City Investing Company

The Company City Investing Company's principal businesses are insurance, worldwide manufacturing, housing and food services. City's Home Group writes a complete range of insurance and ranks among the nation's major property and casualty insurers. City's Rheem manufacturing operations are the world's leaders in water heaters and steel shipping containers and among the nation's foremost producers of heating and air conditioning equipment. City is one of the nation's largest printers of magazines and business forms and owns the country's largest chain of budget motels. The company's 66%-owned subsidiary, GDV, Inc., is one of the nation's leading homebuilders and contract food service companies.

1978 Annual Report

In the interest of providing shareholders more comprehensive information on the company's operations and results, this annual report includes the company's report on Form 10-K, as filed with the Securities and Exchange Commission.

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Highlights

City Investing Company and Subsidiaries

Dollar amounts in millions except per share data

	1977	**1978**
Total revenues	$3,064.9	$3,791.9
Net income	85.2	112.4
Total assets	4,663.7	5,783.4
Common stock dividends	17.6	22.5
Preferred stock dividends	16.1	15.7
Total dividends	33.7	38.2
Employees	44,000	61,500
Shareholders	70,100	69,000
Per share data:		
Earnings per primary share	$3.13	$4.27
Earnings per share — assuming full dilution	2.36	3.06
Book value per share of common stock	18.66	21.42
Common stock dividends per share	.80	1.00

City Investing Company achieved record revenues and earnings in 1978. All major operations contributed to an earnings increase of 32% from the previous year, to $112.4 million. Total revenues rose 24%, to $3.8 billion, reflecting improved market positions and resultant greater unit volume and higher prices for the company's products and services.

City's insurance operations, with record revenues of $1.65 billion, contributed substantially to earnings growth. Investment income and results of property and casualty underwriting and life insurance operations were at record levels. The investment portfolio of City's Home Group grew to $1.9 billion at year-end 1978. The Home Insurance Company ranks among the nation's leaders in property and casualty insurance in commercial risks, which now represent about 80% of its business. In 1978, The Home was reorganized on a geographic profit-center basis and underwriting

Letter to Shareholders

and claim authority was largely decentralized to regional offices to provide greater efficiencies and accountability.

City's worldwide manufacturing operations reported further earnings growth in 1978. Income from operations in air conditioning, water heaters and magazine printing were at record levels. Manufacturing capacity for these products was substantially increased in 1978 to meet greater demand. International manufacturing operations, consisting principally of steel containers, other metal fabricated products and plastics production in Western Europe and Latin America, showed further growth in earnings, while product lines and markets were expanded.

City's budget motel operation continued its record earnings growth. Improved occupancy rates in the nationwide chain, which has been expanded to 254 motels, were largely responsible for the improvement.

During 1978, City's housing operations, comprising single-family homebuilding in the Southwest, community development in Florida and mobile home manufacturing throughout the country, were brought together under GDV, Inc., 66.2% owned by City. As a result, GDV, whose operations are predominantly in the Sun Belt, has become one of the nation's largest housing companies. In 1978, earnings from homebuilding and mobile home production increased considerably, based on record deliveries. GDV ended the year with substantial housing orders for delivery in 1979.

A further step was taken in 1978 in the planned growth and diversification of GDV. In September, pursuant to a cash tender offer, GDV acquired 63.5% of the outstanding shares of Servomation Corp., a leading food service company with calendar 1978 revenues of $452 million. The remaining shares were acquired by merger

Geo. T. Scharffenberger
Chairman and Chief Executive Officer

in January of this year.

GDV's revenues should surpass $1.1 billion in 1979. Originally-reported revenues for 1977, then representing only GDV's Florida community development operations, were just over $100 million. GDV continues to explore opportunities for further growth.

In December 1978, City reached agreement to acquire Uarco Incorporated, a major manufacturer of business forms. This cash acquisition was consummated by merger on February 1, 1979. Uarco's sales for its fiscal year ended September 30, 1978, were $224 million.

In December, City's Southern California Savings and Loan Association completed the acquisition of the assets of First Surety Corp., including Surety Savings and Loan Association, with eight branches in Southern California and deposits of $153 million.

City's financial resources remain strong. The

company's assets have grown to $5.8 billion and shareholders' equity to $794 million. Unused committed credits available to City and its subsidiaries approximated $280 million at year-end 1978, in addition to amounts allocated to completion of the then-pending acquisitions.

Lewis F. Jeffers, Chairman of Hayes International Corporation and a member of the Advisory Committee to City's Board, died in January 1979. Before joining the Advisory Committee, he had been a Director of City for many years. Hayes International was one of the first companies to join City, and we valued our close association and friendship with Lew Jeffers. His many contributions to City will be greatly missed and long remembered.

Joe E. Lonning, Chairman of the Kellogg Company, was elected to City's Board in 1978, and W. Thomas Rice, Chairman Emeritus of Seaboard Coast Line Industries, Inc. joined the Board in 1979.

City's management is confident about the outlook for the Company's operations, many of which are market leaders. As a measure of expected growth, the company's revenues should surpass $5 billion in 1979. Facilities have been expanded and are highly efficient; operating management is experienced and motivated; and financial resources are adequate for expected needs. While the company has grown considerably in just over ten years in its present form, we believe its future is even more exciting.

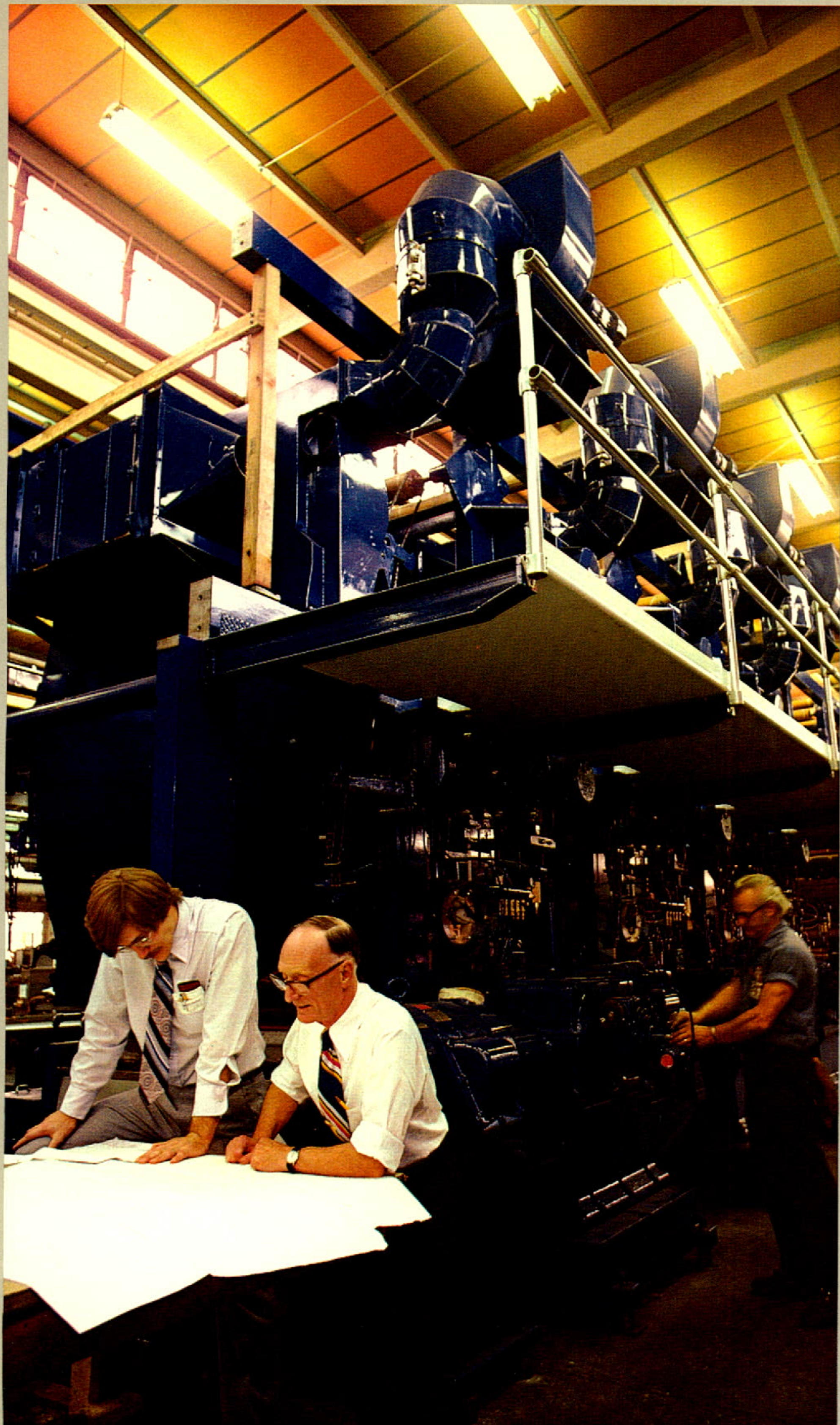
Geo. T. Scharffenberger
Chairman and Chief Executive Officer

March 9, 1979

Left
Peter C.R. Huang
President

Right
Stephen E. O'Neil
President

Heating & Air Conditioning New facilities neared completion in 1978 in the water heater and heating and air conditioning operations of City's Rheem Manufacturing Company. The $20 million, 520,000-square-foot plant pictured here is located in Milledgeville, Georgia, and will double the company's production capacity in residential heating and air conditioning equipment. A $12 million, 250,000-square-foot addition to the Montgomery, Alabama plant will double that facility's size and increase total water heater manufacturing capacity by one-third. Water heaters and heating and air conditioning equipment are sold principally under the Rheem and Ruud brand names. These operations produced record results in 1978.

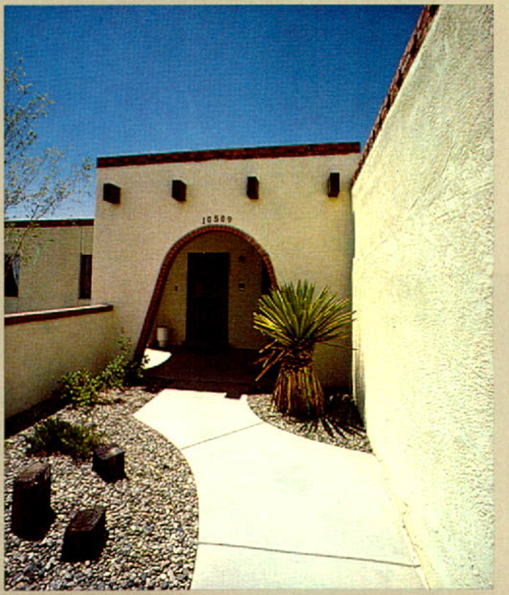


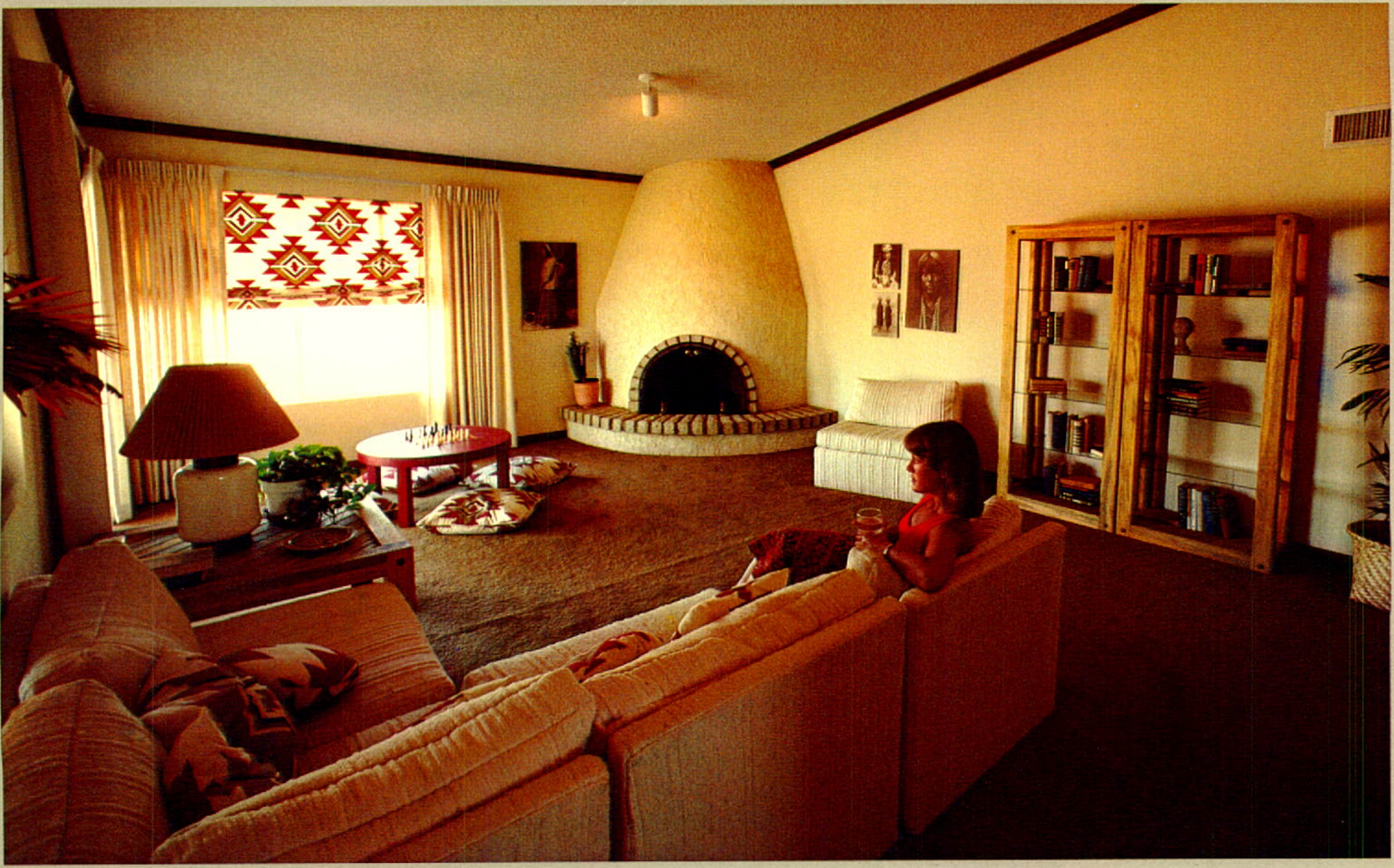
Magazine Printing The volume "explosion" of special-interest magazines and awards of several large, long-term magazine printing contracts required World Color Press to again add to printing capacity. The 72″ web gravure press shown here, being prepared in a manufacturer's plant for installation in the World Color Press facility in Salem, Illinois, is part of a $42 million plant expansion program completed in 1978. World Color Press now operates three major plants in Illinois, and plans to build a fourth.

Budget Motels Motel 6, Inc., the nation's largest economy motel chain, opened 22 motels in 1978 and had 254 in operation at year-end. In addition, 24 new motels were under construction. Chain-wide occupancy improved to 81% in 1978 from 75% the previous year, reflecting the success of the company's "total marketing program" which features appealing color schemes and improved visibility with attractive billboards and on-premise signs.

Insurance As work was completed on the first stage of the new Home Insurance Company office complex at Manchester, New Hampshire, construction began immediately on the second building pictured here. These new offices, comprising 176,000 square feet, house The Home's New England insurance processing operations. The Manchester facility now ranks as one of the most up-to-date information retrieval and dissemination operations in the insurance industry and is geared to provide comprehensive information services to field offices and agents.

Housing City Investing's housing and community development operations are conducted through its 66%-owned GDV, Inc., one of the nation's largest housing companies. GDV's homebuilding activities are conducted primarily in the country's rapidly-growing Sun Belt areas — Florida and the southwestern United States. Sales of single-family homes in 1978 were at record levels, and GDV entered 1979 with a substantial housing backlog.





Food Services Servomation Corp., 63% acquired in September 1978, and merged into GDV, Inc. in January 1979, brings a desired diversification into the growing food service industry. Servomation provides food and refreshments through manual service, such as in the Bankamericard Center cafeteria pictured here, and through vending operations nationwide. Fruit and vegetable juices and "natural" foods are available to the 33,000 students of California State University at Long Beach from this new vending machine installation.

Corporate Offices	767 Fifth Avenue, New York, New York 10022 9100 Wilshire Boulevard, Beverly Hills, California 90212
Independent Auditors	Peat, Marwick, Mitchell & Co.
Transfer Agents	Common Stock and Series A Preference Stock: Chemical Bank, 55 Water Street, New York, New York 10041 Common Stock and Series B Preference Stock: Bank of America, N.T. & S.A., P.O. Box 3415, San Francisco, California 94120 Continental Illinois National Bank and Trust Company of Chicago 231 S. LaSalle Street, Chicago, Illinois 60690 Series B Preference Stock: Citibank, N.A., 111 Wall Street, New York, New York 10015 7½% Convertible Subordinated Debentures: Marine Midland Bank, 250 Park Avenue, New York, New York 10017 8% and 8⅛% Subordinated Debentures: Citibank, N.A., 111 Wall Street, New York, New York 10015 8⅞% Sinking Fund Debentures: First National Bank of Boston, P.O. Box 1897, Boston, Massachusetts 02105 9% and 9⅛% Sinking Fund Debentures: Manufacturers Hanover Trust Company, Corporate Trust Department 40 Wall Street, New York, New York 10015

Corporate Data

Automatic Dividend Investment and Voluntary Share Purchase Plan This plan enables holders of City Investing Common Stock and Cumulative Preference Stock to acquire additional shares of City Investing Common Stock by automatic investment of their dividends and by additional cash purchases, if desired, without paying brokerage commissions or bank service charges. Shareholders interested in this convenient plan are encouraged to obtain a descriptive brochure by writing to:

City Investing Company
Shareholder Services Department
P.O. Box 3192
Church Street Station
New York, New York 10008

Summary of Dividends and Stock Prices Common Stock: Dividends declared for each quarter of 1977 and 1978 were 20 cents and 25 cents per share, respectively, and 80 cents and $1.00 per share for each of the two years.

Preference Stocks: Series A and Series B Preference Stock dividends for each quarter of 1977 and 1978 were 32¾ cents and 50 cents per share, respectively, and $1.31 and $2.00 per share during each of the two years.

Class of Stock	First Quarter		Second Quarter		Third Quarter		Fourth Quarter	
	High	Low	High	Low	High	Low	High	Low
1977								
Common	15⅛	12½	16¼	13½	16⅛	12¼	14¼	11⅞
Series A	29¾	28	31½	28¾	31½	27	26½	26¼
Series B	28¼	24⅜	27¾	24⅝	27⅞	24	26	23⅛
1978								
Common	14¼	11⅜	17⅛	13½	18¼	14⅜	16¾	12½
Series A	27⅛	26⅛	33¼	30¾	36⅞	31½	34	26½
Series B	25⅜	22⅜	28	24¼	29¾	24⅛	27¾	21

1979 Annual Meeting The annual meeting of shareholders of City Investing Company will be held at the Breckenridge Pavilion Hotel, One Broadway, St. Louis, Missouri, at 11:00 a.m. on Friday, May 25, 1979. Commencing at 10:00 a.m., the Company will hold a shareholder information session, including a review of Company operations and a question and answer period.

Securities Listed

New York Stock Exchange (Common, Series A & B Preference, 7½% Convertible Subordinated Debentures, 8%, 8⅛% Subordinated Debentures, 8⅞%, 9% and 9⅛% Sinking Fund Debentures)
Midwest Stock Exchange (Common, Series B Preference)
Pacific Stock Exchange (Common, Series B Preference)
Amsterdam Stock Exchange (Common)
Brussels and Antwerp Stock Exchanges (Common)
Frankfurt Stock Exchange (Common)
London Stock Exchange (Common, Series B Preference)
Zurich, Geneva, Lausanne and Basle Stock Exchanges (Common)

Insurance	The Home Group, Inc. The Home Insurance Company, New York, New York Peter C. R. Huang, Chairman & President Ronald J. Burns, Executive Vice President — Investments Henry P. Lenz, Executive Vice President — Insurance Operations Edward P. Sheridan, Executive Vice President Federal Home Companies, Battle Creek, Michigan Albert C. Trussell, President Seaboard Surety Company, New York, New York Robert P. Scaglione, President
Savings and Loan	Southern California Savings and Loan Association, Los Angeles, California Kenneth D. Childs, President
Housing and Food Services	GDV, Inc. General Development Corporation, Miami, Florida William R. Avella, President Wood Bros. Homes, Inc., Denver, Colorado William H. Tucker, President Guerdon Industries, Inc., Louisville, Kentucky Edward B. Madden, President Servomation Corp., New York, New York Allan P. Lucht, Chairman & President

Operations

U.S. Manufacturing and Printing	Rheem Manufacturing Company Rheem Air Conditioning Division, Fort Smith, Arkansas Robert B. Gilbert, President Rheem Container Division, Linden, New Jersey Carl W. Dinger, President Rheem Water Heater Division, Chicago, Illinois Albert F. Hurley, President World Color Press, Inc., Effingham, Illinois N. Clyde Oberlin, President Alma Plastics Company, Alma, Michigan Leo Fleming, President Hayes International Corporation, Birmingham, Alabama Willis C. Hagan, Jr., President Revco, Inc., West Columbia, South Carolina Daniel B. Dawley, President Uarco Incorporated, Barrington, Illinois Gregson L. Barker, President
International Manufacturing	Rheem International, Inc., New York, New York James V. Risk, President
Motels	Motel 6, Inc., Santa Barbara, California Daniel R. Shaughnessy, President
Energy	City Exploration Company, Houston, Texas Victor R. Williams, Executive Vice President

Form 10-K

City Investing Company

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OF THE
SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended December 31, 1978
Commission file no. 1-5651

City Investing Company

(Exact name of registrant as specified in its charter)

DELAWARE
(State of incorporation)

767 Fifth Avenue, New York, New York 10022
(Address of principal executive offices)

Registrant's telephone number, including area code (212) 759-5300

13-4997980
(I.R.S. Employer Identification No.)

Securities registered pursuant to Section 12(b) of the Act:
Title of each class registered on the New York Stock Exchange

Common Stock*
Cumulative Preference Stock, Convertible Series A
Cumulative Preference Stock, Convertible Series B*
7½% Convertible Subordinated Debentures Due 1990
8% Subordinated Debentures Due 1991
8⅛% Subordinated Debentures Due 1991
8⅞% Sinking Fund Debentures Due 1997
9% Sinking Fund Debentures Due 1996
9⅛% Sinking Fund Debentures Due 1997
Warrants to purchase Common Stock of GDV, Inc., Void After July 15, 1983

* Also listed on the Midwest and Pacific Stock Exchanges.

Indicate by check mark whether Registrant (1) has filed all reports required to be filed by Section 13 of the Securities Exchange Act of 1934 during the preceding 12 months, and (2) has been subject to such filing requirements for the past 90 days.
Yes √. No__.

At December 31, 1978, there were 23,369,912 shares of Registrant's Common Stock, par value $1.25 per share, outstanding, including 845,281 treasury shares.

Contents

City Investing Company

Annual Report on Form 10-K
December 31, 1978

PART I

* Not Applicable.

City Investing Company

City Investing Company's principal businesses are insurance, worldwide manufacturing, housing and food services. City's insurance operations are conducted through The Home Group, Inc., whose wholly-owned subsidiary, The Home Insurance Company, and its subsidiaries write a full line of property, casualty, life, accident and health insurance. City's principal domestic manufacturing operations include the manufacture of heating and air conditioning equipment, water heaters and containers and the printing of magazines. City manufactures containers, water heaters, automotive leaf springs, plastics and other products in foreign countries. Housing and community development, comprising homebuilding, the manufacture of mobile homes and community development in Florida, is conducted through GDV, Inc. (66.2% owned). GDV is also engaged in the sale of food and refreshments through vending machines and manual food service operations. City also operates Motel 6, Inc., a chain of budget motels and Southern California Savings and Loan Association and is an investor in oil and gas exploration activities, primarily in the United States, Ecuador and the North Sea. On February 1, 1979, a subsidiary of City consummated by merger the acquisition of Uarco Incorporated, a manufacturer of business forms.

Substantially all City's internal sources of funds consist of dividends and income tax payments from subsidiaries. The earnings of most of City's subsidiaries are subject to restrictions imposed by debt instruments or applicable law on the amount of dividends that may be paid to City. See City Investing Company (Parent Company Only) financial statements.

City maintains its principal executive offices at 767 Fifth Avenue, New York, New York 10022 (telephone number 212-759-5300). As used herein, the terms "City" and "Company" mean City Investing Company and its subsidiaries, unless the context requires otherwise. City was incorporated in Delaware in 1967 and succeeded by merger in 1968 to a corporation of the same name incorporated in New York in 1904.

Item 1. Business

Business of City

Contributions to total revenues of City's principal industry segments for the five years ended December 31, 1978, were as follows (in millions) (1) (2):

	1974	1975	1976	1977	**1978**
Insurance (3)	$ 972.1	$1,014.2	$1,252.9	$1,475.0	$1,648.9
Savings and Loan (4)	20.9	24.0	27.3	34.4	60.2
Total Insurance and Financial	993.0	1,038.2	1,280.2	1,509.4	1,709.1
Housing and Community Development	356.5	264.1	283.2	367.4	540.6
Food Services	—	—	—	—	112.4
Total Housing and Food Services	356.5	264.1	283.2	367.4	653.0
International Manufacturing (4)	224.5	242.2	332.9	393.2	485.9
Air Conditioning and Water Heaters	163.4	160.9	220.4	269.9	311.8
Magazine Printing	122.8	138.4	154.8	193.9	241.3
Containers	111.1	101.6	110.9	128.0	143.6
Budget Motels	39.6	53.7	63.0	75.1	87.9
Other Manufacturing Operations	113.4	101.6	84.1	128.0	159.3
Total Manufacturing and Lodging	774.8	798.4	966.1	1,188.1	1,429.8
Total Revenues	$2,124.3	$2,100.7	$2,529.5	$3,064.9	$3,791.9

Contributions to income from operations of City's principal industry segments for the five years ended December 31, 1978, were as follows (in millions)(1)(2):

	1974	1975	1976	1977	**1978**
Insurance (3)	$ 25.8	$ 14.3	$ 49.7	$ 103.3	$ 135.2
Savings and Loan (4)	2.3	3.7	5.3	10.2	11.4
Total Insurance and Financial	28.1	18.0	55.0	113.5	146.6
Housing and Community Development	13.3	10.1	18.7	34.7	49.6
Food Services	—	—	—	—	7.7
Total Housing and Food Services (5)	13.3	10.1	18.7	34.7	57.3
International Manufacturing (4)	24.5	17.0	24.8	35.9	42.1
Air Conditioning and Water Heaters	15.6	15.1	20.2	24.4	27.3
Magazine Printing	8.9	10.5	12.7	15.0	19.5
Containers	20.1	8.9	11.2	14.7	15.2
Budget Motels	(.1)	1.2	6.6	11.5	15.6
Other Manufacturing Operations	11.0	11.1	3.4	4.8	3.9
Total Manufacturing and Lodging	80.0	63.8	78.9	106.3	123.6
Energy	(10.7)	(21.3)	(20.2)	(21.9)	(10.5)
Miscellaneous	(2.7)	(3.8)	(3.7)	(6.3)	(9.2)
Expenses of GDV Parent Company	—	—	—	(.5)	(9.5)
Income from Operations (6)	$ 108.0	$ 66.8	$ 128.7	$ 225.8	$ 298.3

(1) Revenues and income from operations for 1977 and prior periods have been restated and reclassified to conform to the 1978 presentation. Income from operations represents revenues less all operating expenses. See Note 17 to City's Financial Statements for additional information about segments of the Company's operations.

(2) The Company's homebuilding, mobile home and community development operations are included in housing and community development. International manufacturing operations include the manufacture of containers, water heaters, automotive leaf springs and plastics, principally in Western Europe, Brazil and Mexico. Other manufacturing operations include City's refrigeration, plastics and aircraft modification activities. Miscellaneous includes C. I. Planning Corporation, which is the advisor to two real estate investment trusts, and, in 1978, provision for loss on assets held for disposal.

(3) See "Insurance" on page 4 for principal insurance industry segments.

(4) During 1976 and 1977, respectively, international manufacturing operations in the United Kingdom and Singapore were consolidated (prior to consolidation, these operations were carried as equity investments). The consolidation of these operations added $42.0 million and $15.8 million to revenues, and $1.9 million and $1.3 million to income from operations in the years indicated. During 1978, the Savings and Loan Association consolidated its homebuilding operation (prior to consolidation, the pretax results of the homebuilding operation were included in income from operations), which added $18.7 million to revenues.

(5) Includes amortization of carrying amount over City's equity in net assets of GDV of $1.5 million in 1977 and $1.9 million in 1978.

(6) See Statement of Consolidated Income on page 20 for additional items included in the determination of net income.

Insurance and Financial

City's insurance and financial operations consist of The Home Group, Inc. and its property and casualty and its life, accident and health insurance subsidiaries ("The Home Group") and Southern California Savings and Loan Association.

Insurance

The Home Group, through The Home Insurance Company and its wholly-owned property and casualty subsidiaries ("The Home"), is engaged in writing a full line of property, casualty, fidelity and surety insurance in every state of the United States, the District of Columbia, Canada and certain other countries. Approximately 80% of The Home's business is in commercial lines and the remainder is in personal lines. In 1978, 11% of The Home's direct property and casualty insurance premiums was written in New York and the balance was distributed widely through all other states, of which only California, Illinois, Michigan, Pennsylvania and Texas accounted for more than 5% of such premiums. For 1978, The Home's written premiums included approximately $77 million in respect of its 18.6% participation in AFIA Worldwide Insurance, an association of ten insurers engaged in insuring foreign risks through approximately 230 branches in 80 foreign countries.

Life, accident and health insurance is written through Federal Home Life Insurance Company in all states of the United States (except New York), the District of Columbia and Canada. Life and health insurance lines are written in the State of New York by PHF Life Insurance Company. Credit life and credit accident and health insurance is written by PHF Life Insurance Company in 31 states.

Contributions to total revenues and income from operations of principal insurance industry segments for the five years ended December 31, 1978, were as follows (in millions) (1):

	1974	1975	1976	1977	**1978**
Property and casualty					
Earned premiums (2)	$ 815.9	$ 856.7	$1,082.6	$1,280.2	$1,409.3
Investment income	62.3	66.1	71.5	83.6	104.0
Life, accident and health					
Earned premiums	81.7	76.4	82.6	92.1	113.2
Investment income	13.3	14.6	16.7	17.7	20.4
Other	(1.1)	.4	(.5)	1.4	2.0
Total revenues	$ 972.1	$1,014.2	$1,252.9	$1,475.0	$1,648.9
Property and casualty					
Underwriting results (2)	$ (42.5)	$ (57.7)	$ (29.0)	$ 12.2	$ 20.9
Net investment income	61.4	65.1	70.4	82.4	102.2
Life, accident and health (3)	8.0	6.6	9.1	8.2	11.0
Other	(1.1)	.3	(.8)	.5	1.1
Income from operations (4)	$ 25.8	$ 14.3	$ 49.7	$ 103.3	$ 135.2

(1) See Note 11 to The Home Group's Financial Statements for additional information about segments of the Company's insurance operations.

(2) See "Property and Casualty Insurance" on page 5 for earned premiums and underwriting results by property and casualty insurance segment.

(3) Investment income is not separately shown since it has no independent significance in determining income from life insurance operations.

(4) See The Home Group Statement of Consolidated Income for additional items included in the determination of net income.

Property and Casualty Insurance

In common with other insurers, underwriting results of The Home were adversely affected during 1974 and 1975 by unprecedented rates of inflation, regulatory and public resistance to premium increases and intensive price competition in commercial lines of insurance. Primarily as a result of premium rate increases, the 1976 underwriting loss was reduced and in 1977 and 1978, The Home reported underwriting profits, reflecting additional premium rate increases, relatively stable rates of inflation and fewer catastrophe losses.

The following table sets forth for the five years ended December 31, 1978, earned premiums and pretax underwriting results by property and casualty insurance segment for The Home, prepared in accordance with generally accepted accounting principles (in millions):

	1974	1975	1976	1977	**1978**
Automobile					
Earned premiums	$ 230.0	$ 231.4	$ 298.8	$ 340.5	$ 352.1
Underwriting results	(20.4)	(35.9)	(12.2)	3.3	(7.5)
Workers' compensation					
Earned premiums	$ 122.7	$ 159.8	$ 199.0	$ 256.6	$ 309.6
Underwriting results	(2.5)	11.0	(4.6)	(24.1)	(32.6)
Commercial multi-peril					
Earned premiums	$ 118.8	$ 136.9	$ 176.8	$ 207.0	$ 230.2
Underwriting results	(2.1)	(8.3)	(6.7)	14.5	45.5
Fire and allied					
Earned premiums	$ 103.9	$ 103.2	$ 118.1	$ 119.5	$ 130.0
Underwriting results	4.3	3.4	8.0	11.9	11.5
Homeowners					
Earned premiums	$ 71.2	$ 69.9	$ 75.5	$ 78.7	$ 74.4
Underwriting results	(8.4)	(6.4)	(4.7)	(7.3)	5.9
Marine					
Earned premiums	$ 61.3	$ 64.2	$ 74.4	$ 77.9	$ 82.6
Underwriting results	(3.6)	2.3	3.7	5.2	2.6
Casualty, fidelity and surety					
Earned premiums	$ 63.1	$ 73.8	$ 98.5	$ 130.0	$ 161.3
Underwriting results	(11.6)	(16.4)	(12.3)	19.8	22.4
Miscellaneous					
Earned premiums	$ 44.9	$ 17.5	$ 41.5	$ 70.0	$ 69.1
Underwriting results	1.8	(7.4)	(.2)	(11.1)	(26.9)
Total					
Earned premiums	$ 815.9	$ 856.7	$1,082.6	$1,280.2	$1,409.3
Underwriting results	(42.5)	(57.7)	(29.0)	12.2	20.9

The Home writes private passenger and commercial automobile insurance. The impact of inflation has had a greater effect upon the profitability of the private passenger line, where the ability to adjust rates is more limited. In general, private passenger automobile insurance has been de-emphasized in recent years. The combination of this de-emphasis and rate increases resulted in underwriting profits in 1977 compared with significant losses during the prior three-year period. In 1978, automobile results were adversely affected by increased underwriting expenses in proportion to premium volume in the private passenger line, and by increased costs of claims, particularly in the commercial line.

Workers' compensation has been unprofitable except in 1975, when underwriting results were favorable, primarily as a result of the cumulative favorable effect of The Home's adoption of the practice of accruing premiums on policies subject to audit. Workers' compensation has customarily been written by The Home in connection with other lines of insurance offered to major commercial customers. In recent years, statutorily-mandated benefits have been increased and the amount of payments under such policies, as a result of higher settlements and jury awards, has substantially increased. Such increases have not been matched by rate increases, which in most cases are regulated. Profitability in 1978 was also affected by substantial additions made to unpaid loss reserves to provide for higher anticipated payments.

Commercial multi-peril insurance involves the underwriting of a variety of risks in a single policy. From 1974 through 1976, inflation and intensive price competition adversely affected this line. Primarily as a result of premium rate increases obtained during 1975 and 1976, underwriting results were profitable in 1977 and 1978. Contributing to the increased profitability in 1978 were a decline in the number and severity of losses and claims and reduced underwriting expenses in proportion to premium volume.

Fire and allied lines have historically been profitable for The Home. In recent years, premium rate increases and the elimination of marginal business contributed to improved underwriting results. Growth in premium volume has been limited by the growing practice of including fire coverage in package policies.

Profitability of the homeowners line, which is subject to intensive price competition, has been adversely affected by inflation and increased residential burglary and theft. In 1978, the homeowners line was profitable primarily due to a decrease in the number and severity of losses and claims.

The term of most commercial multi-peril, fire and allied, and homeowners policies has been reduced to one year.

Marine insurance, consisting of ocean and inland marine coverages, historically has been profitable. In 1978, profitability decreased primarily as a result of increased underwriting expenses in proportion to premium volume.

Prior to 1977, losses in casualty, fidelity and surety lines were high, principally with respect to general liability insurance, as a result of inflation of jury awards and settlements of personal injury claims. In addition, the surety business was adversely affected by the inability of contractors to complete real estate construction contracts due to the difficulty of obtaining financing and escalating construction costs. The abatement of inflation, increased premiums, primarily attributable to rate increases, and the recovery in the real estate construction industry have resulted in significantly improved 1977 and 1978 underwriting results.

The miscellaneous lines include excess coverage activities and reinsurance assumed under treaties. Higher costs on paid claims resulted in increased underwriting losses in 1977 and 1978. Profitability in 1978 was also affected by substantial additions made to unpaid loss reserves to provide for higher anticipated payments under excess lines policies.

An indication of the relative competitive positions of The Home is contained in rankings provided by Best's Executive Data Service for 1977, the latest year for which such publication is available. Although the rankings of that service are not precisely comparable to the lines of business shown above, on the basis of net premiums written by stock, mutual and reciprocal property and casualty groups in the United States, the lines written by The Home were ranked by Best's as follows: private passenger automobile — no fault, 28th; other private passenger automobile liability, 27th; private passenger automobile physical damage, 28th; commercial automobile — no fault, 15th; other commercial automobile liability, 8th; commercial automobile physical damage, 8th; commercial multi-peril, 11th; workers' compensation, 10th; fire insurance, 13th (allied lines, 21st); homeowners insurance, 27th; farmowners multi-peril, 8th; inland marine insurance, 14th; ocean marine insurance, 8th; other liability insurance, 10th; fidelity insurance, 23rd; and surety insurance, 11th. On the basis of net premiums written, The Home ranked 15th among the stock, mutual and reciprocal property and casualty groups in the United States in 1977.

The Home's business is written through approximately 6,600 agents and brokers. Agents are paid on a commission basis and in most cases also represent other insurance companies. Insurance brokers place business with The Home, either directly or through agents, and receive commissions as compensation.

The Home participates in a number of underwriting associations or pools with other insurers. The purpose of such associations or pools is generally to enable members to participate in such risks as marine hull, nuclear energy, oil production and refining, and foreign risks, which an individual company could not underwrite because of large exposure, concentration of liability or location.

As is generally required in the various states in which it does business, The Home also participates in various "involuntary" pools and associations, such as assigned-risk plans for automobile drivers unable to obtain insurance in the voluntary market. The Home's participation in these involuntary pools or associations in any given state is generally proportional to "voluntary" writings of the related lines of business in that state.

Approximately 20 states, including New York, have enacted a type of automobile liability insurance commonly referred to as no-fault insurance, and other states, as well as the Congress of the United States, are considering proposals relating to no-fault insurance. The effect of no-fault insurance on the profitability of the automobile insurance line has been insignificant.

In accordance with industry practice, The Home assumes reinsurance from other insurers and cedes reinsurance to other insurers or reinsurers. These reinsurance arrangements provide greater diversification of business and minimize The Home's losses arising from large risks or from hazards of an unusual nature. A large portion of The Home's reinsurance is effected under general reinsurance contracts known as treaties. In some instances reinsurance is negotiated on individual risks. Although the ceding of insurance does not discharge the original insurer from its primary liability to its policyholder, the insurance company which assumes the coverage assumes the related liability and it is the practice of insurers for accounting purposes to treat insured risks, to the extent of the reinsurance ceded, as though they were risks for which the original insurer is not liable. The largest amount insured by The Home, after reinsurance, on any one risk (excluding workers' compensation) was $6,070,000 at December 31, 1978. Since many policies may be involved in a single occurrence, the maximum exposure of The Home in connection with an occurrence may not be limited to the largest amount insured on any one risk.

Life, Accident and Health Insurance

Life, accident and health insurance earned premiums increased 11% in 1977 reflecting increased volume in individual life and health insurance. While income from life, accident and health insurance improved during 1977, the comparison with 1976 results was affected by certain non-recurring gains in 1976. In 1978, earned premiums increased 23% reflecting increased volume in group accident and health insurance, primarily premiums from City and its principal subsidiaries. Income from operations increased 34%, primarily as a result of increased investment income, reflecting improved cash flow and higher yields on new investments.

The following table summarizes premiums written for the two years ended December 31, 1978, by The Home's life insurance companies (dollars in thousands):

	1977		**1978**	
	Amount	Percent	Amount	Percent
Credit accident and health	$23,463	24.6	$ 28,126	24.3
Individual accident and health	25,773	27.1	27,697	23.9
Group accident and health	4,221	4.4	16,543	14.3
Individual life	25,353	26.6	25,078	21.7
Credit life	11,410	12.0	12,685	11.0
Group life	5,069	5.3	5,602	4.8
Total premiums written	$95,289	100.0	$115,731	100.0

Group accident and health insurance premiums written increased $12.3 million (292%) in 1978, primarily as a result of $11.9 million of reinsurance assumed on a portion of the employee coverage of City and its principal subsidiaries. The Company also assumed reinsurance of $1.1 million of group life insurance premiums on a portion of the City group.

The following table sets forth the classes of life insurance in force at December 31 of the years indicated (in thousands):

	1974	1975	1976	1977	**1978**
Individual life	$1,196,477	$1,297,484	$1,406,245	$1,509,794	$1,634,952
Group life	1,127,513	1,040,410	995,405	1,073,834	1,166,940
Credit life	991,880	905,257	931,704	1,069,710	1,201,835
Total in force	$3,315,870	$3,243,151	$3,333,354	$3,653,338	$4,003,727

Life insurance companies are represented by approximately 500 general agents and 6,000 brokers, some of whom are licensed through general agents. General agents and brokers are paid on a commission basis and in most instances also represent other insurance companies.

Investment Income

Investment income is derived from the investment portfolio of The Home Group. The following table summarizes such investments at December 31, 1978 (in thousands):

Type of Investment	Cost	Quoted market value	Amount at which carried on the balance sheet
Bonds and notes (1)			
United States Government and government agencies and authorities	$ 312,374	$ 291,084	$ 312,374
States, municipalities and political subdivisions	539,159	484,464	539,159
Foreign government	2,448	2,398	2,448
Public utilities	83,294	79,070	83,294
Convertible bonds and bonds with warrants attached	75,583	65,136	75,583
Other corporate bonds and notes	170,831	155,008	170,831
Total bonds and notes	1,183,689	1,077,160	1,183,689
Preferred stocks	36,920	35,255	35,255
Common stocks			
Public utilities	152,629	134,243	134,243
Banks and trust and insurance companies	20,098	15,795	15,795
Industrial, miscellaneous and all other	459,271	398,838	398,838
Total common stocks	631,998	548,876	548,876
Total bonds and notes and stocks	1,852,607	$1,661,291	1,767,820
Mortgage loans on real estate and policy loans of $13,890	51,571		51,571
Invested cash and short-term commercial maturities	48,123		48,123
Total investments (2)	$1,952,301		$1,867,514

(1) Bonds and notes are carried at amortized cost.

(2) Excludes cash of $50,717, investments in stocks of affiliates of $63,332, and investment in GDV, Inc. of $52,276.

The following table summarizes investment results of the portfolio for the five years ended December 31, 1978 (dollars in thousands):

	Net Investment Income(1) (2)	Return on Invested Assets at Book	Net Gains (Losses)	
			Realized(2)	Unrealized(3)
1974	$ 73,610	6.30%	$(11,530)	$(74,946)
1975	78,460	6.60	6,561	53,726
1976	85,781	6.70	8,818	36,783
1977	98,784	6.37	(197)	(23,406)
1978	121,949	6.65	—	(11,258)

(1) After deduction of investment expenses, but before gains and losses on the sale of securities. See Note 6 to The Home Group Financial Statements for components of net investment income.

(2) Before Federal income taxes.

(3) Represents the changes in market value of common and preferred stocks from the beginning to the end of the indicated period, net of deferred Federal income taxes applicable to the excess of book basis of certain securities over tax basis. See The Home Group "Statement of Unrealized Depreciation of Stocks."

Realized gains and losses on the disposition of investments are reflected in income. Unrealized appreciation or depreciation of stocks is shown as a separate component of shareholders' equity and is not included in the determination of net income. Investments in bonds are carried at amortized cost and, accordingly, unrealized changes in the market value thereof are not reflected on the income statement or balance sheet.

Insurance Regulation

The Home Group's insurance subsidiaries are subject to regulation and supervision in jurisdictions in which they transact business. The extent of such regulation varies but generally has its source in state statutes which delegate regulatory authority to departments of insurance. Regulation generally covers, among other things, standards of solvency which must be met and maintained, the licensing of insurers and their agents, the nature of and limitations on investments, premium rates, restrictions on the size of risks which may be insured under a single policy, provisions for unearned premiums, losses and other purposes, deposits of securities for the benefit of policyholders and approval of policy forms. Insurance departments also conduct periodic examinations of the affairs of insurance companies and require the filing of annual and other reports relating to the financial condition of companies and other matters.

The amount of business a property and casualty insurance company may write is determined in part by the amount of its policyholders' surplus as determined in accordance with applicable insurance regulations. At December 31, 1977 and 1978, policyholders' surplus of The Home, as permitted by New Hampshire law, the state of The Home's incorporation, was $300.5 million and $322.4 million, and the premiums-to-surplus ratio was 4.2 to 1 and 4.4 to 1, respectively. Although some property and casualty insurers maintain more conservative ratios, The Home's ratios are generally considered to afford an acceptable level of protection to its policyholders. Acceptable methods of calculating surplus vary from state to state and the application of other methods could result in a higher ratio of premiums to surplus.

Business Forms

On February 1, 1979, The Home Group acquired by merger Uarco Incorporated ("Uarco"), a major manufacturer of business forms, for approximately $106 million in cash.

Uarco is engaged in the design, manufacture and sale of business forms. The forms manufactured by Uarco include sales slips, invoices, purchase orders, bills of lading, payroll checks, stock requisitions, cash reports, inventory records, statements, banking, brokerage and tax forms, personalized computer letters used by customers in direct mail advertising and other stationery forms. The majority of forms produced by Uarco consist of continuous strips, designed for the writing of multiple copies through the use of one-time carbon paper. Such forms are used in data processing systems and in typewriters, billing machines, teletype machines and accounting and other office machines. Uarco also manufactures forms for manual use. In most instances the forms sold by Uarco are custom designed and printed to meet the particular requirements of each customer's office or factory procedures. Uarco sells forms handling equipment and offers service contracts with respect to the forms handling equipment and performs repair work for customers that do not enter into service contracts. In addition, Uarco sells autographic registers and other related items.

Uarco's products are sold under the trade name UARCO, and individual business forms are distinguished by additional trade name designations such as Convelope, E-Z-Out, and Data-Mailer. Markets for Uarco's products range from small businesses to large commercial organizations and governmental bodies. Uarco utilizes 17 plants and warehouses located throughout the United States and in the provinces of Quebec and Ontario, Canada, and sells its products through its own sales force and independent dealers. A large part of Uarco's sales consists of reorders of forms previously designed and produced for specific customers.

Uarco has a single wholly-owned operating subsidiary, Drummond Business Forms Limited, located in Drummondville, Quebec, Canada. In fiscal 1978, Drummond accounted for 11.0% of Uarco's net sales, 19.1% of Uarco's pretax income and 17.0% of Uarco's net assets.

For its five fiscal years ended September 30, 1978, Uarco reported revenues and net income, respectively, as follows: $169,829,000 and $10,396,000 in 1974; $179,638,000 and $9,010,000 in 1975; $186,791,000 and $5,656,000 in 1976; $199,980,000 and $6,744,000 in 1977; and $224,392,000 and $7,895,000 in 1978. At September 30, 1978, Uarco's reported assets aggregated $116,456,000, including current assets of $63,801,000 and net plant and equipment of $46,820,000. Uarco's liabilities at that date totalled $46,918,000, including current liabilities of $18,974,000 and long-term debt of $18,533,000. A study has been undertaken to determine the fair value of the net assets acquired.

Savings and Loan

Southern California Savings and Loan Association conducts its business through 25 offices located throughout Southern California. The Association employs depositors' funds to make first mortgage loans to finance the purchase, construction and improvement of real estate, principally residential, in Southern California. Approximately 30% of the Association's 1977 and 1978 income from operations was derived from its homebuilding operations, which consist primarily of residential housing projects.

In December 1978, the Association purchased for $26.3 million the assets of First Surety Corp., which includes Surety Savings and Loan Association, with eight branches in Southern California. Surety Savings and Loan had deposits of $153.5 million and assets of $179.2 million at December 31, 1978.

At December 31, 1978, savings deposits, including Surety, were $483 million, compared with $307 million at December 31, 1977, and total assets, including Surety, were $631 million, compared with $379 million. In seeking deposits, the Association competes for funds with other savings and loan associations, commercial banks, other financial institutions and the Federal Government and its agencies. Interest rates paid by competitive sources and changes in governmental monetary policies affect the ability of the Association to attract savings deposits. In June 1978, the Federal Home Loan Bank created money market instruments whereby Savings and Loan Associations are allowed to issue six-month certificates of deposit at a rate ¼% higher than the prevailing six-month Treasury Bill rate. This action by the FHLB enabled the Association to retain and attract deposits.

During 1977, new deposits increased and mortgage loans were made at attractive rates, which, together with reductions in Federal Home Loan Bank borrowings and increased profits in homebuilding operations, resulted in increases in revenues and income from operations of 26% and 92%, respectively. As of January 1, 1978, the Association's homebuilding operation was consolidated (prior to consolidation, the pretax results of the homebuilding operation were included in income from operations). The consolidation added $18.7 million to revenues, but had no effect on income from operations. Revenues in 1978 increased 75% (21% excluding the effect of consolidating the homebuilding operation) and income from operations increased 13%. These increases, except for the increase in revenues attributable to the consolidation of the building operation, were attributable to new deposits and loans made at attractive rates.

The Association is a member of the Federal Home Loan Bank system, which functions in a reserve credit capacity for home financing institutions. The Association is subject to detailed and extensive regulation under Federal and California statutes governing all aspects of its business, including interest rates payable on deposits, the amount of advances obtainable from the Federal Home Loan Bank, liquidity, permissible investments, minimum reserves and the payment of dividends.

Housing and Food Services

City's housing and food services operations are conducted through GDV, Inc. (66.2% owned). Housing and community development operations comprise single-family homebuilding, the manufacture of mobile homes and community development in Florida. Food services consist of the sale of food and refreshments through vending machines and manual food service operations.

GDV was organized in 1977 as a holding company to aid in the growth and diversification of General Development Corporation, which has been engaged in community development in Florida since 1956. In April 1978, GDV acquired from City, for a 10% Senior Promissory Note in the principal amount of $25,000,000, Wood Bros. Homes, Inc., which is engaged in the construction and sale of single-family homes primarily in the "Sun Belt" states. In July 1978, GDV acquired from City, for 1,990,105 shares of GDV Common Stock, Guerdon Industries, Inc., which manufactures and sells mobile homes.

In September 1978, GDV acquired 63.5% of Servomation Corp. in a cash tender offer and the balance was acquired by merger in January 1979. The total consideration paid for Servomation was approximately $192 million. Servomation is engaged in the sale of food, beverage and tobacco products through vending machines, manual food service operations and the franchising and operation of the Red Barn chain of fast-service restaurants.

Contributions to total revenues and income from operations of the housing and food services group for the five years ended December 31, 1978, were as follows (in millions):

	1974	1975	1976	1977	**1978**
Single-family homebuilding	$ 72.9	$ 68.1	$ 90.3	$129.0	$228.6
Mobile homes (1)	131.6	85.1	101.4	136.7	164.1
Community development	152.0	110.9	91.5	101.7	147.9
Food services (2)	—	—	—	—	112.4
Total revenues	$356.5	$264.1	$283.2	$367.4	$653.0
Single-family homebuilding	$ (3.1)	$ (4.7)	$ 1.9	$ 8.7	$ 19.9
Mobile homes (1)	(5.8)	(3.1)	(.3)	6.5	10.1
Community development (1)	22.2	17.9	17.1	19.5	19.6
Food services (2)	—	—	—	—	7.7
Income from operations	$ 13.3	$ 10.1	$ 18.7	$ 34.7	$ 57.3

(1) Amounts for mobile homes include amortization of carrying amount over City's equity in net assets of $.7 million in 1974, $1.3 million in 1975, $1.5 million in 1976, $1.5 million in 1977 and $1.5 million in 1978. Mobile homes in 1974 includes revenues of $5.7 million and a loss from operations of $1.2 million applicable to the shut-down of its recreational vehicle activities. Community development includes amortization of City's carrying amount of $.4 million in 1978.

(2) Servomation is included in the Consolidated Financial Statements from October 1, 1978.

Single-Family Homebuilding

Wood Bros. Homes is engaged in the construction and sale of single-family homes in Colorado, Texas, Arizona, New Mexico and Wyoming. Wood Bros. houses are built to a variety of standard plans. Houses sold by Wood Bros. have sales prices from $38,000 to $110,000. In 1978, the average sales price of a Wood Bros. house was approximately $55,100 and the average square footage was 1,600. Houses generally are sold through an internal sales staff. In November 1977, Wood Bros. acquired Raldon Corporation of Dallas, Texas, with a product line and price range similar to Wood Bros. Raldon's 1977 sales were $25 million on 570 homes delivered.

During 1974 and 1975, Wood Bros. was affected by the nationwide recession in the housing industry. During 1976, the housing market improved. For the year ended December 31, 1977, delivered units increased to 2,649, as compared with 2,013 for the year ended December 31, 1976, an increase of 32%. The increase in delivered units, together with a 14% increase in average selling prices, resulted in a 43% increase in total revenues for 1977. Increased revenues and operating efficiencies, primarily relating to the increase in contracted sales, resulted in improved margins and a 348% increase in income from operations to $8.7 million for 1977.

During 1978, delivered units increased 49% to 3,937. This increase, coupled with a 22% increase in average selling prices, resulted in a 77% increase in total revenues for the year. Income from operations increased 132% to $19.9 million, reflecting substantially increased revenues and associated efficiencies of scale.

At December 31, 1978, Wood Bros. houses under contract consisted of 1,614 units, representing approximately $97 million of contracts, compared with 1,626 units, representing $76 million of contracts, at December 31, 1977. Mortgage financing commitments have been obtained for all houses under contract at December 31, 1978, and Wood Bros. anticipates delivery of all such units during the next twelve months.

Mobile Homes

Guerdon Industries is engaged in the manufacture and sale of a full line of single- and double-wide mobile homes for residential, institutional and commercial purposes. Virtually all Guerdon's mobile homes are used for permanent housing. Guerdon manufactures mobile homes in 19 plants located throughout the United States. Shipping costs tend to limit the market for mobile homes to a radius of approximately 400 miles from the plant site. Because of the low capital investment required and the simplicity of mobile home fabrication, entry into this industry is relatively easy and the industry has at times suffered from over-capacity. In March 1979, Guerdon expects to acquire Dualwide Homes, a manufacturer of multi-sectional mobile homes with two plants in California.

Guerdon's mobile homes are marketed through approximately 950 independent dealers and 37 company-owned sales outlets under a variety of trade names including "Great Lakes", "Magnolia", "Leisurama", "Statler" and "Wayco". Guerdon's mobile homes vary in size from 600 to 2,100 square feet. Wholesale prices of Guerdon's mobile homes, including major appliances, range from $5,500 for smaller units to approximately $30,000 for luxury and sectional models. While some mobile homes are purchased for cash, the majority are financed by banks or other lending institutions and, as a result, Guerdon's business is affected by interest rates and the availability of credit. Guerdon frequently enters into floor plan arrangements with financial institutions providing that it will, under certain conditions, repurchase financed mobile homes in the event a dealer defaults or becomes insolvent.

From 1973 through 1975, the mobile home industry experienced a significant decline in unit sales, attributable in part to increased material costs, high interest rates and difficulty of obtaining consumer financing, high levels of unemployment and an increased number of repossessed units returning to the market. Guerdon responded to these depressed industry conditions by reducing corporate overhead and the number of plants in operation to 19 at year-end 1978 from 38 in 1972. During 1977, unit shipments increased 21% to 13,575, and revenues increased 35%, primarily due to increased demand and an increase in prices. Income from operations increased to $6.5 million, attributable in part to efficiencies resulting from increased volume. In 1978, revenues increased 20% and income from operations increased 54%, resulting primarily from a 15% increase in unit shipments to 15,636.

Community Development

General Development is engaged in the business of community development in Florida. General has seven planned communities in which it offers for sale homesite lots, housing and commercial and special-purpose sites. In these communities, General typically owns and operates water, sewer and gas utilities, and the principal recreational facilities such as country clubs, golf courses, community centers and marinas. General's principal communities are Port Charlotte on the west coast of Florida, Port St. Lucie and Port Malabar on the east coast of Florida and Port LaBelle in south central Florida. These communities, together with three smaller communities on the east coast of Florida, comprise approximately 236,000 acres. At December 31, 1978, approximately 96,000 acres had been sold and paid for in full, approximately 43,000 acres were subject to outstanding sales contracts and approximately 97,000 acres, including approximately 20,100 acres which have been platted for sale or development as homesites, are being held for future development. In addition, General owns approximately 28,700 acres of undeveloped land not included in the community total. For information relating to the installment method of accounting used by General, see Note 4 to Consolidated Financial Statements.

During 1977, delivered houses sold by General were 760, compared with 310 in 1976, which accounted for a 144% increase in homebuilding revenues. Installment basis homesite revenues during 1977 were flat compared with 1976, reflecting recorded homesite unit sales in 1977 of 5,278, compared with 5,509 in 1976. During 1977, total revenues increased 11% to $101.7 million and income from operations increased 14% to $19.5 million, primarily attributable to increased homebuilding revenues and profit margins and increased sales of commercial properties, offset in part by reduced interest income on lower contract receivable balances. The increased revenues during the year ended December 31, 1977, reflected a reversal of the prior trend of declining revenues from homesite and housing sales.

During 1978, delivered houses sold by General were 1,284, which accounted for an 86% increase in homebuilding revenues. Installment basis homesite revenues were $52.7 million compared with $37.3 million in 1977, an increase of 41%, as recorded homesite unit sales increased 58% to 8,336. For the year ended December 31, 1978, total revenues increased 45% to $147.9 million and income from operations increased 1% to $19.6 million, reflecting increased homebuilding and homesite unit volume, offset in part by reduced interest income on lower contract receivable balances.

At December 31, 1978, houses under contract consisted of 1,125 units, representing $50.9 million of contracts compared with 399 units, representing $16.2 million of contracts at December 31, 1977, and, at December 31, 1978, General had mortgage financing commitments covering approximately 1,700 units. All houses under contract at December 31, 1978, are expected to be delivered during the next twelve months.

Food Services

Servomation is engaged in 42 states and Canada in the sale of prepared and packaged foods, hot and cold beverages and tobacco products through coin-operated vending machines and manual food service operations, and the franchising and operation of the Red Barn chain of fast-service restaurants.

Servomation conducts its food services operations from 152 regional service centers located throughout the United States. Vending machine operations involve 24-hour delivery of food and beverages, including soups, hot and cold entrees, salads, sandwiches, desserts, snacks and appetizers through machines installed at plant, office, institutional and public locations. Manual food services include the management and operation of cafeterias, executive dining rooms and dining halls, as well as providing food services at special functions, at various office, plant, school, health care and other locations. Concession operations include food and refreshment service for patrons in stadiums, sports arenas, race tracks and other public areas. In connection with its manual food service activities, Servomation also offers clients facility design and food specialty consulting services. During its 1978 fiscal year, approximately 62% of Servomation's operating revenues was derived from vending machine operations and approximately 36% was derived from manual food service operations.

Servomation's food service activities tend to be tailored to the specific needs of its customers. In most of the services provided by Servomation, the continuity of relationships with clients depends more upon the quality and competitiveness of the services offered than upon long-term contracts. Servomation owns, services and supplies the vending machines installed at customer locations and is normally entitled to the revenues derived therefrom, subject to the right of the owner of the premises to receive a commission, which is customarily based on gross sales. Manual food service operations are conducted under a variety of arrangements, including cost-plus contracts and contracts in which Servomation operates the facility for its own account. In most cases, equipment and facilities located on the client's premises and utilized in Servomation's manual food operations are owned by the client.

Servomation believes its total sales are among the largest in the vending and manual food service industry. Its largest competitor in the industry, however, has a sales volume more than twice as large as that of Servomation.

Revenues and net income, respectively, of Servomation for the five years ended December 31, 1978, were $378,094,000 and $9,014,000 in 1974; $372,686,000 and $8,152,000 in 1975; $403,487,000 and $11,498,000 in 1976; $427,745,000 and $13,120,000 in 1977; and $451,514,000 and $13,398,000 in 1978. At December 31, 1978, Servomation's assets, after allocation of GDV's purchase price in excess of book value of net assets acquired, aggregated $195,151,000, including cash and short-term securities of $41,789,000 and net property, plant and equipment of $120,614,000. Liabilities at that date totalled $72,798,000, including long-term debt and obligations under capital leases of $16,328,000 and $7,426,000, respectively.

During recent years, the dollar volume of cigarette sales by Servomation has declined slightly, to approximately $34 million for the 1978 fiscal year. Future developments involving health hazards of smoking and future cigarette price and tax increases may further affect cigarette sales by Servomation.

The Red Barn chain of fast-service restaurants operates in 21 states and Eastern Canada. As of December 31, 1978, 128 of its 219 units were operated by Servomation; the remainder were franchised. Pursuant to the usual franchise arrangement, the franchisee pays Servomation a fixed franchise fee and a royalty consisting of a percentage of gross sales. Restaurant locations are generally leased by Servomation and subleased by it to franchisees. In some cases, the franchisee also leases equipment from Servomation. The franchisee purchases food products and ingredients independently from local vendors. During Servomation's 1978 fiscal year, the Red Barn operation contributed approximately $38 million to total sales and was marginally profitable.

Servomation owns approximately 100,000 vending machines and its maintenance of reliable and trouble-free vending machines is an important aspect of Servomation's business. Servomation's vending machines and food-preparation equipment represent approximately 63% of its capital investment in property and equipment on a cost basis. Servomation also owns approximately 3,100 specially-equipped delivery trucks, other automotive vehicles and office and warehouse equipment necessary for the conduct of its operations.

GDV Investments

GDV has made investments in the securities of various publicly-owned companies, including approximately 8.8% of the outstanding common stock of The Lamson & Sessions Co. (representing an investment of $2,871,000), and approximately 8.2% of the outstanding common stock of Chicago Pneumatic Tool Company (representing an investment of $12,378,000). GDV has reached no decision as to plans with respect to those investments. Another City subsidiary owns an additional 1.8% of the outstanding common stock of Chicago Pneumatic Tool Company (representing an investment of $2,366,000).

Manufacturing and Lodging

International Manufacturing

City's international manufacturing activities are conducted through foreign subsidiaries and affiliated corporations, several of which are jointly owned with major foreign manufacturers. City's foreign subsidiaries and affiliates operate 70 plants in 19 countries. The principal products of this group are containers, water heaters, automotive leaf springs and plastics.

Contributions to total revenues and income from operations of the international manufacturing group for the five years ended December 31, 1978, were as follows (in millions):

	1974	1975	1976	1977	**1978**
Brazil	$ 46.4	$ 56.9	$ 74.2	$ 94.3	$105.9
Mexico	25.0	38.4	56.6	52.0	69.6
Belgium (TMT Group)	49.0	50.8	58.1	67.5	90.4
Italy	51.8	51.9	53.3	61.4	73.6
United Kingdom*	1.7	1.4	43.4	52.6	77.2
Other International Operations*	50.6	42.8	47.3	65.4	69.2
Total revenues	$224.5	$242.2	$332.9	$393.2	$485.9
Brazil	$ 6.2	$ 6.0	$ 6.5	$ 13.1	$ 13.8
Mexico	2.2	4.6	4.8	8.0	10.0
Belgium (TMT Group)	8.2	6.4	9.7	9.6	13.2
Italy	1.4	(4.4)	1.6	(.9)	(1.5)
United Kingdom*	1.7	1.4	3.3	6.5	8.9
Other International Operations*	4.8	3.0	(1.1)	(.4)	(2.3)
Income from operations	$ 24.5	$ 17.0	$ 24.8	$ 35.9	$ 42.1

* During 1976 and 1977, respectively, operations in the United Kingdom and Singapore (included under "Other International Operations") were consolidated (prior to consolidation, these operations were carried as equity investments). The consolidation of these operations added $42.0 million and $15.8 million to revenues, and $1.9 million and $1.3 million to income from operations, in the years indicated.

Rheem Metalurgica is Brazil's leading manufacturer of large steel containers and one of its largest producers of food and beverage cans. During 1977, revenues increased 27% and income from operations doubled from the comparable 1976 period, resulting from higher unit shipments, efficiencies based on full capacity operations and timely price increases in all major lines. In 1978 revenues increased 12% and income from operations increased 5% from record 1977 results. While the product lines were expanded further and the product mix and efficiencies were improved in 1978, margins were somewhat reduced by cost inflation.

Rassini Rheem, a company owned jointly with Mexico's largest steel company, manufactures automotive leaf springs (principally for export to the United States) and commercial fasteners. In late 1976, Rassini acquired a producer of cold-drawn steel products, complementing its fastener operation and, during 1977, began manufacture and sale of steel containers for the petroleum and chemical industry. During 1977, revenues declined 8%, attributable to slight decreases in unit shipments related to generally uncertain economic conditions in Mexico following the 1976 peso devaluation, including a disruption in domestic markets. Income from operations during 1977 increased 69% from 1976, which had been adversely affected by the significant peso devaluation. In 1978, increased unit shipments and higher prices, particularly for fasteners and cold steel bars, resulted in increases of 34% in revenues and 25% in income from operations.

The TMT Group is primarily engaged in container operations in Belgium, the Netherlands and France, and through its affiliate, NV Deceuninck (70% owned), is the leading Belgian producer of extruded plastic products for the building industry. The Deceuninck plastics operation has shown consistent growth in revenues during the five-year period and has been a major and increasing contributor to income from operations. During 1977, revenues increased 16%, as a result of increased shipments of plastic products. However, income from operations was approximately level with 1976, reflecting competitive pressure on margins. In 1978, revenues increased 34% and income from operations increased 37%, reflecting principally Belgian franc exchange gains and increased unit shipments of certain products.

The Italy Group includes Rheem Safim, the largest container manufacturer in Italy; Rheem Radi, a leading water heater manufacturer in Europe; and Radi France, which distributes Rheem water heaters in France. The group sustained a $4.4 million loss in 1975, resulting in part from the general economic climate and labor unrest in Italy, low container volume, pricing constraints, a loss of $1 million on the disposal of a plastics facility, and the phasing down of galvanized water heaters and start-up of glass-lined water heaters. Absent the adverse experience of 1975, and including translation gains of $1.9 million, the group was profitable in 1976. In 1977, revenues increased 15%, but lacking favorable translation adjustments the group was marginally unprofitable. In 1978, revenues increased 20% but losses increased as improvements in container operations were insufficient to offset losses on depressed water heater sales and exchange losses.

Rheem Blagden, which is jointly owned with Blagden & Noakes, Ltd., is a major producer of steel and plastic containers and industrial plastic products in the United Kingdom and a leading steel container reconditioner in Europe. During 1977, revenues increased 21% and income from operations increased 94%. In addition to improved earnings in drum reconditioning and plastic molding operations, 1977 results benefited significantly from appreciation of the pound sterling relative to the dollar versus depreciation of the pound in 1976. In November 1977, Rheem Blagden acquired W. W. Ball & Sons Limited, a manufacturer of molded plastic products, whose revenues were $14 million in 1978. During 1978, Rheem Blagden revenues increased 47% and income from operations 37%. These increases were primarily attributable to the inclusion of a full year's results of W. W. Ball, to continued strength of container operations and to improved volume and margins of other product lines.

Other International Operations include City's consolidated operations in Canada, South Africa and Singapore as well as unconsolidated operations in Argentina, Japan and Spain. The principal products of these companies are containers and, in Canada, water heaters. This category also includes International Manufacturing's corporate expenses and other corporate items. While this group of operations has been profitable, the losses of $.4 million in 1977 and $2.3 million in 1978 were incurred principally as a result of increased interest expenses on higher borrowings at the corporate level to provide for expansion, losses on currency translations relating to corporate borrowings, provision for changes in asset valuations, product development and increased corporate expenses.

Air Conditioners and Water Heaters

The products of these divisions, primarily for residential use, include central heating and air conditioning equipment and a complete line of automatic storage-type water heaters.

Heating and air conditioning products are manufactured at plants in Forth Smith, Arkansas; Milledgeville, Georgia; and Greenville, Alabama, and are sold under the "Rheem" and "Ruud" brand names and private labels. Central heating and air conditioning products for residential use are sold through independent distributors and dealers. Products for commercial and industrial uses are sold by independent sales representatives and wholesale distributors. The $20 million, 520,000-square-foot Milledgeville facility, constructed to supplement the Ft. Smith plant, is scheduled to reach full production in the first half of 1979.

During 1977, increased housing starts and increased allocation of limited productive capacity to the air conditioning segment of the business resulted in a 29% increase in shipments of air conditioning units, and a 5% increase in shipments of residential heating units. Total revenues and income from operations for the division increased 22% and 26%, respectively, despite competitive market conditions. In 1978, the market remained strong. Shipments of air conditioning and heating products increased 14% and 15%, respectively, resulting in an 18% increase in revenues. The increase in income from operations was held to 6% as orders exceeded manufacturing capacity at the Ft. Smith facility, causing inefficiencies which are expected to be eliminated through increased production at Milledgeville.

The water heater division manufactures water heaters at plants located in Chicago, Illinois and Montgomery, Alabama. A $12 million expansion of the Montgomery plant is scheduled for full operation in 1979 and will increase the productive capacity of the water heater division by one-third. Water heaters are sold principally through independent distributors and dealers both for original installation and as replacement units under the "Rheem" and "Ruud" brand names as well as private labels. City believes that Rheem is the largest manufacturer of water heaters in the United States. Although these products are housing oriented, a strong replacement market, which is believed to account for more than 60% of unit sales, makes volume less dependent on trends in housing starts.

Revenues and income from operations of this division have increased consistently since 1973 despite moderate fluctuations in unit volume. During 1977, unit shipments increased 17%, revenues increased 23%, and income from operations improved 16% from the comparable period of 1976, as selling prices rose moderately. During 1978, unit shipments increased 5%, revenues increased 12% and income from operations increased 16%, reflecting continuing growth in market share and moderately increased selling prices.

Magazine Printing

World Color Press is principally engaged in printing magazines under long-term contracts for a variety of publishers. World Color also prints newspaper comic supplements, comic magazines and other specialized publications of both national and regional scope. World Color operates a total of 12 letterpress presses, 34 web offset presses and five rotogravure presses at its plants in Sparta, Effingham and Salem, Illinois. World Color also operates a preparatory facility in Bridgeport, Connecticut. A $42 million, 234,000-square-foot addition to the Salem facility was completed in late 1978. World Color expects to commence construction of a new 300,000-square-foot facility in Mt. Vernon, Illinois in mid-1979. The total cost of this facility is estimated at $36 million, to be expended over a period of three years.

In the five-year period ended December 31, 1978, World Color revenues increased from $122.8 million to $241.3 million and income from operations improved from $8.9 million to $19.5 million. During 1977 and 1978, revenues increased 25% and 24%, respectively, and income from operations increased 18% and 30%. The increases in income from operations, particularly in 1978, were primarily attributable to greater operating efficiencies resulting from increased production. In addition, 1977 and 1978 results benefited from generally favorable conditions in the magazine industry, where increased advertising has resulted in larger publications.

Containers

The container division is a major supplier, primarily to the chemical, petroleum, food and paint industries, of steel shipping containers, principally 55-gallon drums and smaller containers ranging in size down to 3½-gallon pails and plastic containers, primarily 5-gallon pails. The Tipper Tie unit of this division manufactures metal clip closures and processing equipment for the fastening of flexible packaging materials used by the meat, poultry, dairy and chemical industries.

During 1977, income from operations improved 30% on a 15% increase in revenues. Unit shipments of most products increased, as did selling prices. A more modest improvement was registered in 1978, with income from operations up 4% on a 12% increase in revenues. Unit shipments gained in all areas except food containers. The decline in shipments of food containers, coupled with higher steel prices, restricted profit growth.

Budget Motels

Motel 6 operates a chain of 254 budget motels in 37 states comprising 25,473 rooms. Standard room rates range from $9.95 to $16.95 a night, depending on the number of occupants. In 1978, 22 motels were opened, compared with four in 1977. During 1977, revenues and income from operations improved 19% and 75%, respectively, primarily reflecting increased occupancy. Average room rates increased 2% from $11.06 to $11.27. Average occupancy increased from 67% to 75%. During 1978, revenues and income from operations improved 17% and 36%, respectively, primarily due to an increase in occupancy to 81% and to the increased number of motels in operation. Average room rates increased 4% to $11.67. Motel 6 presently plans to add approximately twenty-five motels annually for the next several years.

Other Manufacturing Operations

Other manufacturing operations include City's refrigeration products division, which manufactures chest and upright food freezers and refrigerators for home use and ultra-low-temperature freezers for medical use in two plants in South Carolina; Alma Plastics Company, which manufactures molded and extruded plastic products, primarily for the automotive and appliance industries, in 11 plants; and Hayes International Corporation, which is primarily engaged in the maintenance, modification, and overhaul of military and commercial multi-engine aircraft, substantially for the Defense Department. A newly formed vacuum packaging unit is developing proprietary vacuum packaging systems, principally for the textile industry.

Energy Investments

City's energy activities include exploration and development of oil and gas prospects in the southern United States, the British sector of the North Sea, Ecuador, Colombia and Egypt. City follows the successful efforts method of accounting for costs incurred in searching for and developing oil and gas reserves. At December 31, 1978, City's interest in worldwide proved reserves was 4.9 billion cubic feet of gas and 22.0 million barrels of oil. The carrying amount of energy investments was $7,046,000 at December 31, 1978, net of long-term debt of $14,965,000.

International oil exploration activities such as City's are subject to uncertainties, some of which derive from the relatively large amounts of capital allocated to a limited number of exploratory areas, where there are sometimes attendant unusual economic and political risks.

Miscellaneous

Miscellaneous operations include C. I. Planning Corporation, which is advisor to two real estate investment trusts, C. I. Mortgage Group and C. I. Realty Investors, as well as assets of certain operations, primarily real estate held for disposal. At December 31, 1978, City owned 463,570 shares (18%) of the outstanding stock of C. I. Realty Investors. City expects to make additional open market purchases of such stock from time to time.

Competition

City's subsidiaries encounter intense competition in most of their operations. Competitors include a number of large companies engaged in operations similar to those of one or more of City's principal industry segments, as well as small companies which compete in a limited number of products or services in limited geographical areas. In certain product areas, such as homebuilding, sales are particularly susceptible to cyclical changes in the economy and are affected by the availability of mortgage financing. In the insurance industry, The Home Group competes with mutual insurance companies and reciprocal and foreign insurers, as well as with other stock companies.

Employee Relations

At December 31, 1978, City and its subsidiaries employed approximately 61,500 persons, including approximately 10,400 in its foreign operations. Labor relations have generally been maintained on a normal and satisfactory basis during the past five years. From time to time, there have been work stoppages at various locations but none has been material to City as a whole.

Environmental Matters

City's housing and community development companies and other real estate companies are subject to land use and other restrictions as a result of the adoption of Federal and state legislation and actions by local governmental agencies. These restrictions have in the past and may in the future cause delays and otherwise increase the cost of land development and other real estate projects.

City's manufacturing operations are subject to Federal and state legislation and regulations relating to the discharge of materials into the environment. It is not anticipated that compliance with such regulations will have a material adverse impact on capital expenditures, earnings or the competitive position of City.

Item 2. Summary of Operations

City Investing Company and Subsidiaries

Five Years Ended December 31, 1978

Statement of Consolidated Income
In Thousands of Dollars

The following Statement of Consolidated Income of City and its subsidiaries has been examined by Peat, Marwick, Mitchell & Co., independent certified public accountants, whose report thereon appears elsewhere herein. This Statement of Consolidated Income should be read in conjunction with management's discussion and analysis thereof and the financial statements and related notes included elsewhere herein. Numerical references are to Notes to Financial Statements.

	1974	1975	1976	1977	**1978**
Revenues					
Insurance and financial	$ 993,009	$1,038,147	$1,280,220	$1,509,368	$1,709,064
Housing and food services	356,503	264,136	283,151	367,363	653,017
Manufacturing and lodging	774,827	798,388	966,125	1,188,180	1,429,794
Total revenues	2,124,339	2,100,671	2,529,496	3,064,911	3,791,875
Expenses (2) (5) (6)					
Insurance and financial					
Losses and loss expenses	668,401	682,009	848,619	951,825	1,063,474
Underwriting expenses	275,947	315,570	352,166	416,463	446,885
Other expenses	20,589	22,498	24,389	27,592	52,059
Total	964,937	1,020,077	1,225,174	1,395,880	1,562,418
Housing and food services					
Operating costs	258,538	182,121	200,462	261,068	485,572
Selling and general expenses	66,205	55,865	48,685	59,584	84,358
Depreciation and amortization	5,365	5,458	6,220	6,315	13,712
Interest and debt expense, net	13,065	10,630	9,086	6,245	21,559
Total	343,173	254,074	264,453	333,212	605,201
Manufacturing and lodging					
Operating costs	584,168	611,931	744,219	918,195	1,108,888
Selling and general expenses	58,814	65,684	81,225	93,988	113,696
Depreciation and amortization	21,775	25,069	29,704	34,340	41,802
Interest and debt expense, net	30,112	31,868	32,112	35,319	41,801
Total	694,869	734,552	887,260	1,081,842	1,306,187
Energy investments	10,657	21,335	20,221	21,865	10,511
Miscellaneous	2,734	3,813	3,657	6,268	9,267
Total expenses	2,016,370	2,033,851	2,400,765	2,839,067	3,493,584
Income from operations	**107,969**	**66,820**	**128,731**	**225,844**	**298,291**
Corporate administrative expense	10,921	9,134	11,958	13,368	24,457
Corporate interest and debt expense, net	42,849	42,705	39,344	47,452	51,674
Income taxes (14)	6,455	(9,570)	22,163	63,497	85,521
Net (gains) losses on sales of securities* (B)	7,903	(4,749)	(6,486)	71	—
Minority interest	7,658	7,168	12,845	16,298	24,219
Income from continuing operations	32,183	22,132	48,907	85,158	112,420
Discontinued operations (B) (7)	(4,475)	(3,373)	(4,947)	—	—
Change in accounting (B) (3)	—	8,840	—	—	—
Net income	**$ 27,708**	**$ 27,599**	**$ 43,960**	**$ 85,158**	**$ 112,420**

	1974	1975	1976	1977	**1978**
Net income	$ 27,708	$ 27,599	$ 43,960	$ 85,158	$ 112,420
Dividends on preference stocks other than common equivalent shares	(15,418)	(15,418)	(15,949)	(15,915)	(15,615)
Net income applicable to common and common equivalent shares	$ 12,290	$ 12,181	$ 28,011	$ 69,243	$ 96,805
Net income per share (C)					
Primary	$ .58	$ .59	$ 1.36	$ 3.13	$ 4.27
Assuming full dilution	$ .82	$ .83	$ 1.28	$ 2.36	$ 3.06
Average shares (in thousands)					
Primary	21.036	20,549	20,642	22,097	22,693
Assuming full dilution	35.485	34,997	35,091	36,543	37,136
Common stock cash dividends	$ .66	$ .66	$ .66	$ .80	$ 1.00
Ratio of earnings to fixed charges:					
Consolidated (D)	1.31	1.33	1.79	2.62	2.61
Parent company only (E)	1.40	1.73	1.27	1.38	1.57

* Excludes unrealized appreciation (depreciation) of stocks of $(74,946,000), $53,726,000, $36,783,000, $(23,406,000) and $(11,258,000) for the five years ended December 31, 1978.

(A) The accounting policies followed by City are described in the Notes to Financial Statements.

(B) Income taxes applicable to net (gains) losses on sales of securities were $3,627,000, $(1,812,000), $(2,332,000) and $126,000 for the four years ended December 31, 1977. Income taxes applicable to discontinued operations were $(2,570,000), $(3,114,000) and $(3,267,000) for the three years ended December 31, 1976, and those applicable to the 1975 accounting change were $8,160,000.

(C) Primary and fully diluted earnings per share related to discontinued operations were, respectively, $(.21) and $(.13) in 1974; $(.16) and $(.09) in 1975; and $(.24) and $(.14) in 1976. Primary and fully diluted earnings per share related to the accounting change were $.43 and $.25.

(D) For the purpose of these computations, "earnings" consist of net income, excluding undistributed earnings of entities accounted for on the equity method, plus provision for income taxes, minority interest, and fixed charges. "Fixed charges" consist of interest and debt expense (excluding interest expense of savings and loan association), preferred dividend requirements of a subsidiary and an estimated portion of rentals representing interest costs.

(E) For the purpose of these computations, "earnings" consist of net income, excluding undistributed earnings of subsidiaries and after deduction of Federal income tax benefit, plus tax payments received from subsidiary companies and retained by parent company and Federal tax refunds and fixed charges (excluding interest billed to and subsequently contributed to capital of subsidiaries). "Fixed charges" consist of interest and debt expense, net, plus interest billed to and subsequently contributed to capital of subsidiaries.

Management's Discussion and Analysis of Statement of Consolidated Income

This discussion and analysis is limited to a general review of material changes in the various revenue and expense items appearing on the Statement of Consolidated Income for each of the past two fiscal years as compared with the immediately preceding year. Generally, a change in a revenue or expense item is commented on if it involves a change of more than 10% as compared with the prior period and a change of more than 2% of the average net income for the three most recent years presented.

Contributions to total revenues and income from operations of City's principal industry segments for the five years ended December 31, 1978, are set forth on pages 2 and 3.

Accounting Changes

Amounts for 1977 and prior periods have been restated to give effect to adoption of an American Institute of Certified Public Accountants statement of position, "Accounting for Property and Liability Insurance Companies", which specifies that certain insurance acquisition costs which had previously been deferred and amortized be charged to expense when incurred. The effect of the change, which reduced the amount of prepaid insurance acquisition costs carried in the balance sheet, was to decrease net income, primary net income per share and net income per share — assuming full dilution for the three years ended December 31, 1976, by $1,599,000, $.08 and $.05; $6,101,000, $.30 and $.18; and $293,000, $.01 and $.01; and to increase net income in 1977 by $2,635,000, $.12 and $.07.

In March, 1975, the Financial Accounting Standards Board issued Statement No. 5, which provides that insurance companies may no longer maintain reserves for catastrophes. The Company's catastrophe reserve was discontinued as of January 1, 1975, and the cumulative effect of the change, $8,840,000, was included in net income of the year ended December 31, 1975.

Total Revenues

For the years ended December 31, 1977 and 1978, respectively, total revenues increased $535,415,000 (21%) and $726,964,000 (24%). Insurance and financial revenue increases of 18% in 1977 and 13% in 1978 were primarily attributable to premium rate increases and increased writings in the Company's property and casualty insurance operations. Housing and food services revenues increased 30% in 1977 and 78% in 1978 (47% in 1978 excluding the effect of the acquisition of Servomation Corp., acquired as of October 1, 1978, in a purchase transaction). Excluding the effect of the acquisition of Servomation in 1978, such increases resulted primarily from increases, in 1977 and 1978, of 47% and 53% in housing unit sales, 21% and 15% in mobile home unit sales and, in 1978, 58% in homesite unit sales. Manufacturing and lodging revenues increased 23% in 1977 and 20% in 1978, attributable primarily to increased unit shipments in City's major manufacturing businesses, particularly in its heating and air conditioning operation, and increased production resulting from new printing contracts in City's magazine printing operation.

Total Expenses

For the years ended December 31, 1977 and 1978, respectively, total expenses increased $438,302,000 (18%) and $654,517,000 (23%).

Insurance and financial expenses increased 14% in 1977 and 12% in 1978, primarily as a result of an increase of 12% in losses and loss expenses in each of those years, reflecting higher costs per claim, primarily attributable to inflation. Underwriting expenses increased 18% in 1977 and 7% in 1978, reflecting increased premium volume. Other expenses increased 13% in 1977 and 89% in 1978, reflecting in 1978 the consolidation by the savings and loan subsidiary of its homebuilding operation.

Housing and food services expenses increased 26% in 1977 and 82% in 1978 (49% in 1978 excluding the effect of the acquisition of Servomation Corp.). These increases, excluding Servomation in 1978, were primarily a result of increased unit shipments and increased cost of materials and labor resulting from inflation. Selling and general expenses increased 22% in 1977 and 28% in 1978, excluding Servomation, reflecting increased sales volume. Depreciation and amortization increased 2% in 1977 and 31% in 1978, excluding Servomation, reflecting additions to property, plant and equipment. In 1977 interest and debt expense decreased 31% as a result of lower interest rates and lower borrowing levels. In 1978, interest and debt expense increased $15,314,000 (245%) reflecting higher levels of borrowings, particularly those related to the acquisition of Servomation and to investments in marketable securities, and higher interest rates.

Manufacturing and lodging expenses increased 22% in 1977 and 21% in 1978, including increases in operating costs of 23% and 21%, respectively, reflecting increased unit shipments and production, and increased cost of materials and labor resulting from inflation. Selling and general expenses increased 16% in 1977 and 21% in 1978 as a result of increased sales volume. Depreciation and amortization increased 16% and 22%, reflecting additions to property, plant and equipment. Interest and debt expense increased 10% in 1977 and 18% in 1978, primarily as a result of higher borrowing levels and, in 1978, higher interest rates.

Energy investment losses decreased 52% in 1978 as a result of a reduced level of activity, including the sale of City's coal operation in early 1978.

Miscellaneous expenses increased 71% in 1977, primarily as a result of an increase in City's equity in pretax losses of C. I. Planning due to reduced fees, and 48% in 1978, primarily due to a provision for loss on assets held for disposal.

Corporate Administrative Expense

Corporate administrative expense increased 12% in 1977 and 83% in 1978, reflecting increased accruals for employee costs, including, in 1978, accrual of additional amounts applicable to prior periods.

Corporate Interest and Debt Expense, Net

During 1977, interest and debt expense, net, increased $8,108,000 (21%), reflecting the higher cost of long-term borrowings and increased borrowing levels. During 1978, interest and debt expense, net, increased $4,222,000 (9%).

Income Taxes

For the years ended December 31, 1977 and 1978, the effective income tax rate applicable to income from continuing operations, exclusive of net (gains) losses on sales of securities, was 38.5%. The increase in income tax expense during those periods was a result of increased pretax income.

Net (Gains) Losses on Sales of Securities

During 1977, sales of securities resulted in net capital losses of $71,000 and unrealized depreciation increased $23,406,000. During 1978, unrealized depreciation increased $11,258,000. Unrealized appreciation or depreciation of stocks is shown as a separate component of shareholders' equity and is not included in the determination of net income. Realization of gain or loss on sales of securities is, to a certain extent, within the control of management, which determines the timing and selection of securities sold.

Minority Interest

In 1977, minority interest increased $3,453,000 (27%) reflecting the consolidation of City's partially-owned Singapore operation, which previously had been carried as an equity investment, and increased net income of partially-owned consolidated operations, particularly Mexico and the United Kingdom. In 1978, minority interest increased 49% reflecting the purchases by GDV, Inc., a 66.2% owned subsidiary, from City of its wholly-owned subsidiaries, Wood Bros. Homes, Inc. and Guerdon Industries, Inc. and the purchase as of October 1, 1978, by GDV of 63.5% of the outstanding shares of Servomation Corp.

Discontinued Operations

During 1976, as a result of an increase in estimated disposal and carrying costs related to City's real estate joint venture and bulk land sales operations, and the write-off of a mortgage note receivable, an after-tax loss of $4,947,000 was recognized.

Item 3. Properties

At December 31, 1978, City and its subsidiaries occupied approximately 22,000,000 square feet of plant and office space in the United States (approximately 47% of which was leased). City believes that such properties, including the equipment located therein, are suitable and adequate to meet the requirements of businesses conducted therein. The facilities are, for the most part, being fully utilized.

Item 4. Parents and Subsidiaries

Unless otherwise indicated, corporations listed are included in the financial statements of City Investing Company and subsidiaries.

Name	Jurisdiction in Which Organized		Percentage of Voting Securities Owned by Immediate Parent (including in some cases a negligible number of Directors' Qualifying Shares)
City Investing Company (the Registrant)	Delaware		Owned by Public
Alma Plastics Company	Michigan		100%
CNV Corporation	Delaware	(b)	100%
C. I. Planning Corporation	New York	(b)	100%
City Exploration Company	Delaware	(b)	100%
GDV, Inc.	Delaware		66.2%
General Development Corporation	Delaware		100%
Guerdon Industries, Inc.	Delaware		100%
Servomation Corp.	Delaware		100%
Wood Bros. Homes, Inc.	Delaware		100%
Hayes International Corporation	Delaware		100%
Motel 6, Inc.	Delaware		100%
Rheem Manufacturing Company	Delaware		100%
City Investing International, Inc.	Delaware		100%
Rheem International, Inc.	Delaware		100%
N.V. D.P.G. S.A.	Belgium		70%
Rafim Industries Inc.	Delaware		100%
Rheem Safim S.p.A.	Italy		100%
Rassini Rheem, S.A. de C.V.	Mexico		51%
Rheem Blagden Limited	England		50%
W. W. Ball & Sons Limited	England		100%
Rheem Canada Limited	Canada		100%
Rheem Hume Pte. Limited	Singapore		50%
Rheem Metalurgica S.A.	Brazil		97%

Name	Jurisdiction in Which Organized		Percentage of Voting Securities Owned by Immediate Parent (including in some cases a negligible number of Directors' Qualifying Shares)
Rheem Radi S.p.A.	Italy		88%
Rheem South Africa (Pty.) Limited	South Africa		65%
T.M.T., Societé Anonymé	Belgium		99%
Plametha, B.V.	Netherlands		100%
Rheem Textile Systems, Inc.	New York		100%
Southern California Financial Corporation	California	(b)	100%
Southern California Savings and Loan Association	California		100%
The Home Group, Inc.	Delaware	(a)	100%
New Homsub, Inc.	Delaware		100%
Uarco Incorporated	Delaware	(c)	100%
Drummond Business Forms Limited	Canada	(c)	100%
The Home Insurance Company	New Hampshire		100%
City Insurance Company	New Jersey		100%
Scott Wetzel Services, Inc.	Washington	(b)	100%
Federal Home Life Insurance Company	Indiana		100%
Home Capital Services, Inc.	Delaware	(b)	100%
Home Portfolio Advisors, Inc.	Delaware	(b)	100%
PHF Life Insurance Company	Michigan		100%
Seaboard Surety Company	New York		100%
Sterling Forest Corporation	New York	(b)	100%
The Home Indemnity Company	New Hampshire		100%
The Home Insurance Company of Illinois	Illinois		100%
The Home Insurance Company of Indiana	Indiana		100%
Thico Plan, Inc.	Delaware	(b)	100%
World Color Press, Inc.	Delaware		100%

Approximately 148 domestic and 90 foreign subsidiaries have been omitted in accordance with the provisions of Paragraphs No. 4 and 5 of the instructions to Item 4.

(a) Indicates subsidiaries for which separate consolidated financial statements are filed.

(b) Indicates unconsolidated subsidiaries which are accounted for by the equity method, for which no financial statements are filed because such statements may be excluded under paragraph No. 5 of instructions to Financial Statements.

(c) Indicates subsidiaries reflected as long-term investments in the consolidated balance sheet at December 31, 1978. Through such date approximately 14% of Uarco's outstanding stock had been purchased. The balance of such stock was acquired by merger effective February 1, 1979. Uarco is included in City's consolidated financial statements effective January 1, 1979.

Item 5. Legal Proceedings

Various legal proceedings are pending against the Company, including an indictment and several related treble-damage civil cases against Rheem Manufacturing Company for an alleged conspiracy to fix prices of water heaters. In the opinion of counsel, these proceedings will not result in a material liability to City.

Item 6. Increases and Decreases in Outstanding Securities and Indebtedness

	Common Stock, $1.25 Par Value	$1.31 Cum. Pref. Stk., Conv. Ser. A	$2.00 Cum. Pref. Stk., Conv. Ser. B	$1,000 Cum. Pref. Stk., Series D
December 31, 1977	23,306,887	80,978	7,706,657	5,000
December 31, 1978	23.369,912	53,636	7,704,595	2,000
	63,025	(27,342)	(2,062)	(3,000)

The increase in the number of shares of Common Stock outstanding and the decrease in outstanding Cumulative Preference Stock resulted from the conversion of Cumulative Preference Stock and convertible subordinated debentures. The issuance of such Common Stock was exempt from registration under section 3(a) (9) of the Securities Act. The decrease in the number of shares of Cumulative Preference Stock, Series D, resulted from the redemption of 3,000 shares of such Preference Stock for $3,000,000 during the quarter ended March 31, 1978.

During the year ended December 31, 1978, City's (Parent Company Only) long-term debt (including current maturities), other than convertible debt, increased from $546,037,000 to $559,911,000. During that period, long-term debt of City's subsidiaries (including current maturities and notes payable to banks by the savings and loan subsidiary) increased from $335,214,000 to $661,094,000. Notes payable to banks by subsidiaries under revolving credit agreements increased $223,761,000 (including amounts reflected in the following paragraph), reflecting indebtedness incurred in connection with the acquisition of 63.5% of Servomation Corp. and 14% of Uarco Incorporated, the refinancing of short-term indebtedness of approximately $44,000,000 by Wood Bros. and indebtedness incurred in the ordinary course of business. Notes payable to banks by the savings and loan subsidiary increased $37,000,000, primarily as a result of the acquisition of the assets of First Surety Corp. For a comparison of indebtedness at December 31, 1977 and 1978, by major category, see Note 8 to City's Financial Statements.

During July and August, 1978, GDV, Inc., 66.2% owned by City, entered into four Revolving Credit Agreements with banks providing for revolving credit commitments of up to $180 million, repayment of which was guaranteed by City. As of October 12, 1978, these agreements, together with an earlier agreement, were consolidated into a $200 million Revolving Credit Agreement. City has guaranteed repayment of the principal and interest on any advances under such Agreement. Advances of $139 million were outstanding at December 31, 1978. For further information see Item 5 of City's Quarterly Report on Form 10-Q for the period ended September 30, 1978, incorporated herein by reference.

Item 9. Approximate Number of Equity Security Holders

As of December 31, 1978:

Title of Class	Number of Record Holders
Common Stock ($1.25 Par Value)	42,848
$1.31 Cumulative Preference Stock ($1.00 Par Value), Convertible Series A	755
$2.00 Cumulative Preference Stock ($1.00 Par Value), Convertible Series B	25,348
$1,000 Cumulative Preference Stock ($1.00 Par Value), Series D	1
Common Stock Purchase Warrants Expiring March 1, 1984	49
7½% Convertible Subordinated Debentures	1,706
Warrants to purchase 2,040,000 shares of Common Stock of GDV, Inc. — void after July 15, 1983	1,846

Item 11. Indemnification of Directors and Officers

Incorporated by reference to Item 9 of City's Annual Report on Form 10-K for the year ended December 31, 1975.

Item 12. Financial Statements, Exhibits Filed, and Reports on Form 8-K

(a) Financial Statements

Index to Financial Statements

(b) Exhibits

3. Statement setting forth the computation of per share earnings.

5. Description of change in accounting principles. (Incorporated by reference to note 1 of notes to financial statements of City Investing Company and Subsidiaries and the Accountants' Report.)

11. Computation of Ratio of Earnings to Fixed Charges.

Instruments with respect to issues of long-term debt have not been filed as exhibits as the authorized principal amount of any one of such issues does not exceed 5% of the total assets of the Registrant and its subsidiaries on a consolidated basis. The Registrant agrees to furnish to the Commission a copy of each such instrument upon its request.

Copies of Exhibits will be provided upon written request to the Company.

(c) Form 8-K

City was not required to file a report on Form 8-K during the quarter ended December 31, 1978.

Item 12.1 Executive Officers of the Registrant

Name	Age	Offices Held in City and Present Principal Occupation
Geo. T. Scharffenberger	59	Director, Chairman and Chief Executive Officer
Peter C. R. Huang	43	Director and President
Stephen E. O'Neil	46	Director and President
Daniel E. Lyons	50	Director, Executive Vice President and Chief Financial Officer
Edward P. Sheridan	42	Senior Vice President
David Fain Brown	38	Vice President and General Counsel
Joseph L. DeMieri	38	Vice President and Controller
John J. C. Herndon	47	Vice President — Corporate Communications
John J. McHugh	47	Vice President and Secretary
Lester J. Mantell	42	Vice President and Director of Taxes
Frank R. Moothart	60	Vice President
John J. Quirk	35	Vice President and Treasurer

Mr. Scharffenberger was appointed to the office of Chairman of the Board of City in August 1974. Until February 1976, Mr. Scharffenberger also served as President of City at which time Messrs. Huang and O'Neil were appointed Presidents of City. Messrs. Huang and O'Neil previously served as Executive Vice Presidents of City. Until January 1978, Mr. Sheridan was also Treasurer of City. Mr. Herndon was appointed Vice President — Corporate Communications in December 1976. Prior to that time he served in various managerial capacities in City's International Manufacturing Group. Mr. Mantell was appointed Vice President and Director of Taxes in May 1977. Prior to that time he was Assistant Vice President and Director of Taxes. Mr. Quirk was appointed Vice President and Treasurer in January 1978. Prior to that time he was Assistant Vice President and Assistant Treasurer of City. All other officers have served in the capacity indicated for more than five years. Such persons are elected to serve in the capacities indicated until the next annual meeting, scheduled for May 25, 1979, and until their successors are elected and qualify.

The registrant is not aware of any family relationship (as defined in the instruction to this item) among any of the foregoing officers.

Part II

Part II, Items 13 through 15, have been omitted. Registrant intends to file a definitive proxy statement with the Securities and Exchange Commission not later than 120 days after the close of its fiscal year.

Signature

Pursuant to the requirements of Section 13 of the Securities Exchange Act of 1934, Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

CITY INVESTING COMPANY

By DANIEL E. LYONS
Executive Vice President and
Chief Financial Officer

Date: March 9, 1979

Accountants' Report

The Board of Directors and Shareholders
City Investing Company:

We have examined the balance sheet of City Investing Company (parent company only) and of City Investing Company and subsidiaries as of December 31, 1977 and 1978 and the related statements of income, retained earnings, unrealized depreciation of stocks held by insurance companies and changes in financial position for each of the five years in the period ended December 31, 1978. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the financial position of City Investing Company (parent company only) and City Investing Company and subsidiaries at December 31, 1977 and 1978, and the results of their operations, and changes in retained earnings, unrealized depreciation of stocks held by insurance companies and changes in financial position for each of the five years in the period ended December 31, 1978, in conformity with generally accepted accounting principles applied on a consistent basis after restatement for the change, with which we concur, in accounting for insurance acquisition costs as explained in note (1) to the financial statements, except for the change, with which we concur, in accounting for catastrophe reserves of insurance companies as explained in note (3) to the financial statements.

PEAT, MARWICK, MITCHELL & CO.

Los Angeles, California
February 16, 1979

City Investing Company and Subsidiaries

December 31, 1977 and 1978

Consolidated Balance Sheet

In Thousands of Dollars

Assets	1977	**1978**
Current assets, excluding insurance and financial companies		
Cash and marketable securities (Note 8)	$ 62,250	$ 118,869
Accounts receivable, less allowances, $5,002 and $8,527	200,340	266,031
Contracts receivable from homesite sales, net (Note 4)	24,035	25,121
Inventories (Note 5)	299,240	384,596
Mortgages and notes receivable, due within one year	6,015	11,631
Prepayments and other current assets	25,557	35,749
	617,437	841,997
Investments of insurance and financial companies (Note 3)		
Bonds at amortized cost (market $1,138,841 and $1,094,731)	1,164,671	1,201,927
Stocks at market value (cost $450,385 and $668,918)	377,778	584,131
Mortgage loans	393,126	598,964
Cash and commercial paper	102,976	123,893
Real estate, less accumulated depreciation, $18,673 and $14,676	89,596	71,954
Other	19,724	55,082
	2,147,871	2,635,951
Insurance premiums receivable	248,627	303,002
Prepaid insurance acquisition costs (Notes 1 and 3)	168,165	172,663
Property, plant, equipment and capital leases, at cost (Note 6)	720,009	1,149,125
Accumulated depreciation and amortization	(237,749)	(412,290)
	482,260	736,835
Other investments and long-term receivables (Notes 4 and 7)		
Contracts receivable from homesite sales, net	114,750	112,531
Homesite land and improvements	81,644	78,495
Other	74,107	95,931
	270,501	286,957
Carrying amount over the equity in net assets of subsidiaries (Note 1)	451,020	504,583
Equity in assets of underwriting associations	88,098	102,518
Other assets, principally of insurance and financial companies	189,753	198,913
Total assets	$4,663,732	$5,783,419

See accompanying notes to financial statements.

Liabilities and Shareholders' Equity	1977	1978
Current liabilities, excluding insurance and financial companies		
Notes payable (Note 8)	$98,902	$109,017
Accounts payable	103,362	161,521
Accrued liabilities		
Salaries and wages	14,820	20,928
Pension and other employee benefits	18,995	25,663
Taxes, other than income taxes	12,402	20,565
Interest	21,519	29,552
Estimated homesite improvement costs	17,355	12,600
Other	22,351	32,856
Total accrued liabilities	107,442	142,164
Current maturities of long-term debt (Note 8)	42,703	60,704
Obligations under capital leases	3,261	4,082
Dividends payable	8,500	9,552
Income taxes payable (Note 14)	25,197	21,280
	389,367	508,320
Reserves and liabilities of insurance and financial companies		
Unpaid losses and loss expenses (Note 3)	956,600	1,196,757
Unearned premiums (Note 3)	623,745	646,908
Savings accounts	307,259	482,735
Aggregate life reserves	135,490	147,960
Loans payable	32,040	100,566
Other	227,453	242,090
	2,282,587	2,817,016
Long-term debt (Note 8)	790,270	1,078,085
Obligations under capital leases	84,682	88,603
Deferred income taxes (Note 14)	146,108	180,563
Other liabilities and deferred income	65,974	89,598
Minority interest (Note 1)	81,296	137,793
Convertible subordinated debentures (Note 10)	39,974	39,925
Preferred stock of subsidiary (Note 9)	50,000	50,000
Shareholders' equity (Notes 3, 8, 9, 10 and 11)		
Cumulative preference stocks	12,909	9,839
Common stock	29,134	29,213
Capital surplus	542,131	542,176
Unrealized depreciation of stocks held by insurance companies	(53,999)	(65,257)
Retained earnings	213,933	288,156
Cost of common stock in treasury	(10,634)	(10,611)
Total shareholders' equity	733,474	793,516
Total shareholders' equity and preferred stock of subsidiary	783,474	843,516
Commitments and contingent liabilities (Notes 15 and 16).		
Total liabilities and shareholders' equity	$4,663,732	$5,783,419

City Investing Company
City Investing Company and Subsidiaries

Five Years Ended December 31, 1978

Statement of Retained Earnings

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Balance at beginning of year, as previously reported	$172,511				
Prior years' restatement for change in accounting for insurance acquisition costs (Note 1)	(17,212)				
Balance at beginning of year, as restated	155,299	$153,779	$152,406	$162,439	$213,933
Net income	27,708	27,599	43,960	85,158	112,420
	183,007	181,378	196,366	247,597	326,353
Adjustment for change in accounting for warranty costs (Note 5)	—	—	(4,212)	—	—
Dividends declared					
Cumulative preference stocks	15,601	15,598	16,109	16,028	15,693
Common stock	13,627	13,374	13,606	17,636	22,504
	29,228	28,972	29,715	33,664	38,197
Balance at end of year	$153,779	$152,406	$162,439	$213,933	$288,156

See accompanying notes to financial statements.

City Investing Company
City Investing Company and Subsidiaries

Five Years Ended December 31, 1978

Statement of Unrealized Depreciation of Stocks Held by Insurance Companies

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Balance at beginning of year					
Depreciation based on quoted market prices	$ (72,363)	$(141,790)	$(87,416)	$(41,245)	$(72,607)
Income tax benefit resulting from excess of book basis of certain securities over tax basis	26,207	20,688	20,040	10,652	18,608
Net balance at beginning of year	(46,156)	(121,102)	(67,376)	(30,593)	(53,999)
Appreciation (depreciation) based on end of year quoted market, net of income taxes of $–0–, $60, $(8,822), $8,548 and $533	(68,776)	45,739	35,860	(19,976)	(13,515)
Effect of sale transactions during the year					
Appreciation (depreciation) at beginning of year	(651)	8,695	1,489	(2,838)	1,868
Income tax effect of book basis over tax basis	(5,519)	(708)	(566)	(592)	389
Net change during the year	(74,946)	53,726	36,783	(23,406)	(11,258)
Balance at end of year					
Depreciation based on quoted market prices	(141,790)	(87,416)	(41,245)	(72,607)	(84,787)
Income tax benefit resulting from excess of book basis of certain securities over tax basis	20,688	20,040	10,652	18,608	19,530
Net balance at end of year	$(121,102)	$ (67,376)	$(30,593)	$(53,999)	$(65,257)

See accompanying notes to financial statements.

City Investing Company
and Subsidiaries

Five Years Ended December 31, 1978

Statement of Changes in Consolidated Financial Position

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Source of funds					
Net income	$ 27,708	$ 27,599	$ 43,960	$ 85,158	$112,420
Non-fund charges to income					
Increase in insurance reserves and change in premiums receivable and prepaid insurance acquisition costs	49,079	33,137	175,061	286,273	216,917
Depreciation and amortization	27,140	30,527	35,924	40,655	55,514
Deferred income taxes	8,400	(23,900)	(10,500)	13,700	25,800
Other	3,766	29,815	36,452	29,395	57,854
Funds provided from operations	116,093	97,178	280,897	455,181	468,505
Issuance of senior notes and debentures (with common stock of $19,475 in 1976 and $10,910 in 1977)	25,000	—	125,000	100,000	—
Bank and other borrowings	88,095	160,478	37,614	139,434	344,209
Proceeds from issuance of preferred stock of subsidiary	—	50,000	—	—	—
Net increase in savings accounts and loans payable	3,993	15,344	18,717	24,746	67,239
Contribution by parent to insurance subsidiary	34,901	—	—	—	—
Working capital of companies acquired	17,084	—	—	—	30,161
Other, net	4,144	(1,891)	9,486	2,450	430
	$289,310	$321,109	$471,714	$721,811	$910,544
Application of funds					
Reduction of long-term debt	$ 89,375	$118,514	$177,116	$133,552	$ 77,887
Cash dividends	29,228	28,972	29,715	33,664	38,197
Increase (decrease) in investments of insurance and financial companies					
Bonds	51,093	58,636	78,756	331,246	37,256
Stocks	(150,142)	55,026	103,813	23,157	206,353
Mortgage loans	18,002	21,844	24,220	48,952	46,542
Other	69,162	(17,919)	62,095	(57,869)	18,690
	(11,885)	117,587	268,884	345,486	308,841
Increase (decrease) in unrealized depreciation of stocks	69,427	(54,374)	(46,171)	31,362	12,180
Acquisition of companies (Notes 1 and 19)	20,575	—	—	—	168,848
Additions to property, plant and equipment	97,147	52,950	57,261	104,455	198,984
Purchase of treasury stock	20,531	—	2,125	—	—
Increase (decrease) in working capital, excluding insurance and financial companies (Note 19)	(25,088)	57,460	(17,216)	73,292	105,607
	$289,310	$321,109	$471,714	$721,811	$910,544

In addition to the above, certain 1978 balance sheet accounts reflect changes resulting from the acquisition of companies. See note 19 to financial statements.

See accompanying notes to financial statements.

City Investing Company
(Parent Company Only)

Five Years Ended December 31, 1978

Statement of Income

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Dividends received from subsidiary companies (Note 8)	$ 47,731	$ 62,149	$ 46,725	$ 56,688	$ 58,420
Undistributed net income of subsidiary companies	13,871	(12,033)	32,449	68,975	98,316
Income from mortgages and investments, net	3,393	432	(377)	(1,341)	2,219
Total income	64,995	50,548	78,797	124,322	158,955
General and administrative expense	(10,921)	(9,134)	(11,958)	(13,368)	(24,457)
Interest and debt expense, net	(46,242)	(43,137)	(38,967)	(46,111)	(53,893)
Amortization of intangible assets	(984)	(1,248)	(2,040)	(2,040)	(2,289)
Federal income tax benefit	25,335	25,103	23,075	22,355	34,104
Income from continuing operations	32,183	22,132	48,907	85,158	112,420
Discontinued operations (Note 7)	(4,475)	(3,373)	(4,947)	—	—
Change in accounting (Note 3)	—	8,840	—	—	—
Net income	$ 27,708	$ 27,599	$ 43,960	$ 85,158	$112,420

See accompanying notes to financial statements.

City Investing Company
(Parent Company Only)

December 31, 1977 and 1978

Balance Sheet

In Thousands of Dollars

Assets	1977	1978
Cash (Note 8)	$14,743	$11,684
Due from subsidiaries (Note 14)	22,277	14,183
Prepayments and other current assets	2,212	1,222
Total current assets	39,232	27,089
Investments		
Subsidiaries at cost plus equity in undistributed earnings since acquisition, less unrealized depreciation of stock investments held by insurance companies (Note 3)	1,225,842	1,303,720
Due from subsidiaries	55,954	76,248
	1,281,796	1,379,968
Furniture, fixtures and leasehold improvements, at cost	2,256	2,412
Accumulated depreciation and amortization	(880)	(974)
	1,376	1,438
Unamortized debt expense	10,543	9,847
Other assets	3,783	5,222
Total assets	$1,336,730	$1,423,564

See accompanying notes to financial statements.

Liabilities and Shareholders' Equity	1977	1978
Accounts payable and accrued liabilities		
Interest	$ 13,669	$ 13,127
Other	3,436	2,620
Current maturities of long-term debt (Note 8)	12,046	12,808
Dividends payable	8,500	9,552
Federal income taxes payable	10,200	4,101
Total current liabilities	47,851	42,208
Long-term debt (Note 8)	485,713	501,887
Deferred Federal income taxes (Note 14)	(5,717)	(385)
Other liabilities and deferred income	4,288	15,834
Due to subsidiaries	31,147	30,579
Convertible subordinated debentures (Note 10)	39,974	39,925
Shareholders' equity (Notes 3, 8, 9, 10 and 11)		
Cumulative preference stocks	12,909	9,839
Common stock	29,134	29,213
Capital surplus	542,131	542,176
Unrealized depreciation of stocks held by insurance companies	(53,999)	(65,257)
Retained earnings	213,933	288,156
Cost of common stock in treasury	(10,634)	(10,611)
Total shareholders' equity	733,474	793,516
Commitments and contingent liabilities (Notes 15 and 16).		
Total liabilities and shareholders' equity	$1,336,730	$1,423,564

City Investing Company
(Parent Company Only)

Five Years Ended December 31, 1978

Statement of Changes in Financial Position

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Source of funds					
Dividends received from subsidiary companies (Note 8)	$ 47,731	$ 62,149	$ 46,725	$ 56,688	$ 58,420
Tax payments received from subsidiary companies and retained by parent company and Federal tax refunds in 1974, 1975 and 1976 (Note 14)	30,864	30,655	22,694	29,072	50,866
Total payments received from subsidiary companies and retained	78,595	92,804	69,419	85,760	109,286
Proceeds from sale of investment (Note 7)	16,157	—	—	—	—
Corporate expenses, net (net of non-cash amounts)	(52,133)	(53,690)	(49,704)	(52,069)	(65,998)
Cash from operations*	42,619	39,114	19,715	33,691	43,288
Issuance of senior notes and debentures (with common stock of $19,475 in 1976 and $10,910 in 1977)	25,000	—	125,000	100,000	—
Bank and other borrowings	50,428	37,582	573	30,175	35,218
Distribution of net proceeds by subsidiary from issuance of preferred stock (Note 9)	—	46,985	—	—	—
	118,047	123,681	145,288	163,866	78,506
Application of funds					
Reduction of bank and other borrowings	14,297	76,134	119,441	83,554	21,344
Cash dividends	29,228	28,972	29,715	33,664	38,197
Investments in and advances to subsidiaries (including energy investments)	44,833	40,588	12,865	29,773	28,107
Purchase of treasury stock	20,531	—	2,125	—	—
Other, net	3,250	(140)	(3,352)	4,747	(6,083)
	112,139	145,554	160,794	151,738	81,565
Increase (decrease) in cash	$ 5,908	$(21,873)	$(15,506)	$ 12,128	$ (3,059)

	1974	1975	1976	1977	1978
* Cash from operations	$ 42,619	$ 39,114	$ 19,715	$ 33,691	$ 43,288
Undistributed net income of subsidiary companies	13,871	(12,033)	32,449	68,975	98,316
Depreciation and amortization	(1,363)	(1,546)	(2,308)	(2,323)	(2,612)
Tax payments received and retained in excess of Federal income tax benefit	(5,529)	(5,552)	381	(6,717)	(16,762)
Discontinued operations and cumulative effect of change in accounting	(4,475)	5,467	(4,947)	—	—
Other (charges) credits	(17,415)	2,149	(1,330)	(8,468)	(9,810)
Net income	$ 27,708	$ 27,599	$ 43,960	$ 85,158	$112,420

See also note 1 for information regarding the transfer of certain subsidiary companies.

See accompanying notes to financial statements.

City Investing Company and Subsidiaries

Notes to Financial Statements

(Including Significant Accounting Policies)

(1) Principles of Consolidation

The consolidated financial statements include the accounts of all significant subsidiaries. The accounts of insurance subsidiaries and the savings and loan subsidiary are included as insurance and financial companies.

Amounts for 1977 and prior years have been restated to give effect to adoption of an American Institute of Certified Public Accountants statement of position, "Accounting for Property and Liability Insurance Companies," which specifies that certain insurance acquisition costs which had previously been deferred and amortized be charged to expense when incurred. The effect of the change, which reduced the amount of prepaid insurance acquisition costs carried in the balance sheet, was to decrease net income, primary net income per share and net income per share — assuming full dilution for the three years ended December 31, 1976 by $1,559,000, $.08 and $.05; $6,101,000, $.30 and $.18; and $293,000, $.01 and $.01; and to increase net income in 1977 by $2,635,000, $.12 and $.07

As of January 1, 1978, City transferred to GDV, Inc., 66.2% owned by City, all the stock of Wood Bros. Homes, Inc. in exchange for a 10% Senior Promissory Note of GDV in the principal amount of $25,000,000. The sales price approximated City's investment in Wood Bros. On July 27, 1978, City transferred to GDV, Inc. all the stock of Guerdon Industries, Inc. in exchange for 1,990,105 shares of GDV common stock, increasing City's ownership of GDV common stock from 59% to 66.2%.

In September 1978, GDV, Inc. acquired 63.5% of the outstanding stock of Servomation Corp., a food services company, for cash of $121,733,000. In January 1979, Servomation merged with and became a wholly-owned subsidiary of GDV for additional cash and notes of approximately $70,000,000. The acquisition has been accounted for as a purchase and Servomation's results have been included in the Statement of Consolidated Income since October 1, 1978.

In December 1978, a subsidiary of City acquired the assets of First Surety Corp., which includes Surety Savings and Loan Association, for $26,291,000, and Surety has been included in the December 31, 1978, consolidated balance sheet. The acquisition has been accounted for as a purchase and results of Surety's operations are being included in the Statement of Consolidated Income from January 1, 1979.

In December 1978, City and Uarco Incorporated, a manufacturer of business forms, agreed to the merger of Uarco with a City subsidiary, which, through December 31, 1978, had purchased approximately 14% of Uarco's outstanding stock. The merger was consummated on February 1, 1979. The total cost of the acquisition, which is being accounted for as a purchase, approximated $106,000,000. Uarco's results are being included in the Statement of Consolidated Income from January 1, 1979. The acquisition of Uarco shares through December 31, 1978, is reflected in the Consolidated Balance Sheet at their cost of $14,978,000. Uarco reported revenues of $224,392,000 and net income of $7,895,000 in its fiscal year ended September 30, 1978.

During 1978, 441,170 shares of C. I. Realty Investors, a real estate investment trust, were acquired at a cost of $5,846,000. The ownership of C. I. Realty shares, which approximated 18% at December 31, 1978, is through C. I. Planning Corporation, a wholly-owned subsidiary of City and advisor to the trust.

The carrying amount over the equity in net assets of subsidiaries is not being amortized except where there is an indication of diminution in value or for amounts arising after October 31, 1970, which are being amortized over periods of 40 years or less. The amounts being amortized at December 31, 1977 and 1978, were $96,428,000 and $186,724,000, respectively. Amortization amounted to $1,903,000, $2,184,000, $3,013,000, $2,905,000 and $4,464,000 for the five years ended December 31, 1978.

City Investing Company
and Subsidiaries

Notes to Financial Statements (Continued)

(1) Principles of Consolidation (continued)

All significant intercompany items are eliminated in consolidation. Amounts for 1977 and prior years have been reclassified to conform to the 1978 presentation.

(2) Interest Capitalization

The Company follows the practice of capitalizing interest which constitutes an actual cost of borrowed funds utilized in acquiring and carrying real estate and in construction of houses, manufacturing facilities and motels. Interest capitalized amounted to $5,887,000, $4,020,000, $1,566,000, $665,000 and $5,164,000 for the five years ended December 31, 1978. Capitalization of interest had the effect of increasing (reducing) net income by $2,513,000, $1,607,000, $346,000, $(40,000) and $2,294,000 during the five years ended December 31, 1978, respectively.

(3) Insurance Accounting

The insurance operations of the Company are conducted through its subsidiary, The Home Group, Inc. Financial statements of The Home Group are included elsewhere herein.

Unearned premiums and prepaid insurance acquisition costs are recognized in the statement of income ratably over the terms of the policies. The method followed in computing prepaid insurance acquisition costs limits the amount of such deferred costs to their estimated realizable value by giving effect to the losses and loss expenses expected to be incurred as the premium is earned.

Unpaid losses and loss expenses are based on case basis estimates for reported claims, and on estimates, based on experience, for unreported claims and loss expenses. The provision for unpaid losses and loss expenses, net of estimated salvage recoverable, at December 31, 1977 and 1978, has been established to cover the net cost of insured losses. The amounts are necessarily based on estimates of future rates of inflation and other factors, and accordingly there can be no assurance that the ultimate liability will not exceed such estimates.

In March, 1975, the Financial Accounting Standards Board issued Statement No. 5, which provides that insurance companies may no longer maintain reserves for catastrophes. The Company's catastrophe reserve was discontinued as of January 1, 1975, and the cumulative effect of the change was included in net income of the year ended December 31, 1975.

Investments in stocks are carried at market value. Unrealized appreciation or depreciation of stocks is shown as a separate component of shareholders' equity and is not included in the determination of net income. Unrealized depreciation at December 31, 1978, before income tax benefit, reflects unrealized gains of $16,937,000 and unrealized losses of $101,724,000. Investments in bonds are carried at amortized cost and, accordingly, unrealized changes in the market value thereof are not reflected on the income statement or balance sheet. An identified certificate basis is used to determine cost of securities sold.

(4) Real Estate Accounting

Homesite sales are made by the Company's 66.2% owned subsidiary, GDV, Inc., under non-recourse installment contracts which require payments over an average period of ten years. A sale is recorded when aggregate payments equivalent to 10% of the contract price have been received. The gross profit on recorded sales is deferred and recognized in income on a pro rata basis as payments of principal are received. Deferred profit amounted to $83,413,000 and $79,672,000 at December 31, 1977 and 1978, respectively. Costs and direct expenses are recorded at the time the sale is recognized. Sales

City Investing Company
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Notes to Financial Statements (Continued)

(4) Real Estate Accounting (continued)

of homesites are generally made in advance of the completion of land improvements. The cost of such improvements to be completed in the future are accrued when the sale is recorded. At December 31, 1978, estimated homesite improvement costs of $39,593,000 were accrued in the balance sheet, including $12,600,000 classified as a current liability.

(5) Inventories and Product Warranties

Inventories are stated at the lower of cost (generally first-in, first-out and average) or market. Year-end balances are summarized as follows (in thousands):

	1977	**1978**
Raw materials and work in process	$166,842	$207,041
Finished goods	42,661	47,216
Subdivision land and houses	78,897	93,298
Homesite land, improvements and houses	10,840	21,482
Food and vending machine products	—	15,559
	$299,240	$384,596

Beginning and ending inventories used in determining operating costs were as follows: 1973, $207,647,000; 1974, $254,906,000; 1975, $205,932,000; 1976, $235,499,000; 1977, $299,240,000; and 1978, $384,596,000.

During 1976, the Company adopted the policy of accruing for costs expected to be incurred under product warranties. In prior periods such costs were charged to expense as incurred. Because the effect of this change was not material to prior periods, the amount of reserve necessary at December 31, 1975, after related income tax effect, was charged to retained earnings.

(6) Property, Plant, Equipment and Capital Leases

Additions and major renewals and betterments which have the effect of extending the useful lives of property are carried at cost. Maintenance, repairs and minor renewals are charged against earnings. Upon the disposal of property, the gross book amount, together with the accumulated depreciation or amortization, is removed from the accounts and the gain or loss on disposal is reflected in the statement of income. The Company follows the practice of amortizing investment tax credits. Year-end balances follow (in thousands):

	1977	**1978**
Land and improvements	$ 27,945	$ 51,642
Buildings and leasehold improvements	313,167	461,470
Machinery and equipment	378,897	636,013
	$720,009	$1,149,125

City Investing Company
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Notes to Financial Statements (Continued)

(6) Property, Plant, Equipment and Capital Leases (continued)

Depreciation is recorded principally on a straight-line basis over the estimated useful lives of the assets. Depreciation and amortization provisions include amortization of capital leases. The annual rates of depreciation and amortization of property, plant, equipment and capital leases, are as follows: buildings, 2.5% to 10%; leasehold improvements, term of lease; and machinery and equipment, 2% to 33.3%.

Leases that transfer substantially all the benefits and risks incident to the ownership of property are considered capital leases and are reflected as assets and liabilities in the balance sheet. Assets recorded under capital leases, primarily buildings and leasehold improvements of the Company's budget motel subsidiary, amounted to $102,279,000 and $109,588,000 at December 31, 1977 and 1978, respectively. Related accumulated amortization was $24,885,000 and $34,234,000. Minimum payments due under capital leases for the years subsequent to December 31, 1978, are as follows (in thousands):

1979	$ 13,285
1980	12,650
1981	12,241
1982	12,059
1983	11,789
Thereafter	144,041
Total	206,065
Less imputed interest	113,380
	$ 92,685

(7) Other Investments

Energy investments are represented by participations in leases and concessions both within the United States and elsewhere (principally in Ecuador, Colombia and the North Sea). The Company follows the successful efforts method of accounting for costs incurred in searching for and developing oil and gas reserves. Under the successful efforts method of accounting, only direct costs incurred in individual successful acquisitions and activities are capitalized. Other costs are expensed as incurred. The Company's interest in domestic proved developed gas reserves was 4.9 billion cubic feet at December 31, 1978, and its interest in proved developed oil reserves, principally foreign, was 22.0 million barrels. The carrying amount of energy investments was $7,046,000 at December 31, 1978, net of long-term debt of $14,965,000. During 1976, 1977 and 1978, pretax losses of $750,000, $7,700,000 and $1,000,000 were recognized, respectively, in connection with the Company's domestic coal operation, which was discontinued in early 1978.

During 1974, the Company sold its 26.5% interest in Moore McCormack Resources, Inc. Discontinued operations includes a loss, net of income taxes, of $1,182,000 for the year ended December 31, 1974, applicable to Moore McCormack. Also in 1974, the Company decided to discontinue and dispose of its real estate joint venture and bulk land sale operations. As a result of increased estimates of disposal and carrying costs during 1975 and 1976 and, during 1976, the write-off of a mortgage note receivable, it was determined that additional net of tax losses of $3,373,000 and $4,947,000 should be recognized. The carrying amount of discontinued operations, $21,611,000 at December 31, 1978, consists primarily of mortgages receivable and real estate held for disposal, net of long-term debt of $13,622,000.

City Investing Company
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Notes to Financial Statements (Continued)

(8) Short-Term Notes Payable and Long-Term Debt

Short-term notes payable at December 31, 1977 and 1978, had a weighted average interest rate of approximately 13.0% and 14.2%, respectively. During 1977 and 1978, the weighted average rate approximated 10.3% and 13.6%, respectively, on average month-end borrowings of $84,091,000 and $109,373,000. The highest amount of notes payable outstanding at any month-end was $113,477,000 in 1977 and $143,270,000 in 1978.

Year-end balances of long-term debt, exclusive of amounts due within one year, are summarized as follows (in thousands):

	1977	**1978**
Payable by Parent Company		
Notes payable to banks under revolving credit agreement, due through 1987	$ —	$ —
Notes payable to bank under term loan agreement, due 1985 through 1987, interest rate 9.35%	—	35,000
7¾% senior notes due through 1989	60,000	54,600
8½% senior notes due through 1993	47,000	44,000
9¼% senior notes due through 1994	25,000	23,500
8⅞% sinking fund debentures due through 1997	22,500	19,000
9% sinking fund debentures due 1982 through 1996	125,000	125,000
9⅛% sinking fund debentures due 1987 through 1997	100,000	100,000
8% subordinated debentures due through 1991	50,000	47,500
8⅛% subordinated debentures due through 1991	58,415	55,500
8½% guaranteed dollar notes due 1981 through 1988	15,000	15,000
8¾% guaranteed notes due through 1984	27,900	26,400
Other notes payable, 1978 average interest rate 5.0%	3,176	1,603
Total payable by Parent Company	533,991	547,103
Less unamortized discount, primarily applicable to 8⅛% subordinated debentures ($4,441 and $3,980), 8% subordinated debentures ($11,940 and $11,003), 9% sinking fund debentures ($18,620 and $17,706) and 9⅛% sinking fund debentures ($10,730 and $10,434)	48,278	45,216
	485,713	501,887
Payable by subsidiaries		
Notes payable to banks under revolving credit agreements, 1978 average interest rate 13.14%	16,000	239,761
Loans payable to insurance companies, due through 1989, 1978 average interest rate 8.71%	67,474	82,730
Notes secured by property and equipment, subdivision land and houses, and real estate, 1978 average interest rate 8.74%	59,054	70,991
8⅞% senior promissory notes due 1983 through 1997	35,000	35,000
9% senior promissory notes due through 1991	26,000	24,000
10½% senior promissory notes due through 1991	37,143	34,286
Foreign subsidiary borrowings, 1978 average interest rate 11.85%	18,321	44,554
Other notes payable, 1978 average interest rate 10.73%	45,565	44,876
Total payable by subsidiaries	304,557	576,198
Total long-term debt	$790,270	$1,078,085

City Investing Company
and Subsidiaries

Notes to Financial Statements (Continued)

(8) Short-Term Notes Payable and Long-Term Debt (continued)

Interest rates represent average stated rates, except for borrowing rates in effect under revolving credit agreements, which are based on the prime lending rate. The stated interest rates are effectively increased by the amortization to interest expense of the debt discount. Consolidated long-term debt at December 31, 1977 and 1978, including current maturities, had a weighted average interest rate of approximately 9.56% and 10.55%, respectively. Amounts applicable to the parent company had a weighted average interest rate of approximately 9.98% and 9.95%, respectively.

Notes payable to banks by subsidiaries under revolving credit agreements are due through 1986. Repayment is based on the amount the outstanding balance exceeds the banks' total commitments. Of the amount outstanding at December 31, 1978, $139,000,000 attributable to GDV, Inc., 66.2% owned, including $18,239,000 classified as current, has been guaranteed by City.

In connection with revolving credit and other bank borrowings, the Company maintains average cash compensating balances of 10% of the total commitments plus 10% of the outstanding indebtedness. During 1978, the average compensating balance was approximately $33 million and approximately $28 million was maintained at December 31, 1978. At December 31, 1978, the unused portion of commitments under revolving credit agreements amounted to $242 million, excluding amounts subsequently utilized in connection with the 1979 acquisitions of Uarco and the Servomation minority interest, and the Company also had available an aggregate of $39 million of unused short-term lines of credit. Terms of the revolving credit agreements generally call for a fee of ½ % per annum on the unused portion.

City has agreements with certain insurance company subsidiaries providing that, to the extent such subsidiaries increase their deposits at any of City's depository banks above their customary balances at such banks, City would pay that subsidiary at least quarterly an amount in cash in respect of such excess deposits at the rate of ½ of 1% over the average rate of return to the depositing subsidiary for its investments in commercial paper during such quarter. Such excess deposits currently amount to $10,750,000 and City paid $998,000 during 1977 and $823,000 during 1978 under these arrangements.

Maturities of long-term debt during the five years subsequent to December 31, 1978, are as follows (in thousands):

	1979	1980	1981	1982	1983
Parent Company					
Senior notes	$ 9,900	$ 9,900	$ 9,900	$ 9,900	$ 9,900
Sinking fund debentures	—	—	—	9,325	9,325
Other	2,908	6,625	6,625	6,625	6,625
	12,808	16,525	16,525	25,850	25,850
Subsidiaries					
Revolving credit agreements	18,239	44,000	19,000	7,500	35,761
Insurance company loans	6,831	7,831	9,071	9,071	9,071
Notes secured by property and equipment	10,406	9,234	8,460	5,984	4,245
Senior promissory notes	4,857	4,857	4,857	4,857	4,857
Foreign subsidiary borrowings	3,176	3,946	6,260	6,057	5,714
Other	4,387	3,339	3,586	3,860	30,549
	47,896	73,207	51,234	37,329	90,197
Total	$ 60,704	$ 89,732	$ 67,759	$ 63,179	$116,047
Amortization of discount	$ 3,046	$ 3,177	$ 3,323	$ 3,488	$ 3,477

City Investing Company
and Subsidiaries

Notes to Financial Statements (Continued)

(8) Short-Term Notes Payable and Long-Term Debt (continued)

Included in loans payable of insurance and financial companies is $37,000,000 notes payable to banks by the savings and loan subsidiary. The notes are repayable in 20 quarterly installments of $1,850,000, commencing October 1, 1983. The interest rate is currently 9¼ %.

The Company has complied with the customary restrictions and limitations required under terms of various loan agreements. Retained earnings not subject to restrictions at December 31, 1978, approximated $102 million. Substantially all City's income consists of earnings of subsidiaries. Since the earnings of most subsidiaries are subject to restrictions imposed by debt instruments or applicable law on the amount of dividends that may be paid, these earnings are not necessarily available to City on a current basis.

(9) Capital Stock and Retained Earnings

Authorized capital stock consists of 15,000,000 shares of $1.00 par value cumulative preference stock issuable in series and 60,000,000 shares of $1.25 par value common stock. Capital stock information as of and for the five years ended December 31, 1978, is summarized below:

	Common	Series A	Series B	Series D
Liquidation preference		$14.70	$40.00	$ 1,000.00
Common stock conversion privilege		2.08 shares	1.56 shares	NA
	(Dollars in Thousands)			
Issued at December 31:				
1973				
Shares	22,724,474	356,631	7,708,810	
Amount	$ 28,406	$ 891	$ 7,709	
1974				
Shares	23,186,465	137,034	7,708,810	
Amount	$ 28,983	$ 343	$ 7,709	
1975				
Shares	23,187,836	136,534	7,708,766	
Amount	$ 28,985	$ 341	$ 7,709	
1976				
Shares	23,233,621	114,655	7,708,729	5,000
Amount	$ 29,042	$ 287	$ 7,709	$ 5,000
1977				
Shares	23,306,887	80,978	7,706,657	5,000
Amount	$ 29,134	$ 202	$ 7,707	$ 5,000
1978				
Shares	23,369,912	53,636	7,704,595	2,000
Amount	$ 29,213	$ 134	$ 7,705	$ 2,000

City Investing Company
and Subsidiaries

Notes to Financial Statements (Continued)

(9) Capital Stock and Retained Earnings (continued)

Capital stock activity during the five years ended December 31, 1978, represents conversion of preference stocks, and in 1974 and 1978, conversion of debentures; issuance of series D preference stock in connection with the acquisition of a company in 1975; and redemption of series D preference stock in 1978.

Common stock issued includes 847,081 and 845,281 treasury shares at December 31, 1977 and 1978, respectively. During 1974 and 1976, 1,556,340 and 230,035 shares were reacquired. During 1976 and 1977, primarily in connection with the issuance of debentures, 1,504,562 and 801,900 shares were reissued and, during 1978, 1,800 shares were reissued.

Each share of cumulative preference stock is entitled to one vote. Series A and B are convertible into common stock, subject to customary anti-dilution adjustments. All preference shares are redeemable at the option of the Company as follows: series A, $49.00; series B, $40.00; series D, $1,000.00. The series A shares are carried at their stated value of $2.50 per share and the series D shares are carried at their liquidation value of $1,000.00 per share. The annual dividend on series A, series B and series D shares is $1.31, $2.00 and $100.00, respectively. The preference in involuntary liquidation on all issued preference shares amounted to $310,972,000 at December 31, 1978.

At December 31, 1978, there were 12,130,731 shares of common stock reserved for the conversion of preference stock, 2,911,967 shares reserved for issuance upon the conversion of outstanding debentures and warrants and 1,200,000 shares reserved for issuance under the Company's share unit plan.

A subsidiary of the Company, The Home Group, Inc., is authorized to issue up to 10,000,000 shares of cumulative preferred stock, $1.00 par value, of which 5,000,000 shares were outstanding at December 31, 1977 and 1978. This preferred stock is entitled to a sinking fund commencing December 1, 1986, sufficient to retire the preferred stock by December 1, 2005, has a stated annual dividend of $1.10 per share, is redeemable for sinking fund purposes at $10.00 per share plus accrued dividends and is currently redeemable at $10.935 per share. Dividends on The Home Group preferred stock are reflected as minority interest in the statement of consolidated income.

Retained earnings of the parent company include undistributed earnings of subsidiaries of $389,561,000 and $487,877,000 at December 31, 1977 and 1978, respectively.

(10) Convertible Debentures and Warrants

The convertible subordinated debentures bear interest at 7½% and are convertible into common stock at $16.50 per share. The debentures mature $3,000,000 annually, 1980 to 1989, and are currently callable at 104⅛%. At December 31, 1978, 2,419,697 shares were reserved for issuance upon conversion of the outstanding debentures. Warrants which expire on March 1, 1984, are outstanding to purchase 492,270 shares of common stock at $27.30 per share. Warrants which expire on July 15, 1983, are outstanding to purchase 2,040,000 shares of GDV, Inc. common stock from City at $27.70 per share.

City Investing Company and Subsidiaries

Notes to Financial Statements (Continued)

(11) Share Unit Plan

The Company's share unit plan provides that participants receive, for each unit awarded, either common stock of the Company or cash equivalent to the increase in market value per share of the Company's common stock over an initial five-year period commencing on the date of award. In addition, each participant's account is credited with dividend units equivalent to cash dividends on total units in their account on dividend payment dates. Compensation is recorded based on the increase in value of initial units awarded and the market value of accumulated dividend units. During 1977 and 1978, 187,643 and 279,388 units, respectively, were awarded, 107,259 and 144,141 dividend units were accumulated, and 124,291 and 163,065 units were cancelled or matured. At December 31, 1978, 2,225,044 units were outstanding.

(12) Earnings Per Share

Primary earnings per share is calculated by dividing income, after deducting dividends on the series B and D preference stocks, by the weighted average of common and common equivalent shares outstanding during the year. The cumulative preference stock convertible series A is included as a common stock equivalent.

Fully diluted earnings per share is calculated by dividing income, after adding back interest (net of the income tax effect) on debentures assumed converted and after deducting dividends on the series D preference stock, by the weighted average common and common equivalent shares outstanding during the year, with the assumption that outstanding convertible debentures and the series B preference stock were converted at the beginning of the year.

(13) Investment Income

Components of investment income included in revenues of insurance and financial companies were as follows (in thousands):

	1974	1975	1976	1977	**1978**
Interest income					
Cash and cash equivalents	$ 6,649	$ 2,420	$ 4,493	$ 5,538	$ 4,567
Bond income	42,228	52,028	56,017	66,225	82,535
Mortgage and policy loans	24,305	25,812	28,742	33,817	37,986
	73,182	80,260	89,252	105,580	125,088
Dividend income	18,037	17,080	17,391	20,802	28,018
Net real estate income	1,583	3,097	2,027	3,512	1,834
Other	2,575	4,645	6,374	7,184	8,831
	$ 95,377	$105,082	$115,044	$137,078	$163,771

City Investing Company
and Subsidiaries

Notes to Financial Statements (Continued)

(14) Income Taxes

Provisions for income taxes applicable to income from continuing operations include state income taxes of $4,174,000, $4,940,000, $4,998,000, $7,268,000 and $9,285,000 and foreign income taxes of $10,634,000, $10,248,000, $14,678,000, $22,261,000 and $23,876,000 for the five years ended December 31, 1978. A reconciliation between income taxes applicable to income from continuing operations and the amount computed at the statutory Federal ordinary rate of 48% follows (in thousands):

	1974	1975	1976	1977	**1978**
Amount at statutory Federal ordinary rate	$ 26,016	$ 7,191	$ 37,166	$ 79,212	$106,637
Tax-free interest and 85% dividends received deduction	(18,129)	(17,870)	(18,186)	(20,844)	(27,246)
State income taxes, net of Federal tax benefit	2,171	2,569	2,599	3,779	4,828
Operating losses offset against capital gains	4,051	2,756	—	—	—
Unused foreign subsidiary losses	—	1,677	—	—	—
Adjustment of prior years' tax provisions	(4,900)	(4,000)	—	—	—
Miscellaneous items	(2,754)	(1,893)	584	1,350	1,302
	$ 6,455	$ (9,570)	$ 22,163	$ 63,497	$ 85,521

Deferred income tax provisions (benefits) result from items which are reflected in income for tax purposes in different years than they are reflected in income for financial statement purposes. The source and income tax effects, primarily Federal, of these timing differences between book and taxable income are as follows (in thousands):

	1974	1975	1976	1977	**1978**
Installment accounting practices	$ 5,600	$ 3,100	$ (3,800)	$ (2,800)	$ 2,700
Estimated salvage recoverable on insurance claims	400	—	(100)	6,400	1,900
Investment tax credits	1,200	(1,000)	(1,000)	9,200	7,200
Statutory reserve	—	(2,400)	(7,900)	(2,000)	4,800
Insurance acquisition costs	1,700	1,600	(5,100)	(5,900)	2,200
Excess of tax (book) depreciation	(100)	(2,300)	1,300	4,000	6,100
Statutory reinsurance contracts	(300)	(6,100)	5,400	(100)	(1,300)
Equity in oil and gas investments	(1,900)	(11,800)	(900)	(700)	2,800
Accrued employee benefits	(100)	(600)	(700)	(700)	(6,900)
Reserve for estimated losses	1,200	(400)	(400)	(2,100)	(4,100)
Adjustment of prior years' tax provisions	(4,900)	(4,000)	—	—	—
Miscellaneous items	5,600	—	2,700	8,400	10,400
	$ 8,400	$(23,900)	$(10,500)	$ 13,700	$ 25,800

**City Investing Company
and Subsidiaries**

Notes to Financial Statements (Continued)

(14) Income Taxes (continued)

Pursuant to tax sharing agreements with subsidiaries consolidated for tax purposes, the parent company receives tax payments from such subsidiaries equal to the amount of Federal income taxes that would otherwise be payable by such subsidiaries if they filed on a separate return basis. Amounts due from and due to subsidiaries under the terms of the tax sharing agreements are reflected on the parent company balance sheet.

(15) Pension and Incentive Compensation Plans

Pension plans are in effect which cover substantially all employees who meet eligibility requirements. Actuarial assumptions of the respective plans are generally standardized and equity securities of the joint trust are valued at a three-year average of quoted market.

Provisions charged against income include normal cost plus interest on unfunded past service costs and include amortization of prior service costs over 30 years. Total expense under pension plans was $10,005,000, $9,745,000, $12,250,000, $15,358,000 and $20,396,000 for the five years ended December 31, 1978. Subsequent to the inception of the plans, it has been the policy of the Company generally to fund amounts provided. As of December 31, 1978, the unfunded past service liability based on actuarial estimates was approximately $101 million and the present value of unfunded vested benefits was approximately $32 million.

An incentive compensation plan has been adopted by the Company covering its salaried officers and certain employees under which annual payments may be made in accordance with salary and performance levels with a maximum sum distributable determined by a formula related to earnings.

(16) Contingent Liabilities

Various legal proceedings are pending against the Company, including an indictment and several related treble-damage civil cases against a subsidiary for an alleged conspiracy to fix prices of water heaters. In the opinion of counsel, these proceedings will not result in a material liability to City.

City Investing Company
and Subsidiaries

Notes to Financial Statements (Continued)

(17) Information About Segments of the Company's Operations

Information about the Company's operations in different industries as of and for the years ended December 31, 1977 and 1978, follows (in millions).

1977	Revenues	Operating Profit	Income from Operations	Depreciation and Amortization	Assets	Capital Expenditures
Insurance	$1,475.0	$ 103.3	$ 103.3	$ —	$2,659.0	$ —
Savings and Loan	34.4	10.2	10.2	—	381.9	—
Total Insurance and Financial	1,509.4	113.5	113.5	—	3,040.9	—
Housing and Food Services	367.4	40.7	34.7	6.3	563.4	13.1
International Manufacturing	393.2	44.9	35.9	8.8	285.6	23.2
Air Conditioning and Water Heaters	269.9	30.7	24.4	2.3	171.2	4.7
Magazine Printing	193.9	18.5	15.0	7.6	118.5	24.9
Containers	128.0	17.3	14.7	3.1	82.1	3.5
Budget Motels	75.1	23.9	11.5	9.4	187.8	27.0
Other Manufacturing Operations	128.0	6.4	4.8	3.2	120.7	7.5
Total Manufacturing and Lodging	1,188.1	141.7	106.3	34.4	965.9	90.8
Energy	—	(21.9)	(21.9)	—	7.8	—
Miscellaneous	—	(6.3)	(6.3)	—	13.9	.6
GDV, Inc. Parent Company	—	(.3)	(.5)	—	3.5	—
Combined	$3,064.9	$ 267.4	$ 225.8	$ 40.7	$4,595.4	$ 104.5
1978						
Insurance	$1,648.9	$ 135.2	$ 135.2	$ —	$2,999.6	$ —
Savings and Loan	60.2	11.4	11.4	—	640.4	—
Total Insurance and Financial	1,709.1	146.6	146.6	—	3,640.0	—
Housing and Community Development	540.6	62.1	49.6	8.3	600.0	15.3
Food Services	112.4	8.3	7.7	5.4	240.6	5.2
Total Housing and Food Services	653.0	70.4	57.3	13.7	840.6	20.5
International Manufacturing	485.9	54.1	42.1	11.8	395.5	38.2
Air Conditioning and Water Heaters	311.8	35.8	27.3	2.4	217.6	29.9
Magazine Printing	241.3	23.1	19.5	9.2	146.9	30.4
Containers	143.6	18.4	15.2	3.3	95.7	8.2
Budget Motels	87.9	28.0	15.6	11.5	237.8	66.1
Other Manufacturing Operations	159.3	6.1	3.9	3.6	111.2	5.3
Total Manufacturing and Lodging	1,429.8	165.5	123.6	41.8	1,204.7	178.1
Energy	—	(10.5)	(10.5)	—	7.0	—
Miscellaneous	—	(9.2)	(9.2)	—	20.9	.4
GDV, Inc. Parent Company	—	(1.1)	(9.5)	—	19.2	—
Combined	$3,791.9	$ 361.7	$ 298.3	$ 55.5	$5,732.4	$ 199.0

City Investing Company and Subsidiaries

Notes to Financial Statements (Continued)

(17) Information About Segments of the Company's Operations (continued)

Additional information with respect to revenues and income from operations of the insurance segment is presented under "Business" on page 4. Operating profit represents revenues less all operating expenses except interest expense. Income from operations represents revenues less all operating expenses including interest expense. Additional items included in the determination of consolidated net income are reflected in the Statement of Consolidated Income. Depreciation and amortization included in the determination of operating profit reflects, where applicable, the amortization of carrying amount over equity in net assets.

Assets reflected for the respective segments include, where applicable, the carrying amount over equity in net assets. A reconciliation of combined total assets and consolidated assets appearing in the accompanying balance sheet as of December 31, 1977 and 1978, follows (in millions):

	1977	**1978**
Combined total assets	$4,595.4	$5,732.4
Corporate assets	30.7	29.4
Discontinued operations	37.6	21.6
Consolidated assets	$4,663.7	$5,783.4

Information about the Company's operations in different geographic areas as of and for the two years ended December 31, 1978, follows (in millions):

	Revenues	Operating Profit	Income from Operations	Assets
1977				
United States	$2,546.5	$ 220.4	$ 187.7	$4,139.5
Foreign countries				
Insurance	125.2	12.7	12.7	151.1
Energy investments	—	(10.5)	(10.5)	19.2
International manufacturing	393.2	44.8	35.9	285.6
Combined	$3,064.9	$ 267.4	$ 225.8	$4,595.4
1978				
United States	$3,176.1	$ 301.1	$ 249.7	$5,094.2
Foreign countries				
Insurance	129.9	11.3	11.3	223.0
Energy investments	—	(4.8)	(4.8)	19.7
International manufacturing	485.9	54.1	42.1	395.5
Combined	$3,791.9	$ 361.7	$ 298.3	$5,732.4

City Investing Company
and Subsidiaries

Notes to Financial Statements (Continued)

(17) Information About Segments of the Company's Operations (continued)

International manufacturing operations are conducted principally in Western Europe, Brazil and Mexico. Principal products include containers, water heaters, automotive leaf springs and plastic products. Additional information with respect to revenues and income from operations of the international manufacturing segment are presented elsewhere herein.

(18) Supplementary Profit and Loss Information (in thousands):

	1974	1975	1976	1977	**1978**
Depreciation and amortization of property, plant, equipment and capital leases	$25,237	$28,343	$32,911	$37,750	$51,050
Taxes other than income taxes	$25,223	$28,391	$31,274	$34,219	$47,346
Rents	$ 8,947	$12,078	$11,993	$12,743	$16,682

(19) Supplemental Information Regarding Changes in Consolidated Financial Position

Assets acquired and liabilities assumed in connection with the acquisition in 1978 of 63.5% of Servomation Corp. and 100% of Surety Savings and Loan Association and the purchase of 14% of Uarco Incorporated and 17% of C. I. Realty Investors are summarized as follows (in thousands):

Assets acquired	
Working capital	$ 30,161
Mortgage loans	159,296
Property, plant, equipment and capital leases	120,936
Carrying amount over equity in net assets	57,800
Other investments	20,824
Other assets	21,958
	410,975
Less liabilities assumed	
Savings accounts	153,461
Long-term debt	18,339
Obligations under capital leases	7,659
Other liabilities	18,935
	212,581
Minority interest	(43,733)
Cost of acquired companies	$168,848

At September 30, 1978, reported assets of Uarco Incorporated, which merged with a City subsidiary on February 1, 1979, aggregated $116,456,000, including current assets of $63,801,000 and net plant and equipment of $46,820,000. Uarco's liabilities at that date totalled $46,918,000, including current liabilities of $18,974,000 and long-term debt of $18,533,000. A study has been undertaken to determine the fair value of the net assets acquired.

City Investing Company and Subsidiaries

Notes to Financial Statements (Continued)

(19) Supplemental Information Regarding Changes in Consolidated Financial Position (continued)

Working capital increase (decrease) for the five years ended December 31 ,1978, is summarized as follows (in thousands):

	1974	1975	1976	1977	**1978**
Cash and marketable securities	$ 5,523	$(17,598)	$(24,862)	$ 35,380	$ 56,619
Inventories	47,259	(48,974)	29,567	63,741	85,356
Other current assets	42,304	(19,727)	23,960	53,688	82,585
Notes payable	(69,878)	95,017	(8,043)	(27,833)	(10,115)
Current maturities of long-term debt	(48,345)	36,335	(3,027)	1,819	(18,001)
Accounts payable and other current liabilities	(1,951)	12,407	(34,811)	(53,503)	(90,837)
	$(25,088)	$ 57,460	$(17,216)	$ 73,292	$105,607

(20) Unaudited Quarterly Summary of Operations

The following Summary of Operations for the four quarters of 1977 and 1978 is unaudited but, in the opinion of City's management, all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the interim periods presented have been included (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1977				
Revenues				
Insurance and financial	$345,724	$366,989	$389,714	$ 406,941
Housing and food services	74,678	85,908	99,388	107,389
Manufacturing and lodging	266,094	291,199	323,307	307,580
Total revenues	686,496	744,096	812,409	821,910
Expenses				
Insurance and financial	331,617	344,358	360,242	359,663
Housing and food services				
Operating costs	51,276	60,559	71,794	77,439
Interest and debt expense, net	1,603	1,582	1,457	1,603
Other expenses	14,547	15,255	16,613	19,484
Total	67,426	77,396	89,864	98,526
Manufacturing and lodging				
Operating costs	208,533	224,323	249,485	235,854
Interest and debt expense, net	8,607	9,128	8,921	8,663
Other expenses	29,761	32,325	34,127	32,115
Total	246,901	265,776	292,533	276,632
Energy investments	2,330	4,384	4,420	10,731
Miscellaneous	1,060	700	2,898	1,610
Total expenses	649,334	692,614	749,957	747,162
Income from operations	$ 37,162	$ 51,482	$ 62,452	$ 74,748
Net income	$ 10,756	$ 18,923	$ 23,809	$ 31,670
Primary net income per share	$ .31	$ .69	$ .90	$ 1.23
Net income per share — assuming full dilution	$ .30	$ .53	$ .66	$ .87

City Investing Company and Subsidiaries

Notes to Financial Statements (Continued)

(20) Unaudited Quarterly Summary of Operations (continued)

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1978				
Revenues				
Insurance and financial	$394,729	$416,528	$437,749	$ 460,058
Housing and food services	117,726	136,233	139,372	259,686
Manufacturing and lodging	324,297	356,873	373,949	374,675
Total revenues	836,752	909,634	951,070	1,094,419
Expenses				
Insurance and financial	365,587	377,610	397,497	421,724
Housing and food services				
Operating costs	84,433	99,773	101,893	199,473
Interest and debt expense, net	3,297	3,268	5,566	9,428
Other expenses	17,942	20,995	21,374	37,759
Total	105,672	124,036	128,833	246,660
Manufacturing and lodging				
Operating costs	251,992	276,446	289,170	291,280
Interest and debt expense, net	9,866	10,470	10,219	11,246
Other expenses	38,810	39,548	40,621	36,519
Total	300,668	326,464	340,010	339,045
Energy investments	1,881	2,229	2,401	4,000
Miscellaneous	4,321	3,288	1,731	(73)
Total expenses	778,129	833,627	870,472	1,011,356
Income from operations	$ 58,623	$ 76,007	$ 80,598	$ 83,063
Net income	$ 18,117	$ 28,578	$ 32,464	$ 33,261
Primary net income per share	$ .63	$ 1.08	$ 1.26	$ 1.30
Net income per share — assuming full dilution	$ .50	$ .78	$ .88	$ .90

Results for the 1977 quarters and the first three 1978 quarters have been restated to give retroactive effect to a change in accounting for insurance acquisition costs. As a result of this change, net income for the 1977 quarters was restated and retroactively increased (reduced) by $(1,220,000), $629,000, $(119,000) and $3,345,000, respectively. For the respective quarters, primary net income per share was increased (reduced) by $(.06), $.04, $(.01) and $.15 and net income per share — assuming full dilution was increased (reduced) by $(.04), $.02, $—0— and $.09. For the first three 1978 quarters, net income was restated and retroactively increased (reduced) by $(113,000), $421,000 and $(1,523,000); primary net income per share was increased (reduced) by $—0—, $.01 and $(.07); and net income per share — assuming full dilution was increased (reduced) by $—0—, $.01 and $(.04).

Caution should be exercised in comparing the results of consecutive interim periods since many of City's businesses are seasonal. Absent unusual circumstances, City's manufacturing group, particularly its air conditioning and container operations, typically report higher second and third quarter revenues and income than first and fourth quarter results. Mobile home shipments, house closings and motel

**City Investing Company
and Subsidiaries**

Notes to Financial Statements (Continued)

(20) Unaudited Quarterly Summary of Operations (continued)

occupancy levels are also strongest during the second and third calendar quarters. Generally, with the absence of severe storms and the normal high level of earned premiums compared with premiums written, third and fourth quarter underwriting results are more favorable than during the first two quarters.

(21) Unaudited Replacement Cost Information

In compliance with rules of the Securities and Exchange Commission, City has estimated certain replacement cost information for plant and equipment, and related depreciation expense of manufacturing and housing and food services operations as of and for the years ended December 31, 1977 and 1978. While the replacement cost data have been estimated in accordance with requirements of the Commission, the estimated replacement cost does not reflect the current value of the assets or the amount for which they could be sold. The estimates are based on the hypothetical assumption that the Company would replace its entire inventory and productive capacity at the end of the respective years whether or not the funds were available or such "instant" replacement was physically possible. Plant and equipment, in actuality, are replaced over many years and, in many cases, will be accomplished by rebuilding existing assets. The Company expects that substantial operating cost reductions would result from replacement, which are not reflected in the data below. Also, when competition and other conditions permit, the Company would expect to modify selling prices to recognize future cost changes. Therefore, the Company cautions against any simplistic use of this replacement cost data because it does not take into account these important factors. The difference between historical and replacement cost does not represent additional book value of the Company's common stock.

All replacement cost amounts related to foreign assets have been translated into U.S. dollars at exchange rates in effect at year-end; depreciation expense amounts were translated at the average exchange rate for the year. As a result of high inventory turnover rates, the replacement cost of inventories of domestic manufacturing operations and the effect on cost of sales does not differ significantly from that determined using historical costs. The replacement cost of conventional housing inventories is based on the estimated current value of raw acreage plus estimated development costs incurred. The replacement cost of homesite land inventories is based on the most recent tract purchased. Historical cost of related homesite improvements is representative of replacement cost and, therefore, no adjustment was necessary. The replacement cost of single-family housing and undeveloped homesite inventories, including amounts classified as long-term, exceed their historical cost by $42 million at December 31, 1977 and $57 million at December 31, 1978. Had replacement cost been applicable in determining cost of sales, operating costs would have been approximately $19 million and $27 million greater in 1977 and 1978, respectively, than the amounts computed on an historical basis.

Estimates of the replacement cost of plant assets of the Company as of December 31, 1977 and 1978, together with the estimates of the effect on depreciation expense for the year then ended, are summarized below (in millions):

	Historical Cost		Replacement Cost	
	1977	**1978**	1977	**1978**
Property, plant and equipment (excluding land)	$ 684	$1,026	$1,037	$1,577
Accumulated depreciation	(231)	(405)	(412)	(721)
	$ 453	$ 621	$ 625	$ 856
Depreciation for the year	$ 34	$ 50	$ 54	$ 77

City Investing Company and Subsidiaries

Notes to Financial Statements (Continued)

(21) Unaudited Replacement Cost Information (continued)

The items for which replacement cost data have been estimated exclude, among other items, construction in process and land, which are included in property, plant and equipment at an historical cost of $37 million and $123 million at December 31, 1977 and 1978, respectively. Included in the replacement cost of property, plant and equipment is $65 million and $85 million relating to items that are fully depreciated for book purposes.

The replacement cost of motels, representing approximately 25% and 19%, respectively, of property, plant and equipment at December 31, 1977 and 1978, was estimated using the average cost being incurred to develop new units. This average cost was applied to the number of existing units to determine their estimated replacement cost, which, after accumulated depreciation, exceeded historical cost by $34 million and $43 million. The replacement cost of certain facilities, comprising approximately 11% of property, plant and equipment in 1977 and 6% in 1978, was estimated using construction costs per square foot, substantially based on independent appraisal. The estimated replacement construction costs per square foot in each case were then applied to the floor space assumed to have been replaced.

The replacement cost of the remainder of facilities and equipment, approximately 46% in 1977 and 37% in 1978 of which was developed by independent appraisers, was estimated by applying price level indices to historical cost amounts by year of acquisition.

Accumulated depreciation related to assets valued at replacement cost was estimated by multiplying the ratio of expired life to total life by the replacement cost amount for items assumed to have been replaced. The lives used for this purpose were the same as those used in the historical cost financial statements. Depreciation expense was estimated on a straight-line basis using the same useful lives utilized in the historical cost financial statements.

Accountants' Report

The Board of Directors and Shareholders
The Home Group, Inc.:

We have examined the consolidated balance sheet of The Home Group, Inc. and subsidiaries as of December 31, 1977 and 1978 and the related statements of income, retained earnings, capital surplus, unrealized depreciation of stocks and changes in financial position for each of the five years in the period ended December 31, 1978. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the aforementioned financial statements present fairly the financial position of The Home Group, Inc. and subsidiaries at December 31, 1977 and 1978, and the results of their operations, and changes in retained earnings, capital surplus, unrealized depreciation of stocks and changes in financial position for each of the five years in the period ended December 31, 1978, in conformity with generally accepted accounting principles applied on a consistent basis after restatement for the change, with which we concur, in accounting for insurance acquisition costs as explained in note (1) to the consolidated financial statements, except for the change, with which we concur, in accounting for catastrophe reserves as explained in note (1) to the consolidated financial statements.

PEAT, MARWICK, MITCHELL & CO.

New York, New York
February 16, 1979

The Home Group, Inc.
and Subsidiaries

December 31, 1977 and 1978

Consolidated Balance Sheet

In Thousands of Dollars

Assets	1977	1978
Bonds at amortized cost (market $1,109,263 and $1,077,160)	$1,135,095	$1,183,689
Preferred stocks at market value (cost $36,755 and $36,920)	37,181	35,255
Common stocks at market value (cost $413,630 and $631,998)	340,597	548,876
Mortgage and policy loans	55,598	51,571
Invested cash and short-term commercial maturities	59,998	48,123
Total investments (Note 7)	1,628,469	1,867,514
Cash and cash items (Note 2)	45,133	50,717
Interest, dividends and other receivables	24,377	26,714
Agents' balances and premiums in course of collection (including $105,271 and $111,996 due on future installments)	248,627	303,002
Prepaid insurance acquisition costs	168,165	172,663
Equity in assets of underwriting associations, principally AFIA Worldwide Insurance	88,098	102,518
Land and buildings, at cost less accumulated depreciation of $11,934 and $12,950	46,159	49,635
Investment in GDV, Inc. (market $14,598 and $13,625)	48,373	52,276
Investments in stocks of affiliates (Note 5)	45,858	63,332
Carrying amount over the equity in net assets of subsidiaries	221,397	221,397
Other assets	126,731	133,604
Total assets	$2,691,387	$3,043,372

See accompanying notes to consolidated financial statements.

Liabilities and Shareholders' Equity	1977	**1978**
Unpaid losses and loss expenses	$ 956,600	$1,196,757
Unearned premiums	623,745	646,908
Aggregate life reserves	135,490	147,960
Funds held under reinsurance treaties	100,160	102,296
Federal income taxes ($14,765 and $7,567 payable currently) (Note 8)	91,611	93,992
Long-term debt (including $13,200 payable to affiliate) (Note 3)	13,200	28,200
Other liabilities	115,071	128,302
Total liabilities	2,035,877	2,344,415
Shareholders' equity (Note 5)		
Cumulative preferred stock	50,000	50,000
Common stock	1	1
Capital surpius	454,109	454,109
Unrealized depreciation of stocks	(53,999)	(65,257)
Retained earnings	205,399	260,104
Total shareholders' equity	655,510	698,957
Total liabilities and shareholders' equity	$2,691,387	$3,043,372

The Home Group, Inc.
and Subsidiaries

Five Years Ended December 31, 1978

Statement of Consolidated Income

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Premiums written	$ 903,838	$ 972,795	$1,127,498	$1,347,379	$1,543,353
(Increase) decrease in unearned premiums	(6,206)	(39,730)	37,678	24,911	(20,902)
Earned premiums	897,632	933,065	1,165,176	1,372,290	1,522,451
Investment income (Note 6)	75,547	80,749	88,186	101,325	124,437
Pretax income from equity investments	(1,081)	402	(421)	1,347	1,967
Total revenues	972,098	1,014,216	1,252,941	1,474,962	1,648,855
Losses and claims	601,389	608,912	756,638	850,029	932,306
Loss expenses	67,012	73,097	91,981	101,796	131,168
Insurance acquisition costs	275,356	307,299	342,699	404,431	435,887
Dividends to policyholders	3,767	4,992	7,823	11,810	11,794
Corporate expenses	—	—	219	786	852
Other, net	(1,239)	5,568	3,834	2,767	1,692
Total expenses	946,285	999,868	1,203,194	1,371,619	1,513,699
Income from operations	25,813	14,348	49,747	103,343	135,156
Equity in pretax income of GDV, Inc.	4,665	3,767	3,603	4,013	8,320
Operating income before income taxes	30,478	18,115	53,350	107,356	143,476
Income taxes (Note 8)	(4,777)	(10,799)	8,484	29,612	43,803
Income before net gains (losses) on sales of securities	35,255	28,914	44,866	77,744	99,673
Net gains (losses) on sales of securities* (Note 7)	(7,903)	4,749	6,486	(71)	—
Income before accounting change	27,352	33,663	51,352	77,673	99,673
Cumulative effect of change in accounting for catastrophe reserve, net of income taxes of $8,160	—	8,840	—	—	—
Net income	$ 27,352	$ 42,503	$ 51,352	$ 77,673	$ 99,673

* Excludes unrealized appreciation (depreciation) of stocks of $(74,946,000), $53,726,000, $36,783,000, $(23,406,000) and $(11,258,000) for the five years ended December 31, 1978.

See accompanying notes to consolidated financial statements.

The Home Group, Inc.
and Subsidiaries

Five Years Ended December 31, 1978

Statement of Retained Earnings

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Balance at beginning of year, as previously reported	$220,376				
Prior years' restatement for change in accounting for insurance acquisition costs	(17,212)				
Balance at beginning of year, as restated	203,164	$201,002	$160,105	$178,136	$205,399
Net income	27,352	42,503	51,352	77,673	99,673
	230,516	243,505	211,457	255,809	305,072
Distribution of net proceeds from issuance of preferred stock and loan from affiliate	—	(46,985)	—	(13,200)	—
Dividends paid (Note 5)					
Preferred stock	—	—	5,270	5,500	5,500
Common stock	29,514	36,415	28,051	31,710	39,468
	29,514	36,415	33,321	37,210	44,968
Balance at end of year	$201,002	$160,105	$178,136	$205,399	$260,104

Statement of Capital Surplus

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Balance at beginning of year	$432,311	$457,221	$454,154	$454,109	$454,109
Expenses incurred in connection with issuance of preferred stock	—	(3,067)	(45)	—	—
Contribution to surplus	24,910	—	—	—	—
Balance at end of year	$457,221	$454,154	$454,109	$454,109	$454,109

See accompanying notes to consolidated financial statements.

The Home Group, Inc.
and Subsidiaries

Five Years Ended December 31, 1978

Statement of Unrealized Depreciation of Stocks

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Balance at beginning of year					
Depreciation based on quoted market prices	$ (72,363)	$(141,790)	$ (87,416)	$ (41,245)	$ (72,607)
Income tax benefit resulting from excess of book basis of certain securities over tax basis	26,207	20,688	20,040	10,652	18,608
Net balance at beginning of year	(46,156)	(121,102)	(67,376)	(30,593)	(53,999)
Appreciation (depreciation) based on end of year quoted market, net of income taxes of $—0—, $60, $(8,822), $8,548 and $533	(68,776)	45,739	35,860	(19,976)	(13,515)
Effect of sale transactions during the year					
Appreciation (depreciation) at beginning of year	(651)	8,695	1,489	(2,838)	1,868
Income tax effect of book basis over tax basis	(5,519)	(708)	(566)	(592)	389
Net change during the year	(74,946)	53,726	36,783	(23,406)	(11,258)
Balance at end of year					
Depreciation based on quoted market prices	(141,790)	(87,416)	(41,245)	(72,607)	(84,787)
Income tax benefit resulting from excess of book basis of certain securities over tax basis	20,688	20,040	10,652	18,608	19,530
Net balance at end of year	$(121,102)	$ (67,376)	$ (30,593)	$ (53,999)	$ (65,257)

See accompanying notes to consolidated financial statements.

The Home Group, Inc.
and Subsidiaries

Five Years Ended December 31, 1978

Statement of Changes in Consolidated Financial Position

In Thousands of Dollars

	1974	1975	1976	1977	**1978**
Source of funds					
Net income	$ 27,352	$ 42,503	$ 51,352	$ 77,673	$ 99,673
Non-fund charges (credits) to income					
Increase in unpaid losses and loss expenses	46,324	27,050	156,559	204,022	240,157
Increase (decrease) in unearned premiums	6,469	22,135	(38,216)	(24,442)	23,163
Increase in aggregate life reserves	6,121	8,183	10,195	12,716	12,470
(Increase) decrease in premiums receivable, net of change in reinsurance balances payable	(10,371)	(9,683)	38,157	25,749	(56,321)
Sale of agents' balances to unconsolidated subsidiary	—	—	—	50,000	—
Increase in investments in stocks of affiliates, GDV, Inc. and assets of underwriting associations	(10,205)	(25,164)	(5,335)	(24,684)	(20,819)
(Increase) decrease in prepaid insurance acquisition costs	(5,993)	(2,390)	10,620	12,263	(4,498)
Net change in Federal income taxes	(20,893)	(7,049)	8,978	20,811	3,303
Other, net	(5,961)	27,430	(12,334)	14,018	11,635
Funds provided from operations	32,843	83,015	219,976	368,126	308,763
Bank and other borrowings	—	—	—	13,200	15,000
Proceeds from issuance of preferred stock	—	50,000	—	—	—
Cost assigned to stock contributed by City, including related liabilities, $11,789	36,700	—	—	—	—
Other, net	—	(9,423)	(389)	(7,718)	(4,911)
	$ 69,543	$123,592	$219,587	$373,608	$318,852
Application of funds					
Purchases of bonds and stocks	$137,638	$173,749	$437,677	$577,604	$432,836
Sales and redemptions of bonds and stocks	(162,881)	(117,793)	(298,316)	(197,063)	(176,033)
Other	33,568	(47,120)	52,159	(55,294)	(3,481)
Net increase in investments	8,325	8,836	191,520	325,247	253,322
Cash dividends	29,514	36,415	33,321	37,210	44,968
Distribution of net proceeds from issuance of preferred stock and loan from affiliate	—	46,985	—	13,200	—
Acquisition of shares of Uarco Incorporated	—	—	—	—	14,978
Contribution by City	36,700	—	—	—	—
Increase (decrease) in cash	(4,996)	31,356	(5,254)	(2,049)	5,584
	$ 69,543	$123,592	$219,587	$373,608	$318,852

See accompanying notes to consolidated financial statements.

**The Home Group, Inc.
and Subsidiaries**

Notes to Consolidated Financial Statements

(1) Summary of Significant Accounting Policies

Principles of Consolidation

Substantially all the outstanding capital stock of The Home Insurance Company ("The Home") was acquired by City Investing Company ("City") in a purchase transaction as of August 31, 1968, and, accordingly the net assets acquired were valued at their fair value at date of acquisition. In June 1970, The Home acquired the then outstanding 3.2% minority interest. In October 1975, City organized The Home Group, Inc. ("The Home Group"), formerly CityHome Corporation, and contributed to its capital all the outstanding common stock of The Home in exchange for all of The Home Group's common stock. The accompanying financial statements have been prepared on the basis that The Home Group, rather than City, had acquired The Home.

The accounting practices of insurance companies are prescribed by regulatory authorities. To the extent that certain of these practices differ from generally accepted accounting principles, they have been adjusted for inclusion in the accompanying consolidated financial statements.

Amounts for 1977 and prior years have been restated to give effect to adoption of an American Institute of Certified Public Accountants statement of position, "Accounting for Property and Liability Insurance Companies," which specifies that certain insurance acquisition costs which had previously been deferred and amortized be charged to expense when incurred. The effect of the change, which reduced the amount of prepaid insurance acquisition costs carried in the balance sheet, was to decrease net income for the three years ended December 31, 1976, by $1,559,000, $6,101,000, and $293,000, and to increase net income in 1977 by $2,635,000.

The consolidated financial statements include the accounts of all wholly-owned subsidiaries except Thico Plan, Inc. and its subsidiary, premium finance companies, Home Capital Services, Inc., a broker-dealer, and Scott Wetzel Services, Inc., a loss control servicing company, which are carried at cost plus equity in undistributed earnings since acquisition. The Home has carried its investment in GDV, Inc., 1,946,366 shares, or approximately 17% of the outstanding common shares, at cost plus equity in undistributed earnings since date of acquisition.

In September 1974, City contributed to The Home a group of wholly-owned subsidiaries which collectively own Sterling Forest, a 22,000-acre tract located north of New York City. For purposes of these financial statements, Sterling Forest is carried at City's historical cost plus advances and changes in equity since contribution.

In December 1978, The Home Group and Uarco Incorporated, a manufacturer of business forms, agreed to the merger of Uarco with a subsidiary of The Home Group, which, through December 31, 1978, had purchased approximately 14% of Uarco's outstanding stock. The merger was consummated on February 1, 1979. The total cost of the acquisition, which is being accounted for as a purchase, approximated $106,000,000. The acquisition was financed from borrowings under the $150,000,000 revolving credit agreement described in Note 3. Uarco's results are being included in the Statement of Consolidated Income from January 1, 1979. The acquisition of Uarco shares through December 31, 1978, is reflected in the consolidated balance sheet at their cost of $14,978,000. Uarco reported revenues of $224,392,000 and net income of $7,895,000 in its fiscal year ended September 30, 1978. At September 30, 1978, Uarco's reported assets aggregated $116,456,000, including current assets of $63,801,000 and net plant and equipment of $46,820,000. Uarco's liabilities at that date totalled $46,918,000, including current liabilities of $18,974,000 and long-term debt of $18,533,000. A study has been undertaken to determine the fair value of the net assets acquired.

In December 1977, The Home Group assumed a $9,000,000 promissory note of City payable to an unrelated third party in connection with the transfer by City to The Home Group of a 25% interest in Southern California Savings and Loan Association. In early 1978, the entire transaction was rescinded.

Notes to Consolidated Financial Statements (Continued)

(1) Summary of Significant Accounting Policies (continued)

The accompanying financial statements do not reflect the transfer of the Savings and Loan, the assumption of the obligation or the rescission.

The carrying amount over the equity in net assets of subsidiaries is considered to have a continuing value over an indefinite period and is not being amortized.

All significant intercompany items have been eliminated in consolidation. Amounts for 1977 and prior years have been reclassified to conform to the 1978 presentation.

Premium Revenues

Premiums on property and casualty, accident and health and other short-term contracts are recognized as earned primarily on a pro rata basis over the contract period. Premiums on life insurance and annuity contracts are reported as earned when due.

Prepaid Insurance Acquisition Costs

Acquisition costs incurred in the writing of property, casualty and group insurance business are deferred and amortized ratably over the terms of the insurance policies. The method followed in computing prepaid insurance acquisition costs limits the amount of such deferred costs to their estimated realizable value by giving effect to the losses and loss expenses expected to be incurred as the premium is earned. Acquisition costs related to the individual life and annuity insurance business are deferred and amortized over the premium paying periods in proportion to anticipated premium income.

Insurance acquisition costs of $123,119,000, $128,025,000, $79,985,000, $116,254,000 and $136,031,000 have been deferred, and $117,128,000, $125,633,000, $90,605,000, $128,517,000 and $131,533,000 have been amortized to expense for the five years ended December 31, 1978. Included in insurance acquisition costs in the Statement of Consolidated Income are $153,619,000, $156,643,000, $180,046,000, $205,379,000 and $234,953,000 of commissions and brokerage for the respective years. Also included are $50,949,000, $51,871,000, $58,269,000, $65,524,000 and $68,744,000 of salaries and other compensation.

Unpaid Losses and Loss Expenses and Aggregate Life Reserves

Unpaid losses and loss expenses are based on case basis estimates for reported claims, and on estimates, based on experience, for unreported claims and loss expenses. The provision for unpaid losses and loss expenses, net of estimated salvage recoverable, at December 31, 1977 and 1978, has been established to cover the net cost of insured losses. The amounts are necessarily based on estimates of future rates of inflation and other factors, and accordingly there can be no assurance that the ultimate liability will not exceed such estimates.

Aggregate life reserves have been computed by the net level premium method based on estimated future investment yield, mortality and withdrawal experience. Interest rate assumptions range from 4% to 6½%, depending on the year of issue. Mortality has been calculated principally on select and ultimate tables in common usage in the industry. Withdrawals have been determined principally based on industry tables.

Investments

Investments in stocks are carried at market value. Unrealized appreciation or depreciation of stocks is shown as a separate component of shareholders' equity and is not included in the determination of net income. Investments in bonds are carried at amortized cost and, accordingly, unrealized changes in the market value thereof are not reflected on the income statement or balance sheet.

Notes to Consolidated Financial Statements (Continued)

(1) Summary of Significant Accounting Policies (continued)

Income Taxes

Property and casualty companies are taxed essentially the same as other corporations with taxable income determined on the basis of the annual statements filed with insurance regulatory authorities. Due primarily to tax-free interest and the 85% dividends received deduction, the effective tax rate is usually lower than the statutory rate.

The Home Group and its subsidiaries are included in the consolidated Federal income tax return of City, except for its qualifying life insurance subsidiary, which files a separate return. Income tax provisions have been computed as if The Home Group and its subsidiaries, except the qualifying life insurance subsidiary, filed a separate consolidated return.

Catastrophe Reserves

In March 1975, the Financial Accounting Standards Board issued Statement No. 5, which provides that insurance companies may no longer maintain reserves for catastrophes. The Company's catastrophe reserve was discontinued as of January 1, 1975, and the cumulative effect of the change was included in net income of the year ended December 31, 1975.

(2) Cash and Cash Items

The Home and The Home Indemnity Company have agreements with City providing that, to the extent either company increases its deposits at any of City's depositary banks above its customary balances at such banks, City would pay that company at least quarterly an amount in cash in respect of such excess deposits at the rate of ½ of 1% over the average rate of return to the depositing company for its investments in commercial paper during such quarter. Such excess deposits currently amount to $10 million and City paid $969,000 during 1977 and $770,000 during 1978 under these agreements.

In September 1977, The Home entered into an agreement with its unconsolidated premium finance subsidiary providing for the sale of certain agents' balances. The Home has agreed to pay its subsidiary interest at ½ of 1% above the cost of borrowing and maintain cash balances at 10% of the commitment and 10% of the advances. At December 31, 1978, compensating balances of $10 million were maintained. Interest paid amounted to $969,000 in 1977 and $4,640,000 in 1978.

(3) Long-Term Debt

In January 1979, The Home Group entered into a $150 million revolving credit agreement with a group of banks. Terms of the agreement provide for reduction of the banks' total commitment by $7.5 million in each quarter beginning January 31, 1982. The Home Group is required to maintain cash compensating balances of 10% of the total commitment and 10% of the outstanding indebtedness or pay a fee in lieu thereof. Terms of the agreement provide for interest based on the prime lending rate and call for a fee of ½ of 1% per annum on the unused portion. Under a prior agreement, $15 million had been borrowed to purchase stock of Uarco. Proceeds from initial borrowings under the new agreement were used to repay such indebtedness and the prior agreement was terminated.

During 1977, $13,200,000 was loaned to The Home Group by an affiliate and distributed to City in the form of a dividend. The loan is non-interest bearing and is due on demand through May 1, 1984.

(4) Reinsurance

Unearned premiums and unpaid losses at December 31, 1977, have been reduced for reinsurance ceded by $65,888,000 and $206,206,000, respectively. Reductions at December 31, 1978, were $63,178,000 and $229,160,000, respectively. These amounts represent a contingent liability of The

(4) Reinsurance (continued)

Home in the event that all reinsurers were unable to meet the obligations for existing unpaid losses and unearned premiums ceded under reinsurance agreements.

The following table reflects amounts deducted for reinsurance ceded on the indicated income and expense accounts (in thousands):

	1974	1975	1976	1977	**1978**
Premiums written	$ 80,996	$135,789	$145,430	$153,848	$166,863
Earned premiums	84,632	120,618	143,618	167,538	169,573
Losses and claims and loss expenses	66,357	118,680	100,563	110,901	94,199
Insurance acquisition costs	15,352	21,233	21,155	27,879	28,447

(5) Capital Stock and Retained Earnings

The Home Group is authorized to issue up to 10,000,000 shares of cumulative preferred stock, $1.00 par value, of which 5,000,000 shares were outstanding at December 31, 1977 and 1978. The preferred stock is entitled to a sinking fund commencing December 1, 1986, sufficient to retire the preferred stock by December 1, 2005, has a stated annual dividend of $1.10 per share, is redeemable for sinking fund purposes at $10.00 per share plus accrued dividends and is currently redeemable at $10.935 per share.

Dividends paid by The Home to The Home Group during the year ended December 31, 1978, were $45,413,000. Under New Hampshire law, the state of The Home's incorporation, the maximum dividend that may be paid by The Home without prior approval of the New Hampshire Insurance Commissioner in any twelve-month period is the greater of (i) the investment income (as defined) for the preceding calendar year, or (ii) 10% of policyholders' surplus at the end of the preceding year. The maximum amount of dividends that could have been paid for the twelve months ended December 31, 1978, without prior approval was $74,500,000.

Retained earnings of The Home Group, Inc. and subsidiaries include undistributed earnings of unconsolidated subsidiaries and equity investments of $11,380,000 at December 31, 1977 and $15,889,000 at December 31, 1978.

(6) Investment Income

Components of net investment income were as follows (in thousands):

	1974	1975	1976	1977	**1978**
Interest income					
Cash and cash equivalents	$ 6,649	$ 2,420	$ 4,493	$ 5,538	$ 4,567
Bond income	40,497	50,305	53,937	63,962	79,189
Mortgage and policy loans	5,511	5,338	4,169	4,342	4,052
	52,657	58,063	62,599	73,842	87,808
Dividend income	18,037	17,080	17,391	20,802	27,931
Net real estate income	1,197	1,366	1,403	845	1,834
Other	3,656	4,240	6,793	5,836	6,864
	75,547	80,749	88,186	101,325	124,437
Investment expenses	1,937	2,289	2,405	2,541	2,488
Net investment income	$ 73,610	$ 78,460	$ 85,781	$ 98,784	$121,949

Notes to Consolidated Financial Statements (Continued)

(7) Realized and Unrealized Gains and Losses

Realized and change in unrealized gains and losses are summarized as follows (in thousands):

	1974	1975	1976	1977	**1978**
Realized gains					
Bonds and notes	$ 2,040	$ 1,794	$ 855	$ 2,294	$ 4,335
Preferred stock	—	409	1,523	500	243
Common stock	4,451	9,864	7,329	2,338	3,260
	6,491	12,067	9,707	5,132	7,838
Realized losses					
Bonds and notes	1,341	2,821	780	5,279	5,600
Preferred stock	214	—	—	—	454
Common stock	16,466	2,685	109	50	1,784
	18,021	5,506	889	5,329	7,838
Total realized gains and (losses)	(11,530)	6,561	8,818	(197)	—
Federal income taxes	3,627	(1,812)	(2,332)	126	—
Net realized gains and (losses)	(7,903)	4,749	6,486	(71)	—
Change in unrealized gains and (losses)					
Bonds and notes	(123,678)	13,022	92,117	19,892	(80,697)
Preferred stock	2,259	3,256	5,375	(1,535)	(2,093)
Common stock	(71,686)	51,118	40,796	(29,827)	(10,087)
	(193,105)	67,396	138,288	(11,470)	(92,877)
Federal income tax effect	(5,519)	(648)	(9,388)	7,956	922
Net change in unrealized gains and (losses)	(198,624)	66,748	128,900	(3,514)	(91,955)
Net realized and change in unrealized gains and (losses)	$(206,527)	$ 71,497	$135,386	$ (3,585)	$(91,955)

An identified certificate basis is used to determine cost of securities sold. Unrealized depreciation on preferred and common stocks at December 31, 1978, before income tax benefit, reflects unrealized gains of $16,937,000 and unrealized losses of $101,724,000.

At December 31, 1978, The Home Group did not have investments in any person, other than the United States Government or Federal government agencies or authorities, which exceeded two percent of total investments, except for investments in bonds originating in Canada of $59,646,000, of New York State and agencies of $56,733,000 and of The World Bank of $43,240,000. For the six months prior to December 31, 1978, bonds and notes carried in the balance sheet at $8,400,000 were non-income producing.

The Home Group, Inc.
and Subsidiaries

Notes to Consolidated Financial Statements (Continued)

(8) Income Taxes

Provisions for income taxes applicable to operating income include state income taxes of $—0—, $280,000, $280,000, $311,000 and $806,000 and foreign income taxes of $2,036,000, $2,345,000, $2,268,000, $4,664,000 and $5,265,000, for the five years ended December 31, 1978. A reconciliation between income taxes applicable to operating income and the amount computed at the statutory Federal ordinary rate of 48% follows (in thousands):

	1974	1975	1976	1977	**1978**
Amount at statutory Federal ordinary rate	$ 14,629	$ 8,695	$ 25,608	$ 51,531	$ 68,868
Tax-free interest and 85% dividends received deduction	(18,127)	(17,576)	(18,182)	(20,841)	(26,841)
Adjustment of prior years' tax provisions	(1,900)	(4,000)	—	—	—
State income taxes, net of Federal tax benefit, and foreign income taxes	1,059	1,500	1,304	(874)	1,084
Operating losses offset against capital gains	1,900	2,643	—	—	—
Miscellaneous items	(2,338)	(2,061)	(246)	(204)	692
	$ (4,777)	$(10,799)	$ 8,484	$ 29,612	$ 43,803

Deferred income tax provisions (benefits) result from items which are reflected in income for tax purposes in different years than they are reflected in income for financial statement purposes. The source and income tax effects, primarily Federal, of these timing differences between book and taxable income are as follows (in thousands):

	1974	1975	1976	1977	**1978**
Insurance acquisition costs	$ 1,700	$ 1,600	$(5,100)	$(5,900)	$ 2,200
GDV, primarily from the use of installment accounting practices	1,600	—	(800)	(200)	800
Statutory reinsurance contracts	(300)	(6,100)	5,400	(100)	(1,300)
Statutory reserve	—	(2,400)	(7,900)	(2,000)	4,800
Adjustment of prior years' tax provisions	(1,900)	(2,600)	—	—	—
Estimated salvage recoverable on insurance claims	400	—	(100)	6,400	1,900
Miscellaneous items	(900)	400	1,100	1,800	1,300
	$ 600	$(9,100)	$(7,400)	$ —	$ 9,700

As a result of the examination of Federal income tax returns, the Internal Revenue Service has proposed certain adjustments to income which, if sustained, would result in additional income tax assessments for the years 1968 through 1972. However, The Home Group does not agree with and is contesting the proposed adjustments. It is believed that adequate provision has been made for possible assessments and interest which may result from these examinations.

Under the provisions of the Life Insurance Company Income Tax Act of 1959, under certain circumstances, a portion of a life insurance company's income from operations is set aside in a special Policyholders' Surplus Account and is not subject to tax. Allocations of income to policyholders' surplus of the life insurance subsidiary, aggregating $10,165,000 at December 31, 1978, are excluded from Federal taxable income and, accordingly, income taxes have not been accrued on this amount. If in the future this amount is used for purposes other than those permitted, a tax liability will be imposed at the then-current Federal income tax rates.

Notes to Consolidated Financial Statements (Continued)

(9) Retirement and Incentive Compensation Plans

Pension plans are in effect which cover substantially all employees who meet eligibility requirements. Actuarial assumptions of the respective plans are standardized and equity securities of the pension trust are valued at a three-year average of quoted market.

Provisions charged against income include normal costs plus interest on unfunded past service costs and include amortization of prior service costs over 30 years. Total expense under pension plans was $4,690,000, $4,107,000, $3,150,000, $6,380,000 and $7,898,000 for the five years ended December 31, 1978. Subsequent to the inception of the plans, it has been the policy of The Home Group generally to fund amounts provided. As of December 31, 1978, the unfunded past service liability based on actuarial estimates was approximately $38 million.

An incentive compensation plan has been adopted covering salaried officers and certain employees under which annual payments may be made in accordance with salary and performance levels with a maximum sum distributable determined by a formula related to earnings.

(10) Reconciliation From Statutory to Generally Accepted Accounting Principles

A reconciliation from statutory basis capital and surplus of The Home Insurance Company at December 31, 1977 and 1978 to total shareholders' equity of The Home Group on a generally accepted accounting principles basis follows (in thousands):

	1977	**1978**
Total capital and surplus — statutory basis, as filed with regulatory authorities	$300,520	$322,408
Adjustment for rescission of transfer of 25% interest in Southern California Savings and Loan Association (Note 1)	(7,500)	—
Total capital and surplus — statutory basis, as adjusted	293,020	322,408
Parent company liabilities, net	(12,853)	(12,880)
Prepaid insurance acquisition costs	168,165	172,663
Non-admitted assets	38,876	44,374
Statutory reserves	7,100	12,881
Carrying amount over the equity in net assets of subsidiaries	221,397	221,397
Decrease in investments from statutory value to The Home Group's value	(9,200)	(7,036)
Deferred Federal income taxes	(76,846)	(86,425)
Estimated salvage recoverable on insurance claims	26,934	30,932
Other adjustments	(1,083)	643
Total shareholders' equity — generally accepted accounting principles basis	$655,510	$698,957

Notes to Consolidated Financial Statements (Continued)

(10) Reconciliation From Statutory to Generally Accepted Accounting Principles (continued)

A reconciliation from statutory basis net income of The Home Insurance Company for the five years ended December 31, 1978 to net income of The Home Group on a generally accepted accounting principles basis follows (in thousands):

	1974	1975	1976	1977	**1978**
Net income — statutory basis (including realized gains and losses)	$28,375	$36,810	$61,079	$84,146	$89,040
Increase (decrease) in prepaid insurance acquisition costs	5,993	2,390	(10,620)	(12,263)	4,498
Adjustment of statutory investment income to the basis of The Home Group	(17,870)	(2,826)	358	(2,338)	(534)
Federal income taxes	(810)	2,668	7,343	(107)	(10,390)
Decrease in catastrophe reserve	4,000	17,000	—	—	—
Estimated salvage recoverable on insurance claims	850	—	(153)	13,237	3,998
Statutory reinsurance contracts and reserves	—	(16,543)	(4,900)	(4,230)	10,000
Other adjustments	6,814	3,004	(1,755)	(772)	3,061
Net income — generally accepted accounting principles basis	$27,352	$42,503	$51,352	$77,673	$99,673

(11) Information About Segments of the Company's Operations

A summary of assets applicable to The Home Group's operations by principal insurance industry segment, as of December 31, 1977 and 1978, follows (in thousands):

	1977	**1978**
Property and casualty insurance, including investments of $1,402,114 and $1,611,303	$2,287,540	$2,584,802
Life insurance, including investments of $226,355 and $256,211	309,598	342,382
Combined	2,597,138	2,927,184
Corporate and affiliates	94,249	116,188
Consolidated	$2,691,387	$3,043,372

Assets allocated to the segments include, where applicable, the carrying amount over equity in net assets.

Information with respect to revenues and income from operations is presented under "Business" on pages 4 and 5.

(12) Unaudited Quarterly Summary of Operations

The following Summary of Operations for the four quarters of 1977 and 1978 is unaudited but, in the opinion of The Home Group's management, all adjustments, consisting only of normal recurring accruals, necessary for a fair presentation of the interim periods presented have been included (in thousands):

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
1977				
Earned premiums	$314,747	$333,979	$353,829	$369,735
Investment income	23,292	24,714	25,289	28,030
Pretax income from equity investments	317	567	404	59
Total revenues	$338,356	$359,260	$379,522	$397,824
Net income	$ 10,639	$ 15,853	$ 18,954	$ 32,227
1978				
Earned premiums	$352,718	$372,218	$391,626	$405,889
Investment income	29,233	30,107	30,756	34,341
Pretax income from equity investments	334	755	863	15
Total revenues	$382,285	$403,080	$423,245	$440,245
Net income	$ 19,772	$ 27,024	$ 27,617	$ 25,260

Results for the 1977 quarters and the first three 1978 quarters have been restated to give effect to a change in accounting for insurance acquisition costs. As a result of this change, net income for the 1977 quarters was restated and retroactively increased (reduced) by $(1,461,000), $754,000, $(140,000) and $3,482,000, respectively. For the first three 1978 quarters, net income was restated and retroactively increased (reduced) by $(131,000), $487,000 and $(1,756,000), respectively. The foregoing amounts differ from those reported by City Investing Company due to a difference in effective income tax rates.

Caution should be exercised in comparing the results of consecutive interim quarters. Generally, with the absence of severe storms and the normal high level of earned premiums compared with premiums written, third and fourth quarter underwriting results are more favorable than during the first two quarters.

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David Fain Brown, Vice President & General Counsel
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Earle M. Jorgensen, Chairman, Earle M. Jorgensen Company
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Directors

(1) Member of the Executive Committee
(2) Member of the Accounting and Audit Committee
(3) Member of the Personnel Committee