FILE NAME: Lone Star Industries (LS)

DATE: 1978

DOC#: LS110

DOCUMENT DESCRIPTION: Lone Star Annual Report

Annual Report
1978

Lone Star
Industries, Inc.

America's number one cement producer achieved a billion dollars in sales in 1978 for the first time in its history and reported record earnings.



LSI(01/16/2018)_002365

About Lone Star

Lone Star—the largest cement producer in the United States and the Western Hemisphere—is also a leader in the distribution of building and home improvement materials.

In addition to producing portland cement, Lone Star is the building industry's largest source of ready-mixed concrete and sand-and-gravel aggregates and one of the nation's major sources of crushed stone aggregates and concrete products.

The company is also a leading supplier of lumber and general building materials to contractors and do-it-yourselfers in key growth markets across the United States.

Highlights of the Year

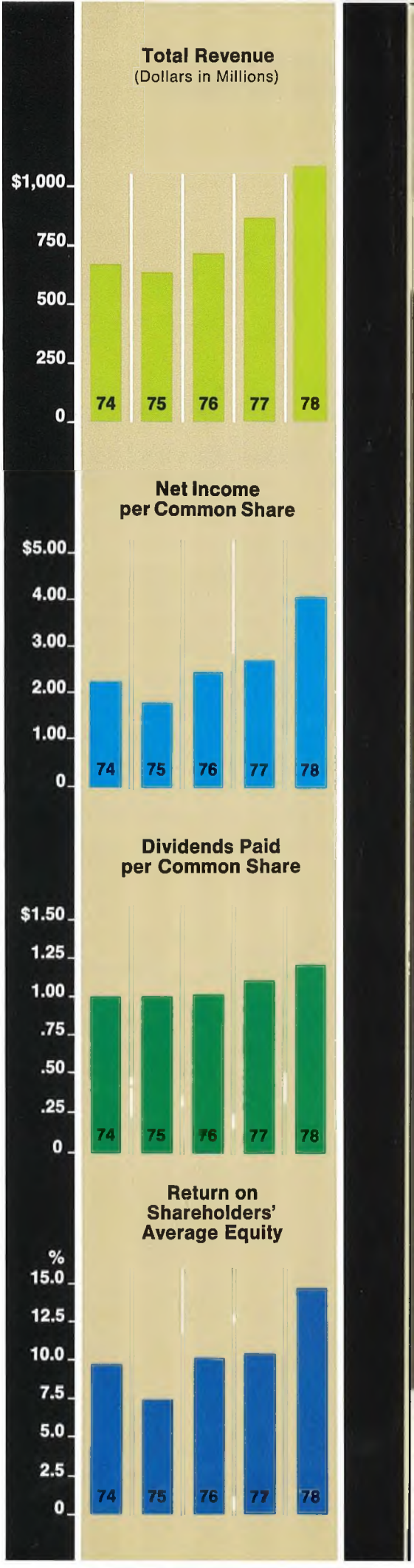
- Net sales advance 27% to 1.1 billion dollars.
- Net income rises 53% to record 45.4 million dollars.
- Income per share climbs from $2.66 to $4.02.
- Return on shareholders' equity increases to 14.5% from 10.3%.
- Annual dividend paid on common stock increases to $1.20 from $1.10 per share. Directors announce expectation that 1979 dividend payments will total $1.40 per share and raise quarterly dividend to $.35 per share in January, 1979.
- Improved results reflect gains in both major lines of business.
- Cement & Construction Materials Group operating profits up 51%.
- Building Centers Group operating profits up 29%.
- Expansion program continues in cement, aggregates and retail Home Care Centers.

LSI(01/16/2018)_002366

Financial Highlights

Dollars in thousands except per share amounts	1978	1977	Increase
Total Revenue	**$1,097,243**	$864,905	27%
Net Income	**$ 45,378**	$ 29,710	53%
Shareholders' Equity	**$ 330,154**	$297,205	11%
Depreciation & Depletion	**$ 28,143**	$ 25,077	12%
Capital Expenditures	**$ 62,336**	$ 41,986	48%
Per Common Share			
Primary Net Income	**$ 4.02**	$ 2.66	51%
Fully Diluted Net Income	**$ 3.68**	$ 2.45	50%
Shareholders' Equity	**$ 29.24**	$ 26.67	10%

Letter to Shareholders **2**
The Cement Industry **4**
Lone Star Today and Tomorrow **7**
Lone Star at a Glance **16**
Cement & Construction Materials Group **18**
Building Centers Group **20**
Financial Review **22**
Quarterly Data, Ratios **29**
Ten-Year Summary **30**
Report of Independent Accountants **32**
Statement of Significant Accounting Policies **32**
Statements of Income & Retained Earnings **33**
Balance Sheet **34**
Statement of Changes in Financial Position **35**
Notes to Financial Statements **36**
Directors **42**
Corporate Data **44**



LSI(01/16/2018)_002367

To Our Shareholders



It is a pleasure to report that in 1978 your company reached a major milestone, reporting more than $1 billion in sales for the first time in its history, as well as the third consecutive year of record profit performance.

The preceding Financial Highlights summary tells the story—net income up 53 percent and return on shareholders' equity ahead to 14.5 percent, up from 10.3 percent in 1977.

Significantly, all of Lone Star's major lines of business enjoyed higher volume and improved margins, stemming from increased demand, improved selling prices and more efficient cost controls.

Details of 1978 are reported on the following pages of this report. One, in particular, deserves special comment here. Among the most gratifying achievements was the dramatic turnaround that Lone Star accomplished in Florida, where a new venture was formed to acquire the assets of bankrupt Maule Industries, Inc., in February, 1978. These diversified operations include Florida's largest cement plant, as well as major operations in ready-mixed concrete, precast concrete products and construction aggregates. By mid-year, the new operation was brought to a break-even point; by year end it was making a positive contribution to Lone Star earnings and is now well-positioned to become an important contributor to overall results in 1979.

Dividend Increased

We believe that the company's shareholders should benefit directly from Lone Star's improved performance. Thus, the cash dividend on the company's common stock was increased from $1.10 per share in 1977 to $1.20 in 1978, marking the third straight year of higher dividends. Because of continuing strong performance, the Board of Directors declared a quarterly dividend of 35 cents per share in the first quarter of 1979—a 17 percent increase—bringing the indicated rate for 1979 to $1.40 per share.

Lone Star's achievements in 1978 have renewed our commitment to do even better in 1979 and beyond. The long-term outlook for cement and its allied products is extremely attractive. We plan to strengthen our position in all markets and to seek new opportunities to build additional capacity in our cement operations.

During 1978, the company intensified its long-range planning effort. The focus of that work is to identify greater opportunities for

LSI(01/16/2018)_002368

Lone Star in its existing businesses and to provide the information needed to manage our operations with the greatest possible effectiveness.

In the years ahead, Lone Star will grow in several different ways:

- First, we will continue to adopt new technology at existing cement operations to reduce fuel consumption and increase operating efficiency.
- Second, we will continue to seek growth through appropriate acquisitions.
- Third, with an improving return on investment in cement operations, Lone Star will build new plants and add capacity at existing plants to help close the gap between the nation's demand for cement and the industry's ability to produce it.
- Finally, Lone Star's greatest strength is its people. Their dedication and effort continue to keep Lone Star the leader in its industry. Thus, Lone Star will continue to attract and develop the best people to accomplish the growth we see ahead.

The Regulatory Environment

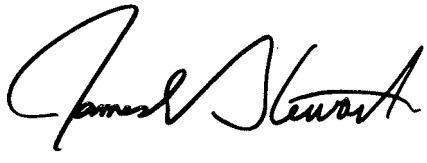
Each day we receive new evidence that demand for cement has outstripped the U.S. cement industry's ability to produce this critically needed building material. In fact, imports of foreign cement were on the rise in 1978. Nevertheless, the Federal Trade Commission, various state and federal environmental agencies, and a maze of other regulatory requirements pose serious impediments to the necessary expansion of domestic cement productive capacity. As we discuss on the following pages, these forces cause delay and add unnecessarily to costs. Unless alleviated, these impediments can ultimately cause serious, long-term shortages harmful to the national economy, affect the balance of trade and restrict the employment potential inherent in larger-scaled operations.

Outlook

The outlook for the cement industry is good, and Lone Star's position is strong.

Admittedly, at this writing, there are major uncertainties in the country's economy. Among them is the extent to which recent developments in the Middle East will affect the nation's energy picture in coming months.

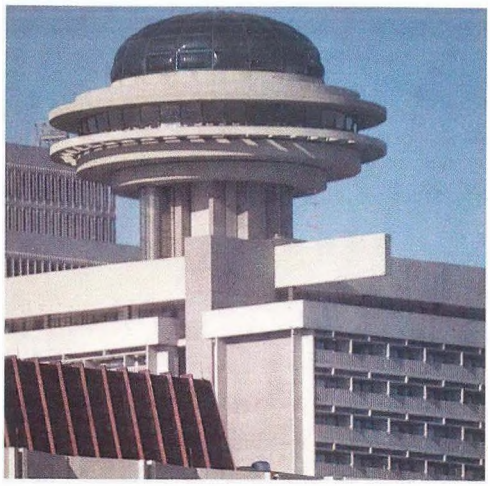
Despite these uncertainties, we are confident that 1979 will be a good year for Lone Star and that it will be the company's fourth straight year of record sales and earnings.

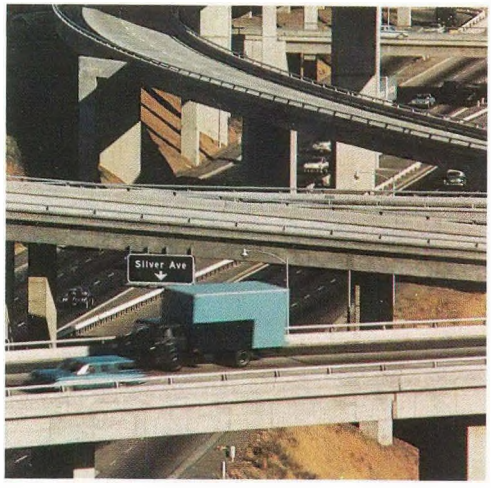


James E. Stewart
Chairman, President and
Chief Executive Officer

March 7, 1979

Expanding Cement Capacity: A Critical Need For the 80's

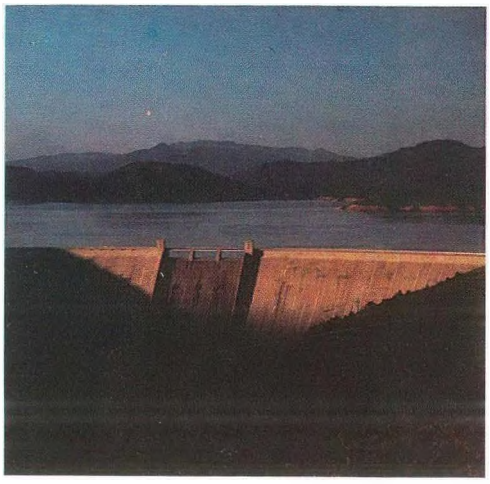




For most of 1978, Lone Star cement plants were operating at capacity and unable to keep up with increased demand. For 1979 and beyond, supplies of cement are expected to fall short of the country's growth needs. With cement shortages already having caused delays in new construction projects and postponements in the maintenance of existing structures, cement producers found it necessary to increase their imports of cement.

In truth, America faces a critical cement shortage over the next decade. Ironically, this is the nation's only shortage in a basic industry product where raw materials are in abundant local supply.

Demand will continue to grow because of the nation's need for dams, housing, power plants, water-supply systems, sewage disposal systems, highways, airport modernization and expansion and mass transit systems. For example, one-fifth of our bridges are in need of major repair or reconstruction. As for the U.S. highway system, the president of the Highway Users Foundation for Safety and Mobility says, "Simply to maintain the status quo will be an enormous and continuing task."



Cement's Capital Crunch

The current shortage has had many contributing causes, including a scarcity of rail cars and a concurrent increase in both residential and non-residential building. But the root cause is that in the past the industry had not been able to attract enough capital to modernize, expand and build new plants.

A cement plant requires more investment per sales dollar than almost any other industry. The cost of a new million-ton-a-year cement plant is now estimated at between $100 million and $120 million.

There is a widespread need for cement and concrete products in both governmental and private-sector projects. Yet instead of strengthening incentives for the industry to build new plants and create new jobs, government regulatory requirements often weaken these incentives.

Consider, for example, the costs of providing adequate environmental safeguards. To meet these requirements, companies now must add 25 to 30 percent to the basic cost of a cement plant.

Delays, too, are costly. Getting through a regulatory logjam of 33 federal, state, district and local agencies to expand Lone Star's Santa Cruz plant in California

LSI(01/16/2018)_002370

took three years—even longer than the time it will take to accomplish the expansion project itself.

The Need to Modernize

Energy also has become a major cost inflator. Fuel costs have increased 115 percent since the onset of the energy crisis. Dealing with this cost factor, Lone Star used a new process that reduced fuel costs by a third when it nearly doubled production at its Roanoke, Virginia plant, emphasizing the top priority Lone Star, like other cement makers, has placed on fuel efficiency.

While much of the industry's capital is tied up in efforts to conserve fuel and abate pollution, its plants urgently need modernization.

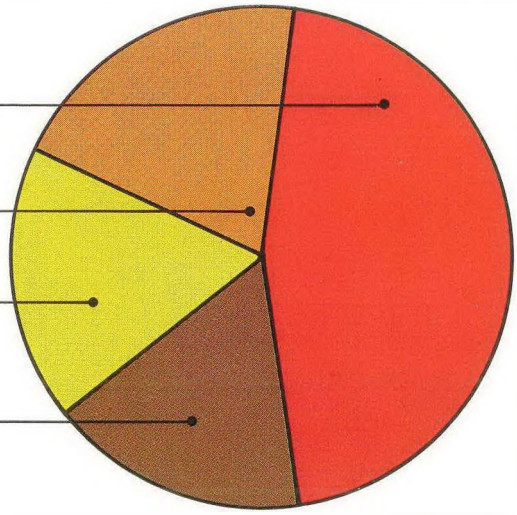
It is estimated that the industry will need over $6 billion to develop the efficient, modern capacity to meet projected demand for cement in the 80's and 90's. This projected cost exceeds the value of all the current assets of the American cement industry.

Meeting the Challenge

By comparison with other basic industries, cement is highly fragmented. A total of 49 companies account for approximately $3 billion in sales. Lone Star, the industry leader, accounts for less than 8 percent of this total, and the top ten producers together account for less than 50 percent.

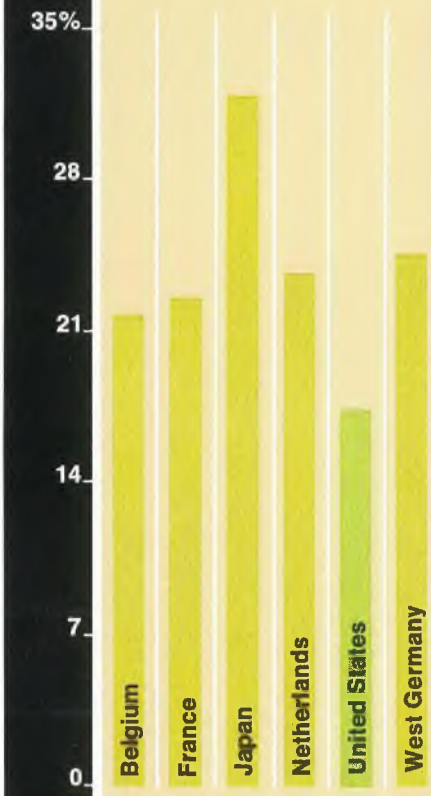
Still, cement's significance far outweighs its size. It is essential to the critically important $200 billion-per-year construction industry, and thus a key component of the nation's economic well-being.

Capital Needs of the Cement Industry 1976-85
(Dollars in Billions)



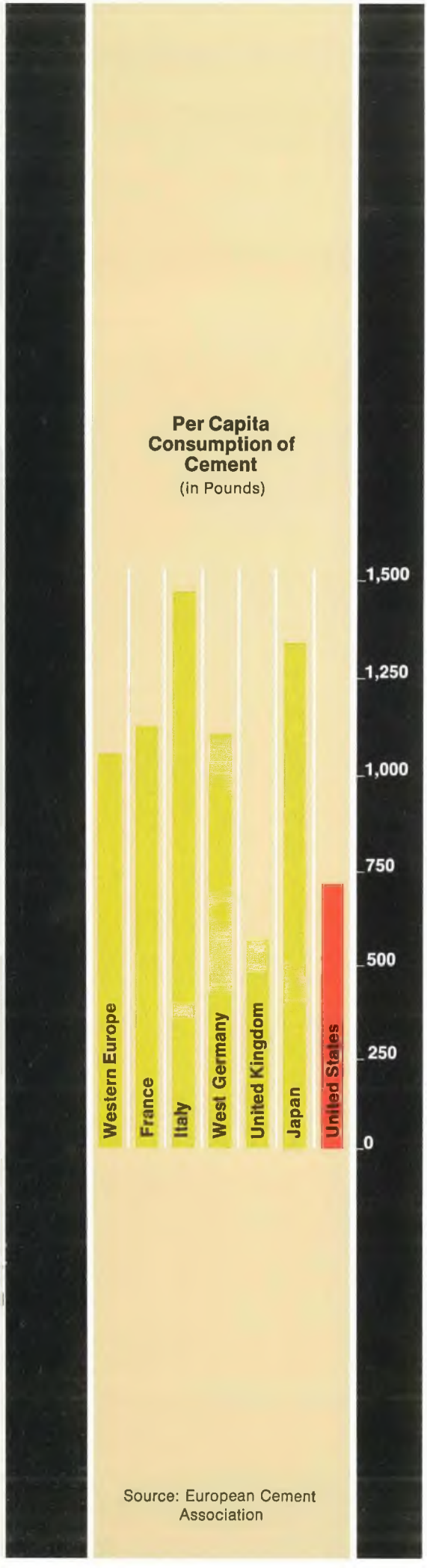
Source: Portland Cement Association

Public and Private Investment as a Percentage of G.N.P.



Source: Organization of Economic Cooperation and Development (Average 1962-1977)

LSI(01/16/2018)_002371



Lone Star believes that the government and the cement industry can and must work together to ensure that cement supplies are available to satisfy the nation's ever-expanding needs.

What, then, can be done to avoid a worsening crisis in cement supply?

The cement industry, for its part, must continue to develop technology for greater fuel efficiency and accumulate capital for expansion.

In the national interest, the government, for its part, should help in the following areas:

- **Prices.** By allowing a free play of market forces so that prices—in response to demand—can rise to levels where investment in new plants and technology will yield an acceptable return.
- **Depreciation & Depletion.** By permitting depreciation allowances on a replacement-cost basis and retaining percentage depletion allowances.
- **Tax Credit.** By increasing the investment tax credit as a spur to investment in new and efficient plant capacity.
- **Double Taxation.** By eliminating double taxation of profits by modifying the tax on stockholders' dividends or further reducing the tax on corporate profits.
- **Capital Gains Taxes.** By further reducing these to promote higher productivity and growth. Heavy capital gains taxes have diverted investment from basic national needs, causing U.S. industry in general to fall behind industry in other countries.
- **Consolidation.** By interpreting anti-trust laws to recognize the highly fragmented nature of the cement industry and the need for appropriate mergers or consolidations. This would permit operational efficiencies and the formation of capital necessary for investment in new capacity.
- **Environmental Regulation.** By streamlining and speeding the process of environmental regulation and by permitting faster recovery of these expenditures, thus balancing environmental and economic benefits in the public interest.

LSI(01/16/2018)_002372

Lone Star Today & Tomorrow

The look of Lone Star changes daily as its growth accelerates. The company knows where it's going, and has set its sights high. This photo portfolio shows some of the projects and activities that helped push Lone Star sales over the billion-dollar mark in 1978. Dynamic operations like these will fuel Lone Star's future growth as well.

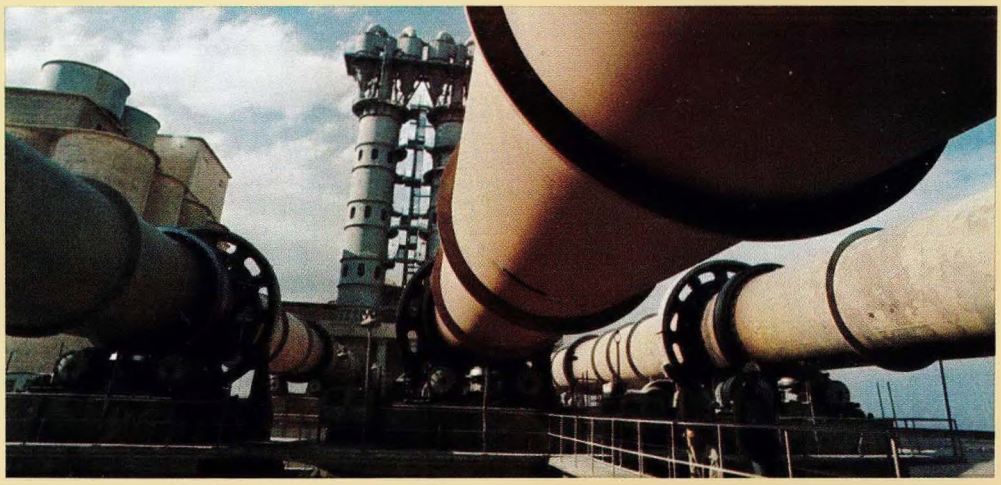






New Lone Star projects in 1978 included a ulexite processing plant in Norfolk, Virginia (left), and a "Secar" calcium-aluminate cement plant (above), also in Norfolk. Operations at Lonestar Florida Pennsuco (above top) near Miami were made profitable after Lone Star assumed management.

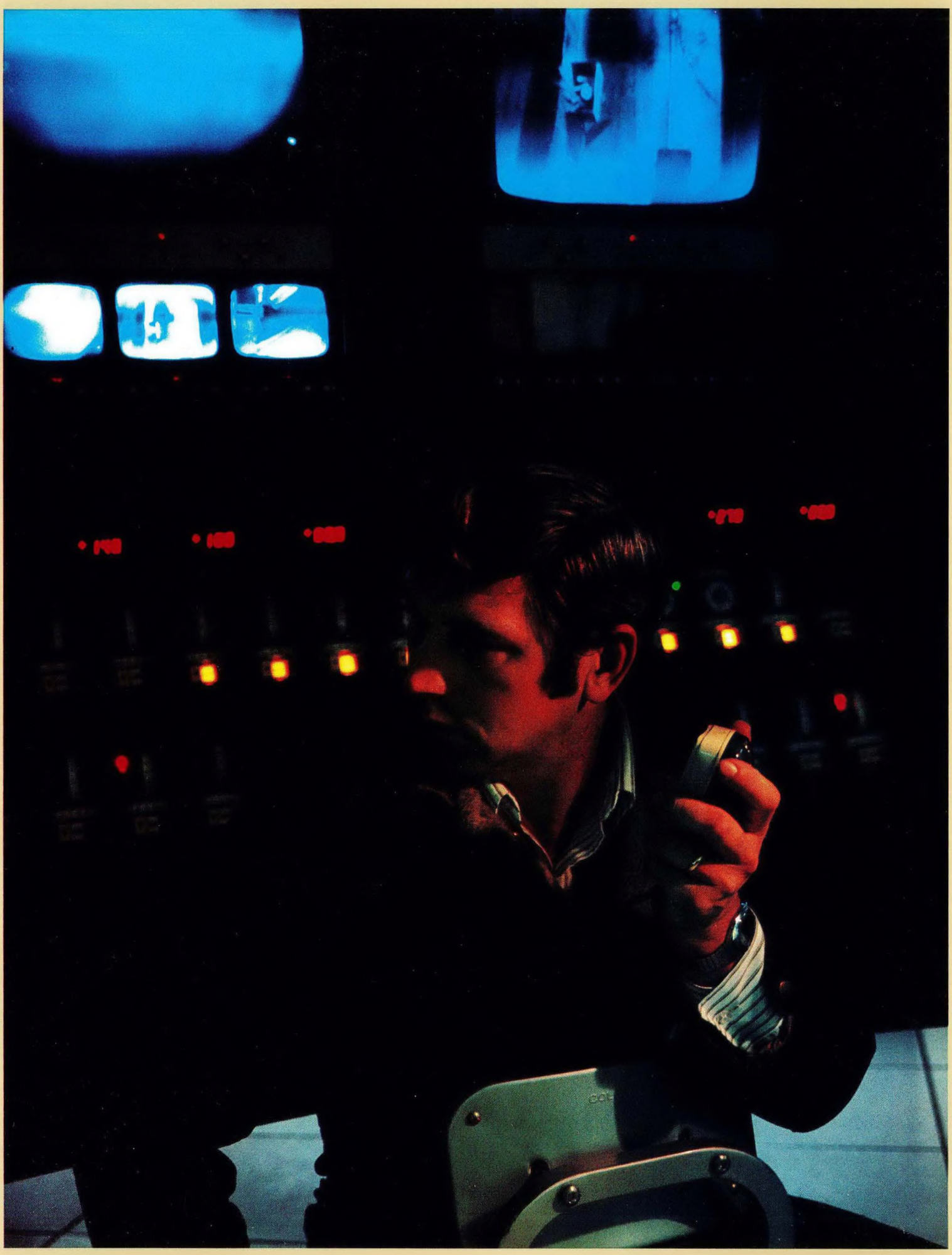
LSI(01/16/2018)_002373



Technology in Lone Star's Roanoke plant keeps cost low and production high. An engineer (right) monitors product quality and energy efficiency from his central control room. Raw materials (below) are converted into pellets, which will be preheated by recycled gases to promote fuel efficiency. Lone Star's Maryneal plant (left) is being converted from natural gas to coal for lower cost operation.

Technology is changing the cement industry. To the layman, cement plants may look pretty much alike. But more and more Lone Star plants are equipped with advanced technology to conserve energy, protect the environment, increase capacity, and most important, help the company reduce production costs in order to further improve margins and returns.

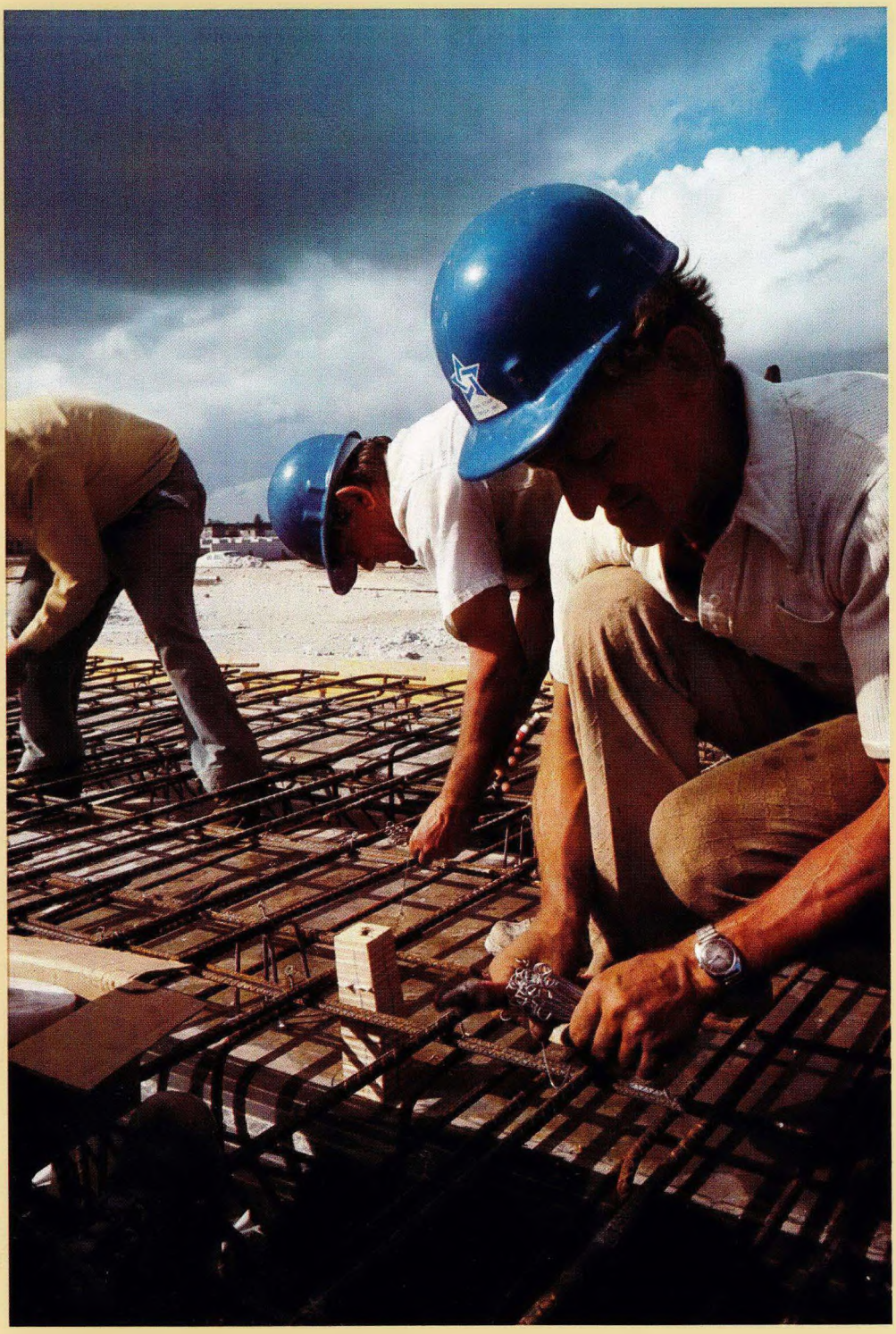




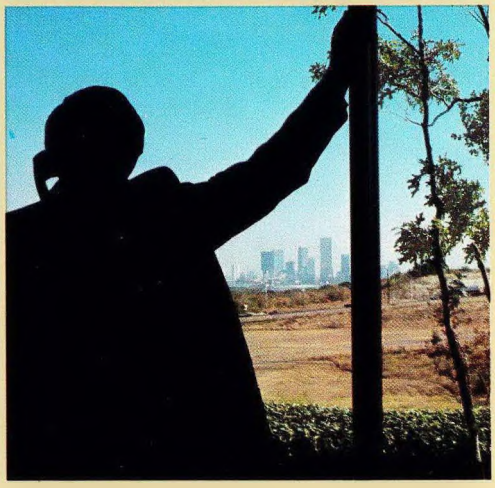
LSI(01/16/2018)_002375

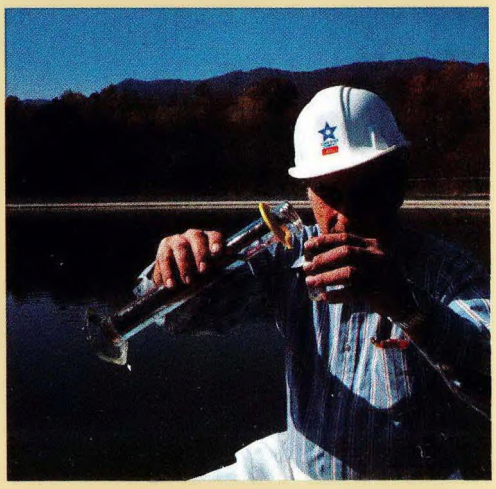






Hard work and commitment to growth characterize Lone Star's management at all levels. Lone Star managers are trained to do the job right, whether it means revitalizing a newly-acquired facility, delivering cement products on schedule, maintaining high environmental standards, or reclaiming lands for commercial and recreational use.





Part of the 42-man team of specialists (above left) that turned Lonestar Florida Pennsuco into a profitable operation in record time. Lonestar Florida products include precast wall panels (below left) and the prestressed concrete test beams (above) for the new Miami mass-transit system. View from an office building at Dallas' Lone Star Park (above right), formerly a cement plant site. Testing water from a settling pond at Roanoke (below right) before it returns to a neighboring stream.

LSI(01/16/2018)_002377



Lone Star's own barges carry aggregates inexpensively to major markets (above). Lone Star's ready-mix truck fleet helps serve the Houston market (right).



Building and rebuilding America's cities will keep future demand for Lone Star products strong. Through history, America's growing construction activity has contributed to the growth and prosperity of our country. Many of the major construction projects of this century—dams, water systems, highways, airport runways and the like—are in serious need of expansion, modernization and renewal.

Barges represent one of the least expensive forms of transportation available. Lone Star's fleet of barges extends its ability to serve customers in areas where other forms of transportation would make delivery impractical and costly.

The Lone Star barges at the left are carrying aggregates down the Hudson River to the concrete suppliers and contractors who are helping rebuild New York. Lone Star is America's largest source of sand and gravel, and one of the largest sources of crushed stone. Lone Star has more than 40 aggregates plants in eight states along the Atlantic, Pacific and Gulf Coasts with extensive reserves for the future.

Lone Star Building Centers serve a growing number of contractors and do-it-yourselfers in the dynamic residential housing market. In the long term, these Building Centers will grow with demand for housing and home improvement. Lone Star opens new retail Home Care Centers each year in fast-growing population centers where consumer demand is strongest . . . one more way Lone Star is planning for the future.

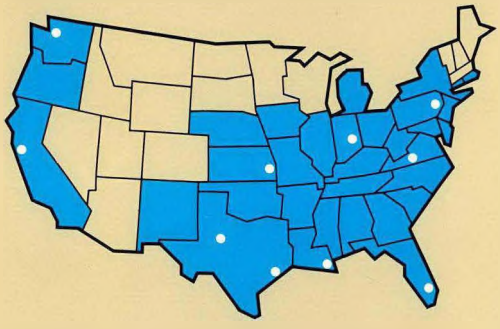




The do-it-yourself boom has increased sales at this Lone Star Home Care Center in California and at another 150 retail locations around the country. Retail lumber sales are an important part of total sales.

Lone Star Cement & Construction Materials Group At a Glance

Operating Statistics	1978	1977
Net sales	**$622.4**	$444.8
Operating profit	**67.0**	44.3
Profit margin	**10.8%**	10.0%
Identifiable assets	**$493.9**	$442.6
Capital expenditures	**52.3**	35.3
Depreciation & Depletion	**24.0**	21.1
Business Segment Sales		
Cement and related products	**$502.7**	$358.9
Construction aggregates	**105.0**	75.8
Other construction materials	**14.7**	10.1
	$622.4	$444.8



Principal States In Which Products Are Sold

Plus Alaska and Hawaii, and in South America: Argentina, Brazil and Uruguay.

Cement Plants

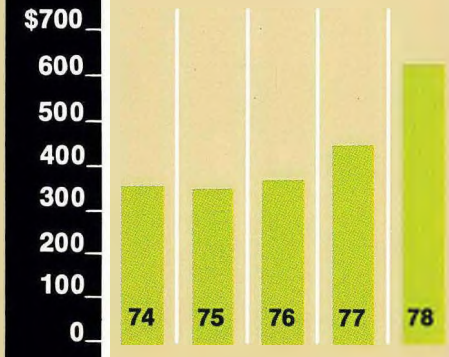
Group net sales rose 39.9% over 1977. All major segments contributed to the higher sales performance: cement and related products up 40.1%, construction aggregates up 38.5%, and other construction materials up 45.5%.

Cement consumption in the United States reached 83.3 million tons, up 8% from 1977. Lone Star continued to outpace the industry, recording more than a 9% increase in shipments of cement during 1978. It also obtained better-than-market performance in shipments of sand, gravel and crushed stone.

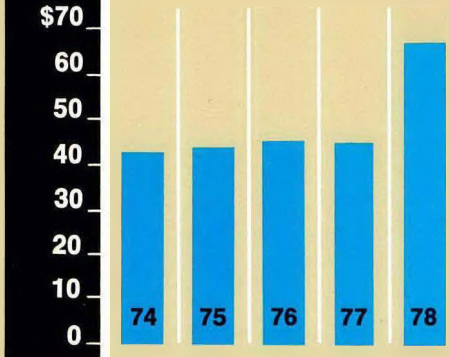
Group operating profits increased by 51.2%. Higher volume, better selling prices and effective cost controls were the major contributors to improved performance in all product lines. Lone Star's South American operations also contributed significantly to the improved performance of the group.

Return on identifiable assets increased to 13.6% in 1978. Capital expenditures increased 48.2% to $52 million, marking the beginning of Lone Star's expanded capital spending program designed to assure that the company has the productive capacity in place to help meet the growing needs of America's construction industry.

Net Sales—Cement & Construction Materials
(Dollars in Millions)

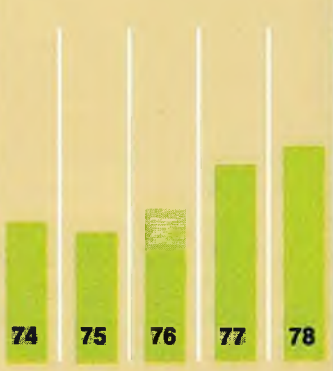


Operating Profits Cement and Construction Materials
(Dollars in Millions)

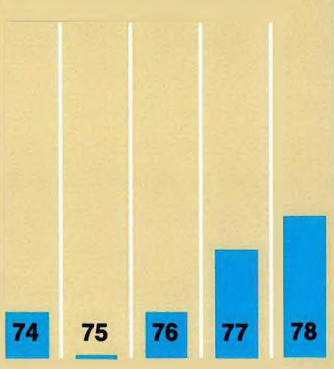


Building Centers Group At a Glance

Net Sales Building Centers
(Dollars in Millions)



Operating Profits Building Centers
(Dollars in Millions)



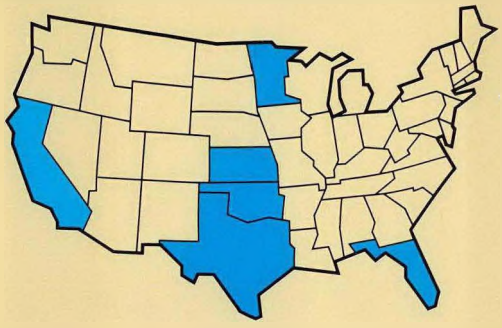
Group net sales increased 11.7% over 1977. Retail sales were up more than 20%, contractor/wholesale 5.7%, and combination unit sales 12.1%.

The continued high level of housing starts and construction expenditures, coupled with the uninterrupted growth of home maintenance and improvement expenditures by consumers were major factors influencing improved sales performance in all segments of the business. South Florida and Minneapolis/St. Paul markets showed unusual strength.

Group operating profits increased 29.5% in 1978. Each type of operation contributed to the improved operating profit: retail up 35.5%, contractor/wholesale up 26.3% and combination units 26.4%. Capital expenditures reached $9.7 million, up 49% from the $6.5 million in 1977.

Lone Star added seven new retail home care centers and one combination unit during 1978, and plans nine new units for 1979. Longer-term plans call for eight to 10 store openings each year.

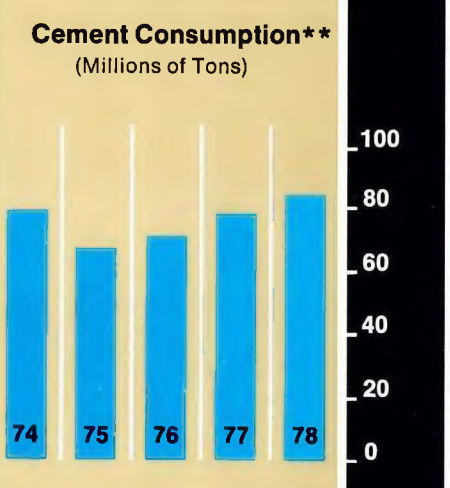
Operating Statistics	**1978**	1977
Net sales	**$453.5**	$406.1
Operating profit	**29.0**	22.4
Profit margin	**6.4%**	5.5%
Identifiable assets	**$181.7**	$159.9
Capital expenditures	**9.7**	6.5
Depreciation & Depletion	**3.8**	3.6
Business Segment Sales		
Retail	**$131.7**	$109.2
Contractor/ wholesale	**180.8**	171.1
Combination	**141.0**	125.8
	$453.5	$406.1



States In Which Operations Are Conducted

Cement & Construction Materials Group Review of Operations





Sources:
*U.S. Department of Commerce
**Portland Cement Association

Lone Star's Cement and Construction Materials Group achieved a 51 percent increase in operating profit on a 40 percent increase in net sales.

During 1978 the group established all-time records for performance in:

- Total net sales
- Total operating profit
- Net sales for each major business segment
- Operating profit for each major product line
- Total cement production and shipments

These records were set even though the year opened with two months of extremely cold weather that curtailed construction activity across much of the country. However, when weather improved in the spring, it unleashed pent-up demand for construction work and materials that outstripped every forecast. By May, Lone Star was producing cement at full capacity, a condition that continued unabated for the remainder of the year.

Lonestar Florida: Anatomy of a Turnaround

Among the most dramatic accomplishments in the Cement and Construction Materials Group was the concerted and successful effort to turn a new venture into a stable, profitable operation.

Early in 1978, Lone Star assumed management of the principal operating assets of Maule Industries, Inc., a major Florida cement, aggregates and concrete producer that had been in bankruptcy proceedings for more than a year.

The receiver had long sought a buyer for the company to avoid the loss of 1,200 jobs. Before stepping in, Lone Star dispatched a team of experts in operations, marketing, finance, personnel and other key areas to make a thorough study. Lone Star proceeded from this point with full awareness of the difficulty of the problems, but with the firm conviction that it was the only company with the management breadth and depth to turn the business around.

As soon as the acquisition was completed, Lone Star moved in 42 management experts from other Lone Star facilities, teamed them up with selected Maule managers and began to rebuild the business. This team:

- built up cement inventories to permit shutdown for major modifications without losing sales;
- launched operator training programs and improved operating and safety techniques;
- installed proven Lone Star quality-control and preventive-maintenance methods;
- overhauled marketing, sales and pricing policies; and

LSI(01/16/2018)_002382

installed new systems for management information, purchasing, inventory accounting and cost control.

In less than a year, aided by improving construction activity, Lone Star brought these operations from a severe loss position to one of increasingly stable profitability.

Other New Projects

The group also initiated or completed a number of other projects that will improve profitability in 1979 and later years:

Santa Cruz Expansion

Lone Star began expanding its plant near Santa Cruz, California, in order to increase productive capacity from 395,000 tons per year to 750,000 and improve the plant's environmental and energy efficiency. Underway is a complete revitalization of the basic plant by replacing the existing small kilns with a single, large kiln. In addition to higher overall plant efficiency and reduced energy consumption, the larger kiln will provide a higher degree of air quality control. The expanded plant is scheduled to be in operation in 1981. Meanwhile, construction is being managed in such a way that it will not interrupt output from the existing facilities.

Lone Star acquired major terminals at Redwood City and Sacramento, California, to receive and store cement from more distant sources. This will help relieve shortages in the San Francisco Bay area until the Santa Cruz expansion is completed.

New Texas Plant

In October, Lone Star announced plans to construct a new million-ton-a-year cement plant in Georgetown, Texas, on property owned by Texas Crushed Stone, Inc., which will produce the raw material. Lone Star will purchase the plant site and raw material reserve property. The plant will employ the most modern technology for energy efficiency and environmental compliance.

Around the Country

Maryneal, Texas—A $5 million conversion of this Texas plant from natural gas to powdered coal is due for completion by early spring, 1979.

Norfolk, Virginia—Lone Star Lafarge, Inc., a joint-venture company, completed construction of a new plant to manufacture "Secar" brand high-purity calcium-aluminate cement, a premium-priced product with applications in refractories, chemical processes and other special industrial uses.

Lone Star also completed a new facility in this market to receive, grind, dry and ship ulexite, which is used in the manufacture of fiberglass.

Sacramento, California—In September, Lone Star officially opened its new $12 million sand-and-gravel plant here. The facility can produce 1.5 million tons of aggregates per year with 30 years of reserves.

Highland, Indiana—Lone Star Minerals, Inc., a joint venture with H. B. Reed & Co., Inc. of Highland, Indiana, began operations in July. The new company links Lone Star's nickel slag processing facilities with the boiler slag facilities of H. B. Reed to produce and market granules for roofing shingles and sandblasting.

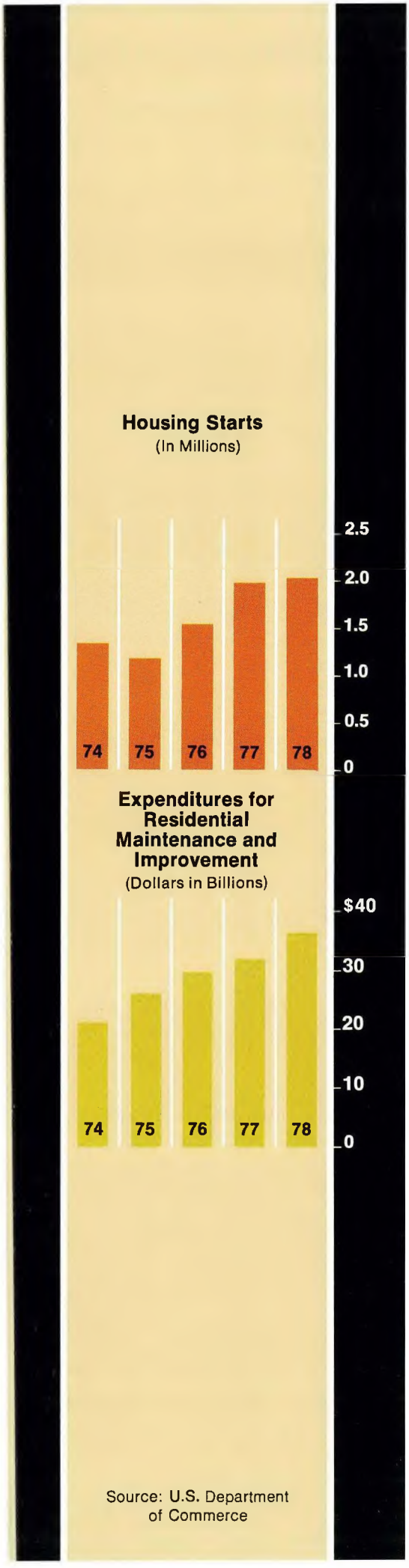
International Division

The International Division achieved record sales and earnings, with particularly strong results in Argentina and Uruguay. Lone Star's South American plants again marketed all the cement they could produce.

Lone Star continues to study the proposed consolidation of its Brazilian interests with those of Lafarge, S.A. of France. The resulting company would be Brazil's second-largest cement producer. Lone Star received a Brazilian government authorization in 1978 to build a new plant at Cantagalo to serve the Rio market.

LSI(01/16/2018)_002383

Building Centers Group Review of Operations



Many Records Are Established

Lone Star's Building Centers Group in 1978 achieved a 29 percent increase in operating profit on a 12 percent increase in net sales, establishing a host of new records.

Profit growth—at a much faster rate than sales—reflected improved cost controls, greater efficiencies and an overall strengthening of management effectiveness at all operating levels.

Contributing to the sales gain were the continued strength of the national economy, the extremely high level of housing starts and the further rapid growth of spending for home improvement and remodeling.

The persistent escalation of housing prices began to be perceived as a hedge against inflation, instead of an impediment to buying. Homeowners also were induced to sustain the value of their investments through home maintenance and improvement, adding to demand for home-building and improvement materials.

Regionally, the greatest factor in the group's operating improvement was the strong and sustained turnaround in the South Florida economy, resulting in low vacancy rates in residential units of all types and strong recovery of residential and commercial construction. The Minneapolis-St. Paul area also showed a surge of construction activity and contractor demand for materials. But a generally favorable economy prevailed in all of the group's major markets.

Retail Sales Rise 21 Percent

Retail sales to do-it-yourself homeowners from Lone Star's Home Care Centers increased 21 percent in 1978, establishing a new sales record for the seventh consecutive year since Lone Star's entry into this business in 1971. The strong retail sales growth stemmed both from higher sales in existing retail outlets and from the opening of seven new Home Care Centers during the year. The retail sales growth represented almost half of the group's 1978 sales increase, outpacing the gains at contractor and combination outlets.

Retail Home Care Center operations also produced the largest advance in operating profits—accounting for over a third of the group's year-to-year increase. For the first time, retail operations produced the group's largest share of both gross profits and operating profits.

The contractor-and-wholesale operations of the Building Centers Group produced a 26 percent gain in operating profit on a 6

LSI(01/16/2018)_002384

percent increase in sales. Combination operations—which serve both contractors and retail customers—yielded a 26 percent operating profit increase on a 12 percent sales increase. Those results were achieved even though distribution of building materials to contractors was hampered early in the year by poor construction weather in most regions. Later in the year, the group's operations were impeded, in the Western Region especially, as cement shortages tended to curtail general construction activity.

Eastern Region Regains Profit Leadership

A resurgence of economic and construction activity in South Florida helped the group's Eastern Region achieve higher net sales and sharply higher operating profit, marking the region as the group's most profitable in 1978.

The North Central Region, primarily in the Minneapolis-St. Paul market area, also showed strong advances in net sales and operating profit aided by a recovery in general construction activity. The Southwestern Region (encompassing Texas, Oklahoma and Kansas) continued a trend of gains in both sales and operating profit. Despite unfavorable weather in the first quarter and the construction slowdown related to the cement shortage in the fourth quarter, the Western Region posted higher operating profit on a slight decline in sales.

Retail Expansion Under Way

Seven additional retail Home Care Centers were opened during 1978, and three more are now scheduled for opening in the first quarter of 1979. The group intends to keep opening stores at the rate of eight to ten each year.

Retail Merchandising Standardized

Substantial progress was made during the year in developing standardized merchandising features, including wall colors, aisle signs and how-to-do-it exhibits.

The standardized designs have been tested and approved in new stores opened during 1978. They will be gradually integrated in redecorating and revising of existing stores on a scheduled basis. The objective is to provide more shopping convenience and product information for the do-it-yourself homeowner—in pleasant, colorful and uncluttered surroundings.

Innovations include drive-through pickup areas, miniature cut-away model homes showing installation methods, and an "energy center" educating the homeowner on how to use insulation, temperature-control devices and other means of reducing energy consumption.

Application of standardized retailing methods, along with national purchasing programs, are part of a continuing effort to increase management coordination among the group's regional operations.

Sale of California Contractor/ Wholesale Operations

Lone Star reached agreement in principle in February, 1979 for the cash sale of contractor, wholesale, combination and related operations in the Los Angeles basin to Louisiana Pacific Corporation, a major forest products firm. Not included in the sale are the Cooper's Home Care Centers. The purchase terms agreed upon, plus outstanding accounts receivable, will release approximately $45 million of capital for Lone Star's future growth and acquisition programs.

LSI(01/16/2018)_002385

Summary of Operating Results by Industry Segment

The table below sets forth the contribution of each industry segment to Lone Star's consolidated net sales and operating profits.

(In millions)	1978	1977	1976	1975	1974
Net Sales					
Cement & Construction Materials:					
Cement and related products:					
Domestic	**$ 388.6**	$270.2	$214.9	$192.0	$188.8
International	**114.1**	88.7	77.1	76.9	72.4
Total	**502.7**	358.9	292.0	268.9	261.2
Construction aggregates	**105.0**	75.8	71.0	69.8	76.8
Other construction materials	**14.7**	10.1	9.7	8.6	11.0
Total	**622.4**	444.8	372.7	347.3	349.0
Lone Star Building Centers:					
Retail	**131.7**	109.2	93.6	84.8	76.4
Contractor and wholesale	**180.8**	171.1	127.0	86.1	116.5
Combination	**141.0**	125.8	102.9	91.4	104.0
Total	**453.5**	406.1	323.5	262.3	296.9
Other Operations	**15.9**	10.4	22.7	20.0	22.9
Total	**$1,091.8**	$861.3	$718.9	$629.6	$668.8
Net Profits					
Operating Profits:					
Cement & Construction Materials:					
Cement and related products:					
Domestic	**$ 38.8**	$ 26.8	$ 22.7	$ 23.7	$ 23.6
International	**11.8**	10.1	14.2	12.0	9.8
Total	**50.6**	36.9	36.9	35.7	33.4
Construction aggregates	**15.8**	7.4	7.8	7.9	9.5
Other construction materials	**0.6**	0.0	0.0	(0.1)	0.1
Total	**67.0**	44.3	44.7	43.5	43.0
Lone Star Building Centers:					
Retail	**10.3**	7.6	3.9	0.5	2.4
Contractor and wholesale	**9.6**	7.6	3.3	0.0	2.9
Combination	**9.1**	7.2	2.2	0.0	4.1
Total	**29.0**	22.4	9.4	0.5	9.4
Other Operations	**3.1**	4.2	3.2	(0.2)	0.6
Total Operating Profits	**99.1**	70.9	57.3	43.8	53.0
Plus: Joint ventures and unconsolidated subsidiary	**2.1**	0.2	2.8	5.3	7.3
Less: Interest expense	**(19.8)**	(19.2)	(14.2)	(15.4)	(15.8)
Corporate and unallocated expenses	**(14.7)**	(10.6)	(11.3)	(6.7)	(7.1)
Income taxes	**(21.3)**	(11.6)	(7.4)	(7.7)	(13.1)
Net Income	**$ 45.4**	$ 29.7	$ 27.2	$ 19.3	$ 24.3

A description of the company's industry segments and additional information regarding identifiable assets, capital expenditures and depreciation and depletion for 1978 and 1977 appears in Note 21 of Notes to Financial Statements on page 41.

Due to the significant interrelationship of the company's cement and concrete operations and the increased significance of concrete sales resulting from the establishment of Lonestar Florida, concrete and concrete products are no longer included in the other construction materials segment. Concrete and concrete products are now included in the cement and related products segment. This change and other reclassifications have been made to conform the above segment data to current year presentation.

International cement and related products results as reported above are derived from South America and represent all the company's operations outside the United States.

Intersegment sales of construction aggregates to other industry segments are not included above, are accounted for at list prices and consist of the following (In millions): 1978, $20.4; 1977, $16.7; 1976, $13.7; 1975, $16.0; and 1974, $16.7.

Corporate and unallocated expenses include corporate administrative expenses, securities income (net of related foreign currency translation losses) and minority interest.

CONSOLIDATED RESULTS

Billion-Dollar Sales Set Record

Lone Star established a new sales record as consolidated net sales rose to $1.1 billion in 1978, an increase of $230.5 million, or 26.8% above the previous record set in 1977. The company's high level of sales for 1978 reflects record sales from both the construction materials and building materials operations. The major portion of the increase is attributable to the company's domestic and international cement and construction materials operations, in which sales increased 39.9%, reflecting the continued growth of construction activity, particularly in the West and Southwest. The results also include $69.0 million in sales of Lonestar Florida, Inc., a new affiliate (see Note 6 on page 36). Sales of cement and related products of $502.7 million account for over 80% of the total sales of cement and construction materials operations and represent an increase of 40.1% over 1977. This increase is primarily attributable to an increase in domestic cement sales volume resulting from a 15% increase in construction expenditures in the U.S. as well as the implementation of necessary price increases. International Division sales increased by $25.4 million, or 28.6%, reflecting higher cement prices, particularly in Argentina. Sales in the lumber and building materials operations rose 11.7% in 1978 as sales increased in all types of operations, particularly retail. Retail sales established a new record of $131.7 million, 20.6% above 1977, reflecting the continued growth in consumer home improvement activities, particularly in Florida.

Cost of Sales Reflects Increased Sales Activity

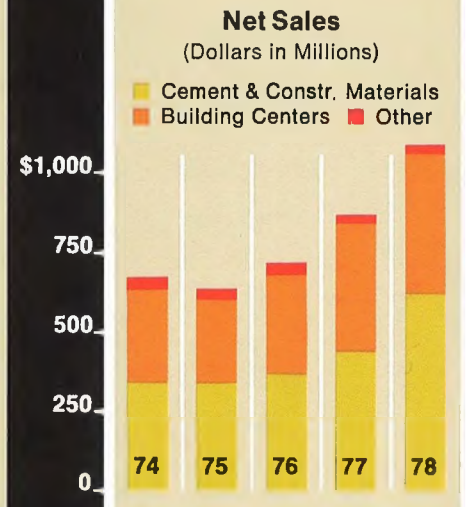
Cost of sales increased 27.5% in 1978 principally due to increased sales and higher costs in both operating groups and the inclusion of the operations of Lonestar Florida, Inc. In the company's Cement & Construction Materials Group, the increase in operating costs is primarily a result of higher power, fuel, labor and maintenance costs associated with increased production. In order to increase output to meet the substantial demand for cement, particularly in the West, increased quantities of clinker were purchased from abroad. The gross profit percentage improved slightly from 1977 as cement and construction materials sales rose at a greater rate than cost of sales. In the Lone Star Building Centers Group, gross margins increased slightly, despite higher costs, due to increased operating efficiencies and an increased proportion of retail sales, which have a higher gross margin.

SG&A Declines as a Percentage of Net Sales

Selling, general and administrative expenses as a percentage of net sales declined to 14.1% in 1978 from 15.1% in 1977. These costs increased by $24.6 million, or 18.9% in 1978 from 1977, principally reflecting the effects of the increased sales activity in both the construction and building materials operations. Higher advertising costs were experienced in the Building Centers group primarily due to increased promotional activities for the retail operations.

Depreciation Expense

Depreciation and depletion expense of $28.1 million in 1978 increased $3.1 million, or 12.2% from 1977. This increase resulted primarily from the increase in total depreciable assets



LSI(01/16/2018)_002387

from $574.3 million in 1977 to $614.9 million in 1978. The International Division's depreciation and depletion expense increased $1.6 million, principally as a result of depreciation charges on 1978 plant improvements.

Operating Profits Near $100 Million

Consolidated operating profits established a new record of $99.1 million, an increase of $28.2 million, or 39.8% from 1977. Profits from the cement and construction materials operations, which account for 67.6% of consolidated operating profits, rose $22.7 million to $67.0 million for 1978, as sales increased at a greater rate than production costs. Operating profits for cement and related products increased $13.7 million, and construction aggregates profits increased $8.4 million, as increased sales volumes and higher unit prices more than offset higher costs for fuel, power, labor and maintenance. Profits from the lumber and building materials operations increased to $29.0 million in 1978 from $22.4 million in 1977, reflecting increased profits for all types of operations. Retail and combination unit profits in 1978 increased $2.7 million and $1.9 million, respectively, primarily as the result of improved margins and the continued improvements in the company's Florida operations. Contractor and wholesale profits increased $2.0 million to $9.6 million reflecting the higher sales levels from increased construction activity, particularly in the Minneapolis area.

Income Taxes Increase on Record Earnings

Federal, foreign and other income taxes increased $9.7 million, or 83.6% from 1977 reflecting an increase in pre-tax earnings of 61.4% and a higher effective corporate tax rate. The higher rate is attributable to increased operating profits in international and retail and distribution operations which have a higher effective tax rate than domestic cement and construction materials operations, and the disposition of surplus properties in 1977 which were subject to a lower effective tax rate.

Record Net Income

Lone Star's net income in 1978 reached a record $45.4 million, a 52.9% increase over the previous record set in 1977. The increase in earnings is attributable to increased sales and operating profits in the company's two major operating groups, particularly in the cement and construction materials operations. This was partially offset by higher income taxes.

In 1978, Lone Star earned a record $4.02 per share of common stock after deducting dividends on preferred stock, compared with $2.66 per share in 1977. Net income per share is based on 11.2 million and 11.1 million weighted average shares outstanding in 1978 and 1977, respectively. Fully diluted income per share, which assumes the conversion into common shares of all convertible preferred shares and all convertible debentures and the exercise of all dilutive stock options, was $3.68 in 1978 and $2.45 in 1977.

Capital Expenditures Climb; Major Modernization Program Started

Lone Star's capital expenditures in 1978 totaled $62.3 million, $20.3 million above 1977. Capital spending for the Cement & Construction Materials Group totaled $52.3 million for the improvement and expansion of existing plants and replacement of equipment. Major projects for 1978 included the completion of a sand and gravel plant in Sacramento, California, the purchase of two terminals on the West Coast and the commencement of a major modernization program at the Santa Cruz cement plant. This latter project, with an estimated cost of $70 million, is designed to reduce energy consumption, increase environmental controls and raise plant capacity by over 350,000 tons per year to 750,000 tons annually. Capital expenditures of $6.8 million by the International Division were totally provided from the financial resources of the South American subsidiaries. The Lone Star Building Centers Group invested $9.7 million in new facilities in 1978, an increase of $3.2 million from 1977. Capital expansion of the group's retail and combination operations added 8 units in 1978, with 9 others expected to be completed in 1979. Capital expenditures by these groups in each of the past five years are summarized in the following table (In millions):

	C&CM	LSBC
1978	$ 52.3	$ 9.7
1977	35.3	6.5
1976	36.1	3.2
1975	29.9	3.5
1974	28.4	13.5
Total	$182.0	$36.4

Stock Prices

The following table shows the quarterly high and low prices of Lone Star's common stock and preferred stock for 1978 and 1977, as reported in The Wall Street Journal.

Lone Star's common shares are listed on the New York, Boston and Pacific Stock Exchanges and are open to trading on the Midwest and Philadelphia Stock Exchanges.

	Common Stock		Preferred Stock	
	High	Low	High	Low
1978 Quarters				
1st	$19⅞	$17¼	$ 75	$ 74
2nd	21¾	18	81	81
3rd	27⅛	19	105	82½
4th	27	18⅝	105	103
1977 Quarters				
1st	$23¼	$19⅜	$ 90	$ 81½
2nd	23⅝	19⅞	85½	85½
3rd	21¼	16¾	81	81
4th	19⅞	16¾	72	69

Dividend Increased

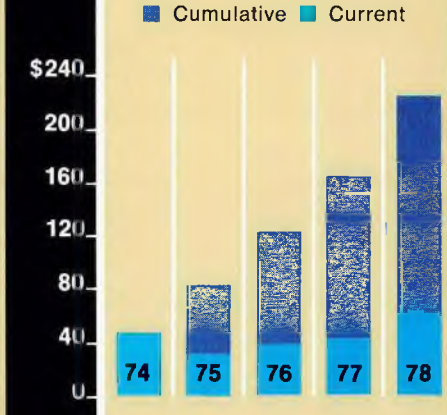
In 1978, the dividend on Lone Star common stock was raised to an effective annual rate of $1.20 per share as the company completed its 44th consecutive year of uninterrupted quarterly dividends on common stock. Cash dividends of $0.30 per share were paid to holders of common stock in each quarter of 1978 and $0.275 per share was paid in each quarter of 1977. The company paid cash dividends of $1.125 per share in each quarter of both years on its preferred stock. Total cash dividends on common shares were $13.4 million in 1978 and $12.2 million in 1977. Dividends paid to preferred shareholders were $232,000 in 1978 and $253,000 in 1977. The variations from 1977 reflect conversions of preferred shares and the increase in dividends paid on common stock.

In January 1979, Lone Star announced another increase in dividends, raising the quarterly cash dividend on common stock to $0.35 per share, equivalent to an annual rate of $1.40 per share.

Net Income per Common Share

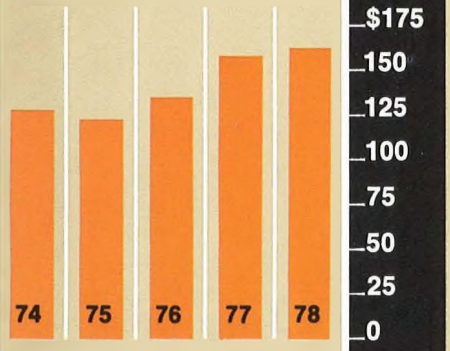


Capital Expenditures
(Dollars in Millions)

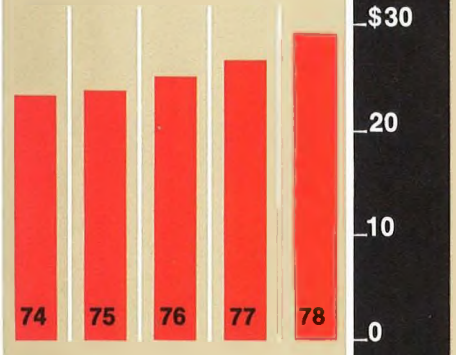


LSI(01/16/2018)_002389

Working Capital
(Dollars in Millions)



Equity per Common Share



Financial Position Strengthens

Working capital (current assets less current liabilities) was $162.4 million at December 31, 1978, compared to $157.1 million at the end of 1977. Funds provided by operations, as shown on page 35, totaled $79.0 million in 1978 and exceeded capital expenditures and dividends. Interest expense was covered 4.4 times by 1978 earnings before interest and taxes.

Long-term debt increased by $3.1 million in 1978, as normal debt repayments were offset by increased long-term borrowings, primarily in the International Division. At year end, long-term debt accounted for a smaller percentage of total capitalization—34.4%, as compared with 36.3% in 1977—due to the high level of earnings for 1978.

The company has $67 million available in a Revolving Credit and Term Loan Agreement with several banks plus an additional $11 million in seasonal lines of credit. At year end, there were no borrowings outstanding under these agreements.

The company repurchased $2.6 million of its 4⅞% Sinking Fund Debentures in the open market in 1978, meeting sinking fund requirements for 1979 under the indenture agreement.

Total shareholders' equity increased 11.1% to $330.2 million at December 31, 1978. This represents an increase of $2.57 per share in common shareholders' equity, to $29.24 at the end of 1978.

GROUP OPERATING RESULTS

Cement & Construction Materials

The Cement & Construction Materials Group recorded net sales of $622.4 million in 1978, an increase of $177.6 million, or 39.9% over 1977. The results included net sales of $69.0 million from the operations of Lonestar Florida, Inc., a new subsidiary (see Note 6 on page 36). Domestic net sales rose 42.7% from 1977 as sales increased in all product lines, particularly in cement. Domestic cement sales, which accounted for nearly half of all domestic sales, increased $56.5 million, or 30.5% from 1977, reflecting increased sales volumes and higher unit prices as strong residential and commercial building activity, particularly in the West and Southwest, has created regional cement shortages. Increased construction aggregates sales of 38.5% is attributable to higher sales volumes resulting from increased demand particularly in the Northeast, Southeast and Pacific regions. Domestic sales of concrete and concrete products increased 72.7% from 1977 primarily as a result of the inclusion of $50.6 million of sales of concrete and concrete products from Lonestar Florida, Inc. International sales increased $25.4 million from 1977 reflecting higher cement prices, particularly in Argentina.

LSI(01/16/2018)_002390

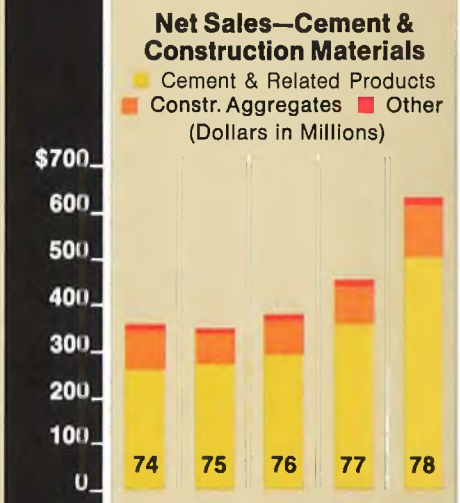
C&CM Net Sales by Product Line

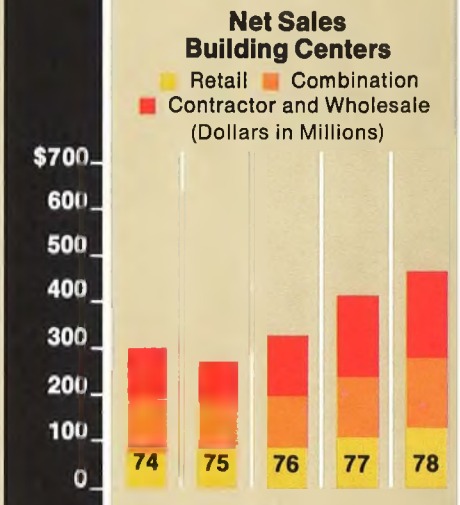
(In millions)	1978	1977	1976	1975	1974
Cement:					
Domestic	**$241.5**	$185.0	$143.4	$121.4	$116.7
International	**108.1**	85.3	74.5	72.5	69.5
	349.6	270.3	217.9	193.9	186.2
Concrete & concrete products:					
Domestic	**147.1**	85.2	71.5	70.6	72.1
International	**6.0**	3.4	2.6	4.4	2.9
	153.1	88.6	74.1	75.0	75.0
Construction aggregates	**105.0**	75.8	71.0	69.8	76.8
Other construction materials	**14.7**	10.1	9.7	8.6	11.0
	$622.4	$444.8	$372.7	$347.3	$349.0

The Cement & Construction Materials Group operating profit for 1978 increased $22.7 million to $67.0 million, primarily as a result of the higher sales level. Operating profits for cement and related products increased by $13.7 million, or 37.1%, primarily from domestic operations where the effect of increased sales more than offset higher costs. Cement sales volumes increased as the higher level of construction activity experienced in the country resulted in cement shortages in the Southwest and Pacific areas of the country. The shortages made it necessary to increase production schedules and to allocate supplies to customers. Foreign cement and clinker were imported to help meet the demand. Labor, power, fuel and supplies costs increased as a result of the increased production levels and higher rates. Higher repairs and maintenance costs are also the result of increased production. Cement profits increased in the International Division on the higher net sales, primarily as a result of the increased cement prices in Argentina. Profits from operations in Brazil were below 1977 due to production problems and higher repair costs. Construction aggregates profits more than doubled from 1977 to $15.8 million in 1978, resulting from the strong demand for construction materials, particularly in the Northeast, Southeast and Pacific regions.

Lone Star Building Centers

Net sales in the Building Centers Group increased $47.4 million, or 11.7% from 1977, as sales increased in all types of operations. Retail sales of $131.7 million represent an increase of $22.5 million or 20.6% from 1977 and established a new sales record for the seventh consecutive year. The increase, which represents 47.5% of the total sales increase in the Group, is attributable to the continued gains in consumer home improvement activities, particularly in Florida, and the opening of 7 new Home Care





LSI(01/16/2018)_002391

Centers in 1978. Combination unit sales and contractor and wholesale sales increased 12.1% and 5.7%, respectively, primarily as a result of the 2.0 million new housing starts in 1978. Increased construction activity was particularly strong in Florida and the Minneapolis area. Combination unit sales and contractor and wholesale sales in Southern California were below 1977 sales levels due to severe weather conditions in the first quarter of 1978 and cement shortages experienced later in the year which affected lumber sales for residential building.

The Building Centers Group operating profit increased by $6.6 million, or 29.5% above 1977, reflecting increases in all types of operations. Retail operating profits of $10.3 million in 1978 increased 35.5% from 1977 as a result of improved margins and the continued improvement in the company's Florida operations. An increase in contractor and wholesale profits of 26.3% is primarily attributable to the favorable effects of new housing starts, particularly in the Minneapolis area. Combination unit profits increased $1.9 million, or 26.4%, reflecting the increased sales level, particularly in Florida, and improved margins.

Other Operations

In 1978, the company's Other Operations recorded net sales of $15.9 million and operating profits of $3.1 million, primarily as a result of strong sales of developed properties in Hawaii.

Comparison of 1977 and 1976 Results

Net sales rose in 1977 to $861.3 million, an increase of $142.4 million, or 19.8% above 1976. The year's sales performance resulted primarily from increased activity in the construction and building materials markets. The major portion of the increase occurred in the lumber and building materials operations, where a continued increase in demand resulted in higher sales in all types of operations. Contractor and wholesale sales and combination unit sales increased from 1976 by 34.7% and 22.3%, respectively, reflecting higher demand, principally in the West and Southwest, resulting from the nearly 2 million housing starts in 1977. Retail sales increased 16.7% from 1976, primarily from increased consumer home improvement activities. Sales in the company's domestic and international cement and construction materials' operations rose 19.3% in 1977, primarily as a result of increased cement sales volumes and higher net realized prices, plus the inclusion of the operations of the Roanoke cement plant received as a result of the termination of the Citadel joint venture in 1977.

Cost of sales increased by 21.2% in 1977 from 1976, primarily from higher net sales and higher costs. The gross margin rate for both operating groups fell slightly as costs for power, fuel, labor and maintenance rose at a slightly higher rate than sales.

Interest expense increased $5.1 million from 1976, principally reflecting $2.9 million of interest related to debt assumed from the Citadel joint venture and additional borrowings during the year.

Consolidated operating profits of $70.9 million were $13.6 million above 1976 as a result of strong sales gains in all types of operations in the company's lumber and building materials operations, where profits increased from $9.4 million in 1976 to $22.4 million in 1977. Operating profits from the cement and construction materials operations were $0.4 million below 1976 as increased profits from domestic operations were offset by lower income from the international operations. International operating profits decreased as a result of lower profits in Brazil, where lower cement shipments more than offset the increased profits in Argentina that resulted from higher cement prices and shipments.

Total income taxes increased in 1977 to $11.6 million from $7.4 million in 1976 as a result of higher pre-tax earnings in 1977 and a higher effective tax rate. The higher effective tax rate is primarily attributable to increased operating profits from the lumber and building materials operations, which have a higher effective tax rate than the cement and construction materials operations.

Net income of $29.7 million was 9.2% higher than 1976. This increase reflects the increased profit contribution made by the company's lumber and building materials operations, partially offset by a lower contribution to net income from the company's international operations and by higher income taxes.

LSI(01/16/2018)_002392

Quarterly Financial Data (Unaudited)

(Dollars in millions except per share amounts)

	Net Sales			Gross Profit*			
	1978	1977	% Increase	1978		1977	
				Amount	%	Amount	%
Quarter							
First	**$ 191.7**	$175.7	9.1%	**$ 38.4**	20.0%	$ 34.6	19.7%
Second	**304.8**	220.0	38.5	**68.3**	22.4	50.3	22.9
Third	**299.6**	224.6	33.4	**67.7**	22.6	52.1	23.2
Fourth	**295.7**	241.0	22.7	**65.3**	22.1	54.1	22.4
	$1,091.8	$861.3	26.8%	**$239.7**	22.0%	$191.1	22.2%

	Net Income		Net Income Per Share			
	1978	1977	Primary		Fully Diluted**	
			1978	1977	**1978**	1977
Quarter						
First	**$ 0.3**	$ 0.2	**$0.02**	$0.01	**$0.02**	$0.01
Second	**16.0**	10.4	**1.42**	0.93	**1.29**	0.85
Third	**16.5**	11.2	**1.47**	1.01	**1.33**	0.92
Fourth	**12.6**	7.9	**1.11**	0.71	**1.02**	0.65
	$45.4	$29.7	**$4.02**	$2.66	**$3.68**	$2.45

*Includes annual depreciation of $23.9 and $20.9 in 1978 and 1977, respectively.

**Fully diluted earnings per share for the year does not equal the sum of the four quarters as a result of the anti-dilutive effect from preferred stock, convertible debentures and stock options in the first quarter.

Financial Ratios and Statistics

(Dollars in thousands except per share amounts)

	1978	1977	1976	1975	1974
Invested capital:					
Long-term debt	**$178,195**	$175,105	$125,813	$165,000	$168,793
Minority interest	**9,467**	9,546	9,371	7,523	6,436
Shareholders' equity	**330,154**	297,205	279,892	264,282	256,325
	$517,816	$481,856	$415,076	$436,805	$431,554
Working capital	**$162,366**	$157,086	$134,712	$122,758	$126,293
Current assets to current liabilities	**2.3**	2.6	2.3	2.4	2.5
Long-term debt to invested capital	**34.4%**	36.3%	30.3%	37.8%	39.1%
Income to average invested capital*	**10.4%**	8.1%	8.3%	6.1%	7.6%
Return on shareholders' average equity	**14.5%**	10.3%	10.0%	7.4%	9.7%
Net income to net sales	**4.2%**	3.4%	3.8%	3.1%	3.6%
Equity per common share	**$ 29.24**	$ 26.67	$ 25.16	$ 23.76	$ 23.47
Percentage of earnings returned to shareholders	**30.1%**	41.9%	42.7%	58.8%	46.7%
Number of employees at year-end	**13,800**	13,000	12,300	12,900	13,300

*Income represents net income, minority interest and interest expense net of income taxes.

Ten-Year Summary of Operations

Dollars in thousands
except per share amounts

	1978	1977
Revenue		
Net sales	**$1,091,815**	$861,324
Other income—net	**5,428**	3,581
	1,097,243	864,905
Deductions from revenue:		
Cost of sales	**828,174**	649,349
Selling, general & administrative expense	**154,481**	129,916
Depreciation and depletion	**28,143**	25,077
Interest	**19,767**	19,253
	1,030,565	823,595
Income before income taxes and extraordinary charge	**66,678**	41,310
Provisions for income taxes	**21,300**	11,600
Income before extraordinary charge	**45,378**	29,710
Extraordinary charge, net of taxes	**—**	—
Net income	**45,378**	29,710
Provision for preferred dividends	**232**	253
Net income applicable to common stock	**$ 45,146**	$ 29,457
Retained earnings at beginning of year[2]	**$ 230,408**	$212,215
Net income	**45,378**	29,710
Cash dividends paid		
Common shares	**13,409**	12,202
Preferred shares	**232**	253
	13,641	12,455
Retained earnings at end of year	**$ 262,145**	$229,470
Per common share[1]		
Income before extraordinary charge	**$4.02**	$2.66
Extraordinary charge	**—**	—
Net income per common share	**$4.02**	$2.66
Per common share assuming full dilution[1]		
Income before extraordinary charge	**$3.68**	$2.45
Extraordinary charge	**—**	—
Net income per common share	**$3.68**	$2.45
Weighted average common shares outstanding	**11,231,892**	11,090,728
Dividends paid per common share	**$1.20**	$1.10

Notes (Dollars in thousands):

(1) Income per common share is based on the weighted average number of shares outstanding in each year after allowing for preferred dividends. Fully diluted income per common share assumes that preferred stock and convertible debentures had been converted and dilutive stock options had been exercised at the beginning of each year.

(2) Retained earnings at the beginning of 1978 have been restated to include $938 of retained earnings of Mineral Aggregates, Inc. acquired in 1978 and accounted for as a pooling of interests. Prior years' results have not been restated as the effect on those years is not significant.

1976	1975	1974	1973	1972	1971	1970	1969
$718,948	$629,550	$668,831	$693,256	$485,996	$382,580	$344,583	$284,321
5,174	12,254	11,635	3,333	3,808	3,414	1,968	2,136
724,122	641,804	680,466	696,589	489,804	385,994	346,551	286,457
535,973	471,187	501,917	517,748	358,101	272,960	241,519	198,956
115,849	105,603	103,987	101,021	65,901	55,920	53,738	41,093
23,521	22,568	21,372	21,476	20,338	18,585	17,443	16,030
14,151	15,443	15,770	12,984	10,255	7,396	7,812	6,668
689,494	614,801	643,046	653,229	454,595	354,861	320,512	262,747
34,628	27,003	37,420	43,360	35,209	31,133	26,039	23,710
7,400	7,689	13,100	16,717	11,714	9,229	8,114	5,231
27,228	19,314	24,320	26,643	23,495	21,904	17,925	18,479
—	—	—	—	—	2,500	—	—
27,228	19,314	24,320	26,643	23,495	19,404	17,925	18,479
275	416	560	586	636	750	909	993
$ 26,953	$ 18,898	$ 23,760	$ 26,057	$ 22,859	$ 18,654	$ 17,016	$ 17,486
$196,608	$188,648	$175,689	$160,421	$148,498	$140,272	$132,438	$123,501
27,228	19,314	24,320	26,643	23,495	19,404	17,925	18,479
11,346	10,938	10,801	10,789	10,936	10,428	9,182	8,549
275	416	560	586	636	750	909	993
11,621	11,354	11,361	11,375	11,572	11,178	10,091	9,542
$212,215	$196,608	$188,648	$175,689	$160,421	$148,498	$140,272	$132,438
$2.44	$1.74	$2.20	$2.42	$2.10	$1.99	$1.65	$1.72
—	—	—	—	—	.23	—	—
$2.44	$1.74	$2.20	$2.42	$2.10	$1.76	$1.65	$1.72
$2.25	$1.62	$2.02	$2.20	$1.92	$1.81	$1.51	$1.56
—	—	—	—	—	.20	—	—
$2.25	$1.62	$2.02	$2.20	$1.92	$1.61	$1.51	$1.56
11,067,511	10,889,022	10,799,561	10,785,212	10,875,064	10,598,765	10,328,238	10,190,805
$1.025	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00	$1.00

Report of Independent Accountants

To the Board of Directors and Shareholders of Lone Star Industries, Inc.:

We have examined the consolidated balance sheets of Lone Star Industries, Inc. and Consolidated Subsidiaries as of December 31, 1978 and 1977 and the related consolidated statements of income and 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. We did not examine the financial statements of the foreign subsidiaries, which financial statements reflect total assets and revenues of 12% and 10%, respectively, of the related consolidated totals for both 1978 and 1977. These financial statements were examined by other public accountants whose reports thereon have been furnished to us. Our opinion expressed herein, insofar as it relates to the amounts included for foreign subsidiaries, is based solely upon such reports.

In our opinion, based upon our examinations and the reports of other public accountants, the aforementioned financial statements present fairly the consolidated financial position of Lone Star Industries, Inc. and Consolidated Subsidiaries as of December 31, 1978 and 1977, and the consolidated 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

COOPERS & LYBRAND

Three Landmark Square
Stamford, Connecticut 06901
February 5, 1979

Statement of Significant Accounting Policies

Consolidation—The financial statements include all subsidiaries and joint ventures. Joint ventures and a domestic finance subsidiary are included on the equity method.

Marketable Securities are stated at the lower of cost or market.

Inventories are stated at the lower of cost or market. The company determines the lower of cost or market for retail merchandise inventories utilizing the retail method. Cost is generally determined for manufacturing inventories on an average basis and for other merchandise inventories, principally lumber, on a first-in, first-out basis.

Real Estate Activities—Income from residential sales is recognized when homes are completed, title passes and the purchase price is received. Income from commercial real estate development is recognized when the contract is signed, a substantial down payment is received and other income recognition criteria are satisfied. Costs attendant to land under development are capitalized as part of the project.

Property, Plant and Equipment is carried at cost and depreciated over the estimated useful lives of the assets on the straight-line method. Significant expenditures which extend the useful lives of existing assets are capitalized. Maintenance and repair costs are charged to current earnings. Cost depletion is calculated on the units of production method. The cost of assets and the related accumulated depreciation are removed from the accounts when such assets are disposed of and any gains or losses are reflected in current earnings.

Income Taxes—Deferred federal income taxes are provided for timing differences between financial and taxable income. Provision is made for appropriate taxes on the unremitted earnings of joint ventures and foreign subsidiaries which are not considered to be permanently invested or restricted. Investment tax credits are recognized on the "flow-through" method.

Pension Plans—The company and certain of its subsidiaries have various pension plans, the cost of which is computed on the basis of actuarial methods with costs for service prior to the establishment or amendment of the plans amortized over twenty-five or thirty years. The company's policy is to fund pension cost accrued.

Income Per Common Share—Primary income per common share is based on the weighted average number of shares outstanding in each year after providing for preferred dividends. Fully diluted income per common share assumes that preferred stock and convertible debentures had been converted and dilutive stock options had been exercised at the beginning of each year.

Foreign Exchange—The company translates cash, receivables and liabilities at year-end exchange rates and other accounts at historical rates of exchange. Income and expense items are translated at average rates of exchange prevailing during the year, except that inventories charged to cost of sales, and depreciation and depletion are translated at historical rates of exchange.

Capitalized Interest—The company capitalizes interest on indebtedness identifiable with capital projects under construction and interest attendant to real estate under development. Such interest is subsequently amortized over the life of the projects when they become operational or is charged to expenses when real estate is sold.

Consolidated Statements of Income and Retained Earnings

For the years ended December 31, in thousands except per share amounts

	1978	1977
Consolidated Income		
Revenue:		
Net sales	**$1,091,815**	$861,324
Other income—net	**5,428**	3,581
	1,097,243	864,905
Deductions from revenue:		
Cost of sales	**828,174**	649,349
Selling, general and administrative expense	**154,481**	129,916
Depreciation and depletion	**28,143**	25,077
Interest	**19,767**	19,253
	1,030,565	823,595
Income before income taxes	**66,678**	41,310
Provisions for income taxes	**21,300**	11,600
Net income	**$ 45,378**	$ 29,710
Net Income Per Common Share		
Primary	**$ 4.02**	$ 2.66
Fully diluted	**$ 3.68**	$ 2.45
Consolidated Retained Earnings		
Retained earnings at beginning of year:		
As previously reported	**$ 229,470**	$212,215
Pooling of interests	**938**	—
As restated	**230,408**	212,215
Net income for the year	**45,378**	29,710
Cash dividends:		
Common stock (1978, $1.20; 1977, $1.10)	**13,409**	12,202
Preferred stock ($4.50)	**232**	253
Retained earnings at end of year	**$ 262,145**	$229,470

The accompanying Statement of Significant Accounting Policies and Notes to Financial Statements are integral parts of the Financial Statements.

Consolidated Balance Sheets

December 31, in thousands

		1978	1977
Assets	**Current Assets**		
	Cash	**$ 4,954**	$ 12,049
	Marketable securities	**18,459**	9,946
	Notes and accounts receivable—net	**106,168**	80,427
	Inventories	**158,607**	148,055
	Other current assets	**4,011**	4,665
	Total current assets	**292,199**	255,142
	Real estate for development and sale	**20,515**	18,438
	Property, plant and equipment	**694,474**	646,798
	Less, allowances for depreciation and depletion	**302,716**	285,336
		391,758	361,462
	Joint ventures and unconsolidated subsidiary	**11,976**	6,839
	Other assets and deferred charges	**21,810**	25,657
		$738,258	$667,538
Liabilities and Shareholders' Equity	**Current Liabilities**		
	Accounts payable	**$ 61,848**	$ 41,331
	Notes payable to banks	**1,614**	3,489
	Accrued expenses	**35,392**	27,912
	Federal and other income taxes	**21,792**	18,573
	Other current liabilities	**9,187**	6,751
	Total current liabilities	**129,833**	98,056
	Long-term debt	**178,195**	175,105
	Deferred income taxes	**52,384**	45,414
	Production payment	**37,000**	41,000
	Other liabilities	**1,225**	1,212
	Minority interest	**9,467**	9,546
		408,104	370,333
Shareholders' Equity	Preferred stock (involuntary liquidating value, 1978, $4,682)	**1,054**	1,248
	Common stock	**11,765**	11,730
	Capital surplus	**66,542**	68,864
	Retained earnings	**262,145**	229,470
		341,506	311,312
	Less, treasury stock	**11,352**	14,107
	Total shareholders' equity	**330,154**	297,205
		$738,258	$667,538

The accompanying Statement of Significant Accounting Policies and Notes to Financial Statements are integral parts of the Financial Statements.

Consolidated Statements of Changes in Financial Position

For the years ended December 31,
in thousands

	1978	1977
Funds Provided By		
Current operations:		
Net income	**$45,378**	$ 29,710
Items not requiring working capital:		
Depreciation and depletion	**28,143**	25,077
Deferred income taxes	**7,893**	5,205
Equity in joint ventures and unconsolidated subsidiary	**(2,084)**	(41)
Other, net	**(372)**	660
Funds provided by operations	**78,958**	60,611
Long-term debt	**3,386**	14,318
Dispositions of property, plant and equipment	**3,897**	7,083
Debt assumed from Citadel joint venture	**—**	35,290
Termination of Citadel joint venture	**—**	24,829
	86,241	142,131
Funds Used For		
Capital expenditures	**62,336**	41,986
Payments of dividends	**13,641**	12,455
Production payment	**4,000**	4,000
Property, plant and equipment received from Citadel joint venture	**—**	62,554
Other, net	**984**	(1,238)
	80,961	119,757
Increase in working capital	**$ 5,280**	$ 22,374
Changes in Working Capital		
Increase (Decrease) in current assets:		
Cash and marketable securities	**$ 1,418**	$ (2,498)
Notes and accounts receivable—net	**25,741**	7,425
Inventories	**10,552**	12,043
Other current assets	**(654)**	1,429
	37,057	18,399
Decrease (Increase) in current liabilities:		
Accounts payable and accrued expenses	**(27,997)**	(1,480)
Notes payable to banks	**1,875**	5,277
Federal and other income taxes	**(3,219)**	326
Other current liabilities	**(2,436)**	(148)
	(31,777)	3,975
Increase in working capital	**$ 5,280**	$ 22,374

The accompanying Statement of Significant Accounting Policies and Notes to Financial Statements are integral parts of the Financial Statements.

Notes to Financial Statements

1. Inventories

Inventories consist of the following (In thousands):

	1978	1977
Finished goods	**$108,666**	$ 98,617
Work in process and raw materials	**11,766**	10,077
Supplies and fuel	**38,175**	39,361
	$158,607	$148,055

2. Property, Plant and Equipment

Property, plant and equipment consists of the following (In thousands):

	1978	1977
Land	**$ 57,599**	$ 51,978
Buildings and equipment	**554,011**	517,761
Construction in progress	**21,992**	20,540
Automobiles and trucks	**45,629**	40,202
Other	**15,243**	16,317
	$694,474	$646,798

3. Foreign Subsidiaries

The financial statements include the following with respect to foreign subsidiaries (Argentina, Brazil and Uruguay) (In thousands):

	1978	1977
Current assets	**$ 43,407**	$ 33,623
Property, plant and equipment (net)	**42,079**	39,901
Other assets	**5,818**	6,565
Current liabilities	**(14,923)**	(13,773)
Long-term debt and other liabilities	**(6,579)**	(1,762)
Minority interest	**(9,363)**	(9,452)
Net assets	**$ 60,439**	$ 55,102
Net sales	**$114,069**	$ 88,717
Pre-tax income	**$ 12,460**	$ 8,541
Contribution to net income	**$ 6,276**	$ 4,470

Local laws limit the amount of accumulated earnings of these subsidiaries available for remittance to the parent company in the form of dividends. At December 31, 1978, subject to local government approval, approximately $10,700,000 of accumulated earnings was available for distribution, of which the company intends to permanently reinvest $2,400,000.

4. Acquisitions

In June 1978, the company acquired Mineral Aggregates, Inc., a producer of roofing granules and abrasives in Tampa, Florida, for 120,000 shares of Lone Star common stock. The acquisition has been accounted for as a pooling of interests. Prior periods have not been restated since the effect is not significant.

5. Joint Ventures and Unconsolidated Subsidiary

The company's investment in and advances to joint ventures and an unconsolidated subsidiary are as follows (In thousands):

	1978	1977
Joint ventures	**$ 9,195**	$4,522
Domestic finance subsidiary	**2,781**	2,317
	$11,976	$6,839

The company and General Electric Credit Corporation formed a joint venture, now called Lonestar Florida Pennsuco, Inc., to purchase and operate the principal operating assets of Maule Industries, Inc. See Note 6 for additional information concerning this venture.

In July 1978, the company and the shareholders of H. B. Reed & Co., Inc. formed a joint venture, Lone Star Minerals, Inc., for the manufacture and marketing of slag roofing granules and abrasive blasting grit. The company contributed 100% of the stock of Mineral Aggregates, Inc. and the assets of a nickel slag facility in Riddle, Oregon for a 50% interest in the joint venture. Reed's shareholders contributed 100% of their common stock for a 50% interest in the joint venture and $5,000,000 in subordinated debentures of Lone Star Minerals, Inc.

6. Florida Cement and Related Operations

The company and General Electric Credit Corporation formed a joint venture, Lonestar Florida Pennsuco, Inc. (originally Lone Star Florida, Inc.), which is being accounted for on the equity basis. The company acquired all of the outstanding common stock for $1,250,000 and General Electric Credit acquired all of the preferred stock for $750,000, with each class of stock having equal voting rights. On February 3, 1978, Pennsuco purchased the principal operating assets of Maule Industries, Inc., a cement, aggregates and concrete producer in Florida. Pennsuco also assumed certain liabilities from Maule, principally mortgages and liens, and borrowed an additional $16,400,000 from General Electric Credit.

Total indebtedness to General Electric Credit of $42,929,000 as of December 31, 1978 is payable in annual installments through 1988 and is collateralized by certain assets of Pennsuco. During the term of the indebtedness, the company may be required to advance to Pennsuco up to $18,000,000 or, if lower, the amount of the then-outstanding indebtedness, for the purpose of maintaining the net worth of Pennsuco at $2,000,000 or to cure any default under the indebtedness. As of December 31, 1978, the company had made advances to Pennsuco of $8,358,000.

The company also formed a wholly-owned subsidiary, Lonestar Florida, Inc., to purchase and resell all the production of the joint venture effective as of February 4, 1978. Purchases from the joint venture are set by contractual formulas at prices which approximate market price discounted for certain of Lonestar Florida's selling costs. Lonestar Florida sales of $68,953,000 are included in the company's consolidated net sales. As of December 31, 1978, Lonestar Florida had accounts payable to Pennsuco of $11,052,000 for production purchased.

Summarized financial information relating to Pennsuco as of December 31, 1978 and for the period then ended is as follows (In thousands):

Current assets	$12,109
Property, plant and equipment (net)	43,673
Receivable from Lonestar (net)	2,694
Other assets	734
Current liabilities	(10,120)
Long-term debt	(44,954)
Other liabilities	(793)
Net worth	$ 3,343
Net sales	$68,472
Net income	$ 1,384
Less: Preferred dividend	(41)
Equity in Pennsuco net income	$ 1,343

7. Capitalized Interest

Interest capitalized for 1978 and 1977 was $998,000 and $1,258,000, respectively. If capitalized interest had been expensed by the company as accrued, reported net income would have been reduced by $464,000 in 1978 and $611,000 in 1977.

8. Notes Payable to Banks

The company has a Revolving Credit and Term Loan Agreement with no borrowings outstanding at December 31, 1978 or 1977. The agreement permits the company to borrow up to $67,000,000 through June 1, 1980 at a specified bank's prime rate of interest plus a ½% per annum commitment fee payable on the average daily unused amount. At maturity the company can convert any or all borrowings under this agreement to a term loan, repayable over a four-year period.

The company had other domestic short-term borrowings of $750,000 and $1,000,000 outstanding at December 31, 1978 and 1977, respectively, at the prime rate of interest. The company maintains compensating balances with various banks at an average of ten to twenty percent of credit lines, or the equivalent, depending upon usage and measured over an extended period of time.

The company's short-term foreign borrowings were $864,000 and $2,489,000 at December 31, 1978 and 1977, respectively. These borrowings were at various terms.

The maximum aggregate notes payable to banks at any month-end were $46,200,000 and $48,700,000 for 1978 and 1977, respectively; the average borrowings were $18,000,000 and $32,800,000 for 1978 and 1977, respectively; and the daily weighted average interest rate on aggregate borrowings was 14.3% and 11.4% for 1978 and 1977, respectively (11.6% and 7.5% on domestic borrowings).

9. Long-term Debt

Long-term debt consists of the following (In thousands):

	1978	1977
4⅞% Sinking Fund Debentures, due 1990	**$ 26,433**	$ 28,990
5⅛% Convertible Subordinated Debentures, due 1993	**28,288**	28,288
8% Sinking Fund Debentures, due 1997	**50,000**	50,000
8½% Promissory Notes, due 1981-1984	**20,000**	20,000
10¼% Pollution Control and Industrial Development Revenue Bonds, due 1980-1992	**28,500**	28,500
Various Notes, due through 2008	**24,974**	19,327
	$178,195	$175,105

Sinking fund requirements to and including 1979 under the 4⅞% debenture agreement have been met by purchases in the open market. Sinking fund requirements for the 8% debentures begin in 1983.

The 5⅛% Convertible Subordinated Debentures are convertible into common stock of the company at the rate of 38.462 shares of common stock for each one thousand dollars in principal amount of debentures. The indenture calls for sinking fund requirements to commence in 1979.

The indentures relating to the debentures and certain of the notes and related agreements restrict the amount of payment of cash dividends, stock repurchases and certain other activities. The amount of retained earnings free of these restrictions at December 31, 1978 was approximately $59,400,000.

10. Production Payment

In 1976, the company sold a portion of future production from limestone quarries located adjacent to two of its cement plants. The proceeds have been deferred and are being reflected in income through 1988, together with related costs and expenses, as the minerals are produced and sold. The company expects to remit $4,000,000 of proceeds within one year and, accordingly, this amount is classified as a current liability. An amount equivalent to interest is payable by the company partially at the rate of 10% and partially at a rate that fluctuates based on a specified bank's prime lending rate.

11. Capital Stock and Capital Surplus

Authorized: 2,000,000 shares Preferred Stock—par value $1.00 per share (Stated value $22.50 per share)
20,000,000 shares Common Stock—par value $1.00 per share

Transactions in capital stock and capital surplus accounts are as follows (Dollars in thousands):

	Preferred		Common			Treasury Common	
	Shares	Stated Value	Shares	Par Value	Capital Surplus	Shares	Cost
Balance, December 31, 1976	60,401	$1,359	11,710,619	$11,711	$68,805	638,006	$14,198
Conversion of preferred stock	(4,945)	(111)	19,780	19	92	—	—
Exercise of stock options	—	—	—	—	(33)	(4,094)	(91)
Balance, December 31, 1977	55,456	$1,248	11,730,399	$11,730	$68,864	633,912	$14,107
Conversion of preferred stock	(8,638)	(194)	34,552	35	159	—	—
Pooling of interests	—	—	—	—	(2,451)	(120,000)	(2,670)
Exercise of stock options	—	—	—	—	(30)	(3,825)	(85)
Balance, December 31, 1978	46,818	$1,054	11,764,951	$11,765	$66,542	510,087	$11,352

Each share of $4.50 Cumulative Preferred Stock is convertible into four shares of common stock. Such stock is redeemable at the option of the company, or entitled upon involuntary liquidation, at $100 per share or a total of $4,682,000 which is $3,628,000 in excess of the total stated value.

The company has reserved 1,936,456 shares of its authorized but unissued common stock for possible future issuance in connection with conversions of preferred stock (187,272 shares) and debentures (1,088,013 shares) and the exercise of stock options (661,171 shares).

LSI(01/16/2018)_002402

12. Stock Options

At December 31, 1978, under all stock option plans, options were outstanding to purchase 251,395 shares (144,349 exercisable) of the company's common stock at $14.25 to $24.50 per share (market value at dates of grant). During 1978, options for 60,816 shares were granted and options for 9,094 shares expired or were cancelled and options to purchase 3,825 shares were exercised at $14.25 per share. At December 31, 1978, options to purchase 409,776 shares were available for grant.

13. Leases

Rental expense in 1978 and 1977 was approximately $10,600,000 and $9,800,000, respectively. Minimum rental commitments under all noncancellable leases principally pertaining to land, buildings and equipment are as follows (In thousands): 1979, $6,166; 1980, $5,634; 1981, $4,958; 1982, $3,825; 1983, $3,389; after 1983, $17,054. Certain leases include options for renewal or purchase of leased property.

14. Other Income—Net

Other income—net, consists of the following (In thousands):

	1978	1977
Securities income (includes foreign)	**$6,277**	$4,289
Foreign exchange losses	**(4,569)**	(2,382)
Income from joint ventures and unconsolidated subsidiary	**2,084**	202
Gains on sales of assets	**1,191**	1,291
Minority interest	**36**	(606)
Other	**409**	787
	$5,428	$3,581

15. Pension Plans

Pension expense connected with the company's plans for 1978 and 1977 was approximately $7,500,000 and $5,500,000, respectively. The higher pension expense in 1978 resulted from increased participation and from amendments to several of the plans, which increased the level of benefits provided. The actuarially computed value of vested benefits for certain plans at 1979 valuation dates exceeded the total of the pension funds and accrued contributions by approximately $20,900,000.

16. Income Taxes

Provisions for income taxes consist of the following (In thousands):

	1978	1977
Federal:		
Current	**$ 7,831**	$ 3,066
Deferred:		
Excess of tax over book depreciation	**5,378**	4,117
Investment tax credits	**1,008**	1,110
Subsidiary separate return net operating loss carryforward	**1,329**	—
Other	**178**	(22)
Total federal	**15,724**	8,271
Foreign	**4,376**	2,979
State and local	**1,200**	350
	$21,300	$11,600

In 1978, $923,000 has been reclassified in the balance sheet from deferred income taxes payable to current income taxes payable as a result of prior year tax filings. The company has investment tax credit carryforwards for federal income tax purposes of $3,100,000, which expire at various dates through 1985. These carryforwards have been recognized for financial statement purposes.

A subsidiary has net operating loss carryforwards and investment tax credit carryforwards for federal income tax purposes from separate return taxable periods of approximately $7,500,000 and $6,200,000, respectively, which expire at various dates from 1981 to 1984 and are available for application against future taxable income of the subsidiary. This subsidiary's net operating loss carryforwards and $3,900,000 of the investment tax credit carryforwards have been previously recognized for financial statement purposes.

The company intends to reinvest a portion of the undistributed earnings of its foreign subsidiaries. Accordingly, no foreign withholding or U.S. taxes were provided on $2,400,000 of unremitted earnings available for distribution at December 31, 1978.

LSI(01/16/2018)_002403

The following is a reconciliation of income taxes computed at the U.S. statutory rate to the provisions for income taxes (In thousands):

	1978	1977
Taxes computed at 48% of income before income taxes	**$32,005**	$19,829
Decreases resulting from:		
Percentage depletion	**4,800**	2,900
Investment tax credits	**5,600**	2,500
Real estate transactions	**61**	1,697
Other, net	**244**	1,132
	$21,300	$11,600

17. Quarterly Financial Data (Unaudited)

Summarized quarterly financial data for 1978 and 1977 appears on page 29 of this report.

18. Current Replacement Cost Information (Unaudited)

Estimated current replacement cost information for inventories and productive capacity as of December 31, 1978 and 1977, and the related effect on cost of sales and depreciation expense for the year are disclosed in the company's annual report on Form 10-K to be filed with the Securities and Exchange Commission.

The estimated current replacement costs of these assets and related expenses are generally higher than the comparable historical cost amounts shown in the financial statements. This is due in part to the impact of inflation. However, the company pursues a policy of increasing its sales prices, where feasible, as production costs increase in order to maintain its profit margins.

The company has no present intention of replacing its productive capacity on a complete and one-time basis, as is assumed in the calculation of the current replacement cost information. However, any such replacement incorporating the latest available technological advances would necessarily be accompanied by certain operating-cost savings.

19. Litigation

Beginning in late 1976, a series of substantially similar class actions was brought against the Portland Cement Association and approximately forty-five cement producers, most of whom were or are members of the Portland Cement Association, including the company, which are now pending in the United States District Court for the District of Arizona. During 1978, substantially similar class actions have been filed by the states of Missouri, Nebraska, Utah, New Mexico and Montana in various Federal District Courts of those states. All of the actions allege that a nationwide combination and conspiracy existed in violation of the antitrust laws to fix, maintain and stabilize cement prices from on or before 1958 to the dates of commencement of the various actions. None of the actions alleges a specific amount of damages, but they seek, among other relief, money damages equal to treble the damages allegedly sustained by the plaintiffs. The actions have not progressed beyond a preliminary stage. Management denies that it has entered into any such alleged combination or conspiracy, believes that the alleged violations are without foundation and intends to vigorously contest all of the actions to the full extent permitted by law. Consequently, while the outcome of this litigation cannot be predicted with certainty, management believes it should not have a material adverse effect on the company's financial position.

20. Subsequent Event

On February 20, 1979, the company announced that it reached an agreement in principle to sell certain assets of its building materials distribution centers to Louisiana Pacific Corporation. Lone Star will receive $10 million for the fixed assets of 16 contractor and combination contractor/retail yards in the Los Angeles area as well as a roof truss manufacturing complex and cargo handling and distribution facilities near the Los Angeles harbor. Lone Star will also receive approximately $22 million, which represents current book value of inventories at these locations. The agreement is subject to approval by the board of directors of each company. The operation of these assets accounted for net sales of $135,691,000 for 1978 and $142,099,000 for 1977. The company does not expect this transaction to have a significant impact on 1979 earnings.

LSI(01/16/2018)_002404

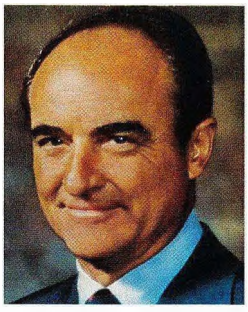
21. Industry Segments and Geographic Areas

Sales and operating profits for the company's industry segments and geographic areas for the years ended December 31, 1978 and 1977 appear on page 22 of this report. Additional industry segment information regarding identifiable assets, capital expenditures and depreciation and depletion consists of the following (In thousands):

	Identifiable Assets		Capital Expenditures		Depreciation & Depletion	
	1978	1977	**1978**	1977	**1978**	1977
Cement and related products	**$371,979**	$333,358	**$33,297**	$20,459	**$16,141**	$13,573
Construction aggregates	**116,767**	104,376	**16,779**	14,705	**7,652**	7,253
Other construction materials	**5,110**	4,852	**2,262**	154	**167**	322
Lumber and building materials:						
Retail	**57,888**	47,543	**5,233**	2,612	**1,426**	1,312
Contractor and wholesale	**63,674**	56,714	**2,170**	773	**1,058**	1,012
Combination	**60,115**	55,669	**2,310**	3,094	**1,296**	1,250
Other	**28,534**	27,620	**152**	100	**299**	248
Total segments	**704,067**	630,132	**62,203**	41,897	**28,039**	24,970
Joint ventures and unconsolidated subsidiary	**11,976**	6,839	**—**	—	**—**	—
Corporate and unallocated items	**22,215**	30,567	**133**	89	**104**	107
Total	**$738,258**	$667,538	**$62,336**	$41,986	**$28,143**	$25,077

Lone Star's principal operations are in the field of construction and building materials as shown in the above table. The cement and related products segment includes the production and distribution of portland, masonry and other types of cement and the manufacture and distribution of ready-mixed concrete and concrete products. The construction aggregates segment includes the mining, processing and distribution of sand, gravel and crushed stone. The retail lumber and building materials segment includes the marketing of building materials and home-improvement products directly to the consumer through Home Care Centers. The contractor and wholesale lumber and building materials segment includes the distribution of lumber and building materials to building contractors and to other distributors. The combination lumber and building materials segment includes the distribution and marketing of these products to both contractors and retail consumers at a single location. Other segments include primarily the company's real estate operations.

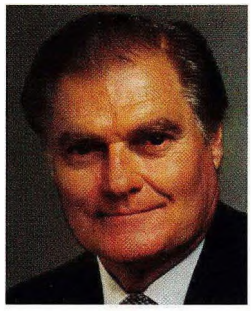
Identifiable assets are those assets that are used in the company's industry segments. Corporate and unallocated assets consist primarily of cash, marketable securities (including foreign), and other assets not identified with a segment. Identifiable assets include $80,127,000 for 1978 and $70,799,000 for 1977 with respect to the company's South American operations. Due to the significant interrelationship of the company's cement and concrete operations and the increased significance of concrete sales resulting from the establishment of Lonestar Florida, concrete and concrete products are no longer included in the other construction materials segment. Concrete and concrete products are now included in the cement and related products segment. This change and other reclassifications have been made to conform the above segment data to current year presentation.



Dwayne O. Andreas

Chairman of the Board and Chief Executive, Archer-Daniels-Midland Company

ADM is an agricultural products processing and milling company which ranks well up in Fortune Magazine's list of the 500 largest industrial corporations. In the decade 1965-1975, it ranked No. 2 in total returns to stockholders and No. 13 in growth rate. Throughout this period, Mr. Andreas was a senior executive of the company, becoming Chief Executive in 1970 and Chairman of the Board in 1972. He is a director of Dart Industries, Inc., Los Angeles, California and White Motor Corporation, Eastlake, Ohio. Mr. Andreas is a trustee of the American Freedom From Hunger Foundation and the U.S. Naval Academy Foundation and a director of the Foreign Policy Association.



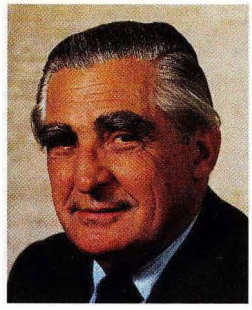
Rex D. Cross

Chairman of the Board and Chief Executive Officer of Pomeroy, Inc.

Pomeroy is a producer of prefabricated building components and hardware for the construction and home building industries, headquartered in Stamford, Connecticut.

Mr. Cross joined Pomeroy in 1957 as Executive Vice President, becoming President and Chief Executive Officer in 1960 and Chairman of the Board in 1965. He is a Director of Ames Iron Works, Oswego, N.Y., and Fitzgibbons Boiler Co. Inc., New York, N.Y. He was educated at the Gulf Coast Military Academy and Tulane University.

Pomeroy's builders hardware group products are manufactured in the United States, Canada, England, Australia and Brazil.



Stephen Galle

Executive Vice President of Bangor Punta Corporation

Mr. Galle joined Bangor Punta in 1961, became Vice President in 1964, Senior Vice President and Chief Financial Officer in 1968 and assumed his present position early in 1978.

Educated at the Pazmany Peter University of Budapest in both law and public accounting, he was associated with the chemical industry of Hungary until he emigrated to the U.S. in 1956.

He is a Director of Bangor Punta, Piper Aircraft Corporation and Producers Cotton Oil Company.

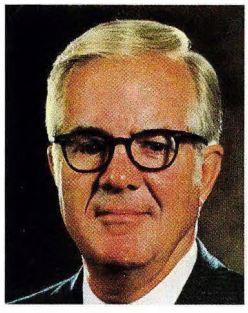


Allen E. Puckett

Chairman and Chief Executive Officer of Hughes Aircraft Company

Dr. Puckett was previously President of Hughes and has held a number of senior management positions in the Weapons Systems and Aerospace groups since joining the company in 1949.

A member of the National Academy of Engineering and the National Academy of Sciences, he is the author of numerous works on high-speed aerodynamics. A graduate of Harvard University with a Ph.D. from the California Institute of Technology, Dr. Puckett has served as Chairman of the NASA Research Advisory Committee on Control, Guidance and Navigation, as Vice Chairman of the Defense Science Board, and as President of the American Institute of Aeronautics and Astronautics.

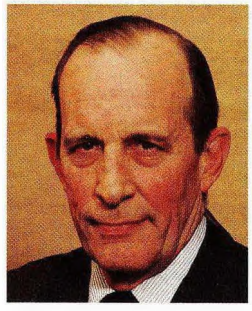


Willard F. Rockwell, Jr.

Chairman of the Executive Committee of Rockwell International Corporation

Mr. Rockwell, who served as Chairman of the Board of Rockwell International from 1967 until 1979, had served as President and Chief Executive Officer of various predecessor companies for more than 30 years.

A registered professional engineer, he was graduated from Penn State University and served seven years on its Board of Trustees. Currently a Trustee of the University of Southern California and the Carnegie Institute of Pittsburgh, he is a Director of several large companies including El Paso Company, Kearney & Trecker Corporation, Mellon National Corporation and Mellon Bank, N.A. He is the recipient of many civic awards and honorary degrees, and is a Trustee of The Conference Board and Chairman of the Executive Committee of the Tax Foundation.



John P. Schroeder

Retired Vice Chairman, J. P. Morgan & Co., Incorporated, and Morgan Guaranty Trust Co. of New York

A graduate of Phillips Exeter Academy and Yale University, Mr. Schroeder joined J. P. Morgan & Co., Incorporated in 1945, becoming Vice President in 1953 and Executive Vice President in charge of the National Banking Division in 1971. He became Vice Chairman and a Director of both the bank and J. P. Morgan & Co. in 1976, and retired at the end of 1978. Mr. Schroeder is also a Director of Phelps Dodge Corporation, Johns-Manville Corporation and Gould, Inc., as well as a member of the Directors' Advisory Council of J. P. Morgan and Morgan Guaranty.

LSI(01/16/2018)_002406



Frank Gard Jameson

Chairman of the Board of Glenair Inc.

Mr. Jameson has been closely associated with space programs for the past twenty years, founding and managing a number of companies in the fields of missile electronics and electronic equipment. Glenair is a West Coast manufacturer of electronic cables and connectors. In recent years, he has served as President of Teledyne Ryan Aeronautical Company, Vice President of Douglas Aircraft and Senior Corporate Vice President of Rockwell International. He holds two Navy Distinguished Public Service Awards and currently serves as Chairman of the Board of Directors of the Freedoms Foundation at Valley Forge. He was educated at Webb Preparatory School, the U.S. Naval Academy, the California Institute of Technology and Stanford University, from which he received a B.S. degree.



Sheldon Kaplan

Partner in the Minneapolis law firm of Maslon, Kaplan, Edelman, Borman, Brand & McNulty

A native of Minneapolis, Mr. Kaplan is a B.A. graduate of the University of Minnesota (Phi Beta Kappa), and has his LL.B. from Columbia University Law School, where he served as editor and decisions editor of the Columbia Law Review. Admitted to the New York bar in 1940, he is currently a member of the Hennepin County and the Minnesota State Bar Associations. Mr. Kaplan served as a Captain in U.S. Army Ordnance during World War II, becoming Chief of the Legal Division, Cleveland Ordnance District, in 1946, before leaving the service and joining his present firm. His other Board memberships currently include the Bangor Punta Corporation, the Piper Aircraft Corporation and the Minnesota Vikings Football Team.

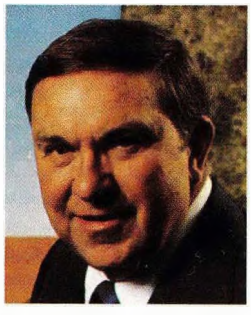


Joseph V. McKee, Jr.

Chairman, National Union Electric Corporation

In 1949, Mr. McKee joined National Union Radio Corp., which changed its name in 1954 to National Union Electric—the same year he became Vice President, Treasurer and a Director. He became Executive Vice President in 1966 and assumed his present post in September 1977. National Union ranks in Fortune's second 500 in sales and well up in the first 500 for return on equity and growth in earnings.

A graduate of Princeton University with a law degree from Columbia University, he is a Director of St. Joe Minerals Corporation and A. B. Electrolux, Stockholm, Sweden, and a Trustee of the Woods Hole Oceanographic Institution and The Greenwich Hospital.



James E. Stewart

Chairman, President and Chief Executive Officer, Lone Star Industries, Inc.

Mr. Stewart became a Director and Chairman of the Executive Committee of Lone Star in 1971. Elected Chairman of the Board in 1973, he became President and Chief Executive Officer in 1978.

Mr. Stewart is a Director of Piper Aircraft, Vice Chairman of the Board and Chairman of the Executive Committee of Bangor Punta Corporation. Included among other activities, he serves as a Director of the Bishop Whipple Schools in Faribault, Minn.



David W. Wallace

Chairman, President and Chief Executive Officer, Bangor Punta Corporation

Mr. Wallace joined Bangor Punta in 1967 as President and Chief Operating Officer. He began his career with White & Case in New York and is a member of the Bar of New York State and the Bar of the United States Supreme Court. In 1954, he joined the Alleghany Corp. where he subsequently became Executive Vice President, a Director and a member of the Executive Committee, followed by a similar position with United Brands.

He holds a B.S. degree in engineering from Yale University and a Doctor of Jurisprudence degree from Harvard Law School.

In addition to several directorships, he is Vice President and Trustee of the Robert R. Young Charitable Foundation and a member of Lloyd's of London.

Executive Committee
James E. Stewart (Chairman)
Sheldon Kaplan
Joseph V. McKee, Jr.
David W. Wallace

Audit Committee
David W. Wallace (Chairman)
Frank G. Jameson
Joseph V. McKee, Jr.

Compensation and Stock Option Committee
Joseph V. McKee, Jr. (Chairman)
Sheldon Kaplan
Willard E. Rockwell, Jr.
David W. Wallace

LSI(01/16/2018)_002407

Cement Plants

Domestic:

California: Santa Cruz
Florida: Miami
Indiana: Greencastle
Kansas: Bonner Springs
Louisiana: New Orleans
Pennsylvania: Nazareth
Texas: Houston
Maryneal
Virginia: Roanoke
Washington: Seattle

International:

Argentina:
Parana
(Entre Rios Province)
Sierras Bayas
(Buenos Aires Province)

Brazil:
Aratu
(Salvador, Bahia)
Guaxindiba
(State of Rio de Janeiro)

Uruguay:
Sayago
(Montevideo)

Cement & Construction Materials Group

Group Headquarters
411 West Putnam Ave
Greenwich, Connecticut 06830

Regional Offices:

Central Region
2511 East 46th Street
Indianapolis, Indiana 46205

Northeast Region
162 Old Mill Road
West Nyack, New York 10994

Pacific Region
2800 Campus Drive
San Mateo, California 94403

Southeast Region
977 Norfolk Square
Norfolk, Virginia 23502

Southwest Region
8383 Stemmons Freeway
Dallas, Texas 75247

Lone Star Florida, Inc.
6451 North Federal Highway
Fort Lauderdale, Florida 33308

Lone Star Lafarge, Inc.
18 Koger Executive Center
Norfolk, Virginia 23502

Building Centers Group

Group Headquarters
3350 Central Avenue N.W.
Minneapolis, Minnesota 55418

Regional Offices:

Eastern Region
8405 Northwest 53rd Street
Miami, Florida 33166

North Central Region
2745 South Lexington Avenue
St. Paul, Minnesota 55121

Southwestern Region
600 Lake Air Drive
Waco, Texas 76703

Western Region
2041 Rosecrans Avenue
El Segundo, California 90245

Other Operations

Lone Star Hawaii, Inc.
Pacific Trade Center
190 S. King Street
Honolulu, Hawaii 96813

Lone Star Minerals, Inc.
8149-C Kennedy Avenue
Highland, Indiana 46322

Lone Star Mining & Exploration Co., Ltd.
2 Bloor Street West
Toronto, Ontario M4W 3E2

Lone Star Properties, Inc.
411 West Putnam Avenue
Greenwich, Connecticut 06830

Lone Star Industries, Inc.

One Greenwich Plaza
Greenwich, Connecticut 06830
Telephone: (203) 661-3100

Officers

James E. Stewart
Chairman, President and
Chief Executive Officer

Robert W. Hutton
Vice Chairman
of the Corporation

John H. Davies
Senior Vice President;
President of the Cement &
Construction Materials Group

Kenneth N. Kermes
Senior Vice President and
Chief Financial Officer

F. Eugene Purcell
Senior Vice President—Public Affairs

Alfred M. Sperry
Senior Vice President—Administration

Gordon A. Fox
Vice President—
Financial Planning

Conrad J. Gordon
Vice President and Controller

Herbert B. Greene
Vice President,
General Counsel and Secretary

James M. Grogan
Vice President;
President of the
Building Centers Group

James E. Rosecrans
Vice President—
Employee Relations

Peter F. Sherwood
Treasurer

Auditors

Coopers & Lybrand

Price Waterhouse & Company
(for International Division)

Transfer Agent and Registrar for Common and Preferred Stock

The Chase Manhattan Bank N.A.,
New York

Annual Meeting

The Annual Meeting of Shareholders will be held at 10:00 a.m. on Thursday, May 3, 1979, at the Washington Plaza Hotel in Seattle, Washington.

Stock Listings

Lone Star common shares are listed on the New York Stock Exchange (symbol LCE), Boston Stock Exchange and Pacific Stock Exchange and are open to trading on the Midwest and Philadelphia Stock Exchanges. Certificates representing Lone Star shares are traded on the Amsterdam Stock Exchange.

10-K Report

A copy of the company's annual report on Form 10-K required to be filed with the Securities and Exchange Commission is available without charge upon request to the Senior Vice President—Administration at the address above.

LSI(01/16/2018)_002409

Lone Star Industries, Inc.
One Greenwich Plaza
Greenwich, Connecticut 06830

LSI(01/16/2018)_002410