028,684
Net earnings per share	$6.98	$5.32	$23.33	$29.29	$38.15

See notes to Summary of Operations on the following page.

Berkshire Hathaway Inc.

NOTES TO SUMMARY OF OPERATIONS

(A) The merger of Diversified into The Company effective December 30, 1978 required a restatement of The Company's previously reported financial information for the years 1974 through 1977 so as to include the results of Diversified's operations for those years. The Company's and Diversified's operations for The Company's year ended December 30, 1978 have also been combined. The merger also required consolidation of the results of Blue Chip's operations for 1977 and 1978; for periods prior to 1977 The Company's interest in the earnings of Blue Chip Stamps is reported on the equity method. These changes in the bases of presentation substantially affect the comparability of the financial information presented in the Summary with that previously reported by The Company. The comparability of the information presented for 1977 and 1978 (which reflect consolidation of Blue Chip's accounts) with that for prior periods (which reflect Blue Chip's results on a one-line equity basis) is also affected by this different basis of presentation.

(B) Average outstanding shares were calculated as follows:

	*Average Outstanding Shares of The Company**	*Equivalent Additional Outstanding Shares***	*Average Outstanding Shares Reported Above*
1974	979,569	190,419	1,169,988
1975	979,569	170,952	1,150,521
1976	975,693	94,206	1,069,899
1977	971,600	66,105	1,037,705
1978	970,678	58,006	1,028,684

*1974-1977 as previously reported. The 1978 figure represents 979,569 shares issued less 8,891 shares in Treasury during the entire year.

**Equivalent additional outstanding shares give effect to the merger of Diversified. In connection with the merger, Berkshire issued 3/10 of a share of its common stock in exchange for each outstanding Diversified share, with cash paid in lieu of fractions. Also in the merger, the Company received shares of Berkshire stock held by Diversified and succeeded to ownership of subsidiaries of Diversified which also held Berkshire shares. Such Berkshire shares were previously outstanding shares of the Company, but are accounted for in the merger, retroactively, as treasury shares. Equivalent additional outstanding shares reflected in the above table are equal to .30 times average Diversified shares outstanding in the computation periods less average Berkshire shares owned in such periods by Diversified and its subsidiaries, and less the approximately 30 equivalent Berkshire shares not issued as a result of fractions; as follows:

	Average Diversified Shares Outstanding		*Average Berkshire Shares Owned By Diversified and Its Subsidiaries*	*Fractional Share Equivalents Not Issued*	*Equivalent Additional Outstanding Shares*
	Total	*30% Thereof*			
1974	1,000,000	300,000	109,551	30	190,419
1975	1,000,000	300,000	129,018	30	170,952
1976	833,118	249,935	155,699	30	94,206
1977	782,490	234,747	168,612	30	66,105
1978	782,490	234,747	176,711	30	58,006

Berkshire Hathaway Inc.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

Insurance Premiums Written

Insurance premiums were written by subsegments[1] of Berkshire property/casualty insurance business as follows:

	($000)		
	1976	1977	1978
Specialized auto and general liability	$ 58,337	$ 87,146	$102,094
Workers' compensation	6,698	19,664	30,214
Reinsurance	21,449	28,676	31,266
Multiple lines underwritten by "Home State" Companies	14,627	23,218	34,739
	$101,111	$158,704	$198,313

[1]See business segment information for definition and narrative discussion of these subsegments.

The traditional specialized automobile and general liability business of National Indemnity and National Fire has always tended to be highly cyclical. These operations have reflected significant volume increases following years which have been unprofitable for the industry. (A greater proportion of risks are considered by underwriters to be "specialized" or "nonstandard" following bad years.) This phase of the cycle recurred in 1976 and 1977 and continued in the first half of 1978, after the horrendous results suffered by the industry in 1974 and 1975. In the last six months of 1978, National Indemnity's and National Fire's premium volume in this business increased only nominally over that for the last six months of 1977; volume from their traditional specialized business is expected to decline in 1979.

Workers' compensation insurance was a relatively insignificant element of Berkshire's insurance business prior to 1976. In that year, a branch office of National Indemnity in Los Angeles began aggressively marketing this coverage, and its premium volume in 1977 was significant. These writings were at inadequate rates and in 1978 the writings by this office were reduced. Net premiums written by Cypress Insurance Company, acquired at the end of 1977, were approximately $14 million in 1978. The addition to the group of this historically successful workers' compensation underwriting organization more than accounts for the increase in this category of premium volume in 1978 compared to 1977.

The increased premium volume of the Reinsurance operation for 1977 compared to 1976 reflects a combination of necessary increased rates plus an increased volume of insured risks. The increase for 1978 over 1977 of approximately 9% essentially reflects premium rate adjustments.

The Home State companies continued to increase their market penetration in each of the states in which they are domiciled. A new Kansas operation was formed in late 1977, its production in 1977 was virtually nil; for 1978 this operation had approximately $3 million of written premiums. An operation was commenced in Colorado in late 1978; as with the Kansas operation for 1977, however, its contribution to 1978 volume was negligible.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES
MANAGEMENT'S DISCUSSION, *Continued*

Sales of Textile Mill Products

Sales from Berkshire's and Waumbec's textile operations were as follows for the past three years.

	($000)		
	1976	1977	1978
Berkshire textile operations	$30,887	$35,554	$39,809
Waumbec textile operations	13,757	9,944	12,865
	$44,644	$45,498	$52,674

1977 compared to 1976: Berkshire's unit sales and dollar sales increased about 15% over 1976. Goods manufactured by others were purchased and resold by Berkshire in 1977 in higher quantity than in 1976, accounting for the higher unit sales in 1977.

Waumbec's 1977 sales both in quantity and price were significantly depressed in 1977; demand for goods was well below levels necessary to maintain reasonable production schedules.

1978 compared to 1977: Sales reflected in the above table reflect sales to outsiders, intercompany sales are excluded. Berkshire's sales in 1978, as reflected in the table, include an increased quantity of goods produced at Waumbec's mill and sold through the Berkshire marketing organization; they also reflect improved prices over 1977.

Waumbec's 1978 sales to outsiders, as reflected in the table, were substantially higher than in 1977, reflecting both an improved order rate and a price recovery from the depressed 1977 levels.

Retail Sales of Apparel

This item represents net sales by Associated. Additional stores opened in late 1976 and in 1977 contributed the most significant portion of the increased sales in 1977 over those for 1976.

Candy Sales

This item represents sales of See's, a subsidiary of Blue Chip Stamps, and appears first in 1977 in Berkshire's Summary of Operations because that was the first year for which Blue Chip's operations were consolidated. Candy sales increased in 1978 over those in 1977 due about 60% to an increase in average selling price per pound; improved volume accounted for the remainder.

Newspaper Revenues

This item represents revenues of the Buffalo Evening News, Inc. a subsidiary of Blue Chip Stamps since April 1977, and revenues reflected for 1977 represent those for only that part of the year subsequent of its acquisition. Full year 1978 revenues increased over those for the part-year 1977; 1978 revenues were, however, adversely affected as a result of a lawsuit filed against the newpaper by a competitor in late 1977 and by the publicity attendant thereto. See Note 19 of Notes to Consolidated Financial Statements.

Trading Stamps and Motivation Service Revenues

These are income items of Blue Chip. 1978 revenues increased over those of 1977 primarily because an exceptionally large short-term motivation division program for a financial institution benefitted 1978 revenues.

Interest and Dividend Income

Interest and dividend income reflected in the Summary of Operations is as follows for the past three years:

	($000) 1976	1977	1978
Interest and dividend income of Insurance Group:			
Subsidiaries of Berkshire	$10,543	$12,532	$19,208
Subsidiaries of Diversified	432	529	736
	10,975	13,061	19,944
Interest income of Berkshire, Diversified and their non-insurance subsidiaries other than Blue Chip	365	99	247
	11,340	13,160	20,191
Interest and dividend income of Blue Chip Stamps, included in consolidation	—	3,636	4,102
Total interest and dividend income	$11,340	$16,796	$24,293

Invested assets of the Insurance Group have increased significantly in the past two years as a result of their increased volume. In addition, income yield on those investments increased in 1978. Blue Chip's investment income increased in 1978 mainly from an increase in yield on their marketable equity securities.

Insurance Underwriting Gain or Loss

Insurance underwriting results are most commonly measured by the "combined ratio" which 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 Written	Earned	RATIOS Losses and Loss Adj. Exp./Earned Premiums	Underwriting Expenses/ Written Premiums	Combined Loss and Expense Ratio
	(in thousands of dollars)				
1976	$101,111	$ 84,875	69.07	29.70	98.77
1977	158,704	143,088	67.70	27.77	95.47
1978	198,313	186,073	71.08	27.13	98.21

Insurance underwriting gain (loss) stated in dollars on the basis of generally accepted accounting principles has resulted as follows for the Insurance Group for the periods indicated below.

	($000) 1976	1977	1978
Specialized auto and general liability	$ 4,768	$ 7,800	$11,543
Workers' compensation	(1,093)	(1,644)	(3,944)
Reinsurance	(2,879)	(1,251)	(2,443)
Home State companies	(548)	896	(2,155)
	$ 248	$ 5,801	$ 3,001

The combined ratio for the specialized auto and general liability business of National Indemnity and National Fire, plus that of Home and Auto, has improved in each of the past two years over the preceding year, and on increased volume. That combination cannot continue indefinitely. We expect the volume of this business to decline in 1979; the combined ratio for this business in 1978 was approximately 88, it is highly unlikely that such a low ratio can be sustained for any extended period.

The combined ratio for the workers' compensation business (which excludes business in that line written by the Home State Companies) in 1978 was 113.6, but that figure reflects favorable results of Cypress Insurance Company, which was not a member of the Insurance Group prior to 1978. Without Cypress, the workers' compensation line would have reflected a combined ratio of a highly unfavorable 130.6 for 1978 compared to 108 for 1977 and 116 for 1976. Reference was made above, with regard to insurance premiums written, to the aggressive marketing from a Los Angeles branch of National Indemnity of workers' compensation in California in 1976 and 1977, and to the fact that the rates at which this business was written were inadequate. Management of the branch has been changed and premium writings by this branch have been significantly reduced, with a view to reduction of total dollars of workers' compensation losses and to an improvement in the combined ratio for this line.

Reinsurance underwriting results in 1978 were impacted adversely by one significant loss recorded in the fourth quarter of the year. The reinsurance division generally covers a limited number of risks with fairly high per-risk exposure, so a single large loss cannot be classified as unusual for this business.

The Home State results in 1978 were affected adversely by an unusual number of spring and summer storms in the midwest.

Gross Profit From Sales of Goods and Services

These figures in the Summary of Operations represent gross profit from operations shown in the following table for the past three years:

	($000)		
	1976	1977	1978
Berkshire-Waumbec textiles	$ 4,162	$ 2,903	$ 6,609
Associated Retail Stores	15,310	16,367	16,810
Other Berkshire/Diversified	1,438	1,890	1,495
Berkshire/Diversified, combined	20,910	21,160	24,914
Blue Chip and its subsidiaries	—	51,945	59,141
Total	$20,910	$73,105	$84,055

Fifteen percent higher 1978 textile sales, compared to 1977, resulted in increased dollars of gross profit from those increased sales; more importantly, the higher levels of production increased gross profit by reducing unit product costs from unsatisfactory 1977 levels, particularly at the Waumbec operation. Price improvement and improvement in product mix also contributed to higher gross profits in the textile business for 1978 as compared to 1977. Price deterioration, combined with inadequate plant utilization in 1977 contributed to the decline in textile gross profits in 1977 from the 1976 level.

Blue Chip's consolidated product and service sales increased about 23% in 1978 over 1977, their gross profit dollars increased a lesser 14%. Cost of sales and services during 1978 increased as a percentage of related revenues from the percentage in 1977 due mainly to escalating costs in the newspaper and candy business.

Interest Expense

This caption represents interest expense, plus amortization of debt discount and expense, for the entities combined and consolidated for the past three years as follows:

	1976	1977	1978
	($000)		
Berkshire companies	$2,028	$2,075	$2,081
Diversified companies	1,027	1,174	1,298
Combined total	3,055	3,249	3,379
Blue Chip companies	—	1,540	1,679
Combined and consolidated totals	$3,055	$4,789	$5,058

Although not shown above, interest and discount amortization of Blue Chip and its subsidiaries in 1976 was $594,000. This increased in 1977 as a result of their financing the newspaper acquisition in that year.

Income Tax Expense

See Note 16 to the Consolidated Financial Statements of Berkshire Hathaway Inc. and Consolidated Subsidiaries in which income tax expense for the last two years is discussed at length.

Equity in Net Earnings of Illinois National Bank

Berkshire's equity in net earnings of the Illinois National Bank represents approximately 98% of the bank's earnings. Financial statements of the bank are included elsewhere herein.

The Illinois National Bank's operations for the last three years is summarized below, in thousands of dollars:

	1976	1977	1978
Interest income	$11,565	$12,463	$14,564
Interest expense	5,884	6,602	7,425
	5,681	5,861	7,139
Non-interest income	1,349	1,348	1,180
	7,030	7,209	8,319
Non-interest expense	3,367	3,409	3,497
Earnings before income taxes and before securities gains	$ 3,663	$ 3,800	$ 4,822
Net earnings	$ 3,847	$ 3,640	$4,343
Berkshire's equity therein	$ 3,750	$ 3,550	$ 4,242

Loans by the bank increased in 1978, and increased rates of interest were earned on interest earning assets. The bank divested of its travel department in April, 1978, in response to requirement of the Comptroller of the Currency; such divestiture explains the decrease in non-interest income in 1978 from the level of earlier years.

Equity in Net Earnings of Wesco

Equity in net earnings of Wesco as shown in the Summary of Operations for 1977 and 1978 represents Blue Chip's equity in Wesco's net earnings, plus Blue Chip's amortization of the excess of its equity in Wesco's net assets over its investment in Wesco, less Berkshire's provision for applicable income taxes. See Note 7 to Consolidated Financial Statements of Berkshire Hathaway Inc. and Consolidated Subsidiaries which explains the slightly different treatment afforded this item in the Consolidated Statement of Earnings for 1977 and 1978.

The combined ratio for the specialized auto and general liability business of National Indemnity and National Fire, plus that of Home and Auto, has improved in each of the past two years over the preceding year, and on increased volume. That combination cannot continue indefinitely. We expect the volume of this business to decline in 1979; the combined ratio for this business in 1978 was approximately 88, it is highly unlikely that such a low ratio can be sustained for any extended period.

The combined ratio for the workers' compensation business (which excludes business in that line written by the Home State Companies) in 1978 was 113.6, but that figure reflects favorable results of Cypress Insurance Company, which was not a member of the Insurance Group prior to 1978. Without Cypress, the workers' compensation line would have reflected a combined ratio of a highly unfavorable 130.6 for 1978 compared to 108 for 1977 and 116 for 1976. Reference was made above, with regard to insurance premiums written, to the aggressive marketing from a Los Angeles branch of National Indemnity of workers' compensation in California in 1976 and 1977, and to the fact that the rates at which this business was written were inadequate. Management of the branch has been changed and premium writings by this branch have been significantly reduced, with a view to reduction of total dollars of workers' compensation losses and to an improvement in the combined ratio for this line.

Reinsurance underwriting results in 1978 were impacted adversely by one significant loss recorded in the fourth quarter of the year. The reinsurance division generally covers a limited number of risks with fairly high per-risk exposure, so a single large loss cannot be classified as unusual for this business.

The Home State results in 1978 were affected adversely by an unusual number of spring and summer storms in the midwest.

Gross Profit From Sales of Goods and Services

These figures in the Summary of Operations represent gross profit from operations shown in the following table for the past three years:

	($000)		
	1976	*1977*	*1978*
Berkshire-Waumbec textiles	$ 4,162	$ 2,903	$ 6,609
Associated Retail Stores	15,310	16,367	16,810
Other Berkshire/Diversified	1,438	1,890	1,495
Berkshire/Diversified, combined	20,910	21,160	24,914
Blue Chip and its subsidiaries	—	51,945	59,141
Total	$20,910	$73,105	$84,055

Fifteen percent higher 1978 textile sales, compared to 1977, resulted in increased dollars of gross profit from those increased sales; more importantly, the higher levels of production increased gross profit by reducing unit product costs from unsatisfactory 1977 levels, particularly at the Waumbec operation. Price improvement and improvement in product mix also contributed to higher gross profits in the textile business for 1978 as compared to 1977. Price deterioration, combined with inadequate plant utilization in 1977 contributed to the decline in textile gross profits in 1977 from the 1976 level.

Blue Chip's consolidated product and service sales increased about 23% in 1978 over 1977, their gross profit dollars increased a lesser 14%. Cost of sales and services during 1978 increased as a percentage of related revenues from the percentage in 1977 due mainly to escalating costs in the newspaper and candy business.

MANAGEMENT'S DISCUSSION, *Continued*

Interest Expense

This caption represents interest expense, plus amortization of debt discount and expense, for the entities combined and consolidated for the past three years as follows:

	($000)		
	1976	*1977*	*1978*
Berkshire companies	$2,028	$2,075	$2,081
Diversified companies	1,027	1,174	1,298
Combined total	3,055	3,249	3,379
Blue Chip companies	—	1,540	1,679
Combined and consolidated totals	$3,055	$4,789	$5,058

Although not shown above, interest and discount amortization of Blue Chip and its subsidiaries in 1976 was $594,000. This increased in 1977 as a result of their financing the newspaper acquisition in that year.

Income Tax Expense

See Note 16 to the Consolidated Financial Statements of Berkshire Hathaway Inc. and Consolidated Subsidiaries in which income tax expense for the last two years is discussed at length.

Equity in Net Earnings of Illinois National Bank

Berkshire's equity in net earnings of the Illinois National Bank represents approximately 98% of the bank's earnings. Financial statements of the bank are included elsewhere herein.

The Illinois National Bank's operations for the last three years is summarized below, in thousands of dollars:

	1976	*1977*	*1978*
Interest income	$11,565	$12,463	$14,564
Interest expense	5,884	6,602	7,425
	5,681	5,861	7,139
Non-interest income	1,349	1,348	1,180
	7,030	7,209	8,319
Non-interest expense	3,367	3,409	3,497
Earnings before income taxes and before securities gains	$ 3,663	$ 3,800	$ 4,822
Net earnings	$ 3,847	$ 3,640	$4,343
Berkshire's equity therein	$ 3,750	$ 3,550	$ 4,242

Loans by the bank increased in 1978, and increased rates of interest were earned on interest earning assets. The bank divested of its travel department in April, 1978, in response to requirement of the Comptroller of the Currency; such divestiture explains the decrease in non-interest income in 1978 from the level of earlier years.

Equity in Net Earnings of Wesco

Equity in net earnings of Wesco as shown in the Summary of Operations for 1977 and 1978 represents Blue Chip's equity in Wesco's net earnings, plus Blue Chip's amortization of the excess of its equity in Wesco's net assets over its investment in Wesco, less Berkshire's provision for applicable income taxes. See Note 7 to Consolidated Financial Statements of Berkshire Hathaway Inc. and Consolidated Subsidiaries which explains the slightly different treatment afforded this item in the Consolidated Statement of Earnings for 1977 and 1978.

Realized Investment Gain, Net of Income Taxes

This item in the Summary of Operations represents the combined net gain of Berkshire and Diversified from sales of securities in each of the five years covered by the Summary, plus in 1977 and 1978, such net gain realized by Blue Chip. This make up for the past three years is as follows:

	($000)		
	1976	*1977*	*1978*
Berkshire companies	$6,762	$4,820	$8,543
Diversified companies	68	97	330
Combined	6,830	4,917	8,873
Blue Chip Stamps, included in consolidation	—	3,945	698
	$6,830	$8,862	$9,571

1977 and 1978 investment gain of the Berkshire and Diversified companies represent such gain realized by the Insurance Group. See Note (J) to the financial statements of the Insurance Group in which such gain is further broken down. Blue Chip realized an exceptionally large gain in 1977 (approximately $7,000,000, net of taxes) on sale of its holdings of Source Capital, Inc. which was partially offset by net losses on disposition of other securities. Insurance subsidiaries hold securities, among other assets, to fund their liabilities to policyholders; Blue Chip holds securities, among other assets, to fund its liability to holders of its outstanding trading stamps.

Realization of investment gains (or losses) is determined by prevailing investment strategy applied under changing economic conditions and is thus unpredictable and sporadic.

Minority Shareholders' Interest in Earnings

The Minority shareholders' interest in earnings of Blue Chip Stamps represent approximately 48.5% of Blue Chip's 1977 earnings and 44.5% of its 1978 earnings (Berkshire's and Diversified's combined holdings of Blue Chip increased from approximately 49.5% at January 1, 1977 to 52.8% at December 31, 1977 and further to 57.6% at December 30, 1978). The minority interest applied to the categories of earnings as shown below for the past two years, in thousands of dollars:

Category of Earnings to Which Minority Interest Applies	*1977*	*1978*
Earnings from operations of companies consolidated, excluding realized investment gain	$3,490	$2,709
Equity in earnings of Wesco	2,824	3,349
Realized investment gain	1,941	313
Total minority shareholders' interest	$8,255	$6,371

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

BUSINESS SEGMENT INFORMATION

Major business segments of The Company, conducted directly and through wholly owned or substantially wholly owned subsidiaries, are the manufacturing and sale of woven textiles, the underwriting of property and casualty insurance and the retailing business.

Blue Chip stamps (approximately 58% owned by The Company at December 30, 1978) and subsidiaries of Blue Chip are engaged in the candy business, the trading stamps and motivation businesses and the newspaper business.

Products of the textile business include curtain and bedspread materials, apparel fabrics and industrial fabrics. Insurance subsidiaries engage in (1) the underwriting of specialized and non-standard automobile and general liability insurance, (2) underwriting of workers' compensation insurance, principally in California and Louisiana, (3) acceptance of contracts providing reinsurance from other insurers, (4) multiple line underwriting of standard and preferred classes of property and casualty insurance, conducted by six "home state" corporations each writing principally only in the state in which it is organized. Associated Retail Stores, Inc. (formerly a subsidiary of Diversified Retailing Company, Inc.) operates a chain of retail stores, which numbered 76 at December 30, 1978, under a variety of trade names, which sell popular-priced women's and children's apparel. See's Candy Shops, Incorporated, a subsidiary of Blue Chip, produces candy (primarily boxed chocolates) and other confectionery products which it distributes through its own chain of retail shops, which numbered 182 at December 30, 1978, in twelve western and midwestern states. Blue Chip provides for retail merchants and their customers in California and Nevada the predominant trading stamp service in that area. Through a separate division operating on a nationwide basis, Blue Chip tailors motivation programs for business, designed to stimulate their customer's sales or productivity, to promote employee attendance or safety, or to provide other motivational functions. Blue Chip's newspaper business represents the Buffalo Evening News, Inc., publisher of a newspaper in upstate New York.

The Illinois National Bank & Trust Co. of Rockford, a commercial bank, is an approximately 98% owned subsidiary of The Company accounted for by the equity method of accounting. Wesco Financial Corporation is an approximately 80% owned subsidiary of Blue Chip. Wesco is a California savings and loan holding company accounted for by the equity method of accounting. Neither the Illinois National Bank nor Wesco are considered business segments for purposes of the following tables.

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 subsidiaries, realized investment gain or loss, general corporate expenses and interest expense.

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 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 segment of income relating to such investment.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

Consolidated Segment Data

($000)

Sources of Revenue	*1974*	*1975*	*1976*	*1977*	*1978*
Insurance*	$ 71,592	$ 70,028	$ 95,846	$156,149	$206,017
Textiles	32,592	32,833	44,644	45,498	52,674
Retailing	34,232	35,303	39,113	42,106	40,762
Candy	—	—	—	63,115	73,954
Trading stamps and motivation	—	—	—	22,225	24,841
Newspaper	—	—	—	31,833	44,791
Other	114	426	2,807	2,709	2,903
Total revenue	$138,530	$138,590	$182,410	$363,635	$445,942

*Sources of Revenue of the Insurance segment is further broken down as follows:

	1974	1975	1976	1977	1978
Premiums earned:					
Specialized auto and general liability	$ 42,338	$ 38,513	$ 50,778	$ 80,690	$ 96,126
Workers' compensation**	639	3,632	5,815	18,916	29,893
Reinsurance	15,153	12,407	17,220	24,100	30,160
Home State multiple lines	5,298	6,670	11,058	19,382	29,894
Total premiums earned	63,428	61,222	84,871	143,088	186,073
Investment income	8,164	8,806	10,975	13,061	19,944
Insurance segment revenues	$ 71,592	$ 70,028	$ 95,846	$156,149	$206,017

**Workers' Compensation coverage written by the Home State Companies, as part of their multiple lines business, is not disaggregated from their total earned premiums. Earned premiums set forth above for Worker's Compensation reflect those for Southern Casualty Insurance Company and for National Indemnity Company's Workers Compensation departments for 1974-1977; premiums earned by Cypress Insurance Company are additionally included for 1978.

Operating profit before taxes including minority interest (parentheses denote loss)	*1974*	*1975*	*1976*	*1977*	*1978*
Identified with segments:					
Insurance*	$ 738	$ (2,627)	$ 11,089	$ 18,606	$ 22,706
Textiles	2,660	1,289	1,148	(620)	2,916
Retailing	1,540	2,007	2,219	2,775	2,757
Candy	—	—	—	12,352	12,482
Trading stamps and motivation	—	—	—	1,091	2,133
Newspaper	—	—	—	751	(2,913)
Other	114	426	796	584	1,168
	5,052	1,095	15,252	35,539	41,249
Not identified with segments:					
Equity in net earnings of:					
Illinois National Bank	4,093	3,450	3,750	3,550	4,242
Wesco	—	—	—	5,715	7,417
Blue Chip	2,123	3,194	5,107	—	—
Realized investment gain (loss)	(2,208)	(2,881)	10,061	13,309	13,987
General corporate expenses	(723)	(422)	(439)	(534)	(1,072)
Interest and financing expense	(2,392)	(2,560)	(3,056)	(4,789)	(5,059)
Operating profit before taxes (including minority interest)	$ 5,945	$ 1,876	$ 30,675	$ 52,790	$ 60,764

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES
Consolidated Segment Data *(Continued)*

*Insurance segment operating profit is further broken down as follows:					
Underwriting gain (loss):					
Specialized auto and general liability	$ (4,218)	$ (7,450)	$ 4,768	$ 7,800	$ 11,543
Workers compensation	(123)	(342)	(1,093)	(1,644)	(3,944)
Reinsurance	(2,319)	(2,651)	(2,879)	(1,251)	(2,443)
Home State multiple lines	(702)	(907)	(548)	896	(2,155)
	(7,362)	(11,350)	248	5,801	3,001
Net investment income	8,100	8,723	10,841	12,805	19,705
Insurance segment operating profit (loss) before taxes	$ 738	$ (2,627)	$ 11,089	$ 18,606	$ 22,706
Identifiable assets at year end					
Identified with segments:					
Insurance	$163,803	$164,195	$215,834	$303,419	$382,860
Textiles	13,282	17,821	20,621	22,191	22,606
Retailing	9,887	10,195	9,965	14,272	14,235
Candy	—	—	—	39,183	44,177
Trading stamps and motivation	—	—	—	79,409	84,922
Newspaper	—	—	—	39,798	38,542
Other	—	—	1,973	2,022	2,147
	186,972	192,211	248,393	500,294	589,489
Not identified with segments:					
Investment in Illinois National Bank	22,417	23,424	24,732	25,839	27,146
Investment in Wesco	—	—	—	43,892	49,370
Investment in Blue Chip	30,172	32,042	42,684	—	—
Corporate cash and short-term investments	4,747	6,266	1,518	491	3,106
Investment in unconsolidated subsidiaries	1,187	1,120	880	1,627	1,477
Combined and consolidated assets at year end	$245,495	$255,063	$318,207	$572,143	$670,588
Capital Expenditures					
Insurance	$ 123	$ 98	$ 273	$ 539	$ 897
Textiles	415	248	1,006	533	450
Retailing	131	125	118	294	247
Candy	—	—	—	2,114	2,777
Trading stamps and motivation	—	—	—	2	130
Newspaper	—	—	—	32,437	1,131
Other	—	—	669	9	8
Total capital expenditures	$ 669	$ 471	$ 2,066	$ 35,928	$ 5,640
Depreciation and amortization of property, plant and equipment, including leaseholds					
Insurance	$ 148	$ 152	$ 163	$ 213	$ 305
Textiles	635	385	402	482	455
Retailing	126	121	124	126	135
Candy	—	—	—	822	1,007
Trading stamps and motivation	—	—	—	109	96
Newspaper	—	—	—	1,507	2,554
Other	—	—	53	49	50
Total depreciation and amortization	$ 909	$ 658	$ 742	$ 3,308	$ 4,602

The 1978 Annual Report of Blue Chip Stamps included the following letter to Blue Chip stockholders from the Chairman and the President of that Company

To Our Stockholders

Consolidated normal operating income (i.e., before parent company gains from sale of securities) for the calendar year 1978 increased slightly, to $13,553,000 ($2.62 per share) from $12,893,000 ($2.49 per share) in the previous fiscal year.

Consolidated net income (i.e., after parent company gains from sale of securities) decreased to $14,280,000 ($2.76 per share) from $16,993,000 ($3.28 per share) in the previous fiscal year.

Our constituent businesses produce fluctuating returns from normal operations as well as from gains or losses on sale of securities held to offset liabilities to trading stamp savers and others. Given this situation, our objective is to earn from all sources a fluctuating return on our shareholders' equity which amounts to a respectable average annual return over a period of years. Last year's total consolidated net income of $14,280,000 represented a return of 14.4% on our shareholders' equity of $99,251,000 at the start of the year. Over the last five years return on shareholders' equity has averaged 15%.

We have three major subsidiaries, See's Candy Shops, Incorporated (100% owned), Wesco Financial Corporation (80% owned) and Buffalo Evening News, Inc. (100% owned). If we used "equity accounting" instead of "consolidated accounting" for See's and the Buffalo Evening News as well as Wesco, our consolidated income for our two reporting years just ended would break down as follows:

Year ended about	Blue Chip equity in See's net income*1	Blue Chip equity in Wesco net income*2	Blue Chip equity in Buffalo Evening News net income (loss)*3	All other Blue Chip net income*4,5	Blue Chip consolidated net income*5
December 31, 1978	$5,802,000	$7,417,000	$(1,427,000)	$2,488,000	$14,280,000
Per Blue Chip share	1.12	1.43	(.27)	.48	2.76
December 31, 1977	5,750,000	5,715,000	340,000	5,188,000	16,993,000
Per Blue Chip share	1.11	1.10	.07	1.00	3.28

*1 After reducing income by amortization of intangibles arising from purchase of See's at a large premium over its book value.

*2 After increasing income by amortization of the discount from Wesco book value at which the interest was acquired.

*3 After reducing income by amortization of relatively minor intangibles arising at acquisition of the newspaper in April 1977.

*4 After deduction of interest and other general corporate expenses. In each year there was an operating loss before securities transactions and before crediting income for (i) interest and dividends resulting from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed, plus (ii) income tax benefit caused by 85% exclusion of dividends in computing federal income taxes.

*5 The 1978 amounts include $727,000 or $.14 per Blue Chip share from securities gains, net of taxes. In 1977 such securities gains were $4,100,000 or $.79 per Blue Chip share.

SEE'S CANDY SHOPS, INCORPORATED

By a razor-thin margin, our 100%-owned subsidiary, See's Candy Shops, Incorporated, had another record year under the skilled leadership of Charles Huggins. The nominal percentage gain in earnings (less than 1%) was much lower than the percentage gain in sales (17%). Comparative figures for See's for the last two years are set forth below:

Year ended about	Sales	Profits after taxes*	Number of pounds of candy sold	Number of stores open at yearend
December 31, 1978	$73,653,000	$6,289,000	22,407,000	182
December 31, 1977	62,886,000	6,262,000	20,921,000	179

*These earnings figures are a little higher than Blue Chip Stamps' share of See's earnings shown in the table above because Blue Chip's share reflects (i) deduction of the approximately 1% share of See's earnings owned by minority stockholders of See's prior to June 6, 1978, (ii) amortization of intangibles arising from purchase of See's stock at a large premium over book value, and (iii) state income taxes on See's dividends received by Blue Chip.

Boxed chocolate consumption per capita in the United States continues to be essentially static, and the candy-store business has been subject to extraordinary cost pressure. Despite substantial increases in See's retail prices, its profits lagged substantially below year-earlier levels until December when an extraordinary burst of holiday-period sales caused the lag to be eliminated. It is very difficult to cope so successfully with the production and distribution problems of a seasonal sales peak which becomes more extreme each year, and the flat earnings trend of 1978 represented outstanding managerial achievement. So far as we know the candy-store business is terrible to mediocre for all other companies, whereas it is quite profitable at See's for the simple reason that both new and old customers have a pronounced tendency to prefer its candy to all others. This customer enthusiasm is caused by a virtually fanatic insistence on expensive natural candy ingredients plus expensive manufacturing and distributing methods ensuring rigorous quality control and cheerful retail service. The fanaticism is rewarded by extraordinary sales per square foot in the stores. We greatly admire See's business methods, which have not been changed in any significant way in the seven years of our ownership. Our main managerial contribution has been to leave See's alone as its proven executives pursued its proven policies. In 1978 we paid $55 per See's share to acquire a tiny minority interest in See's. If our previously owned 99% interest in See's were valued at the same price per share, such interest would have had a total value at that time approximately $25 million more than its aggregate amortized cost in our consolidated financial statements.

WESCO FINANCIAL CORPORATION

Our equity in net income of our subsidiary, Wesco Financial Corporation (80% owned) increased to $7,417,000, a new record, compared with $5,715,000 in the previous year. The substantial improvement in Wesco's contribution was caused primarily by increased operating earnings in Wesco's savings and loan association subsidiary, Mutual Savings, headquartered in Pasadena, California. Conditions in 1978 generally favored savings and loan associations, and Mutual Savings is soundly capitalized and efficient. Wesco is a separate public corporation, with its stock listed on the American Stock Exchange. Summarized financial information for Wesco is contained in Note 1 to our consolidated financial statements and includes an exceptionally strong balance sheet, partly caused by substantial assets outside the subsidiary savings and loan association and available for commitment elsewhere. In February, 1979, Wesco purchased for approximately $15 million a midwestern steel service center business which reported after-tax earnings of $1,918,000 in the full year ended June 30, 1978. For more complete information we encourage Blue Chip shareholders to obtain a copy of Wesco's 1978 Annual Report, which embodies an unusual clarity of reporting and reflects an excellence of management—both directly attributable to Louis Vincenti, Chairman. Simply make your request to:

Wesco Financial Corporation
315 East Colorado Boulevard
Pasadena, California 91109
Attention: Mrs. Bette Deckard, Secretary & Treasurer

BUFFALO EVENING NEWS, INC.

Our 100%-owned subsidiary, Buffalo Evening News, Inc., was acquired in April of 1977 for approximately $34 million and reported, after litigation expenses, increased depreciation and extraordinary expenses stemming from equipment modernization, an after-tax operating loss of $1,427,000 in 1978, compared with net income of $340,000 in the portion of the previous year subsequent to acquisition.

The Buffalo Evening News had no Sunday edition when acquired; a competing paper published without opposition on Sundays. As we explained in detail in our Annual Report last year, the long-term survival of the Buffalo Evening News clearly required that it inaugurate a Sunday edition. (Real trouble has been the invariable eventual outcome for every other daily newspaper in the United States which relied overlong, in an important city, exclusively on weekday publication while a significant daily competitor enjoyed a Sunday monopoly.) Accordingly, the Buffalo Evening News commenced publishing Sundays late in 1977. In response, a lawsuit was filed by the competing paper which for the first time faced the prospect of competition on Sundays as well as weekdays. The lawsuit, in turn, resulted in some interlocutory (i.e., temporary and not final) injunctions (now on appeal) which, among other things, created severe disruptions in normal circulation procedures under midwinter conditions and restricted business promotion practices of our subsidiary's paper while similar but more aggressive practices of the competing paper were allowed. Despite all the difficulties, the new Sunday edition now has a steady circulation of about 156,000, up slightly in recent months. The litigation has continued through 1978, including a counter-complaint by our subsidiary as well as defense against the competing paper's complaint, causing heavy direct litigation expense and other indirect costs. Affected by these factors, plus an unanticipated decrease in weekday circulation and advertising linage (now apparently arrested), operating results at our Buffalo newspaper have, of course, been unsatisfactory.

We anticipate better operating results in the future, although we also expect that improvement in our subsidiary's competitive position in Buffalo will, at best, be extremely slow and that operating results will continue to bear heavy charges for direct and indirect expense of litigation. Newspaper readership habits ordinarily change slowly, if at all, and litigation is notoriously time-consuming, inefficient, costly and unpredictable.

The ultimate security of the Buffalo Evening News remains in doubt, as it will for a very extended period. We purchased a newspaper subject not only to the normal hazards of business competition but also to the hazards of the modern tendency of competitors to seek protection from competition in the courts.

We believe that the Buffalo Evening News remains by far the most respected newspaper in Buffalo, with a tradition of editorial objectivity and integrity and good citizenship, the result of editorial control by autonomous, community-minded local editors. We have maintained and will continue to maintain this tradition of locally-created excellence, as well as an equally important tradition of fair-dealing with all newspaper employees and unions, who have performed loyally and well to help protect our common enterprise under difficult conditions. We expect that our policies eventually will cause our newspaper subsidiary to develop into a more satisfactory investment. But a long and prosperous future is not guaranteed. If the competing paper succeeds in obtaining the kind of permanent injunctions it is seeking, or if any extended strike shuts down the Buffalo Evening News, we believe that it will probably be forced to cease operations and liquidate, at an after-tax cost which could exceed $10 million.

TRADING STAMP AND MOTIVATION BUSINESSES

The final components of our consolidated net income last year were provided by our trading stamp and motivation businesses. These businesses use the same headquarters and warehousing facilities. Combined, the businesses operated at a decreased profit last year (down from $5,188,000 to $2,488,000) after (properly) giving them credit for the entire income (interest and dividends, plus income tax benefits caused by dividends, plus securities gains) from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed. However, the decrease in profit was entirely attributable to a decline in securities gains from the unusually high level of 1977. Profit before securities gains increased from $1,088,000 to $1,761,000.

Trading stamp service revenues increased by a minor amount to $16,531,000 last year compared with $15,723,000 in the previous year. Motivation business revenues increased substantially, from $2,485,000 to $3,791,000.

In our trading stamp business our "float"—resulting from past issuances of trading stamps when volume was many times greater than the current level—is large in relation to current issuances. (Trading stamp revenues peaked at $124,180,000 in fiscal 1970, and our 1978 revenues of $16,531,000 therefore represented a decline of 87% from peak volume.) Eventually, unless stamp issuances improve, earnings from investing "float" will decline greatly. The decline in recent years, however, has proceeded at an extremely slow rate, and our estimated future redemption liability actually increased by a tiny amount in 1978 and was $66,832,000 at yearend.

As discussed extensively in previous annual reports (particularly for fiscal 1976), which we urge shareholders to review, accounting for trading stamp redemption liability (which involves estimating the number of stamps that will ultimately be redeemed and the cost per stamp) is a difficult process under any circumstances, but particularly so in an inflationary economy and when stamp issuances decline by a large percentage. We periodically revise our estimated future redemption liability as conditions warrant.

We intend to remain in the trading stamp business. Many of our present customers, aided by our stamp service, operate unusually successful supermarkets and other businesses, and we believe that, given the opportunity, we can also provide very useful service to new customers.

PINKERTON'S, INC.

At yearend 1978 we owned non-voting stock representing 32% of the equity in Pinkerton's, Inc., the leading national security and investigation service company. Our total investment at cost was $23,364,000.

CONSOLIDATED BALANCE SHEET AND OTHER DATA

Our consolidated balance sheet retains a strength befitting a company whose consolidated net worth supports large outstanding promises to others. As explained in Note 4 to the accompanying financial statements, the aggregate market value of our marketable securities is slightly lower than their aggregate cost.

A section entitled "Principal Business Activities" and a "Summary of Operations" for a five year period are presented beginning on page 4, followed by notes and management's discussion and analysis of the summary. We invite your careful attention to those items and to our audited financial statements.

Cordially yours,

Charles T. Munger
Chairman of the Board

Donald A. Koeppel
President

February 28, 1979

The 1978 Annual Report of Wesco Financial Corporation included the following letter from Louis R. Vincenti, Chairman of the Board and President of Wesco

TO THE STOCKHOLDERS OF WESCO FINANCIAL CORPORATION

Consolidated net earnings of Wesco Financial Corporation and its subsidiaries for 1978 amounted to $8,481,000 ($1.19 per share) compared to $6,449,000 ($.91 per share) in 1977. Quarterly earnings per share were:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1978	$ .21	.37	.25	.36	1.19
1977	.19	.19	.22	.31	.91

This substantial increase in earnings was due to the increase in net interest income on loans and to increased returns on other earning assets.

Total savings in Mutual Savings increased $28,420,000 in 1978 compared to an increase of $54,912,000 in 1977. At year end, out-of-state savings were $47,645,000 (9.8% of total savings) compared with $52,648,000 (11.4% of total savings) in 1977.

On June 1, 1978, savings and loan associations were authorized to issue money market certificates paying a rate of 1/4% more than current six-month Treasury Bills. At year end, $55,259,000 of such certificates were outstanding, and by February 28, 1979 had increased to $83,509,000. Continuing increase is expected during 1979 resulting in rising cost of savings. The cost, on a yield basis, of these funds has varied from 7.621% to 10.328%.

Effective March 15, 1979, the yield on money market certificates was reduced by approximately .50%. This includes loss of differential of .25% over banks when rates are above 9%, and loss of the right to compound interest daily. Money market certificates will, as a result, be less competitive with Treasury bills.

Cost of savings and cost of funds (savings and borrowings) and the yield on the loan portfolio increased in 1978. The spread between the cost of funds and yield on loans has been favorable.

	1978	1977	1976	1975	1974
Cost of savings	6.57%	6.46	6.35	6.29	6.00
Cost of all funds	6.66	6.51	6.43	6.41	6.25
Yield on loans at year end	8.32	8.02	7.70	7.55	7.36
Spread (yield less cost of funds)	1.66	1.51	1.27	1.14	1.11

At December 31, 1978, real estate loans were $472,038,000 compared with $390,569,000 at December 31, 1977. Real estate loans made in 1978 were $146,440,000 including the purchase of certificates of Government National Mortgage Association in the amount of $51,532,000. Real estate loans made in 1977 amounted to $107,546,000 including the purchase of $43,661,000 in 90% participation interest in loans from four large California-based savings and loan associations who service the loans. Loans in process and firm loan commitments, which were $9,396,000 at December 31, 1977, increased to $9,752,000 at December 31, 1978.

During 1978, Wesco and Mutual Savings increased their investment in common and preferred stocks and municipal bonds by $24,718,000 and, at year end, had invested $89,539,000.

Common Stocks:		
Federal National Mortgage Association	2,044,000 shares	$30,862,000
Cleveland-Cliffs Iron Company	388,200 shares	10,545,000
Safeco Corporation	478,823 shares	11,730,000
Other Corporations	55,800 shares	923,000
		$54,060,000
Preferred Stocks:		28,809,000
Municipal Bonds:		6,670,000
		$89,539,000

At December 31, 1978, the market value of these securities was $4,857,000 in excess of cost.

Not included were 273,780 shares (21.6%) of Detroit International Bridge Company purchased in 1977 which were sold on March 12, 1979 at $24.00 per share resulting in a profit, net of Federal and State income taxes, of $1,039,000 ($.14½ per share).

On February 28, 1979, Wesco purchased all of the assets of Precision Steel Warehouse, Inc. of Franklin Park, Illinois for $15,081,876 and the assumption of its liabilities. Precision Steel is in the steel service center business specializing in cold rolled strip steel and has subsidiaries engaged in the manufacture and distribution of packaged tool room specialty products and hose clamps. For the fiscal year ended June 30, 1978, Precision Steel's net earnings after taxes were $1,918,000. This business will be operated through a wholly-owned subsidiary corporation chartered in the State of Illinois.

It is anticipated that marketable securities held in Wesco, at the parent company level, will eventually be sold to provide funds for one or more future corporate acquisitions similar or dissimilar to the Precision Steel acquisition.

Properties acquired by foreclosure were $1,824,000 at December 31, 1978, compared with $2,095,000 at December 31, 1977. Sale of the commercial property at Pacoima, with a cost basis of $289,000, is expected to close by May 30, 1979, resulting in a deferred profit of $255,000. A substantial portion of the Friendly Valley property was sold in 1978 resulting in a deferred profit of $457,000, which is expected to be taken into income by year end 1980. The remaining vacant land at Friendly Valley, with a cost basis of $97,000, will require several years for disposition. A planned development for houses at Santa Barbara, on 22 acres of vacant land on the ocean front adjacent to the Biltmore Hotel, is being processed. We expect approval by Santa Barbara County by April 30, 1979. The time thereafter required to process this project through the California Coastal Commission is indeterminate. Its cost basis is $1,074,000. Property at Upland, California, having an original cost basis of $78,000, is in the course of improvement with a commercial store building. Total investment at 1978 year end was $364,000 and final cost will be approximately $550,000. We plan to retain this property for income. All stores have been leased and should earn an annual pre-tax return of 13½% after expenses including depreciation.

Mutual Savings did not open any new offices in 1978 to add to its sixteen branch offices. A satellite branch office has been approved for a retail shopping center in Pasadena, which is scheduled for opening during 1980.

On January 16, 1979, Wesco increased its regular quarterly cash dividend from $.08½ per share to $.09½ per share payable March 15, 1979 to shareholders of record at the close of business on February 19, 1979.

A "Summary of Operations" for a five-year period is presented on page 4, followed by "Management's Discussion and Analysis" of that Summary. The purpose of the Summary and Discussion is to enable investors to compare periodic results of operations and to assess the source and probability of earnings.

Louis R. Vincenti

LOUIS R. VINCENTI
Chairman of the Board and President

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 balance sheets of the Berkshire Hathaway Inc. - Insurance Group as of December 31, 1978 and 1977 and the related statements of income and unassigned surplus 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. We did not examine the financial statements of Blue Chip Stamps, an investee of the Insurance Group. The Insurance Group's investment in Blue Chip Stamps at December 31, 1978 and 1977 was $31,442,000 and $26,862,000, respectively, and its equity in net earnings of Blue Chip Stamps was $3,230,000 and $3,852,000 for the years 1978 and 1977, 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 solely upon the report of the other auditors.

In our opinion, based upon our examinations and the report of other auditors, the aforementioned financial statements present fairly the financial position of the Berkshire Hathaway Inc. - Insurance Group at December 31, 1978 and 1977 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, after restatement for the merger of Diversified Retailing Company, Inc., with which we concur, as explained in note A to the financial statements.

Peat, Marwick, Mitchell & Co.

March 28, 1979

Berkshire Hathaway Inc.
INSURANCE GROUP

BALANCE SHEETS
(in thousands of dollars)

ASSETS	December 31, 1978	December 31, 1977 (restated)
Investments — other than investment in affiliate (note D):		
Bonds, at amortized cost	$157,651	$132,929
Marketable equity securities, at cost	133,766	108,107
Invested cash, U.S. Treasury Bills and other short-term investments, at cost which approximates market	43,068	22,088
Total investments — other than investment in affiliate	334,485	263,124
Investment in Blue Chip Stamps, an affiliate (note E)	31,442	26,862
Cash	2,570	4,607
Premiums and agents' balances receivable	18,896	13,042
Reinsurance recoverable on paid losses	5,413	5,837
Accrued investment income	4,424	2,891
Property and equipment, at cost less accumulated depreciation of $1,541, 1978; $1,401, 1977	2,757	2,164
Deferred premium acquisition costs	13,846	10,852
Other assets, including $2,948 investment, at cost, in 52,287 shares of Berkshire Hathaway Inc.	3,432	3,865
	$417,265	$333,244

LIABILITIES, CAPITAL STOCK AND SURPLUS	1978	1977
Losses and loss adjustment expenses	$180,870	$139,461
Unearned premiums	69,368	57,128
Current income taxes	4,591	705
Deferred income taxes	8,813	6,989
Other liabilities	10,472	10,463
	274,114	214,746
Capital stock and surplus:		
National Indemnity Company, $10 par value. Authorized 750,000 shares; issued 550,000 shares	5,500	5,500
National Fire and Marine Insurance Company, $100 par value. Authorized 50,000 shares; issued 25,000 shares	2,500	2,500
Columbia Insurance Company, $100 par value. Authorized and issued 20,000 shares	2,000	2,000
Paid-in surplus	24,457	24,457
Unassigned surplus (note F)	108,694	84,041
Total capital stock and surplus	143,151	118,498
Contingency (note E)		
	$417,265	$333,244

See accompanying notes to financial statements.

Berkshire Hathaway Inc.

INSURANCE GROUP

STATEMENTS OF INCOME AND UNASSIGNED SURPLUS

(in thousands of dollars)

	Year ended December 31, 1978	Year ended December 31, 1977 (restated)
Underwriting income:		
Premiums written	$198,313	$158,704
Increase in unearned premiums	12,240	15,616
Premiums earned	186,073	143,088
Losses and claims	108,642	81,463
Loss adjustment expenses	23,621	15,406
Underwriting expenses (note G)	50,809	40,418
	183,072	137,287
Underwriting gain	3,001	5,801
Investment income:		
Interest on bonds	9,671	7,261
Dividends on stocks of unaffiliated companies	8,214	5,235
Interest on short-term investments and other interest	2,059	565
	19,944	13,061
Less investment expenses	239	256
Net investment income	19,705	12,805
Income before income taxes and items below	22,706	18,606
Applicable income tax expense (note H)	4,681	2,761
Income before items below	18,025	15,845
Equity in earnings of Blue Chip Stamps, an affiliate (note E)	3,230	3,852
Income before realized gain on investments	21,255	19,697
Realized gain on investments	12,873	7,031
Applicable income tax expense (note H)	4,000	2,114
Net realized gain on investments (note J)	8,873	4,917
Net unrealized appreciation in market values of preferred and common stocks of unaffiliated companies of $12,628 in 1978 and $28,621 in 1977 has been excluded from the determination of net income.		
Net income	30,128	24,614
Unassigned surplus at beginning of year — as restated	84,041	61,827
Dividends paid to stockholders	(5,475)	(2,400)
Unassigned surplus at end of year	$108,694	$ 84,041

See accompanying notes to financial statements.

Berkshire Hathaway Inc.

INSURANCE GROUP

STATEMENTS OF CHANGES IN FINANCIAL POSITION

(in thousands of dollars)

	Year ended December 31, 1978	1977 (restated)
Funds provided:		
From operations:		
Net income	$ 30,128	$ 24,614
Charges (credits) to income not requiring (providing) funds:		
Equity in undistributed earnings of Blue Chip Stamps	(3,175)	(3,794)
Accretion of discount on bonds	(1,000)	(929)
Depreciation	304	198
Increase in unpaid losses and loss expenses	41,409	36,874
Increase in unearned premiums	12,240	15,617
Increase in premiums receivable and agent balances	(5,854)	(3,187)
Increase in deferred acquisition costs	(2,994)	(3,659)
Increase in liability for income taxes	5,710	512
Increase in accrued investment income	(1,533)	(613)
Other	851	1,136
Funds provided from operations	76,086	66,769
Decrease in cash	2,037	—
	$78,123	$66,769
Funds used:		
Subsidiary acquired:		
Bonds	—	14,656
Preferred and common stocks	—	871
Cash	—	462
Other assets and deferred charges	—	2,288
Unpaid losses and loss adjustment expenses	—	(12,807)
Unearned premiums	—	(1,261)
Other liabilities	—	(1,517)
	—	2,692
Purchases of property, furniture, fixtures and equipment	897	539
Purchase of Berkshire Hathaway Inc. common stock	—	73
Net purchase of investments*	71,751	59,590
Dividends paid	5,475	2,400
Increase in cash	—	1,475
	$78,123	$66,769
*Net purchase of investments:		
U.S. Treasury Bills	20,930	3,506
Bonds	23,772	24,657
Preferred stocks	715	74
Common stocks of unaffiliated companies	24,929	30,527
Common stock of Blue Chip Stamps	1,405	826
Net purchase of investments	$71,751	$59,590

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS
December 31, 1978 and 1977
(dollars in thousands)

(A) Combination and Restatement of Accounts

Note 1 to the consolidated financial statements of Berkshire Hathaway Inc. statements discloses the merger of Berkshire Hathaway Inc. ("Berkshire") and Diversified Retailing Company, Inc. ("Diversified") effected December 30, 1978 and the resulting combination of the accounts of Berkshire and Diversified in the presentation of the accompanying consolidated financial statements. Financial statements of the Berkshire Hathaway Inc. Insurance Group presented herewith combine the accounts of subsidiaries of Berkshire and companies which were formerly subsidiaries of Diversified engaged in fire and casualty insurance underwriting. This combination results in a restatement of the prior year financial statements. Certain significant results from the combination follow:

Capital stock and surplus of the Insurance Group as previously reported as of December 31, 1976		$ 88,462
Add — capital stock and surplus of insurance subsidiaries of Diversified at December 31, 1976		10,694
		99,156
Deduct — equity in undistributed earnings of Berkshire accumulated by insurance subsidiaries of Diversified at December 31, 1976, net of deferred income taxes relating thereto		(2,872)
Capital stock and surplus, December 31, 1976 — restated		96,284
Net earnings of the Insurance Group for 1977 as previously reported	$23,407	
Add — net earnings of insurance subsidiaries of Diversified for 1977	2,489	
	25,896	
Deduct — equity in net earnings of Berkshire Hathaway Inc. reported by insurance subsidiaries of Diversified for 1977	(1,282)	
Net earnings for 1977 — restated		24,614
Dividends paid to stockholders during 1977		(2,400)
Capital stock and surplus, December 31, 1977 — restated		118,498
Net earnings for 1978:		
Subsidiaries of Berkshire	29,052	
Subsidiaries of Diversified	1,076	
Net earnings for 1978		30,128
Dividends paid to stockholders during 1978		(5,475)
Capital stock and surplus, December 31, 1978		$143,151

The elements of capital stock and surplus of insurance subsidiaries of Diversified which have been added to the capital stock and surplus of the Berkshire Insurance Group in the accompanying balance sheets is as follows:

	Dec. 31, 1978	Dec. 31, 1977
Capital stock	$ 2,000	$ 2,000
Additional paid-in capital	3,855	3,855
Unassigned surplus	3,853	2,773
	$ 9,708	$ 8,628

(Continued)

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

Certain components of net earnings, derived from combining the accounts of insurance subsidiaries of Berkshire and insurance subsidiaries of Diversified for the past two years, are as follows:

	1978	1977
Premiums earned:		
Insurance subsidiaries of Berkshire	$180,329	$136,890
Insurance subsidiaries of Diversified	5,744	6,198
	$186,073	$143,088
Underwriting gain (loss):		
Insurance subsidiaries of Berkshire	3,287	5,884
Insurance subsidiaries of Diversified	(286)	(83)
	$ 3,001	$ 5,801
Net earnings:		
Insurance subsidiaries of Berkshire	29,052	23,407
Insurance subsidiaries of Diversified	1,076	1,207
	$ 30,128	$ 24,614

(B) Significant Accounting Policies

See note 2 to the consolidated financial statements of Berkshire which includes a summary of significant accounting policies and practices of the Insurance Group.

(C) Basis of Presentation

The financial statements of the Insurance Group are presented on a combined basis with significant intercompany transactions and balances eliminated, and in accordance with generally accepted accounting principles (GAAP). Such principles 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, 1978	December 31, 1977
Statutory surplus as regards policyholders	$214,331	$181,257
Excess of NAIC market valuations over cost valuations of investments in equity securities (excluding stock of Blue Chip Stamps)	(87,163)	(74,530)
Excess of NAIC market valuations over amortized cost of bonds	(1,350)	(2,010)
Excess of carrying value of investment in Blue Chip Stamps (determined under GAAP pursuant to the equity method) over NAIC market valuation	6,615	4,708
Excess of NAIC market valuation over cost of investment in common stock of Berkshire Hathaway Inc.	(4,728)	(4,021)
Deferred insurance premium acquisition costs	13,846	10,852
Excess statutory liability loss reserves	5,163	3,077
Net recoverable from unauthorized reinsurers	2,093	2,875
Sundry nonadmitted assets	4,386	2,696
Income tax effects and adjustments	(10,042)	(6,406)
Capital stock and surplus per accompanying financial statements	$143,151	$118,498

(Continued)

Berkshire Hathaway Inc.

INSURANCE GROUP

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

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

	December 31, 1978	December 31, 1977
Statutory net income	$27,537	$19,356
Increase in deferred acquisition costs	2,994	3,659
Equity in undistributed earnings of Blue Chip Stamps, net of amortization of excess cost	3,175	3,848
Increase in earned but unbilled premiums	60	20
Increase in unpaid policyholders dividends	(3)	(50)
Income tax effects and adjustments	(3,635)	(2,219)
Net income — GAAP	$30,128	$24,614

(D) Investments — Other Than Investment in Affiliate

A summary of the Insurance Group's aggregate cost and aggregate approximate market value of investments — other than investment in affiliate — was as follows:

	December 31, 1978		December 31, 1977	
	Cost	Market	Cost	Market
Bonds	$157,651	$155,540	$132,929	$138,576
Marketable equity securities:				
Preferred stocks	24,080	32,757	23,365	37,225
Common stocks	109,686	188,172	84,742	145,417
Total marketable equity securities	133,766	220,929	108,107	182,642
Invested cash, U.S. Treasury Bills and other short-term investments	43,068	43,068	22,088	22,088
Total investments — other than investment in affiliate	$334,485	$419,537	$263,124	$343,306

The excess of the aggregate market value over aggregate cost of marketable equity securities represented unrealized gain less unrealized loss as follows:

	December 31, 1978	December 31, 1977
Unrealized gain	$87,691	$77,377
Unrealized loss	528	2,842
Net excess of market over cost	$87,163	$74,535

NOTES TO FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

(E) Investment in Blue Chip Stamps

The investment in Blue Chip Stamps ("Blue Chip") by the companies comprising the Insurance Group represented approximately 27.4% of the company's outstanding shares at December 30, 1978, increased from approximately 25.9% as restated at December 31, 1977. The investment is accounted for by the Insurance Group by the equity method. (This differs from the presentation in the Consolidated Financial Statements of Berkshire Hathaway Inc. and subsidiaries wherein the accounts of Blue Chip are consolidated.)

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

	December 31, 1978	December 31, 1977
Dividends received	$ 331	$ 310
Equity in undistributed earnings	3,507	3,951
Provision for current income taxes	(24)	(22)
Provision for deferred income taxes	(252)	(284)
Amortization of excess of cost of investment over underlying net asset values	(332)	(103)
	$3,230	$3,852

The amortization charge in 1978 of the Insurance Group represents the amount required to adjust the carrying value of the shares to their underlying book value as reported by Blue Chip as of December 30, 1978.

The balance sheets of Blue Chip as of December 30, 1978 and December 31, 1977 are summarized as follows:

BLUE CHIP STAMPS
Consolidated Balance Sheets

ASSETS	Dec. 30, 1978	Dec. 31, 1977
Cash and short-term investments	$ 17,595	$ 16,559
Marketable equity securities, at market (cost, December 30, 1978 — $62,395; December 31, 1977 — $55,186)	62,256	53,010
Inventories	7,960	7,332
Property, fixtures and equipment, net	40,603	40,414
Investment in Wesco Financial Corporation	49,370	43,892
Excess of cost over equity in net assets of consolidated subsidiaries	15,615	15,439
Other assets	23,473	23,460
	$216,872	$200,106

LIABILITIES AND STOCKHOLDERS' EQUITY	Dec. 30, 1978	Dec. 31, 1977
Accounts payable and accrued expenses	$ 13,055	$ 14,199
Income taxes payable	4,413	4,779
Liabilities for unredeemed trading stamps	66,832	66,209
6¾% subordinated debentures due 1978	—	2,168
Notes payable	18,247	13,500
Stockholders' equity	114,325	99,251
	$216,872	$200,106

(Continued)

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

A footnote accompanying the 1978 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 less than 30% of its total shareholders' equity at December 30, 1978. See note 19 of notes to the Consolidated Financial Statements of Berkshire Hathaway Inc.

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

BLUE CHIP STAMPS
Consolidated Earnings Summaries

	52 weeks ended	
	Dec. 30, 1978	*Dec. 31, 1977*
Revenues:		
Candy	$ 73,653	$ 62,886
Newspapers	44,674	31,786
Stamp service	16,531	15,723
Merchandise promotion and motivation service	3,791	2,485
Other	4,937	4,293
Total revenues	$143,586	$117,173
Earnings before securities gains or losses	$ 13,553	$ 12,893
Per share	2.62	2.49
Net earnings	14,280	16,993
Per share	2.76	3.28

(F) Unassigned Surplus

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

(G) Underwriting Expenses

The following expenses comprise underwriting expenses:

	1978	*1977*
Commissions and brokerage	$ 38,977	$ 32,932
Salaries and other compensation	5,394	4,285
Taxes, licenses and fees	3,751	2,942
Other underwriting expenses	5,681	3,918
Total statutory underwriting expenses	53,803	44,077
Increase in deferred acquisition costs	2,994	3,659
	$ 50,809	$ 40,418

(Continued)

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS *(Continued)*
(dollars in thousands)

(H) Federal Income Taxes

Federal income tax expense is made up of the following:

	1978	1977
Current income tax expense	$ 7,133	$ 3,064
Deferred income tax expense	1,824	2,117
Totals	$ 8,957	$ 5,181
The totals are applicable to:		
Operating earnings other than equity in earnings of Blue Chip	4,681	2,761
Equity in earnings of Blue Chip	276	306
Realized investment gain	4,000	2,114
	$ 8,957	$ 5,181
The current expense is applicable to:		
Operating earnings other than equity in earnings of Blue Chip	2,950	768
Dividends received from Blue Chip	24	22
Realized investment gain	4,159	2,274
	$ 7,133	$ 3,064
The deferred expense relates to the following:		
Change in deferred acquisition costs	1,438	1,758
Equity in undistributed earnings of Blue Chip	252	284
Accretion of discount on bonds, not currently taxable	266	235
Accumulated accreted discount on bonds sold	(159)	(160)
Other	27	—
	$ 1,824	$ 2,117

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

	1978	1977
Income tax expense at statutory rate	$18,761	$14,302
Decreases resulting from:		
Tax-exempt interest	(2,652)	(2,266)
85% dividends received credit relating to:		
Dividends from unaffiliated companies	(3,352)	(2,136)
Equity in earnings of Blue Chip Stamps	(1,407)	(1,739)
Long-term capital gain tax rate differential	(2,067)	(1,174)
Discount accretion and other	(167)	(89)
Benefit from affiliates	(159)	(1,717)
	$ 8,957	$ 5,181

(Continued)

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS *(Continued)*

(dollars in thousands)

(J) Investment Gain or Loss

A summary of realized and unrealized investment gain or loss of the Insurance Group for 1978 and 1977 is as follows:

	Net realized gain	*Applicable income taxes*	*Net realized gain less income taxes*	*Net unrealized gain (loss)*
		1978		
Bonds	$ 1,848	$ 574	$1,274	—
Preferred stocks	16	6	10	(5,183)
Common stocks	11,009	3,420	7,589	17,811
	$12,873	$4,000	$8,873	$12,628
		1977		
Bonds	1,612	488	1,124	—
Preferred stocks	97	29	68	3,384
Common stocks	5,322	1,597	3,725	25,237
	$ 7,031	$2,114	$4,917	$28,621

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
206 WEST STATE STREET, SUITE 700
ROCKFORD, ILLINOIS 61101
815-965-9511

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 (a 97.7% subsidiary of Berkshire Hathaway, Inc.) as of December 31, 1978 and 1977 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, 1978 and 1977 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 12, 1979

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

CONSOLIDATED BALANCE SHEETS

December 31, 1978 and 1977

ASSETS	1978	1977
Cash and due from banks	$ 20,231,765	$ 20,973,276
Investment securities (notes 2 and 8):		
United States Treasury obligations	565,983	566,558
United States Government agency obligations	42,372,484	41,553,063
Obligations of states and political subdivisions	63,576,532	58,696,192
Other securities	5,394,458	6,053,613
Federal Reserve Bank stock	300,000	300,000
Federal funds sold	3,000,000	7,000,000
Loans (note 3)	76,121,628	62,267,886
Bank premises and equipment (note 4)	1,105,719	1,021,747
Other assets (note 10)	3,145,995	2,719,924
	$215,814,564	$201,152,259

LIABILITIES AND STOCKHOLDERS' EQUITY	1978	1977
Liabilities:		
Demand deposits	$ 58,132,746	$ 56,978,240
Time deposits	127,001,647	117,890,119
Total deposits (note 5)	185,134,393	174,868,359
Liability for borrowed funds	2,356,584	—
Accrued taxes and other liabilities (notes 6 and 10)	2,413,309	1,716,594
Total liabilities	189,904,286	176,584,953
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 (note 8)	14,610,045	13,266,149
Reserve for contingencies (note 9)	1,300,233	1,301,157
Total stockholders' equity	25,910,278	24,567,306
	$215,814,564	$201,152,259

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

CONSOLIDATED STATEMENTS OF EARNINGS
Years ended December 31, 1978 and 1977

	1978	1977
Operating income:		
Interest and fees on loans	$ 6,479,704	$ 5,479,848
Income on Federal funds sold	298,069	287,622
Interest and dividends on:		
United States Treasury obligations	99,355	172,484
United States Government agency obligations	3,170,672	2,098,230
Obligations of states and political subdivisions	4,032,161	3,848,051
Other securities	484,049	576,652
Federal Reserve Bank stock	18,000	18,000
Total interest and dividend income	14,582,010	12,480,887
Trust fees	709,603	636,939
Service charges on deposit accounts	76,419	116,375
Other	375,615	577,087
Total operating income	15,743,647	13,811,288
Operating expenses:		
Interest on deposits	7,386,698	6,600,325
Interest on borrowed funds	35,999	—
Interest on Federal funds purchased	2,289	1,981
Total interest	7,424,986	6,602,306
Salaries and employee benefits (note 7)	2,173,834	2,096,796
Occupancy, net (note 4)	311,427	269,442
Furniture and equipment (note 4)	212,348	215,021
Provision for possible loan losses (note 3)	60,000	16,000
Other	738,850	811,709
Total operating expenses	10,921,445	10,011,274
Earnings before income taxes and securities (losses) gains	4,822,202	3,800,014
Income taxes, net (note 6)	459,425	429,493
Earnings before securities (losses) gains	4,362,777	3,370,521
Securities (losses) gains, net of related tax (benefit) expense of $(19,867) in 1978 and $11,209 in 1977 (note 6)	(19,805)	269,018
Net earnings	$ 4,342,972	$ 3,639,539

See accompanying notes to consolidated financial statements.

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, 1978 and 1977

	Common stock	*Surplus*	*Undivided profits (note 8)*	*Reserve for contingencies (note 9)*
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
Net earnings	—	—	4,342,972	—
Cash dividends — $12 per share	—	—	(3,000,000)	—
Transfer from reserve for contingencies — loan loss provision	—	—	924	(924)
Balance, December 31, 1978	$5,000,000	$5,000,000	$14,610,045	$1,300,233

See accompanying notes to consolidated financial statements.

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, 1978 and 1977

	1978	1977
Funds provided:		
From operations:		
Net earnings	$ 4,342,972	$ 3,639,539
Items which did not require (provide) funds from operations:		
Depreciation	85,491	96,192
Provision for loan losses	60,000	16,000
Deferred income taxes	(11,786)	376,620
Discount accretion	(163,878)	(169,835)
Other	24,390	78,101
Total funds provided from operations	4,337,189	4,036,617
Increase in:		
Deposits	10,266,034	6,531,692
Liability for borrowed funds	2,356,584	—
Decrease in:		
Federal funds sold	4,000,000	25,000,000
Cash and due from banks	741,511	—
Other, net	708,501	49,926
Total funds provided	$22,409,819	$35,618,235
Funds used:		
Increase in earning assets:		
Investment securities	4,876,153	15,569,736
Loans	13,913,742	6,105,011
Additions to bank premises and equipment, net	329,729	221,961
Cash dividends	3,000,000	2,500,000
Increase in cash and due from banks	—	10,105,165
Other, net	290,195	1,116,362
Total funds used	$22,409,819	$35,618,235

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1978 and 1977

(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. 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, which does not differ materially from accelerated income recognition methods required by generally accepted accounting principles.

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.

Tax benefits arising from losses for tax purposes, which are passed on to the Bank's parent, are not recognized by the Bank.

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.

(Continued)

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(2) Investment Securities

A summary of investments except Federal Reserve Bank stock, by major classification, is as follows:

	Dec. 31, 1978 (in thousands)			*Dec. 31, 1977 (in thousands)*		
	Par value	*Book value*	*Market value*	*Par value*	*Book value*	*Market value*
U.S. Government:						
Treasury	$ 565	$ 566	$ 528	$ 565	$ 566	$ 557
Agencies	44,144	42,372	41,761	41,550	41,553	41,616
State and political subdivisions	64,059	63,577	63,204	59,301	58,696	61,985
Other	6,597	5,394	5,665	7,345	6,054	6,415
	$115,365	$111,909	$111,158	$108,761	$106,869	$110,573

Investment securities with a carrying value of $7,977,564 and $7,988,556 at December 31, 1978 and 1977, respectively, were pledged to secure public deposits and for other purposes.

(3) Loans

A summary of the major classifications of loans, net of unearned discount of $3,919,300 and $2,908,057 at December 31, 1978 and 1977, respectively, is as follows:

	1978	*1977*
Real estate loans	$18,234,896	$14,935,184
Loans to financial institutions	403,100	—
Loans for purchasing or carrying securities	33,000	5,000
Commercial and industrial loans	43,593,359	33,837,853
Loans to individuals	13,172,918	12,697,237
All other loans	1,409,255	1,492,694
Total net of unearned discount	76,846,528	62,967,968
Less allowance for possible loan losses	724,900	700,082
Net loans	$76,121,628	$62,267,886

Loans to officers and directors and loans made to businesses and other interests of officers and directors amounted to approximately $6,413,000 and $1,933,000 at December 31, 1978 and 1977, respectively. Such loans were made at customary terms and rates afforded other borrowers.

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

	1978	*1977*
Balance at beginning of year	$700,082	$707,048
Recoveries on loans previously charged off	6,128	9,471
Provision for loan losses	60,000	16,000
	766,210	732,519
Less loans charged off	41,310	32,437
Balance at end of year	$724,900	$700,082

(Continued)

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

(4) Bank Premises and Equipment

Bank premises and equipment are recorded at cost less accumulated depreciation, as follows:

	1978	*1977*
Land and buildings	$2,083,659	$1,933,879
Furniture, fixtures and equipment	1,126,726	1,119,786
	3,210,385	3,053,665
Less accumulated depreciation	2,104,666	2,031,918
	$1,105,719	$1,021,747

As of December 31, 1978 the Bank had entered into contracts for the construction of a drive-in facility. The total anticipated cost of the facility is approximately $760,000 (excluding furnishings), with approximately $310,000 disbursed at December 31, 1978.

(5) Deposits

A summary of deposits by major classifications at December 31, 1978 and 1977 is as follows:

	1978	*1977*
Demand deposits of individuals, partnerships and corporations	$ 51,658,453	$ 52,720,561
Time and savings deposits of individuals, partnerships and corporations	124,549,588	115,603,809
Deposits of U.S. Government	289,910	1,659,050
Deposits of states and municipalities	2,896,906	2,799,656
Deposits of commercial banks	150,578	236,735
Certified and official checks	5,588,958	1,848,548
Total deposits	$185,134,393	$174,868,359

(6) Income Taxes

Accrued taxes and other liabilities in the accompanying balance sheets include deferred income taxes of $866,871 and $878,657 at December 31, 1978 and 1977, 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.

(Continued)

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

The reconciliation between the report to the Comptroller and the accompanying financial statements at December 31, 1978 and 1977 and for the years then ended follows:

	Per financial statements	*Per comptroller report*	*Net effect of the security write-down*
1978			
BALANCE SHEET ACCOUNTS			
Investments	$111,909,457	$111,290,394	$619,063
Undivided profits	$ 14,610,045	$ 13,990,982	$619,063
STATEMENT OF EARNINGS ACCOUNTS			
Operating income — Interest and dividends on other securities	$ 484,049	$ 497,159	$(13,110)
Net earnings	$ 4,342,972	$ 4,356,082	$(13,110)
1977			
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 — Interst 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

(9) 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 $299,233 and $300,157 for December 31, 1978 and 1977, respectively. The remaining portion of the reserve for contingencies ($1,001,000 for both 1978 and 1977) is not attributable to any specific contingency of the Bank.

(10) Standby Letters of Credit

Standby letters of credit at December 31, 1978 and 1977 totaled $431,999 and $78,289, respectively.

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

Taxes applicable to net earnings were as follows:

	1978	1977
Tax provision applicable to earnings before securities gains (losses)	$459,425	$ 73,771
Tax provision (benefit) applicable to securities gains (losses)	(19,867)	140,336
	439,558	214,107
Add tax benefit to parent corporation applicable to:		
Earnings before securities gains	—	355,722
Securities gains	—	(129,127)
	—	226,595
Income taxes	$439,558	$440,702

The components of consolidated income tax expense are as follows:

	1978	1977
Current income taxes:		
Federal	$386,485	$(226,595)
Add tax effect of operating loss passed to parent for which no benefit received	—	226,595
	386,485	—
State	64,859	64,082
Total current income taxes	451,344	64,082
Deferred income taxes:		
Federal	(8,603)	369,861
State	(3,183)	6,759
Total deferred income taxes	(11,786)	376,620
Total income taxes	$439,558	$440,702

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

	1978	1977
Accrued earnings and expense not reported for income tax purposes until collected or paid, net	$(10,859)	$374,961
Loan loss deductions for tax purposes more (less) than that provided for financial reporting purposes	(927)	1,659
	$(11,786)	$376,620

(Continued)

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS *(Continued)*

The total income tax expense for 1978 amounted to $439,558, an effective rate of 9.2% ($440,702 and 10.8% in 1977). The reasons for the difference between the effective tax rate and the corporate Federal income tax rate of 48% are as follows:

	1978		1977	
	Amount	*% of pretax earnings*	*Amount*	*% of pretax earnings*
Tax expense at statutory rate	$2,295,614	48.0%	$1,958,516	48.0%
Increase (reduction) in taxes resulting from:				
Tax-exempt interest, net of discount accretion	(1,882,558)	(39.4)	(1,790,903)	(43.9)
State income taxes, net of Federal income tax benefits	32,072	.7	36,837	.9
Tax benefit to parent, net	—	—	226,595	5.6
Other — net	(5,570)	(.1)	9,657	.2
Actual tax expense	$ 439,558	9.2%	$ 440,702	10.8%

(7) **Pension and Profit-Sharing Plan**

The Bank has a noncontributory pension plan and a profit-sharing plan for all officers and employees. Based upon the most recent actuarial report available (as of December 31, 1977), 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 $175,329 for 1978 and $213,665 for 1977.

(8) **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 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 years 1978 and 1977 that were 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, 1978.

(Continued)

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

CHARLES T. MUNGER, *Director*
Vice Chairman of the Board of the Company
Chairman of the Board of Blue Chip Stamps

COMMON STOCK PRICES

The common stock of Berkshire Hathaway Inc. is traded in the over counter market. The high and low bid prices for the stock in each quarter of 1977 and 1978 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
1977 1st Quarter	97	85
2nd Quarter	100	95
3rd Quarter	107	100
4th Quarter	139	107
1978 1st Quarter	142	134
2nd Quarter	180	142
3rd Quarter	180	165
4th Quarter	189	152

The Company did not pay a dividend in 1977 or 1978.

BERKSHIRE HATHAWAY INC.
Executive Offices – 97 Cove Street, New Bedford, Massachusetts 02744