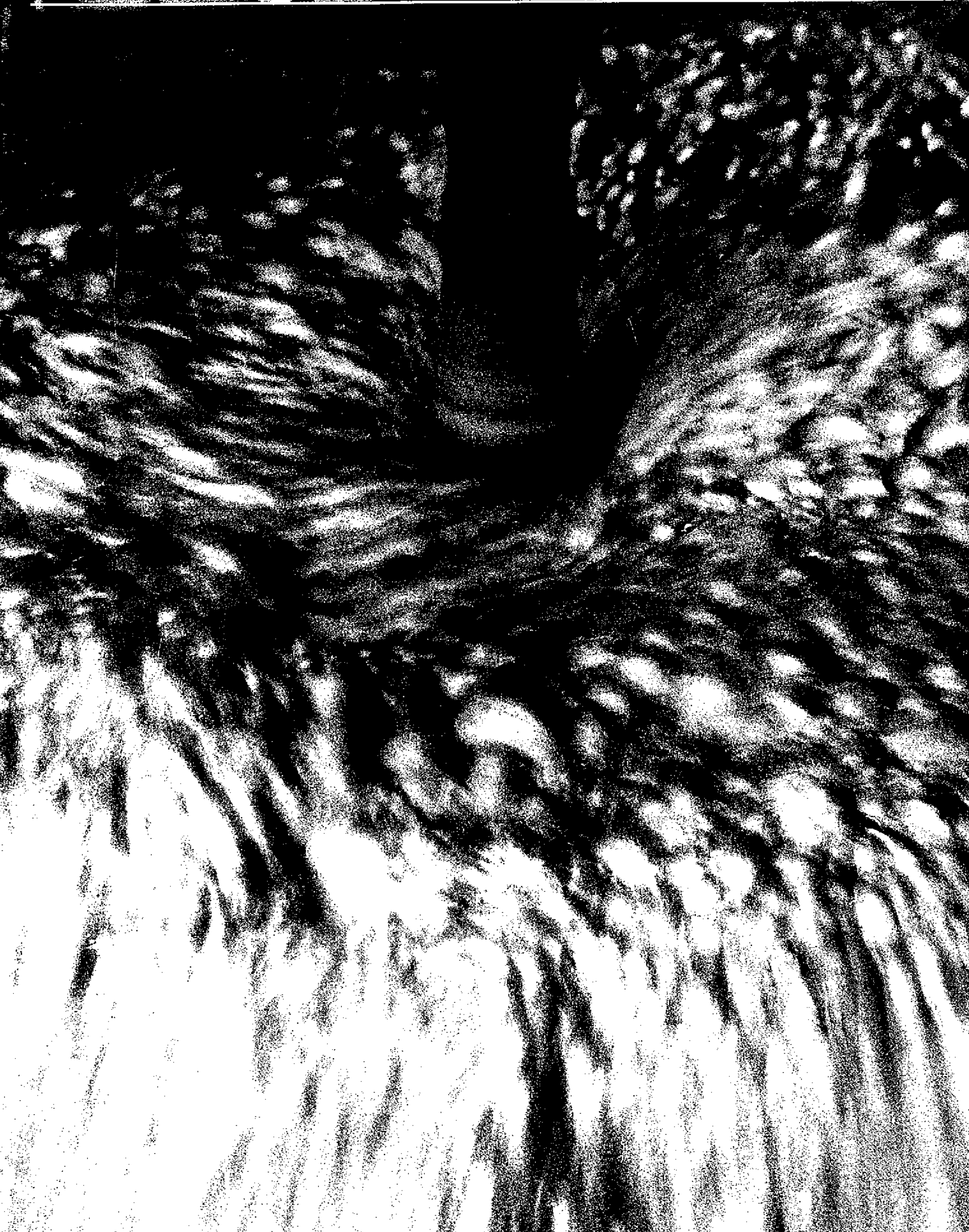
Callahan Mining Corporation 1977 Annual Report



Callahan

Callahan Mining Corporation, as owner, receives 50 percent of cash flow from operations at the Galena mine in Idaho, the country's second largest silver mine. Callahan also receives one-twelfth of income from the Coeur silver mine and continues to participate in a variety of other mining projects. Pinnacle Exploration, Inc., Callahan's 80% owned subsidiary, has a 15% interest in a major uranium project in Colorado.

The Company has two manufacturing operations: Pathway Bellows, Inc. is the nation's leading supplier of metallic expansion joints used in power generation, petrochemical and energy-related industries; and The Flexaust Company is a principal producer of lightweight flexible hose and duct for industrial applications.

Callahan and Pinnacle hold interests in a substantial amount of natural gas in the Canadian Arctic Islands. Callahan also owns 23.3% of the outstanding shares of K.R.M. Petroleum Corporation of Denver.

Highlights

	1977	1976*
Net Sales—Manufacturing	$24,363,000	$23,434,000
Net Sales—Mining (Coeur Mine)	$ 907,000	$ 227,000
Revenue from Galena Mine	$ 4,038,000	$ 4,069,000
Interest, Dividends and Other Income	$ 612,000	$ 571,000
Total Revenues	$29,920,000	$28,301,000
Net Income	$ 3,155,000	$ 2,822,000
Per Share	$ .85	$ .76
Weighted Average Shares Outstanding	3,702,000	3,691,000
Shareholders' Equity	$25,886,000	$24,040,000
Working Capital	$14,273,000	$13,930,000
Ounces of Silver Sold (100% of mine shipments):		
Galena Mine	3,480,000	3,692,000
Coeur Mine	2,306,000	614,000
Average New York Silver Price (Handy & Harman)	$ 4.62	$ 4.35

* Certain items have been reclassified to conform with the Company's 1977 financial statement presentation.

Annual Meeting

The 1978 Annual Meeting of Shareholders will be held on the Third Floor, CBT Plaza, 1120 Post Road, Darien, Connecticut on April 10, 1978 at 10 o'clock in the morning. We hope as many shareholders as possible will attend.

Cover: Silver-rich froth bubbling from a flotation cell in the milling process at the Galena mine.

To Our Shareholders

Nineteen seventy-seven was a year of improved earnings for Callahan.

Net income totaled $3,155,000, or $.85 per share, a 12 percent increase over the $2,822,000, or $.76 per share reported in 1976. Revenues for 1977 rose to $29,920,000 from the $28,301,000 reported in the prior year.

A major contributor to the earnings increase was a full year of revenues from Callahan's 8⅓ percent interest in the Coeur silver mine which operated for only four months in 1976. Also, charges for exploration and other mineral activities were lower than in 1976 when previously capitalized costs at the Virginia Piedmont project were written off.

Revenues from the Galena mine—Callahan's major source of silver income—showed a strong recovery in the fourth quarter and came in at $4,038,000 for the year compared to $4,069,000 in 1976. While results at Galena benefited from an increase in the average price for silver from $4.35 per ounce in 1976 to $4.62 last year, 6 percent fewer ounces were sold than in 1976 and operating costs at the mine continued their upward trend.

On the manufacturing side, the Flexaust Company reported a gain in earnings. Profits at Pathway Bellows, Inc. were down slightly for the year as this unit's operating efficiencies were affected by the continued lag in industrial capital spending.

A more detailed analysis of 1977 projects and results in each of the company's three areas of activity is provided on pages 4-8 of this report.

Outlook for 1978: Silver pricing is still the dominant factor in Callahan's earnings. While higher silver prices should prevail in future years, short-term price forecasting remains difficult. Most of the factors which have recently affected silver's price will continue to do so during 1978. Gold's price, general business conditions, and potential government stockpile sales will all play their part in this scenario. Inflation seems certain to persist worldwide as does the historic shortfall in mine production versus consumption. This latter gap has in recent years been covered by such aboveground sources as exports from India, coin melt, and scrap. However, barring a major influx of silver into the market through government stockpile sales or otherwise, silver's price should average higher in 1978 with its attendant benefits to Callahan. In manufacturing, the company's other principal source of income, strong demand for Flexaust products is expected to continue; and Pathway should benefit from the major $10 million government contract it was awarded last year, with initial revenues starting in the second quarter.

The company continues its work toward adding new revenue-producing interests for the future. Some comments about growth direction and strategies are provided in the questions and answers on the facing page.

Other activities: At the company's 1977 annual meeting, Roger M. Keefe was newly elected to the Board of Directors. Mr. Keefe is vice chairman of CBT Corporation and its principal subsidiary, The Connecticut Bank and Trust Company. He replaced Joseph T. Hall, who did not stand for re-election. Mr. Hall served as president of Callahan for 27 years and was a director of the company for almost 40 years. On behalf of all who are interested in our company, I express our sincere appreciation to him for his good service to Callahan over the years.

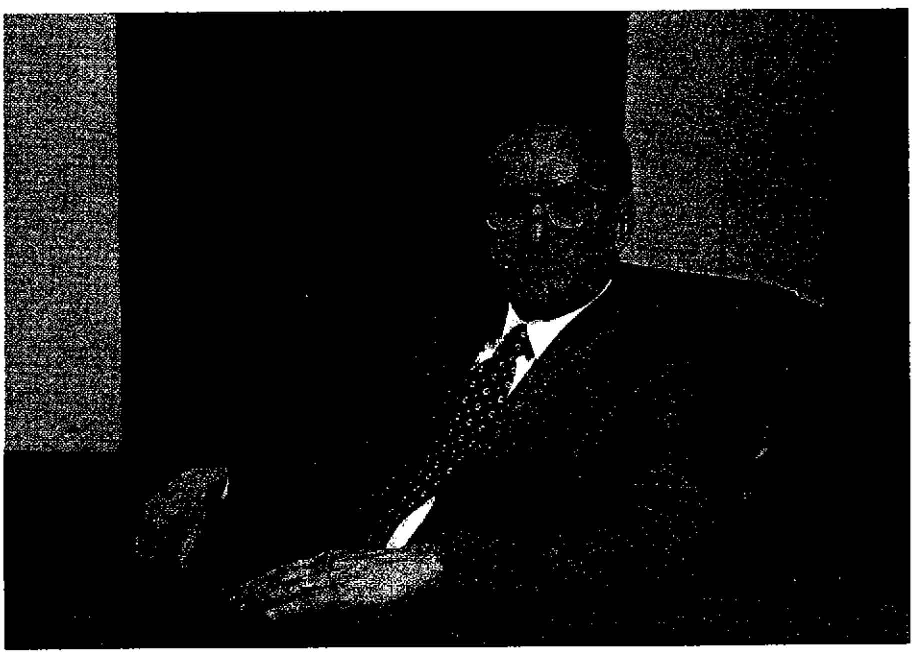
During 1977, the Board of Directors increased the cash dividend from $.30 per share to $.35 per share. The total annual dividend paid in 1977 was $.35 per share in cash and 2 percent in stock.

At a meeting held today, the Board of Directors declared for 1978 an increased cash dividend of $.40 per share and a 2 percent stock dividend payable on March 30, 1978 to shareholders of record on March 10, 1978.

Charles D. Snead, Jr.

Charles D. Snead, Jr.
President

February 28, 1978



Callahan: The Future

What are Callahan's plans for future expansion to sustain earnings growth? The following questions were asked in a year-end conversation with President Charles Snead:

Q. Will the mining business continue to be an important factor in Callahan's future?

A. Yes, we're committed to it. Although metals markets and profit margins in many operations are currently depressed, we feel this is a good time to take positions in properties, rather than having to scramble for an interest when a particular mineral becomes attractive. There still appear to be good opportunities for a company of our size.

Q. What are the criteria for selection of the opportunities?

A. First, we're concentrating on certain minerals—those which we feel have attractive future price potential. There are many minerals of which the United States is a large net importer and some of these have not, in our opinion, been fully explored for domestically.

Q. What commodities might you pursue?

A. There are five basic categories: Precious metals—we've got a good position in silver and we'd like to expand it; base metals—we're interested in lead properties and are already positioned in zinc, though we may have to wait several years for price improvement; the so-called minor metals—we like tungsten, as evidenced by our current exploration program through a newly established venture in California; we're also interested in barite and other industrial minerals; and in the category I'd call energy minerals, there could be added opportunities for us in uranium, although this area is very competitive at the present time. In other words, we're striving for a balanced approach.

Q. How do you plan to achieve it?

A. We would like to grow through acquisition in this area but frankly see very few opportunities within our size range for acquiring going operations or companies that have a good position in these minerals; we know, we've screened them. The growth will probably have to come through internal development, either through our own projects or joint ventures with other companies.

Q. Will this mean a longer wait for return on investment?

A. As compared to buying an ongoing operation—probably. However, we've been concentrating on what I'd classify as "shorter-term opportunities"—properties where we feel lead time to production can be shortened for one reason or another. Then, too, we're revising our technological and economic approach to some properties. At our Virginia Piedmont project for example, we're evaluating potential return from the production of a sulfur product in addition to base metals.

Q. What about Callahan's other interests—manufacturing and oil and gas? Where do you see these going?

A. Manufacturing has been good to us. While we're making a major effort to increase our involvement in natural resources, we're still looking for growth in manufacturing and have considered a good number of acquisition opportunities in this area over the last year, some of which are still active. In oil and gas, we're interested primarily in the exploration side of the business, not refining, gas transmission, or other sectors. We believe exploration is the right area for a company like Callahan.

Q. How will you expand in oil and gas?

A. We continue to pursue acquisition possibilities, both public and private, that have resulted from careful screening. These and other contacts have also raised opportunities for joint participation with companies in the industry which already have a good track record of finding oil and gas or acquiring attractive land positions. We are working on several proposals of this type and are prepared to dedicate exploration funds to the effort as soon as arrangements can be finalized.

Q. Has there been any progress on acquisition studies in this or other areas of interest?

A. Although we have no major reportable results to date, we've had serious discussions with many companies—and they're still in progress. In some instances, we determined that our interest was not there; in others, we could not reach an agreement. When you're evaluating companies in all sectors of interest—oil and gas, mining and manufacturing—it takes time. We've made progress, and are confident that it will pay off.

Q. How would you summarize Callahan's prospects for the future?

A. We're well poised for future growth. Silver will continue to generate good earnings. We have a solid base in manufacturing earnings to help offset silver price fluctuations. We've developed some attractive long-term interests in natural resources and are aggressively seeking other interests in this area. We have a good cash flow and a reasonable amount of funds to finance new projects. In short, we're enthusiastic about the future and feel we're steadily moving toward accomplishment of our objectives.

Mining

A full year of production at the Coeur mine, which began generating income in late 1976, helped Callahan increase its aggregate pretax silver earnings in 1977. While Coeur results were up, revenues from the Galena mine were slightly lower. Fewer ounces of silver were sold by Galena during the year and increased operating costs in part offset the effect of higher silver prices.

Galena Mine: Owned by Callahan and operated by Asarco Incorporated under a long-term lease, the Galena mine produced 1977 revenues of $4,038,000 compared to $4,069,000 in 1976. Under its arrangement with Asarco, Callahan receives 50 percent of cash flow from Galena operations.

Operating costs for the year increased from $2.26 per ounce to $2.33 per ounce. Although the cost increase was not as dramatic as in recent years, it is a trend that will continue as a result of rising costs of labor and supplies.

Ore milled totaled 177,704 tons with an average grade of 21.45 ounces of silver compared with 182,272 tons with a grade of 19.47 ounces of silver milled in 1976.

Much of the development work performed during the year was devoted to advancing the principal access workings on the 4900 foot level, including the main crosscut toward the footwall area of the Silver vein and a drive to connect the No. 3 shaft station with the projected downward location of the Galena shaft.

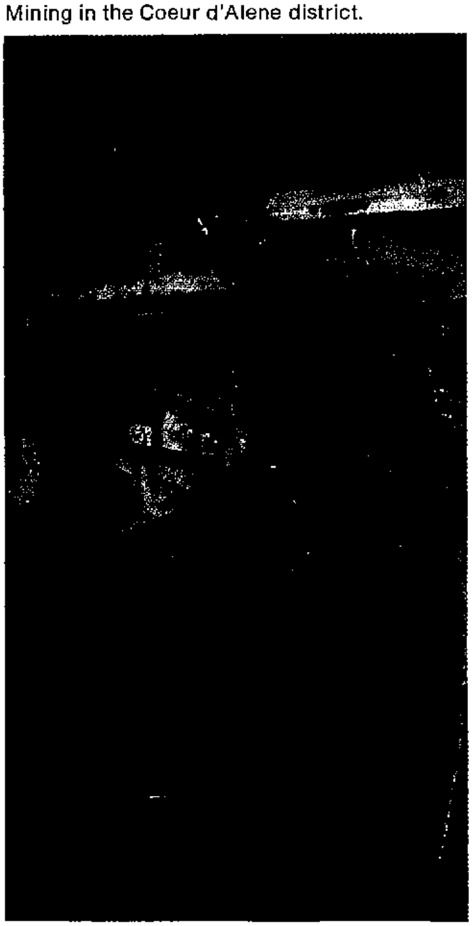
At year-end, ore reserves were lower than at the end of 1976 due in part to recalculation at a higher cutoff grade because of higher mining costs. Reserves continue to be sufficient for more than six years' operation at current mining rates.

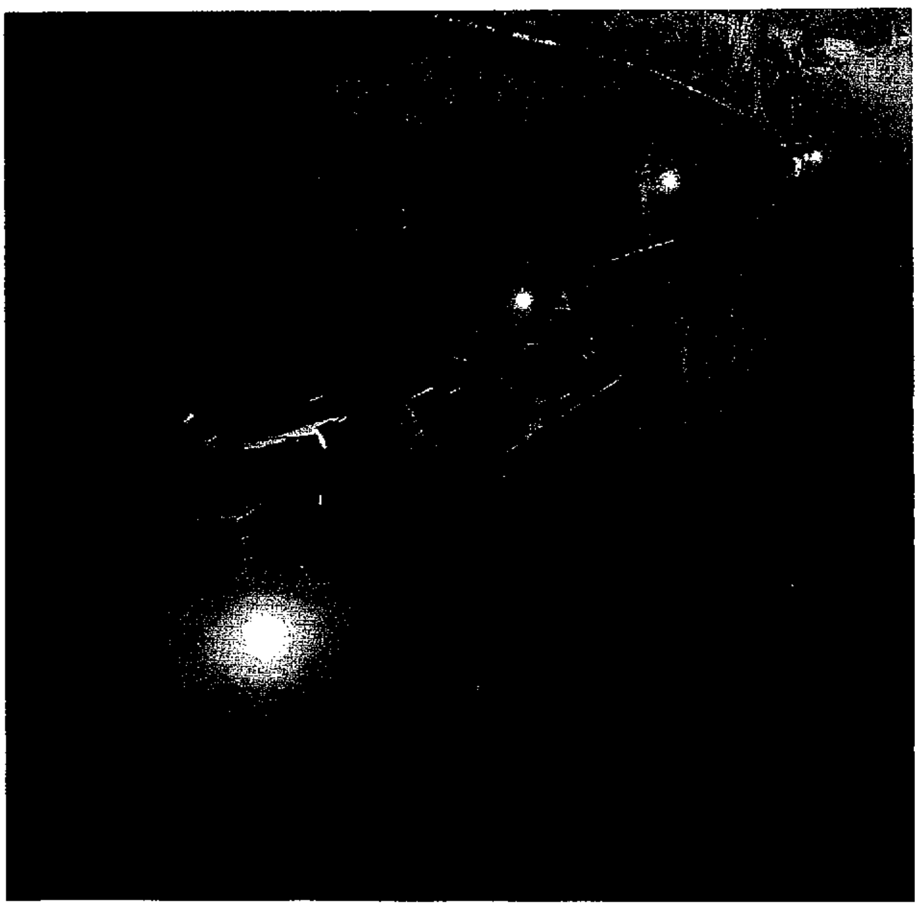
In January of 1978, a new three-year labor contract was negotiated by Asarco with the Galena work force. This agreement continues the enviable record of harmony with labor which has prevailed for the past nine years. Under the settlement, increases in direct wages and benefits will total approximately $1.04 per hour over the life of the contract.

Coeur Mine: Mill production in 1977 at Coeur, which adjoins the Galena mine to the west, totaled 146,924 tons of ore with an average grade of 16.59 ounces of silver. The Coeur output added $436,000 to Callahan's pretax earnings in 1977. Callahan at year-end had recovered $791,000 of its initial $1,693,000 investment in the mine. The company is entitled to 8⅓ percent of mine profits until the investment is fully recovered, and 5 percent of profits thereafter. Asarco, operator and manager of the mine, reported at year-end that ore reserves were increased by development work during the year and are sufficient for 6 years of operation, assuming current production rates.

Pinnacle Exploration, Inc.: Callahan's 80 percent owned subsidiary, Pinnacle Exploration, Inc., retains a 15 percent carried interest in the Pitch uranium properties which Homestake

Mining in the Coeur d'Alene district.





Mining Company has under development in Colorado. In late 1977, The Mined Land Reclamation Commission of Colorado granted a permit for mining work at the property. Homestake's application for construction of a mill will not be acted upon until the latter part of 1978 following completion of environmental impact statements. Stripping in preparation for mining should begin on the Pitch property during the spring of 1978. At year-end 1977, Homestake had invested a total of $5.6 million in this project.

Other Mining Interests: To date, Callahan has been unable to reach a revised agreement for exploration of the Caladay property with Asarco and Day Mines, Inc., the company's partners in this project. Studies and negotiations were conducted among the three companies throughout 1977 and are continuing. The property would be explored from one or more levels of the Galena mine on a basis that will not disrupt or curtail operations at Galena.

Near year-end, agreement was reached between Callahan and 76 Mines, Inc. for exploration of a tungsten property in California. Exploration work, including drilling and bulk sampling, is underway. If encouraged by the results of the program, Callahan can acquire up to 61 percent interest in the project.

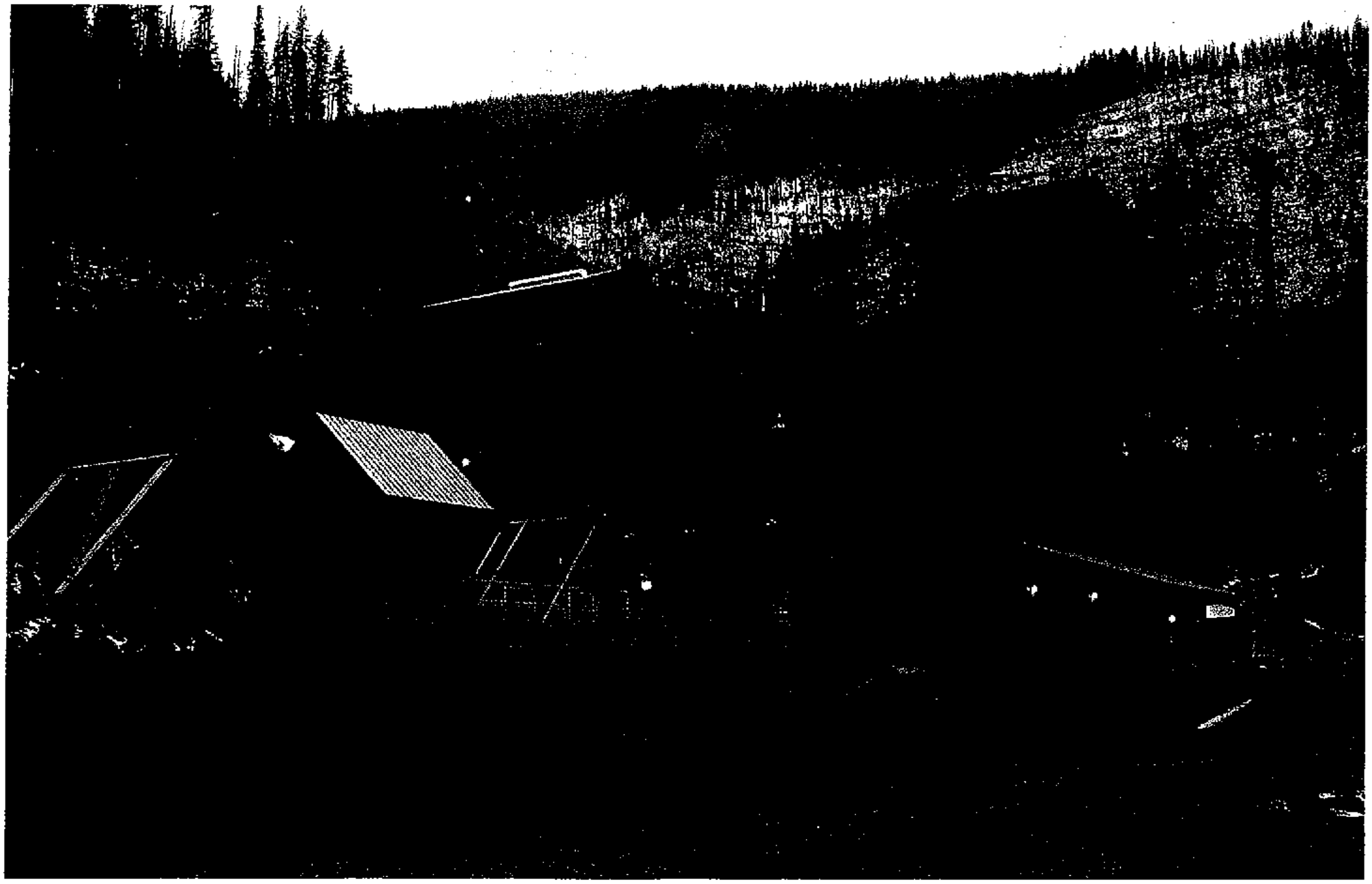
Within the past several weeks, lease arrangements in effect at the Alaskan placer gold properties of Livengood Placers, Inc. (80 percent owned) have been terminated by Livengood because of failure to meet certain provisions of the lease. During 1977, sluicing of gold-bearing gravel from the properties recovered some 1400 ounces of gold. A future program for the properties is under study.

Following decision in early 1977 to terminate work and write down previously capitalized costs at the Cofer property of Piedmont Mineral Associates in central Virginia, exploration for base metals in this area has been continued on a reduced basis. No significant additions to mineralization have resulted to date. However, one of the properties held by Piedmont Minerals is currently being evaluated with a view toward producing a sulfur product in addition to base metal concentrates.

During the year, Callahan and its two partners decided to terminate work at the Washington Zinc Unit in eastern Washington. Economic operations of sufficient size to be of interest to the joint participants did not appear feasible at current or foreseeable prices for zinc. Since that time, efforts have been made to turn the project over to a single company. Several companies have expressed interest in acquiring a position in these properties, but no firm offers have been received to date. Callahan's interest in the mill and other assets at the project has been written down by $39,000 after-tax to reflect current realizable value of these items.

Callahan still retains ownership in the Ropes Gold property near Ishpeming, Michigan subject to a 3 percent production royalty. The property remains inactive pending a sustained higher price for gold.

Mill at the Coeur mine.



Manufacturing

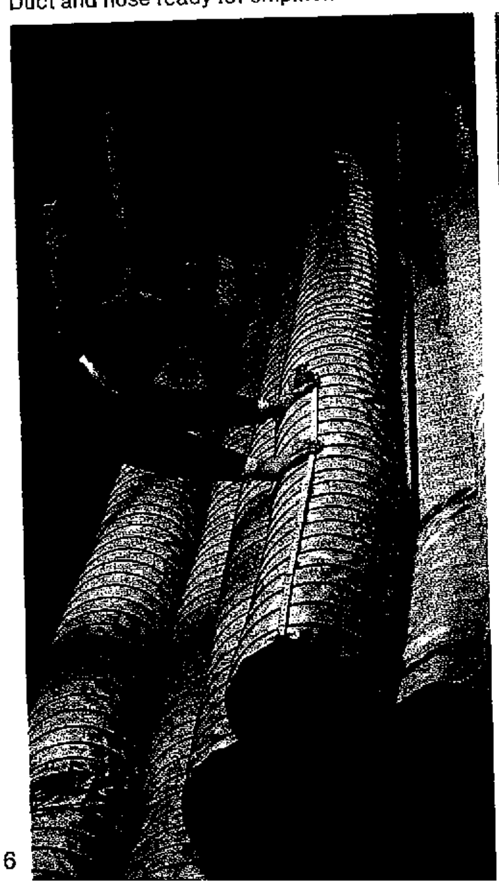
Combined sales from Callahan's two manufacturing units increased 4 percent to $24,363,000 in 1977. Profits from this group, however, fell just short of those turned in for 1976. Strong demand for lightweight hose and duct enabled The Flexaust Company to post record sales and a gain in profits. Pathway Bellows, Inc. reported a slight decline in profits, as operating efficiencies, particularly during the first six months, were adversely affected by the continued lag in industrial capital spending.

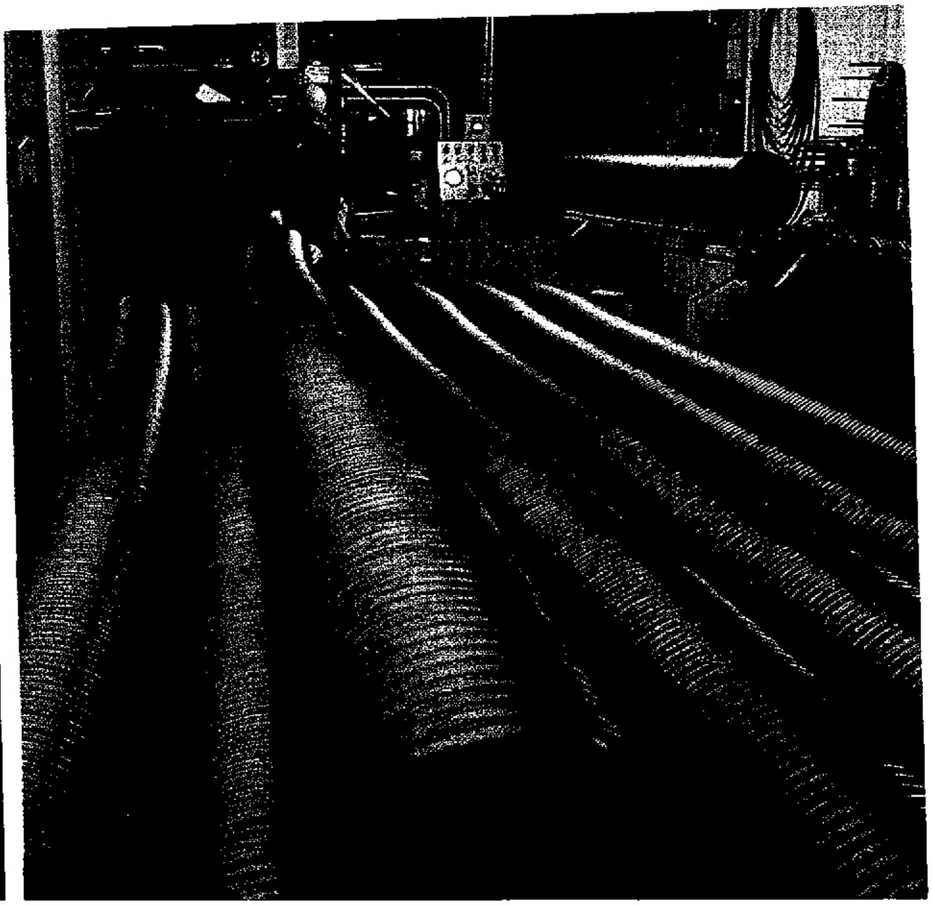
Flexaust and Pathway entered into their first common venture in 1977 through a licensing agreement with the Kléber group in France for the manufacture and marketing of rubber expansion joints in the U.S. and Canada. Marketing efforts are already underway for this line of products under the SPANFLEX name. Production of certain items in the United States will begin in the second quarter upon completion of manufacturing facilities.

The Flexaust Company: In addition to the licensing agreement with the Kléber group, Flexaust entered into two other joint ventures in 1977: Flexadux, a new U.S. company, was formed in partnership with a European producer to make and sell plastic industrial hose in this country and Canada; and Flexaust GmbH was established in West Germany to produce and market Flexaust's regular line of wire-reinforced neoprene-coated fabric hose in Europe. In both joint ventures, Flexaust and its partner will share equally in costs and profits.

While major emphasis was placed last year on expanding markets for the existing Flexaust line, research continued to develop new products. Good progress was made toward developing a line of silicone rubber hose for higher temperature applications.

Duct and hose ready for shipment at Flexaust.



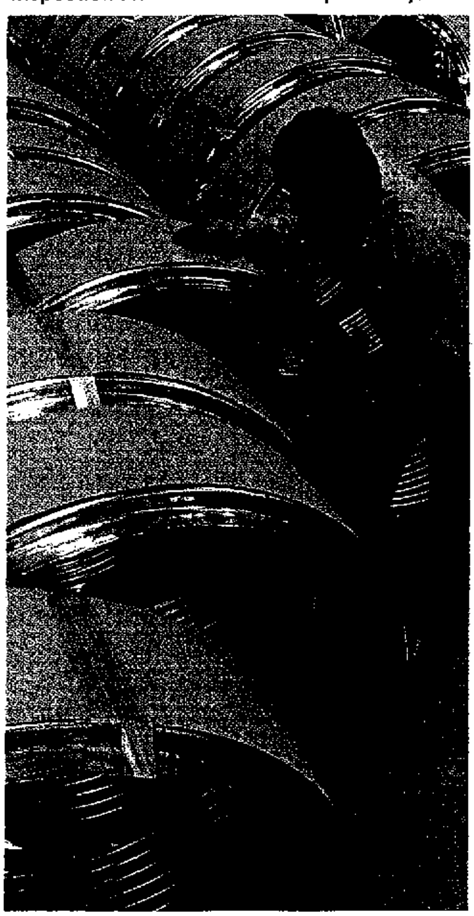


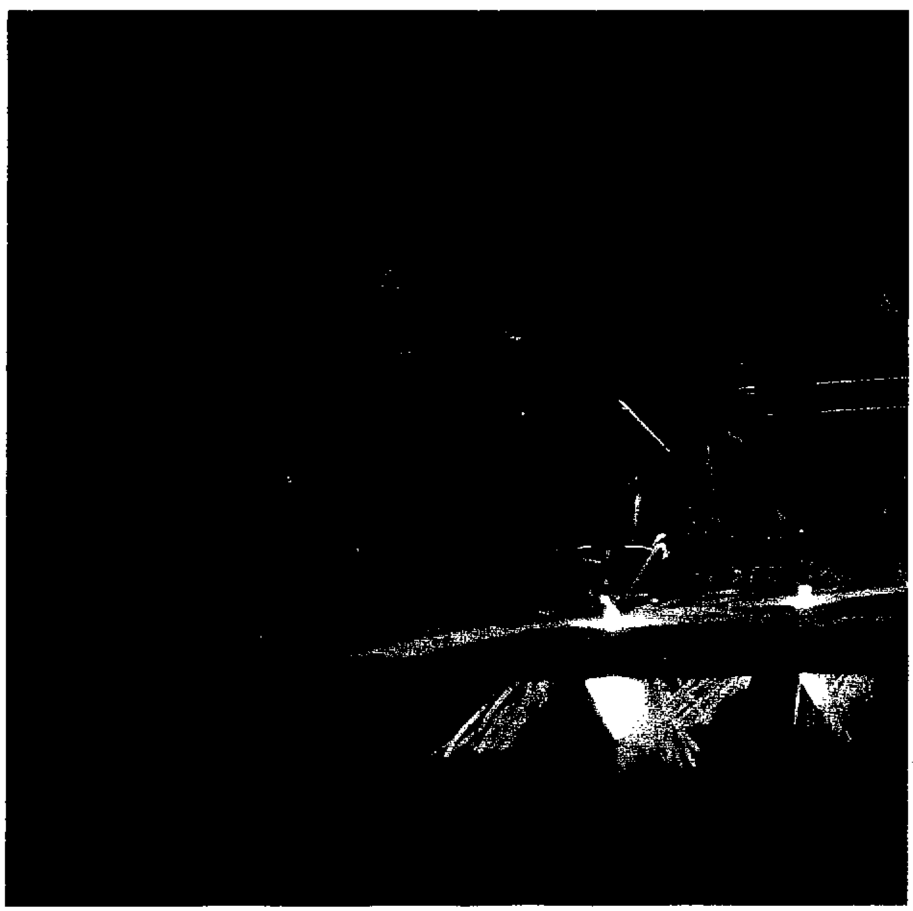
Pathway Bellows, Inc.: In 1977 Pathway was awarded the largest single order ever placed for metal expansion joints. The $10 million contract will provide expansion joints for a major addition to the U.S. Air Force's Arnold Engineering Development Center near Tullahoma, Tennessee. Sales will begin in the second quarter of 1978 and continue into 1980. Pathway will produce the products at both its El Cajon, California and Oak Ridge, Tennessee plants.

To meet work schedules and accommodate facilities for production of rubber expansion joints, the Oak Ridge plant capacity has been expanded by 25 percent. This expansion was financed through $1.2 million of industrial development bonds issued by the City of Oak Ridge and purchased by Morgan Guaranty Trust Company of New York. The industrial development bond issue which originally financed the Oak Ridge plant was also refinanced at this time at a more attractive interest rate.

Pathway's FLEXSPAN fabric expansion joints met with good success in the market after introduction in early 1977. With the recent addition of rubber expansion joints to its line of products, Pathway has become the only expansion joint manufacturer with the capability to design and manufacture all three types of joints: rubber, metal, and fabric.

Inspection and fabrication of expansion joints at Pathway Bellows.





Oil & Gas

Canadian Arctic Islands: Callahan and Pinnacle Exploration, Inc. continue to maintain their participations in natural gas in the Canadian Arctic Islands. Together they hold approximately one-half trillion of the 12.8 trillion cubic feet of natural gas estimated to have been discovered in the area by Panarctic Oils Ltd. and other companies. During 1977, Panarctic continued its work along the Drake-Hecla trend in search of new gas. The Panarctic S.W. Hecla C-58 well, drilled offshore on permits held by others, tested gas from the main Borden Island Sand and proved a southwest extension to the Hecla field.

During the current field season which began in October, four wells have been commenced in the area on permits held by others. One test has been abandoned and three others are still drilling. Panarctic will shortly undertake drilling of the Drake F-76 well, the first offshore well to test production methods in Canada's Arctic Islands. The well will be drilled from an ice platform in the Drake Point gas field in 200 feet of water, one mile offshore on a permit in which Callahan and Pinnacle hold interests. Upon completion, the wellhead will be connected to an onshore test facility via a sea-floor flowline and produced for a period of two months. The operation is being funded by Panarctic and Petro-Canada Exploration Inc.

The Polar Gas Consortium, led by Panarctic, filed application in late 1977 to the National Energy Board of Canada for construction of a 2,300 mile 42-inch diameter pipeline from Melville Island in the Canadian Arctic to Longlac, Ontario.

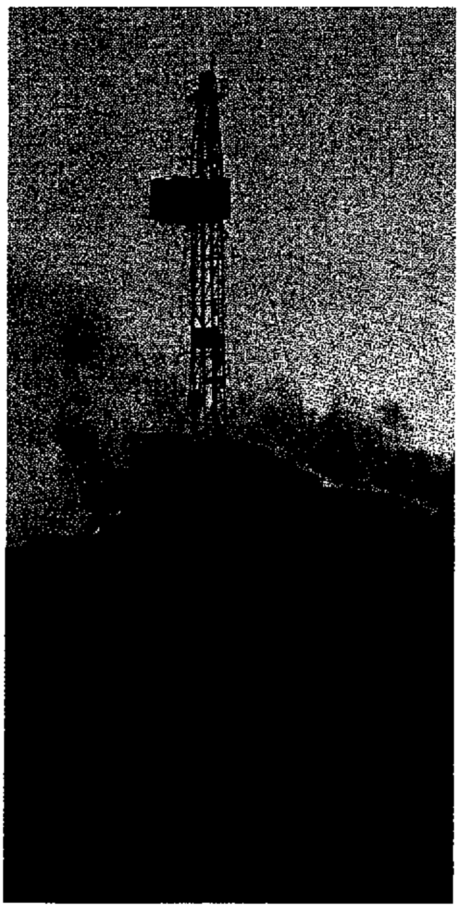
Another consortium, comprised of Panarctic, Petro-Canada, and Alberta Gas Trunk Line, has a plan under study for liquefying the gas at Melville Island and shipping it by tanker to the eastern provinces of Canada.

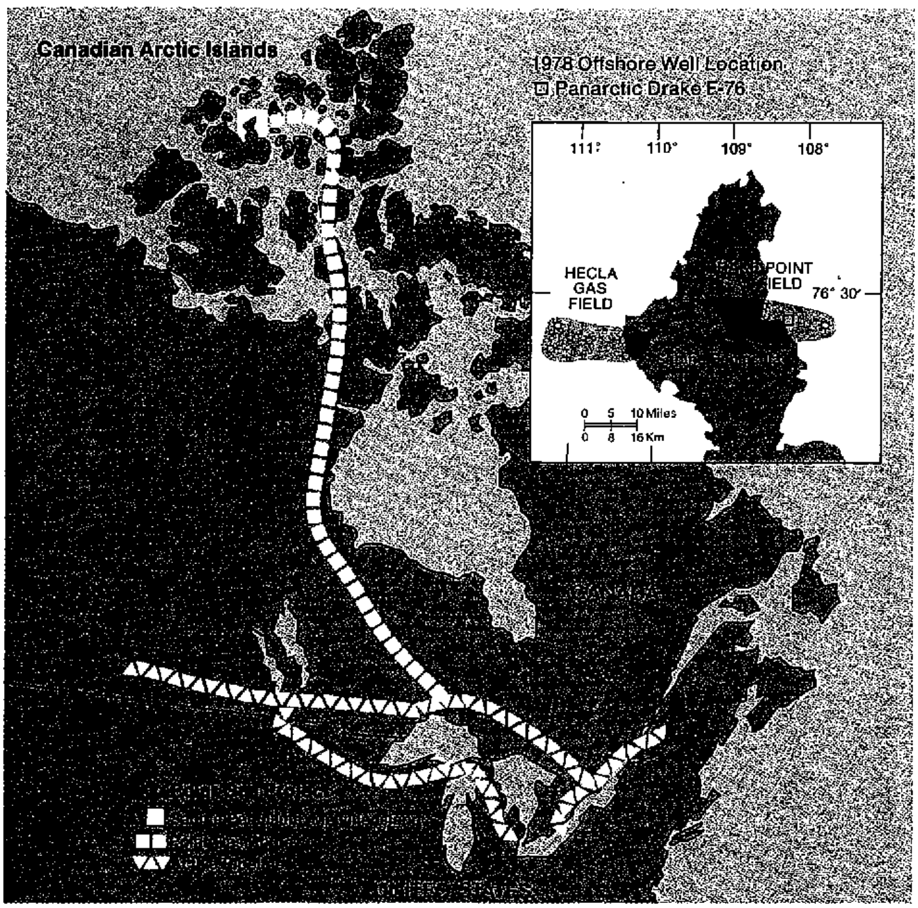
Callahan and Pinnacle had shared a 2 percent gross overriding royalty in some 1.3 million permit acres in the southeast sector of Banks Island in the Canadian Arctic Islands. During 1977, these permits were surrendered to the government by the permit holder following decision not to meet the substantial renewal expenditures required. The write-off arising from termination of the royalty interest amounts to $0.03 per share.

Other Oil and Gas Interests: K.R.M. Petroleum Corporation in which Callahan holds a 23.3 percent interest expects to report lower earnings for 1977 due to weather freeze-ups and longer-than-anticipated lead times to bring certain natural gas reserves into production. Production totaled 107,700 barrels of oil and 417 million cubic feet of gas. As of January 1, 1978, reserves totaled 640,000 barrels of oil and 5.37 billion cubic feet of gas. K.R.M.'s oil and gas properties are in Texas, Mississippi, and the Rocky Mountain and Mid-Continent areas.

A small amount of revenue was also generated for Callahan during the year from three oil producing wells in southern Illinois.

Drilling in the Arctic Islands.





Financial Review

Callahan's earnings in 1977 of $3,155,000, or $.85 per share, were the second highest in the company's history, surpassed only by 1974. In 1977, increased income from natural resources and interest and dividends more than offset a slight decline in manufacturing earnings. A 12.6% return on average shareholders' equity was earned for the year. The cash dividend for 1977 was increased to $.35 per share, approximately 40% of earnings, from $.30 per share in 1976. In both years, a 2% stock dividend was also paid.

At year-end, working capital had increased to $14,273,000 and the ratio of current assets to current liabilities stood at 4.5 to 1. Funds generated internally were sufficient to pay for the cash dividend of $1,271,000, all additions to property, plant and equipment of $1,315,000, long-term investments of $1,098,000, and long-term debt reductions of $309,000.

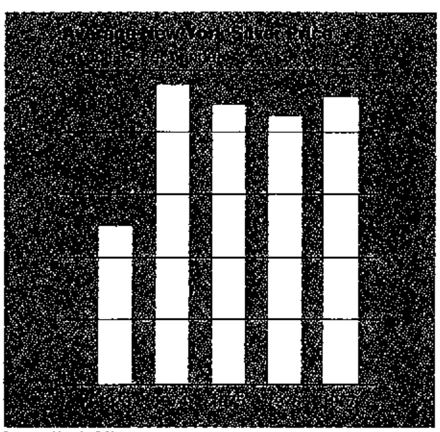
As indicated in Note 10 to the consolidated financial statements, $1,200,000 of new long-term debt was incurred and approximately $1,600,000 of existing debt was refinanced early in 1978. The low rate of interest on this debt, 66% of the prime rate of the Morgan Guaranty Trust Company of New York, will help to leverage future return on shareholders' equity.

Callahan still possesses ample borrowing capacity; coupled with its liquid balance sheet, substantial funds are available to finance growth that should result from the ongoing study of numerous projects and acquisition candidates.

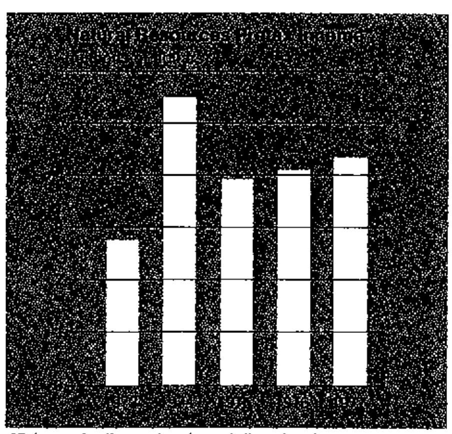
New York Stock Exchange Prices (High-Low)*

	1977	1976	1975	1974	1973
First Quarter	**18 -12¾**	15¾-10¾	13⅛- 7½	20¾-12⅛	13 -10
Second Quarter	**17 -13¼**	17½-12⅝	17 - 9⅛	17¾-10½	11⅜- 8½
Third Quarter	**15⅛-13¼**	17⅛-11½	18¼-11⅝	14¾- 6¼	12⅛- 9⅛
Fourth Quarter	**16 -13**	14⅝-12⅛	14⅜-10¼	11 - 7¼	12 - 9⅛

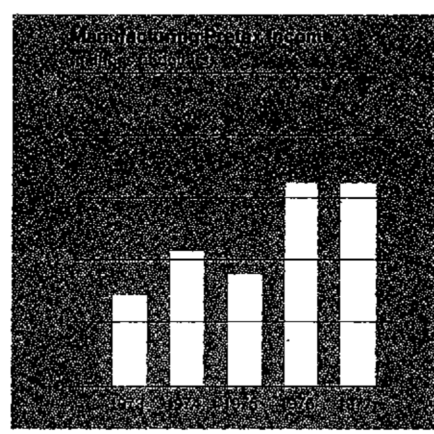
*Not adjusted for stock dividends.

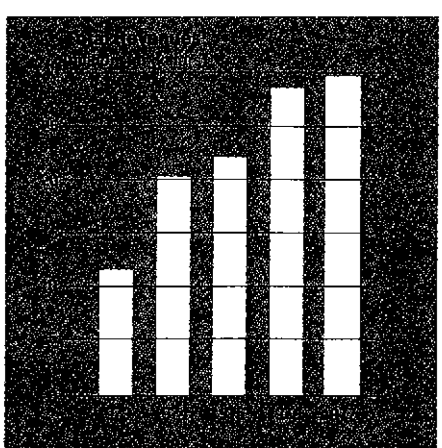


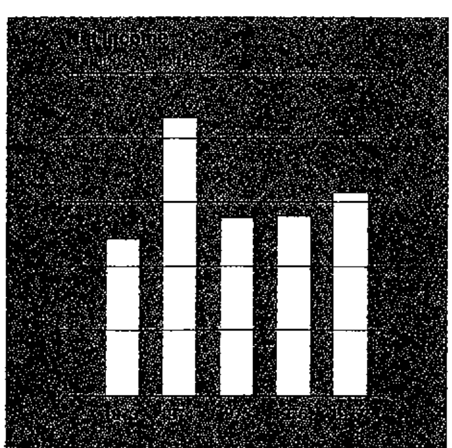
Source: Handy & Harman

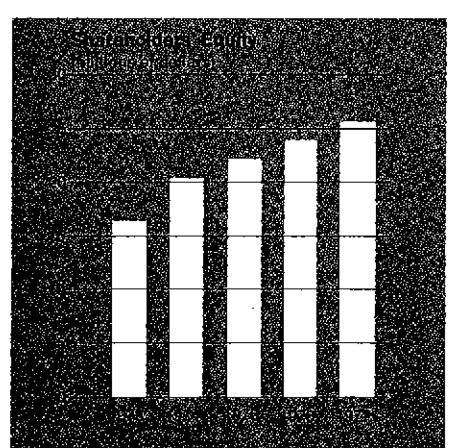


*Before exploration, engineering and other mineral expenses.









Consolidated Statements of Income

for the years ended December 31, 1977 and 1976

	1977	1976 (Note 2)
Revenues:		
Net sales—manufacturing	$24,363,298	$23,433,642
—mining (Coeur mine)	907,202	226,661
Galena mine	4,038,110	4,069,090
Interest, dividends and other income	611,795	571,057
	29,920,405	28,300,450
Costs and expenses:		
Manufacturing:		
Cost of goods sold	16,305,234	15,911,353
Selling	2,584,013	2,156,922
General and administrative	2,247,961	2,055,310
	21,137,208	20,123,585
Mining (Coeur mine)	470,881	125,339
Galena mine	85,538	91,397
Exploration, engineering and other mineral expenses	1,576,265	2,035,220
	23,269,892	22,375,541
Income before corporate and interest	6,650,513	5,924,909
Corporate	1,185,088	991,712
Interest expense	157,879	118,956
	1,342,967	1,110,668
Income before income taxes	5,307,546	4,814,241
Income taxes (Note 8)	2,209,000	2,011,000
Income before equity in net income of affiliated company	3,098,546	2,803,241
Equity in net income of K.R.M. Petroleum Corporation (Note 4)	56,492	19,129
NET INCOME	$ 3,155,038	$ 2,822,370
EARNINGS PER SHARE	$ .85	$ .76
Weighted average shares outstanding	3,702,405	3,690,566

Consolidated Statements of Retained Earnings

for the years ended December 31, 1977 and 1976

	1977	1976
RETAINED EARNINGS:		
Beginning of year	$ 7,411,029	$ 6,655,030
Net income for the year	3,155,038	2,822,370
	10,566,067	9,477,400
Dividends paid:		
Cash—per share 1977—$.35; 1976—$.30	1,271,258	1,064,920
Stock—2%	1,075,143	1,001,451
	2,346,401	2,066,371
Retained earnings, end of year	$ 8,219,666	$ 7,411,029

See notes to consolidated financial statements.

Consolidated Balance Sheets

December 31, 1977 and 1976

			1977	1976
Assets				
Current assets:				
Cash, including interest-bearing time deposits			$ 540,557	$ 789,797
Short-term investments, at cost (approximates market)			8,864,699	9,877,157
Trade and other receivables			5,314,992	4,978,137
Inventories (Note 3)			3,165,312	2,273,323
Prepaid expenses			452,887	460,494
Total current assets			18,338,447	18,378,908
Property, plant and equipment, at cost (Notes 7 and 10):				
Mineral properties, less accumulated depletion of: 1977—$1,228,409; 1976—$1,152,689			800,789	959,691
Plant and equipment:				
Land and buildings			2,147,153	2,119,372
Machinery and equipment			4,639,186	4,135,314
Other			685,934	562,007
Construction in progress			830,272	215,588
			8,302,545	7,032,281
Less accumulated depreciation			1,916,048	1,416,784
			6,386,497	5,615,497
Long-term investments (Note 4)			4,041,675	2,886,849
Exploration projects (Note 5)			3,571,024	4,020,277
Other assets			486,127	577,273
			$33,624,559	$32,438,495
Liabilities				
Current liabilities:				
Notes payable			$ 84,821	$ 78,231
Capitalized lease obligation (Note 10)			222,222	222,000
Accounts payable and accrued expenses			3,071,063	3,042,469
Federal income taxes			687,146	1,106,311
Total current liabilities			4,065,252	4,449,011
Long-term portion of notes payable (Note 10)			344,202	430,335
Capitalized lease obligation (Note 10)			1,388,892	1,611,335
Deferred income taxes			1,744,205	1,706,082
Minority interest			196,176	201,605
Shareholders' Equity				
Capital stock (Note 6):				
Preferred stock $5.00 par value				
Authorized and unissued 3,000,000 shares				
Common stock $3.00 par value				
Authorized 7,500,000 shares				
	Shares			
	1977	1976		
Issued	3,789,601	3,717,645	11,368,803	11,152,935
Less treasury stock	87,586	85,477		
Outstanding	3,702,015	3,632,168		
Capital Surplus (Note 6)			6,667,825	5,845,041
Retained earnings			8,219,666	7,411,029
			26,256,294	24,409,005
Less treasury stock, at cost (Note 6)			370,462	368,878
			25,885,832	24,040,127
			$33,624,559	$32,438,495

See notes to consolidated financial statements.

Consolidated Statements of Changes in Financial Position

for the years ended December 31, 1977 and 1976

	1977	1976
Sources of Working Capital:		
Net income	$ 3,155,038	$ 2,822,370
Add (deduct) items not requiring outlay of working capital:		
Depletion, depreciation and amortization	663,710	596,613
Provision for deferred income taxes	29,000	(46,845)
Equity in net income of K.R.M. Petroleum Corporation	(56,492)	(19,129)
Mine development costs expensed	81,600	572,730
Banks Island royalty interest termination	201,500	—
Other	105,079	77,465
Provided from operations	4,179,435	4,003,204
Coeur mine investment recovered from development ore sales	—	267,991
Net book value of assets sold	212,611	48,385
Capital stock awards (repurchases)	(1,592)	50,491
Total sources of working capital	4,390,454	4,370,071
Uses of Working Capital:		
Property, plant and equipment	1,314,611	634,291
Cash dividends to shareholders	1,271,258	1,064,920
Long-term investments, net of long-term notes payable of $430,335 in 1976	1,098,334	2,437,385
Reduction of long-term debt	308,576	222,000
Other	54,377	(39,192)
Total uses of working capital	4,047,156	4,319,404
Increase in working capital	343,298	50,667
Working capital at beginning of year	13,929,897	13,879,230
Working capital at end of year	$14,273,195	$13,929,897
Changes in the Components of Working Capital:		
Increases (decreases) in current assets:		
Cash and short-term investments	$(1,261,698)	$ 1,354,997
Receivables	336,855	629,614
Inventories	891,989	(192,537)
Prepaid expenses	(7,607)	(270,870)
	(40,461)	1,521,204
Increases (decreases) in current liabilities:		
Notes and accounts payable and accrued expenses	35,184	437,340
Capitalized lease obligation	222	55,333
Federal income taxes	(419,165)	977,864
	(383,759)	1,470,537
Increase in working capital	$ 343,298	$ 50,667

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. 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.

INVENTORIES—Inventories are stated at the lower of cost or market. 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. Reclassification

Certain income and expense items have been reclassified in order to conform with the Company's 1977 financial statement presentation. There was no effect on reported income of prior years.

3. Inventories

Inventories consist of the following:

	1977	1976
Raw Materials	**$2,020,631**	$1,470,742
Work in Process	**850,711**	556,239
Finished Products	**293,970**	246,342
	$3,165,312	$2,273,323

4. Long-Term Investments

Long-term investments of $4,041,675 include the cost of industrial land purchased in El Cajon, California at a cost of $703,000, the investment of $2,313,054 in common stock and sinking fund preferred stocks recorded at cost (market value as of February 21, 1978 of $2,382,000) and holdings of 23.3% of the common stock of K.R.M. Petroleum Corporation, which is stated at original cost plus the Company's share of K.R.M's earnings since date of acquisition, for a total carrying value of $1,025,621 (market value as of February 21, 1978 of $1,050,000). 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.

5. 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. At December 31, 1977, such costs for the Caladay Project aggregated $3,277,000, the recovery of which is subject to the success of the project which cannot be forecast at this time. See page 5.

6. Capital Stock and Capital Surplus

In 1977, shareholders approved amendment of the Corporation's Articles of Incorporation, including provision for a new issue of 3,000,000 shares of preferred stock having a par value of $5.00 per share. No preferred stock was issued in 1977.

The 1977 and 1976 changes in common stock and capital surplus are summarized below:

	Shares of Common Stock		Capital
	Issued	Treasury	Surplus
January 1, 1976	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
2% stock dividend	71,956	1,709	824,616
Restricted stock repurchased	—	400	(1,832)
December 31, 1977	3,789,601	87,586	$6,667,825

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

Restricted Stock Purchase Plan

In 1977, the shareholders approved amendments to the Restricted Stock Purchase Plan, which increased the number of shares authorized to be issued under the Plan by 50,000 shares, extended the Plan beyond December 31, 1977 and accelerated the lapse of restrictions. In 1977, 400 shares were repurchased by the Company at the original purchase price of $3.98 per share. At December 31, 1977, 51,119 shares (as adjusted for the 2% stock dividend paid in 1977), including 1,119 shares of treasury stock, 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, 1976	8,616
Stock dividend adjustments	172
Under option at December 31, 1977 at prices ranging from $9.01 to $13.05 per share, all immediately exercisable	8,788

On February 28, 1978, the Board of Directors declared a 2% stock dividend payable March 30, 1978 to stockholders of record on March 10, 1978. Per share amounts and stock option data have been adjusted for stock dividends declared through December 31, 1977.

7. Depreciation and Depletion Expense

Depreciation totaled $578,695 and $548,915 in 1977 and 1976, respectively. Such amounts include depreciation on assets recorded under a capitalized lease. Depletion aggregated $75,720 and $38,715 in 1977 and 1976, respectively.

8. Income Taxes

The provision for income taxes is comprised of the following:

	1977	1976
Federal:		
Currently payable	**$1,840,000**	$1,715,000
Deferred	**25,000**	(40,000)
	1,865,000	1,675,000
State:		
Currently payable	**340,000**	343,000
Deferred	**4,000**	(7,000)
	344,000	336,000
	$2,209,000	$2,011,000

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:

	1977	1976
Revenues included on books but not on tax return, net of statutory tax depletion	**$150,000**	$317,000
Reversal of development costs previously expensed for tax purposes	**(63,000)**	(422,000)
Other	**(58,000)**	58,000
	$ 29,000	$(47,000)

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 1977 and 1976, as set forth below:

	Thousands of Dollars			
	1977		1976	
	Amount	% of Pretax Income	Amount	% of Pretax Income
Pretax income x 48%	**$2,548**	**48.0%**	$2,311	48.0%
Increases (reductions) in taxes resulting from:				
State income taxes (net of federal income tax benefits)	**179**	**3.4**	175	3.6
Statutory tax depletion	**(368)**	**(6.9)**	(321)	(6.6)
Tax-exempt dividends and interest	**(84)**	**(1.6)**	(9)	(0.2)
Investment tax credits	**(41)**	**(0.8)**	(83)	(1.7)
Reversal of prior years' tax reserves	**—**	**—**	(29)	(0.6)
Other	**(25)**	**(0.5)**	(33)	(0.7)
	$2,209	**41.6%**	$2,011	41.8%

9. Employee Plans

Substantially all parent company employees are covered by noncontributory retirement income plans. It is the policy to fund pension costs accrued. Total expense for the plans in 1977 and 1976 was $235,000 and $237,000, 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, 1977, vested accrued benefits exceeded the value of the pension funds by approximately $48,000.

Under the Employee Stock Ownership and Savings Plan for salaried employees of the Company and Pathway Bellows, Inc., and under 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 $84,000 and $63,000 in 1977 and 1976, respectively.

Bonuses for certain key employees amounted to $99,000 in 1977 and $67,000 in 1976.

10. Long-Term Debt

LEASE OBLIGATION—At December 31, 1977 and continuing through February 8, 1978, the Company was 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 in part the construction of Pathway Bellows, Inc.'s Oak Ridge facility. This transaction involved a capitalized lease and plant and equipment recorded thereunder aggregated $1,722,088 (net of accumulated depreciation of $277,912) and $1,800,576 (net of accumulated depreciation of $199,424) at December 31, 1977 and 1976, respectively. Outstanding principal of the bond at December 31, 1977 was $1,611,114 and bore interest at a rate equal to 82% of The Chase Manhattan Bank's prime rate which was 7¾% at year-end.

On February 9, 1978, the prior lease with The Industrial Development Board was replaced by a new ten-year lease subject to extension. Simultaneously with the signing of the new lease, the principal outstanding on the bond held by Chase Manhattan was paid with proceeds from a $1,590,000 refunding bond issued by the Industrial Development Board and purchased by Morgan Guaranty Trust Company of New York. On the same date, Morgan Guaranty purchased a new $1,200,000 bond issued by the Board to finance expansion of Pathway's Oak Ridge facility. The Company is a guarantor under these bonds. Rentals under the new lease are equivalent to an amount sufficient to pay the principal of and interest on the two bonds. Interest is at a rate equal to 66% of Morgan Guaranty's prime rate.

OTHER—In connection with industrial land purchases made in 1976, the Company has obligations totaling $409,022, of which $64,820 is current, under mortgages maturing from 1982 to 1987 and bearing interest at rates ranging from 7% to 8½%.

11. Unaudited Quarterly Results

	Dollars in Thousands Except Per Share Amounts	
Quarter Ended	**1977**	1976
Revenues:		
March 31	**$ 7,594**	$ 6,419
June 30	**7,151**	7,327
September 30	**7,364**	6,810
December 31	**7,811**	7,745
Total	**$29,920**	$28,301
Income before income taxes:		
March 31	**$ 1,345**	$ 1,105
June 30	**1,256**	1,646
September 30	**1,178**	1,111
December 31	**1,528**	952
Total	**$ 5,307**	$ 4,814
Net income:		
March 31	**$ 777**	$ 613
June 30	**733**	920
September 30	**734**	652
December 31	**911**	637
Total	**$ 3,155**	$ 2,822
Earnings per share (1)		
March 31	**$ .21**	$ .17
June 30	**.20**	.25
September 30	**.20**(2)	.17(3)
December 31	**.24**	.17(3)
Total	**$ .85**	$ .76

(1) 1976 earnings per share figures have been adjusted to reflect the 2% stock dividend paid in March, 1977.

(2) Net of an after-tax charge of $93,000, $.03 per share, reflecting termination of a 2 percent gross overriding royalty interest shared by the Company and Pinnacle Exploration, Inc. (80% owned).

(3) Net of after-tax charges of $70,000, $.02 per share, and $285,000, $.08 per share, in 1976's third and fourth quarters, respectively, for previously capitalized mine development costs.

12. Financial Reporting of Business Segments

The Company is engaged in those businesses described on page 1. During 1977, there were no intercompany sales or related party transactions. A significant customer in 1977 was a major domestic corporation engaged in uranium enrichment to which Pathway Bellows, Inc. made sales of $6,773,000. International operations were not a significant part of the Company's business during the year. Corporate assets consist principally of cash and short and long-term investments. The following information is presented in accordance with Financial Accounting Standards Board Statement No. 14, "Financial Reporting of Business Segments", for the year ended December 31, 1977.

(Thousands of Dollars)

Business Segments	Sales and Revenues	Income before Income Taxes	Identifiable Assets	Depreciation, Depletion and Amortization	Capital Expenditures
Pathway Bellows, Inc.	$17,703	$2,067	$10,147	$410	$1,225
The Flexaust Company	6,660	1,159	2,341	54	67
Natural Resources	4,945	2,812	7,122	179	12
Total, Business Segments	29,308	6,038	19,610	643	1,304
Interest, Dividends and Other Income	612	612	—	—	—
Corporate	—	(1,185)	14,015	21	11
Interest Expense	—	(158)*	—	—	—
Totals	$29,920	$5,307	$33,625	$664	$1,315

*Includes $99,000 of interest expense incurred by Pathway Bellows, Inc., primarily in connection with the financing of its Oak Ridge, Tennessee facilities.

Five Year Summary

(000's omitted)

	1977	1976*	1975*	1974*	1973*
Revenues:					
Manufacturing:					
Pathway Bellows, Inc.	$17,703	$17,457	$12,083	$ 7,320	$ 3,213
The Flexaust Company	6,660	5,977	5,053	5,326	4,757
	24,363	23,434	17,136	12,646	7,970
Natural resources:					
Galena mine	4,038	4,069	4,070	5,751	2,789
Coeur mine	907	227	—	—	—
	4,945	4,296	4,070	5,751	2,789
Interest, dividends and other income	612	571	751	744	663
Gains on sales of investments, principally silver	—	—	—	870	445
Total revenues	29,920	28,301	21,957	20,011	11,867
Costs and expenses:					
Manufacturing	21,137	20,124	15,273	10,461	6,499
Mining (Coeur mine)	471	125	—	—	—
Galena mine	86	91	93	157	86
Exploration, engineering and other mineral expenses	1,576	2,036	1,477	1,394	489
	23,270	22,376	16,843	12,012	7,074
Income before corporate and interest	6,650	5,925	5,114	7,999	4,793
Corporate	1,185	992	846	992	752
Interest expense	158	119	116	10	5
	1,343	1,111	962	1,002	757
Income before income taxes	5,307	4,814	4,152	6,997	4,036
Income taxes	2,209	2,011	1,338	2,718	1,648
Income before equity in net income of affiliated company	3,098	2,803	2,814	4,279	2,388
Equity in net income of K.R.M. Petroleum Corporation	57	19	—	—	—
Net Income	$ 3,155	$ 2,822	$ 2,814	$ 4,279	$ 2,388
Earnings per share	$ .85	$ .76	$ .76	$ 1.17	$ .65
Weighted average shares outstanding	3,702	3,691	3,679	3,672	3,675
Income by lines of business before corporate, interest expense and income taxes:					
Manufacturing	$ 3,226	$ 3,310	$ 1,863	$ 2,185	$ 1,471
Natural Resources:					
Galena mine	$ 3,952	$ 3,978	$ 3,977	$ 5,594	$ 2,703
Coeur mine	436	102	—	—	—
	4,388	4,080	3,977	5,594	2,703
Less: Exploration, engineering and other mineral expenses	1,576	2,036	1,477	1,394	489
	$ 2,812	$ 2,044	$ 2,500	$ 4,200	$ 2,214
Dividends:					
Cash	$ .35	$ .30	$ .30	$ .15	$ —
Stock	2%	2%	2%	2%	3%
Shareholders' equity	$25,886	$24,040	$22,134	$20,116	$16,381
Working capital	$14,273	$13,930	$13,879	$13,799	$11,274
Ounces of silver sold (100% of mine shipments):					
Galena mine	3,480	3,692	3,310	3,604	4,054
Coeur mine	2,306	614	—	—	—
Average New York silver price (Handy & Harman)	$ 4.62	$ 4.35	$ 4.42	$ 4.71	$ 2.56

*Certain income and expense items have been reclassified to conform with the Company's 1977 financial statement presentation.

Analysis of Five Year Summary

1977 Compared With 1976

Manufacturing: Pathway Bellows, Inc. reported an approximate 4% decline in pretax earnings in 1977 compared with 1976. The decrease was caused by reduced operating efficiencies resulting from a continued lag in industrial capital spending, an increase in selling expenses which exceeded the growth in sales, and cost overruns on two large contracts.

In 1977, sales of The Flexaust Company division increased 11% and pretax earnings rose approximately 5% over 1976.

Natural resources: 1977 was the first full year of operations at the Coeur silver mine. Callahan 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. As of December 31, 1977, the Company had recovered $791,000 of its investment.

Interest, dividends and other income: In December 1976 and continuing into 1977, the Company made investments of approximately $1,900,000 in sinking fund preferred stocks. The higher return on these investments was the principal reason for the increase over 1976 in this category of income.

Exploration, engineering and other mineral expenses: This category of expense decreased from 1976 because of lower charges against income for previously capitalized mineral project costs.

Corporate: The higher level of Corporate expense in 1977 over 1976 is attributable primarily to higher professional fees, increased compensation of personnel and higher shareholder reporting and administrative expense.

Interest expense: Higher interest expense resulted primarily from mortgages outstanding on industrial land purchased in California in December 1976.

Income taxes: Although the effective tax rate declined slightly, pretax earnings rose by $493,000 resulting in an increase of $198,000 in income taxes in 1977 over 1976.

1976 Compared With 1975

Manufacturing: Sales of Pathway Bellows, Inc. increased by approximately 45% over 1975 and pretax earnings more than doubled. These increases were 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.

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

Natural resources: The Coeur silver mine was placed on an operating basis effective September 1, 1976.

Interest, dividends and other income: A 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 previously capitalized development costs at the Cofer property of Piedmont Mineral Associates were charged against 1976 earnings.

Corporate: The higher level of Corporate expense in 1976 over 1975 was 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.

Auditors' Opinion

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, 1977 and 1976 and the related consolidated statements of income, retained earnings and changes in financial position for the years then ended. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

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 5 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, 1977 and 1976 and the results of their operations and changes in their financial position for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Cooper & Lybrand

One North Broadway
White Plains, New York 10601

February 27, 1978; with respect to Note 6, February 28, 1978.

Callahan Mining Corporation

CBT Plaza, 1120 Post Road, Darien, Connecticut 06820
Telephone (203) 655-7751

Directors

Dixon H. Cain
Petroleum Engineer

Kenneth H. Crandall
Consulting Professor, Stanford University

Sam Harris
Senior Partner, Fried, Frank, Harris, Shriver & Jacobson, Attorneys

Joseph H. Hirshhorn
Chairman of the Board, Mining and Oil Executive

Roger M. Keefe
Vice Chairman, CBT Corporation and its principal subsidiary, The Connecticut Bank & Trust Company

Jack B. Meyer
Vice President

James C. Parlee
Retired Vice Chairman, INCO Ltd.

Fayez Sarofim
President, Fayez Sarofim & Co., Investment Counsellors

Charles D. Snead, Jr.
President

Officers

Joseph H. Hirshhorn
Chairman of the Board

Charles D. Snead, Jr.
President

Frederick M. Beck
Vice President

Jack B. Meyer
Vice President

William P. Lohden
Treasurer

William A. Nicely
Secretary & Counsel

John T. Mettham
Controller

Frank J. Duzy
Assistant Treasurer

General Counsel

Fried, Frank, Harris, Shriver & Jacobson, New York, N.Y.

Auditors

Coopers & Lybrand
White Plains, N.Y.

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.

PLEASE GIVE THIS YOUR IMMEDIATE ATTENTION

CALLAHAN MINING CORPORATION

(An Arizona corporation)

CBT Plaza, 1120 Post Road
Darien, Connecticut 06820

NOTICE OF ANNUAL MEETING OF SHAREHOLDERS

April 10, 1978

To the Shareholders:

PLEASE TAKE NOTICE, that the Annual Meeting of Shareholders of CALLAHAN MINING CORPORATION (hereinafter the "Corporation" or "Callahan") will be held on the Third Floor, CBT Plaza, 1120 Post Road, Darien, Connecticut, on April 10, 1978, at 10:00 a.m., for the following purposes:

1. To elect directors of the Corporation to serve for the term of one year or until their successors are elected and qualify.
2. To approve the appointment of Coopers & Lybrand as independent public accountants of the Corporation and its subsidiaries for the year ending December 31, 1978.
3. To transact such other business as may properly come before the meeting.

The approximate date on which this proxy statement and accompanying form of proxy was first mailed to shareholders was March 9, 1978.

PROXY STATEMENT

The enclosed proxy is solicited by the management of the Corporation. The holders of the 3,702,015 outstanding shares of the Corporation's stock are entitled to one vote for each share held of record on March 1, 1978.

ELECTION OF DIRECTORS

It is intended that the persons named in the accompanying form of proxy, unless instructed otherwise, will vote such proxy for the election of the nominees for directors listed herein (or for substitute nominees in the event of contingencies not known at present) for the ensuing year and until their successors are elected and qualify, reserving the right, however, to cumulate and distribute their votes in their discretion among the nominees. Shareholders have the right to cumulate their votes in voting upon the election of directors. To vote cumulatively in the election of directors, each shareholder may multiply the number of shares which he is entitled to vote by nine, and cast these votes for one of the nine nominees or distribute them among two or more nominees.

Name and Principal Occupation	Period of Directorship Extends from Year Below to Date Hereof	Shares Owned Beneficially as of January 20, 1978 According to Information Received from Director: Callahan Mining Corporation	Shares Owned Beneficially as of January 20, 1978 According to Information Received from Director: Pinnacle Exploration, Inc. (1)
Dixon H. Cain(2), Petroleum Engineer	1973	15,373(3)	10,000
Kenneth H. Crandall(2), Consulting Professor, Stanford University	1973	539(4)	0
Sam Harris(5), Attorney at Law	1957	132	0
Joseph H. Hirshhorn(5), Chairman of Callahan, Mining and Oil Executive	1955	224,438	142,055
Roger M. Keefe, Vice Chairman, CBT Corporation and its principal subsidiary, The Connecticut Bank and Trust Company	1977	100	0
Jack B. Meyer, Vice President of Callahan	1976	5,804(6)	0
James C. Parlee(2), Retired Vice Chairman, INCO Ltd.	1976	306	0
Fayez Sarofim, President and Chief Executive Officer, Fayez Sarofim & Co. (Investment counselling firm)	1976	131,695(7)	0
Charles D. Snead, Jr.(5), President of Callahan	1971	11,354(8)	0

(1) Pinnacle Exploration, Inc. is an 80% owned subsidiary of Callahan.

(2) Member of Callahan's Audit Committee.

(3) In addition, Mr. Cain is trustee of four trusts holding 19,621 shares of which he and his three children are beneficiaries. He is also a trustee of two other trusts holding 1,020 shares of which his children are beneficiaries.

(4) In addition, Mr. Crandall is a beneficiary of a trust holding 538 shares.

(5) Member of Callahan's Executive Committee.

(6) In addition, Mr. Meyer has a vested interest in 214 shares held under the Corporation's Employee Stock Ownership and Savings Plan.

(7) In addition, 12,263 shares are held by Mr. Sarofim's spouse. He is also a co-trustee of a trust holding 9,263 shares of which his brother-in-law is beneficiary, but Mr. Sarofim disclaims beneficial ownership of such shares.

(8) In addition, Mr. Snead has a vested interest in 143 shares under the Corporation's Employee Stock Ownership and Savings Plan. Also, 149 shares are held by persons who may be deemed to be family members, but it is expressly disclaimed that Mr. Snead is the beneficial owner of such shares.

Remuneration and Other Transactions With Management

The following table sets forth the aggregate direct remuneration paid in 1977 by Callahan and its subsidiaries to: (i) each person who was a director of Callahan at any time during the year ended December 31, 1977, and whose aggregate direct remuneration exceeded $40,000; (ii) the three highest paid officers of Callahan whose aggregate direct remuneration exceeded $40,000 for said fiscal year; and (iii) the aggregate direct remuneration to all persons as a group who were officers or directors at any time during 1977.

Name of Individual or Number of Persons in Group	Capacities in Which Remuneration Was Received	Regular Remuneration	Bonus
Charles D. Snead, Jr.	President and Director	$ 90,439(1)	$18,000
Jack B. Meyer	Vice President and Director	67,789(1)	18,000
William P. Lohden	Treasurer	57,000	6,000
15 Officers and Directors as a Group (including those shown above) (2)	Officers and Directors	452,890(1)(3)(4)	55,750

(1) Callahan furnishes automobiles to Messrs. Snead, Meyer and one other officer for their general use, which includes both business and personal use. Records of the relative personal and business use of such automobiles are not maintained. Consequently, the Corporation has no basis upon which to calculate the value of any personal use, and no such value is included in the remuneration reported above.

(2) Includes information only with respect to periods during which a person served as a director or officer of Callahan.

(3) This figure does not include $48,000 paid on an accrual basis for legal services by Callahan and subsidiaries during the year ended December 31, 1977, to the firm of Fried, Frank, Harris, Shriver & Jacobson of which Mr. Sam Harris, a director of Callahan, is a partner.

(4) This figure also does not include $9,354 paid by Callahan Mining Corporation on an accrual basis to Fayez Sarofim & Co., of which Fayez Sarofim, a Director of Callahan, is President, for investment advisory services rendered during the year ended December 31, 1977 under an Investment Advisory Agreement with Callahan which was instituted in mid-December of 1976. By action of its Board of Directors, Callahan has given Fayez Sarofim & Co., the authority to invest up to $2,000,000 of the Corporation's funds in preferred shares. Under the Investment Advisory Agreement, Fayez Sarofim & Co. has sole discretion regarding decisions to retain, buy and sell securities and is entitled to a fee based on the market value of the Corporation's investments. Such fee is at the rate of .5% of market value per annum for the first $2,000,000 of market value, at the rate of .35% for the next $2,000,000 of market value, and at progressively lower rates for market values in excess of $4,000,000. The Agreement does not have a specific term, but it may be terminated by either party at any time on 30 days' notice and, in addition, Callahan has the right at any time to require Fayez Sarofim & Co. to cease activity with respect to the Corporation's account.

Payments shown under the caption "Bonus" in the table above were distributed in 1977 with respect to the calendar year 1976 under the Executive Bonus Plan which was adopted by Callahan's Board of Directors on April 12, 1976. The purpose of the Plan is to provide an incentive to certain key employees of the Corporation and its subsidiaries who contribute in a notable degree to the profit and growth of the Corporation and such subsidiaries. Under the Plan, an amount equal to 2% of the Corporation's consolidated income before taxes and accrual of the Bonus Plan provision for a calendar year is made available for payment of bonuses, provided after-tax income is at least equal to 10% of shareholder's equity at the beginning of the calendar year in question.

Mr. Snead has an employment contract with the Corporation expiring April 18, 1983 under which he is employed as President and Chief Executive Officer at a minimum annual salary of $92,000.

Mr. Meyer has an employment contract under which he is employed as Vice President at a minimum salary of $69,000. The expiration date of the contract was extended from June 17, 1980 to August 31, 1982 by action of the Board of Directors on October 6, 1977.

Additional information concerning remuneration is set out below under the captions Retirement Income Plans, Qualified Stock Option Plan, Restricted Stock Purchase Plan and Employee Stock Ownership and Savings Plan.

Retirement Income Plans

As of January 1, 1963, Callahan and Pinnacle Exploration, Inc., a subsidiary, adopted Retirement Income Plans for salaried employees and for hourly-paid employees, the costs of which are paid by the respective employers. The following table contains information concerning amounts set aside or accrued during 1977 under the above-mentioned Retirement Income Plans, together with information concerning estimated annual benefits upon retirement.

Name of Individual or Number of Persons in Group	Amounts Set Aside or Accrued During 1977	Estimated Annual Benefits Upon Retirement
Charles D. Snead, Jr.	$ 9,200	$39,200
Jack B. Meyer	7,000	31,800
William P. Lohden	5,500	28,500
15 Officers and Directors as a Group (including those shown above)(1)	37,800	—

(1) Includes information only with respect to periods during which a person served as a director or officer of Callahan.

Qualified Stock Option Plan

The Corporation's Qualified Stock Option Plan expired on August 5, 1975. The following tabulation shows as to certain directors and officers and as to all present directors and officers as a group (i) the amount of shares acquired since January 1, 1977 through the exercise of options granted prior thereto, and (ii) the amount of shares subject to all unexercised options held as of January 20, 1978:

	Charles D. Snead, Jr.	Jack B. Meyer	W. P. Lohden	All Directors and Officers as a Group(2)
Exercised—				
January 1, 1977 to January 20, 1978:				
Number of Shares	—	—	—	—
Unexercised at January 20, 1978(1):				
Number of Shares	3,247	3,344	1,155	7,746
Average Per Share Option Price	$9.01	$10.49	$10.49	$9.87

(1) The figures with respect to unexercised options have been adjusted to reflect all stock dividends declared after the grant of the respective options.

(2) Includes information only with respect to periods during which a person served as a director or officer of Callahan.

Restricted Stock Purchase Plan

The Corporation's Restricted Stock Purchase Plan provides for the sale of shares of Callahan's Common Stock to certain key employees of the Corporation and its subsidiaries at 30% (or such higher percentage as the Board of Directors may determine) of the fair market value of unrestricted shares of Callahan's Common Stock on the date on which an award of shares to an employee under the Plan is approved by the Board of Directors or on the date on which the employee elects to purchase the shares, whichever is lower. Under the Plan, shares purchased may not be sold or disposed of during the first year after their purchase. Such restrictions are removed thereafter at the rate of 10% at the end of the first year and 10% per year over the balance of the period ending with the 10th year from the date of purchase. The Plan also provides that under certain circumstances, shares must be reoffered to Callahan at their original purchase price without interest in the event of the death, disability or other termination of employment other than retirement with the consent of Callahan. An employee holding restricted shares under the Plan is entitled to vote the shares and to receive or retain all dividends and distributions paid out of retained earnings, including stock dividends with respect to which the full fair market value is charged to retained earnings.

No awards were granted under the Plan to any director or officer, nor were any shares repurchased from any director or officer, during the period from January 1, 1977 to January 20, 1978.

Employee Stock Ownership and Savings Plan

The Corporation's Employee Stock Ownership and Savings Plan was adopted by Callahan's Board of Directors on December 10, 1975, and approved by the shareholders at the Annual Meeting on April 12, 1976. Under the Plan each eligible employee may elect to contribute through payroll deductions an amount not less than 2% nor more than 6% of his basic pay. .The Corporation is required to contribute out of current or accumulated earnings or profits an amount which will equal 50% of the employees' contributions to the Plan. An employee may also elect to make supplemental contributions to the Plan without corresponding contributions by the Corporation. Funds contributed by the employee to the Plan are invested at his direction in (a) a Fixed Income Fund, consisting of governmental and corporate obligations and other types of securities bearing a fixed return; (b) a Diversified Fund, consisting of common and preferred stocks, debt securities and other real and personal property; or (c) a Fund invested entirely in shares of Callahan stock. Corporation contributions on behalf of a participating employee are invested in the same proportion that the participant has directed his own contributions to be invested, provided, however, that not less than one-third of Corporation contributions shall be invested in shares of Callahan stock. The following tabulation shows as to certain directors and officers and as to all present directors and officers as a group the amounts of Corporation contributions during the year ending December 31, 1977:

Name	Corporation Contributions to the Plan
Charles D. Snead, Jr.	$1,284
Jack B. Meyer	1,920
William P. Lohden	1,620
All Officers and Directors as a Group (including those shown above)	9,696

APPROVAL OF INDEPENDENT PUBLIC ACCOUNTANTS

The firm of Coopers & Lybrand, One North Broadway, White Plains, New York has examined the financial statements of the Corporation and its subsidiaries for many years and the Board of Directors recommends the continuance of the services of this firm for the year ending December 31, 1978. Accordingly, management will present to the meeting a resolution ratifying the appointment by the Board of Directors of the firm of Coopers & Lybrand as independent public accountants, to examine the financial statements of the Corporation and its subsidiaries for the year ending December 31, 1978, to present their opinion with regard to such statements, and to perform other appropriate accounting services. The affirmative vote of a plurality of the votes cast at the meeting is required to approve the resolution.

The Corporation has been advised by Coopers & Lybrand that the firm does not have any financial interest, either direct or indirect, in the securities of the Corporation or its subsidiaries, and during the past three years has not had any connection with such companies in the capacity or promoter, underwriter, voting trustee, director, officer or employee.

Representatives of Coopers & Lybrand are expected to be present at the Annual Meeting of Shareholders with the opportunity to make a statement if they desire to do so and to respond to appropriate questions.

If the enclosed proxy is executed, it will be voted but may be revoked at any time insofar as it has not been exercised.

Callahan will bear the cost of preparing, assembling and mailing the Notice of Meeting, Proxy Statement and Proxy for the Annual Meeting of Shareholders. In addition to the use of the mails, proxies may be solicited by officers, directors and regular employees of Callahan personally, by telephone or by telegraph. Also, Callahan has retained Georgeson & Co., 100 Wall Street, New York, New York to assist in solicitation of proxies and Callahan will pay that company a fee of approximately $5,000 for such service including expenses. Callahan will pay persons holding stock in their names or those of their nominees for their expenses in sending soliciting material to their principals.

The management does not know of any other matters which may come before the meeting. However, if any other matters properly come before the meeting, it is the intention of the appointees named in the enclosed form of proxy to vote the proxy in accordance with their judgment on such matters.

By order of the Board of Directors

WILLIAM A. NICELY
Secretary

Dated: March 9, 1978

It is important that your stock be represented at the meeting regardless of the number of shares you may hold. If you are unable to be present in person, please date, sign and return the enclosed proxy card promptly. It requires no postage if mailed in the United States.