ANNUAL REPORT 1968

DIVERSIFIED RETAILING COMPANY, INC.

EXECUTIVE OFFICERS

Warren E. Buffett
Chairman of the Board of Directors

Louis B. Kohn, II
President and Treasurer

David S. Gottesman
Vice President

Charles T. Munger
Vice President

Robert M. Goldman
Secretary

DIRECTORS

Warren E. Buffett
David S. Gottesman
Charles F. Heider
Louis B. Kohn, II
Nelson Loud
Charles T. Munger

REPORT OF THE CHAIRMAN

Earnings of $1,997,770 in fiscal 1969, while substantial, were off approximately $400,000 from the previous year. This decline reflects: (1) higher parent company interest due to the replacement of lower rate temporary bank debt with our present 8% debentures; (2) the effect of the 10% Federal income tax surcharge amounting to over $100,000; and (3) a lower profit margin at Hochschild,Kohn, reflecting the cost-squeeze which many department stores were unable to overcome last year.

Partially offsetting these negative factors was the superb performance of Associated Cotton Shops. In fiscal 1969, Associated's management was faced with the expiration of eight Big "N" leases, as detailed in last year's report, the loss of four units during the civil commotion following Martin Luther King, Jr.'s assassination, and the general escalation of costs throughout the retail area. Their response was a record year in sales and profits for this subsidiary. A number of new, highly successful stores were opened in 1968, and more are scheduled for 1969. Such a performance reflects great credit on Ben Rosner and his entire management group.

All earnings of DRC have again been retained to finance future growth of our subsidiaries, as well as to provide funds for future acquisitions. On the latter front, we have diligently pursued many acquisition possibilities, but have found none meeting our standards. The search will continue, but acquisitions will be undertaken only when they make business sense—we will not confuse activity with progress.

I will be happy to hear from any debenture holders who have questions concerning this report or any other aspect of our operation.

Warren E. Buffett

Warren E. Buffett

AUDITORS' REPORT

Board of Directors
Diversified Retailing Company, Inc.
Baltimore, Maryland

We have examined the consolidated balance sheet of Diversified Retailing Company, Inc. and subsidiaries as of February 1, 1969, and the related consolidated statements of earnings and earnings retained in the business for the fiscal year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Associated Cotton Shops, Inc., a consolidated subsidiary, which statements were examined by other independent accountants whose report thereon has been furnished to us. We and the other independent accountants made similar examinations of the financial statements for the preceding year.

In our opinion, based upon our examination and the aforementioned report of other independent accountants, the accompanying balance sheet and statements of earnings and earnings retained in the business present fairly the consolidated financial position of Diversified Retailing Company, Inc. and subsidiaries at February 1, 1969, and the consolidated results of their operations for the fiscal year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

Ernst & Ernst

Baltimore, Maryland
April 23, 1969

ASSETS

	February 1, 1969	February 3, 1968
CURRENT ASSETS		
Cash (including $2,500,000 of short-term investments at February 3, 1968)	$ 2,255,051	$ 3,727,657
Accounts receivable — Note B	11,169,789	10,212,455
Merchandise inventories — Note C	10,052,308	9,793,288
Prepaid expenses	646,768	504,942
TOTAL CURRENT ASSETS	24,123,916	24,238,342
INVESTMENTS AND OTHER ASSETS	1,150,952	1,139,323
PROPERTY, PLANT AND EQUIPMENT — on the basis of cost — Notes D, E and F		
Land	3,577,467	3,457,278
Buildings	5,194,358	5,073,893
Fixtures and equipment	4,865,254	4,264,806
Leasehold improvements	1,483,873	1,442,761
Allowances for depreciation and amortization	(6,281,570)	(5,707,453)
	8,839,382	8,531,285
	$34,114,250	$33,908,950

See notes to consolidated financial statements.

ANY, INC. AND SUBSIDIARIES

BALANCE SHEET

LIABILITIES

	February 1, 1969	February 3, 1968
CURRENT LIABILITIES		
Note payable to bank	$ 400,000	$ 900,000
Trade and sundry accounts payable	4,298,351	4,617,903
Salaries, wages and bonuses	425,809	542,300
Taxes on income—Notes B and I	1,367,137	1,563,180
Current portion of long-term debt	246,322	56,618
TOTAL CURRENT LIABILITIES	6,737,619	7,680,001
LONG-TERM DEBT—less current maturities—Note E	11,637,188	11,878,704
RESERVE—for restoration of leased property	274,006	274,006
DEFERRED INCOME TAXES—Note D	219,600	338,200
DEFERRED CREDIT—Unamortized excess of carrying amount of net assets of subsidiaries over acquisition cost—Note A	3,593,731	4,083,703
STOCKHOLDERS' EQUITY—Note J		
Common Stock, par value $1.00 per share:		
Authorized 1,000 shares; issued and outstanding 300 shares	300	300
Additional paid-in capital	5,999,700	5,999,700
Earnings retained in the business—Note E	5,652,106	3,654,336
	11,652,106	9,654,336
COMMITMENTS AND CONTINGENT LIABILITIES—Notes F, G and H		
	$34,114,250	$33,908,950

STATEMENT OF CONSOLIDATED EARNINGS

	Fiscal year ended February 1, 1969 (52 weeks)	Fiscal year ended February 3, 1968 (53 weeks)
Net sales (including leased department sales)	$83,378,857	$73,385,558
Cost of goods sold	54,827,831	48,150,561
	28,551,026	25,234,997
Selling, general and administrative expenses	25,145,604	21,043,263
	3,405,422	4,191,734
Other income and (deductions):		
Amortization of excess of net assets of subsidiaries over acquisition cost	489,972	457,186
Rental income—net	139,172	147,611
Interest and financing cost	(882,375)	(699,592)
Interest income	89,273	28,884
Miscellaneous	237,406	184,576
EARNINGS BEFORE TAXES ON INCOME	3,478,870	4,310,399
Taxes on income—Notes B, D and I:		
Federal—current	1,073,000	1,595,800
—deferred	170,100	102,100
State and local	238,000	215,000
	1,481,100	1,912,900
NET EARNINGS	$ 1,997,770	$ 2,397,499

STATEMENT OF CONSOLIDATED EARNINGS RETAINED IN THE BUSINESS

	Fiscal year ended February 1, 1969	Fiscal year ended February 3, 1968
Balance at beginning of year	$3,654,336	$1,256,837
Net earnings for the year	1,997,770	2,397,499
BALANCE AT END OF YEAR—Note E	$5,652,106	$3,654,336

See notes to consolidated financial statements.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

February 1, 1969

Note A—Principles of Consolidation

The consolidated financial statements include the accounts of the Company's subsidiaries, Hochschild, Kohn & Co., Incorporated (Hochschild) and Associated Cotton Shops, Inc. (Associated), both of which are wholly-owned. Intercompany accounts and transactions have been eliminated in consolidation.

At the dates of acquisition, the carrying amounts of the net assets of the subsidiaries were in excess of the investment of Diversified in the amount of $4,899,731; such excess is included in the balance sheet and is being amortized over a ten-year period beginning with the respective acquisition dates.

Note B—Receivables

	February 1, 1969	February 3, 1968
Customers regular accounts	$ 3,136,153	$ 3,030,534
Customers revolving credit accounts	7,683,098	6,781,013
Other receivables	476,665	535,263
	11,295,916	10,346,810
Less allowance for doubtful accounts	126,127	134,355
	$11,169,789	$10,212,455

For financial reporting purposes gross profit from revolving credit sales is taken into income at the time of sale, but for income tax purposes such profits are reported when realized by collection of the related accounts receivable. Deferred taxes on income relating to the revolving credit sales at February 1, 1969, which amounted to $1,207,900, have been included with taxes on income under current liabilities in the balance sheet.

Note C—Merchandise Inventories

Inventories, as determined generally according to the retail inventory method, were priced at the lower of cost or market on the following bases:

	February 1, 1969	February 3, 1968
Lower of cost (last-in, first-out) or market	$ 6,503,493	$ 6,184,075
Lower of cost (first-in, first-out) or market	3,548,815	3,609,213
	$10,052,308	$ 9,793,288

Note D—Property, Plant and Equipment

For financial reporting purposes provision for depreciation is computed on the straight-line method except for Associated which provides for depreciation on the declining-balance method for buildings. For income tax purposes Hochschild uses recognized accelerated methods of depreciation. At February 1, 1969 depreciation of approximately $450,000 has been deducted for tax purposes in excess of deductions in the financial statements. Related deferred taxes on income are shown separately in the balance sheet. Depreciation and amortization of property, plant and equipment charged to earnings for 1968 and 1967 were $706,424 and $636,594, respectively.

Note E—Long-term Debt

	February 1, 1969	February 3, 1968
8% Debentures	$ 6,600,000	$ 6,600,000
5¼% Mortgage payable	5,000,000	5,000,000
4% Mortgage payable	283,510	335,322
	11,883,510	11,935,322
Less current portion	246,322	56,618
	$11,637,188	$11,878,704

8% Debentures—due November 1, 1985—the Debentures, which were issued under a Trust Indenture dated November 1, 1967, are not limited in aggregate amount, bear interest at a fixed annual minimum rate of 8% payable semi-annually and bear participating additional interest up to a maximum of 1% based on adjusted consolidated earnings before income taxes.

The Debentures are subject to redemption at the option of the Company at 107½ to October 31, 1969 and at reduced prices thereafter. They are also subject to redemption at par plus accrued interest through operation of a contingent sinking fund. Sinking fund payments on anniversary dates are contingent upon the amount of adjusted consolidated net worth at preceding fiscal year end. No payment will be required at October 28, 1969.

The Articles of Incorporation of the Company allow the Debenture holders, to the exclusion of holders of Common Stock, to vote under certain conditions.

5¼% Mortgage payable—under the deed of trust, substantially all of the property, plant and equipment of the subsidiary, Hochschild, is pledged as collateral. Interest is payable $65,625 quarterly with no payments due on principal until April 1, 1969; thereafter quarterly payments of $111,610 covering principal and interest are due, with final payment to be made on January 1, 1986.

4% Mortgage payable—land and building of the subsidiary, Associated, have been pledged as collateral. Payments are due in monthly installments of $5,750 including interest to January 1972.

The loan agreement under the 5¼% mortgage and the Trust Indenture covering the 8% Debentures contain certain restrictions applicable to the Company and subsidiary, Hochschild, relating to the total amount of indebtedness which may be incurred, maintenance of working capital (minimum requirement of 15% of Hochschild's sales for preceding year) and net worth, redemption of stock and payment of dividends. At February 1, 1969 earnings retained in the business were not subject to such restrictions.

Note F—Leases

There are in effect 92 leases with expiration dates ranging from 1970 to 1998, which provide for basic annual rentals of approximately $2,900,000. Certain of these leases provide for additional rent based on sales volume for payment of real estate taxes and other expenses, and for restoration of the properties. Property carried in the balance sheet at February 1, 1969 in the net amount of $210,573 is pledged to secure performance of restoration under several leases.

A building, not used in retail store operations, is leased from an officer of Associated and the estate of a former officer through 1977 at an annual rental of $90,000 plus real estate taxes in excess of $30,000 and payment of operating expenses. Space in the building is sublet to others. Associated has guaranteed payment of a mortgage of approximately $653,000 on this property. The State of New York has commenced condemnation proceedings against this property. Associated does not anticipate any loss in this connection.

Note G—Pension Plans

Each of the Company's subsidiaries has a pension plan covering substantially all of its employees. The total pension expense for the year was $400,000, which includes amortization of past-service liability over a thirty-year period. The Company's policy is to fund pension cost accrued. As of February 1, 1969 the actuarially computed value of vested benefits of one plan was less than the total value of the pension fund and participants in the other plan do not have a vested interest.

Note H—Litigation

Associated is a defendant in a suit claiming punitive damages of $1,000,000 and personal injury of $10,000. The insurance carrier is defending this action but has notified the Company that it (the insurance carrier) has no liability for punitive damages. In the opinion of the counsel for the Company, recovery by the plaintiff of punitive damages is remote.

Note I—Federal Income Taxes

The provisions for current income taxes have been reduced by $145,500 and $50,000 in the years ended February 1, 1969 and February 3, 1968, respectively, for investment credits.

Note J—Capital Accounts

There were no changes in the capital stock and additional paid-in capital accounts during the years ended February 1, 1969 and February 3, 1968.

EXECUTIVE OFFICES

200 North Howard Street
Baltimore, Maryland 21201

TRUSTEE OF 8% DEBENTURES DUE NOVEMBER 1ST, 1985

Mercantile-Safe Deposit and Trust Company
Baltimore and Calvert Streets
Baltimore, Maryland 21203

AUDITORS

Ernst & Ernst
One North Charles
Baltimore, Maryland 21201