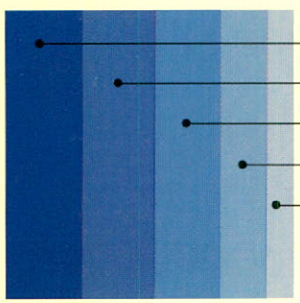
Colt Industries

Annual Report for 1978

Colt Industries had the best year in its history in 1978. Earnings were up 25 percent on a 19 percent increase in sales. New highs were established in sales, earnings, earnings per share, and order backlog. And the company entered 1979 stronger than ever before.

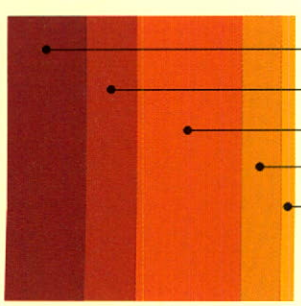
The breadth and balance that have been built into the company's earnings base are clearly apparent in the segment charts below. They are the strength behind the record 1978 performance and the most important of our strengths for the future.

Operating Income by Industry Segment



29%	Industrial and Power Equipment
25%	Fluid Control Systems
23%	Materials
16%	Industrial Seals and Components
7%	Shock Mitigation Systems
100%	

Sales by Industry Segment



28%	Industrial and Power Equipment
18%	Fluid Control Systems
37%	Materials
14%	Industrial Seals and Components
5%	Shock Mitigation Systems
(2%)	Intersegment Elimination
100%	

Financial Highlights

Colt Industries Inc and Subsidiaries

Year ended December 31

	(In thousands of dollars, except per share data)	
	1978	1977
Sales	**$ 1,807,882**	$ 1,525,484
Net earnings	**87,020**	69,460
Earnings per common share:		
Including common equivalent share	**6.66**	5.40
Assuming full dilution	**6.07**	4.87
Common share dividends:		
Total paid	**25,492**	19,516
Per share rate at year-end	**2.10**	1.83⅓
Average number of shares:		
Common and common equivalent basis	**12,565,000**	12,073,000
Fully diluted basis	**14,304,000**	14,230,000
Working capital	**503,441**	473,118
Long-term debt	**294,296**	301,326
Shareholders' equity	**563,541**	503,597
Return on shareholders' equity at year-end	**15.4%**	13.8%
Book value per common share	**38.96**	33.83
Order backlog	**791,708**	613,341
Shareholders of record:		
Preferred	**8,874**	9,728
Common	**29,013**	29,121
Number of employees	**33,100**	30,800

All share and per share amounts have been adjusted to give effect to the three-for-two stock split in the form of a 50% stock dividend distributed on June 30, 1978.

Cover: Menasco landing gear is widely used on private and corporate jetliners like the Rockwell International Sabreliner 60. This versatile aircraft meets business transportation, military airlift, and air taxi requirements and carries up to ten passengers. Menasco California Division produces both nose and main landing gear assemblies.

To Our Shareholders

George A. Strichman
Chairman of the Board

Your company achieved in 1978 a 25 percent increase in earnings on a 19 percent increase in sales and the highest sales, earnings, earnings per share, and order backlog in its history.

Net earnings in 1978 were $87,020,000, equal to $6.66 a common share, on sales of $1,807,882,000. This compares with 1977 net earnings of $69,460,000, equal to $5.40 a common share, on sales of $1,525,484,000. Earnings per share in both years reflect the three-for-two stock split in the form of a 50 percent stock dividend distributed June 30, 1978.

Each Segment Contributed

This performance, and the fact that each of the five industry segments comprising the company contributed to it, dramatically underscores the importance of the breadth and balance that have been built into the company's earnings base over the past several years. Among the five industry segments, increases in operating income ranged from four to 37 percent, and increases in sales volume ranged from 14 to 34 percent. All but one of our divisions increased sales in 1978, and virtually all entered 1979 with higher order backlogs. Several divisions established sales and earnings records of their own. It was, in short, an excellent year.

While the company exceeded 1974 record sales in 1976, it was not until 1978 that we exceeded the 1974 highs in net earnings and earnings per share. It is important to note, in this regard, that 1974 was a year of most unusual demand in the industrial sector and that, except for that unusual peak in 1974, the company's growth trendline through the seventies has climbed steadily and substantially.

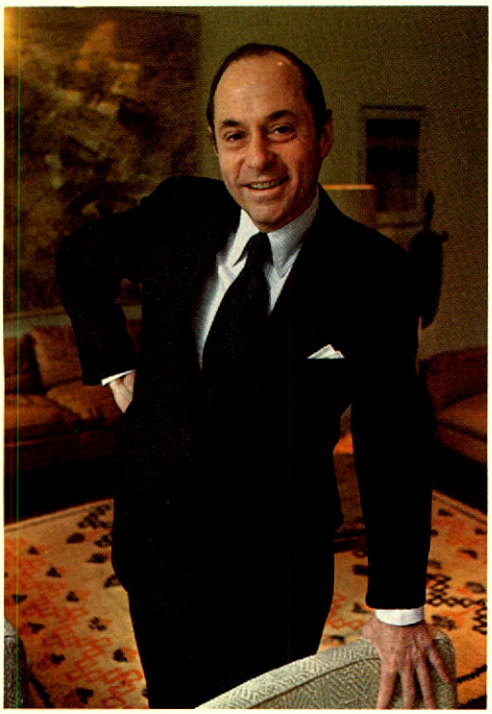
Our sales in 1978 were 2½ times higher and our net earnings were more than six times higher than in 1970. This trendline is clearly demonstrated in the charts in the Financial Review section of this report.

Demand for the company's specialty steels increased significantly during the year, primarily from the automotive and aerospace industries. The Crucible Specialty Metals Division had an excellent year. While demand for our Crucible Stainless Steel Division products was up, prices did not cover the increased costs of production. Earnings for our specialty steels businesses as a whole were, therefore, essentially level with those of a year ago.

Plant and equipment expansion projects in such basic industries as power generation, chemicals, and petrochemicals remained flat during the year, and this affected both our specialty steels businesses and our sales of Trent welded stainless steel pipe and tubing. On the other hand, replacement sales by our Garlock industrial seals and components divisions were up substantially, attesting further to the multimarket, multiproduct strengths and balance of the company.

Fuel Management Systems

Holley Carburetor Division growth over the past several years has been substantial. To assure the direct management attention necessary for continued growth, we have created three Holley divisions, each with a specific product and market area responsibility. Robert M. Burns, president of the Holley Carburetor Division since 1969, was elected a vice president of Colt Industries and will direct the operations of these three new Holley divisions and of F. D. Farnam Co., a leading supplier of auto-



David I. Margolis
President

motive gaskets acquired in January 1979. Long a leader in automotive carburetion systems, Holley is aggressively developing non-carburetor automotive fuel management systems.

In another important organization move during the year, we decentralized and strengthened Garlock international marketing operations by establishing responsibility for international sales with the Garlock operating divisions in the United States.

To meet increased demand for the Holley line of fuel-efficient carburetors for 1980 and 1981 cars and trucks, construction began in 1978 on a new carburetor assembly and test plant in Bowling Green, Kentucky. The Central Moloney Transformer Division is constructing a plant for the production of epoxy components for its own use and for sale to other electrical equipment manufacturers. We continue to make capital expenditures for environmental control at our Midland, Pennsylvania specialty steels mill.

In keeping with our aggressive program of product improvements and extensions, there were in 1978 a number of significant product developments. Among these were a new wear-resistant tool steel and new corrosion-resistant stainless steels produced by our Crucible Particle Metallurgy process, increased capability in our Pratt & Whitney and Elox production equipment, new corrosion-resistant Trent stainless tubing for seawater applications, a new Stemco truck wheel bearing lubrication system, and several new Garlock sealing products.

Growth in Dividend Rate

At the annual meeting in May, the Board of Directors increased the quarterly dividend rate from 68¾ to 78¾ cents per common share and voted a three-for-two stock split. In keeping with the company's growth, there have been six increases in the dividend rate in the past six years; and, adjusted for the 1978 stock split, the annual rate has increased from 40 cents per common share at the beginning of 1973 to $2.10 in 1978. In the five years since we introduced a Dividend Reinvestment Plan, more than 2,300 shareholders have joined, with the largest increase in new participants coming after the 1978 improvement in the plan whereby the company pays bank fees and brokerage commissions on purchases of common stock.

Robert A. Alberty, Dean, Massachusetts Institute of Technology School of Science, and General Louis T. Seith (U.S. Air Force-Retired) were elected directors. George R. Harrison joined Alva W. Phelps as a Director Emeritus.

Your company entered 1979 with an order backlog up 29 percent over the prior year and with a significantly strengthened position as a leading supplier to the industrial sector of the U.S. economy.

George A. Strichman
Chairman of the Board

David I. Margolis
President

January 26, 1979

Industrial and Power Equipment

The company's Industrial and Power Equipment businesses accounted for 28 percent of sales and 29 percent of operating income in 1978. Operating income for the segment was up 15 percent on a 14 percent gain in sales over 1977.

The Industrial and Power Equipment industry segment includes Quincy compressors, Fairbanks Morse diesel engines, Central Moloney transformers, Fairbanks industrial scales, Pratt & Whitney machine tools, Elox electrical discharge machining equipment, Trent welded stainless steel pipe and tubing, Crucible permanent magnets, Crucible heavy-duty coil springs, and Colt firearms.

Compressor, Engine Gains

The Quincy Compressor Division established new highs in both sales and orders in 1978, with the principal growth thrust coming from its basic reciprocating and rotary screw compressor product line. With modifications in its rotary screw compressors, the division entered the market for gas gathering and high-pressure air drilling and expects further growth in petroleum industry applications.

The Fairbanks Morse Engine Division achieved record sales for the second consecutive year. While shipments of Colt-Pielstick diesel engines remained level, there were significant gains in shipments of opposed piston engines and of aftermarket replacement parts. Shipments of opposed piston engines to the municipal market were up, and shipments of spark-ignited opposed piston engines to the gas industry were double those in 1977. New orders for opposed piston engines in 1978 were up significantly over the prior year and included four 12-

1. Air filter is changed on a Quincy helical screw, skid-mounted air compressor that supplies more than 800 cubic feet per minute of high pressure air to an exploratory drilling rig in the natural gas fields of west Texas.

2.Towboat powered by two 10-cylinder Fairbanks Morse diesel engines maneuvers its barges in the Intracoastal Waterway near Vermilion Bay in southern Louisiana. Each of the opposed piston diesel engines delivers more than 1600 horsepower to a twin propeller propulsion system.

3. Five Fairbanks Morse 10-cylinder opposed piston, spark-ignited engines fueled with natural gas power large reciprocating gas line compressors at a natural gas plant along the Gulf Coast. Except for the fuel, these engines are the same design as those that power towboats.

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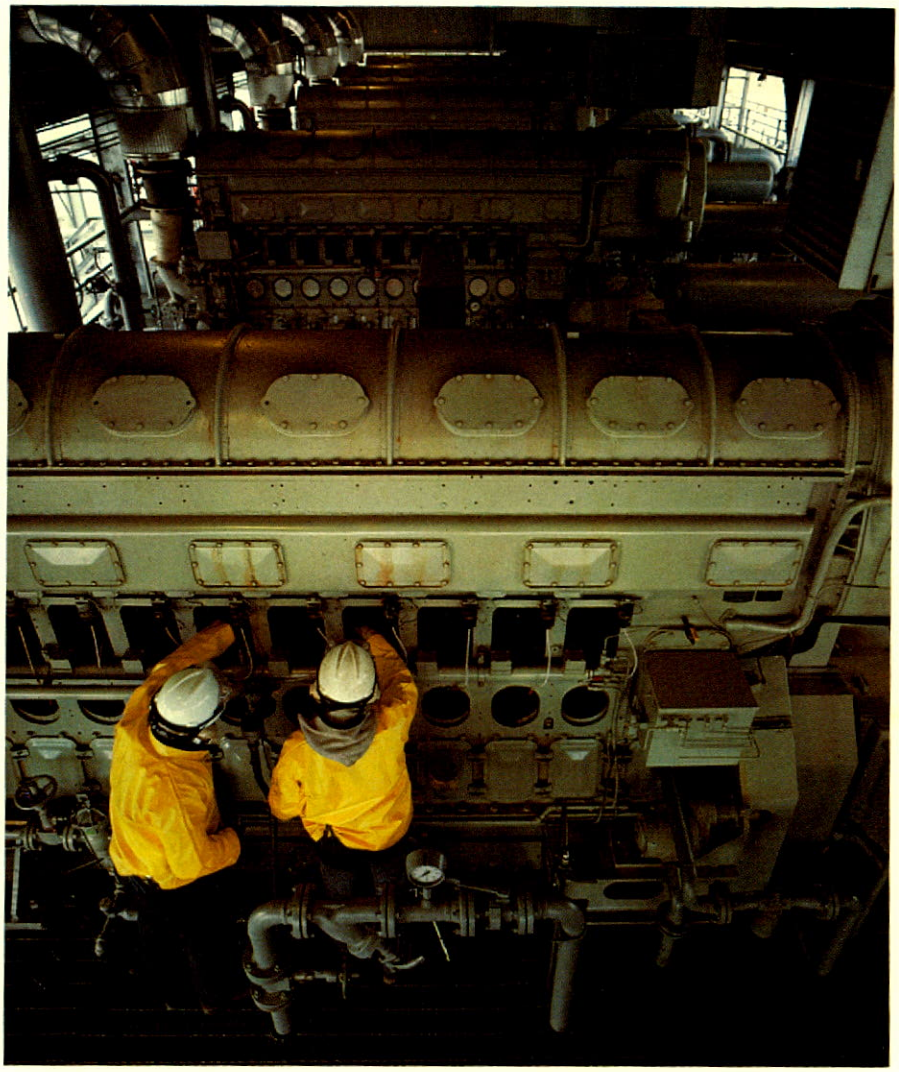

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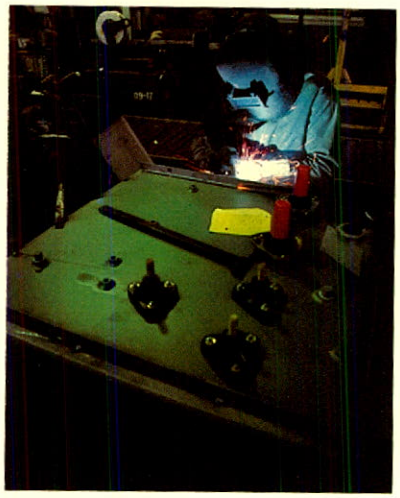

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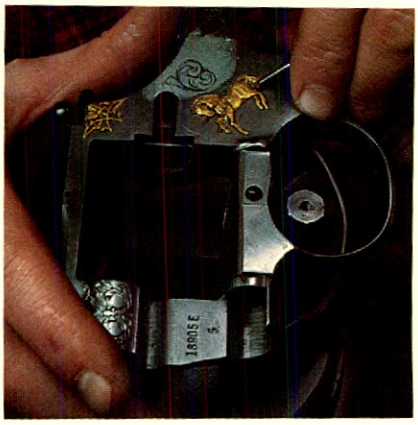


cylinder marine propulsion engines for Martinac Shipbuilding at Tacoma, Washington, three 8-cylinder generator sets for use by Newport News Shipbuilding in the SN688 nuclear submarine program, and fifteen 12-cylinder generator sets for municipal electric power use.

Orders for the division's Colt-Pielstick engines in 1978 exceeded shipments and are expected to increase further in 1979. Orders booked include four nuclear standby 16-cylinder engines for Public Service of Indiana, two 16-cylinder engines for use in a new Great Lakes ore boat, and two 12-cylinder engines for Ecuador for power generation.

The Central Moloney Transformer Division continued to expand beyond its traditional market stronghold in the southern tier of states and has established strong footholds in the Midwest, Rocky Mountain, and western markets. Demand was up for pole-mounted transformers and, because of the high level of new housing construction, was particularly strong for the division's pad-mounted transformers. A new facility is under construction for the production of epoxy components both to meet division needs and for sale to other manufacturers.

Despite mixed demand in markets served, the Fairbanks Weighing Division established sales and order records in 1978. Softness in solid waste disposal and agricultural markets was more than offset by strength in natural resources and food processing, particularly meat processing. The division's service business continued to grow, the portable truck scale product line was expanded, and the Series 7 Dataprinter was introduced with a variety of programmable functions.

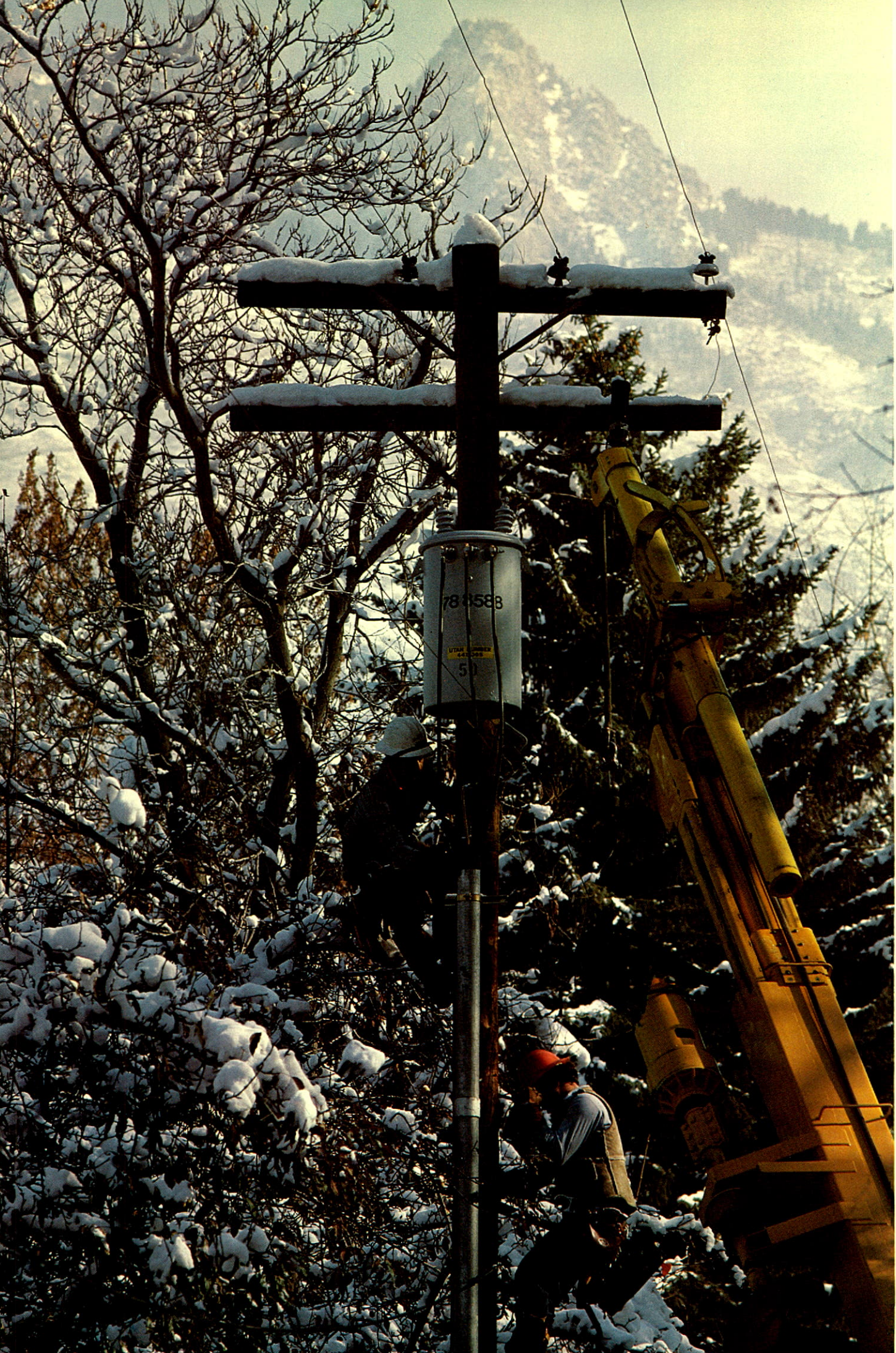
Pratt & Whitney Machine Tool Division sales were up significantly in 1978, and the division increased substantially its incoming orders.

1. Fairbanks stainless steel electronic scale with digital readout and data printer weighs and prints labels for each carton of produce at Marval Poultry Co., a 40,000-bird-per-day turkey processing plant in Virginia.

2. Master engraver in the Colt Custom Gun Shop inlays 24-karat gold on a Colt revolver ordered by a collector.

3. Central Moloney pad-mounted transformer is fabricated in Pine Bluff, Arkansas factory. As more new housing developments place utility lines underground, orders for Central Moloney pad-mounts have increased.

4. A Central Moloney 50 KVA pole-mounted transformer replaces a smaller capacity model in a Salt Lake City suburb where, as in many communities, residential demand for electricity has been growing steadily.



Demand was high across the full line of Pratt & Whitney machine tools and was particularly strong for numerically controlled lathes, vertical machining centers, and Wolverine copy milling machines. Demand came principally from automotive and industrial component suppliers and the aerospace industry.

Enhanced Competitive Position

The division is steadily improving its competitive position by taking full advantage of computer numerical controls (CNC) and advanced mechanical design across its entire line of machine tools. New automatic tool changers and work-transfer and work-handling devices expand the capability of the division's horizontal and vertical machining centers. New CNC turning centers provide shaft and chucking capability in a single line of advanced machines.

New Wolverine models with advanced electronic features, such as direct digitizing from models, provide added flexibility for automotive tool and die work; and multiple-spindle arrangements of these machines help improve productivity in aerospace plants. A single line of advanced computer numerical controls with new diagnostic and optimization features is applied across the division's machines. Completion of transfer of the division's cutting tool business to the Fastcut Operation has improved efficiency in a single, expanded cutting tool plant. Demand in 1978 increased not only for Fastcut end mills but also for Haber and Sterling metal forming tools.

High demand for its electrical discharge machining equipment from the tool, die, and mold industry and also from the aircraft engine

1. Missile component is precision-machined on Pratt & Whitney metal-working lathe recently installed at Texas Instruments plant in Sherman, Texas. New in 1978, the Star-Turn 1800 offers eleven interchangeable components including chuck, headstock, drive motor, and tool-changing turret.

2. New Pratt & Whitney internal supermicrometer provides direct internal measurement to 10 millionths of an inch or .001 millimeter. Digital readout with floating zero can be metric or English at the flip of a switch.

3. Fully computer-controlled, the Elox 300 wire-cut machine produces a die of tool steel which will be used to stamp millions of parts for staplers. Brass cutting wire conducts 3,000 volts of electricity to remove steel to dimensions correct to millionths of an inch.

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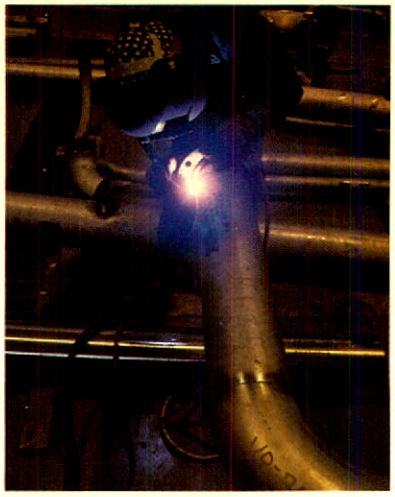

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industry brought record 1978 sales for the Elox Division. The division continued its product development program and introduced in 1978 a new power supply; a new small-capacity, high-precision electrical discharge machine for tool and die makers; and two new wire-cut EDM models, each with microprocessor computer control systems.

While sewage treatment and aerospace markets were strong in 1978, the Trent Tube Division continued to be affected by the low level of capital projects in the power generation and chemical industries. Preliminary test results on the division's Sea-Cure ferritic alloy tubing for seawater and similarly corrosive environment applications are encouraging. The new tubing is in test use at 17 installations in the United States and two in Europe. Trent Tube B.V. in Helmond, The Netherlands, completed its plant expansion, including the capacity to produce large-diameter piping for which demand is increasing. A substantial order for LNG piping was received from Sonatrach in Algeria.

Magnetics Performance Strong

Crucible Magnetics Division sales and new orders were up in 1978 on the continued strength of markets for durable goods. There is a trend away from alnico to ferrite and rare earth magnets, and the division is a leading supplier of both these magnet types. Crucible Spring Division sales were up in response to increased production of railroad cars. Firearms Division sales were down due in large measure to the low level of orders for the M16 military rifle. For collectors and sportsmen, the division will resume the sale in 1979 of a line of black powder revolvers that has not been produced in more than 100 years.

1. Crucible permanent magnets are vital to these automobile radio and tape deck loudspeakers. Every loudspeaker produced contains at least one magnet. Radio, television, and stereophonic sound systems are among the division's most important markets.

2. Railroad car wheel assemblies are inventoried at the Greenville Steel Car Co., a Crucible Spring Division customer. While most Crucible hot-wound alloy steel springs are used in freight car suspension systems, many are used throughout industry.

3. Lap joint flange is welded to a custom-bent section of Trent 304L stainless steel pipe at a major pipe fabricator prior to shipment to TVA power plant.

4. Plastic-wrapped stainless steel pipe, much of it from Trent Tube Division, ready for shipment after custom bends and fittings have been added at ITT Grinnell Industrial Piping Inc. This welded stainless steel pipe will carry fluids at high temperatures and pressures.

Fluid Control Systems

Fluid Control Systems businesses accounted for 18 percent of total company sales in 1978 and 25 percent of operating income. Earnings for the segment were up 37 percent on a 34 percent gain in sales. The three divisions in this segment are Holley Carburetor Division, Chandler Evans Control Systems Division, and Fairbanks Morse Pump Division.

Holley Carburetor Division sales were up substantially in 1978 on the strength of increased demand from both original equipment manufacturers and the automotive aftermarket. Holley is the leader in small car carburetion, and the accelerated shift toward smaller, more fuel-efficient cars was the primary stimulant to division growth. The demand for the division's air injection pumps also increased in response to emission-control and fuel-economy requirements.

Fuel Management Systems

Holley supplies carburetors for many of the smaller cars and was selected in addition to supply Chevrolet four-cylinder cars for the 1979 model year. During the year, Holley received a commitment from Ford Motor Company to furnish a carburetor for its new four-cylinder car, code-named ERIKA, beginning in the 1981 model year.

Long a leader in carburetion technology, Holley has launched an intensive research and development program on non-carburetor fuel management systems; and early in 1979, Holley began road tests of a new system for the controlled delivery of fuel to a car engine.

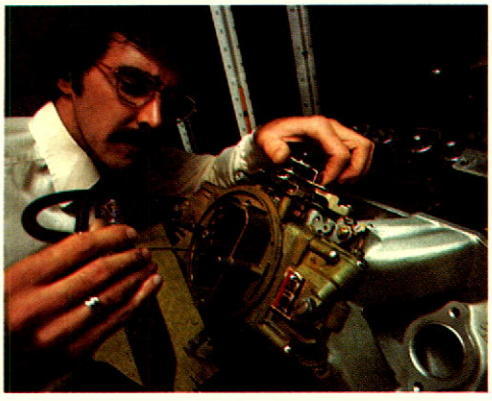
To meet the substantial growth achieved by the Holley Carburetor Division over the past several years and to provide for continued growth, the division was divided into three operating divisions: the

1. Ford Motor Company 1979 Mustang uses engines with Holley Carburetor Division two-barrel, electronically controlled, fuel-metering carburetors designed to meet federal fuel-economy and federal and state emission-control requirements.

2. Holley engineer checks engine intake manifold capacity on airflow test stand. Holley Replacement Parts Division has responsibility for engineering, distribution, and sale of Holley products to the performance market and automotive aftermarket.

3. Air pump housings in production at Holley Special Products Division plant in Sallisaw, Oklahoma. Pumps inject air into automobile engine exhaust systems to help reduce emissions.

4. Holley design engineers Ken Bier, Warren Cowles, and Harry Sherwin work on advanced non-carburetor automotive fuel management system.



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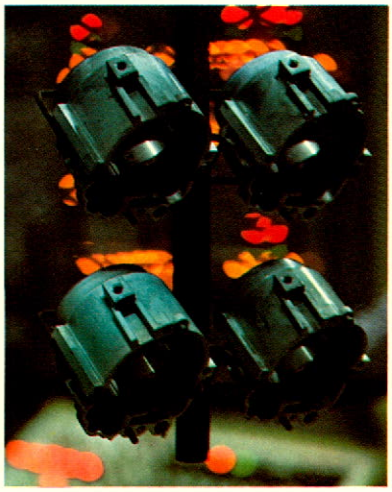

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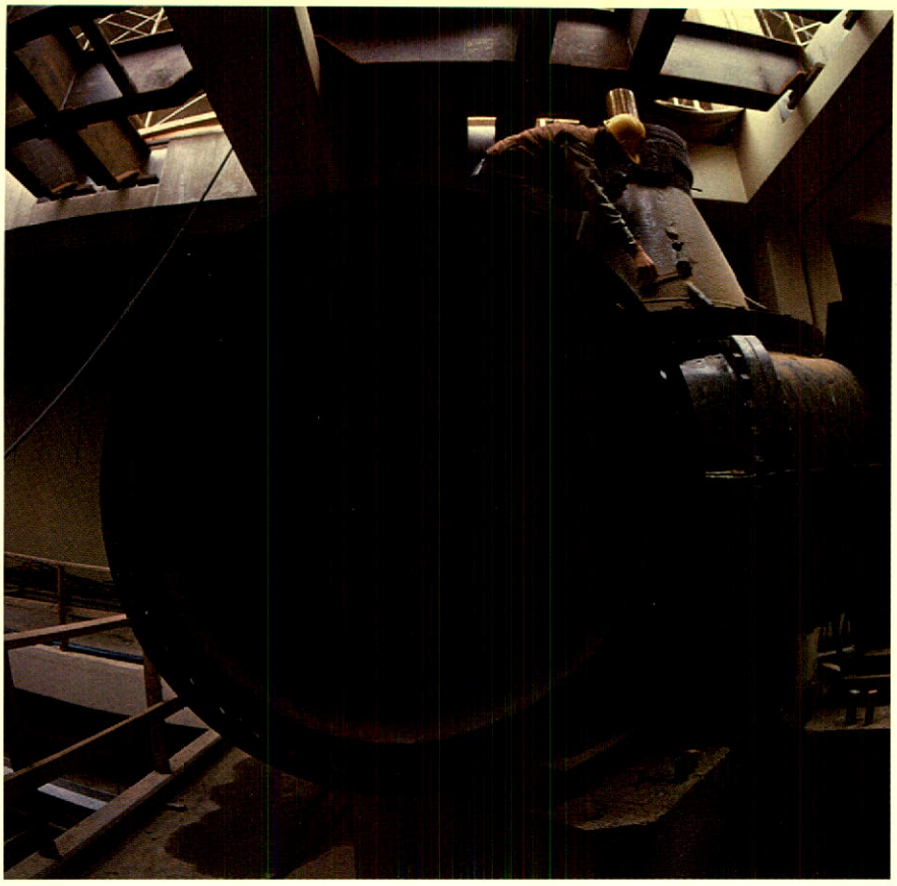

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Holley Carburetor Division, with responsibility for original equipment carburetors and the development of advanced non-carburetor fuel management systems; the Holley Replacement Parts Division; and the Holley Special Products Division. In January 1979, Colt Industries acquired F. D. Farnam Co., a leading producer of automotive gaskets.

Increased demand from both military and commercial aerospace markets kept Chandler Evans Control Systems Division sales at a high level. The division was selected to develop the main fuel pump for the General Electric CF-6-80 engine, one of two jet engines selected to power the new Boeing 767 and the European Airbus Industrie A310 jetliners. The division was also awarded the main fuel pump development program for the GE F101-X engine, funded by the U.S. Air Force as an alternative to the Pratt & Whitney F-100 engine, for the F-15 and F-16 aircraft. Chandler Evans supplies the main fuel pump for the F-100 engine.

A new line of suction-feed main fuel pumps for helicopter engines entered production in 1978. Ongoing developments include gas-actuated fin control systems for U.S. Army and Navy laser-guided missiles, an afterburner pump for the GE F-404 engine for the U.S. Navy F-18, and a digital control system for the GM-Allison advanced turbine engine for future U.S. Army helicopters.

Fairbanks Morse Pump Division volume was up on mixed demand. While pumping equipment for sewage treatment systems continues to account for the largest share of division sales, the market in 1978 was level. Sales of deep well turbine pumps for agricultural irrigation were off, but significant gains were made in domestic water system products. The division reentered the industrial pump market in 1978.

1. One of seven Fairbanks Morse pumps that will move 138 million gallons of sludge a day at the Sacramento Regional Wastewater Treatment plant under construction in northern California. These solids-handling centrifugal pumps have outlet diameters as large as 54 inches and individual capacities exceeding 86,000 gallons per minute.

2. Chandler Evans gas-actuated missile control unit for cannon-fired U.S. Army laser-guided missile is checked for proper vertical alignment prior to shipment.

3. Mechanic replaces cowling after routine check of fuel system on a commercial jetliner. Chandler Evans provides fuel control systems for wide range of military aircraft and commercial aircraft like this Boeing 707.


TWA

Colt Industries' Materials businesses accounted for 37 percent of the company's 1978 sales and 23 percent of its operating income. The segment is made up of the Crucible Specialty Metals Division, the Crucible Alloy Division, and the Crucible Stainless Steel Division.

The Crucible Specialty Metals Division had an excellent year with the principal sales impetus coming from the automotive and aerospace industries. The trend toward smaller cars created heavy demand for the division's tool steels for mold and die production and high speed steels for cutting tools. The sharp increase in orders for commercial jet aircraft created strong demand for the division's titanium fastener stock.

New CPM Tool Steel

Early in the year, the division introduced CPM 10V, a tough, durable, high-strength material produced by the Crucible Particle Metallurgy process. This new tool steel has exceptional wear resistance and provides substantial cost savings over carbides and other materials.

Strength in automotive markets also buoyed Crucible Alloy Division sales, with demand for alloy bars for suspension systems and drive trains increasing during the year. Demand for tough Crucible alloy steels was also up for machine tools and construction and oil field equipment. Capital goods markets stayed soft for carbon and alloy billets, blooms, and ingots. During the year, thermal treating capacity was increased and an additional VAR furnace was put into operation.

The Crucible Stainless Steel Division operated its cold rolling mills at near capacity in 1978, producing stainless sheet and strip for the automotive, appliance, transportation, and food processing industries.

1. Molten alloy steel is poured from electric furnace at a Crucible steel mill. After refinement by vacuum degassing, ingots will be teemed and either pounded into huge forgings or rolled into billets and blooms.

2. Forceps, used in cardiovascular surgery, made from stainless steel supplied by Crucible Specialty Metals Division to Edward Weck & Co., a division of Squibb.

3. Mold for use in production of glass-reinforced resin truck part is machined from 8-ton block of Crucible steel at Tooling Products Ltd., Petersfield, England.

4. Blanks slit and cut from coils of Crucible stainless steel are inventoried by purchasing agent at Vollrath Co. plant in Sheboygan, Wisconsin. Stainless blanks will be made into kitchenware used primarily by hospitals, restaurants, and institutions.

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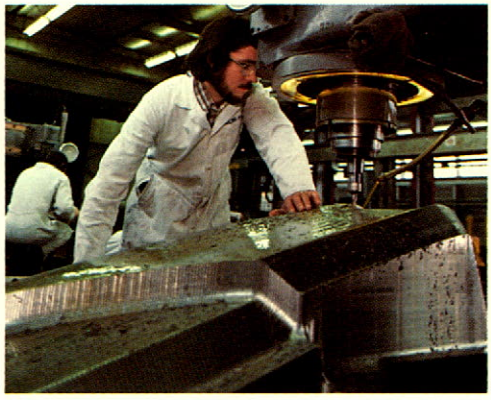

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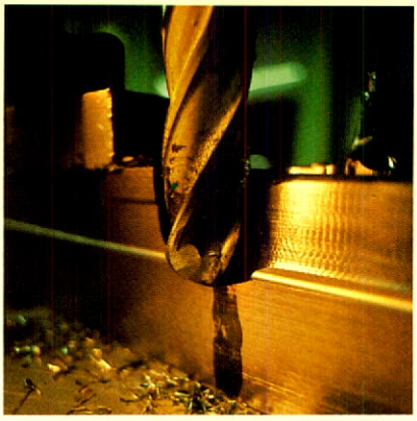

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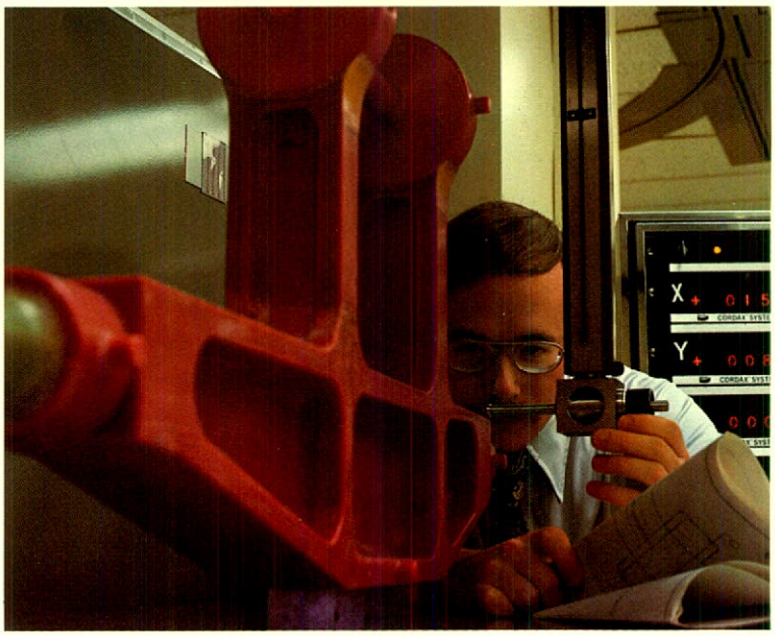


While volume was up, due both to demand and the imposition of quotas on imports of certain specialty steels, price competition was extensive.

In addition to its continuing work with the Crucible divisions in the development of new alloys and production processes, the Crucible Research Center is prime contractor on several government-sponsored projects. The center has been working with the U.S. Air Force and aircraft engine and airframe builders to develop large particle metallurgy titanium parts and, during the year, produced the first near net P/M titanium alloy stabilizer shaft for the F-16.

Environmental Control

Substantial environmental control efforts are being made, particularly at the steelmaking operations in Midland, Pennsylvania. Those operations are the subject of proceedings brought by the federal Environmental Protection Agency (EPA) and the Pennsylvania Department of Environmental Resources (DER). A settlement has been negotiated with the DER based on a plan for the installation of two electric arc furnaces during the next three years providing for conditions of operation and a final required shutdown of coke plant and blast furnaces by the end of 1982. Negotiations seeking agreement on such a plan by the EPA are continuing, but the results thereof cannot be predicted. If agreement is not reached permitting operation of the coke plant and blast furnaces on an adequate basis during the interim period, the steel business at Midland could be substantially affected. Environmental requirements have imposed, and will continue to impose, substantial capital expenditures and costs, including possible penalties.

1. Technicians move stainless steel vessel into position under the Crucible Particle Metallurgy (CPM) atomizer to be filled with tiny micro-ingots of aerospace superalloy steel.

2. Crucible Research Center engineer checks dimensions of wax pattern for titanium alloy aircraft part to be produced by P/M process and hot isostatically pressed to near its final shape.

3. End mill made from CPM steel contours titanium fitting for jet aircraft wing. Cutting tools made from steels produced by the Crucible Specialty Metals Division via the CPM process have longer life and substantially increase machine shop productivity.

4. Caterpillar track-type tractor uses tough Crucible alloy steel in its drive train and heavy duty transmission to enable it to move thousands of yards of earth at construction sites like this New Jersey highway project.


CATERPILLAR

Industrial Seals and Components

The company's Industrial Seals and Components industry segment contributed 14 percent of total sales in 1978 and 16 percent of operating income. This segment continued its pattern of steady growth with a 26 percent increase in operating income on a 21 percent increase in sales over 1977. The segment is comprised of the Garlock Mechanical Packing, Precision Seal, and Special Products Divisions; the Stemco Truck Products Division; the France Compressor Products Division; and Woodville Rubber Company Ltd. in England.

To strengthen the Garlock position in international markets, operations were decentralized and direct selling responsibility for their product lines was assigned to the U.S. operating divisions.

Garlock Mechanical Packing Division sales were up substantially in 1978, due in large part to demand for replacement sealing products in the chemical, petrochemical, and pulp and paper industries. During the year, the division introduced a new compression packing which, because of its high tensile strength and ability to withstand harsh conditions, has met immediate acceptance in the marketplace.

Record Truck Product Sales

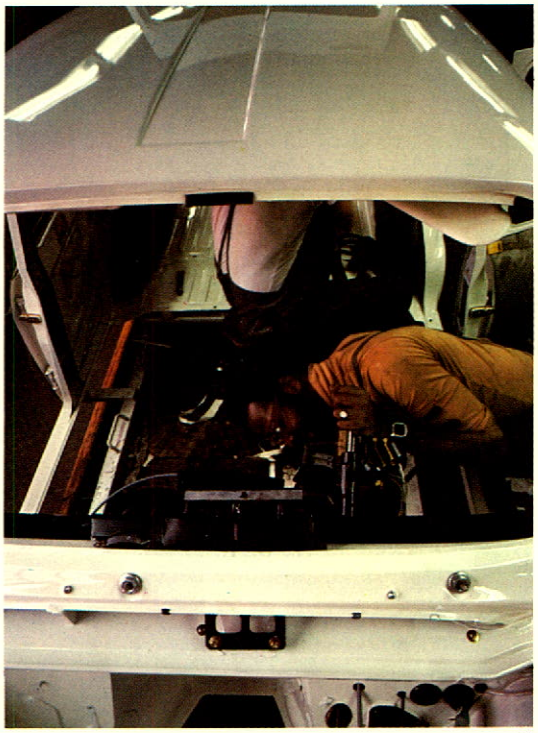
With continuing steady increases in new truck and trailer production and truck freight ton miles driven, the Stemco Truck Products Division chalked up its third consecutive year of record sales. The Stemco hub-seal wheel bearing lubrication system continues to gain in both U.S. and overseas sales; and in 1978, the division introduced its new Guardian hub-seal system. Exhaust system and replacement leaf spring sales were also up, and the division is expanding its overseas markets.

1. Hundreds of bearings made of DU, a steel-bronze-TFE self-lubricating material, are aligned in machine that assures precise geometry. Bearings made from DU have applications ranging from construction vehicle suspension systems to spinning, weaving, and tufting machinery in the textile industry.

2. Steering column is inserted in Renault R5TL sedan assembly line at Renault plant in Flins, France. Steering system includes bushing produced by Chromex S.A., French unit of Garlock Precision Seal Division.

3. Automotive water pump seals designed and produced by Woodville Rubber Company Ltd. are given final quality control check.

4. Each stainless steel compressor valve produced by France Compressor Products Division is fully inspected for dimension, finish, and sealing surfaces prior to shipment. France compressor valves are sold as original equipment and as replacement parts for air and gas compressors.



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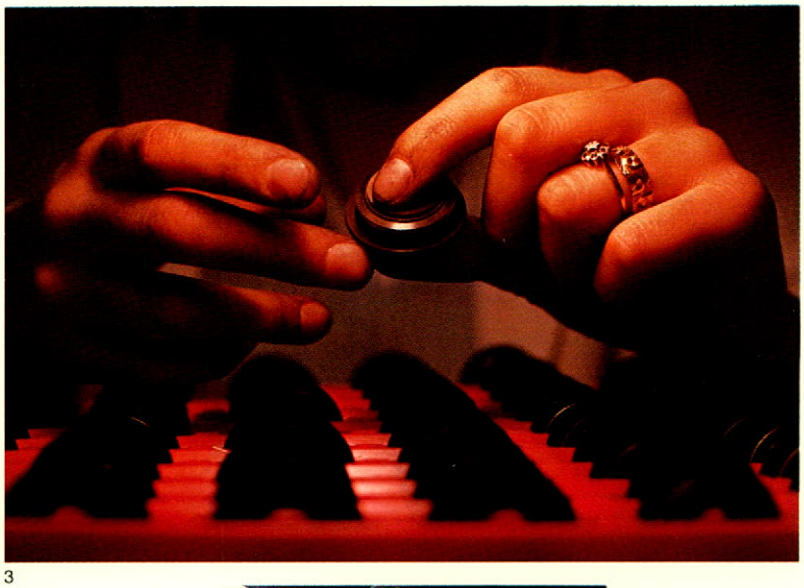

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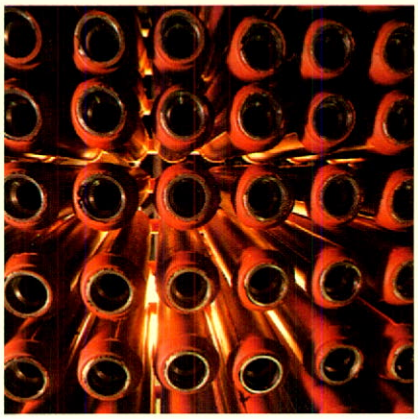

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Garlock Precision Seal Division sales were up in 1978, and the division's engine and transmission seals are receiving a good share of applications in 1980s cars now in the design stage. New products selling well include a patented transmission coupling seal for trucks and a new engine seal with TFE coating on elastomeric compounds for automotive, marine, and other applications. Chromex S.A. in France continues to expand its automotive industry product lines.

Major product successes in the Garlock Special Products Division were the self-lubricating Garlock bearings for advanced vehicle suspension systems, Gar-Fil and Gar-Max self-lubricated bearings for such applications as elbow joints on off-highway construction equipment, and the Gar-Seal 100L Series butterfly valve that received top honors in the *Chemical Processing* magazine new products competition.

France Compressor Products Division sales received a substantial boost from increased natural gas exploration and production activity. The division is producing filled TFE sealing components to withstand corrosive gases. The division closed its Belgian operation and is expanding Liard France S.A. and its penetration of European markets.

Woodville Rubber Company Ltd. achieved substantial growth in 1978 with a high level of demand in the United Kingdom and Western Europe for its custom-made, highly engineered gaskets, seals, and other polymer products. Highlight of the year was receipt of the second-phase production contract for the wing-to-fuselage slot seal on the NATO multi-function fighter aircraft, Tornado. The company's capability for the precise mixing of its compounds was enhanced by installation of new, advanced equipment; and Woodville is expanding its capacity.

1. One-inch-square, lattice-braid compression packing made of TFE yarn is produced by Garlock Mechanical Packing Division for use primarily as a pump sealant in chemical plants working with corrosive gases and liquids.

2. Paper feed rollers for office copying equipment are stacked ready for shipment at Woodville Rubber Company Ltd. plant in Ross-on-Wye, England. Woodville's rubber-bonded-to-metal products are also sold to makers of tape recording systems, record players, and other sound reproduction systems.

3. Woodville-designed and manufactured flexible fuel tank made of open-cell reticulated urethane foam with polymer outer skin is installed as standard equipment in world-famous Lola racing cars.

4. Increasing numbers of truck, bus, and tractor-trailer owners rely on hub-seal wheel bearing lubrication systems produced by Stemco Truck Products Division.


NICHOLAS
INC.
WOODBRIDGE, N.J.

Shock Mitigation Systems

The Shock Mitigation Systems industry segment accounted for 5 percent of the company's total sales in 1978 and 7 percent of its operating income. Operating income was up 29 percent on a 19 percent increase in sales. The primary business of this industry segment is the design and manufacture of aircraft landing gear assemblies; and the business is conducted by the Menasco California Division, the Menasco Texas Division, the Menasco Overhaul Division, and Menasco Canada Ltée.

Follow-on orders for 200 main and nose landing gear assemblies for the Boeing 727 contributed substantially to the increased backlog at the Menasco California Division. This is the division's largest production program, and well over 300 ship sets are now on order.

In October, the division was awarded a contract for the nose gear assembly for the new Boeing 767 wide-body aircraft. Boeing expects deliveries of this aircraft to exceed 1,000 and to extend into the 1990s. Other programs with substantial sales and bookings were landing gear assemblies for the Lockheed C-130 military air transport and the Lockheed P-3C U.S. Navy antisubmarine patrol aircraft.

Actuators designed and fabricated by the Menasco California Division to raise missile canisters from a buried trench to launch position were delivered to Martin Marietta for use in the U.S. Air Force MX missile test program.

The Menasco Texas Division received a $14 million authorization for main and nose landing gear assemblies for the Lockheed L-1011 wide-body jetliner. The authorization covers purchase of materials for additional assemblies. Add-on orders were also received from General Dynamics for landing gear assemblies for the F-16 fighter aircraft.

1. Preflight inspection of nose landing gear on Lockheed L-1011 TriStar jetliner just off the production floor at Lockheed Company, Palmdale, California assembly plant.

2. Hydraulic brake line connectors are tightened on main landing gear units prior to installation on the L-1011 TriStar. Menasco Texas Division in Fort Worth produces both nose and main landing gear for the L-1011, a wide-body jetliner capable of carrying up to 400 passengers.

3. Rockwell International Sabreliner 60 touches down on tough, compact, precision-made Menasco landing gear. Menasco supplies landing gear for many business and commuter aircraft in the U.S., Canada, and Europe.

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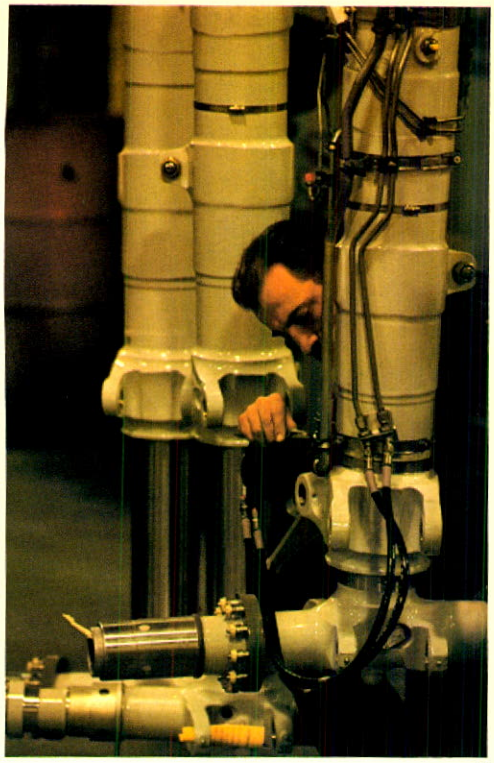

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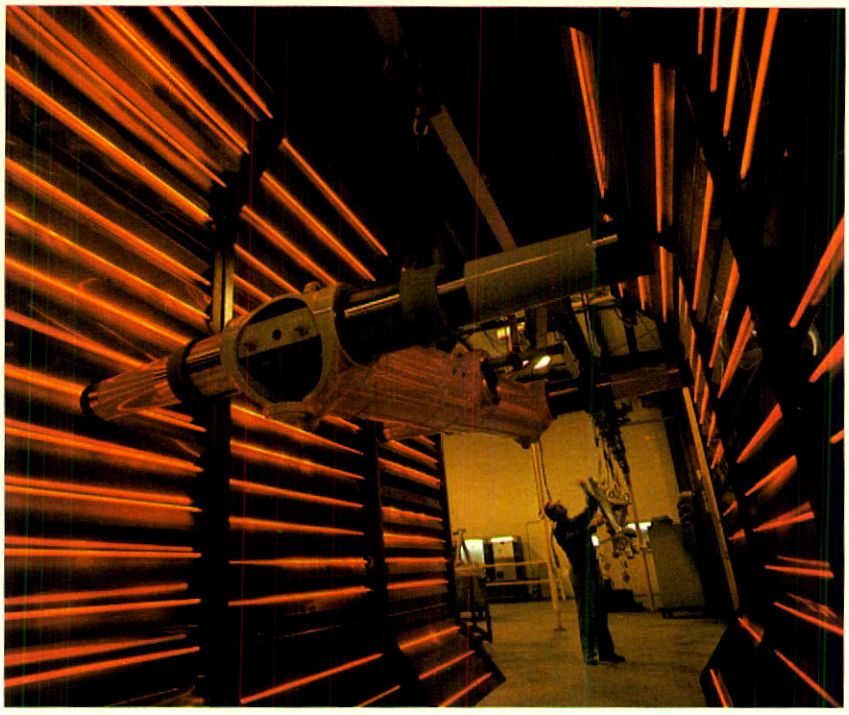


Menasco Overhaul Division sales were up substantially over 1977, due both to the increased size of airline fleets and further penetration by the division into the overhaul market in Canada and the United States. The division customer base for landing gear overhaul services includes airlines in many parts of the world. In addition, sales of overhauled landing gear parts and assemblies increased to customers throughout the world.

The division continued to add to its exchange inventory of landing gear assemblies and overhauled spare parts to provide the fast overhaul turnaround time so important to airline customers. The division also installed additional machinery and equipment to increase capacity.

To increase its share of the overhaul market in Europe, the division appointed Avio Diepen, an aerospace marketing firm headquartered in The Netherlands, as its sales agent in certain European countries.

Menasco Canada Growing

Menasco Canada Ltée booked a number of follow-on orders in 1978. These included main landing gear for the Boeing 737 and fixed side brace for the Boeing 727, nose and centerline landing gear for the McDonnell Douglas wide-body DC-10, landing gear for the Fairchild A-10 attack aircraft, landing gear for the Short Brothers SD3-30 commuter aircraft in Ireland and the DeHavilland DHC-7 commuter aircraft in Canada, and flight control systems for the F-28 passenger jetliner produced by Fokker VFW in The Netherlands. Menasco Canada expanded its flight controls overhaul activity into a full-service facility during the year and initiated an exchange and lease program.

1. Completely rebuilt main landing gear for a DC-9 receives final inspection prior to shipment by Menasco Overhaul Division in Burbank, California.

2. Main landing gear in paint oven prior to final reassembly and return to a Boeing 707 jetliner.

3. Rocky Mountain Airways DeHavilland DHC-7 boards passengers in Aspen, Colorado. This popular Canadian-built commuter aircraft has nose and main landing gear and flap-control system designed and manufactured by Menasco Canada Ltée, Montreal.

Financial Review

Sales and Earnings

In 1978, the company established record sales, net earnings, earnings per share, new orders and, as of year end, record backlogs. Sales in 1978 were $1,808 million, up 19 percent from $1,525 million in 1977. Net earnings for the year 1978 increased 25 percent to $87.0 million as compared with the $69.5 million recorded in 1977. Sales and operating income of each of the company's industry segments improved over 1977, contributing to a higher overall corporate margin. Strong gains were recorded by the Fluid Control Systems, Industrial Seals and Components, and Shock Mitigation Systems segments, where sales and operating income increased substantially.

The results for the year reflect the improved demand from broad industrial markets served by the company's diverse businesses. Order input remained strong throughout the year and backlogs increased steadily. The broad base of the company's balanced earnings power is evident from the earnings contribution of 29 percent, 25 percent and 23 percent of total operating income by the Industrial and Power Equipment, Fluid Control Systems, and Materials industry segments, respectively.

Sales and earnings increases in 1977 over 1976 were attributed to increased demand for Crucible specialty steels plus strong performances throughout the year by almost all of the company's industrial products businesses.

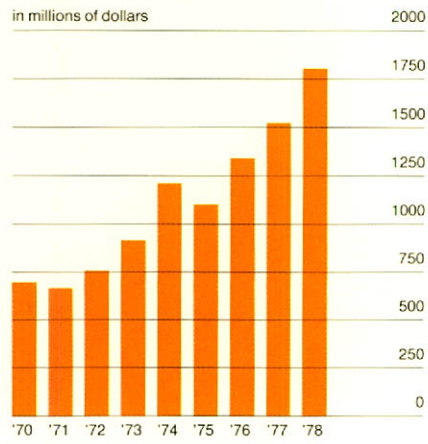
Cost of Sales

Cost of sales in 1978 increased 18 percent over 1977. The increases in cost of sales are directly related to the increased volume of business and to the inflationary cost increases of energy, materials, supplies, maintenance, wages, payroll taxes, and fringe benefits. Depreciation and amortization expense increases in 1978 over 1977 were attributable principally to additions to property, plant, and equipment. The increase in cost of sales in 1977 over 1976 was due directly to the volume of business and also to the prolonged cold weather in January and February, 1977 and a ten-week strike at two West Hartford, Connecticut divisions.

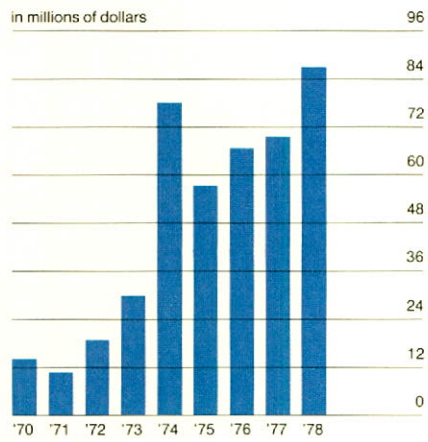
Selling and Administrative Expense

The increases in selling and administrative expense result from the increased volume of business and higher costs. State and local income and franchise taxes increased $4.0 million due to higher earnings in 1978 compared with 1977. In 1978 and 1977, the company incurred foreign exchange losses, including the effect of translating inventories as sold at the new exchange rates, of $1.3 million and $4.4 million after taxes, respectively. The 1978 loss was principally due to the decline of the U.S. dollar in relation to other currencies while the 1977 loss was principally due to the devaluation of the Mexican peso.

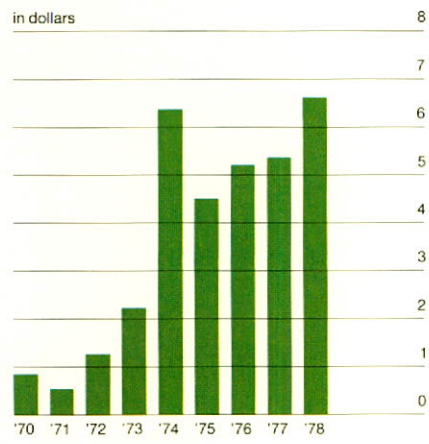
Sales



Net Earnings



Earnings per Share*



*Adjusted for three-for-two stock split.

Interest Expense and Interest Income
The $4.5 million increase in interest expense for 1978 compared with 1977 was due mainly to the issuance of $40 million of 9¾ percent senior promissory notes in December 1977. Interest income in 1978 increased $7.7 million compared with 1977 due to higher average cash balances and higher yields.

Taxes
The effective income tax rates for the years 1978, 1977, and 1976 were 46.5 percent, 46.25 percent, and 42.6 percent, respectively. The rate in 1977 was higher than in 1976 principally because of the reduction of DISC benefits pursuant to the Tax Reform Act of 1976, non-deductible foreign exchange losses, and acquisition costs.

Financial Information by Industry Segment
The Financial Accounting Standards Board and the Securities and Exchange Commission have prescribed the criteria to be applied in financial reporting for segments of a business enterprise. The following financial data by industry segment have been prepared in accordance with these reporting requirements.

Colt Industries manufactures and sells a diversified line of industrial products in the United States and abroad. Company operations are conducted through divisions within five industry segments. These segments are based on the industries, product lines, markets, and technical disciplines in which divisions of Colt Industries operate. The products included in each industry segment consist of the following:

Industrial and Power Equipment: fabricated metal products, primarily welded stainless steel pipe and tubing marketed under the Trent brand name; weighing systems; industrial diesel engines and accessories; compressors; machine tools and measuring equipment; electric distribution transformers; and firearms;

Fluid Control Systems: automotive carburetors, marketed under the Holley brand name; pumps; and aerospace fuel systems and controls;

Materials: Crucible specialty carbon and low-alloy steels; stainless and other special-purpose steels including high-speed, tool, die, valve, and other high-alloy steels; vacuum-melted steels; and titanium alloys;

Industrial Seals and Components: gaskets, packings, valves, and other devices to prevent leakage and seal out contaminants, primarily marketed under the Garlock brand name; Stemco wheel bearing lubrication systems and other truck products; and France compressor products;

Shock Mitigation Systems: Menasco aircraft landing gear assemblies and other shock mitigation systems, flight control systems.

The following table shows financial information attributable to the company's industry segments. Operating income by industry segment is determined exclusive of interest income, interest expense, general corporate expenses, and income taxes:

Sales and Operating Income by Industry Segment
(In millions of dollars)

	1978		1977		1976		1975		1974	
	Operating Income	Sales	Operating Income	Sales	Operating Income	Sales	Operating Income	Sales	Operating Income	Sales
Industrial and Power Equipment	$ 55.2	$ 516	$ 48.2	$ 453	$ 48.8	$ 432	$ 49.4	$ 415	$ 40.7	$ 409
Fluid Control Systems	48.4	320	35.4	238	33.6	212	19.7	187	9.4	191
Materials	44.3	664	42.8	582	27.2	475	39.1	454	106.4	585
Industrial Seals and Components	31.9	250	25.3	206	21.9	181	—	—	—	—
Shock Mitigation Systems	14.2	92	11.0	77	11.1	79	11.9	81	4.5	67
Intersegment elimination	—	(34)	—	(31)	—	(33)	—	(33)	—	(41)
Total segments	194.0	1,808	162.7	1,525	142.6	1,346	120.1	1,104	161.0	1,211
Interest expense	(29.8)	—	(25.3)	—	(23.0)	—	(20.4)	—	(22.3)	—
Interest income	13.1	—	5.4	—	5.1	—	8.8	—	10.5	—
Corporate unallocated	(14.7)	—	(13.6)	—	(8.2)	—	(11.2)	—	(10.8)	—
Consolidated	$162.6	$1,808	$129.2	$1,525	$116.5	$1,346	$ 97.3	$1,104	$138.4	$1,211

Management Discussion of Operating Results by Industry Segment

The Industrial and Power Equipment segment had operating income of $55.2 million in 1978 compared with $48.2 million in 1977 and $48.8 million in 1976, representing 29 percent, 30 percent, and 34 percent, respectively, of the company's total operating income in those years. The year 1978 is the fourth year in a row that this segment has been the largest contributor to the company's total operating income. Most divisions in this segment recorded improved sales and earnings. The operating income in 1978 for this segment was up $7.0 million compared with 1977 principally due to the significant improvement in demand for the products of the Pratt & Whitney Machine Tool, Crucible Magnetics, and Central Moloney Transformer Divisions, offset in part by lower earnings in the Colt Firearms and Trent Tube Divisions, including start-up costs related to expansion of the Trent Tube B.V. facility in The Netherlands. In 1977, the Pratt & Whitney Machine Tool Division was adversely affected by a ten-week strike.

Operating income in 1977 was slightly below 1976 as a result of substantially lower earnings by the Colt Firearms and Trent Tube Divisions, offset by improved earnings of most of the other operating units within this segment. In 1978 and 1977, lower sales and earnings by the Colt Firearms Division were due to the continuing low level of government orders for the M16 military rifle; and at the Trent Tube Division, lower sales and earnings for the last two years resulted from the low level of capital spending in the power generation and chemical industries.

In 1978, the Fluid Control Systems segment was the second largest contributor to the company's total operating income. Operating income was $48.4 million, or 25 percent of total operating income, compared with $35.4 million or 22 percent for 1977. Earnings of the Holley Carburetor Division were up substantially as a result of the automotive industry trend towards production of smaller, more fuel-efficient cars to meet stringent government fuel-economy and emission-control standards. There was increased demand as well for Holley's automotive aftermarket products. The Chandler Evans Control Systems Division experienced higher demand for its products in the aerospace aftermarket, plus increased production of fuel pumps for engines for the F-15 and F-16 fighter aircraft. The increase in profits in 1977 and 1976 reflected continued improved performance by the Holley Carburetor and Chandler Evans Control Systems Divisions.

The Materials segment in 1978 represented 23 percent of total operating income, or $44.3 million, compared with 26 percent and $42.8 million in 1977 and 19 percent and $27.2 million in 1976. The improvement in 1978 was due to the record performance in sales and earnings by the Crucible Specialty Metals Division, offset by lower earnings of the Crucible Stainless Steel and Crucible Alloy Divisions. The lower earnings in the Crucible Alloy Division resulted from lower operating efficiencies; and, in the Crucible Stainless Steel Division, the lower earnings resulted from increased operating costs not fully recovered by price increases.

The Materials segment improvement in 1977 earnings compared with 1976 was attributable to increased demand for specialty steel products, higher operating rates, lower cost of some raw materials, and improved operating efficiencies.

The Industrial Seals and Components segment continued its steady growth pattern and recorded a 26 percent improvement in 1978 earnings on a 21 percent higher sales volume compared with results for 1977. Demand in 1978 remained high, and operating profits were improved as a result of higher volume and increased administrative and manufacturing efficiencies. All market areas shared in this improvement except for the European markets. Particularly strong improvements were achieved by Garlock Mechanical Packing Division and Woodville Rubber Company products. In 1977, operating income increased 15 percent versus the prior year on a 14 percent gain in sales, reflecting a generally good market for most sealing and packing products.

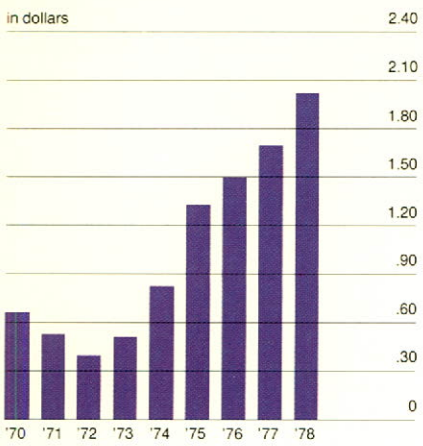
Operating income for the Shock Mitigation Systems segment increased 29 percent over 1977 on a 19 percent improvement in sales volume, reflecting the expanding commercial aircraft landing gear demand resulting from increased airline orders for additional planes. The higher margin in 1978 compared with 1977 was the result of higher operating rates in the manufacture of aircraft landing gear assemblies on mature programs. The slightly lower operating income in 1977 compared with 1976 was directly related to the volume of business.

The following table sets forth the company's total assets by industry segment at December 31 for the last five years:

Total Assets by Industry Segment
(In millions of dollars)

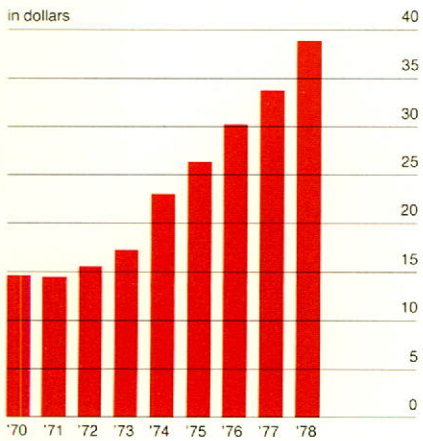
	1978	1977	1976	1975	1974
Industrial and Power Equipment	$ 318	$ 296	$ 268	$ 269	$ 276
Fluid Control Systems	116	101	86	81	96
Materials	395	375	357	328	340
Industrial Seals and Components	190	177	165	156	—
Shock Mitigation Systems	74	65	63	69	67
Total segments	1,093	1,014	939	903	779
Corporate unallocated	171	98	66	32	66
Total Assets	$1,264	$1,112	$1,005	$ 935	$ 845

Dividend Rate per Common Share*



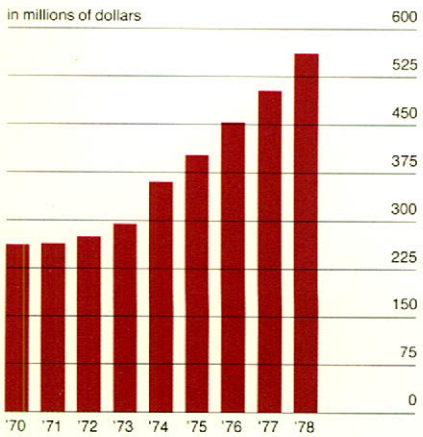
*Adjusted for three-for-two stock split.

Book Value per Common Share*



*Adjusted for three-for-two stock split.

Shareholders' Equity



The following table sets forth information with respect to each class of similar products which accounted for at least 10 percent of the company's sales during either of the last two fiscal years:

Sales by Class of Products

	Percentage of Sales				
	1978	1977	1976	1975	1974
Stainless Steel	16.8	17.8	16.0	17.0	22.9
Specialty Carbon and Low Alloy Steels	14.0	14.7	14.5	18.6	18.1
Industrial Seals and Components	13.8	13.5	13.4	—	—
Carburetors and Components	11.2	9.4	9.1	9.9	10.5

Order Backlog

The order backlog of $791.7 million at December 31, 1978 set a new high for the company and was up 29 percent over the December 31, 1977 order backlog of $613.3 million. Every industry segment ended the year with backlogs up compared with 1977, and most divisions within each segment participated in this increase. The rate of order input during 1978 and high backlog at year-end reflect both current and ongoing strength in demand for the company's products.

Financial Position

The company's financial position at December 31, 1978 was stronger than at anytime in its history. Capital expenditures of $56.0 million and record dividends of $28.8 million were more than adequately covered by internally generated cash. Cash and marketable securities were $166.1 million at December 31, 1978, an increase of $61.1 million over the prior year-end.

The continued improvement in the company's liquidity is demonstrated by its increase in working capital, reduction in long-term debt to shareholders' equity ratio, improved inventory turnover, and lower receivable days outstanding.

Working capital increased during the year by $30.3 million to a record $503.4 million at December 31, 1978. The ratio of long-term debt to total shareholders' equity improved from 59.8 percent at the end of 1977 to 52.2 percent as of December 31, 1978. This improvement was achieved despite the addition to long-term debt at December 31, 1978 of $7.2 million of capital lease obligations in accordance with a new accounting rule effective January 1, 1978. Inventory turned over 3.29 times for 1978 compared with 2.97 times in 1977. Receivable days outstanding at December 31, 1978 were 51 days compared with 52 days at the end of 1977.

In January 1979, the company arranged $150 million revolving credit agreements with six banks under which the company has available at its option $100 million for a three-year revolving period, with conversion to a five-year term loan; as well as $50 million for a one-year revolving period. Interest for the revolving periods will be at the prime rate.

Capital Expenditures

Plant and equipment expenditures during 1978 totaled $56.0 million. Environmental control projects continued at the Midland, Pennsylvania specialty steels mill. In order to meet increasing market demand, production capacity is being expanded by the Central Moloney Transformer Division and the Holley Carburetor Division and at certain Industrial Seals and Components facilities. Machining capabilities were increased at the Menasco California and Texas plants. Modernization of the company's specialty steels mill in Syracuse, New York was continued in 1978 to improve operating efficiencies and eliminate production bottlenecks. The company maintains its policy of selective expansion, cost reductions, modernization, and pollution control improvements to assure continued future production capacity to satisfy the increasing demand for its products. Capital expenditures for 1979 are expected to be in excess of the total amount spent in 1978 and are expected to be more than adequately financed by depreciation and internally generated cash.

Dividends

Record dividends of $28.8 million were paid to the company's shareholders in 1978 and consisted of $25.5 million to common shareholders, up 31 percent compared with 1977; and $3.3 million to preferred shareholders, compared with $4.2 million in 1977.

Quarterly cash dividends on the common stock were paid at the rate of 45⅝¢ per share for the first quarter of 1978; and in May, the Board of Directors increased the quarterly dividend to 52½¢ and voted a three-for-two stock split in the form of a 50 percent stock dividend. The per share data reflects the additional shares distributed on June 30, 1978.

Quarterly dividends on the company's preferred stocks were paid during 1978 and 1977 at the respective annual amounts stated in the titles of such preferred stocks. The lower total amount paid in 1978 reflects the result of voluntary conversions to common stock by preferred holders. The following tabulation sets forth, for each series of convertible preferred stock, the number of shares outstanding at December 31, 1978; the annual dividend rate per share; and the aggregate dividends per share receivable if converted into common stock based on the current annual dividend rate of $2.10 per share of common stock:

Series	Shares Outstanding December 31, 1978	Annual Dividend Rate Per Share	Aggregate Dividends Per Share Receivable If Converted Into Common Stock
A	222,797	$1.60	$ 1.68
B	10,815	4.50	15.97
C	12,785	4.25	4.76
D	475,567	4.25	4.55

Distribution of Earnings

In 1978, Colt Industries paid $28.8 million, or 12.8 percent, of its earnings prior to payment of taxes in dividends to holders of the company's common and preferred stock; retained earnings of $58.2 million, or 25.9 percent, for reinvestment in the company; and incurred tax expense of $137.7 million, or 61.3 percent. This included U.S. federal, state, and local taxes and foreign income taxes. Of the $137.7 million, which does not include miscellaneous taxes, $1.3 million was in sales and use taxes, $4.0 million in U.S. federal excise taxes, $4.8 million in non-U.S. income taxes, $7.5 million in property taxes, $13.3 million in state and local income and franchise taxes, $36.0 million in payroll taxes, and $70.8 million in U.S. federal income taxes.

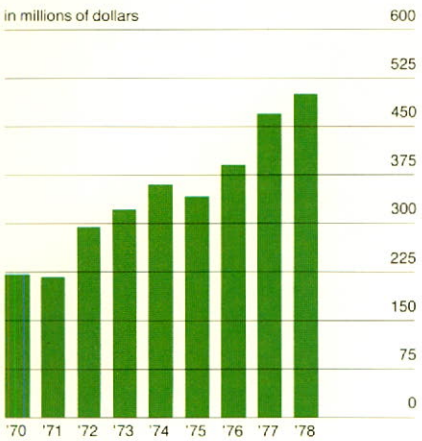
In 1977, the distribution of company earnings prior to payment of taxes was $24.2 million, or 13.4 percent, in dividends; $45.3 million, or 25.1 percent, in retained earnings; and $111.0 million, or 61.5 percent, in taxes. Taxes in 1977 included $1.1 million in sales and use taxes, $3.7 million in U.S. federal excise taxes, $5.0 million in non-U.S. income taxes, $7.4 million in property taxes, $9.3 million in state and local income and franchise taxes, $29.8 million in payroll taxes, and $54.7 million in U.S. federal income taxes.

Market Price of Colt Industries Stock

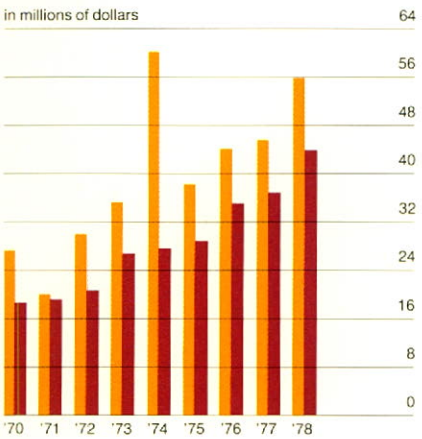
The company's common stock; the $1.60 cumulative preferred stock, convertible Series A; and the $4.25 cumulative preferred stock, convertible Series D; are listed on the New York, Midwest, and Pacific Stock Exchanges. In addition, the common stock is listed on the London Stock Exchange. The following table sets forth the reported high and low market prices of the above-mentioned stock for each quarter during 1978 and 1977, with the common stock prices adjusted for the three-for-two split on June 30, 1978:

	1978		1977	
Common Stock	High	Low	High	Low
First Quarter	32⅛	28⅝	36½	32⅝
Second Quarter	39⅝	30	39½	33
Third Quarter	42⅜	35	37⅛	27¼
Fourth Quarter	39¼	30½	32⅜	28

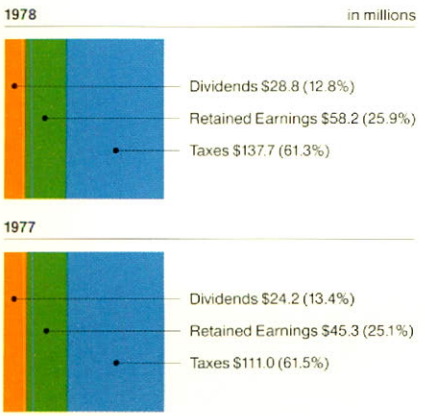
Working Capital



Capital Expenditures
Depreciation and Amortization



Distribution of Earnings



	1978		1977	
	High	Low	High	Low
$1.60 Cumulative Preferred Stock, Convertible Series A				
First Quarter	25	23⅜	28⅞	26½
Second Quarter	31	24	31	26¼
Third Quarter	33	28¼	29½	23¾
Fourth Quarter	30½	25½	25⅝	23½
$4.25 Cumulative Preferred Stock, Convertible Series D				
First Quarter	68¾	62½	75¾	70
Second Quarter	85	65	84	71¼
Third Quarter	89¾	78½	79½	59½
Fourth Quarter	83	65½	68½	61⅛

To the best of the company's knowledge, there is no established trading market for its $4.50 cumulative preferred stock, convertible Series B; $4.25 cumulative preferred stock, convertible Series C; and $2.75 cumulative preferred stock, Series E.

Shareholder Information

At the end of 1978, there were 29,013 holders of the company's common stock and 8,874 holders of the five classes of preferred stock. At the end of 1977, there were 29,121 holders of common and 9,728 holders of preferred.

Including shares held in treasury of 174,525 in 1978 and 116,350 in 1977, there were 13,040,902 shares of common stock outstanding on December 31, 1978 compared with 8,106,164 at year-end 1977. The increase resulted from the issuance of 4,198,955 shares (including 58,175 treasury shares) for the three-for-two stock split and 735,783 shares from the exercise of stock options and conversion of preferred stock.

Dividend Reinvestment Program

The company announced during the year that, in response to increasing shareholder interest, it would pay broker's commissions and bank service fees on purchases of common stock. These were previously charged to participants. The Colt Industries Dividend Reinvestment Plan is for holders of the company's common and preferred stock.

For more information about the expense-free voluntary Dividend Reinvestment Plan, or to participate in the plan, please write to Colt Industries Inc, Department SG, 430 Park Avenue, New York, N.Y. 10022.

Annual Report to the Securities and Exchange Commission on Form 10-K Available

The annual report on Form 10-K, without exhibits, will be made available free of charge to interested shareholders upon written request to the Corporate Secretary, Colt Industries Inc, 430 Park Avenue, New York, N.Y. 10022.

Consolidated Balance Sheet

December 31

Assets		(In thousands) 1978	1977
Current Assets	Cash, including certificates of deposit of $31,270 and $34,506	**$ 32,438**	$ 47,782
	Marketable securities, at cost (approximates market)	**133,630**	57,147
	Accounts and notes receivable—		
	Trade	**241,212**	211,500
	Other	**10,087**	9,170
		251,299	220,670
	Less reserves	**6,425**	5,106
		244,874	215,564
	Inventories (Notes 1 and 12)—		
	Finished goods	**94,408**	92,425
	Work in process and finished parts	**235,068**	205,611
	Raw materials and supplies	**101,390**	94,462
		430,866	392,498
	Less reserves	**32,896**	27,550
		397,970	364,948
	Deferred income taxes (Note 2)	**17,761**	16,515
	Other current assets	**9,280**	6,973
	Total current assets	**835,953**	708,929
Property, Plant, and Equipment, at Cost (Notes 1, 3, and 12)	Land and improvements	**23,616**	23,389
	Buildings and equipment	**144,340**	127,479
	Machinery and equipment	**627,057**	575,151
	Leasehold improvements	**7,206**	7,119
	Construction in progress	**26,646**	29,050
		828,865	762,188
	Less accumulated depreciation and amortization	**456,485**	411,724
		372,380	350,464
	Funds held by custodian for pollution equipment	**161**	1,667
		372,541	352,131
Other Assets	Notes receivable from officers and employees	**4,955**	3,406
	Other assets (Note 1)	**50,364**	47,771
		$1,263,813	$1,112,237

Liabilities and Shareholders' Equity		(In thousands of dollars, except par values) 1978	1977
Current Liabilities	Notes payable to banks (Note 3)	**$ 25,275**	$ 18,218
	Current maturities of long-term debt (Note 3)	**19,998**	18,908
	Accounts payable	**127,629**	84,467
	Accrued expenses—		
	Salaries, wages, and employee benefits	**59,943**	53,839
	Taxes	**62,095**	34,728
	Interest	**4,877**	3,936
	Other	**32,695**	21,715
		159,610	114,218
	Total current liabilities	**332,512**	235,811
Noncurrent Liabilities	Long-term debt (Note 3)	**294,296**	301,326
	Reserves—		
	Employee benefits	**17,517**	12,287
	Losses on long-term leases	**2,623**	2,736
	Other	**1,707**	2,223
		21,847	17,246
	Deferred income taxes (Note 2)	**48,391**	51,286
	Minority interest in subsidiaries	**3,226**	2,971
	Commitments and contingencies (Note 11)		
Shareholders' Equity (Notes 3, 4, and 6)	Preferred stock— $1 par value, 2,438,901 and 2,860,476 shares authorized, 783,406 and 1,204,981 shares outstanding (involuntary liquidation value at December 31, 1978—$62,209)	**783**	1,205
	Common stock— $1 par value, 30,000,000 and 15,000,000 shares authorized, 13,040,902 and 8,106,164 shares issued	**13,041**	8,106
	Capital in excess of par value	**169,220**	167,605
	Retained earnings	**387,041**	333,225
		570,085	510,141
	Less cost of 174,525 and 116,350 shares of common stock in treasury	**6,544**	6,544
		563,541	503,597
		$1,263,813	$1,112,237

The accompanying notes to financial statements are an integral part of this statement.

Consolidated Statement of Earnings

Colt Industries Inc and Subsidiaries

For the five years ended December 31, 1978

		(In thousands, except per share data)				
		1978	1977	1976	1975	1974
Revenue	Net sales	**$1,807,882**	$1,525,484	$1,345,764	$1,103,681	$1,210,909
Costs and Expenses	Cost of sales	**1,446,844**	1,222,948	1,074,428	905,664	968,821
	Selling and administrative	**181,785**	153,407	137,004	89,120	91,901
	Interest expense	**29,804**	25,328	22,996	20,363	22,285
	Interest income	**(13,191)**	(5,419)	(5,115)	(8,772)	(10,534)
	Total costs and expenses	**1,645,242**	1,396,264	1,229,313	1,006,375	1,072,473
Earnings	Earnings before income taxes	**162,640**	129,220	116,451	97,306	138,436
	Provision for income taxes (Note 2)	**75,620**	59,760	49,606	39,870	60,133
	Net earnings	**87,020**	69,460	66,845	57,436	78,303
	Dividends on preferred stock	**3,282**	4,246	4,372	4,400	4,403
	Net earnings applicable to common stock	**$ 83,738**	$ 65,214	$ 62,473	$ 53,036	$ 73,900
Earnings Per Share Data	Earnings per common share including common equivalent share (Notes 1 and 4)	**$6.66**	$5.40	$5.24	$4.54	$6.40
	Earnings per common share assuming full dilution (Notes 1 and 4)	**$6.07**	$4.87	$4.71	$4.11	$5.67
	Average number of shares (Notes 1 and 4)— Common and common equivalent basis	**12,565**	12,073	11,912	11,690	11,549
	Fully diluted basis	**14,304**	14,230	14,146	13,919	13,784
	Cash dividends per common share	**$2.03⅓**	$1.70⅝	$1.50	$1.33⅓	$ .83⅓

The accompanying notes to financial statements are an integral part of this statement.

Consolidated Statement of Retained Earnings

Colt Industries Inc and Subsidiaries

For the five years ended December 31, 1978

		(In thousands)				
		1978	1977	1976	1975	1974
Retained Earnings	Balance, beginning of period	**$333,225**	$287,969	$241,624	$201,924	$136,746
	Net earnings for the period	**87,020**	69,460	66,845	57,436	78,303
	Dividends—					
	Preferred stock	**(3,282)**	(4,246)	(4,372)	(4,400)	(4,403)
	Common stock	**(25,492)**	(19,516)	(15,000)	(13,121)	(8,144)
	Dividends of acquired company prior to pooling of interests—					
	Cash dividends	**—**	(442)	(1,046)	—	—
	Stock dividends	**—**	—	(771)	(215)	(578)
	Three-for-two stock split in the form of a 50% stock dividend	**(4,199)**	—	—	—	—
	Cash paid in lieu of fractional shares on stock split	**(231)**	—	—	—	—
	Adjustment to conform fiscal year of pooled company	**—**	—	689	—	—
	Balance, end of period	**$387,041**	$333,225	$287,969	$241,624	$201,924

Consolidated Statement of Capital in Excess of Par Value

For the five years ended December 31, 1978

		(In thousands)				
		1978	1977	1976	1975	1974
Capital in Excess of Par Value	Balance, beginning of period	**$167,605**	$162,471	$158,378	$157,500	$156,826
	Conversion and retirements of preferred stock and exercise of options	**1,615**	5,134	2,172	705	147
	Stock dividends of acquired company prior to pooling of interests	**—**	—	709	173	527
	Adjustment to conform fiscal year of pooled company	**—**	—	1,212	—	—
	Balance, end of period	**$169,220**	$167,605	$162,471	$158,378	$157,500

The accompanying notes to financial statements are an integral part of these statements.

Consolidated Statement of Changes in Financial Position

Colt Industries Inc and Subsidiaries

For the five years ended December 31, 1978

		(In thousands)				
		1978	1977	1976	1975	1974
Source of Funds	Net earnings	**$ 87,020**	$ 69,460	$ 66,845	$ 57,436	$ 78,303
	Items not requiring use of working capital—					
	Depreciation and amortization	**44,192**	37,051	35,309	29,065	27,817
	Deferred income taxes	**(4,141)**	7,925	2,430	2,837	(928)
	Working capital provided from operations	**127,071**	114,436	104,584	89,338	105,192
	Long-term debt	**24,847**	50,401	84,975	2,611	25,568
		151,918	164,837	189,559	91,949	130,760
Application of Funds	Acquisition of Garlock Inc (excluding working capital of $48,656)	**—**	—	—	38,744	—
	Additions to properties	**55,981**	46,131	44,547	38,683	60,657
	Decrease in long-term debt	**41,359**	23,760	77,324	18,646	18,792
	Dividends paid	**28,774**	24,204	20,418	17,521	12,547
	Other—net	**(4,519)**	(9,803)	(1,691)	(2,765)	(1,653)
		121,595	84,292	140,598	110,829	90,343
Working Capital	Increase (decrease) in working capital	**30,323**	80,545	48,961	(18,880)	40,417
	At beginning of year	**473,118**	392,573	343,612	362,492	322,075
	At end of year	**$503,441**	$473,118	$392,573	$343,612	$362,492

		Increase (decrease) in working capital				
		1978	1977	1976	1975	1974
Changes in Components of Working Capital	Cash, including certificates of deposit	**$(15,344)**	$ 24,060	$ 869	$ (2,021)	$ (606)
	Marketable securities	**76,483**	10,550	33,683	(28,054)	(6,402)
	Accounts and notes receivable	**29,310**	40,121	11,888	(2,019)	27,897
	Inventories	**33,022**	19,095	15,287	26,872	48,543
	Deferred income taxes	**1,246**	3,985	2,247	633	3,650
	Other current assets	**2,307**	(2,963)	(1,886)	5,194	902
	Notes payable to banks	**(7,057)**	(3,407)	(1,499)	(8,450)	(2,441)
	Current maturities of long-term debt	**(1,090)**	(4,694)	(3,238)	(1,548)	(1,361)
	Accounts payable	**(43,162)**	(6,763)	2,610	5,708	(20,622)
	Accrued expenses	**(45,392)**	561	(11,000)	(15,195)	(9,143)
		$ 30,323	$ 80,545	$ 48,961	$(18,880)	$ 40,417

The accompanying notes to financial statements are an integral part of this statement.

1. Summary of Accounting Policies

Principles of Consolidation—Investments in which the company's ownership of common voting stock is over 50 percent are consolidated in the financial statements. Corporations in which the company has stock ownership of at least 20 percent but not over 50 percent are accounted for on the equity basis. Intercompany transactions are eliminated.

Foreign Currency Translation—The accounts of foreign subsidiaries are translated into U.S. dollars as follows: (a) inventories, fixed assets, investments, intangibles, deferred charges and credits and shareholders' equity at historical rates; (b) all other assets and liabilities at year-end rates; (c) income and expenses at monthly weighted average rates, except that depreciation and amortization are translated at historical rates in effect at the time the related assets were acquired. Foreign exchange gains and losses are reflected in earnings currently. The company's net earnings were reduced by $1,300,000, $4,400,000, and $3,000,000 in 1978, 1977, and 1976, respectively, as a result of foreign exchange losses including the effect of translating inventories as sold at the new exchange rates. The losses for 1977 and 1976 were principally due to the devaluation of the Mexican peso. Foreign exchange gains and losses in prior years were not significant in amount.

Inventories—Inventories are valued at the lower of cost or market, less reserves for potential losses from obsolete or slow moving inventories. Cost elements included in inventory are material, labor, and factory overhead. Cost on approximately 47 percent of the domestic inventory is determined on the last-in, first-out basis and on the remainder of the inventory is generally determined on the first-in, first-out basis. The excess of current cost over last-in, first-out cost at December 31, 1978 and 1977 was approximately $85,000,000 and $70,000,000, respectively.

Beginning and ending inventories used in the determination of cost of goods sold were as follows (in thousands):

December 31, 1978	$397,970
December 31, 1977	364,948
December 31, 1976	345,853
December 31, 1975	330,566
December 31, 1974	303,694
December 31, 1973	255,151

Property and Depreciation—Depreciation and amortization of plant and equipment are provided for by the company and its subsidiaries, generally using the straight-line method, based on estimated useful lives of the assets, which in some instances may be less than the lives allowed for tax purposes. For federal income tax purposes, most assets are depreciated using allowable accelerated methods and the Class Life Asset Depreciation Range System (ADR).

The ranges of estimated useful lives used in computing depreciation and amortization for financial reporting were as follows:

	Years
Land improvements	10-50
Buildings and equipment	10-50
Machinery and equipment	3-25
Leasehold improvements	Generally life of lease

Renewals and betterments are capitalized by additions to the related asset accounts, while repair and maintenance costs are charged against earnings. The company and its subsidiaries generally record retirements by removing the cost and accumulated depreciation from the asset and reserve accounts, reflecting any resulting gain or loss in earnings.

At December 31, 1978 and 1977, the company and certain of its subsidiaries had the following assets recorded under capital leases (in thousands):

	1978	1977
Land and improvements	$ 360	$ 351
Buildings and equipment	16,286	4,962
Machinery and equipment	26,317	19,481
Construction in progress	—	832
	42,963	25,626
Less—Accumulated depreciation and amortization	21,290	9,823
	$21,673	$15,803

Certain leases, entered into prior to January 1, 1977 and meeting the criteria for classification as capital leases, were accounted for as operating leases at December 31, 1977. Such leases were capitalized as of January 1, 1978, increasing assets and liabilities by $9,600,000. The impact on earnings in 1977 and in prior years had such leases been capitalized would not have been significant in amount.

Start-up Costs—Start-up costs related to new operations and major facilities are expensed as incurred.

Revenue Recognition—Revenue on the majority of the company's products and services is recorded at the time deliveries or acceptances are made and the company has the contractual right to bill.

Excess of Cost over Net Tangible Assets—In compliance with Opinion No. 17 of the Accounting Principles Board, the excess of cost ($14,252,000) arising from acquisitions subsequent to October 31, 1970 is being amortized on a straight-line basis, over 40 years, and the excess of cost arising from acquisitions prior to October 31, 1970 ($10,466,000) is not being amortized since there is no indication of any impairment in the value of these intangibles.

Earnings Per Share—Earnings per common share, including common equivalent share, are computed by dividing net earnings less dividends on preferred stock by the weighted average number of shares of common stock and common stock equivalents outstanding during each period. Common stock equivalents are shares issuable on the exercise of stock options when dilutive, net of shares assumed to have been purchased with the proceeds.

Earnings per share, assuming full dilution, are computed as above with additional assumptions that all the dilutive convertible securities were converted and related dividends were eliminated.

2. Income Taxes

The provision for income taxes is as follows:

	(In thousands)				
	1978	1977	1976	1975	1974
Current	$79,761	$51,835	$47,176	$37,033	$61,061
Deferred	(4,141)	7,925	2,430	2,837	(928)
Total	$75,620	$59,760	$49,606	$39,870	$60,133

Current includes foreign income taxes of $3,523,000, $3,094,000, $5,430,000, $2,918,000, and $1,957,000; and deferred includes foreign income taxes of $1,283,000, $1,971,000, $148,000, $185,000, and $207,000 for 1978, 1977, 1976, 1975, and 1974, respectively.

Deferred income taxes result principally from timing differences in the recognition of revenue and expense for tax and financial reporting. Significant items were as follows:

	(In thousands)				
	1978	1977	1976	1975	1974
Depreciation	$ 1,897	$ 5,976	$ 3,707	$ 2,486	$ 2,330
Employee benefits	1,426	3,544	182	605	(739)
Other (not individually significant)	(7,464)	(1,595)	(1,459)	(254)	(2,519)
Total	$(4,141)	$ 7,925	$ 2,430	$ 2,837	$ (928)

The tax provisions were determined as follows:

	(In thousands)				
	1978	1977	1976	1975	1974
Tax at statutory U.S. federal income tax rate	$78,067	$62,025	$55,896	$46,707	$66,449
Increases (decreases):					
Investment tax credit	(4,500)	(3,800)	(2,986)	(2,635)	(2,556)
Foreign losses with no tax benefit, DISC, capital gains, etc.	2,053	1,535	(3,304)	(4,202)	(3,760)
	$75,620	$59,760	$49,606	$39,870	$60,133
Effective tax rate	46.5%	46.25%	42.6%	41.0%	43.4%

3. Long-Term Debt

	(In thousands)	
	1978	1977
Colt Industries Inc (a)—		
9¾% senior promissory notes due 1982-1996	$115,000	$115,000
8½% senior promissory notes due 1979-1992	46,666	50,000
6% notes due 1979-1980	5,000	8,000
Pollution control bonds 6%-7% due 1998-2008	11,975	11,500
Capital lease obligations 4.2%-9.2% due 1979-2008 (c)	18,485	19,902
	197,126	204,402
Subsidiaries—(*indicates average interest rates for 1978)		
First mortgage sinking fund bonds 5.3%-6⅞% due serially 1979-1992 (b)	49,230	54,764
8⅞% notes payable to insurance company in installments to 1990	23,000	24,500
Notes due 1979-1989—9.0%*	20,797	20,718
Capital lease obligations 3.9%-11.9% due 1979-2070 (c)	9,246	354
Other long-term debt due 1979-1992—7.9%*	14,895	15,496
	314,294	320,234
Less—Amounts due within one year	19,998	18,908
	$294,296	$301,326

a) The company's loan agreements provide that, for the company and all restricted subsidiaries, current assets shall not be less than 175 percent of current liabilities and that working capital shall not be less than 100 percent of funded debt. In addition, dividends declared subsequent to December 31, 1975 are limited to the sum of $50,000,000, plus net earnings since December 31, 1975. At December 31, 1978, $157,000,000 of consolidated retained earnings was available for dividends. The loan agreements also provide that the company cannot incur any additional funded debt, unless at the time such funded debt is incurred and after giving effect thereto, net tangible assets would then exceed 200 percent of funded debt and 250 percent of senior funded debt.

b) The mortgage bond indentures, secured by approximately $195,000,000 of assets, principally property, plant, and equipment, provide for restrictions on the disposition of property and the creation of additional indebtedness.

c) The amounts payable under capital lease obligations are as follows (in thousands):

1979	$ 5,139
1980	4,898
1981	3,406
1982	2,487
1983	2,407
Remainder	40,623
Total minimum lease payments	58,960
Less—Amount representing interest	31,229
Present value of net minimum lease payments, included in long-term debt	$27,731

d) Minimum payments on long-term debt, including capital lease obligations, due within five years from December 31, 1978 are as follows (in thousands):

1979	$19,998
1980	17,916
1981	15,709
1982	21,590
1983	21,362

e) At December 31, 1978, the company had unused lines of credit aggregating $50,000,000 for short-term bank borrowings. The company has understandings with the banks regarding compensating balances for these credit arrangements but the aggregate amount of such compensating balances was not material at December 31, 1978. During 1978, the average short-term borrowing outstanding was $21,856,000, with $25,275,000 being the maximum amount outstanding at any month-end. The weighted average interest rate on short-term borrowing, principally related to foreign borrowing, was 10.6 percent during the year and 11.2 percent at year-end. The average interest rate during the year was calculated by weighting the short-term borrowing outstanding for each month.

f) During January, 1979, the company entered into two Revolving Credit Agreements for a total of $150,000,000. A commitment fee of ½ of 1 percent per annum is payable on the unused portions.

4. Capital Stock

On May 4, 1978, the Board of Directors authorized a three-for-two stock split in the form of a 50 percent stock dividend. In connection with the stock split, 4,198,955 shares (including 58,175 treasury shares) were issued with the par value of these additional shares ($4,198,955) being transferred from retained earnings to common stock. Cash was paid in lieu of issuing fractional shares.

All share and per share amounts have been adjusted to give effect to the stock split.

Changes in capital stock are shown below for 1976, 1977, and 1978:

	Preferred Shares $1 Par Value	Common Shares $1 Par Value	Treasury Stock Shares	Treasury Stock Cost
Balance at January 1, 1976	$1,286,467	$ 7,656,866	(116,350)	$(6,544,000)
Stock dividends of acquired company prior to pooling of interests	—	37,354	—	—
Conversion and retirements of preferred stock and exercise of options	(25,717)	121,466	—	—
Adjustment to conform fiscal year of pooled company	—	44,275	—	—
Balance at December 31, 1976	1,260,750	7,859,961	(116,350)	(6,544,000)
Conversion of preferred stock and exercise of options	(55,769)	246,203	—	—
Balance at December 31, 1977	1,204,981	8,106,164	(116,350)	(6,544,000)
Conversion of preferred stock and exercise of options	(421,575)	735,783	—	—
Stock issued under three-for-two stock split	—	4,198,955	(58,175)	—
Balance at December 31, 1978	$ 783,406	$13,040,902	(174,525)	$(6,544,000)

The authorized preferred stock is issuable in series. Outstanding preferred stock has voting rights and is entitled to cumulative dividends. At December 31, 1978, the following series were outstanding:

	Annual Dividend Rate	Shares Outstanding	Involuntary Liquidation Value	Redemption Value Per Share
Convertible preferred				
Series A	$1.60	222,797	$ 8,912,000	$ 41.00
Series B	4.50	10,815	1,082,000	101.50
Series C	4.25	12,785	1,279,000	102.50
Series D	4.25	475,567	47,557,000	102.00
		721,964	58,830,000	
Non-convertible preferred				
Series E	2.75	61,442	3,379,000	55.00
		783,406	$62,209,000	

Dividends may not be paid on common stock if the shareholders' equity of the company would thereby be reduced below the aggregate involuntary liquidation preference applicable to outstanding preferred stock ($62,209,000), plus the amount of capital attributable to common stock ($12,866,000).

All series, except Series E, are convertible into common stock of the company: Series A at the rate of four shares of common stock for each five shares of preferred; Series B at the rate of 7.604 shares of common stock for each share of preferred; Series C at the rate of 2.265 shares of common stock for each share of preferred; and Series D at the rate of 2.166 shares of common stock for each share of preferred; subject to certain specified adjustments. These conversion rates have been adjusted to give effect to the stock split.

At December 31, 1978, shares of common stock were reserved for the following purposes:

Conversion of preferred stock	1,319,704
Issuance under stock options	770,206

5. Pension and Retirement Plans

The company and certain of its subsidiaries have in effect, for substantially all employees, pension and retirement plans under which funds are deposited with trustees. As of December 31, 1978, the actuarially computed vested benefits, using a 6 percent interest factor, were $348,789,000, exceeding the market values of fund assets by $132,223,000.

Pension expense of $41,389,000, $38,272,000, $36,103,000, $28,892,000, and $23,129,000 was charged to earnings in 1978, 1977, 1976, 1975, and 1974, respectively, and is the maximum annual provision permitted by Opinion No. 8 of the Accounting Principles Board, including amortization of prior service cost at 10 percent per year.

6. Stock Option Plans

The company's shareholders approved the Colt Industries Stock Option Plan, as amended in 1968, to the extent of 525,000 common shares and the Colt Industries 1974 Stock Option Plan, as amended in 1977, to the extent of 825,000 common shares. They provide for the granting of qualified and non-qualified options to officers and key employees at a price not less than 100 percent of the market price on the date of grant. Under the 1968 plan, options are no longer granted and lapsed options accrue to the 1974 plan. Under the 1974 plan, options may be granted to September 11, 1983. Qualified options granted subsequent to May 20, 1976 and not exercised by May 20, 1981, pursuant to the Tax Reform Act of 1976, will be treated as non-qualified options.

Options granted are exercisable in cumulative annual installments of from 25 to 33⅓ percent, commencing one year to three years from date of grant.

At December 31, 1978, options for 581,957 shares were outstanding (of which 548,207 were non-qualified and 33,750 were qualified) at prices ranging from $9.29 to $37.92 per share and aggregating $17,148,000. Shares available for grant at December 31, 1978 and 1977 were 181,990 and 478,491 (31,801 of which are shares relating to lapsed options under the plan adopted in 1968), respectively.

No charges have been made to earnings for any year with respect to stock options.

A summary of information with respect to stock options which were granted, which became exercisable, and which were exercised during the three years ended December 31, 1978 is presented below:

Granted

	Number of Shares	Option Price Per Share	Option Price Total (In thousands)	Market Price Per Share	Market Price Total (In thousands)
1976	79,575	$23.96-$34.67	$1,962	$23.96-$34.67	$1,962
1977	77,550	$29.25-$36.75	2,742	$29.25-$36.75	2,742
1978	297,500	$29.13-$37.92	11,253	$29.13-$37.92	11,253
	454,625		$15,957		$15,957

Exercisable (a)

	Number of Shares	Option Price Per Share	Option Price Total (In thousands)	Market Price Per Share	Market Price Total (In thousands)
1976	114,834	$ 9.46-$22.17	$1,238	$21.09-$36.50	$3,556
1977	60,919	$10.33-$34.67	1,035	$27.59-$36.67	2,091
1978	48,603	$22.17-$36.75	1,469	$29.08-$42.38	1,592
	224,356		$3,742		$7,239

Exercised (a)

	Number of Shares	Option Price Per Share	Option Price Total (In thousands)	Market Price Per Share	Market Price Total (In thousands)
1976	96,474	$ 9.13-$22.17	$1,045	$21.67-$37.25	$2,894
1977	262,345	$ 9.13-$23.96	2,603	$27.59-$38.92	8,556
1978	92,664	$ 9.29-$34.25	1,052	$28.92-$41.00	2,971
	451,483		$4,700		$14,421

a) The market price per share represents the highest sales price on various dates at which options became exercisable or were exercised as applicable.

In connection with the acquisition of Garlock and Menasco, the company reserved 78,093 shares of its common stock for the exercise of options granted by the company in substitution for previously outstanding options of the acquired companies at an average price of $10.37 per common share of the company. During 1978 and 1977, options for 6,738 and 8,289 shares were exercised. The average market price per common share of the company at the time these options were exercised was $33.33 in 1978 and $33.96 in 1977. At December 31, 1978, options for 6,259 shares were outstanding.

The above shares and per share amounts have been adjusted to give effect to the stock split (see Note 4).

7. Incentive Compensation Plans

The Colt Industries Incentive Plan, approved by shareholders at the 1965 annual meeting, provides that if net earnings of the company for any year, after deducting therefrom the amount of all dividends accruing during such year in respect of preferred stocks, exceeds an amount equal to 6 percent of common shareholders' average equity for the year, then there shall become available for incentive awards for that year an amount equal to 6 percent of earnings before income taxes. Under this plan, the company made cash awards of $2,771,000, $1,903,000, $1,731,000, $1,505,000, and $1,719,000, for 1978, 1977, 1976, 1975, and 1974, respectively.

In 1977, the shareholders approved the 1977 Long-Term Performance Plan which provides for awarding performance shares. Under this plan, performance shares outstanding accrue value depending upon net earnings of the company. If net earnings in any year are less than $50,000,000, performance shares will not accrue value. If net earnings are $50,000,000 or more, the plan provides that each performance share will accrue $5.00 in value plus $.15 for each additional $1,000,000 of net earnings in excess of $50,000,000 to a maximum of $12.50. The charge to earnings to provide for awards under this plan was $1,725,000 in 1978 and $1,240,000 in 1977.

The persons to receive awards under these plans and the amounts thereof are determined by a committee consisting of three directors, none of whom is eligible to receive an award.

8. Segment Information

The company's operations are conducted through divisions within five industry segments consisting of:

Industrial and Power Equipment—fabricated metal products, weighing systems, industrial diesel engines and accessories, compressors, machine tools and measuring equipment, transformers, and firearms;

Fluid Control Systems—automotive carburetors, pumps and aerospace fuel systems and controls;

Materials—specialty carbon and low-alloy steels, stainless and other special purpose steels;

Industrial Seals and Components—gaskets, packings, valves, and other devices to prevent leakage and seal out contaminants;

Shock Mitigation Systems—aircraft landing gear assemblies and other shock mitigation and flight control systems.

Information on the company's industry segments for the two years ended December 31, 1978 is as follows (in millions):

Industry Segments	Operating Income	Sales	Total Assets	Depreciation and Amortization	Additions to Properties
1978					
Industrial and Power Equipment	$ 55.2	$ 516	$ 318	$ 8.5	$16.3
Fluid Control Systems	48.4	320	116	6.4	6.1
Materials	44.3	664	395	20.3	20.0
Industrial Seals and Components	31.9	250	190	6.6	8.8
Shock Mitigation Systems	14.2	92	74	2.1	4.7
Intersegment elimination	—	(34)	—	—	—
Total segments	194.0	1,808	1,093	43.9	55.9
Interest expense	(29.8)	—	—	—	—
Interest income	13.1	—	—	—	—
Corporate unallocated	(14.7)	—	171	.3	.1
Consolidated	$162.6	$1,808	$1,264	$44.2	$56.0
1977					
Industrial and Power Equipment	$ 48.2	$ 453	$ 296	$ 8.0	$14.6
Fluid Control Systems	35.4	238	101	5.9	3.8
Materials	42.8	582	375	15.9	18.7
Industrial Seals and Components	25.3	206	177	5.6	6.9
Shock Mitigation Systems	11.0	77	65	1.5	2.0
Intersegment elimination	—	(31)	—	—	—
Total segments	162.7	1,525	1,014	36.9	46.0
Interest expense	(25.3)	—	—	—	—
Interest income	5.4	—	—	—	—
Corporate unallocated	(13.6)	—	98	.2	.1
Consolidated	$129.2	$1,525	$1,112	$37.1	$46.1

Information on the company's operations by geographic segments for the two years ended December 31, 1978 is as follows (in millions):

Geographic Segments	Earnings Before Income Taxes	Sales	Total Assets
1978			
Domestic Operations	$160.9	$1,664	$1,189
Foreign Operations	1.7	164	139
Intersegment elimination	—	(20)	(64)
Consolidated	$162.6	$1,808	$1,264
1977			
Domestic Operations	$123.2	$1,404	$1,044
Foreign Operations	6.0	138	132
Intersegment elimination	—	(17)	(64)
Consolidated	$129.2	$1,525	$1,112

9. Quarterly Sales and Earnings (Unaudited)

For the two years ended December 31, 1978 (in thousands of dollars, except per share data):

	Quarter			
1978	1st	2nd	3rd	4th
Net sales	$421,484	$458,566	$447,550	$480,282
Gross profit	75,829	92,784	90,892	101,533
Net earnings	16,020	22,722	22,006	26,272
Earnings per common share—				
Including common equivalent share	1.23	1.77	1.67	1.98
Assuming full dilution	1.12	1.59	1.53	1.83
1977	1st	2nd	3rd	4th
Net sales	$357,756	$395,154	$368,115	$404,459
Gross profit	62,786	79,410	75,103	85,237
Net earnings	11,104	19,301	17,234	21,821
Earnings per common share—				
Including common equivalent share	.84	1.51	1.34	1.71
Assuming full dilution	.78	1.35	1.21	1.53

The above per share amounts have been adjusted to give effect to the stock split (see Note 4).

10. Supplementary Earnings Information

	(In thousands)				
	1978	1977	1976	1975	1974
Maintenance	$89,158	$73,935	$63,570	$51,860	$51,691
Depreciation and amortization	44,192	37,051	35,309	29,065	27,817
Taxes, other than federal income taxes—					
Payroll	36,005	29,796	25,804	20,610	21,571
Property	7,449	7,445	6,916	6,089	5,729
State and local	14,610	10,323	10,649	9,071	13,506
Other	3,986	3,674	3,508	3,197	3,093
	62,050	51,238	46,877	38,967	43,899
Rent	17,869	17,390	16,427	14,339	13,809
Rental income	(4,159)	(3,743)	(3,797)	(3,591)	(3,439)
	13,710	13,647	12,630	10,748	10,370
Research and development costs	18,835	17,665	15,475	13,558	13,925

11. Commitments and Contingencies

The company and certain of its subsidiaries are contingently liable as guarantors of certain leases and are defendants in various lawsuits. In the opinion of management, these contingent liabilities are not significant in relation to the financial position of the company and its subsidiaries.

The company and certain of its subsidiaries are obligated under operating lease commitments, expiring on various dates after December 31, 1979 to pay rentals totaling $59,277,000, as follows: $7,461,000 in 1979, $6,310,000 in 1980, $5,258,000 in 1981, $3,977,000 in 1982, $3,286,000 in 1983, and $32,985,000 in later years. These rent payments are before reduction for related sublease rentals of $20,901,000.

12. Replacement Cost Data (Unaudited)

In compliance with rules of the Securities and Exchange Commission, management has estimated the replacement cost of certain inventories and productive capacity of the company and its consolidated subsidiaries as of December 31, 1978 and 1977, together with cost of sales and depreciation on the basis of replacement cost for the two years then ended.

The replacement cost information presented below does not reflect all of the effects of inflation and other economic factors on the company's current costs of operating the business. The SEC rule does not require consideration of these effects on assets and liabilities other than inventories and productive capacity. Further, the replacement cost information standing alone does not recognize the customary relationships between cost changes and changes in selling prices. The company has attempted over the years to adjust selling prices to maintain profit margins. Competitive conditions permitting, the company expects to modify its selling prices to recognize future cost changes. Accordingly, it is management's view that the limited replacement cost data presented herein cannot be used alone to compute the total effect of inflation on net earnings as reported.

Management also cautions that this information should not be interpreted to indicate that the company actually has present plans to replace such assets and that actual replacement would take place in the form and manner assumed in developing these estimates. The replacement cost information is based on the hypothetical assumption that the company would replace its entire inventory and productive capacity at the end of its fiscal year, whether or not such instant replacement were physically possible. In the normal course of business, the company will replace its productive capacity over an extended period of time. Decisions concerning replacement will be made in the light of economic, regulatory, and competitive conditions existing on the dates such determinations are made and could differ substantially from the assumptions on which the data included herein are based. If the company's productive capacity were to be replaced in the manner assumed in the calculation of replacement cost of existing productive capacity, many costs in addition to depreciation (e.g., direct labor costs, repairs and maintenance, utility, and other indirect costs) would be altered. Although these expected cost changes cannot be quantified with any precision, the current level of operating costs other than depreciation would be reduced as a result of the technological improvements assumed in the hypothetical replacement.

It must be recognized that these required replacement cost data are, by their nature, limited in scope, imprecise, and predicated upon certain assumptions and subjective judgments which may vary over time and from company to company.

Set forth below is an analysis of management's estimates of the replacement cost of certain of the inventories and productive capacity of the company and its subsidiaries at December 31, 1978 and 1977, together with an estimate of the replacement cost of sales and depreciation for the two years then ended. Comparable related historical amounts with respect to these same assets, as stated in the accompanying consolidated balance sheet and statement of earnings, are also included for informational purposes.

(In thousands)

	1978		1977	
	Replacement Cost (Unaudited)	Historical Cost (a)	Replacement Cost (Unaudited)	Historical Cost (a)
Inventories—				
Finished goods	$ 116,024	$ 94,408	$ 112,466	$ 92,425
Work in process and finished parts	288,989	235,068	252,729	205,611
Raw materials and supplies	115,268	101,390	104,225	94,462
	520,281	430,866	469,420	392,498
Less reserves	32,896	32,896	27,550	27,550
	$ 487,385	$ 397,970	$ 441,870	$ 364,948
Property, Plant, and Equipment—				
Land improvements	$ 26,501	$ 12,305	$ 24,408	$ 11,949
Buildings and equipment	387,008	144,340	343,640	127,479
Machinery and equipment	1,201,184	627,218	1,088,227	584,330
Leasehold improvements	12,740	7,206	11,756	7,119
	1,627,433	791,069	1,468,031	730,877
Less accumulated depreciation and amortization	1,138,837	456,485	997,416	411,724
	$ 488,596	$ 334,584	$ 470,615	$ 319,153
Cost of Sales	$1,459,654	$1,446,844	$1,235,782	$1,222,948
Depreciation—				
Included in cost of sales	$ 53,664	$ 40,702	$ 46,275	$ 33,793
Included in other operating costs	4,603	3,490	4,649	3,258
	$ 58,267	$ 44,192	$ 50,924	$ 37,051

a) For purposes of comparison with replacement cost, the historical cost data excludes land, ($11,311,000 and $11,440,000), and construction in progress, ($26,646,000 and $21,538,000) at December 31, 1978 and 1977, respectively. Machinery and equipment, at historical cost, includes capital expenditures for pollution equipment of $161,000 and $9,179,000 at December 31, 1978 and 1977, respectively. This pollution equipment, at December 31, 1978 is reported as funds held by custodian and at December 31, 1977 as construction in progress ($7,512,000) and funds held by custodian ($1,667,000).

With respect to inventories, replacement cost has been estimated based on quantities on hand at the end of the year. The excess of replacement cost over historical cost, stated at LIFO included above, at December 31, 1978 and 1977 was approximately $85,000,000 and $70,000,000 re-

spectively. There is no significant effect on the components of inventory such as depreciation, direct labor costs, repairs and maintenance, utility, or other indirect costs as a result of the assumed replacement cost of productive capacity.

Replacement cost of sales was estimated through adjustment of historical cost of sales for the approximate time lag between incurring inventory costs and their subsequent conversion into sales revenue. The replacement cost of sales amount does not include any cost savings in direct labor, repairs and maintenance, utility, and other indirect costs which may result from the replacement of existing assets with assets of improved technology.

The estimated replacement cost of productive capacity was determined by adjusting historical cost by indices of reproduction cost relevant to the plant and equipment of the company. The result was modified by vendor quotations and engineering studies to reflect major technological improvements which management intends to incorporate into the productive capacity through normal capital expenditure programs and to reflect anticipated environmental expenditures.

Accumulated depreciation and depreciation expense, on a replacement cost basis, are based on the expired economic lives used for historical cost purposes and are calculated using the straight-line method. Accumulated depreciation and depreciation expense on a replacement cost basis were computed by adjusting historical cost depreciation by the same reproduction cost indices used to develop the estimated replacement cost of productive capacity. The result was modified by the effect on depreciation of changes to productive capacity resulting from technological replacements and anticipated environmental expenditures. In certain instances, historical depreciation is calculated on an accelerated basis with the corresponding replacement depreciation calculated on a straight-line basis.

Auditors' Report

To the Board of Directors and Shareholders
Colt Industries Inc:

We have examined the consolidated balance sheet of Colt Industries Inc (a Pennsylvania corporation) and subsidiaries as of December 31, 1978 and 1977, and the consolidated statements of earnings, retained earnings, capital in excess of par value and changes in financial position for each of the five years in the period ended December 31, 1978. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements present fairly the financial position of Colt Industries Inc and subsidiaries as of December 31, 1978 and 1977, and the results of their operations and changes in their financial position for each of the five years in the period ended December 31, 1978 in conformity with generally accepted accounting principles consistently applied during the periods.

Arthur Andersen & Co.

New York, N.Y.,
January 26, 1979

Directory of Operations

Industrial and Power Equipment

Fairbanks Morse Engine Division
701 Lawton Avenue
Beloit, Wisconsin 53511
608/364-4411

Diesel engine generator systems for standby, peaking, and continuous service/Diesel engines for industrial drives/Marine diesel propulsion systems and generator systems.

Central Moloney Transformer Division
2400 West Sixth Avenue
Pine Bluff, Arkansas 71601
501/534-5332

Pole, pad-mounted, underground, and station-type distribution transformers/Transformer components.

Pratt & Whitney Machine Tool Division
Charter Oak Boulevard
West Hartford,
Connecticut 06101
203/236-6221

Numerically controlled machining centers/NC and automatic lathes and chuckers/Jig borers/NC and tracer milling machines/Electronic measuring systems/Sterling thread-rolling dies, taps/Haber cold-heading tools/P&W-Fastcut cutting tools.

Elox Division
P.O. Box 2227
Davidson,
North Carolina 28036
704/892-8011

Conventional and traveling wire electrical discharge machining equipment.

Fairbanks Weighing Division
711 East St. Johnsbury Road
St. Johnsbury, Vermont 05819
802/748-5111

Bench and portable floor scales/Warehouse, hopper, and conveyor scales/Portable and stationary truck scales/Static and in-motion railroad scales/Mechanical and electronic indicators.

Quincy Compressor Division
217 Maine Street
Quincy, Illinois 62301
217/222-7700

Reciprocating compressors/Stationary and portable helical screw compressors.

Trent Tube Division
2188 South Church Street
East Troy, Wisconsin 53120
414/642-7321

Welded stainless steel, titanium, and other high-alloy tubing to 150-foot lengths for electric utility condensers and feed-water heaters/Nuclear, liquefied natural gas, and 26-1 special alloy tubing/Stainless and high-alloy pipe and tubing for processing, aerospace, cryogenic, and instrumentation applications.

Crucible Magnetics Division
RFD 2
Elizabethtown, Kentucky 42701
502/769-1333

Cast alnico, Ferrimag ceramic, and Crucore rare earth-cobalt permanent magnets.

Crucible Spring Division
1 McCandless Avenue
Pittsburgh, Pennsylvania 15201
412/782-7300

Hot-wound heavy-duty coil springs for railroad car and other industrial applications.

Colt Firearms Division
150 Huyshope Avenue
Hartford, Connecticut 06102
203/278-8550

Hunting rifles/Sporting, target, and commemorative arms and accessories/Police, security, and military handguns/M16 military rifles/Grenade launchers.

Fluid Control Systems

Holley Carburetor Division
11955 East Nine Mile Road
Warren, Michigan 48090
313/536-1900

Design, manufacture, and sale of OEM car and truck carburetors/Development of non-carburetor automotive fuel management systems.

Holley Replacement Parts Division
11955 East Nine Mile Road
Warren, Michigan 48090
313/536-1900

Engineering, distribution, and sale of Holley products for the automotive aftermarket.

Holley Special Products Division
11955 East Nine Mile Road
Warren, Michigan 48090
313/536-1900

Emission control air injection pumps, controls, and other non-fuel system products.

F. D. Farnam Inc
8405 West 45th Street
Lyons, Illinois 60534
312/447-7155

Gaskets, gasket assemblies for automotive applications.

Chandler Evans Control Systems Division
Charter Oak Boulevard
West Hartford,
Connecticut 06101
203/236-0651

Fuel pumps, fuel controls, valves, and other gas turbine engine control components/Aircraft and missile flight controls, valves, and actuators.

Fairbanks Morse Pump Division
3601 Fairbanks Avenue
Kansas City, Kansas 66110
913/371-5000

Centrifugal, turbine, and axial-flow pumps for pollution control, fire protection, water supply, irrigation, drainage, and industrial applications.

Materials

Crucible Alloy Division
P.O. Box 226
Midland, Pennsylvania 15059
412/643-1100

Alloy and special quality carbon steel ingots, blooms, billets, and bars/Vacuum arc remelted alloys/Stainless forging blooms, billets, and reforging bars/Discs and colters for agriculture/Other flat-rolled special products.

Crucible Stainless Steel Division
P.O. Box 226
Midland, Pennsylvania 15059
412/643-1100

Stainless steel sheet, strip, and plate/Titanium and titanium alloy plate, sheet, and strip.

Crucible Specialty Metals Division
P.O. Box 977
Syracuse, New York 13201
315/487-4111

Crucible particle metallurgy and conventional high-speed steel/Tool and die steels/Stainless free-machining bars and rods/High-temperature aerospace, nuclear, and chemical processing alloys/Valve steels/Commercially pure and alloyed titanium bars, rods, and wire.

Affirmative Action
In striving to develop and maintain an effective work force, the company provides employment, training, and advancement opportunities without regard to race, color, religion, sex, age, or national origin. The company's affirmative action program covers the employment of minorities, women, handicapped persons, and veterans of the Vietnam conflict.

Industrial Seals and Components

Garlock Mechanical Packing Division
1666 Division Street
Palmyra, New York 14522
315/597-4811

Molded and extruded rubber and urethane products/Seals for fluid power applications/Gasketing/Expansion joints/Flexible couplings and flue duct connectors/Braided and other compression packings/Mechanical seals for pumps.

France Compressor Products Division
P.O. Box A
Newtown, Pennsylvania 18940
215/968-5959

Compressor and industrial engine components.

Stemco Truck Products Division
P.O. Box 1989
Industrial Boulevard
Longview, Texas 75601
214/758-9981

Wheel lubrication systems/Exhaust systems and leaf springs for heavy-duty trucks.

Garlock Precision Seal Division
4307 York Road
Gastonia, North Carolina 28052
704/864-8352

Oil seals for automotive and other mechanical equipment/Spiral-wound gaskets/Automotive transmission kits/Molded rubber products.

Garlock Special Products Division
Suite 1250, Midtown Tower
Rochester, New York 14604
716/232-1400

Plastic-based bearings and bearing materials/TFE-coated butterfly valves and components/Ortman hydraulic and pneumatic cylinders/Lubrication powders.

Shock Mitigation Systems

Menasco California Division
First and Cedar Streets
Burbank, California 91510
213/842-9111

Landing gear for military and commercial aircraft/Shock mitigation systems for missiles and other applications.

Menasco Texas Division
P.O. Box 7656
Highway 157 and Pipeline Road
Fort Worth, Texas 76111
817/283-4474

Military and commercial aircraft landing gear/Hydraulic systems and weapons loading systems for submarines and destroyers/Helicopter components.

Menasco Overhaul Division
26 East Providencia Avenue
Burbank, California 91510
213/843-0611

Overhaul and repair of landing gear and related components for U.S. and foreign airlines and military services.

Colt Industries Credit Corporation
430 Park Avenue
New York, New York 10022
212/940-0503

Provides financing and leasing of income-producing equipment for customers of Colt Industries divisions and for users of equipment of other manufacturers in the machine tool, construction, plastics, and other industries.

International Operations

Colt Industries (Canada) Ltd.
Case Postale 520
Sorel, Québec, Canada J3P 5PZ
514/743-7931

Crucible tool and die steels/Custom forgings.

Menasco Canada Ltée
3495 Cote Vertu
Montreal, Québec,
Canada H4R 1R3
514/332-3330

Landing gear and flight controls for military and commercial aircraft/Helicopter rotor components/Flight control overhaul service.

Garlock of Canada Ltd.
66 Jutland Road
Toronto, Ontario,
Canada M8Z 2H3
416/255-9144

Molded and extruded rubber products/Braided packings.

Garlock of Canada Ltd. France Compressor Products Division
P.O. Box 636
Brantford, Ontario,
Canada N3T 5P9
519/753-8671

Compressor and industrial engine components and service.

Crusteel Limited
Rutland Way
Sheffield S3 8DG
Yorkshire, England

Specialty steel and tubing distributors.

Woodville Rubber Company, Ltd.

Alton Lane, Ross-on-Wye
Herefordshire HR9 5NF, England

High-technology specialty molded rubber products.

Trent Tube B.V.
Vossenbeemd 111
Helmond, The Netherlands

Welded stainless steel tubing and pipe.

Garlock AG
Tösstalstrasse 57
CH-8400 Winterthur 11
Switzerland

Distribution, manufacture of Garlock products.

Chromex S.A.
2, rue Tirebarbe
91510 Lardy, France

Oil seals, valve seats, TFE piston rings, and other products for the automotive and other industries.

Liard France S.A.
49, Route National
F-59570 Bavay, France

Compressor and industrial engine components.

Garlock GmbH
Postfach 300 450
Scheffelstrasse 73
4000 Düsseldorf 30
West Germany

Distribution of Garlock products.

Manufacturera Fairbanks Morse, S.A.
Apartado Postal M-10757
Mexico 1, D.F.

Pumps/Motors/Generators/Scales/Transformers.

Garlock de Mexico, S.A.
Poniente 116, No. 571
Mexico 15, D.F.

Industrial packing and gasketing/Compressor components/TFE specialty products and molded rubber products.

Directors and Officers

Directors

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Dean, Massachusetts
Institute of Technology
School of Science
Cambridge, Massachusetts

William D. Ford
Senior Vice President
Secretary and
General Counsel
Colt Industries Inc
New York, New York

George C. Lessner
Attorney
Manchester, Connecticut

Gerald J. Lynch
Chairman
Menasco Inc
Burbank, California

David I. Margolis
President
Colt Industries Inc
New York, New York

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Chairman of the
Executive Committee
Garlock Inc
Rochester, New York

William H. Rea
Chairman
Tyrone Hydraulics Inc.
Pittsburgh, Pennsylvania

Matthew B. Ridgway
General, U.S. Army (Ret.)
Pittsburgh, Pennsylvania

William S. Schwab
Attorney
Chicago, Illinois

Louis T. Seith
General, U.S. Air Force (Ret.)
Arlington, Virginia

George A. Strichman
Chairman of the Board and
Chief Executive Officer
Colt Industries Inc
New York, New York

Max E. Wildman
Partner
Wildman, Harrold, Allen &
Dixon, attorneys
Chicago, Illinois

Directors Emeritus

George R. Harrison
Dean Emeritus, M.I.T.
School of Science
Concord, Massachusetts

Alva W. Phelps
Retired
Kenilworth, Illinois

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Chief Executive Officer

David I. Margolis
President

Salvatore J. Cozzolino
Senior Vice President
Finance and Treasurer

William D. Ford
Senior Vice President
Secretary and
General Counsel

Andrew C. Hilton
Senior Vice President
Administration

Ben H. Cook
Group Vice President

Gerald J. Lynch
Group Vice President

Eugene A. March
Group Vice President

Guy C. Shafer
Group Vice President

Philip Wallach
Group Vice President

Phil Berkowitz
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(New York)

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Bank (Chicago)

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