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

DIVERSIFIED RETAILING CO INC **10-K**

OTHER

CARD 1 DISCLOSURE INC WASHINGTON D. C. 20014 FOR 01/28/78

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

10-K	For:	01/29/77
10-Q	For:	04/30/77
10-Q	For:	07/30/77
10-Q	For:	10/29/77

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SECURITIES AND EXCHANGE COMMISSION
Washington, D. C.
20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15 (d) OF
THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended January 28, 1978.

Commission File No.
2-27473

DIVERSIFIED RETAILING COMPANY, INC.
(Exact name of registrant as specified in its charter)

Maryland
(State or other jurisdiction of incorporation or organization)

52-0846159
(I.R.S. Employer Identification No.)

1300 Mercantile Bank & Trust Bldg.
2 Hopkins Plaza, Baltimore, Maryland
(Address of principal executive office)

21201
(Zip Code)

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, and (2) has been subject to the filing requirements for the past 90 days.

Yes X No ____

Indicate number of shares outstanding of each of the issuer's classes of common stock, as of January 28, 1978.

Common stock - 782,490 shares

PART 1

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 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.

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

Fiscal Year Ended	Open Begin Year	Opened During Year	Closed During Year	Open End Year
2/3/74	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
1/28/78	81	3	4	80

NOTE: Unless the text otherwise indicated, all statements made in PART 1 describe circumstances existing as of January 28, 1978.

The following table indicates the number of stores of Associated operating under the various trade names used by Associated at January 28, 1978:

York	46
Amy	8
Goodwins	7
Fashion Outlet	4
Gaytime	2
Madison's	1
Yorkster	1
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 fifty (1,450) full and part-time employees, and seasonally employs an additional two hundred (200) 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 28, 1978, 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 nineteen (19) 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 28, 1978, Warren E. Buffett, a member of his immediate family, the Company 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 15. 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 securities 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. Financial Information About Industry Segments

Business segment data prescribed by Statement No. 14 of the Financial Accounting Standards Board is presented below for the five years ended January 28, 1978. The Insurance Segment represents operations of Columbia and Southern described above. The Retailing Segment represents operations of Associated, also described above.

In the following table, revenue of the Insurance Segment includes investment income of Columbia and Southern, exclusive of equity in earnings of Berkshire and Blue Chip Stamps (hereinafter referred to as "Blue Chip"), the investments in which are accounted for by the equity method, plus premiums earned by those insurers. Revenues of the Retailing Segment include net sales from Associated's retail stores plus other income earned in the retailing operations.

	Years ended				
	Feb. 2, 1974	Feb. 1, 1975	Jan.31, 1976	Jan.29, 1977	Jan.28, 1978
		(thousands of dollars)			
Revenues:					
Insurance segment*	$ 2,261	3,102	3,199	4,526	6,730
Retailing segment	37,267	34,232	35,303	39,113	42,106
Total revenues	$ 39,528	37,334	38,502	43,639	48,836
*Revenues of insurance segment representing premiums earned on reinsurance ceded from affiliate	$ 1,450	1,839	2,157	3,428	5,179

Operating profit before taxes is presented below. Operating profit of segments is total revenues as above less total expenses identified with the segments. In computing operating profit identified with segments, none of the following items have been added or deducted: equity in earnings of investees, realized investment gains and interest expense.

	Years ended				
	Feb. 2, 1974	Feb. 1, 1975	Jan.31, 1976	Jan.29, 1977	Jan.28, 1978
		(thousands of dollars)			
Operating profit (loss) before taxes:					
Insurance segment	$ 223	(154)	(300)	119	439
Retailing segment	1,514	1,540	2,007	2,219	2,775
Not identified with segments:					
Equity in earnings of investees	2,173	1,740	1,713	5,175	7,272
Realized investment gains	37	(300)	7	99	160
Interest expense	(720)	(677)	(714)	(1,027)	(1,174)
Operating profit before taxes	$ 3,227	2,149	2,713	6,585	9,472

Retailing segment operating profits before taxes in the year ended January 28, 1978 include a non-recurring type gain of approximately $285,000 recorded as a result of certain store condemnation proceedings.

	Feb. 2, 1974	Feb. 1, 1975	Jan.31, 1976	Jan.29, 1977	Jan.28, 1978
		(thousands of dollars)			
Identifiable assets:					
Insurance segment	$ 3,668	5,836	5,538	9,190	11,900
Retailing segment	8,213	9,887	10,195	9,965	14,271
Not identified with segments:					
Investment in affiliates	21,896	23,433	25,907	32,710	41,027
Corporate cash and other	406	310	324	631	348
Consolidated assets	$ 34,183	39,466	41,964	52,496	67,546
Retailing segment:					
Capital expenditures	$ 192	131	131	118	294
Depreciation and amortization	146	126	121	124	126

Capital expenditures, depreciation and amortization were insignificant in the Insurance segment.

ITEM 2. SUMMARY OF OPERATIONS

This Summary Should be Read in Conjunction with the Financial Statements and Notes Thereto Included in Item 13(a)

	Fiscal year ended				
	Feb. 2, 1974	Feb. 1, 1975	Jan.31, 1976	Jan.29, 1977	Jan.28, 1978
	(in thousands of dollars except per share amounts)				
Net sales (a)	$ 37,093	33,976	35,081	38,891	41,716
Gross profit and other income items	13,904	13,333	13,961	15,809	17,269
Operating expenses, except interest	(12,167)	(11,946)	(12,255)	(13,471)	(14,055)
Interest and financing costs	(720)	(677)	(714)	(1,027)	(1,174)
Income taxes applicable to above	(441)	(307)	(489)	(582)	(830)
Earnings before items below	576	403	503	729	1,210
Equity in net earnings of affiliated companies accounted for by the equity method, net of income taxes	1,985	1,582	1,559	4,773	6,738
Realized gain (loss) from securities transactions, net of income taxes	26	(210)	5	68	97
Earnings before extraordinary items	2,587	1,775	2,067	5,570	8,045
Extraordinary items, net of income taxes (b)	395	68	-	-	-
Net earnings	$ 2,982	1,843	2,067	5,570	8,045
Per weighted average outstanding shares (c):					
Earnings before extraordinary items	$ 2.59	1.77	2.07	6.68	10.28
Net earnings	2.98	1.84	2.07	6.68	10.28

(a) Net sales for each of the four fiscal years ended January 29, 1977 have been restated to exclude leased department sales (approximately $1 million per year), consistent with current year presentation.

(b) 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.

(c) In the year ended January 28, 1978, there were 782,490 shares outstanding. 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.

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

MANAGEMENT'S DISCUSSION OF SUMMARY OF OPERATIONS

The most significant contributing factor to increased consolidated earnings for the past two years has been the Company's increased 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 Jan.31, 1976	Jan.29, 1977	Jan.28, 1978
Berkshire	$ 637	3,439	4,376
Blue Chip	922	1,334	2,362
	$ 1,559	4,773	6,738

The Company's equity in net earnings of 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. Berkshire's reported earnings have increased significantly in each of the past two years; shares of Berkshire stock owned by the Company have also increased slightly in each year.

In the year ended January 28, 1978, the Company's equity in realized investment gains of Berkshire and Blue Chip totaled $1,606,000. In the year ended January 29, 1977, $1,018,000 of the equity in investee's earnings represents the Company's share of investment gains realized by Berkshire, contrasted with losses realized by Berkshire in securities transactions, the Company's share of which was $222,000, in the second preceding year.

Retailing operations: Net sales increased approximately 7% in the most recent year over those in the year ended January 29, 1977. Store-to-store sales (sales from stores open in both years) increased approximately 2-1/2%, contributing approximately $900,000 to the additional sales volume. Sales from net additional stores opened contributed approximately $1,900,000 to the overall increase. In the prior year, store-to-store sales increased at a rate of 5% over the second year preceding, while new stores contributed about $1,800,000 to the overall 11% increase in sales volume. Gross profit margins as a per cent of sales have remained fairly constant over the past three years, thus total dollar gross profits have increased in line with increased total sales. Store expenses have increased almost in proportion to increased sales. In the most recent year, Associated recorded a pre-tax gain of approximately $285,000 from certain store condemnation proceedings and this resulted in increased retailing profits more than proportionate to increased sales.

Insurance operations: The insurance segment profit (loss) before taxes for each of the past three years has been as follows:

	Years ended Jan.31, 1976	Jan.29, 1977	Jan.28, 1978
Gain (loss) from underwriting:			
Reinsurance	$(457)	(373)	191
Workmen's compensation	(125)	89	(275)
	(582)	(284)	(84)
Net investment income	282	403	523
Operating profit before taxes	$(300)	119	439

Financial statements and schedules of Columbia Insurance Company and Consolidated subsidiary are included in Item 13(a). Such financial statements reflect those insurance subsidiaries' investment in Berkshire and Blue Chip and their equity in earnings of those investees. See also FINANCIAL INFORMATION ABOUT INDUSTRY SEGMENTS under ITEM 1. above.

Interest expense: In April 1976, the Company borrowed $4,000,000 from a bank, which indebtedness was outstanding until December 7, 1977. On that date, Associated borrowed $7,000,000 from institutional investors; the Company's bank term loan was refunded from the proceeds of this loan. Interest expense has increased in each of the past two years as a result of servicing the increased debt.

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 seventy thousand (970,000) square feet.

Associated owns the land and improvements of nine (9), and leases its remaining seventy-one (71) store locations for terms expiring on various dates through 1993. Associated's executive buying and administrative offices are located in a New York warehouse (see ITEM 1. BUSINESS) leased by Associated for a term expiring on December 31, 1978. The warehouse has a floor area of approximately eighty thousand (80,000) square feet. (See Note 12 of the Notes to Financial Statements).

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.

Southern owns its one story home office building, which affords about 3,500 square feet of office space on approximately 1/4 acre of land, in Alexandria, Louisiana. The facility is considered adequate to the needs of Southern.

ITEM 4. PARENTS AND SUBSIDIARIES

A. Parents

As of January 28, 1978, 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. Buffet, owned approximately 3.98% of that stock. (See ITEM 14. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT and ITEM 15. DIRECTORS OF THE REGISTRANT.) First Manhattan Co. disclaims any status which would cause it to be deemed a parent of the 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 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 28, 1978, 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-seven percent (37%) 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.

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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 14. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT.

As of January 28, 1978, the Company, Associated, Columbia and Southern in the agregate owned beneficially approximately eighteen percent (18%) 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. 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 AND INDEBTEDNESS

	Company	Consolidated
Outstanding debt Jan. 29, 1977:		
Note payable to bank	$ 4,000,000	4,000,000
8% debentures due 1985	6,600,000	6,600,000
9% notes payable	1,505,061	1,505,061
	12,105,061	12,105,061
Installment payments - 9% notes	(11,138)	(11,138)
9-1/4% collateral notes issued	-	7,000,000
Prepayment - note payable to bank	(4,000,000)	(4,000,000)
Outstanding debt Jan. 28, 1978	$ 8,093,923	15,093,923
Represented by:		
8% debentures due 1985	6,600,000	6,600,000
9% notes payable	1,493,923	1,493,923
9-1/4% collateral notes due 3/1/93	-	7,000,000
	$ 8,093,923	15,093,923

On December 7, 1977, Associated borrowed $7,000,000 from institutional investors evidenced by Associated's 9-1/4% promissory notes in that principal amount. The notes are guaranteed by the Company. From the proceeds, Associated paid a $5,500,000 dividend to the Company, who in turn redeemed its $4,000,000 outstanding bank loan. The $3,000,000 proceeds of the borrowing in excess of the bank loan were used for general corporate purposes of the Company and Associated.

No underwriters were involved in the transactions referred to above, and the debt securities issued were not registered under the Securities Act of 1933 because they were issued in transactions by an issuer not involving any public offering within the meaning of Section 4(2) of said Act. The Company believes that the notes were taken for investment by the purchasers.

ITEM 7. CHANGES IN SECURITIES AND CHANGES IN SECURITY FOR REGISTERED SECURITIES

NONE.

ITEM 8. DEFAULTS UPON SENIOR SECURITIES

NONE.

ITEM 9. 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	60

ITEM 10. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

NONE.

ITEM 11. EXECUTIVE OFFICERS OF THE REGISTRANT

Name	Age	Offices(s) Held
Warren E. Buffett	47	Chairman of Board of Directors
Robert M. Goldman (a)	61	President; Director
David S. Gottesman	51	Vice President; Director
Charles T. Munger	54	Vice President; Assistant Secretary; Director
Max E. Blumenthal (a)	37	Secretary, Treasurer

ITEM 12. 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.

ITEM 13. FINANCIAL STATEMENTS, EXHIBITS FILED AND REPORTS ON FORM 8-K

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:	1977 Annual Report of Berkshire Hathaway Inc.
Exhibit B:	Annual Report of Blue Chip Stamps for the Year Ended December 31, 1977
Exhibit C:	1977 Annual Report of Wesco Financial Corporation

C. Reports on Form 8-K

No reports on Form 8-K have been filed by the Company during the last quarter of the year covered by this Report.

PART II

ITEM 14. PRINCIPAL SECURITY HOLDERS AND SECURITY HOLDINGS OF MANAGEMENT

A. Principal Security Holders

Title of Class	Name and Address	Amount Beneficially Owned	Percent of Class
Common	Warren E. Buffett 5505 Farnam Street Omaha, Nebraska 68131	405,791(a)	51.86%
Common	David S. Gottesman 30 Wall Street New York, New York 10005	32,000 (b)	4.09%
Common	Charles T. Munger 606 S. Hill Steet Los Angeles, California 90055	58,472	7.47%

(a) This amount does not include the following shares of common stock, at 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 103,787 shares held of record by First Manhattan Co., of which Mr. Gottesman is a partner. 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. Mr. Gottesman disclaims the beneficial ownership of the shares held in the said trusts. The remaining 43,861 of the 103,787 shares are owned beneficially by other partners of the firm or the spouse of one of such partners.

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 15. DIRECTORS OF THE REGISTRANT

Each of the following persons served as a Director of the Company during the entire fiscal year ended January 28, 1978, and will continue to so serve until his present term expires in February, 1979.

(c) Subject to the exceptions indicated in note (e) 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 28, 1978.

(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, Assoicated, 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, 47, 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, 51, 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, 54, 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, 51, 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, 61, 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 16. REMUNERATION OF DIRECTORS AND OFFICERS

NONE - except that the Company did accrue legal fees and cash advanced in the amounts of $13,853.00 and $719.37, respectively, during its fiscal year ended January 28, 1978 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. (See ITEM 18. INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS.)

ITEM 17. OPTIONS GRANTED TO MANAGEMENT TO PURCHASE SECURITIES

NONE.

ITEM 18. INTEREST OF MANAGEMENT AND OTHERS IN CERTAIN TRANSACTIONS

A. There are described in the following paragraphs certain transactions since the beginning of the fiscal year ended January 28, 1978, or proposed transactions, to which the Company or any of its subsidiaries was or is to be a party in which a director or officer of the Company, a security holder named under Section A of ITEM 14 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 28, 1978, Columbia accepted reinsurance contracts from insurance subsidiaries of Berkshire, representing premiums written in the amount of $7,293,705. Columbia ceded $1,611,067 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 1977 was approximately $59,340. Columbia also paid approximately $38,412 in commissions to one of Berkshire's subsidiary which acted as agent for direct business written by Columbia.

2. Insurance subsidiaries of the Company purchased securities during 1977 for a total consideration of $173,400 from Chiles, Heider & Co., Inc., a broker dealer securities firm of which Charles F. Heider, a Director of the Company is President and largest single shareholder. These transactions, in which the broker dealer firm acted as principal, were in the ordinary course of business.

3. During the Company's fiscal year ended January 28, 1978, 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 ITEM 16. REMUNERATION OF DIRECTORS AND OFFICERS.)

B. During the Company's fiscal year ended January 28, 1978, 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 18 above), during the Company's fiscal year ended January 28, 1978, 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 14 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.

DIVERSIFIED RETAILING COMPANY, INC.

By Robert M. Goldman

Robert M. Goldman, President

Date: April 28, 1978

Item 13. Financial Statements and Exhibits Filed

(a) Financial Statements

Index to Financial Statements

Item 13. Financial Statements and Exhibits Filed (Continued)

(a) Financial Statements, Cont.

(b) Exhibits

A - Annual Report of Berkshire Hathaway Inc. - 1977 and 1976

B - Annual Report of Blue Chip Stamps - 1977

C - Annual Report of Wesco Financial Corporation - 1977 and 1976

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 examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Blue Chip Stamps, an affiliated company. The Company and its subsidiaries' investment in Blue Chip Stamps at January 28, 1978 and January 29, 1977 was $17,739,745 and $15,380,729, respectively, and its equity in earnings of Blue Chip Stamps was $2,362,249 and $1,334,534 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.

The report of the other auditors was qualified with respect to litigation involving a subsidiary of Blue Chip Stamps. As explained in note 7 to the accompanying financial statements, the ultimate outcome of this action and potential liability, if any, cannot be determined at this time.

In our opinion, based upon our examinations and the report of the other auditors and, in 1978, subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the aforementioned financial statements present fairly the consolidated financial position of Diversified Retailing Company, Inc. and subsidiaries at January 28, 1978 and January 29, 1977 and the results of their operations and the changes in their financial position for each of the years then ended, and the financial position of Diversified Retailing Company, Inc. (parent Company only) at January 28, 1978 and January 29, 1977 and the results of its operations and the changes in its financial position for each of the years then ended, all in conformity with generally accepted accounting principles applied on a consistent basis; and the supporting schedules, in our opinion, subject to, in 1978, the effects, if any, of the matter discussed in the preceding paragraph, present fairly the information set forth therein.

PEAT, MARWICK, MITCHELL & CO.

Peat, Marwick, Mitchell + Co.

Omaha, Nebraska
April 14, 1978

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Consolidated Balance Sheets

January 28, 1978 and January 29, 1977

Assets	1978	1977
Cash	$ 3,739,834	2,702,950
U. S. Treasury Bills, at cost which approximates market	5,871,449	3,588,651
Accounts receivable (note 2)	649,745	747,911
Recoverable Federal income taxes	124,998	378,330
Merchandise inventories	6,436,252	5,589,375
Investments, other than affiliates (notes 3 and 4):		
Bonds, at amortized cost	5,604,788	3,472,052
Preferred stock, at cost	133,475	133,475
Common stocks, at cost	1,100,437	1,121,327
Total investments, other than affiliates	6,838,700	4,726,854
Investments in affiliates (notes 6, 7 and 9) (Schedule III):		
Berkshire Hathaway Inc.	23,287,603	17,329,554
Blue Chip Stamps	17,739,745	15,380,729
Total investments in affiliates	41,027,348	32,710,283
Prepaid acquisition costs	1,042,000	373,000
Property and equipment, at cost less allowance for depreciation and amortization of $532,874 in 1978 and $546,361 in 1977 (note 8)	1,050,476	882,719
Other assets	765,670	796,384
	$ 67,546,472	52,496,457

Liabilities and Stockholders' Equity	1978	1977
Losses and loss adjustment expenses	$ 5,869,410	4,627,291
Unearned insurance premiums	4,937,159	3,513,506
Accounts payable and accruals	3,038,169	2,981,159
Salaries, wages and bonuses	124,640	119,764
Taxes other than income taxes	259,042	264,751
Income taxes (note 10):		
Current	314,523	216,914
Deferred	2,107,571	1,266,932
9-1/4% collateral notes payable (note 9)	7,000,000	4,000,000
8% debentures due 1985 (note 9)	6,600,000	6,600,000
9% notes payable (note 9)	1,493,923	1,505,061
Other liabilities	637,009	280,781
Total liabilities	32,381,446	25,376,159
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
Retained earnings	32,427,676	24,382,948
	38,427,676	30,382,948
Less 217,510 shares of common stock in treasury, at cost	3,262,650	3,262,650
Total stockholders' equity	35,165,026	27,120,298
Commitments and contingent liabilities (notes 7, 12 and 13)		
	$ 67,546,472	52,496,457

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Consolidated Statements of Earnings and Retained Earnings

Years ended January 28, 1978 and January 29, 1977

	Year ended Jan.28,1978	Year ended Jan.29,1977
Net sales	$ 41,685,705	38,891,402
Cost of goods sold	25,318,894	23,581,687
Gross profit	16,366,811	15,309,715
Insurance underwriting loss	(83,515)	(284,429)
Interest and dividend income	610,835	519,891
Other income	375,059	263,881
	17,269,190	15,809,058
Selling, general and administrative expenses	14,055,054	13,471,514
Interest and financing costs	1,174,385	1,026,765
	15,229,439	14,498,279
Earnings before income taxes, equity in earnings of affiliates and realized securities gains	2,039,751	1,310,779
Income taxes (note 10)	829,452	581,944
Earnings before equity in earnings of affiliates and realized securities gains	1,210,299	728,835
Equity in earnings of affiliates (notes 6 and 7):		
Berkshire Hathaway Inc.	4,375,578	3,439,022
Blue Chip Stamps	2,362,249	1,334,534
	6,737,827	4,773,556
Earnings before realized securities gains	7,948,126	5,502,391
Realized gains on sales of securities, net of taxes in 1978 of $64,000 and in 1977 of $31,625	96,602	67,624
Net earnings	8,044,728	5,570,015
Retained earnings at beginning of year	24,382,948	18,812,933
Retained earnings at end of year	$ 32,427,676	24,382,948
Earnings per share of common stock, based on weighted average outstanding shares:		
Earnings before equity in earnings of affiliates and realized securities gains	$ 1.55	.87
Equity in earnings of affiliates	8.61	5.73
Realized securities gains	.12	.08
Net earnings	$ 10.28	6.68

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Consolidated Statements of Changes in Financial Position

Years ended January 28, 1978 and January 29, 1977

	1978	1977
Funds provided:		
From operations:		
Net earnings	$ 8,044,728	5,570,015
Charges (credits) to earnings not requiring (providing) funds:		
Equity in current undistributed earnings of affiliates, net of deferred taxes	(6,550,319)	(4,619,004)
Increase in unpaid losses and loss adjustment expenses	1,242,119	608,271
Increase in unearned insurance premiums	1,423,653	2,396,757
Increase in accounts payable and accrued expenses	56,177	490,051
Depreciation and amortization of fixed assets	126,226	123,590
Increase in prepaid acquisition costs	(669,000)	(373,000)
Increase in deferred taxes	321,000	179,000
Decrease (increase) in recoverable Federal income taxes	253,332	(378,330)
Gain on sale of investments	(160,602)	(99,249)
Increase in inventories	(846,877)	(850,354)
Decrease (increase) in accounts receivable	98,166	(276,970)
Increase (decrease) in income taxes currently payable	97,609	(228,289)
Increase (decrease) in other liabilities	356,228	(100,979)
Amortization of excess of carrying amounts of net assets of consolidated subsidiaries over acquisition costs	-	(106,980)
All other	(8,235)	(104,630)
Funds provided from operations	3,784,205	2,229,899
Decrease in cash	-	1,315,111
Proceeds from sale of investments:		
Bonds	885,761	395,150
Common stocks	662,793	-
Proceeds from sale of fixed assets	-	41,699
Increase in notes payable	7,000,000	3,650,000
Proceeds from issuance of 9% notes	-	215,583
	$ 12,332,759	7,847,442
Funds used:		
Investment in Berkshire Hathaway Inc.	1,247,107	985,168
Other investments:		
Bonds	2,923,089	1,548,040
Preferred stocks	-	133,475
Common stocks	537,301	558,191
Purchase of treasury stock	-	3,262,650
Additions to property, plant and equipment	294,442	118,312
Debt repayment	4,011,138	83,231
Increase in Treasury Bills	2,282,798	1,158,375
Increase in cash	1,036,884	-
	$ 12,332,759	7,847,442

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Balance Sheets

January 28, 1978 and January 29, 1977

Assets	1978	1977
Cash	$ 4,899	6,632
Recoverable Federal income taxes	124,998	378,330
Note receivable from subsidiary	6,600,000	6,600,000
Investment in subsidiary (note 5) (Schedule III)	22,355,509	22,336,151
Investment in affiliated company (note 6) (Schedule III)	13,953,734	10,935,998
Unamortized cost of long-term financing	218,261	246,464
Due from subsidiary	801,785	-
	$ 44,059,186	40,503,575

Liabilities and Stockholders' Equity	1978	1977
Accrued interest and other expenses	$ 247,645	269,951
Due to subsidiary	-	636,854
Deferred income taxes	552,592	338,616
Note payable to bank (note 9)	-	4,000,000
8% debentures (note 9)	6,600,000	6,600,000
9% notes payable (note 9)	1,493,923	1,505,061
Unamortized excess of carrying amount of net assets of subsidiary over acquisition cost	-	32,795
Total liabilities	8,894,160	13,383,277
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
Retained earnings	32,427,676	24,382,948
	38,427,676	30,382,948
Less 217,510 shares of common stock in treasury at cost	3,262,650	3,262,650
Total stockholders' equity	35,165,026	27,120,298
Contingency (note 7)		
	$ 44,059,186	40,503,575

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Statements of Earnings and Retained Earnings

Years ended January 28, 1978 and January 29, 1977

	1978	1977
Interest income	$ 528,000	528,017
Amortization of excess of net assets of subsidiary over acquisition cost	32,795	131,130
	560,795	659,147
Expenses:		
General and administrative	27,226	36,017
Interest and financing costs	1,064,959	1,008,740
	1,092,185	1,044,757
Loss before income taxes and equity in net earnings of subsidiary and affiliated company	(531,390)	(385,610)
Income tax credit	253,000	279,000
Loss before equity in net earnings of subsidiary and affiliated company	(278,390)	(106,610)
Equity in net earnings of subsidiary (note 5)	5,519,358	3,355,563
Equity in net earnings of affiliated company (note 6)	2,803,760	2,321,062
Net earnings	8,044,728	5,570,015
Retained earnings at beginning of year	24,382,948	18,812,933
Retained earnings at end of year	$ 32,427,676	24,382,948
Earnings per share of common stock, based on weighted average outstanding shares:		
Loss before equity in net earnings of subsidiary and affiliated company	$ (.35)	(.13)
Equity in net earnings of subsidiary	7.05	4.03
Equity in net earnings of affiliated company	3.58	2.78
Net earnings	$ 10.28	6.68

See accompanying notes to financial statements.

DIVERSIFIED RETAILING COMPANY, INC.
(Parent Company Only)

Statements of Changes in Financial Position

Years ended January 28, 1978 and January 29, 1977

	1978	1977
Funds provided:		
From operations:		
Net earnings	$ 8,044,728	5,570,015
Charges (credits) to earnings not requiring (providing) funds:		
Increase (decrease) in accrued expenses	(22,306)	92,719
Decrease (increase) in recoverable Federal income taxes	253,332	(378,330)
Amortization of excess of carrying amounts of net assets of subsidiary over acquisition cost	(32,795)	(131,130)
Amortization of long-term financing costs	28,203	28,202
Equity in net earnings of subsidiary	(5,519,358)	(3,355,563)
Equity in undistributed net earnings of Berkshire Hathaway Inc.	(2,803,760)	(2,321,062)
Funds used in operations	(51,956)	(495,149)
Proceeds from borrowings	-	3,865,583
Net advances from subsidiary	-	484,330
Dividend from subsidiary	5,500,000	-
Decrease in cash	1,733	43,086
	$ 5,449,777	3,897,850
Funds used:		
Investment in affiliated company	-	551,969
Repayment of debt	4,011,138	83,231
Purchase of treasury stock	-	3,262,650
Net advances to subsidiary	1,438,639	-
	$ 5,449,777	3,897,850

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 28, 1978 and January 29, 1977

(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.

Certain 1977 amounts in the consolidated statements of earnings have been restated to reflect the elimination of leased department sales, due to the immateriality of the amounts involved.

(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 was being amortized to income over a ten-year period. The unamortized balance of $32,795 at January 29, 1977 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 did not have a material effect on consolidated net earnings 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 and investments in preferred and common stock other than affiliates are stated at the lower of aggregate cost or market.

(Continued)

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

Notes to Financial Statements

The basis 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 of debentures and collateral notes have been capitalized and are being ratably amortized over the stipulated life of the debt. Unamortized financing costs included in other assets in the consolidated balance sheets at January 28, 1978 and January 29, 1977 were $258,379 and $246,464, 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.28,1978	Jan.29,1977
Layaway accounts and other receivables of retailing operations	$ 236,716	411,353
Uncollected premiums, net of commissions payable, of insurance operations	308,471	267,804
Investment income due and accrued	104,558	68,754
	$ 649,745	747,911

(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.31,1977	Dec.31,1976
Bonds, at amortized cost	$ 1,182,686	977,926
Stocks, including those of affiliates, at cost	6,204,945	6,204,945

(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, 1977 and 1976 is as follows:

	1977		1976	
	Cost	Market	Cost	Market
Bonds	$ 5,604,788	6,013,023	3,472,051	3,627,950
Equity:				
Preferred stocks	133,475	154,000	133,475	162,750
Common stocks	1,100,437	1,426,279	1,121,327	1,355,230
	$ 1,233,912	1,580,279	1,254,802	1,517,980

(Continued)

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

Notes to Financial Statements

At December 31, 1977, with respect to equity securities, gross unrealized gains were $414,740 and gross unrealized losses were $68,373. A net realized gain of $160,602 (before applicable income taxes) on the sale of securities was included in the determination of net earnings for 1977.

(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.28,1978	Jan.29,1977
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	3,798,118	3,778,760
Carrying value	$ 22,355,509	22,336,151

(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.28,1978	Jan.29,1977
Shares owned	174,715	163,201
Percentage of total outstanding shares	18%	17%
Cost represented by:		
Underlying net asset values at dates of acquisition	$ 12,899,402	11,355,437
Excess of acquired underlying net asset value over cost, net of amortization of $102,822 at January 28, 1978 and $49,704 at January 29, 1977	2,161,070	1,917,330
	10,738,332	9,438,107
Equity in post-acquisition earnings	12,549,271	7,891,447
Carrying value	$ 23,287,603	17,329,554

Deferred income taxes of approximately $903,000 at January 28, 1978 and $567,000 at January 29, 1977 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. 28, 1978	Jan. 29, 1977
Shares owned	108,069	108,069
Percentage of total outstanding shares	11%	11%
Cost represented by:		
Underlying net asset values at dates of acquisition	$ 7,992,237	7,992,237
Excess of acquired underlying net asset values over cost, net of amortization of $106,727 at January 28, 1978 and $60,888 at January 29, 1977	1,726,817	1,772,656
	6,265,420	6,219,581
Equity in post-acquisition earnings	7,688,314	4,716,417
Carrying value	$ 13,953,734	10,935,998

Deferred income taxes of approximately $553,000 at January 28, 1978 and $339,000 at January 29, 1977 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	
	1977	1976	1977	1976
Equity in net earnings	$ 4,657,824	3,660,485	2,971,897	2,455,156
Provision for deferred income taxes	(335,364)	(263,555)	(213,976)	(176,771)
Amortization of excess of underlying net asset values over cost	53,118	42,092	45,839	42,677
	$ 4,375,578	3,439,022	2,803,760	2,321,062

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 $692,275 at January 28, 1978 and $508,000 at January 29, 1977 have been provided with respect to the equity in undistributed earnings. The investment in Blue Chip is summarized as follows:

	Jan.28,1978	Jan.29,1977
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 $2,160,288 at January 28, 1978 and $1,959,928 at January 29, 1977	1,136,783	1,337,143
	8,125,083	8,325,443
Equity in post-acquisition undistributed earnings	9,614,662	7,055,286
Carrying value	$ 17,739,745	15,380,729

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

	Current year	Prior year
Dividends received	$ 202,056	166,542
Equity in undistributed earnings	2,559,376	1,751,828
Provision for current income taxes	(14,548)	(11,990)
Provision for deferred income taxes	(184,275)	(126,132)
Amortization of excess of cost of investment over underlying net asset values	(200,360)	(445,714)
	$ 2,362,249	1,334,534

Amortization of the difference between the Company's cost of Blue Chip shares and approximate underlying net asset values at dates of acquisition had been computed on the basis that such difference would be extinguished by January 31, 1981. Beginning in 1977, the companies commenced amortizing the January 29, 1977 difference between carrying value and underlying net asset value over seven years; the resulting credit will not be significant in any given year.

In 1976 Blue Chip changed from a February 28 year-end reporting basis to an approximately December 31 year-end reporting basis and, accordingly, equity in 1977 earnings is based on the ten months' operations of Blue Chip ended January 1, 1977. This change did not have a significant effect on 1977 net earnings.

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

(Continued)

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

Notes to Financial Statements

In addition to the shares of Blue Chip owned by subsidiaries of the Company, at December 31, 1977, Berkshire owned approximately 35% of the outstanding Blue Chip shares.

Financial statements of Blue Chip are included elsewhere herein.

(8) Property and Equipment

Property and equipment are comprised of the following:

	Jan. 28, 1978	Jan. 29, 1977
Land	$ 271,860	231,715
Buildings	379,998	239,998
Building improvements	214,772	197,211
Leasehold improvements	267,583	246,618
Furniture, fixtures and equipment	449,137	513,538
	1,583,350	1,429,080
Less allowances for depreciation and amortization	532,874	546,361
	$ 1,050,476	882,719

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

9-1/4% Collateral Notes Payable

In December 1977, Associated borrowed from institutional investors $7,000,000 evidenced by 9-1/4% promissory notes of Associated in that aggregate principal amount. The notes are guaranteed by the Company. Interest is payable semiannually on March 1st and September 1st. Principal payments of $777,000 annually are required commencing March 1, 1985; final maturity is March 1, 1993. Optional prepayment terms, in certain circumstances with penalty, are provided in the Note Agreement under which the obligations were issued. Associated and the Company pledged, and granted a security interest in, for the benefit of the noteholders, 118,590 shares of common stock of Berkshire Hathaway, Inc. including 10,521 shares owned by Associated and 108,069 shares owned by the Company plus 591,900 shares of the common stock of Blue Chip Stamps owned by Associated.

From the proceeds, Associated paid a $5,500,000 dividend to the Company, who in turn redeemed its $4,000,000 bank loan outstanding from April 1976; the proceeds retained by Associated and the remainder of amount received by the Company were used for general corporate purposes.

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 $66,000 is payable on November 1, 1978 under these provisions with respect to the fiscal year ended January 28, 1978.

(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% of par plus accrued interest to October 31, 1978 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 $5,225,487 were subject to such restrictions at January 28, 1978.

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:

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
	$ 1,493,923

(Continued)

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

Notes to Financial Statements

(10) Income Taxes

Total income tax expense for the years ended January 28, 1978 and January 29, 1977 is summarized as follows:

	Year ended Jan.28,1978	Year ended Jan.29,1977
Income taxes applicable to:		
Operating earnings	$ 829,452	581,944
Equity in earnings of Berkshire Hathaway Inc.	335,364	263,555
Equity in earnings of Blue Chip Stamps	198,823	138,122
Realized gain on sales of securities	64,000	31,625
Total income tax expense	$ 1,427,639	1,015,246
Current taxes applicable to:		
Operating earnings	508,452	402,944
Distributed earnings of Blue Chip Stamps	14,548	11,990
Realized investment gain	64,000	31,625
Total current	587,000	446,559
Deferred taxes applicable to:		
Equity in undistributed earnings of:		
Berkshire Hathaway Inc.	335,364	263,555
Blue Chip Stamps	184,275	126,132
Tax effect of change in insurance companies' prepaid acquisition costs	321,000	179,000
Total deferred	840,639	568,687
	$ 1,427,639	1,015,246
The above figures represent:		
State and local income taxes	265,000	260,000
Federal income taxes	1,162,639	755,246
	$ 1,427,639	1,015,246

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.28, 1978	Year ended Jan.29, 1977
Income taxes at Federal statutory rate	$ 4,547,000	3,161,000
Tax differences relating to:		
Dividends received credits, including credits applied to equity in earnings of Berkshire Hathaway Inc. and Blue Chip Stamps	(3,061,000)	(2,300,000)
Amortization of difference between cost and underlying net assets of subsidiaries and investees (not deductible for tax purposes)	55,000	142,000
Long-term capital gain rate differential	(62,000)	(16,000)
State and local taxes, net of Federal tax benefit	138,000	135,000
Tax-exempt interest income	(130,000)	(58,000)
All other	(59,361)	(48,754)
	$ 1,427,639	1,015,246

(Continued)

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES
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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 28, 1978. At January 28, 1978 the Company held as treasury stock 217,510 shares of its issued capital stock.

At January 28, 1978 consolidated retained earnings included $18,511,607 representing undistributed earnings of affiliated companies (net of income tax provisions) as follows: Berkshire Hathaway - $11,749,508; Blue Chip - $6,762,099.

At January 28, 1978, the parent Company's retained earnings included $3,798,118 representing undistributed earnings of Associated and $7,242,449 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 28, 1978 and January 29, 1977 was approximately $2,152,000 and $2,103,000, respectively, including contingent rentals of approximately $467,000 and $479,000, respectively.

In November 1976, the Financial Accounting Standards Board issued Statement No. 13, "Accounting For Leases". The statement is effective for lease agreements entered into on or after January 1, 1977, and in 1978 its provisions are to be applied retroactively. All leases in effect at January 1, 1977 would be classified and accounted for as operating leases under the provisions of Statement No. 13, which is also the manner in which they have been accounted for in the past. During 1977 Associated has no capital lease transactions pertaining to real property and equipment leases entered into were immaterial.

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

Fiscal year ending 1979	$ 1,702,336
Fiscal year ending 1980	1,584,632
Fiscal year ending 1981	1,472,608
Fiscal year ending 1982	1,434,846
Fiscal year ending 1983	1,140,713
Fiscal years ending 1984-1988	2,970,447
Thereafter	1,478,600
Total	$ 11,784,182

(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 28, 1978 and January 29, 1977 was $77,194 and $70,856, respectively. At January 1, 1977 (the date of the latest completed actuarial valuation of the Plan), the present value of vested benefits was $906,875; the total of the pension fund assets exceeded the total accrued benefits under the plan. There was no unfunded accrued liability at January 1, 1977 (date of last valuation).

(Continued)

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

(14) Business Segment Data

The Company's principal business segment is retailing of popular priced women's and children's apparel from a chain of stores located in principal cities in ten states in the midwest, mid-south and northeast sections of the United States. This segment is hereafter identified as "retailing". A second business segment of the Company is underwriting of property and casualty insurance. This segment is conducted through Columbia Insurance Company, Omaha, Nebraska and Columbia's subsidiary, Southern Casualty Insurance Company, Alexandria, Louisiana.

In the following table, revenue of the Insurance Segment includes investment income of Columbia and Southern Casualty plus premiums earned by those insurers. Revenues of the retailing segment include net sales from the retail stores plus other income earned in the retailing operations.

	Year ended Jan.28,1978	Year ended Jan.29,1977
Revenues:		
Insurance segment:		
Earned premiums on cessions from affiliate	$ 5,178,782	3,428,367
Earned premiums - non-affiliates	1,018,810	666,462
Investment income	532,790	431,539
Insurance segment revenues	6,730,382	4,526,368
Retailing segment	42,106,014	39,112,505
Total revenues	$ 48,836,396	43,638,873

Operating profit before taxes is presented below. Operating profit of segments is total revenues as above less total expenses identified with the segments. In computing operating profit identified with segments, none of the following items have been added or deducted: equity in earnings of investees, realized investment gains and interest expense.

	Year ended Jan.28,1978	Year ended Jan.29,1977
Operating profit before taxes:		
Insurance segment	$ 439,491	119,039
Retailing segment	2,774,645	2,218,505
Not identified with segments:		
Equity in earnings of investees:		
Berkshire Hathaway Inc.	4,710,942	3,702,577
Blue Chip Stamps	2,561,072	1,472,656
Realized investment gains	160,602	99,249
Interest expense	(1,174,385)	(1,026,765)
Operating profit before taxes	$ 9,472,367	6,585,261
Identifiable assets at year end:		
Insurance segment	11,899,924	9,189,663
Retailing segment	14,271,041	9,965,085
Not identified with segments:		
Investment in affiliates	41,027,348	32,710,283
Corporate cash and other	348,159	631,426
	$ 67,546,472	52,496,457
Retailing segment:		
Capital expenditures	$ 294,442	118,312
Depreciation and amortization	126,226	123,590

(Continued)

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

Capital expenditures, depreciation and amortization were insignificant in the insurance segment.

(15) Supplemental Note - Inventories

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

January 31, 1976	$ 4,739,021
January 29, 1977	5,589,375
January 28, 1978	6,436,252

(16) 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:

	1978	1977
Losses and loss adjustment expenses payable	$ 5,253,970	3,711,949
Unearned insurance premiums	4,559,083	3,314,069
Underwriting gain (loss)	161,175	(239,821)

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: 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 28, 1978										
Affiliates:										
Blue Chip Stamps common stock	841,900	$ 15,380,729	2,561,072	-		202,056	-		841,900	$ 17,739,745
Berkshire Hathaway Inc. common stock	163,201	17,329,554	4,710,942	1,247,107	Acquisition of 11,514 shares	-	-		174,715	23,287,603
		$ 32,710,283	7,272,014	1,247,107		202,056	-			41,027,348

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 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

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 28, 1978								
Associated Retail Stores, Inc.	453,000	$ 22,336,151	5,519,358	-	5,500,000	-	453,000	$ 22,355,509
Affiliate - Berkshire Hathaway Inc. common stock	108,069	$ 10,935,998	3,017,736	-	-	-	108,069	$ 13,953,734
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.

DIVERSIFIED RETAILING COMPANY, INC. AND SUBSIDIARIES

Supplementary Income Statement Information

Schedule XVI

Item	Charged to costs and expenses
Fiscal year ended January 28, 1978:	
Maintenance and repairs	$ 256,980
Taxes, other than income taxes:	
Payroll taxes	655,632
Personal property and real estate	221,024
Other	125,649
Rents:	
Real estate	1,886,326
Equipment	27,000
Fiscal year ended January 29, 1977:	
Maintenance and repairs	242,671
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

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 examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Blue Chip Stamps, an affiliated company. The Company's investment in Blue Chip Stamps at December 31, 1977 and 1976 was $5,165,037 and $4,447,437, respectively, and its equity in earnings of Blue Chip Stamps was $718,560 and $372,787 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.

The report of the other auditors was qualified with respect to litigation involving a subsidiary of Blue Chip Stamps. As explained in note 6 to the accompanying consolidated financial statements, the ultimate outcome of this action and potential liability, if any, cannot be determined at this time.

In our opinion, based upon our examinations and the report of the other auditors and, in 1977, subject to the effects on the financial statements of such adjustments, if any, as might have been required had the outcome of the uncertainty referred to in the preceding paragraph been known, the aforementioned consolidated financial statements present fairly the financial position of Columbia Insurance Company and consolidated subsidiary at December 31, 1977 and 1976 and the results of their operations and the changes in their financial position for each of the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis; and the supporting schedules, in our opinion, subject to, in 1978, the effects, if any, of the matter referred to in the preceding paragraph, present fairly the information set forth therein.

PEAT, MARWICK, MITCHELL & CO.

Peat, Marwick, Mitchell & Co.

Omaha, Nebraska
April 14, 1978

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Balance Sheets

December 31, 1977 and 1976

Assets	1977	1976
Investments - other than affiliates (notes 3 and 4) (Schedule I):		
U. S. Treasury Bills, at cost which approximates market	$ 3,451,854	3,588,651
Bonds, at amortized value	5,604,788	3,472,052
Preferred stocks, at cost	133,475	133,475
Common stocks, at cost	1,100,437	1,121,327
Total investments - other than affiliates	10,290,554	8,315,505
Cash	75,153	78,147
Investment in Berkshire Hathaway Inc. (note 5) (Schedule II)	7,426,202	5,971,586
Investment in Blue Chip Stamps (note 6) (Schedule II)	5,165,037	4,447,437
Investment income due and accrued	104,558	68,754
Uncollected premiums	308,471	267,804
Prepaid acquisition costs	1,042,000	373,000
Income taxes recoverable from parent (note 7)	205,000	385,000
Other assets	79,188	86,453
	$ 24,696,163	19,993,686

Liabilities, Capital Stock and Surplus	1977	1976
Losses and loss adjustment expenses	$ 5,869,410	4,627,291
Unearned premiums	4,937,159	3,513,506
Ceded reinsurance balances payable	-	6,586
Amount due for purchase of securities	-	567,678
Deferred income taxes	1,035,608	560,300
Other liabilities	71,439	24,592
Total liabilities	11,913,616	9,299,953
Capital stock and surplus:		
Capital stock par value $100. Authorized, issued and outstanding, 20,000 shares	2,000,000	2,000,000
Surplus:		
Paid-in	3,855,389	3,855,389
Unassigned (note 13)	6,927,158	4,838,344
Total surplus	10,782,547	8,693,733
Total capital stock and surplus	12,782,547	10,693,733
Contingency (note 6)		
	$ 24,696,163	19,993,686

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Statements of Earnings

Years ended December 31, 1977 and 1976

	1977	1976
Premiums:		
Premiums written	$ 7,621,245	6,337,697
Increase in unearned premiums	(1,423,653)	(2,242,868)
Premiums earned (Schedule VII)	6,197,592	4,094,829
Investment income, net (note 9)	523,006	403,468
	6,720,598	4,498,297
Losses and claims incurred (Schedule VII)	4,700,108	2,697,297
Loss adjustment expenses	583,821	548,361
Underwriting expenses (note 10)	997,178	1,133,600
	6,281,107	4,379,258
Earnings before income taxes, equity in earnings of other companies and realized investment gains	439,491	119,039
Income taxes (benefit) (note 7):		
Current	(273,320)	(203,056)
Deferred	321,000	179,000
	47,680	(24,056)
Earnings before equity in earnings of other companies and realized investment gains	391,811	143,095
Equity in earnings of other companies:		
Berkshire Hathaway Inc. (note 5)	1,281,841	1,055,363
Blue Chip Stamps (note 6)	718,560	372,787
	2,000,401	1,428,150
Earnings before realized investment gains	2,392,212	1,571,245
Investment gains - excludes unrealized appreciation in common stocks of unaffiliated companies of $83,189 in 1977 and $292,481 in 1976:		
Realized investment gains (notes 4 and 11)	160,602	99,249
Applicable income taxes (note 7)	64,000	31,625
Net realized investment gains	96,602	67,624
Net earnings	$ 2,488,814	1,638,869

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Statements of Capital Stock and Surplus

Years ended December 31, 1977 and 1976

		Surplus		
	Capital stock	Paid-in	Net unrealized loss on marketable equity securities	Unassigned
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
Net earnings for the year	-	-	-	2,488,814
Dividends paid	-	-	-	(400,000)
Balance, December 31, 1977	$ 2,000,000	3,855,389	-	6,927,158

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1977 and 1976

	1977	1976
Funds provided:		
From operations:		
Net earnings	$ 2,488,814	1,638,869
Charges (credits) to earnings not requiring (providing) funds:		
Accretion of bond discount	(39,408)	(30,991)
Increase in estimated losses and loss adjustment expenses	1,242,119	608,271
Increase in unearned premiums	1,423,653	2,396,757
Increase in deferred taxes	321,000	179,000
(Increase) decrease in income taxes recoverable from parent	180,000	(167,000)
Increase in uncollected premiums	(40,667)	(81,894)
Increase in accrued investment income	(35,804)	(25,456)
Increase in prepaid acquisition costs	(669,000)	(373,000)
Gain on sale of investments	(160,602)	(99,249)
Increase (decrease) in amounts due for purchase of securities	(567,678)	567,678
Equity in undistributed earnings of affiliated companies, net of deferred taxes	(1,944,721)	(1,372,470)
Amortization	-	24,150
Increase (decrease) in ceded balances payable	(6,586)	6,586
Funds provided from operations	2,191,120	3,271,251
From sale of bonds	885,761	395,386
From sale of common stock investments in unaffiliated companies	662,793	-
Decrease in U. S. Treasury Bills	136,797	-
Decrease in cash	2,994	-
Other, net	54,112	(15,068)
Total funds provided	$ 3,933,577	3,651,569
Funds used:		
Cost of investments purchased:		
Increase in U. S. Treasury Bills	-	1,158,375
Bonds	2,923,089	1,548,040
Preferred stocks of unaffiliated companies	-	133,475
Common stocks of unaffiliated companies	537,301	558,191
Common stocks of Berkshire Hathaway Inc.	73,187	78,500
Increase in cash	-	19,055
	3,533,577	3,495,636
Dividends paid	400,000	-
Decrease in amounts retained by company for account of others	-	155,933
Total funds used	$ 3,933,577	3,651,569

See accompanying notes to consolidated financial statements.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

December 31, 1977 and 1976

(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.

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.

(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 a consolidated income tax return.

(g) Operations

The companies insure only property/casualty insurance risks; therefore, no further disaggregation of the information in the accompanying consolidated financial statements is required under Statement of Financial Accounting Standards No. 14 - Financial Reporting for Segments of a Business Enterprise.

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(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 companies maintain their records. A reconciliation of the aggregate capital stock and surplus ("Surplus as regards Policyholders") as determined under the statutory method to that determined and reported herewith in accordance with GAAP is as follows:

	December 31, 1977	1976
Statutory surplus as regards policyholders	$ 11,509,875	9,652,715
Excess of NAIC market valuations over cost of investments in equity securities other than affiliates	(346,368)	(263,178)
Excess of NAIC admitted asset valuations over amortized cost of bonds	(66,109)	(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.	457,064	1,298,376
Blue Chip Stamps	1,040,037	197,437
Prepaid acquisition costs	1,042,000	373,000
Income tax effects and adjustments	(927,608)	(575,300)
All other	73,656	42,720
Capital stock and surplus per accompanying financial statements	$ 12,782,547	10,693,733

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

	1977	1976
Statutory net income	$ 73,093	111,549
Increase in deferred acquisition costs	669,000	373,000
Amortization of excess cost of investment in Southern Casualty Insurance Company	-	(24,150)
Equity in undistributed earnings of affiliates:		
Berkshire Hathaway Inc.	1,281,841	1,055,363
Blue Chip Stamps	658,560	312,787
Income tax effects and adjustments	(193,680)	(189,680)
Net earnings per accompanying financial statements	$ 2,488,814	1,638,869

(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:

	1977	1976
Bonds, at amortized cost	$ 1,182,686	977,926
Stocks, at cost	6,204,945	6,204,945
	$ 7,387,631	7,182,871

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(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, 1977 and 1976 is as follows:

	1977		1976	
	Cost	Market	Cost	Market
Bonds	$ 5,604,788	5,670,896	3,472,052	3,627,950
Equity:				
Preferred stocks	133,475	154,000	133,475	162,750
Common stocks	1,100,437	1,426,279	1,121,327	1,355,230
	$ 1,233,912	1,580,279	1,254,802	1,517,980

At December 31, 1977, with respect to equity securities, gross unrealized gains were $414,740 and gross unrealized losses were $68,373. A net realized gain of $160,602 (before applicable income taxes) on the sale of securities was included in the determination of net earnings for 1977.

Investments, other than investments in U. S. Treasury Bills, comprising greater than two percent of total investments were as follows at December 31, 1977 and 1976:

Common stocks	Cost	Market value
1977:		
Kaiser Aluminum Chemical Corp.	$ 379,742	337,850
California Water Service Company	275,448	348,453
1976:		
California Water Service Company	$ 275,447	359,515
Kaiser Industries, Inc.	558,190	646,500

Bonds	Amortized cost	Par value
1977:		
Corbin, Kentucky IDR, 5.6%, 1992	$ 229,721	230,000
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

(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:

	1977	1976
Equity in net earnings	$ 1,383,162	1,140,416
Provision for deferred income taxes	(99,588)	(82,110)
Amortization of excess of cost of investment over underlying net asset values	(1,733)	(2,943)
	$ 1,281,841	1,055,363

(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 fiscal year ended December 31, 1977 and its ten fiscal months ended January 1, 1977.

	1977	1976
Dividends received	$ 60,000	60,000
Equity in undistributed earnings	760,000	509,634
Provision for current income taxes	(4,320)	(4,320)
Provision for deferred income taxes	(54,720)	(36,694)
Amortization of excess of cost of investment over underlying net asset values	(42,400)	(155,833)
	$ 718,560	372,787

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 was $296,796 more than underlying net asset value on that date. Beginning in 1977, the Company commenced amortizing 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.

In 1976 Blue Chip changed from a February 28 year-end reporting basis to an approximately December 31 year-end reporting basis and, accordingly, equity in 1976 earnings is based on the ten months' operations of Blue Chip ended January 1, 1977. This change did not have a significant effect on 1976 net earnings of the companies.

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

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(7) Income Taxes

Income tax expense is made up of the following:

	1977	1976
Totals:		
Expense (benefit) applicable to operating earnings	$ 47,680	(24,056)
Expense applicable to equity in earnings of:		
Berkshire Hathaway Inc.	99,588	82,110
Blue Chip Stamps	59,040	41,014
Expense applicable to investment gains	64,000	31,625
	$ 270,308	130,693
Income tax currently payable (recoverable) relating to:		
Loss before income taxes, equity in earnings of other companies and realized investment gain	(273,320)	(203,056)
Distributed earnings of Blue Chip Stamps	4,320	4,320
Realized investment gain	64,000	31,625
Total current	(205,000)	(167,111)
Deferred expense relating to:		
Equity in undistributed earnings of other companies:		
Berkshire Hathaway Inc.	99,588	82,110
Blue Chip Stamps	54,720	36,694
Expense for tax effect of change in deferred acquisition costs	321,000	179,000
Total deferred	475,308	297,804
Total income tax expense	$ 270,308	130,693

Total net income after taking into account realized investment gains or losses but before income taxes was $2,759,122 in 1977 and $1,769,562 in 1976. Income tax expense of $1,324,378 in 1977 and $849,390 in 1976 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:

	1977	1976
Tax expense at statutory rate	$ 1,324,378	849,390
Increase (reduction) in income taxes resulting from:		
Tax-exempt interest	(129,826)	(58,421)
85% dividends received credit relating to:		
Dividends received from unaffiliated companies	(32,692)	(23,903)
Equity in net earnings of other companies	(898,890)	(697,803)
Amortization of cost in excess of the underlying equity in net assets of affiliated companies and subsidiary (1976 only)	21,184	87,924
Capital gains rate differential	(13,482)	(16,198)
Other	(364)	(10,296)
Total income tax expense	$ 270,308	130,693

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(8) 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, 1977	December 31, 1976
Earned premiums	$ 5,178,781	3,428,367
Unearned premiums	4,559,083	3,314,069
Incurred losses and loss adjustment expenses	4,570,697	2,650,124
Commissions	1,499,609	1,351,064

(9) Investment Income, Net

Investment income is comprised of the following:

	1977	1976
Interest on bonds	$ 449,279	370,142
Dividends, unaffiliated companies	80,126	61,397
Real estate income	3,385	3,385
	532,790	434,924
Investment expenses	9,784	31,456
Net investment income	$ 523,006	403,468

(10) Underwriting Expenses

The following expenses made up underwriting expenses:

	1977	1976
Commissions and brokerage	$ 1,551,314	1,355,919
Taxes, licenses and fees	30,117	57,133
Other underwriting expenses	84,747	93,548
Increase in prepaid acquisition costs	(669,000)	(373,000)
	$ 997,178	1,133,600

(11) Investment Gains and Losses

A summary of realized and unrealized investment gains (losses) for 1977 and 1976 follows:

	1977			
	Net gains	Applicable income tax	Net gains less income taxes	Net unrealized gains (losses)
Bonds	$ 56,000	21,286	34,714	-
Preferred stocks	-	-	-	(8,750)
Common stocks	104,602	42,714	61,888	91,939
	$ 160,602	64,000	96,602	83,189

(Continued)

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Notes to Consolidated Financial Statements

(11), Continued

	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

(12) 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:

	1977	1976
Estimated losses and loss adjustment expenses	$ 512,222	317,284
Premiums written	1,852,103	900,343
Losses paid	547,007	746,741

(13) Stockholder's Equity

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

Included in unassigned surplus at December 31, 1977 was $6,724,813 representing undistributed earnings of affiliated companies, net of tax provisions, as follows: Berkshire Hathaway - $4,154,485; Blue Chip - $2,570,328.

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Summary of Investments in Securities - Other than Securities of Affiliates

December 31, 1977

Schedule I

Type of Investment	Cost*	Market value	Carrying value
Bonds:			
States, municipalities and political subdivisions	$ 4,727,593	5,035,710	4,727,593
Industrial and miscellaneous	877,195	977,313	877,195
Total bonds	5,604,788	6,013,023	5,604,788
Preferred stocks - Industrial and miscellaneous	133,475	154,000	133,475
Common stocks:			
Public utilities	275,448	348,453	275,448
Banks, trusts and insurance companies	126,065	174,350	126,065
Industrial and miscellaneous	698,924	903,476	698,924
Total common stocks	1,100,437	1,426,279	1,100,437
U. S. Treasury Bills	3,451,854	3,451,854	3,451,854
Total investments in securities - other than securities of affiliates	$ 10,290,554	11,045,156	10,290,554

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

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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	Recovery of unrealized loss on marketable equity securities	Other: Additions	Other: Explanation	Balance at close of period: Number of shares	Balance at close of period: Amount
1977										
Berkshire Hathaway Inc. common stock, $5 par value	49,715	$ 5,971,586	1,383,162	-	1,733	-	73,187	Purchase of an additional 786 shares	50,501	$ 7,426,202
Blue Chip Stamps common stock, $1 par value	250,000	4,447,437	820,000	60,000	42,400	-	-	-	250,000	5,165,037
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

COLUMBIA INSURANCE COMPANY AND CONSOLIDATED SUBSIDIARY

Premiums, Losses and Claims

Schedule VII

Line of business	Part 1 - Premiums: Unearned premiums beginning of period	Net premiums written	Unearned premiums end of period	Premiums earned during period	Part 2 - Losses and claims: Losses and claims incurred during period	Loss expense incurred during period
1977						
Auto liability	$ 1,028,716	1,592,364	916,453	1,704,627	1,209,224	
Auto physical damage	515,292	653,067	402,337	766,022	505,832	
Reinsurance not elsewhere classified	1,539,651	3,969,601	3,098,338	2,410,914	1,626,650	
Workmen's compensation	208,688	1,303,613	391,468	1,120,833	1,123,565	
All other	221,159	102,600	128,563	195,196	234,837	
	$ 3,513,506	7,621,245	4,937,159	6,197,592	4,700,108	583,821
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	355,384	211,875	221,159	346,100	191,427	
	$ 1,270,638	6,337,697	3,513,506	4,094,829	2,697,297	548,361

BERKSHIRE HATHAWAY INC.

1977

ANNUAL REPORT TO THE STOCKHOLDERS

Berkshire Hathaway Inc.

1977 Annual Report to the Stockholders

BUSINESS OF THE COMPANY

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

CONTENTS

Berkshire Hathaway Inc.

To the Stockholders of Berkshire Hathaway Inc.:

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

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

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

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

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

Textile Operations

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

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

Insurance Underwriting

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

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

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

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

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

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

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

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

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

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

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

Insurance Investments

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

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

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

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

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

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

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

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

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

Banking

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

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

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

Blue Chip Stamps

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

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

Warren E. Buffett, Chairman

March 14, 1978

Berkshire Hathaway Inc.

	1968	1969	1970	1971	1972
	(Dollars in thousands, except per share amounts)				
Insurance premiums written	$22,620	$28,776	$45,086	$66,455	$57,950
Net sales of manufactured products	46,002	40,427	24,569	26,011	27,742
Interest and dividend income	1,972	2,133	2,942	5,043	6,648
Net earnings from insurance and manufacturing operations	2,488	2,699	1,893	4,712	8,387
Equity in net earnings of bank subsidiary	—	1,165	2,973	2,192	2,700
Equity in net earnings of Blue Chip Stamps	—	—	—	63	111
Earnings before realized investment gains or losses	2,488	3,864	4,866	6,967	11,198
Realized investment gains (losses) net of income taxes	2,174	4,089	(301)	719	928
Net earnings	$ 4,662	$ 7,953	$ 4,565	$ 7,686	$12,126
Average shares outstanding	985,482	985,000	979,715	979,569	979,569
Per share:					
Earnings before realized investment gain or loss	$ 2.52	$ 3.92	$ 4.97	$ 7.11	$11.43
Realized investment gain (loss)	2.21	4.15	(.31)	.74	.95
Net earnings	$ 4.73	$ 8.07	$ 4.66	$ 7.85	$12.38
Stockholders' equity at year end	$36.74	$44.83	$49.49	$57.34	$69.72

Ten Year Summary

(Dollars in thousands, except per share amounts)

1973	1974	1975	1976	1977	
$50,372	$60,997	$58,975	$94,773	$151,083	Insurance premiums written
33,411	32,592	32,833	47,174	48,189	Net sales of manufactured products
7,378	8,030	8,918	10,820	12,549	Interest and dividend income
8,141	3,239	1,261	8,957	12,615	Net earnings from insurance and manufacturing operations
2,782	4,093	3,450	3,750	3,550	Equity in net earnings of bank subsidiary
1,008	1,052	2,003	3,366	5,739	Equity in net earnings of Blue Chip Stamps
11,931	8,383	6,714	16,073	21,904	Earnings before realized investment gains or losses
929	(1,340)	(2,022)	6,762	4,820	Realized investment gains (losses) net of income taxes
$12,860	$ 7,043	$ 4,692	$22,835	$ 26,724	Net earnings
979,569	979,569	979,569	975,693	971,600	Average shares outstanding
					Per share:
$12.18	$ 8.56	$ 6.85	$ 16.47	$ 22.54	Earnings before realized investment gain or loss
.95	(1.37)	(2.06)	6.93	4.96	Realized investment gain (loss)
$13.13	$ 7.19	$ 4.79	$ 23.40	$ 27.50	Net earnings
$82.85	$90.04	$94.83	$118.50	$146.07	Stockholders' equity at year end

Berkshire Hathaway Inc.

MANAGEMENT'S DISCUSSION

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

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

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

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

Insurance Premium Written

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

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

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

(2) Workers' Compensation departments of National Indemnity.

(3) Reinsurance department of National Indemnity.

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

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

MANAGEMENT'S DISCUSSION, *Continued*

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

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

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

Net Sales of Manufactured Products

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

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

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

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

Interest and Dividend Income

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

(thousands of dollars)

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

MANAGEMENT'S DISCUSSION, *Continued*

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

Insurance underwriting gain (loss)

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

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

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

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

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

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

MANAGEMENT'S DISCUSSION, *Continued*

Manufacturing business gross profits

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

(in thousands of dollars)

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

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

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

Equity in Net Earnings of Blue Chip Stamps

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

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

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

The average number of shares of Blue Chip owned by Berkshire has increased from the prior year in each of the past three years. Average shares owned in 1975, 1976, and 1977 were, respectively, 1,325,233, 1,579,090, and 1,781,033. At 1977 year end, Berkshire's ownership of Blue Chip shares had increased to 1,889,903, representing approximately 36.5% of Blue Chip's outstanding shares.

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

The Board of Directors and Stockholders
Berkshire Hathaway Inc.:

We have examined the consolidated balance sheets of Berkshire Hathaway Inc. and consolidated subsidiaries as of December 31, 1977 and January 1, 1977, the balance sheets of the Berkshire Hathaway Inc. - Insurance Group as of December 31, 1977 and 1976, and the related consolidated statements of earnings and retained earnings and changes in financial position of Berkshire Hathaway Inc. for the 52 weeks ended December 31, 1977 and January 1, 1977 and the statements of income and unassigned surplus and changes in financial position of the Berkshire Hathaway Inc. - Insurance Group for the years ended December 31, 1977 and 1976. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We did not examine the financial statements of Blue Chip Stamps, an investee of the Company. The Company's investment in Blue Chip Stamps at December 31, 1977 and January 1, 1977 was $35,773,558 and $27,304,491, respectively, and its equity in net earnings of Blue Chip Stamps was $5,738,694 and $3,365,946 for the years 1977 and 1976, respectively. The financial statements of Blue Chip Stamps were examined by other auditors whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for Blue Chip Stamps, is based upon the report of the other auditors.

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

Peat, Marwick, Mitchell & Co.

March 17, 1978

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

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

LIABILITIES AND STOCKHOLDERS' EQUITY

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

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF EARNINGS AND RETAINED EARNINGS

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

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

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

See accompanying notes to consolidated financial statements.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

December 31, 1977 and January 1, 1977

(1) Summary of Significant Accounting Policies and Practices

(a) Basis of Presentation

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

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

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

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

(b) Investment in Securities, Other than Affiliates

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

(c) Investment in Blue Chip Stamps

The investment in Blue Chip Stamps ("Blue Chip") is accounted for on the equity basis. Deferred income taxes are provided for with respect to undistributed earnings of Blue Chip under the assumption that such earnings will be distributed as taxable dividends.

(d) Insurance Premiums

Insurance premiums are recognized as revenues ratably over the term of the policies. Unearned premiums are computed on the monthly pro rata basis and are stated after deduction for reinsurance placed with reinsurers in the amount of $5,268,090 at December 31, 1977 and $4,281,000 at December 31, 1976. Premium acquisition costs such as commissions, premium taxes and certain other underwriting expenses are, pursuant to statutory insurance accounting rules, charged against income when incurred. However, for financial statement purposes, a portion of such costs are deferred and charged against income as the related premiums are earned.

(e) Losses and Loss Adjustment Expenses

The Insurance Group provides for losses and loss adjustment expenses based upon (1) aggregate case basis estimates for losses reported, in respect to direct premiums written, (2) estimates of unreported losses based upon past experience, (3) estimates received relating to assumed reinsurance, and (4) deduction of amounts for reinsurance placed with reinsurers in the amount of $8,532,954 at December 31, 1977 and $8,619,481 at December 31, 1976.

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

These items of property (including significant betterments and renewals) are carried at cost depreciated over their useful lives estimated at the date of acquisition. The double-declining balance method is used to calculate depreciation of new items of textile properties acquired after 1965; the straight-line method is applied for other items. Maintenance, repairs and renewals of a minor nature are generally charged to operations as incurred.

(g) Inventories

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(h) *Income Taxes*

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

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

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

(2) Acquired Businesses

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

In January 1976, the Company acquired net assets valued at approximately $2.1 million comprising a business engaged in the manufacture and sale of branded chemical products used in the automotive after market. Manufacturing facilities of this business are located in Los Angeles, California and Bloomington, Indiana. The acquisition was accounted for as a purchase and results of the operations are included in the 1976 and 1977 consolidated statements of earnings. In a related transaction on the same date, an insurance subsidiary of the Company purchased for approximately $2.2 million all of the outstanding capital stock of a small reinsurance operation, the business of which had previously been conducted with and through the Company's Insurance Group. 1976 and 1977 results of this acquired subsidiary are included in the statements of income of the Insurance Group and the consolidated statements of earnings.

(3) Business Segments

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

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

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

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

(4) Blue Chip Stamps

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

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

Blue Chip Stamps, a California corporation, and its subsidiaries are engaged in five lines of business: (1) See's Candy Shops, Incorporated, a 99%-owned subsidiary, produces candy and other confectionery products of the highest quality in two fully equipped kitchens in California. See's is believed to be one of the largest candy manufacturers distributing through its own chain of retail shops; it now has 179 in nine western states including Hawaii. (2) Blue Chip Stamps provides a trading stamp service to retail merchants and their customers in California and Nevada. Stamp service revenues have declined significantly in recent years from a peak of $124,180,000 in the fiscal year ended February 28, 1970 to $15,723,000 for the fiscal year ended December 31, 1977. Over the past six years Blue Chip has reduced the number of redemption stores from a peak of 90 to 42 at present. (3) Blue Chip operates a separate "motivation division" on a nationwide basis, tailoring for businesses programs designed to perform motivational functions. (4) Wesco Financial Corporation, an 80%-owned subsidiary, owns all of the outstanding stock of Mutual Savings and Loan

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

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

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

BLUE CHIP STAMPS
Consolidated Balance Sheets

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

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

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

BLUE CHIP STAMPS
Consolidated Earnings Summaries

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

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

(5) Investment in Securities of Unaffiliated Companies

A summary of the aggregate cost and approximate market value of investments in securities of unaffiliated companies at December 31, 1977 and 1976 is as follows:

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

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

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

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

(6) Investments in Unconsolidated Subsidiaries

The investment in the unconsolidated bank subsidiary represents approximately 98% of the outstanding stock of The Illinois National Bank & Trust Co. of Rockford. The equity method is used in accounting for this investment. See note 13 regarding divestiture of this investment. Financial statements of The Illinois National Bank & Trust Co. of Rockford and subsidiary are presented elsewhere herein.

The carrying values of $27,451,331 at December 31, 1977 and $25,611,381 at January 1, 1977 for all unconsolidated subsidiaries were approximately $2,500,000 in excess of the parent Company's equity in the net assets as reflected in the financial statements of the subsidiaries at those dates. The major portion of this excess cost originated prior to November 1, 1970 and is not being amortized since it is considered by management to have continuing value over an indefinite period.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(7) Receivables

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

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

(8) Inventories

A summary of inventories follows:

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

Inventories of the parent Company are determined by the last-in, first-out ("LIFO") method. Inventories of subsidiaries are stated at the lower of cost or market, determined under the first-in, first-out ("FIFO") method. Cost using FIFO for all inventories would have exceeded balance sheet carrying amounts by $1,976,635 at December 31, 1977 and $1,542,744 at January 1, 1977, respectively.

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

The composition of plant and equipment is shown below:

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

January 1, 1977	*Properties of manufacturing operations*	*Properties of Insurance Group*	*Total*
Land	$ 251,360	$ 128,847	$ 380,207
Buildings	2,792,915	1,365,863	4,158,778
Machinery and equipment	14,033,720	—	14,033,720
Furniture and fixtures and leasehold improvements	821,803	1,271,184	2,092,987
	17,899,798	2,765,894	20,665,692
Less accumulated depreciation and amortization	14,484,374	1,129,619	15,613,993
	$ 3,415,424	$1,636,275	$ 5,051,699

(10) Promissory Notes and Debentures

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

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

(11) 8% Senior Notes due 1993

The parent Company in 1973 issued $20,000,000 8% Senior notes with final maturity March 1, 1993. The notes call for mandatory annual prepayments of $1,143,000 on March 1 in each of the years from 1979 to 1992, inclusive. Optional prepayments are permitted without premium up to the amount of the required prepayments in each of the years 1979 to 1992; this right is not cumulative. Additionally, the parent Company may also prepay the notes at any time, in full or in part, at a premium declining ratably from the current rate of approximately 5.9% to par in 1992. The parent Company agreed it will not affect any optional prepayment prior to March 1, 1983 from proceeds of any refunding operation involving the incurring of any indebtedness at an effective annual interest rate of less than 8%.

In the note instruments the parent Company agreed, among other things, as to both the parent Company and restricted subsidiaries, as defined, to limitations as to permissible outstanding funded debt and subordinated funded debt and to a limitation on mortgage debt except as to after-acquired property. Further, the parent Company covenanted that it would not make "restricted payments", which term includes dividends or other equity distributions plus investment in unrestricted subsidiaries (those not bound by the terms of the loan agreement), in excess of stated formula amounts. Retained earnings of approximately $81,000,000 as of December 31, 1977 are restricted by this provision.

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(12) Income Taxes

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

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

Total net income before taxes was $32,119,220. A reconciliation of income tax expense at the statutory 48% rate to total income taxes as shown above follows:

	Amount
Tax expense at 48% statutory rate	$15,417,226
Decreases resulting from:	
Tax-exempt interest income	(2,136,000)
100% exclusion relating to equity in earnings of the Illinois National Bank	(1,704,000)
85% dividends received credit:	
On dividends from unaffiliated companies	(2,103,000)
On equity in earnings of Blue Chip Stamps	(2,439,000)
Long-term capital gains rate differential	(1,161,000)
Credit from unconsolidated subsidiary	(227,000)
Other, net	(252,438)
	$ 5,394,788

As of December 31, 1977, unused net operating loss carryovers in acquired subsidiaries exist in the approximate amount of $2,500,000 of which approximately $850,000 expires in 1978. These can only be offset against taxable income earned by the acquired subsidiaries, and any tax benefits realized therefrom would be accounted for as a reduction of purchase price resulting in their amortization into income over a period not to exceed forty years.

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(12) Income Taxes (continued)

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

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

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

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

(13) "One-Bank Holding Company" Status

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

(14) "Savings and Loan Holding Company" Status

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

Berkshire Hathaway Inc.
AND CONSOLIDATED SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(15) Transactions with Affiliates

Members of the Insurance Group in 1977 and 1976 engaged in transactions in the ordinary course of business with Columbia Insurance Company ("Columbia"), a subsidiary of Diversified Retailing Company, Inc. ("Diversified"). Warren E. Buffett, Chairman of the Board of the Company, is also Chairman of the Boards of Columbia and Diversified. At the end of 1977, Mr. Buffett owned more than 50% of the outstanding shares of Diversified. In 1977 and 1976, in connection with reinsurance business, gross premiums of $7,293,705 and $5,777,098, respectively, were ceded to Columbia by insurance subsidiaries of the Company. National Indemnity Company performs all of Columbia's bookkeeping and other administrative services. For these services Columbia pays to National Indemnity Company as part of its ceding commissions an amount ordinarily equal to one-half of the customary originating brokerage commissions. The amount of ceding commissions representing fees for bookkeeping and administrative services paid by Columbia to National Indemnity Company was $59,340 in 1977 and $35,334 in 1976. Reinsurance transactions with Columbia are effected at rates comparable to rates in similar transactions conducted at arm's length with unrelated parties, except as to that portion of the ceding commissions representing fees as to which there are no similar transactions with unrelated parties; management believes that Columbia's capacity to accept cessions of reinsurance from the Company's Insurance Group contributes an element of marketing strength to the Group.

(16) Litigation

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

(17) Compensating Balance

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

Berkshire Hathaway Inc.

INSURANCE GROUP

BALANCE SHEETS

	December 31, 1977	December 31, 1976
ASSETS		
Investments — other than investments in affiliates (note 5):		
Bonds, at amortized cost	$127,324,424	$ 89,215,773
Preferred stock, at cost	23,231,882	22,286,948
Common stock, at cost	83,656,835	53,108,266
U. S. Treasury Bills — at cost which approximates market	18,635,379	14,992,494
Total investments — other than investments in affiliates	252,848,520	179,603,481
Cash	4,532,113	2,592,562
Investment in Blue Chip Stamps (note C)	21,697,062	17,740,283
Accrued investment income	2,786,138	2,005,335
Premiums receivable and agents' balances	12,733,598	7,861,366
Reinsurance recoverable on paid losses	5,837,052	5,221,214
Property and equipment, at cost less accumulated depreciation (note 9)	2,163,733	1,636,275
Deferred premium acquisition costs	9,810,000	6,820,000
Other assets	823,082	903,814
	$313,231,298	$224,384,330
LIABILITIES, CAPITAL STOCK AND SURPLUS		
Losses and loss adjustment expenses	$133,591,629	$ 85,152,259
Unearned premiums	52,190,714	36,736,618
Funds held under reinsurance treaties	5,030,020	3,783,169
Amounts due for purchase of securities	1,338,425	839,495
Current income taxes	909,946	2,560,922
Deferred income taxes	6,276,889	4,536,139
Other liabilities	4,023,714	2,313,187
	203,361,337	135,921,789
Capital stock and surplus:		
Common stock of National Indemnity Company of $10 par value. Authorized 750,000 shares; issued 550,000 shares	5,500,000	5,500,000
Common stock of National Fire & Marine Insurance Company of $100 par value. Authorized 50,000 shares; issued 25,000 shares	2,500,000	2,500,000
Paid-in surplus	20,601,250	20,601,250
Unassigned surplus (note D)	81,268,711	59,861,291
Total capital stock and surplus	109,869,961	88,462,541
	$313,231,298	$224,384,330

See accompanying notes to financial statements.

Berkshire Hathaway Inc.

INSURANCE GROUP

STATEMENTS OF INCOME AND UNASSIGNED SURPLUS

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

See accompanying notes to financial statements.

Berkshire Hathaway Inc.

INSURANCE GROUP

STATEMENTS OF CHANGES IN FINANCIAL POSITION

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

See accompanying notes to financial statements.

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS
December 31, 1977 and 1976

(A) Note References

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

(B) Basis of Presentation

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

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

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

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

Continued

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS, *Continued*

(C) Investment in Blue Chip Stamps

The investment in Blue Chip Stamps (Blue Chip) by the companies comprising the Insurance Group represented approximately 21% of that company's outstanding shares at December 31, 1977, increased from approximately 20% at December 31, 1976. The investment is accounted for by the equity method.

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

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

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

(D) Stockholders' Equity

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

(E) Underwriting Expenses

The following expenses comprise underwriting expenses:

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

(F) Federal Income Taxes

Federal income tax expense is made up of the following:

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

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

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

Continued

Berkshire Hathaway Inc.
INSURANCE GROUP

NOTES TO FINANCIAL STATEMENTS, *Continued*

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

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

(G) Investment Gains and Losses

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

	1977			
	Net realized gains	*Applicable income taxes*	*Net realized gains less income taxes*	*Net unrealized gains*
Bonds	$ 1,556,033	$ 466,810	$ 1,089,223	$ —
Preferred stocks	97,205	29,162	68,043	3,393,000
Common stocks	5,217,246	1,554,028	3,663,218	25,135,000
	$ 6,870,484	$ 2,050,000	$ 4,820,484	$28,528,000
	1976			
Bonds	$ 1,155,664	$ (346,699)	$ 808,965	$ —
Preferred stocks	441,613	(132,484)	309,129	10,117,000
Common stocks	8,645,572	(2,720,817)	5,924,755	35,271,000
	$10,242,849	$ (3,200,000)	$ 7,042,849	$45,388,000

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

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

We have examined the consolidated balance sheets of The Illinois National Bank & Trust Co. of Rockford and subsidiary as of December 31, 1977 and 1976 and the related consolidated statements of earnings, changes in stockholders' equity and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned consolidated financial statements present fairly the financial position of The Illinois National Bank & Trust Co. of Rockford and subsidiary at December 31, 1977 and 1976 and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Peat, Marwick, Mitchell & Co.

January 20, 1978

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

CONSOLIDATED BALANCE SHEETS

December 31, 1977 and 1976

ASSETS	1977	1976
Cash and due from banks	$ 20,973,276	$ 10,868,111
Investment securities (notes 2 and 9):		
United States Treasury obligations	566,558	30,337,817
United States Government agency obligations	41,553,063	160,792
Obligations of states and political subdivisions	58,696,192	54,002,[illegible]92
Other securities	6,053,613	6,62[illegible],[illegible]54
Federal Reserve Bank stock	300,000	30[illegible],[illegible]00
Federal funds sold	7,000,000	32,000,000
Loans (note 3)	62,267,886	56,188,346
Bank premises and equipment (note 4)	1,021,747	895,977
Other assets	2,719,924	2,010,227
	$201,152,259	$193,392,516
LIABILITIES AND STOCKHOLDERS' EQUITY		
Liabilities:		
Demand deposits	$ 56,978,240	$ 54,874,671
Time deposits	117,890,119	113,461,996
Total deposits (note 5)	174,868,359	168,336,667
Accrued taxes and other liabilities (note 6)	1,716,594	1,628,082
Total liabilities	176,584,953	169,964,749
Stockholders' equity:		
Common stock of $20 par value. Authorized and issued 250,000 shares	5,000,000	5,000,000
Surplus	5,000,000	5,000,000
Undivided profits	13,266,149	12,124,955
Reserve for contingencies (note 8)	1,301,157	1,302,812
Total stockholders' equity	24,567,306	23,427,767
	$201,152,259	$193,392,516

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

CONSOLIDATED STATEMENTS OF EARNINGS

Years ended December 31, 1977 and 1976

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

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS' EQUITY
Years ended December 31, 1977 and 1976

	Common stock	Surplus	Undivided profits (note 6)	Reserve for contingencies (note 8)
Balance, December 31, 1975	$5,000,000	$5,000,000	$10,771,923	$1,308,802
Net earnings	–	–	3,847,042	–
Cash dividends – $10 per share	–	–	(2,500,000)	–
Transfer from reserve for contingencies – loan loss provision	–	–	5,990	(5,990)
Balance, December 31, 1976	5,000,000	5,000,000	12,124,955	1,302,812
Net earnings	–	–	3,639,539	–
Cash dividends – $10 per share	–	–	(2,500,000)	–
Transfer from reserve for contingencies – loan loss provision	–	–	1,655	(1,655)
Balance, December 31, 1977	$5,000,000	$5,000,000	$13,266,149	$1,301,157

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

CONSOLIDATED STATEMENTS OF CHANGES IN FINANCIAL POSITION

Years ended December 31, 1977 and 1976

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

See accompanying notes to consolidated financial statements of bank subsidiary.

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
December 31, 1977 and 1976

(1) Significant Accounting Policies

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

Consolidation

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

Investment Securities

Investment securities are stated at cost, adjusted for amortization of premium and accretion of discount. Prior to 1976, accretion of discount was not recorded. During 1976 accretion was recorded, including the cumulative amounts applicable to securities owned which were acquired in prior years. Gains or losses on sales of investment securities are recognized only upon realization and are shown separately in the statements of earnings.

Consumer Credit Loans

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

Bank Premises and Equipment

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

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

Income Taxes

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

Provision for Possible Loan Losses

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

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(2) Investment Securities

A summary of investments by major classifications is as follows:

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

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

(3) Loans

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

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

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

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

(4) Bank Premises and Equipment

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

Berkshire Hathaway Inc.

BANK SUBSIDIARY

The Illinois National Bank & Trust Co. of Rockford

AND SUBSIDIARY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

(5) Deposits

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

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

(6) Income Taxes

Accrued taxes and other liabilities in the accompanying balance sheets include deferred income taxes of $878,657 and $502,037 at December 31, 1977 and 1976, respectively. Such deferred income taxes result primarily from timing differences arising from reporting taxable income on the cash basis. The Bank and its subsidiary join in the filing of a consolidated Federal income tax return with the parent company, Berkshire Hathaway Inc. The tax benefits to and from the parent have been recorded by the Bank, as shown in the reconciliation which follows.

Taxes applicable to net earnings were as follows:

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

The components of consolidated income tax expense are as follows:

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

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

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

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

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

(7) Pension and Profit-Sharing Plan

The Bank has a noncontributory pension plan and a profit-sharing plan for all officers and employees with one full year of service. Based upon the most recent actuarial report available (as of December 31, 1976), the pension fund assets exceeded the actuarial computed value of vested benefits and there was no unfunded past service cost liability. The Bank's policy is to fund pension costs as accrued. The total pension and profit-sharing expense was $213,665 for 1977 and $160,163 for 1976.

(8) Reserve for Contingencies

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

(9) Investment Securities Write-down

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

Berkshire Hathaway Inc.
BANK SUBSIDIARY

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

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS, *Continued*

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

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

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

Berkshire Hathaway Inc.

DIRECTORS AND EXECUTIVE OFFICERS

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

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

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

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

COMMON STOCK PRICES

The common stock of Berkshire Hathaway Inc. is traded in the over the counter market. The high and low bid prices for the stock in each quarter of 1976 and 1977 is set forth in the following table. The quotations represent prices between dealers and do not include retail markup, markdown or commission. They do not represent actual transactions.

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

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

Annual Report Year Ended December 31, 1977

BLUE CHIP STAMPS

Financial Highlights

(In thousands except for amounts per share)

	52 weeks ended Dec. 31, 1977	53 weeks ended Jan. 1, 1977	13 weeks ended Dec. 31, 1977	14 weeks ended Jan. 1, 1977
Revenues:				
Candy	$ 62,886	$56,333	$30,334	$26,254
Newspaper	31,786	—	11,839	—
Stamp service	15,723	17,208	3,958	4,111
Merchandise promotions and motivation service	2,485	8,888	863	958
Other	4,293	5,893	1,099	1,578
	$117,173	$88,322	$48,093	$32,901
Income before income taxes, equity in net income of Wesco Financial Corporation and securities gains (losses)	$ 12,654	$12,180	$ 8,065	$ 8,018
Provision for income taxes	(5,476)	(4,859)	(3,402)	(3,734)
Equity in net income of Wesco Financial Corporation	5,715	4,459	1,905	1,664
Income before securities gains (losses)	12,893	11,780	6,568	5,948
Realized securities gains (losses), less taxes	4,100	(77)	(7)	(33)
Net income	$ 16,993	$11,703	$ 6,561	$ 5,915
Per share:				
Income before securities gains (losses)	$ 2.49	$ 2.27	$1.27	$1.14
Net income	$ 3.28	$ 2.26	$1.27	$1.14
Book value	$19.16*	$16.60		

*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 1977 amounted to $16,993,000 ($3.28 per share) compared to $11,703,000 ($2.26 per share) in the previous fiscal year.

Improvement in normal operating income was small and much less than indicated by these figures because this year's results included $.79 per share from securities gains of the parent company plus $.12 per share attributable to the parent company's share of net capital gains realized by Wesco Financial Corporation.

We have three major subsidiaries, See's Candy Shops, Incorporated (99% owned), Wesco Financial Corporation (80% owned) and Buffalo Evening News, Inc. (100% owned). If we used "equity accounting" instead of "consolidated accounting" for See's and the Buffalo Evening News as well as Wesco, our consolidated income for our two reporting years just ended would break down as follows:

Year ended about	Blue Chip equity in See's net income*1	Blue Chip equity in Wesco net income*2	Blue Chip equity in Buffalo Evening News net income*3	All other Blue Chip net income*4,5	Blue Chip consolidated net income*5
December 31, 1977	$5,750,000	$5,715,000	$340,000	$5,188,000	$16,993,000
Per Blue Chip share	1.11	1.10	.07	1.00	3.28
December 31, 1976	5,112,000	4,459,000	—	2,132,000	11,703,000
Per Blue Chip share	.99	.86	—	.41	2.26

*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 December 31, 1976 figure, due to our reaching 80% ownership of Wesco, includes reversal of income taxes provided in prior years.

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

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

*5 The 1977 amounts include $4,100,000 or $.79 per Blue Chip share from securities gains, net of taxes. In 1976 securities losses reduced income by $77,000 or $.01 per Blue Chip share.

SEE'S CANDY SHOPS, INCORPORATED

First in importance again 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 skilled leadership of Charles Huggins, with the percentage gain in earnings (11%) approximately equal to the percentage gain in sales (12%). 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, 1977	$62,886,000	$6,262,000	20,921,000	179
December 31, 1976	56,333,000	5,618,000	20,553,000	173

*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.

Boxed chocolate consumption per capita in the United States continues to be essentially static, and the candy business has been subject to extraordinary pressure from various factors in the last few years. Considering these business conditions, See's 1977 operating results reflect a remarkable achievement attributable to excellent management, manufacturing and selling an outstanding product. See's is a very old-fashioned company, having been founded in 1921 by a redoubtable woman, then 71 years old, who established a tradition of extreme attention to quality control. From inception, See's has consistently followed the admonition published by Ben Franklin in *Poor Richard*: "Keep thy shop and thy shop will keep thee." The result of its old-fashioned attention to quality control and cheerful retail service is the highest sales per store of any candy store chain in the world. We are privileged to own See's and to be stewards of its business tradition and example.

WESCO FINANCIAL CORPORATION

Almost equal to See's in our earnings picture last year was our equity in net income of our subsidiary, Wesco Financial Corporation (80% owned). The substantial improvement in Wesco's contribution to our consolidated net income was caused by a combination of capital gains and increased operating earnings in Wesco's savings and loan business, coupled with an increase in our ownership. Wesco is a separate public corporation, with its stock listed on the American Stock Exchange. Summarized financial information for Wesco is contained in Note 1 to our consolidated financial statements. Wesco's consolidated balance sheet is exceptionally strong, showing substantial assets outside its subsidiary savings and loan association and available for commitment elsewhere. For more complete information we encourage Blue Chip shareholders to obtain a copy of Wesco's 1977 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

THE BUFFALO EVENING NEWS

On April 15, 1977, we purchased, through a newly organized wholly-owned subsidiary, the newspaper assets of Buffalo Evening News, Inc., publisher of one of two competing area-wide daily newspapers in Buffalo, New York. This was a substantial transaction, and subsequent events in Buffalo have required qualification of our auditor's opinion for 1977. Accordingly, extended discussion is appropriate in this annual report to our shareholders.

The total price paid was $35,509,000, of which $34,076,000 was paid in cash, with the balance representing assumption of certain pension obligations. Although profitable in 1977, the *News* has thus far made an insignificant contribution to consolidated earnings, and, as discussed below, future operating results may well be less favorable than those of 1977. The pro forma effect of the acquisition, assuming ownership of the *News* throughout all of 1977 (including the normally unprofitable early months of the year), would have been to reduce consolidated earnings by $.10 per share.

Nonetheless, we are very pleased to have purchased the *News*. So far as we know, no newspaper acquisition in recent years looks sensible based on past earnings related to the purchase price. Recent buyers of newspapers have paid prices reflecting what they hope to achieve over a very long-term, inflationary future, and we, of necessity, conformed to this pattern in our acquisition.

Our investment decision was based on the belief that the existing journalistic merit of the *News*, encouraged and nourished, will eventually prosper in the marketplace and that inflation will eventually make a prosperous newspaper company a safer asset than any other company which we could then buy at the price paid for the *News*. Experience and reconsideration have made us more confident than ever that we were right in our original appraisal of the journalistic merit of the *News*. The *News* is a meritorious newspaper partly because it was dominated and molded for decades by a legendary editor, Alfred Kirchhofer, who, although retired, still comes to the *News* every day at age 83. Mr. Kirchhofer had and has a passion for accuracy, fairness and service. Present management had continued these standards before our purchase, and we have encouraged their perpetuation.

We have long wanted to buy a large daily newspaper, as demonstrated by our unsuccessful bid for the *Cincinnati Enquirer* in 1971. In order to get a large newspaper property we have been quite willing, as attempted in Cincinnati and accomplished in Buffalo, to purchase a daily newspaper subject to the hazards of competition from another area-wide daily newspaper in the same city.

There are problems and uncertainties inherent in this sort of newspaper investment, as illustrated by the events subsequent to our subsidiary's purchase of the *News*.

For over 60 years the *News* had published only in the afternoons, six days a week, excluding Sundays and holidays. The Saturday afternoon edition was a large, special "Weekend" edition, with comics and other features of the sort traditional in Sunday newspapers, priced to subscribers at 30¢ per issue, twice the 15¢-per-issue price charged Monday through Friday. The competing daily newspaper in Buffalo published seven days a week, every morning, with a price to subscribers in recent years of 15¢ per issue daily except Sunday when it published without competition at a price of 50¢. The *News* had a large circulation lead Monday through Friday, selling approximately 270,000 papers against the competitor's 125,000. On Saturday, the *News* sold approximately 295,000 copies of its large 30¢ weekend edition, compared to approximately 275,000 copies of the 50¢ Sunday morning edition published by its competitor.

After our purchase, the *News* reviewed this situation, as part of an overall effort to improve its newspaper and its long-term prospects. As a result, the *News* determined (1) that through its failure to publish on Sunday it was following a totally obsolete practice, comparable to the unthinkable practice of six-day broadcasting by a large television or radio news station, seriously limiting the quality of its overall service, and (2) that its continuing success over the long term depended on changing that obsolete practice.

The decision was facilitated by recognition that real trouble has been the invariable eventual outcome for every daily newspaper in the United States which has relied overlong, in an important city, exclusively on weekday publication while a significant daily competitor enjoyed a Sunday monopoly. A typical outcome may be indicated, for instance, by the history of daily newspaper competition in Hartford, Connecticut.

For many years Hartford had two daily newspapers, the evening *Times*, by far the most popular daily newspaper in Connecticut, and the morning *Courant*, with only the *Courant* publishing on Sunday. In this publication pattern in 1951, the evening *Times* was dominant weekdays, with circulation of 96,000 compared to the *Courant's* 66,000, and the *Courant* enjoyed the only Sunday circulation of 111,000. The "no Sunday" evening *Times* in 1951 had on weekdays nearly three times the advertising lineage of its morning competitor (including well over 75% of daily retail display lineage), yet even this lead did not ensure continued prosperity. By 1960, the circulation lead of the *Times* on weekdays had narrowed to 122,000 vs. 109,000, and the *Courant* had 148,000 on Sunday. By 1965 the papers were even in weekday circulation, while the *Courant's* Sunday circulation rose to 176,000 and the *Times* maintained a declining but still large weekday lead in advertising lineage of more than three to two.

In the fall of 1968 the *Times* started a Sunday edition. But it was far too late. By 1972 the *Courant* had circulation of 170,000 on weekdays vs. 131,000 for the *Times*, and for Sunday the comparable figures were 202,000 vs. 130,000. The *Courant* had moved far ahead of the *Times* in weekday advertising lineage and utterly overwhelmed the *Times* on Sunday. A few years later the Hartford *Times* folded. This occurred despite the facts that (1) from 1928 until 1973 the *Times* had been owned by the Gannett newspaper chain, one of the largest and most experienced and successful newspaper operators in the world and (2) Gannett had tried to make its Sunday edition successful by pricing it at half the single-copy price of the Sunday *Courant*, with a 65¢ price for seven-day home delivery against 90¢ for comparable delivery of the *Courant*.

By the time our subsidiary purchased the *News* in 1977 most of the former big no-Sunday newspapers had disappeared. There remained in the major cities of the United States only three other area-wide daily newspaper publishing operations without Sunday editions: (1) the *Cincinnati Post* (owned by the prosperous Scripps-Howard chain); (2) the *New York Post* (controlled by the Murdoch chain); and (3) the *Cleveland Press* (also owned by Scripps-Howard). The *Cincinnati Post* and the *New York Post* have recently been losing heavily, and the *Cleveland Press* is losing market share at what to us appears an ominous rate. These losses and troubles have occurred at two of these papers (in Cincinnati and Cleveland) despite a past history of profitability once based, like that of the now-defunct Hartford *Times* and the present *News*, on a much superior weekday circulation position.

With all signs and surveys indicating Sunday newspaper readership was continuing to grow in importance relative to weekday newspaper readership, the *News* knew it should not continue to follow the no-Sunday policy which had created so universal a pattern of failure over the long term in other cities.

The obvious way to change the policy appeared to be to shift the *News'* 30¢ weekend edition to Sunday morning from Saturday afternoon and also to follow a national trend by having the *News* publish on Saturdays in the morning.

Succeeding in such a revision of publication practice is not easy. Newspaper habits are very hard to change, particularly in a city like Buffalo where almost all newspaper circulation is home-delivered.

Realizing the difficulty in changing such habits, Scripps-Howard, for instance, having once allowed its competitor to maintain a Sunday monopoly for a long time, simply gave up and never tried to establish a Sunday edition of its own in Cincinnati—even when its newspaper had a large lead in weekday circulation. Moreover, the history of creation of new Sunday editions elsewhere, in cities with only one area-wide daily newspaper, demonstrated that even without long-established competition of the type the *News* faced in Buffalo inauguration of a Sunday edition requires heavy promotion, free sample copies, etc. [Typical of the pattern, is the very recent plan used, about a year before inauguration of the Sunday *News* in Buffalo, by the Gannett newspaper chain in "going Sunday" with eight of the nine daily newspapers in its Westchester-Rockland Group. These eight no-Sunday papers competed with no similar daily newspapers in Westchester-Rockland, New York. The new Sunday papers were given a newsstand price of 25¢ and were delivered free to 162,000 daily subscribers for the first six weeks, then billed to subscribers only after subsequent deliveries. A nine-paper Sunday circulation guarantee of 150,000 was given to advertisers, with the difference between 150,000 and the number of actual paid subscribers made up through heavy newsstand promotion and free samples.]

With Sunday editions generally so hard to establish, even in the absence of effective competition, a major factor which encouraged the *News*, under the competitive conditions in Buffalo, was the existence of a special large, premium-priced, Saturday afternoon weekend edition of the *News*. The *News* hoped that most of the hard-won patronage of its weekend edition could be retained when publication was transferred to Sunday.

In view of the prospective difficulties, the *News* decided to facilitate the shift of its weekend edition to Sunday morning and the creation of its new Saturday morning edition, scheduled at the onset of the Buffalo winter, by maintaining a 30¢ price for the weekend edition, charging 15¢ for the new Saturday morning paper, and allowing home subscribers, who had formerly paid $1.05 per week for six papers (five papers at 15¢ and one at 30¢), to continue to pay that price for five weeks, covering delivery of seven papers, after which the home-delivered price would rise by 15¢ to $1.20 (six papers at 15¢ and one at 30¢). This promotional arrangement would give home subscribers either five free papers on Saturdays or five half-price papers on Sundays, or a one-third discount for five weeks on a 45¢ Saturday-Sunday combination, depending on your point of view. Advertisers, during the introductory five weeks, were to be assured that such promotion would cause a large circulation on Sundays.

The *News*' plans seemed reasonable to the *News*' executives, calculated as such plans were to employ less aggressive promotion than they observed in general use elsewhere and also the minimum promotion which appeared likely to give the revised schedule a reasonable chance for success in a Sunday publishing venture of a type in which some strong newspaper chains (like Gannett in Hartford) had failed and still others (like Scripps-Howard in Cincinnati) had refused even to engage. However, the *News*' plans caused a strong reaction from its competitor which filed a lawsuit alleging that the *News* was trying to destroy the competitor through methods prohibited by federal antitrust laws. In its lawsuit, the competitor asked, among other things, that preliminary and permanent injunctions be issued against the *News*' introductory promotional programs and against the sale of the Sunday *News* at 30¢ per issue as proposed and also against the sale of advertising by the *News* at rates as proposed. The competitor claimed that its profits from its Sunday edition monopoly were required to assist it in maintaining publication on weekdays. In essence, in the *News*' view, the competitor asked the court to issue sweeping preliminary and permanent injunctions which would ensure failure for the Sunday *News*. The competitor also asked for an award of damages, trebled under the antitrust law, plus attorneys' fees and costs.

A preliminary injunction, under such circumstances, must be granted or denied based on incomplete evidence and does not bind or fix the rights of the parties as they will be determined after full trial. However, issuance of a preliminary injunction, despite its inconclusive and temporary nature, can have an important impact on the parties' businesses.

In our case the United States District Court in Buffalo denied part of the preliminary injunctions demanded but did issue some of them with some adverse practical consequences. Those issued, among other things, cut down the *News*' promotional pricing period for the new publishing schedule from five weeks to two weeks, eliminated guarantees of Sunday circulation to advertisers, and limited future circulation price reductions and free sampling. These injunctions as the *News* conservatively construed them in an attempt to assure over-compliance while struggling mid-winter with a new publication schedule, caused serious interference with normal newspaper circulation methods.

In its opinion the court recognized that reasonable promotion of the new publication schedule was lawful but tentatively concluded, in essence, that more than two weeks of promotional pricing was unreasonable and that related guarantees of circulation to advertisers were unreasonable. Further proceedings are pending as to how the court's orders as heretofore made should be enforced or modified. The *News* is confident that at a full trial it can prove that it has not engaged in unlawful competition. Moreover, the *News* has made antitrust counterclaims in court against the competitor which the *News* believes are more justifiable than the competitor's claims.

Affected to some degree by the litigation (including coverage thereof in the competitor's newspaper in a manner one observer, quoted in a Buffalo news magazine, has suggested might more appropriately have been reserved for World War III), the results to date in the marketplace in Buffalo were roughly as follows in March, 1978, about four months after inauguration of the new publication schedule.

(1) While no audited figures are available since those of the Audit Bureau of Circulation for the six months' period ended September 30, 1977, we believe the *News* continues to enjoy its historical lead in paid circulation Monday through Friday, about 270,000 vs. 125,000.

(2) On Sunday the tables are turned and the competitor is dominant. The paid circulation of the *News'* weekend edition has declined from about 295,000 to slightly over 160,000 after the shift to Sunday publication, whereas the paid Sunday circulation of the competitor has declined very much less and such competitor probably has in the area of a three to two Sunday lead.

(3) On Saturday morning, the *News* leads its competitor in paid circulation by a large margin, but paid Saturday morning circulation of the *News* is about 45,000 lower than the paid regular weekday circulation.

(4) Advertising relates to circulation. On Sundays the competitor holds about 75% of the two papers' combined advertising lineage, and an even greater share of combined advertising revenue because the *News* was required to reduce advertising rates on Sunday as its weekend edition circulation declined. On other days the advertising lineage and revenue tables are reversed in favor of the *News*.

Unless there is some new court injunction, or some unexpected construction of the existing preliminary injunction, it appears to us that from this point changes in competitive position are quite likely to be very slow. [Just how slow, at best, may be indicated by the history of daily newspaper competition in Philadelphia, where the evening *Bulletin*, long dominant on weekdays, belatedly commenced publication of a Sunday edition in 1947 against the long-established Sunday edition of the morning *Inquirer*. At the present time, 30 years later, the *Bulletin*, still the leader on weekdays, remains way behind on Sunday, selling 643,000 copies vs. its competitor's 847,000.] Meanwhile, profitability of the *News* is adversely affected by litigation expenses, extraordinary circulation costs, etc., as well as the increased depreciation expense resulting from our subsidiary's purchase of physical assets at a price higher than their depreciated value on the books of the former owner.

Virtually every employee of the *News* has performed very well under the stress and additional work loads caused by the changes and challenges in Buffalo. In all areas—production, editorial, advertising and circulation—extraordinary efforts have been required of the people of the *News* and they have responded magnificently. The new and revised editions show it. We are committed to the principle of local management of news and editorial product, and we are proud of the quality that management is producing.

We hope this quality of news product and our regard for the essential integrity of the *News* augur well for our long-term expectations. Just as faithful stewardship of the customer-protection and employee-protection standards of Mary See has kept her candy business successful in our hands, so also may faithful stewardship of the journalistic and management standards of Alfred Kirchhofer protect us in Buffalo.

To sum up, (1) Faced with choosing between a no-Sunday publishing policy which has a 100% record throughout the United States of being devastatingly unsuccessful and a Sunday-inauguration policy which involved major uncertainties and difficulties, opting for the latter policy by the *News* was an obvious necessity; (2) Despite the difficulties experienced to date and the many more expected in the future, the *News'* commitment to future Sunday publication is total; (3) The *News* is proceeding in Buffalo on the theory that it will win its litigation by deserving to win and that adequate profits will eventually follow journalistic and managerial merits and good corporate citizenship; and (4) Because of the expense of litigation and other unexpected problems, the near-term profits of the *News* at times may be low or nil, and the ultimate security of the enterprise will almost surely remain in doubt for a very extended period.

TRADING STAMP AND MOTIVATION BUSINESSES

The final components of our consolidated net income last year were provided by our trading stamp business and motivation business. These businesses use the same headquarters and warehousing facilities. Combined, the businesses operated at an increased profit last year (up to $5,188,000 from $2,132,000) after (properly) giving them credit for the entire income (interest and dividends, plus income tax benefits caused by dividends, plus securities gains) from investment of the funds available through "float" caused by trading stamps issued but not yet redeemed. However, profit before securities gains and losses declined from $2,209,000 to $1,088,000, as dividend income was reduced by net sales of securities. This decline was more than offset by net securities gains, after taxes, of $4,100,000 this year compared to net securities losses last year of $77,000.

Trading stamp service revenues continued to decline — to $15,723,000 last year compared with $17,208,000 the previous year. However, the rate of decline has abated. Our motivation business continued to operate at a loss.

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 very slow rate.

As discussed extensively in previous annual reports, accounting for trading stamp redemption liability (which involves estimating the number of stamps that will ultimately be redeemed and the cost per stamp) is a difficult process when stamp issuances decline by a large percentage. We periodically revise our estimated future redemption liability as conditions warrant.

We intend to remain in the trading stamp business. We believe that we provide good and useful service to our present customers and that, given the opportunity, we can provide additional useful service to new customers.

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. In 1977 we again increased our equity, to 27%, by additional purchases of marketable non-voting stock. Our total investment at cost at yearend was $22,616,000.

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 explained in Note 4 to the accompanying financial statements, the aggregate market value of our marketable securities is slightly lower than their aggregate cost, reducing the probability of our realization of future securities gains comparable to those of 1977.

A section entitled "Principal Business Activities" and a "Summary of Operations" for a five-year period are presented beginning on page 7 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

Donald A. Koeppel

Charles T. Munger
Chairman of the Board

Donald A. Koeppel
President

February 24, 1978

Principal Business Activities

Blue Chip Stamps and its subsidiaries are engaged in five 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 confectionary products of the highest quality in two fully equipped kitchens in California. See's is believed to be one of the largest candy manufacturers distributing through its own chain of retail shops; it now has 179 in nine western states including Hawaii.

See's registered slogan "Quality Without Compromise" reflects its attitude. In order to 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 newspaper business.** Buffalo Evening News, Inc., whose assets, subject to certain liabilities, were purchased in April 1977 through a newly organized, wholly owned subsidiary, is publisher of the most widely read daily newspaper in Upstate New York. More than 4,000 paper carriers deliver the News to over two-thirds of the households in Buffalo and Erie counties.

In October 1977 the News' principal competitor brought suit under federal antitrust laws seeking to enjoin the News from engaging in certain alleged practices, and seeking to obtain damages, in connection with the News' expansion of publication to add a Sunday edition. For further information, please refer to Note 10 to the accompanying consolidated financial statements.

Most of the News' revenues are based on advertising volume, which peaks during the fourth fiscal quarter. Newsprint is generally purchased under long-term contracts from Canadian suppliers. The newspaper employs approximately 1,100 full-time employees.

(3) **The trading stamp business.** Blue Chip Stamps provides for retail merchants and their customers in California and Nevada the predominant trading stamp service in that area. 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 redemption stores.

Stamp service revenues have declined from a historical peak of $124,180,000 for the fiscal year ended February 28, 1970 to $15,723,000 for the fiscal year ended December 31, 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 47% of stamp volume during the fiscal year ended December 31, 1977 as compared with 38% the preceding fiscal year. Over the past six years the Company has reduced the number of redemption stores from a peak of 90 to 42 at present. There has been a commensurate reduction of full-time employees to less than 250 currently.

(4) **The motivation and merchandise promotion business.** Blue Chip Motivation, a separate division, operates on a nationwide basis, sharing headquarters and merchandise distribution facilities with the trading stamp business. The name of this division was changed from Blue Chip Incentives during the year in order to describe its activities more accurately. It tailors motivation programs for businesses. These programs use awards of merchandise, travel 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. The motivation business is competitive. Moreover, with the decline of the trading stamp business, motivation programs have become more difficult to sell, because stamp awards do not enjoy their former popularity. Approximately 30 employees are involved in this operation.

This division, for several years, also developed, for oil companies and other large issuers of credit cards, complete merchandise packages for their credit cardholders. 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.

(5) **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 and is believed to be among the 30 largest savings and loan associations in the state. The association competes 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 consolidated revenues or of consolidated income before income taxes, securities gains (losses) and extraordinary items for five fiscal years ended as follows:

	Dec. 31, 1977	Jan. 1, 1977*	Feb. 28, 1976	Mar. 1, 1975	Mar. 2, 1974
Revenues—					
Candy business	$63,115	$56,648	$51,679	$43,370	$36,033
Newspaper business	31,833	—	—	—	—
Trading stamp service	19,740	22,786	25,755	34,973	59,925
Motivation and merchandise promotion business	2,485	8,888	15,210	11,022	6,261
Income (loss) before income taxes, securities gains (losses) and extraordinary items—					
Candy business	12,352	11,059	10,968	6,783	4,153
Newspaper business	751	—	—	—	—
Trading stamp service	185	2,600	438	(34)	4,533
Motivation and merchandise promotion business	(634)	(1,479)	(1,079)	(592)	(66)
Savings and loan business (equity only)	5,715	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:

	Dec. 31, 1977	Jan. 1, 1977*	Feb. 28, 1976	Mar. 1, 1975	Mar. 2, 1974
Revenues—					
Candy business	54%	64%	56%	49%	35%
Newspaper business	27	—	—	—	—
Trading stamp service	17	26	28	39	59
Motivation and merchandise promotion business	2	10	16	12	6
Income (loss) before income taxes, securities gains (losses) and extraordinary items—					
Candy business	67	67	81	76	40
Newspaper business	4	—	—	—	—
Trading stamp service	1	16	3	—	44
Motivation and merchandise promotion business	(3)	(9)	(8)	(7)	—
Savings and loan business (equity only)	31	26	24	31	16

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

3

Summary of Operations

(In thousands except for amounts per share)	52 weeks ended Dec. 31, 1977	53 weeks ended Jan. 1, 1977	52 weeks ended Feb. 28, 1976	52 weeks ended Mar. 1, 1975	52 weeks ended Mar. 2, 1974
Revenues:					
Candy	$ 62,886	$56,333	$51,342	$42,907	$ 35,780
Newspaper	31,786	—	—	—	—
Stamp service	15,723	17,208	20,361	25,564	51,375
Merchandise promotions and motivation service	2,485	8,888	15,210	11,022	6,261
Dividends and interest	3,636	5,211	4,913	7,738	8,260
Other	657	682	818	2,134	543
	117,173	88,322	92,644	89,365	102,219
Costs and expenses:					
Cost of sales and services	61,592	46,358	52,116	54,912	68,156
Selling, general and administrative expenses	41,387	29,190	29,552	23,940	21,481
Interest	1,404	410	437	4,050	3,597
Discount amortization	136	184	212	306	365
	104,519	76,142	82,317	83,208	93,599
Income before income taxes, equity in net income of Wesco Financial Corporation, securities gains (losses) and extraordinary items	12,654	12,180	10,327	6,157	8,620
Provision for income taxes	(5,476)	(4,859)	(4,374)	(1,237)	(2,071)
Equity in net income of Wesco Financial Corporation	5,715	4,459	3,092	2,588	1,641
Income before securities gains (losses) and extraordinary items	12,893	11,780	9,045	7,508	8,190
Realized securities gains (losses), less taxes	4,100	(77)	8	254	(185)
Income before extraordinary items	16,993	11,703	9,053	7,762	8,005
Extraordinary credit	—	—	—	903	—
Net income	$ 16,993	$11,703	$ 9,053	$ 8,665	$ 8,005
Per share:					
Income before securities gains (losses) and extraordinary items	$2.49	$2.27	$1.75	$1.45	$1.58
Realized securities gains (losses)	.79	(.01)	—	.05	(.03)
Income before extraordinary items	3.28	2.26	1.75	1.50	1.55
Extraordinary credit	—	—	—	.17	—
Net income	$3.28	$2.26	$1.75	$1.67	$1.55
Dividends declared*	$ .30	$ .24	$ .24	$ .24	$ .24

*Dividends of $.06 per share per quarter or $.24 per share per year have been *paid*. No change in annual dividend rate occurred in 1977.

See notes and management's discussion and analysis on page 10

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.

Newspaper revenues and other accounts of the Buffalo Evening News, Inc. are included on a consolidated basis from acquisition on April 15, 1977.

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

The extraordinary credit in fiscal 1975 represents federal income tax not payable due to offset of capital loss carry-forwards.

Other revenues in fiscal 1975 include 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 5,179,000 shares of common stock outstanding throughout the five fiscal years, increased by 1,000 in 1974 to reflect the dilutive effect of outstanding stock options.

MANAGEMENT'S DISCUSSION AND ANALYSIS OF THE SUMMARY OF OPERATIONS

Candy sales increased during the fiscal year ended December 31, 1977 due, about 85%, to an increase in average selling price per pound; improved volume accounted for the remainder. Of the increase in candy sales which occurred the preceding fiscal year, approximately 60% resulted from an increase in pounds sold and 40% from pricing improvement.

The decline in stamp service revenues in recent years has been caused by various factors as explained above under Principal Business Activities.

Revenues from merchandise promotions and motivation service have decreased notably since the year ended February 28, 1976 due mainly to the Company's decision, in the summer of 1976, not to seek any more merchandise promotion business, under which the Company had developed, for oil companies and other large issuers of credit cards, complete merchandise packages for their credit cardholders.

The decline in dividend and interest income during the latest fiscal year was caused mainly by a drop in dividends on shares of Source Capital, Inc., which were sold in July 1977.

Cost of sales and services during the two most recent fiscal years was somewhat lower as a percentage of related revenues than in fiscal 1976, 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 ratio of cost to revenues on an overall basis was not significantly affected by either the acquisition of the newspaper or the discontinuance of merchandise promotion business.

The sharp increase in selling, general and administrative expenses during the most recent fiscal year was the result of the newspaper acquisition in April 1977.

Interest expense increased sharply in the latest fiscal year as a result of financing the newspaper acquisition.

The provision for income taxes varied slightly as a percentage of pre-tax income from 42% in fiscal 1976 to 40% in the fiscal year ended January 1, 1977 and to 43% in the year ended December 31, 1977 due primarily to fluctuations in dividend income, which is substantially exempt from federal taxation.

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, coupled in the later year with an increase in average ownership from 67.2% to 80.1%. Part of Wesco's earnings improvement represented an increase in realized capital gains; the Company's share amounted to $612,000. Another factor in the earlier year 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 henceforth be included in consolidated federal tax returns.

Realized securities gains and losses fluctuate from year to year and accordingly are set out separately. The exceptionally large net gains in the most recent fiscal year resulted from a profit of approximately $7,000,000, net of taxes, on sale of the Company's shares of Source Capital, Inc. in July 1977, reduced in part by net losses on other securities dispositions.

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 increase in earnings for the year ended December 31, 1977 compared to the prior year represented unusually large capital gains (see preceding two paragraphs).

Consolidated Statement of Income and Retained Earnings

Blue Chip Stamps

	52 weeks ended December 31, 1977	53 weeks ended January 1, 1977
Revenues:		
Candy	$ 62,886,000	$56,333,000
Newspaper (Note 2)	31,786,000	—
Stamp service (Note 3)	15,723,000	17,208,000
Merchandise promotions and motivation service	2,485,000	8,888,000
Dividends and interest	3,636,000	5,211,000
Other	657,000	682,000
	117,173,000	88,322,000
Costs and expenses:		
Cost of sales and services (Note 3)	61,592,000	46,358,000
Selling, general and administrative expenses	41,387,000	29,190,000
Interest and discount amortization	1,540,000	594,000
	104,519,000	76,142,000
Income before income taxes, equity in net income of Wesco Financial Corporation and securities gains (losses)	12,654,000	12,180,000
Provision for income taxes (Note 7)	(5,476,000)	(4,859,000)
Equity in net income of Wesco Financial Corporation (Notes 1 and 7)	5,715,000	4,459,000
Income before securities gains (losses)	12,893,000	11,780,000
Realized securities gains (losses), less income tax effect (Notes 4 and 7)	4,100,000	(77,000)
Net income	16,993,000	11,703,000
Retained earnings at beginning of year	79,230,000	68,770,000
Dividends declared of $.30* and $.24	(1,554,000)	(1,243,000)
Retained earnings at end of year	$ 94,669,000	$79,230,000
Amounts per share based on average shares outstanding:		
Income before securities gains (losses)	$2.49	$2.27
Realized securities gains (losses)	.79	(.01)
Net income	$3.28	$2.26

*Dividends of $.06 per share per quarter or $.24 per share per year have been *paid*. No change in annual dividend rate occurred in 1977.

See accompanying notes to consolidated financial statements

Consolidated Balance Sheet

Blue Chip Stamps

ASSETS	December 31, 1977	January 1, 1977
Cash (Note 6)	$ 5,335,000	$ 2,526,000
Short-term investments, at cost which approximates market	11,224,000	11,636,000
Marketable equity securities, at the lower of cost or market (Note 4)	53,010,000	63,143,000
Accounts receivable	6,155,000	4,633,000
Merchandise and supplies inventories, at the lower of cost (principally average) or market	7,332,000	6,493,000
Prepaid expenses, principally income taxes (Note 7)	13,142,000	12,337,000
Property, plant and equipment, net (Note 5)	40,414,000	8,417,000
Investment in Wesco Financial Corporation (Note 1)	43,892,000	38,661,000
Excess of cost over equity in net assets of consolidated subsidiaries, less accumulated amortization (Notes 1 and 2)	15,439,000	15,128,000
Other equity securities (Note 4)	4,163,000	4,163,000
	$200,106,000	$167,137,000
LIABILITIES AND STOCKHOLDERS' EQUITY		
Accounts payable and accrued expenses	$ 14,199,000	$ 6,680,000
Income taxes payable (Note 7)	4,779,000	3,315,000
Liability for unredeemed trading stamps (Note 3)	66,209,000	66,867,000
6¾% Subordinated Debentures due December 1, 1978	2,168,000	4,287,000
Note payable to bank (Note 6)	13,500,000	—
	100,855,000	81,149,000
Stockholders' equity (Note 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	94,669,000	79,230,000
Net unrealized loss on marketable equity securities (Note 4)	(2,176,000)	—
Total stockholders' equity	99,251,000	85,988,000
	$200,106,000	$167,137,000

See accompanying notes to consolidated financial statements

Consolidated Statement of Changes in Financial Position

Blue Chip Stamps

	52 weeks ended December 31, 1977	53 weeks ended January 1, 1977
Sources (uses) of cash, including short-term investments, from operations:		
Income before realized securities gains (losses)	$12,893,000	$ 11,780,000
Add (deduct):		
Depreciation and amortization	2,881,000	1,358,000
Decrease (increase) in trade accounts receivable	(3,081,000)	3,667,000
Decrease (increase) in inventories	(839,000)	1,653,000
Increase in prepaid expenses, principally income taxes	(805,000)	(5,384,000)
Equity in net income of Wesco Financial Corporation, less dividends received	(4,023,000)	(3,469,000)
Increase (decrease) in trade accounts payable and accrued expenses	6,086,000	(484,000)
Increase (decrease) in income taxes payable	1,464,000	(1,681,000)
Decrease in liability for unredeemed trading stamps	(658,000)	(2,900,000)
Cash provided by operations before realized securities gains (losses)	13,918,000	4,540,000
Other sources of cash:		
Bank loan for acquisition of newspaper	30,000,000	—
Realized securities gains (losses), less income tax effect	4,100,000	(77,000)
Decrease (increase) in marketable equity securities, net of $2,176,000 net unrealized loss deducted from stockholders' equity at December 31, 1977, and net of reversal of similar provision of $15,560,000 deducted from stockholders' equity at December 27, 1975	7,957,000	(416,000)
Decrease (increase) in accounts receivable from securities transactions	1,559,000	(1,085,000)
Assumption of pension liability upon acquisition of newspaper	1,433,000	—
Disposals of property, plant and equipment	118,000	352,000
Other	—	48,000
	59,085,000	3,362,000
Other uses of cash:		
Additions to property, plant and equipment, including $31,900,000 in the fiscal year ended December 31, 1977 relating to acquisition of newspaper	34,553,000	1,357,000
Purchase of stock of Wesco Financial Corporation	1,208,000	6,422,000
Excess of cost over equity in net assets of newspaper acquired	754,000	—
Purchase of other equity securities	—	4,163,000
Reduction of bank loan	16,500,000	—
Purchase of debentures for retirement	2,119,000	2,105,000
Declaration of cash dividends	1,554,000	1,243,000
	56,688,000	15,290,000
Increase (decrease) in cash, including short-term investments	$ 2,397,000	$ (11,928,000)
Increase (decrease) in—		
Cash	$ 2,809,000	$ 82,000
Short-term investments	(412,000)	(12,010,000)
	$ 2,397,000	$ (11,928,000)

See accompanying notes to consolidated financial statements

Notes to Consolidated Financial Statements

NOTE 1—Subsidiary Companies:

The consolidated financial statements include the accounts of the Company and its consolidated subsidiaries: See's Candy Shops, Incorporated (See's), 99%-owned, and Buffalo Evening News, Inc. (the News), wholly owned (see Note 2). The excess of cost over equity in the net assets of See's and the News is being amortized over 40 years; amortization of $443,000 and $431,000 has been charged to selling, general and administrative expenses in the fiscal years ended December 31, 1977 and January 1, 1977, respectively.

The Company's investment in Wesco Financial Corporation (Wesco), a savings and loan holding company, has increased from 64.4% at December 27, 1975 to 77.6% at January 1, 1977 and to the present 80.1% in January 1977. The investment is recorded at cost plus equity in Wesco's calendar-year net income; the $21,725,000 and $21,522,000 unamortized excess of equity in the net assets of Wesco over cost at December 31, 1977 and January 1, 1977, respectively, is being amortized over 40 years. Summarized consolidated financial information of Wesco and subsidiaries for the years ended December 31, 1977 and 1976 follows:

	December 31, 1977	December 31, 1976
Assets—		
Cash and marketable securities	$162,098,000	$155,153,000
Loans receivable, less unearned loan fees, unrealized profit and loans in process	394,125,000	347,194,000
Other assets	24,871,000	21,001,000
	$581,094,000	$523,348,000
Liabilities and stockholders' equity—		
Savings deposits	$459,908,000	$404,996,000
Other liabilities	39,777,000	41,280,000
Total liabilities	499,685,000	446,276,000
Stockholders' equity, partially appropriated	81,409,000	77,072,000
	$581,094,000	$523,348,000
Total revenues	$ 44,423,000	$ 39,391,000
Net income	$ 6,449,000	$ 5,516,000
Blue Chip Stamps' share of net income	$ 5,166,000	$ 3,708,000
Income tax benefit thereon (Note 7)	—	243,000
Amortization of excess of equity over cost	549,000	508,000
Equity in net income	$ 5,715,000	$ 4,459,000

Wesco's appropriated retained earnings at December 31, 1977 and 1976 include approximately $45,832,000 and $45,578,000, 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, 1977 and 1976.

NOTE 2—Acquisition:

Effective April 15, 1977, the Company acquired the newspaper assets, subject to certain liabilities, of the Buffalo (New York) Evening News, for approximately $34,000,000 in cash plus assumption of certain pension obligations. The acquisition has been accounted for by the purchase method, and the cost of net assets acquired exceeded their fair value by $754,000. The results of operations of the News have been included with those of the Company since the date of acquisition.

The following data present the unaudited consolidated results of operations of the Company on a pro forma basis as if the Company had owned the News throughout each of the last two fiscal years:

	Fiscal year ended	
	December 31, 1977	January 1, 1977
Total revenues	$127,816,000	$127,930,000
Income before securities gains or losses	12,392,000	10,811,000
Net income	16,492,000	10,734,000
Pro forma per share—		
Income before securities gains or losses	2.39	2.08
Net income	3.18	2.07
Actual per share—		
Net income	3.28	2.26

The above unaudited pro forma results of operations, insofar as they pertain to newspaper operations occurring prior to the acquisition of the News, are based upon unaudited financial information furnished by the former owners and reflect, among other things, additional financing costs and depreciation, net of applicable income tax benefits, and amortization of the excess of cost of net assets acquired over underlying value.

The above data are not necessarily indicative of what may be expected in the future.

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. For the fiscal year ended December 31, 1977, no adjustments were made to the liability for unredeemed stamps. During the fiscal year ended January 1, 1977, the Company reduced its liability for unredeemed trading stamps to reflect a reduction in the total estimated number of stamps expected to be redeemed in the future from 97.5% to 97% for stamps issued before March 1974, and 93% thereafter. Additionally, the Company increased its provision for future redemption service expenses per stamp to reflect its estimate that these expenses would increase materially on a per-stamp basis. The net effect of the foregoing revisions, after federal and state income taxes, was to increase net income $1,046,000 or $.20 per share for the fiscal year ended January 1, 1977.

The Company, with additional experience, will probably make further revisions of its redemption expectancy and estimated future redemption costs as circumstances warrant.

NOTE 4—Equity securities:

Cost (first-in, first-out) and market value of marketable equity securities at December 31, 1977 and at January 1, 1977 are set forth below:

	December 31, 1977	January 1, 1977
Cost	$55,186,000	$63,143,000
Market value	53,010,000	73,240,000

In order to reduce marketable equity securities to the lower of cost or market on the consolidated balance sheet, a $2,176,000 valuation allowance was required at December 31, 1977. The valuation allowance, which represented the excess of $4,545,000 of unrealized losses over $2,369,000 of unrealized gains, was charged directly to stockholders' equity (i.e., not included in the determination of net income) without reduction for the tax benefit that would result if losses were ultimately realized and offset by capital gains. As of February 24, 1978 market value of these securities has declined approximately $1,000,000 further.

Approximately $4,000,000 of the unrealized losses at December 31, 1977 relates to an investment in non-voting stock of Pinkerton's, Inc. at cost of $18,453,000. In addition, an investment of $4,163,000 in non-voting stock of Pinkerton Holding Corporation (PHC), for which there is no trading market, is carried at cost in other equity securities; because PHC's principal assets are equity securities of Pinkerton's, Inc., the amount that could be realized if the Company's investment in PHC were sold may also be below cost. Although the Company beneficially owns 28% of the equity in Pinkerton's, Inc. as of February 24, 1978, it does not account for its investment in Pinkerton's, Inc. under the equity method inasmuch as 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 twelve-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 are expected to be presented for redemption over a number of years.

NOTE 5—Property, plant and equipment:

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

	December 31, 1977	January 1, 1977
Land	$ 3,049,000	$ 2,183,000
Buildings	11,160,000	4,225,000
Fixtures and equipment	36,003,000	10,164,000
Leasehold improvements	4,528,000	4,030,000
	54,740,000	20,602,000
Less accumulated depreciation and amortization	14,326,000	12,185,000
	$40,414,000	$ 8,417,000

Depreciation and amortization of property, plant and equipment are provided by the straight-line method over the estimated useful lives of the assets. Total provisions amounted to $2,438,000 and $927,000 for the fiscal years ended December 31, 1977 and January 1, 1977, respectively.

NOTE 6—Debt:

In April 1977 the Company borrowed $30,000,000 from a bank. As a result of prepayments, the loan has subsequently been reduced to $13,500,000, repayable $3,500,000 on April 30, 1981, and $5,000,000 each on April 30, 1982 and 1983. Interest is payable monthly at rates increasing over the term from prime (7¾% at December 31, 1977) to one-half per cent above prime. The loan requires compensating balances of 10 per cent of the average outstanding principal amount initially, increasing to 15% in 1978 and 20% in 1979. All of the Company's shares of See's and the News are pledged as collateral.

The Company has a short-term line of credit of $5,000,000 requiring compensating balances of $500,000 plus 10% of any amount borrowed. At December 31, 1977, there were no borrowings under the line of credit.

NOTE 7—Taxes on income:

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

	Fiscal year ended	
	December 31, 1977	January 1, 1977
Provision for income taxes	$ 5,476,000	$ 4,859,000
Credited to equity in net income of Wesco	—	(243,000)
Charged against (credited to) securities gains (losses)	2,179,000	(42,000)
Total taxes charged in income statement	$ 7,655,000	$ 4,574,000

These taxes are payable or recoverable as follows:

	Fiscal year ended	
	December 31, 1977	January 1, 1977
Payable currently—		
Federal	$ 6,416,000	$ 4,714,000
State	1,634,000	1,340,000
	8,050,000	6,054,000
Recoverable in the future—		
Federal	(384,000)	(1,231,000)
State	(11,000)	(249,000)
	(395,000)	(1,480,000)
Total taxes charged in income statement	$ 7,655,000	$ 4,574,000

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 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	
	December 31, 1977	January 1, 1977
Deductible California franchise taxes over (under) those accrued on the books	$ (360,000)	$ 483,000
Deductible redemption expenses under those accrued on the books	(324,000)	(1,203,000)
Deferred taxes reversed on undistributed earnings of Wesco	—	(319,000)
Other timing differences	289,000	(441,000)
Total taxes recoverable in the future	$ (395,000)	$ (1,480,000)

The Company increased its ownership of Wesco to 80% in January 1977. Accordingly, the earnings of Wesco will be included in consolidated federal tax returns beginning with the fiscal year ended December 31, 1977. Consequently, deferred taxes on undistributed earnings of Wesco, provided in prior years, were reversed as of January 1, 1977.

The provision for income taxes of $5,476,000 for the fiscal year ended December 31, 1977 amounted to 43.3% of pre-tax income of $12,654,000; the provision of $4,859,000 for the prior fiscal year represented 39.9% of pre-tax income of $12,180,000. Following is a summary of the differences between the federal statutory rate and these effective percentages:

	Fiscal year ended	
	December 31, 1977	January 1, 1977
Statutory federal income tax rate	48.0%	48.0%
Federal tax benefit from dividend exclusion	(10.2)	(12.6)
State income taxes net of federal income tax benefit	4.4	4.8
All other, net	1.1	(.3)
Effective income tax rate	43.3%	39.9%

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 $11,622,000 and $11,176,000 at December 31, 1977 and January 1, 1977, 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.

The Company's Federal income tax returns through the fiscal year ended in 1974 have been examined by and settled with the Internal Revenue Service.

NOTE 8—Lease commitments and rental expense:

At December 31, 1977 minimum rental commitments, net of $134,000 minimum sublease rental income commitments, are as follows: 1978, $2,556,000; 1979, $2,272,000; 1980, $1,807,000; 1981, $1,307,000; 1982, $1,081,000; thereafter, $4,445,000.

Rentals and rental commitments apply primarily to a merchandise warehouse, redemption stores and candy shops. All leased facilities are classified as operating leases. Many of the leases contain options permitting the Company at the end of the initial lease term to renew its lease at an increased monthly rate for one or more five-year periods. Portions of store and warehouse space are sublet. Rentals applicable to candy operations are generally determined on the basis of a fixed percentage of sales subject to a specific minimum rental. Rental expense is summarized as follows:

	Fiscal year ended	
	December 31, 1977	January 1, 1977
Minimum rental expense	$3,121,000	$3,444,000
Contingent rental expense in excess of minimum rentals	1,573,000	1,504,000
Sublease rental income	(134,000)	(103,000)
	$4,560,000	$4,845,000

NOTE 9—Pension and profit sharing plans:

Employees of the Company and of its consolidated subsidiaries 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 at amounts sufficient to amortize prior service costs over a 30-year period. Pension costs for the fiscal years ended December 31, 1977 and January 1, 1977 of $1,479,000 and $397,000, respectively, included $1,061,000 in the fiscal year ended December 31, 1977 attributable to the News.

After considering amounts accrued on the consolidated balance sheet and expected future income tax savings related thereto, the total market value of the plans' assets exceeded the actuarially computed value of vested benefits at December 31, 1977 by approximately $1,750,000.

NOTE 10—Legal proceedings:

On October 28, 1977, the Buffalo Courier-Express, Inc., the principal competitor of the Buffalo Evening News (published by the Company's subsidiary, Buffalo Evening News, Inc.) in the Buffalo metropolitan area, filed an action against such subsidiary in the United States District Court under federal antitrust laws seeking to enjoin certain practices allegedly engaged in by the News in connection with its proposed expansion by transfer of its weekend edition from Saturday to Sunday, providing competition for the existing Sunday edition of the Courier-Express. In addition to seeking an injunction, the complaint seeks treble damages in an unspecified amount, attorneys' fees and costs. On November 9, 1977, the court issued a preliminary order granting in part and denying in part a motion for preliminary injunction. Among other things, the order required the News to maintain its proposed subscription pricing structure, to shorten a proposed promotional subscription pricing plan, to withdraw certain circulation guarantees and to limit free sampling. The order is subject to modification as circumstances may warrant pending trial, and is not final on any of the issues raised in the litigation. Plaintiff has moved to have defendant held in contempt for alleged violation of the preliminary injunction and seeks modification of the injunction to impose further restrictions on defendant. Defendant has also moved for modification of the injunction. Hearings on these motions have not been completed. Defendant is resisting plaintiff's motions and has reserved defendant's right to appeal the granting of the preliminary injunction to the Court of Appeals for the Second Circuit. In addition, the defendant has filed an answer and counterclaim denying all liability and seeking affirmative relief of treble damages in an unspecified amount, injunction, attorneys' fees and costs against plaintiff on the ground that plaintiff seeks to monopolize the daily newspaper business in the Buffalo metropolitan area. With discovery incomplete, the outcome of the action and defendant's potential exposure, if any, are uncertain.

NOTE 11—Major business segments:

The following information by Company segment for the fiscal year ended December 31, 1977 is furnished pursuant to a new requirement of the Financial Accounting Standards Board:

	Candy business	Newspaper business	Trading stamp and motivation businesses	Total
Revenues	$63,115,000	$31,833,000	$22,225,000*	$117,173,000*
Operating profit	$12,352,000	$ 751,000	$ 1,091,000*	$ 14,194,000*
Interest and discount amortization				(1,540,000)
Income before income taxes, equity in net income of Wesco and securities gains				$ 12,654,000*
Depreciation and amortization	$ 1,255,000	$ 1,517,000	$ 109,000	$ 2,881,000
Capital expenditures	$ 2,114,000	$32,437,000	$ 2,000	$ 34,553,000
Assets at December 31, 1977	$39,183,000	$39,798,000	$77,233,000	$156,214,000
Investment in net assets of Wesco				43,892,000
Consolidated assets at December 31, 1977				$200,106,000

*Does not include net realized securities gains of $6,279,000 which are set forth separately, after income tax effect, in the consolidated statement of income.

NOTE 12—Quarterly financial information—unaudited:

The following table sets forth certain unaudited quarterly financial information for the two fiscal years ended December 31, 1977:

	Quarter ended			
	December 31, 1977	October 1, 1977	July 2, 1977	April 2, 1977
Total revenues	$48,093,000	$22,510,000	$28,148,000	$18,422,000
Cost of sales and services	24,362,000	12,997,000	14,806,000	9,427,000
Equity in net income of Wesco	1,905,000	1,405,000	1,251,000	1,154,000
Income before securities gains or losses	6,568,000	1,228,000	2,630,000	2,467,000
Per share	1.27	.24	.50	.48
Net income	6,561,000	7,267,000	698,000	2,467,000
Per share	1.27	1.40	.13	.48

	Quarter 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 services	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
Income before securities gains or losses	5,948,000	2,153,000	2,815,000	864,000
Per share	1.14	.42	.54	.17
Net income	5,915,000	2,186,000	2,729,000	873,000
Per share	1.14	.42	.53	.17

During the fiscal year ended December 31, 1977, the Company changed its method of calculating the provision for income taxes during interim periods to comply with a new Financial Accounting Standards Board requirement. If the new method had been in effect for the fiscal year ended January 1, 1977, earnings and earnings per share would have been increased (reduced) by the following amounts:

	Quarter ended			
	January 1, 1977	September 25, 1976	June 26, 1976	March 27, 1976
Income before securities gains or losses, and net income	$ 600,000	$ (300,000)	$ 114,000	$ (414,000)
Per share	.12	(.06)	.02	(.08)

Report of Independent Accountants

Price Waterhouse & Co.

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

February 24, 1978

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 subsidiaries as of December 31, 1977 and January 1, 1977, 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 1). 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.

As explained in Note 10 to the accompanying consolidated financial statements, during 1977 a consolidated subsidiary of the Company was named a defendant in an action seeking damages for alleged violations of the antitrust laws. The outcome of this action and the potential liability, if any, cannot currently be determined. If this action should ultimately result in a liability, appropriate provision will be made in the consolidated financial statements at the time such liability is ascertained, and the 1977 consolidated financial statements will not be restated.

In our opinion, based on our examinations and the report of other independent accountants, and, in 1977, subject to the effects of such adjustments, if any, as might have been required had the outcome of the matter discussed in the preceding paragraph been known, the consolidated financial statements referred to above present fairly the financial position of Blue Chip Stamps and its consolidated subsidiaries at December 31, 1977 and January 1, 1977, 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; rancher

Donald A. Koeppel
President of the Company

Charles T. Munger
Chairman of the Board of the Company

William F. Ramsey
Retired

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

Robert H. Bird
Vice President and Chief Financial Officer

Claude G. Gelineau
Vice President, Sales

Paul F. Holzapfel
Vice President, Motivation

William K. Klepper
Vice President, Merchandise

Jackson B. Reed
Vice President, Operations

Kenneth E. Wittmeyer
Vice President, Industrial Relations

Jeffrey L. Jacobson
Treasurer

Ernest P. Paulson
Secretary and Controller

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
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
April 2, 1977	17	17¾	15¼	16
July 2, 1977	16¾	17½	15¼	16
October 1, 1977	16½	17¼	16	16¾
December 31, 1977	16½	17¼	15¼	16

A cash dividend of $.06 per share was paid in each quarter.
Bank of America, N.T.&S.A., San Francisco serves as Transfer Agent-Registrar.

WESCO FINANCIAL CORPORATION

Annual report 1977

Form 10-K Annual report 1977

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 1977 amounted to $6,449,000 ($.91 per share) compared to $5,516,000 ($.77 per share) in 1976. Quarterly earnings per share were:

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter	Year
1977	$ .19	.19	.22	.31	.91
1976	.16	.20	.21	.20	.77

The increase in earnings is due to the growth of total earning assets chiefly provided by savings growth.

Total savings in Mutual Savings increased $54,912,000 in 1977 compared to an increase of $44,926,000 in 1976. Out-of-state savings were $52,648,000 (11.4% of total savings) compared with $52,508,000 (13.3% of total savings) in 1976.

Cost of savings and cost of funds (savings and borrowings) continued to increase in 1977 due to increased deposits in certificates at a higher yield than the 5¼% passbook rate. The yield on the loan portfolio continues to rise.

	1977	1976	1975	1974	1973
Cost of savings	6.46%	6.35	6.29	6.00	5.60
Cost of all funds	6.51	6.43	6.41	6.25	5.69
Yield on loans at year end	8.02	7.70	7.55	7.36	7.17

At December 31, 1977, real estate loans were $390,569,000 compared with $347,244,000 at December 31, 1976. Real estate loans made and purchased in 1977 amounted to $107,546,000 compared to $42,386,000 made in 1976. In the second half of 1977, Mutual Savings purchased for $43,661,000 a 90% participation interest in loans from the portfolios of four large California-based savings and loan associations who service the loans. Loans in process and firm loan commitments, which were $3,260,000 at December 31, 1976, increased to $9,396,000 at December 31, 1977.

Wesco and Mutual Savings have decreased cash and short-term marketable securities by $11,156,000 in 1977 and increased the investment in common and preferred stocks by $18,101,000.

	1977	1976
Stocks and bonds	$ 64,821,000	46,720,000
Cash and marketable securities	97,277,000	108,433,000
	$162,098,000	155,153,000

The increase is in common stocks. Common stock of Federal National Mortgage Association (FNMA) was increased from 1,044,900 shares at a cost of $14,809,000 to 1,730,000 shares at a cost of $26,011,000. During the third quarter of 1977, Wesco purchased 67,500 shares of Cleveland-Cliffs Iron Company for a cost of $3,680,000. Cleveland-Cliffs Iron Company manages 13% of North American iron ore production, operates fourteen cargo vessels on the Great Lakes, sells forest products, explores for minerals and has interest in Australian iron ore production. The holdings in this Company had been increased to 152,500 shares with an investment of $8,246,000 at December 31, 1977. Wesco purchased an additional 20,000 shares in February 1978 and may continue to make additional purchases depending upon market conditions. Other securities are also being purchased in 1978.

During the second and third quarters of 1977, Wesco invested $1,580,000 at the holding company level in 92,242 shares of Detroit International Bridge Company, which owns and operates a toll bridge between Detroit, Michigan, and Windsor, Ontario, Canada. Later in the year Wesco, with the approval of the Directors of Detroit International Bridge Company, made a tender offer to purchase for cash all the remaining outstanding shares at $20 per share. The tender offer expired on October 25, 1977. At December 31, 1977, as a result of the tender offer, Wesco had increased its holding to 272,908 shares with a total cost of $5,330,000. Companies affiliated with Wesco own an additional 42,020 shares, purchased several years ago as part of insurance company portfolios. The Wesco portion represents 21.5% of the total stock outstanding, and one of Wesco's directors, Charles T. Munger, has been elected a director of Detroit International Bridge Company. After acquiring 21.5%, Wesco has accounted for its investment on the equity basis as required by accounting convention. The current annual dividend being paid by Detroit International Bridge Company amounts to approximately 7.5% on Wesco's aggregate cost.

Properties acquired by foreclosure were $2,095,000 at December 31, 1977 compared with $3,321,000 at December 31, 1976. The last vacant land at Lake San Marcos was sold in 1977 and the one-half interest in the shopping center, motel and restaurant at Lake San Marcos was sold at an unrealized profit of $890,000. The property occupied by the Upland Branch was acquired through foreclosure in 1976. $228,000 of the total cost of this property has been transferred to branch premises as it is anticipated Mutual Savings will retain ownership. The remainder of the Upland property, having a current book cost of $78,000, will be developed with retail stores to be rented for income. Construction will commence early in 1978. Negotiations are currently in progress for the sale of the commercial property in Pacoima. This property has a book cost of $289,000. The remaining balance of the foreclosed property account at December 31, 1977 was $1,728,000 and consists of vacant land at Santa Barbara and at Friendly Valley in Los Angeles County with book values of $1,042,000 and $686,000 respectively. Zoning and other plans are being processed for both parcels and it is anticipated that construction of residences will be permissible in mid-1978 at Friendly Valley and mid-1979 at Santa Barbara.

The 3-for-1 stock split in the form of a 200% stock distribution of the stock of Wesco Financial Corporation was made on April 4, 1977. The number of shares outstanding are 7,119,807. The Blue Chip Stamp Company, at the expiration of their tender offer in January of 1977, owned 80.1% of the Wesco stock. This permits a consolidated Federal income tax return to be filed.

Mutual Savings did not open any new offices in 1977 to add to their sixteen branch offices. A satellite branch office has been approved for a retail shopping center, which is scheduled for opening late 1979, in downtown Pasadena close to the main office.

On January 17, 1978, Wesco increased its regular quarterly cash dividend from $.07½ per share to $.08½ per share payable March 15, 1978 to shareholders of record at the close of business on February 20, 1978.

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

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

Form 10-K

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

For the fiscal year ended December 31, 1977 — Commission file number 1-4720

WESCO FINANCIAL CORPORATION

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	95-2109453 (I.R.S. Employer Identification No.)
315 East Colorado Boulevard, Pasadena, California (Address of principal executive offices)	91109 (Zip Code)

Registrant's telephone number, including area code (213) 684-1500

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Capital Stock, $1 par value	American Stock Exchange Pacific Stock Exchange

There were 7,119,807 shares of Capital Stock outstanding December 31, 1977

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 twelve months (or for such shorter period that the registrant was required to file such reports), Yes. .X. . No. . . . . . and (2) has been subject to such filing for the past 90 days. Yes. .X. . No. . . . . .

Item 1. BUSINESS

(a) Wesco Financial Corporation (Wesco) was incorporated on March 18, 1959. Its principal business is the ownership of all of the outstanding Guarantee Stock of Mutual Savings and Loan Association (Mutual) which serves the Southern California area through sixteen offices, of which six are in Los Angeles County, four in Orange County, two in Ventura County, three in San Diego County and one in San Bernardino County.

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 and investing in marketable securities. Mutual also owns an inactive service corporation. Funds are provided by savings deposits, principal payments on existing loans, borrowings from banks and operations. The chief sources of income to Mutual are income from marketable securities, the excess of interest received on loans and investments over the interest paid on savings deposits, and loan fees and service charges received.

Wesco acts as trustee under deeds of trust, invests in marketable securities, owns and operates the Pasadena business block in which the head office of its subsidiary Mutual is located and a minor amount of other property. Wesco also has a wholly owned subsidiary which acts as an insurance agent, principally for fire and extended coverage property insurance and mortgage life insurance.

(b) (1) Mutual's savings deposits and loans increased compared to prior years.

(2) through (6) not applicable.

(7) Compliance with environmental regulations has had no material effect as to Wesco and its subsidiaries.

(8) Wesco and its subsidiaries employed approximately 160 persons at December 31, 1977.

(9) Not applicable.

(c) Wesco and its subsidiaries are engaged in only one line of business within the definition of this item.

(d) and (e) not applicable.

Item 2. SUMMARY OF OPERATIONS

The following consolidated summary of operations for the five years ended December 31, 1977 should be read in conjunction with the related financial statements and notes thereto included under item 13.

	1977	1976	1975	1974	1973
Revenues:					
Interest on loans	$ 28,482,000	27,521,000	28,438,000	28,463,000	27,450,000
Loan fees and service charges	1,963,000	1,663,000	1,362,000	1,542,000	1,786,000
Interest and dividends on Investments	11,646,000	8,729,000	5,643,000	4,709,000	3,875,000
Other income, net	2,332,000	1,478,000	1,167,000	466,000	1,178,000
	44,423,000	39,391,000	36,610,000	35,180,000	34,289,000
Expenses:					
General and administrative expenses	5,161,000	4,944,000	4,710,000	4,208,000	3,702,000
Interest on savings deposits	28,070,000	24,428,000	21,844,000	20,419,000	20,001,000
Interest on notes payable	2,312,000	1,962,000	2,628,000	3,364,000	1,313,000
	35,543,000	31,334,000	29,182,000	27,991,000	25,016,000
Earnings before taxes on income	8,880,000	8,057,000	7,428,000	7,189,000	9,273,000
Taxes on income	2,431,000	2,541,000	3,077,000	3,262,000	4,665,000
Net earnings	$ 6,449,000	5,516,000	4,351,000	3,927,000	4,608,000
Earnings per capital share*	$ .91	.77	.61	.55	.65
Cash dividends per capital share*	$ .297	.233	.20	.167	.151
FINANCIAL DATA AT YEAR END					
Total assets	$581,094,000	523,348,000	470,127,000	465,646,000	451,980,000
Real estate loans	$387,015,000	344,567,000	371,041,000	386,398,000	387,165,000
Savings deposits	$459,908,000	404,996,000	360,070,000	333,117,000	345,530,000
Shareholders' equity	$ 81,409,000	77,072,000	73,218,000	70,291,000	67,551,000
Book value per share*	$ 11.43	10.82	10.28	9.87	9.49

*Based on 7,119,807 shares outstanding at December 31, 1977.

Management's Discussion and Analysis of Summary of Operations

Interest on Loans

This source of income is dependent upon the amount of loans and the yield thereon. The yields at December 31, 1977, 1976 and 1975 were 8.02%, 7.70% and 7.55% respectively. Total real estate loans outstanding at the end of such years were $390,569,000, $347,244,000 and $374,011,000.

Loan Fees and Service Charges

This income was derived from the following sources:

	1977	1976	1975
Loan fees	$ 849,000	701,000	721,000
Commitment fees	226,000	—	—
Escrow and clerical fees	133,000	130,000	47,000
Prepayment charges	521,000	568,000	314,000
Late charges	76,000	70,000	82,000
Other charges	158,000	194,000	198,000
	$ 1,963,000	1,663,000	1,362,000

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.

Municipal bonds in Mutual Savings showed an unrealized appreciation of $1,084,000 at December 31, 1977 compared to $1,042,000 the previous year. The current return on the tax exempt bond portfolio is 7.84%.

The amount invested in all marketable securities at December 31 for the years indicated is as follows:

	1977	1976	1975
Municipal bonds ..	$ 6,685,000	6,696,000	4,554,000
Other marketable securities	95,663,000	106,912,000	44,220,000

Dividends on Common and Preferred Stock

The increase in dividends on common and preferred stock is due to the increase in common stocks as shown on this three year schedule:

	1977	1976	1975
Common stocks ..	$ 34,257,000	14,809,000	1,853,000
Preferred stocks ..	23,879,000	25,215,000	23,206,000
	$ 58,136,000	40,024,000	25,059,000

The annual dividend income from such investments was:

	1977	1976	1975
Common stocks ..	$ 1,812,000	671,000	194,000
Preferred stocks ..	2,559,000	2,437,000	1,759,000
	$ 4,371,000	3,108,000	1,953,000

Federal National Mortgage Association (FNMA) holdings increased from $14,809,000, 1,044,900 shares to $26,011,000, 1,730,000 shares in 1977. The quarterly dividend in 1977 was $.25 per share compared to $.22 per share. Wesco, at the holding company level, invested $8,246,000 in 152,500 shares of Cleveland-Cliffs Iron Company.

Mutual Savings investments in preferred stocks are limited by regulation to 5% of assets. Although the preferred stocks were below this level at December 31, 1977 due to the call of a large issue in December, the portfolio has been increased by purchases of additional issues to a book value of $28,371,000 at February 22, 1978. 85% of the dividend income from stocks is deductible in computing Federal income taxes.

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 $133,000 was declared in 1977, $171,000 in 1976 and $198,000 in 1975 all in the fourth quarter. The variation in the secondary reserve has been nominal.

Net Gains (Losses) on Sales of Marketable Securities

The net gain of $608,000 in 1977 is accounted for by aggregate net gains on sales of securities of $208,000 and a gain of $400,000 on one issue of preferred stock called in the fourth quarter. The $26,000 net gain in 1976 and the $62,000 net gain in 1975 were the result of net gains on sales with proceeds used to purchase other issues considered more desirable.

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 $316,000 for the year 1977, $255,000 for the year 1976 and $288,000 for the year 1975. All rentable space has been leased and fully occupied since May 1977. Leases contain a provision for increase of rents as costs of operation and maintenance increase. Some improvements in net rental income will occur in 1978 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. Operations and net gains from sales of real property were as follows:

	1977	1976	1975
Gain on sales taken directly into income	$ 662,000	81,000	106,000
Amortization of unrealized profit	426,000	962,000	814,000
Rental income	148,000	136,000	151,000
Maintenance and sales expense ..	(82,000)	(97,000)	(162,000)
	$ 1,154,000	1,082,000	909,000
Unrealized profit on sales of real property at year end	$ 890,000	276,000	1,025,000

Income from sales in the next few years will be limited to that from sales of vacant land in Friendly Valley, Santa Barbara and one property in Pacoima. Rental income will decrease as the commercial property producing most of this income was sold in 1977. The unrealized profit from this sale is $890,000. The note on this property is fully due and payable in 1979. When it is paid the profit can be taken into income, which may occur before 1979 if the note is repaid before maturity. Maintenance and sales expense will decrease as Mutual disposes of the vacant land.

General and Administrative Expenses

Although general and administrative expenses increased $217,000 in 1977, $234,000 in 1976 and $502,000 in 1975, the percentage to gross income decreased from 12.9% in 1975, 12.6% in 1976 to 11.6% in 1977. The increased expense was principally caused by inflation and continued cost of computerizing our accounting system.

Interest on Savings Deposits

Total savings and interest paid for the last three years were:

	1977	1976	1975
Total savings	$459,908,000	404,996,000	360,070,000
Interest on savings	28,070,000	24,428,000	21,844,000

The increase in the interest on savings is due not only to an increase in total savings, but an increase to the higher rates of certificates of deposit. Savings deposits are summarized by interest in Note 7 of Notes to Consolidated Financial Statements.

Interest on Notes Payable

In 1977 and 1976, a 7½% rate was paid on advances made by the Federal Home Loan Bank and a 9¼% rate was paid on a note of $5,500,000 secured by the main office building and business block. Variation in rate in 1975 fluctuated from 7¼% to 10½%. Total of notes payable at year end and interest paid for each year was:

	1977	1976	1975
Notes payable	$ 27,830,000	31,356,000	26,210,000
Interest paid	2,312,000	1,962,000	2,628,000

Taxes on Income

Taxes on income were 27.4% of earnings before taxes on income in 1977, 31.5% in 1976 and 41.4% in 1975. 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% dividend received deduction on common and preferred stock. This deduction has increased as the investment in common and preferred stocks has increased. In addition, income earned on municipal obligations is tax exempt. See Note 9 of Notes to Consolidated Financial Statements for additional information.

Equity in Earnings of Affiliate

During 1977, Wesco acquired an interest in Detroit International Bridge Company. This investment is accounted for on the equity basis. See Note 6 of Notes to Consolidated Financial Statements for additional information.

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 years 1975 and 1976. The New York Stock Exchange suspended trading Wesco stock on March 4, 1977 and Wesco stock began trading on the American Stock Exchange March 7, 1977. Therefore, the quarterly high and low prices for part of March and the remaining three quarters of 1977 reflect trading on the American Stock Exchange. Wesco issued a 3-for-1 stock split on April 4, 1977 which is reflected during the quarter ended June 30, 1977.

	1977		1976		1975	
Quarter Ended	High	Low	High	Low	High	Low
March 31	20⅛	19¾	15⅝	10	11¾	8⅜
June 30*	19¾	19⅜	15¼	13¼	12	10⅞
June 30**	7⅝	5⅞				
September 30	8	6¼	15½	13⅜	11⅞	9
December 31	8⅛	6¾	20	15½	10⅛	8⅞

*Before 3-for-1 split in 1977
**After 3-for-1 split in 1977

Item 3. PROPERTIES

The occupancy of the sixteen offices of Mutual, all serving Southern California, is as follows:

Head Office located at 315 East Colorado Boulevard, Pasadena, California 91109, leased by Mutual from Wesco, which is its parent company, under lease which expires June 14, 1984.

Glendale Office located at 336 North Brand Boulevard, Glendale, California 91203, owned in fee simple by Mutual.

Covina Office located at 200 North Citrus Avenue, Covina, California 91723, owned in fee simple by Mutual.

West Arcadia Office located at 660 West Duarte Road, Arcadia, California 91006, leased by Mutual with one ten-year and two five-year options which will permit occupancy to June 10, 2001.

Corona Del Mar Office located at 2867 East Coast Highway, Corona del Mar, California 92625, leased by Mutual for a five-year period which expires July 14, 1979. Mutual has taken an option on a vacant corner near this location and presently intends to build a new building. The lease will be for an initial term of thirty years and grants Mutual six additional five-year options which will permit occupancy to May 1, 2038.

Canoga Park-Chatsworth Office located at 8393 Topanga Canyon Boulevard, Canoga Park, California 91304, leased by Mutual under a lease which expires May 31, 1980. Four consecutive five-year options to May 31, 2000 have been granted to Mutual.

Thousand Oaks Office located at 1330 Moorpark Road, Thousand Oaks, California 91360, leased by Mutual under a twenty-year lease to March 31, 1993, with a five-year renewal option to March 31, 1998.

Capistrano-San Clemente Office located at 570 Camino de Estrella, San Clemente, California 92672, leased by Mutual under a twenty-year lease with options for three additional five-year terms which will run through December 4, 2010.

Vista Office located at 1010 East Vista Way, Suite A, Vista, California 92083, leased by Mutual under a lease which runs through May 1, 1982 with options to extend to May 1, 2002.

Santa Ana Office located at 631 North Main Street, Santa Ana, California 92701, leased by Mutual under a lease to November 1, 1978, with three three-year options to November, 1987.

Channel Islands Office located at 739 W. Channel Island Boulevard, Port Hueneme, California 93041, leased by Mutual under a lease to August 13, 1990.

Fountain Valley Office located at 17900 Magnolia Street, Fountain Valley, California 92708, leased by Mutual under a lease to 1991 with options to 2006.

Lake San Marcos Office located at 1143-322 San Marino Drive, Lake San Marcos, California 92069, leased by Mutual for a five-year period which expires November 30, 1979, with four additional five-year options to November 30, 1999.

Upland Office located at 160 West Foothill Boulevard, Upland, California 91786, owned in fee simple by Mutual.

Cerritos Office located at 13343 Artesia Boulevard, Cerritos, California 90701, leased by Mutual under a lease to May 31, 1978 with an additional option to May 31, 1985.

Fallbrook Office is presently located at 119 East Ivy, Fallbrook, California 92028. The present lease runs to April 30, 1978 with additional options to October 31, 1981. Mutual has acquired property at 116 through 124½ South Main Street in Fallbrook, where it will build a permanent office.

In the opinion of management, all these properties are adequate and suitable for the needs of Mutual.

Item. 4. PARENTS AND SUBSIDIARIES

Blue Chip Stamps, a California corporation, owns 80.1% of the outstanding stock of Wesco. At December 31, 1977, Wesco owned 100% of the voting securities of the following subsidiaries, both of which are incorporated in California and are included in its consolidated financial statements herein.

Mutual Savings and Loan Association
WSC Insurance Agency

Mutual owns 100% of the voting securities of Wes-Fin Service Corp., a California corporation, which is included in the consolidated financial statements.

Wesco owns 21.5% of Detroit International Bridge Company, which is incorporated in Michigan. Wesco accounts for this investment on the equity basis. Detroit International Bridge Company files separate consolidated financial statements with its wholly owned subsidiary, The Canadian Transit Company.

Item 5. PENDING LEGAL PROCEEDINGS

During recent years, a number of class actions against numerous savings and loan associations and other lenders in California have been pending regarding interest on impound accounts, late charges, prepayment fees and due-on-sale clauses (a clause which permits the entire balance of the loan to become due upon the sale of the mortgaged property). Mutual Savings was at one time a named defendant in several of these actions. However, at the present time, there are only two such class actions in which Mutual Savings is a named defendant, both of which have been in a dormant status for over four years. In one of these, the case of Gabriel W. Solomon et al. vs. United Savings and Loan Association et al., Kern County Superior Court Case No. 123271, filed on May 18, 1973 against 175 savings and loan associations in California seeking refunds of late charges as invalid under Civil Code Sections 1670 and 1671, Mutual has not been served. The action was removed to the U. S. District Court for the Eastern District of California (U. S. District Court No. F887-Civil) on November 1, 1973.

The other such action is the Los Angeles Superior Court Case No. 66361, Martin S. Stolzoff dba Westminster Investment Company et al. vs. Mutual Savings and Loan Association filed on September 5, 1973 which makes a similar charge with regard to late charges collected on delinquent loans by Mutual Savings. It seeks refund of the late charges with estimates exceeding $1,000,000.

In Wesco's opinion, these aforementioned actions will not have a material effect on its financial statements.

Wesco Financial Corporation and Blue Chip Stamps have been named as defendants in two lawsuits brought by Jerry D. Luptak. Both of these cases, which relate to a tender offer made by Wesco for shares of Detroit International Bridge Company, are described below.

(1) Jerry D. Luptak v. Wesco Financial Corporation, Blue Chip Stamps, and Detroit International Bridge Company, United States District Court for the Eastern District of Michigan, No. 772460; (2) Jerry D. Luptak v. Central Cartage Co., Centra, Inc., Wesco Financial Corporation, Blue Chip Stamps, Joseph W. Bower, Robert A. Bower, Philip L. Carret, Charles J. Clark, Q.C., Arthur H. Lamborn, Roy G. Lancaster, Harold A. Ruemenapp, H. Peter Schaub, Jr. and Detroit International Bridge Company (DIBC), United States District Court for the Eastern District of Michigan, No. 870068.

In the first case, plaintiff sought injunctive relief prohibiting Wesco from proceeding with its tender offer for DIBC, requiring it to divest the shares obtained through the tender offer, and prohibiting it from voting shares of DIBC held by it. The Complaint alleged violations of federal securities laws in connection with the disclosures and alleged failures to disclose made in the offer to purchase and information statement that was circulated to DIBC shareholders, particularly, but not exclusively, in connection with the description of the operation and effect of the Canadian Foreign Investment Review Act. The United States District Court for the Eastern District of Michigan, on November 2, 1977, issued an "Order Denying Motion for Preliminary Injunction and Order Dismission Complaint". The plaintiff moved for a new trial and, on December 28, 1977, the court issued an "Order Denying Motion for New Trial and Reconsideration". Plaintiff has now filed a notice of appeal from these orders with the United States Court of Appeals for the Sixth District.

In the second case, filed on January 10, 1978, plaintiff purports to sue individually, and on behalf of all other shareholders of DIBC, and derivatively on behalf of DIBC. The Complaint alleges violations of federal securities laws in connection with the disclosures and alleged failures to disclose in the offer to purchase and information statement circulated to DIBC shareholders in connection with Wesco's tender offer. The Complaint seeks to enjoin defendants from acquiring any further shares of DIBC and from voting any shares acquired by them since September 30, 1977. It also seeks to require the return or divestment of all shares acquired since September 30, 1977, and a judgment in favor of plaintiff for "such damages as are attributable to the illegal actions of defendants". Wesco Financial Corporation and Blue Chip Stamps expect to contest this action vigorously.

Item 6. INCREASES AND DECREASES IN OUTSTANDING SECURITIES AND INDEBTEDNESS

Capital stock $1 par value	
Total shares outstanding at December 31, 1976	2,373,269
Total shares issued in connection with 3-for-1 stock split in the form of a 200% stock dividend on April 4, 1977	4,746,538
Total shares outstanding at December 31, 1977	7,119,807

Authorized shares were increased from 2,500,000 to 7,500,000. The 4,746,538 shares issued in connection with the stock split were not registered under the Securities Act of 1933 because, in the opinion of Wesco's counsel, the issuance of said shares did not constitute a sale within the meaning of Section 2(3) of the Act.

Item 7. CHANGES IN SECURITIES AND CHANGES IN SECURITY FOR REGISTERED SECURITIES

Not applicable.

Item 8. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

Item 9. APPROXIMATE NUMBER OF EQUITY SECURITY HOLDERS

Title of Class	Number of Record Holders
Capital stock $1 par value	1,579

Item 10. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

Notice of Annual Meeting of Stockholders, held April 19, 1977, and proxy soliciting the vote of stockholders for the election of directors were mailed to all stockholders on March 18, 1977. The following directors were elected to hold office until the next annual meeting of stockholders and until their respective successors shall have been duly elected and qualified:

Louis R. Vincenti
William T. Caspers
David K. Robinson
James N. Gamble
Elizabeth Caspers Peters
Warren E. Buffett (Resigned October 18, 1977)
Charles T. Munger

A Consent Statement and Consent Form soliciting the written consent of stockholders to the amendment of Wesco's Certificate of Incorporation to increase the authorized number of shares which Wesco shall have the authorization to issue from 2,500,000 shares to 7,500,000 shares, was mailed to all stockholders on February 2, 1977. 2,248,500 affirmative consents were received, 124,769 consents were not executed, and no negative votes were cast.

Item 11. EXECUTIVE OFFICERS OF THE REGISTRANT

Louis R. Vincenti, Chairman of the Board and President, and Bette Deckard, Secretary and Treasurer, are the sole executive officers of Wesco. The other principal officers of Wesco are also listed below. There is no family relationship between any of them. All officers are elected to serve for one year and until their successors shall have been elected and qualified.

Name and Position	Age
LOUIS R. VINCENTI	72

Chairman of the Board and President
Mr. Vincenti has served as Chairman of the Board for Wesco and Mutual Savings since 1973. He has served as President of Wesco and Mutual Savings since 1961.

BETTE DECKARD — 58

Secretary-Treasurer
Mrs. Deckard has served as Secretary-Treasurer of Wesco and Mutual Savings since 1975. From 1974 to 1975, she served as Vice President and Treasurer for Mutual Savings. From 1971 to 1974, Mrs. Deckard held the position of Vice President and Assistant Treasurer of Mutual Savings.

JOHN R. ARMETTA — 57

Vice President, Property Development
Mr. Armetta has served as Vice President in charge of Property Development for Wesco since 1973 and has served as a Senior Vice President for Mutual Savings since 1969.

HAROLD R. DETTMANN — 55

Vice President, Operations
Mr. Dettmann has served as Vice President in charge of Operations for Wesco since 1976 and as Senior Vice President for Mutual Savings since 1974. From 1971 to 1974, he served as Vice President and Operations Officer for Mutual Savings.

PHILIP E. LYNN — 65

Vice President, Loan Processing
Mr. Lynn has served as Vice President in charge of Loan Processing for Wesco since 1969 and as Senior Vice President for Mutual Savings since 1967.

ROBERT E. SAHM — 50

Vice President, Building Management
Mr. Sahm has served as Vice President in charge of Building Management since 1971 and as Building Manager since 1967.

Item 12. INDEMNIFICATION OF DIRECTORS AND OFFICERS

Section NINTH (6) and (7) of Wesco's Articles of Incorporation provides, under certain conditions and subject to certain limitation, that Wesco, its subsidiaries Mutual Savings and Loan Association, WSC Insurance Agency, Wes-Fin Service Corp., and agents of said subsidiaries, shall be eligible for indemnification by Wesco under the provisions of Section 145 of Chapter 1 of Title 8 of the Delaware Code, as amended.

Since February 1975, the directors and officers liability insurance coverage has been on a joint policy with Blue Chip Stamps and See's Candy Shops, Incorporated.

Item 13. FINANCIAL STATEMENTS, EXHIBITS FILED AND REPORTS ON FORM 8-K

(a) Index to financial statements, schedules, and exhibit filed with this report:

Accountants' Report

Financial Statements

Consolidated Balance Sheets — December 31, 1977 and 1976

Consolidated Statements of Earnings — Years ended December 31, 1977 and 1976

Consolidated Statements of Stockholders' Equity — Years ended December 31, 1977 and 1976

Consolidated Statements of Changes in Financial Position — Years ended December 31, 1977 and 1976

Notes to Consolidated Financial Statements

Schedules

I — Marketable Securities — Other Security Investments

III — Investments in, equity in earnings of, and dividends received from affiliates and other persons

XV — Supplementary income statement information

All other schedules have been omitted as the required information is inapplicable or is presented in the consolidated financial statements or related notes.

Parent company financial information, including Balance Sheets, Statements of Earnings and Statements of Changes in Financial Position are contained in Note 2 of Notes to Consolidated Financial Statements.

Exhibits

Exhibit I — Resolution of Board of Directors Amending By-Laws

(b) Form 8-K — September, 1977 reporting tender offer for the outstanding stock of Detroit International Bridge Company filed October 4, 1977

Form 8-K — October, 1977 reporting Revised Offer to Purchase to the stockholders of Detroit International Bridge Company filed October 31, 1977.

ACCOUNTANTS' REPORT

The Board of Directors
Wesco Financial Corporation:

We have examined the balance sheets of Wesco Financial Corporation and Wesco Financial Corporation and subsidiaries as of December 31, 1977 and 1976 and the related statements of earnings, stockholders' equity and changes in financial position for the years then ended. We have also examined the schedules listed in the accompanying index. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the financial position of Wesco Financial Corporation and Wesco Financial Corporation and subsidiaries at December 31, 1977 and 1976 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; and the supporting schedules, in our opinion, present fairly the information set forth therein.

Peat, Marwick, Mitchell & Co.

Los Angeles, California
January 27, 1978

Consolidated Balance Sheets

December 31, 1977 and 1976

ASSETS	1977	1976
Cash	$ 1,614,000	1,521,000
Short-term bank obligations	21,800,000	16,700,000
Certificates of deposit and banker's acceptances, at amortized identified cost, which approximates market	65,863,000	80,262,000
United States Government and agency obligations and other securities, at amortized identified cost (quoted market, $7,983,000 in 1977 and $9,908,000 in 1976)	8,000,000	9,950,000
Municipal obligations, at amortized identified cost (quoted market, $7,769,000 in 1977 and $7,738,000 in 1976)	6,685,000	6,696,000
Investment in common stocks (quoted market, $34,426,000 in 1977 and $17,763,000 in 1976) (note 3)	34,257,000	14,809,000
Investment in preferred stocks (quoted market, $25,904,000 in 1977 and $28,488,000 in 1976) (note 3)	23,879,000	25,215,000
Loans receivable, less unearned loan fees, unrealized profit and loans in process (notes 4 and 8)	394,125,000	347,194,000
Accrued interest and dividends receivable	3,338,000	3,074,000
Properties purchased and held for investment, at cost	—	89,000
Properties acquired through foreclosure by Mutual Savings and held for sale, at cost, less allowance for losses of $192,000 in 1977 and 1976	2,095,000	3,321,000
Investments required by law:		
Investment in stock of Federal Home Loan Bank, at cost (note 8)	3,337,000	3,593,000
Prepayments to FSLIC secondary reserve	4,331,000	4,608,000
Investment in affiliated company (note 6)	5,330,000	—
Office properties and equipment, net (notes 5 and 8)	5,389,000	5,059,000
Prepaid expenses and sundry assets, at cost	1,051,000	1,257,000
	$581,094,000	523,348,000

LIABILITIES AND STOCKHOLDERS' EQUITY	1977	1976
Savings deposits (note 7)	$459,908,000	404,996,000
Notes payable (note 8)	27,830,000	31,356,000
Advances by borrowers for taxes and insurance	600,000	479,000
Accounts payable and sundry accrued expenses	1,146,000	1,099,000
Cash disbursements to be funded at bank	723,000	668,000
Taxes on income (note 9):		
Current	2,128,000	229,000
Deferred	7,350,000	7,449,000
Total liabilities	499,685,000	446,276,000
Stockholders' equity (notes 9, 10, 13 and 14):		
Capital stock of $1 par value per share. Authorized 7,500,000 shares; issued 7,119,807 shares	7,120,000	2,373,000
Capital surplus arising from stock dividends	23,319,000	28,066,000
Retained earnings	50,970,000	46,633,000
Total stockholders' equity	81,409,000	77,072,000
Commitments and contingent liabilities (notes 11 and 15)		
	$581,094,000	523,348,000

See accompanying notes to consolidated financial statements.

Consolidated Statements of Earnings

Years ended December 31, 1977 and 1976

	1977	1976
Revenues:		
Interest on loans	$ 28,482,000	27,521,000
Loan fees and service charges	1,963,000	1,663,000
Interest on marketable securities	6,840,000	5,135,000
Dividends on common and preferred stocks	4,371,000	3,108,000
Interest and dividends on investments required by law	435,000	486,000
Net gains (losses) on sales of marketable securities	608,000	26,000
Equity in earnings of affiliate (note 6)	150,000	—
Operations and net gains from sales of real property (note 12)	1,154,000	1,082,000
Other income, net	420,000	370,000
	44,423,000	39,391,000
Expenses:		
General and administrative expenses	5,161,000	4,944,000
Interest on savings deposits	28,070,000	24,428,000
Interest on notes payable	2,312,000	1,962,000
	35,543,000	31,334,000
Earnings before taxes on income	8,880,000	8,057,000
Taxes on income (note 9):		
Current	2,530,000	2,283,000
Deferred	(99,000)	258,000
	2,431,000	2,541,000
Net earnings	$ 6,449,000	5,516,000
Earnings per capital share based on 7,119,807 shares (note 10)	$ .91	.77
Cash dividends per share based on 7,119,807 share (note 10)	$ .297	.233

Consolidated Statements of Stockholders' Equity

Years ended December 31, 1977 and 1976

	1977	1976
Capital stock (note 10)	$ 7,120,000	2,373,000
Capital surplus arising from stock dividends (note 10)	23,319,000	28,066,000
Retained earnings:		
Appropriated (notes 9 and 13):		
Beginning of year	44,768,000	44,130,000
Allocation of net earnings	254,000	638,000
End of year	45,022,000	44,768,000
Unappropriated (note 14):		
Beginning of year	31,104,000	27,888,000
Cash dividends declared and paid	(2,112,000)	(1,662,000)
Allocation of net earnings	6,195,000	4,878,000
End of year	35,187,000	31,104,000
Less stock dividends at market value	(29,239,000)	(29,239,000)
Total retained earnings	50,970,000	46,633,000
Total stockholders' equity	$ 81,409,000	77,072,000

See accompanying notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

Years ended December 31, 1977 and 1976

	1977	1976
Funds provided:		
Net earnings	$ 6,449,000	5,516,000
Charges (credits) to earnings not requiring (providing) funds:		
Depreciation and amortization	414,000	344,000
Interest on savings deposits credited to savings accounts	21,670,000	18,537,000
FSLIC primary premium transferred from secondary reserve	106,000	96,000
Deferred income taxes (note 9)	(99,000)	258,000
Equity in net earnings of affiliate	(126,000)	—
Amortization of fees and discounts	(210,000)	(245,000)
Recognition of unrealized profit on real property	(426,000)	(962,000)
Interest income on FSLIC secondary reserve	(302,000)	(313,000)
Funds provided from operations	27,479,000	23,231,000
Principal payments on real estate loans	64,230,000	69,216,000
Additions to deferred loan fees	153,000	81,000
Sales of real property, net of gains	1,488,000	556,000
Increase in notes payable	—	5,146,000
Increase in loans in process	320,000	620,000
Additions to unrealized profit on real property	1,040,000	159,000
Increase in savings deposits	33,242,000	26,389,000
Decrease in stock of Federal Home Loan Bank	256,000	374,000
Increase in advances by borrowers for taxes and insurance	121,000	—
Decrease in cash	—	2,085,000
Other, net	2,415,000	—
Total funds provided	$130,744,000	127,857,000
Funds used:		
Cash dividends declared and paid (note 15)	$ 2,112,000	1,662,000
Decrease in notes payable	3,526,000	—
Investment in real estate loans	107,546,000	42,386,000
Increase in loans on savings accounts	4,483,000	609,000
Investment in buildings and other assets	796,000	330,000
Additions to real property	187,000	406,000
Investment in affiliated company, net (note 6)	5,205,000	—
Decrease in advances by borrowers for taxes and insurance	—	300,000
Increase in marketable securities	6,852,000	79,799,000
Increase in cash	36,000	—
Other, net	—	2,365,000
Total funds used	$130,744,000	127,857,000

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

December 31, 1977 and 1976

(1) Summary of Significant Accounting Policies

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

Principles of Consolidation

The 1977 consolidated financial statements include the accounts of Wesco Financial Corporation (the Company) and its wholly owned subsidiaries, WSC Insurance Agency, and Mutual Savings and Loan Association and its wholly owned subsidiary (Mutual Savings). The 1976 consolidated financial statements include the accounts of the Company and its wholly owned subsidiary Mutual Savings and Loan Association and its wholly owned subsidiaries (Note 6). All material intercompany transactions have been eliminated.

The Company's investment in the common stock of an affiliated company is stated at cost as adjusted for the Company's share of reported earnings or losses less amortization of excess cost.

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 3 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) Parent Company Financial Information (Wesco Financial Corporation)

ASSETS

	1977	1976
Cash	$ 11,580,000	4,130,000
Certificates of deposit and banker's acceptances, at amortized identified cost, which approximates market	—	16,940,000
Investment in common stocks (quoted market, $8,692,000 in 1977)	8,246,000	—
Investment in preferred stocks (quoted market, $276,000 in 1977 and $279,000 in 1976)	267,000	267,000
Real estate loans receivable	604,000	202,000
Accrued interest and dividends receivable	4,000	241,000
Properties purchased and held for investment, at cost	—	89,000
Investments in subsidiaries and affiliated company at equity	63,182,000	57,064,000
Office properties and equipment, net	3,920,000	3,990,000
Prepaid expenses and sundry assets, at cost	235,000	497,000
	$ 88,038,000	83,420,000

LIABILITIES AND STOCKHOLDERS' EQUITY

	1977	1976
Note payable	$ 5,467,000	5,500,000
Accounts payable and sundry accrued expenses	780,000	790,000
Taxes on income:		
Current	361,000	223,000
Deferred	21,000	(165,000)
Total liabilities	6,629,000	6,348,000
Stockholders' equity:		
Capital stock of $1 par value per share. Authorized 7,500,000 shares; issued 7,119,807 shares	7,120,000	2,373,000
Capital surplus arising from stock dividends	23,319,000	28,066,000
Retained earnings:		
Appropriated	45,022,000	44,768,000
Unappropriated	35,187,000	31,104,000
Less stock dividends at market value	(29,239,000)	(29,239,000)
	50,970,000	46,633,000
Total stockholders' equity	81,409,000	77,072,000
Commitments and contingent liabilities		
	$ 88,038,000	83,420,000

STATEMENTS OF EARNINGS

Year ended December 31

	1977	1976
Revenues:		
Dividends from consolidated subsidiaries	$ 5,209,000	4,800,000
Dividends from affiliate	74,000	—
Interest on loans	47,000	23,000
Loan fees and service charges	57,000	85,000
Interest on marketable securities, including interest on deposits in Mutual Savings of $304,000 in 1977 and $75,000 in 1976	1,085,000	1,022,000

STATEMENTS OF EARNINGS (Continued)

	1977	1976
Dividends on common and preferred stocks	134,000	24,000
Net gain (loss) on sales of marketable securities	19,000	(78,000)
Rental of office premises, net	316,000	255,000
Gain on sale of real estate owned	599,000	—
	7,540,000	6,131,000
Expenses:		
General and administrative expenses	382,000	321,000
Interest on notes payable, including interest on loan payable to Mutual Savings of $126,000 in 1976	513,000	126,000
	895,000	447,000
Earnings before items shown below	6,645,000	5,684,000
Taxes on income	651,000	501,000
Equity in undistributed earnings of subsidiaries and affiliate		
Subsidiaries	379,000	333,000
Affiliate	76,000	—
Net Earnings	$ 6,449,000	5,516,000

STATEMENTS OF CHANGES IN FINANCIAL POSITION

Year ended December 31

	1977	1976
Funds provided:		
Net earnings	$ 6,449,000	5,516,000
Charges (credits) to earnings not requiring (providing) funds:		
Depreciation and amortization	227,000	227,000
Deferred income taxes	186,000	(43,000)
Recognition of unrealized profit on real property	(54,000)	—
Undistributed earnings of subsidiaries and affiliate	(455,000)	(333,000)
Funds provided from operations	6,353,000	5,367,000
Principal payments on real estate loans	178,000	40,000
Sales of real property, net of gains	100,000	—
Issuance of notes payable	—	5,500,000
Decrease in marketable securities	8,693,000	—
Other, net	627,000	—
Total funds provided	$ 15,951,000	10,907,000
Funds used:		
Cash dividends declared and paid	$ 2,112,000	1,662,000
Investment in affiliated company	5,663,000	—
Investment in buildings and other assets	167,000	17,000
Decrease in notes payable	33,000	2,430,000
Investment in real estate loans	526,000	—
Increase in cash	7,450,000	3,432,000
Increase in investments in marketable securities	—	3,180,000
Other, net	—	186,000
Total funds used	$ 15,951,000	10,907,000

(3) Marketable Equity Securities

The investment in preferred stocks of $23,879,000 in 1977 and $25,215,000 in 1976 includes marketable equity securities amounting to $13,167,000 and $12,474,000, respectively, at cost. All common stocks, amounting to $34,257,000 in 1977 and $14,809,000 in 1976 at cost, are marketable equity securities. Gross unrealized gains and losses are as follows:

	1977	1976
Gross unrealized gains	$ 1,173,000	3,959,000
Gross unrealized losses	(277,000)	—
	$ 896,000	3,959,000

(4) Loans Receivable

Loans receivable are summarized as follows:

	1977	1976
Real estate loans on residential property of:		
One to four units (home loans)	$304,760,000	259,307,000
More than four units	72,869,000	76,184,000
Real estate loans on other properties	12,940,000	11,753,000
	390,569,000	347,244,000
Less:		
Unearned loan fees	(591,000)	(648,000)
Unrealized profit on sales of real property	(890,000)	(276,000)
Loans in process	(2,073,000)	(1,753,000)
	387,015,000	344,567,000
Loans on savings deposits	7,110,000	2,627,000
	$394,125,000	347,194,000
Number of loans	14,188	13,382

Included in real estate loans on residential property are insured FHA and partially guaranteed VA loans aggregating $2,612,000 for 1977 and $3,104,000 for 1976.

(5) Office Properties and Equipment, Net

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

1977	Company	Consolidated
Land	$ 1,386,000	1,650,000
Office buildings and leasehold improvements	5,280,000	6,418,000
Furniture, fixtures and equipment	6,000	1,265,000
	6,672,000	9,333,000
Accumulated depreciation and amortization	(2,752,000)	(3,944,000)
	$ 3,920,000	5,389,000

1976	Company	Consolidated
Land	$ 1,386,000	1,569,000
Office buildings and leasehold improvements	5,123,000	6,134,000
Furniture, fixtures and equipment	6,000	986,000
	6,515,000	8,689,000
Accumulated depreciation and amortization	(2,525,000)	(3,630,000)
	$ 3,990,000	5,059,000

(6) Investment in Affiliated Companies

During 1977 the Company acquired 21.5% of the common stock of Detroit International Bridge Company. The excess of cost over equity in net assets of $3,104,000 is being amortized over the period expected to be benefited which is 40 years.

At June 30, 1977 the Company received all issued and outstanding capital stock of WSC Insurance Agency as a dividend from Mutual Savings and Loan Association.

(7) Savings Deposits

Savings account balances at December 31 are summarized as follows:

	Stated Rate	1977	%	1976	%
Passbook	5¼%	$158,347,000	35	149,093,000	37
Bonus	5½	2,293,000	—	3,011,000	1
	5¾	16,205,000	4	15,786,000	4
	6	982,000	—	993,000	—
		19,480,000	4	19,790,000	5
Certificates	5¾	3,881,000	1	1,829,000	1
	6	10,433,000	2	16,992,000	4
	6½	56,614,000	12	48,420,000	12
	6¾	13,395,000	3	12,432,000	3
	7	656,000	—	2,514,000	1
	7½	129,511,000	28	118,363,000	29
	7¾	67,107,000	15	33,805,000	8
$100,000 Minimum Certificates	6½ - 7¾	484,000	—	1,758,000	—
		282,081,000	61	236,113,000	58
		$459,908,000	100	404,996,000	100

(8) Notes Payable

The following is a summary of notes payable:

	1977	1976
Company:		
Note payable, secured by main office land, buildings, and assignment of leases, with interest at 9.25%	$ 5,467,000	5,500,000
Mutual:		
Federal Home Loan Bank advances, secured by certain real estate loans amounting to $50,905,000 in 1977 and $59,586,000 in 1976 and Federal Home Loan Bank stock, with interest at 7.50%	22,363,000	25,856,000
	$ 27,830,000	31,356,000

Notes payable mature as follows:

	Company	Consolidated
1978	$ 39,000	3,533,000
1979	43,000	3,537,000
1980	47,000	3,541,000
1981	51,000	3,545,000
1982	56,000	3,550,000
Thereafter	5,231,000	10,124,000
	$ 5,467,000	27,830,000

(9) 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, 1977 and 1976 include approximately $45,832,000 and $45,578,000, 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 through 1976 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 1977 and 1976 include the following components:

	1977		1976	
	Current	Deferred	Current	Deferred
Federal	$1,548,000	(132,000)	1,482,000	129,000
State	982,000	33,000	801,000	129,000
Total	$2,530,000	(99,000)	2,283,000	258,000

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 1977 and 1976 and the tax effect of each were as follows:

	1977	1976
Gain on sale of property, recognized on installment basis for taxes $	127,000	23,000
Financial statement recognition of loan fees less than tax recognition	(277,000)	(611,000)
California franchise tax recognized for financial statement purposes on accrual basis, but on cash basis for tax purposes	(94,000)	(25,000)
FSLIC secondary reserve interest income recognized on the financial statements, but deferred for tax purposes	12,000	55,000
Investment income recognized for financial statement purposes on accrual basis, but on cash basis for tax purposes	209,000	857,000
Other timing differences	(76,000)	(41,000)
	$ (99,000)	258,000

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:

	1977	1976
Computed "expected" Federal taxes $	4,262,000	3,867,000
Increases (reductions) in taxes resulting from:		
Net gains on sales of foreclosed real property	(187,000)	(459,000)
State franchise tax, net of Federal income tax benefit	528,000	484,000
Tax benefit on capital gain items, taxed at a lower rate	(183,000)	(4,000)
Dividends received deduction on common and preferred stocks	(1,831,000)	(1,268,000)
Interest on municipal obligations	(253,000)	(233,000)
Other permanent differences	95,000	154,000
	$ 2,431,000	2,541,000

(10) Capital Stock

On January 18, 1977, the Company announced a three-for-one stock split to be effected in the form of a 200% stock dividend. The Company's Articles of Incorporation were amended to increase the authorized number of shares from 2,500,000 shares to 7,500,000 shares. The stock dividend was distributed on April 4, 1977 to shareholders of record at the close of business on March 18, 1977. The number of shares issued increased from 2,373,269 to 7,119,807 shares. The par value of the 4,746,538 shares issued was transferred to common stock from capital surplus. Per share amounts have been restated giving retroactive effect to the stock split.

(11) Retirement Plan

A noncontributory retirement plan is in effect for all eligible employees of the Company and its subsidiaries. Eligibility is based on age and certain minimum working hour requirements. Employer contributions are computed utilizing the aggregate cost funding method. The contributions for 1977 and 1976 approximated $114,000 and $111,000, respectively. The actuarially computed value of vested benefits as of December 31, 1977 did not exceed the market value of the assets of the retirement fund.

The retirement plan was 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.

(12) Real Estate Operations

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

	1977	1976
Recognized net gains from sales	$ 1,088,000	1,043,000
Income from rentals	148,000	136,000
	1,236,000	1,179,000
Less maintenance and sales expense	(82,000)	(97,000)
	$ 1,154,000	1,082,000

(13) 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, 1977 and 1976.

(14) Dividends

Quarterly cash dividends declared and paid during 1977 amounted to $2,112,000. Quarterly cash dividends declared and paid during 1976 amounted to $1,662,000.

(15) 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 acitons 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.

(16) Interim Period Consolidated Operating Highlights

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

	Three-month reporting period ended			
	Mar. 31, 1977	Jun. 30, 1977	Sept. 30, 1977	Dec. 31, 1977
	(Unaudited)			
Revenues	$10,307,000	10,399,000	11,182,000	12,535,000
Expenses	8,966,000	9,033,000	9,623,000	10,352,000
Net earnings	$ 1,341,000	1,366,000	1,559,000	2,183,000
Earnings per share based on 7,119,807 shares	$ .19	.19	.22	.31
	Mar. 31, 1976	Jun. 30, 1976	Sept. 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 7,119,807 shares	$ .16	.20	.21	.20

WESCO FINANCIAL CORPORATION

Schedule III

INVESTMENTS IN, EQUITY IN EARNINGS OF, AND DIVIDENDS RECEIVED FROM AFFILIATES AND OTHER PERSONS

Years ended December 31, 1977 and 1976

COLUMN A	COLUMN B		COLUMN C		COLUMN D		COLUMN E		COLUMN F
	BALANCE AT BEGINNING OF PERIOD		ADDITIONS		DEDUCTIONS		BALANCE AT END OF PERIOD		
NAME OF ISSUER AND DESCRIPTION OF INVESTMENT	Number of Shares or Units. Principal Amount of Bonds and Notes	Amount in Dollars	Equity Taken Up in Earnings (Losses) of Affiliates and Other Persons For the Period	Other	Distribution of Earnings by Persons In Which Earnings (Losses) Were Taken Up	Other	Number of Shares or Units. Principal Amount of Bonds and Notes	Amount in Dollars	Dividends Received During the Period From Investments Not Accounted For By the Equity Method
Mutual Savings and Loan Association:									
Guarantee stock of $100 par value:									
1976	600(1)	$ 56,731,000	5,133,000	—	4,800,000	—	600(1)	$ 57,064,000	
1977	600(1)	$ 57,064,000	5,578,000	—	4,800,000	409,000(3)	600(1)	$ 57,433,000	
WSC Insurance Agency Capital stock of $1 par value:									
1976	—	$ —	—	—	—	—	—	$ —	
1977	—	$ —	10,000	409,000(3)	—	—	10,000(1)	$ 419,000	
Detroit International Bridge Company $1 par value:									
1976	—	$ —	—	—	—	—	—	$ —	
1977	—	$ —	150,000	5,279,000	74,000	25,000(4)	272,908(2)	$ 5,330,000	

(1) 100% of the outstanding shares.

(2) 21.5% of the outstanding shares.

(3) Wesco received 100% of the outstanding common stock of WSC Insurance Agency as a dividend from Mutual Savings and Loan Association, a wholly owned subsidiary, on June 30, 1977.

(4) Amortization of excess purchase price.

WESCO FINANCIAL CORPORATION

Schedule I

MARKETABLE SECURITIES — OTHER SECURITY INVESTMENTS

December 31, 1977

COLUMN A	COLUMN B	COLUMN C and E	COLUMN D
NAME OF ISSUER AND TITLE OF EACH ISSUE	NUMBER OF SHARES OR PAR VALUE	COST OF EACH ISSUE AND AMOUNT ON THE BALANCE SHEET	VALUE BASED ON MARKET QUOTATIONS AT BALANCE SHEET DATE
United States Government	$ 5,000,000	$ 5,000,000	$ 4,983,000
General Motors Acceptance Corporation	3,000,000	3,000,000	3,000,000
	$ 8,000,000	$ 8,000,000	$ 7,983,000
Securities issued by States & Municipalities	$ 6,685,000	$ 6,685,000	$ 7,769,000
Common Stocks:			
FNMA	1,730,000	$ 26,011,000	$ 25,734,000
Cleveland-Cliffs Iron Company	152,500	8,246,000	8,692,000
	1,882,500	$ 34,257,000	$ 34,426,000
Preferred Stocks:			
Pacific Gas and Electric	188,600	$ 4,560,000	$ 4,800,000
Southern California Edison	41,700	3,945,000	4,229,000
Columbia Gas System Inc.	60,200	3,048,000	3,449,000
Consolidated Natural Gas	25,000	2,589,000	2,900,000
Issued by others	198,251	9,737,000	10,526,000
	513,751	$ 23,879,000	$ 25,904,000

WESCO FINANCIAL CORPORATION

Schedule XV

SUPPLEMENTARY INCOME STATEMENT INFORMATION

Years ended December 31, 1977 and 1976

The following amounts have been charged to expenses in the statements of earnings:

	Year ended December 31			
	1977		1976	
	Company	Consolidated	Company	Consolidated
Maintenance and repairs	$ 501,000	557,000	398,000	438,000
Depreciation and amortization of office properties and equipment	227,000	414,000	227,000	344,000
Taxes, other than taxes on income:				
Payroll taxes	10,000	126,000	11,000	125,000
Property taxes	177,000	295,000	205,000	292,000
Advertising	—	552,000	—	520,000

PART II

Wesco has filed with the Securities and Exchange Commission a definitive Proxy Statement pursuant to Regulation 14A involving the election of directors within 120 days after the close of its fiscal year ended December 31, 1977. Pursuant to the Rules of the Commission by virtue of such filing the information called for in Items 14-18 of this Form 10-K Annual Report has been omitted.

SIGNATURES

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.

WESCO FINANCIAL CORPORATION
(Registrant)

Louis R. Vincenti

By: Louis R. Vincenti, President

Date: March 30, 1978

BOARD OF DIRECTORS

LOUIS R. VINCENTI
Chairman of the Board and President

***WILLIAM T. CASPERS**
Personal Investments

***DAVID K. ROBINSON**
Partner of Hahn & Hahn, Attorneys at Law

***JAMES N. GAMBLE**
Investment Counselling and Trust Administration

ELIZABETH CASPERS PETERS
Personal Investments

CHARLES T. MUNGER
Chairman of the Board, Blue Chip Stamps (trading stamps and control of subsidiaries, See's Candy Shops, Incorporated, Wesco Financial Corporation and Buffalo Evening News, Inc.)

*Audit Committee Member

BETTE DECKARD
Secretary and Treasurer

SUBSIDIARY, MUTUAL SAVINGS, EXECUTIVE OFFICERS

LOUIS R. VINCENTI
President

JOHN R. ARMETTA
Senior Vice President, Property Development

H. R. DETTMANN
Senior Vice President, Operations

H. J. HARRISON
Senior Vice President, Loans

P. E. LYNN
Senior Vice President, Loan Processing

WANDA G. MOTES
Senior Vice President, Savings

TRANSFER AGENTS AND REGISTRARS

SECURITY PACIFIC NATIONAL BANK
P.O. Box 3546 Terminal Annex, Los Angeles, California 90051

MANUFACTURERS HANOVER TRUST COMPANY
4 New York Plaza, New York, New York 10004

LEGAL COUNSEL

Hahn & Hahn

AUDITORS

Peat, Marwick, Mitchell & Co.

LISTED ON

American Stock Exchange
Pacific Stock Exchange

315 East Colorado Boulevard, Pasadena, California 91109 • (213) 684-1500

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