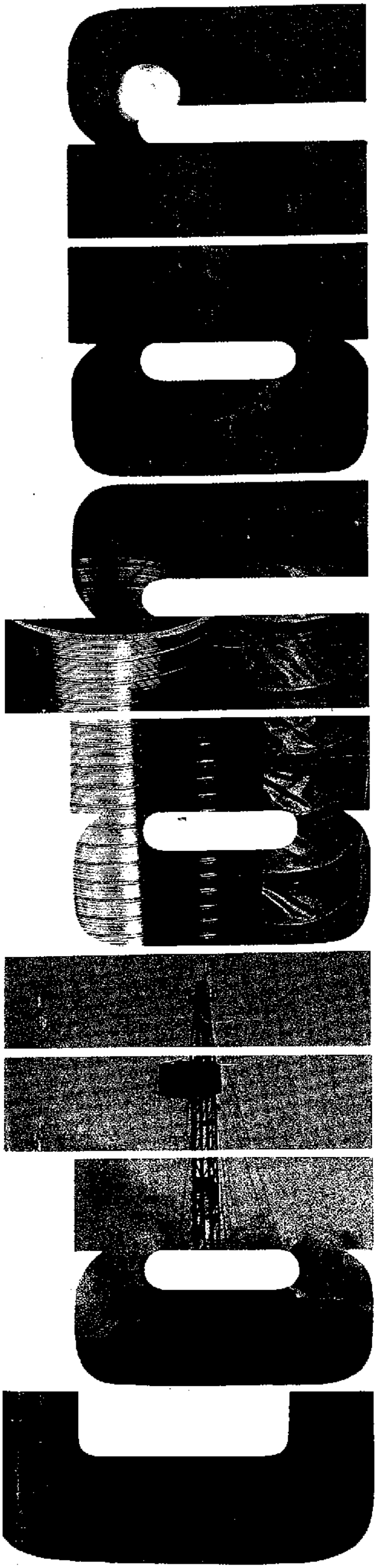


Callahan Mining Corporation Annual Report 1976

(203) 655-7751

CHARLES D. SNEAD, JR.
PRESIDENT

CALLAHAN MINING CORPORATION

CBT PLAZA
1120 POST ROAD
DARIEN, CONN. 06820

Mining / Manufacturing / Natural Gas & Oil

Callahan Mining Corporation owns the Galena mine in Idaho, the country's second most productive silver mine, and receives 50% of the cash flow from that operation. The Company is also receiving one-twelfth of the income from the new Coeur silver mine and is continuing its participation in a variety of other mining projects. Callahan's 80% owned subsidiary, Pinnacle Exploration, Inc., has a 15% interest in a major uranium project now under development.

The Company has two manufacturing units which in the aggregate produced record sales and profits in 1976. Pathway Bellows, Inc., a wholly-owned subsidiary, is the nation's leading manufacturer of metallic expansion joints used in power generation, petrochemical, and other major industries. The Flexaust Company division supplies high quality, lightweight hose and duct to industry from four plants in the United States and Canada.

Callahan and Pinnacle hold interests in a substantial amount of the natural gas thus far discovered in the Canadian Arctic Islands. Callahan also owns 23.4% of the outstanding shares of K.R.M. Petroleum Corporation of Denver, Colorado, a small domestic oil and gas company with production in nine states.

Annual Meeting

The 1977 Annual Meeting of Shareholders will be held on the Third Floor, CBT Plaza, 1120 Post Road, Darien, Connecticut on April 11, 1977 at 12 o'clock noon. We hope as many shareholders as possible will attend.

Callahan

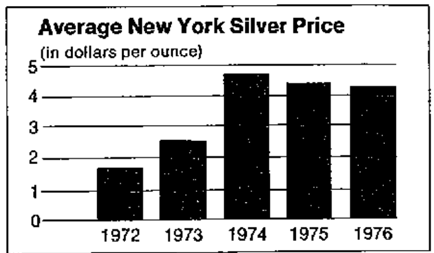
Callahan Mining Corporation · Annual Report 1976

Highlights	1976	1975
Net Sales—Manufacturing	**$23,434,000**	$17,136,000
Net Sales—Mining (Coeur Mine)	**$ 227,000**	—
Revenue from Galena Mine	**$ 4,069,000**	$ 4,070,000
Interest and Other Income	**$ 617,000**	$ 752,000
Total Revenues	**$28,347,000**	$21,958,000
Net Income	**$ 2,822,000**	$ 2,814,000
Per Share	**$ .78**	$ .78
Weighted Average Shares Outstanding	**3,620,000**	3,609,000
Shareholders' Equity	**$24,040,000**	$22,134,000
Working Capital	**$13,930,000**	$13,879,000
Ounces of Silver Produced (100% of mine production):		
Galena Mine	**3,421,000**	3,350,000
Coeur Mine	**661,000**	—
Average New York Silver Price (Handy & Harman)	**$4.35**	$4.42

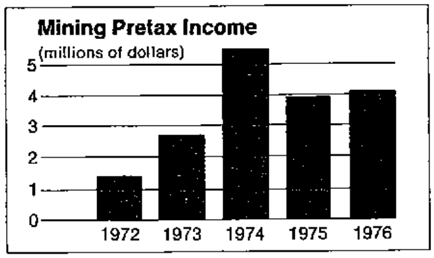
New York Stock Exchange Prices (High-Low)*:

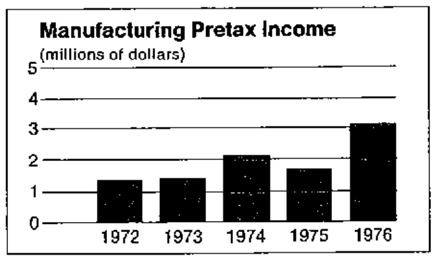
	1976	1975	1974	1973	1972
First quarter	**15¾-10¾**	13⅛- 7½	20¾-12⅛	13 -10	13⅛- 8¼
Second quarter	**17½-12⅝**	17 - 9⅛	17¾-10½	11⅜- 8½	12⅞-10⅜
Third quarter	**17⅛-11½**	18¼-11⅝	14¾- 6¼	12⅛- 9⅛	12⅝- 9½
Fourth quarter	**14⅝-12⅛**	14⅜-10¼	11 - 7¼	12 - 9⅛	11⅜- 9

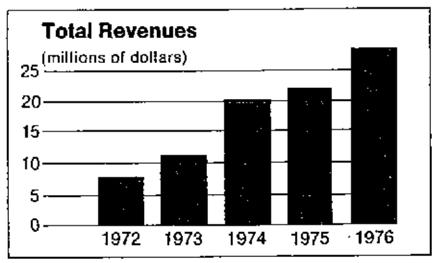
*Not adjusted for stock dividends.

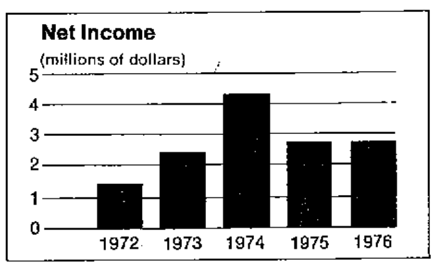


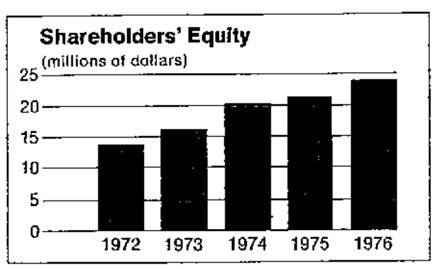
Source: Handy & Harman











To Our Shareholders

Net income for 1976 totaled \$2,822,000 or \$.78 per share as compared to the \$2,814,000 or \$.78 per share reported in 1975. Revenues were ahead of the prior year due principally to a strong performance in 1976 by Callahan's manufacturing units. Galena mine revenues approximated those reported in 1975 despite higher operating costs and an average silver price which languished on the low side of the \$4-5 price range for much of the year.

A restrained economic recovery, availability of silver from secondary supplies, and the potential for government stockpile sales all affected silver's price in 1976. Some improvement has been seen in many of the factors which relate to silver and a moderate near-term increase in price may result. Later in the year, Congress may again consider sale of the 139.5 million ounce stockpile which could affect the price of silver. Any sale of this low-cost government silver seems largely oriented toward reducing Federal deficits and is unwise in our view in light of the prospect of having to replace it later at increased prices.

Long-term, higher silver prices should prevail. While the shortfall in mine production of silver versus demand has in the past few years been largely covered by silver from aboveground sources, these supplies are likely to continue to be consumed or hoarded. The historic gap between mine production and consumption seems destined to continue, not only due to delays in opening new silver mines because of increased capital and production costs, but also due to lowered production from mines from which silver comes as a byproduct, many of which are experiencing losses or shrinking margins as a result of higher operating costs and lagging base metal prices. These factors plus continued inflation should keep silver's price moving upward for the future.

New income from silver was added to Callahan's picture during 1976 as the Coeur mine, which adjoins the Galena mine to the west, was brought into production by Asarco Incorporated. At currently prevailing silver prices, earnings of approximately \$.05 per share annually should be added from Callahan's interest in this silver mine.

As previously noted, Callahan's manufacturing units performed admirably in 1976. Pathway Bellows, Inc. showed results substantially ahead of the prior year and The Flexaust Company turned in another fine performance with record sales and higher profits. Both units anticipate further improvement in 1977.

Other projects not yet producing income were active during 1976. Homestake Mining Company, which is managing work at the Pitch uranium property in Colorado of Callahan's 80% owned subsidiary, Pinnacle Exploration, Inc., announced that it plans to begin construction in 1977 for production of U_3O_8 concentrates in 1979 if environmental and other clearances can be obtained.

Studies are still underway at Callahan's 49% owned zinc-lead property in eastern Washington. Any production decision will be delayed until at least mid-1977, pending environmental approvals and completion of market studies and possible financing arrangements.

Efforts to advance the zinc-copper properties of Piedmont Mineral Associates in Virginia toward production are being deferred. Portions of the deposit presently outlined at the Cofer property are mineable only by high-cost methods which are not feasible at currently softened metal prices. While exploration in the area is continuing, previously capitalized development costs have been charged against 1976 earnings in an amount equal to \$.10 per share.

More natural gas was found in 1976 in the Canadian Arctic Islands. Callahan and Pinnacle now hold approximately one-half trillion of the reported fifteen trillion cubic feet of gas thus far found in this frontier region by Panarctic Oils Ltd. and others. Estimates of gas in this area continue to grow and major financial commitments in support of Panarctic's continuing program have recently been announced. The objective is to achieve threshold gas reserves required for construction of the pipeline now being planned by the Polar Gas Project.

Another oil and gas participation was added to Callahan's holdings during 1976 through the purchase in August of 23.4% of the outstanding shares of K.R.M. Petroleum Corporation of Denver, Colorado. K.R.M. is engaged in the exploration, development, and operation of domestic oil and gas properties and has production in nine states.

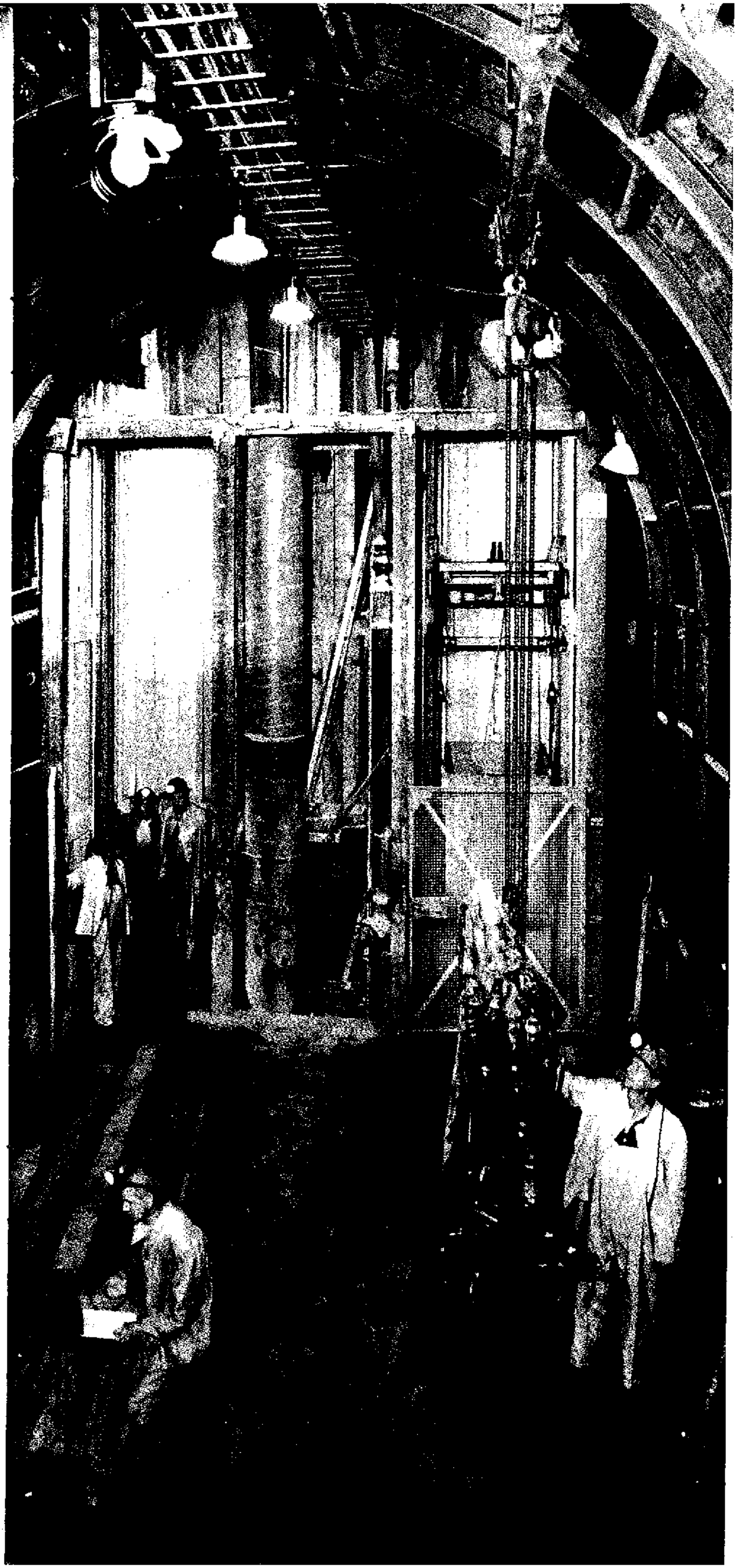
Three new directors were elected to Callahan's board at the annual shareholders meeting in April of 1976. Joining the board were Jack B. Meyer, Vice President of Callahan, who is responsible for our manufacturing activities; James C. Parlee, retired Vice Chairman, INCO Ltd.; and Fayez Sarofim, President of Fayez Sarofim & Co., investment counsellors. These gentlemen replaced David S. Gamble, Jack H. How, and George F. Shaskan, Jr., all of whom served the Company as directors for ten or more years but did not stand for reelection in 1976. Callahan's management and its shareholders are indebted to these former directors for the fine contribution they made to the Company's advancement during their tenure. Shortly after the annual meeting I reported with deep sorrow the death of David S. Gamble.

A cash dividend of \$.30 per share and a 2% stock dividend were paid during 1976. As recently announced, in addition to a 2% stock dividend, the cash dividend for 1977 has been increased to \$.35 per share, payable on March 30, 1977 to shareholders of record on March 4, 1977.

Charles D. Snead, Jr.

Charles D. Snead, Jr.
President

February 23, 1977



Mining

Galena Mine: Revenues accrued from the Galena mine in Idaho, which is owned by Callahan and operated by Asarco Incorporated under long-term lease, totaled $4,069,000 for 1976 as compared to the $4,070,000 reported in 1975. A greater number of ounces of silver were sold for the year from this the nation's second largest silver mine which helped to offset increased labor costs and smelting charges. A total of 182,272 tons of ore, with an average grade of 19.5 ounces of silver, was milled during 1976 compared to 178,382 tons with a grade of 19.4 ounces of silver milled in 1975.

Operating costs continued to rise during the year, although at a somewhat slower rate than experienced in 1975. Over the past four years the average cost of producing an ounce of silver at Galena has nearly doubled.

During 1976 the Galena shaft was deepened to the 4600 level and interconnections with the No. 3 shaft were completed on the 4000 and 4600 levels to improve ventilation and servicing of the lower mine workings. As has been the case for many years, ore reserves at year-end continue to be sufficient for more than six years' operation at present mining rates.

The current labor contract at the mine expires at the end of 1977. Galena has enjoyed a fine record of almost eight years of continued labor harmony and current relationships with the work force at the mine are good.

Coeur Mine: Early in 1976, milling of ore began at the new Coeur silver mine which adjoins the Galena mine to the west. Until recovery of its $1,693,000 investment in Coeur, Callahan will be entitled to 8⅓% of mine profits and will thereafter have a 5% interest in this new silver producer. Some $312,000 of Callahan's investment was recovered during 1976. As of September 1, the property was placed on an operating basis and Callahan began reporting revenue from the mine. At current silver prices, Coeur should add more than $300,000 to Callahan's pretax earnings in 1977. Asarco Incorporated, which operates and manages the mine, estimates that ore reserves are sufficient for more than eight years of operation, assuming a production rate of 2.2 million ounces of silver per year.

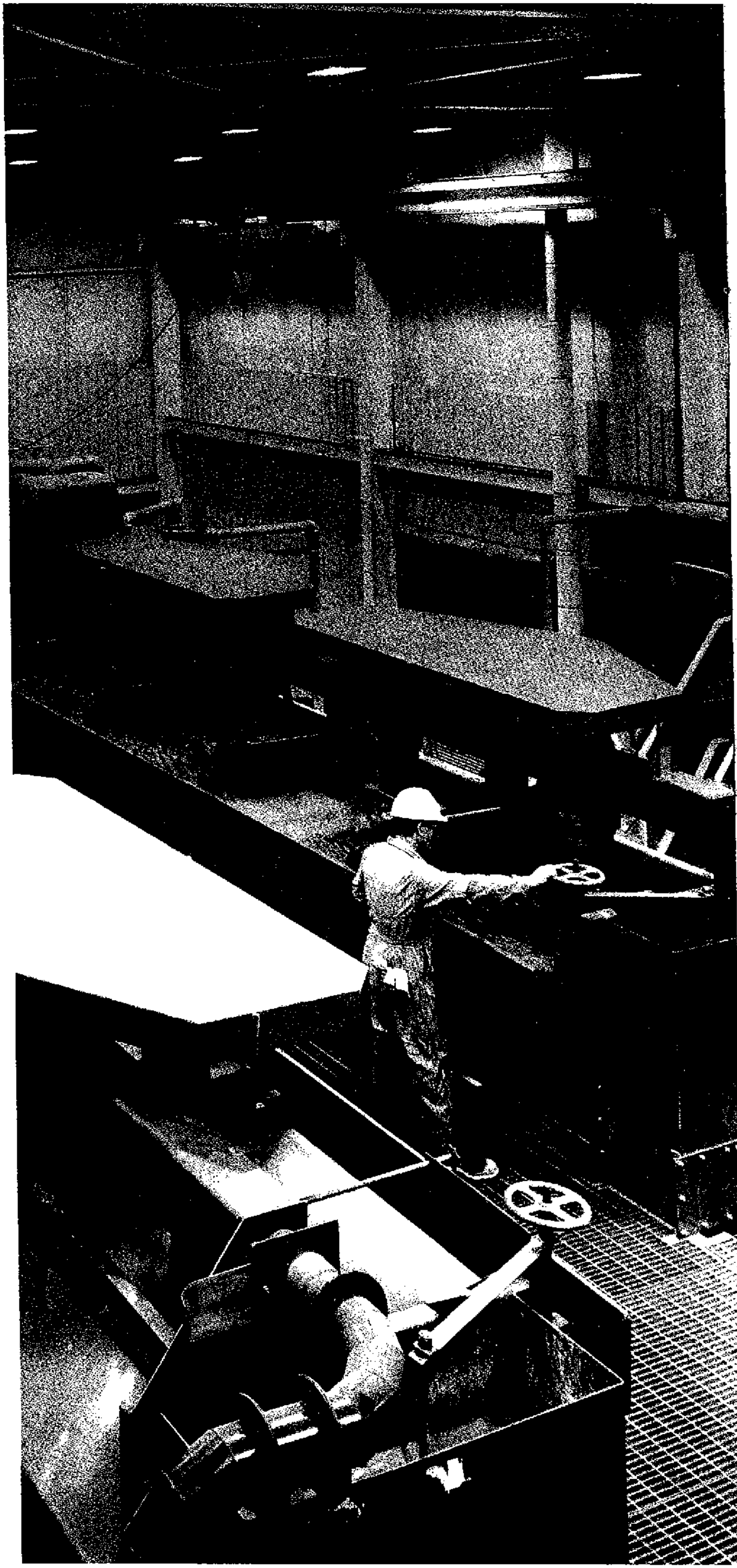
Caladay: Negotiations to structure an arrangement which will permit exploration of the Caladay property from one or more of the lower levels of the Galena mine continued during 1976. Proposals for undertaking this work and cost studies are being reviewed by Asarco Incorporated and Day Mines, Inc. which participate with Callahan in the Caladay and Galena properties. While the Caladay property is attractive for exploration, the cost of a drive from Galena is substantial, and the work must be undertaken in a manner which has minimal impact upon Galena operations.

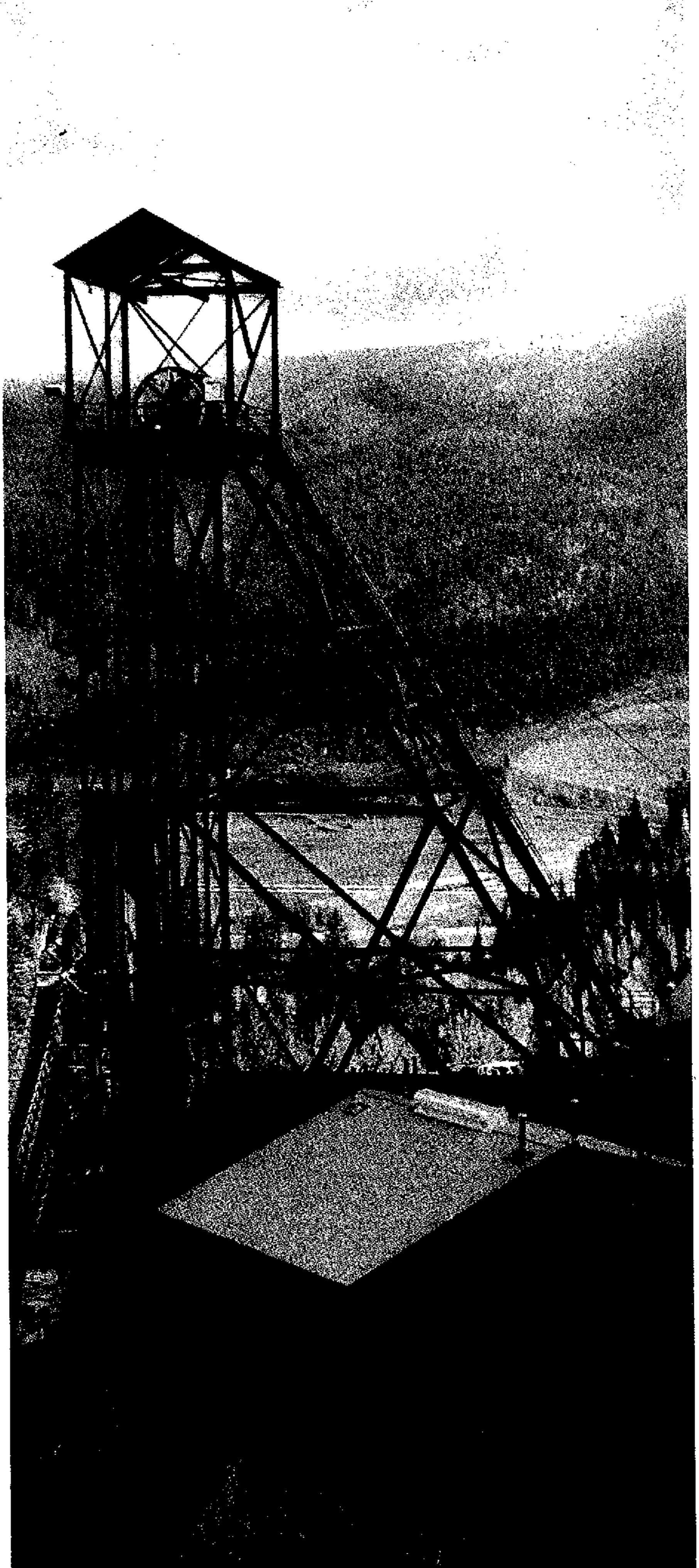
Pinnacle Exploration, Inc. *(80% owned)*: Pinnacle retains a 15% carried interest in the Pitch uranium properties in Colorado which are being developed by Homestake Mining Company. Near midyear 1976, Homestake announced that if studies at the mine progress favorably and government clearances are obtained, construction for production at the mine will begin in 1977. Annual production of at least 600,000 pounds of U_3O_8 concentrates is anticipated by 1979. Within the last month, Homestake has reported completion of contracts for the sale of some seven million pounds of uranium to a group of major electric utility companies with a maximum of 5.5 million of these pounds to come from the Pitch mine in subsequent years.

While environmental permits for the project must still be obtained, two legislative proposals in Colorado which could have adversely affected its future were defeated in November's balloting when Colorado citizens voted against a moratorium on nuclear power developments and defeated a proposal for a mine severance tax.

Homestake is providing all funds required for the project and will be entitled to recover its contributions in excess of $1.2 million before Pinnacle participates to the extent of 15% of mine profits. At the close of 1976, Homestake had spent a total of $3,709,000 at Pitch.

Washington Zinc Unit: Production studies for a 2,000 ton per day operation were advanced during 1976 at this 49% owned zinc-lead property in





eastern Washington. Applications will soon be submitted for environmental permits required for production. Also under consideration are alternatives for financing the project and marketing of lead and zinc concentrates. A production decision is not likely before midyear 1977.

Callahan's expenditures for this project totaled $901,000 at December 31, 1976. Funds are also being provided by subsidiaries of United States Borax and Chemical Corporation and Brinco Ltd. which jointly hold a 51% interest in the property. Arrangements among the parties for operating the project are being finalized, including terms under which the 1,000 ton per day mill on the property now owned by Callahan will be transferred to the venture.

Piedmont Mineral Associates: The program of underground drifting and drilling at the Cofer property of Piedmont Mineral Associates was suspended in the third quarter of 1976. Studies completed in January, 1977 show that while underground work confirmed mineralization indicated by surface drilling, higher than anticipated costs may be experienced in mining the deposit, due in part to inflation in mining costs over the past several years and because low-cost mining methods may not be applicable to portions of the deposit. Higher metal prices are required for profitable mining; and, therefore, efforts to move the Cofer property toward production are being deferred. As a result, previously capitalized development costs have been charged against 1976 earnings as explained in Note 10 to the financial statements. Exploration is continuing on nearby properties. This work could add tonnage and permit consideration of larger scale, lower cost operations.

Livengood Placers, Inc. *(80% owned)*: Klondike Placer Gold Corporation, the lessee of the Alaskan gold properties of Livengood Placers, Inc., recovered approximately 3,500 ounces of unrefined gold from sluicing operations during the field season of 1976. Some $27,000 of revenue was earned by Livengood under its royalty which equals 8% of gross proceeds from gold sales. Klondike reports that current production capacity will be more than doubled by June of 1977 as required under the terms of the lease from Livengood.

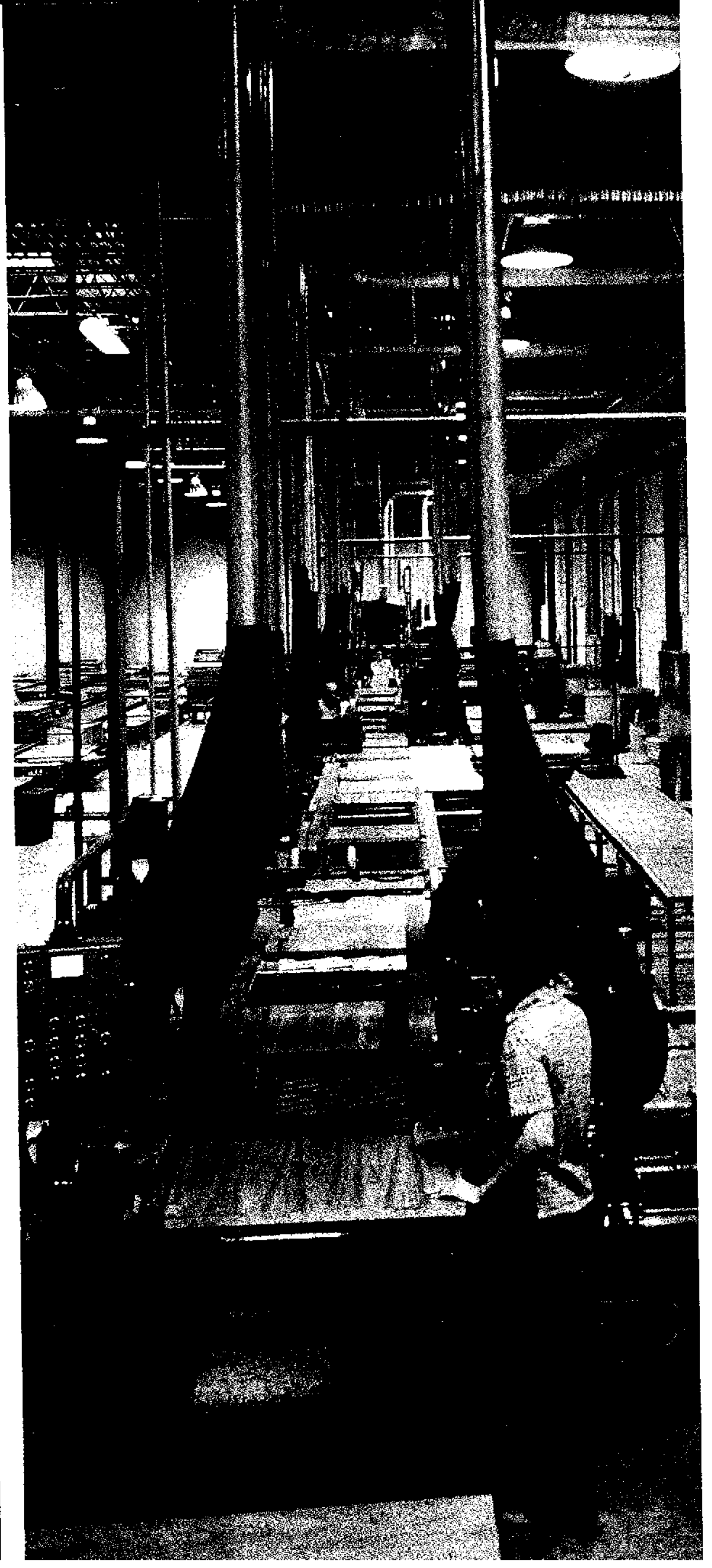
Manufacturing

The Flexaust Company: Sales of lightweight industrial hose and duct by The Flexaust Company division were at an all-time high in 1976, running more than 18% ahead of 1975. Profits showed a 21% improvement as compared to the prior year.

Marketing efforts in the United States were intensified during 1976 by the addition of new regional offices in Houston, Texas and in the Cleveland, Ohio area. Bookings continue strong and a further increase in sales is projected for 1977.

Footage of hose and duct shipped for 1976 was up 17% over 1975. Costs of material and labor continue to rise, though not as dramatically as cost increases experienced in 1974-75. A price adjustment was instituted early in 1977, the first such increase by Flexaust since the beginning of the prior year.

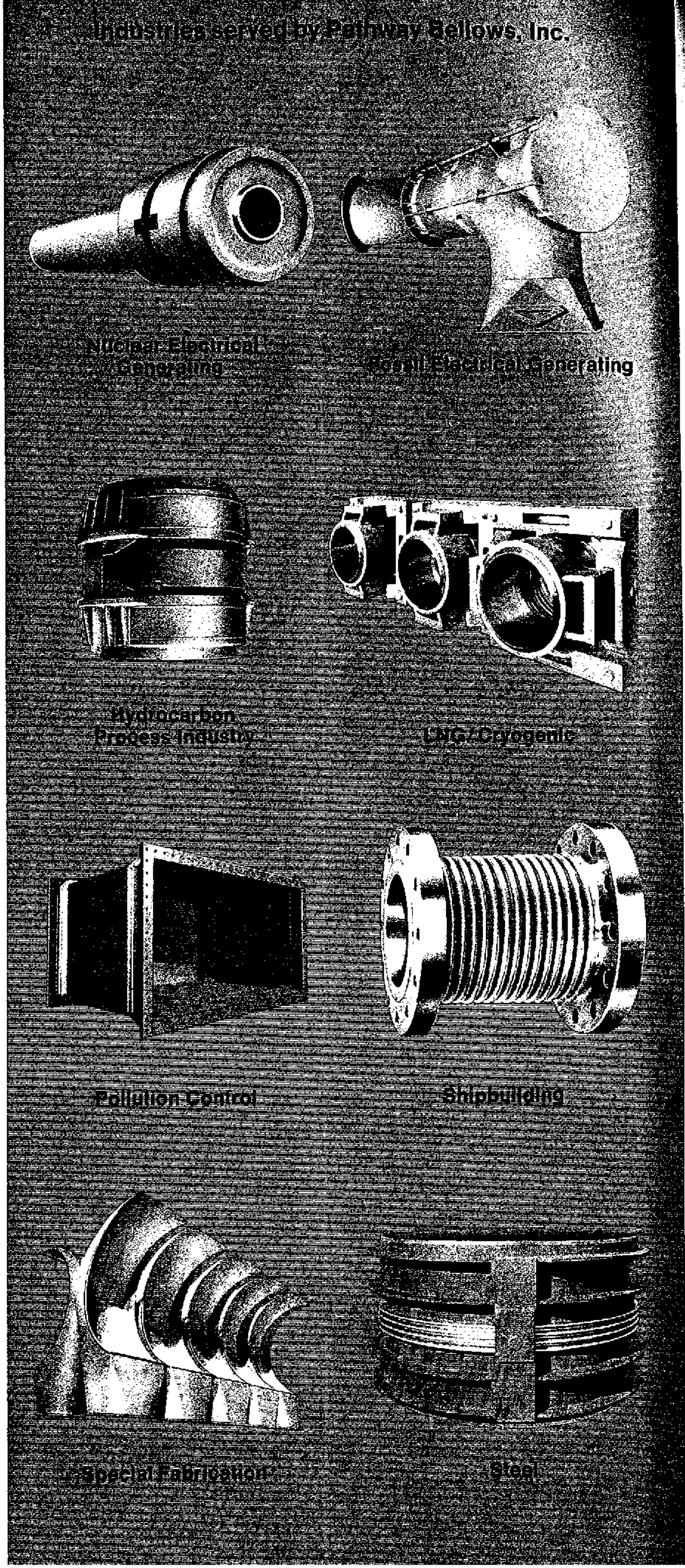
Future growth is being planned for Flexaust initially through development of a hose line for higher temperature applications and by new arrangements for entry into foreign markets. Efforts are also underway to add by acquisition other quality hose products which can be sold through Flexaust's system of more than 400 distributors in the United States and Canada.



Pathway Bellows, Inc.: Record sales and profits were turned in for 1976 by Pathway Bellows, Inc., Callahan's wholly-owned subsidiary, which manufactures expansion joints and piping systems for industry. Sales by Pathway for energy related, pollution control, and other industrial applications have grown more than fifteen-fold since acquisition by Callahan in 1968. Pathway participates in a large market and has been successful at finding new customers for its products. A good business climate in 1977 and reactivation of capital projects slowed by regulatory delays and nuclear referendums can bring a further increase in sales and help maintain Pathway as the leading producer in the metallic expansion joint field.

In its first full year of operation, Pathway's new plant at Oak Ridge, Tennessee performed well, including on-time completion of some 46 major ducting components for pollution control facilities at a TVA power plant. Pathway's Oak Ridge facility continues to supply substantial amounts of hardware for enlargement of the nation's nuclear fuel enrichment facilities located in Tennessee, Kentucky, and Ohio. Shipments from the El Cajon, California plant, where Pathway is headquartered, were at satisfactory levels for the year. Labor relations at both facilities remain good.

During the second quarter, Pathway's new line of FLEXSPAN fabric expansion joints was introduced to enhance future growth in industrial piping and ducting systems markets. Major orders for these products have been obtained and Pathway expects this new line to add substantially to results. New product lines complementary to Pathway's manufacturing and marketing capability continue to be investigated for addition, either through internal development or acquisition.



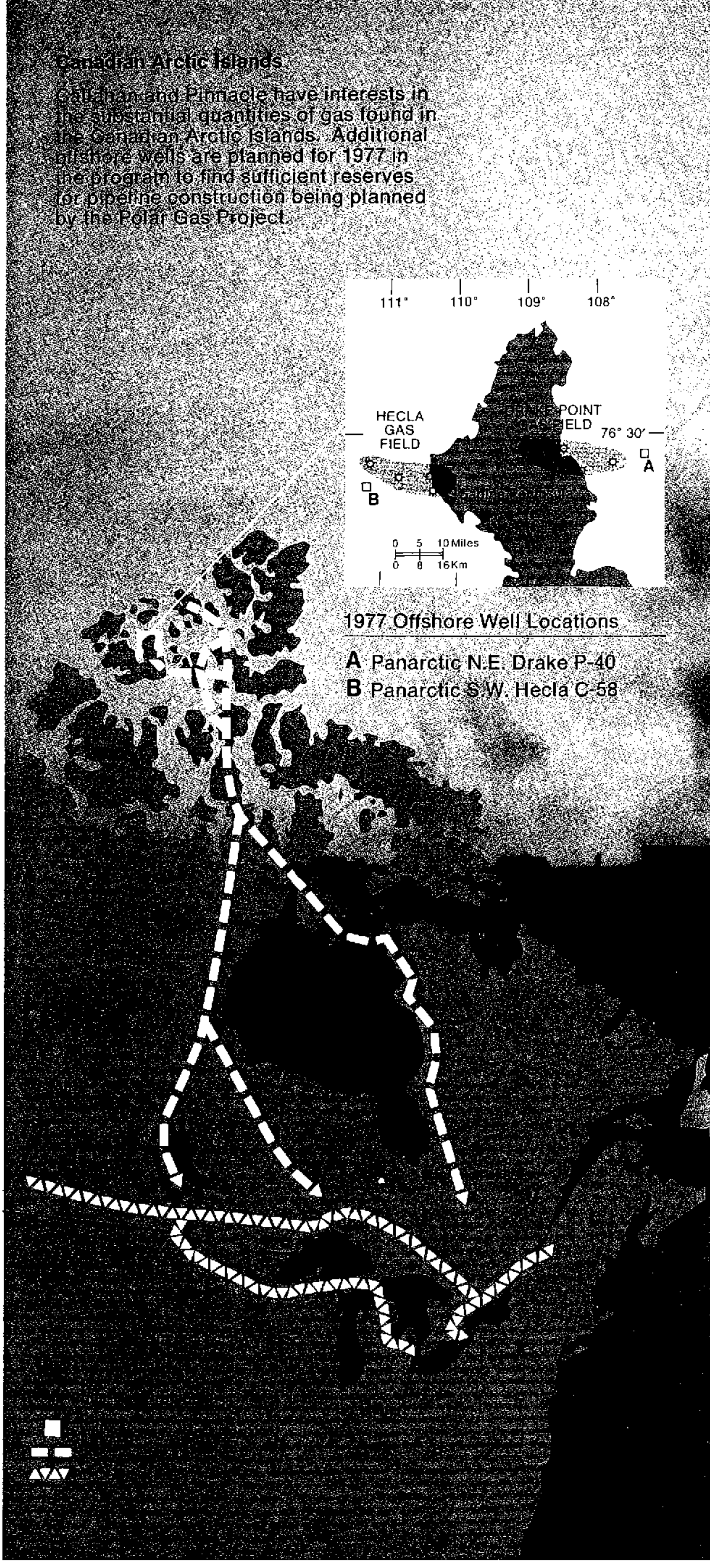
Natural Gas & Oil

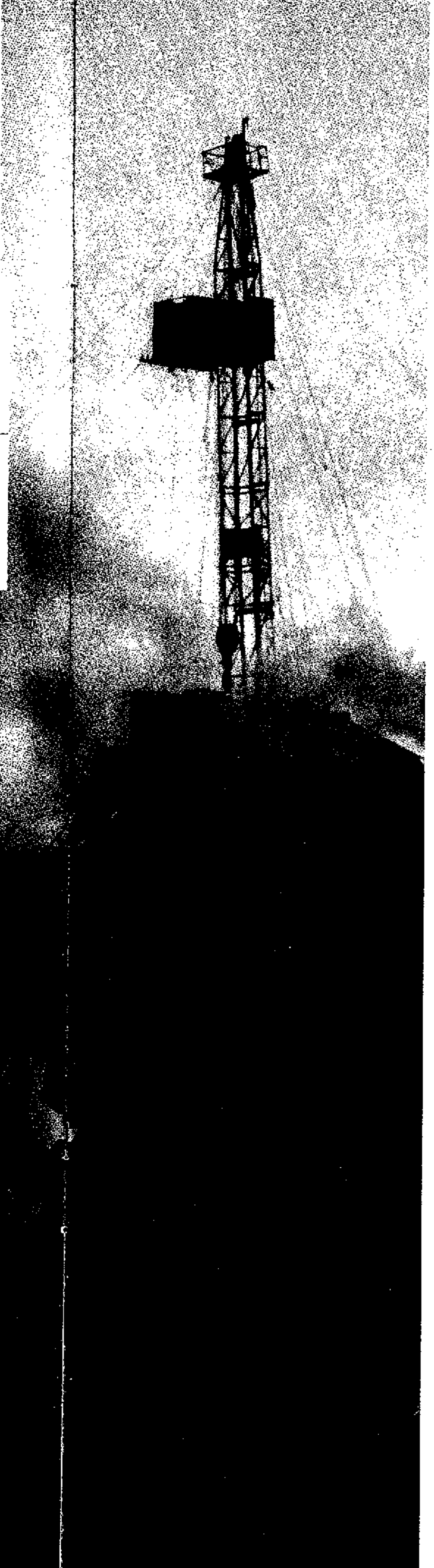
Canadian Arctic Islands: During 1976, exploration work designed to reach threshold reserves required to justify pipeline construction continued in the Canadian Arctic. Early in the year, Panarctic Oils Ltd. announced the successful completion of the Hecla M-25 gas well offshore west of Melville Island and the Jackson Bay gas discovery southwest of Ellef Ringnes Island. While neither of these finds were on permits in which Callahan and Pinnacle have interests, they did add to the quantity of gas thus far found in this frontier area. Soon after these successful stepouts, Panarctic announced that estimated Arctic Islands gas totaled 15 trillion cubic feet.

Efforts to extend the Drake Point gas field to the east of Melville Island and the Hecla gas field to the west of the Island will continue during 1977 by the drilling of additional wells from ice islands located offshore on permits in which Callahan and Pinnacle do not have interests. The Panarctic S.W. Hecla C-58 well will be located some six miles south of Panarctic's Hecla M-25 discovery. The Panarctic N.E. Drake P-40 well is currently drilling some twenty miles offshore to the northeast of Melville. Both wells will be drilled in 1,000 feet of water and are targeted for depths in excess of 4,000 feet.

Since March, 1972, some $2,680,000 has been contributed by Pacific Lighting Gas Development Company to fund the participation by Callahan and Pinnacle with Panarctic in the effort to find the 20-30 trillion cubic feet required for pipeline construction. The initial term of this financing arrangement ends in March of 1977. Negotiations are presently underway with Pacific relative to the first of five one-year extensions of its call on gas in return for further funding.

Of great significance to the continued success of the Arctic Islands program were several major financial commitments undertaken during the year in support of and supplementary to Panarctic's activities. Home Oil Company, a subsidiary of Consumers Gas (Ontario), has agreed to purchase approximately 2.5 million shares of Panarctic Oils Ltd. over





the next three years for a total of $30,500,000. One-third of this amount will be available in 1977 to Panarctic which hopes to spend some $70 million in the Arctic Islands this year. Near the end of November, 1976, a Canadian Arctic drilling consortium with Imperial Oil, Gulf Oil of Canada, Panarctic, and Petro Canada as participants was announced. These companies have agreed to spend $80 million over the next four years on Arctic Islands permits farmed in from Sun Oil of Canada and others. Most of the drilling will be offshore, including the above N. E. Drake P-40 well. This program represents the first entry by two of the largest major Canadian oil companies, Imperial and Gulf, into Arctic Islands exploration work.

The Polar Gas Project, which is planning and designing a pipeline from the Arctic Islands, has stated that it will make application in 1977 to Canadian authorities for required permits. Polar Gas reports that the line has been engineered; that various methods for laying the pipeline have been tested and proved; and that tunnels are being considered for certain water crossings. Panarctic has stated that reserves of 20 trillion cubic feet will support a 42-inch, 2200 mile line delivering 2 billion cubic feet per day to an existing system near Winnipeg; reserves of 30 trillion cubic feet could justify a 48-inch, 3200 mile line to Ontario with a minimum capacity of 3 billion cubic feet per day.

At a cost presently estimated at $10 billion, this pipeline project envisioned for the 1980's will undoubtedly require participation of worldwide sources of capital for completion. While studies show that Canada should have excess gas in the 1980's, a dwindling supply of Canadian oil is anticipated. Continued imports of oil will be required to meet Canada's needs. Balance of payments deficits will have to be offset, probably by gas sales at prices considerably higher than we are now seeing. These and other factors should help insure a unified effort to make this gas available to Canada and the balance of North America.

Other Natural Gas and Oil Interests: Modest amounts of revenue were recorded during 1976 from three producing oil wells in southern Illinois. These wells should return their cost within the next several years and continue as producers for a number of years thereafter.

In August of 1976, Callahan purchased 23.4% of the outstanding shares of K.R.M. Petroleum Corporation of Denver, Colorado which is engaged in the exploration, development, and operation of domestic oil and gas properties with production in Texas, the Rocky Mountains, and Mid-Continent areas. A total of 400,000 common shares were purchased for $2.375 per share and Callahan received a three-year option to purchase 150,000 additional shares at $2.75 per share. During 1976, K.R.M. earned $313,000 on sales of $1,477,000. Production totaled 117,300 barrels of oil and 409 million cubic feet of gas. Reserves at January 1, 1977 totaled 700,365 barrels of oil and 4.98 billion cubic feet of gas. K.R.M. shares are traded over-the-counter and are listed on NASDAQ. As of February 23, the bid price for these shares was $4.125.

Consolidated Statements of Income and Retained Earnings

for the years ended December 31, 1976 and 1975

	1976	1975
Revenues:		
Net sales—manufacturing	**$23,433,642**	$17,136,342
—mining (Coeur mine)	**226,661**	—
Galena mine	**4,069,090**	4,070,271
Interest and other income	**617,501**	751,309
	28,346,894	21,957,922
Costs and expenses:		
Manufacturing:		
Cost of goods sold	**15,911,353**	11,956,679
Selling	**2,156,922**	1,842,950
General and administrative	**2,251,309**	1,618,124
	20,319,584	15,417,753
Mining (Coeur mine)	**125,339**	—
Galena mine	**91,397**	93,019
Exploration, engineering and other mineral expenses (Note 10)	**2,088,515**	1,504,295
	22,624,835	17,015,067
Income before corporate expenses	**5,722,059**	4,942,855
Corporate	**907,818**	778,103
	4,814,241	4,164,752
Income taxes (Note 6)	**2,011,000**	1,351,000
Income before equity in net income of affiliated company	**2,803,241**	2,813,752
Equity in net income of K.R.M. Petroleum Corporation (Note 2)	**19,129**	—
NET INCOME	**2,822,370**	2,813,752
RETAINED EARNINGS:		
Beginning of year	**6,655,030**	5,578,502
	9,477,400	8,392,254
Dividends paid:		
Cash—$.30 per share	**1,064,920**	1,038,623
Stock—2%	**1,001,451**	698,601
	2,066,371	1,737,224
Retained earnings, end of year	**$ 7,411,029**	$ 6,655,030
EARNINGS PER SHARE	**$ .78**	$ .78
Weighted average shares outstanding	**3,620,491**	3,609,062

See notes to consolidated financial statements.

Consolidated Balance Sheets

December 31, 1976 and 1975

	1976	1975
Assets		
Current assets:		
Cash, including in 1976, interest-bearing time deposits	$ 789,797	$ 552,706
Short-term investments, at cost (approximates market)	9,877,157	8,759,251
Trade and other receivables	4,978,137	4,348,523
Inventories	2,273,323	2,465,860
Prepaid expenses	460,494	731,364
Total current assets	18,378,908	16,857,704
Property, plant and equipment, at cost (Note 5):		
Mineral properties, less accumulated depletion of: 1976—$1,152,689; 1975—$1,113,974	959,691	1,863,557
Plant and equipment:		
Land and buildings	2,119,372	2,079,417
Machinery and equipment	4,135,314	3,708,114
Other	562,007	479,274
Construction in progress	215,588	532,209
	7,032,281	6,799,014
Less accumulated depreciation	1,416,784	1,031,663
	5,615,497	5,767,351
Long-term investments (Note 2)	2,886,849	—
Exploration projects (Note 3)	4,020,277	3,797,840
Other assets	577,273	511,754
	$32,438,495	$28,798,206
Liabilities		
Current liabilities:		
Notes payable	$ 78,231	$ 309,638
Capitalized lease obligation (Note 9)	222,000	166,667
Accounts payable and accrued expenses	3,042,469	2,373,722
Federal income taxes	1,106,311	128,447
Total current liabilities	4,449,011	2,978,474
Long-term portion of notes payable (Note 9)	430,335	—
Capitalized lease obligation (Note 9)	1,611,335	1,833,333
Deferred income taxes	1,706,082	1,651,268
Minority interest	201,605	200,669
Shareholders' Equity		
Capital stock $3.00 par value (Note 4):		
Authorized 7,500,000 shares		
Shares: 1976 / 1975		
Issued — 3,717,645 / 3,646,955	11,152,935	10,940,865
Less treasury stock — 85,477 / 97,222		
Outstanding — 3,632,168 / 3,549,733		
Capital surplus (Note 4)	5,845,041	4,978,105
Retained earnings	7,411,029	6,655,030
	24,409,005	22,574,000
Less treasury stock, at cost (Note 4)	368,878	439,538
	24,040,127	22,134,462
	$32,438,495	$28,798,206

See notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

for the years ended December 31, 1976 and 1975

	1976	1975
SOURCES OF WORKING CAPITAL:		
Net income	$ 2,822,370	$ 2,813,752
Add (deduct) items not requiring outlay of working capital:		
Depletion, depreciation and amortization	596,613	295,190
Provision for deferred income taxes	(46,845)	368,784
Equity in net income of K.R.M. Petroleum Corporation	(19,129)	—
Cofer mine development costs expensed	572,730	—
Other	77,465	202,588
Provided from operations	4,003,204	3,680,314
Coeur mine investment recovered from development ore sales	267,991	—
Capitalized lease obligation	—	1,833,333
Receipt of cash surrender value of life insurance policies	12,540	104,354
Capital stock options and awards, net	50,491	99,120
Other	90,160	100,277
Total sources of working capital	4,424,386	5,817,398
USES OF WORKING CAPITAL:		
Property, plant and equipment	634,291	4,561,262
Cash dividends to shareholders	1,064,920	1,038,623
Long-term investments, net of long-term notes of $430,335	2,437,385	—
Capitalized lease obligation	222,000	—
Exploration projects and other costs deferred	15,123	136,865
Total uses of working capital	4,373,719	5,736,750
Increase in working capital	50,667	80,648
Working capital at beginning of year	13,879,230	13,798,582
Working capital at end of year	$13,929,897	$13,879,230
CHANGES IN THE COMPONENTS OF WORKING CAPITAL:		
Increases (decreases) in current assets:		
Cash and short-term investments	$ 1,354,997	$ (365,008)
Receivables	629,614	152,894
Inventories	(192,537)	(517,551)
Prepaid expenses	(270,870)	479,202
	1,521,204	(250,463)
Increases (decreases) in current liabilities:		
Notes and accounts payable and accrued expenses	437,340	241,696
Capitalized lease obligation	55,333	166,667
Federal income taxes	977,864	(739,474)
	1,470,537	(331,111)
Increase in working capital	$ 50,667	$ 80,648

See notes to consolidated financial statements.

Notes to Consolidated Financial Statements

1. Summary of Significant Accounting Policies

PRINCIPLES OF CONSOLIDATION—The financial statements include all companies in which voting control of more than 50% is held. Significant intercompany balances and transactions are eliminated. The equity method of accounting is used for affiliated companies in which significant voting control, normally 20% but not more than 50%, is held. Under this method, the Company's equity in the net income or loss of such affiliates is shown in the consolidated statement of income. The accounts of the Company's Canadian subsidiary are expressed in United States dollars at the current rate of exchange, except for inventories, property, plant and equipment and related depreciation which are translated at historical rates. Unrealized gains or losses on translation are credited or charged to income in the current period.

INVENTORIES—Inventories are stated at cost or market, whichever is lower. Cost is determined substantially by the average cost method although the first-in, first-out method is also used.

PROPERTY, PLANT AND EQUIPMENT—Property, plant and equipment is stated at cost. The depleted cost of mineral properties should not be considered as indicating the current value of the properties. Major plant and equipment additions and betterments are capitalized and maintenance and repairs are expensed. When property, plant or equipment is retired or sold, cost and related accumulated depreciation or depletion are removed from the respective accounts and the net difference, after taking into account any proceeds from disposition, is reflected as a charge or credit to income.

DEPRECIATION AND DEPLETION—Depreciation is provided primarily on the straight-line method although the declining balance method is also used. Such methods are employed so as to write off depreciable assets over their estimated useful lives. Depletion, based upon projected reserves, is provided on the unit of production method so as to amortize the cost of each mineral property over its estimated commercial life.

INTANGIBLE ASSETS—The cost of intangible assets, principally goodwill, is amortized on the straight-line method over periods of up to 40 years.

EXPLORATION AND DEVELOPMENT—Exploration expenditures are charged to earnings. For some projects, facilities expenditures may be necessary before exploration expenses are incurred; for example, surface installations, shafts and hoists. Such costs are capitalized and, if exploration is successful, are depreciated over the estimated life of the reserves or the estimated life of the facilities, whichever is shorter. If exploration is not successful, remaining capitalized costs are written down to realizable value. Development costs are those made after reserves are shown to exist in commercially marketable quantities but prior to the commencement of production. Such costs are capitalized and when production commences are amortized over the estimated life of the reserves.

REVENUES FROM GALENA AND COEUR—Revenues from the Galena and Coeur mines are accrued based upon deliveries of concentrates to smelters. The Company earns 50% of the "cash flow" from Galena operations which is determined by deducting from gross proceeds of sales, expenditures for equipment and buildings, as well as operating and development costs. With respect to the Coeur mine, the Company is entitled to 8⅓% of mine profits until such time as it recovers its $1,693,000 investment, following which it will have a 5% interest in mine profits.

INVESTMENT TAX CREDIT—Investment tax credits are accounted for by the flow-through method as a reduction of the provision for Federal income taxes.

EARNINGS PER SHARE—Earnings per share are based upon the weighted average number of shares outstanding during the year giving retroactive effect to stock dividends.

2. Long-Term Investments

Long-term investments of $2,886,849 include the cost of industrial land purchased in El Cajon, California at a cost of $707,500, the investment of $1,210,220 in sinking fund preferred stocks recorded at cost (market value $1,243,750), and holdings of 23.4% of the common stock of K.R.M. Petroleum Corporation ($969,129), which is carried at original cost adjusted for the Company's share of K.R.M.'s earnings since date of acquisition. The excess ($257,000) of the cost of the Company's investment over its share of K.R.M.'s underlying net assets at date of acquisition is being amortized over a period of forty years. The market value of the Company's investment in K.R.M. based upon the published bid price on February 23, 1977 was $1,650,000.

3. Exploration Projects

As indicated in Note 1, expenses for exploration are charged to earnings. Capitalized expenditures for exploration projects include primarily property acquisition and facilities and equipment costs incurred in order to carry out exploration work. Such costs for the Caladay Project aggregated $3,336,000 at December 31, 1976. The recovery of these costs is subject to the success of the project which cannot be forecast at this time. See page 4.

4. Capital Stock and Capital Surplus

The 1975 and 1976 changes in capital stock and capital surplus are summarized below:

	Shares of Capital Stock		Capital
	Issued	Treasury	Surplus
January 1, 1975	3,564,293	102,217	$4,323,115
2% stock dividend	69,139	2,043	469,909
Restricted stock purchases	10,402	(7,598)	166,679
Qualified stock option exercised	3,121	—	19,881
Restricted stock repurchased	—	560	(1,479)
December 31, 1975	3,646,955	97,222	4,978,105
2% stock dividend	70,690	1,945	758,502
Restricted stock purchases	—	(14,750)	115,316
Restricted stock repurchased	—	1,060	(6,882)
December 31, 1976	3,717,645	85,477	$5,845,041

Information relating to unissued and treasury shares of capital stock under option or available for grant or award is summarized as follows:

Restricted Stock Purchase Plan

In 1976, 14,750 shares were purchased by certain key employees under awards at prices ranging from $3.64 to $3.94 per share and 1,060 shares were repurchased by the Company at the original purchase prices ranging from $3.23 to $3.98 per share. At December 31, 1976, 715 treasury shares (as adjusted for the 2% stock dividend paid in 1976) were available for award at prices to be determined by the Board of Directors. The excess of fair market value at dates of award over purchase prices is amortized by charges to income over the periods of restriction on disposition of shares.

Qualified Stock Option Plan

The Corporation's Qualified Stock Option Plan expired on August 5, 1975. Information with respect to options granted prior to the expiration of the Plan is as follows:

	Shares
Under option at December 31, 1975	10,591
Options expired in 1976	(2,186)
Stock dividend adjustments	211
Under option at December 31, 1976 at prices ranging from $9.19 to $13.31 per share, all immediately exercisable	8,616

On February 23, 1977, the Board of Directors declared a 2% stock dividend payable March 30, 1977 to stockholders of record on March 4, 1977. Per share amounts and stock option data have been adjusted for stock dividends declared through December 31, 1976.

5. Depreciation and Depletion Expense

Depreciation totaled $548,915 and $269,870 in 1976 and 1975, respectively. Such amounts include depreciation on assets recorded under a capitalized lease. Depletion aggregated $38,715 and $23,832 in 1976 and 1975, respectively.

6. Income Taxes

The provision for income taxes is comprised of the following:

	1976	1975
Federal:		
Currently payable	**$1,715,000**	$ 786,000
Deferred	**(40,000)**	305,000
	1,675,000	1,091,000
State:		
Currently payable	**343,000**	196,000
Deferred	**(7,000)**	64,000
	336,000	260,000
	$2,011,000	$1,351,000

Deferred income taxes, which result from timing differences in the recognition of revenue and expense for tax and financial statement purposes, are comprised of the following:

	1976	1975
Development costs expensed on tax return and deferred on books (reversals)	**$(422,000)**	$416,000
Revenues included on books but deferred on tax return, net of statutory tax depletion	**317,000**	—
Difference between tax and book depreciation	**70,000**	—
Other	**(12,000)**	(47,000)
	$(47,000)	$369,000

Total tax expense is less than the amounts which would be provided by applying the statutory federal income tax rate of 48% to income before taxes for the years 1976 and 1975, as set forth below.

	(thousands of dollars)			
	1976		1975	
	Amount	**% of Pretax Income**	Amount	% of Pretax Income
Pretax income x 48%	**$2,311**	**48.0%**	$1,999	48.0%
Increases (reductions) in taxes resulting from:				
State income taxes (net of federal income tax benefit)	**175**	**3.6**	135	3.2
Statutory tax depletion	**(321)**	**(6.6)**	(316)	(7.6)
Investment tax credit	**(83)**	**(1.7)**	(181)	(4.3)
Income from tax-exempt notes	**(9)**	**(0.2)**	(142)	(3.4)
Reversal of prior years' tax reserves	**(29)**	**(0.6)**	(112)	(2.7)
Other	**(33)**	**(0.7)**	(32)	(0.8)
	$2,011	**41.8%**	$1,351	32.4%

7. Employee Plans

Substantially all parent company employees are covered by noncontributory retirement income plans. It is the policy to fund pension cost accrued. Total expense for the plans in 1976 and 1975 was $237,400 and $158,700, respectively, which includes amortization of prior service liability over periods of between 10 and 30 years. As of the most recent valuation date, January 1, 1976, vested accrued benefits exceeded the value of the pension funds by approximately $161,000.

In 1976, the shareholders approved an Employee Stock Ownership and Savings Plan for salaried employees of the Company and Pathway Bellows, Inc. Under this plan and Pathway's savings plan for hourly-paid employees, contributions of participants are matched by the Companies to the extent of 50% of employees' savings. Expense for these plans was $63,000 and $31,000 in 1976 and 1975, respectively.

Bonuses for certain key employees amounted to $67,000 in 1976 and $63,700 in 1975.

8. Lease Rentals

Rental expense (for offices, vehicles and equipment) for the years 1976 and 1975 was $265,680 and $323,294, respectively. The only material long-term noncancellable lease, discussed in Note 9, is capitalized.

9. Long-Term Debt

LEASE OBLIGATION—The Company is the guarantor of a ten-year $2,000,000 bond issue of The Industrial Development Board of the City of Oak Ridge, Tennessee which financed the construction of Pathway Bellows, Inc.'s Oak Ridge facility. Plant and equipment recorded under this capitalized lease aggregated $1,800,576 (net of accumulated depreciation of $199,424) and $1,951,857 (net of accumulated depreciation of $48,143) at December 31, 1976 and 1975, respectively. Pathway has leased the facility for a ten-year period with the right to renew for two successive five-year periods or to purchase the facility at minimal cost upon fulfillment of lease obligations. Rentals under the lease are equal to an amount sufficient to pay the principal of and interest on the bonds. Outstanding principal, $1,833,335 at December 31, 1976, bears interest at a rate equal to 82% of The Chase Manhattan Bank's prime commercial lending rate which was 6.0% at year-end.

OTHER—In connection with industrial land purchases made during 1976, the Company has obligations totaling $473,566, of which $63,231 is current, under mortgages maturing from 1982 to 1987 and bearing interest at rates ranging from 7% to 8½%.

10. Piedmont Mineral Associates

Based upon preliminary analysis of results, underground work at the Cofer property was suspended in July 1976. In the same month, an after-tax charge of approximately $70,000, 2¢ per share, was made against earnings to reflect estimated impairment in the carrying value of the property. Following completion in January 1977 of a detailed study, a decision was made to defer moving the property toward production and remaining capitalized development costs, net of taxes, of $285,000, or 8¢ per share, were charged against fourth quarter earnings.

11. Unaudited Quarterly Results

	Dollars in Thousands Except Per Share Amounts	
Quarter Ended	1976	1975
Revenues:		
March 31	$ 6,419	$ 5,122
June 30	7,327	5,372
September 30	6,810	5,478
December 31	7,791	5,986
Total	$28,347	$21,958
Income before income taxes:		
March 31	$ 1,105	$ 1,193
June 30	1,646	1,286
September 30	1,111	900
December 31	952	786
Total	$ 4,814	$ 4,165
Net income:		
March 31	$ 613	$ 741
June 30	920	801
September 30	652	650
December 31	637	622
Total	$ 2,822	$ 2,814
Earnings per share:*		
March 31	$ .17	$ .21
June 30	.25	.22
September 30 (Note 10)	.18	.18
December 31 (Note 10)	.18	.17
Total	$ .78	$ .78

* 1975 earnings per share figures have been adjusted to reflect the 2% stock dividend paid in April 1976.

Financial Review

Five Year Summary (000's omitted)

	1976	1975	1974	1973	1972
Revenues:					
Net sales—manufacturing:					
Pathway Bellows, Inc.	**$17,457**	$12,083	$ 7,320	$ 3,213	$ 2,841
The Flexaust Company	**5,977**	5,053	5,326	4,757	3,682
	23,434	17,136	12,646	7,970	6,523
Net sales—mining (Coeur mine)	**227**	—	—	—	—
Galena mine	**4,069**	4,070	5,751	2,789	1,486
Interest and other income	**617**	752	744	663	390
Gains on sales of investments, principally silver	**—**	—	870	445	—
Total revenues	**28,347**	21,958	20,011	11,867	8,399
Costs and expenses:					
Manufacturing	**20,320**	15,418	10,475	6,500	5,169
Mining (Coeur mine)	**125**	—	—	—	—
Galena mine	**91**	93	157	86	69
Exploration, engineering and other mineral expenses	**2,089**	1,504	1,394	489	547
	22,625	17,015	12,026	7,075	5,785
Income before corporate expenses	**5,722**	4,943	7,985	4,792	2,614
Corporate	**908**	778	988	756	775
	4,814	4,165	6,997	4,036	1,839
Income taxes	**2,011**	1,351	2,718	1,648	823
Income before equity in net income of affiliated company	**2,803**	2,814	4,279	2,388	1,016
Equity in net income of K.R.M. Petroleum Corporation	**19**	—	—	—	—
	2,822	2,814	4,279	2,388	1,016
Income from discontinued operation	**—**	—	—	—	160
	2,822	2,814	4,279	2,388	1,176
Extraordinary item	**—**	—	—	—	187
Net Income	**$ 2,822**	$ 2,814	$ 4,279	$ 2,388	$ 1,363
Earnings per share:					
Continuing operations	**$ .78**	$ .78	$1.19	$ .66	$ .29
Discontinued operation	**—**	—	—	—	.04
Extraordinary item	**—**	—	—	—	.05
Net Income	**$ .78**	$ .78	$1.19	$ .66	$ .38
Weighted average shares outstanding	**3,620**	3,609	3,602	3,605	3,598
Income by lines of business (before unallocated general exploration, engineering and other mineral expenses, corporate expenses and income taxes):					
Manufacturing	**$ 3,114**	$ 1,718	$ 2,171	$ 1,470	$ 1,354
Mining:					
Galena mine	**$ 3,978**	$ 3,977	$ 5,594	$ 2,703	$ 1,417
Coeur mine	**102**	—	—	—	—
Total mining	**$ 4,080**	$ 3,977	$ 5,594	$ 2,703	$ 1,417
Dividends:					
Cash	**$ .30**	$ .30	$ .15	—	—
Stock	**2%**	2%	2%	3%	—
Shareholders' equity	**$24,040**	$22,134	$20,116	$16,381	$14,033
Working capital	**$13,930**	$13,879	$13,799	$11,274	$ 8,610
Ounces of silver produced (100% of mine production):					
Galena mine	**3,421**	3,350	3,486	4,192	4,222
Coeur mine	**661**	—	—	—	—
Average New York silver price (Handy & Harman)	**$4.35**	$4.42	$4.71	$2.56	$1.68

Financial Review

Net income in 1976 of $2,822,000 was slightly ahead of 1975's $2,814,000 despite after-tax charges against 1976 earnings of $355,000, or $.10 per share, for previously capitalized development costs at the Cofer property of Piedmont Mineral Associates. 1976 saw record levels attained for manufacturing sales and profits, as well as initial participations in profits of the Coeur silver mine and an equity interest in the oil and gas earnings of K. R. M. Petroleum Corporation. Based on 1976 net income, a 12.2% return on average shareholders' equity was earned for the year.

Internally generated working capital in 1976 was sufficient to pay a cash dividend of $1,065,000, $.30 per share, provide for capital expenditures of $634,000, meet capitalized lease obligations of $222,000, and fund the major portion of long-term investments of $2,887,000 as described in Note 2 to the consolidated financial statements.

Callahan's balance sheet position continues strong. Total assets went over the $30 million mark during the year and stood at $32,400,000 as of December 31, 1976. Shareholders' equity climbed to $24,000,000. At year-end, the ratio of current assets to current liabilities was 4.1 to 1 and working capital was $13,900,000. With its sound financial condition and borrowing capacity, Callahan is in a strong position to finance new investments as opportunities are developed.

Analysis of Five Year Summary

1976 Compared With 1975

Manufacturing: Sales of Pathway Bellows, Inc. increased by approximately 45% over 1975 and pretax profits more than doubled. These increases are attributable to higher levels of capital spending by Pathway's customers in the power generation, petrochemical, nuclear, and pollution control fields. The opening of the Oak Ridge, Tennessee plant in September 1975 provided additional manufacturing capacity to accommodate Pathway's growing sales volume. Order backlog at December 31, 1976 was $11,600,000 as compared with $10,400,000 at December 31, 1975.

Sales of The Flexaust Company division increased by 18% over 1975 and pretax profits showed a 21% improvement. These increases were due to intensified marketing efforts and growth in product demand during 1976.

Mining: The Coeur silver mine was placed on an operating basis effective September 1, 1976. Callahan is entitled to 8⅓% of mine profits until such time as it recovers its $1,693,000 investment and will thereafter have a 5% interest in such profits.

Interest and other income: The decline in interest and other income in 1976 compared to 1975 resulted from lower short-term interest rates prevailing during 1976 as well as a reduction in average funds available for investment.

Exploration, engineering, and other mineral expenses: The level of this expense increased over 1975 because, as discussed above, previously capitalized development costs at the Cofer property of Piedmont Mineral Associates were charged against 1976 earnings. Significant fluctuations in exploration expense can occur from year to year depending upon the number and cost of programs underway.

Corporate: The higher level of Corporate expense in 1976 over 1975 is attributable primarily to increased compensation of personnel, higher retirement income plan costs, including adoption of modifications required to comply with the Employee Retirement Income Security Act of 1974, increased professional fees, and the cost of the Employee Stock Ownership and Savings Plan approved by the shareholders in April 1976.

Income taxes: Higher taxes on income in 1976 reflect the increased level of pretax earnings (most of which came from manufacturing income which is subject to a higher effective rate of taxation), a reduction in investment tax credits to $83,000 from $181,000 in 1975 because of substantially reduced capital expenditures, a decrease in tax-exempt interest income, and lower reversals of prior years' tax reserves.

1975 Compared With 1974

Manufacturing: Sales of Pathway Bellows, Inc. increased by 65% in 1975 over 1974. This increase was attributable to higher levels of capital spending by the company's customers as well as Pathway's obtaining an increased share of markets served. Profits were down by 31% from 1974 due to increased operational costs experienced while doubling manufacturing capacity through the addition of a new plant at Oak Ridge, Tennessee, and to cost overruns in completing several major orders during the year.

The Flexaust Company's footage of hose and duct shipped during 1975 was down substantially compared to 1974 due to the general business recession. However, sales in dollars were close to those of 1974 because of price adjustments made to offset inflated costs. Earnings were off by less than 10%.

Galena mine: Revenues from the Galena mine in 1975 were down 29% from the prior year as the result of a lower average silver price, an increase in labor and other operating costs, and reduced ounces of silver sold.

Gains on Investments: Gains on investments in 1974 include gains on sales of silver which will not recur in future years barring further investment. In 1974, the balance of silver bullion remaining from the investment in 2,000,000 ounces made in 1966 was sold. Also in 1974, the Company sold at a profit its investment in Day Mines, Inc. common stock.

Corporate: The reduction in Corporate expenses in 1975 compared with 1974 primarily reflects the absence of expenses incurred in relocating the Company's headquarters to Darien, Connecticut from New York City in June 1974.

Income taxes: The decrease in income taxes in 1975 from 1974 was due to lower pretax earnings, substantially higher investment tax credits, and reversals of prior years' tax reserves.

Auditors' Opinion

Coopers & Lybrand
One North Broadway
White Plains, New York 10601

To the Board of Directors and
Shareholders of
CALLAHAN MINING CORPORATION

We have examined the consolidated balance sheets of Callahan Mining Corporation and Subsidiaries as of December 31, 1976 and 1975 and the related consolidated statements of income and retained earnings and of changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The Company's investment in the Caladay Project is carried at cost, the recovery of which is subject to the success of the project which cannot be forecast at this time, as described in Note 3 to the consolidated financial statements.

In our opinion, subject to the effects on the financial statements of the ultimate realization of the carrying value of the investment in the Caladay Project, the aforementioned consolidated statements present fairly the financial position of Callahan Mining Corporation and Subsidiaries at December 31, 1976 and 1975 and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Coopers & Lybrand

February 18, 1977; with respect to Note 4, February 23, 1977.

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Petroleum Engineer

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Consulting Professor, Stanford University

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Registrar and Transfer Agent

The Bank of New York,
New York, N. Y.

Stock Listed

New York Stock Exchange—Symbol CMN

Availability of 10-K Form

Copies of the Corporation's Annual Report to the Securities and Exchange Commission on Form 10-K are available upon request.

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