SEC FILE NO 2-27473 10--09 SIC 561 D 67 40 00 000

DIVERSIFIED RETAILING CO INC **10-K**

OTHER

CARD 1 MICROFICHE BY DISCLOSURE INCORPORATED FOR 01/29/77

Diversified Retailing Company, Inc. [Md.] Co: D674000000
1300 Mercentile Bank & Trust Building
2 Hopkins Plaza
Baltimore, Md. 21201
SEC File No: 2-27473 Exch: Other
IRS No: 52-0846159 CUSIP: 2553279
Fiscal Year Ends: 1/31 SIC No: 531
Auditor: Peat, Marwick, Mitchell & Co.

10-K	For:	01/31/76	
10-K	For:	01/31/76	Amendment 1
10-Q	For:	05/01/76	
10-Q	For:	07/31/76	
10-Q	For:	10/30/76	

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SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

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FORM 10-K

APR 1977

Annual Report Pursuant to Section 13 or 15(d)
of the Securities Exchange Act of 1934

148

For the fiscal year ended
January 29, 1977

Commission file number:
2-27473

DIVERSIFIED RETAILING COMPANY, INC.

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DISCLOSURE INCORPORATED

State of Incorporation: Maryland

I.R.S. Employer Identification No.: 52-0846159

Address of Principal Executive Offices:
1300 Mercantile Bank and Trust Building
2 Hopkins Plaza
Baltimore, Maryland 21201

Registrant's Telephone Number, Including Area Code:
(301) 547-0500

Securities Registered Pursuant to Section 12(b) of the Act:
None

Securities Registered Pursuant to Section 12(g) of the Act:
None

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES X NO ______

Number of Shares of Common Stock (one class only) outstanding as of January 29, 1977: 782,490.

PART I

ITEM 1. BUSINESS

A. General

Diversified Retailing Company, Inc. (hereinafter referred to as the "Company"), a Maryland corporation, is a holding company which renders financial and operating advice to its wholly-owned subsidiary, Associated Retail Stores, Inc. (hereinafter referred to as "Associated") and to Associated's subsidiary. The Company also owns shares of Berkshire Hathaway Inc. (hereinafter referred to as "Berkshire"); subsidiaries of the Company's also owns shares of Berkshire.

The Company has no direct salaried employees and (with certain nominal exceptions noted under ITEM 12. DIRECTORS OF REGISTRANT and/or under ITEM 13. REMUNERATION OF DIRECTORS AND OFFICERS) does not compensate its Directors and Officers for their services. The Company's President, Robert M. Goldman, acts upon material corporate matters only at the direction of the Board of Directors of the Company.

B. Associated Retail Stores, Inc.

Associated, an Illinois corporation, is the Company's wholly-owned subsidiary. Associated operates a chain of stores which sell at retail popularly priced women's and, in a number of stores, children's apparel. The stores are located in downtown, neighborhood and shopping center retail areas of principal cities in ten (10) states, in leased or owned premises (see ITEM 3. PROPERTIES), and operate under various trade names.

NOTE: Unless the text otherwise indicated, all statements made in PART I describe circumstances existing as of January 29, 1977.

The following table sets forth information as to the number of stores of Associated open, opened, and closed during the years indicate:

Fiscal Year Ended	Open Begin Year	Opened During Year	Closed During Year	Open End Year
2/3/73	65	7	8	64
2/2/74	64	4	2	66
2/1/75	66	4	5	65
2/1/76	65	7	7	65
1/29/77	65	22	6	81

The following table indicates the number of stores of Associated operating under the various trade names used by Associated at January 29, 1977:

York	46
Amy	8
Goodwins	6
Fashion Outlet	4
Gaytime	2
G & A	1
Madison's	1
Yorkster	2
Lanes	9
Robson	1
Tops and Bottoms	1

Associated seeks to afford its customers a wide variety of available merchandise while reducing its overhead costs to as low a level as is possible. Because of the number of stores operated by Associated, it is able to practice certain economies of scale. All of Associated's stores are served by a central buying and warehousing organization located in New York City, from which the stores' apparel lines are administered. A staff of merchandise managers and buyers maintains daily personal contact with the apparel markets located in New York City and elsewhere. Nearly all receiving and purchasing activities are conducted in the central warehouse, from which shipments are made daily to the various stores. Associated utilizes detailed inventory control and analysis procedures, primarily through the use of an owned computer system, to identify popular and fast-selling items for rapid replacement, and to identify those items requiring an immediate reduction in price so that they may be sold quickly. In addition, Associated utilizes interchangeable store fixtures to facilitate the opening and closing of its stores. Associated's policy of making sales only for cash or on credit under approved bank charge account plans has allowed it further to avoid unnecessary overhead costs.

Associated regularly employs approximately one thousand, four hundred (1,400) full and part-time employees, and seasonally employs an additional one hundred seventy-five (175) employees. All of its sales personnel are paid at an hourly rate, and none are paid sales commissions. Approximately eighty percent (80%) of Associated's employees are covered by union contracts which expire at various times. There were no significant changes in employee relations during the fiscal year ended January 29, 1977, and Associated's management considers its relations with its employees to be satisfactory.

The business of most of the stores, particularly those in the larger cities, involves intense competition with other stores selling similar merchandise, including discount and department stores, specialty shops and stores operated by national chains.

In addition to operating the chain of retail stores, Associated wholly-owns one (1) subsidiary,* and that subsidiary owns 99.6% of another company.

(1) Columbia Insurance Company

Columbia Insurance Company** (hereinafter referred to as "Columbia"), a Nebraska corporation, is a wholly-owned subsidiary of Associated which engages in the business of fire and casualty insurance and reinsurance. Columbia operates under a certificate of authority to transact the business of insurance (with the exceptions of life and title insurance) issued by the Department of Insurance of the State of Nebraska, and is currently licensed to conduct one or more insurance businesses in eighteen (18) other states. At present, Columbia's business consists primarily of the acceptance of portions of reinsurance contracts generated through and offered to Columbia by the reinsurance division of National Indemnity Company (hereinafter referred to as "National Indemnity").

National Indemnity is a wholly-owned subsidiary of Berkshire. Although as of January 29, 1977, Warren E. Buffett, a member of his immediate family, the Company

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* On November 30, 1975 two (2) former wholly-owned subsidiaries of Associated, Fashion Outlet of Michigan, Inc. and Anbec, Inc., were merged into Associated. Fashion Outlet of Michigan, Inc., in its former capacity as a Michigan corporation, operated a single women's and children's apparel store on leased premises in Saginaw, Michigan. Associated now operates that store under the name "Fashion Outlet". Anbec, Inc., in its former capacity as an Illinois corporation, owned certain improved real property in Chicago, Illinois, and leased that property to Associated for the latter's operation of one of its retail stores. Associated continues to operate that store.

** Formerly "Reinsurance Corp. of Nebraska".

and its subsidiaries owned substantial amounts of the common stock of Berkshire, and although Mr. Buffett is the Chairman of the Board of Directors of the Company, of Associated, of Columbia, and of Berkshire (see ITEM 4. PARENTS AND SUBSIDIARIES and ITEM 12. DIRECTORS OF REGISTRANT), National Indemnity is not obligated to offer all or any portion of any reinsurance contract to Columbia. Accordingly, Columbia cannot be certain that it will continue to be offered business through the reinsurance division of National Indemnity, presently its principal source of business. Columbia currently is dependent upon the continuance of its business arrangements with National Indemnity since Columbia has no independent staff for generating or evaluating business, settling losses or handling other administrative details.

(2) Southern Casualty Insurance Company

On April 30, 1974 Columbia purchased 99.6% of the issued and outstanding voting securites of Southern Casualty Insurance Company (hereinafter referred to as "Southern"). Southern is licensed to write workmen's compensation coverage in the State of Louisiana.

C. Lines of Business and Classes of Similar Products or Services

The Company believes that for purposes of this Item it conducts only one significant line of business; i.e., through Associated, the retailing of women's and children's apparel.

The Company and/or its consolidated subsidiaries (including Columbia), have investments in Berkshire and Blue Chip Stamps (hereinafter referred to as "Blue Chip") which are accounted for by the equity method. Although these investments are not treated as lines of business for purpose of this Item, equity in earnings of these affiliates contribute significantly to consolidated net earnings as set forth in Item 2 following.

The Company's insurance and reinsurance operations, conducted by Columbia and Southern, are not treated as a separate line of business for purposes of this Item because their written premium volume plus their investment income is less than 15% of the sum of consolidated net sales, written insurance premium volume and consolidated investment income. Columbia's equity in net earnings of Berkshire and Blue Chip represented approximately ninety-six percent (96%) of Columbia's net earnings for 1976; in the prior year, Columbia's equity in net earnings of Berkshire and Blue Chip exceeded Columbia's net earnings. Such equity income is reported on a consolidated basis in Item 2 as described above. See also the consolidated financial statements of Columbia Insurance Company and Consolidated Subsidiary included in Item 10(a).

ITEM 2. SUMMARY OF OPERATIONS

THIS SUMMARY SHOULD BE READ IN CONJUNCTION WITH THE FINANCIAL STATEMENTS AND NOTES THERETO INCLUDED IN ITEM 10(a)

	Fiscal Year Ended				
	February 3, 1973*	February 2, 1974	February 1, 1975	January 31, 1976	January 29, 1977
	(In thousands of dollars except per share amounts)				
Net Sales	$38,918	$38,399	$34,925	$36,145	$39,938
Gross Profit and Other Income Items	$13,919	$13,904	$13,333	$13,961	$15,809
Operating Expenses, Except Interest	(11,778)	(12,167)	(11,946)	(12,255)	(13,471)
Interest and Financing Costs	(687)	(720)	(677)	(714)	(1,027)
Income Taxes Applicable to Operating Earnings	(703)	(441)	(307)	(489)	(582)
Operating Earnings	751	576	403	503	729
Additions to (Deductions from) Operating Earnings, Net of Taxes: Equity in Net Earnings of Affiliated Companies Accounted for by the Equity Method	1,972	1,985	1,582	1,559	4,773
Realized Gains (Losses) from Securities Transactions, Net of Income Taxes	195	26	(210)	5	68
Earnings Before Extraordinary Items	2,918	2,587	1,775	2,067	5,570
Extraordinary Items, Net of Taxes (a)	-	395	68	-	-
Net Earnings	$ 2,918	$ 2,982	$ 1,843	$ 2,067	$ 5,570
Per Weighted Average Outstanding Share (b):					
Earnings before Extraordinary Items	$ 2.92	2.59	1.77	2.07	6.68
Net Earnings	2.92	2.98	1.84	2.07	6.68

* The fiscal year ended February 3, 1973 consisted of 53 weeks

This summary includes the results of the Company and its subsidiaries on a consolidated basis.

(a) The extraordinary gains in fiscal years 1974 and 1975 resulted from receipt of condemnation proceeds for certain Philadelphia properties in excess of depreciated cost of the properties.

(b) In the year ended January 29, 1977, the weighted average shares outstanding were 833,118. There were 1,000,000 shares outstanding in all prior years.

MANAGEMENT'S DISCUSSION OF SUMMARY OF OPERATIONS

Associated's store to store sales comparison for the year ended January 29, 1977 showed an increase of approximately 5% over the prior year. This followed a 3-1/2% increase in store to store sales in the prior year. This store-to-store sales increase in the most recent fiscal year contributed about one-half of the $3.8 million increase in sales, the balance of the increase was contributed by new stores opened primarily in the last half of the year. Associated's potential sales volume was increased significantly in August, 1976 when it acquired in a single transaction leasehold interests in seventeen additional retailing locations in Chicago. The full impact of these added stores will not be reflected until the 1978 fiscal year. Retailing gross profit margins for fiscal 1977 were fairly constant with those of fiscal 1976 (38.4% vs. 38.3%), after an improvement in fiscal 1976 from fiscal 1975 (38.3% vs. 37.5%). The improved margin is attributable to fewer mark-downs in fiscal 1976 than in fiscal 1975.

Total gross profit, which increased as a result of increased sales, and other income items increased over the prior year by approximately 13% in the year ended January 29, 1977, while a lesser 10% increase in operating expenses resulted from tight expense controls. For fiscal 1976 total gross profit and other income items increased 4.7% over fiscal 1975 while the increase in operating expenses was held to 2.6%.

Interest expense increased $313,000 for fiscal 1977 over the prior year. This added expense relates principally to interest on the $4,000,000 bank term loan not outstanding in the prior year. Additionally, for the year ended January 29, 1977, additional interest of $33,000 is payable on debentures since consolidated earnings before income taxes and before interest on long term debt exceeded $6 million.

The more significant factor influencing consolidated earnings before extraordinary items has been the Company's equity in net earnings of Berkshire and Blue Chip. The Company's recorded share of net earnings of these affiliates has been as follows for the past three years, in thousands of dollars.

	Fiscal Year Ended		
	February 1 1975	January 31 1976	January 29 1977
Berkshire	$ 723	$ 637	$3,439
Blue Chip	859	922	1,334
	$1,582	$1,559	$4,773

The Company's equity in net earnings of the investees is essentially a function of the amount of the investees' net earnings and the number of the investees' shares owned by the Company. The Company's share ownership of Blue Chip has remained constant in each of the past three years so that the above reflects increases in Blue Chip's net earnings. Shares of Berkshire stock owned by the Company have increased slightly in each of the past two years; as to the Company, this tended to accentuate the increase in reported earnings of Berkshire in the most recent year and to mitigate the decrease in the prior year from the second preceding year in Berkshire's earnings.

In the most recent year, $1,240,000 of the increase of $2,802,000 in equity in Berkshire's earnings represents increased equity in realized investment gains of Berkshire.

ITEM 3. PROPERTIES

The operating offices of the Company are located in the law firm of Frank, Bernstein, Conaway & Goldman, 1300 Mercantile Bank and Trust Building, 2 Hopkins Plaza, Baltimore, Maryland 21201, in which firm Robert M. Goldman, the President of the Company, and Max E. Blumenthal, the Secretary of the Company, are partners. The Company pays no rent for the said offices and, except for certain legal and bookkeeping activities, only limited operational activities of the Company take place therein.

The stores operated by Associated (see ITEM 1. BUSINESS) range in size of floor area from approximately two thousand (2,000) square feet to approximately sixty thousand (60,000) square feet. The total floor area of all of the stores is approximately nine hundred fifty thousand (950,000) square square feet.

Associated owns the land and improvements of nine (9) of its store locations (the ninth store location having been acquired on March 31, 1977), all of which are in Chicago, Milwaukee, Philadelphia, Chester, Pennsylvania and Gary, Indiana. Associated leases its remaining store locations, for terms expiring on various dates through 1988. The aggregate annual minimum rental paid by Associated during the fiscal year ended January 29, 1977 for the store locations which it leases was approximately $1,317,300. Certain of the leases, however, provide for the payment of additional rent based upon the volume of sales at the particular location, and for the payment by Associated of applicable real property taxes and/or other expenses. (See Note 12 of the Notes to Financial Statements.)

Associated's executive, buying and administrative offices are located in a New York City warehouse (see ITEM 1. BUSINESS) leased by Associated for a term expiring in 1978. The warehouse has a floor area of approximately eighty thousand (80,000) square feet.

Columbia has no independent operating offices and owns no facilities; all of Columbia's activities are supervised by Warren E. Buffett, the Chairman of its Board of Directors, from his offices in Omaha, Nebraska.

ITEM 4. PARENTS AND SUBSIDIARIES

A. Parents

As of January 29, 1977, Warren E. Buffett owned 51.86%* of the Company's common stock; First Manhattan Co. (of which David S. Gottesman was and is a general partner) held of record 13.26% of that stock; and Susan T. Buffett, the spouse of Warren T. Buffett, owned approximately 3.98% of that stock. (see ITEM 11. PRINCIPAL SECURITY HOLDERS AND SECURITY HOLDINGS OF MANAGEMENT and ITEM 12. DIRECTORS OF REGISTRANT.) First Manhattan Co. disclaims any status which would cause it to be deemed a parent Company.

B. Subsidiaries

The Company owns one hundred percent (100%) of the issued and outstanding voting securities of its subsidiary, Associated Retail Stores, Inc., an Illinois corporation. Associated owns one hundred percent (100%) of the issued and

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* This percentage was computed without taking into account Mr. Buffett's interest as trustee under a trust instrument in certain shares of the Company's common stock. See ITEM 11. PRINCIPAL SECURITY HOLDERS AND SECURITY HOLDINGS OF MANAGEMENT.

outstanding voting securities of its subsidiary, Columbia Insurance Company, a Nebraska corporation. Columbia owns 99.6% of Southern Casualty Insurance Company. The above-named subsidiaries are included in the consolidated financial statements of the Company.

As of January 29, 1977, the Company, through its subsidiary, Associated, and Associated's subsidiary, Columbia, owned of record approximately sixteen percent (16%) of the common stock of Blue Chip Stamps, a California corporation; Warren E. Buffett and his wife owned of record approximately thirteen percent (13%) of that stock; and Charles T. Munger owned of record approximately two percent (2%) of that stock. On that date, Berkshire and its subsidiaries beneficially and of record owned approximately thirty-three percent (33%) of the common stock of Blue Chip, and David S. Gottesman and Charles F. Heider, and members of the immediate family of Charles F. Heider, owned beneficially less than one percent (1%) of that stock. The Company takes up equity in earnings relating to its shareholdings in Blue Chip. For purposes of this Item 4, and pursuant to Instruction No. 6 thereto, Blue Chip is deemed to be a subsidiary.

As of January 29, 1977, the Company, Associated, Columbia and Southern in the aggregate owned beneficially approximately seventeen percent (17%) of the common stock of Berkshire, a Delaware corporation. In addition, on that date Warren E. Buffett and Susan T. Buffett, his spouse, respectively owned beneficially approximately 33.6% and approximately 2.5% of that stock. The Company takes up equity in earnings relating to its shareholdings in Berkshire. For purposes of this Item 4, and pursuant to Instruction No. 6 thereto, Berkshire is deemed to be a subsidiary.

ITEM 5. PENDING LEGAL PROCEEDINGS

Neither the Company, Associated nor Associated's subsidiary are parties to any material pending legal proceedings other than ordinary routine litigation incidental to their business, and none of their property is the subject thereof.

ITEM 6. INCREASES AND DECREASES IN OUTSTANDING SECURITIES

Title of Class	Amount Outstanding As of February 1, 1976	Dates of Transactions	Amount of Increase/ (Decrease)	Amount Outstanding As of January 29, 1977
Diversified Retailing Co., Inc., common stock, par value $0.003 per share	1,000,000	March 17, 1976 to May 27, 1976	(217,510)	782,490

Description of Transactions

A description of the nature of the transactions was set forth in Amendment No. 1 to the Company's Annual Report on Form 10-K for the fiscal year ended January 31, 1976, which description is incorporated herein by reference.

ITEM 7. APPROXIMATE NUMBER OF EQUITY SECURITY HOLDERS

Title of Class	Number of Record Holders
Diversified Retailing Co., Inc., common stock, par value $0.0003 per share	58

ITEM 8. EXECUTIVE OFFICERS OF THE REGISTRANT

Name	Age	Offices(s) Held
Warren E. Buffett	46	Chairman of Board of Directors
Robert M. Goldman (a)	60	President; Director
David S. Gottesman	50	Vice President; Director
Charles T. Munger	53	Vice President; Director
Charles F. Heider	50	Director
Max E. Blumenthal (a)	36	Secretary
Larry C. Cummings (a)	33	Treasurer; Assistant Secretary

ITEM 9. INDEMNIFICATION OF DIRECTORS AND OFFICERS

The Company has no charter provision, by-law, contract or arrangement under or pursuant to which any of its Directors or Officers are insured or indemnified in any manner against any liability which may be incurred in their capacity as such. However, under Section 2-418 of the Corporations and Associations Article of the Annotated Code of Maryland, the Company may indemnify any Director, officer, employee or agent of the Company against any expenses or liability incurred as a result of his good faith performance of duty in such capacity, subject to certain restrictions upon such indemnification, which are provided in the said statute.

(a) Both Mr. Goldman and Mr. Blumenthal are partners in the law firm of Frank, Bernstein, Conaway & Goldman, 1300 Mercantile Bank and Trust Building, 2 Hopkins Plaza, Baltimore, Maryland 21201, which firm represents the Company. Mr. Cummings is an employee of that firm.

ITEM 10. FINANCIAL STATEMENTS AND EXHIBITS FILED

A. Financial Statements

A list of the consolidated financial statements and schedules of the Company and/or of the consolidated insurance subsidiaries which are filed herewith immediately precedes those documents herein.

B. Exhibits Filed

Exhibit A: 1976 Annual Report of Berkshire Hathaway, Inc.

Exhibit B: Annual Report of Blue Chip Stamps for the Year Ended January 1, 1977

Exhibit C: 1976 Annual Report of Wesco Financial Corporation

PART II

ITEM 11. PRINCIPAL SECURITY HOLDERS AND SECURITY HOLDINGS OF MANAGEMENT

A. Principal Security Holders

Name and Address	Title of Class	Type of Ownership	Amount Owned	Percent of Class
Warren E. Buffett 5505 Farnam Street Omaha, Nebraska 68131	common	record and beneficial	440,636(a)	56.3%
First Manhattan Co. 30 Wall Street New York, New York 10005	common	record only	103,787(b)	13.26%

(a) This amount includes the following shares of common stock, as to which Mr. Buffett disclaims the beneficial ownership:

(i) 31,113 shares held by Mr. Buffett's wife, Susan T. Buffett;

(ii) 3,732 shares held in trust under the Last Will and Testament of Howard H. Buffett, deceased, as to which Mr. Buffett is the trustee;

(b) David S. Gottesman, a Director and a Vice President of the Company, beneficially owned 32,000 of the said 103,787 shares. An additional 27,926 of the said 103,787 shares are held in trusts for the benefit of certain members of Mr. Gottesman's immediate family. The remaining 43,861 of the 103,787 shares are owned beneficially by other partners of the firm or the spouse of one of each partners. Mr. Gottesman disclaims the beneficial ownership of the shares held in the said trusts.

B. Security Holdings of Management

Title of Class	Amount Beneficially Owned (c)	Percent of Class
Diversified Retailing Co., Inc., common stock, par value 0.0003 per share (d)	496,263 (e)	63.4%

ITEM 12. DIRECTORS OF THE REGISTRANT

Each of the following persons served as a Director of the Company during the entire fiscal year ended January 29, 1977.

(c) Subject to the exceptions indicated in note (f) to this Item, this column indicates the number of shares of the common stock of the Company beneficially owned directly or indirectly by all Directors and Officers of the Company, as a group, as of January 29, 1977.

(d) The Company has no other class of equity securities. No Director or Officer possesses the beneficial ownership of any share or shares of equity securities of the Company's subsidiary, Associated, or of Associated's subsidiary, Columbia.

(e) This amount does not include any of the following shares of common stock:

(i) the shares referred to in note (a) to this Item, which note is incorporated herein by reference;

(ii) the 27,926 shares held in trusts for the benefit of certain members of David S. Gottesman's immediate family referred to in note (b) to this Item, which note is incorporated herein by reference.

A. Warren E. Buffett

Warren E. Buffett is the Chairman of the Board of Directors of the Company, having held that office since the Company's organization in 1966. Since 1970, Mr. Buffett has been the Chairman of the Board of Directors of Associated and of Berkshire, and the Chairman of the Board of Directors of Columbia.

B. David S. Gottesman

David S. Gottesman, a Director and a Vice President of the Company, is and has been for the past five years a general partner in the broker-dealer securities firm of First Manhattan Co., a member of the New York Stock Exchange.

C. Charles T. Munger

Charles T. Munger, a Director and a Vice President of the Company, has been for the past five years, and until January, 1976, a general partner in the broker-dealer securities firm of Wheeler, Munger & Co., a member of the Pacific Coast Stock Exchange. From January, 1976, to July, 1976 Mr. Munger's principal occupation consisted of the management of personal investments. Since July, 1976, Mr. Munger has been Chairman of the Board of Directors of Blue Chip.

D. Charles F. Heider

Charles F. Heider, a Director of the Company, is and has been since 1970 the President of Chiles, Heider & Co., Inc., a broker-dealer securities firm and a member of the New York Stock Exchange.

E. Robert M. Goldman

Robert M. Goldman, a Director and the President of the Company, is and has been since July 1, 1966, a partner of the Maryland law firm of Frank, Bernstein, Conaway & Goldman.

ITEM 13. REMUNERATION OF DIRECTORS AND OFFICERS

Name of Individual or Number of Persons in Group	Capacities in Remuneration Was Received	Aggregate direct Remuneration (a)
Larry C. Cummings	Treasurer	$500.00
All seven Directors and Officers as a group		$500.00 (b)

ITEM 14. OPTIONS GRANTED TO MANAGEMENT TO PURCHASE SECURITIES

None

ITEM 15. INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS

A. Other than the following, there have been no transactions since the beginning of the fiscal year ended

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(a) Subject to the exceptions indicated in note (b) to this Item, this column indicates the aggregate amount of direct remuneration paid by the Company, Associated and Associated's subsidiaries to the person or persons specified, in all capacities, during the Company's fiscal year ended January 29, 1977.

(b) This amount does not include legal fees and cash advanced in the amounts of $16,842.00 and $1,478.33 respectively, which the Company accrued during its fiscal year ended January 29, 1977, to the law firm of Frank, Bernstein, Conaway & Goldman, in which Messrs. Goldman and Blumenthal are and were at the time of such payment partners. Nor does the said amount include any additional such legal fees incurred by the Company between January 1, 1977, and January 29, 1977, for which amounts the said firm had not billed the Company as of January 29, 1977. (See ITEM 15. INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS.)

January 29, 1977, nor are there any presently proposed transactions, to which the Company, Associated or Associated's subsidiary was or is to be a party, in which any Director or Officer of the Company, or any security holder named under section A of Item 11 hereof, or any relative or spouse of any of the foregoing persons who has the same home as such person or who is a Director or Officer of the Company or of Associated or of Associated's subsidiary, had or is to have a direct or indirect material interest:*

(1) During the Company's fiscal year ended January 29, 1977, Columbia accepted reinsurance contracts from insurance subsidiaries of Berkshire, representing premiums written in the approximate amount of $5,777,098. Columbia ceded approximately $606,128 in premiums to insurance subsidiaries of Berkshire. National Indemnity, an insurance subsidiary of Berkshire, performs all of Columbia's bookkeeping and other administrative functions. For these services Columbia pays to National Indemnity as part of its ceding commissions an amount ordinarily equal to one-half of the customary originating brokerage commissions. "Pro rata" business normally carries an originating commission of 1%, and "excess" business, an originating commission of 10%. The amount of ceding commissions representing fees for bookkeeping and administrative services paid by Columbia to National Indemnity during 1976 was approximately $35,335. Columbia also paid approximately $52,749 in commissions to

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* Mr. Benjamin F. Rosner, the President of Associated (but neither an Officer nor a Director of the Company), owns and leases to Associated the land and improvements upon which Associated operates two of its retail stores.

one of Berkshire's subsidiaries which acted as agent for direct business written by Columbia.

(2) During the Company's fiscal year ended January 29, 1977, the Company paid and/or incurred certain legal fees in connection with the representation of the Company by the law firm of Frank, Bernstein, Conaway & Goldman. (See note (b) to ITEM 13. REMUNERATION OF DIRECTORS AND OFFICERS.)

B. During the Company's fiscal year ended January 29, 1977, no Director or Officer of the Company or associate of such persons was indebted to the Company, Associated or Associated's subsidiary.

C. Other than any payments which may have been made pursuant to the terms of any pension, retirement, savings or similar plan which may have been provided by the Company, Associated or Associated's subsidiary, and other than insurance and reinsurance transactions between Columbia and insurance subsidiaries of Berkshire (see subsection A(1) of this ITEM 15 above), during the Company's fiscal year ended January 29, 1977, there was no transaction, and there is no presently proposed transaction, to which any of the said plans was or is to be a party, in which any Director or Officer of the Company, any security holder named under section A of Item 11 hereof, or any relative or spouse thereof or relative of any such spouse who has the same home as any such Director, Officer or security holder or who is a Director or Officer of Associated or Associated's subsidiary, had or is to have a direct or indirect material interest.

* * * * * * * *

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

Date: April 29, 1977

DIVERSIFIED RETAILING COMPANY, INC.

By Robert M. Goldman
Robert M. Goldman, President

Item 10. Financial Statements and Exhibits Filed

(a) Financial Statements

Index to Financial Statements

Item 10. Financial Statements and Exhibits Filed (Continued)

(a) Financial Statements, Cont.

Schedules Supporting Consolidated Financial Statements:

(b) Exhibits

A - Annual Report of Berkshire Hathaway Inc. - 1976 and 1975

B - Annual Report of Blue Chip Stamps - 1976

C - Annual Report of Wesco Financial Corporation - 1976 and 1975

All other Schedules are omitted because the information required therein is not applicable or is given in the financial statements or the notes thereto.

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS

ACCOUNTANTS' REPORT

The Board of Directors
Diversified Retailing Company, Inc.:

We have examined the financial statements and related schedules of Diversified Retailing Company, Inc. and subsidiaries and Diversified Retailing Company, Inc. (parent Company only) as listed in the accompanying index. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Blue Chip Stamps, an affiliated company. The Company and its subsidiaries' investment in Blue Chip Stamps at January 29, 1977 and January 31, 1976 was $15,380,729 and $13,264,615, respectively, and its equity in earnings of Blue Chip Stamps was $1,334,534 and $921,531 for the respective years then ended. 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 report dated April 15, 1976, our opinion on the January 31, 1976 financial statements with respect to the Companies' investment in Blue Chip Stamps, an investee, was qualified as being subject to the effects on the 1976 consolidated and parent Company only financial statements of such adjustments, if any, as might have been required had the outcome of certain litigation against the investee been known. As explained in note 7 to the financial statements, the litigation was resolved during 1976, at no material cost to the investee. Accordingly, our present opinion on the January 31, 1976 financial statements as presented herein, is different from that expressed in our previous report.

In our opinion, based upon our examination and the report of the other auditors, the aforementioned financial statements present fairly the consolidated financial position of Diversified Retailing Company, Inc. and subsidiaries at January 29, 1977 and January 31, 1976 and the results of their operations and the changes in their financial position for the years then ended, and the financial position of Diversified Retailing Company, Inc. (parent Company only) at January 29, 1977 and January 31, 1976 and the results of its operations and the changes in its financial position for the years then ended, all in conformity with generally accepted accounting principles consistently applied during the period subsequent to the change, with which we concur, made as of February 2, 1975, in the valuation of marketable securities as described in note 1 to the consolidated financial statements, and the supporting schedules, in our opinion, present fairly the information set forth therein.

PEAT, MARWICK, MITCHELL & CO.
Peat, Marwick, Mitchell & Co

Omaha, Nebraska
April 15, 1977

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

January 29, 1977 and January 31, 1976

Assets	1977	1976
Cash	$ 2,702,950	4,018,061
U. S. Treasury Bills, at cost which approximates market	3,588,651	2,421,690
Accounts receivable (note 2)	747,911	470,941
Recoverable Federal income taxes	378,330	-
Merchandise inventories	5,589,375	4,739,021
Investments, other than affiliates (notes 3 and 4):		
Bonds, at amortized cost	3,472,052	2,199,877
Preferred stock, at cost	133,475	-
Common stocks, at cost, 1977; market, 1976	1,121,327	533,833
Total investments, other than affiliates	4,726,854	2,733,710
Investments in affiliates (notes 6, 7 and 9) (Schedule III):		
Berkshire Hathaway Inc.	17,329,554	12,641,809
Blue Chip Stamps	15,380,729	13,264,615
Total investments in affiliates	32,710,283	25,906,424
Prepaid acquisition costs	373,000	-
Property and equipment, at cost less allowance for depreciation and amortization of $546,361 in 1977 and $539,328 in 1976 (note 8)	882,719	929,696
Other assets	796,384	744,526
	$ 52,496,457	41,964,069

Liabilities and Stockholders' Equity	1977	1976
Losses and loss adjustment expenses	$ 4,627,291	4,019,020
Unearned insurance premiums	3,513,506	1,116,749
Accounts payable and accruals	2,981,159	2,433,881
Salaries, wages and bonuses	119,764	127,796
Taxes other than income taxes	264,751	313,946
Income taxes (note 10):		
Current	216,914	445,203
Deferred	1,266,932	698,245
Notes payable to banks (note 9)	4,000,000	350,000
8% debentures due 1985 (note 9)	6,600,000	6,600,000
9% notes payable (note 9)	1,505,061	1,372,709
Other liabilities	280,781	512,890
Total liabilities	25,376,159	17,990,439
Stockholders' equity (notes 9 and 11):		
Common stock of $.0003 par value. Authorized 3,333,333-1/3 shares; issued 1,000,000 shares	300	300
Additional paid-in capital	5,999,700	5,999,700
Net unrealized loss on marketable equity securities	-	(839,303)
Retained earnings	24,382,948	18,812,933
	30,382,948	23,973,630
Less 217,510 shares of common stock in treasury, at cost	3,262,650	-
Total stockholders' equity	27,120,298	23,973,630
Commitments and contingent liabilities (notes 12, 13 and 16)		
	$ 52,496,457	41,964,069

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Consolidated Statements of Earnings and Retained Earnings

Years ended January 29, 1977 and January 31, 1976

	Year ended Jan.29,1977	Year ended Jan.31,1976
Net sales (including leased department sales of $1,046,344, 1977; $1,063,197, 1976)	$ 39,937,746	36,144,691
Cost of goods sold	24,628,031	22,267,010
Gross profit	15,309,715	13,877,681
Insurance underwriting loss	(284,429)	(581,874)
Interest and dividend income	519,891	445,177
Other income	263,881	220,770
	15,809,058	13,961,754
Selling, general and administrative expenses	13,471,514	12,254,693
Interest and financing costs	1,026,765	714,304
	14,498,279	12,968,997
Earnings before income taxes, equity in earnings of affiliates and realized securities gains	1,310,779	992,757
Income taxes (note 10)	581,944	488,969
Earnings before equity in earnings of affiliates and realized securities gains	728,835	503,788
Equity in earnings of affiliates (notes 6 and 7):		
Berkshire Hathaway Inc.	3,439,022	637,118
Blue Chip Stamps	1,334,534	921,531
	4,773,556	1,558,649
Earnings before realized securities gains	5,502,391	2,062,437
Realized gains on sales of securities, net of taxes in 1977 of $31,625 and in 1976 of $2,017	67,624	4,710
Net earnings	5,570,015	2,067,147
Retained earnings at beginning of year	18,812,933	16,745,786
Retained earnings at end of year	$ 24,382,948	18,812,933
Earnings per share of common stock, based on weighted average outstanding shares:		
Earnings before equity in earnings of affiliates and realized securities gains	$ .87	.50
Equity in earnings of affiliates	5.73	1.56
Realized securities gains	.08	.01
Net earnings	$ 6.68	2.07

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Financial Position

Years ended January 29, 1977 and January 31, 1976

	1977	1976
Funds provided:		
From operations:		
Net earnings	$ 5,570,015	2,067,147
Charges (credits) to earnings not requiring (providing) funds:		
Equity in current earnings of affiliates, net of deferred taxes	(4,773,556)	(1,558,649)
Dividends received from affiliates, net of current taxes	154,552	187,508
Increase in unpaid losses and loss adjustment expenses	608,271	289,020
Increase (decrease) in unearned insurance premiums	2,396,757	(108,086)
Increase in accounts payable and accrued expenses	490,051	384,316
Depreciation and amortization of fixed assets	123,590	120,992
Increase in prepaid acquisition costs	(373,000)	-
Increase in deferred taxes	179,000	-
Reversal of anticipated losses on common stocks, net of $90,000 deferred tax benefit	-	(210,000)
Loss (gain) on sale of investments	(99,249)	293,273
Increase in inventories	(850,354)	(519,009)
Decrease (increase) in accounts receivable	(276,970)	430,689
Increase (decrease) in income taxes currently payable	(228,289)	25,899
Increase (decrease) in other liabilities	(100,979)	16,486
Amortization of excess of carrying amounts of net assets of consolidated subsidiaries over acquisition costs	(106,980)	(106,980)
All other	(104,630)	(3,342)
Funds provided from operations	2,608,229	1,309,264
Decrease in cash	1,315,111	444,817
Proceeds from sale of investments:		
Bonds	395,150	203,887
Common stocks	-	659,364
Proceeds from sale of fixed assets	41,699	-
Increase in notes payable to bank	3,650,000	350,000
Proceeds from issuance of 9% notes	215,583	163,786
	$ 8,225,772	3,131,118
Funds used:		
Investment in Berkshire Hathaway Inc.	985,168	1,771,442
Other investments:		
Bonds	1,548,040	588,269
Preferred stocks	133,475	-
Common stocks	558,191	-
Purchase of treasury stock	3,262,650	-
Increase in recoverable Federal income taxes	378,330	-
Additions to property, plant and equipment, net	118,312	125,490
Debt repayment	83,231	30,231
Increase in Treasury Bills	1,158,375	615,686
	$ 8,225,772	3,131,118

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Balance Sheets

January 29, 1977 and January 31, 1976

Assets	1977	1976
Cash	$ 6,632	49,718
Recoverable Federal income taxes	378,330	-
Note receivable from subsidiary	6,600,000	6,600,000
Investment in subsidiary (note 5) (Schedule III)	22,336,151	18,141,285
Investment in affiliated company (note 6) (Schedule III)	10,935,998	7,886,196
Unamortized cost of long-term financing	246,464	274,666
	$ 40,503,575	32,951,865

Liabilities and Stockholders' Equity	1977	1976
Accrued interest and other expenses	$ 269,951	177,232
Due to subsidiary	636,854	152,524
Deferred income taxes	338,616	161,845
Note payable to bank (note 9)	4,000,000	350,000
8% debentures (note 9)	6,600,000	6,600,000
9% notes payable (note 9)	1,505,061	1,372,709
Unamortized excess of carrying amount of net assets of subsidiary over acquisition cost	32,795	163,925
Total liabilities	13,383,277	8,978,235
Stockholders' equity (notes 9 and 11):		
Common stock of $.0003 par value. Authorized 3,333,333-1/3 shares; issued 1,000,000 shares	300	300
Additional paid-in capital	5,999,700	5,999,700
Net unrealized loss on marketable equity securities	-	(839,303)
Retained earnings	24,382,948	18,812,933
	30,382,948	23,973,630
Less 217,510 shares of common stock in treasury at cost	3,262,650	-
Total stockholders' equity	27,120,298	23,973,630
	$ 40,503,575	32,951,865

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Statements of Earnings and Retained Earnings

Years ended January 29, 1977 and January 31, 1976

	1977	1976
Interest income	$ 528,017	528,000
Amortization of excess of net assets of subsidiary over acquisition cost	131,130	131,130
	659,147	659,130
Expenses:		
General and administrative	36,017	29,127
Interest and financing costs	1,008,740	676,565
	1,044,757	705,692
Loss before income taxes and equity in net earnings of subsidiary and affiliated company	385,610	46,562
Income tax credit	279,000	88,846
Earnings (loss) before equity in net earnings of subsidiary and affiliated company	(106,610)	42,284
Equity in net earnings of subsidiary (note 5)	3,355,563	1,744,319
Equity in net earnings of affiliated company (note 6)	2,321,062	280,544
Net earnings	5,570,015	2,067,147
Retained earnings at beginning of year	18,812,933	16,745,786
Retained earnings at end of year	$ 24,382,948	18,812,933
Earnings per share of common stock, based on weighted average outstanding shares:		
Earnings (loss) before equity in net earnings of subsidiary and affiliated company	$ (.13)	.04
Equity in net earnings of subsidiary	4.03	1.75
Equity in net earnings of affiliated company	2.78	.28
Net earnings	$ 6.68	2.07

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Statements of Changes in Financial Position

Years ended January 29, 1977 and January 31, 1976

	1977	1976
Funds provided:		
From operations:		
Net earnings	$ 5,570,015	2,067,147
Charges (credits) to earnings not requiring (providing) funds:		
Increase (decrease) in accrued expenses	92,719	(3,459)
Amortization of excess of carrying amounts of net assets of subsidiary over acquisition cost	(131,130)	(131,130)
Amortization of long-term financing costs	28,202	28,202
Equity in undistributed net earnings of subsidiary	(3,355,563)	(1,744,319)
Equity in undistributed net earnings of Berkshire Hathaway Inc.	(2,321,062)	(280,544)
Funds used in operations	(116,819)	(64,103)
Proceeds from borrowings	3,865,583	513,786
Net advances from subsidiary	484,330	101,565
Dividend from subsidiary	-	4,788,757
Decrease in cash	43,086	-
	$ 4,276,180	5,340,005
Funds used:		
Investment in affiliated company	551,969	5,267,392
Increase in cash	-	42,382
Repayment of debt	83,231	30,231
Increase in recoverable Federal income taxes	378,330	-
Purchase of treasury stock	3,262,650	-
	$ 4,276,180	5,340,005

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

January 29, 1977 and January 31, 1976

(1) Summary of Significant Accounting Policies

(a) Principles of Consolidation

Diversified Retailing Company, Inc. (the Company) is a holding company and has no operations. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary, Associated Retail Stores, Inc. ("Associated"), Columbia Insurance Company ("Columbia"), wholly-owned by Associated, and Southern Casualty Insurance Company ("Southern"), 99.6% owned by Columbia. All significant intercompany accounts and transactions have been eliminated in consolidation. Separate financial statements of the parent Company are included herein.

Accounts of Columbia and Southern are maintained on the basis of a calendar year.

(b) Investment in Subsidiary

The investment in Associated is accounted for under the equity method in the parent Company only financial statements. At the date of acquisition of Associated by the Company, the carrying amount of the net assets was in excess of the investment. Such excess amounted to $1,311,309 and is being amortized to income over a ten-year period. The unamortized balance of $32,795 at January 29, 1977 and $163,925 at January 31, 1976 is included in other liabilities in the consolidated balance sheets.

(c) Investment in Affiliated Companies

The Company and its subsidiaries hold common stock investments in Berkshire Hathaway Inc. ("Berkshire") and Blue Chip Stamps ("Blue Chip") and account for such investments by use of the equity method. Deferred income taxes are provided for with respect to undistributed earnings under the assumption that such earnings will ultimately be distributed as taxable dividends.

Through February 1976 Blue Chip determined income on the basis of a fiscal year ending on or about February 28 and recorded its equity in earnings of Blue Chip's year ending with respect to February 28 in its year ending with respect to the preceding January 31. In 1976, Blue Chip changed its fiscal year to end on approximately December 31. Accordingly the Company, for its year ended January 29, 1977, determined its equity in Blue Chip's earnings based on Blue Chip's earnings for the ten months ended January 1, 1977; this change had the effect of reducing the Company's consolidated earnings approximately $120,000 for the year ended January 29, 1977.

Berkshire determines earnings on the basis of a calendar year.

(d) Investments, Other than Investments in Affiliated Companies

These investments represent those of insurance subsidiaries.

Investments in bonds are stated at cost, adjusted where appropriate for amortization of premium or accretion of discount.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

Investments in preferred and common stocks other than affiliates are stated at the lower of aggregate cost or market. At December 31, 1975, the aggregate cost exceeded aggregate market and the reduction from cost to market value was reflected as a direct charge to surplus. In addition, the Company reflected as a direct charge to surplus at January 31, 1976 its share of Blue Chip Stamps' valuation allowance for unrealized loss on marketable equity securities owned by that investee at February 28, 1976. At December 31, 1976, the aggregate market values of both Columbia's and Blue Chip Stamps' portfolios of marketable equity securities had recovered to amounts in excess of cost; accordingly, the charges to surplus were reversed in the current year with no effect on net income.

The cost of investment securities sold is determined generally on a first-in, first-out basis.

(e) Merchandise Inventories

Inventories are priced at the lower of cost or market by use of the retail inventory method except as to warehouse inventories where cost is determined by the first-in, first-out method.

(f) Property and Equipment

Property and equipment represents that of the retailing subsidiaries. Expenditures for maintenance, repairs, renewals and betterments which represent improvements are capitalized; other such items are charged to current operations. At the time assets are retired or otherwise disposed of, the cost and related allowance for depreciation are eliminated from the asset and allowance accounts and any profit or loss on disposition is reflected in current operations. When assets become fully depreciated, the cost and related allowance for depreciation are written off.

Depreciation for both financial accounting and income tax purposes is based on the 150% declining balance method as to buildings and on the straight-line method for substantially all other property and equipment.

(g) Financing Costs

Certain costs incurred in connection with the issuance by the Company of its 8% debentures have been capitalized and are being ratably amortized over the stipulated life of the debentures. Unamortized financing costs included in other assets in the consolidated balance sheets at January 29, 1977 and January 31, 1976 were $246,464 and $274,666, respectively.

(h) Losses and Loss Adjustment Expenses of Consolidated Insurance Subsidiaries

The provision for losses and loss adjustment expenses is based upon past experience and estimates received relating to assumed reinsurance and estimates of unreported losses.

(i) Insurance Premiums

Insurance premiums are recognized as earned ratably over the terms of the policies. Unearned premiums are computed on a monthly pro rata basis. Policy acquisition costs or commissions are deferred when considered recoverable and charged against income ratably over the terms of the policies for purposes of determining consolidated results of the Company and its subsidiaries.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

(j) Federal Income Taxes

The Company and its subsidiaries file a consolidated Federal income tax return. Insurance subsidiaries account for certain items of income and expense differently for financial reporting purposes than for income tax reporting purposes. Provisions are made for deferred taxes in recognition of these timing differences.

The investment tax credit (not material) is accounted for as a reduction of Federal income taxes in the year in which the credit arises.

(2) Accounts Receivable

Accounts receivable consisted of the following:

	Jan.29,1977	Jan.31,1976
Layaway accounts and other receivables of retailing operations	$ 411,353	241,733
Uncollected premiums, net of commissions payable, of insurance operations	267,804	185,910
Investment income due and accrued	68,754	43,298
	$ 747,911	470,941

(3) Securities Deposited With Others

Insurance subsidiaries had deposited the following securities in trust with regulatory authorities or with ceding reinsurers in accordance with reinsurance treaties:

	Dec.31,1976	Dec.31,1975
Bonds, at amortized cost	$ 977,926	973,050
Stocks, including those of affiliates, at cost	6,204,945	3,079,663

(4) Investments - Other than Affiliates

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

	1976		1975	
	Cost	Market	Cost	Market
Bonds	$ 3,472,051	3,627,950	2,199,876	2,199,824
Equity:				
Preferred stocks	133,475	162,750	-	-
Common stocks	1,121,327	1,355,230	563,136	533,833
	$ 1,254,802	1,517,980	563,136	533,833

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

At December 31, 1976, with respect to equity securities, gross unrealized gains were $283,473 and gross unrealized losses were $20,295. A net realized gain of $97,249 (before applicable income taxes) on the sale of securities was included in the determination of net earnings for 1976.

(5) Investment in Subsidiary

The carrying value of the investment in common stock of Associated represents the cost plus equity in undistributed earnings since date of acquisition. This investment is summarized as follows:

	Jan.29,1977	Jan.31,1976
Underlying net asset values at date of acquisition	$ 7,417,659	7,417,659
Additional capital contribution	11,139,732	11,139,732
Equity in post-acquisition undistributed earnings	3,778,760	423,197
Excess of cost over market value of subsidiary and affiliate's marketable equity securities applicable to the Company's equity interest	-	(839,303)
Carrying value	$ 22,336,151	18,141,285

(6) Investment in Berkshire Hathaway Inc.

The carrying value of the investment in common stock of Berkshire Hathaway Inc. (Berkshire) represents the cost plus the equity in earnings since dates of acquisition, adjusted for amortization on a forty year basis of the excess cost over underlying net asset values at dates of acquisition. This is summarized as follows:

	Jan.29,1977	Jan.31,1976
Shares owned	163,201	147,615
Percentage of total outstanding shares	17%	15%
Cost represented by:		
Underlying net asset values at dates of acquisition	$ 11,355,437	9,738,578
Excess of acquired underlying net asset value over cost, net of amortization of $49,704 at January 29, 1977 and $7,612 at January 31, 1976	1,917,330	1,327,461
	9,438,107	8,411,117
Equity in post-acquisition earnings	7,891,447	4,230,692
Carrying value	$ 17,329,554	12,641,809

Deferred income taxes of approximately $567,000 at January 29, 1977 and $304,000 at January 31, 1976 have been provided with respect to the equity in post-acquisition earnings, assuming their ultimate distribution as a taxable dividend.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

The parent Company's investment in Berkshire is summarized as follows:

	Jan.29,1977	Jan.31,1976
Shares owned	108,069	98,900
Percentage of total outstanding shares	11%	10%
Cost represented by:		
Underlying net asset values at dates of acquisition	$ 7,992,237	7,069,566
Excess of acquired underlying net asset values over cost, net of amortization of $60,888 at January 29, 1977 and $18,211 at January 31, 1976	1,772,656	1,444,631
	6,219,581	5,624,935
Equity in post-acquisition earnings	4,716,417	2,261,261
Carrying value	$ 10,935,998	7,886,196

Deferred income taxes of approximately $339,000 at January 29, 1977 and $162,000 at January 31, 1976 have been provided with respect to the equity of the parent Company in post-acquisition earnings.

Equity in net earnings of Berkshire Hathaway Inc. reflects the following for the past two years:

	Consolidated		Parent Company	
	1976	1975	1976	1975
Equity in net earnings	$ 3,660,485	673,265	2,455,156	295,517
Provision for deferred income taxes	(263,555)	(48,473)	(176,771)	(21,275)
Amortization of excess of underlying net asset values over cost	42,092	12,325	42,677	6,302
	$ 3,439,022	637,117	2,321,062	280,544

Financial statements of Berkshire are included elsewhere herein.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

(7) Investment in Blue Chip Stamps

The carrying value of the investment in Blue Chip Stamps (Blue Chip) represents the cost, less amortization of the net excess of cost over equity in net assets at dates of acquisition, plus equity in undistributed earnings. Deferred taxes of $508,000 at January 29, 1977 and $382,000 at January 31, 1976 have been provided with respect to the equity in undistributed earnings. The investment in Blue Chip is summarized as follows:

	Jan.29,1977	Jan.31,1976
Shares owned	841,900	841,900
Percentage of total outstanding shares	16%	16%
Costs represented by:		
Underlying net asset values at dates of acquisition	$ 6,988,300	6,988,300
Net excess cost, less amortization of $1,959,928 at January 29, 1977 and $1,514,214 at January 31, 1976	1,337,143	1,782,857
	8,325,443	8,771,157
Equity in post-acquisition undistributed earnings	7,055,286	5,303,458
Excess of cost over market value of Blue Chip Stamps' marketable equity securities at February 28, 1976 applicable to the Company's equity interest	-	(810,000)
Carrying value	$ 15,380,729	13,264,615

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

	Current year	Prior year
Dividends received	$ 166,542	202,056
Equity in undistributed earnings	1,751,828	1,271,269
Provision for current income taxes	(11,990)	(14,548)
Provision for deferred income taxes	(126,132)	(91,532)
Amortization of excess of cost of investment over underlying net asset values	(445,714)	(445,714)
	$ 1,334,534	921,531

Equity in prior year earnings was based on the fifty-two weeks' operations of Blue Chip ended on February 28, 1976. Blue Chip changed from a February 28 year-end reporting basis to an approximately December 31 year-end reporting basis for 1976 and, accordingly, equity in current year earnings is based on the ten months' operations of Blue Chip ended January 1, 1977.

Amortization of the difference between the Company's cost of Blue Chip shares and approximate underlying net asset values at dates of acquisition has been computed on the basis that such difference would be extinguished by January 31, 1981. Beginning in 1977, it is the Company's intention to amortize the January 29, 1977 difference between carrying value and underlying net asset value over seven years.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

In addition to the shares of Blue Chip owned by subsidiaries of the Company, at December 31, 1976, Berkshire owned approximately 33% of the outstanding Blue Chip shares.

The 1976 financial statements of Blue Chip include the following note (The "Company" refers to Blue Chip):

"The Company was a defendant in a purported class action filed March 1, 1971 to recover for stamp savers monies collected by it as reimbursement for California sales taxes on redemption of stamps. In December 1976 an order of the California Supreme Court dismissing the class action portion of the suit became final. Any further proceedings by plaintiffs would involve immaterial amounts.

A purported class action was filed under Federal securities laws on November 10, 1970 against The Company and certain of its present and former stockholders and directors, on behalf of retailer users of Blue Chip Stamps who failed to purchase securities of The Company in a 1968 offering to retailer users. The complaint alleged damages to plaintiffs of $21,400,000, together with exemplary damages of $25,000,000, interest, attorneys' fees and costs, and prayed that plaintiffs have the right to purchase securities of The Company on the terms of the 1968 offering. The Federal action was concluded on June 9, 1975, when the United States Supreme Court held that the purported class did not have standing to bring such an action. On June 21, 1971 a substantially identical action based on California law was filed in Los Angeles County Superior Court. On August 13, 1976 an order was entered by the court granting The Company's motion to dismiss the action based on the ground that plaintiffs had not complied with the requirements of California law to bring the action to trial within five years from the date of its filing. Plaintiff has filed notice of appeal from the court's ruling. In the opinion of counsel, on the current state of the record and the law, the appeal should be defended successfully and, in the unlikely event that the plaintiff should prevail on the appeal, there would be substantial defenses on the merits."

Financial statements of Blue Chip are included elsewhere herein.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

(8) Property and Equipment

Property and equipment are comprised of the following:

	Jan.29,1977	Jan.31,1976
Land	$ 231,715	231,715
Buildings	239,998	239,998
Building improvements	197,211	200,336
Leasehold improvements	246,618	231,225
Furniture, fixtures and equipment	513,538	565,750
	1,429,080	1,469,024
Less allowances for depreciation and amortization	546,361	539,328
	$ 882,719	929,696

Generally, the estimated useful lives used for computing depreciation range from 20 to 33 years for buildings, 4 to 14 years for furniture, fixtures and equipment and the life of the lease for leasehold improvements.

(9) Debt

Bank Term Loan

In March 1976, the Company arranged for a bank term loan of principal amount of $4,000,000, fully drawn down in April of 1976, repayable in principal installments of $1,000,000 on March 1, 1979 and March 1, 1980 and $2,000,000 on March 1, 1981. Interest on this loan fluctuates at 2% over the Maryland National Bank prime rate. This loan refunded $650,000 short-term borrowings from the bank and the additional proceeds were used to acquire treasury stock. Collateral pledged by the parent Company includes 98,900 shares of Berkshire Hathaway Inc., all issued shares of Associated Retail Stores, Inc. and a $6,600,000 promissory note of Associated to Diversified, due in 1985. Negative covenants supporting the loan preclude (1) additional long-term borrowings by the Company or its subsidiaries, (2) additional pledge of assets by the Company or its subsidiaries, (3) payment of dividends by the Company, and (4) changes in the investment structure of the Company or its subsidiaries particularly with reference to the 841,900 share holdings of Blue Chip Stamps. An event of default against the 8% debentures due 1985 of the Company will constitute an event of default under this borrowing. Further, the lending bank would consider it an event of default for Diversified to be merged, sold or transferred in any way to any other company not effectively controlled by Warren Buffett.

8% Debentures

The debentures were issued under a trust indenture dated November 1, 1967, under which the aggregate principal amount which may be issued is unlimited, the debentures are not secured by any lien, and there are no restrictions against secured or unsecured borrowings of the Company. They bear interest at a fixed annual rate of 8% payable semiannually and bear participating additional interest each year up to a maximum of 1% contingent upon the amount of "adjusted consolidated earnings before income taxes", as defined, for the previous fiscal year. Contingent interest of $33,000 is payable on November 1, 1977 under these provisions with respect to the fiscal year ended January 29, 1977.

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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(Parent Company Only)

Notes to Financial Statements

The debentures are subject to redemption at the option of the Company at 103.5% of par plus accrued interest to October 31, 1977 and thereafter at percentages reducing to 100% at November 1, 1983. The debentures are also contingently subject to redemption at par plus accrued interest through operation of a sinking fund. If the adjusted consolidated net worth, as defined, of the Company is less than $12 million, sinking fund payments are generally required. No such contingent sinking fund payments have been required and none appear imminent.

The debentures are further subject to redemption at the option of each debenture holder, exercisable within 60 days following notice that, other than by reason of the death of Warren E. Buffett, said Warren E. Buffett or an organization controlled by him shall cease to own in combined holdings a larger block of shares with voting rights of the Company than any other stockholder, or combination of stockholders, controlled by a single individual.

The articles of incorporation of the Company provide that if and as long as an event of default exists or the adjusted consolidated net worth of the Company is less than $8,000,000, and either condition continues for a period of thirty days, then the holders of the debentures, to the exclusion of the holders of the Company's stock, shall be entitled to vote (i) to elect directors of the Company, and (ii) to approve the sale, lease or other disposition of all or substantially all of the assets of the Company and distribution of the proceeds thereof to the extent necessary to pay all sums due debenture holders and other creditors. No amendment to such provisions shall be made as long as any debentures are outstanding without the written approval of the holders of two-thirds in principal amount of the debentures then outstanding. If there are such voting rights, each holder of the debentures will have one vote for each $1,000 principal amount of debentures.

The trust indenture covering the debentures contains certain restrictions applicable to the Company relating to net worth, redemption of stock and payment of dividends. Retained earnings of $4,895,487 were subject to such restrictions at January 29, 1977.

9% Notes Payable

The notes payable represent purchase obligations for shares of Berkshire Hathaway Inc. acquired at various dates. These notes become due at varying dates through May 1, 1992 and bear interest at 9% per year, payable semi-annually. The notes are also due on the respective payees' demand on or after the expiration of twelve months following the date of death of Warren E. Buffett.

Principal payments due on these notes are summarized by fiscal year as follows:

1978	$ 11,138
1979	11,138
1980	11,138
1981	36,138
1982	365,376
1983	578,705
1984	7,407
1985	7,407
1986	172,693
1987	33,907
1988	128,500
1993	141,514
	$ 1,505,061

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
AND
DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Notes to Financial Statements

(10) Income Taxes

Total income tax expense for the years ended January 29, 1977 and January 31, 1976 is summarized as follows:

	Year ended Jan.29,1977	Year ended Jan.31,1976
Income taxes applicable to:		
Operating earnings	$ 581,944	488,969
Equity in earnings of Berkshire Hathaway Inc.	263,555	48,473
Equity in earnings of Blue Chip Stamps	138,122	106,080
Realized gain on sales of securities	31,625	2,017
Total income tax expense	$ 1,015,246	645,539
Current taxes applicable to:		
Operating earnings	402,944	542,859
Distributed earnings of Blue Chip Stamps	11,990	14,548
Realized investment gain (loss)	31,625	(87,983)
Total current	446,559	469,424
Deferred taxes applicable to:		
Equity in undistributed earnings of:		
Berkshire Hathaway Inc.	263,555	48,473
Blue Chip Stamps	126,132	91,532
Accreted discount on bonds, net	-	9,950
Tax effect of change in insurance companies' prepaid acquisition costs	179,000	(63,840)
Reversal of tax benefit relating to anticipated loss on sale of investment securities	-	90,000
Total deferred	568,687	176,115
	$ 1,015,246	645,539
The above figures represent:		
State and local income taxes	260,000	226,150
Federal income taxes	755,246	419,389
	$ 1,015,246	645,539

Income taxes computed at the Federal statutory 48% rate applied to income before taxes are reconciled to the income tax expense figures reflected above as follows:

	Year ended Jan.29, 1977	Year ended Jan.31, 1976
Income taxes at Federal statutory rate	$ 3,161,000	1,302,000
Tax differences relating to:		
Dividends received credits, including credits applied to equity in earnings of Berkshire Hathaway Inc. and Blue Chip Stamps	(2,300,000)	(896,000)
Amortization of difference between cost and underlying net assets of subsidiaries and investees (not deductible for tax purposes)	142,000	157,000
Long-term capital gain rate differential	(16,000)	(1,000)
State and local taxes, net of Federal tax benefit	135,000	118,000
Tax-exempt interest income	(58,000)	(48,000)
All other	(48,754)	13,539
	$ 1,015,246	645,539

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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(Parent Company Only)

Notes to Financial Statements

(11) Stockholders' Equity

There were no changes in the issued capital stock and additional paid-in capital accounts during the two years ended January 29, 1977. At January 29, 1977 the Company held as treasury stock 217,510 shares of its issued capital stock.

At January 29, 1977 consolidated retained earnings included $11,961,288 representing undistributed earnings of affiliated companies (net of income tax provisions) as follows: Berkshire Hathaway - $7,373,930; Blue Chip - $4,587,358.

At January 29, 1977, the parent Company's retained earnings included $3,778,760 representing undistributed earnings of Associated and $4,438,689 representing undistributed earnings of Berkshire Hathaway Inc.

(12) Leases

Associated and its retailing subsidiaries lease stores, warehouse facilities and New York offices, under leases expiring at various dates through 1988. The leases require minimum annual rentals plus, under the terms of certain leases, additional payments for taxes, other expenses and percentage rentals. Total rental expense on such facilities for the fiscal years ended January 29, 1977 and January 31, 1976 was approximately $1,840,000 and $1,782,000, respectively, including contingent rentals of approximately $313,000 and $287,000, respectively.

The present value of noncapitalized financing leases is not material. Likewise, the impact on net income if such leases had been capitalized would not be material.

Minimum annual rental obligations under the existing real estate leases were as follows:

Fiscal year ending 1978	$ 1,204,425
Fiscal year ending 1979	995,425
Fiscal year ending 1980	873,925
Fiscal year ending 1981	762,250
Fiscal year ending 1982	706,100
Fiscal years ending 1983-1987	1,586,250
Fiscal year ending 1988	12,100
Total	$ 6,140,475

(13) Pension Plan

Associated has a noncontributory trusteed pension plan covering eligible full-time employees. The total pension expense for the fiscal years ended January 29, 1977 and January 31, 1976 was $70,856 and $7,800, respectively. The expense for fiscal 1977 represents normal cost of the plan plus amortization of initial unfunded past service liability over a 30 year period. The expense for fiscal 1976 relates only to interest on unfunded liability. The unfunded accrued liability at January 1, 1976 (date of last valuation) was approximately $66,000.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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Notes to Financial Statements

(14) Supplemental Note - Inventories

Inventories used in the computation of cost of goods sold were as follows:

February 1, 1975	$ 4,220,012
January 31, 1976	4,739,021
January 29, 1977	5,589,375

(15) Transactions with Affiliates

Columbia derives the major portion of its business through the assumption of reinsurance contracts from insurance subsidiaries of Berkshire Hathaway Inc. The amounts included in the consolidated financial statements that relate to such transactions are as follows:

	1977	1976
Losses and loss adjustment expenses payable	$ 3,711,949	2,720,427
Unearned insurance premiums	3,314,069	1,084,890
Underwriting loss	(239,821)	(102,253)

(16) Stores Operated Subject to Contingent Consideration

In August 1976, Associated entered into an agreement under which it obtained assignments, at various dates through the balance of the year, of leasehold interests in seventeen (17) store locations in Chicago, together with the right to exclusive use of, and, within five years, title to, the trade fixtures and equipment at such locations. Additionally, Associated obtained under the agreement a license for exclusive use of the trade names under which the stores were previously operated. Associated agreed that consideration would become payable to the assignor in an amount equal to 50% of the aggregate net profits of these stores for a period of five years, though Associated is not obligated to continue operations at any of the locations. Such contingent consideration for the year ended January 29, 1977 was only nominal, and the total amount which may be paid is not determinable. The parties agreed that, if any amounts are payable by Associated under this agreement, 5% of such amounts shall be allocated to trade names, an intangible asset; the balance of any such consideration will be charged to operations for the year to which it relates.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Investments in Securities of Affiliates

Schedule III

Name of issuer and description of issue	Balance at beginning of period		Additions			Deductions			Balance at close of period	
	Number of shares	Amount in dollars	Equity taken up to earnings	Other Amount	Other Description	Dividends	Other Amount	Other Description	Number of shares	Amount
Year ended January 29, 1977										
Affiliates:										
Blue Chip Stamps common stock	841,900	$ 13,264,615	1,472,656	810,000	Reversal of beginning equity in net unrealized loss on marketable equity securities	166,542			841,900	$ 15,380,729
Berkshire Hathaway Inc. common stock	147,615	12,641,809	3,702,577	985,168	Purchased 15,586 shares	-			163,201	17,329,554
		$ 25,906,424	5,175,233	1,795,168		166,542				32,710,283

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Investments in Securities of Affiliates

Schedule III, Continued

Name of issuer and description of issue	Balance at beginning of period: Number of shares	Balance at beginning of period: Amount in dollars	Additions: Equity taken up to earnings	Additions: Other: Amount	Additions: Other: Description	Deductions: Dividends	Deductions: Other: Amount	Deductions: Other: Description	Balance at close of period: Number of shares	Balance at close of period: Amount
Year ended January 31, 1976										
Affiliates:										
Blue Chip Stamps common stock	841,900	$ 13,249,060	1,027,611			202,056	810,000	Equity in net unrealized loss on marketable equity securities	841,900	$ 13,264,615
Berkshire Hathaway Inc. common stock	109,551	10,184,776	685,591	1,771,442	Acquisition of 38,064 shares	-	-		147,615	12,641,809
		$ 23,433,836	1,713,202	1,771,442		202,056	810,000			25,906,424

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DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Investment in Securities of Affiliates

Schedule III

Name of issuer and description of issue	Balance at beginning of period: Number of shares	Balance at beginning of period: Amount in dollars	Additions: Equity taken up to earnings	Additions: Other Amount	Deductions: Dividends	Deductions: Other Amount	Balance at close of period: Number of shares	Balance at close of period: Amount
Year ended January 29, 1977								
Associated Retail Stores, Inc.	453,000	$ 18,141,285	3,355,563	839,303 (1)	-	-	453,000	$ 22,336,151
Affiliate - Berkshire Hathaway Inc. common stock	98,900	$ 7,886,196	2,497,833	551,969 (2)	-	-	108,069	$ 10,935,998

(1) Reverse beginning equity in net unrealized loss on marketable equity securities.
(2) Purchase of 9,169 shares.

Name of issuer and description of issue	Balance at beginning of period: Number of shares	Balance at beginning of period: Amount in dollars	Additions: Equity taken up to earnings	Additions: Other Amount	Deductions: Dividends	Deductions: Other Amount	Balance at close of period: Number of shares	Balance at close of period: Amount
Year ended January 31, 1976								
Associated Retail Stores, Inc.	453,000	$ 22,025,026	1,744,319	-	4,788,757 (1)	839,303 (2)	453,000	$ 18,141,285
Affiliate - Berkshire Hathaway Inc. common stock				478,635 (3) 4,854,924 (4)				
	26,392	$ 2,250,818	301,819	5,333,559	-	-	98,900	$ 7,886,196

(1) Dividend consisting of stock in affiliate.
(2) Equity in net unrealized loss on marketable equity securities.
(3) Purchase of 11,098 shares.
(4) Dividend from subsidiary.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Supplementary Income Statement Information

Schedule XVI

Item	Charged to costs and expenses
Fiscal year ended January 29, 1977:	
Maintenance and repairs	$ 603,195
Taxes, other than income taxes:	
Payroll taxes	605,832
Personal property and real estate	215,018
Other	108,693
Rents:	
Real estate	1,839,870
Equipment	45,332
Fiscal year ended January 31, 1976:	
Maintenance and repairs	452,812
Taxes, other than income taxes:	
Payroll taxes	485,893
Personal property and real estate	200,959
Other	141,461
Rents:	
Real estate	1,787,789
Equipment	85,099

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS

ACCOUNTANTS' REPORT

The Board of Directors
Columbia Insurance Company:

We have examined the consolidated financial statements and related schedules of Columbia Insurance Company and consolidated subsidiary as listed in the accompanying index. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Blue Chip Stamps, an affiliated company. The Company's investment in Blue Chip Stamps at December 31, 1976 and 1975 was $4,447,437 and $3,852,636, respectively, and its equity in earnings of Blue Chip Stamps was $372,787 and $250,167 for the respective years then ended. 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 report dated April 15, 1976, our opinion on the 1975 consolidated financial statements with respect to the Company's investment in Blue Chip Stamps, an investee, was qualified as being subject to the effects on the 1975 consolidated financial statements of such adjustments, if any, as might have been required had the outcome of certain litigation against the investee been known. As explained in note 7 to the consolidated financial statements, the litigation was resolved during 1976, at no material cost to the investee. Accordingly, our present opinion on the 1975 consolidated financial statements as presented herein, is different from that expressed in our previous report.

In our opinion, based upon our examination and the report of the other auditors, the aforementioned consolidated financial statements present fairly the financial position of Columbia Insurance Company and consolidated subsidiary at December 31, 1976 and 1975, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the period subsequent to the change, with which we concur, made as of January 1, 1975, in the valuation of marketable securities as described in note 1 to the consolidated financial statements; the supporting schedules, in our opinion, present fairly the information set forth therein.

PEAT, MARWICK, MITCHELL & CO.

Peat, Marwick, Mitchell & Co.

Omaha, Nebraska
March 25, 1977

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Balance Sheets

December 31, 1976 and 1975

Assets	1976	1975
Investments - other than affiliates (notes 3 and 4) (Schedule I):		
U. S. Treasury Bills, at cost which approximates market	$ 3,588,651	2,421,690
Bonds, at amortized value	3,472,052	2,199,877
Preferred stocks at cost	133,475	-
Common stocks at cost, 1976; market, 1975	1,121,327	533,833
Total investments - other than affiliates	8,315,505	5,155,400
Cash	78,147	59,092
Investment in Berkshire Hathaway Inc. (note 5) (Schedule II)	5,971,586	4,755,613
Investment in Blue Chip Stamps (notes 6 and 7) (Schedule II)	4,447,437	3,852,636
Investment income due and accrued	68,754	43,298
Uncollected premiums	267,804	185,910
Prepaid acquisition costs	373,000	-
Income taxes recoverable from parent (note 8)	385,000	218,000
Excess of cost over net assets of subsidiary purchased, net of accumulated amortization of $72,555 in 1976 and $48,405 in 1975	-	24,150
Other assets	86,453	70,548
	$ 19,993,686	14,364,647

Liabilities, Capital Stock and Surplus	1976	1975
Losses and loss adjustment expenses	$ 4,627,291	4,019,020
Unearned premiums	3,513,506	1,116,749
Ceded reinsurance balances payable	6,586	-
Amounts retained by company for account of others	-	155,933
Amount due for purchase of securities	567,678	-
Deferred income taxes	560,300	262,496
Other liabilities	24,592	25,888
Total liabilities	9,299,953	5,580,086
Capital stock and surplus:		
Capital stock par value $100. Authorized, issued and outstanding, December 31, 1976 and 1975 - 20,000 shares	2,000,000	2,000,000
Surplus:		
Paid-in	3,855,389	3,855,389
Net unrealized loss on marketable equity securities (notes 4 and 6)	-	(270,303)
Unassigned (note 14)	4,838,344	3,199,475
Total surplus	8,693,733	6,784,561
Total capital stock and surplus	10,693,733	8,784,561
	$ 19,993,686	14,364,647

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Statements of Earnings

Years ended December 31, 1976 and 1975

	1976	1975
Premiums:		
Premiums written	$ 6,337,697	2,713,246
Decrease (increase) in unearned premiums	(2,242,868)	173,075
Premiums earned (note 15) (Schedule VII)	4,094,829	2,886,321
Investment income, net (note 10)	403,468	282,346
	4,498,297	3,168,667
Losses and claims incurred (note 15) (Schedule VII)	2,697,297	2,325,427
Loss adjustment expenses (note 15)	548,361	340,086
Underwriting expenses (notes 11 and 15)	1,133,600	802,682
	4,379,258	3,468,195
Earnings (loss) before income taxes, equity in earnings of other companies and realized investment gains	119,039	(299,528)
Income taxes (benefit) (note 8):		
Current	(203,056)	(134,445)
Deferred	179,000	(53,890)
	(24,056)	(188,335)
Earnings (loss) before equity in earnings of other companies and realized investment gains	143,095	(111,193)
Equity in earnings of other companies:		
Berkshire Hathaway Inc. (note 5)	1,055,363	213,346
Blue Chip Stamps (note 6)	372,787	250,167
	1,428,150	463,513
Earnings before realized investment gains	1,571,245	352,320
Investment gains - excludes unrealized appreciation in common stocks of unaffiliated companies of $292,481 in 1976 and $44,228 in 1975:		
Realized investment gains (notes 4 and 12)	99,249	6,727
Applicable income taxes (note 8)	31,625	2,017
Net realized investment gains	67,624	4,710
Net earnings	$ 1,638,869	357,030

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Statements of Capital Stock and Surplus

Years ended December 31, 1976 and 1975

		Surplus		
	Capital stock	Paid-in	Net unrealized loss on marketable equity securities	Unassigned
Balance, December 31, 1974	$ 2,000,000	3,855,389	-	2,842,445
Net earnings for the year	-	-	-	357,030
Unrealized losses in common stock investments in unaffiliated companies	-	-	(29,303)	-
Unrealized losses in common stock portfolio of investee	-	-	(241,000)	-
Balance, December 31, 1975	2,000,000	3,855,389	(270,303)	3,199,475
Net earnings for the year	-	-	-	1,638,869
Recovery on common stock investments of unaffiliated companies and investee	-	-	270,303	-
Balance, December 31, 1976	$ 2,000,000	3,855,389	-	4,838,344

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1976 and 1975

	1976	1975
Funds provided:		
From operations:		
Net earnings	$ 1,638,869	357,030
Charges (credits) to earnings not requiring (providing) funds:		
Accretion of bond discount	(30,991)	(21,063)
Increase in estimated losses and loss adjustment expenses	608,271	604,432
Increase (decrease) in unearned premiums	2,396,757	(108,086)
Decrease in assumed losses payable	-	(315,412)
Increase in deferred taxes	179,000	36,111
Increase in income taxes recoverable from parent	(167,000)	(175,156)
Decrease (increase) in uncollected premiums	(81,894)	395,955
Increase in accrued investment income	(25,456)	(8,302)
Decrease (increase) in prepaid acquisition costs	(373,000)	133,000
Loss (gain) on sale of investments	(99,249)	293,273
Reversal of prior year's provision for anticipated losses on common stocks	-	(300,000)
Increase in amounts due for purchase of securities	567,678	-
Equity in undistributed earnings of affiliated companies, net of deferred taxes	(1,372,470)	(407,833)
Amortization	24,150	24,150
Increase (decrease) in ceded balances payable	6,586	(163,418)
Decrease in reinsurance recoverable on loss payment	-	26,241
Funds provided from operations	3,271,251	370,922
From sale of bonds	395,386	203,887
From sale of common stock investments in unaffiliated companies	-	659,364
Decrease in cash	-	65,736
Other, net	(15,068)	(31,769)
Total funds provided	$ 3,651,569	1,268,140
Funds used:		
Cost of investments purchased:		
Increase in U. S. Treasury Bills	1,158,375	615,686
Bonds	1,548,040	588,269
Preferred stocks of unaffiliated companies	133,475	-
Common stocks of unaffiliated companies	558,191	-
Common stocks of Berkshire Hathaway Inc.	78,500	-
Increase in cash	19,055	-
	3,495,636	1,203,955
Decrease in amounts retained by company for account of others	155,933	64,185
Total funds used	$ 3,651,569	1,268,140

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 1976 and 1975

(1) Summary of Significant Accounting Policies and Practices

(a) Principles of Consolidation

The consolidated financial statements include the accounts of the Company and its 99.6% owned subsidiary, Southern Casualty Insurance Company. All significant intercompany accounts and transactions have been eliminated in consolidation.

(b) Investment in Securities, Other than Affiliates

Investments in bonds are stated at cost, adjusted where appropriate for amortization of premium or accretion of discount.

Investments in preferred and common stocks other than affiliates are stated at the lower of aggregate cost or market. At December 31, 1975, the aggregate cost exceeded aggregate market and the reduction from cost to market value was reflected as a direct charge to surplus. In addition, the Company reflected as a direct charge to surplus at December 31, 1975 its share of Blue Chip Stamp's valuation allowance for unrealized loss on marketable equity securities owned by that investee at February 28, 1976. At December 31, 1976, the aggregate market values of both the Company's and Blue Chip Stamps portfolios of marketable equity securities had recovered to amounts in excess of cost; accordingly, the charges to surplus were reversed in 1976 with no effect on net income.

The basis of investment securities sold is determined generally on a first-in, first-out method.

(c) Investment in Affiliated Companies

The Company holds common stock investments in Berkshire Hathaway Inc. and Blue Chip Stamps, which two companies are considered "investees" under the provisions of Accounting Principles Board Opinion No. 18. Accordingly, the Company uses the equity method of accounting for these investments, under which method the Company currently recognizes its proportionate share of earnings reported by those companies, net of deferred income taxes provided for under the assumption that such earnings will ultimately be distributed as taxable dividends. Provision is also made for amortization of the difference between cost of the investments and the underlying equity in net assets at the dates of acquisition; this provision is computed on the basis of a forty year amortization period for the investment in Berkshire Hathaway Inc. and a period of seven years for the investment in Blue Chip Stamps.

Through February 1976 Blue Chip Stamps determined income on the basis of a fiscal year ending on or about February 28; the Company had not recognized this difference in its annual accounting for its equity in earnings of Blue Chip, having recorded its equity in earnings of Blue Chip's year ending with respect to February 28 in its year ending with respect to the preceding December 31. In 1976 Blue Chip changed its fiscal year-end to approximately December 31. Accordingly, for 1976, the Company determined its equity in Blue Chip's earnings based on that company's ten fiscal months' (March 1 - January 1) results. This change in fiscal year reporting in determining equity in Blue Chip's earnings did not have a material effect on the 1976 net earnings of Columbia Insurance Company.

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(d) 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. Policy acquisition costs or commissions are deferred and charged against income ratably over the terms of the policies.

(e) Estimated Losses

The provisions for losses and loss adjustment expenses is based upon past experience and estimates received relating to assumed reinsurance and estimates of unreported losses.

(f) Income Taxes

The Company accounts for certain income and expense items differently for financial reporting purposes than for income tax purposes. Provisions for deferred taxes are being made in recognition of these timing differences.

The companies join Associated Retail Stores, Inc., the parent of Columbia Insurance Company, in filing consolidated income tax returns.

(2) Basis of Presentation

The consolidated financial statements of Columbia Insurance Company and subsidiary are presented in accordance with generally accepted accounting principles (GAAP) which differ in some respects from principles prescribed or permitted by insurance regulatory authorities (statutory methods) in accordance with which the Company maintains its records. A reconciliation of the aggregate capital stock and surplus ("Surplus as regards Policyholders") as determined under the statutory method to that determined and reported herewith in accordance with GAAP is as follows:

	December 31, 1976	1975
Statutory surplus as regards policyholders	$ 9,652,715	3,683,601
Excess of NAIC market valuations over cost of investments in equity securities other than affiliates	(263,178)	-
Excess of NAIC admitted asset valuations over amortized cost of bonds	(32,037)	-
Excess of carrying values of investments in affiliates (determined under GAAP pursuant to the equity method) over NAIC market valuations:		
Berkshire Hathaway Inc.	1,298,376	2,807,013
Blue Chip Stamps	197,437	2,290,136
Prepaid acquisition costs	373,000	-
Income tax effects and adjustments	(575,300)	(43,413)
All other	42,720	47,224
Capital stock and surplus per accompanying financial statements	$ 10,693,733	8,784,561

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

Statutory net income or (loss) is reconciled to GAAP net earnings as follows:

	1976	1975
Statutory net income (loss)	$ 111,549	(375,543)
Increase (decrease) in deferred acquisition costs	373,000	(133,000)
Amortization of excess cost of investment in Southern Casualty Insurance Company	(24,150)	(24,150)
Equity in undistributed earnings of affiliates:		
Berkshire Hathaway Inc.	1,055,363	213,346
Blue Chip Stamps	312,787	190,167
Realized loss on common stocks other than affiliates	-	300,000
Income tax effects and adjustments	(189,680)	186,210
Net earnings per accompanying financial statements	$ 1,638,869	357,030

(3) Securities Deposited with Others

Certain bonds and stocks deposited in trust with regulatory authorities or with ceding reinsurers in accordance with various reinsurance treaties were as follows:

	1976	1975
Bonds, at amortized cost	$ 977,926	973,050
Stocks, at cost	6,204,945	3,079,663
	$ 7,182,871	4,052,713

(4) Investments - Other than Affiliates

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

	1976		1975	
	Cost	Market	Cost	Market*
Bonds	$ 3,472,051	3,627,950	2,199,876	2,199,824
Equity:				
Preferred stocks	133,475	162,750	-	-
Common stocks	1,121,327	1,355,230	563,136	533,833
	$ 1,254,802	1,517,980	563,136	533,833

*"Market value" at December 31, 1975 is the value published in the NAIC Book of Valuation of Securities.

At December 31, 1976, with respect to equity securities, gross unrealized gains were $283,473 and gross unrealized losses were $20,295. A net realized gain of $97,249 (before applicable income taxes) on the sale of securities was included in the determination of net earnings for 1976.

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

Investments, other than investments in U. S. Treasury Bills, comprising greater than two percent of total investments were as follows at December 31, 1976 and 1975:

Common stocks	Cost	Market value
1976:		
California Water Service Company	$ 275,447	359,515
Kaiser Industries, Inc.	558,190	646,500
1975:		
California Water Service Company	$ 275,447	279,315
Omaha National Corporation	118,640	123,200

Bonds	Amortized cost	Par value
1976:		
Port of New York Authority 26th Series, 3-1/2%, 1995	$ 347,013	500,000
Port of New York Authority 26th Series, 3-1/4%, 1993	171,886	250,000
Continental Air Lines Inc., Convertible Subordinated, 8%, 1991	181,539	250,000
FMC Corporation, Convertible, 4-1/4%, 1992	143,202	200,000
New Madrid, Missouri Industrial Revenue, 5.9%, 1993	142,226	165,000
Delaware Industrial Building Commission, IDR, 6.5%, 1992	124,356	130,000
1975:		
Alabama, Camden Industrial Revenue	$ 137,368	137,368
Arkansas, Danville Industrial Revenue, 7-1/4%, 1991	105,000	105,000
Indiana Toll Road Commission, 3-1/2%, 1994	104,157	150,000
Texas, Nueces Pollution Control Revenue, 9%, 1990	149,628	149,628
Chrysler Financial Corporation, various issues	297,159	440,000
FMC Corporation, Convertible, 4-1/4%, 1992	143,202	200,000

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(5) Investment in Berkshire Hathaway Inc.

The carrying value of the investment in common stock of Berkshire Hathaway Inc. represents the cost plus the equity in earnings since dates of acquisition, adjusted for amortization on a forty year basis of the excess cost over underlying net asset values at dates of acquisition.

The Company owns approximately 5% of the total outstanding shares and its equity in net earnings of Berkshire Hathaway Inc. reflects the following for the past two years:

	1976	1975
Equity in net earnings	$ 1,140,416	233,341
Provision for deferred income taxes	(82,110)	(16,802)
Amortization of excess of cost of investment over underlying net asset values	(2,943)	(3,193)
	$ 1,055,363	213,346

(6) Investment in Blue Chip Stamps

The carrying value of the investment in 250,000 shares of common stock of Blue Chip Stamps (approximately 5% of the total outstanding shares) represents the cost plus the equity in undistributed earnings since dates of acquisition, adjusted for amortization of the excess cost over underlying net asset values at dates of acquisition.

Equity in net earnings of Blue Chip Stamps ("Blue Chip") reflects the following for that company's ten fiscal months ended January 1, 1977 and its fiscal year ended February 28, 1976:

	1976	1975
Dividends received	$ 60,000	60,000
Equity in undistributed earnings	509,634	377,500
Provision for current income taxes	(4,320)	(4,320)
Provision for deferred income taxes	(36,694)	(27,180)
Amortization of excess of cost of investment over underlying net asset values	(155,833)	(155,833)
	$ 372,787	250,167

Equity in 1975 earnings was based on the fifty-two weeks' operations of Blue Chip ended on February 28, 1976. Blue Chip changed from a February 28 year-end reporting basis to an approximately December 31 year-end reporting basis for 1976 and, accordingly, equity in 1976 earnings is based on the ten months' operations of Blue Chip ended January 1, 1977.

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

Amortization of the difference between the Company's cost of Blue Chip shares and approximate underlying net asset values at dates of acquisition has been computed on the basis that such difference would be extinguished by January 1, 1980. At 1976 year-end the Company's carrying value of its consolidated holdings of Blue Chip shares amounting to $4,447,437 is $296,796 more than underlying net asset value on that date. Beginning in 1977, it is the Company's intention to amortize the 1976 year-end difference between carrying value and underlying net asset value over seven years, the resulting credit will not be significant in any given year.

(7) Legal Proceedings of Blue Chip Stamps

The 1976 financial statements of Blue Chip Stamps include the following note (The "Company" refers to Blue Chip Stamps):

"The Company was a defendant in a purported class action filed March 1, 1971 to recover for stamp savers monies collected by it as reimbursement for California sales taxes on redemption of stamps. In December 1976 an order of the California Supreme Court dismissing the class action portion of the suit became final. Any further proceedings by plaintiffs would involve immaterial amounts.

A purported class action was filed under Federal securities laws on November 10, 1970 against The Company and certain of its present and former stockholders and directors, on behalf of retailer users of Blue Chip Stamps who failed to purchase securities of The Company in a 1968 offering to retailer users. The complaint alleged damages to plaintiffs of $21,400,000, together with exemplary damages of $25,000,000, interest, attorneys' fees and costs, and prayed that plaintiffs have the right to purchase securities of The Company on the terms of the 1968 offering. The Federal action was concluded on June 9, 1975, when the United States Supreme Court held that the purported class did not have standing to bring such an action. On June 21, 1971 a substantially identical action based on California law was filed in Los Angeles County Superior Court. On August 13, 1976 an order was entered by the court granting The Company's motion to dismiss the action based on the ground that plaintiffs had not complied with the requirements of California law to bring the action to trial within five years from the date of its filing. Plaintiff has filed notice of appeal from the court's ruling. In the opinion of counsel, on the current state of the record and the law, the appeal should be defended successfully and, in the unlikely event that the plaintiff should prevail on the appeal, there would be substantial defenses on the merits.

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(8) Income Taxes

Income tax expense (benefit) is made up of the following:

	1976	1975
Totals:		
Benefit applicable to operating earnings	$ (24,056)	(188,335)
Expense applicable to equity in earnings of:		
Berkshire Hathaway Inc.	82,110	16,803
Blue Chip Stamps	41,014	31,500
Expense applicable to investment gains	31,625	2,017
	$ 130,693	(138,015)
Income tax currently payable (recoverable) relating to:		
Loss before income taxes, equity in earnings of other companies and realized investment gain (loss)	(203,056)	(134,445)
Distributed earnings of Blue Chip Stamps	4,320	4,320
Realized investment gain (loss)	31,625	(87,983)
Total current	(167,111)	(218,108)
Deferred expense (credit) relating to:		
Equity in undistributed earnings of other companies:		
Berkshire Hathaway Inc.	82,110	16,803
Blue Chip Stamps	36,694	27,180
Accreted discount on bonds	-	9,950
Expense (credit) for tax effect of change in deferred acquisition costs	179,000	(63,840)
Reversal of prior year's tax benefit for anticipated loss on sale of investment securities	-	90,000
Total deferred	297,804	80,093
Total income tax expense (credit)	$ 130,693	(138,015)

Total net income after taking into account realized investment gains or losses but before income taxes was $1,769,562 in 1976 and $219,015 in 1975. Income tax expense of $849,390 in 1976 and $105,127 in 1975 would result if computed by applying the statutory U. S. Federal income tax rate of 48% to income before taxes. The differences are reconciled as follows:

	1976	1975
Tax expense at statutory rate	$ 849,390	105,127
Increase (reduction) in income taxes resulting from:		
Tax-exempt interest	(58,421)	(48,156)
85% dividends received credit relating to:		
Dividends received from unaffiliated companies	(23,903)	(20,653)
Equity in net earnings of other companies	(697,803)	(273,702)
Amortization of cost in excess of the underlying equity in net assets of affiliated companies and subsidiary	87,924	87,913
Capital loss rate differential	(16,198)	1,211
Other	(10,296)	10,245
Total income tax expense (credit)	$ 130,693	(138,015)

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(9) Transactions with Affiliates

The Company derives the major portion of its business through the assumption of reinsurance contracts from insurance subsidiaries of Berkshire Hathaway Inc. The amounts included in the financial statements relating to such transactions are as follows:

	December 31, 1976	December 31, 1975
Earned premiums	$ 3,428,367	2,156,605
Unearned premiums	3,314,069	1,084,890
Incurred losses and loss adjustment expenses	2,650,124	1,734,849
Commissions	1,351,064	524,009

(10) Investment Income, Net

Investment income is comprised of the following:

	1976	1975
Interest on bonds	$ 370,142	262,265
Dividends, unaffiliated companies	61,397	50,619
	431,539	312,884
Investment expenses	28,071	30,538
Net investment income	$ 403,468	282,346

(11) Underwriting Expenses

The following expenses made up underwriting expenses:

	1976	1975
Commissions and brokerage	$ 1,355,919	506,173
Taxes, licenses and fees	57,133	50,083
Other underwriting expenses	93,548	113,426
Decrease (increase) in prepaid acquisition costs	(373,000)	133,000
	$ 1,133,600	802,682

(12) Investment Gains and Losses

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

	1976			
	Net gains	Applicable income tax	Net gains less income taxes	Net unrealized gains
Bonds	$ 97,116	30,680	66,436	-
Preferred stocks	-	-	-	29,275
Common stocks	-	-	-	263,206
Other	2,133	945	1,188	-
	$ 99,249	31,625	67,624	292,481

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(12), Continued

	1975			
	Net gains	Applicable income tax	Net gains (losses) less income taxes	Net unrealized gains
Bonds	$ 5,982	(1,795)	4,187	-
Common stocks	(299,255)	89,778	(209,477)	44,228
Recovery of provision for anticipated losses	300,000	(90,000)	210,000	-
	$ 6,727	(2,017)	4,710	44,228

(13) Reinsurance

Amounts stated in the accompanying financial statements are net of reinsurance ceded. The following summarizes the amounts deducted from certain liability, income and expense accounts in connection with reinsurance ceded:

	1976	1975
Estimated losses and loss adjustment expenses	$ 317,284	181,773
Premiums written	900,343	784,052
Losses paid	746,741	525,625

(14) Stockholder's Equity

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

(15) Change in Recording Reinsurance Transactions

During 1975 the Company changed its procedures for recording reinsurance business assumed from other companies. Due to the time lag in receiving reports from ceding companies, pertinent data relating to fourth quarter results had been estimated in prior years. No estimate was provided for 1975 and the consolidated statement of earnings reflects the actual results for the first three quarters. This change was considered necessary from the standpoint of eliminating the potential distortion that exists in estimates of this nature. The results of four actual quarters are reflected for 1976. The effect on 1975 operations of omitting a fourth quarter estimate is approximated below by using actual 1975 fourth quarter results:

Decrease in premiums earned	$ 743,077
Decrease in losses incurred	516,460
Decrease in loss adjustment expenses	78,020
Decrease in commissions	174,102

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Summary of Investments in Securities - Other than Securities of Affiliates

December 31, 1976

Schedule I

Type of Investment	Cost*	Market value	Carrying value
Bonds:			
States, municipalities and political subdivisions	$ 2,796,333	2,927,325	2,796,333
Federal agency	75,010	77,625	75,010
Industrial and miscellaneous	600,709	623,000	600,709
Total bonds	3,472,052	3,627,950	3,472,052
Preferred stocks - Industrial and miscellaneous	133,475	162,750	133,475
Common stocks:			
Public utilities	275,448	359,515	275,448
Banks, trusts and insurance companies	141,065	171,090	141,065
Industrial and miscellaneous	704,814	824,625	704,814
Total common stocks	1,121,327	1,355,230	1,121,327
U. S. Treasury Bills	3,588,651	3,588,651	3,588,651
Total investments in securities - other than securities of affiliates	$ 8,315,505	8,734,581	8,315,505

*Cost represents original cost of stocks, and, as to debt obligations, original cost adjusted for amortization of premiums or accretion of discount.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Investment in Securities of Affiliates

Schedule II

Name of issuer and description of investment	Balance at beginning of period: Number of shares	Balance at beginning of period: Amount	Equity taken up to earnings	Dividends	Amortization of excess cost	Net unrealized (gain) loss on marketable equity securities	Other: Additions	Other: Explanation	Balance at close of period: Number of shares	Balance at close of period: Amount
1976										
Berkshire Hathaway Inc. common stock, $5 par value	48,715	$ 4,755,613	1,140,416	-	2,943	-	78,500	Purchase of an additional 1,000 shares	49,715	$ 5,971,586
Blue Chip Stamps common stock, $1 par value	250,000	3,852,636	569,634	60,000	155,833	(241,000)	-	-	250,000	4,447,437
1975										
Berkshire Hathaway Inc. common stock, $5 par value	48,715	$ 4,525,465	233,341	-	3,193	-	-	-	48,715	$ 4,755,613
Blue Chip Stamps common stock, $1 par value	250,000	3,871,969	437,500	60,000	155,833	241,000	-	-	250,000	3,852,636

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Premiums, Losses and Claims

Schedule VII

Line of business	Part 1 - Premiums: Unearned premiums beginning of period	Part 1 - Premiums: Net premiums written	Part 1 - Premiums: Unearned premiums end of period	Part 1 - Premiums: Premiums earned during period	Part 2 - Losses and claims: Losses and claims incurred during period	Part 2 - Losses and claims: Loss expense incurred during period
1976						
Auto liability	$ 29,312	1,551,723	1,028,716	552,319	430,416	
Auto physical damage	2,203	734,690	515,292	221,601	172,406	
Reinsurance not elsewhere classified	727,204	3,081,604	1,539,651	2,269,157	1,441,263	
Workmen's compensation	156,535	757,805	208,688	705,652	461,785	
All other	201,495	211,875	221,159	346,100	191,427	
	$ 1,116,749	6,337,697	3,513,506	4,094,829	2,697,297	548,361
1975						
Fire	$ 259,967	237,416	224,465	272,918	315,584	
Workmen's compensation	26,681	735,653	2,646	759,688	700,708	
Reinsurance not elsewhere classified	544,652	1,596,515	727,204	1,413,962	1,045,454	
All other	393,535	143,662	162,434	439,753	263,681	
	$ 1,224,835	2,713,246	1,116,749	2,886,321	2,325,427	340,086

BERKSHIRE HATHAWAY INC.

1976

ANNUAL REPORT TO THE STOCKHOLDERS

Berkshire Hathaway Inc.

1976 Annual Report to the Stockholders

BUSINESS OF THE COMPANY

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

CONTENTS

Berkshire Hathaway Inc.

To the Stockholders of Berkshire Hathaway Inc.:

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

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

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

Textile Operations

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

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

Insurance Underwriting

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

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

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

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

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

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

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

Insurance Investments

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

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

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

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

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

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

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

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

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

Banking

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

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

This outstanding earnings record again was achieved while:

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

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

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

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

Blue Chip Stamps

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

Miscellaneous

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

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

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

Warren E. Buffett, Chairman

March 21, 1977

PEAT, MARWICK, MITCHELL & CO.
CERTIFIED PUBLIC ACCOUNTANTS
KIEWIT PLAZA
OMAHA, NEBRASKA 68131

The Board of Directors and Stockholders
Berkshire Hathaway Inc.:

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

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

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

Peat, Marwick, Mitchell & Co.

March 11, 1977

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

ASSETS	Jan. 1, 1977	Jan. 3, 1976
Cash	$ 3,436,996	$ 6,044,526
Investments, other than affiliates (notes 3 and 4):		
U. S. Treasury Bills and other short-term obligations, at cost which approximates market	15,489,052	16,175,265
Bonds, at amortized cost	89,215,773	78,760,945
Preferred stocks, at cost	22,286,948	2,558,275
Common stocks of unaffiliated companies, at cost	53,108,266	39,341,135
Total investments, other than affiliates	180,100,039	136,835,620
Investments in affiliates (notes 5 and 6):		
Common stock of Blue Chip Stamps	27,304,491	18,777,479
Unconsolidated bank subsidiary	24,731,779	23,424,329
Other unconsolidated subsidiaries	879,602	1,120,333
Total investments in affiliates	52,915,872	43,322,141
Recoverable Federal income taxes	—	4,400,000
Accounts receivable from customers, agents and others, net (note 7)	23,730,027	19,710,105
Inventories (note 8)	9,301,321	8,135,615
Real estate, equipment, furniture and leasehold improvements, at cost less allowance for depreciation and amortization (note 9)	5,051,699	3,722,242
Deferred insurance premium acquisition costs	6,820,000	2,950,000
Other assets	1,685,315	621,168
	$283,041,269	$225,741,417

LIABILITIES AND STOCKHOLDERS' EQUITY

Losses and loss adjustment expenses	$ 85,152,259	$ 73,033,492
Unearned premiums	36,736,618	22,344,290
Funds held under reinsurance treaties	3,783,169	2,939,462
Amounts due for purchase of securities	839,495	679,990
Accounts payable and accrued expenses	7,259,034	5,790,070
Income taxes:		
Current	3,346,111	178,546
Deferred	4,677,301	2,518,786
7½% debentures due 1987 (note 10)	464,260	505,820
Sundry installment promissory notes (note 11)	4,522,326	3,602,480
8% senior notes due 1993 (note 12)	20,000,000	20,000,000
Excess of net assets of consolidated subsidiaries over cost of investment	579,070	579,070
Other liabilities	388,493	679,219
	167,748,136	132,851,225
Stockholders' equity (note 12):		
Common stock of $5 par value. Authorized 1,100,000 shares; issued 979,569 shares	4,897,845	4,897,845
Retained earnings	110,827,343	87,992,347
	115,725,188	92,890,192
Less 6,647 shares of common stock in treasury at cost	432,055	—
Total stockholders' equity	115,293,133	92,890,192
Commitment and contingent liability (notes 14 and 17)		
	$283,041,269	$225,741,417

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

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

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.

AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

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

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
January 1, 1977 and January 3, 1976

(1) Summary of Significant Accounting Policies and Practices

(a) Basis of Presentation

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

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

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

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

(b) Investment in Securities, Other than Affiliates

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

(c) Investment in Blue Chip Stamps

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

(d) Insurance Premiums

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

(e) Losses and Loss Adjustment Expenses

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

(g) *Inventories*

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

(h) *Income Taxes*

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

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

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

(2) Acquired Businesses

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

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

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

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

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

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

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

(3) Bonds and Common Stocks Deposited with Others

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

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

(4) Investment in Securities of Unaffiliated Companies

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

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

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

(5) Investment in Blue Chip Stamps

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

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

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

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

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

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

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

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

BLUE CHIP STAMPS
Consolidated Balance Sheets

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

BLUE CHIP STAMPS
Consolidated Earnings Summaries

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

(6) Investments in Unconsolidated Subsidiaries

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

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

(7) Receivables

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

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(8) Inventories

A summary of inventories follows:

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

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

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

The composition of plant and equipment is shown below:

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

(10) 7½% Subordinated Debentures

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(11) Sundry Installment Promissory Notes

This caption includes the following:

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

*Guaranteed by parent Company.

(12) 8% Senior Notes due 1993

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

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

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(13) Income Taxes

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

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

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

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

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

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

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

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(14) "One-Bank Holding Company" Status

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

(15) "Savings and Loan Holding Company" Status

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

(16) Transactions with Affiliates

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

(17) Litigation

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

(18) Compensating Balance

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

Berkshire Hathaway Inc.
INSURANCE GROUP

BALANCE SHEETS

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

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

STATEMENTS OF INCOME AND UNASSIGNED SURPLUS

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

See accompanying notes to financial statements.

Berkshire Hathaway Inc.

INSURANCE GROUP

STATEMENTS OF CHANGES IN FINANCIAL POSITION

	Year ended December 31, 1976	1975
Funds provided:		
From operations:		
Net income	$ 18,515,371	$ 716,270
Charges (credits) to income not requiring (providing) funds:		
Equity in undistributed earnings of Blue Chip Stamps	(1,561,912)	(1,029,578)
Accretion of discount on bonds	(1,033,805)	(384,278)
Depreciation	162,972	152,155
Increase in unpaid losses and loss expense	10,970,214	272,395
Increase in unearned premiums	13,992,841	639,423
Increase in funds held under reinsurance treaties	643,707	82,178
Decrease (increase) in agents' balances and premiums in course of collection	(858,928)	2,633,813
Increase in reinsurance recoverable on loss payments	(700,302)	(2,061,819)
(Increase) decrease in deferred acquisition costs	(3,832,608)	1,450,000
Decrease (increase) in recoverable income taxes	4,100,000	(1,499,266)
Increase (decrease) in liability for income taxes	4,604,059	(561,998)
Increase in accrued investment income	(356,043)	(210,800)
Other, net	306,919	381,172
	26,637,114	(136,603)
Funds provided from operations	45,152,485	579,667
Net sale of investments	—	5,444
	$ 45,152,485	$ 585,111
Funds used:		
Subsidiary acquired:		
Bonds	735,797	—
Common stocks	1,911,578	—
U. S. Treasury Bills	887,361	—
Cash	126,204	—
Other assets and deferred charges	94,430	—
Unpaid losses and loss adjustment expenses	(1,148,553)	—
Unearned premiums	(399,487)	—
Other liabilities	(32,818)	—
	2,174,512	—
Purchase of real estate, furniture and equipment	273,001	97,807
Net purchase of investments	41,239,554	—
Dividend paid	1,000,000	—
Increase in cash	465,418	487,304
	$ 45,152,485	$ 585,111
Net purchase (sale) of investments:		
U. S. Treasury Bills	192,290	4,774,180
Bonds	8,685,226	6,846,016
Preferred stocks	19,728,673	(296,910)
Common stocks of unaffiliated companies	11,855,553	(11,328,730)
Common stock of Blue Chip Stamps	777,812	—
Net cost of investments (sold) purchased	$ 41,239,554	$ (5,444)

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS
December 31, 1976 and 1975

(A) Note References

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

(B) Basis of Presentation

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

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

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

	1976	1975
Statutory net income	$14,293,893	$ 1,814,693
Increase (decrease) in deferred acquisition costs	3,832,608	(1,450,000)
Equity in undistributed earnings of Blue Chip Stamps, net of amortization of excess cost	1,561,912	1,029,579
Subsidiary acquisition cost adjustment	170,095	—
Income tax effects and adjustments	(1,343,137)	(678,002)
Net income per accompanying financial statements	$18,515,371	$ 716,270

Continued

Berkshire Hathaway Inc.

INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS, *Continued*

(C) Investment in Blue Chip Stamps

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

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

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

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

(D) Stockholders' Equity

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

(E) Underwriting Expenses

The following expenses comprise underwriting expenses:

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

(F) Federal Income Taxes

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

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

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

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

Continued

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS, *Continued*

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

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

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

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

(G) Investment Gains and Losses

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

	1976			
	Net gains	*Applicable income taxes*	*Net gains less income taxes*	*Net unrealized gain*
Bonds	$ 1,155,664	$ (346,699)	$ 808,965	$ —
Preferred stocks	441,613	(132,484)	309,129	10,117,000
Common stocks	8,645,572	(2,720,817)	5,924,755	35,271,000
	$10,242,849	$ (3,200,000)	$ 7,042,849	$45,388,000

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

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

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

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

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

Peat, Marwick, Mitchell & Co.

January 14, 1977

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

CONSOLIDATED BALANCE SHEETS

	December 31,	
ASSETS	1976	1975
Cash and due from banks	$ 10,868,111	$ 18,797,271
Investment securities (note 2):		
United States Government obligations	30,337,817	24,181,462
United States Government agencies	160,792	15,576,776
Obligations of states and political subdivisions	54,002,192	46,959,481
Federal Reserve Bank stock	300,000	300,000
Other securities	6,629,054	4,053,154
Federal funds sold	32,000,000	—
Loans (notes 3 and 6)	56,188,346	58,081,252
Bank premises and equipment (note 4)	895,977	966,626
Accrued interest receivable	1,545,707	2,040,487
Other assets	464,520	514,603
	$193,392,516	$171,471,114

LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Demand deposits	$ 54,874,671	$ 53,477,577
Time deposits	113,461,996	93,501,325
Total deposits	168,336,667	146,978,902
Federal funds purchased	—	1,000,000
Accrued taxes and other liabilities (note 5)	1,628,082	1,411,487
Total liabilities	169,964,749	149,390,389
Stockholders' equity:		
Common stock of $20 par value. Authorized and issued 250,000 shares	5,000,000	5,000,000
Surplus	5,000,000	5,000,000
Undivided profits	12,124,955	10,771,923
Reserve for contingencies	1,302,812	1,308,802
Total stockholders' equity	23,427,767	22,080,725
	$193,392,516	$171,471,114

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

CONSOLIDATED STATEMENTS OF EARNINGS

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

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY

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

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

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

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1976 and 1975

(1) Significant Accounting Policies

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

Consolidation

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

Investment Securities

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

Consumer Credit Loans

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

Bank Premises and Equipment

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

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

Income Taxes

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

Provision for Loan Losses

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

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(2) Investment Securities

A summary of investments by major classifications is as follows:

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

Investment securities with a par value of $7,801,000 and $7,531,000 at December 31, 1976 and 1975, respectively, were pledged to secure public deposits for other purposes.

(3) Loans

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

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

(4) Bank Premises and Equipment

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

(5) Income Taxes

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

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

Taxes applicable to net earnings were as follows:

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

The components of consolidated income tax expense are as follows:

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

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

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

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

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

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

(6) Allowances for Loan Losses

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

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

(7) Pension and Profit-Sharing Plan

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

Berkshire Hathaway Inc.

LINES OF BUSINESS

Sources of Revenues:

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

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

Sources of Net Earnings:

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

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

Berkshire Hathaway Inc.

FIVE YEAR SUMMARY OF OPERATIONS

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

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

Insurance Premiums Earned and Insurance Underwriting Gain (Loss)

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

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

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

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

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

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

(2) Reinsurance Department of National Indemnity.

(3) Home and Automobile Insurance Company.

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

MANAGEMENT'S DISCUSSION, *Continued*

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

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

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

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

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

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

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

MANAGEMENT'S DISCUSSION, *Continued*

Manufacturing Business Revenues and Gross Profits

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

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

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

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

Interest and Dividend Income

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

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

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

MANAGEMENT'S DISCUSSION, *Continued*

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

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

Income Taxes (Credit) Applicable to Insurance and Textile Operations

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

Equity in Net Earnings of Bank Subsidiary

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

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

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

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

1975 Compared to 1974

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

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

MANAGEMENT'S DISCUSSION, *Continued*

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

1976 Compared to 1975

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

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

Equity in Net Earnings of Blue Chip Stamps

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

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

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

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

Realized Investment Gains (Losses)

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

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

Berkshire Hathaway Inc.

DIRECTORS AND EXECUTIVE OFFICERS

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

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

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

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

COMMON STOCK PRICES

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

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

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

Annual Report Year Ended January 1, 1977

BLUE CHIP STAMPS

Financial Highlights

(In thousands except for amounts per share)

	53 weeks ended Jan. 1, 1977*	52 weeks ended Feb. 28, 1976	14 weeks ended Jan. 1, 1977*	13 weeks ended Feb. 28, 1976
Candy sales	$56,333	$51,342	$26,254	$24,980
Stamp service revenues	17,208	20,361	4,111	4,721
Merchandise promotions and incentive sales	8,888	15,210	958	5,125
Other revenues	5,893	5,731	1,578	1,871
Total revenues	$88,322	$92,644	$32,901	$36,697
Income before income taxes, equity in net income of Wesco Financial Corporation and securities gains (losses)	$12,180	$10,327	$ 8,018	$ 6,222
Provision for income taxes	(4,859)	(4,374)	(3,734)	(2,973)
Equity in net income of Wesco Financial Corporation	4,459	3,092	1,664	925
Income before securities gains (losses)	11,780	9,045	5,948	4,174
Realized securities gains (losses), less taxes	(77)	8	(33)	9
Net income	$11,703	$ 9,053	$ 5,915	$ 4,183
Per share:				
Income before securities gains (losses)	$ 2.27	$ 1.75	$1.14	$ .81
Net income	$ 2.26	$ 1.75	$1.14	$ .81
Book value	$16.60	$13.54**		

*In December 1976 the Company changed its 52-53 week fiscal yearend from approximately February 28 to approximately December 31.

**After reduction for net unrealized loss on marketable equity securities as explained in Note 4 to the accompanying consolidated financial statements

To Our Stockholders

Consolidated net income of Blue Chip Stamps and its subsidiaries for the calendar year 1976 amounted to $11,703,000 ($2.26 per share) compared to $9,053,000 ($1.75 per share) in the previous fiscal year.

Improvement in normal operating income was less than indicated by these figures because this year's results included $.06 per share from an unusual tax credit and were also increased by reduction in our provision for future trading stamp redemption service expenses amounting to $.20 per share after taxes.

We have two major subsidiaries, See's Candy Shops, Incorporated (99% owned) and Wesco Financial Corporation (64% owned at the start of last year, increased to 78% owned at the end of the year). If we used "equity accounting" instead of "consolidated accounting" for See's 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	All other Blue Chip net income*3	Blue Chip consolidated net income
December 31, 1976	$5,112,000	$4,459,000	$2,132,000	$11,703,000
Per Blue Chip share	.99	.86	.41	2.26
February 28, 1976	4,988,000	3,092,000	973,000	9,053,000
Per Blue Chip share	.96	.60	.19	1.75

*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. The February 28, 1976 figure is after provision for income taxes assuming full distribution of all Wesco earnings. The December 31, 1976 figure, due to our reaching 80% ownership of Wesco (see following page), includes reversal of such provisions for prior years.

*3 In each year there was an operating loss 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.

With this annual report our fiscal year changes from one ending about February 28 to one ending about December 31. Our fiscal year is now the same as that of our subsidiary, Wesco Financial Corporation, which is required by law to report on a calendar year basis. It should be noted that See's and Blue Chip's fiscal year which ended approximately December 31, 1976 contained 53 weeks, compared to only 52 in the prior year.

SEE'S CANDY SHOPS, INCORPORATED

First in importance in our earnings picture last year was our equity in our 99%-owned subsidiary, See's Candy Shops, Incorporated. See's had another record year under the outstanding leadership of Charles Huggins, although the percentage gain in earnings (2%) was not nearly as large as the percentage gain in sales (10%). 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, 1976	$56,333,000	$5,618,000	20,553,000	173
February 28, 1976	51,342,000	5,513,000	19,388,000	171

*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, (ii) amortization of intangibles arising from purchase of See's stock at a large premium over book value and (iii) state income tax on See's dividends received by Blue Chip.

Last year See's had difficulty controlling its costs and more difficulty may lie ahead. Cocoa, which amounts to about one-third of See's candy ingredients by weight, is now selling at a price which is astronomical compared to past experience, requiring increases in candy prices. Despite the cost-control difficulties, very satisfactory financial results have been achieved, and there appears to be no diminution in the public preference for See's outstanding product. Because boxed chocolate consumption per capita is essentially static, only an outstanding product could have caused the increase in pounds sold of 6% which See's achieved last year without significantly adding to the number of its stores.

WESCO FINANCIAL CORPORATION

Next in importance, after See's, in our earnings picture last year was our equity in net income of our subsidiary, Wesco Financial Corporation (64% owned through most of the year and 78% owned at the end of the year).

Most of the improvement in Wesco's contribution to our consolidated net income was caused by increased earnings in Wesco's savings and loan business. Wesco is a separate public corporation, with its stock listed on the American Stock Exchange. We encourage Blue Chip shareholders to obtain a copy of Wesco's 1976 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

We increased our ownership of Wesco late last year through a tender offer, which was ultimately extended into January of 1977, when we realized our goal of increasing our ownership to 80%. Having reached 80% ownership, we will in future years file consolidated federal income tax returns including Wesco, which will eliminate future federal income taxes on dividends from Wesco. Another effect of reaching 80% ownership was to delete liability accumulated in the past for future income taxes applicable to distribution as dividends of our share of undistributed Wesco net income for periods prior to 1976. This reversal caused inclusion of an unusual tax credit, amounting to $.06 per Blue Chip share, in that part of our 1976 earnings attributable to our equity in Wesco.

TRADING STAMP, INCENTIVE AND MERCHANDISE PROMOTION BUSINESSES

The final components of our consolidated net income last year were provided by our trading stamp business and incentive and merchandise promotion businesses. These businesses all use the same headquarters and warehousing facilities. As a group the businesses operated at a substantial profit ($2,132,000) last year after (properly) giving them credit for the entire income (interest and dividends plus income tax benefits caused by dividends) from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed.

We decided during the year to terminate our merchandise promotion business—where our primary activity was a mail order business in collaboration with major oil companies in which we never achieved satisfactory operating margins. Our departure from this business was nearly complete by the end of 1976.

Trading stamp service revenues continued to decline—to $17,208,000 last year compared with $20,361,000 the previous year.

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 and is declining. Eventually, unless stamp issuances improve, earnings from investing "float" will decline greatly. The decline to date, however, has proceeded at a slow rate, giving us the prospect of earning significant income from investing "float" for a considerable number of years.

As discussed extensively in our previous annual report, 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 particularly difficult process when stamp issuances decline by a large percentage. We periodically revise our estimated future redemption liability as conditions warrant. For the calendar year 1976 the effect of revisions—primarily to reflect success in controlling redemption service costs—was to increase reported income.

We intend to remain in the trading stamp business. We believe that we provide good and useful service to our present customers. We hope for an eventual upturn in revenues.

PINKERTON'S, INC.

Early in 1976 we acquired non-voting stock representing 14% of the equity in Pinkerton's Inc., the leading national security and investigation service company. We increased this equity to 25% by subsequent purchases of marketable non-voting stock during 1976. Our total investment at cost at yearend was $20,915,000.

BUFFALO EVENING NEWS

After the close of the calendar year, on February 17, 1977, we contracted to buy, through a newly organized wholly-owned subsidiary, the newspaper assets of Buffalo Evening News, Inc., publisher of an afternoon newspaper in a two-newspaper competitive market in Buffalo, New York. The agreed price is approximately $33,000,000 cash plus assumption of certain pension obligations. A very large majority of the price is being paid for tangible assets, and we anticipate financing the acquisition primarily through a term loan from a bank.

Accounting reports furnished by the seller indicate earnings realized by it in 1976, from the assets to be acquired by our subsidiary, of approximately $1,400,000 before state and federal income taxes. Our new subsidiary, as purchaser, will have higher depreciation charges than the seller because the purchase price for tangible assets is higher than the seller's cost. In addition, the buyer's future earnings must reflect amortization of that portion of the purchase price which is attributable to subscription lists and goodwill. Also, we will be required to pay interest on the funds borrowed to pay the purchase price. For these reasons it appears likely that our consolidated earnings in 1977 will be somewhat depressed by the acquisition.

Nonetheless, we are extremely pleased to buy this newspaper. It is a high quality publication, with a long and distinguished history, has annual revenues of approximately $40,000,000, and is, by far, the leader in its two-newspaper market. If we are patient and sensible, maintaining and improving the quality of the Buffalo Evening News, we believe it will prove to be another wise acquisition.

CONSOLIDATED BALANCE SHEET AND OTHER DATA

Our consolidated balance sheet remains strong, as befits a company whose consolidated net worth supports large outstanding promises to others. As reflected in Note 4 to the accompanying financial statements, the aggregate market value of our marketable securities is greater 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
Charles T. Munger
Chairman of the Board

Donald A Koeppel
Donald A. Koeppel
President

March 10, 1977

Principal Business Activities

Blue Chip Stamps and its subsidiaries are engaged in four lines of business:

(1) **The candy business.** See's Candy Shops, Incorporated, a 99%-owned subsidiary acquired in January 1972, produces candy (primarily boxed chocolates) and other confectionery products of the highest quality in two fully equipped kitchens in California. See's is believed to be one of the largest candy manufacturers distributing through its own chain of retail shops; it now has 173 in nine western states including Hawaii.

See's registered slogan "Quality Without Compromise" reflects its attitude. In order to carefully control shelf life of the candy, which contains no significant artificial preservatives, See's does not sell through department stores, drug stores, etc. Cocoa, sugar and certain other ingredients are generally available but subject to wide price fluctuations from time to time. Emphasis on quality has helped make See's the predominant fresh candy business entity in California.

A substantial portion of each year's candy sales are generated during the Christmas and Easter seasons, when the high shop volume is augmented to an increasing degree by quantity sales to organizations at reduced prices. See's finances its seasonal inventory buildup by liquidating short-term investments. At Christmas the number of employees peaks at about three times the full-time base of approximately 1,000.

(2) **The trading stamp business.** Blue Chip Stamps provides a trading stamp service to retail merchants and their customers in California and Nevada. The service includes the issuance of trading stamps, catalogs, savings books, signs, banners and other promotional material as well as the redemption of Blue Chip stamps for merchandise or cash through forty-four redemption stores.

Stamp service revenues have declined from a historical peak of $124,180,000 for the fiscal year ended February 28, 1970 to $17,208,000 for the fiscal year ended January 1, 1977. This decline has resulted primarily from two factors. First, many supermarket operators discontinued or reduced the use of trading stamps in connection with their conversion to discount merchandising. Second, many service stations as a result of the gasoline shortage, eliminated the use of stamps. The reduction in stamp revenues has increased the relative importance to the business of the remaining customers: two Southern California supermarket chains, Stater Bros. Markets Division of Petrolane Incorporated and The Boy's Markets, Inc., accounted for 38% of stamp volume during the fiscal year ended January 1, 1977 as compared with 29% the preceding fiscal year. Over the past five years the Company has reduced the number of redemption stores from a peak of 90 to 44 at present. There has been a commensurate reduction of full-time employees to less than 300 currently.

(3) **The incentive and merchandise promotion business.** Blue Chip Incentives operates as a separate division on a nationwide basis. It tailors incentive programs for businesses. These programs use awards of merchandise, travel, points and stamps in order to stimulate sales or productivity, promote attendance or safety, or perform other motivational functions. The division's deluxe catalog is the cornerstone of many of these programs. With the decline of the trading stamp business, incentive programs have become more difficult to sell, because stamp awards do not enjoy their former popularity. Approximately 20 employees are involved in this operation.

This division, until recently, also developed, for oil companies and other large issuers of credit cards, complete merchandise packages for their credit card-holders—including item selection, graphics design, mailing of promotional materials and fulfillment of merchandise orders. In the summer of 1976, the Company decided not to seek any new business of this type, as profit margins had proved to be unsatisfactory.

(4) **The savings and loan business.** Wesco Financial Corporation, an 80%-owned, unconsolidated subsidiary controlled since late 1973, owns all of the outstanding stock of Mutual Savings and Loan Association, which operates at sixteen locations in Southern California. The association is engaged primarily in the business of lending money, principally secured by first liens against real estate, to enable borrowers to purchase, construct or refinance real property. In addition, investments in preferred stocks, municipal bonds and other securities have become increasingly important in recent years as a secondary source of income. Approximately 160 employees are employed in this line of business.

The following table sets forth the contribution, in thousands of dollars, of each line of business accounting for, during either of the last two fiscal years, ten per cent or more of total (consolidated) revenues or of total income before income taxes, securities gains (losses) and extraordinary items for five fiscal years ended as follows:

	Jan. 1, 1977	Feb. 28, 1976	Mar. 1, 1975	Mar. 2, 1974	Mar. 3, 1973
Revenues—					
Candy business	$56,648	$51,679	$43,370	$36,033	$32,591
Trading stamp service	22,786	25,755	34,973	59,925	96,108
Incentive and merchandise promotions	8,888	15,210	11,021	6,261	3,624
Income (loss) before income taxes, securities gains (losses) and extraordinary items—					
Candy business	11,059	10,968	6,783	4,153	4,597
Trading stamp service	2,600	438	(34)	4,533	7,115
Incentive and merchandise promotions	(1,479)	(1,079)	(592)	(66)	224
Savings and loan business	4,216	3,292	2,832	1,673	—

Set forth below is the relative contribution of each such line of business for the same fiscal years:

	Jan. 1, 1977	Feb. 28, 1976	Mar. 1, 1975	Mar. 2, 1974	Mar. 3, 1973
Revenues—					
Candy business	64%	56%	49%	35%	25%
Trading stamp service	26	28	39	59	73
Incentive and merchandise promotions	10	16	12	6	2
Income (loss) before income taxes, securities gains (losses) and extraordinary items—					
Candy business	67	81	76	40	38
Trading stamp service	16	3	—	44	60
Incentive and merchandise promotions	(9)	(8)	(7)	—	2
Savings and loan business	26	24	31	16	—

SUBSEQUENT EVENT

In February 1977, Blue Chip Stamps, through a newly organized, wholly owned subsidiary, agreed to buy the newspaper assets, subject to certain liabilities, of the Buffalo Evening News, Inc., publisher of the more successful of two daily newspapers in Buffalo, New York for approximately $33,000,000 cash plus assumption of certain pension obligations. The transaction is subject to approval of the Federal Reserve Board and is also contingent upon other matters. Consummation is expected to occur in April 1977. For further information, please refer to Note 11 to the accompanying financial statements.

Summary of Operations

(In thousands except for amounts per share)	53 weeks ended Jan. 1, 1977	52 weeks ended Feb. 28, 1976	52 weeks ended Mar. 1, 1975	52 weeks ended Mar. 2, 1974	52 weeks ended Mar. 3, 1973
Revenues:					
Candy sales	$56,333	$51,342	$42,907	$ 35,780	$ 32,049
Stamp service revenues	17,208	20,361	25,564	51,375	88,736
Merchandise promotions and incentive sales	8,888	15,210	11,022	6,261	3,624
Dividends and interest	5,211	4,913	7,738	8,260	7,315
Other	682	818	2,134	543	599
	88,322	92,644	89,365	102,219	132,323
Costs and expenses:					
Cost of sales and redemptions	46,358	52,116	54,912	68,156	95,662
Selling, general and administrative expenses	29,190	29,552	23,940	21,481	21,729
Interest	410	437	4,050	3,597	2,638
Discount amortization	184	212	306	365	358
	76,142	82,317	83,208	93,599	120,387
Income before income taxes, equity in net income of Wesco Financial Corporation, securities gains (losses) and extraordinary items	12,180	10,327	6,157	8,620	11,936
Provision for income taxes	(4,859)	(4,374)	(1,237)	(2,071)	(3,828)
Equity in net income of Wesco Financial Corporation	4,459	3,092	2,588	1,641	—
Income before securities gains (losses) and extraordinary items	11,780	9,045	7,508	8,190	8,108
Realized securities gains (losses), less taxes	(77)	8	254	(185)	(82)
Income before extraordinary items	11,703	9,053	7,762	8,005	8,026
Extraordinary credit (charges)	—	—	903	—	(925)
Net income	$11,703	$ 9,053	$ 8,665	$ 8,005	$ 7,101
Per share:					
Income before securities gains (losses) and extraordinary items	$2.27	$1.75	$1.45	$1.58	$1.58
Realized securities gains (losses)	(.01)	—	.05	(.03)	(.02)
Income before extraordinary items	2.26	1.75	1.50	1.55	1.56
Extraordinary credit (charges)	—	—	.17	—	(.18)
Net income	$2.26	$1.75	$1.67	$1.55	$1.38
Dividends declared	$ .24	$ .24	$ .24	$ .24	$ .24

NOTES TO SUMMARY OF OPERATIONS

In December 1976 the Company changed its 52-53 week fiscal yearend from approximately February 28 to approximately December 31.

The Company's equity in Wesco Financial Corporation's net income is included under the equity method beginning with the fiscal year ended in 1974. Ownership of the savings and loan holding company increased from 21.9% at March 3, 1973 to 44.6% at March 2, 1974, to 64.4% in August 1974 and to the present 80.1% in January 1977.

The extraordinary charges for fiscal 1973 represented settlements of lawsuits, less income tax effect. The extraordinary credit for fiscal 1975 represented federal income tax not payable due to offset of capital loss carry-forwards.

Other revenues in fiscal 1975 included a $1,254,000 gain on sale of a warehouse and a $311,000 gain on purchase and early retirement of outstanding debentures.

Per share amounts are based upon the weighted average number of shares of common stock outstanding during the fiscal year, adjusted for the dilutive effect of any outstanding stock options. Shares used in the summary have been 5,179,000 since fiscal 1974; 5,180,000 shares were used in fiscal 1974, including 1,000 dilution, and 5,129,000 shares in fiscal 1973, including 60,000 dilution.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

Candy sales increased substantially from the year ended March 1, 1975 to the year ended February 28, 1976; approximately 60% of the increase resulted from an increase in average selling price per pound, and approximately 40% was due to an increase in the number of pounds sold. Of the more moderate increase in candy sales from the year ended February 28, 1976 to the year ended January 1, 1977, approximately 60% resulted from a further increase in pounds sold and approximately 40% from continued pricing improvement.

The decline in stamp service revenues throughout the five-year period shown on the summary has been caused by various factors as explained above under Principal Business Activities.

Revenues from merchandise promotions and incentive sales increased from the year ended March 1, 1975 to the year ended February 28, 1976 due to expansion of the merchandise promotion business, under which the Company developed, for oil companies and other large issuers of credit cards, complete merchandise packages for their credit card-holders. In the summer of 1976, the Company decided not to seek any more business of this type, and revenues for the year ended January 1, 1977 dropped accordingly.

The drop in dividend and interest income from the year ended March 1, 1975 to the year ended February 28, 1976 was caused mainly by the sale of marketable securities in fiscal 1975 to repay $40,000,000 of bank loans.

Cost of sales and redemptions during the two most recent fiscal years decreased as a percentage of related revenues, principally due to adjustments of the liability for unredeemed trading stamps, which the Company revises periodically as changing conditions warrant. In February 1976, the stamp liability account was adjusted to reflect a reduction in the total number of stamps expected to be redeemed in the future as well as the likelihood that future redemption service expenses would increase materially on a per-stamp basis. In August 1976, due to favorable current experience in controlling costs, the stamp liability account was adjusted further to reflect a lower estimated future redemption service expense requirement per stamp.

The sharp increase in selling, general and administrative expenses from the year ended March 1, 1975 to the year ended February 28, 1976 was the result of the increased cost of printing and mailing merchandise promotional material to credit card-holders, as well as increased commissions paid with respect to such promotions, employee compensation, rent and other expenses. In the year ended January 1, 1977 merchandise promotion expenses dropped notably with discontinuance of the program, more than offsetting other increases in this expense category.

Interest expense dropped sharply in the year ended February 28, 1976 due to the repayment of bank loans late in the prior fiscal year.

The provision for income taxes jumped as a percentage of pre-tax income from 20% for the year ended March 1, 1975 to 42% in the year ended February 28, 1976 primarily because of a sharp increase in See's pre-tax income, taxed at a relatively high effective rate. The effective rate subsequently decreased to 40% in the year ended January 1, 1977 because See's pre-tax income represented a slightly lower proportion of income before taxes.

The Company's equity in net income of Wesco Financial Corporation increased during the two most recent fiscal years primarily as a result of an improvement in the subsidiary's earnings. A secondary factor in the year ended January 1, 1977 was the reversal of estimated provisions for income taxes on Wesco's undistributed earnings; such provisions are no longer required because the Company's ownership of Wesco now exceeds 80% and Wesco's earnings will be included in consolidated federal tax returns in future years.

Realized securities gains and losses fluctuate from year to year and accordingly are set out separately. The after-tax changes from net gains of $254,000 in the year ended March 1, 1975 and $8,000 in the year ended February 28, 1976 to net losses of $77,000 in the year ended January 1, 1977, although significant, were not abnormal to the business.

Revenues, expenses, earnings and other items set forth in the summary of operations are not necessarily indicative of future revenues, expenses, earnings and other items. In particular, a significant part of the earnings for the year ended January 1, 1977—the reversal of income tax accruals on Wesco's earnings which amounted to $319,000 (see Note 8 to the accompanying financial statements), and the adjustments of the stamp liability account totalling $1,046,000 (see Note 3 to the accompanying financial statements)—does not reflect any real or permanent increase in earning power.

Consolidated Balance Sheet

Blue Chip Stamps

(Notes 1 and 2)

ASSETS	January 1, 1977	February 28, 1976
Cash	$ 2,526,000	$ 2,032,000
Short-term investments, at cost which approximates market	11,636,000	24,695,000
Marketable equity securities, at the lower of cost or market (Note 4)	63,143,000	56,712,000
Accounts receivable	4,633,000	7,894,000
Merchandise and supplies inventories, at the lower of cost (principally first-in, first-out) or market	6,493,000	7,295,000
Prepaid expenses, principally income taxes (Note 8)	12,337,000	14,462,000
Property, fixtures and equipment, net (Note 5)	8,417,000	8,290,000
Investment in Wesco Financial Corporation (Note 2)	38,661,000	28,588,000
Excess of cost over equity in net assets of See's Candy Shops, Incorporated, less accumulated amortization (Note 2)	15,128,000	15,487,000
Other equity securities (Note 4)	4,163,000	—
	$167,137,000	$165,455,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable and accrued expenses	$ 6,680,000	$ 6,227,000
Income taxes payable (Note 8)	3,315,000	11,560,000
Liability for unredeemed trading stamps (Note 3)	66,867,000	71,135,000
6¾% Subordinated Debentures due 1978 (Note 6)	4,287,000	6,392,000
	81,149,000	95,314,000
Stockholders' equity (Notes 6 and 10):		
Common stock, par value $1.00		
Shares authorized—7,000,000		
Shares outstanding—5,179,000	5,179,000	5,179,000
Paid-in capital	1,579,000	1,579,000
Retained earnings	79,230,000	68,361,000
Net unrealized loss on marketable equity securities (Note 4)	—	(4,978,000)
Total stockholders' equity	85,988,000	70,141,000
	$167,137,000	$165,455,000

See accompanying notes to consolidated financial statements

Consolidated Statement of Income and Retained Earnings

Blue Chip Stamps

(Notes 1 and 2)

	53 weeks ended January 1, 1977	52 weeks ended February 28, 1976
Revenues:		
Candy sales	$56,333,000	$51,342,000
Stamp service revenues (Note 3)	17,208,000	20,361,000
Merchandise promotions and incentive sales	8,888,000	15,210,000
Dividends and interest	5,211,000	4,913,000
Other revenues	682,000	818,000
	88,322,000	92,644,000
Costs and expenses:		
Cost of sales and redemptions (Note 3)	46,358,000	52,116,000
Selling, general and administrative expenses	29,190,000	29,552,000
Interest and discount amortization	594,000	649,000
	76,142,000	82,317,000
Income before income taxes, equity in net income of Wesco Financial Corporation and securities gains (losses)	12,180,000	10,327,000
Provision for income taxes (Note 8)	(4,859,000)	(4,374,000)
Equity in net income of Wesco Financial Corporation (Notes 2 and 8)	4,459,000	3,092,000
Income before securities gains (losses)	11,780,000	9,045,000
Realized securities gains (losses), less income tax effect (Notes 4 and 8)	(77,000)	8,000
Net income	11,703,000	9,053,000
Retained earnings at February 28, 1976 and March 1, 1975	68,361,000	60,551,000
Add net loss for the nine weeks ended February 28, 1976 (Note 1)	98,000	—
Cash dividends of $.18 for the 44 weeks ended January 1, 1977 and $.24 for the 52 weeks ended February 28, 1976 (Note 6)	(932,000)	(1,243,000)
Retained earnings at end of year	$79,230,000	$68,361,000
Amounts per share based on weighted average shares outstanding:		
Income before securities gains (losses)	$2.27	$1.75
Realized securities gains (losses)	(.01)	—
Net income	$2.26	$1.75

See accompanying notes to consolidated financial statements

Consolidated Statement of Changes in Financial Position

Blue Chip Stamps

(Notes 1 and 2)

	53 weeks ended January 1, 1977	52 weeks ended February 28, 1976
Sources (uses) of cash, including short-term investments, from operations:		
Income before realized securities gains (losses)	$ 11,780,000	$ 9,045,000
Add (deduct),		
Depreciation and amortization	1,358,000	1,478,000
Decrease (increase) in trade accounts receivable	3,667,000	(4,105,000)
Decrease in inventories	1,653,000	4,472,000
Increase in prepaid expenses, principally income taxes	(5,384,000)	(7,773,000)
Equity in net income of Wesco Financial Corporation less dividends received, net of income taxes	(3,469,000)	(2,204,000)
Increase (decrease) in trade accounts payable and other accruals	(484,000)	628,000
Increase (decrease) in income taxes payable	(1,681,000)	9,558,000
Decrease in liability for unredeemed trading stamps	(2,900,000)	(1,048,000)
Cash provided by operations before realized securities gains (losses)	4,540,000	10,051,000
Other sources of cash:		
Decrease in marketable equity securities (net of $4,978,000 net unrealized loss deducted from stockholders' equity at February 28, 1976)	—	10,469,000
Decrease (increase) in accounts receivable from securities transactions	(1,085,000)	1,740,000
Proceeds from disposal of property, fixtures and equipment, net of income taxes and gains on sales	352,000	131,000
Increase in accounts payable from securities transactions	—	110,000
	3,807,000	22,501,000
Other uses of cash:		
Increase in marketable equity securities (net of reversal of $15,560,000 unrealized loss deducted from stockholders' equity at December 27, 1975)	416,000	—
Additions to property, fixtures and equipment	1,357,000	1,195,000
Purchase of stock of Wesco Financial Corporation	6,422,000	—
Purchase of other equity securities	4,163,000	—
Purchase of debentures for retirement	2,105,000	120,000
Payment of dividends	1,243,000	1,243,000
Realized securities (gains) losses net of income tax effect	77,000	(8,000)
Other	(48,000)	112,000
	15,735,000	2,662,000
Increase (decrease) in cash, including short-term investments	$ (11,928,000)	$ 19,839,000
Increase (decrease) in—		
Cash	$ 82,000	$ 526,000
Short-term investments	(12,010,000)	19,313,000
	$ (11,928,000)	$ 19,839,000

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

NOTE 1—Change in fiscal year end:

In December 1976 the Company changed the end of its 52-53 week fiscal year from approximately February 28 to approximately December 31. The results of operations for the nine weeks ended February 28, 1976 are included in the amounts shown for both fiscal years presented in the statement of income—the year ended January 1, 1977 as well as the year ended February 28, 1976. Summarized results of operations for the nine week period ended February 28, 1976 are as follows:

Total revenues	$15,669,000
Loss before securities gains	$ (107,000)
Realized securities gains, net of income taxes	9,000
Net loss	$ (98,000)

Because of the change in yearend, the amounts reflected in the consolidated statement of changes in financial position for the fiscal year ended January 1, 1977 are not the same as the changes between the amounts presented in the accompanying consolidated balance sheets, the dates of which are only ten months apart.

NOTE 2—Subsidiary companies:

The consolidated financial statements include the accounts of the Company and its 99%-owned subsidiary, See's Candy Shops, Incorporated (See's). The excess of cost over equity in the net assets of See's is being amortized over 40 years; amortization of $431,000 has been charged to selling, general and administrative expenses in each of the fiscal years ended January 1, 1977 and February 28, 1976.

The Company's investment in Wesco Financial Corporation (Wesco), a savings and loan holding company, has increased from 64.4% at March 1, 1975 and February 28, 1976 to 77.6% at January 1, 1977 and to 80.1% in January 1977. The investment is recorded at cost plus equity in Wesco's calendar-year net income, less taxes; the $21,522,000 and $18,131,000 unamortized excess of equity in the net assets of Wesco over cost at January 1, 1977 and February 28, 1976, respectively, is being amortized over 40 years. Summarized consolidated financial information of Wesco and subsidiaries for the years ended December 31, 1976 and 1975 follows:

	December 31, 1976	December 31, 1975
Assets—		
Cash and marketable securities	$155,153,000	$ 77,417,000
Loans receivable, less unearned loan fees, unrealized profit and loans in process	347,194,000	373,059,000
Other assets	21,001,000	19,651,000
	$523,348,000	$470,127,000
Liabilities and stockholders' equity—		
Savings deposits	$404,996,000	$360,070,000
Other liabilities	41,280,000	36,839,000
Total liabilities	446,276,000	396,909,000
Stockholders' equity, partially appropriated	77,072,000	73,218,000
	$523,348,000	$470,127,000
Total revenues	$ 39,391,000	$ 36,610,000
Net income	$ 5,516,000	$ 4,351,000
Blue Chip Stamps' share of net income	$ 3,708,000	$ 2,800,000
Income tax (provision) benefit thereon (Note 8)	243,000	(200,000)
Amortization of excess of equity over cost	508,000	492,000
Equity in net income	$ 4,459,000	$ 3,092,000

Wesco's appropriated retained earnings at December 31, 1976 and 1975 include approximately $45,578,000 and $44,940,000, respectively, 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, 1976 and 1975.

NOTE 3—Stamp service accounting:

The Company 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. The Company's estimated cost of future redemptions depends upon two factors: (1) the percentage of stamps issued which will ultimately be redeemed and (2) the future cost per stamp of the merchandise and redemption service expenses which will be required.

The Company periodically reevaluates both factors affecting the estimated cost of future redemptions and as a result has made the following revisions:

For the fiscal year ended February 28, 1976—

(1) The Company reduced its liability for unredeemed trading stamps and increased net income to reflect a reduction in the total estimated number of stamps to be redeemed in the future, computed by modifying the Company's former assumption that 97.5% of all stamps issued would ultimately be redeemed. The modifications (i) as of the conclusion of the fiscal year ended in 1974, reduced by approximately 4% the total number of stamps then estimated to be redeemed in the future, and (ii) for the two subsequent fiscal years ended in 1975 and 1976, reduced the redemption expectancy, applicable to stamps issued in such years, to 93%. These reductions reflected the Company's estimate (unchanged) that ultimate redemption rates are reduced by a decline in issuances, with most of the reduction occurring with respect to stamps issued after the decline, and that, accordingly, the Company would have to redeem about 97% of stamps issued before March 1974, and only 93% thereafter.

(2) The Company increased its provision for future redemption service expenses per stamp to reflect its estimate that a lower volume of redemptions would cause these expenses to increase materially on a per-stamp basis.

For the fiscal year ended January 1, 1977—

(1) The revisions discussed in (1) and (2) above, recorded at February 28, 1976, were considered properly includable in the fiscal year ended January 1, 1977.

(2) The Company in August 1976 reduced its provision for future redemption service expenses per stamp due to favorable experience in controlling such costs.

The effect of the foregoing revisions after federal and state income taxes was to increase net income $573,000 or $.11 per share for the fiscal year ended February 28, 1976 and $1,046,000 or $.20 per share for the fiscal year ended January 1, 1977.

The Company expects stamp issuances to continue to decline and, with additional experience, will probably make additional revisions of its redemption expectancy and costs in the future.

NOTE 4—Equity securities:

Marketable equity securities are carried at the lower of aggregate cost (first-in, first-out) or market. Cost and market value for the securities are set forth below:

	January 1, 1977	February 28, 1976
Cost	$63,143,000	$61,690,000
Market value	73,240,000	56,712,000

At February 28, 1976 the Company established a $4,978,000 valuation allowance to reduce the amount of marketable equity securities reflected in its balance sheet from historical cost to the lower of aggregate cost or market. The valuation allowance was charged directly to stockholders' equity. At January 1, 1977 the market value of the portfolio of marketable equity securities had recovered to an amount in excess of the aggregate cost and accordingly the valuation allowance was reversed with no effect on income. At January 1, 1977, gross unrealized gains and losses were $14,729,000 and $4,632,000 respectively.

Other equity securities of $4,163,000 represent an investment in Pinkerton Holding Corporation non-voting common stock. Through this holding and a direct investment of $16,752,000 in non-voting common stock of Pinkerton's, Inc., carried in marketable equity securities, the Company beneficially owns 25% of the equity in Pinkerton's, Inc. The Company considers its influence at Pinkerton's, Inc. to be insignificant because it has no vote as a stockholder and only one representative on the eleven-man board of directors.

Marketable equity securities, among other assets, are held primarily for the purpose of satisfying the Company's obligation to redeem outstanding trading stamps which, based on the Company's experience, will be presented for redemption over a number of years.

NOTE 5—Property, fixtures and equipment:

Following is a summary of property, fixtures and equipment, stated at cost:

	January 1, 1977	February 28, 1976
Land	$ 2,183,000	$ 2,315,000
Buildings	4,225,000	4,186,000
Furniture, fixtures and equipment	10,164,000	9,808,000
Leasehold improvements	4,030,000	3,867,000
	20,602,000	20,176,000
Less accumulated depreciation and amortization	12,185,000	11,886,000
	$ 8,417,000	$ 8,290,000

Depreciation and amortization of property, fixtures and equipment are provided by straight-line and accelerated methods over the estimated useful lives of the assets. Total provisions amounted to $927,000 and $1,047,000 for the fiscal years ended January 1, 1977 and February 28, 1976.

NOTE 6—Debentures:

The indenture underlying the debentures requires sinking fund payments of approximately $2,000,000 in November 1977 and 1978. Under the terms of the indenture, the Company is permitted to pay cash dividends in any fiscal year in an amount not to exceed the greater of (a) 24 cents per share or (b) 25% of net income for the preceding fiscal year. Dividends may not be paid if the Company is in arrears in any sinking fund payments.

NOTE 7—Pension and profit sharing plans:

Employees of the Company and of its consolidated subsidiary who meet certain eligibility requirements are covered under either Company-sponsored noncontributory pension or profit sharing plans or union-sponsored pension plans. The Company-sponsored plans are funded annually; the cost for the fiscal years ended January 1, 1977 and February 28, 1976 approximated $397,000 and $375,000 respectively. The total market value of the plans' assets exceeded the actuarially computed value of vested benefits at January 1, 1977 by approximately $1,000,000. The Company amended its plan to comply with the Employee Retirement Income Security Act of 1974 and has received a favorable determination from the Internal Revenue Service. The amendments did not have a material effect on the Company's consolidated financial position or results of operations.

NOTE 8—Taxes on income:

The consolidated statement of income contains charges (credits) for income taxes as follows:

	Fiscal year ended	
	January 1, 1977	February 28, 1976
Provision for income taxes	$ 4,859,000	$ 4,374,000
Charged against (credited to) equity in net income of Wesco	(243,000)	200,000
Charged against (credited to) securities gains (losses)	(42,000)	4,000
Total taxes charged in income statement	$ 4,574,000	$ 4,578,000

These taxes are payable or recoverable as follows:

	Fiscal year ended	
	January 1, 1977	February 28, 1976
Payable currently—		
Federal	$ 4,714,000	$ 6,472,000
State	1,340,000	1,572,000
	6,054,000	8,044,000
Recoverable in the future—		
Federal	(1,231,000)	(2,839,000)
State	(249,000)	(627,000)
	(1,480,000)	(3,466,000)
Total taxes charged in income statement	$ 4,574,000	$ 4,578,000

Of the above taxes, the amounts currently payable are included in income taxes payable on the consolidated balance sheet, net of prepayments. The amounts recoverable in the future are included in prepaid income taxes or investment in Wesco and result from the following timing differences in the recognition of revenue and expense items on the books as compared to the tax returns:

	Fiscal year ended	
	January 1, 1977	February 28, 1976
Deductible California franchise taxes over (under) those accrued on the books	$ 483,000	$ (101,000)
Deductible redemption expenses under those accrued on the books	(1,203,000)	(3,240,000)
Deferred taxes provided (reversed) on undistributed earnings of Wesco	(319,000)	133,000
Other timing differences	(441,000)	(258,000)
Total taxes recoverable in the future	$ (1,480,000)	$ (3,466,000)

Because the Company's ownership of Wesco now exceeds 80%, the earnings of Wesco will be included in consolidated federal tax returns in future years. Consequently, deferred taxes on undistributed earnings of Wesco, provided in prior years, have been reversed as of January 1, 1977.

The provision for income taxes of $4,859,000 for the fiscal year ended January 1, 1977 amounted to 39.9% of pre-tax income of $12,180,000; the provision of $4,374,000 for the prior fiscal year represented

42.4% of pre-tax income of $10,327,000. Following is a summary of the differences between the federal statutory rate and these effective percentages:

	Fiscal year ended	
	January 1, 1977	February 28, 1976
Statutory federal income tax rate	48.0%	48.0%
Federal tax benefit from dividend exclusion	(12.6)	(13.7)
State income taxes net of federal income tax benefit	4.8	4.8
All other, net	(.3)	3.3
Effective income tax rate	39.9%	42.4%

Investment tax credits, which have not been material, are recognized as the tax benefits are realized.

The consolidated balance sheet includes prepaid income taxes of $11,176,000 and $12,935,000 at January 1, 1977 and February 28, 1976, resulting primarily from (1) deducting certain redemption service expenses for tax purposes when stamps are redeemed and for book purposes when stamps are issued and (2) a difference between book and tax accounting for the number of outstanding stamps expected to be redeemed.

In March 1976 the Company settled its disagreement with the Internal Revenue Service with respect to its income tax returns for the fiscal years ended in 1969 through 1974, resulting from the Service's contentions that the Company (1) overstated its liability for unredeemed stamps by overestimating the number of stamps issued which would ultimately be redeemed and (2) should change its tax accounting method to deduct a greater portion of its redemption service expenses for tax purposes when stamps are redeemed, rather than when issued. The effect of the settlement was reflected in the financial statements for the fiscal year ended February 28, 1976. In the fiscal year ended January 1, 1977 the Company was assessed additional California franchise taxes based upon the federal settlement. The settlements had no effect on the consolidated statement of income, as the tax deficiencies constituted timing, rather than permanent, differences.

NOTE 9—Lease commitments and rental expense:

At January 1, 1977 minimum rental commitments are as follows:

For the fiscal year ending approximately December 31—	
1977	$2,319,000
1978	1,985,000
1979	1,804,000
1980	1,502,000
1981	1,083,000
For the five fiscal years ending approximately December 31—	
1986	$3,007,000
1991	1,140,000
1996	105,000

Net rental expenses were $4,845,000 and $4,420,000 for the fiscal years ended January 1, 1977 and February 28, 1976. Rentals applicable to candy operations are generally determined on the basis of a fixed percentage of sales subject to a specific minimum rental. Percentage rental expenses in excess of minimum rentals, which are included above, were $1,504,000 and $1,547,000 for the fiscal years ended January 1, 1977 and February 28, 1976.

Substantially all of the candy subsidiary's leases are, based on current assumptions, considered "financing leases" as defined by the Securities and Exchange Commission. The respective present values of aggregate rental commitments (including estimated future percentage rentals) of these leases were approximately $15,950,000 and $12,602,000 at January 1, 1977 and February 28, 1976. In computing present values, prime interest rates ranging from 1.5% to 12% were used and averaged approximately 6% in each of the fiscal years. The effects on net income assuming the leases had been capitalized at inception, would not have been material.

NOTE 10—Legal proceedings:

The Company was a defendant in a purported class action filed March 1, 1971 to recover for stamp savers monies collected by it as reimbursement for California sales taxes on redemption of stamps. In December 1976 an order of the California Supreme Court dismissing the class action portion of the suit became final. Any further proceedings by plaintiffs would involve immaterial amounts.

A purported class action was filed under federal securities laws on November 10, 1970 against the Company and certain of its present and former stockholders and directors, on behalf of retailer users of

Blue Chip Stamps who failed to purchase securities of the Company in a 1968 offering to retailer users. The complaint alleged damages to plaintiffs of $21,400,000, together with exemplary damages of $25,000,000, interest, attorneys' fees and costs, and prayed that plaintiffs have the right to purchase securities of the Company on the terms of the 1968 offering. The federal action was concluded on June 9, 1975, when the United States Supreme Court held that the purported class did not have standing to bring such an action. On June 21, 1971 a substantially identical action based on California law was filed in Los Angeles County Superior Court. On August 13, 1976 an order was entered by the court granting the Company's motion to dismiss the action based on the ground that plaintiffs had not complied with the requirements of California law to bring the action to trial within five years from the date of its filing. Plaintiff has filed notice of appeal from the Court's ruling. In the opinion of counsel, on the current state of the record and the law, the appeal should be defended successfully and, in the unlikely event that the plaintiff should prevail on the appeal, there would be substantial defenses on the merits.

NOTE 11—Event subsequent to January 1, 1977:

On February 17, 1977 the Company, through a newly organized, wholly owned subsidiary, entered into an agreement to purchase the newspaper assets, subject to certain liabilities, of the Buffalo (New York) Evening News for approximately $33,000,000 in cash plus assumption of certain pension obligations. The transaction is subject to approval by the Federal Reserve Board and is also contingent upon other matters.

The Company has not provided pro-forma financial information based on the assumption that the transaction had occurred as of the beginning of the current fiscal year for the following principal reasons. First, the Company expects that, if the transaction is approved, it will finance the purchase mainly by a term bank loan which may be supplemented in part by use of the Company's available resources. Although negotiations are in process, no agreement has been reached as to loan amount, terms of payment or interest rate. Consequently, the cost of financing the purchase, either in interest or in the form of reduced income from existing investments, cannot be accurately estimated. Second, the purchase price significantly exceeds the seller's aggregate depreciated cost of the assets acquired less the liabilities assumed. It will be necessary to make a study to allocate portions of the price paid among assets acquired as well as to estimate useful lives of various items of plant and equipment for the purpose of computing depreciation. It is anticipated (i) that a substantial writeup of the tangible assets acquired will occur, (ii) that some portion of the total cost of all acquired assets will be allocated to subscription lists and goodwill, and (iii) that an additional liability will be recorded in an amount requiring complex actuarial computations of pension obligations.

Because specific information concerning the foregoing is not available, any estimate of what the impact on the Company's earnings would have been if the newspaper assets had been acquired at the beginning of the fiscal year is tentative, approximate and very likely inaccurate. However, management estimates—after considering additional depreciation expense and financing costs, net of applicable income tax benefit, and amortization of goodwill—that if the Company had acquired the newspaper at the beginning of its fiscal year ended January 1, 1977 such an acquisition would have resulted in a detrimental effect on the Company's pro-forma net income (including net income of the newspaper operation) of something between $500,000 and $1,500,000, or $.10 and $.29 per share, respectively.

For the year ended December 31, 1976, unaudited total revenues and net income, as reported by the seller, from the operations of the newspaper assets to be acquired were approximately $39,600,000 and $700,000, respectively. The assets, net of liabilities, which are to be acquired for approximately $33,000,000, are recorded in the accounts of the seller as of December 31, 1976 at approximately $20,300,000. The Company's subsidiary will also take over pension plans for which seller estimates that vested benefits are approximately $4,000,000 in excess of plan assets.

NOTE 12—Quarterly financial information—unaudited:

The following interim financial information is furnished pursuant to a new rule of the Securities and Exchange Commission. It has not been audited by the Company's independent accountants in accordance with generally accepted auditing standards and accordingly they express no opinion thereon.

	14 weeks ended	13 weeks ended		
	January 1, 1977	September 25, 1976	June 26, 1976	March 27, 1976
Total revenues	$32,901,000	$13,718,000	$20,777,000	$20,926,000
Cost of sales and redemptions	15,708,000	6,760,000	10,607,000	13,283,000
Equity in net income of Wesco	1,664,000	1,018,000	979,000	798,000
Net income	5,915,000	2,186,000	2,729,000	873,000
Net income per share	$1.14	$.42	$.53	$.17

The amounts shown for the first and second quarters have not previously been reported due to the change in fiscal yearend explained in Note 1.

Report of Independent Accountants

Price Waterhouse & Co.

606 SOUTH OLIVE STREET
LOS ANGELES, CALIFORNIA 90014
213-625-4400

March 10, 1977

To the Board of Directors and
Stockholders of Blue Chip Stamps

We have examined the consolidated balance sheet of Blue Chip Stamps and its consolidated subsidiary as of January 1, 1977 and February 28, 1976, and the related consolidated statements of income and retained earnings and of changes in financial position for the fiscal 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 Wesco Financial Corporation which is accounted for on the equity method in the consolidated financial statements (Note 2). These statements were examined by other independent accountants whose report thereon has been furnished to us. Our opinion expressed herein, insofar as it relates to the amounts included for Wesco Financial Corporation, is based solely upon such report.

In our opinion, based on our examinations and the report of other independent accountants, the consolidated financial statements present fairly the financial position of Blue Chip Stamps and its consolidated subsidiary at January 1, 1977 and February 28, 1976, and the results of their operations and the changes in their financial position for the fiscal years then ended, in conformity with generally accepted accounting principles consistently applied.

Price Waterhouse & Co.

Directors and Officers

DIRECTORS

Warren E. Buffett
Chairman of the Board of Berkshire Hathaway Inc., a textile manufacturer also engaged through subsidiaries in banking and insurance, and of Diversified Retailing Company, Inc., which is engaged in the operation of women's apparel stores and through subsidiaries in insurance

Z. Wayne Griffin
Personal investments, real estate development

Donald A. Koeppel
President of the Company

Charles T. Munger
Chairman of the Board of the Company

William F. Ramsey
Executive Vice President of the Company

Ron Stever
Chairman of the Board of Stever, Klove & Bradway, Inc., employee benefit consultants, and of Crescent Wharf & Warehouse Co.

Andrew J. Wolf
President of A & B Supermarkets, Inc., a retail grocery chain

OFFICERS

Charles T. Munger
Chairman of the Board

Donald A. Koeppel
President

William F. Ramsey
Executive Vice President

Raymond H. Allen
Vice President, Information Systems

Robert H. Bird
Vice President, Secretary and Treasurer

William K. Klepper
Vice President, Merchandise

Kenneth E. Wittmeyer
Vice President, Industrial Relations

Ernest P. Paulson
Controller and Assistant Secretary

TRANSFER AGENT-REGISTRAR

Bank of America, N.T. & S.A.
San Francisco

Stock Quotations

The following table summarizes the range of over-the-counter quotations reported by the National Association of Securities Dealers, Inc. with respect to the Company's common stock:

	High		Low	
Fiscal quarter ended	Bid	Asked	Bid	Asked
May 31, 1975	8	8¾	6½	7¼
August 30, 1975	9¼	10	7½	8¼
November 29, 1975	8	8¾	6¼	7
February 28, 1976	13¾	14½	5¾	6½
March 27, 1976	14	14¾	6¼	7
June 26, 1976	15	15¾	12¼	13
September 25, 1976	15	15¾	13½	14¼
January 1, 1977	17	17¾	15	15¾

A cash dividend of $.06 per share was paid in each quarter.

WESCO FINANCIAL CORPORATION

Annual report 1976

Headquarters building of Wesco Financial Corporation and Mutual Savings — Pasadena's City Hall in foreground

TO THE STOCKHOLDERS OF WESCO FINANCIAL CORPORATION

Consolidated net earnings of Wesco Financial Corporation and its subsidiaries for 1976 amounted to $5,516,000 ($2.32 per share) compared to $4,351,000 ($1.83 per share) in 1975. Quarterly earnings per share were:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1976	$ .48	.60	.63	.61	2.32
1975	.36	.36	.54	.57	1.83

Total savings in Mutual Savings increased $44,926,000 in 1976 compared with an increase of $26,953,000 in 1975. Out-of-state savings were $52,508,000 (13% of total savings) at December 31, 1976 compared with $52,313,000 (14.5% of total savings) in 1975. Substantial growth of savings in 1977 is expected.

Cost of savings and cost of funds (savings and borrowings) continued to increase in 1976 as did the yield on the loan portfolio of Mutual Savings.

	1976	1975	1974	1973	1972
Cost of Savings	6.35%	6.29	6.00	5.60	5.56
Cost of all funds	6.43	6.41	6.25	5.69	5.59
Yield on loans at year end	7.70	7.55	7.36	7.17	7.03

Real estate loans made during 1976 totaled $42,386,000 compared with $36,317,000 in 1975. Loans in process and firm loan commitments, which at December 31, 1975 were $1,643,000, increased to $3,260,000 at December 31, 1976.

On December 29, 1976, Wesco, the parent company, borrowed the sum of $5,500,000 payable in monthly installments, including interest at 9¼%, for a period of thirty years. At December 31, 1976, Wesco's cash and short-term securities, at the parent company level, were $21,070,000, compared with $14,458,000 at December 31, 1975. Search for suitable opportunities for investment of a substantial portion of these funds has been underway for sometime and may result in a major corporate acquisition.

Mutual Savings in 1976 continued its program to diversify its assets by investing an additional $2,009,000 in public utility preferred stocks, $2,142,000 in municipal bonds and $14,809,000 in the purchase of 1,044,900 shares of common stock of Federal National Mortgage Association (FNMA).

At year end 1976 the amount invested in stocks and bonds by Wesco and Mutual Savings on a consolidated basis and their market value and unrealized gain were:

	Cost	Market Value	Unrealized Gain
Preferred stocks	$25,215,000	28,488,000	3,273,000
Common stocks	14,809,000	17,763,000	2,954,000
Municipal bonds	6,696,000	7,738,000	1,042,000
Total	$46,720,000	53,989,000	7,269,000

Wesco and Mutual Savings have increased cash and short-term marketable securities due in one year or less. Total investment of the stocks, bonds, cash and short-term marketable securities at year end is:

	1976	1975
Stocks and bonds	$ 46,720,000	29,613,000
Cash and marketable securities	108,433,000	47,804,000
Total	$155,153,000	77,417,000

Further information concerning these assets and income therefrom is included in Management's Discussion in this Annual Report.

Properties acquired by foreclosure were $3,321,000 at December 31, 1976 compared with $3,286,000 at December 31, 1975. A commercial property, acquired in 1975 with a book cost of $289,000, has been sold with the escrow scheduled to close in 1977 at a profit of approximately $160,000. Property at Upland, California, occupied by our branch office, was acquired by foreclosure in 1976 at a book cost of $293,000. We expect to retain ownership of this parcel. Our occupancy expense will be less than was being paid under a prior rental arrangement. A one-half interest in a modern shopping center, motel and restaurant at Lake San Marcos, acquired by foreclosure, has a book value at December 31, 1976 of $816,000 and in 1976 produced a net profit of $144,000, a return of 18% on cost.

The remaining balance of the foreclosed property account at December 31, 1976 was $1,923,000 and consists of vacant land at Santa Barbara, Friendly Valley in Los Angeles county and Lake San Marcos in San Diego County, with book values of $955,000, $621,000 and $347,000 respectively. We are processing development plans for the vacant land at Santa Barbara and Friendly Valley and hope to commence construction of residences at Santa Barbara in the fall of 1978 and at Friendly Valley in the fall of 1977. No profit will be realized from these developments during 1977. We believe it will be possible to dispose of the remaining vacant land at Lake San Marcos during 1977 and 1978.

Blue Chip Stamps, by a tender offer expiring January 27, 1977, acquired 373,730 shares of Wesco and is now the owner of 1,901,029 shares (80.1% of all shares). This resulted in delisting by the New York Stock Exchange. Trading of Wesco stock commenced on March 7, 1977 on the American Stock Exchange.

On January 18, 1977, Wesco increased its regular quarterly cash dividend from $.17½ per share to $.21½ per share payable March 10, 1977 to shareholders of record at the close of business on February 18, 1977 on 2,373,269 shares then outstanding. A 3-for-1 stock split in the form of a 200% stock dividend was declared by Wesco with distribution to be made on April 4, 1977 to shareholders of record on March 18, 1977.

Mutual Savings, which has sixteen offices, did not open any new branch offices during the year 1976. Applications are pending for satellite branch offices in a proposed retail shopping center in Pasadena and in an existing new shopping center in Glendale.

A "Summary of Operations" for a five-year period is presented on page 2, 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

WESCO FINANCIAL CORPORATION AND SUBSIDIARIES

Summary of Operations

Year ended December 31, 1976 and four prior years

	1976	1975	1974	1973	1972
Revenues:					
Interest on loans	**$ 27,521,000**	28,438,000	28,463,000	27,450,000	25,318,000
Loan fees and service charges	**1,663,000**	1,362,000	1,542,000	1,786,000	2,662,000
Interest on marketable securities	**5,135,000**	3,171,000	3,202,000	2,950,000	2,362,000
Dividends on common and preferred stocks	**3,108,000**	1,953,000	974,000	463,000	185,000
Interest and dividends on investments required by law	**486,000**	519,000	533,000	462,000	251,000
Net gains (losses) on sales of marketable securities	**26,000**	(62,000)	(429,000)	(72,000)	2,000
Operations and net gains from sales of real property	**1,082,000**	909,000	593,000	831,000	622,000
Other income, net	**370,000**	320,000	302,000	419,000	385,000
	39,391,000	36,610,000	35,180,000	34,289,000	31,787,000
Expenses:					
General and administrative expenses	**4,944,000**	4,710,000	4,208,000	3,702,000	3,436,000
Interest on savings deposits	**24,428,000**	21,844,000	20,419,000	20,001,000	19,304,000
Interest on notes payable	**1,962,000**	2,628,000	3,364,000	1,313,000	611,000
	31,334,000	29,182,000	27,991,000	25,016,000	23,351,000
Earnings before taxes on income	**8,057,000**	7,428,000	7,189,000	9,273,000	8,436,000
Taxes on income:					
Current	**2,283,000**	3,735,000	3,262,000	4,263,000	3,018,000
Deferred	**258,000**	(658,000)	—	402,000	1,082,000
	2,541,000	3,077,000	3,262,000	4,665,000	4,100,000
Net earnings	**$ 5,516,000**	4,351,000	3,927,000	4,608,000	4,336,000
Earnings per capital share					
Based on 2,373,269 shares outstanding before announced 3-for-1 stock split	**$ 2.32**	1.83	1.65	1.94	1.83
Based on 7,119,807 shares outstanding adjusted for announced 3-for-1 stock split	**$ .77**	.61	.55	.65	.61
Cash dividends per capital share					
Based on 2,373,269 shares outstanding before announced 3-for-1 stock split	**$ .70**	.60	.50	.453	—
Based on 7,119,807 shares outstanding adjusted for announced 3-for-1 stock split	**$ .233**	.20	.167	.151	—
FINANCIAL DATA AT YEAR END					
Total assets	**$523,348,000**	470,127,000	465,646,000	451,980,000	448,240,000
Real estate loans	**$344,567,000**	371,041,000	386,398,000	387,165,000	367,679,000
Savings deposits	**$404,996,000**	360,070,000	333,117,000	345,530,000	361,272,000
Shareholders' equity	**$ 77,072,000**	73,218,000	70,291,000	67,551,000	64,018,000
Book value per share*	**$ 32.48**	30.85	29.62	28.46	26.98

*Book value per share is based on 2,373,269 shares outstanding at December 31, 1976.

Management's Discussion and Analysis of Summary of Operations

The accompanying Summary of Operations covers the five years ended December 31, 1976.

The principal business of Wesco Financial Corporation (Wesco) is the ownership of all of the outstanding stock of Mutual Savings and Loan Association (Mutual Savings) which operates sixteen offices in Southern California. Wesco also owns and operates a Pasadena business block in which its head office and the head office of Mutual Savings are located. This block is fully improved with a 9-story modern office building, a 420-car garage and four retail stores. Wesco, the parent company, invests its cash funds in short-term marketable securities. Mutual Savings' principal business is the lending of money secured by first liens on real estate (principally residential) to enable borrowers to purchase, construct, or refinance real property. Funds are provided by savings deposits, principal payments on existing loans, borrowings from banks and operations.

INTEREST ON LOANS. This source of income is dependent upon the amount of loans and the yield thereon. The yields at December 31, 1976, 1975 and 1974 were 7.70%, 7.55% and 7.36% respectively. Total real estate loans outstanding at the end of such years were $347,244,000, $374,011,000 and $389,167,000.

LOAN FEES AND SERVICE CHARGES. This income was derived from the following sources:

	1976	1975	1974
Loan fees	$ 701,000	721,000	858,000
Commitment fees	—	—	89,000
Escrow and clerical fees	130,000	47,000	102,000
Prepayment charges	568,000	314,000	334,000
Late charges	70,000	82,000	59,000
Other charges	194,000	198,000	100,000
	$1,663,000	1,362,000	1,542,000

Loan fees consist of fees currently earned plus transfer of unearned fees to earnings. Unearned loan fees at year end have decreased from $1,075,000 in 1974 to $812,000 in 1975 and to $648,000 in 1976 and was caused by transfer to earnings of an amount considerably in excess of additions to the unearned loan fee account. Transfer to earnings was $409,000 in 1974, $342,000 in 1975 and $245,000 in 1976.

INTEREST ON MARKETABLE SECURITIES. Investments have consisted principally of certificates of deposit of major banks, short-term bank obligations, banker's acceptances, United States Government bonds, notes, bills and agency securities and state municipal bonds. Maturity of these marketable securities, other than municipal bonds, has been less than one year. The variation in income shown on the accompanying Summary is accounted for by the varying amounts invested and the varying yields obtained in the particular year. The amount invested in marketable securities from time to time is dependent on the cash flow available for investment and the amount committed for investment in real estate loans.

Mutual Savings increased its holdings of state and municipal bonds by approximately $2,142,000 during 1976 to a total on December 31, 1976 of $6,696,000 at cost and $7,738,000 at market value. The unrealized appreciation included in the latter figure of $1,042,000, up from $78,000 at the previous year end, reflects the favorable conditions which existed in the tax-exempt bond market in 1976. The average maturity of Mutual Savings' tax-exempt bond portfolio is just over twelve years, the current return on our investment is 7.84%, and interest income for 1976 was $486,000 compared with $54,000 for 1975. The amount invested in all such marketable securities at December 31 for the years indicated is as follows:

	1976	1975	1974
Municipal bonds	$ 6,696,000	4,554,000	—
Other marketable securities	106,912,000	44,220,000	34,019,000

DIVIDENDS ON COMMON AND PREFERRED STOCK. During 1976, Mutual Savings invested $14,809,000 by purchase of 1,044,900 shares of common stock of Federal National Mortgage Association (FNMA). At December 31, 1976, the market value of the stock was $2,954,000 in excess of cost. In 1976 FNMA paid quarterly dividends of $.22 per share, a return of 6.57% on cost. The dividend rate was increased to $.25 per share for the first quarter of 1977. During 1977 to March 3, Mutual Savings has purchased an additional 605,100 shares at a cost of $9,706,000, resulting in a total investment of $24,736,000. The investment in stock of FNMA by Mutual Savings is, by law, limited to 5% of its assets which at December 31, 1976 was approximately $25,000,000. FNMA is a U. S. Government sponsored corporation whose primary function is providing a secondary market for FHA and VA mortgages. Its stock is listed on the New York Stock Exchange.

During 1976, $2,009,000 of additional funds were invested in public utility preferred stocks increasing the holdings of Mutual Savings and Wesco to $25,215,000 ($267,000 in Wesco) at cost on December 31, 1976 with an annual yield of 10.10%. Reflecting the strength in the market for preferred stocks, the market value of these securities at year end was $28,488,000, including unrealized appreciation of $3,273,000 up from $619,000 a year earlier. Mutual Savings' portfolio of preferreds is limited by regulation to 5% of its assets, which at December 31, 1976 was approximately $25,000,000. It is the present intention of management to maintain that position. Instances may arise from time to time in which the Company's position can best be protected by selling some of these preferred stocks in the market resulting in the realization of a portion of the difference between the cost and the market value of these securities. In particular, the redemption features, which apply to all these preferreds, are being considered carefully with regard to the continued retention of the holdings.

The amounts invested at year end were:

	1976	1975	1974
Common stocks	$ 14,809,000	1,853,000	5,079,000
Preferred stocks	25,215,000	23,206,000	12,900,000
Total	$ 40,024,000	25,059,000	17,979,000

The annual dividend income from such investments was:

	1976	1975	1974
Common stocks	$ 671,000	194,000	745,000
Preferred stocks	2,437,000	1,759,000	229,000
Total	$ 3,108,000	1,953,000	974,000

85% of the dividend income from stocks is deductible in computing Federal income taxes. Dividend income will increase in 1977 because of planned additional investment and the increased dividend by FNMA.

INTEREST AND DIVIDENDS ON INVESTMENTS REQUIRED BY LAW. This source of income consists of dividends received on stock of the Federal Home Loan Bank of San Francisco and interest received on our secondary reserve held by the Federal Savings and Loan Insurance Corporation. A dividend of $229,000 was declared in 1974, $198,000 in 1975 and $171,000 in 1976 all in the fourth quarter. The variation in amount of interest on the secondary reserve has been nominal.

NET GAINS (LOSSES) ON SALES OF MARKETABLE SECURITIES. A loss of $429,000 taken on sale of securities in 1974 is accounted for by two transactions. In order to improve the quality and yield on public utility preferred stocks owned, some sales were made at a loss of $171,000 and the funds reinvested in other preferred stocks considered of better quality and providing a higher yield. Government and agency obligations were sold at a loss of $256,000 and proceeds reinvested so as to reduce the time to maturity. The loss of $62,000 in 1975 and the gain of $26,000 in 1976 is due principally to sales of securities with the proceeds being used to purchase more desirable issues.

OTHER INCOME. The principal portion of other income is rentals derived from the Pasadena business block, owned by Wesco, in which the head office of Mutual Savings is located. This income, reported on a net basis after applicable expenses, was $255,000 for the year 1976, $288,000 for the year 1975 and $206,000 for the year 1974. All rentable space has been now leased and full occupancy will occur by May 1, 1978. Leases contain a provision for increase of rents as costs of operation and maintenance increase. Some improvement in net rental income will occur in 1977 and future years.

OPERATIONS AND NET GAINS FROM SALES OF REAL PROPERTY. Mutual Savings, over a period of years, has acquired real property by foreclosure. Some of the vacant land so acquired was disposed of from time to time and, on other occasions, residential units were built thereon. No construction occurred during 1976. Operations and net gains from the sale of real property and the sources thereof was as follows:

	1976	1975	1974
Gain on sales taken directly into income	$ 81,000	106,000	181,000
Amortization of unrealized profit	962,000	814,000	410,000
Rental income	136,000	151,000	108,000
Maintenance and sales expense	(97,000)	(162,000)	(106,000)
Total	$1,082,000	909,000	593,000

Unrealized profit on the sales of real property at year end was:

1976	1975	1974
$ 276,000	1,025,000	1,404,000

During the next several years income from sales will be limited to that realized from sales then made and no addition to earnings is expected from the unrealized profit of $276,000 on hand at December 31, 1976. Rental income from operations should continue in future years. Maintenance and sales expenses will decrease as vacant land is disposed of.

GENERAL AND ADMINISTRATIVE EXPENSES. General and administrative expenses increased $502,000 in 1975 and $234,000 in 1976 as compared to the respective prior years. Business expenses were 12.6% of gross income in 1976, 12.9% in 1975 and 12% in 1974. The increases were occasioned principally by inflation, the expense of opening and operating four additional offices in 1974, three additional offices in 1975 and the cost of computerizing our accounting system.

INTEREST ON SAVINGS DEPOSITS. Total savings and interest paid thereon for the past three years were:

	1976	1975	1974
Total savings	$404,996,000	360,070,000	333,117,000
Interest on savings	24,428,000	21,844,000	20,419,000

Savings deposits are summarized at December 31 by interest rates as follows:

	1976	1975	1974
5¼%	37%	38	36
5½	1	1	2
5¾	4	3	3
6	5	10	23
6½	12	11	8
6¾	3	4	3
7	1	1	1
7½	29	27	22
7¾	8	5	—
Over 7¾	—	—	2
	100%	100	100

Total savings are expected to increase during 1977 with a slight increase in the percentage of higher rate accounts.

INTEREST ON NOTES PAYABLE. The variation in interest on notes payable is due to fluctuations in amounts borrowed from time to time and varying rates paid. Rates of interest on borrowings varied in 1976 from 7¼% to 9¼%, in 1975 from 7¼% to 10½% and in 1974 from 7½% to 12%. The total of notes payable at year end for the past three years and the interest paid in each year was:

	1976	1975	1974
Notes payable	$ 31,356,000	26,210,000	50,975,000
Interest thereon	1,962,000	2,628,000	3,364,000

TAXES ON INCOME. Taxes on income were 31.5% of earnings before taxes on income in 1976, 41.4% in 1975 and 45.4% in 1974. Total tax expense varies with the increase or decrease in pre-tax accounting income adjusted for permanent differences (generally non-taxable revenue or non-deductible expense items). The main reason for the decreasing effective tax rates is the 85% dividends received deduction on common and preferred stock. This deduction has increased as the investment in preferred stock has increased. In addition, in 1976 and 1975, income earned on municipal obligations was tax exempt and gains on sales of foreclosed property increased compared to 1975 and 1974.

A reconciliation of total income tax and the amount computed by applying the U. S. Federal income tax rate of 48% to earnings before taxes on income follows:

	1976	1975	1974
Computed "expected" Federal taxes	$3,867,000	3,565,000	3,451,000
Increase (reductions) in taxes resulting from:			
Net gains on sales of foreclosed real property	(459,000)	(278,000)	(219,000)
State franchise tax net of Federal income tax benefit	484,000	418,000	422,000
Dividends received deduction on common and preferred stocks	(1,268,000)	(796,000)	(397,000)
Interest on municipal obligations	(233,000)	(25,000)	—
Other permanent differences	150,000	193,000	5,000
Taxes on income	$2,541,000	3,077,000	3,262,000

Deferred tax expense was $258,000 in 1976, ($658,000) in 1975 and nil in 1974. The primary reasons for the changes in deferred taxes are deferred loan fees and accrued investment income. Recognition of loan fee income has been greater for tax purposes than for financial statement purposes the past three years. Recognition of investment income was greater for tax purposes than for financial statement purposes in 1975 and 1974; however, in 1976, investment income recognized for financial statement purposes was greater.

STOCK MARKET DATA. The following table indicates the quarterly high and low prices for Wesco's capital stock on the New York Stock Exchange for the last three years.

	1976		1975		1974	
Quarter Ended	High	Low	High	Low	High	Low
March 31	15⅝	10	11¾	8⅜	15	11⅛
June 30	15¼	13¼	12	10⅞	15	9⅝
September 30	15½	13⅜	11⅞	9	13½	6¼
December 31	20	15½	10⅛	8⅞	9¾	7½

A copy of Form 10-K for 1976, filed with the Securities and Exchange Commission, is available without charge upon a stockholder's written request addressed to Mrs. Dolores Henderson, Assistant Secretary, Wesco Financial Corporation, 315 East Colorado Boulevard, Pasadena, California 91109.

Consolidated Balance Sheets

December 31, 1976 and 1975

ASSETS	1976	1975
Cash	$ 1,521,000	3,584,000
Short-term bank obligations	16,700,000	—
Certificates of deposit and banker's acceptances, at amortized identified cost, which approximates market	80,262,000	40,000
United States Government and agency obligations, at amortized identified cost (quoted market, $9,908,000 in 1976 and $44,291,000 in 1975) (note 3)	9,950,000	44,180,000
Municipal obligations, at amortized identified cost (quoted market, $7,738,000 in 1976 and $4,632,000 in 1975)	6,696,000	4,554,000
Investment in common stocks (quoted market, $17,763,000 in 1976 and $1,567,000 in 1975) (note 11)	14,809,000	1,853,000
Investment in preferred stocks (quoted market, $28,488,000 in 1976 and $23,825,000 in 1975) (note 11)	25,215,000	23,206,000
Loans receivable, less unearned loan fees, unrealized profit and loans in process (notes 2 and 3)	347,194,000	373,059,000
Accrued interest and dividends receivable	3,074,000	1,581,000
Properties purchased and held for investment, at cost	89,000	288,000
Properties acquired through foreclosure by Mutual Savings and held for sale, at cost, less allowance for losses of $192,000 in 1976 and $251,000 in 1975	3,321,000	3,286,000
Investments required by law:		
Investment in stock of Federal Home Loan Bank, at cost (note 3)	3,593,000	3,967,000
Prepayments to FSLIC secondary reserve	4,608,000	4,792,000
Office properties and equipment, net (notes 3 and 5)	5,059,000	5,080,000
Prepaid expenses and sundry assets, at cost	1,257,000	657,000
	$523,348,000	470,127,000

LIABILITIES AND STOCKHOLDERS' EQUITY		
Savings deposits	$404,996,000	360,070,000
Notes payable (note 3)	31,356,000	26,210,000
Advances by borrowers for taxes and insurance	479,000	779,000
Accounts payable and sundry accrued expenses	1,099,000	1,032,000
Cash disbursements to be funded at bank	668,000	646,000
Taxes on income (note 4):		
Current	229,000	981,000
Deferred	7,449,000	7,191,000
Total liabilities	446,276,000	396,909,000
Stockholders' equity (notes 4, 7, 8 and 13):		
Capital stock of $1 par value per share. Authorized 2,500,000 shares; issued 2,373,269 shares	2,373,000	2,373,000
Capital surplus arising from stock dividends	28,066,000	28,066,000
Retained earnings	46,633,000	42,779,000
Total stockholders' equity	77,072,000	73,218,000
Commitment, contingent liabilities and subsequent event (notes 6, 10 and 13)		
	$523,348,000	470,127,000

See accompanying notes to consolidated financial statements.

Consolidated Statements of Earnings

Years ended December 31, 1976 and 1975

	1976	1975
Revenues:		
Interest on loans	$ 27,521,000	28,438,000
Loan fees and service charges	1,663,000	1,362,000
Interest on marketable securities	5,135,000	3,171,000
Dividends on common and preferred stocks	3,108,000	1,953,000
Interest and dividends on investments required by law	486,000	519,000
Net gains (losses) on sales of marketable securities	26,000	(62,000)
Operations and net gains from sales of real property (note 9)	1,082,000	909,000
Other income, net	370,000	320,000
	39,391,000	36,610,000
Expenses:		
General and administrative expenses	4,944,000	4,710,000
Interest on savings deposits	24,428,000	21,844,000
Interest on notes payable	1,962,000	2,628,000
	31,334,000	29,182,000
Earnings before taxes on income	8,057,000	7,428,000
Taxes on income (note 4):		
Current	2,283,000	3,735,000
Deferred	258,000	(658,000)
	2,541,000	3,077,000
Net earnings	$ 5,516,000	4,351,000
Earnings per capital share (note 13):		
Based on 2,373,269 shares outstanding before announced three-for-one stock split	$ 2.32	1.83
Based on 7,119,807 shares outstanding, adjusted for announced three-for-one stock split	$ .77	.61
Cash dividends per share (note 13):		
Based on 2,373,269 shares outstanding before announced three-for-one stock split	$ .70	.60
Based on 7,119,807 shares outstanding, adjusted for announced three-for-one stock split	$ .233	.20

Consolidated Statements of Stockholders' Equity

Years ended December 31, 1976 and 1975

	1976	1975
Capital stock (note 13)	$ 2,373,000	2,373,000
Capital surplus arising from stock dividends (note 13)	28,066,000	28,066,000
Retained earnings:		
Appropriated (notes 4 and 8):		
Beginning of year	44,130,000	43,042,000
Allocation of net earnings	638,000	1,088,000
End of year	44,768,000	44,130,000
Unappropriated (note 7):		
Beginning of year	27,888,000	26,049,000
Cash dividends declared and paid	(1,662,000)	(1,424,000)
Allocation of net earnings	4,878,000	3,263,000
End of year	31,104,000	27,888,000
Less stock dividends at market value	(29,239,000)	(29,239,000)
Total retained earnings	46,633,000	42,779,000
Total stockholders' equity	$ 77,072,000	73,218,000

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1976 and 1975

	1976	1975
Funds provided:		
Net earnings	**$ 5,516,000**	4,351,000
Charges (credits) to earnings not requiring (providing) funds:		
Depreciation and amortization	**344,000**	335,000
Interest on savings deposits credited to savings accounts	**18,537,000**	16,611,000
FSLIC primary premium transferred from secondary reserve	**96,000**	88,000
Deferred income taxes (note 4)	**258,000**	(658,000)
Amortization of fees and discounts	**(245,000)**	(342,000)
Recognition of unrealized profit on real property	**(962,000)**	(814,000)
Interest income on FSLIC secondary reserve	**(313,000)**	(320,000)
Funds provided from operations	**23,231,000**	19,251,000
Principal payments on real estate loans	**69,216,000**	51,419,000
Additions to deferred loan fees	**81,000**	79,000
Sales of real property, net of gains	**556,000**	4,423,000
Increase in notes payable	**5,146,000**	—
Increase in loans in process	**620,000**	843,000
Additions to unrealized profit on real property	**159,000**	489,000
Increase in savings deposits	**26,389,000**	10,342,000
Decrease in stock of Federal Home Loan Bank	**374,000**	—
Decrease in cash	**2,085,000**	—
Other, net	**—**	3,222,000
Total funds provided	**$127,857,000**	90,068,000
Funds used:		
Cash dividends declared and paid (note 7)	**1,662,000**	1,424,000
Decrease in notes payable	**—**	24,765,000
Investment in real estate loans	**42,386,000**	36,317,000
Investment in buildings and other assets	**330,000**	275,000
Additions to real property	**406,000**	1,626,000
Increase in stock of Federal Home Loan Bank	**—**	222,000
Decrease in advances by borrowers for taxes and insurance	**300,000**	350,000
Increase in marketable securities	**79,799,000**	21,970,000
Increase in cash	**—**	3,119,000
Other, net	**2,974,000**	—
Total funds used	**$127,857,000**	90,068,000

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

December 31, 1976 and 1975

(1) Summary of Significant Accounting Policies

The following items comprise the significant accounting policies which the Company follows:

Principles of Consolidation

The consolidated financial statements include the accounts of Wesco Financial Corporation (the Company) and its wholly owned subsidiary, Mutual Savings and Loan Association and its wholly owned subsidiaries (Mutual Savings). All material intercompany transactions have been eliminated.

Marketable Securities

Certificates of deposit, banker's acceptances, U.S. Government and agency obligations are carried at identified cost, adjusted for amortization of premium and accretion of discount over the term of the security and are not carried at the lower of cost or market because it is management's intention to hold them to maturity.

Common and preferred stocks are carried at identified cost. See note 11 for discussion of marketable equity securities.

Loan Fees

Loan fees for originating loans are deferred for amounts in excess of 1% of the loan amount plus $200 for nonconstruction loans and 2% of the loan amount plus $200 for construction loans. Deferred fees are amortized into income by use of the straight-line method over seven years.

Loan Valuation Allowances

Valuation allowances for estimated losses on specific loans are charged to earnings when any significant and permanent decline reduces the market value of the underlying security to less than the loan. Such losses are usually indicated during foreclosure proceedings.

Real Property Valuation Allowances

Valuation allowances for estimated losses on real property are charged to earnings when any significant and permanent decline reduces the market value to less than the carrying value.

When the Company intends to hold real estate held for sale for a period in excess of 18 months, future direct holding costs for maintenance, property taxes, insurance, direct selling expenses, costs of completion or improvement and a discount factor to give effect to the cost of money are considered in determining the amount of required valuation allowances.

Office Properties and Equipment

Office properties and equipment are depreciated by use of the straight-line method over the estimated useful lives of the various classes of assets from the respective dates of acquisition. The useful lives used for the principal classes of assets are:

Buildings and improvements	10 to 45 years
Furniture, fixtures and equipment	4 to 10 years
Leasehold improvements	3 to 25 years

Maintenance and repairs are charged to appropriate expense accounts in the year incurred; renewals and material betterments are charged to property accounts.

Cost and accumulated depreciation and amortization applicable to assets retired or otherwise disposed of are eliminated from the related accounts and the profit or loss on disposition is credited or charged to earnings.

Profit on the Sale of Real Property

Profit on the sale of real property is recognized when the buyer has made an irrevocable commitment to the sale and has met certain down payment and amortization requirements. In general, the down payment requirements range from 5% to 25% for improved property and from 15% to 30% for unimproved property based on the use of the property and cash flow projections. Amortization requirements include the payment on an annual level payment basis (principal and interest) over a period not to exceed from 15 to 30 years, depending on the type and use of the property, with payments commencing not later than one year from date of sale.

(2) Loans Receivable

Loans receivable are summarized as follows:

	1976	1975
Real estate loans on residential property of:		
One to four units (home loans)	$259,307,000	273,496,000
More than four units	76,184,000	87,250,000
Real estate loans on other properties	11,753,000	13,265,000
	347,244,000	374,011,000
Less:		
Unearned loan fees	(648,000)	(812,000)
Unrealized profit on sales of real property	(276,000)	(1,025,000)
Loans in process	(1,753,000)	(1,133,000)
	344,567,000	371,041,000
Loans on savings deposits	2,627,000	2,018,000
	$347,194,000	373,059,000

(3) Notes Payable

The following is a summary of notes payable:

	1976	1975
Federal Home Loan Bank advances, secured by certain real estate loans amounting to $59,586,000 and Federal Home Loan Bank stock, with interest at 7.50%	$ 25,856,000	26,200,000
Note payable, secured by main office land, buildings, and assignment of leases, with interest at 9.25%	5,500,000	—
Bank notes due on dem. ıd with interest principally at prime secured by certain marketable securities and real estate loans	—	10,000
	$ 31,356,000	26,210,000

Notes payable mature as follows:

1977	$ 3,524,000
1978	3,533,000
1979	3,537,000
1980	3,541,000
1981	3,545,000
Thereafter	13,676,000
	$ 31,356,000

(4) Taxes on Income

If certain conditions are met, savings and loan associations, in determining taxable income, are allowed special bad debt deductions based on specified experience formulas or on a percentage of taxable income before such deduction. The bad debt deduction must be within certain limitations based on outstanding loans and the ratio of reserves and undivided profits to savings deposits. Mutual Savings has reached such limitations, which preclude deductions from income in arriving at Federal taxes on income.

The investment tax credit, which is insignificant, is recorded by the flow-through method of accounting whereby, in the year available for utilization, it is applied as a reduction of income tax expense.

Appropriated retained earnings at December 31, 1976 and 1975 include approximately $45,578,000 and $44,940,000, respectively (before elimination of $810,000 in consolidation), of tax reserves for 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.

Federal income tax returns of the Company and Mutual Savings for 1972 and 1973 are currently under examination by the Internal Revenue Service. In the opinion of management, additional tax assessments, if any, will not have a material effect on the accompanying consolidated financial statements.

Income taxes for 1976 and 1975 include the following components:

	1976		1975	
	Current	Deferred	Current	Deferred
Federal	$1,482,000	129,000	2,867,000	(594,000)
State	801,000	129,000	868,000	(64,000)
Total	$2,283,000	258,000	3,735,000	(658,000)

Deferred taxes result from timing differences in the recognition of revenue and expense for tax and financial statement purposes. The sources of these differences in 1976 and 1975 and the tax effect of each were as follows:

	1976	1975
Financial statement recognition of loan fees less than tax recognition	$ (611,000)	(290,000)
California franchise tax recognized for financial statement purposes on accrual basis, but on cash basis for tax purposes	(25,000)	(128,000)
FSLIC secondary reserve interest income recognized on the financial statements, but deferred for tax purposes	55,000	45,000
Investment income recognized for financial statement purposes on accrual basis, but on cash basis for tax purposes	857,000	(150,000)
Other timing differences	(18,000)	(135,000)
	$ 258,000	(658,000)

A reconciliation of total income tax and the amount computed by applying the U.S. Federal income tax rate of 48% to earnings before Federal and state taxes on income follows:

	1976	1975
Computed "expected" Federal taxes	$3,867,000	3,565,000
Increases (reductions) in taxes resulting from:		
Net gains on sales of foreclosed real property	(459,000)	(278,000)
State franchise tax, net of Federal income tax benefit	484,000	418,000
Dividends received deduction on common and preferred stocks	(1,268,000)	(796,000)
Interest on municipal obligations	(233,000)	(25,000)
Other permanent differences	150,000	193,000
	$2,541,000	3,077,000

(5) Office Properties and Equipment, Net

Office properties and equipment, at cost, less accumulated depreciation and amortization consist of the following:

	1976	1975
Land	$1,569,000	1,509,000
Office buildings and leasehold improvements	6,134,000	5,989,000
Furniture, fixtures and equipment	986,000	919,000
	8,689,000	8,417,000
Accumulated depreciation and amortization	(3,630,000)	(3,337,000)
	$5,059,000	5,080,000

(6) Retirement Plan

A noncontributory retirement plan is in effect for all eligible employees of the Company and its subsidiaries. Employer contributions are computed utilizing the aggregate cost funding method. The contributions for 1976 and 1975 approximated $111,000 and $87,000, respectively. The actuarially computed value of vested benefits as of December 31, 1976 did not exceed the market value of the assets of the retirement fund.

The retirement plan has been changed effective July 1, 1976 to comply with the provisions of the Employee Retirement Income Security Act of 1974. Changes were made to various plan provisions and actuarial assumptions; however, the effect of such changes was immaterial.

(7) Dividends

Quarterly cash dividends of $.17½ per share declared and paid during 1976 amounted to $1,662,000. Cash dividends declared and paid during 1975 amounted to $1,424,000.

(8) Reserve Requirements

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 by Mutual Savings as of December 31, 1976 and 1975.

(9) Real Estate Operations

Operations and net gains from sales of real property are summarized as follows:

	1976	1975
Recognized net gains from sales	$1,043,000	920,000
Income from rentals	136,000	151,000
	1,179,000	1,071,000
Less maintenance and sales expense	(97,000)	(162,000)
	$1,082,000	909,000

(10) Contingent Liabilities

Mutual Savings is named as one of the defendants in several class actions relating to certain common practices in the mortgage lending field. The outcome of this litigation cannot be predicted; however, based on the facts presently available, the Association believes there are substantial defenses to these actions and that losses, if any, would not be material.

In addition, Mutual Savings is involved in litigation arising in the normal course of business. In the opinion of management, this litigation in the aggregate will not have a material effect on the accompanying consolidated financial statements.

(11) Marketable Equity Securities

The investment in preferred stocks of $25,215,000 in 1976 and $23,206,000 in 1975 includes marketable equity securities amounting to $12,474,000 and $10,500,000, respectively, at cost. All common stocks amounting to $14,809,000 in 1976 and $1,853,000 in 1975 at cost, are marketable equity securities. At December 31, 1976, market value of such marketable equity securities was $3,959,000 in excess of cost representing gross unrealized gains. At December 31, 1975, the difference between cost and market value was not material.

(12) Interim Period Consolidated Operating Highlights

Consolidated operating highlights for the respective interim three-month reporting periods for the year ended December 31, 1976 are as follows:

	Three-month reporting period ended			
	Mar. 31, 1976	Jun. 30, 1976	Sept. 30, 30, 1976	Dec. 31, 1976
	(Unaudited)			
Revenues	$9,370,000	9,767,000	10,178,000	10,076,000
Expenses	8,241,000	8,334,000	8,679,000	8,621,000
Net earnings	$1,129,000	1,433,000	1,499,000	1,455,000
Earnings per share based on 2,373,269 shares	$ .48	.60	.63	.61

(13) Subsequent Event

On January 18, 1977, the Company announced a three-for-one stock split to be effected in the form of a 200% stock dividend. To accomplish this stock split, the Company's Articles of Incorporation must be amended to increase the authorized number of shares from 2,500,000 shares to 7,500,000 shares. Subject to majority approval by shareholders of the amendment to the Articles of Incorporation, the stock dividend will be distributed on April 4, 1977 to shareholders of record at the close of business on March 18, 1977.

ACCOUNTANTS' REPORT

The Board of Directors
Wesco Financial Corporation:

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

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of Wesco Financial Corporation and subsidiaries at December 31, 1976 and 1975 and the results of their operations and the 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.

Los Angeles, California
February 3, 1977

BOARD OF DIRECTORS

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P. E. LYNN
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WANDA G. MOTES
Senior Vice President, Savings

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